



Financial Services Authority

Retail Distribution Review – Interim Report

April 2008

Overview

Why we are issuing the Interim Report

1. The Retail Distribution Review (RDR) is an important component of our overall retail market strategy, complementing our Treating Customers Fairly and Financial Capability initiatives. The aim of the RDR is for more consumers to have sufficient confidence in the market to want to use its products and services more often. To achieve this, we need an industry that more clearly acts in the best interests of its customers and treats them fairly.
2. This Interim Report sets out the principal areas of feedback that we have received on DP07/1¹. It identifies some possible changes to the regulatory landscape suggested by that feedback. We believe the changes have the potential to give more consumers a fair deal, and have confidence in the products they buy and in the advice they take. So this could deliver a significantly better future market for the distribution to retail customers of all types of investment, including those advised on by private client investment managers.
3. We do not provide a full analysis of feedback on DP07/1 in this paper. That will be contained in a Feedback Statement in October 2008, together with our conclusions based on further economic analysis of the ideas in this paper. It is only after that stage that we will put forward detailed proposals for our policy and for necessary transitional arrangements. We are issuing this paper because we think it is better to give early feedback, ahead of the October paper, to indicate the direction of travel rather than to have a period of silence.

The future for the retail distribution of savings and investments

4. In DP07/1 we set out a possible view of the future of retail distribution based on the work of industry practitioners, consumer representatives and other market stakeholders. We received 888 responses to the paper and, together with a considerable amount of other feedback received from speaking events during the

1 DP07/1 – A Review of Retail Distribution: www.fsa.gov.uk/pubs/discussion/dp07_01.pdf

discussion period, we now have a clearer understanding of the views of different market participants.

5. Many respondents have called for a simpler landscape, in particular for a clear distinction between ‘advice’ and ‘sales’. So we have modified the DP07/1 view to reflect this and other feedback, and as the starting point for further work we set out below a much simplified landscape consisting of three components. We will now determine how close we can get to this and, in the context of the desired outcomes of the RDR, how close we want to get to this, by considering the consequences for consumers and firms and the legal implications:
 - **Advice** – there would be only one type of adviser and a step-change in the standards required of advisers, building on the existing requirement that a firm must act honestly, fairly and professionally in line with the best interests of its clients. So all advisers would be independent, both in terms of status and in their practices, operating remuneration determined without product provider input and recommending products from across the whole market. They would also all meet appropriate minimum professional standards.
 - **Sales** – our starting point for sales is services that are strictly non-advised. These services are intended to encourage higher levels of savings and protection so that the needs of more consumers are met. They can operate within the current regulatory framework, but we recognise we may need to do more here to give guidance to firms.
 - **Money Guidance²** – this is a newly proposed information and guidance service. In partnership with the Treasury, we are taking forward a ‘Pathfinder’ following recommendations made by the Thoresen Review, to determine whether and how this national service might develop. Although the FSA will be co-leading the Pathfinder work, Money Guidance is not an FSA regulated activity. Taken in conjunction with our work on financial capability, Money Guidance has, amongst other things, the potential to stimulate more consumers to seek out regulated advice and sales services. So this demand side initiative may be highly relevant to the future for retail distribution.

What we want the market to do now

6. We are issuing three specific challenges to the industry. This is consistent with our desire for market-led approaches in the first instance:
 - We are challenging more product providers to change their business models so that they do not determine how much advisers are paid.
 - We are challenging the industry to develop and implement an agreed common framework for professional standards.

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 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.

- We are encouraging firms to present propositions to us for new sales services and challenging them to make the case for FSA action to help implement their ideas in a way that delivers better outcomes for consumers.

Could this simpler future landscape achieve the aims of the review?

7. We think that the simpler landscape has the potential to deliver greater clarity for consumers and could lead to a material increase in the levels of consumer confidence in the advice sector. A more professional financial advice sector, together with wider access to straightforward sales services, could then mean that many more consumers meet their savings needs.
8. To achieve this will necessitate change, significant for some, requiring a period of transition to ensure that intended outcomes are delivered while minimising the detrimental impacts on consumers of any short-term upheaval.
9. We recognise there are many significant considerations in terms of the impact on consumers and firms and from legal constraints. For instance, there may need to be changes for those firms and advisers in the tied and multi-tied³ sectors who currently provide advice, as defined in the Regulated Activities Order but who, by their nature, are not independent. These changes would only be needed to deliver the clarity for consumers envisaged by the simpler landscape and are not driven by any concerns over the quality of the current services in these sectors. We may also need to take action to allow firms to develop sales services that include some element of advice.
10. Considerations such as these may mean that it is not possible, or desirable, to achieve this view of a simple and clean separation of market services. In that case, we may have to make modifications to this starting point to deliver the best outcomes for consumers.

What we will do now

11. We will look in more detail at the implications of implementing this simpler future for retail distribution to establish how close we can and want to get to delivering it. In taking the ideas forward we will remain focused on achieving the best fit with the desired outcomes from the RDR. Our considerations will include:
 - how consumers and firms might respond if changes were made;
 - European and domestic legal issues;
 - how we could strengthen the incentives for firms to deliver good consumer outcomes; and

3 Firms tied to more than one product provider.

- whether firms would be sufficiently viable to operate in the new regulatory landscape and still be able to deliver on their longer-term commitments to their customers.
12. We also need to complete our analysis of responses as we move towards the Feedback Statement in October and then determine our approach to policy making.
 13. We set out an update on our thinking on prudential rules for Personal Investment Firms in the Feedback Statement⁴ on Discussion Paper DP07/4⁵. In that Feedback Statement we explain that we will consider further how best to extend and refine our current capital resource requirements according to the size of a firm, and will consider arrangements whereby firms that cease trading bear more of the costs of their customers' claims than is currently the case.
 14. We will publish a Feedback Statement on the RDR in October 2008 which will contain:
 - A full analysis of responses to DP07/1.
 - An update on the progress the market has made in response to our three specific challenges, and on our reactions to that progress.
 - Comments on the features of the market we will be seeking to deliver through regulatory change.
 - How we might make that change happen (for example changes to rules) and how we would like the industry to respond. We still favour market-led solutions where appropriate.
 - A timetable for possible regulatory changes and necessary transitional arrangements.
 15. We are not seeking formal feedback on this paper but if you do wish to comment on the matters raised then please write to rdr@fsa.gov.uk.

4 We published Feedback Statement FS08/2 on the Review of Prudential Rules for Personal Investment Firms on 29 April 2008: www.fsa.gov.uk/pubs/discussion/fs08_02.pdf

5 DP07/4: *Review of the Prudential Rules for Personal Investment Firms*, published on 7 July 2007: www.fsa.gov.uk/pubs/discussion/dp07_04.pdf

1 Introduction

What we want the Retail Distribution Review to achieve

- 1.1 The Retail Distribution Review (RDR) was launched in June 2006 in response to longstanding problems in the market for the distribution of retail investment products. The review involves the FSA, industry and consumer representatives working together to understand better the root causes of the current market inefficiencies and to find solutions that are attractive both to consumers and to firms. It should help the market for retail investments prepare for and adapt to changes such as the potential introduction of Money Guidance⁶, the launch of Personal Accounts⁷, and reflect other social developments and trends such as increased personal indebtedness.
- 1.2 The RDR is an important component of our overall retail market strategy, complementing our Treating Customers Fairly and Financial Capability initiatives. The aim of the RDR is for more consumers to have sufficient confidence in the market to want to use its products and services more often. To achieve this, we need an industry that more clearly acts in the best interests of its customers and treats them fairly.
- 1.3 We set out the desired outcomes from the RDR in Discussion Paper DP07/1 (the DP). The purpose of the DP was to put forward ideas for wider market debate on how best to deliver these outcomes. They remain central to the review:
 - 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;

⁶ See footnote 2.

