

# Annex 4

## Regulatory boundary of generic financial advice

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1.1 The regulatory factors impacting on the scope of generic financial advice (GFA) are varied and complex and have a significant impact on the depth of the service. GFA differs from Financial Services Authority regulated advice chiefly because it does not result in a recommendation to buy, surrender or change a specific product from a specific provider. Within the regulatory boundary there is potential for a degree of confusion about what GFA is and what it is not.<sup>1</sup>

1.2 The relevant pieces of legislation impacting on potential GFA advice topics are:

- FSA regulation through the Financial Services and Markets Act 2000 (FSMA) which falls unevenly across the potential range of advice topics. Some topics fall outside the jurisdiction of regulation and, depending on when the FSA regulation came into effect, some topics are partially regulated.
- Consumer Credit Act 2006 (CCA) regulation affects debt-related topics. For example, providing guidance on ways to vary payments due under a regulated consumer credit agreement, such as a credit card debt, would bring GFA within the boundary of the CCA.

1.3 The Review commissioned Nick Lord, a consultant, to analyse the impact of regulation on the scope of GFA.<sup>2</sup> His paper assesses the relationship between GFA and regulated advice. Within the boundary of FSA and CCA regulation, the paper recommends a pragmatic and practical boundary for the scope of GFA that will enable the service to meet the needs of those who would benefit the most from GFA, while maintaining clear water between GFA and regulated advice. Based on that analysis, the Review's starting point suggests that the current regulatory boundary should not act as an inhibitor to providing individuals with the information, guidance and tools they require to help them make better financial decisions.

1.4 Based on the analysis in Lord's paper and the evidence gathered in the Interim Report, the Review's starting point suggests that the current regulatory boundary should not act as an inhibitor to providing consumers with the information, guidance and tools they require to help them make better financial decisions. The pilots that will be run by the Review will help to test whether or not this is the case, and to help make recommendations on what changes to the regulatory landscape may be required, if any.

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<sup>1</sup> Confusion between regulated and unregulated advice may stem from the fact that regulated advice is defined in law through the Financial Services and Markets Act (FSMA) but GFA is not defined in law in the same way.

<sup>2</sup> *Generic Financial Advice – Defining the Advice Boundary of the Service*, Nick Lord is available at [http://www.hm-treasury.gov.uk/independent\\_reviews/thoresen\\_review/thoresenreview\\_index.cfm](http://www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm) as Annex 4.

# **Generic Financial Advice – Defining the Advice Boundary of a New Service**

## **1. Introduction**

### **2. The Breadth of Generic Financial Advice (GFA)**

### **3. Regulatory Boundaries and GFA**

### **4. The Impact of Financial Services Authority Regulation on GFA**

### **5. The Impact of Consumer Credit Act Regulation on GFA**

### **6. Other Legal Implications of GFA**

### **7. The Depth of Advice Provided by a Generic Financial Advice Service (GFAS)**

## **1. Introduction**

1.1 This paper discusses the issues that impact on the parameters of generic financial advice (GFA). In particular, it suggests how a pragmatic and practical advice boundary could guide the work of the Generic Financial Advice Service (GFAS).

1.2 Determining the advice boundary of GFA requires consideration of various issues. These include the needs of the target group, the level of demand on the service, and the training and competence of GFAS advisers. However, the issue that raises most debate amongst consumer and industry stakeholders is the relationship between GFA and regulated financial advice.

1.3 The Call for Evidence sought views on how best to clarify the boundary between generic and regulated advice. Many respondents commented on the complex and blurred nature of this boundary. There was a consistent call for a clear explanation of how regulation affects GFA and for the setting of a boundary that consumers and advisers can easily understand.

1.4 The paper therefore concentrates on the relationship between GFA and regulated advice. It proposes an advice boundary for GFA that will enable a GFAS to meet the needs of its clients whilst maintaining clear water with regulated advice. The paper considers the range of topics that GFA will cover (the “breadth” of the service) and the level of detail and complexity with which it will engage its clients (the “depth” of the service).

## **2. The Breadth of GFA**

2.1 Proposing an advice boundary for GFA first requires consideration of the range of topics that a GFAS will cover.

2.2 Question BS4 of the Thoresen Call for Evidence asked: “What should be the content of generic financial advice? Which subjects should be included/excluded?”

2.3 Respondents that answered this question mainly proposed that GFA should cover a broad range of topics:

*Generic advice should cover the fullest possible range of financial planning issues consumers have to grapple with. If generic advice is acting as a triaging service, identifying the individual’s needs and, if necessary, passing them on to a suitable source of more detailed advice, it would be neither possible nor desirable to exclude particular subjects.<sup>1</sup>*

*A wide definition of generic financial advice is more appropriate if the needs of consumers are to be met. It would not be appropriate to exclude subjects or restrict content if the aim of the service is to provide consumers with “holistic” advice<sup>2</sup>*

*Generic financial advice, if it to be of use to people, should cover a broad range of personal finance issues. Within this it would seem essential to include advice on; savings, pensions, borrowing and credit options, insurance, current accounts, family finance provision (including Child Trust Funds and student finance).<sup>3</sup>*

*It should cover the broad spectrum of financial needs from debt management and budgeting through to saving and pension provision. The process and guidance should be designed to help and support people to determine for themselves what their financial needs are and how they might achieve their objective.<sup>4</sup>*

*Pretty much all everyday topics should be covered.<sup>5</sup>*

*The service will need to cover all manner of subjects linked to finance.<sup>6</sup>*

*We strongly believe that from the beginning of delivery the service will need to evolve in content terms at a pace with changes in the industry and most importantly customer demand – i.e. be a truly customer-driven service.<sup>7</sup>*

*Nothing should be excluded if there is a demand for information in any particular area.<sup>8</sup>*

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<sup>1</sup> ABI

<sup>2</sup> Which?

