Feedback Statement

08/6

Financial Services Authority

Retail Distribution Review

Including feedback on DP07/1 and the Interim Report

November 2008

Contents

The Financial Services Authority is not inviting comments on this Feedback Statement.
If you have any queries, please send them to RDIP@fsa.gov.uk

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Overview

Introduction

1. The Retail Distribution Review (RDR) is one of the core strands of our retail market strategy. It complements our aims to improve financial capability and further ensures firms deliver fair outcomes for consumers. It is essential for promoting a resilient, effective and attractive retail investment market. The RDR will modernise the industry, giving more consumers confidence and trust in the market at a time when they need more help and advice with their retirement and savings planning.

2. We have used the RDR to address the root causes of some long-term problems[1] with how the market operates, and at the same time to prepare the market for the future. In doing this, we have taken a different approach than with previous policy initiatives. Over the past two and a half years, we have sought input from a wide range of industry practitioners, consumer representatives and other stakeholders to get their views on the issues to be addressed and to identify potential solutions. We are enormously grateful to all those who have contributed considerable constructive energy to this review. They have helped us to identify and develop ideas, giving us feedback along the way to raise our awareness of the likely impact of our proposals. This means that now, as we publish this Feedback Statement, we have a very clear view of how the market will react and where our regulatory interventions are most needed.

3. We have now decided on the changes we want for the retail investment market. There are three measures that we regard as most fundamental to delivering the market outcomes (see paragraph 8 below) that we set out to achieve and which will materially alter and improve the interactions between consumers and the industry. These are to:

   - improve the clarity for consumers of the characteristics of different service types and the distinctions between them;
   - raise professional standards; and
   - reduce the conflicts of interest inherent in remuneration practices and improve transparency of the cost of all advisory services.

1 We set these out in more detail in DP07/1 – A Review of Retail Distribution: www.fsa.gov.uk/pubs/discussion/dp07_01.pdf

4. We intend to consult on implementing changes over a period running through to 31 December 2012. The changes are far-reaching and challenging. We know that there will be concerns about introducing such significant change at a time of market turmoil and uncertainty. However, given the market's appetite for change that became increasingly evident during this review, and the progress that many have made already to move in the direction we are proposing, we believe that we are right to set out our final proposals for consultation now and give the market sufficient time to implement the changes. The RDR provides a golden opportunity to re-build the confidence and trust of consumers at a crucial time. We also believe this is a business opportunity for firms.

5. Throughout this document we describe how we will take the proposals through to consultation in June 2009. Although we have more detail to develop, and analysis to perform, in particular in drafting amendments to our rules and guidance in the FSA Handbook, the package of proposals set out in this Feedback Statement represents our preferred option.

Purpose of the Retail Distribution Review

6. We launched the RDR to address the many persistent problems we had observed in, what is now, over 20 years of regulation of the retail investment market. Insufficient consumer trust and confidence in the products and services supplied by the market lie at the root of what we are seeking to address. The poor standards of practice that we continue to observe in our supervision of some firms serve only to exacerbate this issue. In launching the RDR in June 2006, we decided to go beyond simply treating the symptoms of these problems and sought to address the root causes.

7. The market is developing and changing and we all need to be prepared for this. Our financial capability work, and a possible national Money Guidance service[2], should result in increasing numbers of consumers being better informed and more capable when using financial services. The introduction of auto-enrolment with Personal Accounts[3] in 2012 will mean many consumers will be faced with new choices about their pension provision. The growth of platforms and wrap-based services means that the way investment services are delivered is changing with more emphasis on the underlying asset allocation, risk and performance than on product selection. Also the impact of the current level of personal indebtedness may yet cause a shift towards a savings culture where more people will seek expert help with their financial decisions.

8. Our clear and ambitious aims for reform reflect these developments. They also reflect our view, supported by many people we have spoken to over the course of the review, for the RDR to contribute to rebuilding consumer confidence. Throughout the review we have focused on achieving challenging outcomes and we have been open-minded on the best way to deliver them. Specifically, we want:

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2 The final report from the Thoresen Review of Generic Financial Advice, commissioned by the Treasury, was published on 3 March 2008. The report sets out a high-level blueprint for a national money guidance service for providing consumers with information, guidance and tools in relation to their money matters. 'Money Guidance' describes what the service is and will not necessarily be the external brand name.

3 The government is setting up a pension scheme, known as 'Personal Accounts', which employers will use to provide a workplace pension, by automatically enrolling all of their employees who meet certain criteria and by making a minimum contribution.

- an industry that engages with consumers in a way that delivers more clarity for them on products and services;
- 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 that can support delivery of all of these aspirations and which does not inhibit future innovation where this benefits consumers.

Key proposals

Summary

9. This Feedback Statement sets out the detailed proposals that we will take forward to consultation, with the intention of full implementation by 31 December 2012, by which date all firms and individuals would need to meet the requirements. We believe that we have a coherent set of proposals that we can consult on, representing the most effective package for delivering our intended market outcomes.

10. We summarise below the intended effects, if implemented, of the proposals we plan to take to consultation.

Clarity of services

- The regulatory landscape distinguishes between investment advice that is independent and sales services. Sales will include a spectrum of services ranging from advice that is not independent, through simplified advised and non-advised guided sales processes, to execution-only business. We intend to conduct consumer research to explore options for improving the way in which services are described and presented to consumers.
- Independent advice is truly independent: new requirements make clear that independent advisers, not just those advising on packaged products[4], need to provide unbiased, unrestricted advice based on a comprehensive and fair analysis of relevant markets.
- Clarity on the nature and distinction of different services allows Money Guidance services to provide clear guidance to those consumers seeking help on where to go for which type of investment services.
- Existing practices are reinforced so that firms' advice and sales processes also include, where relevant, some of the broad characteristics of Money Guidance

4 'Packaged products' means units in regulated collective investment schemes (which include units in UCITS and certain non-UCITS retail schemes), shares in investment trusts (when sold through a dedicated service), life assurance policies with an investment component and certain types of pension product.

services. This could include a review of clients' ability to repay debt when undertaking 'know your customer' work and assessing suitability.

Remuneration

- For independent advice to be perceived as truly independent, new requirements remove product provider influence over adviser remuneration and advisers are required to set their own charges for advice. We would prefer to go further and not allow providers to play any role in remuneration, but we recognise the legal (particularly European) and practical (e.g. personal taxation) barriers to this at present. Product providers will be permitted to facilitate payments to advisers through the customer's product or investment. However, by the end of 2012, any payment for advisory services made through the customer's product or investment must be funded directly by a matching deduction from that product or investment made at the same time as that payment.
- For customers to understand clearly the different services being provided and to recognise the value of advice, separate disclosure is required of the costs of advisory services from product costs for both independent and non-independent advisory firms.

Professional standards

- An overarching Professional Standards Board, with similar powers to standards boards in other professions, is established to provide a common framework for professional standards across all advice channels. Moreover, a principle is established to require the same competency levels for the same advice roles, whether providing independent or non-independent investment advice.
- For all investment advisers, there is a benchmark qualification of at least QCA level four[5], and possibly higher levels for designated specialists, but all individuals are encouraged to opt for higher levels to suit their specific needs.

Consumer access and liability management

- We continue to offer to help firms to provide simplified 'guided sales' processes for consumers with more straightforward needs by giving firms greater clarity about how our rules apply. Our objective is to provide greater certainty for firms about how these services will be judged, and so reduce their uncertainty about their potential liability if they decide to offer these services.
- The rules around Basic Advice[6] are removed; we expect a handful of individual waiver requests that we will deal with on a case by case basis.

5 The Qualifications & Curriculum Authority is the regulator for examination providers in England and Wales, and level four is judged to be equivalent to the first year of a bachelor's degree.

6 Basic Advice was introduced in April 2005 as a new form of regulated advice for the sale of 'Stakeholder' savings and investments products, following the recommendations in the Sandler Review of Medium and Long-Term Retail Savings in the UK which reported in 2002.

Prudential requirements for personal investment firms

- We separately consult on proposals to simplify the calculation of capital resources for Personal Investment Firms, making it consistent for all firms, mandate a sliding scale of additional capital firms should hold as a provision against potential liability for any activities excluded by their professional indemnity insurance policies, and raise the overall minimum capital requirement to £20,000[7].

11. We gave very careful consideration to certain other proposals, including the introduction of a 'long-stop' time limit on the period within which complaints must be brought. We concluded that we should not consult on introducing a long-stop because we have been unable to demonstrate that it would bring additional benefits to both consumers and firms, for example an increase in investment in the sector to the benefit of consumers, resulting from reduced uncertainty over liability.

How we have developed the review

12. We published a Discussion Paper in June 2007[8] to set out our thinking based on the work of five groups of practitioners, consumer representatives and other stakeholders. In April 2008 we issued an Interim Report[9], summarising feedback on the Discussion Paper and setting out how we had modified our thinking to reflect that feedback. Our further research, analysis and discussions with stakeholders on the Interim Report confirmed that there is merit in proceeding to consult on many of the ideas – in particular, the proposals to make the nature of different services much clearer to consumers, to raise minimum professional standards and to make significant changes to remuneration practices.

13. But we also identified material challenges in implementing the simpler regulatory landscape described in the Interim Report, despite the strong preference expressed by many respondents for a clear distinction between advice and sales. We concluded that, although the simplicity of that landscape offered considerable potential for improvements in consumers' understanding of the market, implementation could result in many, predominantly less affluent, consumers having significantly reduced access to advice services. We also had further discussions with the European Commission which confirmed that implementing these ideas may be inconsistent with MiFID[10].

14. So while retaining much of the shape of the proposals in the Interim Report, we have introduced some changes. We think these changes will reduce the adverse impact on consumer access, but still offer the prospect of greater clarity for consumers than currently exists. We believe this package now represents a much better fit with the intended market outcomes and current legislative framework.

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7 See Consultation Paper CP08/20.

8 See footnote 1

9 www.fsa.gov.uk/pubs/discussion/rdr_interim_report.pdf

10 Markets in Financial Instruments Directive

Impact of proposals and analysis of costs and benefits

15. At this stage, we have carried out only a high-level cost benefit analysis (CBA). The purpose is to give an early indication of where the costs and benefits are likely to arise and the conditions for these to materialise. It will only be feasible to conduct a full CBA once detailed rules are proposed and we will develop this ahead of publishing a Consultation Paper in June 2009. The scope of this CBA is economic costs and benefits. Non-economic outcomes may also result from the proposals, and they are discussed elsewhere in this paper.

16. The proposals clearly have the potential to deliver significant benefits but depend on several things, in particular whether the RDR can materially close off incentives to offer unsuitable advice or to make an unsuitable sale and whether this can be done at a cost lower than the benefits. Some of the risks to success can be reduced by various mitigating actions, which will be developed further ahead of implementation.

Next steps

17. The next phase is to take these proposals through to a Consultation Paper and implementation. Consequently this ceases to be a 'review' and we are taking this work forward under the 'Retail Distribution Implementation Programme'. This Programme will include making changes to our Handbook, putting in place appropriate mitigation strategies to address downside risks, and amending our approaches to supervision accordingly.

18. We intend to consult in June 2009 on detailed Handbook changes and on the final implementation date of 31 December 2012. We have chosen this date to give sufficient time for full policy development and for an orderly transition. We also intend to consult on phasing in some of our proposals ahead of 2012.

19. We encourage the industry to continue to take more immediate steps to transition ahead of regulatory requirements to do so, as many have already, for instance by upgrading qualifications and changing their remuneration practices and systems.

20. We are discussing the establishment of support services for firms and individuals with trade, professional and other bodies to provide help through the transition period. We will play our part too, for example by promoting such support through our website and in other communications with firms.

21. We are not seeking feedback on this paper as the proposals are based on the feedback we have received already. There will be further opportunities to comment on specific policy proposals after we publish the Consultation Paper in 2009.

1 Introduction

Purpose of this Feedback Statement

1.1 This Feedback Statement (FS) sets out our proposals for the way ahead for the retail market for the distribution of investment products. It brings to an end nearly two and a half years of open discussion, and marks the beginning of formal consultation on hard proposals which represent our preferred implementation options.

1.2 We describe in this FS how we now intend to proceed. There are many points of detail that are still being considered that we will consult on in 2009. So although this paper should bring greater certainty for the way ahead, we recognise that there will still be unanswered questions.

1.3 We describe later in this FS the many views that we received, in writing and orally, on the Discussion Paper 07/1[1] (the DP) and on the Interim Report[2] (the IR). These views, together with our own research and analysis, have helped to shape our thinking, and we are very grateful to the very many respondents who took the time to share their thinking with us.

1.4 We also set out in this paper the immediate steps that we are taking and those that we encourage the market to take. We explain the transition timetable that we will consult on, and indicate how firms might now need to prepare themselves.

Background to the Retail Distribution Review

1.5 The RDR set out to address root causes and catalyse market solutions to the many persistent problems that we have encountered in the distribution of retail investment products and services over more than 20 years of regulation. Our approach has been to work with the grain of the market, have an open debate about possible solutions, and to use regulation to facilitate solutions where appropriate.

1 www.fsa.gov.uk/pages/Library/Policy/DP/2007/07_01.shtml

2 www.fsa.gov.uk/pubs/discussion/rdr_interim_report.pdf

1.6 The RDR has also provided an opportunity to consider change in the context of wider market developments and trends, including the launch of Personal Accounts[3], the possible introduction of a national Money Guidance[4] service, the changing nature of services supplied by firms, and the constant evolution of consumer attitudes to savings and protection.

1.7 Throughout the review we have focused on a number of challenging outcomes and we have been open-minded on the best way to deliver them. We set these out in the Overview to this paper.

1.8 We have progressed the RDR through a number of stages:

- We started by establishing the scope, priorities and approach for the review[5].
- We set up five groups of practitioners, consumer representatives and other stakeholders to come up with ideas on particular aspects of the market.
- We combined these ideas and issued the DP in June 2007, which then invited wider input. We embarked on a pro-active communication strategy, attending or speaking at nearly 100 events in the latter half of 2007, to stimulate further debate on the issues raised by that paper. Over a six-month discussion period we received 888 responses to the 70 questions we posed in the DP. We analyse those responses later in this Feedback Statement.
- We published the IR in April 2008 which gave a summary of feedback received on the DP and outlined a possible future distribution landscape based on that feedback. The central proposition in the IR was for a simple landscape with a clear distinction between advice and sales where all advice would be independent, all else would be non-advised sales, and the landscape would complement the proposed Money Guidance services.
- We committed, before taking final decisions, to do further work to understand the market impact of these ideas and the legal and regulatory barriers.
- We have published this full Feedback Statement on the DP and IR to update stakeholders on the outcome of our further work and the decisions we have now made on what we will consult on in 2009.

3 See footnote 3 in the Overview.

4 See footnote 2 in the Overview.

5 www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/1102_cb.shtml

Prudential requirements for Personal Investment Firms

1.9 In CP08/20 we set out our proposals following a review of prudential requirements for Personal Investment Firms (PIFs). In brief, the proposals are:

- Capital Resources: revising the rules to simplify the calculation and make it consistent for all firms. The effect would be to raise the quality of capital that all firms would be expected to hold to meet their capital requirements.
- Capital requirements: extending the Expenditure Based Requirement to all firms based on three months of relevant annual expenditure and raising the minimum capital floor from £10,000 to £20,000 for all firms. This would ensure a level playing field between small and large firms. And it revises the minimum capital for the first time in 14 years to reflect subsequent inflation and the minimum we consider a firm should be prepared to hold to support its business.
- Professional indemnity insurance (PII): mandating a sliding scale of additional capital that firms should hold as a provision against potential liabilities for any business or activity excluded by their PII policies. The additional capital will be subject to a minimum of £5,000. This will reduce the potential for firms to underestimate the additional capital necessary to cover exclusions.

1.10 In Feedback Statement 08/2[6] we said that we would look to the development of appropriate mechanisms whereby firms that cease to be authorised have arrangements in place so that they bear more of the costs of their customers' subsequent claims than is currently the case. Therefore we are taking the opportunity to consider developing, for PIFs, rules on leaving resources behind (LRB) to meet some of these costs. At this stage we are not consulting formally on this new area of prudential policy but will continue to explore the relevant issues. In particular, we are monitoring the debate on the Banking Bill currently before Parliament which, if passed unchanged, could allow the Treasury to make regulations which would enable the FSCS to fund itself using contingency (pre-) funding. The issue of pre-funding has been looked at solely in the context of deposit-taking firms. No decision has been taken as yet to whether it will be introduced for deposit-takers. Further consultation and engagement with stakeholders would take place before any conclusion was reached. This debate is relevant to our work on LRB for PIFs because it concerns the funding of consumer claims against financial firms in default.

Implications for other sectors

1.11 In the DP and in the IR, we noted that if the feedback and our own analysis suggested a wider application of the RDR approach, we would consider and discuss this openly with the market.

6 www.fsa.gov.uk/pubs/discussion/fs08_02.pdf

1.12 We have received a range of views. Consumer groups have been broadly in favour of extending the scope of ideas being developed in the RDR. Industry groups expressed more mixed views. We have also drawn on the work carried out in the development of ICOBS[7], and on analysis undertaken this year as part of our review of mortgage policy.

1.13 During our next financial year, 2009/10, we will build on our previous work to develop a clear view on the scope for read-across of RDR ideas and approaches. This work will recognise the different ways that different markets work, and we will consult widely before bringing forward any detailed proposals. Where it becomes clear that developing proposals for the RDR Consultation Paper would create practical difficulties for firms operating across markets, we will consider what adjustments need to be made to prevent that.

1.14 Our initial view on general insurance markets, consistent with our approach in ICOBS, is that we should focus on particular markets in considering the potential benefits from approaches developed in the RDR. It is in pure protection markets that customers are most dependent on advice; and in payment protection markets that commission-based models have contributed to substantial consumer detriment. Firms can elect to sell pure protection products under either COBS[8] or ICOBS, so we will assess the implications of the RDR for these markets as we develop proposals for COBS. We will also consider whether any application to PPI markets is appropriate, taking into account market and regulatory developments.

1.15 We are currently undertaking a thorough review of our mortgage regime (a Business Plan commitment for 2008/09). The purpose of the review is to establish the root causes of problems that continue to cause consumer detriment in the mortgage market. That work has identified a number of issues we want to consider further within the normal scope of our policy work. Our analysis has not so far identified a need to apply an RDR approach across that market. But should future feedback on the RDR or our further analysis shows it would be useful, we will of course review this.

Consumer responsibility

1.16 The issue of the relative responsibilities of firms and consumers has been raised with us by the industry both before and during the RDR. Many firms believe the balance of responsibility is currently skewed too far toward firms and that consumers have little or no responsibility for their decisions when purchasing retail investment products. As mentioned in the IR, we made a commitment to publish a Discussion Paper setting out our views on the issue of consumer responsibility in our Business Plan 2008/09[9]. When we publish this in December 2008 it will contain:

- a high-level overview of the general principles of Common Law that are relevant in this context;
- some discussion of factors affecting the capability of consumers in the financial services market;

7 The New Conduct of Business sourcebook for non-investment insurance.

8 The Conduct of Business sourcebook.

9 Page 28 in the FSA Business Plan 2008/09: www.fsa.gov.uk/pubs/plan/pb2008_09.pdf

- a description of how we consider consumer responsibility in our activities; and
- a discussion of what a 'better' world might look like in relation to the retail market, the pre-requisites for its delivery, and sensible steps that consumers might take to protect their own best interests.

Next steps

1.17 We have identified some challenging and important policy proposals that we wish to pursue. How we plan to implement these, and then mitigate risks arising, are explained later in this paper. We will now work to develop these proposals in detail with a view to consulting on them in June 2009. We set out a high-level transition plan later in this paper.

1.18 We plan to publish a Consultation Paper in June 2009 to include draft Handbook text. The consultation period will last for four months. We anticipate making the rules and publishing a Policy Statement in first quarter 2010, which will set out the finalised timetable for implementation.

1.19 We will take forward the future work streams for delivering and implementing the proposals that we will now consult on under the 'Retail Distribution Implementation Programme'.

1.20 Between now and June we will conduct further research to inform our detailed policy proposals. In addition, we will continue our dialogue with government agencies, the European Commission, trade associations and other stakeholders to refine our proposals and develop them in more detail. In particular, we expect to continue working closely with the industry and other stakeholders, to build on the work of the Professionalism Group and to develop further our plans which have been significantly influenced by the recommendations of that Group.

1.21 As previously mentioned, we are publishing a separate Consultation Paper concurrently with this paper on prudential requirements for PIFs. This work will be progressed in parallel with the Retail Distribution Implementation Programme.

Contents of this Feedback Statement

1.22 We have drafted this Feedback Statement with a wide audience in mind. To this end, the chapters increase in the level of detailed analysis of the proposals which we hope will help readers. This does mean some necessary duplication between the different chapters. At the start of each key chapter, we have summarised the content. This is necessarily simplistic.

1.23 This paper comprises the following:

- Chapter 2 outlines the work we have done to assess the proposals in the IR and to reach conclusions.

- Chapter 3 describes the decisions we have now taken on proposals for the way ahead for the market for the distribution of retail investment products and services.
- Chapter 4 describes the principles behind independent advice and the outcomes we want it to deliver.
- Chapter 5 describes the principles and outcomes for non-independent advice and sales services.
- Chapter 6 describes the transitional arrangements we intend to consult on.
- Chapter 7 describes the research and analysis we have conducted since the IR in more detail.
- We give feedback on the responses to the DP in Annex 1, and on comments made on the IR in Annex 2.
- We set out a high-level cost benefit analysis (CBA) in Annex 3, give a glossary of terms used in this document in Annex 4, and supply a list of non-confidential respondents to the DP in Annex 5.
- Annex 6 explains how we are developing the Money Guidance concept, in conjunction with the Treasury, and highlights the impact that Money Guidance could make on the market landscape.
- In Annex 7 we set out some questions and answers on when advice on investments is regulated by the FSA and we point readers to current FSA guidance. In Annex 8 we identify and summarise guidance materials on the suitability obligation for advice processes, and comment on what this might mean for a simplified advice process.
- We provide the report submitted to us by the Professionalism Working Group in Annex 9.

Who should read this paper?

This paper is aimed at regulated firms and appointed representatives involved in the manufacture and distribution of retail investment products, their trade bodies and professional bodies whose members are involved in the sector. It will be of significant interest to consumers and their representative groups.

2 How the ideas have developed

In the Discussion Paper (DP) we set out the ideas of five market groups and described what these might add up to for the future of retail distribution. Following feedback we modified certain proposals, and set out a simpler future landscape in the Interim Report (IR). The IR ideas aimed to reflect feedback that there should be a distinction between those giving independent advice, and those selling on behalf of one or more product providers. We suggested that only those acting independently might be able to provide advice but we signalled very clearly our intentions to consider how close we could and would want to go to delivering this stark distinction. The IR also contained ideas on professional standards and remuneration that were similar in many respects to the corresponding ideas in the DP.

From our further discussions and analysis we concluded that there was a significant risk that the IR landscape ideas would reduce the availability of, and accessibility to, advisory services for many less affluent consumers. In the light also of the European Commission's view that implementing these ideas in the way suggested may be inconsistent with MiFID[1], we have decided to modify the landscape proposal to include a distinction between independent advice and sales advice (i.e. advice that is not independent).

The ideas set out in the Discussion Paper

2.1 In the DP we set out our desire for the RDR to stimulate delivery of certain market outcomes (see Overview) which have remained unchanged since the DP. To deliver these outcomes and as the basis for wider discussion and analysis, we set out in the DP a possible view of the future of retail distribution based on the ideas of five groups comprising industry practitioners, consumer representatives, and other market stakeholders.

2.2 In brief, the ideas were to substantially strengthen current regulatory requirements for firms and individuals who offer financial planning advice services, and simultaneously look to the industry to raise professional standards. To avoid exacerbating an advice gap that might restrict access, particularly for less affluent

1 Markets in Financial Instruments Directive.

consumers, there were embryonic ideas in the DP about a new regulatory regime for simplified advice processes for those consumers with more straightforward needs. We categorised two types of service providers for financial planning advice services, namely 'Professional Financial Planners' and 'General Financial Advisers', and called the more straightforward advice service 'Primary Advice'.

2.3 At the core of the ideas for regulatory change were the need to prevent product providers from setting remuneration for independent advisers, which we termed 'Customer Agreed Remuneration', and ideas for amending the prudential rules for Personal Investment Firms (PIFs).

2.4 We noted in the DP that there was 'general agreement that the quality of advice and clarity of services offered to many consumers need to improve'. We added that this could be achieved by 'improved standards of professionalism and a clearer distinction between the different services being offered to consumers'.

2.5 The themes of greater clarity, higher professional standards, and remuneration practices that remove the potential for conflicts of interest and improve cost transparency, all remain at the heart of the proposals we set out in this paper and on which we now plan to consult.

The simpler future landscape in the Interim Report

2.6 In the IR we noted that there had been much feedback on the DP calling for a regulatory landscape that was simpler for consumers than currently exists. Moreover, the proposed market for advice set out in the DP was considered by many to be too complex. There were also calls for making a clear distinction between 'advice' and 'sales', so that consumers are more aware of the extent to which services may be designed to sell them a product, in contrast to those that offer completely impartial advice.

2.7 So, in reflecting this feedback, we said in the IR that our starting point for further work would be the simplest interpretation of a landscape. This consisted of three components – 'advice', 'sales' and the proposed 'Money Guidance'[2] service – where all advice would be truly independent and all other regulated services would be classed as non-advised sales. Key characteristics for a truly impartial independent sector were the removal of any provider influence over remuneration, higher professional standards and the ability to recommend solutions selected from across the whole market.

2.8 We recognised that although, at least superficially, this landscape had many attractions including the potential for greater clarity for consumers, there might be detrimental consequences if we were to implement it. We acknowledged this in the IR and committed to doing further work to establish whether:

- based on the potential market impact, we would want to implement the landscape described in the IR; and
- based on UK and European legislative requirements, we could implement it.

2 See footnote 2 in the Overview.

2.9 We describe below our conclusions from this analysis and other research we have undertaken on the simple regulatory landscape described in the IR. We explain how this work informed the final proposals for the way ahead that we set out in Chapter 3. We give more detail on the research and analysis we have conducted in Chapter 7.

Assessing whether we would want to implement the Interim Report landscape

2.10 After we published the IR we received a large amount of feedback from firms and consumer groups, particularly in relation to the simpler future landscape. Our discussions with trade associations, individual firms and consumer groups revealed strong but diverse views about the IR ideas.

2.11 Understandably, the simplicity of having a clear distinction between sales and advice had broad appeal for many, particularly consumer representatives. But there were also some who seemed to support the way in which the distinction was defined solely because it would prohibit other firms from offering their existing advisory services. This was clearly not our intention.

2.12 We listened carefully to the views of different groups, challenging those most critical of the ideas to explain the practicalities of adapting services so that they would fit into the proposed landscape. We sought to understand what effect such adaptation or withdrawal of services might have on existing, and potential new, customers.

2.13 We explored whether, as an alternative to offering advice services, some banks and other non-independent advisory firms could simply offer non-advised sales services. However, we accept that without a personal recommendation some consumers would not be willing to buy or, if they were willing, would not appropriately recognise their savings priorities. So we were concerned that this could inhibit delivery of our longer-term aim to increase consumer access.

2.14 We concluded from all our discussions and analysis that there was a significant risk that the landscape set out in the IR could reduce the availability of, and accessibility to, advisory services for a significant number of predominantly less affluent consumers. We were also concerned that if some firms decided no longer to offer advice services that this might have detrimental consequences for their existing customers particularly those who were then no longer advised on their existing products. We were particularly concerned about those firms operating in affinity markets, whose businesses and customers would be left in a significantly worse position if the IR landscape were taken forward.

Assessing whether we could implement the Interim Report landscape

2.15 In the IR, we noted that as a consequence of the simpler landscape, some who currently offer advice services, may not be able to continue their business without modification. In particular, firms that currently offer advice services from a restricted range of product providers (often known as 'tied' or 'multi-tied' advice) would be affected.

2.16 The concept of 'investment advice' is defined in MiFID. Given this, we have discussed, in broad terms, the practicality of adopting the simple landscape set out in the IR with the European Commission. They were concerned about the idea of restricting the term 'advice' to those firms that offer independent advice, as this would, in their view, conflict with the broad concept of 'investment advice' that MiFID sets out. Furthermore, if we allowed non-independent advice services to continue but prevented them being described as 'advice', the Commission indicated this could lead to some firms that would be authorised under the Directive to give advice not being able to describe their services accurately. This could confuse consumers and create inconsistencies across the European Union.

2.17 In the light of the Commission's initial views, and our wider concerns on the market impact, we believe it is necessary to modify the IR landscape, retaining a distinction between independent advice and sales advice, so not prohibiting the provision of advice by those that are not independent.

2.18 We discuss this further in Chapter 3 and outline our plans to amend our current notifications under Article 4 of the MiFID Implementing Directive to ensure that all the new rules we are planning to consult on would be consistent with the Directive.

3 The way ahead for the retail investment market

We have now decided on the proposals for changes that we want to consult on for the retail investment market. We regard measures to make the distinctions between different service types clearer to consumers, to raise professional standards and to reduce the conflicts of interest inherent in remuneration practices and improve transparency of the cost of all advisory services, as fundamental to delivering the market outcomes we set out to achieve. We intend to consult on implementing changes over a period running through to 31 December 2012.

Our proposals include consulting on establishing clear distinctions between independent advice and sales advice (i.e. advice that is non-independent). We intend to consult on rules to introduce a new set of standards for independent advice which extend to all investments, not just to packaged products[1]. We will consult on setting up a Professional Standards Board, to be run by the FSA at least in the short term, with the aim of increasing professional standards for all. We will consult on no longer allowing product providers to set remuneration terms for intermediaries, and on requiring intermediaries to set their own charges. We want consistent professionalism and remuneration standards throughout the landscape, so we will consult on measures that have equivalent effects to all similar roles, whether independent or not. We also intend to continue a dialogue with the industry on more straightforward sales processes (guided sales) but the onus is still on the industry to make a case for us to take any action.

Introduction

3.1 In this chapter we set out a high-level view of the regulatory landscape we will now take forward to consultation. Our proposals for consultation reflect the debate and discussion that has taken place throughout the review, and which our Discussion Paper (DP) and Interim Report (IR) sought to stimulate. They also reflect our view of the best way to deliver the intended market outcomes from the RDR which we set out in the Overview.

1 See footnote 4 in the Overview.

3.2 For clarity, we explain below, and in later chapters, the high-level changes we will consult on. We do not give detail on how the decisions might apply, or be adapted, for certain sectors, such as the corporate pensions market. The detail will be in the Consultation Paper that we will publish in June 2009. But we are very clear that the high-level measures that we set out in this paper represent what we want to achieve.

3.3 In finalising our proposals, we have retained a strong focus on delivering a package of proposals for consultation that we believe is the best possible fit with our intended market outcomes and will give more consumers the confidence to want to use retail investment products and services more often. We think the package provides scope for firms and individuals to supply a full spectrum of services to meet the diverse needs and preferences of different consumers.

How we have modified our view of the future regulatory landscape

3.4 After we published the IR, we received further feedback from the market and this helped our analysis of the potential impacts of the IR proposals on consumers and firms that we outlined in Chapter 2. Some parts of the IR have been very widely, albeit not universally, supported by industry and consumer groups, particularly the ideas for raising minimum professional standards and changing remuneration practices. As we anticipated, the area that was most controversial was the sharp distinction between advice and sales, which under the central proposition in the IR would have led to some firms (e.g. those supplying tied and multi-tied advice services) having to adapt their current business models or having to stop offering advisory services.

3.5 From the analysis we conducted on the IR ideas and which we discuss in Chapters 2 and 7, we have now concluded that there is merit in consulting on professionalism and remuneration proposals, but we will need to modify the proposals that would restrict the range of advice services. This modification retains a distinction between independent advice and sales, but allows for a wider range of, appropriately labelled[2], advisory services.

3.6 So while retaining much of the shape of the underlying thinking in the IR and DP, we think these changes will reduce the adverse impact on consumer access, retain much of the benefits of simplicity, and can help to build trust and confidence in investment services. We believe this represents a much better fit with our intended market outcomes.

2 We discuss later in this chapter how we will conduct consumer research to determine how services should be best described to consumers. The labelling in this paper should be regarded as working titles only.

Summary of proposals that we will take to consultation

3.7 We summarise below the intended effects, if implemented, of the proposals we plan to take to consultation.

Clarity of services

- The regulatory landscape distinguishes between investment advice that is independent and sales services. Sales will include a spectrum of services ranging from advice that is not independent, through simplified advised and non-advised guided sales processes, to execution-only business. We intend to conduct consumer research to explore options for improving the way in which services are described and presented to consumers.
- Independent advice is truly independent: new requirements make clear that independent advisers, not just those advising on packaged products, need to provide unbiased, unrestricted advice based on a comprehensive and fair analysis of relevant markets.
- Clarity on the nature and distinction of different services allows Money Guidance services to provide clear guidance to those consumers seeking help on where to go for which type of investment services.
- Existing practices are reinforced so that firms' advice and sales processes also include, where relevant, some of the broad characteristics of Money Guidance services. This could include a review of clients' ability to repay debt when undertaking 'know your customer' work and assessing suitability.

Remuneration

- For independent advice to be perceived as truly independent, new requirements remove product provider influence over adviser remuneration and advisers are required to set their own charges for advice. We would prefer to go further and not allow providers to play any role in remuneration, but we recognise the legal (particularly MiFID) and practical (e.g. personal taxation) barriers to this at present. Product providers will be permitted to facilitate payments to advisers through the customer's product or investment. However, by the end of 2012, any payment for advisory services made through the customer's product or investment must be funded directly by a matching deduction from that product or investment made at the same time as that payment.
- For customers to understand clearly the different services being provided and to recognise the value of advice, separate disclosure is required of the costs of advisory services from product costs for both independent and non-independent advisory firms.

Professional standards

- An overarching Professional Standards Board, with similar powers to standards boards in other professions, is established to provide a common framework for professional standards across all advice channels. Moreover, a principle is established to require the same competency levels for the same advice roles, whether providing independent or non-independent investment advice.
- For all investment advisers, there is a benchmark qualification of at least QCA level four[3], possibly higher levels for designated specialists, but all individuals are encouraged to opt for higher levels to suit their specific needs.

Consumer access and liability management

- We continue to offer to help firms to provide simplified 'guided sales' processes for consumers with more straightforward needs by giving firms greater clarity about how our rules apply. Our objective is to provide greater certainty for firms about how these services will be judged, and so reduce their uncertainty about their potential liability if they decide to offer these services.
- The rules around Basic Advice[4] are removed; we expect a handful of individual waiver requests that we will deal with on a case by case basis.

Prudential requirements for personal investment firms

- We separately consult on proposals to simplify the calculation of capital resources for Personal Investment Firms, making it consistent for all firms, mandate a sliding scale of additional capital firms should hold as a provision against potential liability for any activities excluded by their professional indemnity insurance policies, and raise the overall minimum capital requirement to £20,000[5].

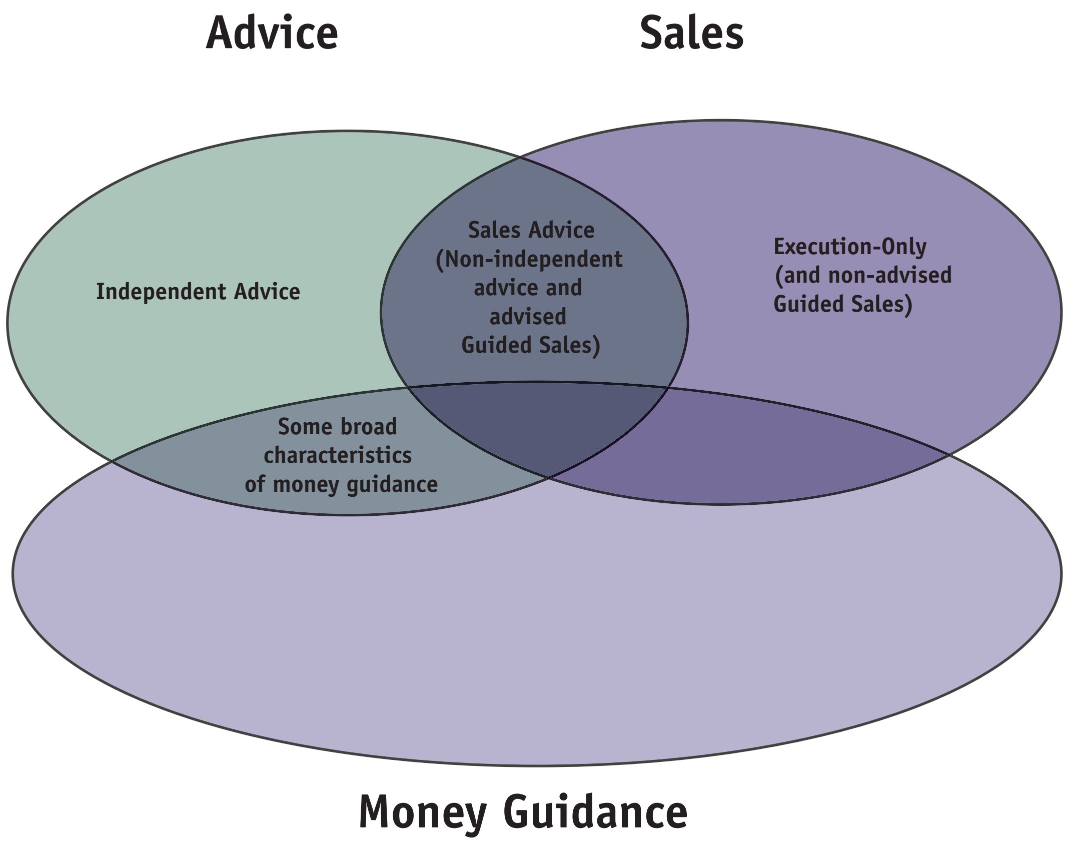
3.8 Figure 1 shows the regulatory landscape that we will now consult on. Although much of the debate following publication of the IR has focused on landscape issues, we have always regarded three enablers for delivering our intended market outcomes as key – giving clarity to consumers on the services being supplied, our pursuit of higher minimum professional standards, and making remuneration transparent and free from provider influence.

3 See footnote 5 in the Overview.

4 See footnote 6 in the Overview.

5 See Consultation Paper CP08/20.

Figure 1



3.9 We consider in later chapters the more detailed characteristics of advice and sales services. For clarity the main differences from the simpler landscape put forward in the IR are:

- We will seek to distinguish independent advice from sales and sales advice (rather than having a sharp distinction between 'advice' and 'sales', where the latter comprised strictly non-advised services only).
- The characteristics of independent advice are largely as we set out in the IR for 'advice': we want consumers to be able to see independent advice firms as being equipped to give comprehensive and fair analysis of their relevant markets and provide unbiased, unrestricted advice. In this way, we propose to modernise the requirements that independent advisers have to meet in making suitable recommendations to their clients.
- We are not requiring existing advice services (such as tied and multi-tied businesses) to change their business models, but we will want non-independent advice to be distinguishable for consumers from independent advice. We expect the distinction to derive from making the nature and scope of services clear for consumers (with non-independent advisers making clear the limitations of their client propositions) and not from any differences in professional standards or remuneration practices. So, importantly, we are proposing to consult on requiring that those delivering non-independent advice services operate to similar high minimum professional standards, and have similar minimum qualifications,

as apply to equivalent roles in the independent advice sector. And we are proposing changes to the way the costs of both independent and non-independent advisory services are set out for clients.

- We are emphasising that certain characteristics of Money Guidance services ought to form part of advice and sales processes, where relevant. For instance, where a 'know your customer' process is undertaken, and depending on its intended scope in individual circumstances, we might expect firms to give wider consideration to a client's financial needs, for instance exploring the scope to rationalise their debts or ability to repay their debts. We recognise that this is already commonplace practice for many firms, but we want to emphasise in describing the regulatory landscape that it should not be necessary for all consumers to go through Money Guidance (if it proceeds) to receive certain services, and that these should be available in the regulated market too.

Understanding the nature of the service

3.10 As we noted in the IR, many respondents to the DP had suggested that a clear distinction between sales and advice is needed to help more consumers understand the nature of the service supplied. While we have decided not to pursue the simpler landscape described in the IR for the reasons explained in Chapter 2, it remains central to our proposals that consumers understand the nature, and limitations, of services supplied. As we describe in Chapter 4, the standards for independent advice are intended to ensure that it is genuinely free from product provider influence or restrictions that would limit the range of solutions that independent advisers can recommend to their clients.

3.11 Ahead of the June 2009 Consultation Paper we will further develop proposals aimed at ensuring that consumers have a clearer understanding of the nature of the service supplied. We intend to conduct consumer research to explore options for improving the way in which services are described and presented to consumers, both in terms of the appropriate labels and the approach to disclosure of those services. This will include consideration of negative as well as positive disclosures, to reinforce distinctions between service types.

3.12 We intend that non-independent advice should be regarded as a form of 'sales' service, reflecting the duality of the service. On the one hand, it is an advised process where the consumer receives a suitable product or investment recommendation based on their needs; on the other hand, the advice process is restricted in order to promote the products or services of a single or limited range of suppliers.

3.13 A two label system featuring 'independent advice' and 'sales' may be appealing in its simplicity, but it is not without challenges. For labels to be effective, they need to be short, have a high-level of common understanding among consumers, be an accurate even if rather broad descriptor of the service, and be displayed prominently from the outset. Furthermore, consistent with our desire to facilitate innovation, we will want to make it possible for the same firm to supply both independent and non-independent advisory services.

3.14 So there are many practical implementation issues to consider. The findings from our proposed consumer research on how different services might be presented to consumers will help us to decide how we can most effectively take action.

3.15 Our past experience with disclosure is a further important consideration. It suggests to us that disclosure alone may be insufficient to ensure good consumer outcomes. So whatever approach we decide to pursue, we recognise that effective supervisory oversight will be critical so that we can satisfy ourselves that the service described to consumers is indeed the service supplied to them. More generally we will look at proposals for describing services to consumers in the context of the broader package of reform, to ensure that this is coherent and is consistent with our aim of enhancing the quality of the interactions between consumers and firms.

EU and UK legal implications

3.16 Since publishing our IR, we have investigated further the potential legal implications and constraints on our ideas. The overall package of proposals that we intend to consult on is, we believe, consistent with both EU and UK law. However, there are two key areas where the legal environment continues to be particularly important for our proposals.

3.17 The changes to remuneration practices and to independent advice will require us to amend our notifications to the European Commission under Article 4 of the MiFID Implementing Directive. We have discussed both of these policy areas with the Commission, and plan to submit draft amendments to our notifications alongside preparing detailed rule changes for consultation next year.

3.18 We are also mindful of the need to continue to discuss the competition implications of our proposals with the Office of Fair Trading (OFT). We will need to make sure that we identify and discuss with the OFT any implications that may emerge, for instance:

- in relation to any new standards we might require for advisers setting their own charges;
- in setting up a Professional Standards Board; and
- in proposing any labels or required descriptions for particular types of services; and
- around industry development of guided sales models.

Intended outcomes and risks of implementation

3.19 We set out our intended market outcomes in the Overview. A key component of these intended outcomes is raising the levels of consumer confidence and trust in services supplied by the industry. Throughout the review we have acknowledged that there are many practitioners who consistently deliver good quality outcomes to their customers. So we have been frequently challenged about whether our changes will make a material beneficial difference to consumer outcomes for those firms that do treat their customers fairly. In response we have argued that our proposals are intended to address both the actual quality of outcomes and consumer perceptions of that quality, not least to encourage more new savers and investors into the market. We particularly recognise the importance of tackling those firms that do not deliver the outcomes we are seeking.

3.20 We have deliberately taken a different approach to resolving the long-standing issues in this market than we and previous regulators have done. We have consulted at length with the market, securing widespread consensus around the intended outcomes and increasing levels of agreement on how we might achieve them. We recognise, therefore, that the proposals that we will now consult on have not been developed in the way of more traditional policy reviews. However, we believe that the market is not only attuned to the need for change but also has a very good understanding of the outcomes we are seeking. This gives us more confidence that we can make the package of proposals work.

3.21 We acknowledge that implementation is not without risks. We intend to address the potential adverse outcomes with a range of policy options that we will develop in more detail and consult on in 2009. These are likely to include both supervisory and other tools to address unintended consequences.

3.22 At this early stage, we recognise that for successful implementation we will need all market participants to understand the standards we expect in the new regulatory environment. One of the challenges we will face is to ensure that we do not simply replace the current set of market problems with another. We will be especially watchful of firms that may want to find alternative ways to maintain the status quo and thereby scupper the intended market outcomes. For example, we recognise there may be a number of ways for product providers to exert influence over advisory processes. We will step up our supervisory efforts to help deliver successful implementation and the realisation of the intended outcomes. We will establish monitors to assist this and we will take the necessary actions to deter firms from looking for alternative ways to preserve features of the market that our proposals are intended to address.

Assessing the benefits of the Retail Distribution Review

3.23 In line with our commitment to assess the effectiveness of major initiatives, we plan to carry out targeted post-implementation reviews of proposals. We will provide more information about how we will do this when we consult on implementation in 2009.

3.24 We will develop indicators so we can track and assess the benefits being delivered through the market outcomes we are seeking to deliver, compared to a baseline[6]. Although we recognise that we cannot expect the RDR in isolation of other initiatives to deliver all of the intended outcomes, we still think it important to develop a set of measurable indicators to assess the effectiveness of the proposals and their implementation.

The Interim Report challenges to progress market change

3.25 In the IR we issued three challenges to the industry to maintain the momentum for change and to make progress ahead of potential new regulatory requirements. We outline briefly below how we consider the industry has responded to each of these challenges and the progress made.

Professionalism

3.26 In light of strong consensus from the feedback to the DP, and the common areas which respondents believed should be taken forward, we set a challenge for the industry and all relevant stakeholders to progress development and implementation of an agreed common framework for professional standards. This was to include consideration of, amongst other things: governance (including oversight procedures); the approach to standard setting; roles; examinations; continuing professional development; ethics and behaviours; and transition.

3.27 We received a number of responses to this challenge from the industry. Some were as part of wider responses to the IR (we summarise these comments in Annex 2). We were invited to meet with several firms and industry-wide groups to hear their views on how a common framework for professional standards should be progressed. The challenge was also tackled by a Professionalism Group, which we established in the wake of positive moves within the industry to take these matters forward in a consensual manner. The Terms of Reference for the group reflected the feedback from the DP and were set by the FSA. We made these available on our website[7] in July 2008. The recommendations from this Group and whether and, if so, how we propose to pursue them (taking into account other feedback and our own views) are set out in Chapter 4.

Remuneration

3.28 In light of increasing levels of support for our proposals in the DP and to reflect industry developments, we challenged all product provider firms to bring forward practices that will end their role in setting advisory remuneration, and so no longer use commission to incentivise advisers to recommend their products. In meeting this challenge, we wanted to see firms recognising and dealing with the difficulties of developing approaches that advisers can and do engage with, and that do not simply lead to higher commissions being paid. We said that how the industry responds to this challenge could influence whether and how we make new rules in this area.

6 Assessed against what would have happened to market outcomes in the absence of the RDR.

7 www.fsa.gov.uk/Pages/About/What/rdr/group/index.shtml

3.29 We have seen some further signs of change since we published the IR, although it is clear that several product providers are awaiting regulatory certainty before committing themselves to changing the way that they interact with their distributors. We have heard about a few firms cutting commission rates on life assurance bonds to match those on collective investments, as a prelude to making more fundamental changes. Some advisory firms have embarked on significant changes to their approach to remuneration which may put further pressure on product providers to change their processes and systems. We were also pleased to see new sales growth of some products distributed largely through intermediaries that do not pay commission to advisers (e.g. exchange traded funds).

3.30 There were also a number of disappointing observations. Some providers are reported to be using commission rate increases, particularly on life assurance bond business, to stimulate sales in difficult trading conditions. In some cases, these providers may be standing behind the RDR and positioning this as offering flexibility to advisers to select their commission terms. But we have a concern that in this transitional period, in the absence of some of the controls that we are considering implementing for advisory firms and without the whole provider market operating in a consistent manner, this may simply lead to further commission increases and the possibility of unsuitable sales. Some of our proposals are designed to mitigate this risk post-implementation.

3.31 We are aware that not all asset managers offer share classes for the products that do not pay trail commissions to advisory firms, forcing some of these advisory firms to offset trail commission against fees despite a preference to operate a 'clean' fee model. Commercial pressures may already be leading to some change in this area, and the new rules we consult on would, as far as possible, require product providers to remove all pre-determined commission payments from products so that adviser firms can have full control over their own charging mechanisms.

Guided sales

3.32 Building on our Primary Advice[8] proposals in the DP, and in the context of the proposed simpler landscape, we said in the IR that we would consider whether to take action to develop a new regulatory regime. This would be to enable firms to provide new types of sales services to serve consumers with more straightforward needs seeking less complex financial advice. In doing so, we recognised that under the simpler landscape set out in the IR, some firms, e.g. those providing tied and multi-tied advisory services, would have had to adapt their services to provide advice or otherwise provide non-advised sales services. We recognised that within this landscape some of these firms might want us to take action to allow them to provide something more than a non-advised service, but without needing to adapt to meet the new standards for independent advice. This might be necessary to enable some firms to achieve ongoing commercial viability while providing consumers with choice and access to a range of advisory services.

8 A new form of regulated advice service proposed in the RDR Discussion Paper which would deliver a more straightforward service for those consumers with more straightforward needs.

