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A legal update from Dechert's Financial Services Group

The FSA's Retail Distribution Review: Planning for Implementation

In the run up to the implementation of the Retail Distribution Review ("the RDR"), most firms are now planning how best to implement the RDR for their businesses. This *DechertOnPoint* reports on the background to the RDR and the latest Financial Services Authority ("FSA") and other regulatory developments in relation to the RDR, some practical issues when it comes to implementing the RDR and certain issues to bear in mind both now and post-RDR.

Background to the RDR

When originally established by the FSA, the RDR was envisaged as a two year root and branch review of the UK's retail investment market. In the RDR, the FSA adopted a new approach to policy making, conducting an open consultation with industry and consumers to try to establish and address the persistent problems in the retail investment market which have resulted in insufficient consumer trust and confidence. The FSA saw a major challenge in restoring trust and confidence and, as a result, has implemented measures to increase consumer access to financial advice and ultimately encourage consumers to save.

The FSA's own thinking has developed during the course of the RDR. It is therefore worth revisiting some of the stages in the RDR from its outset in June 2006.

The RDR should also be seen as part of the FSA's wider strategy. It is a key retail priority and complements the FSA's long term work of improving financial capability, and ensuring that firms treat their customers fairly. The FSA believes that the RDR process should also help the industry to prepare for and adapt to other related changes.

The FSA originally launched the RDR in June 2006 to try and make a real difference to the retail investment market, to address its inefficiencies and poor outcomes for consumers. Reflecting the FSA's preference for market-led solutions the FSA set up formal groups to come up with ideas and try to reach agreement on possible solutions to the retail distribution problem.

The over-arching aim of the RDR was to increase the number of consumers with sufficient confidence in the market to want to use financial services products and services more often. The FSA recognised that, to achieve this, the industry must consistently act in the best interests of its customers and should treat those customers fairly.

The FSA defined the desired market outcomes from the RDR as being the establishment of:

- an industry that engages with consumers and that delivers more clarity for them on products;
- a market which allows more consumers to have their needs and wants addressed;
- standards of professionalism that inspire consumer confidence and build trust;
- remuneration arrangements that allow competitive forces to work in favour of consumers;

- an industry where firms are sufficiently viable to deliver on their longer term commitments and where they treat their customers fairly; and

- a regulatory framework supports the delivery of these aspirations and which does not inhibit future innovation where this benefits consumers.

The Key Initial Proposals: DP07/1

DP07/1 published in June 2007 considered the efficiency of the retail distribution marketplace and set out the FSA's initial proposals on improving the market for the benefit of all participants. These initial proposals were set out in the following sections:

Dividing the Market for Regulated Advice

The FSA proposed dividing the market for regulated advice services into two parts:

- professional financial planning and advisory services; and

- primary advice services.

The FSA proposed significantly strengthening the existing regulatory requirements for firms and advisers who offer a full range of financial planning and specialist advice services. In tandem, it expected the industry to raise its standards using ideas put forward by the five consultative groups. However, the FSA noted that these proposals risked an increase in costs to firms, resulting in only those better off consumers being able to afford full financial advice.

Professional Financial Planning and Advisory Services: Full Advice

These services would be offered by highly qualified advisers who would provide customers with the full range of advice. Within this category, two types of adviser were proposed:

- highly qualified advisers: who agree remuneration directly with the customer, not the product provider, to avoid potential conflict issues; they would be truly "independent" advisers; and

- general financial advisers: other advisers who would provide full financial advice, but do not meet the conditions of the highly qualified advisers, but who may use provider-driven remuneration (i.e., commission) and who would not be able to call themselves "independent" even if they do so currently.

The FSA proposed:

- that both these types of adviser could also provide a focused advice service that could be cheaper than the full advice service (focused advice would limit an adviser to considering a number, but not all, of a consumer's financial needs); and

- increased regulatory requirements on general financial advisers, to reduce the risk of lower professional standards and to encourage firms to operate at the higher standards.

The FSA envisaged there would be a transitional period before any prudential or higher professional requirements were brought in and consideration would be given to the possibility of grand-fathering existing qualifications.

Primary Advice Services for Consumers Unable to Access Full Advice

The FSA envisaged that this form of advice would serve the needs of consumers who may not be able to access full financial advice. These services would involve providing advice to customers with more straightforward needs using a limited range of simple products. This type of advice could be cheaper and simpler to explain to customers than the full professional financial planning and advisory services.

These services could be aimed at a wider range of customers than the existing basic advice regime, with a range of products wider than the stakeholder products and without caps on charges.

To enable firms to offer these services, some of the existing suitability requirements would need to be reduced significantly and the FSA also proposed regulating this sales process by introducing standardised processes.

The FSA also proposed working with the Financial Ombudsman Service (the "FOS") to make sure that firms working in this area understood what was needed to ensure compliance.

Advisers providing this type of advice would need skills and qualifications appropriate to these services.

The FSA's Interim Report: April 2008

On 29 April 2008, the FSA published an interim report (the "Interim Report") outlining the principle areas of feedback it has received on the proposals set out in DP07/1. As a starting point for future work and debate the Interim Report was intended to set out, as a starting point for future work and debate, the FSA's own responses to the feedback. It did not contain policy decisions, but rather indicated the direction of the FSA's thinking ahead of its November 2008 feedback statement.

Responses Received to DP07/1

DP07/1 provoked substantial debate, as was reflected in the total of 888 responses the FSA received to its proposals from a broad range of stakeholders. These responses reflected increasing agreement on the need to deliver the RDR outcomes and to make it easier for consumers to understand the market. However, the key overriding feedback to DP07/1 was that the proposed advice regime was too complex. Respondent's called for a simpler regime. In particular that:

- there should be a clear separation between advice and sales;
- the landscape should complement a proposed national money guidance service;
- there should be a single tier of advice, rather than the many tiers of adviser and advice envisaged by the proposals;
- the proposals for primary advice could be delivered through guided sales, but they should not be labelled as advice as to do so dilutes the advice brand;
- the FSA should apply a principles-based, not a prescriptive approach, to remuneration; and
- the demands and responsibilities of different roles in the market necessitate raising minimum professional standards (which means skills and behaviours as well as knowledge).

A Long-stop Date for Complaints

DP07/1 also pointed out that the FSA's rules do not set a long-stop date by which complaints must be brought. Feedback to DP 07/1 suggested that this long-stop is seen as a real barrier to market development. Unsurprisingly, firms and trade bodies expressed support for introducing a long-stop time limit into the FSA's complaints rules, whereas consumer bodies strongly opposed the move on the basis that the long-term nature of investment products means that a complaint may not emerge for many years after a product is purchased.

Non-advised Sales

The starting point for sales in the Interim Report was services that are strictly non-advised and are intended to encourage higher levels of savings and protection, so that the needs of more consumers are met. This would include:

- execution only sales, where the customer knows precisely what they want to buy and does so; and
- guided sales under which consumers go through a non-advised information buying process which leads to a choice of product.

It was accepted that full advice is unlikely to be readily available to all and a guided sales process would allow firms to offer something in a way that is economical for them, affordable to consumers and would allow consumers to make simple, straightforward choices. However, the FSA considers that it is vital that consumers participating in such a process realise that they have not had the benefit of advice. In order to provide more clarity about the dividing line between giving information and giving advice, the FSA committed to working with the FOS following publication of the Interim Report to determine how the two bodies will judge the guided sales process, so that firms are better able to determine whether they wish to offer this service and if so, for what type of products.

Problems and Obstacles to a Simpler Model

The step-changes proposed in the Interim Report gave rise to numerous potential obstacles relating to a trade-off between the desire to deliver the simpler model and the need to cater for a market wide enough to accommodate the diverse needs of different consumers. These are wide-ranging and were discussed in the Interim Report and relate not only to whether the FSA in fact wants to make the changes, but also include certain UK and EU legal (in particular competition) restraints which may have limited the changes the FSA could make.

Some sticking points that a simpler model presented the FSA were:

- What could the FSA do to support simple and transparent sales processes, which are economically viable but at the same time offer appropriate levels of consumer protection and choice? Would a simplified advice regime result in a contraction in the supply of retail investment services available that would be detrimental to consumers? How would the proposed requirements for advice impact on firms' business models?
- Professional standards: some advisers would not be able to meet the requisite criteria, including qualifications and experience, necessary to offer independent advice;
- Remuneration: new requirements would have to avoid making changes that create immediate difficulties for adviser firms charging, and their clients paying, for their services; and
- What would be the impact on those firms that currently provide advisory services, but would not meet the proposed criteria for advisers (such as tied agents and multi-tied advisers)?

