Consultation Paper

09/18***

Financial Services Authority

Distribution of retail investments: Delivering the RDR

June 2009

FSA®

Contents

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 30 October 2009.
Comments on our proposals specifically relating to corporate pensions business (Questions 5 and 14) should reach us by 31 July 2009.

Comments may be sent by electronic submission using the form on the FSA's website at www.fsa.gov.uk/Pages/Library/Policy/CP/2009/cp09_18_response.shtml).

Alternatively, please send comments in writing to:

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1 Overview

Executive Summary

In June 2006, we launched our Retail Distribution Review (RDR), looking at how investments are distributed to retail consumers in the UK.[1] Through the review, we identified various long-running problems that impact on the quality of advice and consumer outcomes, as well as confidence and trust, in the UK investment market.

Following extensive discussion with industry and consumer representatives, we are now proposing amendments to our regulatory requirements to deliver various changes. Together with other elements of our retail strategy, including our work on financial capability and our focus on testing consumer outcomes, our proposals are designed to tackle important issues within our existing regulatory framework.

Our proposals involve:

- improving the clarity with which firms describe their services to consumers;
- addressing the potential for adviser remuneration to distort consumer outcomes; and
- increasing the professional standards of advisers.

Improving clarity for consumers about advice services

We are proposing changes to make it easier for consumers to distinguish between the different forms of advice on offer to them, with all investment firms clearly describing their services as either 'independent advice'or 'restricted advice'. Our rules and guidance will ensure that firms that describe their advice as independent genuinely do make their recommendations based on comprehensive and fair analysis, and provide unbiased, unrestricted advice. Equally, where consumers choose to use a restricted service – such as a firm that can only give advice on its own range of products – this will be made clear.

1 Discussion Paper (DP) 07/1: *A Review of Retail Distribution* (June 2007) www.fsa.gov.uk/pages/Library/Policy/DP/2007/07_01.shtml.

Addressing the potential for remuneration bias ('Adviser Charging')

Under our proposals, all firms that give investment advice must set their own charges, in agreement with their clients, and will have to meet new standards regarding how they determine and operate these charges. The proposals bring to an end the current, commission-based system of adviser remuneration: we propose to ban product providers from offering amounts of commission to secure sales from adviser firms and, in turn, to ban adviser firms from recommending products that automatically pay commission. Consumers will still be able to have their adviser charges deducted from their investments if they wish, but these charges will no longer be determined by the product providers they are recommended.

Increasing professional standards of advisers

We plan to raise the minimum level of qualification for investment advisers, and to institute an overarching Code of Ethics and enhanced standards for continuing professional development. We are also proposing visible maintenance and enforcement of these standards through the establishment of a Professional Standards Board (and will consult separately on this in the fourth quarter of 2009).

Next steps

Taking effect from the end of 2012, our proposals impact on all regulated firms involved in producing or distributing retail investment products and services, including banks, building societies, insurers, wealth managers and financial advisers.

We invite responses to this consultation paper by 30 October 2009 and we plan to publish a Policy Statement containing our final rules in the first quarter of 2010.

Background

1.1 In Feedback Statement (FS) 08/6,[2] we set out high-level proposals and committed to consult on the detail of new requirements to deliver change. Since then, we have continued our dialogue with firms, trade associations and other stakeholders to develop and refine our proposals. In particular, we have built on the work of the Professionalism Group through a broader Professional Standards Advisory Group, which has provided advice on the development of our professional standards proposals.[3] We have also undertaken consumer and industry research to assess the costs and analyse the benefits of our proposals and how to make them work most effectively.

2 FS08/6: *Retail Distribution Review - Including feedback on DP07/1 and the Interim Report* (November 2008) www.fsa.gov.uk/pages/Library/Policy/DP/2008/fs08_06.shtml.

3 The PSAG is a broadened version of the Professionalism Group. It is made up of consumer and practitioner representatives, trade associations, the Financial Services Skills Council, and relevant professional bodies and awarding organisations.

1.2 This CP describes the changes that we are now proposing and includes draft Handbook text to deliver these changes. Our proposed rule changes relate to advised services, but we also discuss the role of non-advised services. Our proposed changes to raise professional standards do not involve changes to our Handbook at this stage. We have also consulted separately on proposals to increase prudential requirements for personal investment firms.[4]

Objectives of the RDR

1.3 The RDR was set up with the following broad objectives:

- 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;
- remuneration arrangements that allow competitive forces to work in favour of consumers;
- standards of professionalism that inspire consumer confidence and build trust;
- 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.

1.4 Through this CP, we are putting forward a holistic package of proposals, which aim to bring about important changes to the retail investment market. Our proposals seek to improve consumer outcomes and confidence, and to support long-term industry viability.

Scope of proposals

1.5 A key feature of our proposals is that they cover a greater range of products. As well as covering all products currently classified as packaged products,[5] including annuities, our draft rules in this CP apply more widely to retail investment products, including unregulated collective investment schemes, all investments in investment trusts and structured investment products.[6] This wider application reflects the developments that have occurred in the UK investment market over recent years, and fits well with the European Commission's aim for consumers to receive equivalent protection when buying different types of retail investment products (discussed below).

4 CP08/20: *Review of the Prudential Rules for Personal Investment Firms (PIFs)* (November 2008) www.fsa.gov.uk/pages/Library/Policy/CP/2008/08_20.shtml.

5 'Packaged products'means regulated collective investment schemes, investment trust savings schemes, life assurance policies with an investment component and certain types of pension product.

6 All structured products except for structured deposits.

1.6 In contrast, the starting point for our proposals relating to raising standards of professionalism is the existing scope of investments covered by our training and competence requirements, which already extend beyond packaged products. So, our professionalism proposals apply to investment advice on all designated investments. We will work with the Financial Services Skills Council (FSSC) and qualification awarding bodies appropriately to align the scope of the relevant qualifications with any additional products that need to be covered in future.

1.7 We are also considering whether there is scope for a wider application of any of our proposals across the general insurance and mortgage markets.

European context and developments

1.8 The Markets in Financial Instruments Directive (MiFID) Implementing Directive limits the scope for Member States to apply additional requirements in certain areas it covers. Article 4 sets out the conditions for creating or retaining national requirements that go beyond MiFID and requires that these be notified and justified to the European Commission. In January 2007, the Treasury notified the Commission that we intended to retain certain requirements when we implemented MiFID. The proposals in this CP that relate to clarity for consumers about advice services and adviser remuneration depend on the Commission accepting an amendment to our current notification under Article 4. Following discussions with the Commission, Appendix B sets out our draft amended notification, which we intend to submit formally after this consultation has closed and our draft rules have been finalised.[7]

1.9 As noted above, the European Commission has initiated work on retail investment product regulation, with the publication of a Communication on what it describes as 'Packaged Retail Investment Products'(PRIPs) in April 2009.[8] The Communication proposes a new horizontal legislative approach to investor protection, involving harmonised requirements for disclosure and sales practices across retail investment products generally. In relation to sales practices, the Commission's work may eventually extend various conduct of business requirements to a wider set of products, as we have sought to do ourselves in the UK by applying some elements of MiFID across firms that are not subject to the Directive. We support the aims of the Commission's initiative and believe that our RDR proposals will be compatible with, and complementary to, the changes it is likely to bring.

7 The precise details of our proposals on oral disclosure for firms providing restricted advice are not yet included in the notification, as noted in Chapter 2.

8 Communication from the Commission to the European Parliament and the Council: *Packaged Retail Investment Products* (April 2009) http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm#communication.

1.10 The rules we are consulting on in this CP apply in relation to 'retail investment products' and, based on the indications contained in the Commission's Communication, we believe that they reflect the products that the PRIPs work will cover. As an example, it would appear from the Commission's Communication that the PRIPs work could extend aspects of the MiFID conduct of business requirements to structured products. We have tried to take account of this in our own proposals by including structured investment products in our definition of 'retail investment product', which would capture these products under the rules we are consulting on in this CP.[9] As the European work progresses, we will need to consider the impact it has on the rules not covered by the RDR proposals, and we will monitor developments to ensure that our proposals are aligned with the PRIPs work where this is appropriate.

Summary of cost-benefit analysis

1.11 Generally, the RDR proposals are interlinked as they all contribute to achieving the same outcomes (that is, improvements for consumers and long-term viability for the industry). So it makes sense to assess the likely impacts of the RDR proposals on real markets as a whole, although this is not straightforward. In developing the cost-benefit analysis, we have consulted leading academics and commissioned work from Oxera and Deloitte.

1.12 The direct costs to the FSA are estimated to be £2 million one-off, and £1.2 million annually. Incremental compliance costs are estimated to be £430 million one-off, and £40 million a year. The annualised costs amount to £140 million over five years. This cost represents approximately 0.3% of annual gross new business premiums and 1% of industry profits. There may also be short-term costs arising from market exits by independent financial advisers and increases in product prices. In the longer term, cross-subsidies between consumers may be unwound: this may be a cost for smaller investors, but a benefit for larger investors.

1.13 A key benefit of the RDR proposals is improved quality of advice and reduced incidence of mis-selling, leading to increased persistency. This benefit may be very large. For example, even if compliance levels have improved since systematic mortgage endowment and pension mis-selling occurred, total compensation paid to consumers in those cases was £2.7 billion and £11.8 billion respectively, albeit over several years. We recognise that achieving these benefits will require close supervision of RDR rule changes.

1.14 The RDR is also expected to improve consumer confidence by removing some negative perceptions of the advisory process, which undermine confidence and often deter people from seeking advice.

9 We are conscious that structured deposits are included in the Commission's PRIPs Communication and in developing our Banking Conduct Regime we will look at the desirability of bringing them within the scope of our advice regime. (There is currently no FSA advice regime for deposit taking activities, but in Policy Statement 09/6: *Regulating retail banking conduct of business* (April 2009), we announced plans to review this - www.fsa.gov.uk/pages/Library/Policy/Policy/2009/09_06.shtml).

Structure of the paper

1.15 This CP is set out as follows:

- Chapter 2 sets out our proposals for redefining how firms describe and disclose their advice services to consumers. It sets out the distinction between 'independent advice'and 'restricted advice', outlines the consumer research which has led us to use the term 'restricted advice' to describe non-independent advice, and summarises the proposed new disclosure requirements that advisers will need to meet when describing their services to consumers.
- Chapter 3 discusses streamlined advice processes. These are particular advice services which can be characterised as more streamlined processes featuring simple and straightforward products, and includes simplified advice processes (advised guided sales) and Basic Advice. We set out our latest thinking on simplified advice processes and our plans for Basic Advice. We also describe briefly the role of non-advised services and Moneymadeclear money guidance.
- Chapter 4 sets out our proposed new Adviser Charging requirements under which adviser firms will be paid by the customer who is receiving the advice, not by the product provider for selling their product. As well as explaining the requirements facing adviser firms and provider firms in introducing Adviser Charging (including firms providing corporate pensions), it discusses the changes we are proposing more generally to our approach to inducements.
- Chapter 5 sets out our proposals to raise the professional standards for investment advisers, including plans to consult in the fourth quarter of 2009 on setting up an independent Professional Standards Board. It sets out our proposals for raising qualifications and our high-level view on possible future standards for ethics and continuing professional development.
- Chapter 6 sets out the wider implementation challenges, including implications for supervision, and how we are reviewing our approach to protection and mortgage markets in light of the RDR proposals.
- Chapter 7 contains a summary of the cost-benefit analysis.
- We have also included a number of annexes, which contain our analysis of the compatibility of our proposals with our statutory objectives and the principles of good regulation; a cost-benefit analysis for our proposals; a summary of the timetable for future consultations and implementation; an analysis of the potential relevance of our proposals for the general insurance market; and a list of the consultation questions in this paper.
- Draft Handbook text and our draft amended notification to the European Commission are included as Appendices A and B.

Timetable

1.16 This consultation will close on 30 October 2009. However, we would appreciate early feedback on the issues raised in relation to corporate pensions business, as we are aiming to consult on draft rules later this year, so we are asking for responses to questions 5 and 14 by 31 July 2009.

1.17 We will then finalise the draft rules in light of responses to this CP and publish a Policy Statement (PS) giving feedback in the first quarter of 2010. The final timetable for implementation is likely to require firms to implement changes by 31 December 2012. We will consult on the timetable for establishing an independent Professional Standards Board in the fourth quarter of 2009.

Who should read this paper?

1.18 This CP 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 also be of significant interest to consumers and their representative groups.

2 Describing and disclosing advice services to consumers

Introduction

2.1 In FS08/6, we outlined our proposals for a new standard for independent investment advice aimed at ensuring that advice is genuinely independent, covering the broad range of products that an independent adviser would be expected to consider when making a recommendation. We also said that we wanted to improve clarity for consumers about the different types of advice services on offer and that this would necessitate a clear definition of what it means for a firm to offer independent advice.

2.2 We believe that our proposed requirements will give greater clarity to firms, consumers and supervisors about what it means to offer independent advice and will help ensure our rules are better able to keep pace with developments in the retail investment product market. This chapter sets out our more detailed proposals to achieve these outcomes; essentially, by clarifying the standard we expect for describing independent advice, and revising the disclosure requirements for all firms offering advice.

2.3 Our proposals involve:

- Widening the range of products (beyond packaged products) to which the independence standard will apply by creating a newly defined wider category of 'retail investment products' sold to retail clients.
- A new standard for independence requiring firms that provide independent advice to make recommendations based on a comprehensive and fair analysis of the relevant market, and to provide unbiased and unrestricted advice.
- An advice landscape that is clearer for consumers and which is made up of independent advice and restricted advice. Firms will be required to make clear to the consumer, before providing advice, which of these services they are offering.

2.4 The draft Handbook text reflecting these proposals can be found in COBS 6.2A (which replaces COBS 6.2) and is included in Appendix A.

A new standard for independence

The range of products an independent adviser should consider

2.5 Our current requirements on describing the breadth of a firm's personal recommendations apply to packaged products only. We are proposing widening this range of products in order to ensure that the definition of independent advice reflects the broader range of investment products on which consumers would expect to receive truly independent advice.

2.6 Therefore, we are proposing a new Handbook definition for 'retail investment products' to which our independence requirements will apply. In addition to packaged products, 'retail investment products' includes unregulated collective investment schemes, all investments in investment trusts (not just those in investment trust savings schemes), structured investment products, and other investments which offer exposure to underlying financial assets, but in a packaged form which modifies that exposure compared with a direct holding in the financial asset.

2.7 The new definition aims to reflect the European Commission's view, as set out in its recent Communication on PRIPs, that regardless of the legal form of a product, if that product produces broadly comparable functions (for retail investors) as other retail investment products, then it will be subject to the same rules.

2.8 This will mean that firms that provide independent investment advice to retail clients will be expected to consider more than just packaged products for their clients. One of the challenges for independent advisers will be to ensure they have sufficient knowledge of all of the types of products which could give a suitable outcome for their clients. The rules do not mean that we expect to see all advisers recommending products such as structured investment products, for example, as a matter of course. But, we would expect that if a structured investment product would best meet the client's needs and risk profile, then an independent adviser should have sufficient knowledge of these products to be able to recognise this and make a recommendation to buy this product.

2.9 We are aware that few independent firms constrain themselves to looking at packaged products only. The new standards aim to reflect this while also ensuring any new developments in the market will be captured by the rules. For example, although many exchange-traded funds (ETFs) would be regarded as packaged products, evidence suggests that they are not generally sold to retail clients in significant numbers. This may be because advisers do not feel they are suitable for their clients or because advisers feel ETFs are not a product with which they need to familiarise themselves. However, to the extent that ETFs can be a cheap and transparent way to invest in a particular market, even under our current whole of market requirement, these products should be considered when deciding which products are suitable for a retail client.

2.10 The wider scope of the proposals will mean the new definition of independence may capture more firms and products than it does currently. For example, some firms (like certain wealth managers) may consider that they offer an independent advice

service if they recommend their own product (for example, their own collective investment scheme), where that product invests in a wide range of underlying investments. While nothing precludes firms that offer their own products from holding themselves out as providing independent advice, they cannot limit themselves to providing advice solely on the products that they themselves manufacture. Instead, they should consider their products against a wider range of products and solutions in the market, and be prepared to recommend these other products. As will be the case with many bancassurers, if a firm decides that it wants to offer only products which give access to that firm's investment strategy, they will be able to do so, but will need to make clear to their clients that they provide restricted advice.

2.11 Similarly, some advisers offer funds that they have a degree of influence over – funds that we refer to as 'distributor influenced funds'. While an independent adviser may offer such funds, in order to be regarded as independent they cannot restrict their advice to these funds alone. We would expect an independent adviser to assess rigorously whether such a product is suitable for its client and whether recommending it is in the best interests of the client, compared to others in the market, to record the reasons for any decision and not assume that a particular product will be the best choice in all cases. The adviser must still act in the client's best interests, consider the suitability of the fund, its asset allocation, strategy and structure before recommending it.

2.12 For some consumers there may be other solutions that an independent adviser should consider when making a recommendation. For example, if a consumer simply wants to invest in a product which beats inflation and is 100% capital guaranteed, then it is reasonable to expect that an independent adviser would also consider cash deposits or national savings & investments products when making a recommendation. This is reflected in our draft Handbook guidance on providing unbiased and unrestricted advice.

Q1: Do you agree with our proposal to widen the range of products to which the new independence standard will apply?

Advice based on a comprehensive and fair analysis of the relevant market

2.13 It remains important for an independent adviser to review the whole market for the field in which they provide advice in order to deliver genuinely independent advice. However, we recognise that it is possible to provide independent advice even if a firm specialises in a narrow and distinct field (for example, retirement planning). In this case, provided the whole of that specialised (relevant) market is considered, it is possible to provide independent advice.

2.14 Our draft Handbook text sets out guidance on what we mean by 'relevant market'. It should comprise all of the 'retail investment products' that are capable of meeting the investment needs and objectives of the consumer. Therefore, independent firms will still be able to opt to provide independent advice on a specialist relevant market – for example, on ethically and socially responsible investments. Firms that do so

will need to make this clear to their clients to ensure that those clients are not left with the impression that they are receiving independent financial advice on all retail investment products.

2.15 For the majority of independent advisers who are not specialising in a particular market, the relevant market will generally include all 'retail investment products', so an independent adviser should be considering all 'retail investment products' when making a recommendation.

2.16 Our draft Handbook text also provides guidance for firms using panels or third parties to provide a comprehensive and fair analysis of the market. We recognise that when used appropriately a panel, or outsourcing the market search to a third party, can help a firm meet its obligations. However, we also recognise that poor use of a panel or search tool can result in an outcome that is not in line with the client's best interests rule. Firms will need to ensure that any panel is acceptably broad in its composition and is reviewed sufficiently frequently to ensure that use of the panel does not materially disadvantage their clients. Where a firm uses a third party to conduct a comprehensive and fair analysis, the firm is responsible for ensuring that the criteria used by the third party, and the analysis conducted are suitably robust.

Providing unbiased, unrestricted advice

2.17 In FS08/6, we said we would not expect independent advisory firms to be unreasonably biased or restricted in the products they offer. This includes that firms should not have any kind of contractual agreement, or any other constraint or obligation, with any service or product provider that would restrict their ability to act in their clients'best interests. Any product provider's actions (for example, in giving systems support or training) should not be allowed to influence the advice given in any way.

2.18 We also said that at this stage we do not want to prevent independent advisory firms from being financed, owned or part-owned by product providers, but that we would review this if we saw any sign of it resulting in provider influence. So, an advisory firm should take sufficient steps to ensure that its parent company's financial interest in it, or any financial interest a firm may hold, does not influence it or prevent it in any respect from providing unbiased, unrestricted advice, which is also in line with the inducements rules discussed in Chapter 4.

2.19 We gave an example in FS08/6 of how the new independence rules could affect firms using a platform. Issues an independent adviser will need to consider when recommending a platform service include whether using one platform can be in line with the requirement to provide a comprehensive and fair analysis of the market. We are undertaking a thematic review of how intermediaries use platform services which will focus on assessing suitability and ensure that firms are treating customers fairly. We feel it would be sensible to wait for the outcome of this review before deciding whether any further guidance is needed in this area. However, as we discuss in Chapter 4, given the increasing use of platforms we are keen to hear views on whether changes are needed to the way we regulate wrap platforms and fund supermarkets.

Q2: Do you agree with our proposals for a new standard for independence that requires firms providing independent advice to make recommendations based on a comprehensive and fair analysis of the relevant market, and to provide unbiased and unrestricted advice?

Describing the advice service

Consumer research

2.20 We are seeking to make a clear distinction between independent advice, which is unbiased, unrestricted and based on a comprehensive and fair analysis of the relevant market, and advice which does not meet these requirements. The intended outcome is that consumers are clear at the outset about which of these services they are being offered.

2.21 To inform our proposals in this area, in January 2009 we commissioned IFF Research to conduct qualitative consumer research to explore options for improving the way in which advice services are described and presented to consumers. A key aim was to identify a suitable 'label' for non-independent advice that was effective in communicating to consumers the restricted nature of that advice. We have published the IFF research report on our website.[1]

2.22 The research tested six possible labels for non-independent advice, which were selected following consumer focus groups to identify the best options to test. These were 'sales advice' (the working title for non-independent advice used in FS08/6), 'restricted advice', 'tied advice', 'limited advice', 'affiliated advice' and 'non-independent advice'. The research did not identify a single simple label that would clearly distinguish between independent and non-independent advice for the consumer. 'Restricted advice' was the most effective of the options tested, but, on its own, was not sufficiently informative for consumers.

2.23 'Restricted advice' was generally perceived as advice on products from a restricted range of companies or just one, rather than the whole market. The terms 'tied advice', 'limited advice' and 'non-independent advice' also suggested a limited range, but were less effective than 'restricted advice'. 'Tied advice' was perceived as relating to a single company. 'Limited advice' produced mixed views, with some respondents thinking that the advice would be limited in some way but would cover products from the whole market. 'Non-independent advice' was perceived as the type of advice one would receive from a bank or similar large firm. 'Affiliated advice'and 'sales advice' were ineffective at communicating to consumers on product range. 'Affiliated advice' was perceived as covering a wide range of products and 'sales advice' was perceived as a sales-oriented service that may cover the whole market.

1 Describing advice services and adviser charging (June 2009) www.fsa.gov.uk/pubs/consumer-research/crpr78.pdf.

2.24 The research highlighted the difficulties in seeking to develop a simple labelling system for independent and non-independent advice. In particular, the research found that the same label means different things to different people. This suggests that a label on its own is unlikely to be an effective way to inform consumers about the service they are being offered.

2.25 The research showed that consumers responded well to descriptions of the two types of advice, and to short, one-sentence statements explaining that non-independent advice covers a limited range of products only. Research respondents generally found these 'descriptors' more informative and helpful than a label, commenting that it was easier to understand when less was left to interpretation. This suggests that a label used together with additional supporting information (to provide context and help clarify what the label means in terms of the service the particular adviser is offering) is likely to be more effective in helping consumers understand the service than a label on its own.

New disclosure requirements for firms

2.26 Based on this consumer research, and to help consumers understand which service they are being offered, we have developed proposals aimed at making a clear distinction between independent advice and non-independent advice. Non-independent advice will be called 'restricted advice'. We propose that all firms providing investment advice on retail investment products will be required to disclose in writing to each client, before providing the service, whether they will provide 'independent advice' or 'restricted advice'. The draft Handbook text mandates the use of the terms 'independent advice' and 'restricted advice' as part of a firm's initial disclosure information. For example, a firm offering restricted advice might include in its initial disclosure information the following statement: *"We offer restricted advice, which means that we offer advice on [Firm X] products only"* or *"We offer restricted advice, which means that we offer advice on products from a limited number of companies that [Firm X] has selected*." However, we are not mandating a precise form of words that firms must use. The requirement is simply that the disclosure must include the term 'restricted advice'. So firms will have flexibility to explain to clients what restricted advice means with reference to the particular service they are offering, bearing in mind the general requirement that the information should be fair, clear and not misleading.

2.27 In addition, firms offering restricted advice will be required to provide oral disclosure using a specific form of words that will include the name of the firm they work for and the range of products they advise on.[2] This will help consumers better understand the nature of the service they are being offered. Advisers offering restricted advice will be required to provide one of the following oral disclosures as appropriate, in good time, before providing the service: *"I am a [Firm X] adviser, offering restricted advice, which means that my advice is restricted to advice on [Firm X] [products/stakeholder products] only"* or *"I am a [Firm X] adviser, offering restricted advice, which means that my advice is restricted to advice on [products/stakeholder products] from a limited number of companies that [Firm X] has selected"*.

2 This requirement is not yet included in our draft notification in Appendix B.

2.28 As mentioned above, at this stage we are not introducing a mandated form of words for written disclosure regarding restricted advice, other than to say that the disclosure must include the term 'restricted advice.' However, we are interested in receiving your views on whether there is merit in having a mandated form of words for written disclosure regarding restricted advice.

2.29 We propose amending our current Handbook guidance on the services and costs disclosure document (SCDD) and the combined initial disclosure document (CIDD) to enable firms to meet the new disclosure requirements with regard to the written disclosure element by using one or more of these documents should they wish to do so. We have included the proposed amendments in the draft Handbook text (Appendix A).[3] In summary, for the SCDD we have combined *Section 2 – Whose products do we offer?* and *Section 3 – Which service will we provide you with?* into one section *(Section 2 – Which service will we provide you with?)*. We have also made some changes to what was previously *Section 4 – What will you have to pay us for our services?* (which is now *Section 3 – What will you have to pay us for our services?*) to reflect the Adviser Charging requirements discussed in Chapter 4. We have made similar amendments to the investment sections of the CIDD so that there is consistency between the SCDD and the CIDD with regard to investment business. In relation to non-advised services, the SCDD and CIDD remain broadly unchanged.

Q3: Do you agree with our proposals for new disclosure requirements for firms?

Q4: Do you think we should introduce a mandatory form of words for firms to use when explaining restricted advice? What might this look like?

'Independence'and group personal pensions

2.30 Our current rule COBS 6.2.15R(2) gives firms holding themselves out as independent a specific exemption for group personal pension schemes (GPPs). This takes account of situations where firms may advise an employer on the choice of a GPP only. To enable correct disclosure of a firm's 'independence' in these circumstances, we require firms to inform employees that, for the purpose of enrolling employees in the GPP already selected for the employer, a firm will not compromise its independence if it advises on the merits of joining that scheme only.

2.31 In our draft rules we have removed this exemption, because we consider that it may not be necessary. An independent adviser will have knowledge of other products in the market and, in most cases, the existence of an employer's contribution is likely to make the GPP on offer the most suitable for the employee, in line with an independent recommendation. Furthermore, as we discuss in Chapter 4, GPPs are often promoted to employees without personal advice being given, through workplace presentations and direct offer financial promotion information packs. In these cases, the exemption would not be needed.

3 Note that the revised template for the SCDD contained in Appendix A is not marked with underlined or struck-through text, as is the case with the rest of the draft Handbook text.

Q5: What are your views on removing this GPP exemption?

2.32 In order to help firms think through the practical implications of the proposals set out in this chapter, and how these may affect them, the following box highlights some of the issues that firms in particular sectors should consider.