3.33 We challenged firms to make the case to us if they wanted us to take action to enable them to operate new sales services. We encouraged firms to present propositions to us for new sales services, noting that this could include introducing a new regulatory regime or giving individual guidance to firms as appropriate. We were clear that we would only design a new regulatory regime if the industry made a strong enough case for it. We noted that the overriding consideration for us in examining proposals for any actions would be ensuring an appropriate degree of consumer protection. As such, we would need to be satisfied that consumers would understand the limitations of the services supplied.

3.34 This challenge was explored in part through a roundtable group with representatives from trade associations, consumer representatives, the Financial Ombudsman Service, and other stakeholders. We cover the progress made by these discussions in more detail in Chapter 5. We have also met with a number of firms to discuss their individual ideas for new sales services. These were generally at fairly early stages of development and some discussions are continuing.

4 A new approach to independent advice

We intend to consult on replacing the current rules that govern when advisory firms can describe their services as independent. There are three main areas that these new rules will cover:

- *Remuneration arrangements: we will consult on requiring independent advisory firms to set their own charges for advice and only allow these charges to be paid by product providers if they match corresponding deductions from products or investments. Product providers will not be allowed to set remuneration terms.*
- *Suitable independent advice processes: we will consult on advisory firms being equipped to give a comprehensive and fair analysis of their relevant markets, and provide unbiased and unrestricted advice. These requirements would apply to all giving independent advice, not just those advising on packaged products*[1]*.*
- *Minimum professional standards, including adviser qualifications: we will take forward many of the recommendations for implementing a framework for professional standards made in feedback on the Discussion Paper (DP) and Interim Report (IR) by the industry and consumer groups. We also considered the recommendations of a Professionalism Group that we set up, and that included representatives from professional and skills bodies. Its report*[2] *is attached at Annex 9.*

Introduction

4.1 The ideas in the IR included measures to deliver a step-change in the quality of independent advice services supplied to consumers. Such measures are a core component of the proposals that we will now take forward to consultation.

4.2 This chapter outlines proposed new standards and highlights some of the associated issues that we will need to tackle in drafting Handbook changes. As well as outlining the nature of the Handbook material we plan to consult on in 2009, we also set out our proposals for raising professional standards, building on the feedback to the DP

1 See footnote 4 in the Overview.

2 See Annex 9 for the full report.

and IR, and taking account of the recommendations made to us by the Professionalism Group.

4.3 Our proposed new capital requirements for personal investments firms are likely to be of most relevance to independent advisory firms. Apart from in high-level terms, these are not covered in this paper, as they can be found in our separate Consultation Paper[3].

Overview of proposed requirements for independent advice

4.4 At present, advisers wishing to describe their services as independent must meet two requirements: a 'whole of market requirement' to make recommendations to consumers on packaged products from the whole market (or a whole sector of the market); and a 'fee option requirement' to offer consumers the opportunity to pay by fee for their advice.

4.5 We now propose to consult on removing these requirements and introducing new requirements in three main areas:

- **Independent remuneration – 'Adviser Charging':** In the DP and IR, we explained that we were considering an end to product providers determining how much advisers are paid, to avoid the risk that provider influence could lead to bias (or to the perception of it). Our views on this subject have not changed, and we use this chapter to explain our plans to consult on new rules next year that would stop product providers from setting commission – requiring instead that adviser firms set their own charges. Although this change would be most meaningful for independent advisers – providing a way to demonstrate their independence from any product provider – there are also applications to non-independent advisory businesses which we discuss in Chapter 5.
- **Independent advice processes:** We think there is a need for new clarity on what 'independent advice' should comprise, reflecting trends in the development of products, services and business models. We plan to consult on a more principles-based approach to replace current requirements including those for 'whole of market'. We are considering two new high-level rules for adviser firms (or for business entities within firms) that wish to call themselves independent, to underpin what independent advice should deliver to customers. In this chapter, we discuss our plans to consult on these new rules which require that any independent adviser firm, regardless of the products they offer, should:

  a) be equipped to give comprehensive and fair analysis of their relevant markets; and

  b) provide unbiased, unrestricted advice.

3 See Consultation Paper CP08/20.

- **Professional standards for independent advisers:** In the IR, we issued a challenge to the industry and other relevant parties to take forward the development of a framework for securing and maintaining higher professional standards. We facilitated the creation of a Professionalism Group to develop recommendations. We summarise its ideas later in this chapter and we also indicate how we intend to take them forward where we think this is appropriate.

Adviser Charging

The issues

4.6 In the DP we acknowledged that all approaches to advisory remuneration, in all channels, pose risks to consumers depending on how they are operated. We pointed out that it was not the method of payment that was often the issue – there are essentially only two methods, either the customer pays directly or the provider (or other third party) pays on their behalf. It is the processes for determining what gets paid that can cause conflicts of interest, and can create risks that advisers may not act in the best interests of their clients.

4.7 At present, the most common method by which independent adviser firms are paid is to receive commission from product providers, in return for arranging sales of their products. What is paid, and when, is ultimately determined by the product provider in conjunction with the adviser, creating the potential for bias in the adviser's recommendation. Furthermore, the presence of the potential for bias can itself undermine consumer confidence in the advice they receive[4].

4.8 Current commission arrangements also make it worthwhile for advisers to switch at least some of their clients' investments between product providers at regular intervals. Although such switching may often be in the client's interests, the incentives for advisers are not always aligned with delivering better client outcomes. While, in the life assurance sector in particular, costs from switching activity are often largely borne by product providers (rather than advisers or consumers paying directly), these costs are likely to be reflected, at least in part, in higher product charges for the market as a whole.

The intended outcome

4.9 Our approach to adviser remuneration will be designed to reduce significantly the potential for providers to influence independent advisers' remuneration, reducing the potential for bias (and the perception of bias) and improving overall industry sustainability and consumer confidence. We also want to improve consumer awareness that independent advice has a cost and has a corresponding value, to empower more consumers and further boost their confidence in the market.

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4 In a survey in 2006, the Financial Services Consumer Panel found that 53% of surveyed consumers were inclined to think that financial services firms 'sell the product that pays the most commission, not what is best for you' – www.fs-cp.org.uk/pdf/experience_mar06.pdf

Why Adviser Charging?

4.10 Many oral and written responses to the DP questioned the idea that an adviser's remuneration could ever really be 'customer agreed' (i.e. with each individual negotiating with their adviser the amount that they will pay). This level of negotiation was never envisaged and it is unrealistic, at least in the short term, to expect most consumers to behave that way. So we have moved away from describing the proposed new approach to adviser remuneration as 'Customer Agreed Remuneration', although the underlying behavioural changes we are looking for from advisers and product providers are unchanged.

4.11 In broad terms, we want consumers and firms to benefit from an end to product providers influencing – and being seen to influence – how much independent advisers earn in relation to the recommendations they make. But while the simplest way to achieve this could be to ban all forms of commission, so that clients always pay their advisers' fees themselves, we recognise that there are practical and legal reasons why this may not be workable at this time.

4.12 We may still want a ban to be a long-term aim. But at present many consumers may not want, or be able, to pay an adviser up front, especially if they are buying a regular premium product rather than investing a lump sum. Indeed, there may be tax advantages that accrue to a customer when payments for advice are made through the product, rather than the customer paying directly, for instance if investing in a pension product. Furthermore, independent adviser firms may want to offer services that involve charging clients a percentage of their investments at given intervals, in return for periodic advice, aligning their rewards with their clients' investment returns. Discussions with the European Commission indicate that a wider ban on commission may be inconsistent with MiFID.

4.13 So, our immediate intentions are to consult on new rules in 2009 to introduce 'Adviser Charging', which would mean that:

- all independent adviser firms set their own charges, and make their clients fully aware of what services supplied to them will cost; and
- product providers cannot determine how much commission independent adviser firms receive, or include adviser commission within their product prices; but
- product providers may, if they wish, offer facilities for customers to have their adviser firm's charges deducted from their investments, but from the end of 2012 providers would not be able to offer to finance advances to advisers from their own funds (a practice known as 'factoring', which also encompasses 'indemnity commission' arrangements and which would no longer be permitted).

4.14 While this approach falls short of a complete ban on all payments passing from product providers to adviser firms, the changes in the way that adviser charges are determined should demonstrate to consumers that any advice they receive is free from provider influence.

What will Adviser Charging mean for consumers?

4.15 For clarity, we set out below what Adviser Charging might mean in terms of payment options for consumers. This is purely illustrative and should not be regarded as FSA guidance.

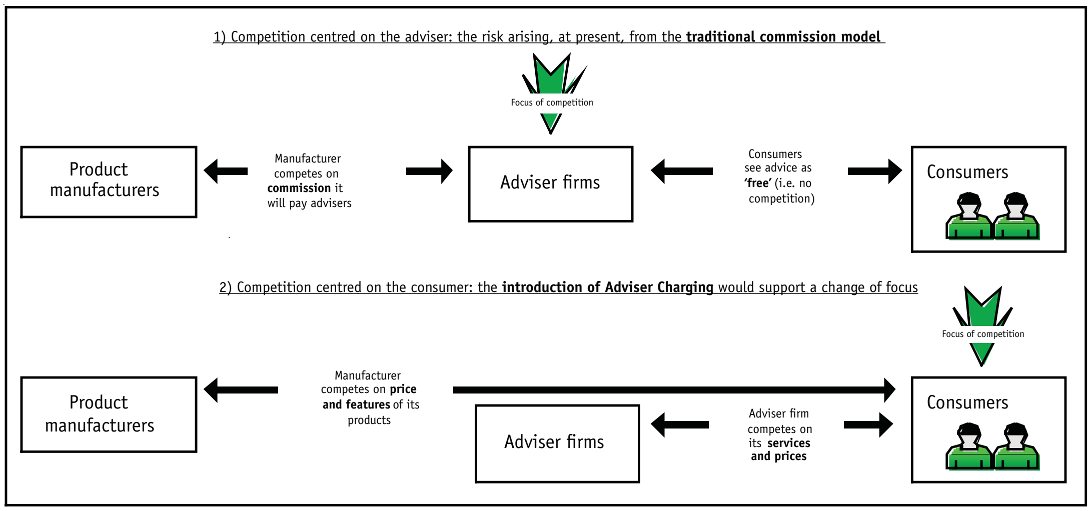
4.16 At their first meeting, the adviser will set out for the client how charges will be determined. They might also discuss whether payments are expected to be made in one lump sum after the initial advice process is concluded, or whether a series of payments over a period of time might better reflect the nature and timing of the services being supplied. It might also be established whether payments are due irrespective of whether a new investment is bought, or whether payments are contingent on a purchase.

4.17 Later in the process, the charges are calculated based on the services supplied (or to be supplied) and might be payable in a number of ways:

- The client may pay these charges directly (e.g. by cheque) – either in one sum or as a series of payments over time (as discussed earlier in the process). If no purchase is made, and payment is due, then direct payment may be the only possible approach.
- The adviser may arrange for the product provider to deduct payments (in one lump sum or payments over time) from the client's investments and pass these to the adviser. As we discuss above, there may be tax advantages for the client to arrange payment in this way, or it may be that the adviser requires periodic payments based on a proportion of investment value and this is the most administratively straightforward arrangement.
- If the client has bought a regular premium product as opposed to making some form of lump sum or single premium investment, then there may be limitations to the amount that can be paid as an up-front charge by deduction from the product or investment. This is particularly true if the amount of regular premium is small relative to the charge.
  - If the customer is then unwilling or unable to pay any up-front charge directly then the adviser may have to agree to receiving it as a series of payments.
  - Alternatively, our current rules allow the product provider to advance payments from its own funds to an adviser and then recover the costs from the client through additional product charges over a period of time (often the full term of the product, although it can be a shorter period). We refer to this as 'factoring', and it is the basis on which indemnity commissions would typically operate. We discuss factoring later, and indicate that we want to consult on not allowing such arrangements for new business after the end of the transition period (i.e. from 31 December 2012) because of the residual risks of provider influence.

4.18 Regardless of which mechanism the client uses to pay adviser charges, Figure 2 further illustrates how in current traditional commission arrangements (scenario 1) competition is centred on the adviser, and how with Adviser Charging (scenario 2) competition is then centred on the consumer.

Figure 2



What will Adviser Charging mean for firms?

4.19 While independent adviser firms have been required for some time to offer consumers the opportunity to pay for their services by fee rather than commission, very few adviser firms receive a significant proportion of their income in this way. Under Adviser Charging, firms that are currently predominantly commission-based would need to think carefully about the new pricing structures they adopt. Firms that currently operate commission rebating may already have charging tariffs in place for certain services, so may have less to do to adopt Adviser Charging across their full business.

4.20 In delivering Adviser Charging, adviser firms would need to make decisions about both the pricing structures they offered (e.g. hourly rates, a price for a particular service, or a regular percentage of the client's assets) and the mechanisms by which they could collect payments. Apart from charging clients directly (e.g. through a cheque or direct debits), advisers could make use of flexible remuneration systems offered by product providers or third parties. For example, some life and pension providers offer 'factory-gate pricing', where customers can request that their adviser charges are deducted alongside product charges. Another example comes from wrap platforms, some of which already facilitate the deduction of adviser charges from customers' accounts, across a single product or their whole portfolio.

4.21 Overall, any payment mechanism where an adviser firm decides how much to charge (and consumers whether or not to engage the firm), rather than a product provider deciding how much the adviser will receive by offering commission, could be acceptable. Ahead of consultation next year, we plan to work with the industry to ensure that we make clear to firms in setting our proposed new standards, and in our communications to firms, that they have a range of options. We are also conscious of the need in the coming months to be as clear as possible about what approaches would be acceptable, so firms that want to build or expand systems for collecting remuneration can do so.

4.22 We are aware that there may be greater difficulties for some firms than for others in offering facilities for adviser charges to be deducted from products. While 'factory-gate pricing' arrangements are already offered by some life companies, fund managers face practical barriers to offering equivalent systems because the total price of a unit in a collective investment scheme (CIS) cannot vary between customers (except by making multiple asset classes available). In contrast, CISs and open-architecture life products are more readily available on wrap platforms (which can provide a different mechanism for adviser charges to be collected) than, for example, traditional life products or stakeholder pensions.

4.23 So we may want to make sure that adviser firms are aware of the range of different charging mechanisms available, now and in the future. Some product providers will be able to offer more flexibility to collect adviser charges than others. To the extent this may give them a competitive advantage, we want to be satisfied that competitive forces act to the advantage of the customer, as should be the case with any other differentiating factor (such as the availability of different options attaching to different providers' versions of the same product).

Tackling the risks associated with Adviser Charging

4.24 While the adoption of Adviser Charging has the potential to deliver clear benefits, we need to be mindful that the market for investment advice is by no means perfectly competitive. Consumers may engage an adviser because they lack the skills, information or confidence to understand financial products and services, and they may exhibit price-taking behaviours as a result.

4.25 One of the key risks associated with our proposal is that consumers could suffer if some advisers were to adopt harmful new charging practices, such as discriminatory pricing against those consumers that they perceive to be financially unsophisticated. Another key risk is that any new rules we bring in could be ineffective at ending provider influence over adviser remuneration, if providers seek to exert influence through other means.

4.26 As part of the discussions between advisers and their clients under Adviser Charging we expect clarity on what happens if products are terminated early when being used to pay an adviser's charges. To the extent that new products are taken out in their place, and assuming that, following consultation, we no longer allow factoring from the end of 2012, ongoing advisers' charges should simply move to the new product. Product providers, in a 'no-factoring' world, would not be taking on any financing risk so there should be no issue of transferring persistency risk to the client or adviser in relation to adviser charges, although providers may still want to recoup their own unrecovered costs, perhaps by applying some form of exit penalty.

4.27 We expect to see changes in investment product design to reflect the need to accommodate different patterns of adviser charges that might be paid through the product or investment. Product providers may be less willing to absorb losses than currently. So, for instance, regular payment products might more often be designed to accommodate high front-end charges to reflect adviser charging arrangements that are weighted towards up-front payments for services.

4.28 If a product is terminated, and no new products or investments are taken out, advisers may make termination payment requests from their clients to recover any unpaid adviser charges relating to services already provided. This may be unexpected if the arrangements between a client and their adviser have not made clear at the outset what happens in this situation.

4.29 With all these risks in mind, we are contemplating consulting on a range of proposals both for adviser firms and for product provider firms. We also outline below some of the supervisory measures we are considering, to ensure that we can be effective in monitoring, and challenging firms against, the new standards.

The proposals we may apply to adviser firms

4.30 In the coming months, we will be developing an appropriate set of standards to consult on for adviser firms, with the aim of ensuring that these firms can and do set and operate their own charging structures fairly. These are likely to cover – but not necessarily be limited to – the following areas:

- **We would expect adviser firms to decide on their standard charges for different services in advance of meeting clients** – rather than setting their charges on an ad hoc basis – and we plan to consult on a requirement for adviser firms to provide their client early in the process with a note of the basis for charging and to keep records.
- **Adviser firms would also need to make clear to each of their clients individually what services they are to receive, and how current or future advice charges will cover them.** If adviser charges are to be paid over time, but the client receives the advisory firm's services up front, adviser firms will need to consider how to make the total charges (not just the regular payment) clear. Firms would also need to make clear when further charges might be payable, for instance whether arranging to switch a client's investment to another provider would generate a further charge. Also, it should be clear to the client whether they can decide to stop payments if, for instance, they change adviser.
- **Any new pricing structures that adviser firms adopt would need to be compatible with the firm giving impartial advice.** We therefore plan to consult on standards that make clear that charging structures should not vary inappropriately according to the product provider, and to some extent the product type, that an adviser firm recommends (e.g. we would not expect adviser charges to vary materially according to whether a particular advice service culminates in a recommendation to purchase units in a collective investment scheme or an equivalent life assurance product).
- **Advisers will need to be aware of how the new approach to their remuneration may affect the advice they provide.** At present, some advisers recommending medium- and long-term investment products (e.g. endowments, life assurance bonds) may expect to be able to find a better product for their clients to switch to every few years. In future, customers may have to incur a greater share of the

costs of switching away from a product before the end of its term[5], which may in turn make switching less beneficial. So, for example, we would not expect adviser firms to offer regular switching advice if the cost of that advice is most likely to outweigh the benefits it will create for the customer.

The proposals we may apply to product provider firms

4.31 To make Adviser Charging work, we believe that it will be necessary to consult on rules that stop product providers from determining their own commission terms for advisers (bearing in mind, however, possible legal restrictions on our ability to apply such rules to incoming product providers). If we are to achieve genuine change, the only payments to pass between product providers and advisers should be to deduct and pass on advisers' own charges. With this in mind, we expect to consult on rules that prevent any other payments being offered, including product charge 'rebates' and payments to reward the use of a particular platform. However, we only intend to apply these new rules going forward – this will not apply to any arrangements in place at the time any rule change is implemented. Current arrangements will remain subject to our inducements rules.

4.32 If advisers help the product provider with some aspect of product administration, for instance by uploading new business data directly into the provider's systems, then this should be covered by the adviser's charges. An ability to carry out such administrative tasks is just one reason why one adviser firm may be able to access a cheaper product price for its clients than a competitor.

4.33 We will want to make sure that Adviser Charging is not undermined by product providers finding alternative ways of exerting influence that encourage advisers not to act in the best interests of their clients. We plan to consult on changes to our Handbook to make clear that any incentives paid or provided to an independent advisory firm that do not explicitly enhance the service given to the customer are unacceptable. We want to take an outcome-focused approach and reflect this in changes to our Handbook and to our supervisory approaches, as appropriate, to prevent provider firms from seeking to exert the wrong sort of influence over independent advisory firms.

4.34 We want to consult on preventing 'factoring' from the end of the transition period. This is where a product provider advances payments to an adviser and recovers the costs from the customer through additional regular charges, often over the full duration of the product. In the longer run, we agree with respondents who advocate that 'perfect matching' is desirable, whereby an adviser firm receives payment in the same pattern as it is deducted from a client's product or investments. If we cannot make the case for preventing factoring, we will need to consider setting appropriate standards to stop product providers using such a facility to exert inappropriate influence. For instance, we might investigate requiring the use of industry standardised terms for factoring, subject to competition law considerations, so that no matter which provider is recommended the same factoring terms would apply.

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5 At present, many life assurance and pensions products are designed so that there are no surrender or transfer penalties and the product provider absorbs the financial strain.

4.35 Factoring is most likely to be required by less affluent customers when purchasing a regular premium life assurance or pension product when the adviser charges are payable up-front. In these circumstances, the customer's initial monthly investment may not be sufficient to cover the adviser's charge and the customer may be unable or unwilling to pay a fee up-front. Factoring can therefore help the customer's cashflow needs.

4.36 Given that we propose to continue to allow product providers (in addition to third parties) to facilitate the collection of adviser charges from customers' investments, we need to consider what actions are needed to deal with the risks these create. Overall, it is important that such arrangements do not cause either advisers or consumers to believe that individual product providers can continue to influence the remuneration that advisers receive. We propose to consider introducing of specific material into our Handbook about the ways in which arrangements can operate, covering the following areas:

- **Operating limits on commissions:** at present, we are aware that many of those firms already offering 'factory-gate pricing' have begun to introduce limits on the commission payments that they will deduct and pass on to advisers (sometimes known as 'decency limits'). These limits are sometimes used by product providers to ensure that charges deducted from a product cannot be so great as to cause uneconomic returns for investors, but in practice they could also act as a cap, or even a focal point price, that advisers may feel they are allowed to charge. To avoid provider influence over adviser charges continuing in future, we may need to issue rules or guidance on the way that any limits are calculated and operated.

- **Collecting and reporting data:** in order to enable us to monitor levels of adviser charges paid out by product providers – and also the role and impact of any limits that product providers apply – we plan to consult on additional reporting requirements for product provider firms.

- **Separating the cost of advisory services from the costs of the product or investment:** in order to provide greater clarity to consumers on the services being provided, and on those to be supplied in the future, we want effective disclosure to customers to separate out the costs of advice services from other product costs. For independent advice channels, this means that product providers will need to make clear the additional product charges payable to cover the payment of adviser charges, if these are being made through the product. We will explore how we might use Reduction in Yield[6] as part of these disclosure requirements to provide a consistent basis for comparisons across the market. We recognise that European law (e.g. the UCITS Directive) may limit the forms of disclosure we can require.

Relevant tax issues

4.37 Under the Finance Act 2004, the tax position for Adviser Charging would not change simply because an adviser firm sets its own charges. Her Majesty's Revenue & Customs (HMRC) confirms that payments made under genuinely commercial

6 Reduction in Yield is a measure of the impact of charges that takes into account both initial and ongoing charges.

remuneration arrangements for pension advice, which are commensurate with the advice given, would not create unauthorised payments – so no unauthorised payment charges would apply[7].

4.38 It has been suggested that Adviser Charging could increase costs to clients if, in practice, it prevents them from paying for all of an adviser's services – including advice on other products – from their pension. However, we believe that this view may arise from a misunderstanding of current legislation. HMRC confirms that arrangements that are either not genuinely commercial or cover wider financial advice – not just pension advice – may create unauthorised payments (and be subject to income tax charges currently of up to 70%[8]).

4.39 Some firms have also queried whether advisers' charges would automatically be subject to Value Added Tax (VAT) if they were set by advisers, rather than paid for by commission set by product providers. It is our understanding that this is not the case: whether adviser charges are subject to VAT is not determined by who sets the charges (the adviser or the product provider) or by whether payment is by fee or commission but is determined by the nature of the service provided. We will liaise further with HMRC, ahead of our consultation next year, to make sure that the tax position of Adviser Charging is clear.

Informing our supervision

4.40 To ensure that our proposals can deliver a genuine reduction in the potential for product and provider bias, we will need to monitor and challenge product providers and adviser firms about the way that they implement Adviser Charging. To achieve this, we are likely to require additional information from firms and, as one element of this, we will investigate whether it is appropriate to consult on changes to our Product Sales Data as a way of gathering information from product providers on any adviser charges that they collect.

4.41 We will also consider whether our current persistency returns would be capable of delivering the information we will need about levels of product lapsing and switching in the industry, following the introduction of Adviser Charging. One option is that we could consult on replacing our current persistency reporting requirements with additional information in our Product Sales Data regarding the number of policies terminated during any reporting period. This data could be broken down according to product type and advisory firm.

How we move to Adviser Charging

4.42 As well as consulting on new rules for advisers and product providers next year, we will also need to amend our notifications under Article 4[9] of MiFID if we are to go

7 Payments for pension advice made under genuinely commercial arrangements are considered as 'scheme administration member payments' (section 171(1) Finance Act 2004).

8 The tax charges that flow as a consequence of a payment being unauthorised are set out at sections 208, 209 and 239 of the Finance Act 2004.

9 Article 4 of the Markets in Financial Instruments Directive (MiFID) Level 2 Directive imposes a number of tests that must be satisfied if member states are to maintain conduct of business or systems and controls requirements that go beyond MiFID. The additional requirements must be notified and justified to the European Commission, which will publish the notification.

ahead with these proposals. Discussions so far suggest that the Commission is receptive to our making such changes (as explained in the EU and UK legal implications section of Chapter 3).

4.43 In the coming months, we will work to refine our proposals for advisers and product providers, so that we can translate them into Handbook rules and guidance for consultation. We will also prepare rules for consultation to govern the transitional arrangements for firms to move to Adviser Charging.

4.44 While independent advisory firms will clearly need some time to prepare for setting and operating their own charging structures, in line with new standards, it is likely that product providers will need longer to re-design their products and administration systems. With this in mind, we plan to consult on a two-stage implementation for our new rules. Chapter 6 covers our plans for transitional arrangements in more detail.

Remuneration in the corporate market

4.45 While the main focus of our policy on adviser charging so far has been aimed at resolving issues in the individual market, a number of firms and consumer groups have come forward to discuss with us whether and how Adviser Charging might be adopted by firms offering advice on group personal pensions (GPPs). The GPP market is somewhat different to other investment product markets, so it may necessitate a different approach. For example, while advice on GPP schemes is frequently provided to an employer, it is quite common for employees to choose whether or not to join their firm's GPP without getting advice.

4.46 We have received feedback suggesting that we should consider a role for employers (which may entail legislative changes) because advice given to employers about GPPs is not generally subject to our regulation. We could only consider requiring Adviser Charging in circumstances where firms advise employees – and this creates two conflicting challenges. On the one hand, there is a risk that we could inadvertently incentivise firms to stop offering advice to employees at all if we did apply the new requirements to GPPs; on the other hand there is a risk that firms could be incentivised to set up GPPs for customers that would previously have been advised to take out individual policies, if we exempt GPPs from any new rules. In the coming months, we will explore the scope for applying Adviser Charging in the GPP market, keeping in mind that doing so could bring new problems as well as benefits.

What is suitable independent advice?

The issues

4.47 In setting out our proposals for the regulated landscape we want more consumers to be clear about the distinction between different types of services available to them. The feedback we have received on the DP and on the IR highlights the importance that the industry also attaches to clarity and simplicity for consumers. Now that we have modified the simple landscape we set out in the IR, this has elevated the importance of making a clear distinction.

4.48 So we need a clear definition of what it means for a firm to offer 'independent' advice – as opposed to providing some form of 'sales' advice. This needs to be described in terms that can make intuitive sense to consumers. We must also make clear that the standards expected of independent advisers will be high, and firms wanting to describe themselves as independent will need to ensure that they can act in a genuinely unrestricted manner.

4.49 At present, advisory firms wishing to describe their services as independent must meet two requirements: a 'whole of market requirement' to make recommendations to consumers on packaged products from the whole market (or a whole sector of the market); and a 'fee option requirement' to offer consumers the opportunity to pay by fee for their advice. However, there are limitations with the way the first requirement is currently defined, not least as a result of it relating only to 'packaged products'. Moreover, although there is guidance in our Handbook, it may not always be clear to advisers how they should satisfy requirements particularly in relation to new forms of products and services (e.g. platforms).

4.50 Rather than simply re-write or extend the whole of market requirements, we think it better to take a broader, consumer-oriented, view of what suitable independent advice should mean in an evolving market.

The intended outcome

4.51 Replacing our independence rules will ensure that firms, consumers and supervisors will understand what is expected if advice is described as independent. It will also make clear that we are starting afresh in terms of the standards expected. The new rules will help to encourage innovation and ensure our rules are not as vulnerable to future developments as in the past.

The new standards we intend to consult on

4.52 Starting afresh, we have considered how best to communicate the high standards that we expect of genuinely independent advisers. We want to make sure that our Handbook supports and enables independent advisory firms to design businesses that search out and deliver the solutions that meet their clients' needs. We propose to do this through two outcome-focused principles for independence which we discuss further below. We also give some examples of how these might apply to different types of firm. These examples are deliberately simplistic. In taking our proposals to consultation next June we will develop more complex examples to help firms to assess whether their business meets these principles.

4.53 **Principle 1: Be equipped to give comprehensive and fair analysis of their relevant markets.** We continue to believe that it is important for independent advisers to be able to review the whole market, to deliver genuinely independent advice. However, we recognise that the whole market means different things for different firms. It is possible to provide independent advice even if a firm specialises in quite a narrow field, provided that the whole of the relevant market is considered independently. When considering what can be classed as a relevant market, consideration needs to be given to whether a client could expect to receive a suitable outcome from elsewhere, the reason for taking advice and the degree of substitutability with other products or investment types. A product type such as a pension may be a relevant market, because some clients would not be able to obtain the outcome they require from any other type of product. However, a product such as an investment bond, would not be classed as a relevant market as there are a number of other products that are directly substitutable.

Example – 'Greenfield Financial Advisers' is a specialist advisory firm recommending only ethical and socially responsible investments from the whole of this market. It is possible for the firm to hold itself out as providing independent advice as the client not only wants to make an investment, but wants to do so in line with their beliefs – the same logic can be applied to something like Islamic finance. A product outside this market will not be suitable so the relevant market can be classed as ethical products, so independent advice can be given, providing the firm makes its market clear to clients. For example, using the description 'Greenfield's Independent Financial Advisers' could be misleading, but 'Greenfield's – providing independent advice on ethical products' might be acceptable, as the client should be clear on the service they would then receive.

4.54 Under the new rules we plan to consult on, independent advisory firms would need to be able to demonstrate how they monitor and respond to changes in the products and services available in the market on an ongoing basis. If a firm selects a panel to represent the best products in the market they would need to ensure, and be able to demonstrate, that the process they use and the criteria they apply to select the firms on their panel are sufficiently robust to allow the panel to be suitable for its client base. The prices of the products selected for the panel should be competitive at any particular time (in relation to product features offered) and firms would need to be able to demonstrate that clients are not materially disadvantaged by the use of a panel. Firms would also need to demonstrate that they have processes and controls to require their advisers to go off-panel under particular circumstances, for instance if it is clear that the best outcome for the client is delivered through a product that is not on the panel.

4.55 Independent advisory firms that use portals or sourcing systems in selecting their panels of products or providers would also need to ensure they understood the criteria used to select the providers for the systems they use, to ensure they met their obligations to deliver a comprehensive and fair analysis of their relevant market. For example, if the providers whose products are available through a portal are there because they have paid a fee while other providers are missing because they have not paid a fee, using this system alone would not satisfy conditions for a comprehensive or fair analysis of the market. This would mean an independent adviser should not rely solely on the portal to source their products.

4.56 **Principle 2: Provide unbiased, unrestricted advice.** We would not expect independent advisory firms to be unreasonably restricted, or biased in any way, in the products or services they offer. This would mean firms should not have any form of contractual agreement with any service or product provider, nor should they have any other constraint or obligation (such as arrangements with other entities within the same group of companies) that might limit their ability to select the best solution for their clients. Furthermore, any product provider's actions, for example in giving system support or training, should not in any way be allowed to influence the advice given.

Example – 'National IFA' is a large IFA firm. To improve efficiency, enabling a cheaper service to be provided to its clients, National makes use of the platform supplied by the provider XYZ automatically for all customers. The platform does not enable transfers off and only offers its own products, albeit these offer links to a wide range of underlying funds. This model would not be in line with the independent principles as it restricts the type of products the client has access to while also restricting the client's ability to switch products should they wish to. Using a platform is possible under the independence principles, if it produces at least as good an outcome for the client as not using a platform. In giving suitable advice, an independent advisory firm would need to ensure the client is not materially disadvantaged by using one platform rather than other platforms in the market.

4.57 There is a clear link between the proposed standards and the existing suitability requirement. What constitutes 'suitable' advice is driven by the required characteristics of the service type. This is a principle that applies to all advisory services, not just independent advisory firms.

Example – 'Unit Wealth Managers' is a wealth management advisory firm that focuses on serving more affluent consumers. It only offers its clients its own collective investment scheme (CIS) – comprising links to a range of funds and fund managers from across the market and chosen to fit with the typical needs of the firm's clients. Although this product has initially been designed with the independence principles in mind, it is unlikely that a suitable outcome for each individual customer, within the context of the provision of independent advice, will always be achieved with this particular product. The firm is restricting itself by only offering its own CIS and is therefore not meeting independence principles. If Unit Wealth Managers analysed all other potential solutions in the relevant market alongside its own scheme, and was prepared to recommend these other products, then this is likely to be consistent with giving suitable advice in an independent context.

4.58 We received several responses to the DP which suggested that an advisory firm should not be deemed to be independent if a product provider held any form of financial interest in that firm. We have investigated a number of advisory firms that are currently owned or part-owned by providers to see whether they place a disproportionate amount of business with their parent. We did not find evidence of a systemic cross-industry issue at present. We are also mindful that in current economic conditions, and given our wider concerns with the sustainability of the sector, we should be cautious about acting to limit access to capital. So we do not aim to prevent independent advisory firms from being financed, owned, or part owned, by product providers at present. But we will want to keep this under review and monitor the situation more closely in future. In particular, we will want to be satisfied that firms have appropriate controls to prevent ownership or other financing arrangements translating into any form of restriction on the products and services that the firm might access in formulating recommendations for its clients.

How our new rules on independence would apply

4.59 Overall, we expect the new standards to challenge some firms that currently describe themselves as 'independent' to ensure that they really do act as such and are genuinely free from influence or restriction on what they can and do recommend.

4.60 We do not intend to restrict our independence standards to firms advising on packaged products. We intend to consult on applying our new independence principles more widely – applying them across all forms of investment advice – meaning that we will see, for example, private banks making the independent or non-independent nature of their advice services clear.

4.61 In order to reinforce the distinctions between independent and non-independent forms of advice, we will explore how the different characteristics of non-independent services (for example, restricted access to products) can be more clearly communicated to clients. We emphasise that we do not view independent advice as necessarily the best service for every consumer.

4.62 As well as consulting on the new independence rules we discuss here, we will also need to amend the notification we made for our current rules under Article 4 of the MiFID Implementing Directive. Discussions so far suggest that the Commission is receptive to us making such changes (as outlined in Chapter 3).

Professional standards

The issue

4.63 A pivotal review objective is to have standards of professionalism amongst those who deliver services in the retail investment market that inspire consumer confidence and build trust. We aim to deliver this in three ways:

- by improving the quality of advice being given to clients by raising minimum levels of competence, skills and knowledge;
- by improving the perception of the sector by establishing and enforcing common ethical and behavioural standards; and
- supporting these and wider RDR proposals and mitigating the potential risks from them, by implementing an agreed, visible and effective common framework for professional standards to govern standards of practice.

4.64 These standards could relate to behaviours (for instance in applying Adviser Charging) or advice processes (for instance, the steps an adviser should go through in helping clients with particular financial needs). In combination, we want the professionalism work to lead to financial advice being seen as on a par with other professions.

Intended outcomes

4.65 Feedback from the market shows that many industry practitioners see significant scope for improving the image of the financial advice sector in the UK. It is not generally perceived in the same way as other professional services and consequently may not be attracting sufficient numbers of talented new entrants. To address the wider RDR aim of improving the efficiency of the marketplace, and making it work better for firms and consumers, we have consistently stressed the need for increased minimum professional standards. We see this as necessary not only to improve actual outcomes for consumers, but also to improve consumer perceptions, raising confidence and trust in the services supplied and encouraging more consumers to want to use those services. These are aims that were widely shared by industry and consumer representatives in responding to both the DP and the IR.

Progress made by the industry

4.66 Since we published the DP, there has been increasing acceptance across the retail investment market of the need to increase minimum professional standards. We set out in detail in Annexes 1 and 2 the feedback to the DP and IR respectively. In summary, the industry has responded positively to the ideas set out in the IR which suggested a minimum qualification at QCA level four[10] as opposed to higher benchmarks for some types of adviser that were floated in the DP.

4.67 We have seen tangible developments, for example a significant increase in take up of QCA level four study courses, the launch of the ifs School of Finance Diploma, and several firms initiating coordinated training and development programmes for advisers. We recognise and welcome the significant steps that have been taken by many across the industry to raise professional standards and we are committed to making this a 'no-regrets' move for them, however the professionalism proposals are further developed and implemented.

4.68 In the IR, we highlighted our intention to seek a market-led solution, and issued a challenge to stakeholders to work together to develop and implement an agreed common framework for professional standards. As promised, we helped to facilitate this by bringing together a 'Professionalism Group'[11]. This Group formed a Working Group to develop their detailed proposals which we discuss below.

Proposals of the Professionalism Group

4.69 We set terms of reference for this Group based on the key points raised in feedback to the DP. The Group was tasked with formulating ideas for a framework for professional standards across the full range of advisory services, but we accepted that, until we could give them certainty about how we intended to take forward the ideas in the IR to create a distinction between advice and sales, the Group should predominantly focus its attention on the independent advice sector. In its report, the Group used the term 'Professional Financial Advisor' (PFA) as a working title for individuals operating as independent advisers, but this not a term we have any immediate intentions to adopt.

10 See footnote 5 in the Overview.

11 This group was independently chaired by Michael Foot, chairman of Promontory Financial Group (UK), and comprised senior representatives of the Financial Services Skills Council, the ifs School of Finance, the Chartered Insurance Institute, the Chartered Institute of Bankers in Scotland, the Securities and Investments Institute and the Institute of Financial Planning.

4.70 We have built on the Group's recommendations to propose changes to the professional standards that will apply to those advisers who are not independent. These proposals are explained further in Chapter 5 but in summary we do not see any reason to apply different professional standards to individuals giving advice, whether in the independent advisory sector or otherwise, if they are performing essentially the same role. So we anticipate that the same professional standards should apply to similar roles – but this does not necessarily mean that the same minimum standards would apply to all roles.

4.71 For clarity, the Group has proposed, and we have accepted, that at least for an interim period the FSA will set up a Professional Standards Board as a sub-committee of the FSA Board. This means that for as long as the Professional Standards Board is part of the FSA, there will be no mandatory requirement for advisers to join a professional body. As we describe below, we will use our current powers to require all advisers to comply with relevant standards. The issue of whether and, if so, how and when mandatory membership of a professional body is eventually required depends on whether and, if so, how and when a Professional Standards Board independent of the FSA is launched. We explain this further below when discussing the Group's recommendations.

4.72 The Group's package of recommendations is contained in its report to us, which we have included in full at Annex 9. We summarise below their proposals and explain in each case what we plan to take forward and how. We also note other areas for consideration, that were outside the main points of focus for the Group.

4.73 **Group's Proposal Area 1 – establishing an Independent Professional Standards Board (IPSB). The Group proposed that:**

- **An IPSB to be set up as soon as possible, initially as a sub-committee of the FSA Board, but to be developed into a fully independent Board, with a Chair and majority of Board Directors who are themselves independent of the industry (and independent of any relevant professional or skills body).**
- **After a period, the IPSB may then seek its own statutory powers and become fully independent, outside of the FSA. At this point, if it is within the IPSB's legal powers, the IPSB should require all PFAs to have a relationship with it through a Professional Body.**
- **The IPSB should follow FSA practice in areas such as cost benefit analysis and consultation when setting standards for the profession.**
- **The IPSB should have a role across the whole investment advice sector.**

4.74 Our views on the Group's Proposal Area 1:

- *We support these proposals as a means of delivering consistently higher standards but are very clear that they must deliver genuine improvements for consumers, and must be above any accusation of vested interests. We support the need for statutory powers on the grounds of maintaining impetus and allowing effective monitoring and disciplinary action, which are seen as crucial for improving consumer perception and trust. We intend to consult on the formation of such a body as part of FSA, and on whether it should in time be launched* *independent of the FSA, with statutory footing. We note and agree with the group's recommendation that the second stage should be considered carefully in the light of experience of the first stage, and we stress that solutions here must avoid regulatory duplication and addition to costs without consequent benefits for firms and consumers.*

- *At least in the initial phase, when it is run as part of the FSA, raising standards of competence is likely to be addressed by rules and/or guidance within the Training & Competence sourcebook. If we follow this course, the new standards will apply to all investment advisers, and not only members of professional bodies. It is envisaged that supervision of the standards for members of professional bodies will be delegated in some way to the professional bodies themselves. Supervision of these standards will fall to us for non-members, and will require a significant resource commitment, which will be further explored to inform our consultation process.*
- *Launching an IPSB separate from the FSA and with statutory powers would require the Treasury to take the lead. Subject to the outcome of the consultation process, we would work with the Treasury to consider further how the legislation would be made, and a potential timescale. It would require significant FSA resource to help the Treasury make the case for this proposal, and then agree respective responsibilities, by conducting a review of our functions in this area and consulting on removing possible areas of duplication and overlap.*
- *As noted above, the issue of membership of professional bodies would not be relevant in the initial phase. The IPSB, if given an independent statutory footing, would have freedom to seek legal advice on membership requirements, and take the approach it believed most effective to deliver its objectives.*
- *We fully endorse measures to ensure the strict neutrality and accountability of the IPSB, which include no position on the Board for the representatives of professional and skills bodies, the appointment of an independent chair, a Board with a majority of independent members and a requirement to carry out cost benefit analysis and consult. It is also fundamental that, as far possible, we avoid duplicated regulation, which is most relevant in the areas of monitoring and enforcement. The implementation issues and costs will be considered carefully at the consultation stage.*

4.75 **Group's Proposal Area 2 – the IPSB will oversee new minimum qualification standards for Professional Financial Advisers.**

4.76 Our views on the Group's Proposal Area 2:

- *We strongly support an increase in the knowledge requirement to QCA level four (or equivalent), which is consistent with much of the feedback we have received, and agree that this should be delivered via a new benchmark qualification, tailored to the modern adviser and consumer. The FSSC currently sets appropriate examination standards on our behalf, so the increase from QCA level three to four could be delivered by the FSSC setting higher appropriate exam standards and amending its appropriate examinations list. There would be no need for a rule change.*

- *The Group's proposal to subsequently raise the benchmark qualification for new entrants to degree level is consistent with our long term aim of raising the standing of financial advice to the level of other professions and is consistent with some of the DP feedback (see Annex 1) and the view of the Financial Services Consumer Panel. However, we are well aware that this would represent a significant change for the industry. We see the need for careful cost benefit analysis to consider the impact on firms and on the supply of advice, and a sensible subsequent transition period. Our consultation in June 2009 will be developed around the first phase of transition only – to establish QCA level four as the minimum benchmark over the period to 31 December 2012.*

4.77 **Group's Proposal Area 3 – the IPSB will create and oversee a new Code of Ethics and deal with breaches.**

4.78 Our views on the Group's Proposal Area 3:

- *We believe that a consistent and visibly-enforced code of ethics is essential for improving consumer outcomes and changing consumer perceptions. Statutory powers would be desirable to enable effective enforcement, and would be available in both the FSA-sponsored and stand alone phases of the IPSB.*
- *There are several issues arising from the Group's proposals for a Financial Ombudsman Service (FOS) role in dealing with complaints against advisers. Their ideas present practical challenges and will need to be considered further. First, because FOS considers complaints about firms rather than individual advisers, this may affect its ability to take into account an IPSB code which would apply at an individual level. Second, the definition of a FOS complaint will not cover all issues of conduct as intended here, because some of the standards may be matters of good practice rather than prohibitions of detrimental practices. Third, there may be information-sharing limitations due to the first point above, which often means that the FOS has limited knowledge of the background of the adviser concerned. We are ready to work with the FOS to explore these issues and to look for mutually acceptable solutions.*

4.79 **Group's Proposal Area 4 – the IPSB should be responsible for setting and enforcing new consistent minimum standards for Continuing Professional Development (CPD).**

4.80 Our views on the Group's Proposal Area 4:

- *Effective and consistent CPD is arguably as important as raising the benchmark knowledge requirement. This does not necessarily mean more CPD, and we support the Group's view that there are different ways to achieve the intended outcome of up-to-date relevant knowledge.*
- *Paragraph 38 of the Group's report suggests that non-professional body members should pay the IPSB to monitor their observance of CPD requirements. We understand the intention of creating a level playing field, but recognise logistical challenges to delivering this through our fee levy. Further analysis is required to determine the legal and operational challenges associated with this suggestion.*

4.81 **Group's Proposal Area 5 – the IPSB should promote public awareness of the new arrangements and what the public can expect from a PFA.**

4.82 Our views on the Group's Proposal Area 5:

- *We agree that there is an important public relations role for the IPSB to raise consumer awareness and improve their perceptions, points which were often raised in feedback to the DP. We see this as an early task for the IPSB.*

4.83 **Group's Proposal Area 6 – the IPSB should liaise closely with the FSA to ensure a coordinated approach to monitoring and enforcement of the new standards.**

4.84 Our views on the Group's Proposal Area 6:

- *This will be an important area to consider if it is decided to proceed with an IPSB that is fully independent of the FSA.*

4.85 **Group's Proposal Area 7 – there needs to be easily-accessible ways for consumers to locate suitably qualified advisers, which should include revamping the FSA Register and making it more consumer-friendly.**

4.86 Our views on the Group's Proposal Area 7:

- *In PS07/23[12] we set out our response to our question in CP07/17[13] asking firms if they believed that publishing what type of advice is provided by individual firms would be beneficial to consumers. Based on the responses to this question we noted that any future systems changes in this context would be subject to a full cost benefit analysis. In relation to the benefits to consumers we noted that we intend to explore this more fully with the respondents supporting publication, and in particular the Financial Services Consumer Panel. This work will take into account the further development of the RDR and our ongoing work on regulatory transparency.*

4.87 **Group's Proposal Area 8 – Advisers should have to obtain and display a Practising Certificate.**

4.88 Our views on the Group's Proposal Area 8:

- *Clarity for consumers on the services available from advisers has always been a key aim of the RDR. We can see the potential benefits of practising certificates to help to achieve this aim, and to further support improved perceptions of advisers. We think that if the IPSB is a visibly effective authority that will significantly assist delivery of these aims, but we agree that this proposal should be taken forward as a supplementary measure. We support the Group's further recommendations of simplicity in terms of content and administration, to keep costs at a minimum.*

12 Integrated Regulatory Reporting (IRR): Changes to reporting requirements affecting most firms. www.fsa.gov.uk/pubs/policy/ps07_23.pdf

13 www.fsa.gov.uk/pubs/cp/cp07_17.pdf

4.89 **Group's Proposal Area 9 – implementation of the Group's recommendations should begin when the FSA's consultation on RDR proposals has concluded:**

- **New courses for new qualification requirements for advisers should start to be taught by mid-2010.**
- **Where existing advisers have a qualification at level four or above, any gap between that and the new requirement should be filled by additional CPD rather than having to sit further courses.**
- **The new Code of Ethics and the new CPD requirements should be introduced as soon as practicable in 2010.**
- **Existing advisers who need to upgrade their qualifications should do so by the end of 2012, although they could continue to the end of 2014 under supervision.**

4.90 Our views on the Group's Proposal Area 9:

- *We have consistently stated during the RDR that we welcome firms and individuals taking the initiative before our proposals are finalised where their actions are consistent with our intended market outcomes. Professionalism is a good example of this. Our approach here is to recognise the efforts of the individuals who have already taken steps, and also to set out clearly the action required from those who have waited for our final proposals.*
- *As noted above, we support the establishment of an IPSB, subject to the outcome of consultation. We anticipate that the process of consultation will mean that we would not be able to establish an IPSB before 2010, but we will consider what can be done in the interim to maintain momentum, and we support the Group's recommendation that existing advisers should continue progress towards the higher qualification level proposed.*
- *We support the Group's proposals on transition in terms of both new and existing advisers, with the exception of the recommendation of a further two-year period under supervision for existing advisers who have not met the higher examination requirement by the end of 2012. This means that when the new testing standards are set and examination providers have agreed the courses and modules to meet them, this should become the requirement for new entrants from that time. We estimate that this will be in mid-2010.*
- *Those who are on course to complete, or already hold (at least) a QCA level four qualification currently in use in the investment advice sector, can continue, with any gaps relative to new knowledge requirements to be dealt with via CPD. The IPSB, once established, might need to consider how far to apply this principle to holders of QCA level four qualifications in related financial services disciplines.*
- *The Group's recommendations did not address those who have an existing qualification above level three, but which is not classed as level four (e.g. the CII's Advanced Financial Planning Certificate and the ifs School of Finance Professional Investment Certificate). We propose the same approach as set out by the Group for those with an existing level four qualification, i.e. any gaps relative to new knowledge requirements to be dealt with via CPD.*

- *Feedback to our DP was mixed in terms of whether we should 'grandfather'[14] existing competent advisers to the new standard. It is important to note that the benchmark qualification level suggested in the DP for some advisory roles was significantly higher than the QCA level four being proposed now. We also think that a four-year period from publication of this Feedback Statement gives time for the industry to transition in an orderly manner. Therefore we are holding our line as stated in the IR, and will not consult on allowing grandfathering.*
- *In the time available, the Group did not consider on-the-job assessment for existing advisers as a potential alternative to the examination route. However, we acknowledge the volume of supporting feedback received on this point and are therefore maintaining the position we set out in the IR, which is that we are open to any solution which provides a rigorous test of adviser competency. We will keep this on the agenda for the IPSB to consider.*

Remaining issues

4.91 The Group has not specifically covered standards for the skills required by investment advisers (e.g. listening, questioning and explaining skills). We believe that these are important areas in terms of overall competence, which we must keep on the agenda of the IPSB, to be given full consideration in due course. The FSSC will be a natural lead adviser to the IPSB on this work.