⁷ The government is setting up a pension scheme, known as 'Personal Accounts', which employers will be able to use to fulfil new obligations from 2012 to provide a workplace pension, by automatically enrolling all of their employees who meet certain criteria and by making a minimum contribution.

- 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.

Purpose of this Interim Report

- 1.4 We published the DP in June 2007 and invited responses to 70 questions. The feedback period ended on 31 December 2007. At the same time as publishing DP07/1 on the RDR we issued DP07/2⁸ on Platforms and DP07/4⁹ on prudential rules for Personal Investment Firms (PIFs).
- 1.5 In March 2008, we published a Feedback Statement (FS08/1) on DP07/2 and confirmed our commitment to the current, principles-based approach to platforms. We also announced that in the second quarter of 2008 we will begin thematic work on intermediaries' use of platforms to assess current market practice and the extent to which firms are treating customers fairly. We are publishing a Feedback Statement (FS08/2) on DP07/4 at the same time as publishing this Interim Report on the RDR.
- 1.6 This Interim Report sets out the principal areas of feedback that we have received on DP07/1. It identifies a possible view of the future landscape based on that feedback which we now wish to explore in more depth. We do not provide a full analysis of feedback on the DP in this paper. That will be contained in a Feedback Statement in October 2008, together with our conclusions on more extensive economic analysis of the ideas we have put forward.
- 1.7 We regard this paper as a continuation of the discussion process. We want to use it to maintain the momentum for change and we are making three specific challenges to the market to accelerate progress towards a better future for consumers and firms.

Contents of the Interim Report

- 1.8 In Chapter 2 we provide a high-level summary of the main points of feedback we have received and outline a possible simpler future landscape suggested by that feedback. We then set out more detailed considerations under the following headings:
- Advice (Chapter 3)
 - Sales (Chapter 4)
 - Consequences of simplicity (Chapter 5)
 - Challenges for the industry (Chapter 6)
 - Other issues and next steps (Chapter 7)

8 DP07/2 – *Platforms: the role of wraps and fund supermarkets*: www.fsa.gov.uk/pubs/discussion/dp07_02.pdf

9 DP07/4 – *Review of the Prudential Rules for Personal Investment Firms*

- 1.9 We give a summary of our research to date in Annex 1.
- 1.10 We are not seeking formal feedback on this paper, but if you do wish to comment on the matters raised then please write to rdr@fsa.gov.uk.

2 A simpler future landscape

Many respondents have called for a simpler landscape, including a clear distinction between 'advice' and 'sales', although there are different views on how the separation might be defined. This separation, together with the newly proposed Money Guidance service, is our starting point for a simpler landscape. 'Advice' would be restricted to those who can meet a step-change in standards and who are, in practice, acting as the agent of the customer. All other regulated services would be 'sales'. We discuss the consequences of this separation in Chapter 5.

What the feedback has told us

- 2.1 We received 888 formal responses to the DP from a broad range of stakeholders. This is in addition to the feedback we received from the 20 consultation sessions we ran for smaller firms, from attendance at roadshows, industry seminars and conferences and from our numerous discussions with firms, consumer bodies and practitioners.
- 2.2 Our thinking at this point is based on reading a significant and representative sample of written responses, but we still have more to do. We will continue with this work, as well as exploring certain issues in more depth, and report back in October 2008 in our Feedback Statement. We think it is better to give early feedback now to indicate the direction of travel rather than to have a long period of silence.
- 2.3 There are a number of areas where feedback suggests widespread consensus between respondents. Closer analysis shows that some respondents may not have thought through to the next level of detail and some have very different views on how they would implement the same high-level ideas. One area where there does appear to be increasing agreement is on the need to deliver the RDR outcomes and, in particular, to make it easier for consumers to understand the market.
- 2.4 We paraphrase some of the many areas of apparent consensus below:
 - The DP proposals are too complex – there are 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 advice¹⁰ 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.

2.5 In several areas there were pockets of consensus:

- The regulated market must align with Money Guidance¹¹ (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 is needed).

Keeping it simple

2.6 We want to build on what many respondents have told us is the most important test of regulatory changes; that is, the extent to which consumers will be able to understand the different services then available to them. We also think that to make a material difference to consumers in this market we may need to make radical changes. Consequently, our starting point for the future landscape should be as simple as possible. We will then determine how close we can and want to get to this, by considering the consequences, in the context of the desired outcomes of the RDR, for consumers and firms and the legal implications.

2.7 So our starting point, as illustrated in Figure 1 (see page 13), consists of three distinct services for consumers: Advice, Sales and Money Guidance. To keep it simple, there would only be one tier of adviser providing advice services – in contrast to the DP proposals.

2.8 We believe that this has the potential to improve consumer understanding of the market significantly, although there are material consequences associated with seeking simplicity. There may, for instance, be less choice for consumers. We will

¹⁰ This was the name given in DP07/1 to a possible new simplified advice service.

¹¹ See footnote 2.

have to balance that against whether the quality of what remains is sufficient to attract many more new consumers than would otherwise be the case. We consider the consequences of simplicity further in Chapter 5. We recognise that in making final decisions, there may have to be trade-offs against this simple view to achieve the right outcomes for consumers.

Separating ‘advice’ from ‘sales’

- 2.9 Many respondents have suggested that a clear distinction between ‘sales’ and ‘advice’ is needed to help more consumers understand the nature of the services supplied. In other words, it should be clearer and easier for consumers to distinguish between a process that focuses on their needs (and may or may not result in a product sale) and one which is only intended to sell them a product.
- 2.10 As mentioned above, despite the apparent consensus for a clean distinction between ‘advice’ and ‘sales’, and one that consumers can easily understand, it is not clear that respondents agree on how to define this separation nor that all have thought through the implications. So we are using, as a basis for further consideration, a way of distinguishing between ‘advice’ and ‘sales’ that would make it appear very much simpler to a consumer than at present.
- 2.11 The starting point for advice services is, of course, the requirement for firms to act honestly, fairly and professionally in accordance with the best interests of their clients. This would be underpinned by a step-change in standards that then become the conditions for ‘independence’. In other words, the only advice would be independent advice – again, simplifying the consumer’s view of the market.

The starting point for sales is non-advised services

- 2.12 There would be a significant risk of consumer confusion if certain forms of advice were to continue but were re-labelled as ‘sales’ when they did not meet the step-change requirements to be called ‘advice’. So to retain the theme of simplicity, the starting point for ‘sales’ is any service that is non-advised in legal terms. We will discuss later what we may be prepared to do to allow another form of sales process to emerge that may involve giving some form of regulated advice (for instance by incorporating a personal recommendation).
- 2.13 There are two forms of ‘sales’, both of which can be offered today:
- Execution-only: the customer knows precisely what they want to buy and does so. Money Guidance may boost demand for this service.
 - ‘Guided’ sales¹²: customers go through an information-providing process that is non-advised and that then leads to some choosing to buy a product.

12 We define ‘guided’ sales in this way solely for the purposes of this Interim Report.

- 2.14 The purpose of guided sales is to allow consumers to make simple, straightforward choices. But it is important that they understand the nature and limitations of services being provided.
- 2.15 We recognise that some firms may be deterred from offering guided sales because of uncertainties over what our current regulations permit or how we would view their business propositions. So we may need to give more proactive guidance on what can be done.

Money Guidance

- 2.16 The Thoresen Review of Generic Financial Advice, which was launched in 2007, recommended that the FSA, in partnership with the Treasury, lead a ‘Pathfinder’ programme to set up a service offering impartial information and guidance on money matters. This recommendation has been accepted by the government. Although we will be co-leading the Pathfinder work, Money Guidance (the working name for this service) is not an FSA-regulated activity nor is it a commercial service.
- 2.17 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.
- 2.18 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.