<sup>3</sup> Credit Action & CCCS

<sup>4</sup> Friends Provident

<sup>5</sup> Ian Churchill

<sup>6</sup> Axa

<sup>7</sup> ae4

<sup>8</sup> Mycompanypension

2.4 Based on the responses to the Call for Evidence, the following topics could be viewed as “core” to the GFA service :

a) Social Security Benefits and Tax Credits - Some of the target group will qualify for tax credits and other means tested benefits. Others may seek guidance after a life change event and be unaware of entitlement to non-means-tested benefits. The GFAS will need to be able to identify where there is possible entitlement to additional social security benefit or tax credit income.

b) Budgeting - Budgeting is crucial for consumers to identify and understand their financial needs and plan their finances. Budgeting guidance will therefore be an essential part of providing generic advice and the GFAS will want to encourage its clients in making and following a realistic budget

c) Savings and Investment - Consistent with the stated aims for the GFAS, it should encourage saving where this is financially possible and appropriate.

d) Protection Insurance - Appropriate levels of protection insurance form the basis for a sound financial plan. The GFAS will encourage its clients to consider and determine their own appropriate needs for such insurance.

e) Buying a Home and Mortgages - The level of home ownership, aspiration to home ownership, and initiatives aimed at helping lower and middle income consumers to become homeowners makes it important that the GFAS can offer guidance in this area.

f) Consumer Credit and Other Borrowing - The sensible use of credit is a powerful facility that can help consumers fund expensive one-off costs or assist with budgeting over a period of fluctuating income. The GFAS will help its clients decide how they can make best use of credit and, where appropriate, provide guidance on the most suitable type of borrowing.

g) Taxation - Most employed consumers within the target group will have a straightforward tax position. However, the GFAS will need to be able to appropriately identify where a client may benefit from further guidance on tax issues – e.g. where the client is self-employed or where there may be entitlement to additional tax allowances because of age or circumstances.

h) Financial Implications of Life Change - Some clients will be motivated to contact the GFAS following a life change event, e.g. separation from spouse, divorce, birth of new baby, loss of job, or retirement. Advising on such events requires that the GFAS is able to provide information and guidance on the financial implications of such events, such as entitlement to Child Support, Child Trust Fund payments, redundancy payments, and the merits of equity withdrawal.

i) Pensions - Demand for guidance on pensions issues will likely increase as public policy highlights the importance of providing for retirement income. The introduction of Personal Accounts in 2012 is likely to be a particular trigger point for demand. The GFAS will need to be able to discuss the relative merits of pension saving compared to other saving or calls on income.

j) Bank Accounts - Accessing and making best use of a suitable bank account is a key feature in consumers managing their finances. The GFAS will guide its clients on factors to consider in choosing a suitable account.

k) Consumer Redress - Another likely trigger point in consumers seeking GFA will be where they have questions about possible redress in respect of financial products. For example, the GFAS would probably have received a large number of calls about endowment mis-selling if it had been in existence over the past ten years. Whilst it might be unhelpful to position the GFAS as part of the “consumer revenge” culture, it is important that the service is able to provide guidance to consumers who wish to discuss possible redress.

l) Utilities – Spending on utilities is likely to be a significant proportion of the expenditure of the target group. Energywatch recently reported that consumers could save substantial sums on energy bills through identifying the least expensive provider. The GFAS will need to guide its clients on how they can best recognise the most suitable utility supplier for their needs.

2.5 The topics covered by a GFAS may change over time to meet consumer demand and to reflect developments within personal finance. Periodically, the GFAS will need to review the range of coverage to ensure that it properly meets the needs of its clients.

2.6 The 12-week consumer pilots of GFA will take a pragmatic approach to the breadth of topics. The pilots are focusing on the essential issues as highlighted by the Review’s consumer focus groups:

- o Budgeting
- o Saving for a home
- o Planning for retirement and saving for a pension
- o Protection
- o Saving
- o Tax and social security benefits
- o Credit advice

### **3. Regulatory Boundaries and GFA**

3.1 Some of the above proposed topics for a GFAS fall within financial services regulation. It is important to identify the impact of this regulation on

GFA in order to establish how the GFAS can best operate without crossing the regulatory boundary.

3.2 This is a complex issue to unravel. Some of the work of the GFAS will be in areas where the FSA regulates advice (e.g. investments, pensions, insurances, and mortgages). The prevalence of consumer credit means that advice on repayment of credit is likely to be an important feature of the GFAS, and this is regulated by the OFT. If the GFAS is required to hold a consumer credit licence then this may make it accountable to the Financial Ombudsman Service. In addition, the full breadth of GFA will cover topics where statutory regulation exists but does not extend to regulation of advice (e.g. utilities), or where there is a combination of statutory and non-statutory regulation (e.g. banking issues). Finally, the GFAS will provide guidance on some topics not covered by regulation of any kind (e.g. advice on budgeting).

3.3 It is also important to remember that many people contacting the GFAS will already hold existing regulated financial products. The work of the GFAS must reflect this reality. As one respondent to the Call for Evidence confirmed:

*It would be a serious mistake to think of prospective generic advice clients as blank canvasses onto which a template of ideal financial behaviour can be easily imposed.<sup>9</sup>*

## **4. The Impact of Financial Services Authority regulation on GFA**

4.1 The FSA regulates various “activities” within the financial services sector. This includes the provision of advice.

4.2 Four “tests” decide whether the provision of advice requires FSA authorisation. However, before looking at these tests, we first need to consider the possibility that GFA will be exempt from FSA authorisation through providing “information” rather than “advice”.