4.92 The FSA's Smaller Businesses Practitioner Panel and APCIMS[15] have both raised concerns about potential employment law implications of the professionalism proposals. In particular, whether there are consequences of some existing advisers not being allowed to continue in the role they were contracted to perform if they do not demonstrate appropriate competence at the new minimum levels for their role. We intend to address this question in the consultation process, but at this stage we do not see insurmountable barriers.

4.93 The Group did not make recommendations on the subject of specialisms, that is, the need for higher levels of knowledge and competence for certain roles and/or technical areas. Our view is that different role requirements may mean different skills and knowledge requirements, and we will put this matter on the agenda of the IPSB.

Long-stop

4.94 The Discussion Paper suggested that we might consider changing the FSA's dispute resolution sourcebook (DISP) in order to introduce a 15-year 'long-stop' on bringing complaints against financial services firms. This would be in line with in the way that the Limitation Act 1980 (and the Prescription and Limitation (Scotland) Acts 1973 and 1984 in Scotland) set limits for claims in negligence.

14 'Grandfather' here means allowing some current practitioners to be granted 'adviser' status permanently by virtue of their past experience, despite not holding all relevant qualifications that a new entrant would need.

15 The Association of Private Client Investment Managers and Stockbrokers.

4.95 To justify the introduction of a 'long-stop' time limit on the period within which complaints must be brought, we needed to identify benefits to firms or consumers beyond the savings for firms in compensation payments. This is because the savings in compensation payments are the same as the costs to consumers from the introduction of the long-stop. In other words, it is a transfer from consumers to firms. Additional benefits that would make the introduction of a long-stop cost-effective would be, for example, an increase in investment in the sector to the benefit of consumers, resulting from reduced uncertainty over liability.

4.96 Feedback to the question about a long-stop in the DP is in Annex 1. The feedback from the industry, particularly from the IFA community, was forceful – the strength of feeling on this issue was clear. The industry's feedback focused on 'fairness' arguments, for example that the general law of limitation did not apply to advisers, and that they were concerned about handling 'stale claims' – particularly into retirement. However, we were unable to convert these arguments into a persuasive analysis that introduction of a long-stop would deliver net benefits for consumers, and other responses – including some from firms – highlighted the consumer detriment and reputational damage that a long-stop could cause.

4.97 Therefore, in the IR we asked for further information to help our cost benefit analysis of the introduction of a long-stop, and we have pursued this in the period since then. Feedback we received on the issue of the long-stop following the IR is in Annex 2. We are aware of only three entities that actively went further by trying to find information to demonstrate net benefits to consumers, and we are grateful to them for doing so. One said that it had not been able to find sufficient evidence that the absence of a long-stop was a critical factor constraining the supply of savings and investment services to retail customers. It thought that introducing a long-stop in present circumstances might further undermine consumer confidence.

4.98 Information from the other two entities:

- included an estimate of the cost of long-term record-keeping;
- argued that potential investors in advice businesses focus in depth on the potential liabilities in them, and that a long-stop would give potential investors greater certainty about liability, but was unable to quantify how much of the uncertainty about liability related to business undertaken more than 15 years previously; and
- argued that the impact of the absence of a long-stop will increase as more time elapses since the introduction of financial services regulation in 1988.

4.99 Our own work estimated that reducing the time for holding records from 30 to 15 years would save an average advisory firm about £3,000 per year, which was very much in line with the figures provided on the cost of long-term record keeping, bearing in mind that firms would still need to retain records for at least 15 years under a long-stop arrangement. These savings are not trivial, but we were not convinced that they would provide sufficient additional benefits to both consumers and firms. In addition, we learned that broader uncertainties over liability have more impact on potential investors than the specific uncertainty associated with the lack of a long-stop.

4.100 As mentioned in the IR, the Financial Ombudsman Service (FOS) estimated that the introduction of a 15-year long-stop would time-bar approximately 2,000 of its cases a year. This figure excluded 7,000 mortgage endowment complaints that would have been time-barred in 2007/08 by such a long-stop because it was clear that the number of these complaints was falling dramatically and hence was unlikely to figure in the medium term. Work with a sample of product providers found that there are further complaints, relating to business undertaken more than 15 years previously, upheld by firms that are not referred to FOS.

4.101 Having thought carefully about this additional information, we have concluded that we should not introduce a long-stop because we have been unable to demonstrate that it would bring additional benefits to consumers and firms (for example from greater investment in the sector) given that the consumer detriment from time-barred complaints is equal to the resulting benefit for firms from compensation payments.

4.102 We recognise that many in the industry will be deeply disappointed by this decision.

5 Sales services (to include non-independent advice)

Different consumers will have different needs and preferences, so we think a full spectrum of different services should be accessible to consumers. The nature of the service being provided and the costs of that service should be made clear to consumers. Sales services are part of that spectrum and are intended to assist a consumer to make a product purchase. These services include:

- Non-independent advice – full advice services to recommend purchases to clients based on a comprehensive review of their needs (either limited to specific needs or the full range). We will consult on firms being subject to equivalent professionalism and remuneration standards as will apply to independent advisory firms. Unlike independent advisory firms, client recommendations are made from a limited range of suitable solutions.
- Guided sales – straightforward sales processes for customers with more straightforward needs, which might be advisory or non-advised.
- Other non-advised sales – i.e. Execution-Only.

We also plan to consult on withdrawing the rules for Basic Advice.

Introduction

5.1 The retail investment market is characterised by poor consumer understanding and low levels of financial capability. One consequence is that, unlike in many other markets, consumers are often unaware of their need for particular products. Moreover, even if they are aware of their needs, the long-term nature of some investment products can deter some consumers from buying because they find it hard to determine whether it is worth it.

5.2 Consequently most of the purchases consumers make in this market are currently the result of an advised process. The process typically includes (among other things) both raising the consumer's awareness of needs and helping them to make the decision to take action to address that need. Many consumers prefer to use a trusted source for these services – an adviser recommended by family, friends or workplace colleagues for instance. Some consumers want impartial advice, which they should be able to get from independent advisory firms; others are attracted by well-known brands –

particularly the major financial institutions such as the banks or insurance companies. Some will want a short, straightforward process whereas others will be more comforted if the provider of the service takes the time to find out as much as possible about them. And some will want help just choosing who amongst these and others to go to. Different consumers will have different preferences.

5.3 Following the publication of the Interim Report (IR), we undertook market impact analysis of the ideas set out in that paper (see Chapter 7 for fuller description). We concluded that the majority of consumers buying investment products need help not only to identify their needs but also to encourage them to take action. Non-advised services can only offer limited assistance and are predominantly used by those consumers who have a pretty clear idea of what they want at the outset. We further concluded that by requiring advice firms that did not meet the criteria for independence that we floated in the IR to adapt their services or not provide advice, we risked having many consumers whose needs and preferences would not be addressed.

5.4 So in deciding on what we now intend to consult on, we wanted to ensure that the future for retail distribution includes a full spectrum of services and service providers, to allow as many consumers as possible to have their needs and preferences addressed. In doing this we hold strongly to the view, which many others have played back to us in giving feedback on the Discussion Paper (DP), the IR or in other ways, that there has to be absolute clarity for all consumers on the nature and limitations of services offered to them. The consumer research we refer to in Chapter 3, and which we intend to conduct ahead of the Consultation Paper, will explore both the labels that are used to describe different services as well as other measures that we might introduce to prescribe how those services are presented.

Sales services

5.5 For the purposes of this paper (and subsequent debates) we describe services to assist a product purchase, and do not meet the new conditions for independent advice, as ‘sales’. This is a working title, but is intended to convey that the provider of those services is in some way restricted, for instance to offering solutions from a limited range of suppliers.

5.6 In this chapter we explain our proposals for sales services. As we explained earlier in this paper, we do not think that the best outcome for all consumers can only be achieved through independent advice, and sales services have an important part to play in the overall landscape. The three main service types we envisage as part of the spectrum of sales services are:

- **Non-independent advice services** which for the purposes of this chapter mean full holistic or focused advice services. These are services that meet the legal definition of advice, but do not meet the conditions for independent advice. Tied and multi-tied services in the current market may (subject to meeting the standards required) fit in here as may some current IFA firms that no longer meet the criteria for independence. These services combine the features of an impartial process to assess need, with an obligation to sell from a suite of products. We recognised this potential ambiguity in the IR when we discussed the consequences of the ideas set out in that paper.

- **Guided sales,** which is a working title for more straightforward sales processes and which may evolve in both advised and non-advised forms. These are services that many in the market have argued are needed particularly to provide cost-effective solutions for less affluent consumers with more straightforward needs for whom a full advice process may not be economic (and may not be economic to supply). Finding an approach which is economic for both parties, and affords sufficient consumer protection, is the key challenge with these services and we describe how we are tackling this later in the chapter.
- **Other non-advised sales,** in particular execution-only services where the consumer chooses to make a purchase, seeking assistance only with the purchase transaction itself.

Non-independent advice

5.7 We are intent on raising minimum professional standards and improving remuneration practices for all types of advisory service. So the proposals we consult on in 2009 will include requirements for non-independent advice to meet the same or equivalent (in terms of their effect) standards as will apply to independent advice. An important consequence of this is that those IFAs who are unwilling to adopt the new standards for independent advice will not be able simply to re-label themselves as 'non-independent' in order to avoid making changes. They would still have to adhere to new professional standards and make the charges associated with their advice transparent.

5.8 As we discussed earlier in this paper, it is important for consumers to understand the nature of the service offered and we will be conducting consumer research to inform our further proposals in this area. We will particularly want a non-independent advisory firm to make the scope and limitations of their services clear to clients. It will be as important that non-independent advisory firms provide an impartial and professional service for consumers – within the limitations that they set out – as it will be for an independent adviser.

5.9 Our proposals for remuneration and professionalism in the context of non-independent advisory services are explained in more detail below.

Remuneration for non-independent advisory firms

The issues for non-independent advice

5.10 In Chapter 4, we explained our plans to consult on the introduction of a new system of remuneration for adviser firms. 'Adviser Charging' would require all independent advisory firms to set their own charges, and stops product providers from determining how much commission advisers receive when recommending a particular product. In removing a key source of potential bias, this change could complement significant improvements in the professionalism of the advice industry and, as a result, improve consumer confidence. We also intend more effective transparency for customers, to clarify the services being provided and their relative costs. In particular, when purchases are made we would want clarity on the costs of advisory services by showing these separately from other product costs.

5.11 In view of certain different characteristics we may have to apply some of these changes to remuneration practices in the non-independent sector slightly differently from the independent sector. But we want changes to have an equivalent effect, and for there to be sufficient consistency not to give commercial advantages to any one sector that might inhibit consumers from accessing the most appropriate services for their needs and wants. We are particularly intent on consulting on separate disclosure of the costs of advisory services from product costs for both independent and non-independent advisory firms.

The intended outcomes for non-independent advice

5.12 The main outcome we want, equivalent to our intentions for independent advice, is for remuneration arrangements for non-independent advisers to operate in a way that does not prevent consumers from receiving suitable advice, where suitability is assessed in relation to the nature and limitations of the services provided.

5.13 We are not simply seeking to galvanise more competition on prices. We recognise that higher costs may equate to better services, so lower price is not necessarily the only important competitive factor. We would want firms to make it clearer to consumers what services will cost them and to make it clearer what will be supplied for these costs empowering some to apply more pressure on service suppliers. There are very low levels of consumer trust and confidence in the sector and, consistent with a key RDR aim, we want consumers to be more confident that what firms say they will deliver is delivered.

5.14 We recognise that in the case of some non-independent firms there may be no separation between product provider and adviser firm. So the issues of provider bias may not arise, or arise in a different way with non-independent firms. But incentives to sell particular products or simply to make a sale are likely to be a common feature of many advisory businesses.

Proposals for non-independent firms

5.15 We will consult on applying the principles of Adviser Charging for independent adviser firms to non-independent firms, as far as is practicable. So we expect to consult on several over-arching remuneration standards that could be applied to all advisers.

5.16 Our plans to consult on introducing Adviser Charging for independent advisory firms reflect the idea that these firms need to demonstrate their complete independence from any product provider. In contrast, in the non-independent advice sector, many different forms of advice are available – including advice provided directly by individual product providers on their own products, and advice from firms acting for a third party product provider or for a panel of product providers. We will need to ensure applicability across this full spectrum.

5.17 We set out consultation proposals in Chapter 4 for independent advisory firms and repeat these below to consider how they could apply to non-independent advisory firms. We have more work to do to develop the detail on what follows for the Consultation Paper in June 2009.

a. **We would expect adviser firms to decide on their standard charges for different services in advance of meeting clients.** While a non-independent firm might only be offering a limited range of advice services, we would still expect it to decide and make clear how much it will charge, and how that charge can be paid (recognising that there may be fewer payment options for some types of non-independent service provider than may be offered by an independent firm, for instance if selling its parent's products).

b. **Adviser firms would also need to make clear to each of their clients individually what services they are to receive, and how current or future advice charges will cover them.** We expect non-independent advisers to be able to explain their charges clearly, setting out for the client what they will receive in return for the payments they will make.

c. **Any new pricing structures that adviser firms adopt would need to be compatible with the firm giving impartial advice.** While not all non-independent advisers offer advice on a full range of asset types, whatever products and services firms do choose to advise on, they need to ensure that their advice is fair. So, for example, if a multi-tied firm includes in its range different types of products that are potentially substitutable, we would not generally expect its adviser charges to vary according to which product is recommended.

d. **Advisers will need to be aware of how the new approach to their remuneration may affect the advice they provide.** All types of advisers will need to be aware of the potential consequences of any changes that may arise in the cost to the customer of switching or lapsing a product before the end of its term.

The impact on consumers receiving non-independent services

5.18 As with any market it is important for the consumer to be aware of how much they are paying for a product they buy. This enables them to compare products and services and make an informed choice about which service to use at a price they are willing to pay. One of the problems in the market for financial advice is that consumers are often unaware how much they are paying for the advice they receive – they often have a perception that it is free.

5.19 To allow fair comparison between firms, and in particular between independent advisory firms and non-independent advisory firms, the consumer would need to be aware of costs in all segments of this market. There may need to be means by which consumers could easily compare costs across firms (e.g. through surveys in the national press). So we need to consult on a consistent approach to avoid market distortions. For instance, if we did not require cost disclosure for non-independent advisers, the consumer could receive what appears to be 'free' non-independent advice. By contrast, consumers will be clear that they are paying for independent advice.

5.20 Even if consumers do not use the information to make comparisons, there is potential for them to be more aware of the services being supplied, and the corresponding costs, which may have a positive effect by putting more pressure on advisers to deliver what they promise.

The impact on firms offering non-independent services

5.21 While it is perhaps unsurprising that the same remuneration standards could usefully be applied to what are currently described as multi-tied advisers as to independent advisers, it is less obvious that advisers employed by banks and other product providers – to advise solely on their own products – would be able to adopt exactly the same standards. So we may need to apply requirements in different ways for different types of non-independent firm, but in doing so we will want to remain focused on delivering equivalent outcomes for consumers. We aim to hold discussions with both the independent and non-independent sector to determine the best way forward as we work up our detailed proposals ahead of consultation in June 2009.

5.22 We are particularly keen to apply equivalent disclosure of charges to all types of firm. However, providing the right information to consumers to help them to make informed choices is not a straightforward task. Although firms have had to disclose their own costs in the past they have not previously had to consider what a customer actually pays through implicit or explicit charges for different elements of the full service. Putting a figure on this may be an arbitrary process for some as the cost of the product and advice is tied up in aggregated charges, and there are lots of cross-subsidies within and between the product portfolios of a firm. But a low stated charge for advice could be mirrored by a higher implied charge for the product – it may not be easy for a firm to offer competitive cost elements for both simultaneously.

5.23 We will also consider the banking reform work we are doing on internal remuneration and how this may assist achievement of the standards we require. The recent 'Dear CEO[1]' letter contains a number of points that could be read across to remuneration practices for advisers. For example, the traditional model of a base salary with significant extra bonus payments made on the basis of revenue generated (i.e. products sold) may lead to advisers being primarily motivated to sell products to consumers rather then offer appropriate advice. Any adverse consequences can be partly mitigated by scaling bonus payments according to certain 'quality' factors, which may include persistency. How effectively these arrangements address the risks of poor consumer outcomes often depends, however, on how well management exercises broader controls over sales activity.

Professionalism for non-independent advisory firms

The issues for non-independent advice

5.24 The wider market reputation concerns, that are a key driver of our professionalism work, apply equally to all in the retail investment market providing services to consumers, irrespective of distribution channel. We therefore intend that the

1 www.fsa.gov.uk/pubs/ceo/ceo_letter_13oct08.pdf

framework for professional standards on advice that we discuss in Chapter 4 should also apply to sales services.

The intended outcomes for non-independent advice

5.25 We want to consult on proposals for a general principle of equivalent professional standards for equivalent roles, irrespective of the distribution channel. This does not mean the same standards for every different role – so, for instance, as with independent advisory firms, there may be higher requirements for specialists than for generalist advisers. It is, of course, also likely that some advisers will choose to gain higher standards than the minimum.

Proposals for non-independent firms

5.26 Our proposed approach to raising professional standards, including our response to the Professionalism Group's recommendations as set out in Chapter 4, will apply to non-independent advisers in the same way. For this reason we do not repeat these here. We believe that the possible creation of an Independent Professional Standards Board (IPSB) should govern professional standards in non-independent advice and deliver a similar 'step-change' in actual minimum standards as in the independent advice sector. If established, it will be the responsibility of the IPSB to make the judgements on required standards for different roles, in conjunction with the Financial Services Skills Council when appropriate.

5.27 Since we published the IR, several providers of tied and multi-tied advice services have strongly argued that the required capabilities for their advisers should be fundamentally the same as for independent advisers. Many of these firms have highlighted either their willingness to observe higher professional standards in future, or outlined steps they have already taken in this regard as well as some of the benefits they have seen.

Guided Sales

Overview of issues and progress

5.28 In the DP, we commented that raising the standards for those supplying full financial planning services could further restrict the supply of advice services, particularly to less affluent consumers. To address this potential problem, we put forward ideas in the DP based on suggestions from the Consumer Access Group – one of the five groups of market representatives and other stakeholders that met in the first half of 2007 – to consider market-wide issues. We suggested the need for a new form of regulated advice service – which we called 'Primary Advice' – which would deliver a more straightforward service for those consumers with more straightforward needs.

5.29 We describe in more detail the feedback we received on Primary Advice proposals in Annex 1. In summary, many respondents feared that the risks of consumer detriment from such a service were too high. There were concerns that consumers would be insufficiently clear on the limitations of such services and that new widespread mis-selling issues could emerge, seriously damaging consumer confidence in the whole investment advice profession. But there were some who supported the aims of Primary Advice, recognised (as we did) that the ideas were 'green', and urged us to take this work further.

5.30 So in the IR, we moved away from the name 'Primary Advice' because feedback suggested the potential for confusion. As a starting point for further discussion, we introduced 'guided sales', positioning this as an information-providing non-advised process that leads to some people choosing to buy a product. We said that the purpose of guided sales was to allow consumers to make simple, straightforward choices, and that it was important that they understand the nature and limitations of services being provided. The IR challenged the industry to make the case to us if they wanted us to take action to enable them to operate any other form of new sales services. We were clear that we would only design a new enabling regulatory regime if the industry made a strong enough case for it and that case would need to make clear how consumer protection issues were addressed. We also made clear that we would not design the business proposition for these services.

Taking forward the industry challenge

5.31 The challenge was explored in part through a roundtable group with representatives from the British Bankers' Association (BBA), the Association of British Insurers (ABI), the Association of Independent Financial Advisers, the Financial Ombudsman Service (FOS), the Financial Services Compensation Scheme, Which?, and the Financial Services Consumer Panel. This roundtable group was established in response to feedback from those interested in developing guided sales processes who suggested that the way in which the FSA and the FOS judge transactions would be a significant factor in the decision about whether to offer the service. Their concern was uncertainty about liability – they wanted more clarity about the dividing line between giving information and giving advice, assurance about how the service would be judged, and confidence that it would not be judged against a subsequently revised standard. We have also met with a number of firms to discuss their ideas for new sales services.

5.32 Ideas for possible business propositions for new guided sales services have broadly taken two forms. First, business models that are non-advised processes – we will now call these non-advised guided sales. Second, business models that would constitute investment advice and a personal recommendation under our rules – we will now call these simplified advice processes. On the whole, firms' models were at fairly early stages of conceptual development. As such, firms had not yet quantified the level of demand for the proposed service, demonstrated the underlying economics and commercial viability of their models, or explained in detail how consumer protection issues would be addressed.

5.33 We have concluded that, as yet, no case has been made for us to take action to develop a new regulatory regime for simplified advice processes. However, we are ready to help firms develop their proposals for new services within the current regulatory framework and will continue to work with interested firms to this end. There is considerable scope within the current regulatory framework for firms to provide streamlined services, both non-advised guided sales and simplified advice processes. It is clear, however, that there is a degree of misunderstanding about what is required by our rules, what is and is not permitted, and what does and does not constitute regulated advice, as we discuss below.

Two options for firms

5.34 In the absence of a case for developing a new regulatory regime to enable guided sales services, there are two broad options for firms wishing to develop new services:

- develop a truly non-advised process within the meaning of our rules; or
- develop an advised process within our current rules.

5.35 In many cases, for instance where firms want their process/service to include a personal recommendation, it will be necessary to pursue the second option. Many firms consider a personal recommendation a necessary element of the process in order to ensure sufficient take-up of products. Any process that involves a personal recommendation will constitute regulated advice and so firms will need to design their processes to meet the relevant requirements, such as the suitability requirement. As we discuss in more detail later, the suitability requirement is a flexible standard, determined with reference to the nature and extent of the service provided. As such, there is already scope for firms to design simplified advice processes that are capable of meeting it.

5.36 Firms considering the first option should be aware that even if a process is not regulated advice within the meaning of our rules, it may still be advice under the general law and be judged as such by the FOS and the courts. Accordingly, firms may derive greater certainty and better manage their risk by pursuing the option of developing an advised process within our current rules.

5.37 Regardless of which option firms pursue, it will be vital for them to ensure that their customers understand the service they are being offered and any limitations in scope and/or regulatory protections.

Is it regulated advice? – Understanding the boundary

5.38 Non-advised guided sales services can be delivered within the current regulatory regime. However, it appears that firms may be unclear about what does and does not constitute advice regulated by us. For example, we have seen business models for new services that the designers intended to be non-advised processes, but that would constitute investment advice under our rules because the process added up to an implicit 'personal recommendation'. We recognise the attraction for the industry of reduced liability associated with a non-advised service, but in light of the risk of crossing the boundary into advising on investments, or providing what might be interpreted as 'advice' under the general law, firms may derive greater certainty if they design their models as advised processes that satisfy the suitability standard.

5.39 This lack of clarity about what does and does not constitute advice could potentially deter firms from offering non-advised guided sales services. With this in mind, we are publishing a set of Questions and Answers which were originally developed for the roundtable group we refer to above, to help them better understand the boundary between advised and non-advised processes. This material, which can be found in Annex 7, should be of assistance to firms developing new processes in helping them assess whether their process is advised or non-advised and the reasons why.

Suitability – scope for simplified advice processes

5.40 In designing possible models for new services, many we spoke to in the industry felt that in order to produce a sufficiently high conversion rate and ensure commercial viability, the process would need to involve some form of personal recommendation to the client. Firms were keen to understand the implications of providing a personal recommendation, in terms of what is required by our rules, particularly the suitability requirement.

5.41 Our discussions with the industry revealed that there is some misunderstanding about the suitability requirement. Specifically, firms seem to have an unnecessarily restrictive interpretation of the suitability requirement, though this may reflect their anxiety about how simplified advice processes will be assessed by us and the FOS. This misinterpretation has the potential to act as a barrier to firms developing and offering simplified advice processes. Accordingly, we are publishing in Annex 8 a short document about the suitability requirement, also initially prepared for the roundtable group. As the document makes clear, suitability is a flexible standard, determined with reference to the nature and extent of the service provided. As such, there is scope for firms to design simplified advice processes that are capable of meeting the suitability requirement within the current regulatory framework; and firms may find that such services provide greater certainty regarding liability than would be achieved by a service that operated on the boundary of non-advice. Firms may find this material of assistance when developing their ideas for simplified advice processes.

How we can help

5.42 A key issue for firms considering providing new services is uncertainty, particularly uncertainty about liability. We could provide firms with greater regulatory certainty by providing guidance in relation to these types of services.

5.43 There are two forms of guidance that we could provide: general guidance and individual guidance. Alternatively, it might be possible to provide clarification through FSA supporting materials or by confirming industry guidance. Guidance could cover areas such as the products that can be delivered through simplified advice processes; the information about the customer that should be collected and analysed; and achieving customer understanding of the limitations of the service and of the risks and potential rewards associated with the products. But there is a clear trade-off between the level of regulatory certainty that guidance provides, for example through the level of detail in the guidance, and the flexibility for firms to innovate.

5.44 At this point, we have decided that providing guidance specifically on simplified advice processes is premature. Firms are still in the early stages of developing possible models and there is a risk that if we provide guidance now, this could restrict the ability of firms to innovate and design new models. There is not yet a clear industry view on the extent and form that any additional guidance should take. There is a risk that by providing detailed guidance now, we effectively design a process, thereby restricting the ability of firms to design their own unique processes to suit particular products and business models.

Professional standards for guided sales

5.45 As noted in Chapter 4, much of the Professionalism Group's work took place before we could give certainty about the proposed nature of advised services. In the case of guided sales, this uncertainty persists. If and when these services develop, our view is that an IPSB will have a role to play in setting appropriate standards for those offering simplified advice processes. In particular, knowledge levels will be a matter for the IPSB and the Financial Services Skills Council to address depending on the precise nature of the roles that individual firms deploy.

5.46 For those offering non-advised guided sales, we also expect that the IPSB would have a role in setting professional standards, potentially with more focus on standards of practice than knowledge levels.

Next steps

5.47 At present, no case has been made for us to develop a new regulatory regime to enable firms to provide simplified advice processes. There is scope within the current regulatory framework for firms to provide both non-advised guided sales and simplified advice processes. We recognise that firms may need more time to develop their models for new simplified advice processes and that the material we provide in this FS may inform their thinking. We are keen to help firms develop their proposals for simplified advice processes within the current regulatory framework and will continue to work with firms to this end where their models are sufficiently well-developed and supported by thorough analysis.

5.48 In July 2009, after publication of the Consultation Paper for other proposals in this FS, we will look again at whether, in the light of models being designed by firms and any other new evidence, we should take further action to enable these simplified advice processes.

Basic Advice

5.49 We include Basic Advice in this chapter because it is a simplified sales process that has many similarities with some of the ideas discussed with firms for guided sales.

5.50 Basic Advice was introduced in April 2005 as a new form of regulated advice for the sale of 'Stakeholder' saving and investments products, following the Sandler Review[2] recommendations. Following its subsequent introduction, we announced in CP06/19 Reforming Conduct of Business Regulation (October, 2006) that we would conduct a full review[3] of Basic Advice in recognition that the market for Basic Advice had not developed as expected.

5.51 The findings of this review suggested that there were low levels of demand for investment products amongst consumers likely to be in the target market for Stakeholder products. At the same time firms surveyed as part of the review reported that they were unwilling to supply Basic Advice because of the low margins (a result of a combination of low premiums and capped charges) and high perceived regulatory risk. This led us to conclude that together these factors resulted in a relatively small market for Basic Advice.

5.52 In light of these findings we intend to consult on withdrawing the rules around Basic Advice. Given that the volume of products sold through Basic Advice represents a very small proportion of the market, this would not be expected to have any material effect on the sales of stakeholder products. Moreover, we recognise that for some firms, Basic Advice has been incorporated into their business model and we would therefore look to consider waiver applications where these were appropriate. However, we will also consider further how the positive aspects of the Basic Advice process could be incorporated in any simplified sales and advice processes which the industry develops.

Non-advised sales

5.53 In the IR we set out two forms of sales, both of which can be offered today, namely Execution-Only and non-advised guided sales. We discuss guided sales above.

5.54 With Execution-Only, the customer knows precisely what they want to buy and does so. The proposed national Money Guidance service may boost demand for Execution-Only services as more people will be receiving help with their financial affairs which may result in them taking their own financial decisions.

5.55 We also need to consider pricing issues for non-advised transactions. Often the cost to the consumer of buying certain products, particularly life assurance products, is the same whether they take advice or not. However, if we are to require for independent and non-independent advice, that there is separation of the cost of advisory services and the cost of the product, then a consumer might expect a lower price when buying products directly without taking any advice. We would not necessarily expect a provider's product costs to be the same for all channels of distribution, and prices may reflect many factors including different target customer characteristics (e.g. propensity to lapse, and where relevant, mortality experience) and different marketing costs.

2 Sandler Review: Medium and Long-Term Retail Savings in the UK – www.hm-treasury.gov.uk/d/summary.pdf

3 Basic Advice Post implementation Review – www.fsa.gov.uk/pubs/Basic_Advice_PIR.pdf

5.56 With Execution-Only transactions there can still be an intermediary (e.g. 'Discount Brokers'), and we intend to apply similar disclosure standards so that the costs of their services are separated out. We will also consider how professional standards should apply to individuals providing intermediation services but who are not providing advice. However, as with non-advised guided sales, standard setting would fall to the Professional Standards Board in the same way as we anticipate for those supplying forms of advice.

6 Transitional arrangements

Our broad intentions

6.1 Implementing the proposals described in this paper is likely to require significant actions from many firms and individuals. We will also have to make changes, not only to our Handbook, but also to some of our supervisory approaches. We will consider this in more detail as we develop our policy proposals ahead of the Consultation Papers (CPs) next year.

6.2 We want any new regulatory requirements and industry-led initiatives resulting from the RDR to be implemented in a manner that causes minimal disruption to consumers, to firms and to individuals. However we also want all beneficiaries of the RDR changes to take advantage of the opportunities as quickly as possible; we need to maintain the momentum for change that has built up over the course of the review; and we need to be prepared for the future.

6.3 In designing these transition and implementation plans, we have taken into account:

- the responses to the Discussion Paper (DP) and Interim Report (IR);
- the results of the market impact and high-level cost benefit analyses we have undertaken;
- the feedback on professional standards and the recommendations of the Professionalism Group;
- the need for a realistic timetable for consultation, Handbook development and implementation of new rules;
- the need to provide support through the transition, principally by trade and professional bodies, particularly to smaller firms affected by the RDR; and
- the lead time for firms and us to make significant systems changes.

6.4 We are also mindful that market conditions when we publish this paper may limit the extent to which some firms can progress transition, at least in the short term. We have sought to balance out all of these factors in determining what now follows in this chapter.

Implementation deadline

6.5 The overall proposal for consultation is for the industry to have implemented all RDR propositions by the end of 2012. This gives firms and individuals just over four years from publishing this paper to full implementation. Many respondents to the original DP, and more recently to the IR, have suggested that firms and individuals will need between three and five years to transition to any new arrangements. This is based principally on the time it takes to undertake the necessary exams to meet new qualification standards (and for training and examination bodies to take people through) and on the likely time for systems changes to be made to implement remuneration changes. We must also factor in the time it will take to complete the regulatory processes to change our Handbook, ensure full consultation and change our supervisory approaches where appropriate.

6.6 2012 for implementation has other benefits:

- 2012 coincides with the introduction of Personal Accounts. Personal Accounts pose new challenges for consumers, potentially increasing the need for good quality, and trustworthy, advice;
- 2012 coincides with the implementation of Solvency II for insurers, and gives firms time to consider the accounting implications of proposed changes; and
- assuming the Money Guidance Pathfinder is a success, the full national roll-out will be well underway if not complete, potentially bringing more people into the regulated market.

6.7 Firms and individuals will of course be at liberty to implement some of the proposals earlier than 2012: we recognise that many started this journey some time ago and encourage others to do so. Some firms and individuals may choose not to meet the step-change requirements anticipated by the RDR and may see this as the appropriate time to retire or leave the industry and, although not our preferred option, this timetable would enable an orderly wind-down or sale of those businesses.

Transition

6.8 Table 1 sets out a high-level implementation plan. The timings should not be regarded as finalised at this stage as they will depend on more detailed policy development and consultation processes. We will publish a more detailed plan as part of the CP next year.

6.9 Of particular interest to advisory firms will be the proposed arrangements for upgrading the knowledge standards for current advisers. As we discuss in Chapter 4, we expect to finalise the arrangements for testing competencies in mid-2010. We do not, at this stage, rule out some form of non-examination based test for existing advisers. However, advisers may choose to upgrade their qualifications by passing an appropriate QCA level four course. This would be a ‘no regrets’ move, even though at some point in the transition period we expect the structure and content of such courses to change to more appropriately reflect up-to-date role requirements.

6.10 A staggered implementation of some of the RDR propositions appears to be sensible and appropriate. This is particularly the case where we anticipate that industry solutions will prevail where there are no apparent reasons why implementation could not be as early as mid-2009. For example, if we enabled a guided sales 'regime' by giving general guidance early in the transition, this would help deal with the concerns that there might be an advice gap as some firms transition or choose to leave the industry.

6.11 Similarly, we believe that part of a suite of professional standards will be standards that could address some of the risks associated with advisory firms having full responsibility for remuneration arrangements. So we may wish to see at least the ethical and behavioural professional standards put in place as early as possible, even if it takes longer for the qualifications to be attained.

6.12 More detailed regulatory implications, such as changes to reporting requirements, our supervisory strategy and any changes that might be made to the packaged product regime (as a result of proposals we are consulting on to change independence rules) or other regimes, are difficult to determine until we have finalised and set out detailed rule requirements in the CP in 2009. Nevertheless, it seems unlikely that we would be ready to consult, make policy and implement much earlier than 2011.

Table 1
High-level provisional timetable for staging transition

	2009	2010	2011	2012
Professional standards	• Consult on FSA acting as interim Professional Standards Board (PSB)	• Policy Statement containing final Handbook text • Establish interim PSB • Establish the case for creation of independent PSB with statutory powers or retaining as part of the FSA • Finalise appropriate competencies for different roles and agree how existing advisers should be tested • New entrant advisers required to obtain new qualifications	• PSB establishes codes of ethics/behaviours and starts monitoring of advisers	• All advisers must have passed competency tests by year-end (possible that some others can continue subject to appropriate oversight)

<table>
<tr><th></th><th>2009</th><th>2010</th><th>2011</th><th>2012</th></tr>
<tr><td>Remuneration</td><td>• Publish CP containing draft rules to implement RDR proposals</td><td>• Policy Statement containing final Handbook text
• Consult on changes to regulatory reporting</td><td>• New rules requiring independent advisory firms to set own charges come into effect
• New rules and guidance on disclosure of costs of advice services and product costs come into effect</td><td>• New rules requiring product providers to no longer determine or price commission into products come into effect
• New rules to prevent factoring of payments for advice (which will also prevent indemnity commissions)
• Further tighten up monitoring of indirect benefits
• First submissions under new regulatory reporting due in 2013 based on end 2012 data</td></tr>
<tr><td>Conditions for independence</td><td>• Publish CP containing draft rules to implement RDR proposals</td><td>• Policy Statement containing final Handbook text, including guidance for firms on new criteria</td><td>• New rules come into effect</td><td>• All firms wishing to describe their services as independent adhere to all standards for independence</td></tr>
<tr><td rowspan="2">Other changes</td><td rowspan="2">• Continue industry discussions on Guided Sales
• Consumer research into descriptions for services
• Policy Statement on new prudential rules for Personal Investment Firms</td><td>• Review need for general guidance on Guided Sales, if appropriate</td><td>• Introduce new descriptions for services</td><td></td></tr>
<tr><td colspan="3">• Staged, stepped introduction of new prudential rules (further detail is in the Consultation Paper on review of prudential rules for Personal Investment Firms)</td></tr>
</table>

Specific proposals

6.13 There are a few specific transitional issues that we are currently considering. We intend to confirm these when we publish the CP in 2009.

- It may be sensible to introduce a requirement for advisers to set their own charges ahead of a requirement for product providers to stop building pre-set commission into their products. In this case, advisers would be required to rebate any commission over and above that needed to pay their charges.

- While the collection of adviser tariff information might be needed in time for the roll-out of compulsory adviser charging, other mitigating actions could be introduced either on a slower track or a 'wait-and-see-if-needed' basis.

- There may be some grounds for further staged changes for certain proposals. We would need to be satisfied that there were appropriate interim arrangements to address any risks arising specifically from making changes in this way.
- We will need to ensure a coherent approach to change. For instance, we may introduce some changes to the landscape only once we have identified (through consumer research and testing) the right descriptions and labels, and then to do this hand-in-hand with a major consumer awareness campaign. It might be that the Money Guidance Pathfinder or national service gives us that opportunity but we should not rely on that alone.

Assisting firms and individuals to transition

6.14 We want there to be help for those, perhaps in smaller firms, who may find the scale and scope of changes daunting or confusing. We think it is vital to offer a coordinated support service, perhaps through professional and trade bodies, throughout the transition period. This would aim to help people to see what needs to be done and to help them to recognise how it can be achieved. We will discuss this with relevant bodies but we are pleased to see that some have already factored this into their short term business planning. We may also need to play a specific role in facilitating this and in communicating the availability of support.

6.15 A number of areas for support are likely, including:

- general support on what actions firms and advisers might need to take;
- training support for firms and advisers;
- guidance for firms on transforming the income profile of their businesses; and
- guidance for firms on raising capital to meet new requirements and to pay transformation costs.

6.16 Conversely, we have also seen some product providers launching 'academies' and other support facilities for advisers wishing to increase their qualifications. Whilst some models are well-meaning, we will need to be sure that these do not constitute inducements that would create unmanageable conflicts or otherwise distort advice processes.

Risks and other issues

6.17 We have identified a number of other possible implementation risks which we will want to address. As is often the case with any major transformation, there are risks of certain detrimental behaviours in the run-up to implementing new rules. Possible areas where such behaviours might occur and where we will be paying particular attention through supervision and by gathering other intelligence include:

- providers offering 'closing down' commission deals to encourage a flood of new business in the run up to 2012 on provider-determined commission terms;

- provider firms finding ways to circumvent our intended outcomes through alternative financing arrangements with advisory firms, or advisory firms seeking to raise financing by providers by threatening the withdrawal of future support and/or systematic switching-out of customers' investments; and
- advisers seeking to maximise income before initial commission is withdrawn by churning customers' investments and products.

6.18 We intend to intensify our monitoring of areas such as these during the transition period, and we will not hesitate to act against significant abuses.

7 Research and analysis

Introduction

7.1 As we described earlier in this paper, since we published the Interim Report (IR) we have undertaken further analysis and research to help us to understand the impact of the simpler future landscape set out in that paper and to enable us to refine our thinking accordingly.

7.2 The key research and findings are summarised in this section. Certain associated full research reports can be found on our website[1].

Analysis of impact on firms' business models and customers

The previous landscape (as set out in the IR)

7.3 We carried out internal analysis of a range of business models in the market and their customer bases and how they would be affected by the previous landscape set out in the IR. In particular, we considered the extent to which some multi-tied and tied firms would be able to change their business model (for instance by adapting to the new requirements for independent advice) rather than leave the market. We concluded that under that landscape proposal there was a significant risk of fewer advice firms and fewer advisers, at least in the short term. In particular there was likely to be a shortage of advisers prepared to deal with mass market consumers, especially those with the means and a need to buy regular premium investment products. Consumers seeking regulated advice would also be likely to have to pay more for it.

7.4 We considered product providers and the impact that the IR landscape would have on their distribution strategies, as well as on their product ranges and product pricing strategies. We concluded that, under certain conditions, adverse financial impacts on some providers could result from an inability to distribute through tied and multi-tied advice channels.

1 www.fsa.gov.uk/pubs/consumer-research/crpr70.pdf; www.fsa.gov.uk/pubs/other/Basic_Advice_PIR.pdf; www.fsa.gov.uk/pubs/other/basic_advice.pdf; www.fsa.gov.uk/pubs/consumer-research/crpr71.pdf; www.fsa.gov.uk/pubs/consumer-research/crpr72.pdf; www.fsa.gov.uk/pubs/consumer-research/crpr73.pdf.

Refined landscape

7.5 Following the initial analysis, the landscape was refined so as to reduce the adverse impact on consumers and firms. As we developed this refined landscape, further internal work was carried out to analyse the impact that possible final proposals might have on the retail investment market. We also started to develop mitigating strategies for some of the risks identified by our analysis.

7.6 Advisory firms currently offering whole of market advice (which may or may not be independent, i.e. offering a fee option) and wishing to provide an independent advice service in the new regulatory landscape will have to be equipped to give a comprehensive and fair analysis of their relevant markets. These firms might need to undertake a range of transitional activities, potentially including:

- redesigning customer processes to accommodate changes to remuneration;
- re-skilling staff to meet new standards of professionalism;
- altering or removing contractual arrangements with product providers; and
- reviewing systems, processes and controls to ensure they are able to maintain awareness of what is available in their relevant markets and are free to select appropriate solutions for their clients.

7.7 Remuneration changes are likely to impact most on those firms that are predominantly remunerated by commission. Independent advisers are currently required to offer a fee option. Deloitte analysis[2] suggests that if commission-based intermediaries can adopt a range of fee structures (e.g. a mix of fees based on the value of transaction, fund-based fees and hourly fees), then in the short-term many may use an approach to fees that mirrors the complex and varied structures of commissions, albeit with terms they now set for themselves.

7.8 Product providers may incur costs in changing their systems, to accommodate forms of 'factory gate pricing' and to accommodate a range of adviser charges into their design and administration of products.

7.9 The above description of some of the compliance costs that firms are likely to incur are considered further together with other costs and the potential benefits in the high-level cost benefit analysis (see below).

Potential consequences for firms operating in other markets

7.10 The RDR proposals may have further consequences for investment firms that also operate in mortgage and general insurance markets. We have not carried out an in depth analysis yet. However, preliminary analysis of firms' business models suggest that for example, some banks may consider reflecting the changes required for their investment distribution business by applying the same model to both investment and non-investment business. Similarly, insurance firms may decide to adopt the same model for distributing their investment and general insurance products, and this might

2 www.fsa.gov.uk/pubs/other/deloitte_research.pdf

in turn impact product design in both markets. We discuss our plans for assessing the case for applying some of the RDR proposals to other sectors in Chapter 1.

Research on adviser cost and remuneration structures

7.11 To inform our proposals on remuneration structures, we commissioned a piece of research to assess the profitability of investment intermediaries. The aim of this research was to enable a better understanding of the variety of business models that exist in the intermediary market, the main drivers of costs and how profitability is managed. The research would also help to assess whether any widespread change in remuneration models would change or clarify for firms the costs of providing services and postulate what impact this might have on the supply of advice and the access to advice for consumers.

7.12 A mixture of qualitative and quantitative research was used to collect data on intermediary costs, revenue and behaviours and focussed on the construction of a model – populated by both primary and secondary research data – which would analyse current patterns of profitability, cross subsidies and the potential impact of changes in remuneration structures. The results gave us an indicative view of how various business models might be affected by changes in their remuneration structures.

7.13 The research found that cross-subsidies between products, across case sizes and, by implication, across customers, exist in current commission-based business models. A regulatory proposal that implied a shift towards a mainly fee-based remuneration structure would mean that these cross-subsidies may no longer be sustainable in their current format although other ways of cross-subsidising may arise. Also, if fee-based remuneration was fixed across all product categories (e.g. hourly-fees) it would probably mean that the cost of advice would become disproportionately high for small-size cases to the detriment of consumers.

7.14 The research also demonstrated that existing fee-based structures vary significantly and are capable of mirroring complex commission shapes. On this basis it is likely that in order to maximise the retail market they are able to serve, firms would probably tailor these structures to reflect their services in a way that is clear and acceptable to a variety of consumers.

Consumer research on streamlined sales processes

7.15 We conducted consumer research in relation to streamlined sales processes to understand the type of service that consumers want. We commissioned some qualitative consumer research[3] to help understand the barriers which may be preventing consumers from engaging with the investment sector and to explore consumers' needs and wants in relation to accessing investment advice and products.

7.16 On the barriers to investing, the research found that consumers had different attitudes towards saving and investing. While many agreed that in principle it was a good idea to save, the same could not be said for investing. Consumers found the

3 Qualitative research is an approach used to explore a theme or issue in depth with a relatively small sample of people.

subject of investments quite difficult. Some consumers said they would use an adviser to help them, others said they felt 'unworthy' of advice which they saw as being for people with more money and knowledge than them.

7.17 In terms of the type of service that consumers would value, their ideal advice model was very similar to the service provided by independent financial advisers – albeit many consumers said they did not use this service or really see it as being for them. Consumers felt that personalisation of the process and a reasonable amount of time face to face with the adviser were of greatest importance.

7.18 The research suggests that in order to be effective in attracting smaller investments from a wider base than current users of advice, a streamlined service needs to be widely adopted, supported and promoted, and it needs to be clearly focused on inviting small investments.

Long-stop

7.19 The IR said that although feedback from firms and trade bodies had been largely in favour of a 'long-stop' time limit on the period within which complaints must be brought, and consumer bodies strongly opposed a long-stop, we had not been able to identify net benefits to consumers and firms (such as greater consumer access and saving) that would arise from introducing one. The IR asked for further information to help our thinking.

7.20 We did not simply wait for responses, but approached trade associations to explain what sort of information would be needed to build a case for introducing a long-stop. We had similar discussions with a large advisory firm that approached us, and with a corporate finance adviser. Our conclusions are described in Chapter 4.

Cost Benefit Analysis (CBA)

7.21 Since the April 2008 IR we have undertaken further cost benefit analysis to inform RDR proposals. In particular, we have worked with academics at the University College London (UCL) and consultants to analyse consumer and firm behaviour in response to proposals.

7.22 A detailed cost benefit analysis of the RDR is challenging. The proposals are not independent of each other and the dynamic nature of the market means it is difficult to identify the baseline. Importantly, there are a number of factors that could lead an intermediary not to give suitable advice or to make an unsuitable sale. The success of the RDR depends upon the combination of measures counteracting these factors.

7.23 There is the potential for consumers to benefit from better quality advice and a wider variety of advisory models. However, there are risks that may prevent these benefits from arising, and further consultation and analysis, to review the design of these measures, is needed before we can draw conclusions. Further research is also needed to estimate the costs of the proposals. Consequently, this section presents an analysis of the potential costs and benefits of the set of proposals. It does not give a detailed assessment of costs and benefits in aggregate. The benefits are contingent on certain conditions being met but not all conditions are relevant to each market. Furthermore, even if not all conditions are met in the market to which they apply, the RDR package of proposals may still result in net economic benefits. The table below sets out our high-level analysis. More detail is available in Annex 3.

Table 2: High-level CBA

Proposals and their impact on incentives and behaviours in the market

Proposals	Benefits	Costs	Conditions for net benefits – not clear yet if met
Improved labelling of landscape	Improved match for some consumers between preferred quality level and selected service level	Compliance costs of effectively informing consumers about labels	Consumers understand and act on labels
Remuneration (adviser sets price of advice)	Removes provider bias (and may reduce product bias) leading to improved adviser recommendations and, presumably therefore, consumer purchases	Compliance costs Price discrimination and excessive charging Possible reduced competition between providers if reduced influence on advisers leads to greater use of tied sales forces and similar	Effective mitigating measures put in place to prevent providers from replacing commission with other ways to influence behaviour of advisers that are costly to consumers Mitigating measures prevent price discrimination/excessive charging by advisers Benefits of reduction in provider bias greater than compliance costs and possible reduced competition between providers
Professionalism and training for advisers	Improves adviser recommendations and, presumably therefore, consumer purchases	Compliance costs Other price increases due to reduced supply of advisers and their higher expected remuneration, possibly leading to reduced consumption	Benefits to consumers from better purchases exceeds price increase/ reduced consumption that occurs due to increased cost of professionalism and training (Underlying assumption: lack of training and professionalism is one driver of poor quality of advice)

Proposals	Benefits	Costs	Conditions for net benefits – not clear yet if met
Independence (i.e. independent advice will have to be based on a comprehensive and fair analysis of relevant markets)	Improves adviser recommendations and, presumably therefore, consumer purchases	Compliance costs	Benefits from improved product purchases greater than price increase/ reduced consumption arising from compliance costs arising from independence requirements
Simplified advice processes	Increases access for some consumers to a form of advice, leading in some cases to more advantageous transactions (e.g. through improved match for some consumers between preferred quality level and available services, or through more suitable sales) and in some other cases to advantageous transactions that would not otherwise have occurred	Consumer detriment if firms fail to provide advice that is suitable with reference to the nature and extent of the service or the customer's understanding of it, or if customers use the service when it is not appropriate for them	Simplified advice processes are economically viable for firms to provide, and firms achieve sufficient greater confidence about the associated liability to offer them Increased access to advice through simplified advice processes and resulting suitable product purchases by consumers exceeds any detriment should firms not deliver advice that is suitable in the context of the service provided Mitigating measures (for example: FSA guidance, FSA supervision, and firms' arrangements to filter out customers for whom service is not appropriate) significantly reduce risk of consumer detriment

7.24 We will undertake research with firms and further analysis to produce an estimate of the compliance costs associated with RDR proposals. We will also conduct research to look at how consumers might engage with the proposed advisory landscape.

Feedback on DP07/1

Introduction

1. We received 888 responses to Discussion Paper DP07/1 'A Review of Retail Distribution'. Many of the respondents answered the individual questions in the DP. Others wrote to us setting out their views on the ideas in the DP in a more general way, and stating what action they thought the FSA should (or should not) take. Some respondents provided both general feedback and answers to the specific questions.