Type of firm	Typical issues to consider
Independent financial advisers (IFAs)	Does the firm satisfy our new independence standards which require the firm to provide advice that is: • based on a comprehensive and fair analysis of the relevant market; and • unbiased and unrestricted? If not, it will not be able to hold itself out as independent and will need to disclose to clients that it will provide restricted advice. Does the firm need to modify the way it does business in order to satisfy the new independence standards? • For the majority of IFAs that are not specialising in a particular market, they should be considering all 'retail investment products' when making a recommendation. • Some firms may need to consider a wider range of products than they do currently, to reflect the new 'retail investment product' definition (for example, ETFs, structured investment products). • Where the firm specialises in a narrow and distinct field (for example, retirement planning, ethical investments), the firm should make this clear to clients and should not hold itself out as independent in a broader sense. • In order to provide unrestricted advice, the firm should consider financial products such as national savings & investments products and cash deposit ISAs where these would meet the needs and objectives of the client. Firms that use panels and/or third parties should review the use of these to ensure they are in line with our rules. Firms are responsible for ensuring the criteria used by the third party are sufficient to meet the comprehensive and fair analysis requirement.
Wealth managers (e.g. private client investment managers)	Does the firm want to describe its advice as independent? If so, it will need to consider – similarly to an IFA – whether it provides advice that is based on a comprehensive and fair analysis of the relevant market; and unbiased and unrestricted. In practice this might mean the following: • A wealth manager might need to consider whether, in practice, it is offering a narrow, specialist service (e.g. advice on investing in a particular geographical region) and if so, how to make this clear and avoid holding itself out as independent in a broader sense. • Some wealth managers may need to check whether they are already considering a full range of solutions for their clients (for example, looking at the suitability of different tax wrappers and products that a client could invest through, or considering insurance-based or structured products). If a wealth manager does not meet the new independence standards, it will need to disclose to clients that it will provide restricted advice. Where a wealth manager designs or operates products that invest in a number of underlying investments, such as in house collective investment schemes, basing their advice on such products would not in itself meet the requirements for providing unrestricted advice, even where the products invest in a wide range of underlying investments. Such firms could therefore either: • disclose to clients that it will provide restricted advice; or • consider its in-house products impartially, as part of its comprehensive and fair analysis.

Type of firm	Typical issues to consider
Banks, other single-ties and multi-ties	Traditional bank advisers, other single-tied and multi-tied adviser firms do not satisfy our new independence standards. Firms bound by any form of agreement with a provider that restricts the firm's product range or imposes any obligation that may limit the firm's ability to provide unbiased and unrestricted advice will not satisfy the unbiased and unrestricted requirement. Firms will need to disclose to clients that they will provide restricted advice.

3 Streamlined advice processes and non-advised services

3.1 In this chapter, we discuss streamlined advice processes, specifically simplified advice processes (advised guided sales) and Basic Advice. We set out our latest thinking on simplified advice processes and our plans for Basic Advice. We also discuss briefly the role of non-advised services and money guidance.

Simplified advice processes (advised guided sales)

3.2 Simplified advice processes are streamlined advice processes that provide the consumer with a suitable personal recommendation based on an assessment of their needs. Simplified advice processes are regulated as advice under our current rules.

3.3 The concept of 'guided sales' was originally introduced in the April 2008 *Retail Distribution Review – Interim Report*, where it was described as an information-providing non-advised process. Its purpose was to allow consumers to make simple, straightforward choices. However, it became clear that it would be difficult to develop a commercially viable non-advised guided sales model. The general view of the industry is that without either an explicit or an implicit personal recommendation there will be insufficient take-up of products to make the process commercially viable – and the inclusion of a personal recommendation means it constitutes advice.

3.4 In FS08/6 we introduced the term 'simplified advice processes' which we used to describe guided sales processes that are advised. Reflecting the general view that guided sales would need to be advised in order to work, we said that we were keen to help firms develop their models for simplified advice processes within the current regulatory framework and that we would continue to work with firms on this.

3.5 While the term 'simplified advice process' does not appear to have been widely adopted, we prefer to use this term rather than 'guided sales', as it makes clear that the process is advised. We consider that the term 'guided sales' is ambiguous, less clear and could cause confusion for consumers and firms. Simplified advice processes involve a firm providing a personal recommendation to a client. Our new requirements for independent advice and how firms describe their services (set out in Chapter 2) and our proposed new Adviser Charging rules (set out in Chapter 4) – both of which apply in relation to a personal recommendation – will therefore apply to simplified advice processes.

3.6 Since publishing FS08/6, we have continued to engage with the industry on simplified advice processes to develop a way forward. The industry generally agrees that such services can be offered within the current regulatory framework. However, the industry has identified potential barriers to implementing simplified advice processes, such as uncertainty about how the FSA and the Financial Ombudsman Service would judge the process and the associated risk of liability. We will continue to explore with the industry whether and how these barriers might be overcome, but we do not intend to create a new regulatory regime for these services. Instead, we could, for example, consider developing a set of guiding principles that firms would use when designing and implementing simplified advice processes, if this is something the industry would find helpful.

Q6: Do you agree that we should not create a new regime for simplified advice processes, but continue to work as needed with firms and the industry?

Professional standards for simplified advice processes

3.7 Since publishing FS08/6, we have met a number of firms interested in offering some form of simplified advice process. Some firms have asked what professional standards will apply, noting that this is an important cost driver for their business models. At this stage, we are of the view that because investment advice is being given, the same professional standards (that we propose in Chapter 5) should also apply to simplified advice processes.

3.8 We want to deliver a real change in advisory standards. We are concerned that allowing simplified advice processes to operate at a lower level of professionalism may undermine our attempts to raise standards of professionalism across the industry. It could also be confusing for consumers if all advisers were not required to attain the same level of qualifications.

Q7: Do you agree that the professional standards set out in Chapter 5 should also apply to simplified advice processes?

Basic Advice

3.9 Basic Advice was introduced in 2005 as a new form of regulated advice that firms can use to sell charge-capped stakeholder savings and investment products with a streamlined sales and advice process. With Basic Advice, the consumer is asked some pre-scripted questions about their income, savings and other circumstances to identify the consumer's financial priorities and suitability for a stakeholder product, but a full assessment of their needs is not conducted nor is advice offered on whether a non-stakeholder product may be more suitable.

3.10 In FS08/6, we set out plans to consult on removing the Basic Advice regime from our Handbook. However, following further reflection and to support the wider stakeholder regime, we now propose to retain the Basic Advice regime.

3.11 In the light of this, we have examined what RDR proposals, if any, should apply to Basic Advice. We propose that our new rules on disclosing to consumers whether the firm will provide independent advice or restricted advice should also apply to Basic Advice. This will mean that firms providing Basic Advice will need to disclose to their clients that they are providing restricted advice – the nature of the Basic Advice service means that it will always constitute restricted advice.

3.12 We do not intend to apply the proposed professionalism qualification requirements to Basic Advice. This is consistent with our current approach, whereby the higher level competence and ethical requirements in our training and competence rules apply to Basic Advice, but there is no appropriate examination requirement.

3.13 We do not propose applying our Adviser Charging rules to the Basic Advice regime. We have not identified the same market failures here that Adviser Charging seeks to address elsewhere, so it does not seem proportionate or appropriate to apply Adviser Charging to Basic Advice.

Q8: Do you agree that we should retain Basic Advice, and require those offering Basic Advice to disclose that they are providing restricted advice?

Non-advised services

3.14 While many consumers choose to buy investment products on an advised basis, consumers can also buy investment products through non-advised services, commonly referred to as execution-only services. Execution-only services do not provide the consumer with advice or a recommendation to buy a product; instead, they allow the consumer to purchase a product that the consumer has chosen. We are not consulting on any changes to non-advised services (although in Chapter 4 we ask a question about whether the principles of Adviser Charging should be applied to non-advised services).

Moneymadeclear money guidance

3.15 The Thoresen Review of Generic Financial Advice, commissioned by the Treasury, was published on 3 March 2008. It set 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 does not recommend specific courses of action, products, or types of product and is therefore outside the regulatory framework for investment advice.

3.16 In April 2009, the Treasury and the FSA launched the Moneymadeclear pathfinder (in the North West and North East of England) that will test the national money guidance approach.[1] Moneymadeclear may become a national service in due course, depending on the outcome of the pathfinder.[2] In this event, the service will be an important gateway for consumers into advice services or non-advised services and could help more consumers identify and meet their savings and investment needs.

3.17 While Moneymadeclear is not part of the RDR, together with our broader financial capability initiatives, it will play an important role in helping to deliver the full benefits of the RDR proposals for consumers. For example, there will be a need to inform and educate consumers about Adviser Charging (what it means for them, what information they should expect from firms) and about independent and restricted advice.

1 The service offers practical and impartial help and information on money matters for people in the North East and North West of England. It aims to help people tackle their money worries and make informed financial decisions with confidence. The service can be accessed through our Moneymadeclear website, by telephone, and face-to-face through regional partner organisations and charities. Moneymadeclear staff are trained to provide consumers with clear, impartial and personalised information and guidance on money matters, such as avoiding debt problems, coping with a change in circumstances, or preparing for the future.

2 In the April 2009 budget, the government announced that *"roll-out of a national money guidance service will begin in 2010, subject to preliminary findings from the pathfinder demonstrating that the service can be effective"*.

4 Incentives and charging

4.1 At present, firms that give advice on investments face the prospect of earning different amounts of money depending on which particular firm they recommend a product from and which type of product they recommend. This creates a potential conflict of interest that can be damaging to consumers and undermine trust in the investment industry. In FS08/6, we explained that we want to bring to an end the current commission system and, instead, for adviser firms to set their own charges. This chapter describes the rule changes we are proposing to bring about this change.

4.2 As well as describing the requirements we are consulting on for adviser firms, provider firms and vertically-integrated firms, this chapter explains how we propose to strengthen our approach to inducements more generally, and asks what approach we should take towards firms' internal remuneration mechanisms. We also discuss how our proposals affect corporate pensions, and ask for views on whether we should consult on changes for wrap platforms and fund supermarkets. Finally, we ask for views on whether change is needed in respect of charging for non-advised transactions.

4.3 Draft Handbook text reflecting these proposals can be found, in the main, in COBS 6.1A and 6.1B, while changes to our inducements text are at COBS 2.3 (see Appendix A).

Adviser Charging: what it means for firms that give advice

4.4 We propose that adviser firms should only be paid for the advice and related services that they provide through 'adviser charges'. By this, we mean that adviser firms should be paid by charges that are set out up-front and agreed with their clients, rather than by commissions set by product providers to secure distribution of their products (including so-called 'soft' commissions, paid in non-monetary forms).

4.5 Regardless of whether adviser charges are paid directly by a client as a fee (for example, by cheque or direct debit) or are paid as deductions from their investments, these charges should reflect the services being provided to the client, not the particular product provider, or product, being recommended.

4.6 All firms have a responsibility to act in the best interests of their clients and, for firms that offer advice, this responsibility means making the best available recommendation for the client (including, where appropriate, making a recommendation not to buy a product at all or to take alternative action). Where firms offer restricted advice, relating only to a limited range of products or providers, they must still make their recommendations in their clients' best interests – for example they must recommend paying off debt, rather than buying any of their products, where this would be in a client's best interests. For this reason we propose to apply our Adviser Charging requirements to all firms that give advice on investments. (Later on in this chapter we discuss what this means, in practice, for vertically-integrated firms that give advice on their own products.)

Setting and operating charges responsibly

4.7 Adviser firms will be expected to decide on their own charging structures, reflecting the services that they offer, and to apply these charging structures consistently to consumers. We are not seeking to prescribe the basis on which a firm might charge for its services – for example, a firm might charge a fixed fee, an hourly rate or a percentage of funds invested – but we will expect to see firms drawing up and operating their own charging structures responsibly. In particular, our draft Handbook text makes clear our expectations as set out below.

- Adviser charges should not vary inappropriately according to the product provider that a firm recommends. While adviser firms may be used to receiving greater amounts of remuneration from some product providers than others, we do not expect to see such variation replicated in the charging structures that adviser firms adopt for themselves. Where different product providers differentiate themselves by offering different levels of service, this can, of course, be taken into account – along with other product features – in making a recommendation to a consumer about what to purchase.

- Adviser charges should not vary inappropriately according to the type of product offered, where different types are substitutable. Where an adviser firm could recommend a number of competing types of products – for example, collective investment schemes, investment trusts or life assurance bonds – its charging structure should not incentivise it to recommend a particular type of product, against the interests of the consumer. (In contrast, where a different product type is associated, justifiably, with a different level of service – for example, giving advice on whether to transfer a pension might involve a different service to giving advice on whether to top up an ISA – a different charge could reasonably apply.)

- Adviser recommendations should not be influenced by the existence of terms or facilities offered by product providers to collect adviser charges. We accept that it can be beneficial for a consumer to choose to pay their adviser charges out of their investment (for example, because tax relief may be available) but the convenience to an adviser firm of receiving either up-front or recurring adviser charges through this mechanism should not influence the recommendation made.

4.8 Adviser firms will also need to communicate both their overall charging structures, at the outset, and the specific amounts an individual is charged, so that consumers are clear about what they will pay. Our approach to disclosing adviser charges is discussed later in this chapter.

4.9 Through these new standards, we aim to reduce the potential for remuneration to influence adviser recommendations, directly or indirectly. At the same time, adviser firms should remain clear that our rules on suitability and clients' best interests continue to require them to make the best available recommendations for their clients.[1]

Providing ongoing services in return for ongoing charges

4.10 When firms set out their charges, they will need to make clear exactly what services the charges cover. To improve clarity for consumers, we are proposing that ongoing charges should only be levied where a consumer is paying for an ongoing service, such as a regular review of the performance of their investments. Through this proposal, we want to avoid recreating the difficulties that consumers face at present in trying to assess what services they are entitled to (if they are entitled to any at all) in return for the continuing payment of trail commission out of their investments.

4.11 We propose allowing one important exception to this approach. We would allow a firm to levy an ongoing charge, without this necessarily paying for an ongoing service, where a client is buying an investment to which they will contribute over time. This exception seeks to preserve access to advice for a consumer who may not have the money to pay for advice at the outset. So, for services relating to regular contribution products, an adviser firm could operate a charging structure where the consumer pays over time, as long as this is made clear to the consumer before the service is provided.

4.12 These proposals reflect our desire for adviser firms to charge for their services, rather than to be paid by commission set by product providers. It is not our aim to restrict the ability of consumers to gain access to credit, if they wish to do so in order to pay for the services of an adviser firm. Under our proposals, adviser firms will remain free to arrange credit facilities, subject to the requirements of the Consumer Credit Act 1974, and the existence of clear loan arrangements should serve to tackle the risk of consumers misunderstanding how they are paying for the services on offer. The implications of stopping payments, or defaulting on any loan arrangement, would, of course, need to be made clear.

1 See, for example, *Quality of advice on pension switching: A report on the findings of a thematic review* (December 2008), which gives several examples of unsuitable advice involving the recommendation of pension transfers against clients' best interests (www.fsa.gov.uk/pubs/other/pensions_switch.pdf).

Ban on receiving commission and rebating it to the consumer

4.13 The rules that we are consulting on require adviser firms to be paid by adviser charges: the rules do not allow adviser firms to receive commissions offered by product providers, even if they intend to rebate these payments to the consumer. This is a deliberate decision, as we do not believe that the potential for product provider commission to bias advice, or to undermine trust, can be properly dealt with while product providers continue to set commissions receivable by adviser firms.

Q9: Do you agree with our proposals on Adviser Charging for firms that give advice?

Adviser Charging: what it means for product providers

4.14 To end the system of product providers offering amounts of commission to adviser firms, we are proposing new responsibilities on product providers, as well as on adviser firms. Just as the rules we are consulting on would prevent adviser firms from receiving commissions set by product providers, we are also consulting on a ban on product providers offering commissions (or other payments or benefits) in relation to advice on investments given to retail clients.

4.15 This requirement is not designed to prevent product providers from offering different product prices through different distribution channels (for example, a large IFA network might be able to secure a product with a lower product charge than a sole trader). In order for the market to operate competitively, we are content that different product prices will continue to be available through different channels, but where firms access lower prices they will have to pass these on completely to their consumers, without retaining a margin.

4.16 Product providers that currently pay no commission to advisers on their products will see little practical change to their regulatory requirements, and other firms will be free to adopt such an approach if they wish, leaving adviser firms or third parties to collect adviser charges separately. Where product providers choose to offer facilities for consumers to pay their adviser charges through deductions from investment products, they will face additional requirements.

Distinguishing product and adviser charges: a ban on negative charges

4.17 One requirement that would apply to all product providers is that they should not structure their charges in a way that could conceal from consumers the distinction between the product charges and the adviser charges that they will pay. In particular, we believe that the rule is needed to tackle the risk that product providers might continue to influence adviser charges indirectly by offering products that could be seen as offsetting some or all of the adviser charges payable.

4.18 This means that we are consulting on rules that would ban, for example, products that offer initial allocation rates greater than 100%. At present, such products are usually accompanied by higher annual management charges, which are less transparent

to the consumer and, in future, could lead to the misperception that adviser charges payable have been offset and adviser firms' services are therefore free. Under the new rules, offering products with negative charges in this way would breach the requirement for product charges and adviser charges to be kept distinct.

Responsibilities on providers that deduct adviser charges

4.19 We will not be requiring product providers to offer facilities for consumers to pay their adviser charges in the form of deductions from their investments. This means that they will have the option not to remunerate adviser firms from their products. However, if product providers choose to offer consumers the option of having their adviser charges deducted from their investments, they face the challenge of making sure that, in practice, it is still the consumer and the adviser firm that determine the adviser charges to be paid.

4.20 We are proposing various new responsibilities for product providers that facilitate the collection of adviser charges, to tackle the risk that through such mechanisms they might otherwise continue to influence adviser remuneration, directly or indirectly. At the same time, we also recognise the need for product providers to be able to decline, or at least alert the FSA to, requests from adviser firms for payment of extreme adviser charges – for example, charges that are so high that they would prevent any realistic prospect of a consumer's investment growing at all.

4.21 With these factors in mind, we are consulting on placing responsibilities on product providers that offer facilities for deducting adviser charges from investments, particularly in the following three areas:

- Offering reasonable flexibility of charges: Product providers must offer a sufficient number of options, so that advisers and consumers have real choice about the structure and levels of adviser charges that can be deducted. Offering sufficient flexibility will be important as adviser firms will not generally be allowed to accept and then rebate sums of money from product providers (except where rebates occur because a consumer has elected to stop receiving a service for which they have previously paid).

- Validating and monitoring adviser charges: Product providers need to obtain clear instructions from consumers on the amount and timing of any adviser charges that are to be paid from their investments. Perhaps more importantly, we would also require providers to take account of the impact that adviser charges could have on the performance of the product, and how this will affect outcomes for consumers. We expect such validation and monitoring activities to be conducted responsibly, without undermining the need for adviser firms to be accountable for their own charges, or influencing recommendations made inappropriately. We propose to ban provider firms from marketing their products or services to adviser firms on the basis of the particular adviser charges that they will facilitate (sometimes known as their 'decency limits'), or other validation and monitoring techniques that they may utilise.

- Matching payments deducted from consumers with payments passed to adviser firms: Under our new requirements, money taken from consumers' investments to pay adviser charges must be matched by broadly concurrent payments to the adviser firms in question. Provider firms will not be able to advance finance to advisers out of their own funds (a practice often referred to as 'factoring'). As noted earlier, it is not our aim to stop consumers from gaining access to credit to pay for the services of an adviser firm if they wish to do so. Our requirement for matching of payments would aim to prevent provider firms from influencing adviser recommendations inappropriately through the factoring rates and terms that they may employ. If they wished to, adviser firms could still choose to create flexible charging methods for paying for advice on regular contribution products, which might better suit those consumers facing cash-flow difficulties.

Considering the impact on different product providers

4.22 The new requirements we are consulting on are deliberately designed to offer product providers the choice of whether, and if so how, to facilitate the collection of adviser charges. At present, certain investment products (for example, investment trusts, exchange-traded funds) are often cited as paying no commission, and we believe that providers can and should be allowed to continue to operate such business models. In practice, though, different types of product providers – such as insurers, fund managers and structured product providers – design and distribute their products within different legal and practical environments.

4.23 Our requirements aim to create a level playing field, and avoid mandating precisely how product providers should meet the responsibilities described previously. The potential impact of our Adviser Charging proposals on different types of product providers is summarised in the following box.

Type of product provider	Potential impact
Insurers	In some cases **insurers** already offer products where the deductions made from the product to pay the adviser can be varied, and they may now be considering whether and how to adapt their systems to meet the new standards on which we are consulting. Key challenges for insurers may include delivering payments on a matched basis, monitoring and challenging payments appropriately and bringing to an end pricing practices such as the use of greater than 100% allocation rates.
Fund managers	In contrast, **fund managers** cannot vary the ongoing deductions made from a fund for particular consumers without creating separate share classes (arranging for variable initial payments does not cause the same problem as these can be deducted before a consumer's money is invested). Taking this into account, the rules we are consulting on do not require complete flexibility of the adviser charges that can be deducted from products over time, but instead would allow fund managers to choose to offer a reasonable range of different share classes if they wished, to support different levels of ongoing adviser charges. Equally, fund managers might choose to rely on third parties, such as platforms, to help collect adviser charges through consumer cash accounts, or to pursue other mechanisms, such as schemes to allow consumers to sell units at regular intervals to release cash to pay their adviser charges.

Type of product provider	Potential impact
Wealth managers	In many cases, **wealth managers** (or private client investment managers) are also product providers, as they commonly design collective investment schemes as well as individual stock portfolios, and will therefore need to decide how to comply with our rules for product providers. Where investment managers distribute their products through adviser firms, they will need to consider whether facilities for deducting adviser charges are needed, or whether they can rely on adviser firms to collect their own adviser charges. As with lots of product providers, many private client investment managers are 'vertically-integrated', offering advice as well as manufacturing products and portfolios.

Q10: Do you agree with our proposals on Adviser Charging for product providers?

Adviser Charging: what it means for vertically-integrated firms

4.24 So far, this chapter has focused on how we plan to tackle the potential for a product provider firm to influence advice given by another firm. However, we also need to consider what approach to take where it is the product provider (or a firm in the same group) that gives the advice to the consumer. These circumstances can, and do, arise in a variety of different situations: at one extreme, some product providers offer advice solely on their own products (for example, through a branch network or dedicated force of advisers), while at the other extreme, an independent financial advice firm could be a subsidiary of a product provider whose products it rarely recommends in practice.

4.25 This range of different business models means that the risks associated with adviser remuneration can vary between different firms. For example, where a product provider offers advice solely on its own products, we do not (by definition) have to worry about the potential for product provider bias to arise – although we may be concerned both about ensuring that consumers understand the restricted nature of the advice they are receiving (as discussed in Chapter 2) and about tackling the potential for other forms of bias to arise (for example, in relation to the type of product recommended). At the same time, an independent adviser firm owned by a product provider would have to manage its conflicts of interest, tackling the potential for product bias to occur in relation to its parent company, but in this example, there may be little or no commission being paid between the firms.

4.26 These examples serve to illustrate that our proposals for Adviser Charging may not target precisely the same aims in vertically-integrated firms as we are seeking to achieve in relation to other adviser firms in the industry. A greater focus may actually be needed on how firms' internal incentives and remuneration systems can influence the advice that consumers receive. Despite this, it remains important to consider how our Adviser Charging proposals can and should affect vertically-integrated firms, to try to maximise the potential for consumer understanding about the services they are buying and what they cost.

4.27 Since issuing FS08/6, we have held discussions with a group of representatives from product providers that are involved in providing investment advice (including banks, building societies and insurers). We did not ask this group to recommend a particular approach but, making use of these and other discussions, we have considered various options for adapting Adviser Charging for vertically-integrated firms.

Separating product and adviser charges in an integrated firm

4.28 In this paper, we are consulting on applying the same approach to charging in vertically-integrated firms as to any other firms that give investment advice. This means that vertically-integrated firms would be required to separate their adviser charges from their product charges, even when distributing through in-house advisers. This separation would allow vertically-integrated firms to adopt the same approach to devising and explaining their adviser charges as other adviser firms, and would also allow them to use the same approach to charging when recommending in-house products as when recommending products from other product providers.

4.29 The key advantage of this sort of approach is that it would deliver a level playing field between vertically-integrated firms and other firms giving advice. It would be clear to consumers, regardless of what type of firm they approached, that adviser charges would be payable in addition to any product charges.

Providing equivalent information on charges

4.30 Some product providers have already expressed their view that there is no need for vertically-integrated firms to actually adopt separate adviser and product charges, when instead they could simply disclose to consumers the portion of their charges associated with each. At present, vertically-integrated firms disclose a 'commission equivalent' figure, as they do not necessarily pay or receive a commission when recommending one of their own products. In the same way that this equivalent figure reflects the costs associated with providing advice services, it could be argued that product providers could calculate and disclose an equivalent figure for adviser charges in future.

4.31 This sort of approach could have the advantage for firms of being less disruptive to adopt. New potential consumers engaging with the firm might still be able to view some form of charging structure, showing how much of the charges they would pay would go towards providing their advice service. However, this information would remain illustrative, rather than reflecting actual charges to be incurred. There would be a risk that adviser services provided by vertically-integrated firms might be seen as free, while other adviser firms would be levying clear adviser charges.

4.32 We are not convinced that this sort of approach, involving the disclosure of 'equivalent' adviser charges, should be permissible, and as a result are consulting on applying Adviser Charging to all firms that give investment advice. However, we would be interested to receive any evidence that respondents might put forward about the costs associated with this approach, or any alternatives.

Ensuring charges are representative

4.33 In determining the split between their adviser charges and product charges, we would expect vertically-integrated firms to allocate expenses fairly, in a way that represents the costs of the services being provided. For example, both adviser and product charges should typically include the costs which would be included if either service was to be provided separately. The draft Handbook text we are consulting on also makes clear that the resulting charges should aim to minimise any cross-subsidisation between the costs and profits accruing in respect of each service.

Q11: Do you agree with our proposals on Adviser Charging for vertically-integrated firms?

Describing adviser charges

4.34 With the introduction of Adviser Charging, we will expect adviser firms to decide on standard charges for different services in advance of meeting individual clients (i.e. to decide upon an overall charging tariff). The firm would then make clear to each of its clients individually what services they are to receive and how adviser charges will apply to them. We want firms to provide clear, concise disclosure documents that will help consumers to understand the different services being provided and to recognise the cost and value of advice. For this to happen, consumers must also receive information that outlines the cost of the advice separately from the cost of the product.

Information provided by adviser firms

4.35 In January 2009, we commissioned some consumer research to better understand the extent to which consumers could benefit from increased transparency and easier access to the cost of advice, with respect to the disclosure of adviser charges. We considered disclosure at two separate stages in the process: pre-transaction (in the form of price lists) and point of sale information (which would be provided to the consumer after they had received advice, outlining the total cost of advice). The findings gave us a broader insight into the effectiveness of current disclosure formats and features of disclosure that are generally ineffective in aiding consumer understanding.