### Advice or information?

4.3 FSA regulation applies to the provision of “advice” but not “information” The FSA handbook provides perimeter guidance on the distinction:

*In the FSA's view, advice requires an element of opinion on the part of the adviser. In effect, it is a recommendation as to a course of action. Information, on the other hand, involves statements of fact or figures. In general terms, simply giving information without making any comment or value judgement on its relevance to decisions which an investor may make is not advice. In the FSA's opinion, however, such information may take on the nature of advice if*

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<sup>9</sup> Prudential

*the circumstances in which it is provided give it the force of a recommendation.*<sup>10</sup>

4.4 This division between advice and information suggests that the GFAS could stay outside FSA regulation by only providing “information”. However, relying on this option could prove troublesome. Consider the following example:

*The client contacts the GFAS because she has recently separated from her husband and moved with her children into new accommodation. She wants to discuss her changed financial position. She tells the GFAS adviser that she has no life insurance. Referring to the insurance protocol, the adviser explains that most people in the client’s situation take out life insurance if they think that their death would leave their dependants with insufficient money to meet future needs. The adviser further explains how the client can get more information on the different providers of life insurance and the factors she should consider in deciding how much life cover she should take.*

4.5 Here the GFAS adviser has not specifically advised that the client should take out life insurance. However, some people would consider that the example seems to have the feel of providing advice being guided or feeling guided in the direction of taking out life insurance. Crucially, the client may feel that she has been advised to take out life insurance.

4.6 It is also possible that the work of the GFAS may change over time. There may be a future agreement amongst industry and consumer stakeholders on the benefits of some simple types of financial products, which a GFAS could recommend to its clients. If there were such an agreement on a course of action, it would be unhelpful if the GFAS were not able to offer the appropriate advice.

4.7 There is a danger that always providing information rather than advice could mean that the client does not take action. Several respondents to the Call for Evidence have stressed the importance of the GFAS encouraging its clients to take action in respect of their finances.

*We strongly believe that generic financial advice has the potential to change people’s saving and spending behaviours. Generic advice must not simply provide information to enable people to make informed decisions, but must empower them to act. It is important, therefore, that the Thoresen Review team give careful consideration as to how to maximise the likelihood that people will act on the advice they receive. When establishing guidelines and protocols for the delivery of generic advice, it is important to remember that the way advice is delivered is just as important as the content of the advice itself.*<sup>11</sup>

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<sup>10</sup> PERG 8.28.4

<sup>11</sup> Resolution Foundation

*Getting consumers to face up to tackling their personal finances is the key challenge facing the Review and the new service. People need to be encouraged to think about their finances and then, crucially, to act.<sup>12</sup>*

*Generic advice should concentrate on encouraging the individual to take action to move to personalised financial advice.<sup>13</sup>*

4.8 Therefore, it seems inappropriate that the GFAS should seek to exempt itself from FSA authorisation on the basis that it provides “information” rather than “advice”. This does not mean that the GFAS should seek to provide advice in all situations but it does mean that the service should not be unduly restricted where there is general agreement that advice is appropriate.

### FSA authorisation

4.9 The relevant legislation that prescribes whether advice is authorised by the FSA is the Financial Services and Markets Act 2000. Section 19 prescribes that any person who carries on a regulated activity in the UK must be authorised by the FSA or exempt. Breach of section 19 may be a criminal offence and is punishable on indictment by a maximum term of two years imprisonment and/or an unlimited fine.

4.10 Deciding whether a person giving advice must be authorised by the FSA is determined by applying four tests:

- Is the provision of advice carried on in the UK?
- Is the advice given by way of business?
- Does the advice relate to a specified investment?
- Does the advice relate to a specified activity?

4.11 All four tests must be met to require FSA authorisation. The question therefore is whether the provision of GFA will meet all four tests.

### Is the provision of advice carried on in The UK?

4.12 The GFAS will provide advice in the UK, and so will meet this test.

### Is the advice given by way of business?

4.13 Section 22 of FSMA prescribes that regulation only applies if the provision of advice is carried on “by way of business”.

4.14 Some stakeholders have suggested that the GFAS will be able to claim exemption from FSA regulation since it will provide advice free of charge and will not receive any commercial benefit from the advice it provides.

4.15 There is no elaboration in the FSMA of what is meant by “carried on by way of business”, and there are no reported cases on this point. The FSA perimeter guidance manual does offer some guidance as follows:

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<sup>12</sup> Aegon

<sup>13</sup> National Australia Group

*Whether or not an activity is carried on by way of business is ultimately a question of judgement that takes account of several factors (none of which is likely to be conclusive). These include the degree of continuity, the existence of a commercial element, the scale of the activity and the proportion which the activity bears to other activities carried on by the same person but which are not regulated. The nature of the particular regulated activity that is carried on will also be relevant to the factual analysis.*<sup>14</sup>

4.16 In the absence of any other definition, the ordinary (dictionary) meaning of "business" applies, which is "commercial activity". It must therefore be debatable whether the GFAS will engage in "commercial activity" or not (regardless of whether it charges for their services or make a profit). The FSA guidance is helpful but not sufficient to enable the providers of the GFAS to feel confident that they fall one side or other of the "business" test.

4.17 It should also be noted that the FSMA financial promotions regulations contain a similar "business" test. Section 21 provides:

"(1) A person ("A") must not, in the course of business, communicate an invitation or inducement to engage in investment activity."

In 2005, the Treasury created a specific exemption from s.21(1) for advisers working within free of charge debt advice centres. Such advisers were allowed exemption from the financial promotion restriction in respect of specified financial products.<sup>15</sup> This exemption reinforces the point that it is inappropriate to rely on the "business" test to avoid FSMA regulation.