2. Both types of response were welcome. We realise that providing a general narrative was easier for some small firms for whom responding to the DP involved a significant commitment of management time. We were delighted with the engagement by small firms.

3. Respondents included trade, professional and consumer organisations, firms of independent financial advisers (both directly authorised and appointed representatives), banks, building societies, life companies, discretionary investment managers, authorised professional firms, general insurance intermediaries, mortgage intermediaries and compliance consultants. The majority of respondents were firms of independent financial advisers (IFAs) or advisers working within them.

4. When considering the responses to consultations, the number of responses to a particular question or issue is of some relevance but we will not necessarily determine policy in accordance with the view expressed by the majority of respondents. Weighting responses in accordance with firm numbers might give a disproportionate importance to sectors that did not, for example, reflect their market share. Responses from consumers are relatively few, and so such an approach may not reflect their interests. The FSA must also have regard to its statutory objectives and the principles of good regulation. Therefore we have not provided a numerical analysis of the responses to each question.

5. As we explained in the RDR Interim Report (IR), the feedback to the DP, both oral and written, could be summarised into areas of apparent consensus and areas where there were pockets of consensus. Areas of apparent consensus were:

   - The DP proposals were too complex – there were too many tiers of adviser and advice.

- The demands and responsibilities of different roles in today's market necessitate raising minimum professional standards (which means skills and behaviours as well as knowledge).
- The most appropriate minimum qualification for advisers should be below the highest of the several levels suggested in the DP.
- The FSA must not dilute the advice brand – so primary advice[1] should not be labelled as 'advice'.
- Methods of remuneration should not be closed down – the FSA should apply a more principles-based approach.
- Independent means 'whole of market'.
- Liability risk is a barrier to market development.

6. Pockets of consensus described in the IR were:
    - The regulated market must align with Money Guidance[2] (but some thought there would be little or no overlap between target consumer segments).
    - A 'long-stop' limitation period should be introduced for complaints (but consumer groups were strongly against this and some firms thought this would adversely impact the industry's reputation).
    - Make membership of a professional body mandatory for advisers (but some thought this would be tantamount to dual regulation).
    - There is no need for primary advice (but some thought it was needed).
7. This feedback to the DP informed the revised view of the regulatory landscape set out in the IR, and the debate about the RDR moved on from the proposals in the DP. As a result some of the questions in the DP are now less relevant.
8. The proposals that we now intend to take forward to consultation have been informed by the written and oral feedback to the DP, the feedback received on the IR (see Annex 2), and our own research and analysis. While readers will see how feedback to the DP has shaped our thinking, for example about greater clarity for consumers about services, they will also see that there are issues where we have decided we should follow a different course of action than that favoured by the majority of respondents.
9. This chapter summarises the feedback by referring to each question in the DP. To ensure this is complete, we have read each general response as well as the responses to individual questions, to ensure that major points of feedback in the former were captured.

1 This was the name given in DP07/1 to a possible new simplified advice service.

2 See footnote 2 in the Overview.

Professional Financial Planning and Advisory Services – Full Advice

Q1: How will increased requirements and consequential higher costs of providing full professional financial planning services affect advisory firms? Could the impact be significant enough for them to no longer offer these services, and, if so why?

10. There were many comments pointing out that if costs went up then firms would need to be more selective about the clients they would then serve and that in some cases their advisory charges might have to rise. Concerns were expressed that this may mean some consumers no longer being able to access advice and being forced to accept a 'lesser' service.

11. A significant number of respondents, particularly individuals and those representing small firms, thought these proposals would drive advisers out of the industry. Others were fearful that this would drive firms out of the market, with some comments that small firms were most at risk.

12. But there were also many who disagreed that there would be a detrimental market impact. Some of these argued that there were many firms already operating to these standards and that as those most affected were those who had most to do to deliver higher standards it was not necessarily a bad outcome for some of these firms to leave the market. Others commented that we should regard the costs as a long-term investment that would bring long-term benefits to consumers and firms.

Our response: Chapter 3 explains our conclusion that raising professional standards, removing provider influence from remuneration for independent advice, and seeking equivalent remuneration standards for non-independent advice will help rebuild trust and contribute to improved consumer outcomes. Chapter 4 explains that we have chosen to consult on a lower minimum qualification than that envisaged for 'professional financial planners' in the DP.

Q2: Is it helpful to re-define the term 'fee-based' to mean any advisory remuneration derived in discussion with the customer, and not influenced by the product provider? How would this work in the different market sectors?

13. This question gave respondents an early opportunity to offer a wide variety of views on remuneration issues.

14. A significant number of respondents thought that it was helpful to move to what the DP called 'Customer Agreed Remuneration', possibly relabelled as 'fees', irrespective of whether payment is made through a purchased product or paid direct by the customer. Some suggested that we should consider carefully how to apply the approach to different product sectors. Several of the responses also commented on the need to tackle the inconsistent tax treatment (and consequential different net costs to the customer) between payments made as commission, and those made in the form of traditional fees. Some said that the VAT treatment needed to be simplified.

15. A lesser but still significant number of respondents thought a re-definition of 'fee-based' would be unhelpful and confusing to consumers. Some of these respondents nonetheless supported a move to Customer Agreed Remuneration. There were also some who commented that they already operate, in their view, sufficiently transparent remuneration arrangements. We regularly met IFAs at our consultation sessions who explained they achieved this by discussing the level of commission they would earn for their services with the customer, and rebating the difference (between this and the commission paid by the product provider) to the customer.

Our response: Chapter 4 sets out our proposals for Adviser Charging – removing provider influence from remuneration for independent advice, whilst enabling adviser remuneration to be deducted from the product, rather than being paid direct from customer to adviser. Chapter 4 also covers the tax position of Adviser Charging. Chapter 5 explains that we will seek equivalent remuneration standards for non-independent advice.

Q3: Do you agree with defining 'independence' in terms of freedom from bias, even if the adviser only selects products from a limited range? How far should this be taken, if at all? Would an independent label still have value, if these ideas are implemented?

16. The vast majority of responses were in favour of retaining the 'whole of market' concept as a key attribute of independence – a point we acknowledged publicly during the discussion period. Several respondents argued that customers expect an independent adviser to have unrestricted access to the market to find the best deal for their client. Some feared that the independence brand and industry reputation would be seriously undermined if conditions for independence permitted selecting from a limited range. For instance, we were told: 'It is, of course, impossible for an adviser with only a limited range of products available to claim to be acting only for the consumer.'

17. Some respondents thought that independence needed to better reflect the fiduciary obligations of advisers under laws of agency. Although several, mainly smaller, IFA firms could not see the need for the approach to remuneration to be connected to independence, some others thought that acting in the best interests of clients required an approach where advisers agreed remuneration with customers. Some went further to suggest that for an independent adviser, remuneration should not be contingent on a product sale.

18. There were a few responses that picked up on a theme we later played back in the IR, that use of single-product wrappers with open architecture fund access, or limited ranges selected from the whole market and frequently reviewed, might in some circumstances achieve similar consumer outcomes.

Our response: We are not proceeding with the idea that advisers selecting from a limited range might be considered 'independent'. Chapter 4 explains how we will consult on rewritten rules and guidance on independence to: a) make clear that independent advisers need to provide unbiased, unrestricted advice based on a comprehensive and fair analysis of relevant markets, b) on broadening the rules to cover other investments, not just packaged products; and c) stop product providers determining independent advisers' remuneration.

Q4: Should we allow, in principle, the grandfathering of advisers to the new professional financial planner role if they do not have the necessary minimum qualifications or an equivalent? If we did allow this, what might be the consequences and how should we then encourage advisers to secure relevant qualifications? If you think we should not allow grandfathering, why not?

Q9: Should we allow, in principle, the grandfathering of advisers to the general financial adviser role if they do not have the necessary minimum qualifications or an equivalent? If so, how should we encourage (or require) any up-skilling to the necessary standards?

19. We have combined the analysis of responses on these two questions because of the similarities in the issues raised.

20. There were inconsistent interpretations of what was meant by 'grandfathering'. Some thought this meant allowing advisers a finite period to continue to operate before requiring them to have the necessary qualifications; others thought it was permanently giving advisers the relevant status without any further assessment. We clarified in the IR that we meant the latter of these interpretations. In analysing DP responses, we tried to assess, from any additional comments, whether some who said they supported grandfathering were really in favour of it according to our definition.

21. There were strong opinions both for and against grandfathering for both roles. Advisory firms and individuals seemed to be evenly split, while other firms were marginally against grandfathering, particularly in relation to the professional financial planner role. Typical of the views of those against grandfathering was this from an adviser: 'They either have sufficient knowledge to pass the papers needed or they do not. If they are not prepared to demonstrate their knowledge by taking exams they should step aside.' It was also argued that allowing grandfathering would do nothing to raise the standard of financial advice because advisers' knowledge would not be tested. Nor would it improve consumers' level of confidence in the advice sector.

22. Not all of those in favour of grandfathering thought it should be automatic – some suggested that it should only apply to those above a certain age and/or with a minimum number of relevant years of experience and/or with a minimum past record (for instance based on numbers of past complaints, continuing professional development (CPD) points, and other key performance indicators). For example, we were told: 'Years of experience and suitable evidence of ongoing CPD should be sufficient to grandfather IFAs like myself into any new scheme', and 'I feel that my years of experience (with no complaints) should count for something in the industry'. There was a concern about driving advisers out of the industry. For instance: 'But age and experience must be taken into consideration. If these rules come into force you will be forcing many advisers who offer good quality advice to many clients into forcible retirement or redundancy.' We also heard views at our consultation sessions that grandfathering should be subject to minimum standards.

23. There were several respondents who recognised that there would be significant implications if grandfathering were not permitted. Many feared a significant damaging impact on advice capacity in the industry, although it was not clear whether all of these respondents would still hold this view if a transition period were to be applied. Some others recognised further consequences, for instance: 'The CII must offer more frequent examinations to allow for this'.

24. Some respondents said that qualifications were neither a reliable indicator of competence nor an indication that an adviser will necessarily provide better, higher quality advice. We were told that: 'Some of the highest qualified individuals are very poor at advising clients and are unable to explain concepts and products to clients'.

25. Although most responses on this issue were from IFA firms or their advisers, we have been informed that some in the private client investment management and stockbroking community have similar concerns about experienced long-standing advisers having to take further qualifications.

Our response: We recognise the concerns in this area, both about allowing grandfathering, and not allowing it. Chapter 4 explains that we do not propose to allow grandfathering. Chapter 6 proposes a transition period ending on 31 December 2012, and explains that we do not rule out some form of non-examination-based test for existing advisers.

General Financial Advisers

Q5: Do you agree with the proposed distinction between professional financial planner and general financial adviser? If greater distinction is needed between general financial advisers and professional financial planners, how might this best be achieved?

Q6: Is there sufficient incentive for advisers to want to be professional financial planners? What further restrictions should we place on the permitted activities of general financial advisers, if any, and why?

Q7: Do you think that this two-tiered approach is desirable and, if so, should this be a transitional feature of the market or more permanent? Should there be any other classification of adviser offering full advice services beyond professional financial planner or general financial adviser?

26. We have combined the analysis of responses on these three questions. There was a substantial body of opinion against the concept of a two-tiered approach to full financial advice. This strength of feeling was evident across all types of respondent, including those representing consumer interests. 'We do not agree with this distinction, nor should there be consideration of any greater distinction. FSA is seeking to formally define differences that effectively exist and function well within the current marketplace'.

27. Nonetheless, there were many who advocated the importance of distinguishing those who had higher professional qualifications and whose remuneration is not determined by product providers. Some of these respondents, whilst supporting a distinction, did not like the proposed labels for the advisers. If the proposals were implemented, many respondents, particularly advisory firms and individuals, did not think there was sufficient incentive for them to aspire to become 'professional financial planners' (PFPs). There was more support in favour of requiring a 'fee option' for 'general financial advisers' (GFAs) than against it, and many thought that no restrictions should be applied to the activities of GFAs. Several respondents commented that they regarded the GFA category as the natural home for the majority of IFAs.

28. Opinion was balanced on whether GFAs should be a permanent market feature. There were some who thought that a different market distinction was needed, with splitting advice from sales and a return to depolarisation being two common responses. 'We do see merit in the two-tiered approach. However, we do not see any benefit in creating a temporary or transitional regime. We feel that this would add confusion for the customer and a lack of clarity for advisory firms.'

Our response: We have decided not to distinguish the market for full advice between professional financial planners and general financial advisers. Chapter 3 sets out our intention to consult on distinguishing between investment advice that is independent and sales advice.

Q8: What are the arguments for and against mandating the use (or preventing the use) of particular remuneration methods, for instance requiring the use of fee-based remuneration according to our wider definition in 2.30[3] by all advisers? What might be the market consequences if we took such action? How else might we encourage firms to adopt particular remuneration methods (or discourage the use of some others, for instance traditional indemnity commission)?

29. Most respondents argued against mandating remuneration methods or the prevention of specific existing methods. Most felt that consumers understood and benefited from their current choice over the method of their adviser's remuneration; or that remuneration was not an appropriate regulatory concern and was best left to the market. Many respondents felt that customer agreement, disclosure and transparency in remuneration were far more important than any particular remuneration method. Many respondents believed that Customer Agreed Remuneration (CAR) would achieve the desired clarity for consumers and should be made mandatory.

3 Paragraph 2.30 of DP07/1 said 'To facilitate this change in remuneration practices, we might re-define the term 'fee-based' to mean any advisory remuneration derived in discussion with the customer and not influenced by the product provider. We could then require that all professional financial planners should be fee-based, according to this wider definition. The definition encompasses arrangements currently categorised as fees. It also includes commission payments, including those expressed as a percentage of on-going funds under management, but only where such payments have been determined with the customer's agreement. We would want to understand what forms such agreement might take. We also want to consider how the fee-based concept could be broadened to apply to different sectors of the industry, including direct selling businesses and banks, without giving competitive advantages to any sector.'

30. However, many respondents interpreted the question as an attack on commission and urged that commission bias should be addressed directly if it was believed to be a problem. Some said that there was no evidence of commission bias in the marketplace and that Treating Customers Fairly already prohibited excessive customer charges.

31. A number felt that commission standardisation, a return to commission capping, monitoring of advisers' earnings per transaction, or regulation of specific product providers' remuneration structures would be preferable to the restriction of the remuneration methods available to advisers. We heard this view regularly during our consultation sessions. Others suggested that the choice of remuneration method should not be linked to the professionalism of advice, maintained that there was no reason to discourage specific remuneration methods like indemnity commission, or stated that commission was popular because very few clients currently choose to pay by fee.

32. A few respondents urged an end to indemnity commission, discounted initial charges and rebates of annual management charges; or felt that the implementation of fees as opposed to commission was a necessary hallmark of independent advice. Consumer groups, including the Financial Services Consumer Panel, were adamant that all commission and other indirect influence on intermediary remuneration by product providers should be eliminated in the interest of preserving independent advice. Some suggested that PFPs should be mandated to use fees, while GFAs could offer a choice of remuneration methods to their clients because it was felt that indemnity commission should only be available as an incentive to advisers who provided a genuine continuing service to clients. Arguments in favour of mandatory fee-based remuneration included a demonstrably clean break with current practice; greater certainty for clients; standardisation of disclosure; incentives for on-going service and the improvement of the industry's reputation by combating perceived commission bias. Other respondents gave a more nuanced view of the future of traditional indemnity commission, suggesting that while it should not be regarded as wrong, it should no longer be relied upon as the norm and should be replaced gradually by trail or renewal commission.

33. A large number of respondents addressed the specific market consequences of specifying or restricting remuneration methods and their comments were predominantly negative. Most comments suggested that mandating a fee structure as an alternative to commission would lead to a serious contraction of the independent advice market. Many also felt that the consumer detriment of this contraction would fall disproportionately on poorer clients who would be unable to pay up-front fees for financial advice. Respondents also suggested that the removal of choice would actually contribute to consumer confusion; that any such move would be anti-competitive, or that it would at the very least cause advice firms significant transitional cash-flow difficulties.

34. The few suggestions of ways we might encourage particular remuneration methods included: reduced capital adequacy requirements for advisers who choose not to use indemnity commission, accounting for potential commission 'clawback' in Retail Mediation Activity Returns (RMAR), and regulatory incentives for using remuneration models less open to perceived bias.

Our response: We recognise the strength of feeling amongst many small IFA firms against removing payment by commission. During the consultation period we sensed that some people did not understand that Customer Agreed Remuneration would enable payment of remuneration out of the product, as well as separate payment by the customer. We also recognise the strong feedback from consumer groups favouring the elimination of commission and the elimination of provider influence on intermediary remuneration.

Chapter 4 of this Feedback Statement explains our intention to remove provider influence from determining remuneration for independent advice. Remuneration will be determined by the adviser, but payment of it can be arranged by the provider. This recognises that at present many consumers may not want, or be able, to pay an adviser up front. Chapter 5 explains that we will seek equivalent remuneration standards for non-independent advice. Chapter 6 sets out our proposal for a transition period ending on 31 December 2012 in recognition of the significance of these changes.

Primary Advice

Q10: What are likely to be the characteristics of the target consumer segments for Primary Advice?

35. Relatively few suggestions were offered on the likely characteristics of the target consumer segments for Primary Advice. Of the suggestions that were made, there was no strong consensus regarding the characteristics of individual segments. Some felt that income should not form the basis of segmentation, and instead it would be more appropriate to categorise according to factors such as preferences, confidence, capability, age and lifestyle, or by the specific need to be addressed, for example someone requiring preliminary pension advice, or young parents with health or protection needs. Others suggested that income should be a factor, and that segments should be characterised according to more general demographic factors, such as age and income, or a combination of factors such as age and income plus key life stage and behaviours, for example high net worth retired over 65, or mass market with family.

36. Where respondents offered suggestions on the general target audience for Primary Advice, many saw it as either being the ‘mass market’ of low and middle income consumers, or as consumers of varying income levels but who wished to address relatively simple needs. Some also commented that the market for Primary Advice would be large due to the increasing number of consumers cut off from full advice processes by the increasing costs of providing that advice.

37. Some respondents also commented on the type of product that could be sold through Primary Advice. The consensus here was that simple products would be appropriate, perhaps structured so that they could be bought ‘off the shelf’, although others commented that they did not believe that there was such a thing as a simple product.

Our response: Chapter 5 explains that some in the industry remain interested in services we are now giving the working titles ‘non-advised guided sales’ and ‘simplified advice processes’. They see potential for such services to be successful commercially, and want to undertake further work to confirm this and develop the detail of the services.

> Q11: Do you think there is enough potential benefit suggested by this DP for Primary Advice to become a significant advice channel in the UK? If not, what else might be done to encourage firms to enter such a market?

38. Many respondents did not think that there was enough potential benefit for Primary Advice to become a significant channel in the UK, or if they did see it as such they were concerned about the benefits for consumers.

39. Many thought that product providers, banks and building societies would become the main players in this market, as only large firms would have the infrastructure and consumer base needed for the volume sales required to make Primary Advice financially viable. This led to concerns that Primary Advice would not benefit consumers as the potential for target-driven activity would lead to poor quality advice coupled with expensive products and poor consumer protection, and therefore a high risk of mis-selling and consumer detriment.

40. Some respondents were concerned that Primary Advice would not become a significant advice channel because it does not fundamentally address the underlying issues preventing consumers from engaging with the financial sector. Main factors cited by respondents as not being addressed included the economics of the market that leads to a large sector of consumers being excluded from financial services because they are not a commercially viable proposition; and wider consumer attitudes to debt, saving and the importance of seeking financial advice.

41. A number of suggestions were made about how to encourage firms to enter the Primary Advice market. A common suggestion was to ensure that Primary Advice was set up to be economic and simple to operate, with a margin of profitability for firms, including small firms, that would therefore make it economically viable for firms to offer this service. Suggestions were also made about the possibility of offering some form of incentive to firms, such as a direct monetary incentive, a tax break or a regulatory dividend from the FSA. Some respondents thought that a lower level of regulation and therefore lower compliance costs would make the market a more viable proposition. However, others thought that the level of regulation should be increased around this type of advice, for example by introducing more prescriptive rules, to give firms greater certainty. A number of respondents also emphasised the importance of receiving clarity over the approach to be taken around Primary Advice by the Financial Ombudsman Service (FOS).

42. Several respondents thought that the issue of consumer attitudes must be addressed, to raise consumer understanding and awareness of the importance of financial services and advice, as without consumer engagement Primary Advice would not be a sustainable channel. Some respondents focused on the role of consumer education, starting in schools and extending into adulthood. Other respondents saw that wider political changes would be required to change customer attitudes, such as the end of means tested benefits, and limiting availability of credit.

Our response: As mentioned in our response to question 10, some in the industry believe there is potential for what we refer to in this Feedback Statement as 'non-advised guided sales' and 'simplified advice processes', to be successful. Further detail is in Chapter 5. Since the DP was published the final report from the Thoresen Review of Generic Financial Advice, commissioned by the Treasury, has set out a high-level blueprint for a national service for providing consumers with information, guidance and tools in relation to their money matters. Annex 6 explains how this may increase demand for 'non-advised guided sales' and 'simplified advice processes'.

Q12: What should be the conditions for Primary Advisers to be called independent?

43. Most respondents did not support the use of the term independent for Primary Advisers, and therefore did not believe that there were any relevant conditions for Primary Advisers to be called independent.

44. There was a strong consensus that in order to be called independent, Primary Advisers would have to be able to offer products from the whole of market, and many respondents thought they would also need to offer customer agreed remuneration. As most respondents thought that neither of these conditions is likely to apply to Primary Advice in its proposed form then the term independent would not be relevant.

45. Several respondents also commented that consumers currently have a relatively good understanding of the term independent in relation to financial advice, and respondents were therefore concerned that consumers would be confused or misled if a different definition applied to Primary Advice, and that they would not receive the duty of care that they may expect from an independent adviser. There were also concerns that the 'brand' of independent financial advice would become devalued if a new lower standard came into force for the Primary Advice section of the market.

46. A minority of respondents did suggest possible conditions for the use of the term independent for Primary Advisers. Some suggested that as an alternative to choosing products from the whole of market, independent Primary Advisers would not be able to be tied or multi-tied, and that criteria should be set for a minimum panel size, and products would be selected from appropriate product ranges rather than the whole of market. Others focused on the need for a minimum level of qualifications, for example to the same standard of the next level of advice (i.e. to the level of general financial advisers). Some respondents also suggested conditions for remuneration, including that a fixed fee should be charged regardless of the transaction, and that a fee-based option should be offered.

Our response: Those who have talked to us so far about offering what we have given the working title 'simplified advice processes' in Chapter 5 of this Feedback Statement have not expressed a desire for these to be 'independent' services. We think it unlikely that a simplified advice process that met the proposed requirements in Chapter 4 for advice to be independent would be commercially attractive to firms, because of the cost of operating it. However, Chapter 3 explains that it would be possible for a firm to offer both independent and non-independent services, so an IFA firm would be able to offer a non-independent guided sales service provided it ensures customers understand its limitations, including that it is not independent.

Q13: Is Primary Advice the right name? Would use of the term 'information' instead of 'advice' give consumers more confidence to use these services? What might be the implications of using the term 'information'?

47. Most respondents did not think that Primary Advice was the right name, and a number of respondents had issues with both the terms 'primary' and 'advice'. Many respondents did not agree with the name of the service because they did not agree with the concept of Primary Advice. Of the respondents that did favour the term 'Primary Advice', most did so because they thought it was a reasonable representation of the service to be provided, rather than an exact fit.

48. Some respondents were concerned that the term 'primary' would confuse consumers as they may understand from this that the type of advice offered would be top of the range. Others felt that having a service called 'Primary Advice' would be particularly confusing in a market where other services with similar names may be available, such as 'Basic Advice' and 'Generic Advice', so it would be important to differentiate between these services in some way.

49. More respondents preferred the term 'advice' than 'information', although some were concerned that calling the service advice would mislead some consumers about the nature of the service that they were receiving, and may also open the door to some providers designing volume sales processes under the guise of advice. Some respondents were keen for the name of the service to reflect the responsibility for product choice – preferring 'information' if the responsibility for the decision was with the customer, and 'advice' if the responsibility lay with the adviser. Several respondents commented that many consumers do not understand the regulatory difference between advice and information, so it was not important which term was used, as long as it was clear to consumer what the process was.

50. However the term 'information' was not favoured by many respondents for a number of reasons. On the basis that the title of the service should reflect what it is setting out to achieve, some thought that to call it 'information' would be inappropriate, as it is aimed at directing consumers towards broadly appropriate products and therefore goes beyond information provision. Others felt that the term 'information' would not give consumers the confidence they need to encourage them to engage with the service, and that because there are already many sources of information available, the title should indicate that it does offer more. It was also commented that consumers may be reluctant to pay for a service that provides only information.

Several respondents also felt that many advisers currently working in the market would not want to lose their adviser status to become 'primary information providers', and that such a move would therefore reduce the availability of both information and advice in the UK.

51. However, some respondents did favour the term 'information', if the process was as simple as guiding someone through a decision tree.

52. A wide variety of alternative names were offered for the proposed service. Some of the most popular suggestions included 'assisted sales', 'assisted purchase', 'basic advice', 'financial guidance' and 'product sales'. Many respondents felt that 'sales' should appear somewhere in the title, reflecting their expectation that sales would feature strongly in the process. Others felt that 'guidance' would be a preferable term to both advice and information, as it would reflect that full advice was not being given, but the service was going beyond information giving.

53. Several respondents commented that terminology is secondary compared to designing a service that meets consumer needs in a way that consumers clearly understand, and they felt that only once the details of this service are clear would it be possible to decide on a suitable name.

Our response: We recognise that the working title 'Primary Advice' was unpopular. We are no longer using it, and those interested in offering simplified services favour terms such as 'guided sales' or 'assisted purchase'. Chapter 5 explains that there is some industry interest in offering services of two broad types that for the purposes of this Feedback Statement we have described as 'non-advised guided sales' and 'simplified advice processes' to assist readers' understanding. These are working titles for the Feedback Statement: Chapter 3 explains that we intend to conduct consumer research to explore options for improving the way in which services are described and presented to consumers.

Non-advisory services

Q14: What issues in relation to non-advisory services should the Review consider, and why?

54. Most respondents, particularly advisory firms and individuals, had no comments to make here. Others raised a variety of issues to consider, including administration, data protection, clarity of product information and complaints.

55. A particular concern was making it very clear to customers that they were not receiving advice and what the consequences of this were, in particular in terms of recourse to the FOS and the Financial Services Compensation Scheme (FSCS). A number of respondents commented that many customers will think they have been advised when they have simply been provided with information: 'The main problem is that no matter how many times consumers are told that they are not receiving advice, they genuinely perceive that they have received it'. One suggestion was for the client to 'sign a simple disclaimer' confirming that they understand that they have not received advice.

56. Some of the larger providers expressed support for an Assisted Purchase service on a non-advised basis, and some recognised the potential for consumer confusion: 'such a model would need to include rigid conditions to ensure that the distributor did not stray into the provision of advice'.

57. Several respondents advocated not allowing non-advised sales, or only allowing services to be online with no human interaction. Not all shared this view. As one respondent put it, 'no advice is better than poor advice'.

58. There was also a view that applying the same price to products distributed with and without advice was not treating customers fairly.

Our response: Chapter 5 of this Feedback Statement sets out the approach we propose to take to non-advised and execution-only services.

Other implications of service propositions

Q15: What are the possible implications for consumers, if the proposed market for advice is introduced?

59. A substantial number of respondents commented on the potential for the proposals in the DP to lead to more confusion for consumers. 'Yet more confusion and the undoing of the last 20 years' progress in getting the message across to the public' was how one respondent saw this.

60. There were a number of associated concerns. The most common was that the proposals would further restrict access to advice to all but the most affluent. Some respondents thought that many consumers might be deterred from seeking advice. There was also concern that some might go through a Primary Advice process without fully understanding its limitations, and that Primary Advice would be poor quality with insufficient consumer protection, resulting in consumer detriment

61. But there were some respondents who thought that under the proposals the market for advice would give consumers more choice, enabling them to more easily distinguish between services supplied by higher qualified advisers and those who are less qualified. Some also saw the potential for Primary Advice to address any advice gap, for instance that it would '… help to make advice more readily available to the less financially capable and those on lower incomes'.

Our response: We have adapted our view of the proposed regulatory landscape since the DP. This is set out in Chapter 3, and Chapter 2 explains how it reflects our concern to ensure the availability of services to less affluent customers.

Q16: Would the ideas put forward help more consumers to access financial advice relevant to their needs? Do you have other ideas?

62. There were further comments from a large number of respondents, particularly from smaller IFA firms, on the potential for the proposals to have the opposite effect to that intended, and for more consumers to find it hard to access advice. Some commented that there was no need for any new ideas. 'Changing the categories of advisers and tinkering with remuneration structures won't increase access.'

63. A number of respondents argued that whatever changes are implemented, it was important to emphasise the value of independent advice and to promote this more actively with consumers.

64. There were others who argued that the proposals were a step in the right direction 'As long as the consumer knows what the adviser can and can't do, how that adviser is remunerated and regulated then the ideas should work'. Some respondents thought something more was still needed, for instance to stimulate consumer interest in seeking out advice services.

65. A number of alternative ideas were raised, including a clearer separation of advice and sales and charge-capping products for Primary Advice.

Our response: We have adapted our view of the proposed regulatory landscape since the DP. This is set out in Chapter 3. Chapter 2 explains how the revised landscape reflects our concern to ensure the availability of services to less affluent customers, and Chapter 5 explains how we can help firms develop non-advised guided sales services and simplified advice processes.

Conclusions

Q17: Do you think that the view of the future distribution market for investment products set out in this DP can address the current market problems? If not, why and what could?

66. The most common response to this question was the view that the DP proposals would not address current market problems and were too complex to lead to improvements. Several respondents queried whether the existing model was indeed broken, but some of these acknowledged that even if it was not broken there was scope for it to work more efficiently.

67. A number of respondents commented on how these were essentially supply-side proposals and that they would not, on their own, encourage consumers to save more. Some talked about the need for actions from the Government, for instance to improve tax incentives.

68. A significant body of responses mainly, but not exclusively, from medium-sized and larger firms, thought that the DP proposals were a step in the right direction but needed to go further, for instance by refining Primary Advice proposals. One respondent suggested that the '… best way to improve things is to work on the competence of advisers, simplify regulation so that there are fewer rules but they are all enforced absolutely and reduce the amount of incomprehensible paperwork for consumers as nobody reads it ...'.

Our response: We have adapted our view of the proposed regulatory landscape since the Discussion Paper. Chapter 3 summarises the revised proposal.

Q18: Will many firms make significant changes to their business models? If so, why and how? If not, why not?

69. There was significant acknowledgement that business models will have to change for a large number of advisory firms, particularly for smaller firms. Some of these respondents thought that change was needed. 'Yes, I think we have to change and that change is good if it is done in a timely manner and is in the benefit of the consumer.'

70. A few respondents reflected on how the proposals might fundamentally change the financial dynamics of their businesses. 'Advisers will have to move to a model less dependent on cross-subsidy and one that is efficient enough to work well on lower fees per "sales" and still turn in a sensible profit level.'

71. Some thought that such change was unjustified and was being forced on the industry. They were concerned that change would stop many firms from trading, with those that were less well capitalised most at risk. 'Many will be forced to break something that wasn't broken, without the tools and resources to fix it.'

72. There were some comments that change was constantly happening and that the RDR would have no material impact on those firms that had already made changes. However at some public events we were told that if we are to make regulatory changes, we should not tinker with the regime – we were told we must get it right, and then allow the market a period of stability.

Our response: We recognise that the changes in this Feedback Statement are far-reaching and challenging for firms, and so Chapter 6 sets out proposals for a transition period ending on 31 December 2012 to enable firms to make them.

Making the transition

Q19: We welcome views on what would represent a sensible transition period for the industry.

73. Most respondents to this question were in favour of there being a limited period of time during which the industry would be required to enact any changes, but it should be noted that a proportion of respondents said that this question suggested that the requirement for new qualifications was a foregone conclusion within the RDR.

74. Some IFAs and intermediaries suggested that the time period for this type of change could be dependant on how quickly the examining bodies could retrain and re-examine advisers. As there are only certain times of each year that exams are sat this could restrict the time available to advisers to actually sit exams. This method of examination could be changed, and possibly speeded up, by requiring qualification providers to provide more online examinations and testing.

75. Some appointed representatives thought that allowing 'grandfathering' may speed up the process and could therefore have a bearing on any timetable, whereas the professional bodies thought the current existing levels of qualification in the industry should be considered further before finalising a timetable for change.

76. Some respondents were concerned that any timetable should take into account the effect that time spent studying and preparing for examinations may have on their businesses and their customers, should a timetable be set which was overly tight. This could be avoided by not setting an actual time limit but requiring firms to state what level of qualifications their advisers possess on all correspondence.

77. Respondents were generally positive about setting a timetable if changes were required. Suggestions about the length of time allowed for firms to complete any required changes varied greatly from no time at all to a gradual change over many years. The most commonly quoted timeframe was between three and five years which would be dependent on how many future qualifications were required.

Our response: We recognise the concern amongst respondents that there should be a reasonable period of time to make the transition. We will consult on a transition period ending on 31 December 2012. The proposed transition period is covered in more detail in Chapter 6. Although some respondents were concerned that asking about transition meant the FSA had already decided on a requirement for new qualifications, that was not the case.

Q20: In what ways could we help firms to change their business practices and standards to adapt to new requirements that might emerge from this review?

78. Respondents' main comments on this were that the FSA could help any transition by communicating clearly to all firms, in plain English, with any requirements. It was also suggested that this would be an opportunity to remove any unnecessary jargon.

79. Respondents also stressed that any new requirements should be allowed a 'bedding in' time i.e. there should be a period where further requirements would not be introduced.

80. Some IFAs suggested that we should hold seminars for firms where any new requirements would be explained and could be discussed in order that everyone clearly understood what was required and when things would happen.

81. The consumer bodies were insistent that any changes to the regulatory framework incentivised firms to treat customers fairly and change their business practices and standards to make the market work better for consumers.

82. A few respondents suggested that throughout this period of change all firms should be assigned a relationship manager from the FSA to help with any new requirements.

83. One IFA suggested that the best way for the FSA to change firms' business practices and standards was for us to regulate products and manufacturers.

Our response: We recognise that the changes in this Feedback Statement are far-reaching and challenging for firms. Chapter 6 sets out our approach to supporting the transition.

Higher standards of competence and behaviours

Q21: Do you agree that these qualifications are at the right level for the roles described?

84. Most respondents felt that the level of qualifications proposed in the DP for the top tier of advisers was too high, but many of these saw a need for standards to be raised within the industry, to enhance its reputation and build trust among consumers. AIFA's research found that most older and longer established IFA clients felt that their IFA's level of qualifications was not relevant, but that consumers with little or no experience looked for a measure they could relate to – the proxy most commonly used being qualifications. When the surveyed clients were asked what level they expected their IFA to be qualified to, the most popular response was degree or equivalent.

85. Some respondents felt that some advice scenarios are too complicated to be tackled by those qualified only to the level currently represented by the Certificate in Financial Planning[4]/Certificate for Financial Advisers[5].

86. A number commented that achieving the CII's Chartered Financial Planner qualification involves studying very specialised topics not all of which may be relevant to individual advisers or which they are unlikely to use. They favoured a more flexible approach with more emphasis placed on appropriate content rather than level of the qualification. There was recognition that higher minimum specialist qualifications would be relevant for certain roles, such as those offering focused advice in a particular area of expertise.

87. A considerable number of respondents felt that the QCA level four[6] qualification would be more appropriate for those offering the top level of advice, and that beyond this there are 'diminishing marginal returns' from further qualification relative to other methods of raising the quality of advice. Some called for a single named qualification and adviser designation to provide clarity and consistency for the industry and consumers, and believed a consumer awareness campaign would support this. Some said designations are often more important than qualifications to consumers.

88. Some felt qualifications should be relevant to all members of the industry such as stockbrokers and product providers and not just financial advisers.

89. Respondents argued that raising professional standards and competence is not just about examinations, but also about skills (particularly interaction with clients), knowledge, expertise, core behaviours and the application and maintenance of these.

90. Many emphasised the importance of experience and asked for this to be given sufficient relevance and value. Others felt that experience should not be a substitute for qualifications as the industry has changed substantially in the last 30 years, for

4 Offered by the Chartered Insurance Institute.

5 Offered by the ifs School of Finance.

6 See footnote 5 in the Overview.

example in the complexity of taxation and products, and the greater importance on written communication in giving advice.

91. Some respondents called for a period of practical experience or practicing certificates to be introduced and CPD to be a requirement of qualification. An example offered by some respondents included the requirement for individuals to have two years experience, after completing a Bachelor of Laws (LLB) degree, to become a solicitor.

92. Some sought an alternative 'vocational' qualification based on assessing actual cases for those advisers who have high levels of cognitive skills but poor exam technique. BS ISO 22222[7] was given as an example of an alternative type of assessment. However, caution was voiced regarding ISO standards being too 'process-focused'.

93. Smaller firms raised concerns about the cost of the new qualifications and the opportunity cost of study time for their businesses. They thought examination and study support would be needed from the examining boards and professional bodies, particularly study support groups, and were concerned professional bodies would not make arrangements to put individuals studying for similar exams in touch with each other.

Our response: We have listened to concerns that the proposed level of qualification for the top tier of advisers in the DP was too high, and the feedback that it should be set at QCA level four. Chapter 4 explains that we support the Professionalism Group's proposal that the minimum qualification is set at QCA level four.

Role profiles

Q22: Do you agree that there would be clear benefits for consumers of introducing role profiles?

94. There were mixed views on this question. Some supported the use of role profiles, but others were undecided. Some of these found it difficult to understand how they would be used and wanted more detail before making up their minds. The remaining respondents did not favour the use of role profiles, the most common reason being that they would add unnecessary complication for consumers.

95. Many said that role profiles would not help consumers, who use advisers as a 'front door' to advice, and often do not know what they want or need before they see an adviser. They were concerned that the role profiles would lead to consumers dealing with different advisers for different advice unnecessarily, with consequent cost implications. Some said that advisers already refer on work they are unable to do if, for example, they do not have the necessary specialist knowledge.

96. A number of respondents who did not favour the use of role profiles with consumers, did recognise the value of firms using them internally or their being used for discussions within the industry, or between the FSA and the industry.

7 BS ISO 22222 is a globally accepted benchmark for individuals providing the professional service of personal financial planning, which tests competency, knowledge and sets out ethical principles as well as requiring appropriate CPD and three years' experience.

97. Some respondents did not think role profiles would keep up with the rapidly changing market place, and that they could act as an anti-competitive restraint on the growth of new or alternative methods of service delivery. They argued that members of other professions, such as law and accountancy, are free to select the range of services they will offer. There were also concerns that role profiles would not translate to some areas of the advice market, such as stockbroking or investment management, where only a small part of the role relates to regulated investment products.

98. Some respondents were concerned that industry-led introduction and maintenance of role profiles could lead to a lack of universal application and confusion. Those in support of role profiles took a different view, believing they would add clarity and help consumer understanding of where to get appropriate and affordable advice, particularly at the complex end of the advice market. For example they would help distinguish financial planning from other forms of financial advice. Supporters of role profiles stressed that it was vital they are clear, concise and free from jargon. They should set out services offered, requisite knowledge, skills and behaviours. One of their most useful aspects would be to differentiate between specialisms. A consumer education campaign would be required to help consumers understand the role profiles.

99. Some respondents wanted to see the role profiles linked to qualifications, because they felt this would help consumers' understanding. Others, however, saw the value of separate role profiles because they did not consider qualifications to be the sole determinant of capability. One respondent argued that to ensure impartiality, role profiles should set out the generic knowledge, skills and behaviours required, without linking them to a particular body's qualification. Some respondents thought role profiles could be used to set expectations both for the industry regarding professionalism, qualifications and ethical behaviour, and to set expectations for consumers around levels of service.

Our response: We do not propose to take forward the idea of role profiles, but we believe that the overall outcome will be achieved through the package of proposals for raising professional standards set out in Chapter 4.

Q23: What role should regulation play in helping to make the necessary changes to qualifications and behaviours?

100. Some saw a role for the FSA, with a smaller number believing we should not have a role. Many respondents were undecided. This spread of views was consistent across most types of respondents, with the exception of life companies, many of which were in favour of regulation from the FSA.

101. Many of those who did not think we should have a role saw no role for regulation at all. Others thought the current level of regulation in this area was sufficient, while some suggested regulation in these areas should be the responsibility of the professional bodies, or a single professional body. These respondents thought the professional body or bodies should be given the powers to remove the right of advisers to practice if minimum levels of qualifications and behaviours are not met.

102. Some respondents were concerned about potential conflicts of interest arising from an expanded role for professional bodies. They thought we should set a framework and clear expectations around the design, implementation and enforcement of standards. The professional bodies' role would be to maintain and uphold these standards, with the FSA monitoring that they did so consistently, for example in the content of examinations and setting of fee levels. Others suggested that regulatory powers should be held by the Financial Services Skills Council (FSSC), and that the FSSC should have a role in setting and maintaining examination standards.

103. Others saw a clear role for the regulator in: setting and upholding minimum qualification levels for both general and specialist advisers; maintaining a transparent, consistent and recognisable qualification process; promoting examinations; recording examination passes from each adviser and awarding designations (e.g. 'Professional Financial Planner') once candidates have achieved them; and use of enforcement where necessary, and more specifically against individuals and directors. A number of respondents wanted the regulator to promote consumer understanding and awareness of qualifications, and so give advisers an incentive to achieve them.

104. Many thought behaviours would be difficult to regulate. Some respondents felt that behavioural change could not be achieved through regulation. Some said that behavioural change is strongly influenced by a firm's culture and therefore senior management should be held responsible for this type of change in firms. Others suggested that regulation could help by giving examples of good and poor practice, setting out how behaviours could be evidenced, mandating membership of a professional body (monitored by the regulator), an enforceable code of ethics, and ongoing monitoring and assessment of CPD.

105. Some respondents thought the approach taken should be more principles-based and outcome-focused than monitoring each individual's qualifications and ethics or FSA prescription of particular qualifications. They were concerned that a rule-based approach would be too inflexible to adapt in the future. A number of respondents wanted standards to be set for the long term, giving a period of stability before further changes are contemplated.

Our response: We have opted for a market-led solution to increasing professional standards. Chapter 4 explains that we propose to establish an overarching Professional Standards Board to be run initially by the FSA, and then possibly as an independent statutory body.

Better labelling of services

Q24: Do you agree that better labelling of available services is essential in building the professionalism and reputation of the sector and in making services clearer to consumers?

106. More respondents agreed that better labelling would help to build professionalism and reputation in the sector, than those who thought it would not. A significant number of respondents did not express a clear view one way or another. Some of

these were undecided, but others did not understand the difference between labelling and the role profiles (question 22).

107. Those who supported better labelling thought that current labels, such as ‘whole of market’, ‘multi-tied’, and ‘tied’ were confusing for consumers. Some thought the current wide gap in skills and services meant the absence of clear labelling exposes clients to risk of using an inappropriate adviser. Labelling would enable consumers to distinguish between generalist and specialist advisers. The key to successful labelling would be clarity, simplicity and consistent terminology, although some thought this might be difficult to achieve in practice. The emphasis must be on explaining services, not on creating additional paperwork. Setting expectations and providing clarity for consumers would be strong drivers for change. It was important not to have too many labels, and they should be set for the long term, giving a period of stability to consumers and firms. There was strong support for a long-term and high-profile consumer education programme to support the labels.

108. Some thought that better labelling could promote a clearer qualification and career structure, raise the profile of the industry, and attract higher quality entrants who currently join more clearly defined professions like accountancy.

109. We heard a clear view from some respondents, and many at our consultation sessions, that the ‘independent’ brand was recognised, understood and powerful among consumers. They did not want to see it changed.

110. Many of the respondents who did not support changes in labelling were concerned that changes would bring confusion for consumers, arguing that the constantly changing financial services market place made a simple labelling system for client services impossible. Consumers do not always know what they want before approaching an adviser, and so labelling may force them to choose too early in the process. Some thought success depended on consumers shopping around, which is not what evidence would suggest. Built-up consumer disinterest and consumer reluctance to engage will be hard to overcome. ‘Investment’ in labelling would only be worthwhile if consumers are held more responsible for reading and seeking to understand the information provided.

111. Some respondents said that personal trust between adviser and client, people skills, client service and ethics were more important in raising professionalism and reputation than labelling. Labelling may eliminate consumer confusion but would not necessarily improve professionalism and reputation. Some respondents questioned whether labelling was compatible with Markets in Financial Instruments Directive (MiFID).

Our response: We recognise that consumer understanding of the way services are described is vital. Chapter 3 explains our intention to consult on improving the clarity for consumers of the characteristics of different service types and the distinctions between them. It sets out the revised proposed regulatory landscape, and explains that before the June 2009 Consultation Paper we will undertake consumer research to explore options for improving the way in which services are described and presented to consumers. This will include consideration of negative as well as positive disclosures, to reinforce distinctions between service types.

Enhanced role and focus of professional bodies

> Q25: Do you agree with these proposed measures to enhance the role of professional bodies and do you think these would make a difference to the professionalism of the financial advice sector?

112. Many respondents agreed that the role of the professional bodies (PBs) should be enhanced and that this would make a difference to the professionalism of the sector. A smaller number of respondents thought it would not, and the remainder did not express a clear preference.

113. Some respondents, including the Chartered Insurance Institute, advocated compulsory membership of a PB. The Securities & Investment Institute regarded encouragement of membership as insufficient and suggested that membership could be increased by the provision of a 'safe harbour'. Others argued that membership should be purely voluntary and that the proposal for strong encouragement of PB membership, backed by the provision of incentives, amounted to a form of compulsion by the back door. Some were concerned that the proposed enhancement of PBs' reporting and sanctioning powers was incompatible with the principle of voluntary membership. Several thought that cost alone, rather than any lack of professional ambition, would remain a significant and legitimate disincentive to voluntary membership of PBs.

114. Some respondents regarded increased collaboration between the PBs, or their consolidation, as a necessary precursor to implementation of the recommendations of the Professionalism and Reputation Group set out in the DP. Some envisaged the development of a joint code of conduct under a single professional standards board; but more believed that a simpler solution was to amalgamate the existing PBs into a single independent entity with a recognisable brand which would be responsible for maintaining professional standards and discipline. A few thought this would be anti-competitive and retrograde. Consumer bodies looked for clarity and robust enforcement of professional standards to enable better public understanding of the relevance of PB membership.

115. Many respondents sought clarification of the proposed interaction between the PBs and the FSA. While an element of oversight by professional peers was welcomed, concerns were expressed about:

- a perceived underestimation of the legal difficulties surrounding information sharing;
- the cost and complexity of the processes necessary to justify refusal of membership or to enforce potentially career threatening sanctions by PBs;
- the inconsistency with other comparable professions of creating a two-tier regulatory environment; and
- the danger that the PBs would become quasi-regulators by impinging on areas in which it was felt that the FSA should maintain exclusive oversight.

116. Reasons for disagreeing with an enhanced role for PBs included:

- a widespread perception that the PBs had pecuniary or other vested interests in an enhanced role;
- fear of encouraging a monopoly or oligopoly in responsibility for professional standing;
- concern that encouragement of wider membership would lead to a decline in the standard of support provided by PBs;
- concern at the additional cost to members of PBs acquiring sufficient resources for their enhanced functions; and
- opposition to the use of PBs as a proxy for statutory regulation by the FSA.

117. A small number of respondents did not believe that the proposed enhancement would make any difference to the professionalism of, or public confidence in, the sector. They doubted the PBs' ability to monitor and influence members' working practices effectively. They believed that professional standards within the industry were already sufficient, or they suggested that the current proposals offered no substantive enhancement of the PBs' role and powers.

Our response: Chapter 4 explains that we will consult on establishing an overarching Professional Standards Board (PSB) to be run initially by the FSA, and then possibly as an independent statutory body. It also explains that when the PSB is run by the FSA, standards of competence are likely to be addressed within the Training & Competence sourcebook. This will apply to all investment advisers, not only members of professional bodies. If the PSB is given an independent statutory footing, it would have freedom to seek legal advice on membership requirements, and take the approach it believed most effective to deliver its objectives. We recognise the importance of avoiding regulatory duplication and addition to costs without consequent benefits for firms and consumers.

Q26: Do you agree with the overall recommendations of the Professionalism and Reputation Group?

118. The majority of respondents agreed with the overall recommendations of the Professionalism and Reputation Group, which were described in the DP. Professional and trade bodies were supportive of the Group's proposals, subject to a range of detailed comments made in answer to previous questions. Many of these bodies welcomed the FSA's engagement with the issues at stake, but acknowledged the scale of the challenge ahead and the necessity of further detailed work on the proposals.

119. A large number of respondents qualified their support or gave caveats about certain aspects or potential consequences of the proposals. Comments included anxiety that the professional bodies would become pseudo-regulators; that consumers would not understand or would not derive any concrete benefit from the changes; that practitioners were not being offered tangible incentives, or that the plans were too ambitious and likely to be excessively disruptive to the industry.

120. Some respondents disagreed with specific parts of the proposals and reiterated previous explicit complaints about market segmentation, labelling, role profiles or the creation of a closed shop for practitioners. Other respondents within this group felt that the proposals were simply too complex to be implemented.

121. A few respondents agreed with the recommendations in principle but were also concerned about their implementation in practice. Some reiterated their belief that greater cooperation between the professional bodies, or some consolidation, was necessary to lay the groundwork for change; or that there should be a generous transitional period. Others advocated additions to the proposals, including the need for access to the full qualification records and personal histories of authorised individuals, or an emphasis on the role of vocational training and supervision.