Incentives for good outcomes

- 2.19 The DP proposed the use of risk-based prudential requirements as an incentive to achieve higher professional standards and to adopt remuneration practices that are not influenced by product providers. The viability of risk-based capital as an incentive has been considered by our parallel review of prudential rules for PIFs¹³.
- 2.20 Feedback from the Independent Financial Adviser (IFA) community, particularly at our consultation sessions, said that we should do more to differentiate between those advisers and firms who ‘do the right thing’ and those who do not. Some respondents, including a number of trade associations, have suggested a risk dashboard against which firms could be assessed.
- 2.21 So we intend to explore forms of incentives, including non-monetary regulatory dividends, for all types of firm to deliver good consumer outcomes. This is consistent

13 See footnote 4.

with our risk-based approach. It might include incentives for individuals to seek higher qualifications than the minimum requirements.

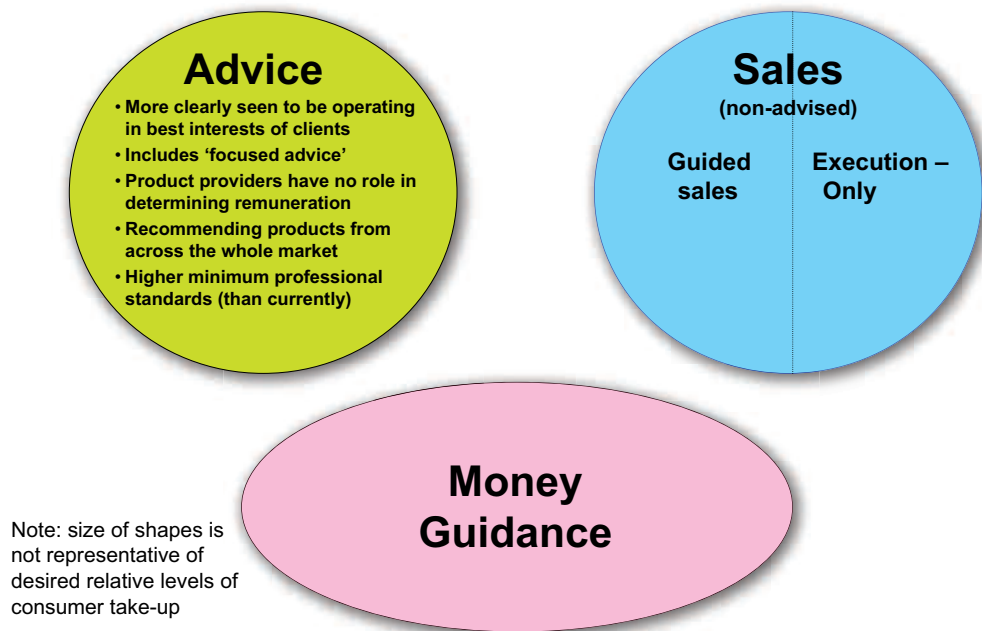
How might this new landscape affect consumers and firms?

- 2.22 The nature of services supplied within the retail market could be very different in the future. For instance, product providers may need to change their approach to compete for distribution more on the basis of the quality and price of their products than currently, and this could significantly affect the design of their products.
- 2.23 We think that the ideas in this paper have the potential to support an increase in the levels of consumer confidence in the advice sector. To achieve this would necessitate change, significant for some, and so require a period of transition to ensure that intended outcomes are delivered while minimising the detrimental impacts on consumers of any short-term upheaval. We also think that a more professional financial advice sector, together with wider access to straightforward sales services could lead to more consumers meeting their savings needs. So this could all add up to a market that delivers better outcomes for consumers and firms.
- 2.24 We made clear in the DP and in subsequent speeches that there are no current plans for a read-across of the RDR from the investment market to the mortgage or general insurance markets. This remains the case, not least in view of the current market conditions in the mortgage market.
- 2.25 But we recognise that the creation of a simpler landscape for distributing investment products, when many consumers will also be buying products from other market sectors, begs questions about the impact on consumer understanding of the wider market. Of course, firms that offer products and services beyond the investment sector would be free to apply any new requirements for that sector across others too (to the extent that existing regulations would permit).
- 2.26 We have an open mind about where the review goes and, as its aims are for the long term, implementation may occur when market conditions are very different. The RDR must meet our desired outcomes for the investment market, but if the feedback and our own analysis suggest a wider application then that is something we will of course consider and discuss openly with the market perhaps, in the case of mortgages, as part of the wider review of the MCOB regime that we announced in our Business Plan 2008/09¹⁴.

14 Page 26 of the FSA Business Plan 2008/09: www.fsa.gov.uk/pubs/plan/pb2008_09.pdf

Figure 1

The future of retail distribution: A simpler landscape



3 Advice

We are looking at there being only one type of adviser and a step-change in the standards required of advisers, building on the existing requirement that a firm must act honestly, fairly and professionally in line with the best interests of its clients. So all advisers would be independent, both in terms of status and in their practices, operating remuneration determined without product provider input and recommending products from across the whole market. They would also all meet appropriate minimum professional standards.

Building on requirements to work in clients' best interests

- 3.1 Delivering a step-change in the quality of full and focused¹⁵ advice services supplied to consumers could require a number of changes:
- Financial advisers would be truly independent.
 - Financial advisers would operate remuneration arrangements agreed with customers and determined without input from product providers.
 - Financial advisers would need to be able to recommend products from across the whole market.
 - Financial advisers would adhere to higher minimum professional standards.
 - For PIFs, Feedback Statement FS08/2¹⁶ explains that we will consider further how we might extend and refine our current capital resource requirements according to the size of a firm, and that we will consider arrangements whereby firms that cease trading bear more of the costs of their customers' claims than is currently the case.
- 3.2 With the exception of the final bullet above, we expand on these areas in the remainder of this chapter.

15 We will consider whether we need to offer further guidance to the industry on focused advice.

16 See footnote 4.

Conditions for independence

- 3.3 As we said earlier, the simpler future regulatory landscape means conditions for independence would match the step-change conditions for advice.
- 3.4 At present, the conditions for independence relate only to advising on packaged products¹⁷. There has been widespread feedback that to be classified as ‘independent’ means operating on a Whole of Market (WOM) basis. We acknowledged this during the discussion period and the vast majority of responses to the Discussion Paper confirm the weight of opinion.

Recommending products from across the whole market

- 3.5 We have had some comments that unless a firm can advise on other designated investments in addition to packaged products, it cannot be truly recommending from across the whole market. Designated investments and portfolio management services are becoming increasingly visible to consumers as an option (for instance through platforms) which is why the step-change standards are not just intended to apply to those advising on packaged products, but also cover, for instance, private client investment managers.
- 3.6 In Feedback Statement 08/1 on Platforms, we comment that to meet current conditions for independence, the suitability of placing a predominant proportion of investment business on a particular platform depends on the circumstances. There may not be a case for anything stricter to be reflected in our rules in the future.
- 3.7 So in developing the step-change standards for advice, we will consider whether we should give further guidance to firms on what being ‘able to recommend products from across the whole market’ should mean. This might cover how we would make supervisory judgements on the suitability of firms’ practices in applying the requirement. We might also give more guidance to those firms advising on packaged products on how they might use regularly reviewed ‘panels’ of preferred suppliers selected from the whole market, as is often the practice today.

Professional standards

- 3.8 This is the area where we see most scope for our preference for market-led solutions. We welcome initiatives underway such as the recent ‘Joint Statement of Principles on Professionalism in Retail Financial Services’¹⁸ and hope that these stimulate progress towards industry-wide agreement. To assist this progress, we are willing to facilitate discussions, involving all relevant parties, and to play our part in taking professional issues forward. We are challenging representatives of the whole industry, and other

17 ‘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.