4.18 In the absence of definitive case law or a further specific exemption for the GFAS, it is appropriate to assume that the GFAS will meet the 'by way of business' test.

#### Does the advice relate to a specified investment?

4.19 The list of specified investments is provided in part III of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). The list is as follows:

- Deposits
- Electronic money
- Rights under a contract of insurance
- Shares etc.
- Debt instruments
- Warrants
- Certificates representing securities
- Units in a collective investment scheme
- Rights under a stakeholder or personal pension scheme

<sup>14</sup> FSA Full Handbook Perimeter Guidance Manual para 2.3.3

<sup>15</sup> s.73 The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

- Options
- Futures
- Contracts for differences
- Lloyd's investments
- Rights under a funeral plan
- Rights under a regulated mortgage contract
- Rights under a home reversion plan
- Rights under a home purchase plan

Does the advice relate to a specified activity?

4.20 The RAO also provides the list of specified activities as follows:

- Accepting deposits
- Issuing e-money
- Effecting or carrying out contracts of insurance as principal
- Dealing in investments (as principal or agent)
- Arranging deals in investments and arranging a home finance transaction
- Managing investments
- Assisting in the administration and performance of a contract of insurance
- Safeguarding and administering investments
- Sending dematerialised instructions
- Establishing etc collective investment schemes
- Establishing etc. pension schemes
- Providing basic advice on stakeholder products
- Advising on investments
- Advising on regulated mortgage contracts
- Advising on home reversion plans
- Advising on home purchase plans
- Managing, arranging, or advising on Lloyd's market activities
- Providing funeral plans
- Entering into and administering a regulated mortgage contract
- Entering into and administering a home reversion plan
- Entering into and administering a home purchase plan
- Agreeing to do most of the above activities

4.21 Clearly, most of these investments and activities are outside the remit of the GFAS. However, there are some products, notably deposits, mortgages, insurances, home reversions, home purchase plans, and stakeholder and personal pensions, which could fall within the discussions between the GFAS and its clients. It is therefore vital that that the GFAS avoids providing advice that falls within regulatory scope when discussing these products.

4.22 Where clients do not already hold FSA-regulated products, it will be relatively easy for the GFAS to remain outside regulation by ensuring that it does not provide advice on whether the client should take out a particular

regulated product. So, for example, the GFAS must not advise that a client takes out a specific mortgage product.

4.23 However, the situation is more complex where the client already holds a regulated product. In these cases, the client may seek guidance on the appropriateness of the product or the GFAS adviser may realise that the client could benefit from changing the product.

4.24 A detailed consideration of the regulation as it applies to mortgages and insurances will indicate the possible ways in which the GFAS could require FSA authorisation through discussion of existing products:

#### Advising on mortgages

4.25 53A of the RAO states that:

Advising a person [on a regulated mortgage contract] is a specified kind of activity if the advice –

- a) is given to the person in his capacity as a borrower or potential borrower; and
- b) is advice on the merits of his doing any of the following -
  - i) entering into a particular regulated mortgage contract, or
  - ii) varying the terms of a regulated mortgage contract entered into by him in such a way as to vary his obligations under that contract.

4.26 The Thoresen Review's analysis of the potential users of GFA shows that more than 20% of the "most vulnerable" groups of consumers have mortgages, and this percentage steadily increases as the extent of vulnerability reduces. In such cases, the existing or future mortgage will probably be the client's major financial commitment, which the client may want to discuss as part of the GFA process.

4.27 Where the existing mortgage loan is already regulated, any advice that discusses the merit of changing the terms of the specific mortgage (e.g. ask the lender to provide alternatives to paying at the high standard variable rate of interest, consider transferring from repayment to interest only, or consider remortgaging with another lender) could be a regulated activity. This is confirmed by the FSA perimeter guidance manual at PERG 4.6.2:

*In the FSA's view, the circumstances in which a person is giving advice on the borrower varying the terms of a regulated mortgage contract so as to vary his obligations under the contract include (but are not limited to) where the advice is about:*

*(1) the borrower obtaining a further advance secured on the same land as the original loan; or*

*(2) a rate switch or a product switch (that is, where the borrower does not change lender but changes the terms for repayment from, say, a variable*

*rate of interest to a fixed rate of interest or from one fixed rate to another);  
or*

*(3) the borrower transferring from a repayment mortgage to an interest-only mortgage or the reverse situation.*

4.28 Note that there is no suggestion here that the GFAS will or should recommend a new mortgage product. However, what some stakeholders might consider a sensible and appropriate part of GFA - advising the client on options for varying the terms of their major financial commitment - could bring that advice within regulatory scope.

Example:

*The client contacts the GFAS because she wants to start saving and does not know where to begin. She can afford to put £10 per month into savings. The adviser discusses the client's budget and as part of this asks the client about her mortgage. The client tells the adviser that she took out a mortgage with XYZ mortgage lender two years ago as a first-time buyer. Her initial fixed rate of interest has finished and she now pays at the standard variable rate of interest. There is no redemption penalty associated with the loan. The adviser recommends that the client consider changing her mortgage from the current deal with XYZ and explains the advantages and disadvantages of so changing.*

4.29 In this situation, the client has provided some detail about the specific mortgage product taken out through a specified provider. Whilst most stakeholders would agree that it is sensible and appropriate to suggest that the client should consider the merits of changing the existing XYZ mortgage, the adviser has arguably gone too far and provided regulated advice.