122. IFAs tended to be more sceptical about the Group's recommendations than other types of respondent, with nearly half of responses being negative. A large number of respondents elected not to answer the question or remained undecided.

Our response: Chapter 4 sets out the revised proposals on professionalism that we will consult on.

Q27: Do you have other suggestions for how the overall aim of raising professional standards and enhancing the reputation of the market could be met?

123. There was no consensus among respondents, with many declining to answer or adding nothing further to their previous responses within this section. Several respondents merely reiterated the view of the Professionalism and Reputation Group that a renewed focus on professional status backed by reinvigorated professional bodies was necessary. Nevertheless, a large number of respondents made additional suggestions for the ways in which professional standards and the reputation of the market could be enhanced. These are summarised below.

124. Many respondents emphasised the importance of improved consumer education, better public relations and positive reinforcement of the market by the FSA and the government. Suggestions included the importance of public awareness campaigns aimed at demonstrating the benefits of financial advice; praise of good practice from the FSA; a qualification threshold and greater regulation imposed on financial journalists, and promotion within universities of Independent Financial Advice as a respected career path.

125. A smaller number of respondents believed that enhanced supervision of firms' compliance and robust enforcement action by the FSA would be enough to raise professional standards and enhance the market's reputation. Suggestions were focused on more rigorous inspection visits at short notice; heavier fines and sanctions, and closer monitoring of sectors of the industry responsible for generating complaints. There was, however, no consensus about which sector generated the most risk to the reputation of the market, with many IFAs urging closer supervision of direct sales forces, while other respondents were critical of small directly regulated advisers.

126. A similar number of respondents urged the importance of a broader conception of professional standards based upon experience and CPD to complement qualifications and membership of professional bodies; regular training and a formal process of CPD; monitoring by an independent ethics committee; centralised or electronic registration of CPD; and tailored training based on feedback of firms' adherence to Treating Customers Fairly were some of the suggestions made. Some respondents also envisaged a structured system of vocational training, similar to the model used by other professions, which would allow the integration of initial qualifications and ongoing professional development to ensure that expected standards were met by new entrants.

127. However, a small number of respondents disputed that the reputation of the market needed improvement, or suggested that such improvement as was necessary was already taking place. A further minority believed that renewed consumer confidence in the market relied upon little more than a period of stability in which to allow recent regulatory changes to bed down.

Our response: Chapter 4 sets out the revised proposals on professionalism that we will consult on, including how we plan to raise professional standards and the role for the professional and skills bodies. We also support the need for promotion of the industry, as recommended by the Professionalism Group. The proposals will also recognise that professionalism is about more than qualifications and membership of professional bodies, and includes skills, ethics and CPD.

Q28: What role should we play in raising professionalism as opposed to relying on the professional bodies? Or can the industry lead the way in delivering improvements?

128. Many respondents envisaged a partnership between all stakeholders in raising and monitoring professional standards. Respondents frequently suggested that we should set a framework for professional standards and that the relevant professional bodies (PBs) should be charged with monitoring practitioners' compliance with those standards.

129. A large number of respondents thought we should take a clear lead in defining and improving minimum professional standards. Responses included the belief that self-regulation had failed in practice; that the industry and professional bodies were too fragmented to reach a practical consensus, or that the PBs were pursuing their own interests rather than those of either practitioners or consumers. Respondents also urged the maintenance of an accessible register of advisers containing a broader range of information to allow professional conduct to be tracked. Consumer groups were particularly clear that, while continuing to work with other stakeholders, the FSA must clearly set out the minimum standard of professional competence expected from advisers.

130. However, a similar number of respondents believed that the industry should be left to police its own professional standards and that this was not a regulatory matter. A minority of respondents believed there should be no change in the current system for monitoring and improving professionalism within the industry, or that further involvement by the regulator would be counter-productive. The views expressed included uncertainty over whether regulation could be used successfully to influence

professionalism, frustration at the recent pace of regulatory change, or concern about whether the regulator was itself qualified to police the industry's professional standards.

131. Few respondents believed that PBs alone should be entrusted with raising professional standards. However, comments which were supportive of this approach noted that professional standards should be promoted by relevant professional bodies in a way that reflects existing practice within comparable professions like the law and medicine.

Our response: Our approach to professionalism since the DP reflects our desire for a market-led solution. The Professionalism Group has led on this issue since the Interim Report. Chapter 4 explains the FSA's role in taking forward the Group's recommendations. This includes consulting on establishing an overarching Professional Standards Board (PSB) to be run initially by the FSA, and then possibly as an independent statutory body.

Regulatory and prudential standards to manage liabilities

Q29: Do you agree with the group's[8] view that a system of risk-based financial resource requirements for personal investment firms, with a higher minimum requirement than at present, and which includes regulatory dividends, will contribute to better outcomes for consumers and a more sustainable distribution sector?

132. In aggregate, responses did not support this proposal, but there was support amongst trade bodies, professional bodies, banks and product providers.

133. A key concern, which was most prevalent among IFAs but was commented on across most categories, was that increased capital requirements could increase barriers to entry and drive smaller IFAs out of business, reducing consumer choice and innovation in the sector. Some questioned if there was a link between capital levels and consumer detriment, with some saying that it was often the larger firms (with substantial capital) that generated the most complaints. It was also mentioned by many that the current system (£10,000 minimum per firm rather than per adviser) was skewed against sole traders or small IFA practices.

134. The concept of regulatory dividends received widespread support, with many considering them an effective way of changing firm behaviour. However, some questioned how this would work in practice. Some were concerned that the FSA would not have the resources to monitor the market and analyse risk in the setting of regulatory dividends.

135. Another area that was commented on across some sectors was professional indemnity insurance. Some wanted to know to what extent this had been considered when drafting the proposals contained in question 29, and if it had been considered as a substitute for increased capital requirements.

8 One of the formal groups of senior market individuals, which contributed ideas to the DP, considered the sustainability of the distribution sector.

Our response: Chapter 3 of Feedback Statement 08/2[9] on the Review of Prudential Rules for Personal Investment Firms explains the difficulty in identifying appropriate predictors of loss, other than those linked to the size of firm, upon which to base a system of risk-based prudential requirements. Chapter 2 of our Consultation Paper on the Review of Prudential Rules for Personal Investment Firms explains our proposal to consult on extending the expenditure-based requirement to all firms because it is likely to be proportional to firm size.

Q30: Do you agree that firms that give financial advice should be required to make some provision or arrangement for liabilities to customers which may come to light after they have ceased trading?

136. Many respondents supported the idea of firms making some provision or arrangement for liabilities to customers which may come to light after they have ceased trading, but questions were asked about how this would operate in practice. Some also said that continuing to cover liabilities after firms ceased to exist did not happen in other industries so asked why this should happen in financial services.

137. A key issue was time barring, and many respondents were against an open-ended time commitment for liabilities. Typically time limits of between five and ten years were suggested.

138. In terms of how to cover liabilities, most respondents suggested professional indemnity insurance, but some suggested a bond or separate account-based system.

139. Some respondents were concerned with the cost and complexity of any system, with some seeing this as prohibitive. There was some support for the present FSCS system, but a greater number of respondents objected to this or any similar system, seeing it as allowing strong firms to subsidise the weak.

140. Respondents across most categories raised the issue of phoenix firms, saying that the liabilities generated when these were wound up (with the owners subsequently setting up a new firm, free of liabilities, with the old firm's liabilities shouldered by FSCS) would need to be tackled.

Our response: Chapter 1 outlines the approach we have taken to this issue in our Consultation Paper on the Review of Prudential Rules for Personal Investment Firms. Further detail is available in Chapter 4 of that Consultation Paper.

Q31: Do you agree that giving small firms incentives to employ compliance service providers will help increase the quality of their advice? Do you have other ideas on enhancing supervision of small firms and what are they?

141. This question generated a lot of comments, especially from IFAs, although concerns were expressed from others in the financial services industry. A good proportion of

9 www.fsa.gov.uk/pubs/discussion/fs08_02.pdf

the respondents confirmed that they already used compliance consultants but were unspecific as to whether this actually improved the quality of their advice.

142. Some of the concerns which were raised were about what incentives would be given to small firms and how any incentives would be funded. Other respondents were more concerned that this may be subsidising non-compliant firms to get to the position where they should already be.

143. Questions were also raised about what difference employing compliance consultants makes to firms. At present there are no FSA standards for compliance consultants so the quality of their work can vary. Some firms spoke in favour of this as a method of compliance, whereas others pointed out that as compliance consultants have no liability, the responsibility for compliance is still ultimately with senior managers of firms. So being required to employ consultants was simply another cost to firms.

144. Some IFAs were very much in favour of the use of compliance consultants, especially where the IFAs stated that they already employed a compliance firm or had access to external compliance functions via a network. Some IFAs suggested that supervision would be better achieved by subcontracting some supervision to compliance services providers, although some respondents argued that if responsibility for compliance is to be entrusted to third-party providers, those providers ought to be subject to the same supervisory standards as firms monitoring their own advisory services.

145. One firm of compliance consultants said this may encourage an unhealthy attitude that regulation is too complex without the help of an expert and that firms can simply outsource the responsibility to a consultant and forget about it. A varied selection of firms did state that regulation should be simplified to eliminate the requirement for compliance consultants and their costs.

146. One point which was raised throughout the responses to this question was whether the use of compliance service providers leads to better quality advice. There was no clear consensus. Most did agree that the use of compliance consultants improved record keeping and compliance in general.

Our response: We have decided not to proceed with this proposal. We have concluded that our proposals on clarity of services, remuneration and professionalism are more appropriate ways to achieve the outcomes we seek. This is not a reflection on the quality of compliance consultants' services, but rather a consequence of the RDR's desire to tackle the root causes of problems in the market for distribution of retail investment products.

Q32: Do you agree that we should consider changing the time limits we set for the periods within which cases can be referred to the FOS by introducing a 15-year 'long-stop', such as applies in the courts?

147. More than eight out of ten respondents who expressed a view were in favour of introducing a 15-year long-stop and many of these felt that the time limit should be shorter than 15 years. The main argument made in favour of a long-stop was the fact that the proposed time limit would be in line with the general law of limitation, and

many respondents were surprised that the FSA rules were not already aligned with these provisions in the general law.

148. The other main argument made was that it was unfair on advisers to be potentially subject to indefinite liability, often into retirement, for the advice that they gave, in contrast with other professions.

149. Respondents also noted that a long-stop would bring greater certainty and clarity to firms, and could reduce the cost of professional indemnity insurance. They noted that consumers sometimes complained many years after the original advice had been given, sometimes in response to changing market conditions, and it was unrealistic to expect them to be able to remember the details of decisions taken many years earlier. Other respondents pointed out that the average holding of some products was well below 15 years, and so a long-stop would make little difference to customers' right to complain in those circumstances. Some respondents felt that introducing a long-stop would make customers take greater responsibility for understanding what they were buying, as they would have only a limited period of time in which to complain.

150. A few respondents misunderstood the proposal for a 15-year long-stop to be an extension of the existing three and six-year time limits for bringing complaints, and therefore objected to what they saw as an increase in their liability, whereas in fact the long-stop would have limited it. So we took these responses as being in favour of a long-stop.

151. Those respondents who argued against a long-stop included advisers and providers as well as consumer groups. The main points they made were that it would be unfair to customers to introduce a long-stop, since the industry often provided long-term products and lifetime advice, and people who gave bad advice should retain the liability for it. These respondents also argued that the lack of a long-stop had only a limited effect on certainty and was not a bar to entry to the industry.

152. Some respondents suggested alternative versions of a long-stop provision, for example giving customers the right to complain for at least the term of the product, or introducing differential periods of liability for different types of products or more or less serious types of complaint.

Our response: We recognise the strength of feeling on this issue, particularly in the IFA community. Chapter 4 explains how we have considered it, and the reasons for our decision not to consult on the introduction of a long-stop. We recognise that many in the industry will be deeply disappointed by this decision.

Q33: What do you consider to be the risks and benefits of introducing a 15-year 'long-stop'?

153. As well as the points made in response to Question 32, respondents identified the risks of introducing a 15-year long-stop as including the risk of negative impact on the industry's reputation and the risk that additional requirements would be introduced alongside a long-stop, for example a general requirement to contact customers.

154. Respondents argued that the benefits of introducing a long-stop would include reminding the public of the need to seek advice and keep track of the progress of

their investments and other products, and to raise any concerns in a timely manner. Other benefits would include easier access to affordable professional indemnity insurance and encouraging more advisory firms to participate in the market and greater certainty about the future prospects of individual firms.

Our response: Chapter 4 explains how we have approached our analysis of the costs and benefits of introducing a long-stop, and the reasons for our conclusion not to propose introducing one.

Q34: Should this 15-year 'long-stop' apply to business undertaken before and after the introduction of this 'long-stop'?

155. Most respondents were in favour of applying the long-stop to business undertaken both before and after the date of its introduction, on the basis that this was needed to bring certainty to the industry and because the principle of a long-stop was right in itself. Those respondents who did not favour applying the long-stop retrospectively were divided between those who agreed with the principle of a long-stop but felt that it would be unfair to apply it to business that had already been taken out and those who did not agree with a long-stop at all.

156. A small number of respondents suggested that a long-stop might be applied retrospectively for a few years, for example to contracts taken out in the last five years, or since 2001. Others suggested that if a long-stop was going to be applied retrospectively, firms would have to send warning letters to all affected customers before the new rules came into force.

Our response: As explained in the answers to the previous two questions, we have decided not to propose the introduction of a long-stop.

Q35: Do you agree that stakeholders should try to identify circumstances that may prompt valid complaints at an earlier stage, and within a 'long-stop' period?

157. Most respondents agreed that firms should communicate regularly with their customers. They pointed out that this was good business practice in line with Treating Customers Fairly, and many firms already operated in this way, for example by providing annual benefit statements. Respondents also recognised that it was sensible to identify examples of inappropriate advice or services as early as possible.

158. Some respondents, however, felt that the existing requirements to provide regular information to customers were adequate and doing more to identify circumstances that might prompt valid complaints might also trigger inappropriate complaints and damage the reputation of the industry. They therefore felt that any special arrangements should be used where particular issues come to light, and it would be important to ensure that the information provided was sufficiently clear about the customer's right to complain. Some respondents also argued that the existing complaints process was effective, and that the regulator had the resources to highlight issues through the media if necessary. Respondents also argued that it could be difficult to keep in touch with all clients who might be affected and it would be

unfair to impose requirements on UK-regulated firms that would not apply to other firms operating in the UK.

Our response: We have decided not to pursue this idea. The feedback and our decision not to proceed with the long-stop, coupled with our proposals for tackling the root causes of the problems we seek to address in this paper, should reduce complaints in the long-term.

Q36: Do you agree that stakeholders should seek ways of ensuring that measures taken by the industry to prompt valid complaints are taken into account when deciding whether a consumer was aware that he or she had grounds for complaint?

159. A large majority of respondents supported the idea that firms that provided better and more regular information should take this into account when considering customers' complaints. Some respondents expressed concern that prompting valid complaints might also give rise to unfounded complaints. A small number of respondents expressed the view that customers who made complaints without good grounds should be penalised. Some respondents also noted that firms would have to discuss their plans with their professional indemnity insurers if they were considering inviting or prompting clients to complain.

Our response: As mentioned in the answer to the previous question, the RDR is not pursuing measures to prompt valid complaints at an earlier stage.

Q37: If it is not possible to agree on consumer responsibilities, would it help to agree on a set of 'sensible consumer actions' when buying a retail investment product, which could be made available to customers and taken into account when considering complaints, even if these are not legal obligations on consumers? Do you have any other suggestions?

160. The subject of consumer responsibilities and 'sensible consumer actions' caused a good deal of response both positive and negative across a spectrum of firms, bodies and individuals.

161. On the positive side, creating a list of 'sensible consumer actions' was seen as a helpful addition to current processes, but some respondents thought this would only confuse a customer who is already overwhelmed with paperwork.

162. Again a greater proportion of IFAs thought this could be a positive addition to their processes and could help in reducing the level of claims made to the FOS by consumers claiming to have been misinformed. Other firms and compliance consultants felt that 'the FSA should resist any attempt by the industry to shuffle off its responsibilities by agreeing a set of consumer responsibilities'.

163. Home finance brokers suggested that a code of practice could help in this area as customers would be informed of such things as complaints procedures before starting the purchase process and an authorised professional firm suggested that customers

should be issued with a list of what the product will not do, so that customers know in advance what they cannot expect from the product.

164. Respondents generally gave many positive suggestions to address this issue but a large percentage also commented that the current Treating Customers Fairly (TCF) processes should cover this area of business.

Our response: As explained in Chapter 1, we will publish a Discussion Paper on the issue of consumer responsibility in December 2008.

Q38: Do you agree that preparing a record of good contemporary market practice, by a group with strong industry and consumer representation and credibility, would lead to greater certainty about the standards against which advice will be judged?

165. In principle, respondents favoured the idea of a record of good contemporary market practice. One respondent commented that this would be the ideal step towards a future Consumer Charter. A larger firm described it as of great interest and use to the industry provided that it had the FSA's unequivocal endorsement.

166. However, many respondents – including IFAs, appointed representatives and a consumer group – asked who is going to represent the industry in the working group that would produce this record. Small firms were particularly concerned whether they would be represented. Some suggested that unbiased and proportionate representation is important in order to produce credible outcomes.

167. Many respondents argued that a record of this kind would be very useful especially for small firms, but too difficult to implement in practice as each case can only be judged on its own merits. A small number of respondents also wondered how these standards would be applied by the FOS when it assesses complaints since each complaint is looked at individually and decisions vary accordingly.

168. A few also stated that this record would not reflect the variety of business practices in a constantly evolving market and could only be of value for standardised services and products.

169. Some industry respondents, especially larger firms, are also concerned that if this guidance becomes too prescriptive there is a risk of it turning into a quasi rule that could stifle the benefits of more principles-based regulation. One larger firm suggested that the focus of the group should not be defining detailed standards of behaviour but more about helping future regulators gain an understanding of the risks and assumptions at a particular point in time. One respondent suggested that this record should be used as a standard to be applied over the next year but not have retrospective effect.

170. A sizeable minority was not supportive of the idea and argued that it would be too difficult and costly to achieve such a record given the precedent of the AIFA 'stakes in the ground' project which resulted in a document that was too generic. Some respondents believed that similar standards are already in place, for instance professional Codes of Conduct.

171. Finally, a small number of respondents felt that they could not provide an answer until they had a greater understanding of this initiative.

Our response: We have focused our consideration of how firms might achieve greater assurance about how services might be judged on the type of streamlined 'guided sales' services described in Chapter 5. Chapter 5 also explains how we have been working on this (with trade bodies, consumer representatives and the FOS) and the options for providing greater certainty through guidance, and the potential trade-off between flexibility to innovate and the greater certainty that could be provided through detailed guidance. We have not concluded our work on this because the industry is still considering models for 'guided sales', so it is too early to tell whether we will learn anything from it that we can apply to other services.

Q39: What do you think the cost of preparing a record of good contemporary market practice, and revising it annually, will be?

172. Many respondents said they were unable to quantify the costs for preparing and reviewing a record for good contemporary market practice without further information about how it would work.

173. Some commented however that professional organisations with relevant experience of this type of information gathering should be in a position to provide a cost estimate. A larger firm argued that the experience of the industry with MiFID Connect[10] should give a good indication of start up costs.

174. Many expected this process to be a costly and time-consuming exercise for the industry and expressed considerable concern about who was to meet the costs. Some responded that this process would be fairly expensive notably for small firms, while others commented that costs were likely to be significant if this record was not kept simple and concise. Nevertheless, some felt that the benefits would eventually outweigh the costs. In particular, IFAs spoke of costs being partially offset by reduced professional indemnity insurance (PII) costs, fewer complaints payouts by the FOS and regulatory dividends. One respondent pointed out that the industry would be ready to bear any costs associated with this effort, if both the FSA and the FOS endorsed it. Another respondent stated that initial costs might be substantial, but ongoing costs would be significantly less.

175. Finally, a few respondents viewed that there would be no extra cost involved if professional bodies that already have experience of this type of work were custodians of this initiative. One respondent suggested that professional body memberships should cover these costs, whilst a larger firm believed that firms and trade bodies would contribute their time to such a guide on a pro-bono basis.

10 MiFID Connect has published industry guidance in relation to suitability which FSA has confirmed (this can be found at: www.mifidconnect.org/content/1/c6/01/02/00/suitability_guideline_100807.pdf).

Our response: As explained in the answer to the previous question, we have not taken forward the idea of a record of good contemporary market practice at this stage. However our work on how we might provide greater certainty about how 'guided sales' services might be judged has highlighted the potential trade-off between flexibility to innovate and the greater certainty that could be provided through detailed guidance. This will be an important consideration for us and the industry to consider in taking forward that work.

Q40: What regulatory incentives, in addition to risk-based prudential requirements, do you think would encourage financial advisory businesses to improve the quality of their advice?

176. Respondents made a variety of positive comments regarding the impact of potential regulatory incentives on quality of advice. Although there was no consensus, there were several recurring suggestions for further regulatory incentives.

177. Many respondents argued for a regulatory dividend for firms with proven compliance records. The most common suggestion was for the FSA, FOS and FSCS fee rebates, or for a 'no claims bonus' scheme to apply to professional indemnity insurance. Trade and professional bodies agreed with the need for a risk-based supervisory regime leading to less regulatory scrutiny for firms with good compliance records.

178. A number of respondents suggested a system of fee rebates based upon a firm's employees holding particular qualifications or being members of relevant professional bodies. Several related suggestions were made, including the linking of a reduction of fees and levies to minimum qualification standards, improved CPD or compulsory membership of a professional body.

179. A small number of respondents advocated the publication of data on firms' regulatory compliance record or envisaged a system of 'name and praise' to complement a 'naming and shaming' policy in order to encourage the sharing of best practice. Other suggestions included a rating system or 'kitemark' to denote firms with a good record of compliance; a star system for individual advisers, or an excellence award for firms which haven't received complaints or caused a compliance issue.

180. A large number of respondents gave negative comments. Some believed that no further changes were necessary or that further regulatory incentives were an inappropriate way of ensuring that practitioners adhered to what were perceived as minimum acceptable professional standards. The most common criticism of further action was that the desire for business survival and growth outweighed any possible regulatory incentive for the provision of quality advice. Consumer bodies, in particular, believed that naming and shaming, together with quicker and more rigorous enforcement, would be preferable to the provision of further regulatory incentives.

Our response: We believe the great incentive for firms of all types to make the challenging changes proposed in this Feedback Statement is the business opportunity arising from building consumer confidence and trust through greater clarity of services, changes in remuneration, greater consumer recognition of the value of advice, raising professional standards, and from increased consumer access at the lower end of the market. Although firms may be disappointed that we are not proposing additional regulatory incentives, we believe the medium- to long-term business opportunity far outweighs the benefits of any regulatory incentive. Further, the FSA has a risk-based approach to supervision: firms that pose a risk to our statutory objectives receive more attention than those who do not. We expect that as our proposals address the root causes of problems in this market, the need for supervisory attention should reduce.

Transparency of remuneration

Q41: What data should be collected, and from whom, to help us to focus our attention on those firms most likely to be causing consumer detriment when advising consumers to switch product?

181. The answers to this question tended to debate the difference between 'switching' and 'churning' investments and policies. Many respondents pointed out that switching is not necessarily a recipe for consumer detriment and that in some cases switching is a positive action whereby consumers can benefit by moving their investments from out-of-date poorly performing products.

182. Some respondents suggested that information regarding 'switched' investments should be collected from regulated intermediaries who actually distribute the products and not the product providers simply because they are the originators of the products. Others thought that this sort of information should be identifiable from firms' management information produced for TCF monitoring purposes.

183. Some respondents also suggested that the FSA should carry out regular consumer surveys, exploring the reasons why customers chose to switch investments. Customer/adviser declarations were also suggested as a means of confirming that a switch was in a customer's interests.

184. Some respondents said that the FSA already collects too much data, via the Retail Mediation Activities Return (RMAR), and that no further data should be required. Again others thought differently and suggested that figures for remuneration from rebroking business and pension transfers should be collected as part of the RMAR. Receiving providers should submit returns on all switched investments, and should ensure that the intermediary recommending the switch provides a plausible explanation.

185. A number of respondents suggested that no further information was needed as management information produced for TCF purposes should provide evidence of the extent to which firms are assessing current performance against current TCF principles, and taking the steps necessary to ensure fairness is embedded in the organisational culture

Our response: In Chapter 4 we consider the risks of Adviser Charging, including how it might affect the nature of the advice advisers provide, and the standards that we may set to address problems such as churning. We will consider whether our persistency returns are capable of delivering the information we will need about levels of product lapsing and switching in the industry, following the introduction of Adviser Charging. We also explain that, in future, customers may have to incur a greater share of the costs of switching away from a product before the end of its term, which may make switching less beneficial.

Q42: Do you agree that greater clarity for consumers on what services are being supplied, how much they are paying for them, and more influence for consumers on remuneration generally will help to address inappropriate advice risks?

186. More respondents agreed with this proposition than disagreed with it, believing that it would help match the differing expectations that exist between consumers and advisers. However a large number of respondents did not express a clear view, some because they could not see how clarity could be achieved in practice.

187. Most who supported the proposition did not think it would, on its own, be sufficient to address the risk of inappropriate advice. Much more consumer education was required to ensure consumers truly understood the information provided, for example, the consequences of different types of remuneration. Some respondents said that transparency and information-based remedies to achieve greater consumer awareness have been seen to have limited impact in complex sectors such as financial services, specifically where there are pressurised sales processes.

188. A number of respondents felt that greater consumer clarity could be achieved through a review of existing disclosure documents such as the menu and initial disclosure document (IDD), rather than introducing new measures. They suggested the information could be given in a clearer and more digestible way. Many cautioned against providing additional paperwork to consumers, arguing that the present level of disclosure constitutes an overload that has led to consumer confusion. Respondents suggested: annual disclosure of all costs to consumers; using platforms to achieve cost transparency; ensuring total costs are outlined to consumers from the beginning to end of the contract; and ensuring total costs (including trail commission) are stated on all statement and valuations. There was considerable emphasis on the need for better disclosure of trail commission.

189. Reasons why respondents disagreed that greater clarity for consumers would not help address inappropriate advice included:

- poor training and competence was considered much more likely to result in inappropriate advice than remuneration: if an adviser is incompetent it does not matter whether he is remunerated by fee or commission, the advice will still be poor;
- greater clarity for consumers would not prevent rogue advisers from ‘mis-selling’, because they would always find a way to do so regardless of the level of consumer awareness;

- inappropriate advice was caused by product bias, which could not be addressed through remuneration disclosure but should instead be addressed at source through product providers; and
- it was unlikely that the majority of consumers would feel confident or knowledgeable enough to play a useful role in influencing and/or negotiating remuneration.

190. Some respondents felt that both provider and adviser remuneration should be transparent. One respondent said: 'Greater clarity on what services are being supplied would certainly help to set realistic expectations and clarify the division of responsibility between customer, adviser and provider – it is in everyone's interests to improve this'.

Our response: Chapter 3 explains our intention to consult on improving the clarity for consumers of the characteristics of different service types and the distinctions between them. Chapter 4 explains our proposal to consult on 'Adviser Charging' for independent advice, retaining many of the characteristics of 'Customer Agreed Remuneration', but recognising that it is unrealistic, at least in the short-term, to expect most consumers to negotiate charges. We want to improve consumer awareness that advice has a cost and a corresponding value. Chapter 5 explains the remuneration proposals we intend to consult on for non-independent advice services. We will consult on requiring separate disclosure of the costs of advice from product costs for both independent and non-independent advice. Chapters 4 and 5 set out a range of proposals for adviser firms and product providers to further mitigate against the unintended consequences of changing remuneration practices. We also recognise that the effective mitigation of these risks will require a step-change in our supervisory approach.

Q43: How, if at all, should we intervene on the issue of consumers' rights to switch off trail payments?

191. More respondents thought consumers should not have the right to switch off trail payments than did think they should have this right, although many were undecided. There was a similar spread of views about whether the FSA should intervene to switch off trail payments.

192. Respondents saw three different purposes for trail commission: (a) in lieu of a reduced initial commission; (b) to meet costs of ongoing administration, for example, replacement of policy documents; and (c) to provide further servicing such as investment reviews. Many thought the purpose of the trail commission should be disclosed in the terms of business and at the time of the transaction. If trail commission was not in lieu of a reduced initial commission, advisers should demonstrate ongoing service, or consumers should have the right to switch off payments. If trail payments are in lieu of reduced initial commissions, consumers should not be able to turn off the payments. A number of respondents expressed doubt that the FSA would be able to intervene because the client agreement which outlines trail commission is a contract between client and adviser.

193. There was disagreement between respondents about whether consumers currently have the right to switch the trail commission to a new adviser. Some thought that this was a consumer right and that it was common practice, whereas some referred to provider systems which are not able to do this, and other providers that are reluctant to do so.

194. Some respondents called for consumers to have the benefit where trail commission can be stopped, for example through reduction of annual management charges or increasing allocation of units, rather than product providers benefiting. Others would like to see the FSA give consumers the right to choose which adviser trail commission is paid to. A number of respondents were concerned about whether the benefit could be passed to consumers and therefore whether any changes the FSA made to trail commission as part of the RDR would result in a better outcome for consumers. Some wanted to see us check the level of servicing being provided for the amount of trail commission being received. Some respondents called for the FSA to require annual disclosure of all trail payments received, and for consumers to sign a form of consent periodically to enable advisers to continue to receive such payments.

195. Several respondents thought trail commission was beneficial for consumers because it was a tax efficient alternative to fees. If consumers were able to switch off trail the industry would be likely to revert to higher initial commission structures to secure their income. Many respondents said that if trail commission did not exist, consumers would have to pay fees for reviews, which they thought would reduce demand for reviews, and might also reduce in the quality of ongoing advice. A reduction in trail commission would have a significant impact on the industry because some business models are based on this recurring remuneration, enabling them to plan ahead because of its stability. Some respondents expressed doubt that product providers have systems which are able to make changes to trail commission payments.

196. Most respondents thought it would be helpful for the FSA to clarify the role of trail commission and consumer rights in relation to it. Some suggested a TCF industry standard specifically for these payments, and an FSA role in raising consumer awareness about what trail commission is and consumers' rights in respect of it.

Our response: Chapters 4 and 5 explains our proposals for improving transparency of the cost of all advisory services. We believe that there should be more clarity on what trail payments are for, the circumstances in which they can be switched off, and this should be discussed up-front with clients by advisers.

Customer Agreed Remuneration

Q44: What do you think is the most appropriate approach under Customer Agreed Remuneration (CAR) to matching (in terms of amounts and timing) payments from the consumer to the provider, and payments from the provider to the intermediary, and why? What role, if any, might there be for regulation, or for guidance from other parties, to establish uniformity of approaches in the market?

197. The overwhelming majority of respondents believed that maintaining flexibility in the timing of payments made to advisers was important. Several respondents argued that the essence of CAR was client disclosure, transparency and agreement of remuneration methods; and the timing of payments was integral to any such agreement. As such, it did not require additional regulation.

198. Several respondents argued that there should be no change in current payment practices and/or that payment matching was a complex distraction from the need to introduce commission standardisation or capping. Some respondents were also opposed to matching on the grounds that it was expensive and administratively unworkable. It was also argued that there should be no objection to non-matching payments where they were economically equivalent. Some respondents also argued that initial commission was a form of legitimate factoring and an essential means of controlling cash-flow. A more detailed study into the potential impact of any change was also suggested by some respondents.

199. Some respondents, however, emphasised their support for payment matching as the only way of eliminating commission bias. They also argued that strict payment matching was an opportunity to enhance transparency, and that increasing use of new platform and wrap infrastructure could help facilitate the process. A few respondents also argued that matched payments gave a more sustainable business model.

200. Most respondents felt that there was little scope for regulatory intervention because payment matching was a purely commercial or accounting decision. They argued that flexibility was preferable to uniformity in the marketplace, provided that there was full disclosure to the customer. Nevertheless, some respondents valued uniformity and urged the FSA to produce guidelines aimed at ensuring consistency and curbing consumer confusion. Some respondents, however, viewed uniformity of payment matching as being driven by product providers.

Our response: Chapter 4 sets out our proposals for moving to an 'Adviser Charging' model. We agree with respondents who advocate 'perfect matching', where an adviser firm receives payment in the same pattern as it is deducted from a customer's investments, and so Chapter 4 explains that we intend to consult on preventing 'factoring' of remuneration by product providers from the end of 2012.

Q45: Do you agree with the concept of third party financing, and if so, how might this operate?

201. The majority of respondents disagreed with the concept of third party financing of advisers' remuneration on the basis that it would create greater complexity, consumer uncertainty, and could reintroduce bias. In particular, respondents thought that third party financing would be open to abuse by product providers, and that it could result in market distortion or contraction.

202. Some respondents also expressed reservations about the practical implementation and operation of third party financing. It was argued that it would be an unattractive option for existing factoring providers due to poor persistency levels, and that factoring would be subject to an additional regulatory regime in the form of the Consumer Credit Act.

203. Some respondents, however, supported the concept of third party financing on the grounds that it was a useful tool for managing cash-flow, and it could – by diversifying finance sources – improve business resilience.

204. Several respondents were undecided and called for research into how third party financing would work in practice. Some respondents also suggested that any move to a fee-based model, under which advisers would be remunerated directly through fees paid directly by customers, could be aided by factoring which would help advisers manage their cash-flow.

Our response: We believe that decisions about adviser remuneration being funded by third parties unconnected to the product provider should be a commercial matter, and so we do not propose to take any regulatory action to enable it.

Q46: What do you think are the main barriers, including taxation, which would prevent firms from moving to a CAR model? How might these barriers be addressed?

205. Most respondents suggested one or more of a range of potential barriers to the introduction of CAR, or appealed for greater clarity on aspects of the proposals. However, several respondents denied that there were any barriers and supported introduction of the current proposals. In addition a number of respondents declined to answer the question.

206. Many respondents drew attention to a perceived uncertainty over the status of VAT on fees, as opposed to commission; while others argued that there was an established and understood distinction between VAT being levied on advice but not in respect of intermediation. Some respondents also drew attention to the income tax relief available in respect of wide-ranging financial advice provided under the auspices of a pension contract. A few respondents expressed further concern that the 'passporting' regime under the MiFID would allow firms to circumvent the CAR regime and preserve their existing pure commission remuneration model.

207. Many respondents highlighted resistance to change amongst consumers, insufficient consumer education, unwillingness to pay fees and potential loss of income as the biggest barriers to the adoption of CAR. However, a similar number of respondents saw advisers themselves as presenting a bigger barrier. Their comments included the difficulty of persuading advisers to commit to cultural change; advisers' current insecurity in presenting the value of their advice to clients and their unwillingness to move away from commission.

208. Some respondents cited their concern over the cost and complexity of introducing new systems and controls to handle CAR which complied with regulatory and accounting expectations. Some respondents focused on advisers' dependency on indemnity commission and the challenge of transitional cash-flow management. A particular concern was disaggregating and attributing payment across providers and distribution channels, although a few respondents recognised the potential of platforms and wraps to address this problem. A few respondents were also concerned that moving to CAR would result in a potential loss of cross-subsidy, or felt that managing legacy business would prove difficult; while some bancassurers believed

that CAR introduced an asymmetry across business models which discriminated against tied advisers.

209. Respondents also noted a number of other perceived practical barriers to the introduction of CAR including: the difficulty of payment matching; the 'huge administrative costs' involved in changing payment systems, early adoption penalties for those firms which had already moved to a fee-based remuneration model which differed from the expectations expressed in our DP; the need to secure product provider agreement to the CAR model, and particularly acute cash-flow problems faced by new entrants to the industry.

Our response: We have considered the barriers and risks associated with moving to an Adviser Charging model of remuneration, including examining the tax implications. This is covered in Chapter 4, together with our proposals for mitigating the risks associated with Adviser Charging. We recognise that both advisory firms and product providers will need time to change to Adviser Charging (for example, making systems changes). With this in mind, we plan to consult on a two-stage implementation for our new rules. Chapter 6 covers our plans for transitional arrangements in more detail.

Q47: Do you agree that CAR could assist advisory firms to move towards a fee-based revenue model (according to the current definition of fees)? Could this help to erode the perception that advice is a free commodity?

210. Most respondents agreed that CAR could help firms move towards a fee-based revenue model. However, a few respondents felt that the transition to a fee based model was already underway and that CAR would not provide any additional impetus. In addition, some respondents restated their opposition to CAR or to a fee based remuneration model, citing lack of client demand for fees or the need to preserve customer choice. The Association of British Insurers believed that, while CAR may eventually move the market towards a traditional fee based model, it may have the opposite effect in the short-term by offering a variety of ways for consumers to pay for advice.

211. Most respondents also agreed that the adoption of CAR would help to erode the perception that advice was a free commodity, with many criticising consumers' belief in 'getting something for nothing'. However, some denied that consumers were naive enough to perceive financial advice as free or argued that consumers' perception of the cost of advice was less important than their essential unwillingness to pay for it. One respondent argued that consumers' perception that advice was free was inadvertently beneficial because it encouraged them to seek it out.

212. Some respondents felt that clarity of communication was separate from the introduction of CAR and that advisers were already obliged to disclose that advice was not free. One consumer group felt that advisers made misleading statements to clients in respect of the cost of advice, but the Financial Services Consumer Panel agreed that CAR would both encourage a fee-based service and help to correct client perception of advice. A number of respondents were undecided or elected not to answer the question.

Our response: Our revised remuneration proposal, Adviser Charging, which is described in Chapter 4, may help advisory firms move to a fee-based model (according to the current definition of fees). However the objective of introducing Adviser Charging is to remove provider influence from adviser remuneration, not to move firms to a model where fees are paid direct from customer to adviser. We recognise the legal and practical barriers to this at present, for example the unwillingness of many consumers to pay upfront fees by cheque. Chapter 3 explains that an objective of our remuneration proposals is for consumers to understand the services being provided and to recognise the value of advice.

Q48: What are the main challenges to implementing CAR, and what might be the implications for consumers, firms (of all types) and the FSA?

213. Respondents noted a wide range of potential challenges to implementing CAR for consumers, firms and the FSA. Many of these challenges related to habit, inertia or fear of change on the part of both advisers and consumers. Nevertheless, some respondents denied that they had faced challenges when adopting a CAR model and did not anticipate any further challenges if the model were to be adopted as proposed.

214. Some respondents focused on the consumer confusion potentially caused by merging different methods of remuneration within CAR. A number of respondents reiterated concern that consumers were unwilling to pay for something intangible and would leave the advice market, either as a result of being informed that advice was not free, or if they were asked to pay for it directly. Others believed that consumers would be ill-equipped to place a fair monetary value on the long-term benefits of financial advice, or that they would suffer from the effects of information asymmetry when attempting to negotiate advisers' remuneration. Many respondents saw the principal challenge of implementing CAR as providing consumers with sufficient education to allow them to overcome these potential difficulties.

215. A number of respondents focused on the cost and cash-flow difficulties of implementing the proposed changes; or mentioned their fear of facing additional regulatory burdens. Some chose to address the specific challenges faced by product providers. Comments included concern over providers' capacity to facilitate complex remuneration options; the difficulty of disaggregating product costs or of moving to factory gate pricing; the challenge of implementing fundamental changes to systems and controls; uncertainty over how to share persistency risk, and questions as to what extent providers would reduce their underlying product charges to reflect advice costs being met directly by the consumer in future.

216. However, more respondents focused on the challenges faced by independent advisers, whom they felt would suffer from a contraction in the advice market caused by consumers' confusion, the availability of 'off the shelf' products and by pressure from bancassurers with large promotional budgets. A few respondents feared the onset of a 'race to the bottom' (by which they appeared to mean a 'price war') in the agreement of remuneration which would make their business unviable. Some believed that justifying necessarily higher initial fees to clients would prove difficult. Many respondents also noted the challenge for advisers faced with a significant cultural

change which would depend upon increased transparency and preclude their reliance on traditional forms of commission.

217. Some respondents noted specific challenges for the FSA which included the importance of establishing and effectively policing a principles-based regulatory framework for CAR without undue interference with the free market; deciding what constitutes fair remuneration (or monitoring the market's own determination); clarifying and harmonising disclosure to clients, managing the public's perception of CAR, and promoting good practice. A number of respondents reiterated general criticisms of CAR, believed that it was too complex to be introduced, that it should not be made mandatory, that the cost of introduction would be disproportionate to any benefit, that consumers would not accept the model or that it ought to be introduced only after a long lead time; while some others declined to answer the question.

Our response: Chapter 4 sets out our proposals for moving to an 'Adviser Charging' model. It also covers the challenges and risks associated with it. To address the practical challenges of the transition to Adviser Charging, including system changes for firms and providers, we have set out a proposed phased approach to implementation in Chapter 6.

Q49: What market mechanisms (if any) do you envisage could contribute to reducing the risk of price discrimination as a result of CAR? Would the risk of price discrimination be a concern for consumers and how may this risk be mitigated?

218. Many respondents commented on the advantages of encouraging a competitive market for advice in which consumers were better able to shop around but the majority found no place for market mechanisms in reducing the risk of advisers exploiting information asymmetry. Most believed that consumers were operating in a free market and could consequently choose whether or not to retain any particular adviser and on what terms; while some felt that this freedom was the essence of CAR.

219. Many respondents suggested that any potential difficulties stemming from information asymmetry would be resolved through full and transparent disclosure of charges to consumers before they were committed to a transaction, but believed disclosure to be a professional duty which was not reliant on formal market mechanisms.

220. Some respondents were concerned that flexibility of remuneration was paramount; noting that advisers routinely took account of customers' ability to pay (rather than their willingness to do so) under their current charging structures, and that this broadened the range of potential consumers that they were able to advise. A few remarked that any restriction of their latitude in deciding upon remuneration or in their ability to cross-subsidise on a case-by-case basis would, in turn, restrict their client base and lead to a contraction in the advice market.

221. A few respondents felt that there was some scope for market mechanisms to limit the impact of information asymmetry on consumers. Suggestions included FSA guidance and monitoring of fee calculations, publication of acceptable fee ranges, standardised hourly rates or transactional fees, or a suggested menu of charges. Others believed that the FSA, professional and trade bodies, external compliance consultants and the

product providers themselves all had a duty to monitor prevailing market practices and to take action to curb excess where necessary.

222. A number of respondents believed that existing rules, regulations and principles would be sufficient to safeguard consumers from any potential disadvantage caused by information asymmetry. Respondents specifically referred to the Treating Customers Fairly (TCF) requirement. Some respondents felt that information asymmetry would not any present problems at all, or believed that the question implied that advisers would act dishonestly – which they vigorously denied – while a few declined to answer the question.

Our response: We set out in Chapter 4 a range of proposals to mitigate the risks of Adviser Charging, including price discrimination.

Primary Advice

Q50: What should be our role in endorsing the criteria for segmenting consumers for Primary Advice? What role is there for the industry to provide appropriate standardisation?

223. In their responses to this question many respondents provided general comments on segmentation, with most being against segmentation of consumers. In particular many respondents, particularly IFAs, felt that any categories arising from segmentation would be too simplistic and would prevent the complexity and variation of many consumers' needs from being adequately catered for, therefore leading to a high risk of inappropriate advice. Several respondents commented that segmenting consumers by level of income or other limited characteristics and then linking these segments with particular products and levels of advice could be seen as being discriminatory, particularly if the products and advice were perceived as inferior to those sold outside Primary Advice. Others commented that Primary Advice should be open to all and consumer segmentation should not be attempted.

224. There were also concerns amongst IFAs that segmentation of consumers coupled with a simplified sales process would lead to the re-emergence of direct sales forces, which may then take advantage of the simplified process to focus selling to particular consumer segments without adequately assessing the needs of the individual consumers concerned.

225. Where opinions were given about the role of the FSA in endorsing the criteria for Primary Advice most respondents agreed that we should have some involvement. This ranged from the FSA setting the segmentation criteria, to working closely with industry, to endorsing criteria that were set by the industry – with the latter two options being the most favoured.

226. However most respondents were in favour of the industry driving standardisation, for example through some type of industry working group, with the FSA providing a sufficient degree of regulatory endorsement of the framework, but without stifling innovation. It was suggested that we could achieve this by providing clarity around issues such as the boundaries of the Primary Advice process, providing guidance on

best practice, and using our supervisory role to ensure that Primary Advice was delivered correctly. One respondent suggested that there should be a partnership between the FSA and the industry to agree appropriate benchmarks, to ensure Primary Advice customers with specific needs are treated consistently regardless of which firm they approach. Some respondents noted that it would involve a major investment of time and money for firms to be involved in this standardisation.

227. A small number of respondents strongly disagreed with the industry having any role in standardisation, on the basis that they disagreed with the concept of consumer segmentation. Other respondents, particularly smaller firms, had concerns over the industry driving standardisation, for reasons including that they thought that the industry does not have a good track record of agreeing standardisation, and that they were concerned that the firms with the power in the decision making process would not represent their views adequately.

228. Some respondents suggested that consumers should be required to take some responsibility in the Primary Advice process, and should in effect 'segment themselves', for example by making their own decisions on what their advice needs were, rather than being told which category they fit into. A number of respondents also highlighted the importance of consumer education.

Our response: Chapter 5 explains that we have moved away from the name 'Primary Advice', but that some in the industry are exploring models for simplified services, sometimes referred to by the names 'assisted purchase' or 'guided sales'. These have not been developed in detail yet, and Chapter 5 sets out our approach to helping firms develop such processes within the current regulatory framework.

Q51: To what extent is there unmet demand for some form of simple advice, bearing in mind that the wider proposals in this DP and other market developments could alter the demand in the future?

229. Many respondents saw a potential demand for some form of simple advice. However many differentiated between there being an unmet 'demand' and an unmet 'need'. Many respondents thought that there is a need for accessible good quality, affordable and truly impartial basic level advice, but that this need goes largely unrecognised by many consumers, for reasons including poor consumer education and a general lack of engagement with the financial sector. Therefore, something would need to be done to stimulate this latent demand so that consumers in need of financial advice would be more aware of it and therefore more likely to take advantage of any proposed solution.

230. However, some respondents also commented that it would be very difficult to stimulate demand for something which many consumers do not realise that they need, and that many consumers would continue to show apathy towards financial services, particularly in current economic conditions, and where increasing levels of personal debt also act as a barrier to encourage consumers to invest. Consumer attitudes were also seen to be an issue as many consumers are used to the culture of borrowing, not saving, and it was commented that it may take more than a change in the structure of advice to overcome this. Trust was also felt to be an issue, with

consumers needing to feel confident that the advice they were given and products sold would serve their needs as expected, before they would consider engaging more with the financial sector.

231. Some respondents, particularly larger firms, did see a positive demand for more accessible advice. However they thought that the process would need to be as simple and as quick as possible so that consumers would find it easier to fit financial advice into their routine. It was also suggested that the simple advice process would need to allow a clear articulation of the benefits of the products involved in order to 'sell' these to consumers who may not be familiar with the benefits of financial products. A number of respondents favoured the introduction of some kind of guided regulated sales process, which they referred to as 'assisted purchase'.

232. There were concerns, particularly amongst smaller firms and IFAs, that financial advice in this sector would not be economically viable due to high compliance costs and low margins, and several stated that they would be reluctant to enter into this market. They were also concerned that larger suppliers, such as bancassurers and those with access to a direct sales force, would therefore benefit from proposals over smaller firms, and some respondents feared that proposed changes would lead to the rise of poorly skilled sales forces pushing 'flavour of the month' products, resulting in inappropriate sales and further undermining trust in this market. Therefore many felt that proposals would need to include measures to ensure that Primary Advice was not seen as being inferior or untrustworthy.

Our response: Chapter 5 explains that some in the industry are exploring models for simplified services. They have not yet quantified the level of demand for the proposed service, demonstrated the underlying economics and commercial viability of their models, or explained in detail how consumer protection issues would be addressed, but they believe there is sufficient potential to explore them further.

Q52: Do you think that a Primary Advice service would benefit consumers and, at the same time, provide sufficient consumer protection?

233. Most respondents who answered the question directly did not believe that a Primary Advice service would either benefit consumers or provide sufficient consumer protection. Whilst many agreed that access to advice should be improved, most did not believe that Primary Advice was the way to achieve this.

234. Several respondents commented that the proposals for Primary Advice stemmed from high aspirations rather than reality, and that to introduce Primary Advice without further detailed research into consumer needs would lead to innovations that would be ineffective, costly to the industry and which would further erode consumer confidence. Similarly some respondents were concerned that the proposals were an attempt to design an advice mechanism according to the needs of the industry and not consumers. Some respondents were concerned that Primary Advice would lead to less well-off consumers receiving a lower standard of advice, receiving products that were poor value for money, while having reduced access to redress.

235. IFAs were particularly opposed to the proposals, again voicing concerns that Primary Advice was not true advice but sales, and the introduction of Primary Advice and the 'one size fits all' approach would lead to systemic mis-selling. Some respondents were also concerned about practical issues such as how advisers would identify that some consumers were suitable for Primary Advice before carrying out a full fact find, leading to some consumers receiving Primary Advice when inappropriate for their needs. Others were concerned that the small scale provision associated with this market would merely replace state benefits (e.g. because of means-testing).

236. Many respondents were also concerned about the added complexity that Primary Advice would bring from a consumer point of view, for example by blurring the distinction between advice and no advice, which would cause confusion and possibly deter consumers from engaging with the market.

237. Fewer respondents provided detailed responses on the consumer protection issue, although many indicated that they did not believe that consumer protection would be sufficient. Some respondents stated that the low margins likely to be associated with these products would mean that there was little provision to fund adequate compliance arrangements, and that the limitations around the products would lead to long term anxiety over whether consumers have the right products.