18 Published on 4 April 2008, this document committed several bodies to a series of measures across three key areas: tackling the ‘alphabet soup’ of qualifications; improving professional standards and ethics; and developing higher, minimum qualifications for the retail financial sector.

relevant stakeholders, to respond positively to this offer. We give more detail on this challenge in Chapter 6.

- 3.9 We recognise that we must take account of existing government initiatives on standard setting and the impact on our role and on our regulatory requirements. This makes it essential that any discussions on professional standards involve all those who have responsibilities in this area including, in particular, the Financial Services Skills Council (FSSC).
- 3.10 Most feedback supports a single tier of adviser for full advice. There is also significant agreement that the QCA¹⁹ Level 4 qualification²⁰ rather than something higher (which some respondents still favour) should apply as the minimum academic qualification for 'advice'. In addition, many agree that certain roles, for instance those offering focused advice in a particular area of expertise, would require even higher minimum specialist qualifications. Our research (see Annex 1), indicated that 76% of small IFA firms saw themselves offering the top tier of advice envisaged in the DP in the longer term, so there is a willingness to be seen to adhere to the highest standards.
- 3.11 We acknowledge, as many have reminded us, that competence is not just about examinations. It is about skills, knowledge, expertise, ethical behaviour and the application and maintenance of all of these. A simpler landscape could have all advice firms being subject to similar professional standards, administered through professional bodies but perhaps, as some have suggested, overseen by a single, independent, professional standards board. Common standards of practice could then also be developed for specific client situations, reducing the scope for inconsistency and poor practice across some or all of the industry.
- 3.12 We will need to agree whether, not least due to the implications of competition law, we could or, indeed, should make membership of a professional body compulsory, as some feedback has suggested. Not doing so risks individuals and firms choosing to side-step certain professional requirements. But to the extent that consumers can then more clearly see that some advisers do not belong to a professional body, it may act as one way for them to discriminate between 'good' and 'bad' advisers. Introducing compulsion carries a cost that will ultimately fall on consumers. But without compulsion, there may be less scope for a reduction in the regulatory burden. For instance, experience of a mandatory system may help to inform any future decision we may make on the role of the customer function under the Approved Persons regime, although this decision would clearly be driven by other factors.
- 3.13 A single tier of adviser, with minimum qualifications equivalent to QCA Level 4 would make transition easier than was envisaged in the DP for the top tier of advisers. Some respondents expressed interest in a form of 'on the job' assessment for existing experienced advisers to demonstrate the requisite minimum levels of competence and knowledge, as an alternative to examinations. We think that this idea should be explored further as part of our challenge on raising minimum professional standards (see Chapter 6). This would include assessing the extent that

19 Qualifications & Curriculum Authority – the regulator for examination providers in England and Wales.

20 For example the Chartered Insurance Institute's Diploma in Financial Planning.

this approach would provide a rigorous test and a genuinely effective way of delivering the outcomes for professionalism that we are seeking.

- 3.14 We are fully aware of the need for sufficient transitional arrangements to minimise any short-term detrimental effects on the availability of advice in the market. Our current view is that ‘grandfathering’²¹ should not be a feature of change, but we would like to see this debated more fully by the group we will facilitate to take forward the challenge of a common approach to raising professional standards.

Remuneration

- 3.15 In line with the views of some firms and consumer bodies who feel that the industry would need to be pushed hard to deliver real change in this area, we want to stop product providers playing any part in the determination of advisory remuneration. This would remove the potential for provider-led remuneration to result in bias, as well as removing the perception that this happens, as opposed to simply relying on firms’ own controls to achieve this. We want providers to meet their responsibilities to design, target and market their products in ways that treat their customers fairly – and this includes the ways in which they remunerate both their in-house staff and third-party distributors.
- 3.16 In the DP we discussed how we may require remuneration practices for certain advisers to operate in a way that ‘reduces effectively any conflicts of interest that might otherwise inhibit them acting in the consumer’s best interests’²². To achieve this, we could go so far as to consider no longer permitting any payments to pass from manufacturers to distributors, but we recognise that this is not practicable at the present time.
- 3.17 So we are not seeking to end the role for product providers in organising payments to advisers from customers’ accounts or investments. We are also not seeking to end the practice of ‘factoring’ whereby the provider advances payments to the adviser and recovers the cost from the customer out of regular charges over the duration of the product (e.g. a traditional front-end commission arrangement) so long as the product provider has played no part in determining how much remuneration will be paid. We intend to consider factoring further, in particular to understand better the risks (including provider and product bias) arising from these arrangements that may lead to consumer detriment.
- 3.18 We also need to understand the implications for different firms, in particular for those in fund management, of moving away from provider-driven commissions. We recognise that many (including in the group pensions market) would not want, or are possibly unable, to move to a pure fee basis, and we need to keep this in mind in devising any regulatory action in this area.
- 3.19 Many responses put forward a high level, more principles-based approach to remuneration as opposed to the more prescriptive approach described above. There

21 ‘Grandfathering’ 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.

22 See paragraph 2.29 in the DP.

were different views on what these principles might be, how they would apply and to whom. Some respondents would clearly welcome the sort of flexibility put forward in the DP²³; some others may see a ‘more principles-based’ approach as one that enables them to preserve the status quo of provider-driven commission, without addressing the potential for bias. So we question whether a more principles-based approach, in this particular context, would go far enough to raise a customer’s confidence and trust that their adviser really is working in their best interests.

- 3.20 So there are some practical areas we need to consider further to understand the risks better and, if we do make new rules, to satisfy ourselves (e.g. through our cost-benefit analysis) that we put in place appropriate mitigants:
- How do we tackle the risks that product providers will develop ‘workarounds’ to retain influence over advice outcomes?
 - How do we tackle the risk of price discrimination if consumers are to play a part in ‘agreeing’ remuneration terms? In a market where shopping around by consumers is limited, there may need to be a mechanism for ensuring that charges set for advice are fair. We are doing more work on this, including considering whether there should be an ongoing role for product providers to monitor and/or to supply us with data to identify outliers.
 - Could or should we impose regulatory limitations on the amounts paid, as some have suggested? Outright caps on commission rates or fixed tariffs would clearly create concerns in regard to competition, but we recognise that some firms would welcome some form of regulatory intervention in this area.
 - How far do we rely on consumer information to deliver change? Historically, disclosure alone has not been effective but how should it support a wider solution?
 - What appropriate transition arrangements would be needed, so that changes do not result in immediate difficulties for adviser firms charging, and their clients then paying, for services?

Liability Management

- 3.21 The Discussion Paper explained that our rules do not set a ‘long-stop’ time limit within which complaints must be brought, in the way that 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 (this is where damage does not become apparent until perhaps some years after the occurrence of a negligent act). We are also aware that in 2001 the Law Commission proposed that, except in the case of personal injury claims, defendants should be protected from claims in court more generally by a ‘long-stop’ of ten years²⁴. Feedback from firms and trade bodies to the DP has been in favour of introducing a long-stop time limit into our complaints rules, whereas consumer groups strongly oppose the introduction of a long-stop.

23 The DP discussed who should set adviser remuneration and how this should be done (‘Customer Agreed Remuneration’ or CAR), leaving firms to choose particular payment mechanisms.

