Policy briefing

February 2012

RDR Update: FSA Papers on Independent/Restricted, Adviser Charging, and Distributor-Influenced Funds

Summary

On 27 February 2012, the FSA published three papers that are relevant to the implementation of the Retail Distribution Review (RDR) which takes effect at the end of this year. These were:

- **Guidance Consultation on Independent and Restricted Advice:** clarifies some of the previous questions about the two categories of advice. The document stems from questions asked at the FSA RDR roadshows.
- **Policy Statement on Legacy Assets:** follow-up to a consultation in November on treatment of trail commission and legacy assets. Trail commission from pre-RDR advice would still be allowed, provided no new advice is given.
- **Guidance on Distributor-Influenced Funds:** sets out the steps the FSA would like firms that offer such funds to take to comply with the RDR, manage conflicts of interest, etc.

The FSA also published some other papers, including an RDR update newsletter, top Q&As about RDR implementation, and a Handbook update.

Overview

On 27 February 2012, the FSA published three papers that are relevant to the implementation of the Retail Distribution Review (RDR) which takes effect at the end of this year. The papers are designed to clarify final points especially regarding issues such as trail commission, duties of restricted advisers, and treatment of legacy assets:

- **Guidance Consultation: Retail Distribution Review – Independent and Restricted Advice:** this paper focuses on the standard of independent advice and addresses common points raised by firms implementing the new requirements. www.fsa.gov.uk/static/pubs/guidance/gc12_03.pdf
- **Policy Statement PS12/3: Distribution of Retail Investments – RDR Adviser Charging Treatment of Legacy Assets:** this is follow-up to the regulator's consultation CP11/26 covering the treatment of legacy assets and sets out their final thinking on how these are defined and should be treated under the RDR rules. www.fsa.gov.uk/static/pubs/policy/ps12-03.pdf
- **Finalised Guidance: Distributor-Influenced Funds – Points for Distributors to Consider:** this paper sets out the FSA expectations on how firms should offer and deal with such funds. It defines DIFs, and offers content and guidance questions on issues such as training and competence, conflict of interest, independence, client communication, and suitability. www.fsa.gov.uk/static/pubs/guidance/fg12_04-adviser.pdf

Please note that not all the documents are readily accessible from the FSA home page. All three documents, plus a Handbook Notice that was also published, are best found at: www.fsa.gov.uk/library/publications_by_date

Guidance Consultation: Independent and Restricted Advice

While many aspects of the scope of service labelling for firms offering retail investment advice have been finalised, successive discussions in a number of settings suggest the presence of unresolved issues that needed clarification:

- Standards for independent advice: defines the different component parts of giving advice on "retail investment products" within a "comprehensive and fair analysis of the relevant market".
- The majority of firms providing independent advice will need to be able to provide advice on all types of retail investment products. Although a firm could specialise in certain financial situations, for example saving for retirement, if it provides independent advice it does not necessarily mean it can rule out in advance advising on certain retail investment products.
- A firm would not need to consider certain retail investment products when giving independent advice if the firm can identify a common relevant market across all of its clients that do not include certain investment products.
- If a firm chooses to specialise in a particular relevant market, it should not hold itself out as acting independently in a broader sense. For example a firm 'Greenfield', which specialises in ethical and socially responsible investments , should not hold itself out as 'Greenfield Independent Financial Advisers', but 'Greenfield – providing independent advice on ethical products' may be acceptable.
- The regulator also said non-specialist firms did not need to advise on niche areas in order to hold themselves out as independent. It said for practices such as pension transfers or long term care advice, an independent adviser need only to identify the client need and refer them to a specialist adviser.
- Restricted advice must meet the same suitability, adviser charging and professionalism standards as independent advice. The key difference is disclosure, which in writing must explain the nature of the restriction, and must also do this orally if the firm engages in oral interaction with the client.
- It reiterates that Simplified Advice is a form of restricted advice because it does not consider all types of retail investment products that may be suitable for consumers.
- In terms of communication and promotions, the consumer must be left in no doubt of the type of advice offered. Firms offering independent advice may advertise themselves ("hold themselves out") as such. However if they also offer restricted advice, then it may not hold itself out as independent to those clients to whom it offers those services.

Policy Statement PS12/3: Adviser Charging and Legacy Assets

This Policy Statement follows consultation CP11/26 in November which covered the treatment of legacy assets under the RDR adviser charging rules. Legacy assets are retail investment products purchased prior to the RDR, and still hold when the new rules come into force. There was some question how the commission ban on advisers giving a personal recommendation would impact trail commission given before the RDR.

Where top-ups are paid into a product:

- No commission will be allowed on the new investment amount, but trail commission can continue on the pre-RDR investment amount.
- The guidance also confirms that additional commission cannot be paid on top-ups into a retail investment product, or increases to regular payments into a product. Trail commission would be allowed to continue on investment amounts resulting from pre-RDR advice or a pre-RDR transaction, such as new payments or increases in regular payments into a life policy or unit trust.
- The policy statement also includes guidance which will be added to the COBS (chapter 6.1A) which clarifies how trail commission could be paid. The guidance gives examples of cases where a personal recommendation

relating to a pre-RDR investment does not lead to an additional investment into the product: no change to the product; a reduction in the investment amount or the level of regular payments; a change from accumulation units to income units or vice versa; or fund switches within a 'life policy' as defined in the Handbook glossary.