238. A number of suggestions were made about how the consumer protection issue could be managed. Several respondents suggested that products would need to be kept as simple as possible in order to minimise issues around advice, although some respondents doubted whether it was possible to design products that would be sufficiently simple and provide value to the consumer. Others suggested that a strong emphasis should be placed on full disclosure. One respondent suggested that protection must sit within the product itself, or else full advice would need to apply, and another suggested that the FSA should regulate the products as well as the advice. Others suggestions included a ban on target driven sales and that larger firms should use salaried advisers to provide Primary Advice.

Our response: As described in the answer to the last question, some firms feel there is sufficient potential in the types of 'guided sales' services described in Chapter 5 to undertake more detailed analysis work. They have not yet quantified the level of demand for the proposed service, demonstrated the underlying economics and commercial viability, or explained in detail how consumer protection issues would be addressed. A case has not yet been made for us to develop a new regulatory regime for such services, but Chapter 5 explains why we believe it is possible for firms to deliver streamlined services within the current regulatory framework.

Implications of debt for savings advice

Q53: What are your views on the extent to which people with existing debts should be encouraged or discouraged by financial advice to make investments and to save?

239. A minority of respondents stated that debts must always be repaid before investing or saving. Most who directly answered the question said that although they agreed in

general that it should be a priority for debts to be repaid before saving or investing, there were situations where according to individual circumstances and preferences, as long as debt was being managed, it would be appropriate to advise a consumer to invest or save. Examples of relevant factors that were mentioned to be taken into account include the cost of borrowing and prevailing interest rates, the affordability of outstanding debt, liquidity, tax considerations and attitude to risk.

240. Respondents also stated that the type of debt would have a bearing on the advice given. For example, many thought that mortgage debt should not preclude someone from saving or investing, although there may be circumstances where it may be more appropriate to advise a consumer to make repayments of mortgage debt than to save or invest. Several respondents also differentiated between debts with a scheduled repayment date, such as a personal loan, from debts with no scheduled repayment date, such as a credit card, with this second category having a higher priority to be repaid than the first.

241. Many respondents emphasised that consumers with debt do also have wider financial planning needs. Debt management may form an important part of this, but it also includes protection needs, and extends into some form of saving and investment, such as saving an emergency cash fund or investing in pension provision. Other types of savings or investments may also be appropriate according to individual circumstances and aspirations, although most respondents considered accessible saving products more likely to be suitable than investments in the majority of cases.

242. A number of respondents also made the point that in the modern world debt is commonplace, and many people would never have the opportunity to save or invest if it was only appropriate to do so when totally free of debt. Several respondents also stated that it can be beneficial to consumers to learn the discipline of saving, even through saving a relatively small amount, where for example the repayment of debt is a more important priority. Once the habit of saving is formed it can act as a useful discipline to encourage people to persevere with repaying debt and then to continue saving once debts have been cleared.

243. Many respondents, particularly IFAs, used these points to highlight the importance of sound financial advice in determining the complex individual circumstances surrounding the appropriateness of savings or investment products. Banks and providers highlighted the importance of keeping things as simple as possible and clearly explaining options to consumers.

Our response: As explained in Chapter 5, firms have not developed detailed models for 'guided sales' services, including the treatment of existing debt. We anticipate this is one of the areas on which those developing the models will seek guidance. The feedback we have received will be available to inform our thinking when developing guidance, as will the nature and extent of the service being provided, and the customer's understanding of that service.

Q54: Are there any particular exceptions and how should we consider this in the context of decision trees for Primary Advice?

244. Most respondents did not suggest any particular exceptions beyond what had already been discussed in question 53, and a number of respondents used the opportunity to voice their opposition to the concept of Primary Advice.

245. Some respondents did make suggestions both about the types of debt that would be allowed, and the types of product that could be offered to people with some form of debt. The former category included mortgages and other secured loans, debt with fixed end dates and young professionals with student debt but high earning potential. The latter included savings for emergency use, protection products and pensions. Many respondents again made the point that every case is individual, and therefore it would not be easy to identify a set list of potential exceptions, and that any exceptions would only apply in particular circumstances.

246. A number of suggestions were made about how debt considerations could fit into the decision processes for Primary Advice. Several respondents emphasised that debt must not be ignored; others thought that consumers should be responsible for considering their own debt position, and there should be a requirement for consumers to sign a disclaimer to confirm that they understand the effect of debt on their financial position. Several respondents stressed the importance of giving sufficient consumer information, to give clarity around the standard of advice given, and to explain the issues around debt and the options for dealing with debt. Others also stressed that the process must be kept as simple and as flexible as possible if it is to have a chance of being effective.

247. Some respondents commented that rules or guidance would be needed on the treatment of debt, including how to establish an order of priority regarding the repayment of debt. Some respondents made the point that many debt situations would be too complex for decision trees to handle, and some suggested that they would only be suitable for use up to a certain level of complexity, at which point the consumer would need to be referred on to either a full advice process or to a debt advice agency.

248. Several respondents had concerns that products would be mis-sold to customers with debt, particularly where volume driven sales processes do not fully consider outstanding debt. For example detriment could occur if an investment product was sold through the Primary Advice process to someone with a high level of indebtedness if the consumer was unable to maintain either the debt repayments or the product premiums. To counter this it was suggested that Primary Advice would either not be suitable for consumers with debt, or that there would need to be sufficient safeguards, such as close monitoring, built in to the process to guard against this.

Our response: As mentioned in the answer to the previous question, the feedback on this issue will be available to inform our thinking when developing guidance on 'guided sales' services.

Tax, benefits and Primary Advice

Q55: What are the tax or benefits issues that could hinder the development and/or success of a Primary Advice service? What are your views on how these might be resolved?

249. Many respondents did not offer an opinion on this question, and a number of respondents used the opportunity to further voice general concerns over Primary Advice covered in previous questions. Of those that did offer a response to this question, many saw the effect of savings on future eligibility for benefits through means-testing as the biggest issue. A large proportion of the target audience for Primary Advice has the potential to be affected by means-testing, particularly in retirement, and there was some debate whether this section of market should be encouraged to save. It was suggested that saving for a pension would be a waste of money if it later affected eligibility for means-tested benefits in retirement. However other respondents thought it preferable for consumers to be encouraged to save, because in most cases this would improve their financial situation, even if some may potentially miss out on state help.

250. The general complexity of the tax and benefit regime was another concern raised by a number of respondents, many of whom felt that primary advisers would not be sufficiently competent in this area, and that a lack of awareness of benefit and tax implications would have a high risk of leading to consumer detriment. Concerns were also raised that the Primary Advice process would not be sophisticated enough to fully capture benefits and tax issues.

251. Many respondents commented that issues around means-testing and complexity would be further compounded by changes made to the benefit and tax situation over time. The main concern was that advising in this area would be extremely difficult and that changes made after advice was given would lead to complaints in later years. Some respondents suggested that Primary Advice should be indemnified from future claims based on means-testing reducing the effect of savings.

252. A number of respondents made suggestions as to how tax and benefits issues could be approached to resolve them. Some thought that intervention from the government would be vital if Primary Advice is to work. Joined-up thinking between government departments could coordinate the approach taken for tax, benefits and savings, to address issues such as those around means-testing, and the Primary Advice process would then acknowledge the importance of tax and benefit considerations. Others suggested that total reform of the state pension system was required. One respondent suggested that a benefit statement could then be produced by the government showing details of an individual's benefit situation which could then be used in the Primary Advice process.

253. Some respondents took a different approach, believing that simplicity will be key to Primary Advice. As tax and benefit issues are complicated, they would not be included in the Primary Advice process, and recommendations would be constructed in such a way that the majority of customers would be better off, although not all. Some suggested that a disclaimer should be provided to consumers making it clear

that tax and benefit issues would not be considered as part of the Primary Advice process, and to explain that benefits entitlement may be lost. It was also suggested that recipients of Primary Advice are unlikely to require tax planning, and so this should not form part of the service.

Our response: As explained in the section on 'guided sales' in Chapter 5, any guidance we develop on this will be determined with reference to the nature and extent of the service being provided, and the customer's understanding of the service. As with the feedback on the treatment of debt in such services (see earlier questions), the feedback on this issue will be used to inform our thinking.

Standardised portable fact finds

Q56: Do you think that these standardised and portable fact finds will help with the provision of advice to a wider range of consumers and help contain costs?

254. The majority of respondents, including IFAs, trade bodies and appointed representatives, were not convinced that standardised and portable fact finds could facilitate the provision of advice. First, respondents pointed out that advice is not limited to fact finds which only serve as records of the exercise undertaken by the adviser. Advice requires comprehension of the underlying client objectives and attitudes, and therefore it needs to make significant use of soft facts. A client's true objectives can only be ascertained through discussion with that client. A respondent suggested that this initiative completely misunderstands the trust dynamic between client and adviser.

255. Moreover, some expressed the view that standardised fact finds could not substitute the 'know your customer' process, which ensures advice is tailored to clients needs, particularly as the information they contain can soon become out of date. In addition, many respondents rejected the idea of placing reliance on fact finds completed by third parties. This was believed to lead to increased liability for firms. Some respondents also thought that portable fact finds would only work in the assisted purchase area, where consumers are responsible for their own buying decisions.

256. A few respondents spoke of a shift to 'one size fits all' logic that could lead to poor quality advice and consequent consumer detriment. One respondent thought that firms would be reluctant to pass information to competitors.

257. A large number of respondents considered portable fact finds to be a good idea in principle but raised concerns over their workability in practice. In particular, many believed that portability could be possible provided that 'sell by dates' have not expired and customers confirm that no changes have occurred in the meantime. Others were concerned about the stance of the FOS as they believe the FOS tends to uphold consumer complaints on the grounds that compliance with the FSA 'know your customer' requirements does not necessarily mean compliance with general law requirements. Some expressed concerns over data protection. Finally, a larger firm and a trade body saw more scope for a series of common questions instead of

standardised fact finds, believing the latter to be impractical because different providers will seek more or less information depending on business philosophy.

258. Some respondents welcomed standardised and portable fact finds on the grounds that they would promote uniformity and consistency and ensure that all relevant facts are collected facilitating the provision of advice. Among the respondents who provided positive feedback some suggested that standardised and portable fact finds would offer certainty to firms and give consumers ownership of their financial affairs.

Our response: The high level models for 'guided sales' services that have been shared with us so far do not include use of standardised and portable fact finds. Our approach to guided sales is that the industry should design business models, not the FSA, and so we do not plan to give further consideration to portable fact finds unless the industry seeks it. If it is sought, the feedback on this question will be available to support our thinking.

Q57: How should we strike the appropriate balance between verification of data and reliance on that data by other firms when using a portable fact find?

259. Most respondents rejected reliance on data collated by third parties as they fear that incorrect information could lead to inappropriate or inadequate advice which could in turn expose firms to legal risk. Many respondents suggested that the responsibility for data accuracy should be placed upon firms, these being either originators, data suppliers or receiving firms.

260. An equally large number of respondents suggested that the responsibility for the accuracy of the fact finder should be owned by consumers. One respondent supported the idea of shared responsibility between consumers who would be responsible for data accuracy and advisers who would run a verification check that could flag up potential errors.

261. However, some respondents, mainly IFAs, believed that it would be impossible to strike a balance between reliance and verification and that the idea of portable fact finds should be abandoned all together.

262. A few respondents considered the introduction of 'sell-by dates' as an effective way to minimise the risk of inaccurate and outdated information. One respondent pointed out that the FSA should consider developing an accreditation system for fact finds, while another responded that in addition to 'sell-by dates' before placing reliance on the fact finds firms should be under an obligation to ask the client if there has been any change of substance in their circumstances.

263. Finally, only a small minority of IFAs favoured reliance on data provided by third parties without the need of further verification.

Our response: As explained in the answer to the previous question, we do not plan to give further consideration to portable fact-finds unless the industry seeks it.

Product approval

Q58: Do you agree that using product criteria would help firms deliver appropriate products to the target market for Primary Advice?

264. There was some support for our proposal, but where detailed responses were given, the common view was that there would need to be greater clarity on criteria before firms could make a detailed judgement.

265. Though individual responses differed greatly, there was an overall trend for larger organisations (some banks/building societies, life insurers, trade bodies and investment managers) to warn against overly prescriptive criteria, arguing that this could stifle product innovation and choice. Smaller firms, where they were supportive, often welcomed the criteria and the clarity it would give to the market. Many smaller firms/IFAs also supported price capping.

266. Some respondents, both IFAs and other categories, emphasised the need to learn from stakeholder/CAT products. These were usually seen as too prescriptive, which has ultimately led to limited take up.

267. Overall, if the concept of product criteria was accepted, it followed that there was often support for the FSA to have a role in the approval of product design and structure. Some were concerned, however, that this would not be in keeping with a more principles based regime.

Our response: As explained in the part of the 'guided sales' section in Chapter 5 entitled 'Other ways we can help', we anticipate that those developing such services will seek guidance about the products that would be delivered through them. The depth of guidance that will be sought is likely to depend on the industry's preferred trade-off between greater certainty from guidance and flexibility to innovate.

Q59: Do you think having FSA-endorsed products would help? If so, how would this work?

268. In aggregate, the responses did not support this proposal.

269. Though individual responses differed greatly there were several reoccurring themes. Firstly, many respondents considered that the FSA would be stepping outside of its remit in endorsing products. Some respondents drew parallels with the issues surrounding split caps, perceiving that the FSA approved these products.

270. Endorsing products was also seen to create several market problems. Respondents were unsure if an endorsement meant that the FSA would be liable in mis-selling/compensation claims if these later arose. Some believed that the implication of endorsement would be that non-endorsed products would be considered inferior by consumers, even if these products would sometimes be more suitable for their needs.

271. If the FSA went down the endorsement route, some respondents favoured a simple 'kitemark' approach. For many respondents, clarity and simplicity of criteria would be key. Some considered individual product endorsement to be too complex to be

practical. A more generic approach, approving product groups, was suggested by some. Some also suggested that consumers self-select from a range of approved products.

272. Finally, many believed that the profitability of endorsed products would be key. They pointed to CAT/stakeholder products. They argued that the take up of these has been low, as their limited profitability creates limited incentives to sell them.

Our response: The high level models for 'guided sales' services that have been shared with us so far do not involve FSA-endorsed products, and we have no plans at present to pursue this idea. As mentioned in the answer to the previous question, we anticipate that those developing such services will seek guidance about the products that would be delivered through them.

Q60: Do you have any other suggestions or options for limiting risks of inappropriate products being sold via Primary Advice?

273. The majority of respondents to this question, many of whom did not favour the introduction of Primary Advice, did not have suggestions for limiting risks associated with it.

274. Many respondents who did offer suggestions emphasised the importance of simplicity, particularly in terms of type of product offered, product design and sales process. Complexity would increase the risk to consumers. Some suggested that the processes and products should be more generic, with some suggesting self-select decision trees. Some suggested use of standardised fact finds, and simple, lower-risk, standardised products. Product criteria should be clear, and one suggestion was that these should be agreed between the FSA and product providers. Clearer labelling and rating of risks was seen as important, not just for services involving an element of advice, but also for non-advised self-select services.

275. Several respondents said it was important to consider a customer's debt position before any recommendation was made. One suggested that Primary Advisers should be licensed. A few emphasised the importance of training and competence for those delivering Primary Advice, and education about it for consumers.

276. Some respondents thought that commission structures skewed the sales processes, and that this would need to be addressed. A few thought pay and responsibilities should be closely aligned with the needs of the consumer, and that senior management in distributors and product providers should be held partly liable for mis-selling, with fines used as a deterrent.

277. A few said it was important for the FSA and the FOS to work closely on suitability standards for Primary Advice and similar services.

Our response: As explained in Chapter 5, models for 'guided sales' have not been developed in detail yet, so the exact way in which consumer protection will be achieved cannot be determined. However our preferred approach is that they be developed within the current regulatory framework, rather than designing a new regime. In judging these models, or providing guidance to assist their development, we will take into account that suitability is a flexible standard, determined with reference to the nature and extent of the service provided. The customer's understanding of the service will also be an important consideration

Suitability

Q61: Do you agree that different suitability standards would encourage delivery of Primary Advice and what should these be?

278. Although there was a wide range of responses, the majority did not support the proposal, with many arguing that standards should be the same across the market. They feared that differing suitability standards would be used by market participants to lower standards in the market. A significant number of respondents argued that sales would increase but that this would be at the expense of consumer protection. Some argued that suitability standards should differ, but that it should be higher for the type of customer targeted for primary advice, as they will be in a more financially vulnerable position.

279. Where there was support, many mentioned that this would allow cost effective 'basic' advice to be delivered, increasing access. Simplicity and standardisation of criteria was emphasised, with the use of decision trees and suitability letters mentioned by several respondents. Several respondents mentioned that any more 'basic' advice service should be caveated with the fact that the advice is merely 'suitable' rather than 'most suitable' for a clients needs.

280. Some legal points were raised. A few questioned how this would relate to general law or MiFID. A few also considered that the proposition in Question 61 ran counter to the principle that firms should treat customers fairly.

281. Notably, a significant number of trade bodies, banks and discretionary investment managers did not have a clear cut stance one way or another on this topic. Some suggested that further research needed to be done in this area. Others suggested alternative distribution/advice models, including assisted purchase and/or simplified decision trees/fact finds.

Our response: As explained in the section of Chapter 5 on 'guided sales', no case has been made for us to design a new regime for simplified advice services. As we explain in Annex 8, suitability is a flexible standard, determined with reference to the nature and extent of the service provided. As such, there is scope for firms to design simplified advice processes that are capable of meeting the suitability requirement within the current regulatory framework.

Decision processes

> Q62: Do you think that decision trees would be a useful means of ensuring that consumers had access to some type of information/advice?

282. The majority of respondents did not support this proposal, but a significant minority did think that decision trees would be of use. The majority of life insurers and discretionary investment managers who responded did support the proposal.

283. Many said the perceived low take up of stakeholder decision trees meant that decision trees would not work. Several respondents said that financial products are sold, not bought, so take up from decision trees would be low unless prompted by an adviser. Some considered that decision trees were inherently too simplistic for consumers' often complex requirements. Clarity was needed about the liability of the distributor, or whether the consumer was responsible, where a product was purchased using a decision tree.

284. Some suggested improvements. Educating consumers, or providing guidance by advisors or through clear signposting or criteria, was repeatedly mentioned. Others suggested tight criteria and comprehensive testing to avoid the generation of poor advice.

285. Many respondents supported decision trees, but as a starting tool and not a replacement for proper advice. Some considered their role to be limited to information tools. A few respondents, across different stakeholder groups, commented that clients' debts should be built into any decision tree process.

Our response: Detailed models for 'guided sales' have yet to be developed. However we anticipate that some firms will seek to automate parts of the process, to make the service cost-effective and manage potential liability by ensuring consistency.

> Q63: What other ways might be used to standardise the advice process for Primary Advice?

286. The majority of respondents elected not to answer the question or had nothing further to add to their answers to previous questions. There were no significant differences in responses from different types of respondent. Many respondents also addressed issues covered elsewhere and foremost among these suggestions were the use of:

- scripted fact-finding processes, decision trees and standardised paperwork;
- standardised products and suitability warnings; and
- simplified charging structures and a cap on fees in respect of Primary Advice.

287. Furthermore, a large number of respondents, including the Financial Services Consumer Panel, reiterated their principled objections to the provision of standardised advice or drew attention to the practical difficulties in implementing the Primary Advice model.

288. Some respondents, representative of different sectors, suggested that standardisation of the advice process would be assisted by exploiting the full potential of information

technology, particularly the internet. A number of suggestions were made, including improving the online availability of FSA advice guides and factsheets; the use of web-based questionnaires; interactive web-based learning, and standardisation of technology platforms at point of sale.

289. A small number of respondents believed that the provision of Primary Advice would be assisted by standardised training courses, workplace presentations or clinics.

Our response: Please see our response to Question 62.

Application of risk-based prudential requirements to Primary Advice business

Q64: How should risk-based prudential requirements and risk-based supervision for personal investment firms that give Primary Advice take account of the risk and consumer protection issues associated with it?

290. The complex nature of this question meant that only a limited number of replies were received.

291. The IFA community were concerned that the introduction of Primary Advice would lead to mis-selling by large target-driven sales forces, increasing the risk of complaints and associated costs to the industry. They suggested that firms providing primary advice should pay a higher levy and have higher capital adequacy requirements.

292. A large percentage of the respondents said they were concerned that sales of Primary Advice products would not meet the current TCF standard and that there should be a requirement that guides are sufficiently well trained and supervised to take customers through Primary Advice services.

293. A large percentage of respondents also suggested that Primary Advisers must have the necessary skills and appropriate qualifications to the services they provide, and that firms would require robust management information which identified complaints and dissatisfaction by advice type to identify mis-selling.

294. Generally respondents were not in favour of Primary Advice. They felt that advice should mean ‘full’ advice.

Our response: The answer to Question 29 explains our reasons for relating capital resources requirements for personal investment firms to size of firms rather than adopting a risk-based system. We do not propose to introduce risk-based prudential requirements for ‘guided sales’ services. Our approach to supervision will remain risk-based. If guided sales services are introduced we may undertake thematic or other supervision work (for example to determine whether advice given is suitable with reference to the service provided), but the scope and frequency is likely to depend on our assessment of risk at the time, either for such services generally or at a particular firm.

Other ways of increasing access for more consumers

> Q65: Does the boundary between advice and information need to be clarified? What other regulatory changes might help delivery of non-advised products to consumers in a clear and meaningful way?

295. Respondents to this question were in favour of clarifying the boundary between advice and information by a margin of over four to one. A number of respondents stressed the importance of the FSA policing the boundary. Respondents argued that the boundary should be clarified not just for firms, but also for consumers. This would need to be clear and simple. For example, one respondent suggested: 'Compulsory issue of a plain English guide on one page.' As well as understanding whether they were receiving advice or information, consumers would need to understand their rights to redress were much reduced where they acted on information alone.

296. There was recognition that achieving clarity in consumer understanding would be difficult, because some consumers who had received information alone thought they had received advice. Some respondents believed that provision of information in a non-advised process was insufficient to encourage a consumer to act in his or her best interests: to do so they needed reassurance or a recommendation.

297. Those who did not support providing greater clarity either thought the boundary was already clear, or that it was too difficult to clarify it. As one respondent put it: 'Once you open your mouth you're into advice with all the liabilities that go with it.' Others were concerned that information-only services would lead to poor consumer outcomes, arguing that consumers need advice. Some respondents used their answer to this question to express their concern that consumer detriment would arise from the introduction of Primary Advice.

298. Calls for a distinction between 'advice' and 'sales', as well as a distinction between advice and information were apparent in the feedback on this question. These came from the AIFA, the Financial Services Consumer Panel, and a number of other respondents, for example: 'let's start by calling a salesman a "salesman" and an adviser an "adviser", and 'Call Primary Advice sales and they will understand'. There were differing views on whether there should be boundaries between more types of service than just advice and information, or whether this would be confusing for consumers.

Our response: We have recognised that the industry needs greater certainty about where the boundary between giving advice and not giving it lies, to give them confidence to offer simplified advice processes and non-advised guided sales services. Annex 7 to this Feedback Statement contains questions and answers on when advice on investments is regulated by the FSA.

> Q66: Do you think that an 'assisted purchase' model could work?

299. Many respondents to the DP did not have a view on this question, but for those who did, it created a clear split by type of respondent. From the IFA sector, those who did not think an assisted purchase model could work outnumbered those in favour by a

multiple of more than three. The concerns raised by the former group were fairly consistent, these being that consumers would be confused about whether they had received advice, and that such a service was ‘selling, so why call it something else?’

300. The IFA respondents in favour stressed the need for the client to be very clear about who had made the decision, and the need to be able to make a profit if distributing in this way. A smaller number of this group suggested limits in terms of who could supply such a service, and/or the product range available.

301. Banks, building societies and life insurers were generally in favour, seeing assisted purchase as a potentially effective way to reach new customers. They stressed the importance of making it clear to the customer what level of service they were going to receive.

302. Consumer bodies were not in favour, putting forward the view that it would undermine clarity in the marketplace, and present confusion with consumers as to whether they had received advice or not.

303. Of the trade associations, the British Bankers Association and the Association of British Insurers were supportive, but felt that the support of the FOS and the FSA would be necessary for it to be successful. One respondent thought that the impact of technological developments on distribution will address the consumer access issues that assisted purchase was designed to address, removing the need for change.

304. The remaining respondents, for example employee benefit consultants and technology providers were split fairly equally, with those in support seeing opportunities to reach new customer segments, e.g. within worksite marketing, and those against raising similar arguments to the IFA sector and consumer bodies.

Our response: The ‘assisted purchase’ model referred to in the DP, and to which this question relates, closely resembled an execution-only service. Chapter 5 explains that ideas for new guided sales services that industry participants shared with us have broadly taken two forms: models that are non-advised processes, and models that would constitute investment advice and a personal recommendation under our rules. Although many firms consider a personal recommendation a necessary element of the process in order to ensure sufficient take-up of products, interest remains in non-advised guided sales services.

Q67: Are there any other models that you think could work?

305. Over one-third of those who responded directly to this question, the vast majority of whom were IFAs, said they could not think of any other models, or did not have time to do so. Many other respondents used this question to say that they did not think the present model for distribution of retail investment products was broken. When combined with those who thought that Primary Advice would expose consumers to too much risk of detriment, and those that thought only full or independent advice should be available, this group represented one in five respondents. About one in ten advocated a very clear distinction between types of services, usually: a) between advice, sales and information; or b) independent and non-independent advice; c) a return to polarisation. A few suggested a service similar to that provided by the

‘home service’ of over thirty years ago, acknowledging some shortcomings in its products, but observing that at least it meant people had some savings.

306. A few respondents diagnosed the reason for the savings gap as the ready availability of credit, arguing that regulation made it easier for consumers to borrow than to save, and warned that the levels of consumer debt were so high that many consumers would be unable to save for some time. A change in consumer attitude to saving was required, with some arguing for greater regulation of lending. As the principal of one small advisory firm put it: ‘The consumer savings and protection gap is very high and getting worse mainly due to the fact that borrowing is too easy to obtain. Consumers cannot afford to save as they borrow too much and have no savings culture because of a severe lack of financial education from school education onwards which has yet to be addressed. Consumers have already said that 30% plus will opt out of personal accounts if auto enrolled. You have to ask yourself why they would say this? It is not just because of means-testing in retirement but over-borrowing etc. IFAs in general give out a lot of free advice but consumers want and can easily get the house that is beyond their means plus the car and holidays etc because borrowing is too easy…..you have to be more strict with the lending institutions’. This theme came up several times at our consultation sessions.

307. Over a quarter of respondents who answered this question suggested different approaches. The most mentioned was a streamlined process variously referred to as ‘assisted purchase’, ‘financial guidance’ or similar phrases. Life companies and banks were the most interested in such models, and a few IFAs thought they had potential. In some cases respondents said such services should involve an element of regulated advice, but were clear that the name should distinguish it from ‘full advice’. These processes could be completed in less than an hour, so that consumers were not deterred by a long process. They would use information about customers’ circumstances to identify solutions appropriate to their broad financial needs, and would provide a reasonable outcome rather than the best possible outcome.

308. Other ideas included more use of focused advice, use of non-advised information-based services, use of internet-based automated systems, greater consumer education, more resources for Citizens Advice, use of supermarkets to improve consumer access, and greater use of trade unions, affinity groups and workplace advice. One respondent said ‘The key is to involve institutions that this group of consumers trust, and that could mean primarily the Post Office’. Another said that ‘Complicated and expensive advice is only necessary because the industry sells complicated and unnecessary products’. Two respondents, and someone who attended one of our consultation sessions, suggested a scheme whereby financial advice for lower income groups is subsidised by the state (the legal aid scheme was used as an analogy) or employers. One respondent suggested limiting compensation to somewhere between four and ten times the remuneration the adviser received for the transaction to give firms greater certainty about potential liability. Another suggested developing the ‘portable factfind’ idea (see question 56) into a ‘prescription’. This could take the form of a product prescription where the adviser specifies product type and usage but not the brand. Alternatively it could refer the consumer to a specialist adviser or

prescribe a change of behaviour (for example in spending habits), or prescribe a provider's particular investment product.

Our response: We understand the concerns expressed by many respondents on the relative ease for acquiring debt relative to savings, and have shared these more widely within the FSA. Chapter 3 sets out our proposals for distinguishing between services, including undertaking consumer research to explore options for improving the way in which services are described and presented to consumers. We have moved away from the name 'Primary Advice', but Chapter 5 explains that we intend to help firms develop proposals for simplified advice processes that fit within the current regulatory framework. Our financial capability work[11] continues, and Annex 6 explains the plans of the Treasury and the FSA to commence the 'Pathfinder' programme recommended by the Thoresen Review of Generic Financial Advice early in 2009.

Q68: Is there an argument for more radical approaches, such as further compulsory savings (beyond the levels envisaged by Personal Accounts)?

309. This issue was seen by some as outside the scope of the FSA and a matter for politicians. Several respondents went on to point out the electoral risks if any political party promoted more compulsory savings because it would be seen as a stealth tax and anti-democratic.

310. There were mixed views on further compulsory savings. Many respondents were against it, some arguing that mass market consumers do not save because they cannot afford to save. Several respondents suggested that this was a matter for government and that more compulsion could have adverse macro-economic consequences.

311. A number of respondents pointed out that there was an opt-out on Personal Accounts and so this was not strictly a compulsory regime. Several respondents did not think Personal Accounts would work, and some suggested that there should be no opt-out.

312. There were calls for further compulsion, particularly for retirement savings, with several respondents pointing to the Australian model. Some thought that the means-testing system needed to be reviewed first because it currently penalises savers. One respondent suggested that there needed to be a public debate on the whole issue of compulsion.

313. Many suggested that it was not further compulsion that was needed but better tax incentives to save. Another strong message was that consumer debt should be tackled as a higher priority issue than savings.

314. Several respondents argued that improving financial capability through consumer education in order to raise awareness of needs and promote advice is the most sustainable way to grow the market and tackle under-saving.

315. A number of other ideas were suggested including:

a. Diverting inheritance tax to fund stakeholder pension plans for all newborn babies.

11 See pages 28-29 of the FSA Business Plan 2008/09 (http://www.fsa.gov.uk/pubs/plan/pb2008_09.pdf)

b. Allowing other forms of saving to be administered centrally alongside Personal Accounts, also funded through payroll deductions.

c. Removing the state safety net for low- or non-savers from a future date to reinforce personal responsibility.

d. Raising National Insurance contributions to increase the size of state benefits, and/or to pre-fund state benefits.

e. Giving a state subsidy to individuals to pay for advice.

Our response: There are many initiatives to help with financial inclusion, and we are doing much through our financial capability strategy to help improve consumers' understanding. Since we published the DP the final report from the Thoresen Review of Generic Financial Advice has recommended a Money Guidance service to help with more specific needs which is likely to improve demand for products and services from consumers (see Annex 6). Chapter 5 explains that we continue to be willing to work with firms to improve supply by helping them develop proposals for simplified advice processes and non-advised guided sales.

Regulatory certainty

Q69: Can you provide material examples of how regulatory uncertainty has created a barrier for your firm?

316. While a large number of respondents suggested that uncertainty and regulatory fatigue was a significant barrier to firms, particularly with respect to their ability to plan for the future and utilise their time efficiently, most did not choose to elaborate with specific examples. There were no distinguishing responses from different types of firms. Some common examples of barriers included:

a. uncertainty over Personal Accounts and the interaction between pension provision and state means-testing;

b. the lack of client understanding of depolarisation;

c. the implementation of MiFID, TCF, more principles-based regulation and the revised Conduct of Business rules;

d. perceived retrospective revision of product suitability standards by the FOS;

e. regulatory changes requiring regular revision of both documentation and financial promotions; and

f. the current and future role of the IDD and the menu.

317. A small minority of respondents noted barriers caused by a perceived discrepancy between regulatory interpretation by the FSA and the FOS. The Association of Private Client Investment Managers and Stockbrokers (APCIMS) expressed concern that the intended flexibility in the FSA's policy positions may sometimes be undermined in practice because firms were being encouraged by their supervisors to 'ratchet-up' their regulatory compliance beyond the required level.

318. Most respondents declined to answer or did not give material examples of regulatory uncertainty providing a barrier to their business. In addition, a small number felt that some degree of regulatory uncertainty was inevitable and that the requirements of more principles-based regulation and TCF would have a positive impact on regulatory uncertainty.

Our response: The main area of uncertainty communicated to us during the RDR is firms' desire for greater certainty about how services will be judged. Our approach to reducing this uncertainty is described in the section of Chapter 5 on 'guided sales'.

Q70: Do the proposals put forward in this DP go far enough to improving the position? If not, what other measures could we introduce?

319. Some respondents chose not to add further to their earlier responses, while others used this question as an opportunity to sum up their overall views of the DP.

320. There were mixed views ranging from those who thought implementing DP proposals would shrink the market to others who argued that the proposals did not go far enough. Some thought that there was no justification for carrying out the RDR. For example one respondent wrote: 'The statement that has led to the FSA calling for this industry-led review is unprecedented and we believe it is out of all proportion to the reality of the situation.' Some respondents thought the ideas in the DP promoted the vested interests of larger institutions and failed to take consumer views into account.

321. Some commented on whether the RDR was tackling the problem of under-saving in the right way '…I do not think that the fact that many people are not saving lies in the distribution of financial services…'. Several commented that certain proposals – for instance raising professional standards – should be all that was necessary to improve consumer outcomes. A few suggested that different proposals should apply to different sub-sectors of the industry.

322. Several made comments about the need for the FSA to take a tougher stance with those who do not comply with required standards. Some also commented that the review did not sufficiently address demand-side issues and that more was needed on consumer education.

323. The RDR was welcomed by some respondents as a great opportunity to improve the market, although there were some comments that the specific proposals in the DP were too complex. There was a call from several respondents for a period of regulatory stability once the RDR had been implemented.

324. Some put forward some alternative or additional ideas, for instance: 'The proposals suggested could be easily applied to the MCOB and ICOB regimes and it seems to make a great deal of sense to address the market as a whole'.

Our response: We have revised the proposals in the DP in the light of the feedback to it, the feedback we received on the IR, and our own analysis. This Feedback Statement contains the proposals on which we intend to undertake detailed consultation, and our reasons for believing they will deliver the outcomes we set for the RDR.

Feedback on Interim Report

Introduction

1. When we issued the IR in April 2008, we made clear that it represented a continuation of the RDR discussion process. To assist this, the IR gave a high-level summary of the principal areas of feedback we had received on DP07/1. We also set out our own thinking based on that feedback and indicated the steps that we planned to take, ahead of the full Feedback Statement, to validate the proposed direction of travel set out in the IR.

2. Although we did not invite formal feedback on the IR, we expected that some would still wish to submit comments. We received nearly 80 written submissions from across the market. After publication we continued to meet with firms, trade associations, consumer groups, the European Commission and the OFT to discuss and listen to their thoughts on the potential market impact of IR proposals and to listen to alternative suggestions. We summarise in this chapter the written and oral feedback we received, which further informed the decisions we set out in this FS.

Overview of IR feedback

3. There was a greater degree of consistency between respondents to the IR than we found on the DP. This was unsurprising as we recognised that those most adversely affected by the simpler future landscape set out in the IR were the most likely respondents.

4. In general, most of those responding supported the ideas for:

   - building in to the regulatory landscape greater clarity on the nature of different services, and the distinctions between them;
   - raising minimum standards of professionalism; and
   - tackling product providers' role in setting remuneration terms for advisers.

5. These three areas remain at the core of what we now intend to consult on. As we discuss earlier in this FS, we think these proposal areas have the potential to materially improve the 'customer experience' and it was gratifying to find many comments in support of this in the IR feedback.

6. The most common area of disagreement was, as expected, on the regulatory landscape ideas and their effect on tied and multi-tied advice services. Some strong arguments were put forward, particularly in oral discussions, which helped our own thinking. In some of these discussions we challenged firms to demonstrate why adapting their business models to fit the IR landscape would not be beneficial for them or for their customers.

7. We found many respondents had sympathy with the concept of a clear separation between advice and sales, but some had concerns that the two types of service are hard to separate and that we risked causing widespread detriment to many consumers.

8. We give more detail on some of the main feedback areas in the remainder of this chapter.

A simpler future landscape

9. The central proposition in the IR for a clear distinction between advice and sales was welcomed by many respondents as the strongest theoretical basis for achieving a simpler landscape. They told us that a clean split would improve consumers' understanding of services.

10. Several respondents, however, expressed concern about the adverse impact the split would have on consumer choice and access to advice. We were told that excluding non-independent advice channels from the advice sphere would significantly reduce access to advice for middle market and less affluent consumers. This would, it was argued, create an 'advice gap' which would disadvantage those most in need of advice and, contrary to the aims of the RDR, promote a market in which fewer consumers had their needs and wants met.

11. We received feedback particularly from firms operating in affinity markets[1] that not only was it not possible to adapt their business models to create viable alternatives to fit into the proposed landscape, but significant detriment would be caused to existing customers who may no longer be advised on their current products. For instance, it was thought unlikely that independent advisory firms would be able to justify the expense of developing bespoke software tools to support advice provision for particular affinity groups (e.g. to support advice and assistance on their customers' industry-wide pension schemes), because they would not focus their activities in the same way the respondent affinity firms. Hence some services would no longer be available. Moreover, customers of firms that offered advice on financial products outside the scope of the RDR (e.g. protection, mortgages, general insurance) would be confused by the inability to maintain advice services on some products while still offering advice on others.

12. Several respondents also told us that the proposed landscape inferred that independent advice services were superior to non-independent services when, in their view, qualified tied and multi-tied advisers were as capable of delivering good

1 Affinity markets are population groups linked by a common factor such as a profession, a trade, an employer, a socio-economic or medical characteristic.

outcomes for customers as IFAs. We were clear in the IR, and remain so here, that we are not making judgements about the relative merits of the different services.

13. Many respondents, particularly retail banks and others with non-independent businesses, argued that under the proposed landscape, they would be restricted to providing a non-advised sales service, unable to provide recommendations to customers, which would reduce demand for their service and make their current business models commercially unviable. We were told that the landscape proposition risked casting aside sustainable business models, further risking achievement of the RDR intended market outcomes.

14. Several respondents argued that the split between advice and sales risked over-simplifying the landscape because there was substantial overlap between both services.

15. Whilst superficially attractive, it was also suggested that the way that 'advice' and 'sales' were defined in the proposed landscape did not reflect consumers' understanding of labels. Further consumer research was needed before committing to specific labels. One respondent argued that customers were less concerned about the labels for services and more concerned about the quality of the service they received.

16. Some respondents suggested alternative landscapes, although many of them still drew on the key components of our proposition (advice, sales and Money Guidance).

17. Overall the feedback on this topic reflected support for the simplicity of the split between advice and sales, but raised deep concerns about the adverse impact it would have on access to advice for less affluent consumers.

Raising professional standards

18. There was strong support, across all types of respondent, for the proposed direction of travel for raising professional standards. Many respondents argued that higher professional standards could help to rebuild consumer confidence in the financial advice sector.

19. There was significant consensus that the new minimum knowledge requirements should be equivalent to QCA level four. In our discussions with firms, we were told that many in the market were already taking steps to move to new standards without waiting for it to be required by us. Several respondents also argued that higher qualifications at QCA level five or six would be a more appropriate minimum qualification, particularly where advisers were offering expert, specialist advice.

20. A number of respondents also suggested that workplace assessments should be used as an alternative to direct knowledge assessments to demonstrate that an adviser had, through accumulated experience and expertise, the requisite minimum level of knowledge. There were concerns, however, that internal, firm-based assessments may not carry the weight of formal qualification requirements, nor would they address the need for a consistent basis for demonstrating professional standards to the general public.

21. Many respondents argued that appropriate transitional arrangements were essential to the successful implementation of higher knowledge requirements. The majority of respondents were opposed to the use of grandfathering[2] to aid the transition on the basis that it would undermine confidence in the industry and thwart efforts to implement demonstrably consistent minimum standards across the profession. Many respondents argued instead for a practical transition period of three to five years. Some respondents also suggested that advisers unable to make the transition deadline should be allowed to continue to provide advice, but under the supervision of a fully qualified adviser.

22. There was consensus that qualifications were only one measure of competence and that ethics, skills, and commitment to continuing professional development (CPD), were additional measures which should form part of a holistic approach to improving professional standards.

23. Many of those respondents who wanted to retain non-independent advice in the landscape also agreed that higher professional standards should be applied to both independent and non-independent advice channels in order to ensure a level playing field and consistency in the application of standards across the industry.

24. There was widespread support for an independent professional standards board responsible for raising and monitoring standards. Many respondents argued that having one, over-arching professional standards board would provide greater focus and consistency to improving and monitoring standards. On the extent of the board's responsibilities, many argued that they should include setting and monitoring practice standards across the industry, developing a code of ethics, and exercising enforcement powers where there was a failure to meet standards.

25. Several respondents had concerns, however, that having both the FSA and a standards board involved in enhancing and monitoring standards, could lead to a system of 'dual regulation' under which advisers would be subject to oversight by two separate regulatory systems. To prevent any overlap and duplication of regulatory functions, a number of respondents suggested that a clear delineation of the board's enforcement powers and responsibilities would be necessary.

26. Mixed views were presented on whether membership of a professional body should be made mandatory. Those in favour, including many firms and individuals, argued that it was necessary in order to secure real changes in professional skills and behaviour and to reduce the scope for inconsistency in standards of practice in the industry. Those against argued that introducing mandatory membership had human rights and competition law implications, and that it would carry a cost that would ultimately be passed to the consumer.

2 See footnote 14 in Chapter 4.

Remuneration

27. The feedback reflected strong support for removing the role of product providers in setting advisers' remuneration. Many respondents argued that removing provider-led remuneration would reduce the potential for bias, improve the quality of advice, and secure better outcomes for consumers.

28. Several respondents told us, however, that the term 'Customer Agreed Remuneration' (CAR) suggested that customers would be actively involved in negotiating the price they would pay for advice. They argued therefore for a term that more accurately reflected advisers' roles in setting their remuneration.

29. To improve the transparency of costs, many respondents argued for separate disclosure of the costs of advice and the costs of manufacturing products. They told us that effective disclosure would be essential to ensuring that consumers understood and recognised that advice had a price and a value.

30. However, many respondents warned that it would be difficult to entirely remove product provider influence that could bias advice processes. It was argued that there was a real danger that providers could continue to use soft commissions and other inducements. And concerns were expressed about consumers' willingness to pay, upfront, advisory fees.

31. Several respondents also expressed concerns about the potential for advisers to adopt adverse charging practices, including unreasonably high pricing, and discriminatory pricing against consumers who they perceived to be less financially capable.

32. Other practical difficulties, including the scale of the changes that would be required to product providers' systems to reflect new remuneration arrangements, and the associated costs, were cited by a number of respondents. Several respondents also questioned whether consumers, who have always assumed that their advice is free, would be willing to pay for advice directly or indirectly (i.e. as an additional explicit charge on the product).

33. There was strong support, among those arguing to retain non-independent advice, for the application of equivalent remuneration standards to both independent and non-independent firms. We were told that this would help achieve a level playing field, demonstrating consistent application of standards to consumers. For instance, it was suggested that transparency was key and that all channels must be required to disclose charges for advisory services and product separately.

Whole of market

34. Many respondents agreed with the proposal to re-define the conditions for 'independent advice', particularly the concept of 'whole of market'. We were told that whole of market was often misunderstood both by advisers and consumers, and that it was unrealistic to expect advisers to search the many thousands of products in the

market. Several respondents argued that the whole of market requirement, which applies only to packaged products[3], was outdated and its usefulness limited because of innovations in product development and evolving service models. They argued that whole of market should be extended to apply to a wider range of investment solutions, reflecting the open-architecture characteristics which are often present in products and services in today's market.

Long-stop

35. Mixed views were presented on whether a 15-year long-stop for bringing complaints against financial services firms should be introduced. Several firms and their trade bodies supported the long-stop on the grounds that holding an indefinite liability made placing a value on firms difficult, and that this inhibited market rationalisation. Moreover its absence meant that liability could follow advisers into their retirement. Introducing a long-stop, it was argued, would allow firms to better manage their financial risks, may help them to receive professional indemnity insurance at a rate which would reduce costs to consumers, and might encourage more capital investment in firms.

36. By contrast, others, including a number of consumer groups, argued that placing a time bar on complaints would cause consumer detriment particularly given that any problems with investment products might not emerge until several years after a product is purchased. We were told that if consumers were time-barred from issuing complaints against firms, it would undermine efforts to improve perceptions of, and rebuild confidence in, the industry.

Guided sales

37. As we noted in Chapter 3, the IR challenged the industry to present propositions for new sales services. We have received comments through the IR feedback and also met with firms and trade associations to discuss and assist their development of possible propositions.

38. Much of the feedback was strongly supportive of the idea of new, straightforward types of sales services. Several respondents argued that this could increase choice and access to advice for consumers, particularly those with less complex financial needs. We were told that such services could provide an additional, more cost-effective way for some consumers to invest, making some financial services products more accessible.

39. Several respondents told us, however, that further research and exploratory work was needed on the potential liability that firms could face with such services. They would also need to consider further how to ensure sufficient consumer protection, including how the nature and limitations of the service might be meaningfully explained to consumers. We were also told that the product range that a new sales service would offer also required further consideration, although many respondents envisaged that it would focus on a limited range of lower risk products, such as ISAs, stakeholder pensions and term assurance.

3 See footnote 3 in the Overview.

40. To be effective, several respondents argued that guided sales services may need to include a personal recommendation to reassure customers that they were making 'good decisions'. We were told that information alone might not be sufficient to encourage customers to make a buying decision. Several respondents also felt that there were dangers in making guided sales strictly non-advised, because regardless of any warnings given to customers that they were not receiving advice, many would still interpret it as such.

41. There was also a concern from some that because a guided sales service would be shorter, and the product range more restrictive, it would fail to address the needs of customers adequately.

High–level cost benefit analysis

Introduction

1. It will only be feasible to conduct a full cost benefit analysis (CBA), that is an estimate of the costs and an analysis of the benefits, once detailed rules are proposed at the Consultation Paper stage. We are not required to quantify the benefits, although we are committed to doing so where possible. In this case, given the complex package of measures being brought in over time against an already changing landscape, a reliable quantification of the benefits would be exceptionally difficult to produce. Hence the overall decision on the proportionality of the measures will be based on a challenging regulatory judgement.

2. In light of the circumstances, we have so far carried out only a high-level CBA. This outlines the potential costs and benefits of the RDR and defines necessary conditions for the benefits to arise. It also outlines some key risks and discusses how the proposed mitigants may reduce some of the risks or help benefits to arise. The focus of this CBA is economic costs and benefits. Non-economic outcomes may result from the proposals, but they are discussed elsewhere in the paper.

3. This high–level CBA is organised by reference to the different markets for advice. Although some benefits are contingent on certain conditions being met, it is important to note that not all conditions are relevant to each market. Furthermore, even if not all conditions that apply to a market are met, the RDR package of proposals may still result in net economic benefits in the market concerned.

Costs and benefits analysis

Landscape and labelling

4. A key benefit can be that the RDR delivers a multi-channel landscape that is clear to consumers, enabling them to select the level of service that reflects their preferences, and that will give more consumers access to advice. There remains some, possibly reduced, risk that firms' incentives to sell consumers more expensive (profitable) services than consumers want or need may be greater than their incentive to retain

clients longer term. Thus, if consumers are to benefit significantly from the variety in the landscape, firms' incentives need to be altered further, for example through supervision. Alternatively, consumers need to be confident that they understand the meaning of the channels' labels well enough to select their preferred level of advice.

5. In addition to consumers being confident enough to make choices free of any undue influence from firms, they need to be able to identify which firms are operating in which channel. It is important that regulatory labels do not unnecessarily restrict the ability of firms to differentiate their business models in their dealings with customers; they might even enhance it. It also matters that the regulatory costs of supplying a higher quality service are not so high as to unnecessarily deter firms from doing so, given the number of consumers who understand and are willing to pay for higher quality.

The market for independent advice

Potential benefits

6. All of the proposals aim to improve the quality of financial advice, leading to improvements in outcomes for consumers, with a higher proportion purchasing a suitable product.

- **Remuneration (adviser sets price of advice) –** as providers cannot influence the behaviour of advisers through remuneration structures, there could be an increase in the quality of recommendations that advisers make to consumers. To maximise this benefit, it is important that providers cannot influence advisers through other means – that is they cannot influence advisers to sell their products except through competing around the price and quality of their product. (For obvious reasons, one would expect providers to seek such influence and they will, for example, continue to be permitted to invest in advisory firms.)
- **Training and professionalism –** this could raise the quality of advice and recommendations made to consumers by increasing the competence, motivation and capability of financial advisers. The extent of this benefit depends on whether the Professional Standards Board sets, monitors and enforces appropriate standards.
- **Independence (whole of relevant market search, etc) –** this could improve the quality of advisers' recommendations, for example by increasing the quality of panels. It could also increase advisers' disciplining of product specifications (price and quality).
- **Increased capital requirements –** this should permit a more orderly wind-down of advisory firms, putting less pressure on the FSCS.

7. There may be an increase in demand for advice if consumers' willingness to pay for the improved services is greater than the cost of providing them. For example, this could arise from increased consumer confidence and trust in the industry.

8. **Product bias –** The proposals do not specifically address product bias, and so at first sight we might expect advisers to continue to offer unsuitable advice because it is

more profitable to sell one product rather than another. It is possible, however, that the changes in remuneration arrangements, especially if consumers exert discipline, will make the price of advice more cost-reflective, thereby reducing the scope for product bias. Consumers' ability to exercise discipline will be increased if firms publish price lists. Increased professionalism may also help here as advisers who have invested in qualifications will likely be more responsive to, and keener to avoid, supervisory discipline. Thus enhanced supervision of product bias may also be important to the desired outcome of increased suitability of advice.