24 Limitation of Actions (2001) Law Comm. No 270 [www.lawcom.gov.uk/docs/lc270sum\(1\).pdf](http://www.lawcom.gov.uk/docs/lc270sum(1).pdf)

- 3.22 The long-term nature of investment products means that the need for a complaint may not emerge until many years after a product is purchased. The Financial Ombudsman Service (FOS) estimates that the introduction of a 15-year long-stop would time-bar approximately 2,000 of its cases a year. This estimate excludes complaints dealt with by firms that are not referred to the FOS. So to justify a long-stop we will have to identify wider benefits to consumers and to firms, for example greater consumer access and saving, arising from a long-stop or a package of changes including one. These benefits would need to exceed the consumer detriment from time-barred complaints. So far we have not been able to find the case for this.
- 3.23 We recognise that this is an important issue for many firms and we would be interested in any information which will help our thinking.
- 3.24 As mentioned in our Business Plan 2008/09²⁵, we will re-engage relevant stakeholders on the issue of consumer responsibility and publish a Discussion Paper in the fourth quarter of 2008, setting out our thinking on the legal position and the actions consumers should take to protect their own best interests and inviting views.

4 Sales

Our starting point for sales is services that are strictly non-advised. These services are intended to encourage higher levels of savings and protection so that the needs of more consumers are met. They can operate within the current regulatory framework, but we recognise we may need to do more here to give guidance to firms.

Sales – more consumers buying savings and protection products

- 4.1 Part of our vision for the retail market is that more consumers could make appropriate provision for their financial needs. Guided sales could help large numbers of consumers to address their needs. At the same time, full advice is unlikely to be readily available to all, so many consumers may need to use ‘sales’ channels.
- 4.2 The starting point for a simpler future landscape is that all ‘sales’ are non-advised. This is either execution-only (the customer pre-selects a product and buys it) or a guided sale (the customer buys a product after going through a non-advised process to help them to make their choice of product).
- 4.3 In the DP we put forward embryonic proposals for a new type of service that would be less costly to supply and that could be more appropriate for consumers with more straightforward needs who might otherwise not be targeted by advisory businesses. We called this ‘primary advice’.
- 4.4 The aim of primary advice in the DP was to allow more consumers to address their savings needs. From our own research, it is not clear that there are large numbers of consumers with the means to save who are not currently doing so. The introduction of Personal Accounts²⁶ from 2012 may further reduce the numbers with unmet savings needs. On the other hand, Money Guidance may help more consumers feel able to save, in some cases after helping them to budget better or to manage their credit commitments more effectively. Furthermore, there may be many consumers who are currently already taking advice and who are saving, who may want to use sales services from time to time to make additional product purchases.

26 See footnote 7.

- 4.5 We are interested in how sales services might extend beyond savings and investment products to include delivery of certain kinds of protection products (for instance term assurance) and, in particular, more pro-actively tackle the protection needs of those with debt.
- 4.6 Some firms have already developed services that encourage customers to go through an automated process that then prompts them to decide what they want and helps them to buy a product. It may be that, particularly if we provide further guidance on what can be done under current regulations, more firms could work within those regulations to provide similar services where there is commercial demand.
- 4.7 We recognise that this ‘pure’ form of sales may not go far enough to meet consumer needs, or may not create sufficient leverage for firms for such a business model to be viable. We address this point in our consideration of consequences in Chapter 5. From our early analysis of the economics of supply we have identified that the key characteristics of successful business models will be efficient lead generation processes so that there is fast throughput of potential customers, and a high sales conversion rate. This may require material expenditure on marketing systems.
- 4.8 Firms’ need for low cost models to make provision of guided sales services viable may increase incentives for third party providers to operate ‘vertical restraints’ (for example, a contract restricting a firm operating guided sales to one provider’s products for a period of time in exchange for the provision of systems infrastructure, or possible remuneration arrangements that bind the distributor). We need to consider the potential competitive effects of this and assess whether it could lead to consumer detriment.

Liability

- 4.9 Feedback from those interested in researching services of a guided sales nature is that the way in which the FSA and the FOS judge transactions will be a significant factor in the decision about whether to offer the service. They want more clarity about the dividing line between giving information and giving advice, assurance about how the service will be judged, and confidence that it will not be judged against a subsequently revised standard. Over the next few months we will explore, with the FOS, how this might be addressed while ensuring appropriate consumer protection.

5 Consequences of simplicity

We want to explore how close we can get to delivering the simpler regulatory landscape. There will be two types of consequence. First, there would be impacts on consumers and firms in the current market. Second, UK and European Union (EU) legal constraints may limit the changes we can make. As a consequence of the way in which we might limit the services that can be described as ‘advice’, some who currently offer advice services would have to describe themselves differently; alternatively, such services may not be able to continue without modification. We are prepared in principle to design a new regulatory regime to allow a more streamlined sales process that is quick and easy to deliver and where the limitations are clearly understood by customers, but firms must make a case for this first.

How close can we realistically get to a simpler regulatory landscape?

- 5.1 We recognise that there are challenges in delivering the view of a simpler landscape outlined in this paper. There are two main factors that we must consider:
- Practical implications: as a more principles-based regulator, we need to consider the extent to which we should intervene, and in particular whether and how we might prohibit the use of certain current business models in the future.
 - Legal constraints: European and UK legal considerations will affect how far we can go in making new rules and reviewing certain definitions and concepts. In particular, we will take account of any competitive anomalies that new rules might cause.
- 5.2 So there may have to be trade-offs between our view of a simpler landscape and a market that offers a wide enough range of services to cater for the diverse needs of different consumers. In particular, there are two big questions that must be answered:

- What happens to those services that meet current conditions to be described as ‘advice’ but which would not meet the new conditions? This may include, in particular, those current advisory businesses that are not independent through which over 20% of new long-term insurance business was generated in 2007²⁷.
- Do we take action to develop a new regulatory regime to enable firms to provide a sales service that involves an element of persuasion or seeks information from the client that would, in the context of a sale, inevitably lead to advice being given (in a legal sense)?

5.3 In both cases, we could be retaining considerable ambiguity in the regulatory landscape. Would consumers understand the nature and limitations of services described as ‘sales’ but which are actually advice in legal terms, or would it simply confuse them?

Legal considerations

5.4 We set out in Chapter 5 of DP07/1 the EU Directives and UK legislation that are most relevant to implementation. We said that the Markets in Financial Instruments Directive (MiFID) is likely to have the greatest impact. We are in contact with the European Commission and we have held high-level discussions with them on the RDR and on our current thinking.

5.5 There are many areas that we must consider, for instance:

- Whether we can limit the market for advice to only those firms meeting the step-change standards we set out in Chapter 3.
- How far we can go towards prescribing market practices for advisory remuneration.
- We are neutral about whether we see the need for a new regulatory regime for the sale of investment products that goes beyond the current non-advised regime. We would need to consider how such a regime would operate in relation to MiFID.
- In setting the step-change requirements for advice, mandatory membership of a professional body could raise difficult competition law questions. We have already started to discuss these with the Office of Fair Trading and they have indicated a need to understand the possible impact on consumers and firms.
- We need to determine what happens to Basic Advice (recognising that any decisions here may also require actions from the Treasury).²⁸

Consequences of separating advice from sales

5.6 Between now and the October Feedback Statement we need to explore further:

27 New Long-Term Insurance Overview statistics taken from the Association of British Insurers’ website.

28 In PS07/6 *Reforming Conduct of Business Regulation* we announced our intention to undertake a full review of Basic Advice and intend to report our findings alongside the RDR Feedback Statement due for publication in October 2008.

- what consumers understand, and the industry means, by ‘advice’ and ‘sales’ (such further feedback will help us to develop proposed changes);
- the legal issues and possible competition issues of regulatory intervention; and
- the economic impacts on the retail investment market of a split between advice and sales (the winners and losers, effects on the availability of advisory services in the overall market, and the implications for consumers). Similar initiatives have not been implemented before in other countries, and the economic impacts are potentially significant.