FSA's Challenge to the Industry

In the Interim Report, the FSA issued the following three specific challenges to the industry:

- for more product providers to change their business models so that they do not determine how much advisers are paid;
- for the industry to develop and implement an agreed common framework for professional standards (to facilitate this the FSA set up a RDR Professionalism Working Group to allow it and the industry to work together); and
- encouraging firms to present propositions to the FSA for new sales services and challenging firms to make a case for FSA action to help implement those ideas in a way that delivers better outcomes for consumers.

The industry's response to these challenges were instrumental in shaping the FSA's final RDR policy proposals that were outlined in a Feedback Statement published in November 2008 (see below).

The FSA's Feedback Statement 08/6 Including Feedback on DP07/1 and the Interim Report

On 25 November 2008, the FSA published its RDR feedback statement which:

- outlined the FSA's proposals for modernising the retail investment industry and which the FSA describes as "far reaching and challenging";
- described how the FSA will take the proposals though to consultation in 2009;
- explained how and why the FSA's current proposals differ from those put forward in the Interim Report;
- provided feedback on responses to DP07/1 and the Interim Report; and
- provided a progress update on how industry is meeting the three challenges set by the FSA in its Interim Report.

The key proposals on which the FSA intended to consult in 2009 are intended to restore consumer trust and confidence and meet the other RDR outcomes by:

- improving the clarity of services for consumers of the characteristics of different types of service being offered, and the distinctions between them;
- modernising remuneration by reducing conflicts of interest that are inherent in remuneration practices and improving the transparency of the cost of advisory services;
- introducing new professional standards for independent advice; and
- improving consumer access and liability management.

Potential Cross-border Implications of the RDR Proposals

The FSA's RDR proposals gave rise to a number of potential cross-border implications for retail investment business, on which the FSA has given further consideration in finalising its proposals. For example:

- Firms passporting investment services into the UK will not have to comply with the higher standards that will apply to UK regulated firms. This is because other Member States predominantly rely on the suitability and disclosure requirements in MiFID to ensure that retail customers are protected. The FSA's proposals go beyond MiFID and will potentially result in an uneven playing field, putting UK firms at a competitive disadvantage. Similarly, UK firms offering their services outside the UK may be at a competitive disadvantage if they are required to comply with the FSA's higher standards.

- Questions also arise around the use of overseas branches by UK firms. Such branches will be governed by the rules of the Member State in which they are located: could the difference in standards open up the branch office to a misselling claims if consumers claim that they would have received a higher standard of protection had the service been offered in the UK?

- Will non-UK firms operating cross-border into the UK be able to receive commission from UK providers? What will be the position regarding receipt of commission, for UK firms operating cross-border into other Member States that are in competition with firms regulated by the host Member State?

Aspects of the FSA's existing investment advice regime go beyond the requirements of MiFID will therefore be the subject of MiFID Article 4 notifications, under which the Commission allows such super-equivalence. However, the FSA confirmed that, in general, its proposals (in particular in relation to remuneration practices and to independent advice) will only require minor modifications to its existing MiFID Article 4 notifications.

Prudential Requirements as an Incentive for Personal Investment Firms to Improve Outcomes

In July 2007, the FSA published a discussion paper (DP07/4) on a review of the prudential rules for personal investment firms ("PIFs") as a means of reducing consumer detriment. In this parallel review with the RDR, the FSA proposed the use of risk-based prudential requirements as an incentive to achieve higher professional standards and to adopt remuneration practices that are not influenced by product providers.

The FSA provided feedback to DP07/4 in Feedback Statement FS08/2, published in April 2008. In FS08/2 the FSA said that it intended to consider further how best to define and extend its current capital resource requirements according to the size of a firm. The FSA also said that it would consider arrangements whereby firms that cease trading bear more of the costs of their customers' subsequent claims than is currently the case.

The FSA's proposals to improve the prudential rules for PIFs were published on 27 November 2008 in Consultation Paper 08/20, "Review of the Prudential Rules for Personal Investment Firms" (CP08/20). The FSA believed that those proposals would help to reduce the impact of market failures in the PIF sector.

Further Steps Taken by the FSA

The publication of the Feedback Statement FS08/6 by the FSA marked the end of the review phase of the RDR.

The next phase was taken forward by the FSA under its "**Retail Distribution Implementation Programme**".

In 2009, the FSA formally consulted on detailed FSA Handbook changes to implement the FSA's modified proposals as set out in FS08/6, with a final implementation date of 31 December 2012, by which date all the changes introduced through the RDR must have been fully implemented by the industry.

In the interim, the FSA encouraged the industry to take more immediate steps to move towards the FSA's desired outcomes as set out in FS08/6 before they are required to do so, for example, by upgrading qualifications and changing their remuneration practices and systems.

The FSA also published a series of sector related consultations relevant to RDR, for example, on corporate pensions, platforms and nominee-related issues, a detailed consideration of which is beyond the scope of this *DechertOnPoint*.

Following publication of its final rules on charging and advice in March 2010 (PS10/06), the FSA published a consultation paper on professionalism requirements for the industry in June 2010 (CP10/14).

CP10/14 set out the FSA's stance on professional standards under the RDR and the supervision and enforcement of these standards. In particular:

- it confirmed its proposal made in December 2009 (CP09/31) not to create a new

Professional Standards Board. Instead, it will set the standards expected of investment advisers itself, and will supervise and enforce the standards by increased oversight of individual advisers;

- the FSA consulted on requiring advisers to hold a "Statement of Professional Standing" confirming that they are qualified to give advice, their knowledge is up-to-date and they subscribe to a code of ethics. Such statements will be issued by FSA accredited professional bodies. (The FSA believed that this will help deliver consistent standards across the sector and that these proposals, supported by changes to the FSA Handbook, will complete the move to higher professional standards); and

- it also sets out the final list of level 4 qualifications that retail investment advisers will need to pass by 31 December 2012 (if they are subject to gap-filling and were competent as at 30 June 2009) or according to the longer timetable set out in paragraph 3.8 of CP10/12 (the thirty month time limit). (This will enable advisers to prepare for RDR implementation).

Using industry feedback from CP10/14, the FSA has since issued a policy statement with final rules.

It is also worth noting that the FSA has consulted with trade bodies and other interested parties regarding the data requirements that will be necessary to ensure that the FSA can monitor and review the implementation of RDR. Further, following its discussion paper in March 2010 (DP10/2), the FSA has issued a consultation paper on platforms and their impact on the sector.

EU Issues

At an European Union level it is worth bearing in mind the EU initiative on packaged retail investment products ("PRIPs"). In its update in December 2009, the European Commission said that it was consulting with competent authorities and other interested parties on legislative proposals to implement the commitments it made in an April 2009 Communication.

A Task Force of the then Level 3 committees (CEBS, CEIOPS and CESR) issued a report on PRIPs on 6 October 2010. The report's recommendations included:

- providing a suggested definition of PRIPs, as "a product where the amount payable to the investor is exposed to fluctuations in the market value of assets or payouts from assets, through a combination or wrapping of those assets, or other mechanisms than a direct holding";

- regulating selling practices; and

- providing investors with a Key Investor Information document along the lines of the template in place for UCITS.

On 3 June 2011, the FSA published Issue 2 of a newsletter relating to the RDR which clarified certain passporting issues. The newsletter sought to clarify when a firm passporting under MiFID or the Insurance Mediation Directive (the "IMD") is within the scope of the RDR rules or the rules of their home state. The newsletter states that:

- branches set up in the UK will be subject to the FSA's Conduct of Business sourcebook ("COBS") and consequently RDR rules such as the scope of advice and adviser charging; and

- EU firms passporting into the UK on a services basis will be subject to their home state's rules on conduct of business and training and competence, which means that they will not be subject to the FSA's RDR training and competence requirements such as holding relevant qualifications or ongoing continuing professional development.

The newsletter notes that not all investment products fall within the scope of MiFID and the IMD and this means that firms passporting into the UK seeking to provide pension advice will require a top-up permission and will be subject to the FSA rules.

Whilst the FSA does not expect significant changes as a result of the introduction of the PRIPs regime it is worth bearing in mind that amendments may be required when the PRIPs regime comes into force.