9. **Sales bias –** The proposals do not address sales bias, and so we might in principle expect advisers to continue to seek profits from making sales even when it is not in consumers' interests. Except often where advice is fee-based, advisers may face a charging mechanism in which income is contingent on a sale being made. It is conceivable, however, that professionalism and guidance about standards of conduct will be helpful, although sales bias is very hard for supervisors to detect, which greatly reduces incentives for good behaviour (i.e. suitable advice).

Potential costs and further risks to benefits arising

10. We set out below the types of compliance costs that could arise from the 'independent advice' proposals. These are preliminary at this stage and we will carry out further work to estimate them. These costs include:

- costs of moving to adviser charging (in a report prepared for the ABI, the costs of switching to Customer Agreed Remuneration were estimated by economic consultants CRA to be about £60 million of one-off costs and £15 million additional costs a year);
- costs from increased training requirements and any additional requirements associated with increased professionalism for those firms who otherwise would not do this, which we estimate to be £4,000 to £8,000 per adviser;
- costs to firms in meeting any changed independence requirements (the extent of these costs is not known at this stage);
- costs from any increases in prudential requirements for PIFs (for example, the proposal for a three–month EBR with a £20k minimum capital requirement is estimated to cost firms an additional £26–36 million per year); and
- costs from inclusion of some characteristics of Money Guidance services in the advice process. However, this would only be to the extent that these Money Guidance characteristics would be something that the firm would not provide in the normal course of events.

11. These increases in compliance costs could increase the price of independent advice and heighten barriers to entry to the market but these effects depend on the state of competition now, which we have not fully analysed.

12. Some consumers who do not realise that they are paying for advice (i.e. they think it is free) will not be willing to pay for advice when they realise that it is costly. This is a benefit to the extent that these consumers refuse transactions because they see the cost as being greater than their willingness to pay.

13. There is a risk that adviser charging will lead to some consumers facing excessive charges as advisers are well placed to take advantage of ill-informed and vulnerable customers. On the other hand, many consumers are already exposed to this risk as some firms have already adopted such remuneration models. Moreover, this risk can be reduced by mitigants. Although the exact nature of these mitigants is yet to be determined, they must be able to be supervised and enforced effectively and not significantly add to the costs for firms and the regulator. Some of the mitigants being considered on Adviser Charging are:

- Provider-set decency limits – this would be effective at limiting the extent of excessive charging and product providers may have significant incentives to limit the costs associated with investing in their products, although there is also a risk that providers can compete around decency limits, and continue to influence intermediaries.
- Market-wide decency limits – this would be effective at limiting excessive charges but prices might converge on the cap with consequent negative effects on competition, as widely discussed by the OFT.
- Supervisors could ensure that the purchase of the product is not self defeating (i.e. check that the total price of product and advice is not greater than the expected excess return above the risk-free rate).
- Transparency of prices – if firms are required to publish price lists then the potential for them to charge excessive prices to some consumers will be reduced.

The market for non-independent advice (multi-tied and tied)

14. The requirements are mostly similar to those for independent advisers and so the benefits and costs described above are broadly applicable in this sector of the market.

15. However, it will be more difficult to control the influence that product providers have over tied agents, and the clear benefit of reduced provider bias in the independent sector is not relevant here. Some firms have however already committed themselves to addressing these conflicts of interest, under our regime for Treating Consumers Fairly, by moving away from advisers incentivised by sales targets to salaried advisers. Enhanced supervision could also moderate the remuneration structures and incentive mechanisms that exist in the tied sector.

The market for guided sales (advised)

16. Advised Guided Sales are already permitted, but it is not clear that suitable business models can be found. We are merely encouraging firms to develop business models that are economically viable and can provide adequate advice on the basis of a simplified process. One problem is regulatory uncertainty about liability. Benefits

could be achieved to the extent that greater regulatory certainty leads to firms expanding into this space.

Potential benefits

17. Simplified, cheaper forms of advice would benefit consumers who cannot afford, or are unwilling to pay for, fuller advice now, to the extent that the resultant transactions are suitable. Some consumers, who currently receive other forms of advice, may switch to guided sales because it better fits their preferences.

Potential costs

18. There is a risk that people who purchase products through a guided sales process will receive an unsuitable product because the advice provided does not reflect their need for a fuller service. This could represent a cost, for example to consumers who purchase a product when they would have been better off if they had purchased nothing at all.

Provider market

Potential benefits

19. To the extent that provider influence on advisers is reduced then product providers may choose to compete around the price and quality of their products in order to attract market share. This will yield benefits to the extent that advisers select products based on price and quality.

Potential costs

20. Generally, consumers have not shopped around much in the markets for retail investments and so do not exert much market discipline. However, advisers are likely to exert some discipline on product providers when they update their panels, although we know that some advisers may be influenced by other incentives. There is a risk that competition between providers in the guided sales market may be low because:

- Product providers may revert to tied sales forces to maintain some influence over the sale of their products.
- The guided sales market may be concentrated to the very few firms that enjoy significant economies of scale.

Basic Advice

21. Few firms have offered Basic Advice, so its removal will make the landscaper simpler and aid consumer understanding without materially reducing choice.

Conclusion

22. The RDR package is made up of many interlinked proposals. All of the proposals aim to achieve the same outcomes (better quality and easier access to advice). The CBA of the RDR is not the sum of the individual parts, and the implications of the proposals are not straightforward. The proposals clearly have the potential to deliver significant benefits but much depends on whether the RDR can materially align intermediaries' incentives to those of consumers and whether this can be done at a cost lower than the benefits. Some of the risks to success can be reduced by the various mitigants that are being developed. As already mentioned, not all of the conditions for benefits need to be met in order that the RDR package as a whole delivers net benefits.

23. We will undertake further research and analysis to allow us to estimate the costs and analyse the benefits of proposed rule changes for the Consultation Paper.

Glossary of terms

We set out below some of the key terms used throughout this document to explain what we meant by them. This glossary is for use with this Feedback Statement only.

Adviser Charging

The proposed new approach to adviser remuneration under which independent adviser firms and non-independent firms would set and disclose their own charges, in particular to make their clients fully aware of the services to be provided to them and their cost. It will still be possible for adviser charges to be paid out of products or investments.

Affinity markets

Affinity markets are population groups linked by a common factor such as a profession, a trade, an employer, a socio-economic or medical characteristic.

Banking Bill

The Banking Bill was introduced to Parliament on 7 October 2008. It makes provision for a permanent statutory regime for dealing with failing banks, and new governance arrangements for the Bank of England, including a Financial Stability Committee. It also proposes amendments to the Financial Services and Markets Act 2000, including the compensation scheme that protects depositors' accounts.

Basic Advice

This was introduced in April 2005 as a new form of regulated advice for the sale of 'Stakeholder' saving and investment products, following the Sandler Review recommendations.

CAR – Customer Agreed Remuneration

An approach to adviser remuneration proposed in the Discussion Paper under which the adviser and customer would agree the level and pattern of remuneration. Products would be priced by manufacturers to exclude charges to cover the cost of adviser remuneration. In this Feedback Statement, we have proposed a new term – 'Adviser Charging', replacing CAR (see above), although it shares many of the original characteristics.

Collective Investment Schemes

These are arrangements that allow a number of investors to pool their assets and have them professionally managed by fund management companies. There are many different types of scheme, including unit trusts and Open-ended Investment Companies (OEICs).

A collective investment scheme, as defined in section 235 of the Financial Services and Markets Act 2000 (Collective Investment Schemes), is in summary:

- any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and
- which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062).

Execution-only

A transaction executed by a firm upon the specific instructions of a client where the firm does not give advice on investments relating to the merits of the transaction, and in relation to which the rules on assessment of appropriateness in Chapter 10 of the FSA's Conduct of Business Sourcebook do not apply.

FSA Handbook

This sets out all the FSA's rules made under powers given to it by the Financial Services and Markets Act 2000.

Grandfathering

In the context of this Feedback Statement, means allowing some current practitioners to be granted 'adviser' status permanently by virtue of their past experience, despite not holding all relevant qualifications that a new entrant would need.

Guided Sales

This is the term we use in this Feedback Statement to refer to straightforward sales services for customers with more straightforward needs. These services might be non-advised (which for the purposes of this Feedback Statement we refer to as 'non-advised guided sales'), or might constitute investment advice and a personal recommendation under our rules (which for the purposes of this Feedback Statement we refer to as 'simplified advice processes').

Long-stop

This refers to a time limit within which claims can be brought. For example, the Limitation Act 1980 (and the Prescription and Limitation (Scotland) Acts 1973 and 1984 in Scotland) sets a 15 year long-stop for court claims in relation to latent negligence (where the damage does not become clear until perhaps some years after the occurrence of a negligent act).

MiFID – Markets in Financial Instruments Directive

MiFID is a major part of the European Union's Financial Services Action Plan. It sets the initial authorisation conditions and ongoing regulatory requirements for investment firms, regulated markets and multilateral trading facilities.

Money Guidance

The final report of the Thoresen Review of Generic Financial Advice, commissioned by the Treasury, was published on 3 March 2008. It sets out a high-level blueprint for a national Money Guidance service for providing consumers with information, guidance and tools in relation to their money matters. 'Money Guidance' describes what the service is, but may not be the final brand name.

Non-advised guided sales

The term we use in this Feedback Statement to describe guided sales services which are non-advised.

Packaged Products

'Packaged products' means units in regulated collective investment schemes (which include units in UCITS and certain non-UCITS retail schemes), shares in investment trusts (when sold through a dedicated service), life assurance policies with an investment component and certain types of pension product.

Personal Accounts

This is a pension scheme to be implemented by government in 2012, which employers will use to provide a workplace pension, by automatically enrolling all of their employees who meet certain criteria and by making a minimum contribution.

Primary Advice

A new form of regulated advice service proposed in the RDR Discussion Paper which would deliver a more straightforward service for those consumers with more straightforward needs. We are no longer using this term.

QCA - Qualifications and Curriculum Authority

This is the regulator for examination providers in England and Wales.

Simplified advice processes

The term we use in this Feedback Statement to describe guided sales services which constitute investment advice and a personal recommendation under our rules.

UCITS

UCITS are collective investment schemes. They must comply with Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as amended (the UCITS Directive).

Wrap platforms

These are web-based portfolio administration services that allow intermediaries, and sometimes their clients, to view and administer investment portfolios. Several different wrap platforms are available – provided by life companies, fund managers and other types of firms – offering access to a variety of tools, products and services.

List of non-confidential respondents to DP07/1

We have listed below all non-confidential respondents. In some cases, respondents stated that they were responding on their own behalf rather than on their firm's behalf. This was not always clear so there may be some respondents noted below who responded in another capacity.

For the sake of clarity, we stated in DP07/1, as is our normal practice, that a standard confidentiality statement in an e-mail message would not be regarded as a request for non-disclosure.

1 FS ltd

2020 Financial Services Ltd

2plan

4 Most Limited

A G B Financial Services Ltd

A G Shackcloth and Company

A S L Financial Planning Ltd

Abacusone Financial Services

Glenn Abbott

Absolutely Independent Financial Advisers Ltd

Advance Investments Ltd

Aegis Financial Consultants Ltd

AEGON UK plc

Affinity Finance

Age Concern

Airedale PFS Ltd

AisaProfessional

Alan Taylor & Co

Albert Goodman Financial Planning Ltd

Alchemy Financial Ltd

Alexander Fairbanks

Allfield Financial Group

Alliance & Leicester

Alliance for Finance

Alliott Graham Brown Financial Planning Ltd

Alpha Financial Management

Alps FS Ltd & Juniper Investment Specialists

AMA Finance Ltd

Analysis (NI) Ltd

Anand Associates Ltd

Annandale Financial Services

Antrams

Ben Appleby

Aquila Financial Management Ltd

Arch Financial Planning Ltd

Archtrust Financial Services Ltd

The Arden Court Group Ltd

Ark Financial Planning Ltd

ARM Associates

Armstrong Davis Chartered Financial Planners Ltd

Arnott Guy & Co Ltd

Artemis

Artic Life and Pensions

Ascot Lloyd Financial Services Ltd

ASM Horwath Financial Consultants Ltd

Aspin Analysis Ltd

Aspire IFA Ltd

The Association of British Insurers

The Association of Friendly Societies

The Association of Investment Companies

The Association of Private Client Investment Managers and Stockbrokers

The Association of Professional Compliance Consultants

Astute Financial Planning

Dermod Atkinson

AWA Wealth Management

AWD Chase De Vere

AXA Life

Clive Bagwell

Tom Baigrie

Kevin Bailey

Simon Bailey

Baker Hudson Ltd

Steven Ball

Ballie Gifford & Co

Barchester Green Ltd

Barclays Bank Plc

Barclays Global Investors Ltd

Barrett Hussey Financial Ltd

Barry Pipe (Financial Services) Ltd

Clive Barwells

Bates Investment Services Ltd

Robertson Baxter

BDO Stoy Hayward Investment Management Ltd

Beacon Financial Ltd

Bedale Financial Services

Bede Financial Services Ltd

Danny Begg

Bentley Brown & Co Ltd

Berkeley Associates

Berkeley Burke & Company Ltd

Berkeley La Roche Financial Consultants

Richard Bertin

Best to Invest Ltd

Bestinvest

Bill Lyons IFA Ltd

Martin Blackie

Blacktower Financial Advisers Ltd

Kathryn Blake

Nigel Bolithe

Bond Pearce Compliance Consultants

Boswell Financial Services Ltd

Chris Botterill

BPH Wealth Management

Brant Financial Ltd

Brett & Randall Insurance Brokers Ltd

Brewin Dolphin Ltd

Bridgend Financial

The British Banking Association

Mike Broadwood

Brokerhouse

Michael Brooke

Brooks Macdonald

Dominic Browning

Ken Bryant

BSI SVS/6 Financial Services Committee

Buckles Investment Services Ltd

Richard Bugg

The Building Societies Association

Burns-Anderson Plc

Buryfield Grange Limited

Brian Butcher

M J Butterfield

Nicola Butterworth

C G B Financial Services Ltd

Canada Life Ltd

Capital Financial Services IFA

Capital Ideas

Capital Tower

Cardif Pinnacle

Ray Carrig

Robert Carter

Cartlidge Morland

John Cary

Castle Court Consulting Ltd

Castle Financial Services Ltd

Phil Castle

Cathedral Independent Financial Planning Ltd

The Cattellyst Consultancy

Eric Catterson

Caversham Buchanan

Central Financial Planning Ltd

G Cerone

Chadney Bulgin

Charles Dickson Financial Planning

Charles Royle & Company

Charles Stanley & Co Ltd

Charles Stuart Financial Services Ltd

Charles Wilkinson Financial Planning Ltd

The Chartered Institute of Bankers in Scotland

The Chartered Insurance Institute

Charterhouse Estate Planning and Investment Services Ltd

Chelmsford Financial Management Ltd

Chelsea Financial Services Plc

Cheshire Trafford UK Ltd

Chestergate Financial Planning Ltd

Chesterton House Financial Planning Ltd

Peter Chesworth

Andy Chidgey

Paul Chidley

Hubert Child

The Children's Mutual

Christchurch Investment Management Ltd

Christmas Financial Planners

Christopher Miller Ltd

David Chubb

CIB Financial Management Ltd

Clancy's Financial Planning

Scott Claringbold

Ian Clark

Stuart Clark

Lee Clarke

Clarke Robinson & Co Ltd

Clarke Roxburgh Financial Planning Ltd

Clarkson Gray Financial Planning Ltd

Clarkson Hill Group Plc

Piers Clarkson

Simon Claxton

Clayden Financial

Karen M Clegg

Clifford Gribble

Cofunds Ltd

Tony Cole

Compliance News Ltd

The Compliance Institute

Compliance & Training Solutions (UK) Ltd

Ian Cooper

Patrick Cooper

Mike Coram

County Life & Pensions Ltd

Courtney Havers LLP

John Cousens

Simon Cox

Credenda

Kevin J Crook

Crossman Giles Ltd

Crown Wealth Management Limited

Nicol Cunningham

Derek Curtis

Cutting and Carter Ltd

CWC Research

CWP Financial Services Ltd

Dale Independent

David Lett Associates

David Severn Consulting

David Smith Financial Services

David Winter IFAs Ltd

Craig Davidson

Julian Davies

Brian Davis

Andrew N Dawborn

DC Pensions & Investment Ltd

DEB Financial Planning Ltd

Deloitte

Karl Dennis

Denyer Insurance Consultancy Ltd

Derek Winspear Financial Ltd

Deryck Crossland

Devereux Financial Services Ltd

Nick Devon

Dewhurst Torevell & Co Ltd

The Dexter Partnership LLP

Mark Dickens

Andrew Dickson

DKLS Ltd

Gail P Doheney

Douglas McDiarmid

W A Douglas

John A Douglass

Mark Downing

DSG Financial Planning

Dukes IFA

Dunham Financial Services Ltd

Jon Dunn

E A Kench & Co Financial Services Ltd

David Eastwood

Ebor Asset Management LLP

Eldon Financial Planning Ltd

Elementum

Elgar Financial Limited

Enterprise Consulting (IFA) LLP

EP Financial Services Ltd

Eqi Consultancy Compliance Consultants

Equilibrium Wealth Management Ltd

Ernst & Young LLP

Ethical Partnership Ltd

Ethos Financial Management

Euro Platinum Ltd

Mark Evans

Martin Evans

George Everard

The Exchange

Executive Advisory Services Ltd

Fabian JA Finlay FCA

C J Fagon

Fallon Associates Ltd

Fairway IFA

John Faragher

Fensham Howes Ltd

Robert Fenton

Fernbank Financial Services

Fidelity International

Fidelius Ltd

Financial Advice & Services Ltd

Financial Aspects Ltd

Financial Escape Ltd

Financial Foresight (NI) Ltd

Financial Inclusion Centre

Financial Planning Standards Board

Financial Services Consumer Panel

Financial Services Skills Council

Financial Services Smaller Businesses Practitioner Panel

First Trust Independent Financial Advisers Ltd

Fiscal Engineers Ltd

Harry Fish

Fisher and Company (Financial Services) Ltd

Johnson Fleming

Focus Independent Financial Advisers & Independent Insurance Consultants

Focused Financial Planning Ltd

Foot Davson Financial Advice Ltd

Formula Ltd

Fortitude Financial Planning Ltd

Forum for Fee-based Advice

Andy Foster

Foster Denovo Ltd

The Foxwood Consultancy

R H Fraser

Fraser Tennant Pensions & Investments Ltd

French & Associates Ltd

Friends Provident Life and Pension Ltd

Mario Frixou

D Frost

The Fry Group

FutureCertainty

G R Associates

The GAEIA Partnership

Gannon Lindsay Wray

Garden City Financial

GDC Associates

GDP Financial Planning

Gee & Company (Financial Planning) Ltd

Geo Little Sebire & Co

Gibson Pension & Investments Ltd

Gissings Consultancy Services Ltd

Glamorgan Financial Services Ltd

Global Expatriates Ltd

Global Financial Strategies Ltd

Matthew Goulding

J Graham

Graham Worrall & Co

Grangewood Financial Management Ltd

Greaves West & Ayre

PJ Green

Richard Green

Chris Greenhill

Gresham Two Ltd

Stuart Grierson

Griffiths & Armour (Financial Services) Ltd

The Grosvenor Consultancy

Grovewood Consultancy Mortgages

Guildhall Financial Management Ltd

David Gunnersen

Terry Halewood

Brian Handscombe

Derek Hardie

Hargreaves Lansdown

Harkin Financial Services Ltd

Peter Harrington

Veronica Harrison

Harrold Financial Planning

Hartford Life Limited Product Provider

Havisham Associates Ltd

Tim Hayes

Syrett Hayley

HB Dobbin Financial Planning Ltd

HBOS Plc

Heatley & Associates

Hedley Asset Management Ltd

Helm Godfrey Partners Ltd

Mark Hemmings

Henderson IFA Ltd

Gary Heppleston

HFM Columbus Group Holdings Ltd

Highclere Financial Services

Highland Mortgage & Investment Services

Ian Hill

John Hill

Jonathan Hill

Hillcrest Insurance & Investment Services

HLS Financial Management Ltd

Brian Hobbs

Home Financial Services Ltd

Homeplan Finance UK Ltd

Lindsay Hopkins

Hopwood Ash Limited

Horbury Financial Services Ltd

Howard Northover

Owen Hoye

HSBC

Jim Humphrey

Humphreys Financial Services Ltd

Nigel Hutchinson

Mark Hynes

Ian Henderson & Associates

ICP Group

IFA 1 Ltd

IFA Defence Union

Iimia Financial Planning Ltd

Imperial Independent

In Partnership

Independent Financial Options

Independent Mutual Ltd

The Institute of Chartered Accountants in England and Wales

The Institute of Financial Planning

Intelligent Pensions Ltd

Intermediary Mortgage Lenders Association

International Financial Data Services

Investment and Life Assurance Group

The Investment Coach Limited

Investment Management Association

Investment Quorum Ltd

Investors Planning Associates Limited

Isis Financial Associates Ltd

IT Associates Financial Planning Ltd

Ivan A Hargreaves & Co Ltd

J Carr & Co LLP

R Jackson

J Farrington Financial Ltd

James Hair & Co

Philip James

James Fernley & Partners

James Gordon Brooke

Christopher James-Roll

Jane Davies Associates

JP Morgan Asset Management

Chris Jardine

JDP Financial Services

Jewell and Petersen Ltd

The JHC Partnership Ltd

JJFS Independent Financial Advisers

John Paye Financial Services

Johnson Birkett Ltd

Johnsons Independent Financial Advisers

Gregor Johnston

Jonathan Blake Money Management

Ian Jones

J W Jones

Derek W Jury

Just Retirement Solutions Ltd

Simon Kane-Gallagher

Kay Burt Investments

Andrew Kemp

Ian Kemp

James Kenny

J M Kerry

Robin Keyte

Nick Kidby

Adrian Kidd

Killick & Co

A King

Kingmakers Ltd

Kingston Independent Financial Advisers Ltd

Bruce Kinloch

Pete Kliskey

Christopher Kuit

Gordon Laing

Paul John Lambert

Langtons

Lawrence Clarke Ltd

Lawrie Hainey Services

John F Leach

LEBC Group

Sam Leckie

N J Leeson

LifeSearch

Lifestyle Financial Management Ltd

Lincoln Financial Group

Darren Littlejohn

Liverpool Victoria

London and Country Mortgages Ltd

London Society of Chartered Accountants

Long View

Lonsdale Financial Consulting Ltd

Julie Lord

Lotus Benefit Consultants

Louise Tattersall

Kevin Lowbridge

Lowland Financial

LRH Wealth Management Ltd

The M & G Group

M Thurlow & Co

MacDonald Reid Scott

TS Mackenzie

MacLean Financial Management LLP

John Maddick

Glyn Maddock

Magill & Co Ltd

Ian Maitland

Nick Manders

Veronica Mann

Steve Manning

Mantle & Partners

N Marshall

Marshall Wooldridge Ltd

Martec Associates Ltd

Philip Martin

Tony Martin

MAS Consulting Ltd

Master Adviser IFA Ltd

A J Mathers

Clive Matthews

Mattioli Woods

Martin McArthur

Charles McGinnis

Stuart McGurk

Jim McHugh

McLeod Ross Financial Advisers

MCN Financial Services Ltd

Gary McNeilly

The Medical Partnership

Merlin Financial Consultants

Lee Merrett

MFS IFAs

MI Financial Services LLP

Mike Whieldon Financial Services Ltd

Jack Miller

Milne Wright & Co

Minerva Fund Managers Ltd

Colin Moat

Momenta Holdings Ltd

Moneywise GB Ltd

Monopoly Financial Consultants

Montgomery Charles Financial Management Ltd

Moores Warren Ltd

Morgans Ltd

Gosbee Morgan

Morrell Middleton Financial Services Ltd

Morrice and Wright IFA Ltd

Anthony Morris

Gary Morris

Mortgages Made Easy

Morton Financial Services Ltd

Morton Wilson

Andy Moxon

Mulberry Financial Ltd

Munro Partnership Limited

Murphy & Associates Ltd

Lester Murphy

Ken Nairn

The National Consumer Council

Nationwide Building Society

Ned Naylor

Mitchell Neale

Newbroad Ltd

Brian A Newton

NHFA Ltd

Nicholas Sellis Anger IFA

Nolan Baptist & Bond

Norfolk & Suffolk Financial Services Ltd

Norwest Consultants

Norwich Union Life

Norwood Lake Finances

Oak County Financial Services Ltd

Oak Financial (SW) Ltd

Oakfield Financial Services Ltd

Oakworth Consultancy Services Ltd

Octavian Group

O'Halloran & Co

Oliff Associates

Oliver Financial Planning

Omega Consulting (Norwich) Ltd

The On-Line Partnership Ltd

Openwork

Optimal Planning Ltd

Optimal Wealth Management Ltd

Origo Services Ltd

Andrew Osmond

Oval Financial Services Ltd

Paradigm Partners LLP

Paramount Group Ltd

Park Financial Ltd

P i Financial

P J Williams, Middlesex University

P R Beavers Financial Ltd

Dean Padley

Page Russell Ltd

Paladin Financial Services Ltd

Craig Palfrey

Paolo L Standerwick

Park Lane Financial Services

Parker Castle (Financial Management) Ltd Independent Financial Advisers

Trevor Parker

John Parry

David Patrickson

Steve Patterson

John Payton

Pegasus Portfolio Planning

Tanya Pein

Pennant Independent Financial Services Ltd

Penny Welsh & Associates Independent Financial Advisers

Pension & Investment Partners LLP Independent Financial Advisers

Perception Support Ltd

Perry Appleton Financial Management Ltd

Personal Financial Planning Services Ltd

Personal Touch Financial Services Ltd

Stephen Pett

PFS Asset Management Ltd

Phillip Bates & Co Financial Services Ltd

Brian M Pickering

John S Pidgeon

PIFA Ltd

PKF Financial Planning Ltd

Police Mutual

Portimex International Ltd

M J Pountney

Powsney & Co Ltd

Premier Financial Associates Ltd

Premier Wealth Management

Richard Preston

Prestwood

Principals in Practice Ltd

Tim Prior

ProACT Financial

Jean Proctor

Professional Pensions and Investments Ltd

Professional Portfolio Management Ltd

Professional Wealth Management Ltd

Provident Solutions Ltd

Prudential UK

Geoffrey Purcell

Pyramid Financial Solutions Ltd

Qdos Independent Financial Solutions

QS Financial Planning Solutions Ltd

R H Financial Ltd

R M Gillingham & Son Ltd

R P Frost Independent Financial Advisers

R T P Independent Mortgages and Financial Services

David Rackham

Rational Finance Ltd

Chris Read

Rees Astley Ltd

Janice Reeve

Regency Investment Services Ltd

Angela Reilly

Eduardo Renjel Raul

Philip Renwick

Resources Compliance

Results Financial Ltd

Retirement Planning (UK) Ltd

Retirement Planning Associates Ltd

RHT Financial Services Ltd

Richard Arnold Financial Management Ltd

Richard Billington IFA Ltd

Dawn Richards

Susan Richards

Mark Ridgment

Ring Associates Ltd

Mike Ripley

Ritchie Salkeld & Co

Robert Graham Financial Planning Ltd

D C Roberts

Mark Roberts

ROC Consultants (IFAs) Ltd

Roger Davies Consultants Ltd

Brian M Rooney

Colin Rothery

Rothmere Wilson

Adam Rowbottom

David M Rowland

The Royal Bank of Scotland Plc

Royal London Group

Eddie Royce

Michael Royde

Stephen Rudge

David Rushton

Eric H Rushto

Paul Russell

Rutherford Wilkinson plc

John Ryan

S G Holding and Partners

S J Eastham Financial Services

Sacre Associates

James Sadler

Save & Invest (Financial Planning) Ltd

Savoy Financial Planning Ltd

Paul Scarff

Chris Scarles

Patrick Schan

Scottish Widows Plc

Securities & Investment Institute

Selwyn Goldberg
The Sensible Financial Planning Co
Sesame Group Ltd
SFIA Ltd Independent Financial Advisers
John Shackleton
Shepard Insurance & Mortgage Services Ltd
Lara Shepherd
Graham Shields
SIFA
Liz Sim
Simon Cross Associates
Simon Pritchard-Jones
Simply Biz Services Ltd
R F Simpson
T Simpson
Skandia Life
Skipton Financial Services Ltd
Colin Smith
John Smith
Mark Smith
Frank Smyth
Edwin Snapper
Nicholas Soboljew
The Society of Pension Consultants
Solicitors Financial Services
Southam Financial Services Ltd
Sovereign (Financial Services) Ltd
Spectrum Financial Planning
Spofforths Financial Planning Ltd
St James's Place
Mike Stafford
Standard Life
Star House Financial Services Limited
Starkey Financial Panning
Brian Steeples
Simon Steggles
Step By Step Mortgage & Financial Services Ltd
Steve Morris Financial Planning
Don Stewart
Christine Storer
Tim Storer
Simon Strapp
Leith Stuart
Andrea Sutcliffe
Dixon Sutcliffe
Tim Sutcliffe
Tag Wealth Management
T Bailey Asset Management
Tax Incentivised Savings Association
T R S Independent Financial Advisors
Teachers Provident Society
Tee Financial Plc
Templar Financial Planning
Temple Bar IFA Ltd
Tenet Group Ltd
Thinc Group
Thinc Wealth Management
Threadneedle Asset Management Ltd
Three Counties IFS
Threesixty Services LLP
Throgmorton Financial Services

Tinsdale Investment Management Ltd

TISCO Financial Planning Limited

TMS Financial Solutions Ltd

Paul Tomlinson

RM Toogood

Torquil Clark Ltd

Trafalgar Square fpc

Troy French & Partners

TTR Barnes Financial Services

Paul Tune

Turner & Co

UK Financial Services

UK Shareholders Association

Unite – Amicus Section

Unum Ltd

Vale Asset Management

Vale Financial Services

Vantis Financial Management Ltd

Vertix Financial Services

Virtual Net (Europe) Plc

Richard Wadsworth

W Walker

Ben Walters

Alan P Ward

Ware & Kay Financial Services Ltd

Warnes Anderton Ltd

Stuart Warr

Warwick Butchart Associates Ltd

A P Waterfield

Watt Investment Consultancy

Jo Watt

Chris Welsford

Wensley Mackay Financial Services Ltd

Wesleyan Assurance Society

Wessex Financial Planning Limited

John Westlake

Whfis Ltd

Which?

Craig White

D A White

Mike H Whittaker

Kevin Whittington

Paul Wilkinson

Simon Willcox

William Brown Financial Services

William St Clare Ltd

William Young

Brian Williams

Christopher Williams

David Williams

Williams Farrall Woodward

Simon Williamson

Willow Financial Management

Keith Wilson

John M O Winch

The Winchester Consultancy LLP

Wingham Wyatt Financial Services Ltd

Winnell Douglas Ltd

David Woan

Neil Woods

Wyatt IFA

Peter Yarr

Yellowtail Financial Planning Ltd

YML Group Ltd

Yorkshire Investment Group

Mark Young

Zurich Financial Services Ltd

Annex 6

Money Guidance

Introduction

1. The FSA, in partnership with the Treasury, is leading a 'Pathfinder' programme to test the Thoresen Review of Generic Financial Advice's blueprint[1] for a national service offering impartial information and guidance on money matters. Although we will be leading the Pathfinder work, Money Guidance (the working name for this service) is not an FSA-regulated activity nor is it a commercial service.

2. Money Guidance sets out to help consumers become more aware of their money matters, including their savings and protection needs, and to help them to address those needs. So it will be important that the savings and investment market comprises a variety of clearly signposted services, including opportunities to self serve through non-advised services, and that consumers have trust in these services.

3. Depending on the outcome of the Pathfinder work, Money Guidance may become a national service in due course. It would not necessarily be the only service of its type, nor would it be the only gateway for consumers into regulated advice or sales services. But the widespread emergence of services of this type could create a significant opportunity to help more consumers to identify and then meet their needs, including their savings and investment needs.

Overview of Pathfinder

4. Announced in March 2008, the Money Guidance Pathfinder is a one-year pilot to test the delivery of the UK's first Money Guidance service. It forms the Government's and FSA's joint response to the Thoresen Review of Generic Financial Advice which was commissioned by the Treasury in 2007.

5. We are basing the Pathfinder programme on the following principles that the Thoresen review said should underpin a Money Guidance service:

- 'On my side': impartial advice from the Government and the financial services industry.

1 The final report from the Thoresen Review of Generic Financial Advice, commissioned by the Treasury, was published on 3 March 2008.

- Supportive: support and guidance for individuals to help them take better decisions, take action and change their behaviour so they can make positive steps towards improving their finances.
- Preventative: the service is not designed for those in financial trouble. It should help people budget and plan for both today and the future, and help them withstand financial shocks, avoid problems and reach their goals. People who are having problems can contact the service to find out where to go for help.
- Universal: available to all. Certainly in the medium term, the service should also be free.
- Sales free: the service is not a way to sell products. It cannot recommend a product from a specific provider or tell people to change or get rid of an existing product – this is what regulated advice does. Buying a product or taking commercial advice will be right for many people so the service needs to explain who people should contact in the financial services industry, in line with other principles. This could include explaining the different types of service available, particularly the types of adviser.

Objectives

6. We aim to launch a face-to-face, web and telephone-based Money Guidance service in the North West and North East of England in early 2009, reaching between 500,000 and 750,000 people by March 2010.

What is Money Guidance?

7. Money Guidance is the description now preferred for what used to be called 'Generic Financial Advice' – guidance that is personalised but not regulated – to help people deal with the money matters that shape their everyday lives.

8. The priority for Money Guidance will be to help people take positive steps to improve their finances, help them plan and budget to avoid their own financial crises and credit crunches and equip them with the tools and information they need now and in the future. Money Guidance will be geared to help people with basic budgeting, retirement planning, protection, saving and borrowing, understanding tax and benefits better and demystifying the technical language that is so often used in the financial services industry.

9. Money Guidance complements the work of the RDR in devising a landscape that is simple, clear, and appealing to consumers, where appropriate providing a simple path from Money Guidance to regulated advice and services.

Progress

10. We have created a team to take forward the work under the direction and governance of a joint FSA/Treasury Programme Board. Our team is putting together plans for developing the key components of the Pathfinder, in particular:

- engagement with potential users to reach those who will benefit most from the service – including branding, marketing, advertising, public relations and, importantly, working with trusted intermediaries;
- definition of the content of the service – including training partner organisations;
- operation and delivery of the face-to-face and telephone elements of the service;
- delivery of web- and paper-based guidance, and operation of the knowledge management system; and
- evaluation of the Pathfinder during and after delivery.

11. Money Guidance is an essential element of the overall National Strategy for Financial Capability, helping people to stay in control of their finances and find a way through the often complex world of financial services.

12. So we are drawing on the experience and achievements of the FSA-led National Strategy for Financial Capability, which has reached 5.2 million people (as at end-October 2008). For example, we are taking a partnership approach, and engaging experienced partners to deliver elements of the service.

13. The National Strategy reaches people at key stages and places in their lives, with learning, information and guidance. We aim to give people the skills and knowledge they need to make more responsible and sensible decisions about their money at key stages in their lives, so they can take control of their finances and demand better services from the industry. Our programme targets: school children; young adults who are not in education, employment or training (NEET); students in universities and further education (FE) colleges; employees in workplaces; and new parents.

14. We also deliver straightforward information through our 'Moneymadeclear' and 'What About Money?' consumer websites, interactive tools and publications, and we reach a wide range of consumers via our Partnership Development work with non-profit organisations.

Interfaces of Money Guidance with the regulated market

15. In the Interim Report we said the Money Guidance service should complement the aims of the RDR to increase consumer access to financial products and services. As part of the National Strategy for Financial Capability, Money Guidance aims to give more people the confidence and capability to take their own financial decisions, to get impartial information and guidance for their everyday financial needs, and know where to go for impartial, sales-free guidance.

16. Money Guidance operates outside the regulatory boundary. It does not recommend specific courses of action, products, or types of product. It aims to contribute to filling the 'advice gap' identified in the Government's long-term approach to financial capability at the beginning of last year. Many people are well served by those providing financial advice and help on a commercial basis. For those with urgent debt problems there is a well-established network of debt counselling services provided by the voluntary sector, and supported by significant government funding.

What is not readily available is information and guidance that is tailored to an individual's needs and circumstances, helping more consumers to take the next step. This might be to go to a debt counsellor. It might be to go to a regulated advice firm. But it will stop short of actually undertaking a regulated activity itself.

17. So this sort of guidance is not focused on products, but aims to give people the skills and confidence to start to take control of their financial affairs. But given what is known about the savings and protection gap, many of those who need Money Guidance also have unmet needs for financial products and investments, as well as existing products which they may not fully understand or be managing effectively.

18. Money Guidance aims to equip such people to make more appropriate financial choices and engage with the financial services industry on a more equal footing. This should have benefits for those providing financial advice and services and help to develop the regulated market as more people are likely to have identified savings, investment or protection needs once they have received impartial Money Guidance. In addition, the RDR should present them, when they reach that point, with a simpler and more transparent framework for obtaining products and services.

But how do we increase consumer access?

19. We have a statutory objective to promote public understanding of the financial system and a strategic aim to drive forward consumer capability, enabling consumers to engage proactively and responsibly with financial matters. Our Financial Capability work is the key driver for these objectives, and as part of the National Strategy for Financial Capability, Money Guidance aims to give more people the confidence and capability to take their own financial decisions, to get impartial information and guidance for their everyday financial needs, and know where to go for impartial, sales-free guidance.

20. The Thoresen Review identified a potential level of demand of some four million users per year. That has the potential to make a huge difference to literally millions of people, and to bring more people into the financial services sector.

21. This should complement the aims for the RDR to increase consumer access to financial products and services. We anticipate that the industry will be able to serve the needs of many of those consumers who have received Money Guidance who would benefit from regulated services. There is no supposition that everyone who has received Money Guidance will need or want pensions and investments advice. Nor is it the case that people will have to take Money Guidance to access the products and services of the industry.

Next steps

22. We are on track to start the face-to-face, web and telephone-based Pathfinder service in early 2009 in the North East and North West of England. We are working closely with the Treasury on the detailed service content, branding, delivery mechanisms, and tendering for face-to-face services. As we evaluate the Pathfinder, we will be well on the way to implementing the changes from the RDR, and both are significant and important initiatives for the FSA and the retail landscape.

23. The launch of the Pathfinder will give people in the North East and North West of England the support they need, particularly in these times of economic turbulence. Money Guidance complements and enhances the existing learning, information and basic guidance we already provide as part of the National Strategy for Financial Capability to provide support to people in the immediate term, and to future generations.

Advising on investments and making personal recommendations – issues of borderline for non-advised services

What is the purpose of this Annex?

This Annex contains questions and answers (Q&As) on when advice on investments is regulated by the FSA and when the requirement to assess suitability under COBS 9.2 applies. It also signposts readers to where current FSA guidance can be found.

Q1: What is regulated investment advice?

1. Under article 53 of the FSMA 2000 (Regulated Activities Order) 2001 ('the Regulated Activities Order'), the regulated activity of 'advising on investments' covers advice which:

   - is given to a person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and
   - is advice on the merits of his (whether as principal or agent) buying, selling, subscribing for or underwriting a particular investment which is a security or a relevant investment or exercising any right conferred by such an investment to buy, sell, subscribe for or underwrite such an investment.

2. The key factors in determining whether regulated advice has been given are:

   - the advice must relate to an investment which is a specified security or a relevant investment for the purposes of the regulated activity (e.g. shares, units in collective investments etc);
   - the advice must be about a particular investment (e.g. ABC Smaller Companies Fund) rather than generic advice;
   - the advice must be given to persons in their capacity as investors or potential investors;
   - it must be advice (that is, not just information); and

- the advice must relate to the merits of investors or potential investors (or their agents) buying, selling, subscribing for or underwriting (or exercising rights to acquire, dispose of or underwrite) the investment.

Sources: PERG 8.24.1G, PERG 8.24.2G.

Q2: What is the difference between providing information and giving advice?

3. In the FSA's view, advice requires an element of opinion on the part of the adviser. In effect, it is a recommendation as to a course of action. Information, on the other hand, involves statements of fact or figures.

4. In general terms, simply giving information without making any comment or value judgement on its relevance to decisions which an investor may make is not advice.

5. Information may often involve:

- listings of share and unit prices;
- company news or announcements;
- an explanation of the terms and conditions of an investment;
- a comparison of the benefits and risks of one investment as compared to another;
- league tables showing the performance of investments of a particular kind against set published criteria;
- details of directors' dealings in the shares of their own companies; or
- alerting persons to the happening of certain events (for example, XYZ shares reaching a certain price).

Sources: PERG 8.28.1G, PERG 8.28.2G, PERG 8.28.3G.

Q3: When might the provision of information become regulated advice?

6. In the FSA's opinion, information may take on the nature of advice if the circumstances in which it is provided give it the force of a recommendation. For example:

- a person may offer to provide information on directors' dealings on the basis that, in his opinion, were directors to buy or sell investors would do well to follow suit;
- a person may offer to tell a client when certain shares reach a certain value (which would be advice if the person providing the information has offered to do so on the basis that the price of the shares means that it is a good time to buy or sell them); and

- a person may provide information on a selected, rather than balanced, basis which would tend to influence the decision of the recipient.

Source: PERG 8.28.4G.

Q4: What is generic advice?

7. For the purposes of article 53 of the Regulated Activities Order, advice must relate to a particular investment or investments – generic or general advice is not covered. Examples of generic advice may include:

   - financial planning;
   - advice on the merits of investing in Japan rather than Europe;
   - advice on the merits of investing in investment trusts as opposed to unit trusts or unit-linked insurance; and
   - advice on the merits of investing offshore, or in fixed income rather than floating rate bonds.

8. If you are a regulated firm, however, the generic advice that you provide may be subject to rules in the FSA Handbook. For example, if you recommend to a client that he or she should invest in equities rather than bonds and this advice is not in fact suitable, you are likely, depending on the circumstances of the case, to contravene COBS requirements to:

   - act honestly, fairly and professionally in accordance with the best interests of your clients; and
   - provide information to clients that is fair, clear and not misleading.

Sources: PERG 8.26.1G, PERG 8.26.2G, PERG 13.3 Q21.

Q5: Does the medium used to give advice matter?

9. Advice can be provided in many ways, including:

   - face to face;
   - orally to a group;
   - by telephone;
   - by correspondence (including email);
   - in a publication, broadcast or website; and
   - through the provision of an interactive software system.

Sources: PERG 8.30.2G

Q6: What is a personal recommendation?

10. A personal recommendation is a 'sub-set' of the regulated activity of advising on investments. A personal recommendation is defined in our glossary and broadly follows the Markets in Financial Instruments Directive (MiFID) definition, though its application in the Handbook extends to non-MiFID products. When a firm makes a personal recommendation it is required to assess suitability under COBS 9.2. There are three main elements to a personal recommendation:

- there must be a recommendation;
- the recommendation must be presented as suitable for the person to whom it is made or based on the investor's circumstances; and
- the recommendation must relate to a particular investment.

Source: PERG 13.3 Q19

Q7: Can you give us some practical examples of what would not be considered to be a personal recommendation?

11. A recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public (article 52 of the MiFID implementing Directive (2006/73/EC)). A 'distribution channel' is one through which information is, or is likely to become, publicly available because a large number of people have access to it. Advice about financial instruments in a newspaper, journal, magazine, publication, internet communication or radio or television broadcast should not amount to a personal recommendation.

12. Merely providing information to clients should not itself normally amount to investment advice. Some practical examples are listed in Q2 and Q3.

13. However, you should bear in mind that, where a person provides only selective information to a client – for example, when comparing one investment product against another, or when a client has indicated those benefits that he seeks in a product – this could, depending on the circumstances, amount to an implied recommendation.

Source: PERG 13.3 Q20.

Q8: My firm is planning to offer a non-advised process over the internet which allows customers to buy our products online. We intend to ask the customer some questions and then show them products we offer. If we want to ensure that this process does not lead to a personal recommendation what should we bear in mind?

14. Pre-purchase or scripted questioning involves putting a sequence of questions in order to extract information from a person with a view to facilitating the selection by that person of a product that meets his needs. A decision tree is an example of pre-

purchase or scripted questioning. The process of going through the questions will usually narrow down the range of options that are available.

15. In our view, firms will need to be alert to the risk of providing an implicit recommendation in relation to pre-purchase or scripted questioning. For example, an implicit recommendation may arise where the service involves a combination of:

- collecting information about the investor's circumstances;
- using an element of opinion in translating this into a risk profile and then into a particular product; and
- using words such as 'might be appropriate for you'.

Although we accept that statements that explain the status of communications may be helpful where there might otherwise be ambiguity, if it is clear from the circumstances that a firm is making a personal recommendation, a disclaimer to the customer that advice is not being given will have no effect.

16. Whether or not pre-purchase or scripted questioning in any particular case constitutes a personal recommendation will depend on all the circumstances. The process may involve identifying one or more particular investment products. If so, to avoid making a personal recommendation, the critical factor is likely to be whether the process is limited to, and likely to be perceived by the person as, assisting the person to make his own choice of product which has particular features which the person regards as important. The questioner will need to avoid providing any judgement on the suitability of one or more products for that person. And firms will need to bear in mind that the number of products will not be determinative, so that putting forward a list of products for that person's final choice will not of itself avoid a personal recommendation.

17. The potential for variation in the form, content and manner of pre-purchase or scripted questioning is considerable, but there are two broad types. The first type involves providing questions and answers which are confined to factual matters (for example, the amount of the investment). In our view, this does not itself lead to a personal recommendation if it involves the provision of information rather than a recommendation. There are various possible scenarios, including the following:

- the questioner may go on to identify one or more particular investment products which match features identified by the pre-purchase or scripted questioning; provided these are selected in a balanced and neutral way (for example, they identify all the matching products available without making a recommendation as to a particular one) this need not involve a personal recommendation;
- the questioner may go on to recommend (explicitly or implicitly) one particular product over another (this would be a personal recommendation); and
- the questioner may, before or during the course of the pre-purchase or scripted questioning, give a recommendation or opinion which influences the choice of investment product and, following the pre-purchase or scripted questioning, identify one or more particular investment products; the key issue then is

whether the advice can be said to relate to a particular investment product or products, but this scenario is more likely to result in a personal recommendation.

18. The second type of pre-purchase or scripted questioning involves providing questions and answers incorporating opinion, judgement or recommendation. There are various possible scenarios, including the following:

- the pre-purchase or scripted questioning may not lead to the identification of any particular investment; in this case, the questioner has provided advice, but it is generic advice and does not amount to advising on investments; and
- the pre-purchase questioning may lead to the identification of one or more particular investments; in this case it is more likely that there will be a personal recommendation.

19. We consider it is necessary to look at the process and outcome of pre-purchase or scripted questioning as a whole. It may be that the element of advice incorporated in the questioning can properly be viewed as generic advice if it were considered in isolation. But, although the actual advice may be generic, the process has ended in identifying one or more particular investments. The combination of the generic advice and the identification of a particular or several particular products to which it leads may well, in our view, cause the questioner to be giving an implicit personal recommendation. Factors that may be relevant in deciding whether the process involves a recommendation may include:

- any representations made by the questioner at the start of the questioning relating to the service he is to provide;
- the context in which the questioning takes place;
- the stage in the questioning at which the opinion is offered and its significance;
- the role played by the questioner who guides a person through the pre-purchase or scripted questions;
- the type of questions and whether they infer the use of opinion or judgment by the firm;
- the outcome of the questioning (whether particular products are highlighted, how many of them, who provides them, their relationship to the questioner and so on); and
- whether the pre-purchase or scripted questions and answers have been provided by, and are clearly the responsibility of, an unconnected third party, and all that the questioner has done is help the person understand what the questions or options are and how to determine which option applies to his particular circumstances.

20. Firms planning to offer non-advised processes should bear in mind the answer to Q4 above i.e. that if you are a regulated firm, the generic advice that you provide may still be subject to COBS requirements. Firms should also consider the extent to which the appropriateness test will be relevant and bear in mind the requirements of the

general law in relation to any broad liability for their activities (whether through judgements of the courts or the FOS).

Source: PERG 13.3 Q19, Q20.

How firms may treat the information in this Annex

21. We have provided this Annex because it is clear, from our discussions with industry participants about offering simplified 'guided sales' processes for consumers with more straightforward needs (see Chapter 5), that the way in which the FSA and the Financial Ombudsman Service (FOS) judge transactions would be a significant factor in firms' decisions about whether to offer such services. Amongst other things, they wanted more clarity about the dividing line between giving information and giving advice, because some are interested in offering a non-advised process. This Annex seeks to give greater clarity by providing our view on where the dividing line lies.

22. This Annex is supporting material, not guidance issued under section 157 of the Financial Services and Markets Act 2000. It does signpost readers to where current FSA guidance can be found. Firms are not required to comply with guidance, or supporting material such as this Annex, but with the overarching rules. There may be several ways of complying with a regulatory requirement, and complying with the guidance or other material we publish is only one approach. Firms may be able to demonstrate that other approaches are equally valid for their business model. Although it is not possible to breach guidance or standards outlined in a communication as such, these communications may nevertheless be relevant to our approach in individual enforcement cases, for example to explain the regulatory context (See Enforcement Guide 2.22-2.27). If a person acts in accordance with guidance or supporting materials, in relevant circumstances, then the FSA will not take action against the person in relation to the aspects of the rules to which the material relates.