4.30 To avoid the regulated boundary, the GFAS must not offer guidance on the merits of the client varying her existing loan with XYZ mortgage lender. The adviser can inform the client that all mortgage lenders offer mortgages with interest rates below the standard variable rate and that whilst there may be some advantages in staying at the standard rate, this will almost certainly be more expensive compared to other deals. The adviser could use, or could refer the client to, further information sources such as the FSA "Moneymadeclear" items on types of mortgage interest rate deals and explain how the client can use comparative tables or regulated advice to identify alternative mortgage deals. It is important to note that this information and guidance is valid irrespective of the mortgage lender and not specific to the XYZ mortgage and so will take consumers a long way in terms on understanding their current financial position and the pros and cons of taking action.

4.31 Clearly, the more information the adviser asks, or the client volunteers about the mortgage (e.g. name of lender, interest rate paid, remaining term, whether repayment or interest only), the more that any discussion about possible changes to the mortgage will be seen as being specific to that

mortgage and therefore at risk of falling within the regulatory boundary. Another consideration for the GFAS in maintaining a clear boundary with FSA-authorized advice is to ensure that the discussion with the client does not go into detail about existing products.

4.32 It should also be noted that the regulatory situation on mortgage advice is further complicated because:

- The FSA only took over regulatory responsibility for mortgages from 1<sup>st</sup> November 2004. Therefore, advice on mortgages taken out before 1<sup>st</sup> November 2004 is unregulated (although advice that significantly changes the original mortgage may be regulated);
- The FSA does not regulate all of the UK mortgage market. For example, all second-charge mortgages are unregulated. A GFAS would therefore be beyond FSA regulation when advising on the advantages and disadvantages of a client taking out a specific second-charge debt consolidation loan but would be caught by regulation if advising on the merits of extending a specified existing first mortgage to consolidate the same debt.

4.33 The variable nature of mortgage advice regulation is unhelpful in the boundary-setting of GFA. Defining the boundary of GFA around regulation could mean that information and advice are provided to a greater depth on mortgages taken out before November 2004, and more “restricted” information and advice are offered on mortgages taken out after November 2004. To ensure consistency, it is recommended that a GFAS treats all mortgages as FSA-regulated products when determining the depth of the advice it provides.

#### Advising on insurance contracts

4.34 The FSA regulates the sale of general insurance policies (e.g. motor insurance, home contents insurance) and some long-term insurance policies (e.g. critical illness, life assurance). It also regulates some parts of the after-sale process (e.g. helping policyholders to make insurance claims).

4.35 Article 53 of the RAO makes advising on contracts of insurance a regulated activity. It covers advice given to the insured or potentially insured person or any agent of that person. Advice is regulated where it covers the merits of buying or selling of an insurance policy or increasing cover under an existing policy.

4.36 Many clients within the GFAS target group will have existing regulated insurance policies. The reality of providing GFA is that it will sometimes include a discussion about such policies.

#### *Example:*

*A single parent aged 30 with three children seeks the advice of the GFAS about life insurance. The client explains that she has one policy with AB insurance company that she took out twelve years*

*ago. This pays out £25,000 on her death. This is the full extent of her insurance cover and she expects no other non-statutory payments to help her dependents in the event of her death.*

4.37 Discussions with industry and consumer stakeholders demonstrate a general agreement that GFA should encourage appropriate levels of life protection insurance. The insurance protocol could lead to a GFAS providing guidance to this client that “most people in your situation would increase your level of cover”. The protocol would go on to discuss the pros and cons of increasing cover, the risks of not taking action and signpost the caller to comparison tables. This advice will only fall under regulation if the adviser then recommends that the client approaches AB insurance company to increase the cover under her existing policy.

4.38 To avoid the FSA regulation boundary, the GFA adviser must ensure that they guide the client on the need to increase her level of insurance cover – and here the insurance advice protocol might suggest appropriate levels of cover – without giving any advice about whether the client should amend the AB policy. The adviser can refer the client to further information sources to compare or buy products, such as comparison tables.

#### Financial promotions

4.39 One further FSA matter needs consideration. In determining whether it falls within FSA regulation, the GFAS needs to assess whether it will make “financial promotions”.

4.40 A financial promotion is an invitation or inducement for a client to enter into an FSA-regulated product such as a mortgage or a life insurance policy. The invitation does not have to be to a particular product with a specified provider.

4.41 There is an important exemption to the financial promotion rules within the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. Article 17 (Generic Promotions) of this legislation provides an exemption for any communication which:

- does not identify (directly or indirectly) a person who provides the investment to which the communication relates; and
- does not identify (directly or indirectly) any person as a person who carries on an investment activity in relation to that investment.

4.42 This exemption suggests that the GFAS could guide a client towards a particular type of product regulated by the FSA so long as it does not recommend any specific provider.

4.43 However, the financial promotions rules could prove an obstacle in the GFAS referring to comparison websites. If a GFAS advisor says "I suggest that you look at the best buy table for mortgages or insurances provided by xyz, then there is a danger that this indirectly results in the client obtaining

advice or buying a product after consulting the comparison website. This applies even if the table is comprehensive and genuinely impartial.

4.44 As a general rule of thumb, if the comparison website is operated by a person who is authorised under the FSMA or is an appointed representative of an authorised person, then a promotion for use of that website will not be exempt under article 17 and vice versa. It should also be noted that the GFAS could specifically steer consumers to the FSA's own consumer website because the FSA does not carry on a controlled activity.

4.45 This means that the GFAS must exercise care when referring clients to comparison tables. Specific providers of comparison websites (other than the FSA) should not be explicitly recommended.

#### Summary of the impact of FSA regulation

4.46 There is a risk that a GFAS could fall within FSA regulation through meeting each of the four tests. The main risk occurs where a client already holds a regulated product. Discussion about the merits of the client varying or discharging this specific product falls within regulation even though in some instances the advice may be accepted good practice (for example, changing from a repayment to an interest-only mortgage in the case of temporary financial difficulty, or increasing life insurance cover to reflect a change in personal circumstances).