Consequences of changing the standards for advice

- 5.7 The step-change in standards for advice would apply to the whole IFA community and many private client investment managers and stockbrokers. Some may not be prepared to move towards the new minimum standards even after the necessary transitional arrangements, and understanding the potential size of this group will be a key element of our further research before October.
- 5.8 Our starting point is a future landscape that is simpler for consumers to understand, where they can easily distinguish between advice and sales services, and where it is clearer that advisers are only working in the best interests of their clients. So there may need to be changes for firms and advisers in the tied and multi-tied²⁹ sectors who currently provide advice, as defined in the Regulated Activities Order, but who would fall short of the step-change requirements. These changes would only be needed to deliver the clarity for consumers envisaged by the simpler landscape and are not driven by any concerns over the quality of the current services in these sectors.
- 5.9 We would have three main options, which may be applied differently to particular market segments. First, we could adapt the conditions for ‘advice’ to allow these businesses to continue. Requirements for professional standards and remuneration may then need to be equivalent to the step-change standards for other advisers. This option would allow these firms and agents to continue to describe themselves as ‘advisers’. This would therefore represent a significant departure from our simpler future landscape.
- 5.10 Second, we could continue to allow such firms to operate advisory services (in legal terms) but not allow them to describe their services as ‘advice’. We might want higher minimum conditions, for instance on remuneration transparency, to avoid some current firms seeing this as a ‘safe harbour’ to continue existing business practices that do not treat customers fairly. This could be labelled as a form of ‘sales with persuasion’ rather than ‘advice’. This would add complexity for consumers in understanding the regulatory landscape, which is the significant risk of this approach.
- 5.11 Third, we could follow a much more limited route, and one that might be easier for consumers to understand, by considering how we could prohibit services that do not

29 Firms tied to more than one product provider.

meet the step-change conditions for advice from continuing at all. To survive, following a transition period, firms and advisers would have to adapt their business models by opting to either:

- meet the step-change conditions for advice, which may mean transforming into an independent firm (and recommending products from across the whole market); or
- convert their services into a non-advised sales service; or
- if we create a new regulatory regime for sales, adapt accordingly. This may mean a more limited range of activities than the current regime probably including a limited range of simple products.

Can guided sales be supplied within the current regulatory regime?

- 5.12 Firms have already started presenting to us possible business propositions for guided sales services. These have taken two different forms.
- 5.13 The first form has been business models which are non-advised, and can already be implemented. An example of such a model might be a filtering process based on questions merely designed to identify the characteristics of the product the customer desires (e.g. ‘do you want a unit trust?’ or ‘do you want income or accumulation units?’).
- 5.14 The second form is business models that include an element of ‘persuasion’ or involve seeking out and processing client information which, in the context of a sale, would constitute investment advice (some by design, and others intended to be non-advised but which, on closer scrutiny, are not). Some firms feel that, in practice, having gone through the process, customers may still need to be persuaded to go ahead and buy a product. So a non-advised approach may not attract enough demand or may not deliver the necessary conversion rates to ensure commercial viability of business models. It may also not allow enough consumers to recognise their savings priorities and then to address them.
- 5.15 So this second form may mean some proposed services need to operate within the legal definition of regulated advice to deliver good outcomes for consumers and firms. But many firms also want a fast, streamlined process (some firms have proposed 30 minutes) in order to attract more demand and this may not be compatible with a full advisory process. Furthermore, the liability risk may then significantly reduce the economic attractiveness of such business models for suppliers. So we might need to take some form of action – for instance individual guidance or even designing a new regulatory regime – for these services to be offered.
- 5.16 If we do need to make changes to our rulebook then the industry has to make a solid case first. The overriding consideration for us in examining proposals for any actions would be ensuring an appropriate degree of consumer protection. This includes being satisfied that consumers would understand the limitations of services supplied, which are likely to include a restricted product range. As we mentioned earlier, we would be

particularly interested in what consumers would understand by describing a service as ‘sales’, when it is advice in a legal sense.

- 5.17 Clearly there are many issues to explore here, for example: whether there is demand for a new service; how firms would demonstrate what the customer understood the service to be; how that understanding could be achieved in an overall process that may only last 30-45 minutes; how to ensure significant consumer detriment is avoided whilst ensuring the service is attractive and engaging; and how to give firms confidence about the standard that the service would be judged against.
- 5.18 We have been receiving input from the FOS to help our consideration of the liability issues arising from potential business models for guided sales, including those that operate within the legal definition of advice. This will continue as ideas for sales services are developed. We will explore with the FOS whether, similar to that for Basic Advice, its approach might be to judge the service against a standard appropriate to the service being provided and the customer’s understanding of the service. That would be different to the standard for ‘advice’ as described in Chapter 3, but not below the standard the general law (including EU law) would expect, because consumers could refer cases to the courts instead of the FOS.
- 5.19 There may well be scope for FSA ‘confirmed’ industry guidance to establish a common approach. Alternatively, to achieve greater certainty about liability, another way might be to use an industry group or body, containing credible consumer representatives, to:
- develop and periodically review an industry-standard automated system to use information about a customer to recommend appropriate types of product; and
 - pre-vet the mapping of those recommendations to individual firms’ products.
- This might help satisfy the FOS in individual cases that the mapping of the customer to the product was appropriate, limiting the scope for complainants to raise ‘hindsight’ arguments.
- 5.20 We do not intend to design business models or systems, nor take a lead in doing so, but would consider what role we might take if the industry wishes to explore such an option.

Transitional issues

- 5.21 We expect that whatever end-state is agreed for the future regulatory landscape there would need to be transitional arrangements. We will consider this in more detail in the Feedback Statement in October. How such arrangements would work will depend on the extent of change.
- 5.22 To the extent that we are now considering a different view of the future regulatory landscape from that set out in the DP, there are different transitional issues. For instance, a simpler future would have only one type of adviser, as opposed to two distinct levels of adviser operating to different standards as set out in the DP. We also

acknowledge a strong view that the minimum qualification for advisers should be the equivalent of QCA Level 4, rather than something more than this as was suggested as a possibility for some advisers in the DP. As raised earlier, we do not think ‘grandfathering’ will be a feature of change, so this will impact on transitional arrangements³⁰.