23. FSA supporting materials do not bind the Courts or the FOS. However, DISP 3.6.4R states that in considering what is fair and reasonable in all the circumstances of the case, the Ombudsman will take into account (where appropriate) what he considers to have been good industry practice at the relevant time. So, there is no explicit requirement for the FOS to consider FSA supporting materials. But relevant FSA supporting materials may help the Ombudsman to establish what was thought to be good industry practice at a particular time or to explain to a consumer that a firm's approach is not unique.

24. We intend to make the content of this Annex available on our website.

Suitability requirement – implications for simplified advice processes

1. This Annex identifies and summarises guidance materials available on the suitability obligation. It also offers some comments on what this might mean for a simplified advice process.

Summary of the suitability requirement

2. *COBS rules:* The obligation to assess the suitability of a personal recommendation sits in COBS 9.2. The MiFID requirement is contained in COBS 9.2.1R and the main MiFID implementing requirements are contained in COBS 9.2.2R to 9.2.6R.

3. *Three types of information required:* The focus of the suitability requirement is COBS 9.2.2R(1), which in summary requires the firm to obtain such information about the client, as is necessary, to provide a reasonable basis for believing that the transaction to be recommended:

   (a) meets his objectives;

   (b) is such that he can bear any related investment risk; and

   (c) is such that he has the necessary experience and knowledge to understand the risks involved.

4. The suitability test is qualified by reference to 'the nature and the extent of the service provided.' COBS 9.2.2R (2) and (3) provide some detail about what information might need to be obtained but this detail is qualified by the condition 'where relevant'. COBS 9.2.3R provides the detail as to the information to be obtained about the client's knowledge and experience; this is also qualified by 'to the extent appropriate…to the nature of…the client…the service...the product or transaction…and the complexity and risks'.

5. *Reasonable reliance and other matters:* COBS 9.2.4R prohibits a firm from encouraging a client not to provide information. COBS 9.2.5R allows firms to reasonably rely on information provided by the client. COBS 9.2.6R prohibits a firm from making a personal recommendation without the information it needs.

Summary of relevant MiFID Connect Guidance

Status of MiFID Connect Guidance

6. MiFID Connect has published industry guidance in relation to suitability ('the Guidance') which we have confirmed (this can be found at: www.mifidconnect.org/content/1/c6/01/02/00/suitability_guideline_100807.pdf). We have taken significant, relevant extracts from that guidance into this Annex because of the status of that guidance and the extent to which it can be relied on by firms. MiFID Connect explains that 'There is no regulatory obligation to follow a MIFID Connect guideline – but the fact that a firm has followed a MIFID Connect guideline will be taken into account by the FSA in the context of supervision or enforcement.'

Focused advice

7. The Guidance makes clear that the suitability standard is flexible relating to the type of service: 'the nature of the Suitability Obligation and the range and level of detail of information required from clients will depend on the type of service being provided and the nature of the client. Firms will therefore have flexibility in meeting the objectives of the rules on suitability, taking into account the nature and extent of the service being provided and the client…' (Para 3.1).

8. Accordingly, 'The information required is that which is "necessary" to test suitability. As there are several types of services which are subject to the Suitability Obligation, the range and depth of information that may be considered "necessary" will vary from one service to another.' (Para 3.1). The detail that will be needed will therefore vary, potentially quite significantly. The Guidance gives as an example *Ad-hoc advice* 'This includes a range of situations which could require very different levels of detail relating to the client's circumstances to be taken into account. For example, a request to a firm to carry out an ad-hoc review of a client's entire portfolio may require the firm to effect a detailed review of the client's overall investment objectives, knowledge and financial situation. However, where a client instructs a firm only to give personal recommendations relating to an identified portion of his/her assets or in relation to the desirability of investing in a specific investment, without reviewing the client's entire portfolio, the suitability assessment could involve a narrower review, focusing on the client's objectives, financial situation and knowledge in relation to that particular portion of assets or specific investment.' (Para 3.1.1)

9. This is reiterated elsewhere 'Under COBS 9.2.2R, where information relating to the client's financial situation is necessary, a firm needs to obtain the necessary information to understand the essential facts about the client to enable the firm to offer the service required. Therefore, if a client seeks ad-hoc investment advice (in the form of a personal recommendation) on the timing of the sale of an existing investment, detailed information about his financial circumstances is unlikely to be necessary since the investment advice provided is of a very focused nature (unless the reason for the sale was directly related to the client's financial circumstances)…' (Para 3.2.2)

10. What is "necessary" in terms of the information about the client's investment objectives, financial information, ability to bear the risk and knowledge and

experience 'will vary from case to case and as such the firm must decide in each case what is necessary under the Implementing Rules. The scope and detail of the information required to have been obtained may vary enormously depending upon the client, the product and the service concerned.' Consequently 'Firms will need to consider how best to obtain the necessary information relating to clients. For example, depending on the type of service and the complexity of the product, firms may require clients to complete a standardised questionnaire, a tailored questionnaire or a combination of both.' (Para 3.2)

11. The assessment of what is necessary will take into account 'the type of product, service or transaction to be recommended or entered into, and the nature of the client...' but the 'amount of information required may also vary depending upon the size of the proposed investment and the range of financial products in respect of which the firm intends to advise…Therefore, where the client only seeks personal recommendations on investments in very low risk and non-complex products (for example, gilts) and is investing a relatively small amount, the amount of information the firm may consider necessary in respect of his financial situation may be much less than the amount of information required if he were interested in more complex commodity derivatives and he is investing a large amount...' (para 3.2.2). Elsewhere, the Guidance says 'As COBS 9.2.2R refers to information which is necessary given the nature and extent of the service to be provided and the transaction to be recommended, the more complex and high risk the product, the higher the threshold of required information.' (Para 3.2.5)

Nature of the client

12. There are some other relevant points which the Guidance raises which relate to specific character of the client. So where the client is working, or has worked, in finance they are more likely to understand the nature of risk. On the other hand firms should take extra care when providing services where there are concerns about capacity to understand or language barriers. (Para 3.1.1)

Client's ability to bear the investment risk

13. The Guidance provides commentary on the part of the test relating to the client's ability to bear the investment risk. It says 'Firms should have a reasonable basis for believing that the transaction recommended or entered into is such that the client would be able to financially bear the risk, if the transaction recommended or entered into carries with it a financial risk…' and 'Firms should, where relevant, assess what the impact of a reasonably foreseeable loss relating to recommended investments would be.' (Para 3.2.4)

Client's knowledge and experience to understand the risks

14. As regards the client's knowledge and experience to understand the risks the Guidance says 'Having obtained information on the knowledge and experience of the client, firms will be better placed to ensure that they have sufficient information to assess the client's understanding of the nature of risks involved in a proposed

transaction or in the management of his portfolio. Giving a client a product risk warning, provided that it is understood, may supplement the existing knowledge of the client. This, combined with the client's experience may, in some cases, result in an overall assessment that the client has sufficient knowledge and experience for the purposes of the suitability assessment. In some instances, for example in relation to very simple products, a risk warning may be sufficient to ensure that the client has sufficient knowledge relating to the risk of an investment service or financial instrument, as long as the firm has a reasonable basis for believing that the client has read and understood it. In an advisory relationship, there will be additional ways in which a firm may establish the client's level of knowledge and experience so that a suitable recommendation can be made.' (Para 3.2.4). Elsewhere the Guidance says the process can allow for the client acquiring the knowledge as part of the sales process '…One of the factors that might contribute to a client having appropriate knowledge is if the firm has provided information to the client about the nature of the product or service and the risks that it entails, and has a reasonable basis for believing that the client has read and understood it.' (Para 4.3)

Suitability requirement – implications for simplified advice processes

15. The rules provide firms with significant scope for innovation in terms of the sales process. This can be demonstrated from the following elements drawn from this Guidance that are particularly relevant to designing a simplified selling process focused on a narrow range of low risk and simple products where the client is investing a relatively small amount (these should be read in the context of the rules and guidance as a whole):

    - 'the process can involve a narrower review, focusing on the client's objectives, financial situation and knowledge in relation to that particular investment';
    - 'firms may use a standardised questionnaire';
    - (as regards the client's financial situation) 'the amount of information the firm may consider necessary in respect of the client's financial situation may be much less than the amount of information required if he were interested in more complex products and he is investing a large amount';
    - (as regards the client's knowledge) 'a risk warning may be sufficient … as long as the firm has a reasonable basis for believing the client has read and understood it'.

16. If firms chose to provide a simplified sales service on a limited range of products, they would need to ensure that there were the appropriate safeguards around the service, for example by terminating the process where the firm is not be able to satisfy itself that it meets the suitability test or where the process is not appropriate for the client's needs.

17. In all cases it will be important to clarify the nature of the service being provided including any limits on the range and scope of the advice being offered. This is both to satisfy disclosure requirements (including COBS 2.2.1R) and as part of assessing suitability against the client's objectives and understanding of the risks.

How firms may treat the information in this Annex

18. We are providing this Annex because it is clear, from our discussions with industry participants about offering simplified 'guided sales' processes for consumers with more straightforward needs (see Chapter 5), that the way in which the FSA and the Financial Ombudsman Service (FOS) judge transactions would be a significant factor in firms' decisions about whether to offer such services. Many firms consider a personal recommendation a necessary element of the service to ensure sufficient take-up of products. Any process that involves a personal recommendation will constitute regulated advice and so firms will need to meet the suitability requirement. We believe that there is a degree of misunderstanding about what is required by our rules in this area. This Annex seeks to give greater clarity by setting out our view that there is scope for firms to design simplified advice processes that are capable of meeting the suitability requirement within the current regulatory framework.

19. We should also explain how firms may treat the information in this Annex. This Annex is supporting material, not guidance issued under section 157 of the Financial Services and Markets Act 2000. Firms are not required to comply with guidance, or supporting material such as this Annex, but with the overarching rules. There may be several ways of complying with a regulatory requirement, and complying with the guidance or other material we publish is only one approach; firms may be able to demonstrate that other approaches are equally valid for their business model. Although it is not possible to breach guidance or standards outlined in a communication as such, these communications may nevertheless be relevant to our approach in individual enforcement cases, for example to explain the regulatory context (See Enforcement Guide 2.22-2.27). If a person acts in accordance with guidance or supporting materials, in relevant circumstances, then the FSA will not take action against the person in relation to the aspects of the rules to which the material relates.

20. FSA supporting materials do not bind the Courts or the FOS. However, DISP 3.6.4R states that in considering what is fair and reasonable in all the circumstances of the case, the Ombudsman will take into account (where appropriate) what he considers to have been good industry practice at the relevant time. So, there is no explicit requirement for the FOS to consider FSA supporting materials, but relevant FSA supporting materials may help the Ombudsman to establish what was thought to be good industry practice at a particular time or to explain to a consumer that a firm's approach is not unique.

21. We intend to make the content of this Annex available on our website.

Professionalism Working Group Report

Report of the professionalism working group on Independent Professional Financial Advisers

November 2008

Introduction

1. A wide variety of professionals give "financial advice" in one form or another to retail investors. The FSA's Retail Distribution Review (RDR) provides a set of new definitions within this general space, with the primary aim of clarifying for the retail investor what he/she can reasonably expect from the professional with whom they are dealing.

2. This Report by this Professionalism Working Group (PWG) deals mainly with those professionals who will in future be providing independent financial advice (PFAs as they will be called in this Report). We think that the principles underlying this Report should apply to all those giving advice, as defined in the FSA's Feedback Statement. The PWG believes that the step-change in professionalism we envisage, both in terms of raising levels of qualifications (to QCA Level 4 or equivalent) and raising standards of behaviour, should apply to all advisers, whether independent or not. That is what we think the public will expect. The PWG has consciously not made recommendations for "sales" as described in the Interim Report. But we believe that standards for professionalism clearly need to be set out across the whole industry.

3. A summary of our main proposals is provided on page 14.

<u>The need for change</u>

4. The case for change is compelling. Retail investors need to be able to have confidence in their PFA if the industry is to serve the investor's needs well. Public trust and confidence goes to the heart of retail financial services; and long-term improvement in public confidence is central to achieving the RDR objectives. The clarification of what constitutes independent financial advice is a major step on this road; but, as the industry and key consumer groups made clear some time ago, the new categorisation of independent financial advice needs to be underpinned by a step-change in:

a) the minimum level of qualifications that advisers require, having due regard to the type of advice that they provide;

b) the clarification and raising of the standards of ethical behaviour that the client can reasonably expect from the PFA in, for example, avoiding financial conflicts of interest between the client and the adviser;

c) the setting of consistent minimum Continuing Professional Development (CPD) requirements that will ensure that advisers keep up to date with the issues relevant to their areas of advice.

5. This Report provides a series of recommendations to help obtain these improvements. At the heart of them is the proposal for a new Independent **Professional Standards Board (IPSB)**. The essence of this concept is to provide the consumer with a clear and independent underpinning of standards for financial advice to help rebuild trust and confidence in the sector. A great deal of work by a wide variety of interested parties is going to be needed to bring this project to fruition, not least among the early members of a new IPSB. But, for reasons we explain below, it has to be in the long-term interest of the public and of the industry itself that higher standards are set and seen to be met.

6. Using the structure created by and under an IPSB, our proposals seek to ensure that:

a) every PFA achieves the new higher minimum qualification level where he/she does not already have this and continues to develop their knowledge and skills throughout their career;

b) every PFA subscribes to and conforms with a Code of Ethics that should guide the relationship between the investor and the PFA;

c) the public has an increasingly clear understanding of what it can reasonably expect from a PFA, that the advice offered is fully independent and that the basis for charges is completely transparent to the client. When someone is dissatisfied with the service they receive, they need to know what they can do about it;

d) it is clear to the public that the IPSB is there to act as the guardian of standards and that it will continue to drive standards upwards.

7. Such an approach will only work effectively, in our view, if there is clarity over the standards being set and if there are clear and effective systems for:

i) monitoring the performance of PFAs against the new standards;

ii) allowing customers to satisfy themselves about the performance of a PFA with whom they deal and to be able to complain about perceived shortfalls;

iii) disciplining shortfalls by a PFA in a proportionate, open and fair manner.

8. Some of this is achieved under present arrangements. A PFA will be an FSA approved person, will have to meet the various requirements set by the FSA and is subject to its disciplinary proceedings. In addition, the firm which employs the PFA has its own obligations to the FSA and, where applicable, exercises oversight over the individual adviser. A PFA may also be a member of one or more Professional Bodies (PBs) who cater for professionals in this area, such as the Chartered Insurance Institute, the Institute of Financial Planning, the ifs School of Finance, the Securities & Investments Institute and the Chartered Institute of Bankers in Scotland. In that case, the individual is also subject to various requirements set by that PB and to its own disciplinary proceedings.

9. While these current arrangements have some merit and certainly flexibility, they will not be adequate – in the view of the Working Group and from the thrust of responses to the FSA RDR Discussion Paper – for the proposed step-change in standards. They leave:

   a) opaque and potentially conflicting spheres of responsibility between the FSA, the existing Professional Bodies and the firms themselves. There is no single standard setter and no overarching and uniform Code of Ethics. Nor are there adequate arrangements for co-ordinating what each of the various stakeholders in the present system does;

   b) arrangements in which individual PFAs who are members of small authorised firms that are not part of networks and who are not members of a PB may have very limited external oversight over their operations;

   c) a situation in which members of the public do not find it easy to understand what they can reasonably expect from their PFA.

<u>The way forward</u>

10. It would be possible to address the current problems in several very different ways. At one extreme, the FSA could become responsible for setting all standards, monitoring all PFA behaviour and for all discipline. It has the legal powers already to do this and, at present, it is the only or prime exerciser of some of these powers (for example, only the FSA has the power to ban an individual from being a PFA).

11. At the other extreme, one could envisage the creation of a completely new body and, with Government approval, this body would receive the range of statutory powers currently vested in the FSA that would allow it to set standards, and to monitor and enforce them.

12. We think that the first option (passing all responsibility to the FSA) would draw it into far greater levels of involvement in the industry than it currently has and would not sit well with its many other functions. For example, the FSA presently provides no specific Code of Ethics other than the material contained in the Statement of Principle and Code of Practice for Approved Persons (APER); and it usually focuses only on the more serious disciplinary matters. Such a concentration of responsibility could also lose much of the expertise and goodwill currently brought by the industry, for example through the work of the Professional Bodies, in encouraging high standards and promoting and monitoring their members' CPD.

13. At the other extreme would be the second model, the creation of a new body with a full range of statutory powers and protections. Even if HM Treasury were minded to agree to these powers being given to such a new body, we think it would be risky to create a new and untried body to adopt the necessarily wide range of statutory powers needed to "take over' the FSA's role in relation to PFAs. It would mean abandoning a current system that – whatever its shortcomings – meets many of the present needs to protect the public. It would be potentially disruptive to the industry and could add significantly and quickly to the present costs of protecting consumers if it meant duplicating some of the FSA's infrastructure for monitoring and enforcement.

14. Instead, we are proposing a process of evolution, rather than revolution, albeit a fairly rapid evolution, which would set the stage for a firm decision in 2-3 years time as to whether the eventual aim set out in this Report is indeed the best option. **In the first instance, we recommend that the IPSB be set up as soon as possible under the aegis of the FSA and then, having established itself and if it still appears to be the best way forward, that the IPSB should become independent of the FSA and obtain its own statutory powers.**

15. This approach recognises that – while standards need to be raised and while gaps in the present arrangements need to be filled – we should build on what is available and "test the waters". **It reflects the fact that there is already demonstrable market momentum in respect of some of these changes, notably in raising qualifications.** It also recognises that, like most of the financial sector, the retail distribution sector is in a state of rapid evolution and that it is difficult (and perhaps presumptuous) to predict in great detail what the "best" governance arrangements for it might be in a few years' time. The proposals set out below therefore chart a way forward that, if successful, should quickly improve the present position for retail investors, while giving the new IPSB several years to find its feet and to test the validity of our longer-term proposals.

<u>What the new IPSB would do in the first phase (before it sought statutory powers of its own)</u>

16. We propose the creation of an IPSB as soon as it is clear that the FSA's RDR proposals find general support.

17. The initial role of this new body would be to:

i) oversee the proposed new minimum qualifications set out below and the integration of existing qualifications into the new arrangements;

ii) create and oversee a new Code of Ethics that would clarify and underpin the behaviours expected of PFAs;

iii) be responsible for setting and overseeing the delivery of new minimum consistent standards of Continuing Professional Development (CPD). We recommend that this should be done, for RPB members, by the IPSB delegating its monitoring role to the relevant RPB with suitable checks;

iv) provide publicity for and promotion of the new arrangements, so that over time retail investors will have a better idea of what they can reasonably expect from a PFA, and what they can do if they are dissatisfied with the service they have received;

v) **liaise with FSA in the latter's monitoring and enforcement of the new standards.**

18. Longer-term, we see the IPSB as aspiring to promote the knowledge, skills and professional standards of the industry on a continuing basis, for example by further raising entry requirements, and by helping to improve the public's understanding of the services on offer.

19. During this interim phase, there would be no compulsion on any PFA who is currently not a member of a relevant Professional Body to join one. The IPSB, working with the FSA, would have to ensure that there was a level playing field for all PFAs, and that the new standards were being met by RPB members and non-members alike. We believe it is essential that the FSA should make it clear to the market during this initial phase that it will be good practice to abide by the IPSB's standards and that it should encourage professionalism using its regulatory powers, where needed, to promote the step-change. During this phase, also, the FSA would have to endorse any standards set by the IPSB (such as the new Code of Ethics), as only the FSA would have the statutory powers necessary adequately to discipline serious breaches of the new standards.

What the IPSB would do in the longer-term

20. When the IPSB had been up and running for a period (perhaps 2 years), we envisage that it would apply to the Treasury to be given the statutory powers it would need to be able to monitor and discipline standards in its own right. (A rough parallel here is provided by the Financial Reporting Council, which applied for and received statutory powers in 2004.)

21. The IPSB would continue with the roles set out in para.17 above using its own powers rather than drawing on those exercised by the FSA in support of the IPSB's objectives. It would be a matter for discussion and negotiation between the IPSB and the FSA as to the extent to which FSA continued to monitor and enforce standards in the longer-term. The IPSB would be able to focus on this one industry. But, against that, the creation of a monitoring and enforcement infrastructure for the IPSB might add to total costs, by duplicating what the FSA already has. Stage 1 of the IPSB would provide further insight as to which of these two arguments should prevail in the interests of retail investors.

22. **At the point where the IPSB obtains statutory powers, and if legal advice at the time confirms it is possible, the Working Group recommends that every PFA should belong to one of the Professional Bodies recognised by the IPSB (RPBs).** This would avoid the need otherwise for the IPSB to have its own monitoring system for "non-joiners", which would duplicate existing infrastructure and add to costs. It is important to note that the status of RPB would be open to any professional body that endorsed the objectives and minimum standards of the IPSB and which demonstrated to the IPSB that it had the capacity to deliver, on behalf of its members, whatever monitoring requirements (for example in respect of CPD) that the IPSB requires.

23. This change would provide for a structured and consistent relationship between the IPSB and all PFAs in which the RPBs could play a significant role, under IPSB

oversight and standards, in assisting the IPSB to continue to raise standards across the whole industry.

The proposed structure of the IPSB

24. **In its initial phase, we propose that the FSA should create the IPSB and constitute it as a sub-committee of the FSA Board, chaired initially by a member of the FSA Board.** The FSA would then help the IPSB to develop a robust nominations process, consistent with Nolan principles, for identifying and recruiting suitable candidates to the IPSB Board. These candidates would need between them to provide a wide range of skills, expertise and experience to ensure the proper functioning of the Board. These independents would need to be remunerated. **To be clear, the Chair plus a majority of the IPSB Board should be clearly and fully independent** (**i.e. not directly involved in the industry itself**)**.** Neither the Professional Bodies nor the Financial Services Skills Council (FSSC) would sit on the IPSB Board.

25. The IPSB would no doubt wish to avail itself of expertise from within the industry and from, for example, the FSSC. Such expertise could be drawn upon by having Advisory Committees to the main Board, in key areas such as education, ethics, and monitoring and enforcement of the new standards. How this was done in practice would be for the IPSB itself to decide.

26. In addition, the IPSB would wish to consult closely with the FSA as to how the latter was seeking to monitor and enforce the new standards. At this stage, only the FSA would have the necessary powers to do this work.

27. No later than when the IPSB received the necessary statutory powers, we envisage that the Board would establish itself outside the umbrella of the FSA, though no doubt still continuing to work closely in co-ordination with the FSA. Some of the relevant issues that will arise then are touched on below.

What raising the minimum qualification level among PFAs involves

28. There is general agreement that the minimum qualification level for a PFA to provide advice needs to be raised. **We recommend that, as soon as practicable, the minimum level of qualification for all existing professionals and new entrants should be raised from Level 3** (**in England & Wales**) **to Level 4** (**Scottish equivalent SCQF Level 8**)**. The proposed IPSB would have oversight of the way in which this was done and would set in place mechanisms to ensure, for example, that future qualifications offered to new entrants were set at the necessary minimum.** While the IPSB lacks statutory powers, the FSA would need to underpin this requirement upon PFAs with its own powers, exercised through the Memorandum of Understanding between FSA and FSSC.

29. Many current PFAs already have Level 4 qualifications or higher, for example because they already require more extensive or deeper knowledge to be authorised to operate in areas such as pensions advice or financial planning. Others are already taking courses that, if successfully passed, will bring them to Level 4. The rest are at Level 3.

30. Any Level 4 qualification obtained must be directly relevant to the work of the PFA, however. A process (described further in Appendix 1) will now need to be followed to

establish the new Level 4 qualification for PFAs and then see what gaps, if any, there are between it and existing Level 4 qualifications.

31. **We recommend that, if any gaps are found between relevant qualifications** (**at Level 4 and above**) **and the new qualification blueprint to be established by the FSSC, then the gap should be closed by a programme of work that would be incorporated into the CPD requirements set for the individuals concerned.** The IPSB would be able to oversee the transition and assure itself that the necessary minimum levels had been reached. How long it took an individual to "close the gap" would depend upon individual circumstances but in many cases it should be relatively brief. Our proposals on transition are given in paras. 61-66 below.

32. We estimate, on present trends, that a sizeable majority of PFAs will already be at a closely relevant Level 4 by the end of 2009, as there are significant numbers of existing PFAs already improving their qualifications. If our recommendation in para. 31 is accepted, no-one currently taking a relevant qualification at Level 4 or above need feel that their current work is being wasted; and so the present momentum towards higher levels of qualification will not be lost.

33. Looking further ahead, we hope that the IPSB will continue to aspire to raising minimum standards considerably further over time. **We think it would be highly desirable to seek to move the minimum level of qualification for all new entrants up to honours degree-equivalent** (**England & Wales Level 6, SCQF Level 10**) **as soon as possible.** Degree-equivalent courses are the typical minimum entry level for many other professions.

34. Existing professionals and new entrants will undoubtedly want to know more about how the move to a new minimum Level 4 will affect them. The process by which appropriate examination standards are currently set and how awarding bodies meet these standards are, as noted earlier, set out in Appendix 1. We do not see any need for changes in the way that this system currently works but, as noted above, we do see the need to map existing qualifications into the new arrangements. It is also urgent to maintain momentum, and we urge that the FSA take early action to provide the FSSC with sufficient financial resources to begin this work.

CPD requirements and how they underpin the requirements

35. Knowledge and skills need to be kept up to date and refreshed so that PFAs remain competent to perform their job. Many PFAs – usually through their RPB or firm – already commit to substantive CPD and it is not obvious that more is needed of them. But we **recommend that the industry go further and that regular CPD be required of all PFAs, to a common minimum standard set by the IPSB.** We think that this will help to reassure the public that indeed the individual they are approaching for advice has a good current knowledge relevant to their role. We think it necessary also that the public is reassured that CPD requirements are "adequate" for that purpose – in amount and thoroughness; and that there are checks on the fact that CPD claimed by an individual has been done.

36. CPD must be "meaningful" and delivered in user-friendly fashion. It must be more than a "box ticking exercise" or measurement of hours spent. But it is clear that

people learn in different ways, that there is no single "best way" to provide CPD and that the needs of particular parts of the industry may be different.

37. We envisage that an early role for the IPSB will be the setting of adequate minimum CPD standards for all PFAs. **We recommend (though this will be a matter for the IPSB to decide) that, for PFAs who are members of an RPB, the IPSB should expect the RPB to monitor their members' CPD record, to standards set by IPSB.** Where a PFA is a member of more than one RPB, he/she would nominate the RPB whose CPD requirements they will meet and the other RPBs would accept that this met their own CPD requirements.

38. **For PFAs who are not members of an RPB, we recommend that any such individual should be required to demonstrate, as part of his/her registration requirements, that he/she has undertaken appropriate CPD training courses. The monitoring standards that the IPSB sets to monitor the quality of RPB CPD would be applied by the IPSB to non-RPB members as well.** The non-member would need to pay for this, to provide symmetry with the implicit payment already being made by RPB members to their Professional Body for the monitoring of their CPD.

Raising standards of behaviour

39. At present, all PFAs are bound by the FSA's rules and the general Principles that the FSA has enunciated. If they are a member of one of the Professional Bodies noted earlier, they will also be expected to comply with a Code of Ethics, and sometimes more detailed guidance from the PB as well. However, the FSA's rules and the various detailed Codes have never been considered as a whole, their relevance to the "new world" set out in the FSA's RDR has not been reviewed, nor has the consistency between them been checked.

40. We think that it would be clearer for all if the more important elements of "good behaviour" towards the client were brought together into a single high-level Code of Ethics. This will be particularly important while people get used to the adviser-charging model that underpins the definition of "independent advice". **We therefore recommend that another early task for the IPSB would be to set out its own high level Code of Ethics.**

41. Every PFA would be expected to commit to such a Code and agree to be bound by it. During the IPSB's interim phase, its Code will in effect be an FSA Code if it is to form the basis of any FSA monitoring or enforcement. We would hope the Financial Ombudsman Service would take the Code into account in its own work.

42. Although the exact form of the Code would be for the IPSB to decide, we suggest in Appendix 2 a summary of the high-level principles that the IPSB might consider for inclusion. This Code would need to be consistent with the high-level principles already set out by the FSA for dealings with customers; but we see it as relatively easy to achieve this consistency.

43. There may be good reasons why a particular RPB would wish to go beyond the new high-level Code and provide more detailed guidance to its members. However, the IPSB should be able to check that such guidance was indeed compatible with the

high-level Code. Only a PB that agreed to have its material checked in this way would be eligible to be recognised by the IPSB as a body able to monitor CPD to at least the standards required by the IPSB. We would expect any such material from an RPB to contain or explicitly acknowledge the core principles of the high-level Code.

Helping the public to understand the profession better

44. Raising minimum qualifications and standards of behaviour of PFAs should be directly beneficial to the public. Equally, the public should be helped if the IPSB proactively seeks to explain the new arrangements, though this will not be an easy or short-term task. But the retail investor will still reasonably want to know:

a) will the new arrangements make it easier or cheaper for the consumer to get redress?

b) who will be responsible for monitoring and enforcing the new minimum standards and how will this be done?

c) can more be done to assist the public in finding a competent, suitably qualified, and current professional for the kind of financial advice that the individual member of the public wants?

d) will the new arrangements end up costing the consumer more, given that all costs incurred by the industry will eventually find their way through to the consumer? And will the benefits outweigh any extra cost?

Complaints and compensation

45. We think that the current Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS) are already adequate to cover retail complaints and requests for compensation. In our view, they should continue to be the sole means by which retail investors can obtain redress from PFAs.

46. We hope that, over time, a higher minimum level of knowledge and ethical behaviour should reduce the number of cases currently brought to the Ombudsman.

47. Against that, at least initially, it is possible that a greater number of complaints about the behaviour of PFAs may be received following publicity given to the new Code of Ethics; but it should be possible – so far as complaints by a retail investor are concerned – for these to be dealt with by the Ombudsman in the normal course of his work, though he will need to be adequately resourced to do it.

48. It would be highly desirable for there to be close two-way communication and the sharing of information between the FOS and the IPSB. The FOS may be able to take into account the new Code of Ethics and other guidance issued by the IPSB in dealing with some of its cases; and the FOS will no doubt wish to liaise regularly with the IPSB over the latter's code. Equally, in respect of discipline, there will be need for the FOS to be able to pass information to the body responsible for PFA discipline (currently the FSA) which may, as noted elsewhere, eventually become the IPSB with statutory powers, rather than the FSA.

49. Further, it is likely to be necessary for the FSA, the IPSB and any PB recognised by the IPSB to be able to exchange information (including information about individuals) in either direction between any two or more of the parties. This will be necessary if an RPB is, for example, to share information with other RPBs about the expulsion of one of its members or if CPD undertaken with one RPB is to be given due credit by others to which the individual belongs. This will be particularly relevant in Stage 2 of the IPSB's evolution when a PFA will have to have a direct link with an RPB or the IPSB itself.

Monitoring and enforcing the new standards including CPD proposals

50. At present, the monitoring of PFAs occurs in two ways. The FSA has its own monitoring role which focuses primarily on firms rather than on individuals. This focus is based on the logical view that most breaches occur as a result of inadequacies in the firm's systems and controls in monitoring its PFAs, rather than the actions of the PFA alone.

51. The FSA report that the resources put into this monitoring role have increased significantly of late. A high level of engagement in our view significantly reduces the risk that firms are not meeting minimum standards; and we urge the FSA to provide sufficient resources to permit a major and proactive programme in this area.

52. Separately, the RPBs in this area conduct some oversight of their members who make up perhaps 60% of all PFAs. Details vary between individual RPBs but all have CPD requirements and monitor how these are met in various ways. That would continue, to minimum standards set by the IPSB, under our proposals.

53. In respect of disciplinary powers, only the FSA currently has the power to ban an individual from the industry. In addition, all RPBs conduct disciplinary proceedings against members for certain breaches of their rules though, for all bar one, these are typically "local" breaches, such as non-completion of CPD or non-payment of RPB fees. The majority of RPBs restrict their disciplinary activity given their lack of statutory powers, the costs of disciplinary action and the difficulty of making an adverse finding stick (when the individual does not need to be a member of the RPB to practice).

54. Looking ahead, we consider that the FSA will need to adapt the nature of its on-site visits to firms, and also to use the data and other resources it has, to address what are likely to be the main issues arising out of the new arrangements for independent financial advice.

55. Any involvement by the IPSB in these issues or indeed in the issues for firms raised by FSA requirements would involve unnecessary and costly duplication between the IPSB and the FSA in Stage 1. Rather, the IPSB should be focusing on setting the minimum requirements, the CPD standards and compliance with the Code of Ethics – all things that are the responsibility of the individual PFA. Close liaison between the IPSB and the FSA, no doubt based on some form of Memorandum of Understanding between them, should clarify the roles of both institutions and make sure there is no duplication of cost and effort.

56. In Stage 2, the balance of responsibilities between the IPSB and the FSA would need to be reviewed. The main balancing considerations were set out in para.21. Likewise, as noted earlier, there will need to be close liaison between the IPSB, the FSA, the RPBs and the Ombudsman. For example, where a PFA seeks to move from one RPB to another, it needs to be possible for the "new" RPB to check that the individual is not being or has not been disciplined by his/her previous RPB.

Helping the public to find the adviser they want

57. Although the consumer currently has access to a number of aids in finding a suitable PFA, it seems clear that the current situation is far from ideal. In particular, the material in the FSA Register on an individual PFA does not explain the areas in which the individual is allowed to provide advice. Other existing registers are either insufficiently clear about what individuals can do or are based on payment of subscriptions and only include the details of those who subscribe, so consumers may find it difficult to check authorisation.

58. We therefore recommend that either the IPSB on its own behalf, or the FSA through revamping its register, provides a much clearer and consumer-friendly explanation of what a PFA is authorised to do. If the FSA is to do this, it would involve revisiting the definition and nature of some of its Controlled Functions which form the basis for material on individuals provided in the FSA Register. In our view, this would be the simplest and most cost-effective way to proceed and we recommend that the FSA urgently consider how its Register could be amended to be more consumer-friendly in this respect.

59. We also recommend requiring PFAs to have and display a Practising Certificate (PC). A PC would be available for inspection by any actual or potential client. Its essential purpose would be to provide a client with a simple description of the advisory services that individual is authorised by the FSA to provide and to show that the PFA meets the IPSB's standards.

60. A further short discussion of the PC and an illustration of how it might look are provided in Appendix 3. It would be for the IPSB to carry this issue forward and to determine what features the PC would actually contain and how it could best be issued in a cost-effective manner.

Transition

61. As explained earlier, there is a great deal of work that would need to be done to identify the new qualifications and the way in which existing qualifications will map into them. The sooner this work is begun the better; likewise any preparation that FSA can undertake prior to the creation – if the consultation process is favourable – of the IPSB during the second half of 2009. However, it is important to stress that advisers should continue to work towards higher level qualifications while this process continues.

62. It is likely to be April 2010 before courses consistent with the new Level 4 qualifications requirement are available from the Professional Bodies for existing

PFAs without relevant qualifications at this level and for new entrants. It is likely to take a similar time to provide CPD covering the "bridging requirements".

63. This means that existing PFAs who need only a CPD bridging course to get to the new minimum should be able to do so during 2010 or 2011. For existing PFAs at Level 3 **we recommend that they be given until the end of 2012 to meet the step-change to the new qualification requirements (to Level 4) in full.** In practice, we expect the large majority of PFAs to have transitioned by the end of 2010 or shortly after. The IPSB should be able to issue regular figures on how the transition is progressing, to flag up progress and any problems.

64. **After the end of 2012, we recommend that an existing PFA who is not at the new level be able to provide advice only if that advice has been supervised and signed off by a PFA who is fully qualified. Even this limited provision would cease at the end of 2014.**

65. This timetable strikes us as the best balance between the interests of the consumer and the natural desire of many PFAs for the minimum qualification level to rise and the need to oversee a potentially significant leap in requirements for a sizeable minority of practicing PFAs.

66. **We recommend that the other elements of the package affecting PFAs – the adoption of uniform minimum standards for CPD and commitment to the new Code of Ethics be introduced as soon as possible in 2010.** The consumer should start to benefit from these changes from the outset.

<u>The relationship between the IPSB and the industry other than PFAs</u>

67. This PWG conducted nearly all of its work before the FSA was able to specify its detailed proposals for the rest of the industry.

68. It seems clear to the Working Group that there would be significant benefits for all advisers – not just PFAs – to have a relationship with the IPSB. The whole industry is keen to raise standards and will want to improve the knowledge base of their staff, promote CPD and pursue high ethical standards. These aspirations are not limited to PFAs but apply equally to what FSA is now describing as "non-independent advisers"

69. In addition, individual advisers should have a strong interest in as much consistency as possible between the independent and non-independent sectors. Many individuals will move between the two sectors during their careers and it would be desirable for them, as well as for firms, for it to be clear how qualifications and CPD obtained in one sector "scored" if the adviser moved to the other. Also, a high-level Code of Ethics should have a key role to play in raising standards of behaviour throughout the industry.

70. Quite separately, the IPSB might also have an easier task of explaining to consumers how the industry worked if it had a clear relationship with all advisers.

<u>The costs and benefits of the IPSB</u>

71. The PWG, for the reason explained in para. 67 above, has conducted its cost calculations looking solely at the work proposed for the IPSB in relation to PFAs.

72. For the interim phase of the IPSB (when it operates within the umbrella of the FSA) we suggest that the direct costs over the first couple of years might be as follows:

Source of cost £000 Financial years	2009/10*	2010/11	2011/12
Board remuneration	200	350	350
Expert staff/advisers	250	1,100	1,300
Publicity	150	250	300
TOTAL	600	1,700	1,950

73. The key assumptions underlying these estimates are that:

a) the selection of a Chairman and up to 9 independent Board members would start around the middle of the 2009/10 financial year and be complete by the start of the 2010/1 financial year.

b) the number of expert staff/advisers would build up (in terms of full-time equivalents) during the second half of 2009/10 to around 10 by the end of the financial year; numbers would average 12 in 2010/11 and 15 in 2011/12. The assumption is that some of the more routine work (such as the provision of legal advice on the relation between the IPSB and the FSA) would be provided by the FSA;

c) it is assumed that a modest publicity budget is set initially, again administered in part by FSA staff (from their Press Unit) to reduce costs to the new body;

d) given the discussion in paras.50-56, we assume that the FSA will continue to meet the costs from the monitoring and enforcement of the new standards. As noted earlier, its spending in this area has already risen significantly but high levels will need to be maintained.

e) no other costs (e.g. for premises) in the expectation that these will be provided and paid for by the FSA, at least initially.

74. Whether the extra costs in (a-e) above are met wholly by the FSA or by the IPSB (or by a shared solution), they will fall initially on the firms and individuals who make up the independent advice sector. In due course, extra costs will be passed to the retail investors who should benefit from the improvements that these costs are designed to underpin. If there are 50,000 PFAs in the new regime, the overall direct costs – if all were allocated to PFAs - would amount to around £40 per head per year, which compares with a minimum sum from each PFA already raised by FSA of at least £1,500 a year. We are not able to estimate accurately the additional cost of the IPSB providing or overseeing the provision of Practising Certificates; but the overall extra cost should still be very modest for PFAs.

75. It can be seen that, if it were possible to create a working relationship between the IPSB and all financial advisers, it should be possible to reduce the average cost for all advisers, because some of the IPSB's fixed costs (such as its Board) would not rise despite the greater numbers.

76. **We recommend that, to underpin the transparency with which FSA has always approached issues of costs and fees, that the main elements of the FSA approach, including the publication of a draft budget, cost-benefit analysis and ex-post explanation of expenditure should all be carried over to the IPSB.** The IPSB will also need to ensure that RPB charges for anything delegated to them (such as perhaps the issuing of a PC) are kept to reasonable levels.

77. If and when the IPSB achieves statutory independence, the logic is that more/all of the cost burden falling onto the FSA would shift to the IPSB. But, provided that duplication of effort is avoided, it is not clear that the overall costs involved need rise significantly.

78. The paragraphs above address only direct costs. There would, of course, be considerable training costs for firms and or individuals to absorb during the transition period; but this is an inevitable price for the raising of standards.

SUMMARY OF RECOMMENDATIONS

An Independent Professional Standards Board (IPSB) should be set up as soon as possible.

To support the required "step-change" in standards, the IPSB from the outset should:

i) oversee new minimum qualifications for Professional Financial Advisers (PFAs);

ii) create and oversee a new Code of Ethics and deal with breaches;

iii) be responsible for setting and enforcing new consistent minimum standards for Continuing Professional Development (CPD);

iv) promote public awareness of the new arrangements and what the public can expect from a PFA;

v) liaise closely with FSA over the latter's monitoring and enforcement of the new standards.

The IPSB should initially be a sub-committee of the FSA Board but should develop into a fully independent Board, with a Chair and Directors who are themselves independent of the industry.

After a period, the IPSB may then seek its own statutory powers and become fully independent, outside the FSA. At this point, if it is within the IPSB's legal powers, the IPSB should require all PFAs to have a relationship with it through a Recognised Professional Body. The balance of responsibilities between the IPSB and FSA would need to be reviewed.

As soon as practicable, the minimum qualification level for a PFA should be raised to QCA Level 4 or equivalent and the IPSB should subsequently raise this to degree-equivalence level.

Where existing PFAs have an existing relevant qualification at Level 4 or above, any gap between that and the new requirement should be filled by additional CPD.

It needs to be easier for the public to find suitably qualified PFAs. The FSA Register should be revamped and made more consumer-friendly.

PFAs should have to obtain and display a Practising Certificate.

Work should begin when the FSA's RDR proposals are generally endorsed:

– the new qualification should start to be taught by mid-2010;

– the new Code of Ethics and the new CPD requirements should be introduced as soon as practicable in 2010

– existing PFAs who need to transition should do so by the end of 2012, though they could continue to the end of 2014 under supervision;

IPSB should follow FSA good practice in areas such as cost-benefit analysis and consultation.

The IPSB should play a positive role for the whole financial advice industry.

List of Appendices

1) How qualification requirements are set and monitored

2) Principles for inclusion in a high-level Code of Ethics

3) Practising Certificates

Appendix 1: Creation of new exam standards and exams

1. Once the final shape of the new retail distribution landscape becomes clearer, the following timetable can be implemented. The timetable is tight, and a best estimate based on the information currently available is given at the end of this Appendix. It follows the process used to date by the FSSC for developing Appropriate Examination Standards. This process is based on the Memorandum of Understanding between the FSA and the FSSC and would require the FSA in the first instance and then the IPSB in future to fund this work.

2. A blueprint needs to be developed by the FSSC for the new Level 4 qualification, which articulates the new requirements. This will cover knowledge, understanding and application and will provide a consistent benchmark against which all eligible professional and awarding bodies may offer qualifications. New qualifications will need to be developed, or existing provision potentially modified, to meet the requirements articulated within the new blueprint.

3. There is a requirement for current provision to be mapped against the requirements of the new blueprint when they have been established. The benefit of an independent mapping process will be to provide clear positioning of current and new qualification offers. Practitioners and consumers will be able to see, at a glance, what meets the new requirements.

4. A further strand of this work should explore what existing advisers holding Level 3 qualifications or Level 4 requirements that do not match the new qualification need to do to 'top up' to meet the new requirements. For those with at least Level 4 requirements already, the main Report recommends that any "gap" be filled by way of additional CPD requirements. New entrants would be required to take the new Level 4 qualification.

5. The new blueprint will be developed by the FSSC. Industry steering and working groups will determine the overall skeleton and detailed content, which will be published for full consultation. Consultation feedback will be used to refine the blueprint prior to the publication of the final version.

6. Professional bodies, which will have been involved throughout the blueprint development process, will bring forward qualification offers that meet the new requirements. Following approval of qualifications against the new blueprint, the professional bodies would develop the questions for the first and subsequent sittings according to their normal timescales and processes. The same would be true for any accompanying study material.

7. The best estimate for the timetable, once the overall direction of policy has been set, is given in the table below:

Task	**Time**
Steering and working groups are formed to develop the new blueprint for the Appropriate Examination	4 weeks
Skeleton blueprint is developed	4 weeks
Detail for blueprint is developed	8 weeks
Steering group reviews detail and finalises consultation draft	4 weeks
Blueprint consultation period	12 weeks
Review and amend blueprint with consultation feedback	4 weeks
Blueprint published	
Professional bodies develop syllabus based on blueprint	
Submission window for professional bodies	4 weeks
New provision approved	
Professional bodies develop exam questions and study material	TBD by professional bodies
Professional bodies launch new exams	TBD by professional bodies

TBD – To Be Determined.

Appendix 2: Principles for inclusion in a high-level code of ethics

1. Many Professional Bodies require their members to subscribe to a "code" but the purpose and construction of these varies considerably.

2. For a Code to have maximum impact on the giving of financial advice, we think it should be short, transparent and easily understood by those affected by it. If there is room for uncertainty, for example because of developments within the industry that raise issues that may not have been obvious when the Code was created, then there must be an authoritative body (in this case the proposed IPSB) to issue guidance and clarification.

3. PFAs are already subject to:

   a) the regulations and principles set out in the FSA Handbook of Rules & Guidance;

   b) the Code applied by their Professional Body if they are a member of one;

   c) the requirements of their firm which are often set out in a Code of Conduct.

4. In the case of independent financial advice, the client's willingness to trust the advisor is critical. As the President of the Chartered Insurance Institute Lord Hunt of Wirral said[1] "*the public must benefit from the RDR or there is little point in it….A new professional framework will be of little value unless the public believe that the (proposed) Professional Standards Board and the Professional Bodies will act in the public interest …..*"

5. We take Codes as "key features which set apart professionals from other employees. They set standards at which the professional should conduct their professional dealings and draw upon the ethical values required of a profession."[2]

6. Existing Professional Codes vary hugely, from the 1 page document produced by the Securities & Investment Institute (SII) to documents of over 100 pages. We are firmly of the view that the IPSB Code should be at or near the 1 page end of the spectrum given its purpose.

7. The SII Code draws on work started by the Worshipful Company of International Bankers in 2005, which contained 7 basic principles. It is these 7 Principles, reproduced below, that we think should be the starting point for the IPSB, which will have to make up its own mind as to the final form of the Code that it eventually endorses, to which all retail independent advisors will be required to adhere.

8. Before the Code is finally released by the IPSB, we envisage that each Professional Body that wishes to be recognised by the IPSB would submit any subordinate or more detailed Code to the IPSB, for confirmation that it is consistent and informed by the 7 Principles.

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1 From the foreword to '*Building Trust and Confidence in retail financial services - a new professional framework*' CII RDR Position Paper 5 December 2007

2 From Friedman, Daly, Andrzejewska: '*Analysing codes of professional bodies*' published by PARN (Professional Associations Research Network), 2005

9. As explained in the main Report, we envisage that the FSA would monitor and enforce the Code while the IPSB is in transition. (To do this, the FSA itself would have to endorse the Code.) If and when the IPSB obtained its own statutory powers, it would have the freedom to introduce its own monitoring and enforcement arrangements or delegate them to the FSA; but that would be a decision to be taken at the time.

CORE PRINCIPLES

The Principles	**Stakeholder/beneficiary**
1. To act honestly and fairly at all times when dealing with clients, customers and counterparties and to be a good steward of their interests	Client-industry
2. To act with integrity in fulfilling the responsibilities of your appointment and seek to avoid any acts, omissions or business practices which damage the reputation of your organisation, your Professional Body and the financial services industry.	Firm-Professional Body – industry
3. To observe applicable law, regulations and professional conduct standards when carrying out financial service activities	Regulator-industry
4. To observe the standards of market integrity, good practice and conduct required or expected of participants in markets when engaging in any form of market dealings	Market participant
5. Be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest	Client
6. To attain and actively manage a level of professional competence appropriate to your responsibilities and commit to continued learning and the development of others	Self-colleagues-industry
7. To strive to uphold the highest personal and professional standards	Self-industry-clients

Appendix 3: The purpose and form of a practising certificate (PC)

1. Some form of PC is a feature of a number of long-standing professions with professional bodies, including solicitors and accountants.

2. The main purpose of a PC is generally seen as a confirmation to a third party (usually a member of the public) that the individual named on the Certificate is licensed or authorised to do certain things, that he/she has the relevant skills and that, in professions such as those identified above, is in good standing with the relevant professional body. The emphasis must be on simplicity, if the PC is to benefit the public. The PC must also be current, which is why nearly all run for only one year.

3. The Working Party suggest that an annual PC should be required for each PFA from a date to be announced (after the activation of the IPSB and probably early in 2010). The PC would be available for inspection, on request, by a member of the public.

4. It will be for the IPSB to decide the final composition of the PC. But we think it must contain a simple description of the advisory services the individual is qualified by the FSA to provide, together with a start and end date for the PC.

5. We think the PC should also demonstrate the individual's commitment to the competency, ethics and CPD standards set by the IPSB and, if the individual is a member of an RBP, to that body's standards too.

6. Other items could be considered for inclusion, such as the individual's formal qualifications or the firm for which the individual worked at the date of the issue of the certificate. But it is doubtful if the value of the extra information would outweigh the greater complexity.

7. It would be for the IPSB to determine how a PFA would obtain the PC. The emphasis needs to be on a highly cost-efficient process that will ensure that the information on the PC is accurate and up to date.

8. An example of how a PC might look is attached but, again, we would stress that the exact form and method of providing a PC will be for the IPSB to decide.

SECURITIES & INVESTMENT INSTITUTE

PRACTISING CERTIFICATE

This is to certify that

Richard Bennett

is authorised to practice as a Professional Financial Adviser

1st July 2008 to 30 June 2009

This entitles the individual to:

- ✓ advise on investments
- ✓ advise on investment management services
- ✓ manage investments
- ✓ arrange transactions

FSA

IPSB logo to come

CPD SII

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