4.36 MiFID places high-level requirements on firms to provide appropriate, comprehensible information about their services, costs and associated charges. However, it does not require this information to be provided at the same time, or separately from any other material. As Member States are not generally permitted to go beyond the Directive in introducing domestic legislation, we are not mandating a particular template for pre-transaction or point of sale information about adviser charges. However, we are consulting on rules and guidance that assist firms in understanding the steps they must take to produce fair, clear and not misleading information on their charges.

4.37 We propose that adviser firms should provide each potential client with their charging structure ahead of providing advice. This means that adviser firms should provide some form of price list or tariff, outlining the services that they offer and the associated adviser charges, and keep records of this information. We are also consulting on guidance for firms on the best way they can ensure that this information is consumer-friendly and best communicates information on services and costs.

4.38 We propose that firms must provide their clients with the total adviser charge payable in cash terms as soon as this is practicable, and make a record of the total adviser charge payable by each client. (This requirement would be similar to the current requirement for firms to disclose 'hard', or actual, commission to be received.) If the total adviser charge differs materially from the standard charging structure outlined in the initial price information, then the firm would be expected to inform the client of this and make a record that there has been a material difference, noting the reason for this. This will ensure that consumers are charged what they agreed to at the outset and encourage advisers to deviate from the standard charging structure only when the service provided requires this.

4.39 At present, some firms choose to use a SCDD or CIDD to present information about the cost of services they offer in relation to investments. This option will continue to be open to firms and we are therefore consulting on changes to these documents to reflect the introduction of Adviser Charging.

Information provided by product providers

4.40 Under our proposals for Adviser Charging we would, ideally, want product disclosure to clearly separate the cost of product charges and the cost of adviser charges, where these are paid from the product. Achieving this separation may require significant changes to Key Features Illustrations (KFIs) as well as consideration of the continued suitability of generic projections in these circumstances. However, given the changes that may result from the European Commission's work on the Key Information Document (KID) and their work on PRIPs, we have chosen not to consult on changes to our disclosure requirements at this stage.

4.41 We expect to revisit this topic once the impact of any changes that flow from the European Commission's work is known. In the meantime we would welcome views as to how the separate disclosure of product and adviser charges might best be achieved.

Q12: Do you agree with our proposals on the disclosure of adviser charges?

Strengthening our approach to inducements and individual remuneration

4.42 If we are to be successful in tackling the potential for product and provider bias to occur, once the current commission mechanism is removed, we will also need to make sure that other sources of influence do not distort adviser recommendations. At the same time, our analysis of vertically-integrated models, in particular, highlights the fact that managing distortions that may arise through internal incentive and

remuneration mechanisms can be just as important as dealing with bias arising from payments from third parties. This section discusses how we might change our approach to inducements and individual remuneration across all retail investment firms.

Payments that lead to enhanced services for consumers

4.43 In 2007, we changed our rules on inducements, in order to implement MiFID. At the same time, we considered whether to apply the requirements in MiFID to business that was not covered by the Directive itself, to avoid having dual standards. In the area of inducements, we chose not to apply the additional new requirement that any payments and benefits paid to and from third parties must be 'designed to enhance the quality of the service to the client' beyond the scope of the Directive. This reflected our view at the time that it was sufficient to rely on another requirement, which banned any payments that impair compliance with the firm's duty to act in the best interests of their client.

4.44 Having reviewed this decision, we now think that it would send a clearer message to firms to apply the 'enhancement test' more widely across retail investment business. For example, we want to be clear that we will not in future tolerate retail investment product providers offering any incentives to adviser firms that are not explicitly designed to enhance the service to the client.

4.45 Because of the need to ensure that firms engage with the standards expected of them and the renewed importance of the inducements rules following the introduction of Adviser Charging, we propose to apply the requirement that payments and benefits are designed to enhance the quality of the service to the client to retail investment business generally. We also intend to make this standard a key supervisory focus, as we implement the proposals in this paper.

Changes to our inducements guidance

4.46 With the introduction of Adviser Charging, we are proposing some changes to clarify our guidance on inducements, and we also intend to increase significantly our focus on our existing inducements rules.

- Our Handbook is clear about the need for any credit provided by product providers to adviser firms to be on commercial terms. We now intend to clarify that the provision of credit to an adviser firm's clients may also be a benefit for the firm itself. This is because, under our proposals, firms will no longer be able to look to product providers to advance their income on any particular product they recommend: where credit is needed adviser firms will, instead, either have to look to third parties to factor their income, or ask consumers to take credit themselves.
- We are reinforcing our expectation that any significant non-monetary benefits that product providers offer to adviser firms – such as access to training programmes – should be widely available across adviser firms if they are to be provided at all, rather than being used to reward particular firms.

- Our guidance will make clear that adviser firms cannot generally accept benefits from provider firms on which they will need to rely, citing in particular the need for adviser firms to avoid relying on the free provision of important software, such as customer relationship management systems or portfolio modelling tools.
- We have chosen not to consult on changes to our rules on ownership and equity holdings, as we believe it is already clear that adviser firms cannot favour the products of their parent companies, or other firms with which they are connected. Firms face a clear obligation to manage such conflicts of interest effectively, and we will continue to challenge firms on this issue as necessary.
- More generally, we continue to remind firms of the guidance we provide on reasonable indirect benefits, which considers, for example, the appropriateness of advisers conducting different types of marketing exercises in association with providers.

4.47 As we also highlighted in Chapter 2, our Handbook makes quite clear that, where a product provider owns or has an interest in an adviser firm, it should not be able to exercise any influence over the personal recommendations made by the firm. We will monitor this standard carefully in the coming months, but it should not be interpreted as constraining provider investment or as undermining the role of provider appointed Non Executive Directors (NEDs) on the Boards of adviser firms, including networks.

4.48 In view of the challenges for NEDs set out in our recent regulatory response to the global banking crisis,[2] it is important that our expectations in respect of the role of provider appointed NEDs are clear. We expect providers to appoint NEDs with the appropriate level of technical expertise and for them to play a full and active role in oversight of the firm. In fulfilling those duties we expect individual conflicts of interest regarding business mix and distribution of the parent providers' products to be appropriately managed.

Remuneration of individual advisers

4.49 In March 2009, we published a consultation paper on remuneration practices in financial services,[3] including a new Code of Practice on remuneration policies for large banks, building societies and broker dealers (contained in Annex 2 of that consultation paper). We also asked whether the Code should be applied more widely to financial services firms, and noted our intention to discuss whether it should apply to retail investment intermediaries as part of this consultation.

2 DP 09/2: *A regulatory response to the global banking crisis* (March 2009) www.fsa.gov.uk/pages/Library/Policy/DP/2009/09_02.shtml

3 CP09/10: *Reforming remuneration practices in financial services* (March 2009) www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_10.shtml

4.50 The draft Code consists of a general rule and ten principles, which are designed to ensure that firms' remuneration policies are consistent with effective risk management. As such, it has a somewhat different objective to the rest of the proposals discussed in this chapter, which focus on tackling the potential for bias and distortion of advice. However, the Code has some similarities with the proposals discussed here, particularly as it seeks to ensure that:

- firms have clear, documented procedures for setting remuneration, including appropriate measures to tackle conflicts of interest (see Principle 2); and
- non-financial performance metrics form a significant part of the performance assessment process, including adherence to effective risk management and compliance with regulation (see Principle 6).

4.51 So far, informal discussions about remuneration practices within firms have suggested that some firms already feel that the remuneration of their investment advisers and salespeople is subject to significant regulatory oversight as part of Treating Customers Fairly (TCF). In considering the possible extension of the Code to retail investment intermediaries – and whether other steps are needed to ensure that the same outcomes that Adviser Charging seeks to achieve are secured within all firms – we will need to think carefully about whether the objectives of our policy should be modified to take account of the specific nature of the advice sector. We will also take account of the interaction with TCF.

4.52 The sorts of questions we will need to consider are whether it is already clear that, under firms' internal incentive and remuneration schemes:

- adviser performance should not be assessed solely in relation to recommendations converted into sales (that is, the quality of advice given should play a central role in individual assessment and remuneration);
- individual assessment and remuneration should clearly reflect the need for advisers to be involved in sales that do not result in a recommendation to make a purchase; and
- individuals should not be rewarded (financially or otherwise) for recommending the product of one particular product provider over another, or for recommending a particular type of product over another where both may be suitable for the consumer (except to the extent that variation is needed to ensure that advisers are not incentivised to recommend products that involve the least time or effort).

4.53 We are currently carrying out a number of fact-finding visits on remuneration practices within the wider financial sector, and these will inform our policy on remuneration. We have not at this stage prepared any draft rules for consultation on this particular subject, but we would welcome views on the following general question, and will take the answers into account when formulating our policy.

Q13: What approach should we take to the remuneration of individuals giving investment advice?

Transitioning to Adviser Charging

4.54 The rules we are proposing would come into effect from the end of December 2012. The rules would not require adviser firms to revisit business conducted before the deadline, and firms will be able to continue to receive ongoing remuneration payable on products sold beforehand. Similarly, where the amount of ongoing commission payable increases simply because a consumer chooses to increase their contributions to a product after the deadline, this should not trigger the new requirements.

4.55 With the introduction of Adviser Charging, consumers and adviser firms will have control over how much money adviser firms receive as remuneration for their services, and for how long payments continue. This is a significant change from the current commission-based system that many firms use, as – at present – we generally prevent adviser firms from changing the amount of trail commission that they receive during the life of a product. In contrast, under Adviser Charging firms and consumers may eventually choose to negotiate and renegotiate services that they have purchased, and the money being paid for these, over time.

4.56 We are aware that some adviser firms would like us to relax our restrictions on changing commission payable after a sale, in order to allow them to start renegotiating their remuneration. But while it seems appropriate that firms should be able to start to adopt Adviser Charging straightaway if they wish to, it remains less clear that they should be given freedom to renegotiate the commissions on their back books. In general, it seems unlikely that it will be in the best interests of consumers to start paying additional commission for products and services that they have already received.

4.57 We plan to allow firms to adopt Adviser Charging, to the extent that this is possible, at any point between now and the end of 2012, either by charging fees directly or (as commission can still be paid at the moment) by rebating any commission that they receive over and above their adviser charges. Where firms have charged in one of these ways – complying, as far as they can with the Adviser Charging requirements – we will accept that any adviser charges paid can be renegotiated in the future, as consumers may want to change or terminate the services they are paying for. Despite this, we do not see a case for allowing firms to renegotiate past commissions – before or after the end of December 2012 – that were not agreed in line with our rules on Adviser Charging.

The European framework and territorial application of our rules

4.58 As we explained in FS08/6, the changes we are proposing to introduce Adviser Charging – as well as the changes discussed earlier in the CP about the way that advice services are described – will require us to amend our notifications to the European Commission under Article 4 of the MiFID Implementing Directive. Since then, we have discussed our new requirements with the Commission, and Appendix B contains a draft amendment to our notifications to reflect the new proposals.

4.59 Our notifications explain why the requirements we are putting forward are proportionate to the specific risks that we have identified in the UK. As it is not at all clear that equivalent risks and circumstances have arisen in other Member States, we do not intend to apply these requirements in situations where UK firms conduct business in other Member States.

Corporate pensions and Adviser Charging

4.60 In FS08/6, we said we would explore the scope for applying Adviser Charging in the corporate pensions market (group personal pensions, group stakeholder pensions and group SIPPs are collectively referred to as 'GPPs' in this paper). The draft rules for Adviser Charging cover GPPs, but only where a potential member of a GPP is given a personal recommendation (and any related services) on the merits of joining the scheme.

4.61 We recognise that GPPs are often promoted to employees without personal advice being given, through group worksite presentations and direct offer financial promotion information packs. This may occur after the employer receives advice on providing pensions for his employees, either from an authorised financial adviser or from another adviser not authorised under the Financial Services and Markets Act (FSMA). This advice to employers does not generally amount to a 'personal recommendation' (and therefore would not be subject to proposals in this CP), even if it identifies a specific GPP provider, and we do not propose it should be as this would not necessarily protect employees (and might drive the market towards trust-based occupational schemes, which are also generally outside our regulatory scope).

4.62 The predominant market model is for GPPs to be promoted to individual employees without personal advice, sometimes with commission being paid by the product provider that assisted the employer in choosing the scheme. If we do not apply the principles behind Adviser Charging to unadvised GPP business, we may run the risk that our proposed rules on Adviser Charging could be circumvented in this market.

4.63 We also recognise that the wider pensions landscape will change in the next few years, particularly with the introduction of Personal Accounts (PAs).[4] At this stage, we do not know what shape and level of charges will apply to PAs, but it seems likely that there will be circumstances where recommendations to employers to establish GPPs as qualifying alternatives to PAs could be justified (for example, where an employer wants to contribute more than the maximum amount proposed for PAs). Equally, there could be recommendations given to employers which are more questionable, such as recommending a GPP that is more expensive than PAs on the grounds of wider investment choice (something not likely to be needed by most consumers eligible for PAs). We want to be confident that our rules protect consumers in such situations and reflect the eventual charging structure of PAs.

4 The Pensions Act 2008, set to come into effect in 2012, places new duties on employers to automatically enrol their eligible employees into a qualifying pension scheme. The Personal Accounts scheme is a central multi-employer defined contribution occupational pension, which employers will be able to use to fulfil their new duties. It is expected to be a low cost scheme.

4.64 Suggestions are invited as to the best way of ensuring that the intentions behind Adviser Charging are applied where GPPs are sold without advice. For example, one suggestion is that we should introduce the concept of 'arranger charging' for GPPs, so that where advice is not given to employees, any intermediary remuneration would be negotiated between the intermediary and the employer, even if it was ultimately obtained from contributions or scheme funds. This could be disclosed to potential GPP members alongside the usual Key Features Document. We can see some merits in this sort of approach, but also recognise that it would be complicated to work, so we would welcome comments on this and other potential solutions, as well as on our proposal to apply Adviser Charging where advice is given to individual employees.

Q14: Do you agree that Adviser Charging should be applied where individual advice is given on GPPs? Do you think that the principles of Adviser Charging should be applied to non-advised GPP business, and if so how?

4.65 We are inviting responses to this paper within four months of publication, but we would welcome early responses to Question 14 (and also Question 5) by 31 July 2009, as we intend to publish a further consultation with draft GPP rules later this year.

Tax implications

4.66 In FS 08/6, we confirmed our understanding that whether adviser charges are subject to Value Added Tax (VAT) is not determined by who sets the charges or whether the payment is by fee or commission, but is determined by the nature of the service provided. This view has not changed, so we do not expect the introduction of Adviser Charging to automatically change the tax status of adviser remuneration payments.

4.67 We also clarified that payments made under genuinely commercial remuneration arrangements for pension advice, which are commensurate with the advice given, would not create unauthorised payments – so no unauthorised payment charges would apply.[5] Having received specific questions on this subject, we can confirm our understanding that this approach does apply to annuities – enabling an annuity provider to pay adviser charges from a pension fund.

Regulating platforms and their charges

4.68 In drafting the rules contained in Appendix A, we have taken every effort to ensure that adviser firms will not be able to continue to receive commissions, profit shares or other remuneration determined by product providers and other third parties. At the same time, we have begun to receive questions from the industry about the acceptability of other firms, such as fund supermarkets, continuing to receive commission set by product providers. These, in turn, lead to wider questions about the best way to achieve transparency of incentives and charges on platforms in the longer term.

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

4.69 In the light of the growing size and importance of the platform market, we also recognise that our proposals in this CP may encourage, or accelerate, changes in the different roles that platforms perform (for example, adviser charges might increasingly be collected, in future, via platform cash accounts). Our disclosure regime consists largely of requirements for adviser firms and for product providers and, in line with our commitment in FS08/1,[6] we are also keen to improve the quality and effectiveness of platform disclosure documents as charging structures and lines of payment can be complex.

4.70 So, while we are not consulting on rules relating to wrap platforms and fund supermarkets in this paper, we will be conducting a review of whether detailed requirements would now be appropriate for the platforms market. This will involve both a thematic supervisory review and consideration of how we might introduce platforms into our Handbook.

Q15: Do you think changes are needed to the way that we regulate wrap platforms and fund supermarkets?

Charging for non-advised services

4.71 Our key aim, in consulting on Adviser Charging, is to tackle the potential for commission paid to adviser firms to bias or distort advice. As a result, it is not clear that there would be a particular case for applying the same sort of approach to non-advised services (except perhaps, as already discussed, where unregulated advice is given to an employer). Despite this, we need to bear in mind the fact that, in future, consumers could be confused because they face disaggregated product and adviser charges when they approach an adviser firm, but aggregated product and distribution charges when they use a non-advised channel.

4.72 Our proposals leave in place the current requirements for firms to disclose the commission, or commission equivalent, that they receive when selling investments without advice. In the longer term, we will need to consider whether this approach is appropriate, and would welcome comments on this.

Q16: Do you think that the principles of Adviser Charging, or any other alternative approaches to remuneration, should be applied to non-advised services?

6 FS08/1: *Platforms and more principles-based regulation – Feedback on DP07/2* (March 2008) www.fsa.gov.uk/pages/Library/Policy/DP/2008/fs08_01.shtml.

5 Professional standards for advisers

Background

5.1 Our objective is to deliver standards of professionalism that inspire consumer confidence and build trust so that, in time, financial advice is seen as a profession on a par with other professions. Achievement of this objective is linked closely to the wider package of RDR proposals, in particular on Adviser Charging. Crucially, these professional standards will apply to all investment advisers who are giving advice, whether giving independent or restricted advice. Chapter 3 sets out our approach to simplified advice processes, and raises a consultation question on professional standards. The standards of competence applying to the Basic Advice regime will not be affected by these proposals. Equally, the position with regard to advisers passporting in under MiFID is unchanged, so it is not considered in this chapter.

5.2 Building on feedback to DP07/1, and the challenge set out in the RDR Interim Report, we convened a Professionalism Group (PG) in the second half of 2008 to help develop our thinking on professional standards. In FS08/6, we published the report from this group, and gave our response to its key proposals. Since then, we have been working with a broader Professional Standards Advisory Group (PSAG)[1] to develop further our thinking in four areas – a Professional Standards Board (PSB), qualifications, ethics and continuing professional development (CPD). Our propositions in each of these areas are set out below.

5.3 The overall implementation date for our changes is the end of 2012, consistent with the wider RDR. We would remind firms and advisers that the 'no regrets' position we first described in FS08/6, and restated below, still stands, which means that advisers can take action on qualifications now without having to wait until 2010 for new benchmark qualifications. From the date of this consultation paper to the implementation deadline at end-2012, firms will have three and a half years to get their advisers qualified. We are aware that many advisers have decided to begin now to upgrade their qualifications, and we strongly encourage all advisers to do so.

1 This was a broadened version of the Professionalism Group, comprising consumer and practitioner representatives, trade associations, the Financial Services Skills Council, and relevant professional bodies and awarding organisations.

Professional Standards Board

5.4 The central proposition of the PG was the creation of an independent PSB to set and implement higher and consistent standards for the industry in the areas of qualifications, ethics, and CPD.

5.5 As set out in FS08/6, our original intention was to consult in this CP on setting up the PSB as part of the FSA by mid-2010, with a view to considering whether it should be launched as an independent statutory body at some point in the future. However, after detailed exploration of the options with the PSAG, we have decided instead to accelerate the decision on whether the PSB should be created as a separate statutory entity, independent of the FSA, rather than having an interim solution of the PSB being first operated as part of the FSA. This brings the decision point forward to mid-2010, and allows final implementation by 2012, where FS08/6 originally anticipated a decision on this around 2015. This will maintain momentum in progressing development of the new standards.

5.6 In preparing for this consultation, we will continue to be advised on the possible alternative frameworks for a PSB by the PSAG. We will publish our consultation in the fourth quarter of 2009.

Qualifications

5.7 A key part of the step change in professional standards is to raise the entry level of professional qualifications for investment advisers. This section sets out our approach, covering the four main areas discussed below.

Benchmark qualifications

5.8 From the outset of the RDR, we have made clear that we believe a higher minimum qualification requirement is needed for investment advisers. We agreed with the PG's recommendation that this should be set at Qualifications Credit Framework (QCF) Level 4 or equivalent,[2] and proposed that all existing advisers should reach this level by end-2012. New entrants to the industry will be expected to study towards a new benchmark qualification once finalised in 2010.

5.9 To deliver this change, the Financial Services Skills Council (FSSC) will consult for three months from mid August 2009 on new benchmark appropriate examination standards for retail investment advisers.[3] We expect that there will be core subjects for all investment advisers, including regulation and ethics, personal taxation, investment principles and risk, and practical application of technical knowledge.[4] The FSSC will then, once examination providers have created new qualifications,

2 The Qualifications and Credit Framework (QCF), which applies across England, Northern Ireland and Wales, replaces the National Qualifications Framework. Level 4 is judged to be the vocational equivalent to the first year of a bachelor's degree, equating to Level 8 under the Scottish Credit and Qualifications Framework (SCQF).

3 This change will apply to activities 2, 3, 4, 6, 10, 12, and 13 listed in our TC Sourcebook, Appendix 1.1.

4 We explained this in our Qualifications Update on 6 March 2009, which was intended to update stakeholders on developments concerning the qualifications work. The statement can be found at www.fsa.gov.uk/pages/About/What/rdr/qual_update.shtml.

produce and maintain a revised list of appropriate examinations which satisfy these standards. As currently, this will allow investment advisers to meet the knowledge (as well as application) aspect of our competence requirements by selecting an appropriate examination from the FSSC list, as provided for in our Handbook at TC 2.1.10E.

5.10 While this proposal does not require a rule change, we fully recognise the impact it will have on the industry, so it is covered in the cost-benefit analysis to this CP (see Chapter 7 and Annex 2).[5] We also strongly encourage firms and individuals to engage fully in the FSSC's consultation process.

Transitional arrangements

5.11 As noted above, the rise in the minimum qualification level will apply to both new and existing advisers – there will not be 'grandfathering' to the new requirements.[6] To allow advisers to take steps towards the new benchmark now, we have said that they can use existing Level 4 qualifications, and that any gaps in the content between existing Level 4 and new exams can be filled with CPD. This 'no regrets' position was noted in FS08/6 and elaborated on in the Qualifications Update (as noted above). The CPD 'gap-filling' will need to be completed to the same deadline (end-2012). Gaps will be created between existing Level 4 qualifications and the new core subjects that will be set by the new Appropriate Examination Standards that FSSC will be consulting on during 2009. Advisers will need to fill any gaps with structured CPD. We have amended the Qualifications Update to address certain transitional issues that have been raised in recent months. Firms and advisers should refer to the Update to confirm our expectations for different scenarios.

5.12 As indicated in Chapter 1, the scope of our professionalism proposals is based on the existing scope of our training and competence regime (that is, advice activities in relation to 'designated investments')[7] and the FSSC is developing new qualification standards on that basis. Once the scope of the EU PRIPs regime is decided, we will work with the FSSC and qualification awarding bodies to align the scope of the relevant qualifications with any additional PRIPs products going forward.[8] In the meantime, and consistent with our 'no regrets' policy and philosophy, advisers should continue to study for available Level 4 qualifications, topping up any additional necessary PRIPs knowledge in the future through CPD – as they would with any change in regulatory scope, since changes in scope do not automatically necessitate the taking of new exams.

5 With respect to the professionalism proposals, the CBA is based on applying the proposals to the scope of the investments covered by the current training and competence regime. We will carry out any further necessary CBA in relation to PRIPs changes once the scope of those changes is final.

6 By this we mean that there will be no automatic transitioning of all existing advisers.

7 The relevant activities in question are:
- advising on securities;
- advising on derivatives;
- advising on packaged products;
- advising on friendly society tax-exempt policies;
- undertaking the activity of being a broker fund adviser;
- advising and dealing in securities; and
- advising and dealing in derivatives.

8 In conjunction with any other changes required to the scope of our training and competence regime.

Alternative assessments

5.13 Together with PSAG, we have considered an alternative to the written examination route to help facilitate the transition. These alternative assessments will represent equivalent, rigorous oral versions of the written industry examinations (covering the same technical content), and will be aimed at experienced individuals who would prefer not to take written exams, but believe that they can demonstrate knowledge at Level 4 even though they do not hold a Level 4 qualification. This alternative will apply as a transitional provision only to investment advisers in practice as at 30 June 2009, and will be withdrawn after end-2012.

5.14 Awarding organisations that would like to offer such assessments can now base their assessments on their current Level 4 qualifications. Such assessments will also fall under the 'no regrets' policy and so may need a top up through CPD. Alternatively, awarding organisations may choose to wait for the new benchmark examination standards following the FSSC's consultation, which should mean that candidates would not be subject to 'gap filling' through structured CPD.

5.15 Any alternative assessment must be independent and conducted by the relevant awarding organisation. A firm's in-house function could play a role in preparing candidates, but the assessment itself must be conducted by an independent assessor (provided by the awarding organisation).

5.16 The recruitment and training of assessors will be a matter for awarding organisations in the same way as they are for written examinations. To be credible, assessors will need to be experienced practitioners or individuals who can demonstrate extensive relevant knowledge of the industry or sector.

Relevance of qualification content

5.17 We recognise the wide variety of business models and advisers that are within the scope of the RDR. We have heard from the industry its desire to avoid, as far as possible, study that is not relevant to an individual's activities or that is overly focused on the technical at the expense of practical application. While it is important that all investment advisers gain technical knowledge of the core subjects as specified in the FSSC's standards (see paragraph 5.9 above), awarding organisations will be able (as usual) to tailor their examinations to a particular sector. Application of knowledge will also be central to the new qualification (and we recognise that it is already a key part of existing qualifications).

5.18 There will be additional required elements to the core content, also at Level 4, to cater for the wide range of different activities in the industry. The issue of whether some advice activities require knowledge above Level 4 will be considered by the PSB, or the FSA as the case may be.

5.19 Again, we strongly encourage advisers from all sectors to engage fully in the FSSC consultation process, as this will help to ensure that the future standards are appropriate to all sectors and roles in the marketplace.

Ethics

5.20 In FS08/6, we stated that one way in which we would aim to promote standards of professionalism would be 'by improving the perception of the sector by establishing and enforcing common ethical and behavioural standards'. We said, 'we believe that a consistent and visibly-enforced code of ethics is essential for improving consumer outcomes and changing consumer perceptions.'

5.21 A draft new Code of Ethics for investment advisers will be formally consulted on by the PSB (or FSA) once a decision has been taken on its status (see paragraph 5.5 above). However, we envisage that the formal proposal will build on the model Code put forward by the industry PG and published in FS08/6. We see this as a useful starting point because it reflects good features and standards from existing codes operated by professional bodies that play a particular role in the financial adviser sector. Box 1 below contains a version of this model Code that reflects further discussions we have held with industry stakeholders since FS08/6 was published. We are inviting views on this.