The FSA's RDR Implementation Proposals

Summary of the Key RDR Proposals

It is worth repeating here how the FSA's final RDR rules are intended to improve the quality of advice and improve consumer trust and confidence in the industry. This is to be done by:

- **Improving clarity for consumers about advice services.** Investment firms will be required to clearly describe their services as either "independent advice" (that is, they genuinely do make recommendations based on comprehensive and fair analysis of the their clients' needs) or "restricted advice" (for example, where advice is given only on a limited range of products).

- **Addressing the potential for remuneration bias.** Firms giving investment advice will be required to set their own charges, which they must agree with their clients, and must meet new standards on how these charges are determined and operate; commission bias will be brought to an end through a ban on product provider commission being paid to advisers, which will prevent advisers automatically recommending products that pay commission.

- **Increasing professional standards of advisers.** The minimum level of qualification for investment advisers will be raised to a new, higher level, regarded as equivalent to the first year of a university degree and a professional standards board will maintain and enforce an overarching code of ethics and enhanced standards for continuing professional development.

As mentioned above, the final RDR rules will need to be implemented by firms by **31 December 2012**. However, as highlighted in this OnPoint, firms need to make changes now to implement the proposals.

Which Firms and Products Are Affected by the RDR?

The FSA's proposals impact on all regulated firms involved in producing or distributing retail investment products and services such as independent financial advisers ("IFAs"), wealth managers, fund managers, multi-tied advisers, tied advisers, private bankers and stockbrokers. Firms carrying on mixed business models, which engaged with clients on a regular basis and at some stage in the relationship are likely to give investment advice, must ensure that if investment advice is given, their advisers meet all the requirements of the RDR.

The RDR professionalism standards (outlined in more detail later in this OnPoint) will apply to all UK based advisers who make personal recommendations to retail clients about investment products and services. The proposals do not alter the home/host state arrangements for competence as set out in the Markets in Financial Instruments Directive and consulted on in CP06/15.

The proposals do not relate to general insurance and mortgage products and services.

New Definition of Retail Investment Product

The FSA's RDR rules apply to a wider range of retail investment products than the pre-RDR packaged product definition. This is achieved through the introduction of a new FSA Handbook definition of "retail investment products", which includes:

- packaged products;

- unregulated collective investment schemes;

- all investment in investment trusts (i.e. not only in investment trust savings schemes);

- structured investment products; and

- other investments that offer exposure to underlying assets, but in a packaged form, which modifies that exposure.

This definition is consistent with that consulted on in CP09/18 and includes individual personal pensions, but does not include individual stocks and shares or structured deposits. This is because the FSA has adopted an approach consistent with the European Commission's thinking regarding its work on PRIPs. (In PS10/6, the FSA said that it is waiting to see how the PRIPs proposals develop before considering whether changes to the FSA's regime for structured products are necessary.)

In PS10/6, the FSA also made it clear that where firms are in doubt they should assume that the RDR rules do apply to their product.

New Standard for Independent Advice Including Disclosure of "Independent" and "Restricted" Status

The FSA seeks to achieve a new standard for independent investment advice to ensure that advice is genuinely independent and improves clarity for retail clients. This will be achieved through new rules and guidance in the FSA's Conduct of Business sourcebook (COBS 6) which sets out the FSA's requirements about information that firms provide about themselves, their services and their remuneration. The proposed new COBS 6 rules require that:

- Before providing advice or recommending a product, all advisers must inform their clients in writing, as part of a firm's initial disclosure information, whether they provide "independent advice" or "restricted advice", or both. The FSA has not prescribed the exact wording to be used but the terms "independent advice" or "restricted advice" must be used in the disclosure. Where a firm provides both independent advice and restricted advice the disclosure must clearly explain the different nature of the two services.

(The FSA has introduced (with effect from 31 December 2012) changes to its Handbook guidance on the existing services and costs disclosure statement (SCDD) (in COBS 6 Annex 1) and the combined initial disclosure statement (in COBS 6 Annex 2) for firms who wish to use those documents to meet the new written disclosure requirement.)

- Independent advisers consider a broader range of products; and
- Independent advisers make recommendations based on a comprehensive and fair analysis of their client's needs and provide unbiased and unrestricted advice.

All adviser firms, whether they offer independent advice or restricted advice, must continue to comply with the existing high level requirement to act in the best interests of their clients. This may involve firms recommending clients not to buy any product or to take alternative action. All disclosures made by firms regarding their status must also meet the high level requirement that they are fair, clear and not misleading.

Independent Advice

Firms providing independent advice will need to make recommendations based on a comprehensive and fair analysis of their client's needs, and provide unbiased and unrestricted advice. The only exemption is in COBS 6.2A.3R for Group Personal Pension Schemes, which following consultation the FSA has decided to retain. Firms holding themselves out as independent must be able to demonstrate to the FSA how they have satisfied these requirements.

A firm which recommends its own products may still offer independent advice provided that it considers its own products against the wider range of products and solutions available, and is also prepared to recommend those other products, as appropriate. The FSA has made it clear that firms offering a single product that invests in a number of underlying products would not meet the requirements of independent advice.

Key Practical Implications of the New COBS 6 Requirements for Independent Advisers

Comprehensive and Fair Analysis

- Independent advisers must review the whole market for the field in which they provide advice (referred to in the draft rules as the "relevant market"). This means that the firm must take into account all retail investment products capable of meeting the investment needs and objectives of its client. Generally, this will mean that firms will have to consider all retail investment products when making a recommendation. A firm which concludes that certain products, such as structured products or unregulated collective investment schemes, are not suitable for its clients, will not then need to review the market for that product for each client.
- Where the relevant market is limited (for example, because the firm specialises in a distinct field or because the investment needs and objectives of the client are limited to a certain type of product, such as ethical investments), the firm may still provide independent advice. It would not need to consider products that were not suitable for the market it specialises in. However, the FSA indicates in PS10/6 that it expects that examples of a specialised relevant market to be relatively rare and that certain products, for example life products and pensions, will be potentially suitable for the vast majority of retail clients.
- In summary, a firm holding itself out as independent within a relevant market must:
    - consider all retail investment products within the relevant market;
    - establish and maintain appropriate systems and controls to ensure that it does not make a personal recommendation to a retail client if there is a retail investment product outside the firm's relevant market that would be able to meet the retail client's investment needs (see the guidance contained in COBS 6.2A.22(3)G);
    - if their scope is limited in any way, make this clear to their clients; and
    - direct a retail client to an adviser firm that is able to consider all products which meet the client's needs and objectives, if it is unable to do so itself because its relevant market is limited in some way.

- The new definition of retail investment product means that independent advisers will require sufficient knowledge of all types of products within the retail investment product definition so that they are able to recommend those products that will give a suitable outcome for their clients. Independent advisers will need to keep up to date with developments in the market so that they can consider any new products (even if those products are not generally popular with retail clients) when determining which products may be suitable for a retail client.

- Firms that rely on panels or outsource the search to other third parties to analyse the market must ensure that the panel is sufficiently broad in its composition and is reviewed frequently to ensure that its use does not materially disadvantage their clients. Where a firm outsources its analysis to a third party it remains responsible for ensuring that the quality of the criteria used and the analysis conducted are suitably robust. The FSA will expect firms to be able to demonstrate clearly why they believe a particular market or product (or class of products) is not suitable for their clients and to meet the rules on panels more generally, including the requirement for any panel to be reviewed regularly. (The guidance in COBS 6.2A.19G clarifies that firms are able to exclude certain retail investment products from a panel, provided they have a valid reason for doing so.)

Unbiased and Unrestricted Advice

- There is no ban on advisory firms being owned, part-owned or financed by a retail investment product provider firm (i.e. a product provider). However, a firm offering independent advice should not be bound by any agreement with, or obligation to, a product provider that will restrict or limit in any way its advice or recommendation to its clients or its ability to act in its clients' best interests. Firms will need to be able to demonstrate how they have selected a product in accordance with the client's best interests rule.

- Unrestricted advice requires firms to consider other relevant financial products that fall outside the definition of retail investment products, such as national savings and investment products and cash deposit ISAs, if they may meet the needs and objectives of the client.

- The FSA has stated that practices such as giving advisers greater rewards for recommending their own/parent company's product ahead of other products in the market will not be compliant with its unbiased standard. The FSA recognises the possibility of consumer detriment, and will continue to monitor this area closely.

Restricted Advice

The FSA is proposing to label any advice that is not independent as "restricted advice". A firm will offer restricted advice where the advice it provides relates only to a limited range of products or product providers. Typically this type of advice will be provided by traditional bank advisers (who often only offer their own products), single-tied and multi-tied adviser firms.