5.23 The main areas that are likely to require transitional arrangements include:

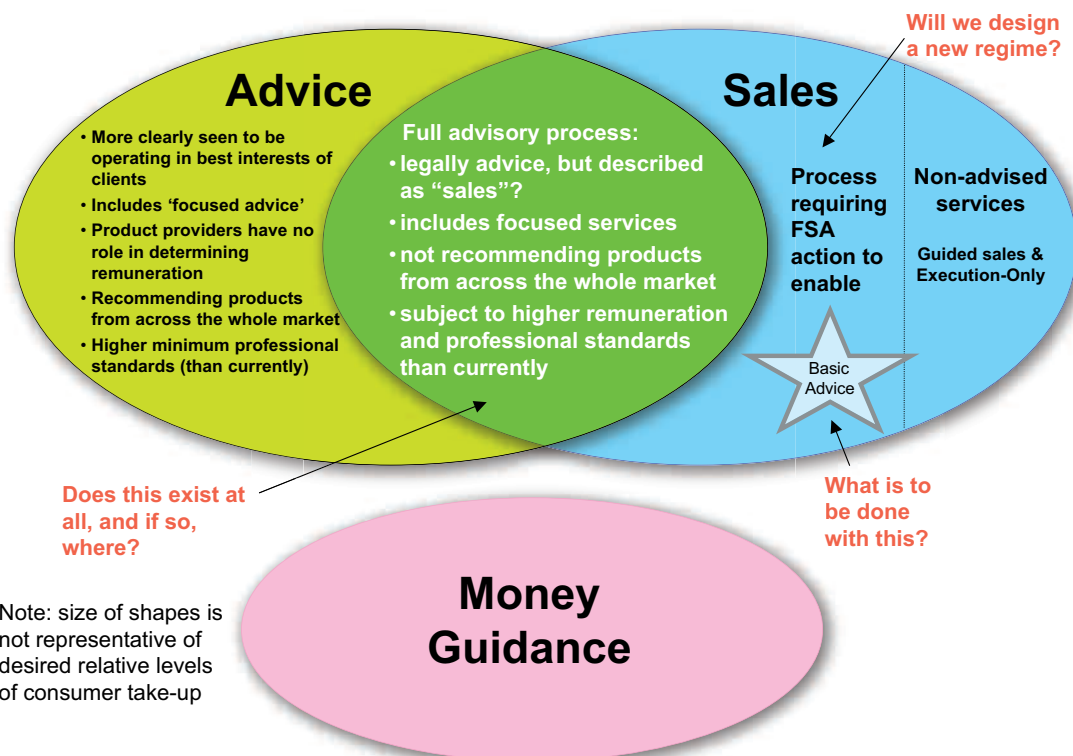
- Professional standards – most respondents have expressed concerns that there would need to be a transition period to ensure that the market can maintain a sufficient supply of services to consumers as advisers upgrade their qualifications.
- Remuneration – particularly if firms need time to change systems as well as practices.
- Business models – if new requirements for advice mean that certain businesses would have to change their customer propositions.

Conclusion

5.24 We acknowledge that it will be challenging to get as close as we can to the simpler future market set out earlier, not least because of legal and practical implications. There are significant risks that ‘simpler’ may still not be ‘simple’. We particularly need to resolve the consequences shown in Figure 2.

Figure 2

The future of retail distribution: How do we tackle the consequences?

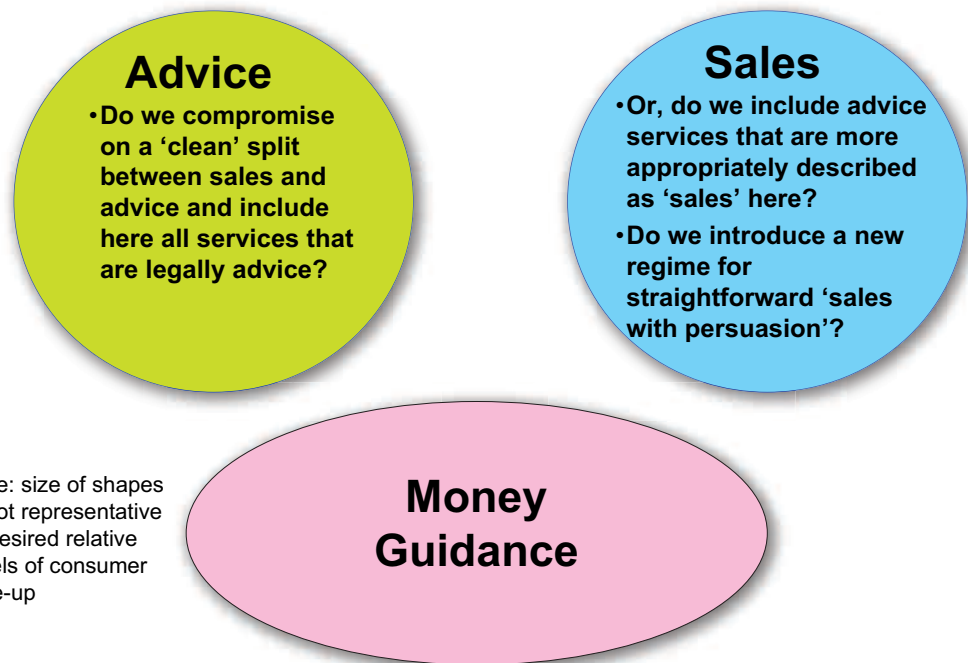


30 But as we explain in paragraph 3.13 we will explore non-examination tests of competence for existing advisers.

5.25 Whatever we do, we need consistency and clarity about what ends up as ‘advice’ and what as ‘sales’ to avoid ambiguities that could be even more confusing for consumers than the current landscape. So there is much to resolve before the October Feedback statement if we are to deliver the market landscape in Figure 3.

Figure 3

The future of retail distribution: can we deliver a simpler landscape?



6 Challenges for the industry

We are issuing three specific challenges to the industry to maintain the momentum for change. These relate to further progress on an agreed way forward for professional standards; for more product providers to stop influencing advisory remuneration; and for firms to make the case to us if we need to take actions to enable them to operate new sales services.

Professional standards

- 6.1 We are encouraged by the feedback we have received on professional standards, and particularly by the discussions between various professional bodies and others (for instance the FSSC) which show that there is considerable agreement that action is needed. We have consistently stated that this is an area where we believe the industry needs to take the lead.
- 6.2 Consequently, we are challenging the industry and all relevant stakeholders to progress development and implementation of an agreed common framework for professional standards. This needs 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.
- 6.3 We recognise some of the practical difficulties given the different interests represented by different bodies, so we will take leadership in facilitating progress and building on statements of intent that some have issued. Our challenge is to representatives of the whole industry, and all other relevant stakeholders, to deliver on this apparent consensus for change. We are willing to play our part in facilitating discussions and taking whatever other actions that only we are able to progress, but the involvement and cooperation of all relevant industry parties will be vital if the industry is to avoid more direct intervention from us.
- 6.4 So our challenge is for the industry and all other relevant parties to take professional standards forward by:
 - ensuring their participation through senior level representatives;

- formulating terms of reference;
- scoping what needs to be delivered and by when;
- implementing a delivery plan; and
- providing us with regular updates on progress so that we can monitor achievements.

Remuneration

- 6.5 In the last few years, several product providers have changed their remuneration practices so that they no longer set advisory remuneration terms for the sale of some or all of their products. At present, while becoming more prevalent, these practices do not yet represent the most common approach. At the same time, it is not clear that all of the new remuneration mechanisms in use support a real shift to adviser firms in setting their own remuneration, or in explaining to customers and being responsible for their remuneration. It is also not clear that advisers are always ready for such responsibility.
- 6.6 We challenge all product provider firms to bring forward practices that will end their role in setting advisory remuneration, and so no longer use remuneration to incentivise advisers to recommend their products. In meeting this challenge, we want to see firms recognising and dealing with the difficulties of offering systems that advisers can and do engage with, and that do not simply lead to higher commissions being paid.
- 6.7 How the industry responds to this challenge could influence whether and how we make new rules in this area.

Business models for 'sales'

- 6.8 We will continue to encourage firms to present propositions to us for new sales services and challenge them to make the case for us to take any necessary action for them to implement their ideas, for instance by introducing a new regulatory regime, or by giving individual guidance to firms as appropriate. We are clear that we will only design a new enabling regulatory regime if the industry makes a strong enough case for it.
- 6.9 This means we would expect firms to be able to demonstrate that the only way that they can implement a sufficiently viable business model for sales is if we take such action. We would also need firms to demonstrate to our satisfaction that any action we might take would not risk widespread consumer detriment, including the risk that consumers do not properly understand the limitations of the services supplied to them.

7 Other issues and next steps

Other areas for further consideration

- 7.1 We set out below some further observations and issues that have been communicated to us, through responses to the DP and at the many public events that we attended during the discussion period. These, and the issues set out in earlier chapters, are not intended as the complete list of matters that we will consider further.