5.22 Whether or not the new Code of Ethics forms part of the FSA Handbook (again depending on the outcome of the consultation on the PSB), our view is that the standards set out in the Code should be consistent with the relevant standards of behaviour already expected of advisers under our FIT and APER sourcebooks. We indicate in Box 1 how the proposed standards are consistent. We envisage that the Code will amplify existing standards, and will be published for consumers as a succinct statement of standards of ethical behaviour that they can expect of investment advisers.

5.23 We also envisage that the relevant professional bodies will incorporate the future new Code into their own standards for their members, including their own codes of ethics or codes of practice. Each professional body (PB) would be free to supplement the core Code as they see appropriate for their members and the sector in which they operate, and we propose that the PSB/FSA should recognise those professional body codes that are consistent with the core Code. How these ethical standards might be supervised in the future will be covered in the consultation on the PSB in the fourth quarter of 2009.

Box 1: A possible draft Code of Ethics for investment advisers

1. To act honestly and fairly at all times when dealing with clients and to act in the best interests of each client [APER Principles 1+2]
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 and the financial services industry [APER Principles 1+2+3]
3. To observe applicable law, regulations and professional conduct standards when carrying out financial service activities [APER all]
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 [APER Principle 3]
5. To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest [APER Principle 1]
6. To attain and actively manage a level of professional competence appropriate to your responsibilities and commit to continued learning to ensure the currency of your knowledge, skills and expertise [APER Principle 2]
7. To decline any engagement for which you are not competent unless you have access to such advice and assistance as will enable you to carry out the work competently [APER all]
8. To uphold the highest personal and professional standards [APER all]

Q17: What are your views on this model Code of Ethics as the basis for further PSB/FSA consideration and consultation?

Continuing Professional Development

5.24 In FS08/6, we stated, in the context of the package of proposals on developing professionalism, 'effective and consistent CPD is arguably as important as raising the benchmark knowledge requirement', though we also recognised that 'there are different ways to achieve the intended outcome of up-to-date relevant knowledge.'

5.25 As with Ethics, we propose that the PSB (or FSA) would formally consult on a consistent overarching standard for CPD. Again, wherever the new standard may be located (in a PSB rulebook or elsewhere) we believe that it should build on current FSA expectations[9] and current industry good practice as far as possible, while indicating good practice to individuals and firms whose standards currently fall short. Existing good practice may include, for example, a professional body's CPD scheme, those good 'in-house' schemes that individual firms operate, or appropriate third party

9 Principally as set out in Section 2 of our TC sourcebook and under APER Principle 2.

providers' offerings. As with the Code of Ethics, if an adviser is a member of a professional body that has a CPD scheme, we envisage that they can follow this scheme if it has been recognised by the PSB/FSA as meeting the overarching standards. Firms' in-house CPD schemes (or third party CPD tools) would also need to meet the overarching CPD standard. The detail of how CPD standards might best be monitored and enforced in the future will be covered in the consultation on the PSB.

5.26 Box 2 below summarises our current thinking on what the future overarching CPD standard might involve (subject to formal consultation by the PSB or FSA in the future), following discussion with our group of stakeholders in PSAG. We invite any initial views.

Box 2: Possible principles for an overarching CPD standard for investment advisers

- The future standard should build on existing FSA requirements for individuals (FIT/APER) and firms (TC).
- It should apply consistently to individuals and their employers (and to sole traders)
  - whether individuals are members of a relevant professional body or not
  - whether their employers currently have formal in-house CPD schemes
  - whether their employers use external providers of CPD schemes
  - but recognise acceptable good practice in accredited professional body schemes, in-house schemes/standards or external providers
- It should be flexible enough to match individual needs, objectives, job needs and ways of learning; accommodate an appropriate range of CPD activities, inputs and outputs; and be relevant to an individual adviser's role.
- It should secure the buy-in of both individuals and their employers; benefits to all must be clear, with shared ownership of CPD objectives and integration of personal development and regulatory competency.
- Annual CPD activity should:
  - cover standards of ethical behaviour relevant to an individual's particular job/role;
  - cover, as relevant to the individual adviser's role, the core subjects of regulation, ethics, investment principles and risk, personal taxation, practical application of knowledge and specialist expertise;
  - aim to address any 'gaps' in the individual's technical knowledge compared to the knowledge the firm considers the individual needs; and
  - aim to address other development needs identified in relation to knowledge, skills (for example, communication skills) and behaviour.
- The arrangements for maintaining the competence of an employee should involve measurable objectives, targets and outcomes. This should include a minimum of 35 hours of relevant CPD activity in each 12-month period (or 100 hours over a three-year period).

- Acceptable CPD activity may be structured or unstructured, though an appropriate balance should be maintained without disproportionate emphasis on unstructured activity.
- The precise balance will be for each firm (or PB) to determine, but as a guide, the FSA would indicate an expected balance of 60-70% structured/40-30% unstructured.
  - Structured activity may involve attending seminars, lectures, conferences, certified completion of appropriate e-learning tutorials, workshops or courses dealing with a relevant topic.
  - Unstructured activity may include research and reading industry or other relevant material. Activity should be relevant to the aims outlined above, including FSA TC 2.1.13G.
- CPD arrangements should involve the evaluation of the success of the activity in meeting the objectives, targets and outcomes.
- A firm may allow an individual to arrange their own CPD, but must satisfy itself that these arrangements meet the overarching standards.
- A sole trader would be responsible for determining their own CPD needs, again ensuring that these arrangements meet the overarching standards.
- Examples of good practice might include:
  - Investment advisers should complete a forward-looking CPD plan each year, agreed with their manager, and maintain some form of CPD activity log (available to the firm, FSA and PB – if a member). This can be self-certified, but firm/PB/FSA/PSB may ask for some activity to be evidenced. Should they move jobs or employers, the individual would be able to use this log as a portable record of CPD activity they had undertaken.
  - Individuals evaluate learning outcomes for each activity, including how they will be transferred to workplace/day to day activity.
  - An annual CPD review is built into the firm's appraisal round and annual confirmation of competence, to integrate personal development and regulatory competency.

Q18: Do you have any comments on this approach to CPD for investment advisers, including comments on any changes that it would involve to current practices?

6 Wider implementation challenges

Supervisory strategy

6.1 In FS08/6, we recognised that we would need to take action to mitigate the unintended consequences of changing remuneration practices and the standards for independent advice, and that effective mitigation would require us to enhance our supervisory approach.

6.2 After the rules come into effect, and during the transitional period ending on 31 December 2012, we will monitor for signs of firms finding alternative ways to preserve features of the market that our proposals are intended to address, and will take the necessary action to deter firms from frustrating the intended market outcomes.

6.3 There are a number of ways in which product providers might seek to exert influence over advisers both in the transitional period and after the rules take effect. To prevent this, we will identify and challenge those business models most likely to exploit the RDR. We intend to monitor Product Sales Data (PSD) for provider firms to identify trends (increased sales of high commission products, for example); and, through our 'conduct risk toolkits' (such as the pension switching template published earlier in 2009), we will challenge adviser firms to explain any increases in switching we may identify, where this appears inappropriate.[1] In addition, as the RDR will not apply retrospectively to legacy business pre-2012, we will monitor and take action on firms exploiting this situation in order to maximise their revenue without also adapting to the RDR in the run up to 2012.

6.4 In particular, and to ensure that our proposals deliver a genuine reduction in the potential for product and provider bias, we will monitor and challenge the way that product providers and adviser firms implement the new Adviser Charging requirements. This will involve supervising the way that adviser firms set and operate their own Adviser Charging tariffs, and ensuring that provider firms do not continue to influence

1 The Conduct Risk supervision area will build on its 2008/09 project, which analysed the quality of advice in relation to pension switching. This work is likely to include the quality of advice given in relation to other products and other conduct risk areas, including the quality of product disclosure. The pension switching template is available on the FSA website (www.fsa.gov.uk/pages/Library/Other_publications/pension_switching/index.shtml).

adviser remuneration, directly or indirectly. Furthermore, as more provider firms begin to introduce systems for collecting adviser charges, we will monitor the checks and balances that firms may introduce, including any new systems, to ensure that adviser firms, and not providers, are genuinely taking the lead in setting their own charges.

6.5 The new standards for independent advice will also require greater supervisory focus on the criteria that advisers use to select products.

6.6 We will fully integrate oversight of the new requirements for Adviser Charging and standards for independent advice into our business-as-usual supervisory activities and, where appropriate, will use a thematic supervisory approach.

Changes to reporting requirements

6.7 We plan to consult on collecting extra data in order to monitor and challenge the way product providers and adviser firms implement the various elements of the RDR. This data will inform our Conduct Risk and business-as-usual supervisory strategies. In particular, we will consult on changes to Product Sales Data (PSD). This may include requirements on provider firms to report on adviser charges facilitated through investment products. We will also be reviewing whether there is a need to collect product charges data.

6.8 We will review our current persistency returns to assess whether that data can deliver the necessary information about levels of product lapsing and switching, following the introduction of Adviser Charging.

6.9 In April 2009, our Handbook development newsletter (notice no. 110) indicated that we expected to consult on a more general review of the regulatory reporting of PSD in the first quarter of 2010. We now plan to incorporate the changes to PSD arising from the RDR into that consultation to minimise changes for firms. Any changes to persistency reporting would be consulted on at the same time.

6.10 Outside of the Handbook, we also expect to make changes to the data we collect for the Comparative Tables. The Comparative Tables (part of the Moneymadeclear website) enable consumers to compare the cost of products from different providers. Currently, the costs of both product manufacturing charges and commission charges are included in the Comparative Tables, and we advise provider firms to use their most commonly used commission rates when submitting data to us.

6.11 Following the introduction of Adviser Charging, we expect to require firms to submit data based on product manufacturing charges only. There is a risk that firms that introduce factory gate priced products ahead of the RDR deadline in 2012 may include only product charges to ensure their products are at the top of the tables.

As part of our supervisory strategy through the transitional period up to 31 December 2012, we will monitor for this type of behaviour and take action to counter it. We will communicate any changes to the basis for submitting data for the Comparative Tables to participating product providers through a Comparative Tables bulletin and by reissuing the Welcome Pack that details the data collection requirements.

Prudential requirements for PIFs

6.12 In November 2008, we consulted on proposed amendments to the capital resources and professional indemnity insurance requirements for personal investment firms (PIFs). The consultation period closed on 31 March 2009 and we received 102 responses. Respondents raised a variety of issues, including some concerns about the impact of the increased capital resources requirement and the feasibility of the timetable for implementation. We will continue our discussions with industry about these issues as we develop our policy.

6.13 Our intention remains to publish the Policy Statement to CP08/20 in the fourth quarter of 2009. This will ensure that our proposed Handbook changes come into force on 31 December 2009 with a transitional period until 31 December 2012, in order that firms affected by the changes report under the new rules and guidance from 1 January 2013 onwards. However, in order to bring about our proposed Handbook changes, we will also require two consequential changes to the accompanying reporting form (RMAR). The consequential changes are: amending the Guidance only to the RMAR to reflect the proposals concerning professional indemnity insurance (PII) exclusions; and amending the forms, systems and guidance for the capital resources and connected requirements proposals. We plan to consult on these changes in the July and October Quarterly CPs so that the PII exclusions will be ready for implementation by December 2009 and the amendments to the reporting forms will be implemented by February 2010.

Implications for other sectors

6.14 At this stage, we have confined the RDR proposals to the retail investment market. However, it is not unreasonable to consider that there may be similar market problems to those addressed by the RDR in the general insurance and mortgage markets. We are currently assessing the benefits of a wider application of the RDR proposals across these markets. If we consider that a wider application is appropriate, we will consult on this – bearing in mind the implementation timeframe for the retail investment market so that the extent of change is limited, especially for firms operating across these markets.

General insurance

6.15 In FS08/6, we noted our initial view that we should focus on particular general insurance markets when considering the potential benefits of applying the RDR approaches. We noted that it is in pure protection markets that customers are most dependent on advice. Most retail investment intermediaries also transact pure protection business, and firms can elect whether to sell pure protection products under the COBS or ICOBS rules. In Annex 4, we consider whether possible changes in behaviour of firms brought about by implementing the RDR proposals in the retail

investment market could contribute to market distortions related to pure protection products. We also set out in Annex 4 why we are considering what future work might be undertaken in reviewing the distribution of protection products other than through retail investment intermediaries.

6.16 The proposed remuneration structure for the sale of retail investment products could mean significant changes to cash-flows for some advisers. If we make no changes in the regulation of the sale of pure protection policies, then we consider that some firms may see a commercial incentive to shift their sales focus to pure protection products to maintain commission income. Our view is that there would be material risks in such a shift in focus that was not driven by consumer needs, but by a change in the relative financial rewards to the adviser. We consider these risks are sufficient for us to review closely whether changes are needed in our regulatory approach to pure protection markets to ensure such consumer detriment does not arise from firms' responses to the implementation of the RDR proposals in the retail investment market.

6.17 We are not bringing forward any proposals for the sale of pure protection products at this stage. We will take account, in our review, of evidence provided by market participants and other stakeholders on the nature and materiality of risks to consumers that could result were the RDR proposals implemented for the sale of retail investment products, while no regulatory changes were made for the sale of pure protection products by retail investment firms. In the first quarter of 2010, we will publish the results of our analysis and any proposals concerning the sale of pure protection products by retail investment firms.

Q19: What consumer detriment, if any, would arise if we implemented the RDR proposals for the sale of retail investment products and took no action on regulating the sale of pure protection products under ICOBS by retail investment firms? We would welcome any evidence on this.

Mortgages

6.18 We are currently undertaking a thorough review of regulation for the mortgage market. By the third quarter of 2009, we will publish a paper on the future shape of regulation and how our approach should evolve to reflect this. At this time we will consult on whether any wider application to the mortgage market, from the RDR proposals in relation to the investment market, is appropriate.

Post-implementation review

6.19 After the implementation of the new rules, we plan to carry out a targeted post-implementation review (PIR) of the RDR. This will seek to measure the benefits the RDR has delivered in practice. Though both are separate assessments, the PIR

will build on the analysis in the CBA. We have developed a number of measurable indicators to track and assess the benefits that we expect the RDR to deliver. We will compare these indicators against baseline data. The baseline chosen as a benchmark for our assessment is the second quarter of 2010, but we also intend to capture the changes in the market that have taken place since the RDR Discussion Paper in 2007. These will include early attempts by firms to adapt their business models in advance of the RDR, and steps taken by advisers to increase their level of qualification.

7 Summary of cost-benefit analysis

7.1 The RDR comprises many interlinked proposals. Since all of these aim to achieve the same outcomes (that is, improvements for consumers and long-term viability for the industry), it makes sense to assess the likely impacts on real-world markets of the RDR as a whole, although this is not straightforward.

7.2 This CBA reflects analysis undertaken within the FSA, the results of consulting academic economists about market mechanisms through which benefits and indirect costs might arise, work by Oxera on impacts on competition and market structure, and a survey of compliance costs and changes to business models by Deloitte.[1]

Costs

Direct costs to the FSA

7.3 We estimate one-off costs of £2 million and ongoing costs of £1.2 million. The one-off costs consist of improvements in our information systems; the ongoing costs consist of additional supervisory staff costs. We will report on the supervision costs in connection with the Professional Standards Board as part of a separate consultation in the fourth quarter of 2009.[2]

Compliance costs

7.4 Deloitte's survey was based on early policy assumptions of the RDR proposals as published in Feedback Statement 08/06. We acknowledge that now the detailed proposals are available, these estimates may be subject to a margin of error. We encourage firms to provide us with new information where appropriate as part of the consultation process.

1 *Firm behaviour and incremental compliance costs*, Deloitte (2009) http://www.fsa.gov.uk/pubs/other/fbicc.pdf and *Retail Distribution Review Proposals: impact on market structure and competition*, Oxera (2009) http://www.fsa.gov.uk/pubs/other/oxera_rdr.pdf. For information on how the FSA used Deloitte's estimates and administrative data to estimate total incremental compliance costs, please see *Estimates of total incremental compliance costs for RDR proposals* http://www.fsa.gov.uk/pubs/other/rdr_report_Jun09.pdf.

2 As mentioned in Chapter 5, in the fourth quarter of 2009 we will consult on whether a Professional Standards Board should be established as an independent statutory body. The consultation will include an estimate of the costs and benefits of options.

7.5 Using average cost estimates from Deloitte's survey and our administrative data, we estimate firms' incremental compliance costs to be approximately £430 million one-off and £40 million annually. If you annualise these costs over five years they amount to £140 million (and £165 million if we include the cost of proposed capital requirements). Costs of £140 million represent approximately 0.3% of annual gross new business premiums (about £50 billion according to ABI data) and 1% of industry profits (approximately £12 billion based on estimates by the FSA). They can also be compared with estimates of consumer detriment from mis-selling, which may be broadly in the region of £0.0025 to £0.06 per £1 invested for certain products considered vulnerable to mis-selling, based on work by Oxera on Suitability Letters that was previously published by us.[3] Taking the mid-point of this range, the detriment to consumers would be £1 billion, in the unlikely event that all transactions in vulnerable products were mis-sales. Expressed as the annualised compliance cost (£140m) this represents 15% of consumer detriment that arises from mis-selling.

Indirect costs

7.6 Oxera report that it is difficult to assess the combined effect of the proposals on exit from the independent sector. In their review of secondary sources, Oxera found that most estimates put the level of exit from the independent sector at about 20% of firms, with the majority of these joining the non-independent sector. Firms expecting to exit the independent sector are mostly small and commission based. Oxera comment that the proposed alternative assessments (of equivalent standard) mentioned above, mean that the estimate of 20% is likely to be too high, since they may be preferred by some advisers. Furthermore, Oxera conclude that barriers to entry and expansion are low and market exits from the independent sector should not be detrimental to consumers in the long term. In the short term, choice for consumers may be reduced. This does not necessarily mean there would be fewer transactions but consumers who switch to advice in the non-independent sector would be likely to purchase a product from a relatively narrow range, and because of this, receive a lower level of service, albeit possibly at a lower price. It is unclear whether this would represent an increase or decrease in consumer welfare.

7.7 Oxera report a risk of higher product prices in the short term, but conclude that in the long term an increase in price may be competed away, through increased transparency of product prices (for example, use of price comparison sites including FSA Comparative Tables), a supervisory focus on the price of products in assessing suitability, and large intermediaries competing by offering lower product prices as a means of attracting consumers.

7.8 Oxera identify that in the longer term there may be some unwinding of cross-subsidies leading to a higher advisory charge for small investors, which would be more reflective of the true cost of advice. Large investors would face lower charges, however.

3 This estimate should be treated as indicative. Oxera made a number of assumptions about consumer valuations of different outcomes. This is explained fully in their report. Oxera (2007) Assessment of the benefits of the FSA suitability letter www.fsa.gov.uk/pubs/other/oxera_suitability.pdf.

7.9 We do not have evidence that the regular premium market will become unprofitable for advisers, although some advisers are likely to experience short-term cash flow problems. Even if consumers were denied access to the regular premium market, they would switch to alternative products, including potentially advantageous lower cost products, such as Personal Accounts and Stakeholder Products.

Benefits

7.10 Many consumers are expected to be significantly better off under our proposals because these would improve the quality of advice, reduce the incidence of mis-selling, and lead to increased persistency. These benefits are expected to arise from voluntary compliance with the new rules and greater incentives to comply, since it will be easier for us to supervise and enforce standards of suitability. Under the supervision of the PSB, advisers will be required to adhere to new standards of ethical behaviour and CPD.[4]

7.11 These benefits may be very large. For example, even if compliance levels have improved since systematic mortgage endowment and pension mis-selling occurred, total compensation paid to consumers in those cases was £2.7 billion and £11.8 billion respectively, albeit over several years.

7.12 Increased persistency is also beneficial to product providers. This is because it lowers the risk of early termination of contracts that impose unexpected costs on product providers. Further, increased persistency is socially beneficial because it reduces the waste of scarce resources on unnecessary transaction costs. In the longer term, to the extent that consumers switch to paying for advice up-front in cash, they will assume persistency risk that is presently borne by product providers.

7.13 Whereas increased consumption of resources on compliance is a cost to the economy as a whole, some of the increase in consumer benefit arising from improved suitability of recommendations is matched by a reduction in supplier profits. In general, one would expect costs incurred by firms to be passed on to consumers.

7.14 The RDR is expected to improve consumer confidence by removing some negative perceptions of the advisory process, which undermine confidence and often deter people from seeking advice. In the longer term, this may serve to narrow the savings gap.

Q20: Do you have any comments on the cost benefit analysis?

4 We will consult separately on standards for ethics and CPD in the fourth quarter of 2009 as part of the Professional Standards Board consultation.

Annex 1

Compatibility statement

Introduction

1. In this Annex, we set out our view on how the proposals outlined in this CP are compatible with our statutory objectives and the principles of good regulation.

Compatibility with our statutory objectives

2. The proposals outlined in this CP are consistent with our statutory objectives of working towards improving confidence in the financial system, securing the appropriate degree of protection for consumers, and promoting public awareness.

Market confidence

3. We believe our proposals will remove product provider influence over adviser remuneration; improve the clarity of services offered by advisers; and set higher professional standards for all investment advisers. This will serve to improve the quality of advice and consumer confidence in the market for investment advice as advisers' remuneration will no longer be influenced by providers, services will be labelled clearly and the level of professionalism improved.

Consumer protection

4. We propose to improve the distinction between independent advice and non-independent advice through clear labels to communicate better to the consumer the type of advice they are receiving. The removal of provider influence over adviser remuneration will mean that overall their influence over advisers to sell their products is likely to be reduced, further preventing consumer detriment.

5. The changes to the independence requirements, levels of training and professionalism could also raise the quality of advice and recommendations. These proposals all serve to enhance the level of consumer protection in the market.

Public awareness

6. Through improving the clarity of advice received and disclosure, our proposals aim to improve public awareness about the nature, scope and cost of advice. For example, the proposed disclosure requirements will provide clearer information for the consumer on the advice service received.

Compatibility with the need to have regard to the principles of good regulation

7. Section 2(3) of the Financial Services and Markets Act 2000 (FSMA) requires that, in carrying out our general functions, we must have regard to the principles of good regulation. The proposals set out in this CP fulfil our principles of good regulation as set out below.

The need to use our resources in the most efficient and economic way

8. By using the outcomes-based approach, we have taken, where possible, a flexible approach to regulation to enable further market development under the new regime without the need to amend rules in the future. We have proposed further guidance to address issues raised in response to FS08/6 and to aid firms in complying with the new requirements, which will reduce future uncertainty in the application of rules and the need for individual guidance.

The responsibilities of those who manage the affairs of authorised persons

9. Our proposed rules mark a clear move in the direction of more outcomes-based regulation. Many of the current rules will be replaced by more outcomes-based rules. Firms' senior management will have a greater role to play in ensuring that outcomes are achieved in a way that is consistent with the proposed rules and their own business models.

10. We have also sought to ensure that our approach is flexible enough to enable firms to meet the requirements in a way which is suitable for their business. For example, firms are free to choose how they meet the disclosure requirements of Adviser Charging rather than being restricted to a prescribed format.

The principle that a burden or restriction which is imposed should be proportionate to the benefits

11. We have carried out a cost-benefit analysis (see Chapter 7). We consider that our proposals are proportionate.

The desirability of facilitating innovation

12. Our proposals are not expected to hinder innovation (see the cost-benefit analysis for further details). Moreover, they set a framework within which beneficial innovation could arise.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom

13. The proposals have paid specific regard to developments occurring in the European Union (EU), specifically the work on retail investment products, in order to minimise changes for firms in the near future. For example, the changes made to disclosure requirements have been minimal and build on existing rules to reflect a clearer and effective outcomes-based approach to disclosure. We do not believe our proposals will have a materially damaging effect on the competitive position of the UK.

The need to minimise the adverse effects on competition

14. Our proposals have been designed to minimise the effects on competition by taking a flexible approach to regulation, which will allow firms to implement our requirements in a manner that is compatible with the nature of their business. We have taken account of the variety of sales channels that exist in the market and the likely innovations in this area. We have also sought to ensure that the proposed rules do not place a disproportionate obligation on any particular sales channel.

15. Our disclosure requirements have been designed to improve regulatory flexibility for firms and reduce the administrative burden placed on firms in the future. We aim to introduce minimal changes while encouraging firms to produce clear and effective disclosure to enable their customers to better understand the service they are receiving. In the long term, this could encourage consumers to shop around for better services, further improving competition.

The desirability of facilitating competition

16. In the long term, competition may be enhanced if advisers place greater focus on price/quality of product trade-off to attract new customers, and with better comparable disclosure, consumers have the tools to enable them to shop around and compare services encouraging advisers to become more consumer-oriented. As a result, providers may also place greater focus on designing better quality products for consumers and using the most efficient distribution channels.

Why our proposals are most appropriate for meeting our statutory objectives

17. In developing our proposals, we have taken steps to engage extensively with 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. Through this, we developed a better understanding of the key complexities in the markets, solutions that could be most effective in resolving these and how the market could potentially react to proposed regulatory interventions.

18. We have taken into account the responses to DP07/01 and FS08/06, and conducted several pieces of research. The ensuing debate and analysis has led us to believe that the proposals we have outlined are most appropriate in attempting to tackle the persistent problems observed in the retail investment market.

Cost-benefit analysis (CBA)

1. Generally, the RDR proposals are interlinked as they all aim to achieve the same outcomes (that is, improvements for consumers and long-term viability for the industry). So, it makes sense to assess the likely impacts of the RDR proposals on real-world markets as a whole, although this is not straightforward.

2. This CBA reflects analysis undertaken within the FSA, the results of consulting academic economists about market mechanisms through which benefits and indirect costs might arise, work by Oxera on impacts on competition and market structure, and a survey of compliance costs and changes to business models by Deloitte.[1]

Costs

Direct costs to the FSA

3. The direct costs of regulation are those we incur in implementing our proposals. To supervise the new requirements we will need to make investments in our information systems and to employ additional staff. We estimate one-off costs to be £2 million and ongoing costs £1.2 million per year. The supervision costs in connection with the Professional Standards Board will be published separately in a consultation in the fourth quarter of 2009.[2]

Compliance costs

4. Deloitte's survey was based on policy assumptions of the RDR proposals as published in Feedback Statement 08/06. We acknowledge that now the detailed proposals are available, these estimates may be subject to a margin of error. In addition, the changes that firms may need to make to fulfil the proposed requirements could vary significantly from firm to firm depending on the nature of their current business model. We therefore encourage firms to provide us with new information that may impact on these estimates as part of the consultation process.

1 *Firm behaviour and incremental compliance costs*, Deloitte (2009) http://www.fsa.gov.uk/pubs/other/fbicc.pdf and *Retail Distribution Review Proposals: impact on market structure and competition*, Oxera (2009) http://www.fsa.gov.uk/pubs/other/oxera_rdr.pdf. For information on how the FSA used Deloitte's estimates and administrative data to estimate total incremental compliance costs, please see *Estimates of total incremental compliance costs for RDR proposals* http://www.fsa.gov.uk/pubs/other/rdr_report_Jun09.pdf.

2 As mentioned in Chapter 5, in the fourth quarter of 2009 we will consult on whether a Professional Standards Board should be established as an independent body or as a part of the FSA. The consultation will set out its role and responsibilities. This consultation will include an estimate of the costs and an analysis of the benefits of each option.