4.47 Using the regulatory boundary to define the scope of GFA would result in a service with inconsistent boundaries. For example, information and guidance on mortgages taken out before 1st November 2004 could theoretically go to greater depth than information and guidance on mortgages taken out after 1st November 2004. For reasons of consistency for consumers, GFA advisors, and FSA-regulated advisors, this paper recommends that information and guidance is provided to consumers to a consistent depth.

4.48 Advice protocols will need to reflect this risk and offer sufficient clear water between GFA and FSA-regulated advice to help ensure advisers do not cross the boundary. Chapter 7 of this paper discusses how the GFAS could decide an appropriate depth of advice.

## **5. The Impact of Consumer Credit Act Regulation on GFA**

5.1 Research for the Thoresen Review on the potential users of the GFAS shows that more than 60% of the primary target group have some outstanding unsecured debt, with approximately a third having unsecured debt that amounts to more than ten times their savings and investments (excluding any pension savings). Advice on credit and debt is therefore likely to be an important part of the GFAS:

5.2 Many respondents to the Call for Evidence also stress the importance of credit and debt advice as part of the remit for the GFAS.

*The personalised nature of generic advice means that the content will vary according to individual circumstance. Clearly, there will be a key role in dealing with personal debt<sup>16</sup>*

*Debt management must be an initial focus.<sup>17</sup>*

*The main focus of generic advice should be personal accounts and debt management.<sup>18</sup>*

5.3 However, it is important to emphasise that the primary focus of GFA is not debt advice. Chapter 2 of the interim report shows that there is an existing supply of good quality debt advice within established agencies and it will be important for the GFAS to refer complex debt cases to these agencies.

5.4 The prevalence of consumer credit means that many GFAS clients will have consumer credit agreements regulated under the Consumer Credit Act 2006. The Act prescribes that providing advice about the liquidation of these debts (which it terms debt-counselling) is an activity that requires a consumer credit licence.<sup>19</sup> The Act also stipulates that most holders of a consumer credit debt counselling licence are subject to the jurisdiction of the Financial Ombudsman Service (FOS) in respect of complaints on advice provided under the activities of the licence.<sup>20</sup> The FOS jurisdiction imposes various regulatory compliance procedures, including an appropriate and effective complaints-handling procedure.

5.5 Providing advice on how clients may vary payments due under a regulated consumer credit agreement would therefore bring the GFAS within the bounds of OFT and FOS regulation.

5.6 It is possible to provide clear water between GFA and OFT regulation if a GFAS does not provide advice on whether a client should vary the payments made on a regulated consumer agreement. However, this will require finesse from the GFAS adviser.

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<sup>16</sup> Aegon

<sup>17</sup> IMA

<sup>18</sup> Prudential

<sup>19</sup> The Act defines debt-counselling as the giving of advice to debtors or hirers about the liquidation of debts due under consumer credit agreements or consumer hire agreements. Consumer Credit Act 1974 s145(6)

<sup>20</sup> Consumer Credit Act 2006 s59(3)(e)

*Example:*

*A client contacts the GFAS to discuss whether he should repay his credit card debt of £500 by using some of his instantly accessible savings that total £12,500. He explains that he pays an interest rate of 20% on the credit card debt and has recently been making minimum payments on the credit card.*

In this situation, the GFAS explains (by reference to the advice protocol) that the relative rates of interest rates payable on savings and credit card accounts makes it appropriate for most people to use savings to repay credit card debt so long as it leaves sufficient cash savings to fund irregular or unanticipated spending. However, the adviser is careful that they do not advise the client that he should repay the £500 owed on the credit card.

*Example:*

*A client contacts the GFAS because she is having difficulty paying her mortgage and is threatened with repossession. She explains that she has a large amount of credit card debt and these payments are taking 25% of her income. She is paying the credit cards in preference to the mortgage because of her concern that she will be sent to prison for not paying the credit card bill. The next payment on her credit card is due and she has the cheque written and ready to send.*

In this situation, the GFAS provides details of debt advice agencies but also advises on the principle of priority debts, which means that mortgage payments should take preference over payments towards unsecured credit agreements. The adviser is careful to avoid providing specific advice about whether the client should or should not send the credit card payment.

5.7 Similar to the discussion on mortgages above, this analysis is complicated by the fact that some GFAS clients may have unregulated credit agreements. For example, loans of over £25,000 are currently unregulated. Therefore, the GFAS would not require a consumer credit licence to provide advice on the merits of the client paying off or otherwise varying the repayments made under such a loan. However, as with mortgages, differentiating agreements in this way makes little sense for either the GFAS or its clients and we think it important that a GFAS treats all credit agreements as consumer credit act regulated products when determining the depth of the advice it provides.

#### Summary of the impact of consumer credit regulation on the GFAS

5.8 The prevalence of consumer credit means that many GFAS clients will have consumer credit agreements regulated under the Consumer Credit Act 2006. Providing advice on whether a client should re finance or otherwise vary payments made under these agreements is a regulated activity and requires

that the GFAS holds a consumer credit licence. This then leads to further accountability to the FOS.

5.9 This paper recommends that GFAS should not offer debt advice to the extent that requires an advisor to suggest a client varies the terms of an existing credit agreement. GFAS will offer guidance on creating and maintaining a budget and tips to maximise income, make ends meet and plan ahead, but it will not offer information and guidance for complex debt cases. Clients with priority debts will be referred to existing debt counselling services and the consumer pilots of GFAS will help test out this referral mechanism.

## **6. The Legal Implications of GFA**

6.1 One reason for establishing clear differentiation between regulated advice and GFA is that working to this boundary should reduce the risk of a GFAS being sued for wrong advice.