Observations

- 7.2 We received many comments on the relative ease of borrowing relative to saving and investing. Borrowing is outside the scope of the RDR, but we do think that guided sales processes could make it easier for more consumers to save.
- 7.3 Concern was expressed about whether consumers would understand the limitations of services supplied and would be able recall them at the time of any complaint. This is an area where we welcome insights derived from the consumer research of firms who are developing new sales services.
- 7.4 Some respondents have suggested tackling professionalism at firm rather than adviser level. This proposal means advisory firms would operate as in certain other professions where the advice may be delivered by an employee but is ‘signed off’ by a fully qualified senior who takes full responsibility for the advice.
- 7.5 Several respondents have raised the issue of our approach to firms wanting to alter commission payments after they have been agreed (on which we provide guidance in our Handbook at COBS 2.3.11G). The guidance reminds firms of the likelihood that increasing commission, after disclosing it to a customer, will breach our rules on disclosure of charges, remuneration and commission, and on inducements. But respondents suggest that it also means that there is no incentive for an adviser, particularly if newly appointed by the customer, to recommend that their client maintains an existing holding and so can lead to ‘churning’.

Other issues to consider

- 7.6 In considering the step-change conditions for advice as set out in Chapter 3, we need to think about whether this means we should seek to restrict product providers from taking financial interests in advisory firms (e.g. ‘better than best’ controls that previously existed to tackle the possibility that advisers owned by product providers would recommend their products excessively).
- 7.7 Feedback has consistently indicated a need for us to consider separately how ideas might apply to the group market, where we recognise significant differences from the individual market, for instance the role of the employer as sponsor and payee (often the only payee) in a product purchase.
- 7.8 We need to consider the implications for FSA data collection (including Retail Mediation Activity Returns, Product Sales Data and Persistency) and for our approach to supervision generally.
- 7.9 There may also be implications for other aspects of our regulation, for instance our:
- requirements on consumer information;
 - ‘packaged product’ regime, which places particular additional requirements on firms selling mainstream investment products in the retail market; and
 - ‘Approved Persons’ regime, under which we approve individuals for controlled functions.
- 7.10 In addition to our regular discussions with the European Commission, we are having ongoing discussions with the Treasury and Her Majesty’s Revenue and Customs on relevant tax and benefit issues, and with the Office of Fair Trading on competition issues.

Next steps

- 7.11 In conducting our further work we want to know how we deliver this view of the future for retail distribution within the current UK and European legislative context (recognising that the aims of the RDR are for the longer term and so timeframes for implementation may mean that this context could change). We want to consider the impact on consumers and firms in the light of our desired outcomes that we set out in paragraph 1.3 above, and also apply some of the tests, such as ‘simplicity’, that have come through in the feedback. We want to satisfy ourselves that the potential longer-term impact on the economic viability of firms will not be detrimental to consumers, for instance by reducing the supply of services from the market as a whole.
- 7.12 Our analysis may lead us to conclude that some ideas cannot or should not be taken forward or that they need material amendment. So we have yet to take any decisions on implementing changes. But we recognise now that many of the decisions will involve difficult choices to be made as it may not be possible to satisfy all the decision criteria simultaneously.

7.13 So before publishing the Feedback Statement in October 2008 we will:

- further analyse responses to the DP;
- explore, as a starting point, how close we can get to a simpler landscape consisting of ‘advice’, ‘sales’, and Money Guidance, including the extent to which our intended outcomes can be delivered by economically-sustainable firms that treat their customers fairly, and how we tackle the legal implications;
- consider the step-changes required in the standards of advisory services;
- consider carefully information the market might be able to provide to help cost-benefit analysis of introducing a ‘long-stop’ time limit on claims;
- consider actions we might be able to take to support quick, economically-viable, sales processes that provide appropriate consumer protection;
- with the FOS, consider how far it might be possible to clarify the extent of the potential risk of regulatory action or successful consumer complaints against firms in relation to any new sales processes;
- look further at incentives for firms to deliver good customer outcomes; and
- consider transitional arrangements.

7.14 We will also consider how best to extend and refine our current capital resource requirements for PIFs according to the size of a firm, and we will consider arrangements whereby PIFs that cease trading bear more of the costs of their consumers’ claims than is currently the case. This is discussed in more detail in the Feedback Statement on the Review of Prudential Rules for PIFs³¹.

31 See footnote 4.

Overview of relevant research

Analysis of potential market impact

1. In December 2007, we investigated the potential impact that the proposals set out in DP07/1 would have on small firms of financial advisers, if they were implemented. We undertook a quantitative survey of 501 firms using quotas to ensure a representative sample of firms and using show-cards to ensure consistency of understanding of those surveyed. We were particularly keen to explore the future business model firms would adopt and their appetite to adopt the new ideas of primary advice and customer agreed remuneration.
2. We intend to carry out further work on potential market impact as the change proposals evolve.
3. Our main findings were:
 - 55% of firms were interested in offering Professional Financial Planner (PFP) services initially and 63% General Financial Adviser (GFA)³². After allowing for a transition period, 76% would choose to offer PFP services either by itself or alongside other services. Only 9% of firms saw themselves offering just GFA services in the long term.
 - 64% thought it would take three years or less to be ready for a post-RDR world (with 25% ready in one year).
 - 37% of firms would make no change to their business strategy.
 - 31% of firms might consider leaving the market as a result of the RDR, although it is not clear that all of these would actually do so.
 - Around a third of firms would be interested in offering a 'primary advice' service, mostly in conjunction with other types of service. Many firms saw wider value in primary advice than just for existing clients. 66% of firms likely to provide primary advice thought it would be valuable as a way of attracting new clients and/or a way to train and get value from junior advisers.

32 The PFP and GFA were the two tiers of adviser, each subject to different requirements, proposed in DP07/1.

- The aspiration was for a primary advice process lasting an average of 2 hours (as opposed to an average of 8 for ‘full advice’) with average revenue per transaction of £500.

Remuneration

4. We are currently carrying out research into the remuneration of firms involved in the advice and distribution of retail investment products, to understand better the potential effects of changing our regulatory approach in this area.
5. A key part of this work has been to review remuneration arrangements already in use where product providers do not specify how much commission advisers should receive. We have visited a range of firms offering ‘factory-gate pricing’ - where the product provider sets the product costs and allows the adviser to deduct additional charges for their services, with their customer’s consent. We have looked at the remuneration techniques adopted by firms using platforms, and talked to some advisers who set their own charges but use commission offsetting to receive payment.
6. As well as looking into the costs and implications of setting up and using alternative remuneration methods, we also need to understand the cost structures that adviser firms must finance from that income. We have commissioned external research to examine adviser firms’ business models, and will use this material to help us to analyse the potential impact of changes in the way that firms are remunerated on the market as a whole.
7. In the coming months, we plan to hold further discussions with industry and consumer groups to discuss practical implications of our possible policy approaches in more detail, including looking at what is a sensible timetable for change. As discussed earlier in this paper, we also need to consider how we would address the practical challenges involved in ensuring that consumers do not suffer detriment as a result of being faced with new ways of selecting and paying for services.

Simple sales models (primary advice)

8. Research to date on primary advice has focused on demand, to understand the potential size of the market and on the type of service that consumers would value. We also built on research that we were undertaking to look at the market for Basic Advice to see if there were lessons that could be learned from that.
9. The economic research on the potential size of the market for a more streamlined advice process looked at individuals whose incomes fell in the range £25,000-£50,000 a year, the indicative range of income suggested in the DP. At the same time, research which we have carried out with users of Basic Advice showed that some people do value a simpler advice process.

10. We are examining how this market might be impacted by Money Guidance, which could serve to increase demand for medium term savings products, and Personal Accounts, which could reduce demand.
11. We are also currently carrying out qualitative consumer research to understand more about the nature of the services that consumers would value most as part of a more streamlined sales process.

The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: <http://www.fsa.gov.uk>

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