Some Key Practical Implications of the Proposed New COBS 6 Requirements for Firms Providing Restricted Advice

Systems and Controls

Firms must establish and maintain appropriate systems and controls (see the guidance contained in COBS 6.2A.22(2)G).

Disclosure of Status

- By not prescribing the wording of written status disclosures, the FSA intends to give firms providing restricted advice the flexibility to describe what restricted advice means in the context of the particular service they offer.

- Where a firm engages in spoken interaction with a retail client it must disclose orally to customers that it provides restricted advice and the nature of that restriction in good time before the provision of its services in respect of a personal recommendation. Examples of statements that would comply with this requirement are set out in COBS 6.2A.10G. Firms training manuals should set out what their advisers are required to tell their clients. The FSA intends to carry out mystery shopping exercises to monitor the extent to which the rules in this area are being complied with. Following feedback to CP09/18 the FSA decided not to prescribe the wording of oral disclosures, as they accepted that the proposed wording would not work for all business models.

- At present, the FSA does not feel that it is necessary for a client receiving restricted advice to be told that independent advice is available, as this will be clear in the Services and Costs Disclosure document.

Suitability

- Firms offering restricted advice are still required to ensure that the product is suitable for the retail clients. In PS10/6 the FSA made it clear that if restricted adviser firms choose to limit their product range to a certain range of investments or investment strategies (for example, multi-manager funds or distributor influenced funds), they should be aware that there will be customers for whom such products are not suitable.

- The FSA said in PS10/6 that it is not acceptable for a firm to recommend a product that most closely matches the needs of the customer, from the restricted range offered, when that product is not suitable. So, for example, if a stakeholder pension is suitable for a customer, a firm should not recommend or sell a more expensive SIPP to that customer because it is the closest product that the adviser has to meeting the needs of the customer concerned.

Adviser Charging: Commission and Remuneration Bias to End

On 31 December 2012, new FSA adviser charging rules will come into force which ban the payment of commission for advised sales in investment products. Instead of paying by commission, consumers will agree the adviser's charge and choose whether this should be paid as a fee or facilitated through a product. On the same date, the FSA's new rules on consultancy charging will also come into force which will ban the payment of commission for all sales of new corporate pension schemes.

The new rules are intended to allow adviser firms and their clients to have control over how much money they receive as remuneration for their services and for how long payments continue. This will be achieved principally by:

- requiring all firms giving investment advice to set out up-front their own charges, which they must agree with their clients;

- introducing new standards governing how these charges are determined and operate; and

- ending the commission bias that exists under the current system through a ban on commission being paid by product providers to advisers: this will prevent advisers automatically recommending products that pay commission.

Professionalism: Increased Standards

The aim of the RDR in the area of professionalism is to achieve higher, more consistently applied and enforced standards for all retail investment advisers. This is seen as an important step in enhancing the reputation of, and trust in, the retail investment adviser industry generally.

The FSA intends to achieve this by:

- raising the minimum level of qualification for all investment advisers (whether they give independent or restricted advice) to a new, higher level; and

- adopting an internal FSA model, whereby the FSA will maintain, supervise and enforce an overarching code of ethics, and new, enhanced standards for continuing professional development ("CPD").

What Will the New Professional Standards Mean for Firms and Advisers?

- The FSA will introduce a greater requirement for individual investment advisers and the firms that employ them to prove initial and ongoing competence, including ethical behaviour. Firms will need to obtain independent confirmation (in the form of a statement of professional standing) that their employees have met requirements for attaining and maintaining technical competence.

- Individual advisers will be required to hold, and provide their firm with, a Statement of Professional Standing ("SPS"). This will be an independent verification from an accredited professional body that the adviser meets the new professional standards, in particular relating to their knowledge and qualifications. Accredited bodies will be able to issue SPSs.

- Membership of an accredited body will not be mandatory but will mean that individual advisers are provided with support and assistance in identifying and completing their CPD activity. It is hoped that this will encourage membership.

- The professionalism proposals will not apply to advisers operating under the Basic Advice regime.

- Firms will remain responsible for advice given by their investment advisers. The importance of investment adviser competence will be a emphasised by the FSA on a firm-wide supervisory level.

However:

- Firms will still be able to decide how to meet the FSA's training and competence requirements to suit their business models. They will remain responsible for ensuring that their advisers are competent. Firms must also ensure that their advisers meet the FSA's training and competence requirements, specifically in the areas of qualifications, CPD and ethical behaviour, and that advisers hold a valid SPS.

- The FSA will provide links from the FSA Register to lists/registers maintained by accredited bodies that will include information on advisers' professionalism. The availability of such information is expected to be an important factor in influencing consumer trust and confidence in the retail investment advice sector. However, customers and firms will only be referred to the FSA Register if they want to check that the FSA has approved a person (only the FSA can remove the adviser's status as an approved person).

- Pre-competent advisers do not have to hold an SPS or carry out CPD activity. They must, however, comply with APER and hold the regulatory module of an appropriate qualification.

Data Collection and Supervision: Individual Advisers

A key part of the FSA's future supervisory approach under the RDR will be to use enhanced professional standards data to identify individual retail investment advisers. The FSA expects to use the information it receives through its firm-facing supervisory activity on individual investment advisers to improve its ability to carry out investigations into alerts and indicators about such advisers.

Individual Advisers Professional Standards: Alerts

In CP10/14, the FSA explained how it intends to use data in supervising on an ongoing basis the professional standards of individual retail investment advisers and to enable it to gain an understanding of the professional development of such advisers in the interests of protecting customers. Proposals for new professional standards data, in addition to existing notification requirements were set out in CP10/14 and feedback and final policy was confirmed in chapter 4 of PS11/1.

From end 2012, the FSA intends to implement proposals for firms to supply data about individual advisers' professional standards. New reporting requirements (in TC 2.2B) will require firms to submit data reports identifying individual investment advisers and providing certain details about them, including their professional qualifications. Firms must also name the accredited body that has verified the firm's compliance with certain requirements in TC 2.1 relating to adviser competence. These reports should comply with the prescribed standard format and be made on a quarterly basis (unless nothing has changed since the previous report).

From July 2011, in accordance with TC 2.1.31R, firms must alert the FSA about issues that relate to their individual advisers as soon as reasonably practicable after it becomes aware, or has information which reasonably suggests, that any of four specified events has or may have occurred and the event is significant. (Handbook guidance is provided on what amounts to "significant"). The four specified events are if an adviser:

- who has previously been assessed as competent, is no longer considered competent for the purposes of the rules in TC 2;

- has failed to attain an appropriate qualification within the prescribed time limit;

- has failed to comply with a Statement of Principle in carrying out his controlled function; or

- has performed an activity in TC Appendix 1 before having demonstrated the necessary competence and without appropriate supervision.

These enhanced data requirements are intended to help the FSA to build a longer term view of advisers as they move between firms during their career. The FSA expects firms to notify it of issues as they are identified, including issues identified after the adviser has ceased to be employed by them.

Proposals for Data Collection on Adviser and Consultancy Charging

The FSA also discussed options for collecting transactional data relating to individual advisers. These options were first outlined in CP10/14, and were developed and expanded on in CP11/8 and continue:

- new requirements under the retail mediation activities return to allow the FSA to collect data on adviser and consultancy charging revenue, payment methods and client numbers, and charging structures, from all firms that provide advice on retail investment products (including firms that provide services on group personal pensions);
- new complaints data at individual investment adviser level: this data will be reported by firms on both a regular and an ongoing basis, through two of the FSA's existing reporting methods (i.e., firms' regular complaints reporting using the complaints return form and their ongoing complaints alerts); the FSA intends to use this data in combination with other risk indicators as an indicator of behaviour that could imply potential consumer detriment.

CP11/8 will close to responses on 8 July 2011, and the FSA is expected to publish feedback in the second half of 2011. If the proposals in CP11/8 are implemented, the FSA has indicated that new rules will come into effect on 31 December 2012. However, the FSA does not expect firms with reporting periods that start before 31 December 2012 to collect and report retrospectively the proposed new data from when their financial reporting period began. They will only need to submit data that was generated from 31 December 2012 onwards.

Individual Adviser Transactional Data

The FSA explained in CP11/8 that it does not consider that it is appropriate at present to introduce an additional set of requirements for transactional data which it currently collects through the product sales data to help inform its supervision strategy relating to individual investment advisers. However, the FSA will continue to develop its thinking on how transactional data might supplement the firm-level RMAR data to enhance its supervision of the new rules relating to individual advisers.

