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THE RETAIL DISTRIBUTION REVIEW

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The FSA's consultation on the Retail Distribution Review (“RDR”) was published at the end of June 2009. Whilst the industry has welcomed the clarity finally provided in terms of scope and proposed detailed rules, there remain a number of areas of contention to be debated over the consultation period. We set out below a very brief summary of the three main pillars of the RDR, and touch on some of the issues.

Improving clarity about services for consumers

One of the central aims of the RDR has always been to make it easier for consumers to distinguish between the different levels of service on offer from investment firms. This has particular relevance when considering the different types of advised services. Ensuring that **“independent advice”** really is independent remains a key objective. Where advisory firms are unable to demonstrate that they provide independent advice, they would need to make it clear to consumers that they provide **“restricted advice”**.

The **range of products** that an independent adviser will be expected to consider will be significantly widened. The new concept of **“retail investment products”**, in addition to packaged products, would include for example unregulated collective investment schemes, investment trusts and other investments offering exposure to underlying financial assets in a packaged form. In order to offer independent advice to retail clients, firms will therefore have to consider more than just packaged products. Ensuring that advisers have an adequate knowledge of all the types of products is one challenge that may arise. Where firms consider that they offer independent advice and wish to recommend their own product (certain Wealth Managers, for example), they will only be able to do this where their own product is considered against comparable products and solutions in the market. Most importantly, such firms must be prepared to recommend these other products if they are most suitable.

For advice to be independent, firms will also need to be able to demonstrate that it is based upon a comprehensive and fair analysis of the whole of the **relevant market** in which they provide advice. FSA anticipate that firms that specialise in a narrow and distinct field, such as retirement planning, will still be able to provide independent advice provided that the whole of that specialised relevant market is considered. The FSA will require firms to confirm in writing whether they provide independent or restricted advice, and will also require oral disclosures using a specific form of words by those firms providing restricted advice.

Removing bias in remuneration: Adviser Charging

Another pillar of the RDR requirements is the removal of conflicts of interest which currently exist in relation to the remuneration of advisers. It is proposed that in future adviser firms should only be paid for the advice that they provide through **adviser charges**. Commission payments, and in particular trail commission, will be banned and instead advisers will be paid by charges set out and **agreed up front with their clients**. Adviser charges can be paid via fees, or can be paid via the product provider as a deduction from the client's investment but, in the case of the latter, strict requirements apply to ensure there can be no product provider bias.

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In all cases, the adviser charge must be reflective of the service actually provided to the client, and **cannot vary inappropriately** according to the provider or type of product recommended. Charging structures will need to be developed which do not conceal any amount or purpose of adviser charging, and must be disclosed in good time before the provision of advice.

Product providers will also have their part to play and will be responsible for alerting the FSA or declining requests from advisers for payments of extreme adviser charges. If the firm providing advice is the product provider itself, then the level of adviser charging must be reasonably representative of the services associated with providing the advice. If product providers facilitate the payment of adviser charges, they must do so within strict requirements to prevent this becoming commission by the back door.

Delivering standards of professionalism that inspire consumer confidence and build trust

Whether investment advisers give independent or restricted advice, they will be affected by FSA's propositions in four areas: a Professional Standards Board (“PSB”), qualifications, ethics and continuing professional development (“CPD”). The creation of an independent PSB to set and implement higher and consistent standards remains a key objective. The decision as to whether this body is created as a separate entity, rather than as part of the FSA, will now be moved forward to mid-2010 to allow for final implementation by 2012.

A **step change** in professional standards will include a higher minimum qualification requirement (judged to be the vocational equivalent of the first year of a bachelor's degree) and it is proposed that all existing advisers should reach this level by end-2012. The Financial Services Skills Council will consult later in 2009 on appropriate examination standards and will produce and maintain a revised list of appropriate examinations. “**Grandfathering**” of existing advisers to the new requirements will not be allowed, although advisers may use existing equivalent qualifications and use CPD to fill gaps between these and the new exams before end-2012.

Rigorous oral versions of the written industry examinations, conducted by relevant awarding organisations, will be permitted as **alternative assessments** and will be aimed at experienced individuals in practice as at 30 June 2009 who would prefer not to take written exams.

The establishment and enforcement of common ethical and behavioural standards remains an aim and the FSA have set out a development of the model code previously put forward by the industry professionalism group.

FSA consider that effective and consistent CPD is as important as raising the benchmark knowledge requirement. It is expected that an overarching CPD standard would, amongst other things, apply equally to individuals, employers and sole traders, and would be flexible, gain buy-in, include measurable targets and outcomes and would allow for both structured and unstructured CPD activity. FSA anticipate that all of these elements together will mean that over the longer term financial advice is seen as a profession on a par with other professions.

A long road to 2012

The main focus of the published materials to date appears to be on the larger product providers and IFA firms. There are a number of other firms that will be affected in some way, from small advisory firms who will struggle to remain independent under the new rules, to stockbrokers who have not had a great deal of attention in the proposals thus far. Apart from time spent on attaining new qualifications, there will be a significant amount of time required addressing the challenges the RDR presents and working out impacts to current business models.