Advice that leads to no change to the product:

- Trail commission can continue, although any new payment for the advice would need to take the form of adviser charging.
- Whether or not new advice is given after the RDR comes into force: as a general rule, if no new advice is given post-RDR, then commission is still allowed on the existing product. Para 2.7 provides a scenario whereby regular payments are automatically increased or there is an automatic rebalancing of funds, but no new advice is given. Commission would still be allowed to be paid.

Changes that take place automatically following pre-RDR advice, with no new advice post-RDR:

- Commission can continue to be received, for example, where there are automatic increases to regular payments or rebalancing in accordance with pre-RDR advice, given that no new advice is provided post-RDR.

Fund switching within an insurance product:

- Trail commission can continue on the product as a whole, though new adviser remuneration would need to take the form of adviser charges. Top-ups would need to be treated in the same way as any other top-ups, i.e. new commission could not be paid on the new investment amount.

Offsetting trail commission against adviser charges:

- New commission cannot be accepted post-RDR, even if the adviser intends to refund it to the client, but trail commission for pre-RDR advice or transactions can be offset against adviser charges.
- If new advice is given post-RDR: this must be paid for through RDR-compliant adviser charging. This must not simply be re-labelled trail commission. "An adviser receiving trail commission for pre-RDR advice or transactions can agree with the client that he or she will rebate the commission to the client as part of a new adviser charging agreement with that client, given that the commission relates to pre-RDR advice or transactions." (para 2.10).

Finalised Guidance: Distributor-Influenced Funds

This paper looks at Distributor-Influenced Funds (DIFs) or funds that have been created by particular distributors (be it advisers or networks) on a bespoke basis. The implications of these are that the distributor firm or network has some influence on their investment strategy. Administration can be done within the distributor firm or outsourced. The funds could be arranged as Open-Ended Investment Companies (OEICs) but may take other structures such as unit trusts or insurance funds.

The regulator is concerned that DIFs are suitable to the client and does not increase complexity or costs, and that staff are sufficiently competent to work with the products. The guidance paper sets out issues related to firms offering DIFs, and suggests corrective actions or considerations that would satisfy the regulator:

Adviser charging:

- Distributors can currently receive commission for recommending the product plus get a share of the annual management charge (AMC).
- However post-RDR, distributors should only receive an adviser or consultancy charge and should no longer receive any other direct or indirect benefit (including any AMC share) for their role.

- The Adviser Charge for recommending DIFs should not vary inappropriately compared to substitutable or competing retail investment products.

Training and competence:

- DIFs will have competence implications for staff, not just for advisers but those working with fund managers on fund allocation.
- Such staff will need to understand asset allocation, portfolio construction, and if the firm is undertaking a fund management responsibility, this expertise must extend to investment management.

Conflicts of interest:

- Offering DIFs could present situations that might give rise to conflicts of interest.
- Firms must consider sources of conflict of interest but some are suggested in the paper.
- These include holdings of DIFs in the buy-back of funds from retiring advisers, and non-monetary incentives.

The paper also looks at issues related to adviser charging, independence, suitability, client communications and management and control. In each case it describes the possible sources of concern and poses reflective questions that the regulator would like the firm to consider when developing an appropriate reaction.

Other Papers

The FSA also published several other papers on 27 Feb:

FG12/05: Top Questions Asked at the RDR Roadshows

Sets out 11 questions and answers on various aspects of the RDR including: fact-finds and other client-related activities for advisers without an appropriate qualification; expected help from Accredited Bodies for advisers preparing to meet the professionalism requirements; structured CPD explained; distinguishing independence and restricted advice; etc. www.fsa.gov.uk/static/pubs/guidance/fg12-05.pdf

Retail Distribution Review Newsletter, Issue 4

A two-page update on developments in preparation for the RDR. Includes notes on the documents summarised in this briefing, HM Revenue & Customs expected guidance on the VAT regime for advisers (due out this week); help for firms such as implementation surgeries, the guide entitled *Is your firm on track?*; and reminders on Approved Persons. www.fsa.gov.uk/static/pubs/newsletters/rdr4.pdf

Handbook Notice 117

The update notice highlights a number of amendments to the FSA Handbook stemming from the FSA Board meeting on 23 Feb 2012. www.fsa.gov.uk/static/pubs/handbook/hb-notice117.pdf It includes:

- new qualifications to the qualifications lists in the Training and Competence sourcebook;
- new adds guidance to COBS-6 on the interaction between trail commission on pre-RDR investments and the payment of adviser charges for post-RDR advice; finally
- a new section in the Perimeter Guidance manual setting out recommendations and whether these amount to advising on investments.

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