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“... the FSA propose to make a distinction between independent investment advice and sales services...”

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RETAIL DISTRIBUTION IMPLEMENTATION PROGRAMME

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Overview

In June 2007 the FSA issued a Discussion Paper setting out their thoughts on their Retail Distribution Review (“RDR”). This was followed by an Interim Report in April 2008. In the light of further discussion the FSA now have a clear view of how the market will react to their proposed changes and also where regulatory intervention is most needed. At the end of November the FSA published a Feedback Statement on RDR and a Consultation Paper on proposed connected changes to the prudential regime for Personal Investment Firms (“PIFs”). In taking this forward, the RDR now becomes the “Retail Distribution Implementation Programme”.

Why are the FSA doing this work?

The FSA’s aim with RDR is to modernise the industry and give consumers more confidence and trust in the market at a time when they need more help and advice with their savings, investments and retirement planning. The FSA hope to achieve three outcomes which they believe will materially alter and improve the interactions between consumers and the industry:

- improve clarity for customers on the types of services being offered and the differences between them;
- raise professional standards; and
- reduce conflicts of interests which result from remuneration practices and improve the transparency of the cost of all advisory services.

What are the key proposals?

Clarity of Services: the FSA propose to make a distinction between independent investment advice and sales services. Independent advice will be truly independent – unbiased, unrestricted advice based on a full and fair analysis of the relevant markets. Sales services will include advice that is not independent, simplified advice, non-advised guided sales and execution only business. Disclosures to the customer to explain the scope of service will need to set out clearly what type of service is being provided.

Remuneration: for independent advice, the FSA propose that all advice will be paid for on a fee basis, with the fees determined by the adviser, not the provider. The FSA also propose that by the end of 2012, if any advisory services are paid for through the customer’s product or investment, that fee must be matched by a deduction from that product or investment at the same time the payment is made to the advisor. It will be possible for sales services to be paid for by commission or other provider remuneration.

Professional standards: the FSA hope to establish an overarching professional standards board which will be similar to those which cover other professions. This will provide a common framework of professional standards with the same competency levels required for the same advice roles, whether independent or non-independent.

“...the FSA propose to simplify the current complex prudential requirements for Personal Investment Firms...”

Consumer access and liability management: the FSA will try to help those firms providing a simplified ‘guided sales’ service to consumers by giving more clarity about how the FSA rules apply and what is expected. This will provide greater certainty to these firms about how these services will be judged and therefore reduce uncertainty about their potential liability if they decide to offer these services. The FSA will also consult on removing the rules relating to basic advice.

Prudential requirements

The detail of the FSA’s proposals on prudential requirements for PIFs is given in CP 08/20. These proposals apply to all PIFs that do not hold client money and do not manage investments or deal in them as agent or principal. The aim of the proposals is to simplify the capital resource requirements for personal investment firms to ensure consistency for all firms.

Capital resources: the FSA have concerns that the current prudential requirements for PIFs are very complex, and could influence firms’ business models depending on what is the most cost-effective prudential regime. The FSA propose to simplify the rules by no longer differentiating different types of firm and delivering a clear, simple and consistent approach for all PIFs. FSA propose to replace the existing rules with the following key requirements for all firms:

- expenditure based requirement – all firms will be required to hold funds equivalent to three calendar months fixed expenditure. Variable expenditure will not need to be included in this calculation;
- minimum capital requirement – the FSA consider that the minimum amount of capital a firm should hold to demonstrate creditworthiness is £20,000.

Professional Indemnity Insurance (“PII”): many firms that use PII to cover the cost of claims for unsuitable advice or general errors or omissions use exemptions to improve the cost effectiveness of policies. The FSA are proposing to introduce requirements for firms to hold a minimum level of additional capital resources where such exemptions exist. This will only apply if the policy exemption is relevant to the business the firm carries out. The FSA have set out the proposed level of minimum additional capital resources in a table in the consultation paper and any PIFs who have PII policies with exemptions should familiarise themselves with it.

Implications for other sectors

During 2009/10, the FSA will work to understand how different markets work and how RDR might apply across markets. The FSA are aware that pure protection insurance is an area where consumers are heavily reliant on advice, and commission based models have contributed to substantial consumer detriment, particularly in relation to products such as PPI. The FSA are also undertaking a review of the mortgage regime to try to establish the root cause of problems that continue to cause consumer detriment, though their analysis has not yet identified a need to apply an RDR approach across this market.

What next?

The Retail Distribution Implementation Programme will include changes to the FSA Handbook and to supervision. Following a future consultation paper on the proposed changes the final implementation date will be 31 December 2012, but the FSA are encouraging firms to start to take steps to transition ahead of the regulatory changes being formally consulted on. Firms should however bear in mind that the FSA have considered proposing either a shorter deadline or stepped implementation for the prudential changes.

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