Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sir, Madam,

Call for Input on Regulatory Barriers to Social Investments

This is the response of the UK's Financial Services Consumer Panel to the FCA's Call for Input on Regulatory Barriers to Social Investments.

The Panel believes that there is a risk that consumers do not take account of the financial risks associated with social investment products because they are attracted to the philanthropic or ethical approach of such investments. Much greater transparency is needed in this market, about both the financial and social performance of investments. Consumers need to have the information to decide, for example, whether they are content to take a high financial risk for non-monetary rewards.

The Panel also has concerns over the extent to which consumers can make informed decisions on investments in this sector. Social investment is a broad church in which there is relatively little data available on the investment performance and behaviour of its constituents. There is also a lack of transparency about costs and charges (as there is across retail investment in general). Comparison within the sector and with others is difficult at best.

Regulation of social investments can only be effective from a consumer protection perspective if there is a clear understanding of who social investors are, their financial and behavioural characteristics, and their motivation.

We have provided answers, below, to those questions on which we have a view.

Yours sincerely,

S.V. Lewis

Sue Lewis
Chair, Financial Services Consumer Panel

Consultation Questions

Q4: Have you identified barriers to investment in the social sector for retail investors? If yes, please provide details of these barriers, in particular identifying those that may be caused by regulation.

Lack of clarity, classification and transparency put consumers at a disadvantage in this market. Social investment is a broad term, including a wide range of investment types and activities.

Consumer understanding of how social investment behaves as an asset class, the returns, risk, liquidity and correlation with other assets is low. There is relatively little performance and charges data available to retail investors in this market, making it difficult to appraise the risk profile of different investments and compare various options effectively.

What data there are suggest financial returns compare poorly with other asset classes, underlining the importance of understanding an individual's motivations for investing (i.e. for investment growth or for more altruistic/philanthropic reasons). Investors may also want to assess the social impact of an investment. There is currently little data to enable them to do this.

There is an advice barrier too. Financial advisers (other than those who specialise in ethical and socially responsible investing) are reluctant to advise on social investments, not only because they are considered too esoteric and there is little data, but also because investors in this area may have non-financial objectives that can make suitability difficult to establish (and which may therefore create advice liability concerns).

These factors are all barriers to effective consumer engagement in the sector. While they may not be regulatory, there is a role for the regulator in making the market more transparent and easier to assess and therefore mitigating some of the risks faced by retail investors.

Q5: What kind of rules do retail investors need to consider when making sound investment? Have you identified any consumer protection concerns in this area? Please explain these concerns and how they might be addressed.

We are concerned about the policing of the boundary between the financial and social motivation when a consumer makes an investment into a social enterprise. For example, the strong brand association with - say - a football club, a locally-branded financial services mutual, or a community energy scheme may lead to behavioural biases that cause an individual to underestimate the financial risk involved.

We are concerned that the marketing of such schemes might lead people to make inappropriate financial decisions, without understanding that a substantial part of their investment is at risk, or illiquid and so is, in effect, a donation. There should be more thought to how to police this boundary, how to quantify the risk, and what risk warnings are suitable. A similar argument applies to, for example, pension fund offerings to retail consumers that are branded as "ethical" or "social".

Risk warnings should acknowledge the potential for the Social Investment Tax Relief to encourage individuals and advisers to make decisions on the basis of this alone, without factoring in the wider investment suitability considerations.

The marketing and promotion of social investments should reflect its limited suitability to mainstream retail investors, including those qualifying as high net worth or sophisticated. Consumer protection safeguards (including recourse to the FSCS and, where relevant, the FOS) should feature prominently.