New Code of Ethics

In CP09/18 the FSA consulted separately on a draft new code of ethics setting out the standards of ethical behaviour consumers can expect of their investment advisers. However, having considered feedback to its proposals, the FSA formed the view that, as ethics apply at all levels, constructing an ethical code aimed solely at the retail investment sector would not be the most effective way forward.

The FSA has therefore decided that any changes should apply to all approved persons and not merely those within the scope of the RDR. It has therefore decided, among other things, to clarify the requirements in the statements of principle in APER (which apply to all approved persons), and to use changes to the Training and Competence sourcebook to underpin the RDR professional proposals as outlined in this OnPoint. The FSA's proposals in this regard are set out in a separate consultation paper (CP10/12), and subsequent policy statement with final rules, on competence and ethics (PS10/18).

Overarching Standards for CPD

The new RDR requirements relating to CPD are set out in TC 2 of the FSA Handbook and come into force on 31 December 2012. The FSA's proposals on CPD were principally consulted on in CP10/14, with final rules being set out in PS11/1. The final CPD requirements cover, amongst other things:

- A minimum of 35 hours of CPD to be undertaken annually for all retail investment advisers. Although initially proposed, there is <u>no</u> reduction in the number of hours for part-time workers. Firms may suspend the CPD requirements where an adviser is continually absent for a reason specified in the rules (for example, maternity leave or long-term sickness).
- The nature, form and content that qualifying CPD should take. A significant portion (21 hours) should involve structured learning (such as, seminars, workshops, courses and e-learning, but not including research for clients). Each session of structured learning should be of a minimum of 30 minutes in length. The balance can be made up with unstructured CPD, such as conducting research, reading industry material and participating in professional development coaching.
- That all CPD should be measurable, relevant to retail investment advice activities, and

should consider learning outcomes. Measurement should be in terms of hours spent and learning achieved, including test results where testing is carried out.

- An obligation for firms and advisers to maintain records of CPD undertaken. Advisers must be able to demonstrate that they have completed structured CPD and this should include a record with evidence of learning activity completed, the target learning outcome and how this has been met, and (if assessed) the result of the assessment.

A key component of the revised standards is that advisers will be required to keep their knowledge and skills updated with new and relevant knowledge. Firms' own training and competence schemes are expected to continue to play an important role in helping advisers meet the requirements.

The FSA has said that it will keep under review whether it is necessary to introduce a requirement for advisers to undertake more detailed periodic testing of their knowledge and skills.

The FSA will hold individual advisers to account for breaches of the future standards. CP09/31 sets out some ways in which advisers may be held to account, for example through publicly reported enforcement activity.

Improved Benchmark Qualifications

All existing investment advisers (that is, advisers deemed competent at or before 30 June 2009) must reach the Qualifications Credit Framework ("QCF") Level 4 or equivalent (i.e., the equivalent of the first year of a bachelors degree) by the end of 2012. Investment advisers who fall outside this definition (that is, new entrants to the investment adviser sector after 30 June 2009) are still subject to the Level 4 requirement, but not to the end 2012 deadline. However, the FSA confirmed in PS10/18 that, with effect from 1 January 2011, such advisers are required to attain an appropriate qualification within 30 months of starting to carry on the activity for which a qualification is required. There will be no transitional period during which those without the required level of qualifications will be able to practice. The FSA will consider a waiver application submitted by the relevant firm if an individual needs more time.

The FSA envisages that there will be exemptions from "some elements" of the QCF Level 4 requirements for those with qualifications in related financial services disciplines such as solicitors, accountants and actuaries.

No FSA Handbook rule changes are necessary to effect these changes. Although, as mentioned above, the FSA amended its Training and Competence sourcebook (TC) requirements in 2010 as part of a general review.

A list of qualifications that have been assessed by the FSA as meeting the FSA's TC requirements, which came into force on 1 February 2011, is set out in Appendix 1 of PS11/1. The list makes clear the status of qualifications that are appropriate under the RDR. The list, which can be found in TC Appendix 4E of the FSA Handbook, will be updated through the FSA's quarterly consultation process. (The FSA's process for assessing new qualifications and the criteria it uses is set out in PS10/18.)

The FSA has made it clear that all firms should now have a clear idea of which advisers need to study for new qualifications, and have in place a plan to put advisers through qualifications by the end of 2012. The FSA will take action if it finds evidence of advisers that are operating without the appropriate qualification, for example by attempting to get around the requirements by operating under supervision.

The FSP's Role

The Financial Skills Partnership (the "FSP") (formerly the Financial Services Skills Council (FSSC))is responsible for creating exam standards through industry consultation, which are then made publicly available for any awarding body to create qualifications. A detailed explanation of the FSP is set out in CP09/31.

Following consultation, the FSP published new benchmark "appropriate examination standards" for all retail investment advisers which accommodate the changes being implemented through the RDR.

What Can Firms and Their Advisers Do Now to Comply with the New Professional Standards?

- All advisers should be taking action to ensure that their qualifications will meet the new standards by the end of 2012. Until the new benchmark qualifications are available in the third quarter of 2010, the existing Level 4 exams can be taken. A "no regrets" provision, where advisers can work towards appropriate existing Level 4 qualifications and top-up any gaps with CPD (CPD top-up) means that it is not necessary for advisers to wait for the new benchmark qualifications to become available in 2010. A non-exhaustive list of existing, transitional qualifications that meet the no-regrets policy can be found in Section 2 of CP09/31. These examinations meet the criteria set out in CP09/31, paragraph 2.72. A final list of qualifications that meet the new requirements is set out in the Appendix 2 of CP10/14, although "gap filling" may be required for some.

- Any knowledge gap between the current and the new standards should be filled with structured qualification gap filling (formerly referred to by the FSA as "top-up CPD"), which should also be completed by the end of 2012. The FSA sets out its proposals on CPD qualification top ups or gap filling and what it should comprise in CP09/31, paragraphs 2.86-2.95. Key points to note include:
  - For all individual advisers a gap analysis will need to be carried out to identify the nature and size of any gaps between pre-RDR and new standards (and, therefore, what qualification gap filling is necessary). It is expected that many existing qualification providers will carry out this exercise for individuals against their own qualifications, and this may involve making appropriate suggestions and arrangements to help individuals address those gaps. Some advisers may prefer to do their own analysis. Whichever method of gap analysis is chosen, an accredited body will need to verify the gap analysis before issuing the SPS. An example assessment template, which sets out learning outcomes, is provided in Annex 3 of CP09/31.
  - Advisers will have to retain records of their analysis of learning gaps as well as exam certificates and structured CPD evidence. The FSA suggests that those advisers holding a transitional qualification should be able to evidence: structured learning (through an exam or CPD), the learning outcome covered, the results of the assessment and the name of the independent assessor.
  - The FSA intends to recognise prior learning where individuals already have the evidence that they have filled some of their learning gaps, so CPD carried out in the past can be used to meet the qualification gap fill requirements.
- Qualifications commenced after September 2010 are likely to meet the updated RDR examination standards, so no qualification gap filling will be necessary. New entrants to the advice industry should study towards the new benchmark qualifications as soon as they become available. Those studying for pre-RDR qualifications may chose to continue (providing all parts are at a level equivalent to Level 4) and address any gaps with structured CPD rather than additional examinations. Such CPD should focus on the relevance of the activity to the learning outcome and indicative content. It will continue to be the case that, for most types of advice, as long as new entrants are appropriately supervised, they can advise clients before they are signed off as being competent.
- Investment advisers in practice at 30 June 2009, who can demonstrate knowledge at Level 4 (even though they do not hold the qualification) can sit rigorous oral or alternative versions of the written industry examinations instead to test their competence and knowledge. It was initially proposed that only oral assessments would be allowed and would, in any event, be withdrawn at the end of 2012. However, the FSA clarified in CP09/31 that it now intends to permit oral or alternative assessments on an ongoing basis. Where oral exams are taken on the basis of existing Level 4 equivalent qualifications (that is, before the new benchmark standards are available in mid-2010) the adviser will need to "gap-fill" through structured CPD.
- Existing investment advisers may be assessed as an alternative to written or oral exams. Such "alternative assessments" must meet the criteria set out in paragraph 2.84 of CP09/31. The FSA makes it clear that such assessments should not be seen as an easy option.