5. We asked Deloitte to conduct a survey of the incremental compliance costs product providers and intermediaries expect to incur if our proposals are implemented. Using Deloitte's estimates of firms' average incremental compliance costs, we estimate one-off costs to be approximately £430 million and ongoing costs to be £40 million per year. Annualising one-off costs over five years at a cost of capital of 4% produces a cost of £100 million. This figure, when combined with ongoing costs, puts annual costs in the region of £140 million (and £165 million if we include the costs of proposed capital requirements).[3] Costs of £140 million represent approximately 0.3% of annual gross new business premiums (£50 billion), according to 2008 data from the ABI, and 1% of total industry profits (approximately £12 billion based on estimates by the FSA). They can also be compared with estimates of consumer detriment from mis-selling, which may be broadly in the region of £0.0025 to £0.06 per £1 invested for certain products considered vulnerable to mis-selling, based on work by Oxera on Suitability Letters that was previously published by the FSA.[4] Taking the mid-point of this range, the detriment to consumers would be £1.0 billion, in the unlikely event that all transactions in vulnerable products were mis-sales. Expressing annualised compliance costs as a percentage of this figure suggests that they would be 15% of consumer detriment from mis-selling.

6. We provide a more detailed breakdown of compliance costs in tables 1 and 2 below. Table 1 shows the compliance costs for intermediaries. Table 2 shows the compliance costs for product providers.

Table 1: Summary of incremental compliance costs for intermediaries

One-off costs	Total
Professional qualifications	£120m
IT/Systems changes	£71m
Disclosure documents and marketing	£19m
Remuneration: designing a tariff	£1m
Total one-off costs	**£210m**
Ongoing costs	
Disclosure: explanation of status	£14m
Remuneration: ongoing revisions	-
Disclosure: remuneration	£11m
Independence: additional search costs	£16m
Total ongoing costs	**£40m**

Source: Deloitte (2009), our own estimates based on Deloitte data for ARs, and FSA administrative data. Figures may not add-up due to rounding.

3 Since CP08/20 was published, we have conducted further analysis of the additional capital firms would need to raise, and estimate this to be £600 million. We estimate the real cost of capital to be 4%. The annual cost of the incremental capital is therefore £24 million.

4 This estimate should be treated as indicative. Oxera made a number of assumptions about consumer valuation of different outcomes. This is explained fully in their report. Oxera (2007) Assessment of the benefits of the FSA suitability letter (www.fsa.gov.uk/pubs/other/oxera_suitability.pdf).

7. The largest one-off cost for intermediaries is the cost of advisers attaining a QCF Level 4 qualification. Approximately 75% of advisers will need to raise their level of qualification to QCF Level 4.[5] Firms may incur the cost of advisers' training and examination. Alternatively, the adviser may incur this cost. We do not have information that would allow us to apportion costs, so we have included these costs as costs to firms. The next highest one-off cost is the cost of IT systems for implementing adviser charging. The majority of costs in this category are expected to be incurred by product providers with a direct sales force. Other incremental costs include the cost of altering disclosure documents. Some firms will incur the cost of devoting compliance staff to making these changes to documents; other firms will employ compliance consultants.

8. Intermediaries expect to incur higher costs as a result of spending longer explaining to customers the scope of their advice and how they are remunerated. The combined cost of these two pieces of disclosure is the highest ongoing cost for intermediaries. Intermediaries who continue to offer independent advice expect to spend an extra five hours per week on average on market search which, in principle, ought to improve the quality of recommendations. This is the next highest ongoing cost.

Table 2: Summary of incremental compliance costs for providers

Costs	Providers
One-off costs for IT/Systems changes	£220m
Ongoing costs	minimal
Total one-off costs	£220m

9. Deloitte found that the main cost for product providers, which include bancassurers and investment managers, is the cost of altering their systems to charge consumers a factory gate price for products, such as introducing additional share classes. Further information on the estimates that firms provided is available on page 29 of Deloitte's report. We estimate total one-off costs to be £220 million.

10. For information, at the end of the chapter, we present tables showing the average incremental costs by type of intermediary firm and product provider, based on Deloitte's estimates and FSA calculations.

Indirect costs

11. Indirect costs are the negative impacts of regulation (reductions in consumers' welfare or firms' profits) that result from factors other than us recharging our direct costs to firms and firms expending resources on compliance costs. In the following section, we identify indirect costs that are likely to arise if the RDR proposals are implemented.

5 Our central estimate of incremental compliance costs is based on a population of 60,000 advisers. We acknowledge that there may be as many as 85,000 advisers registered, but our central estimate recognises that firms may have in place an existing policy on training their staff to QCF Level 4, meaning that costs of training are not incremental, and that firms would comply with the proposed regulations in the most efficient way. For instance, if advice on retail investment products is auxiliary to the main commercial activity of the firm, it may not necessary train all of its advisers to conduct advice on retail investment products if the RDR proposals are introduced; some staff may instead specialise in retail investment products.

Market exit by IFAs

12. Oxera reviewed the likely impact of market exit from the independent advice sector, taking into account RDR proposals and proposed capital requirements. Intermediaries may exit this sector by joining the non-independent sector or by leaving the industry altogether. Oxera identified reasons why intermediaries may join the non-independent sector. First, intermediaries may join multi-tied networks in response to higher prudential capital requirements. Networks would meet the cost of capital centrally. Secondly, the cost of independence requirements may mean that advisers limit the scope of products on which they provide advice, allowing them to continue in business on their own but not as part of the independent advice sector. Alternatively, the cost of independence requirements may contribute to intermediaries in the independent advice sector deciding to join a multi-tied network.

13. The cost of additional prudential capital and independence requirements may mean that some intermediaries decide to exit the industry altogether. Another factor that may contribute to intermediaries leaving the industry is the costs of advisers obtaining the QCF Level 4 qualification. Some advisers may judge that they would be unable to recoup the cost of investing in this qualification, affecting the viability of some intermediary firms, particularly those where the majority of advisers are close to retirement age. Overall, Oxera did not consider it likely that any individual requirement would cause significant numbers of intermediaries to leave the industry altogether but they found that the combination of new requirements may have this effect.

14. Specifically, Oxera did not find it likely that prudential requirements would have a significant impact on market structure. Most firms hold sufficient capital to meet the new requirements and a significant minority need only to raise a small amount of capital. Many firms are likely to maintain their existing buffer of capital held over capital requirements. Oxera did not consider being unable to do this a sufficient reason to exit the industry. Nor did they find strong evidence to suggest that independence requirements would mean a significant number of Independent Financial Adviser (IFA) firms would leave the industry or even the independent sector. In reviewing the effect of professionalism requirements, Oxera report results from a survey by NMG that found that 10% of advisers might leave the industry rather than achieve the QCF Level 4 qualification. Oxera note that a new development since this survey was conducted is the proposal that experienced advisers may take an alternative assessment (of equivalent standard), which may be preferred by some advisers and therefore reduce the number of advisers who decide to leave the industry.

15. Oxera report that it is difficult to assess the combined effect of the proposals on exit from the independent sector. In their review of secondary sources, Oxera found that most estimates put the level of exit from the independent sector at about 20% of firms, with most of these joining the non-independent sector. Firms expecting to exit the independent sector are mostly small and commission based. Oxera comment that the proposed alternative assessments, mentioned above, mean that the estimate of 20% is likely to be too high. Furthermore, Oxera conclude that barriers to entry and expansion are low and market exits from the independent sector should not be detrimental to consumers in the long term. In the short term, choice for consumers

may be reduced. This does not necessarily mean there would be fewer transactions, but consumers who switch to advice in the non-independent sector would be likely to purchase a product from a relatively narrow range and because of this receive a lower level of service, albeit possibly at a lower price. It is unclear whether this would represent an increase or decrease in consumer welfare.

Higher product prices in the short term

16. Oxera reviewed the effect of the proposals on product prices, considering various mechanisms through which prices may rise or fall.

17. Oxera argue that advisers have strong incentives to negotiate high levels of commission from product providers, since this directly affects their revenue. In today's market, the total product charge that providers set, which comprises the commission payments to intermediaries and the product price, is to some extent constrained by past performance tables, which show product returns net of the product charge. Advisers use these tables as a source of information for recommending products to consumers. Since the product charge is constrained by past performance tables and advisers negotiate high levels of commission, there is pressure on providers to keep the product price low.

18. Oxera identify that this pressure may be removed if our proposals are implemented. First, advisers will be remunerated by the consumer, and, secondly, product price will only be one of a number of factors they consider in forming a recommendation. Oxera expect providers to try to avoid direct price competition, and one way they can do this is by offering different levels of administrative service to advisers, with different product prices. Interviews with industry confirm that providers will also offer different product prices to intermediaries by volume of business. This means that there is likely to be greater variability in product prices so, in the short term, it may not be possible to produce the tables of returns net of charges described above, especially as adviser charges will be negotiated individually. Moreover, again in the short term, consumers are unlikely to replace the competitive pressure on providers by shopping around more, since price transparency will fall initially as a result of the greater variability in product prices and adviser charges.

19. In the long term there are ways in which higher product prices might be competed away, depending on the behaviour of firms and the effect of our supervision. One possible mechanism is the development of improved price comparison sites, for instance, focusing on average prices, including FSA Comparative Tables. A second mechanism is that supervisors focus more on the price of products when supervising the suitability of recommendations, which the FSA intends to pursue. A third mechanism is large intermediaries competing by offering lower product prices as a means of attracting consumers. For this to be a profitable strategy, however, consumers may need to respond by shopping around more.

Unwinding of cross-subsidies

20. Oxera reviewed whether the proposals would cause any change in intermediaries' pricing strategy.

21. A cost study by Deloitte found that commission-based remuneration often means that investors of large sums subsidise investors of small sums.[6] This study also found that, post–RDR, intermediaries would typically design their fee structures to replicate existing commission cash flows. Overall, in the short term, the price of advice seems likely to be about the same as it is now.

22. Oxera reviewed whether, in the longer term, to the extent that intermediaries charge hourly fees, this would remove the cross-subsidy between investors of large sums and investors of small sums. Oxera also reviewed whether, where intermediaries use volume-based fees, greater clarity about the costs of advice would mean investors of large sums more frequently negotiate a discount. This would also lead to an unwinding of the cross-subsidy. Oxera concluded that unwinding of cross-subsidies is a realistic possibility in the longer term.

23. If cross-subsidies are unwound, investors of smaller sums would face higher costs of advice. This may cause them to switch from the independent to the non-independent sector for advice, or not to seek advice, instead, for instance, putting their money into a savings account. Typically a consumer driven by regulation to select the next best alternative would suffer a loss of consumer surplus. In the present case, however, consumers' investment returns may be increased by switching to lower cost investment vehicles.

24. On the other hand, investors of larger sums would benefit from the unwinding of cross–subsidies since they would pay less for advice. With the price of advice more reflective of the cost, there would be a gain in economic efficiency since investors of large sums, who typically value independent advice more than investors of small sums, would be more likely to use this service.

Effect on the regular premium market

25. We do not have evidence that the regular premium market will become unprofitable for advisers, although some advisers are likely to experience short-term cash flow problems. Even if consumers were denied access to the regular premium market, they would switch to alternative products, including potentially advantageous lower cost products, such as Personal Accounts and stakeholder products.

Benefits

26. Discussion Paper 07/01 identified the market failures present in the market for the advised sale of retail investment products. In brief, consumers are at risk of being mis-sold an investment product due to three sources of bias. First, the payment of commission by product providers to advisers can lead to provider bias, where advisers

6 Deloitte (2008), *Costing Intermediary Services* (www.fsa.gov.uk/pubs/other/deloitte_research.pdf).

recommend a provider's products on the basis of commission payments. Secondly, product bias may exist. Some products carry higher commission payments than others, biasing recommendations towards the former types of product. Thirdly, remuneration by commission means that advisers' remuneration is contingent on making a sale. Each source of bias can lead to the consumer not being given a suitable recommendation.

Improved quality of advice

27. The package of RDR proposals is designed to tackle these three sources of bias and lead to consumers receiving better quality advice. The replacement of commission with advisory charges reduces advisers' incentives to recommend a less suitable product with higher commission rather than a more suitable one with lower commission. This should remove the effect of provider bias and mitigate product bias.

28. Independence requirements combined with higher standards of professionalism are also expected to reduce product bias. Independence requirements mean that advisers will be expected to cover a wider range of retail investment products than currently, including substitute products, such as Exchange Traded Funds or national savings and Investment products, which currently carry little or no commission. However, advisers may seek to justify higher adviser charges by recommending more complex products, but we will use improved data collection and outcomes testing to supervise suitability and identify this behaviour. Independence requirements will be reinforced by an enhanced emphasis on ethical standards of behaviour for advisers by the PSB.

29. Supervision of Adviser Charging and ethical standards for members of professional bodies address sales bias. The results from Deloitte's survey indicate that the majority of firms will base fees on a percentage of the consumer's investment. This leads to the potential for sales bias. Even fee-based advisers may find it easier to collect a fee if they recommend that the consumer undertakes a transaction. However, the rules on Adviser Charging (supported by an updated supervisory strategy) will reduce the risk of recommendations being given where the cost of advice is likely to be more than the return. All investment advisers will be expected to adhere to a code of ethical standards. Both of these measures will mitigate sales bias to some extent.

30. The implementation of Adviser Charging, the ban on factoring, and higher standards of professionalism are expected to improve levels of persistency, by removing the incentive for advisers to recommend inappropriately that consumers switch between different products in order to generate income for advisers. Increased persistency is also beneficial to product providers. This is because it lowers the risk of the occurrence of levels of early termination of contracts that impose unexpected costs on product providers. Further, increased persistency is socially beneficial because it reduces the waste of scarce resources on unnecessary transaction costs. In the longer term, to the extent that consumers switch to paying for advice up-front in cash, they will assume persistency risk that is presently borne by product providers.

31. In summary, many consumers are expected to be significantly better off under our proposals because these would improve the quality of advice, reduce the incidence of mis-selling, and lead to increased persistency. These benefits are expected to arise from voluntary compliance with the new rules and greater incentives to comply since it will be easier for the FSA to supervise and enforce standards of suitability. Advisers will be required to adhere to new standards of ethical behaviour and CPD under the supervision of the PSB.[7]

32. These benefits may be very large. For example, even if compliance levels have improved since systematic mortgage endowment and pension mis-selling occurred, total compensation paid to consumers in those cases was £2.7 billion and £11.8 billion respectively, albeit over several years.

33. Whereas increased consumption of resources on compliance is a cost to the economy as a whole, some of the increase in consumer benefit arising from improved suitability is matched by a reduction in supplier profits, as when there is a reduction in churning. On the other hand, some of the increase in consumer benefit will be in the form of the value that consumers place on not being exposed to levels of risk in excess of their risk appetite. This is a gain in economic welfare. Other gains in welfare are possible in the longer term if consumers are able to purchase products of equivalent quality to those currently available but at lower cost.

34. In general, one would expect costs incurred by firms to be passed on to consumers. As demonstrated above, however, there is significant scope for the benefits to consumers of our proposals greatly to exceed the compliance costs.

Improved trust leading to an increase in the number of (appropriate) sales

35. The proposals are expected to improve consumer confidence by removing some negative perceptions of the advisory process, which undermine confidence and often deter people from seeking advice. Consumer research by BMRB Social Research[8] finds trust to be a more important factor than price for selecting an adviser, and that commission damages trust in advisers, when consumers take these payments into consideration. Where a lack of trust exists it means that consumers are unlikely to be willing to accept advisers' recommendations (or even seek financial advice). The behavioural economics literature finds that consumers are strongly averse to the potential of losing what they own; are reluctant to rely on someone else to secure a benefit; and factor in the cost of regretting a decision into their decision-making process. Such is the extent of these behavioural biases, they would be willing to forgo a beneficial opportunity such as an appropriate new investment. Such opportunities are more likely to be foregone in the absence of trust.[9]

7 We will consult separately on standards for ethics and CPD in the fourth quarter of 2009 as part of the PSB consultation.

8 February 2008, BMRB Social Research, Services and Costs Disclosure, FSA Consumer Research Paper 65a (www.fsa.gov.uk/pubs/consumer-research/crpr65a.pdf).

9 De Meza, Irlenbusch, Reyniers (2008), *Financial capability: A Behavioural Economics Perspective*; Harvard Magazine (2006), The Marketplace of Perceptions.

36. Consumer research by Strictly Financial[10] suggests that confidence can be established in advisers through the demonstration of knowledge and qualifications. The research by BMRB Social Research also found that wider scope of advice improves trust. So in the long term, the professionalism and independence proposals, together with the removal of commission payments, should help to improve levels of trust. This means that consumers are more willing to accept recommendations made to them, and that some beneficial transactions take place that would not have taken place under the current regime. In the longer term, this may serve to narrow the savings gap.

Tables of Average Costs per Firm[11 12 13]

Directly Authorised Firms						
	Commission based			Fee based		
One-off costs						
	Small (less than 4 advisers)	Medium (4 to 9 advisers)	Large (more than 10 advisers)	Small (less than 4 advisers)	Medium (4 to 9 advisers)	Large (more than 10 advisers)
Cost per adviser	**£**	**£**	**£**	**£**	**£**	**£**
Professionalism	2,500	2,500	2,500	2,500	2,500	2,500
Cost per firm	**£**	**£**	**£**	**£**	**£**	**£**
IT/Systems changes	1,000	2,000	5,000	1,000	3,000	20,000
Disclosure documents and marketing	2,500	5,000	6,500	3,000	3,500	21,500
Remuneration – devise new tariff	–	500	500	–	500	NA
On-going costs						
Cost per adviser	**£**	**£**	**£**	**£**	**£**	**£**
Disclosure of status	500	500	500	500	500	500
Disclosure of remuneration	500	500	500	500	500	500
Cost per firm	**£**	**£**	**£**	**£**	**£**	**£**
Remuneration – on-going revisions	–	–	–	–	500	NA
Independence: additional search costs	3,000	6,000	11,000	3,500	6,000	5,500

10 November 2008, *Strictly Financial, Assessing investment products*, FSA Consumer Research Paper 73 (www.fsa.gov.uk/pubs/consumer-research/crpr73.pdf).

11 Figures are rounded to the nearest £500. If the estimate is less than £250, it appears as a dash.

12 Source Deloitte (2009) and FSA estimates.

13 These averages are based on firms who would need to make changes to comply with RDR proposals; not all firms need to make each type of change presented in the tables above.

Appointed Representatives			
One-off costs			
	Small (less than 4 advisers)	**Medium (4 to 9 advisers)**	**Large (more than 10 advisers)**
Cost per adviser	**£**	**£**	**£**
Professionalism	2,500	2,500	2,500
Cost per firm	**£**	**£**	**£**
IT/Systems changes	1,000	2,000	5,000
Disclosure documents and marketing	2,500	5,000	6,500
Remuneration – devise new tariff	–	500	500
On-going costs			
Cost per adviser	**£**	**£**	**£**
Disclosure of status	500	500	500
Disclosure of remuneration	500	500	500
Cost per firm	**£**	**£**	**£**
Remuneration – on-going revisions	–	–	–
Independence: additional search costs	1,500	3,000	5,500

Direct Sales Force	
One-off	
Cost per adviser	**£**
Professionalism	£2,500
Cost per firm	**£**
IT/Systems changes	8,000,000
Disclosure documents and marketing	21,000
Remuneration – devise new tariff	12,000
On-going	
Cost per adviser	**£**
Disclosure of status	500
Disclosure of remuneration	500

Product Providers			
	Revenue from Retail Investment Sales Less than £50 million	**Revenue from Retail Investment Sales £50-500 million**	**Revenue from Retail Investment Sales More than £500 million**
IT/Systems changes £	250,000	2,000,000	7,500,000

Annex 3

Timetable for future consultations and implementation

1. Professional standards

2009	• Interested parties can respond to proposals contained within this CP • FSSC consultation on new benchmark exam standards for advisers • Consult on Professional Standards Board (PSB) being set up independently of the FSA	Advisers who are not operating with a Level 4 qualification need to get qualified at the new level
2010	• Policy Statement about move to Level 4 qualifications and basis on which a PSB will be established • New 'RDR compliant' benchmark qualifications become available • Statement on what CPD top up looks like	
2011	–	
2012	To be deemed competent by their employer all existing advisers (as at November 2008) must be qualified at Level 4 by year-end	

2. Remuneration

2009	Interested parties can respond to draft rules contained within this CP
2010	• Policy Statement containing final Handbook text • Consult on changes to regulatory reporting
2011	–
2012	• All advisers must be ready to operate adviser charges by the end of the year • Product providers will be unable to offer products with commission or factoring services by the end of the year • Further tightening up / monitoring of indirect benefits • Data to be collected for first submissions under new regulatory reporting due in 2013 • Revised instructions issued for submitting data to Comparative Tables

3. Independent and non-independent advice services

2009	Interested parties can respond to draft rules contained within this CP
2010	Policy Statement containing final Handbook text, including guidance for firms on new criteria
2011	–
2012	• All advisers must describe their services as independent advice or restricted advice by the end of the year • All independent advisers must comply with the new independence and product requirements

4. Other changes

2009	• Consult on changes to RMAR on PII exclusions and reporting forms • Policy Statement on new prudential rules for Personal Investment Firms • CP on shape of regulation for mortgage market, including possible application of RDR proposals • Consult on changes to GPP rules
2010	• Amendments to RMAR reporting forms implemented • Publish results of analysis and way forward in pure protection market
2011	–
2012	–

Analysis of the general insurance (GI) market

Introduction

1. In this Annex, we consider whether possible changes in behaviour of firms brought about by implementing the RDR proposals in the retail investment market could contribute to market distortions related to pure protection products – in particular, to an increase in unsuitable sales of these products. This is because many retail investment intermediaries also transact pure protection business, and firms can elect whether to sell pure protection products under the COBS or ICOBS rules.

2. We also outline why we are considering what future work we might do in looking at the distribution of protection products other than through retail investment intermediaries.

Overlap in distribution channels

3. In FS08/6, we noted that it is in pure protection markets that consumers are most dependent on advice. For example, nine out of ten critical illness cover (CIC) customers surveyed in 2008 said that they rely on their adviser to recommend the best CIC policy for them.[1] Sales of these products – and of term life insurance – are mainly intermediated sales.[2]

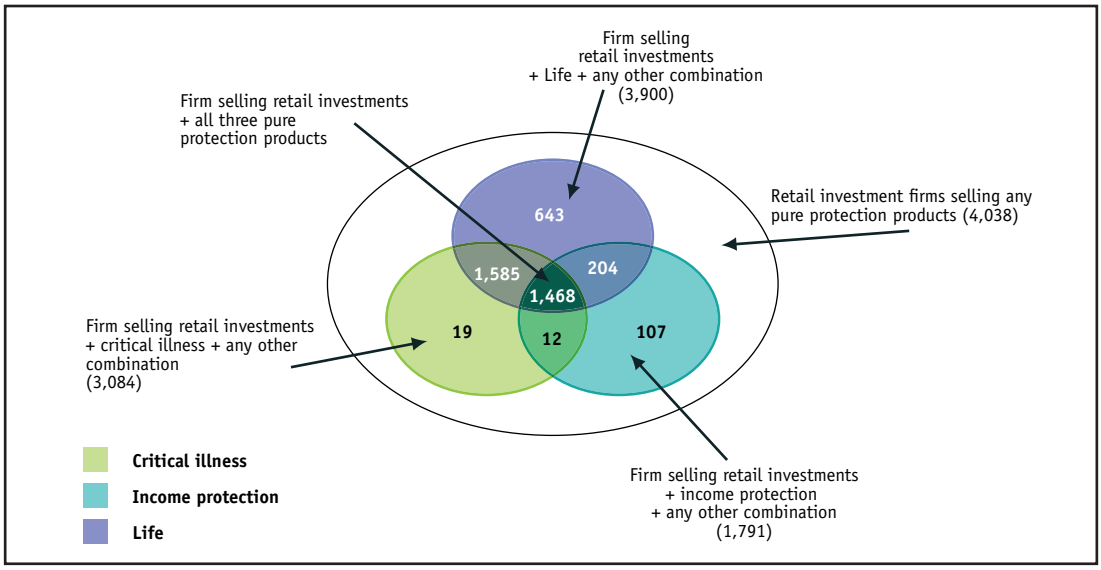
4. Many retail investment intermediaries also transact some (non-investment) pure protection business.[3] For example, in February 2009, our calculations based on RMAR data received by us, showed that approximately 4,000 of 4,539 (or 88% of) authorised retail investment intermediaries sold one or more kinds of pure protection products (critical illness, life assurance, and/or income protection). As Figure 1 shows, life insurance was the pure protection product sold by the largest number of retail investment firms, then critical illness, and income protection by fewer firms.

1 April 2009, FSA Consumer Research Paper 77, Post implementation review of ICOBS: Oral Disclosure Rule in sales of Critical Illness Cover – baseline survey (page 53) (www.fsa.gov.uk/pubs/consumer-research/crpr77.pdf).

2 February 2009, Mintel, Critical Illness Cover (CIC) report - Finance Intelligence. This report noted that direct sales of CIC are rare. This reflects the complex nature of the product and that it is generally sold and not bought.

3 On average, general insurance business (largely pure protection) represented approximately 20% of retail intermediaries' income, and approximately 90% of this general insurance income was net commission. This is based on FSA calculations using RMAR data (February 2009). Note: firms' reporting periods are determined by their Accounting Reference Dates (ARDs). ARDs vary for different firms. So the majority of the returns in this dataset was submitted in 2008 for the preceding financial year.

Figure 1: Number of retail investment intermediaries selling different pure protection products

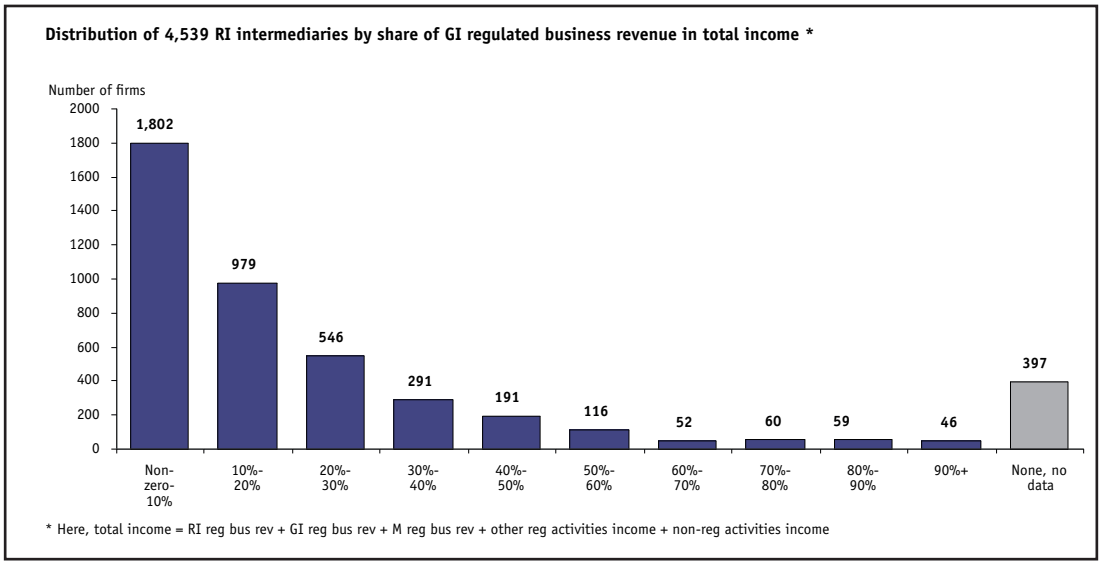


Source: FSA calculations based on RMAR data, February 2009

5. Of the retail investment intermediaries who offer any of these three pure protection products, the average share of total business income from retail investment was 64%; from general insurance it was 18%; and from mortgage business it was 11%. The remaining 7% was from 'other activities'.