6.2 Nevertheless, the GFAS will still be subject to the common law and therefore face liability risk in respect of its service.

6.3 It is therefore essential that the GFAS takes out and maintains an appropriate level of professional indemnity insurance.

6.4 Some stakeholders have pointed to a possible difficulty in the GFAS obtaining professional indemnity insurance because professional indemnity insurers are unclear on how GFA differs from regulated advice and the associated liability risk. It is therefore important that the GFAS is able to explain how the agreed depth of advice will limit the risk of clients experiencing financial detriment because of the advice they receive. Advice protocols have been drafted in conjunction with industry and consumer groups to help GFA advisers stick within the terms of GFA.

## **7. The Depth of Advice Provided by a GFAS**

7.1 So far, this paper has proposed a broad range of topics that should be covered by a GFAS and analysed the applicable regulatory boundaries. This section considers and proposes a depth of advice that should ensure that the service maintains clear water with regulated advice whilst also offering a valuable service to its clients.

7.2 The consideration starts from the assumption that there needs to be clear differentiation between regulated advice and GFA. It also takes full account of the views of respondents to the Call for Evidence.

7.3 The Call for Evidence asked respondents for their views on the relationship between GFA and regulated advice. Question BS5 asked: "How can the boundary between generic and regulated advice be clarified so that it is clearly understood by both consumers and those giving generic advice? Where should it be drawn?"

7.4 Most respondents who answered this question did so with reference to FSA-regulated advice. They all advocated that the GFA boundary should avoid regulation by stopping short of recommending specific products offered by a specific provider (e.g. “you should open a cash ISA with AB bank”). However, some respondents further suggested that the boundary should allow the GFAS to recommend types of products (e.g. “you should open a cash ISA”).

*Generic advice should be confined to a product type as a whole, not to individual provider’s products<sup>21</sup>*

*Regulated advice matches an individual with a specific regulated product from a particular provider, whereas generic advice does not - the distinction is clear-cut.<sup>22</sup>*

*Generic financial advice should give individuals information and where necessary provide explanation on some of the factors people should take into account in reaching a decision on their own. Regulated advice involves giving specific advice on what an individual should do, and make recommendations on what specific regulated products the individual might buy.<sup>23</sup>*

*We would see regulated advice as that advice which moves the consumer into a direct relationship with a sales environment.<sup>24</sup>*

*For us, generic advice is about providing relevant information in a systematic and comprehensive way so that the enquirer is able to make their own decisions. It does not conclude with a specific recommendation which is the main difference with regulated advice.<sup>25</sup>*

*The boundary can perhaps best be drawn by determining whether the advice constitutes a specific call to action to purchase or divest a particular financial product.<sup>26</sup>*

*We believe that regulated advice is where a specific financial product/service is being sold. Generic advice is where individuals are given enough information so that they can make informed choices but stops short of making recommendations on specific products.<sup>27</sup>*

*We think this is relatively straightforward if, in principle, the new advice service sticks to generic matters and does not recommend specific products or provide.<sup>28</sup>*

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<sup>21</sup> Newcastle Building Society

<sup>22</sup> HBOS

<sup>23</sup> NAPF

<sup>24</sup> Which?

<sup>25</sup> TPAS

<sup>26</sup> Pension Decisions

<sup>27</sup> CIPD

<sup>28</sup> Children’s Mutual Building Society

*For example, we would suggest that a core aspect of GFA would be explaining the differences between various different savings vehicles. We also suggest that it might be legitimate to then go on to advise that on the basis of a given client's particular circumstances, taking out an ISA might be a suitable course of action (within the context of explaining all relevant benefits and drawbacks. The "cut-off" would, in our view, have to be applied at the point at which the client might then ask which company's ISA the adviser would recommend.<sup>29</sup>*

7.5 The consensus from the evidence suggests that a GFAS must not provide advice on the merits of a client taking out any specific regulated financial product offered by any individual company or organisation. For example, a GFAS must not recommend that a client should take out a 5.5% fixed rate mortgage over two years with the XYZ building society. This is a clear boundary with regulated advice.

7.6 However, the analysis of FSA and OFT regulation requires that the advice boundary for the GFAS needs to go further. To avoid the boundary of regulation, the GFAS must not provide advice on the merits of a client varying an existing regulated financial product. For example, the GFAS must not recommend that a client should increase the amount of life insurance currently held with ABC insurance company and must not provide advice that a client should increase the payments made on a regulated credit card agreement with XYZ bank.

7.7 The analysis in the above two paragraphs refers to regulated products. But the breadth of topics identified in paragraph 2.4 covers a much wider range of products and topics. Therefore, in some cases the GFAS will offer advice in completely unregulated areas. For example, there is no regulation that prevents the GFAS from recommending a client take out a credit card with XYZ bank that offers 0% interest on purchases for 12 months. Similarly, there is no regulation that prevents the GFAS from recommending that a client transfer to a specific utility company.

7.8 Consequently, it is possible to propose an advice boundary that differs across products and topics. For example, the GFAS could provide specific product recommendations where there was no regulation exists.

7.9 Such an uneven advice boundary would be unhelpful. Prescribing a consistent boundary across all areas of financial topics would ensure clarity for all stakeholders, including the clients of a GFAS. It should also help ensure greater availability of professional indemnity insurance.

7.10 This paper therefore recommends that GFA should not advise on the merits of a client taking out a specific financial product provided by a specific provider, or on the merits of a client varying contributions to any existing specific financial product provided by a specific provider. "Financial product"

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<sup>29</sup> Money Advice Trust

should be widely defined to apply across the full breadth of GFA and therefore include the full range of pecuniary products and services that may affect GFAS clients.