Impact on Simplified Advice, Basic Advice and Other Non-advised Services

Simplified Advice

CP09/18 described simplified advice processes as, "streamlined advice processes that provide the consumer with a suitable personal recommendation based on an assessment of their needs. Simplified advice processes are regulated as advice under [the FSA's] current rules." (The majority of respondents to CP09/18 acknowledged that there is benefit in offering a simplified advice model, both economically and in terms of increasing consumer access to investment advice for those unable to pay, as long as the product range on offer is restricted.)

As simplified advice processes involve a firm providing a personal recommendation to a client, the new requirements for independent advice (in relation to adviser charging and disclosure of a firms services) will apply to simplified advice processes. The same professional standards will also apply to simplified advice as to other forms of advice.

Although many respondents to CP09/18 called for lower qualification standards to apply to simplified advice, the FSA explained in PS10/6 that it is concerned that to do so could be confusing for consumers and would undermine its aim to increase the professionalism of the sector. The FSA acknowledges the concerns about the costs associated with training advisers to the simplified advice model and whether it makes sense for advisers to be required to learn material they would never need in a simplified advice process. The FSA remains open-minded on the content of required training, which would depend on issues such as the product range available and how the system would work in practice. The FSA is waiting for industry to respond with a developed simplified advice qualification proposition, and has committed to build on any propositions presented to them.

Although the industry identified certain barriers to firms offering simplified advice (in particular, lack of certainty about how the FSA and Financial Ombudsman Service would judge the process and assess liability and concerns about profitability) the FSA makes it clear that it does not intend to create a new regulatory regime for simplified advice which it has said can be provided, outside MiFID, within the existing regime.

The FSA initially suggested that guiding principles could be developed for firms to use when designing and implementing simplified advice processes. However, in PS10/6 the FSA said that it was too early to develop such guidance, pointing to the lack of consensus across the industry on the aim of the simplified advice process.

Basic Advice

Basic advice is a form of regulated advice used to sell stakeholder products with streamlined sales and advice processes. Importantly, basic advice does not consider whether a wider range of non-stakeholder products might be more suitable. The FSA confirmed in PS10/6 that, to support the wider stakeholder regime, it will not be removing the basic advice regime from its Handbook (as had previously been proposed in FS08/6).

Firms offering basic advice will be subject to the new disclosure requirements about the type of advice offered, and will need to disclose that they offer restricted advice. Such firms will not, however, be subject to the new adviser charging rules or the proposed professionalism qualification requirements. This means that commission may still be offered by product providers.

In CP09/31, the FSA proposed a ban on the payment of commission on group stakeholder pension schemes including those sold through basic advice. However, in the context of its work on corporate pensions, the FSA has stated that it intended to consider the use of basic advice in the wider stakeholder product marketplace further. The issues under consideration include:

- whether the current infrequent use of the basic advice method of distributing stakeholder pensions could increase significantly if the proposal in CP09/18 to allow commission on sales made that way was implemented; and
- whether the stakeholder pension regulations prohibit taking charges from stakeholder pension funds in excess of the minimum standard for charges based on 1% or 1.5% of members funds.

The FSA has not reported in detail on the outcome of this work. (In PS10/6, the FSA simply said that it believed that basic advice was needed to continue to support the wider stakeholder regime, but that it recognised issues raised about basic advice and would keep the position under review. It also said that it is in discussions about these concerns with the Department for Work and Pensions.)

Non-advised Services Including Execution-only Services and Money Guidance

The FSA's RDR rules (including those relating to adviser charging) do not affect the provision of execution-only services (that is, services that allow consumers to buy products of their choosing, and do not involve the provision of advice or recommendations to buy a product).

The FSA has concluded that changes are not necessary at present but it will keep the position under review. In particular, the FSA will look to see if firms exploit the distinction between advised and non-advised sales in a way that is likely to result in poor consumer outcomes. So the existing rules for non-advised services will continue to apply. This means they will continue to allow aggregated product and distribution charges.

The scope will also remain the same, so the current rules for non-advised sales will apply to the narrower definition of "packaged product" rather than the wider definition of "retail investment product" which will apply to advised sales. The FSA accepts that retaining the packaged product regime alongside the new RDR regime (which applies to the wider definition of retail investment product) will lead to inconsistencies. However, in PS10/6 the FSA explains that in preparation for the introduction of the new PRIPs regime, it will consider whether it should extend the application of other areas of the FSA's conduct of business rules to the wider range of products covered by the new retail investment product definition. (Once the European Commission's work on PRIPS has been finalised, it will also be clear, for example, whether changes to commission disclosure for non-advised sales will be necessary.)

The FSA's RDR rules do not apply to money guidance services. (Money guidance services provide information and guidance to help consumers identify and meet their investment needs, but do not provide advice or give recommendations).

Platforms and RDR

Platforms are online services, used by intermediaries (and sometimes directly by consumers) to view and administer investment portfolios. As well as providing facilities for investments to be bought and sold, platforms are often used by firms to aggregate, and arrange custody of, clients' assets.

Discussion Paper on Platforms

In CP09/18, the FSA invited responses to the general question of whether changes are needed in the way wrap platforms and fund supermarkets are regulated. Responses were used by the FSA to inform its discussion paper on RDR issues affecting platforms published in March 2010 (DP10/2).

DP10/2 sets out a summary of the responses received to CP09/18 and invites further views on regulatory options for the regulation of platforms following the implementation of the RDR; in particular on:

- how platforms should be remunerated for the services they provide in connection with advised sales once the RDR comes into effect at the end of 2012;
- the delivery of adviser charging through platforms; and
- the use of platforms by advisers providing independent or restricted advice.
- The FSA's four RDR-driven key outcomes for platforms are that:
- platforms' services do not undermine the objectives of the RDR, especially adviser charging;
- platforms do not provide incentives to advisers which lead to customers incurring additional costs from the unnecessary switching of investments onto or between platforms;
- no consumer detriment is incurred by the ways that platforms are remunerated, for example, incentives which may restrict choice; and
- customers are provided with a clear description of the platform charges and what services they will receive.

The FSA also discusses in DP10/2 specific regulatory issues affecting platforms which are unrelated to the RDR, including:

- making re-registration of platform assets compulsory to improve customers' ability to transfer assets between platforms;
- ensuring the capital adequacy of platform operators; and
- the provision of information and voting rights relating to authorised funds when investments are made through platforms.

(The FSA published a consultation paper (CP10/29) setting out it's proposals for the future regulation of platforms in November 2010).

Platforms Thematic Review and Good Practice

The FSA has also conducted a thematic review looking at how platforms are supervised and whether additional rules and guidance on the operation and use of platform services are now necessary for the platforms market. The review fell into two strands:

- investment advice and platforms: a review of the suitability of advice, and the systems and controls, of firms advising customers to invest through platforms; and

- platform operator disclosure documents: a review of disclosure material produced by platform operators. (The FSA was particularly concerned to establish whether it is necessary to improve the quality and effectiveness of platform disclosure documents in an area where charging structures and lines of payment can be complex due to the large number of parties to which platforms provide services).

The findings of the review were published in March 2010 together with good practice documents relating to the findings of both tranches of the review. The findings of these thematic reviews influenced the FSA's March 2010 discussion paper (DP10/2) on options for further regulation of platforms. In summary, in relation to investment advice and platforms, the FSA found evidence of poor practice in all the key areas assessed. The FSA also found a general lack of customer focus in its review of platform operator disclosure documents, with little evidence that operators had reviewed their materials following the FSA's work on good and poor practices in key features documents (KFDs).

Consultation Paper on Platforms, The RDR and Related Issues

In CP10/29, the FSA set out proposals aimed at ensuring that platform services used to buy and manage investments are aligned with standards required by the RDR.

The FSA defines a platform service in CP10/29 as a service which involves arranging, and safeguarding and administering assets, and is provided in relation to retail investment products which are offered to retail clients by more than one product provider. However, the service is not solely paid for by adviser charges or ancillary to the activity of managing investments for a retail client.