6. Our calculations also indicated that for the majority of retail intermediaries (2,800 firms, or 62%), pure protection[4] contributes less than 20% of total income; and that around 500 firms (or 12%) receive over 40% of income from pure protection.

Figure 2: Distribution of income from pure protection (plus limited other GI business)



Source: FSA calculations based on RMAR data, February 2009

4 Figures in this paragraph are for pure protection plus a limited amount of other GI business transacted by retail investment advisers.

7. For the 4,038 authorised retail investment intermediaries that sell any of the protection products, 91% of income from the sales of GI (including pure protection products) is from net commission. 86% of income from investment is from net commission.[5] Fee income was only 3% of income from general insurance sales, as opposed to 8% of income from retail investment sales. Some commentators[6] have expressed concern that a fee-based model is unlikely to be viable for pure protection products. They argue that this is because consumers would be unwilling to pay on a fee basis for protection advice.

8. Firms selling pure protection products do so under the ICOBS sourcebook by default, but our rules allow firms to elect to sell these products in accordance with the COBS sourcebook instead of ICOBS (and to reverse that election later). FSA rules require records of the election (and any reversal) to be kept in a durable medium so that the basis for any sale is clear, but we do not collect this information centrally. According to an informal AIFA survey of some of its members (in late 2008), it appears that approximately 40% of pure protection sales by retail intermediaries is under ICOBS, and 60% is under COBS. We would want to maintain this choice, unless there are strong reasons for removing it.

Risks to consumers in pure protection markets from firms' response to RDR

9. The proposed remuneration structure for sale of retail investment products could mean significant changes to cash-flows for retail investment advisers. Firms that currently receive up-front indemnity commission on a retail investment product in the form of a lump sum for a period of five years (for example) would, under RDR proposals, face changes. Any ongoing adviser charges would be received by the firm when they were paid, not up-front.

10. Were there to be no change in the regulation of sales of pure protection products by retail investment intermediaries, this could act as an incentive for some firms to shift their sales focus to pure protection products. This could arise if they believe that (i) their income from investment business may fall owing to the introduction of fee-based charging, or (ii) the up-front commission income from commission on sale of pure protection products is highly attractive given an expected reduction in up-front investment business income from switching away from commission.

11. If advisers perceive protection as being a more attractive market in which to operate, then we consider that the nature of consumers' needs and of the transaction between consumers and advisers is such that advisers have considerable discretion to direct sales conversations with consumers increasingly towards protection products, rather than towards investments.

5 FSA calculations based on February 2009 RMAR data. Note: Firms' reporting periods are determined by their ARDs. ARDs vary for different firms. So the majority of the returns in this dataset was submitted in 2008 for the preceding financial year.

6 December 2008, LifeSearch Bulletin, *"… there is no chance at all that protection can be widely sold on a fee basis"*; and 2004, The Insurance Report, Swiss Re Life & Health (pages 84 and 85).

12. We are clear that an increase in the number of advisers offering pure protection is not a concern in itself. Indeed, an increase in good quality advice being offered on protection needs is likely to be beneficial for many consumers for whom additional purchases of pure protection products may be good choices.

13. However, where we would be concerned is where such a shift in focus could have the effect of increasing sales of protection products that did not reflect a proper assessment of the suitability to consumers' needs, but was instead driven by a change in the relative financial rewards to the adviser.

14. Attaining the higher professionalism required under our proposals to sell investment products would require significant investment by many intermediaries. We would be concerned where pure protection products were being offered by some advisers who exit the investments market to avoid the need to invest in developing their expertise. The consequences here could be similar to those described above, with the pure protection market attracting a disproportionate number of advisers who are focused on maintaining commission income, or who are unwilling to invest in further professional development, or both. A similar effect could apply from firms not wishing to meet new standards for the provision of independent investment advice, although risks here seem less clear.

15. Other potential forms of arbitrage relating to specialisation within intermediary firms seem to create less risk for consumer outcomes. A firm may decide that it will expect only certain advisers to meet the new higher professionalism standards, while others could specialise in pure protection advice under ICOBS. A further possibility would be the setting up of separate legal entities to handle pure protection business within retail investment firms – this could also mean that such firms would not be subject to the proposed new capital requirements set out in CP08/20. None of this is necessarily a problem, provided that the full range of consumers' needs are still properly considered.

Conclusion

16. The analysis above shows the extent of the overlap in distribution channels for sales of investment and pure protection products. Our initial view is that unless we act to limit potential material risks to consumers, potential distortions in advice relating to pure protection products may arise. These potential distortions may arise from:

- the pure protection market attracting a disproportionate number of investment advisers who would like to maintain commission-based sales, and who may be unwilling to invest in further professional development (in turn, this could affect standards, and ultimately lead to poor consumer outcomes); and
- a continuous incentive for advisers, when giving holistic advice, to focus on pure protection products on which product providers advance commission up-front, instead of investment products that do not, at the expense of balanced assessments of suitability for their clients (it would be difficult for the FSA or any third party to identify such a marginal shift, since there is no reason why decisions of this nature would be recorded).

Next steps

17. These risks seem sufficient for us to need to review closely whether changes are needed in our regulatory approach to pure protection markets to ensure new forms of consumer detriment do not arise from firms' responses to the implementation of RDR in investment markets.

18. Our 2006-2007 ICOB Review focused on identifying and remedying the causes of consumer detriment (at point of sale) from inappropriate purchases. New rules were introduced for the sale of pure protection products, including rules focusing on the quality and balance of oral disclosure and requiring firms to clarify the implications of non-advised sales. However, the scope of that review did not include the nature of remuneration, the scope of advice, or any case for restrictions on non-advised sales for pure protection products. We also did not consider in detail whether to bring forward proposals for specific qualification requirements for the sale of protection products when sold under ICOBS in order to achieve higher standards of professionalism.

19. The progress of the RDR puts us in a stronger position to review our regulatory approach to how protection needs are met in consumers' transactions with retail investment firms. We are not bringing forward any proposals for the sale of pure protection products at this stage, but will take account of comments and evidence provided by respondents to this CP. Our ICOBS work programme does not imply that the sale of pure protection products by retail investment firms should be treated in the same way as the sale of investment products. In the first quarter of 2010, we will publish the results of our analysis and our proposals for taking our agenda forward for the sale of pure protection products by retail investment firms, with a timetable for consultation and implementation. We are conscious that many retail investment firms need clarity on this as they consider their responses to our RDR proposals.

20. To assist us with our analysis, we would welcome evidence that will help us test and develop our initial view on the nature and materiality of risks to consumers under a scenario where the RDR proposals are implemented for the sale of retail investment products but there is no regulatory action on the sale of pure protection products.

Widening the analysis

21. Whilst the most pressing questions we need to address relate to pure protection sold by retail investment intermediaries, we are considering the extent to which we will need to look at distribution of protection products other than through retail investment intermediaries. We recognise that pure protection products sold by retail investment intermediaries are only one way that consumers' protection needs are met. For example, mortgage intermediaries are another important sales channel for pure protection products and given our Mortgage Market Review work, we need to ensure we have a coherent framework for products sold alongside mortgages that works for consumers and firms.

22. We consider PPI to be integral to any wider analysis of how consumer protection needs are met. PPI products are sold – and have too often been sold badly – as meeting consumers' protection needs. We do not consider that there are separate underlying consumer demands for pure protection and for payment protection policies.[7] Instead, the impact on pure protection sales of credit providers' focus on PPI sales is likely to have been complex and powerful.

23. We are conscious that the dynamics relating to group sales are significantly different from those in sales of individual policies. The organisations that purchase group policies have complex needs and may either possess or buy in specialist expertise to assist their choices of provider. This initial analysis has not considered the implications of the RDR for sales of group protection policies, but we recognise that many pure protection policyholders have group cover (for example, 50% of income protection). We will speak separately with key stakeholders in this group market.[8]

7 April 2009, The Income Protection Task Force: White Paper II.

8 Products sold on a group, rather than on an individual basis. For example, where policyholders get critical illness cover through their employer's group policy.

Annex 5

List of questions

Q1: Do you agree with our proposal to widen the range of products to which the new independence standard will apply?

Q2: Do you agree with our proposals for a new standard for independence that requires firms providing independent advice to make recommendations based on a comprehensive and fair analysis of the relevant market, and to provide unbiased and unrestricted advice?

Q3: Do you agree with our proposals for new disclosure requirements for firms?

Q4: Do you think we should introduce a mandatory form of words for firms to use when explaining restricted advice? What might this look like?

Q5: What are your views on removing this GPP exemption?

Q6: Do you agree that we should not create a new regime for simplified advice processes, but continue to work as needed with firms and the industry?

Q7: Do you agree that the professional standards set out in Chapter 5 should also apply to simplified advice processes?

Q8: Do you agree that we should retain Basic Advice, and require those offering Basic Advice to disclose that they are providing restricted advice?

Q9: Do you agree with our proposals on Adviser Charging for firms that give advice?

Q10: Do you agree with our proposals on Adviser Charging for product providers?

Q11: Do you agree with our proposals on Adviser Charging for vertically-integrated firms?

Q12: Do you agree with our proposals on the disclosure of adviser charges?

Q13: What approach should we take to the remuneration of individuals giving investment advice?

Q14: Do you agree that Adviser Charging should be applied where individual advice is given on GPPs? Do you think that the principles of Adviser Charging should be applied to non-advised GPP business, and if so how?

Q15: Do you think changes are needed to the way that we regulate wrap platforms and fund supermarkets?

Q16: Do you think that the principles of Adviser Charging, or any other alternative approaches to remuneration, should be applied to non-advised services?

Q17: What are your views on this model Code of Ethics as the basis for further PSB/FSA consideration and consultation?

Q18: Do you have any comments on this approach to CPD for investment advisers, including comments on any changes that it would involve to current practices?

Q19: What consumer detriment, if any, would arise if we implemented the RDR proposals for the sale of retail investment products and took no action on regulating the sale of pure protection products under ICOBS by retail investment firms? We would welcome any evidence on this.

Q20: Do you have any comments on the cost benefit analysis?

Appendix A

Draft Handbook text

[RETAIL DISTRIBUTION REVIEW INSTRUMENT 2010]

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making power);
(b) section 145 (Financial promotion rules);
(c) section 156 (General supplementary powers); and
(d) section 157(1) (Guidance); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [xxxx].

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the [Retail Distribution Review Instrument 2010].

By order of the Board
[date]

Annex A

Amendments to the Glossary

In this Annex, underlining indicates new text and striking through indicates deleted text unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

adviser charge	any form of charge payable by or on behalf of a *retail client* to a *firm* in relation to the provision of a *personal recommendation* by the *firm* in respect of a *retail investment product* (or any related service provided by the *firm*) which is agreed between that *firm* and the *retail client* in accordance with the *rules* on *adviser charging and remuneration* (*COBS* 6.1A).	
independent advice	a *personal recommendation* to a *retail client* in relation to a *retail investment product* where the *personal recommendation* provided meets the requirements of the *rule* on independent advice (*COBS* 6.2A.3R).	
restricted advice	(a)	a *personal recommendation* to a *retail client* in relation to a *retail investment product* which is not *independent advice*; or
	(b)	*basic advice*.
retail investment product	(a)	a *life policy*; or
	(b)	a *unit*; or
	(c)	a *stakeholder pension scheme*;
	(d)	a *personal pension scheme*;
	(e)	an interest in an *investment trust savings scheme*;
	(f)	a *security* in an *investment trust*;
	(g)	any other *designated investment* which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in the financial asset;
	(h)	a *structured capital-at-risk product*;
	whether or not any of (a) to (h) are held within an *ISA* or a *CTF*.	

Amend the following definitions as shown.

combined initial disclosure document	information about the breadth of *advice*, *scope of advice* or *scope of basic advice* and the nature and costs of the services offered by a *firm* in relation to two or more of the following: (a) *packaged products* or, for *basic advice*, *stakeholder products*; (b) *non-investment insurance contracts*; (c) *regulated mortgage contracts* other than *lifetime mortgages*; (d) *home purchase plans*; (e) *equity release transactions*; which contains the keyfacts logo, headings and text in the order shown in, and in accordance with the notes in, *COBS* 6 Annex 2.
services and costs disclosure document	information about the ~~*scope of advice*~~ breadth of *advice* or *scope of basic advice* and the nature and costs of the services offered by a *firm* as described in *COBS* 6.3.7G, which contains the keyfacts logo, headings and text described in *COBS* 6 Annex 1G.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text unless otherwise stated.

2.2.-1 R (1) …

(2) This section applies in relation to other *designated investment business* carried on for a *retail client*:

(a) …

(b) in relation to a ~~*packaged product*~~ *retail investment product*, but as regards the matters in *COBS* 2.2.1R (1)(a) and (d) only.

…

2.3.1 R A *firm* must not pay or accept any fee or commission, or provide or receive any non-monetary benefit, in relation to *designated investment business* or, in the case of its *MiFID or equivalent third country business*, another *ancillary service*, carried on for a *client* other than:

(1) …

(2) a fee, commission or non-monetary benefit paid or provided to or by a third party or a *person* acting on behalf of a third party, if:

(a) …

(b) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, is clearly disclosed to the *client*, in a manner that is comprehensive, accurate and understandable, before the provision of the service;

(i) this requirement only applies to business other than *MiFID or equivalent third country business* if it includes giving a *personal recommendation* in relation to a ~~*packaged product*~~ *retail investment product*;

…

(c) in relation to *MiFID or equivalent third country business* or when carrying on a *regulated activity* in relation to a *retail investment product*, the payment of the fee or commission, or the provision of the non-monetary benefit is designed to

enhance the quality of the service to the *client*.

…

…

2.3.6A G *COBS* 6.1A (Adviser charging and remuneration) and *COBS* 6.1B (Product provider requirements relating to adviser charging and remuneration) set out specific requirements as to when it is acceptable for a *firm* to pay or receive commissions, fees or other benefits relating to the provision of a *personal recommendation* on *retail investment products*.

…

~~Packaged products evidential provisions and guidance on inducements~~ Paying commission on non-advised sales of packaged products

2.3.9 G The following *guidance* and *evidential provisions* provide examples of arrangements the *FSA* believes will breach the *client's best interests rule* if ~~it~~ a *firm* sells~~, *personally recommends*~~ or arranges the sale of a *packaged product* for a *retail client*.

…

Providing credit and other benefits to firms that advise on retail investment products

2.3.11A G The following *guidance* and *evidential provisions* provide examples of arrangements the *FSA* believes will breach the *client's best interests rule* in relation to a *personal recommendation* of a *retail investment product* to a *retail client*.

2.3.12 E (1) This *evidential provision* applies in relation to a holding in, or the provision of *credit* to, a *firm* which holds itself out as making *personal recommendations* to *retail clients* on ~~*packaged products*~~ *retail investment products*, except where the relevant transaction is between *persons* who are in the same *immediate group*.

(2) A ~~*product provider*~~ *retail investment product* provider should not take any step which would result in it:

(a) …

(b) providing *credit* to a *firm* in (1) (other than ~~*commission* due from the *firm* to the *product provider* in accordance with an indemnity *commission* clawback arrangement~~ continuing to facilitate the payment of an *adviser charge* where it is no longer payable by the *retail client*, as described in *COBS* 6.1A.5G);

unless all the conditions in (4) are satisfied. A ~~*product provider*~~ *retail investment product* provider should also take reasonable steps to

ensure that its *associates* do not take any step which would result in it having a holding as in (a) or providing *credit* as in (b).

(3) A *firm* in (1) should not take any step which would result in a ~~*product provider*~~ *retail investment product* provider having a holding as in (2)(a) or providing *credit* as in ~~paragraph~~ (2)(b), unless all the conditions in (4) are satisfied.

(4) The conditions referred to in (2) and (3) are that:

(a) the holding is acquired, or *credit* is provided, on commercial terms, that is terms objectively comparable to those on which an independent *person* unconnected to a ~~*product provider*~~ *retail investment product* provider would, taking into account all relevant circumstances, be willing to acquire the holding or provide credit;

(b) …

(c) there are no arrangements, in connection with the holding or *credit*, relating to the channelling of business from the *firm* in (1) to the ~~*product provider*~~ *retail investment product* provider; and

(d) the ~~*product provider*~~ *retail investment product* provider is not able, and none of its *associates* is able, because of the holding or *credit*, to exercise any influence over the *personal recommendations* made in relation to ~~*packaged products*~~ *retail investment products* given by the *firm*.

(5) In this *evidential provision*, in applying (2) and (3) any holding of, or *credit* provided by, a ~~*product provider's*~~ *retail investment product* provider's *associate* is to be regarded as held by, or provided by, that ~~*product provider*~~ *retail investment product* provider.

(6) ~~In this *evidential provision*, in applying (3) references to a "*product provider*" are to be taken as including an unauthorised equivalent of a *product provider*; that is, an unauthorised *insurance undertaking* or an unauthorised *operator* of a *regulated collective investment scheme* or of an *investment trust savings scheme*;~~ [deleted]

(7) …

2.3.12A G Where a *retail investment product* provider, or its *associate*, provides *credit* to a *retail client* of a *firm* making *personal recommendations* in relation to *retail investment products*, this may create an indirect benefit for the *firm* and, to the extent that this is relevant, the provider of *retail investment products* may need to comply with *COBS* 2.3.12E as if it had provided the *credit* to the *firm*.

…

2.3.14 G (1) In relation to the sale of ~~*packaged products*~~ *retail investment products*, the table on reasonable non-monetary benefits (*COBS* 2.3.15G) indicates the kind of benefits which are capable of enhancing the quality of the service provided to a *client* and, depending on the circumstances, are capable of being paid or received without breaching the *client's best interests rule*. However, in each case, it will be a question of fact whether these conditions are satisfied.

(2) The *guidance* in the table on reasonable non-monetary benefits is not relevant to non-monetary benefits which may be given by a ~~*product provider*~~ *retail investment product* provider or its *associate* to its own *representatives*. The *guidance* in this provision does not apply directly to non-monetary benefits provided by a *firm* to another *firm* that is in the same *immediate group*. In this situation, the *rules* on *commission equivalent* (*COBS* 6.4.3R) or the requirements on a product provider making a *personal recommendation* in respect of its own *retail investment products* (*COBS* 6.1A.9R) will apply.

Reasonable non-monetary benefits

2.3.15 G This table belongs to *COBS* 2.3.14G

Reasonable non-monetary benefits		
	Gifts, Hospitality and Promotional Competition Prizes	
1	A ~~*product provider*~~ *retail investment product* provider giving and a *firm* receiving gifts, hospitality and promotional competition prizes of a reasonable value.	
	Promotion	
2	A ~~*product provider*~~ *retail investment product* provider assisting another *firm* to promote its ~~*packaged products*~~ *retail investment products* so that the quality of its service to *clients* is enhanced. Such assistance should not be of a kind or value that is likely to impair the recipient *firm's* ability to pay due regard to the interests of its *clients*, and to give advice on, and recommend, ~~*packaged products*~~ *retail investment products* available from the recipient *firm's* whole *range* or *ranges*.	
	Joint marketing exercises	
3	A ~~*product provider*~~ *retail investment product* provider providing generic product literature (that is, letter heading, leaflets, forms and envelopes) that is suitable for use and distribution by or on behalf of another *firm* if:	
	(a)	the literature enhances the quality of the service to the *client* and is not primarily of promotional benefit to the ~~*product*~~

		~~*provider*~~ *retail investment product* provider; and
	(b)	…
4	A ~~*product provider*~~ *retail investment product* provider supplying another *firm* with 'freepost' envelopes, for forwarding such items as completed applications, medical reports or copy client agreements.	
5	A ~~*product provider*~~ *retail investment product* provider supplying product specific literature (for example, *key features documents*, minimum information) to another *firm* if:	
	(a)	…
	(b)	…
6	A ~~*product provider*~~ *retail investment product* provider supplying draft articles, news items and *financial promotions* for publication in another *firm's* magazine, only if in each case any costs paid by the *product provider* for placing the articles and *financial promotions* are not more than market rate, and exclude distribution costs.	
	Seminars and conferences	
7	A ~~*product provider*~~ *retail investment product* provider taking part in a seminar organised by another *firm* or a third party and paying toward the cost of the seminar, if:	
	(a)	…
	(b)	…
	Technical services and information technology	
8	A ~~*product provider*~~ *retail investment product* provider supplying a 'freephone' link to which it is connected.	
9	A ~~*product provider*~~ *retail investment product* provider supplying another *firm* with any of the following:	
	(a)	quotations and *projections* relating to its ~~*packaged products*~~ *retail investment products* and, in relation to specific *investment* transactions (or for the purpose of any scheme for review of past business), advice on the completion of forms or other *documents*;
	(b)	access to data processing facilities, or access to data, that is related to the ~~*product provider's*~~ *retail investment product* provider's business;
	(c)	access to third party electronic dealing or quotation systems that are related to the ~~*product provider's*~~ *retail investment*

			product provider's business; and
	(d)		software that gives information about the ~~*product provider's*~~ *retail investment product* provider's ~~*packaged products*~~ *retail investment products* or which is appropriate to its business (for example, for use in a scheme for review of past business or for producing *projections* or technical product information).
10	A ~~*product provider*~~ *retail investment product* provider paying cash amounts or giving other assistance to a *firm* not in the same *immediate group* for the development of software or other computer facilities necessary to operate software supplied by the ~~*product provider*~~ *retail investment product* provider, but only to the extent that by doing so it will generate equivalent cost savings to itself or *clients*.		
11	A ~~*product provider*~~ *retail investment product* provider supplying another *firm* with information about sources of mortgage finance.		
12	A ~~*product provider*~~ *retail investment product* provider supplying another *firm* with generic technical information in writing, not necessarily related to the *product provider's* business, when this information states clearly and prominently that it is produced by the *product provider* or (if different) supplying *firm*.		
	Training		
13	A ~~*product provider*~~ *retail investment product* provider providing another *firm* with training facilities of any kind (for example, lectures, venue, written material and software).		
	Travel and accommodation expenses		
14	A ~~*product provider*~~ *retail investment product* provider reimbursing another *firm's* reasonable travel and accommodation expenses when the other *firm*:		
	(a)	participates in market research conducted by or for the ~~*product provider*~~ *retail investment product* provider;	
	(b)	attends an annual national event of a *United Kingdom* trade association, hosted or co-hosted by the ~~*product provider*~~ *retail investment product* provider;	
	(c)	participates in the ~~*product provider's*~~ *retail investment product* provider's training facilities (see 13);	
	(d)	visits the ~~*product provider's*~~ *retail investment product* provider's *United Kingdom* office in order to:	

		(i)	receive information about the ~~*product provider's*~~ *retail investment product* provider's administrative systems; or
		(ii)	attend a meeting with the ~~*product provider*~~ *retail investment product* provider and an existing or prospective *client* of the receiving *firm*.

2.3.16 G In interpreting the table of reasonable non-monetary benefits, ~~*product providers*~~ *retail investment product* providers should be aware that where a benefit is made available to one *firm* and not another, this is more likely to impair compliance with the *client's best interests rule* and that, where any benefits of substantial size or value (such as adviser training programmes or significant software) are made available to *firms* that are subject to the *rules* on adviser charging and remuneration (*COBS* 6.1A), these benefits should be made available commonly across such *firms* if they are provided at all.

2.3.16A G In interpreting the table of reasonable non-monetary benefits, a *firm* that provides a *personal recommendation* of a *retail investment product* to a *retail client* should be aware that acceptance of benefits on which the *firm* will have to rely is more likely to impair compliance with the *client's best interests rule*. For example, acceptance of software on which the *firm* will need to depend for services such as portfolio planning or customer relationship management would be likely to conflict with the *rule* on *inducements* (*COBS* 2.3.1R).

After COBS 6.1 insert the following new sections. The text is not underlined.

6.1A Adviser charging and remuneration

Application – Who? What?

6.1A.1 R This section applies to a *firm* which makes a *personal recommendation* to a *retail client* in relation to a *retail investment product*.

6.1A.2 R This section does not apply to a *firm* when it gives *basic advice* in accordance with the *basic advice rules*.

Application – Where?

6.1A.3 R This section does not apply if the *retail client* is outside the *United Kingdom*.

Requirement to be paid through adviser charges

6.1A.4 R A *firm* must:

(1) only be remunerated for the *personal recommendation* (and any other related services provided by the *firm*) by *adviser charges*; and

(2) not solicit or accept (and ensure that none of its *associates* solicits or accepts) any other commissions, remuneration or benefit of any kind in relation to the *personal recommendation* (or any other related service), regardless of whether it intends to refund the payments or pass the benefits on to the *retail client*.

6.1A.5 G A *firm* may receive an *adviser charge* that is no longer payable (for example, after the service it is received in payment for has been amended or terminated) provided the *firm* refunds any such payments to the client.

6.1A.6 G Services related to the *personal recommendation* may include, but are not limited to, *arranging* the transaction and conducting administrative tasks associated with it.

6.1A.7 G The requirement to be paid through *adviser charges* does not prevent a *firm* from making use of any facility for the payment of *adviser charges* on behalf of the *retail client* offered by another *firm* or other third parties provided that the use of that facility is in accordance with the *rules*.

6.1A.8 G Examples of payments and benefits that should not be accepted under the requirement to be paid through *adviser charges* include:

(1) a share of the *retail investment product* charges or *retail investment product* provider's revenues or profits (except where the *firm* providing the *personal recommendation* is the *retail investment product* provider); and

(2) a commission set and payable by an overseas firm that is not itself subject to the *rules* on product provider requirements relating to adviser charging and remuneration (*COBS* 6.1B).

Requirements on a product provider making a personal recommendation in respect of its own retail investment products

6.1A.9 R If the *firm* or its *associate* is the *retail investment product* provider, the *firm* must ensure that the level of its *adviser charges* is at least reasonably representative of the services associated with making the *personal recommendation* (and related services).

6.1A.10 G In determining representative *adviser charges* a *firm* should take into consideration the following factors:

(1) the separation of the expected long term costs associated with making a *personal recommendation* and distributing the *retail investment product* and the costs associated with manufacturing and administering the *retail investment product*;

(2) the allocation of costs and profit to *adviser charges* and product charges such that any cross-subsidisation is immaterial; and

(3) the appropriateness of the level of *adviser charges* and product

charges set if the *personal recommendation* and any related services were provided by an unconnected *firm*.