7.11 Analysis of the responses to the Call for Evidence and further discussion with both industry and consumer group stakeholders has identified three further areas for consideration in proposing the depth of GFA. These are:

- Should the service refer clients to specific providers?
- Should the service guide clients to specific types of products?
- Is there a need for the GFAS to benefit from a regulatory carve-out that would avoid the complex regulatory boundary issues discussed in this paper?

#### Specific providers

7.12 The advice boundary proposed above refers to individual products rather than individual providers or groups of providers. In theory, this would not prevent the GFAS from recommending that a client takes out a product with XYZ bank rather than ABC bank. Whilst it seems unlikely that the GFAS would want to guide clients to specific providers, the possibility that it could provide such information and guidance could risk contravening the financial promotions regulations explained at paragraph 4.39. This paper therefore proposes that the GFAS should not recommend any specific financial provider or type of provider even where the suggestion does not relate to a specific financial product. For example, the GFAS must not offer guidance that it is better to save with credit unions rather than banks. Instead the service should explain the options, the advantages and disadvantages, and the consequences of the different types of institutions.

#### Non-specific products

7.13 The FSA Generic Advice Working Group has previously discussed the regulatory boundary for GFA in some detail. The August 2005 report from the FSA, *Financial Capability: developing the role of generic financial advice* used the debate from the working group to propose a matrix of topics and activities that could define GFA and avoid a generic financial adviser overstepping the mark into regulated advice.

## 7.14

Breadth → Depth ↓	Benefits	Budgeting		Emergency provision	Protection	Saving and Investment	Taxation	Referrals
								<input type="checkbox"/> More information
2. Reason for		<b>“Generic Advice”</b>						<input type="checkbox"/> Other specialist advice, e.g. debt counselling
								<input type="checkbox"/> Basic financial advice
								<input type="checkbox"/> Full financial advice

## Key

	Advice is unregulated by the FSA		Benefits and taxation included to the extent relevant (specialist advice outside scope)
	Proposed scope of “generic financial advice”		Some, but not all, advice regulated by the FSA
			Advice is regulated by the FSA

7.15 The FSA proposed that the boundary for GFA should fall short of any recommendation of product types.

7.16 HMT adopted a similar approach to setting the boundary for GFA. The January 2007 paper *Financial Capability: the Government’s long-term approach* defines GFA as “unregulated advice which takes account of the specific financial circumstances of an individual but which does not result in a product recommendation”.

7.17 Some respondents to the Call for Evidence have suggested that the GFAS should be more ambitious than proposed by the FSA and HMT. They argue that there are some simple products that a common-sense approach identifies will be of advantage to clients of a GFAS. For example, those with financial dependants will benefit from guidance on the need to consider the needs of those dependants in the event of the client’s death, and term life insurance is a straightforward product that the GFAS could recommend.

Similarly, clients who pay income tax and who wish to establish an initial emergency savings fund could reasonably be guided towards a cash ISA.

7.18 For the initial trial of a GFAS, this paper recommends that advisers should follow the proposal of the FSA Working Group and not recommend types of product. Instead, GFAS would provide information and guidance on the different types of products and the advantages, disadvantages, and implications of each type. GFA could say that “most people in your situation would be well advised to consider life insurance” but it would not go as far as to say “I recommend life insurance to you”. Evaluation of the trial should include consideration of whether not being able to recommend types of product was seen as an unhelpful barrier to clients and/or advisers.

#### Regulatory carve-out

7.19 Some stakeholders have suggested that the GFAS should seek a regulatory carve-out that would explicitly exempt it from FSA authorisation. This would completely remove the boundary between GFA and FSA-regulated advice.

7.20 There is a clear attraction to this suggestion, particularly given the complexity of the regulatory boundary. However, creating a carve-out from FSA and OFT regulation could send the wrong message to stakeholders and GFAS clients. The requirement that GFA stops short of regulated advice offers protection for GFAS clients and advisers as well as reassurance for the regulated sector and professional indemnity insurers.

7.21 In any case, a regulatory carve-out is clearly not a short-term option. The pilot of GFAS allows a test of whether an advice boundary that does not recommend specific products or types of products or advise clients to vary their contribution to existing specific products is a practical alternative to a regulatory carve-out.

#### What can the GFAS say?

7.22 The above proposals for an advice boundary have concentrated on how the GFAS should restrict its advice to avoid providing regulated advice.

7.23 It is important to note that this advice boundary allows the GFAS to provide information and guidance to a significant depth before encroaching on regulated advice. For example, the advice boundary states that the GFAS should not discuss the merits of a client changing their existing mortgage with ABC mortgage lender. Within this boundary, the adviser can explain the pros and cons of different types of mortgages, the advantages and disadvantages of changing to another mortgage (either with the same lender or a different lender), can suggest questions to ask of the providers and signpost clients to comparison tables and/or the regulated advice sector for further information.

7.24 As another example, the advice boundary provides that the GFAS would not recommend that clients save in a cash ISA. However, the service

can explain the different types of cash savings products, the tax advantages of saving in a cash ISA and can say that most people in the GFAS target group would choose to save in an instant access cash ISA if they wanted to establish an emergency savings fund which paid a tax-free rate of interest. The service could then signpost clients to further sources of information that would enable them to choose a specific product if they had decided that a cash ISA was appropriate for their needs.

7.25 The boundary also allows the GFAS to explain how the financial services sector operates and how clients can best use available information to identify products and services that best meet their needs. So whilst the regulatory boundary means that the GFAS should not refer to a specific comparison website (other than that provided by the FSA), it can explain how these websites work and suggest questions that clients should ask of product providers and intermediaries.

7.26 Individual advice protocols will further explain how the GFAS can work within the advice boundary to provide information and guidance to a significant depth that will help consumers make better financial decisions.