The FSA's proposals, in summary, cover:

- **Adviser charging:** the FSA proposes to amend guidance in its Conduct of Business sourcebook (COBS) to clarify that payments from platforms to adviser firms in relation to personal recommendations are not allowed;

- **Independent advice:** a draft rule for adviser firms using a platform generally or for firms that give independent advice and wish to use one platform for a majority of clients has been proposed;

- **Platform remuneration:** the FSA proposed to increase transparency by making rules which require platforms to tell customers how much they will receive in fees or commission; firms which give advice will not be allowed to use a platform service that presents retail investment products in a biased manner although platforms will still be able to charge fund managers or other platform providers a fee for providing administration services (with risk mitigation);

- **Rebates:** product providers will no longer be able to offer commission in the form of a cash rebate (which can then be used to pay an adviser) although fund managers will not be prevented from rebating part of their fund charges to customers in the form of additional fund units or shares;

- **Re-registration:** the FSA will be introducing a rule to make it compulsory for all nominee companies, including platforms, to offer to re-register a customer's assets to another nominee company within a reasonable time; and

- **Fund information and voting rights:** for investments in authorised funds through platforms and other types of nominee company, the FSA has proposed that nominees should disseminate fund information from authorised fund managers to end investors in a timely manner and that they should pass on voting rights to end investors, or facilitate the exercise of voting rights and nominees should also provide aggregate investor base information in response to reasonable requests from authorised fund managers.

FSA Occasional Paper on Regulating Platform Charges

Alongside CP10/29, the FSA published a paper on regulating platform charges. The paper has been prepared for the FSA and uses formal economic analysis to study the role of platform charges in the market for retail investment services. The paper discusses how the regulation of platform charges affects markets, efficiency and consumers.

Prudential Requirements for Personal Investment Firms

As mentioned earlier in this OnPoint, in parallel with the RDR, the FSA has reviewed its prudential requirements for personal investment firms ("PIFs") with a view to identifying what changes, if any, would improve the outcomes for consumers. The review related to the rules applying to non-MiFID scope PIFs. In particular, the FSA focused on the need to reduce the frequency and impact of misselling by PIFs, and mitigating the impact of latent liabilities (i.e., those liabilities that crystallise in the future) where a PIF has left the market or defaulted.

The FSA's initial thinking and proposals stemming from its review of the prudential rules for PIFs were set out in a July 2007 discussion paper (DP07/4). The FSA provided feedback to DP07/4 in Feedback Statement 08/2 (FS08/2). The FSA's final proposals to improve the prudential rules for PIFs were published in November 2008 in Consultation Paper 08/20 (CP08/20).

In its July 2009 quarterly consultation (CP09/20), the FSA consulted on consequential changes to the guidance on professional indemnity insurance in the Retail Mediation Activities Return (the "RMAR").

The FSA's final rules for PIFs, and its feedback to CP08/20 and CP09/20), were published in November 2009 in policy statement 09/19, "Review of the prudential rules for Personal Investment Firms (PIFs)" (PS09/19). Key changes under the new rules require PIFs to:

- calculate their capital resources in a simpler, and more consistent, way;
- hold capital resources worth at least three months of their annual fixed expenditure in realisable assets, such as cash;
- hold minimum capital resources of £20,000 (the minimum own funds requirement of £10,000 will be removed); and
- comply with more specific requirements on the level of additional capital resource needed where they have any type of exclusion on their PII.

The changes to PII requirements came into effect on 31 December 2009, and the changes to the capital resources requirements will come into effect on 31 December 2011, subject to a transitional period for the new capital requirements to 31 December 2013.

The FSA plans to consult on necessary changes to reporting requirements, and on an appropriate prudential regime for pension and third party administrators. The FSA is also following up on responses to CP08/20 and considering how expenditure-based capital resources requirements can be applied consistently to all PIFs, in particular to advisers paid by commission.

Application of the RDR to General Insurance and Mortgage Markets

The FSA has assessed the benefits of wider application of the RDR rules across the general insurance and mortgage markets. The FSA committed to consulting separately on any changes in these areas, bearing in mind the implementation time frame for the retail investment market, and given that many firms operate across the markets.

General Insurance Market

Firms can elect to sell pure protection products under COBS as well as the Insurance Conduct of Business sourcebook ("ICOBS"). Annex 4 of CP09/18 outlined the potential changes in behaviour of firms following implementation of the RDR proposals in the retail investment market, which could result in market distortions relating to pure protection products. The FSA expressed concern that firms may begin to favour the sale of pure protection products if the FSA makes no changes to the way protection products are sold and continues to allow advisers to be remunerated by way of commission.

CP09/18 invited evidence on what is likely to happen if the FSA takes no further action on regulating the sale of pure protection products under ICOBS by retail investment firms. Feedback to this question as well as the FSA's conclusions on the possible risks if changes are made as proposed for investment advice, but not for pure protection, can be found in CP09/31.

The FSA set out its proposals in consultation paper 10/8 (CP10/8), "Pure protection sales by retail investment firms: remuneration transparency and the COBS/ICOBS election", published in March 2010, confirming that it would not be introducing adviser charging for sales under ICOBS. In a subsequent policy statement (PS10/13) published in September 2010 the FSA confirmed that it has decided to:

- Post-RDR implementation, to allow firms to elect to apply the COBS rules to pure protection sales (rather than the ICOBS rules), without requiring them to apply adviser charging rules to those sales; and
- require retail investment firms to explain to customers their remuneration for pure protection services associated with investment advice and to disclose the amount of commission received if the customer then purchases a pure protection product. This will apply to non-advised sales of pure protection

products. The FSA defines "associated" for this purpose as circumstances where a firm is likely to agree an adviser charge for investment advice with the customer or if it has done so in the previous twelve months. Firms must decide on when they should make the disclosure, depending on the services being provided.

On the decision not to extend the RDR proposals relating to adviser charging to pure protection sales, the FSA takes the view that while there may be an incentive to sell more protection, it believes that, subject to its new requirements to enhance transparency outlined above, its existing regulatory approach provides a sound basis for protecting consumers from inappropriate sales (so long as firms are compliant). The FSA accepts that the potential for mis-selling pure protection remains and has stated that it will act if it sees new patterns of commission-driven sales arising to the detriment of consumers.

In CP09/18, the FSA said that it believed there was merit in adopting a labelling regime for pure protection advice consistent with that proposed for investment advice and mortgage advice which will use the terms "independent" and "restricted", and that it would consult on applying consistent labelling across all distribution channels for pure protection advice in the third quarter of 2010. However, the FSA has since announced (in CP10/8) that it no longer intends to consult in the near future on reading across the RDR labelling regime into sales of pure protections products. The FSA will publish its findings on its work in this areas in due course and will keep the issue under review.

The FSA said, in CP10/14, that it would consider further the costs and benefits of introducing professional standards for those selling pure protection products, as a way of improving the quality of sales in general and product explanations in particular.

The FSA also indicated in CP10/8 that it intends to review the sales standards of pure protection products by mortgage intermediaries, following concerns that mortgage intermediaries may be increasingly moving into product areas, such as pure protection, where they have little or no experience.

As the FSA pointed out in CP09/31, the European Commission has announced plans to update the Insurance Mediation Directive in the three years up to 2012, and this could affect the decision it has reached regarding the treatment of pure protection products.

Mortgage Market

In DP09/3, the FSA published a discussion paper setting out its proposals for the future of the mortgage market. DP09/3 concludes that there is no need to apply to the mortgage market the constraints on adviser charging, but there is merit in aligning with the RDR approach in a number of other areas. In summary:

- the FSA believes that aligning with the RDR labels ("independent" for whole of market and "restricted" where limited advice is being given) makes sense and will be less confusing for consumers; and
- the FSA sees merit in applying a code of conduct to mortgage intermediaries, although it does not consider that it is necessary to improve the qualifications standard.

The RDR in the Context of International Developments

FSA Amendment of its Article 4 Notification to the European Commission

In 2007, the FSA made so-called Article 4 notifications to the European Commission (the "Commission") when it imposed requirements that went beyond those envisaged by MiFID.

The new rules of the FSA relating to adviser charging and adviser remuneration, including possible changes to the way adviser charges are described, required the FSA to amend its notification to the Commission as MiFID covers these areas. The FSA has submitted an amended notification to the Commission (included in Appendix B of CP09/18) which explains why the FSA believes that the measures are justified to address specific risks it has identified in the UK.

Related European and International Developments

Any changes the FSA makes to the framework of the retail investment market must also take account of ongoing work at European and international level in this area. The key developments are summarised below. In particular, the FSA has been careful to avoid duplicating work in areas on which the European Commission is focusing, as outlined below:

- **UCITS:** The Commission adopted two directives and two regulations which implement the new UCITS Directive (2009/65/EC) ("UCITS IV"). Among other things, the new EU framework for investment funds introduces a new standardised fund document for investors (known as the key information document ("KII")). As result the FSA has not proposed rules on how adviser charges should be reflected in product disclosure documents.