Requirement to use a charging structure

6.1A.11 R A *firm* must determine and use an appropriate charging structure for calculating its *adviser charge* for each *retail client*.

6.1A.12 G A *firm* can use a standard charging structure.

6.1A.13 G In determining its charging structure and *adviser charges* a *firm* should have regard to its duties under the *client's best interest rule*. Practices which may indicate a *firm* is not in compliance with this duty include:

(1) varying its *adviser charges* inappropriately according to provider or, for substitutable and competing *retail investment products*, the type of *retail investment product*; or

(2) allowing the availability or limitations of services offered by third parties to facilitate the payment of *adviser charges* to influence inappropriately its charging structure or *adviser charges*.

6.1A.14 G (1) In order to comply with the *clear, fair and not misleading rule*, a *firm* should not use a charging structure that would conceal the amount or purpose of any of its *adviser charges* from a *retail client*.

(2) A *firm* is likely to be viewed as operating a charging structure that conceals the amount or purpose of its *adviser charges* if it makes arrangements for amounts in excess of its *adviser charges* to be deducted from a *retail client's* investments from the outset, in order to be able to provide a cash refund to the *retail client* later.

Initial information for clients on the cost of adviser services

6.1A.15 R A *firm* must disclose its charging structure to a *retail client* in writing, in good time before making the *personal recommendation* (or providing related services).

6.1A.16 G A *firm* may wish to consider disclosing as its charging structure a list of the advisory services offered by the *firm* with the associated indicative charges which will be used for calculating the *adviser charge* for each service.

6.1A.17 G In order to meet the requirement in the *rule* on information disclosure before providing services (*COBS* 2.2.1R), a *firm* should ensure that the disclosure of its charging structure is in clear and plain language and, as far as is practicable, uses cash terms. Where a *firm's* charging structure is in non-cash terms, examples in cash terms should be used to illustrate how the charging structure will be applied in practice.

6.1A.18 G A *firm* is unlikely to meet its obligations under the *clear, fair and not misleading rule* and the *client's best interest rule* unless it ensures that;

(1) the charging structure it discloses reflects, as closely as is practicable, the total *adviser charge* to be paid. For example, the *firm* should avoid using a wide range; and

(2) if using hourly rates in its charging structure, it states whether the rates are indicative or actual hourly rates, provides the basis (if any) upon which the rates may vary and provides an approximate indication of the number of hours that the provision of each service is likely to require.

6.1A.19 G A firm may meet the disclosure requirements in this section by using a *services and costs disclosure document* or a *combined initial disclosure document* (*COBS* 6.3 and *COBS* 6 Annex 1G or *COBS* 6 Annex 2).

On-going payment of adviser charges

6.1A.20 R A *firm* must not use an *adviser charge* which is structured to be payable by the *retail client* over a period of time unless:

(1) the *adviser charge* is in respect of an ongoing service for the provision of *personal recommendations* or related services and the *firm* has disclosed that service along with the *adviser charge*; or

(2) the *adviser charge* relates to a *retail investment product* to which the *retail client* has contracted to contribute to regularly over a period of time and the *firm* has disclosed that no ongoing *personal recommendations* or service will be provided.

Disclosure of total adviser charges payable

6.1A.21 R (1) A firm must agree with and disclose to a *retail client* the total *adviser charge* payable to it or any of its *associates* by a *retail client*.

(2) A disclosure under this section must:

(a) be in cash terms (or convert non-cash terms into illustrative cash equivalents);

(b) be as early as practicable;

(c) be in a *durable medium* or through a website (where it does not constitute a *durable medium*) where the *website conditions* are satisfied; and

(d) where there are payments over a period of time, include the amount and frequency of each payment due, the period over which the *adviser charge* is payable and the implications for the *retail client* if the *retail investment product* is cancelled before the *adviser charge* is paid and, where there is no ongoing service, the sum total of all payments.

6.1A.22 G A *firm* may include the information required by the *rule* on disclosure of total adviser charge (*COBS* 6.1A.21R) in a *suitability report* or a *key features illustration*.

6.1A.23 G A *firm* would be unlikely to comply with the *rule* on disclosure of total adviser charge (*COBS* 6.1A.21R) and the *clear, fair and not misleading rule* if its disclosure of the total *adviser charge* did not:

(1) provide information to the *retail client* as to which particular service an *adviser charge* applied to;

(2) include information as to when payment of the *adviser charge* is due;

(3) inform the *retail client* if the total *adviser charge* varies materially from the charge indicated for that service in the *firm's* charging structure; and

(4) where an ongoing *adviser charge* is expressed as a percentage of funds under management, clearly reflect in the disclosure how that *adviser charge* may increase as the fund grows, for example by illustrating the *adviser charge* assuming a fund growth rate which is consistent with an *intermediate rate of return*.

Record-keeping

6.1A.24 R A *firm* must keep a record of:

(1) its charging structure; and

(2) the total *adviser charge* payable by each *retail client*;

(3) where the total *adviser charge* paid by a *retail client* has varied materially from the charge indicated for that service in the *firm's* charging structure and the reasons for that difference.

6.1B Product provider requirements relating to adviser charging and remuneration

Application – Who? What?

6.1B.1 R This section applies to a *firm* which is a *retail investment product* provider in circumstances where a *retail client* receives a *personal recommendation* in relation to the *firm's retail investment product*.

6.1B.2 R This section does not apply to a *firm* when a *retail client* receives *basic advice* in accordance with the *basic advice rules*.

6.1B.3 G This section applies to a *firm* when it makes a *personal recommendation* on a *retail investment product* and where a *retail investment product* for which

it is the *retail investment product* provider is the subject of a *personal recommendation* made by another *firm*.

Application – Where?

6.1B.4 R This section does not apply if the *retail client* is outside the *United Kingdom*.

Requirement not to offer commissions

6.1B.5 R A *firm* must not offer or pay (and must ensure that none of its *associates* offer or pay) any commissions, remuneration or benefit of any kind to another *firm*, or to any other third party for the benefit of that *firm*, in relation to a *personal recommendation* (or any related services), except those that facilitate the payment of *adviser charges* from a *retail client's* investments in accordance with this section.

6.1B.6 G The requirement not to offer or pay commission does not prevent a *firm* from making a payment to a third party in respect of administration or other charges incurred, for example a payment to a fund supermarket or a third party administrator.

Distinguishing product charges from adviser charges

6.1B.7 R A *firm* must:

(1) take reasonable steps to ensure that its *retail investment product* charges are not structured so that they could mislead or conceal from a *retail client* the distinction between those charges and any *adviser charges* payable in respect of its *retail investment products*; and

(2) not include in any marketing materials in respect of its *retail investment products* or facilities for collecting *adviser charges* any statements about the appropriateness of levels of *adviser charges* that a *firm* could charge in making *personal recommendations* or providing related services in relation to its *retail investment products*.

6.1B.8 G A practice that would be likely to breach the *rule* on distinguishing product charges from adviser charges (*COBS* 6.1B.7R(1)) would be deferring or discounting product charges so that the product charge could appear to offset any *adviser charges* that are payable, for example by offering to invest more than 100% of the *retail client's* investment.

Requirements on firms facilitating the payment of adviser charges

6.1B.9 R A *firm* that offers to facilitate, directly or through a third party, the payment of *adviser charges* from a *retail client's retail investment product* must:

(1) obtain and validate instructions from a *retail client* in relation to an *adviser charge*;

(2) monitor the effect on the *firm's retail investment product* of levels of *adviser charges*;

(3) offer sufficient flexibility in terms of the *adviser charges* it facilitates; and

(4) not pay out or advance *adviser charges* to the *firm* to which the *adviser charge* is owed over a materially different time period, or on a materially different basis to that in which it recovers the *adviser charge* from the *retail client* (including paying any *adviser charges* to the *firm* that it cannot recover from the *retail client*).

6.1B.10 G A *firm* that offers to facilitate the payment of *adviser charges* should consider whether its arrangements for monitoring the effect of *adviser charges* on each *retail investment product* are sufficient to enable it to meet its responsibilities under the *clients' best interests rule* and *Principle* 6 (Customers' Interests). A *firm* may wish to consider, for example, the extent to which product stress testing suggests that a *retail investment product* can continue to perform as it was designed if particularly high levels of *adviser charges* are deducted from it.

6.1B.11 G A *firm* should consider whether the flexibility in levels of *adviser charges* it offers to facilitate is sufficient so as not to unduly influence or restrict the charging structure and *adviser charges* that the *firm* providing the *personal recommendation* or related services can use.

6.1B.12 G The requirement in the *rule* on requirements on firms facilitating the payment of adviser charges (*COBS* 6.1B.9R(4)) does not prevent a *firm* from entering into an agreement with another *firm* which is providing a *personal recommendation* to a *retail client*, or with a *retail client* of such a *firm*, to provide it with *credit* separately in accordance with the *rules* on providing credit and other benefits to *firms* that advise on *retail investment products* (*COBS* 2.12 and 2.12A).

Delete COBS 6.2 in its entirety. The deleted text of this section is not shown.

~~6.2 Describing the breadth of a firm's personal recommendations~~

Insert the following new section. The text is not underlined.

6.2A Describing advice services

Application – Who? What?

6.2A.1 R This section applies to a *firm* that either:

(1) makes a *personal recommendation* to a *retail client* in relation to a

retail investment product; or

(2) provides *basic advice* to a *retail client*.

Application – Where?

6.2A.2 R This section does not apply if the *retail client* is outside the *United Kingdom*.

Firms holding themselves out as independent

6.2A.3 R A *firm* must not hold itself out to a *retail client* as acting independently unless the only advisory service it offers to that *retail client* is:

(1) based on a comprehensive and fair analysis of the relevant market; and

(2) unbiased and unrestricted.

6.2A.4 G (1) A *firm* that provides both *independent advice* and *restricted advice*, should not hold itself out as acting independently for its business as a whole. However, a *firm* may hold itself out as acting independently in respect of its services for which it provides *independent advice* or *advice* which meets other independence requirements for particular *investments*. For example, a *firm* that provides independent *advice* on *regulated mortgage contracts* in accordance with *MCOBS* but *restricted advice* on *retail investment products* will not be able to hold itself out as an independent financial adviser. However, it would be able to hold itself out as an adviser providing independent advice for mortgages provided it was made clear in accordance with the *clear, fair and not misleading* rule that it provided *restricted advice* for *retail investment products*.

(2) A firm whose relevant market is relatively narrow 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 could not hold itself out as "Greenfield Independent Financial Advisers". "Greenfield – providing independent advice on ethical products" may be acceptable.

(3) A *firm* that provides *basic advice* on *stakeholder products* may still use the facilities and stationery it uses for other business in accordance with the *rule* on basic advice on stakeholder products: other issues (*COBS* 9.6.17.(2)).

Describing the breadth of a firm's advice service

6.2A.5 R A *firm* must disclose in writing to a *retail client*, in good time before the provision of its services in respect of a *personal recommendation* or *basic advice* in relation a *retail investment product*, whether its advice will be:

(1) *independent advice*; or

(2) *restricted advice*.

Content and wording of disclosure

6.2A.6 R (1) A *firm* must include the term "independent advice" or "restricted advice" or both, as relevant, in the disclosure.

(2) Where a *firm* provides *independent advice* in respect of a relevant market that does not include all *retail investment products*, a *firm* must include in the disclosure an explanation of that market, including the types of *retail investment products* which constitute that market.

(3) Where a *firm* provides *restricted advice*, a *firm* must include in its disclosure an explanation about whether the advice is limited to *retail investment products* from a single company, a single group of companies or a limited number of companies.

(4) Where a *firm* provides both *independent advice* and *restricted advice*, the disclosure must clearly explain the different nature of the *independent advice* and *restricted advice* services.

Medium of disclosure

6.2A.7 R A *firm* must provide the disclosure information required by the *rule* on describing the breadth of a *firm's* advice service (*COBS* 6.2A.5R) in a *durable medium* or through a website (where it does not constitute a *durable medium*) provided the *website conditions* are satisfied.

6.2A.8 G A *firm* may meet the disclosure requirements in the *rule* on describing the breadth of a *firm's* advice service (*COBS* 6.2A.5R) and the *rule* on content and wording of disclosure (*COBS* 6.2A.6R) by using a *services and costs disclosure document* or a *combined initial disclosure document* (*COBS* 6.3 and *COBS* 6 Annex 1G or *COBS* 6 Annex 2).

Additional oral disclosure for firms providing restricted advice

6.2A.9 R Where a firm provides *restricted advice* and engages in spoken interaction with the *retail client*, a *firm* must disclose orally on first contact with the *retail client* one of the following statements, as appropriate:

(1) "I am a [Firm X] adviser offering restricted advice, which means that my advice is restricted to advice on [Firm X] [products/stakeholder products] only" or

(2) "I am a [Firm X] adviser offering restricted advice, which means that my advice is restricted to advice on [products/stakeholder products] from a limited number of companies that [Firm X] has selected".

Guidance on what constitutes a relevant market

6.2A.10 G A relevant market should comprise all *retail investment products* which are capable of meeting the investment needs and objectives of a *retail client*.

6.2A.11 G A relevant market can be limited by the investment needs and objectives of the *retail client*. For example, ethical and socially responsible investments or Islamic financial products could both be relevant markets. However, a *firm* would be expected to consider all *retail investment products* within those investment parameters.

6.2A.12 G For a *firm* not specialising in a particular market, the relevant market will generally include all *retail investment products*.

Guidance on providing unbiased and unrestricted advice

6.2A.13 G A *personal recommendation* on a *retail investment product* that invests in a number of underlying *investments* would not of itself meet the requirements for providing unbiased and unrestricted advice even where the *retail investment product* invests in a wide range of underlying *investments* .

6.2A.14 G In order to satisfy the *rule* on *firms* holding themselves out as independent (*COBS* 6.2A.3R) a *firm* should ensure that it is not bound by any form of agreement with a *retail investment product* provider that restricts the *personal recommendation* the *firm* can provide or imposes any obligation that may limit the *firm's* ability to provide a *personal recommendation* which is unbiased and unrestricted.

6.2A.15 G A *firm* may be owned by, or own in whole or part, or be financed by or provide finance to, a *retail investment product* provider without contravening the 'unbiased, unrestricted' requirement provided the *firm* ensures that such ownership or finance does not prevent the *firm* from providing a *personal recommendation* which is unbiased and unrestricted.

6.2A.16 G In providing unrestricted advice a *firm* should consider relevant financial products other than *retail investment products* which are capable of meeting the investment needs and objectives of a *retail client*, examples of which could include national savings and investments products and *cash deposit ISAs*.

Guidance on using panels and/or third parties to provide a comprehensive and fair analysis of the market

6.2A.17 G A *firm* may provide a *personal recommendation* on a comprehensive and fair analysis basis required by the *rule* on *firms* holding themselves out as independent (*COBS* 6.2A.3R) by using 'panels'. A *firm* would need to ensure that any panel is sufficiently broad in its composition to enable the *firm* to make *personal recommendations* based on a comprehensive and fair analysis, is reviewed regularly, and that the use of the panel does not materially disadvantage any *retail client*.

6.2A.18 G Where a *firm* chooses to use a third party to conduct a fair and comprehensive analysis of its relevant market, the *firm* is responsible for ensuring the criteria used by the third party are sufficient to meet the requirement. For example, criteria which selected *retail investment product* providers on the basis of payment of a fee (or facilitation of *adviser charges*), whilst excluding those not paying a fee (or such facilitation) would not meet the comprehensive and fair analysis requirement.

Record keeping

6.2A.19 G A *firm* is reminded of the general record keeping requirements in *SYSC* 3.2 and *SYSC* 9. A *firm* should keep appropriate records of the disclosures required by this section.

Amend the following as shown.

6.3.1A R This section does not apply to a *firm* when it makes a *personal recommendation* to a *retail client* and that *retail client* is outside the *United Kingdom*.

6.3.3 G (1) ~~The *rules* referred to in (4) are derived from the *Single Market directives* and the *Distance Marketing Directive*.~~ In the *FSA's* opinion, a *firm* may comply with ~~them~~ the *rules* referred to in (4) of which (a) to (g) are derived from the *Single Market directives* and the *Distance Marketing Directive* by ensuring that in good time before:

…

…

(4) For the purposes of (1), provision of a *services and costs disclosure document* or *combined initial disclosure document* will comply with:

…

(b) the *rule* on information about costs and charges (*COBS* 6.1.9R) but only if ~~the hourly rates indicated~~ in the *services and costs disclosure document* or *combined initial disclosure document*:

(i) where a *firm* is providing a *personal recommendation* or related services and the total *adviser charge* can be determined, the total *adviser charge* is disclosed as part of the charging structure; or

(ii) where the total *adviser charge* cannot be determined or a *firm* is not providing a *personal recommendation*, if hourly rates are disclosed, the hourly rates are actual

hourly rates rather than indicative hourly rates;

…

(f) the investor compensation scheme *rule* in *COBS* 6.1.16R(1) and (2); ~~and~~

(g) the *rule* on information to be provided by an *insurance intermediary* (*COBS* 7.2.1R(1) and *COBS* 7.2.1R(2)~~.~~;and

(h) the *rule* on describing the breadth of a *firm's* advice service (*COBS* 6.2A.5R), the *rule* on content and wording of disclosure (*COBS* 6.2A.6R) and the *rule* on initial information for *clients* on the cost of advice services (*COBS* 6.1A.15R).

…

6.3.8A G Where a *firm* makes a *personal recommendation* to a *retail client* in relation to a *packaged product* and uses the *services and costs disclosure document* or *combined initial disclosure document* to make the disclosures required under the *rule* on describing the breadth of a *firm's* advice service (*COBS* 6.2A.5R) and the *rule* on content and wording of disclosure (*COBS* 6.2A.6R), it may also use these documents for its disclosures in respect of any other *retail investment products*.

…

6.3.14 G A *firm* would be unlikely to comply with the *client's best interests rule* and the *fair, clear and not misleading rule*, if:

(1) the *services and costs disclosure document* or the *combined initial disclosure document* that it provided initially did not reflect the relevant *adviser charge* or expected *commission* arrangements; or

…

…

6.3.17 G ~~A firm should take reasonable steps to ensure that its representative provides a copy of the appropriate range of packaged products to a client on the client's request.~~ [deleted]

…

6.3.20 G (1) In accordance with the *rule* on information disclosure before providing services (*COBS* 2.2.1R), if a *firm's* initial contact with a *retail client* with a view to providing a *personal recommendation* on *packaged products* is by telephone then the following information should be provided before proceeding further:

…

~~(b) whether the *firm* offers *packaged products* from the whole market or from a limited number of *companies* or from a single *company* or a single group of *companies*;~~

~~(c) whether the *firm* will provide the *client* with a *personal recommendation* on *packaged products*;~~

~~(d) that the *client* can request a copy of the appropriate range of *packaged products*;~~

~~(e) whether the *firm* offers a *fee* based service, a *commission* based service, a service based on a combination of *fee* and *commission*, or a combination of these services, and the consequences for the *client* of proceeding with each type of service; and~~

~~(f) that the information given under (a) to (e) will subsequently be confirmed in writing.~~

(b) whether the *firm* provides *independent advice* or *restricted advice* and, where a *firm* provides *restricted advice*, the oral disclosure required by the *rule* on additional oral disclosure for *firms* providing *restricted advice* (*COBS* 6.2A.9);

(c) the *firm's* charging structure; and

(d) that the information given under (a) to (i) will subsequently be confirmed in writing.

6.3.21 R A *firm* must take reasonable steps to ensure that its *representatives* when making contact with an employee with a view to giving a *personal recommendation* on his employer's *group personal pension scheme* or *stakeholder pension scheme*, inform the employer:

…

~~(3) The amount and nature of any payments that the employee will have to pay, directly or indirectly, for the personal recommendation.~~

(4) that the employee will have to pay an *adviser charge* (if applicable).

6.3.22 G ~~The payments that the employee would have to pay could be:~~

~~(1) fees;~~

~~(2) commission~~

~~(3) commission equivalent;~~

~~(4) a combination of the above.~~ [deleted]

…

6.4.1 R This section applies to a *firm* ~~carrying on *designated investment business* with~~ when it sells or *arranges* the sale of a *packaged product* to a *retail client* where the *firm's* services to sell or *arrange* are not in connection with the provision of a *personal recommendation*.

…

6.4.3 R (1) If a *firm* sells~~, personally recommends~~ or *arranges* the sale of a *packaged product* to a *retail client*, and subsequently if the *retail client* requests it, the *firm* must disclose to the *client* in cash terms:

…

…

…

6.4.5 R (1) A *firm* must make the disclosure required by the *rule* on disclosure of *commission* or *equivalent* (*COBS* 6.4.3R) as close as practicable to the time that it sells~~, personally recommends~~ or *arranges* the sale of a *packaged product*.

…

…

6.4.7 R A *firm* must not enter into an arrangement to pay *commission* other than to the *firm* responsible for a sale, unless:

…

(2) ~~another *firm* has given a *personal recommendation* to the same *retail client* after the sale; or~~ [deleted]

…

…

6.4.9 G The *rules* in this section build on the disclosure of fees, commissions and non-monetary benefits made under the *rule* on inducements (*COBS* 2.3.1R). ~~However the *rules* in this section do not require disclosures before the *firm* makes a *personal recommendation*.~~

Delete COBS 6 Annex 1G in its entirety and replace it with the following. The text is not underlined.

6 Annex 1G Services and costs disclosure document described in COBS 6.3.7G(1)

Firms should omit the notes and square brackets which appear in the following specimen.

keyfacts®

about our services and costs [Note 1]

[Note 3]
[123 Any Street
Some Town
ST21 7QB]

ABC plc
Financial Services

[Note 2]]

1. The Financial Services Authority (FSA)

The FSA is the independent watchdog that regulates financial services. This document is designed by the FSA to be given to consumers considering buying certain financial products. You need to read this important document. It explains the service you are being offered and how you will pay for it.

2. Which service will we provide you with? [Note 4] [Note 5]

☐ Independent advice – We will advise and make a recommendation for you after we have assessed your needs. Our recommendation will be based on a comprehensive and fair analysis of the market. **[Note 6]**

☐ Restricted advice – We will advise and make a recommendation for you after we have assessed your needs, but we only offer products from one company or a limited number of companies. **[Note 7].**

☐ No advice – You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of products that we will provide details on. You will then need to make your own choice about how to proceed.

3. What will you have to pay us for our services? [Note 8]

[You will pay for our services on the basis of [insert charging arrangements **[Note 9]**]. We will discuss your payment options with you and answer any questions you have. We will not charge you until we have agreed with you how we are to be paid.**[Note 10]**]

[non-advised services **[Note 11 -13]**

[Advised services **[Note 14]**
The cost of our services [Note 15-17]
Your payment options [Note 18]
[Settling your adviser charge through a single payment [Free text **Note 19]]**
[Settling your adviser charge by instalments [Free text **Note 20]]**
[Paying by instalments through your recommended product [Free text **Note 21]**
[Paying through other arrangements [Free text **Note 22]]**
[Keeping up with your payments [Free text **Note 23]]**
[Payment for ongoing services [Free text **Note 24]]**

[**Other benefits we may receive [Note 25]**]

4. Who regulates us? [Note 26]

[ABC Financial Services] [123 Any Street, Some Town, ST21 7QB] **[Note 27] [Note 28]** is authorised and regulated by the Financial Services Authority. Our FSA Register number is [ ]. **[Note 29]**
Our permitted business is [ ]. **[Note 30]**

[or] **[Note 31]**

[Name of *appointed representative* or *tied agent*] **[Note 2]** is [an appointed representative or a tied agent] of [name of *firm*] [address of *firm*] **[Note 27] [Note 28]** which is authorised and regulated by the Financial Services Authority. [Name of *firm*'s] FSA Register number is [ ].
[Name of *firm's*] permitted business is [ ] **[Note 30]** [Name of *appointed representative* or *tied agent*] is regulated in [an EEA state or the United Kingdom]. **[Note 29]**

You can check this on the FSA's Register by visiting the FSA's website www.fsa.gov.uk/register or by contacting the FSA on 0845 606 1234. **[Note 29]**

5. Loans and ownership [Note 31]

[[XXX plc] owns [YY]% of our share capital.]
[[XXX plc] provides us with loan finance of [YY] per year.]
[[XXX] (or we) have [YY]% of the voting rights in [ZZZ].] **[Note 32][Note 33][Note 34][Note 35]**

6. What to do if you have a complaint [Note 26]

If you wish to register a complaint, please contact us:

…in writing Write to [ABC Financial Services], [Complaints Department, 123 Any Street, Some Town, ST21 7QB].

… by phone Telephone [0121 100 1234]. **[Note 36]**

If you cannot settle your complaint with us, you may be entitled to refer it to the Financial Ombudsman Service. **[Note 37]**

7. Are we covered by the Financial Services Compensation Scheme (FSCS)? [Note 26] [Note 38] [Note 39]

We are covered by the FSCS. You may be entitled to compensation from the scheme if we cannot meet our obligations. This depends on the type of business and the circumstances of the claim.

Most types of investment business are covered up to a maximum of £50,000.

Further information about compensation scheme arrangements is available from the FSCS.

The following notes do not form part of the *services and costs disclosure document*.

Note 1 – permission to use the keyfacts logo: the *Financial Services Authority* has developed a common keyfacts logo to be used on significant pieces of information directed to *clients*. The keyfacts logo and the text 'about our services and costs' may only be used and positioned as shown in the *services and costs disclosure document* (see *COBS* 6.3.4R). The logo may be re-sized and re-coloured. It may only be used if it is reasonably prominent and its proportions are not distorted. A specimen of the keyfacts logo can be obtained from the *FSA* website http://www.fsa.gov.uk/pubs/other/keyfacts_logo.

Note 2 – insert the *firm's* or *appointed representative's* or *tied agent's* name (either the name under which it is *authorised* or the name under which it trades). A corporate logo or logos may be included. If an individual who is employed or engaged by an *appointed representative* or *tied agent* provides the information, the individual should not put his or her own name on the *services and costs disclosure document*.

Note 3 – insert the address of the head office and/or if appropriate the principal place of business from which the *firm*, *appointed representative* or *tied agent* expects to conduct business (this can include a *branch*) with *clients*. (An *appointed representative* or *tied agent* should include its own name and address rather than those of the *authorised firm*).

Section 2: Which service will we provide you with?

Note 4 – the *firm* should select, for example by ticking, the box(es) which are appropriate for the service that it expects to provide to the *client*. This needs to be done only in relation to the service the firm is offering to a particular *client*. More than one box can be selected if more than one service is being offered to a particular *client*. If more than one box is selected, the *firm* should clearly explain the different nature of the services by adding text to this section, such that the explanation of the services the *firm* offers under this section is fair, clear and not misleading. Do not remove boxes that are not selected.
The *firm* should tick the first box in section 2 if it will be providing *independent advice.*
The *firm* should tick the second box in section 2 if it will be providing *restricted advice*, including *basic advice* (on *stakeholder products*).
The *firm* should tick the third box in section 2 if it will not be providing advice.