  UCITS IV is due to be implemented by member states by 1 July 2011.

- **PRIPs:** as mentioned earlier in this OnPoint, the Commission published an April 2009 communication setting out the measures it intends to take to improve protection for consumers who invest in PRIPs and is committed to ensuring that markets for PRIPs are driven by greater transparency, enhanced information requirements and a sales process that is aligned with consumers' interests.

As explained above, the FSA's new definition of "retail investment product" attempts to reflect the ideas in the Commission's April 2009 communication on PRIPS.

- **The Joint Forum:** (i.e., the Basel Committee on Banking Supervision, the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors) has carried out work on customer suitability in retail sales of financial products and services. In April 2008, the Bank for International Settlements published a customer suitability report by the Joint Forum, which considered how supervisors and regulated firms across the banking, securities and insurance sectors deal with risks posed by the sale of unsuitable retail financial products.

- **MiFID:** In developing the RDR proposals, and making its final rules, the FSA had in mind the need to comply with MiFID and not to impose requirements additional to those in that Directive. The FSA will bear in mind those issues where it has had to moderate its approach (for example, the total ban on product providers from playing any role in adviser remuneration) as it participates in the Commission's review of MiFID and the PRIPs initiative.

- **Review of the EU mortgage markets:** Any consideration of how the RDR implementation proposals might apply to the mortgage market will also have to take account of the European Commission's review of the EU mortgage markets.

Key Dates Timeline on RDR Implementation

The timeline below sets out future developments that relate to implementation of the RDR proposals.

Date	Regulatory body/other organisation	Action
April-September 2011	FSA	The FSA will run regional roadshows for small financial advisers. These will provide an overview of the RDR rules and to help advisers understand what is required of them to ensure that their business model is compliant by 31 December 2012.
July 2011	Firms	Rules come into effect requiring firms to notify the FSA when they identify competence and ethics issues with their advisers.
8 July 2011	Firms and other stakeholders	Deadline for responses to CP11/8 on data collection in relation to the retail mediation activities return (RMAR) and complaints data.
Q3 2011	FSA	Consultation expected on how the expenditure-based requirement for PIFs applies to firms that share commissions.

Date	Regulatory body/other organisation	Action
Q3 or Q4 2011	FSA	Policy statement to CP11/3 on FSA's rules on product disclosure changes for RDR and SIPPs due to be published.
Second half of 2011	FSA	Policy statement to CP11/8 on data collection in relation to the retail mediation activities return ("RMAR") and complaints data due to be published.
31 December 2012	Retail investment adviser firms	Implementation date for all RDR changes including deadline for all investment advisers to attain required qualifications.
From 31 December 2011-31 December 2013	FSA	PIFs subject to new prudential rules on a transitional basis.
Before end of 2012	FSA	Thematic work and monitoring will assess firms readiness to implement the RDR proposals including those relating to professionalism, remuneration (adviser charging) and description of services. This will include how business models are affected by the RDR, in particular firms with mixed business models, to ensure that where investment advice is given, advisers meet all the requirements of the RDR.

The FSA's Intended Supervisory Approach to RDR

The FSA has given some guidance on how it plans to supervise the RDR going forward. In the run up to the implementation deadline, the FSA has been undertaking an extensive roadshow to inform both small and larger firms about the RDR and what the FSA expects from them in relation to the RDR.

Through data gathering exercises the FSA will monitor firms' preparedness for the RDR and will observe how the market is reacting in the run up to implementation. The FSA plans to conduct thematic reviews of certain products (and has already undertaken a thematic review of investment bonds). The FSA was keen to ensure that firms and advisers are not led into any bad practices ahead of RDR implementation. The FSA plans to use product sales data to check trends in churning and manipulation of sales to avoid adviser charging. This supervisory role will continue once the RDR comes into force as the FSA also monitors providers which facilitate adviser charging.

The FSA will also use thematic reviews to test the quality of advice given by financial advisers. It has specifically mentioned that it will check the allocation of product and service charges in vertically integrated firms (for example, a product provider firm who also gives advice on its own products). In addition, the FSA will monitor individual advisers to ensure they comply with the necessary professionalism standards. In order to do so, the FSA intends to use a triage function to analyse data from various sources (including consumer complaints, thematic reviews, and notifications from firms and accredited bodies). The triage function will assess the data and inform FSA firm supervisors before a decision is made about who is to take action.

Practical Steps in Planning for the RDR

While many firms now agree that the RDR will bring positive changes for customers and will present opportunities for their development, the key issue remains as to how can firms deal with the increased cost of the RDR? In particular, concerns have been raised about how firms can cope with the initial and ongoing costs of compliance in relation to the professionalism requirements of relevant staff. One survey suggests that in order to be profitable, advisers will need to be charged out to customers at between £150 to £200 per hour, almost as expensive as going to the dentist in London. Many firms believe this will be too expensive for all but their wealthiest clients, and will price significant numbers of clients out of the market. With this in mind it is unfortunate that the FSA has so far refused to consider a "simplified advice" service which could allow firms a safe harbour to give limited simplified advice to individuals who might otherwise be priced out of the market. The FSA, while sympathetic to an extent, has stated that it cannot see why advice given to consumers of the so-called "simplified advice" should be governed by lower professional standards than those being proposed in the RDR. The rationale on this position is that the RDR's professionalism requirements should apply in these situations and it will not benefit customers to remove them. However, the FSA has said that there is nothing to stop firms running simplified advice pilots under the current regime and the FSA would welcome findings from firms on such pilots. We understand that a number of firms are currently undertaking such trials. So, with the simplified advice route not currently available what options remain to firms looking to reduce their cost base? Two possibilities are considered below:

- **Outsourcing:** Under the RDR there is nothing to prevent firms outsourcing aspects of their work – both externally to a financial services support firm and internally by making greater use of administrative staff. For example, administrative staff might carry out the fact finding element of the client work, with the adviser then using that information to formulate the advice. While both these types of outsourcing can reduce costs, it is important to bear in mind the regulatory risks associated with such systems and to ensure that such risks are managed accordingly. For example, if a firm decided to outsource some of its functions to a financial services support firm it would need to ensure that an FSA compliant agreement were in place and that the firm retained sufficient control over the support service firm to meet its FSA and other regulatory requirements. Also, by delegating the fact finding part of the firm's service to an administrative staff member there is a risk that the information obtained from the client will not be sufficient for the adviser to be able to give his or her advice.

- **Using technology:** Another way to reduce costs might be to automate as many functions as possible to deliver substantial time (and money) savings. Platforms are very popular with firms because they can offer a range of tools to advisers to help them administer their clients' portfolios and can be used to purchase products. However, it is worth bearing in mind in this context the FSA's policy paper in relation to platforms, which may affect the way platforms can be remunerated for their services and which thus impacts on a firm's cost base as well.

Firms should also have a strategy in place to inform their clients about the forthcoming changes and how such changes will benefit them.

Concluding Comments

Given the debate prompted by the FSA's initial RDR proposals (which involved a complex two-tier regime for advice) it was unsurprising that the FSA subsequently simplified its proposals for retail distribution in the investment market. However, the simpler model proposed in the Interim Report which envisaged a clear split between sales and advice, has proved to be too simplistic. The FSA has responded to criticism that this simple model presented potentially disastrous consequences, for certain tied and multi-tied advisers. The FSA's final proposals indicate that it accepts that there is consumer demand for this type of advice and that a failure to offer it could depress, rather than encourage, the savings habit.

However, the FSA's modified proposals have been attacked by some as failing to deliver clarity and, as a result, failing consumers. The challenge for the FSA has been to find a means of describing a tier of advice (often referred to as "sales advice") so that consumers can easily identify it from independent advice.

In terms of the impact of the RDR on other non-investment products, it is hard to see how some of the FSA's proposals following the RDR will not filter into other markets, particularly in relation to the proposed standards on professionalism (that is, qualifications, competence and knowledge) and in relation to remuneration. Different standards for mortgage and general insurance firms are likely to give rise to further complications both for firms and consumers.

The debate will no doubt continue and a further opportunity to voice concerns will no doubt be offered when the FSA is replaced in due course by the Financial Conduct Authority with its increased emphasis on protecting consumers.

Firms should now have completed their RDR implementation plans and should actively be considering how best to manage costs in the post RDR world.

It is also worth bearing in mind that PRIPs regulations have still to come, and also that firms should expect further developments in the professionalism and qualifications area going forward.

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