Note 5 – if the *services and costs disclosure document* is provided by an *appointed representative* or *tied agent*, the service described should be that offered by the *appointed representative* or *tied agent*.
Note 6– if the *firm* selects this box and the *firm* does not consider *all retail investment products*, the firm should include an explanation of the types of products it does consider, in a way that meets the fair, clear and not misleading rule. For example, if a *firm* only considers ethical and socially responsible investments, this should be explained here.

Note 7 – if the *firm* selects this box, it will be offering:

(a) products from a limited number of companies; or
(b) products of a single company or single group of companies; or
(c) its own products (e.g. where the *firm* is a *product provider* offering only its own products, or is part of a *product provider* offering only the products sold under that part's trading name); or
(d) *basic advice* on *stakeholder products*.

The *firm* should replace the preceding text with the relevant text as set out below. If the *firm* does not select this box, then no amendments should be made to the preceding text.

(a)	"Restricted advice – We will advise and make a recommendation for you after we have assessed your needs. We [can] **[Note a]** only offer products from a limited number of companies. You may ask us for a list of the companies whose products we offer" **[Note b]**.
(b)	"Restricted advice – We will advise and make a recommendation for you after we have assessed your needs. We [can] **[Note a]** only offer products from [name of provider]" or if the provider has only one product the *firm* should amend the text to the singular, for example "We [can] **[Note a]** only offer a pension from [name of provider]"
(c)	"Restricted advice – We will advise and make a recommendation for you after we have assessed your needs. We only offer our own products"
(d)	"Restricted advice – We will provide basic advice on a limited range of stakeholder products and in order to do this we will ask some questions about your income, savings and other circumstances, but we will not conduct a full assessment of your needs or offer advice on whether a non-stakeholder product may be more suitable." **[Note c]**: "We [can] **[Note a]** offer products from a single stakeholder product provider"; or "We [can] **[Note a]** offer products from a limited number of stakeholder product providers You may ask us for a list of the companies whose products we offer" **[Note b]**; or "We only offer our own stakeholder products"

[Note a] – insert "can" if the *firm's* range of products is determined by any contractual obligation.
[Note b] – the list of products will be the range of *retail investment products* that is appropriate having regard to the services that the *firm* is providing, or may provide, to the client. For services provided in relation to non-investment insurance contracts, this is the list required by *ICOBS* 4.1.6R(2).
[Note c] – the *firm* should insert one of the three statements, whichever is relevant.

Section 4: What will you have to pay us for our services?

Note 8 - in this section, the *firm* should outline how it intends to charge its *clients* for the services provided. If the *firm* is not intending to provide a *personal recommendation* it should refer to the notes under 'Non-advised services' below. If the *firm* is intending to provide a *personal recommendation*, it should refer to the notes under 'Advised services'. If the *firm* is providing both a *personal recommendation* and 'non-advised' services, the *firm* should set out the charging arrangements for the non-advised and advised services separately, and make clear which charging arrangements apply to which service using appropriate sub-headings.

Note 9 – a *firm* should disclose all of the charging arrangements it offers its *clients*, from the alternatives of *adviser charge*, *fee, commission* or a combination.

Note 10 – if applicable, a *firm* should disclose to the *client* the possibility that other costs including taxes (for example VAT), related to transactions in connection with the *packaged product* and that are not paid via the *firm* or imposed by it, may arise for the *client*.

Notes for non-advised services

Note 11 - any reference in this section to *"commission"* means *commission* and *commission equivalent*

Note 12 - a *firm* that is not proposing to give *personal recommendations* on *packaged products* can amend this section accordingly. The *firm* need not provide information regarding payment options but should provide at this section at least a statement explaining that the *client* will be told how much the *firm* will be paid before the *firm* carries out any business for the *client* and honour that undertaking. For example, "We will tell you how we get paid and the amount before we carry out any business for you." If a *firm* chooses to provide the *client* with the total price in this section and any part of that price is to be paid in or represents an amount of foreign currency, the *firm* should provide an indication of the currency and the applicable currency conversion rates and costs.

Note 13 - in order to comply with *COBS* 2.3.1R as qualified by 2.3.2R, *firms* receiving non-monetary benefits may wish to disclose such benefits in summary form here, under the heading "**Other benefits we may receive**"**.** If a *firm* does so, it should provide the undertaking described in *COBS* 2.3.2R(1) (to provide further details on request) in writing, in this section and honour that undertaking. However, it is not the purpose of this section to provide significant or extensive explanation of non-monetary benefits such that it distracts from the wider purpose of the document.

For example:
"We sell a range of products from a variety of firms; some of these firms provide us with annual training, which allows us to offer you a better service. This year we expect to receive in total [XX] hours worth of training from XYZ, ABC and DEF firms, predominantly from ABC. Some of the cost of this training may be passed to you as part of the total charges you pay should you choose a product provided by XYZ, ABC or DEF. Further information regarding these arrangements is available on request."

Notes for advised services

Note 14 – *firms* proposing to provide a *personal recommendation* on *packaged products* should use the following notes to provide information to the *client* on the *firm's* charging structure and the *client's* payment options.

Note 15 – a *firm* should include here its charging structure, outlining as closely as possible, the services that it offers and the charge for each service. The *firm* should ensure that this is presented in clear and plain language and, as far as practicable, uses cash terms.

Note 16 - the charging structure should be expressed in pounds sterling or, where relevant, another appropriate currency. Where a *firm's* charging structure is in non-cash terms, examples in cash terms should be used to illustrate how the charging structure will be applied in practice. Where a *firm* uses hourly rates in its charging structure, it should state whether the rates are actual or indicative and provide an approximate indication of the number of hours a particular service may take. If a *firm* chooses to provide the *client* with the total *adviser charge* in this section and any part of that *adviser charge* is to be paid in or represents an amount of foreign currency, the *firm* should provide an indication of the currency and the applicable currency conversion rates and costs.

For example

Our charging structure

Service	Initial charge	Ongoing charge for twice yearly reviews
Review of your pension arrangements (pre-retirement)	Charged at £100 per hour (exc. VAT) - approx. 4-6 hours	
Advice on what to do with your pension fund (at retirement)	Charged at £130 per hour (exc. VAT) - approx. 2-3 hours	
Where to put your savings (for those with up to £25,000 to invest)	3% of your investment, if you go ahead with our recommendations	Service available on request for 0.5% of your investment per year

Note 17 - where a *firm* provides an ongoing service, it should disclose the ongoing service that will be offered and that there will be an *adviser charge* for that service. The *firm* can also include in this section additional information the *client* would receive before the provision of the *personal recommendation* or related services.

For example

"There will be an additional charge for any ongoing work, such as periodic or ongoing reviews, we carry out on your behalf. We will confirm the rate, frequency and length of this ongoing service before beginning any ongoing service.

Note 18 - a *firm* must use the headings (i) "Your payment options" and (ii) the following sub-headings as applicable; "Settling your adviser charge in a single payment" and/or "Settling your adviser charge by instalments". A *firm* should outline the payment options offered to *clients* and any restrictions on these payment options. In addition, a *firm* should provide an explanation relating to each option offered in clear and plain language.

Note 19 - Additional text to be included under the heading "Settling your adviser charge in a single payment"

The text for describing how the *client* can settle the *adviser charge* through a single payment is not prescribed, but should be clear and in plain language. This could commence with an explanation of the arrangements relating to the single payment of the *adviser charge*, including any specific provision as to the circumstances when an *adviser charge* will be payable, (including where relevant, payment of any "non-contingent" *adviser charge* (i.e. where the client will be charged even if they do not purchase a product)), the type of payments accepted by the *firm* and the timing

for the payment of the *adviser charge*. For example:

"Whether you buy a product or not, you will pay us an adviser charge for our advice and services, which will become payable on completion of our work".
"You will be required to settle the payment of your adviser charge on completion of our work in [insert number of days] days. We accept cheque or card payments. We do/do not accept payment by cash. You will be provided with a receipt upon payment"

Note 20 - Additional text to be included under the heading "Settling your adviser charge by instalments"

This text should be included where a *firm* is offering payment of its *adviser charge* by instalments and no ongoing service is provided. *Firms* should make it clear that the option to pay by instalment does not relate to an ongoing service. A *firm* which offers the payment of an *adviser charge* over a period of time for ongoing services should use the text in **Note 24** below.
A firm should note that the option for *clients* to pay their *adviser charge* by instalments is only permitted where regular premium products are recommended (see *COBS* 6.1.A.21R). If a *firm* offers the option to pay the *adviser charge* by instalments, the *firm* must use the headings (i) "Settling your adviser charge by instalments" and (ii) the following sub-headings as applicable; "Paying by instalments through your recommended product" and/or "Paying by other arrangements".
The text for describing the option to pay for the *adviser charge* by instalments is not prescribed, but should be clear and in plain language. This should commence with an explanation of the arrangements relating to the payment of the *adviser charge* over time.

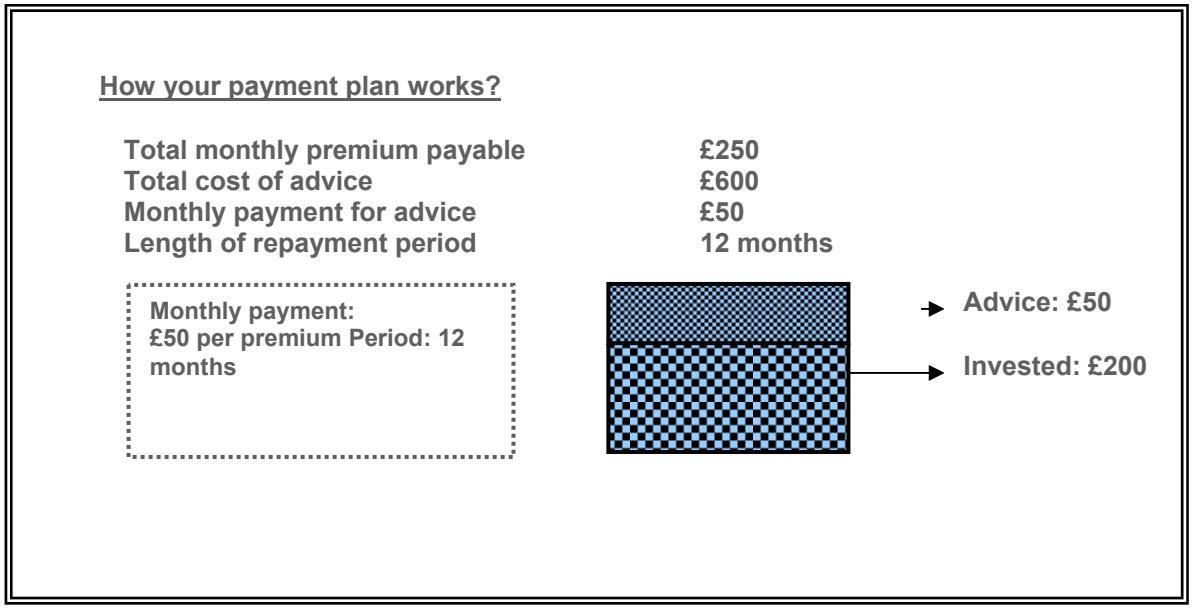
Note 21 - Additional text to be included under the heading "**Paying by instalments through your recommended product"**

A *firm* which offers the *client* the option to have the *adviser charge* facilitated through a *retail investment product* should include this heading. The text for describing a *client's* option to pay by instalment through the recommended *retail investment product* is not prescribed, but should be clear and in plain language. This could commence with an explanation of the arrangements including any specific provision as to the circumstances when this option is permitted/not permitted and the frequency and period over which this arrangement will operate. A *firm* could consider the use of graphical representations to ensure that the *client* understands what they are paying for; how much they are required to pay and how frequently.

For example

"If you buy a financial product, you can choose to have your adviser charge deducted from the product through instalments. Although you pay nothing to us up front, that does not mean that our service is free. You still pay us indirectly through deductions from the amount you pay into your product. These deductions will pay towards settling the adviser charge. These deductions could reduce the amount left for investment".

and



with the following text:

"You have chosen to pay for the advice you have received today through instalments. These instalments will be deducted from the premium you pay each month and allocated towards settling the adviser charge. For example, the total cost of advice is £600. You have been recommended a regular premium product of which £250 will be paid each month. £50 will be taken from this amount to pay off your adviser charge over 12 months. The remaining £200 will be invested during this time. At the end of this period the adviser charge would have been settled in full. From month 13 the full £250 will be invested".

Note 22 - Additional text to be included under the heading "Paying through other arrangements"

Where a *firm* is offering the option to pay its *adviser charge* by instalments through arrangements other than facilitating payment through the recommended *retail investment product*, it must use the heading "Paying through other arrangements". The text for describing the client's option to pay through other arrangements is not prescribed, but should be in clear and plain language. This could commence with an explanation of the option to pay through other arrangements and how this could work in practice.

Note 23 - Keeping up with your payments

This text is not prescribed, but a *firm* must include the heading "Keeping up with your payments" if it is offering the *client* the option to pay by instalments. In this section the *firm* should outline the implications for the *client* if they fail to keep up with their payments before the *adviser charge* has been paid, including if its recommended product is cancelled before the *adviser charge* is paid.

Note 24 – Payment for ongoing services

If a *firm* provides an ongoing service to the client for which there is an *adviser charge* payable over a period of time, the *firm* must include the heading "Payment for ongoing services". The text for describing how the client pays for ongoing service is not prescribed but should be in clear and plain language and should also include the nature of the service to be provided.

For example
"We have a range of ongoing services we can provide to ensure that your personal recommendation is reviewed frequently and remains relevant to your changing circumstances. The frequency of the charge will depend on the service you choose and is usually made by direct debit on the 1st of every month. Ask you adviser for more details"

"We offer an ongoing service where we review your account every 3 months and inform you of new recommendations or changes that may be relevant to your circumstances. This service is provided at a charge of [insert charge here] per month and can be either deducted from your investment or paid by direct debit. This service can be cancelled at any time. Please ask your adviser for more details"

Note 25 - in order to comply with *COBS* 2.3.1R as qualified by 2.3.2R, a *firm* receiving a benefit, in relation to the facilitation of the payment of an *adviser charge* may wish to disclose such benefits in summary form here, under the heading "**Other benefits we may receive**"**.** If a *firm* does so, it should provide the undertaking described in *COBS* 2.3.2R(1) (to provide further details on request) in writing, in this section and honour that undertaking.

For example

"ABC firm provides us with a specialised software CD-ROM and accompanying [XX] hours worth of training per annum. We use this software in processing your details when you apply for an investment product and wish to facilitate the payment of the adviser charge through deductions from your investment. Some of the cost of this software may be passed on to you as part of the total charges you pay ABC firm. Further information regarding this arrangement is available on request."

Section 5: Who regulates us?

Note 26 – the *firm* may omit this section for services relating to *packaged products* if the *firm* has, on first contact with the *client*, provided the *client* with its *client* agreement which contains that information. If this section is omitted, the other sections of the *services and costs disclosure document* should be renumbered accordingly.

Note 27 – if the *firm's* address on the *FSA Register* differs from that given on the *services and costs disclosure document* under Note 3, the address on the *FSA Register* should be given in this section. If the address is the same as that given under Note 3 it should be repeated in this section.

Note 28 – where the *authorised firm* trades under a different name from that under which it is *authorised*, it should include the name under which it is *authorised* and listed in the *FSA Register*. It may also include its trading name(s) if it wishes.

Note 29 - an *incoming EEA firm* will need to modify this section if it chooses to use the *services*

and costs disclosure document (see *GEN* 4 Annex 1R(2)). A *tied agent* that is regulated in an *EEA State* other than the *United Kingdom* will similarly need to modify this section.

Note 30 – insert a short, plain language description of the business for which the *firm* has a *permission* which relates to the service it is providing.

Note 31 – where the information is provided by an *appointed representative* or *tied agent*, the *appointed representative* or *tied agent* should use this text instead. The *appointed representative* or *tied agent* should give details of the *authorised firm(s)* that is its *principal(s)* for each type of service that it is providing to a particular *client*.

Section 6: Loans and ownership

Note 32 – omit this section where there are no relevant loan or ownership arrangements under the following notes. If this section is omitted the other sections of the *services and costs disclosure document* should be renumbered accordingly. Where the information is provided by an *appointed representative* or *tied agent,* it should cover loans made to or by that *appointed representative* or *tied agent*, or holdings in or held by that *appointed representative* or *tied agent,* as appropriate.

Note 33 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *firm* which is held by a provider or *operator* of a *packaged product* or by the parent of the provider or *operator*.

Note 34 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of a provider or *operator* of a *packaged product* which is held by the *firm*.

Note 35 – insert, in the *firm's* own words, a short description of any *credit* provided to the *firm* by a *product provider* (other than *commission* due to the *firm* in accordance with an indemnity claw-back arrangement) or by any *undertaking* in the *immediate group* of the *product provider* where the amount of the *credit* exceeds 10 per cent of the share and loan capital of the *firm*.

Section 7: What to do if you have a complaint

Note 36 – if different to the address in Note 3, give the address and telephone number which is to be used by *clients* wishing to complain.

Note 37 – if the *firm* is carrying on an activity from an establishment which is outside the *United Kingdom* it should make clear that the *Financial Ombudsman Service* will not be available. The *firm* may refer to any similar complaints scheme that may be applicable.

Section 8: Are we covered by the Financial Services Compensation Scheme (FSCS)?

Note 38 – when an *incoming EEA firm* provides the *services and costs disclosure document*, it should modify this section as appropriate.

Note 39 - when a *firm* which is not a *participant firm* provides the *services and costs disclosure document*, it should answer this question 'No' and should state the amount of cover provided (if any) and from whom further information about the compensation arrangements may be obtained.

Amend the following as shown.

6 Annex 2 Combined initial disclosure document described in COBS 6.3, ICOBS 4.5, MCOB 4.4.1R(1) and MCOB 4.10.2R(1)

….

keyfacts®

about our services and costs **[Note 1]**

[Note 3]
[123 Any Street
Some Town
ST21 7QB]

ABC plc
Financial Services **[Note 2]**

1 The Financial Services Authority (FSA)

The FSA is the independent watchdog that regulates financial services. This document is designed by the FSA to be given to consumers considering buying certain financial products. You need to read this important document. It explains the service you are being offered and how you will pay for it.

2 Whose products do we offer? **[Note 4][Note 6]**

Investment

☐ ~~[We offer products from the whole market.] **[Note 5]** [We offer our own product(s); you can ask us for a list, but our recommendation will be made following an analysis of the whole market.] **[Note 8]**~~

Please refer to section 3 of this document

☐ ~~We [can] **[Note 7]** only offer products from a limited number of companies. [These include our own product(s) but our recommendation will be made following an analysis of our entire range of products.] **[Note 9]**~~
~~Ask us for a list of the companies whose products we offer. **[Note 15]**~~

☐ ~~We [can] **[Note 7]** only offer [a] product[s] from [a single group of companies] [name of single company]. **[Note 11(1)] [Note 16]**~~
~~[or] **[Note 11(2)]**~~
~~We only offer our own products.~~

~~[free text [**Note 17**]]~~

Insurance

☐ We offer products from a range of insurers [for] [list the types of *non-investment insurance contracts*].

☐ We [can] **[Note 7]** only offer products from a limited number of insurers [for] [list the types of *non-investment insurance contracts*].

Ask us for a list of the insurers we offer insurance from. **[Note 15]**

☐ We [can] **[Note 7]** only offer [a] product[s] from [a single insurer] [name of single *insurance undertaking*] [for] [list the types of *non-investment insurance contracts*]. **[Note 10] [Note 11(1)] [Note 16]**

[or] **[Note 11(2)]**

We only offer our own products for [list the types *of non-investment insurance contracts*].

Home Finance Products [Note 13]
[Compliance with Islamic law [Note 18]

Our services are regularly checked by [name(s) of scholar(s)] to ensure compliance with Islamic law. Ask us if you want further information about the role of our scholar(s).]

[1] [Lifetime] [Mortgages] [Equity Release Products] [and home reversion schemes] [Note 13]

☐ We offer [lifetime] [mortgages] [home reversion plans] [equity release products] from the whole market.

☐ We [can] **[Note 7]** only offer [lifetime] [mortgages] [home reversion plans] [equity release products] from a limited number of [lenders / companies].
Ask us for a list of the [lenders / companies] we offer [lifetime] [mortgages] [home reversion plans] [equity release products] from. **[Note 14]**

☐ We [can] **[Note 7]** only offer [a limited range of the] [a] [lifetime] [mortgage] [s] [home reversion plan] [s] [equity release products] from [a single lender / company] [name of single lender / company**]. [Note 11(1) and (3)][Note 16]**

[or]

We only offer our own [lifetime] [mortgages] [home reversions plan] [equity release products]. **[Note 11(2)]**

☐ We do not offer [lifetime mortgages] [home reversion plans]. **[Note 12]**

[2] [Islamic Home Purchase Plans] [Note 19] [Note 13]

☐ We offer Islamic home purchase plans from the whole market.

☐ We [can] **[Note 7]** only offer Islamic home purchase plans from a limited number of providers.

Ask us for a list of the providers we offer Islamic home purchase plans from. **[Note 14]**

☐ We [can] **[Note 7]** only offer [a limited range of the] [a] Islamic home purchase plan [s] from [a single provider] [name of single provider]. **[Note 11(1) and (3)][Note 16]**

[or]

We only offer our own Islamic home purchase plans. **[Note 11(2)]**

3 Which service will we provide you with? [Note 4][Note 6]

Investment

☐ Independent advice – We will advise and make a recommendation for you after we have assessed your needs. Our recommendation will be based on a comprehensive and fair analysis of the market. **[Note A]**~~We will advise and make a recommendation for you after we have assessed your needs.~~

☐ Restricted advice – We will advise and make a recommendation for you after we have assessed your needs, but we only offer products from one company or a limited number of companies. **[Note B]**~~You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of products that we will provide details on. You will then need to make your own choice about how to proceed.~~

☐ No advice - You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of products that we will provide details on. You will then need to make your own choice about how to proceed. ~~We will provide basic advice on a limited range of stakeholder products and in order to do this we will ask some questions about your income, savings and other circumstances but we will not:.~~

- ~~conduct a full assessment of your needs;~~
- ~~offer advice on whether a non-stakeholder product may be more suitable~~

~~**[Note 5]**~~

~~[free text **[Note 20]**]~~

Insurance

☐ We will advise and make a recommendation for you after we have assessed your needs [for] [list the types of *non-investment insurance contracts*].

☐ You will not receive advice or a recommendation from us [for] [list the types of *non-investment insurance contracts*]. We may ask some questions to narrow down the selection of products that we will provide details on. You will then need to make your own choice about how to proceed.

[Home Finance Products] [Note 13]

[1] [Mortgages] [Equity Release Products] [Note 13]

☐ We will advise and make a recommendation for you on [lifetime mortgages] [home reversions] [equity release products] after we have assessed your needs.

☐ You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of [lifetime mortgages] [home reversions] [equity release products] that we will provide details on. You will then need to make your own choice about how to proceed.

[2] [Islamic Home Purchase Plans] [Note 13]

☐ We will advise and make a recommendation for you after we have assessed your needs.

☐ You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of products that we will provide details on. You will then need to make your own choice about how to proceed.

4 What will you have to pay us for our services? [Note 20A]

Investment

[You will pay for our services on the basis of [insert charging arrangements **[Note 20B]**]. We will discuss your payment options with you and answer any questions you have. We will not charge you until we have agreed with you how we are to be paid.**[Note 20C]**]

[non-advised services **[Note 21 -23]**]

[Advised services **[Note 24]**]
The cost of our services [Note 25-27]
Your payment options [Note 28A]
[Settling your adviser charge through a single payment [Free text **Note 28B]]**
[Settling your adviser charge by instalments [Free text **Note 28C]]**
[Paying by instalments through your recommended product [Free text **Note 28D]**
[Paying through other arrangements [Free text **Note 28E]]**
[Keeping up with your payments [Free text **Note 29]]**
[Payment for ongoing services [Free text **Note 30]]**
[Other benefits we may receive [Note 31]]

~~[non-advised sales **[Note 20B]**]~~

~~[You will pay for our services on the basis of **[Note 21]**[**Note 22]**. We will discuss your payment options with you and answer any questions you have. We will not charge you until we have agreed with you how we are to be paid.]~~

~~[**Paying by fee [Note 23]**]~~

~~[free text **[Notes 24-25]**]~~

~~[**Paying by commission (through product charges) [Note 23]**]~~

~~[free text **[Notes 26-28]**]~~

~~**[Paying by a combination of fee and commission (through product charges)[Note 23]]**~~

~~[free text **[Notes 29-30]**]~~

~~**[Other benefits we may receive [Note 31]]**~~

~~[free text **[Note 31]**]~~

Insurance [Note 32]

☐ A fee [of £ [ ]] [for] [list the types of services provided for *non-investment insurance contracts*].

☐ No fee [for] [list the types of services provided for *non-investment insurance contracts*].

You will receive a quotation which will tell you about any other fees relating to any particular insurance policy.

[Home Finance Products] [Note 13]

[1] [Mortgages] [Equity Release Products] [Note 13]

☐ No fee. [We will be paid by commission from the [lender/company that buys your home].] **[Note 33]**

☐ A fee of £[ ] payable at the outset and £[ ] payable when you apply for a [lifetime] [mortgage] [home reversion plan] [equity release product]. [We will also be paid commission from the [lender/company that buys your home.]]. **[Note 33] [Note 34]**

You will receive a *key facts illustration* when considering a particular [lifetime] [mortgage] [home reversion plan] [equity release product], which will tell you about any fees relating to it. **[Note 13]**

Refund of fees [Note 32] [Note 13]

If we charge you a fee, and your [lifetime] [mortgage] [home reversion plan] does not go ahead, you will receive: **[Note 35]**

☐ A full refund [if the [lender/company] rejects your application]. **[Note 36]**

☐ A refund of £ [ ] [if your application falls through]. **[Note 36] [Note 37]**

☐ No refund [if you decide not to proceed]. **[Note 36]**

[2] [Islamic Home Purchase Plans] [Note 13]

☐ No fee. [We will be paid by commission from the provider.] **[Note 33]**

☐ A fee of £[ ] payable at the outset and £[ ] payable when you apply for an Islamic home purchase plan. [We will also be paid commission from the provider]. [Note 18]

Refund of fees [Note 35]
If we charge you a fee, and your Islamic home purchase plan does not go ahead, you will receive: **[Note 32]**

☐ A full refund [if the provider] rejects your application]. **[Note 36]**

☐ A refund of £ [ ] [if your application falls through]. **[Note 36] [Note 37]**

☐ No refund [if you decide not to proceed]. **[Note 36]**

5 Who regulates us? [Note 39]

[ABC Financial Services] [123 Any Street, Some Town, ST21 7QB] **[Note 40] [Note 41]** is authorised and regulated by the Financial Services Authority. Our FSA Register number is [ ]. **[Note 42]**
Our permitted business is []. **[Note 43]**

[or] **[Note 44]**

[Name of *appointed representative* or *tied agent*] **[Note 2]** is [an appointed representative or a tied agent] of [name of *firm*] [address of *firm*] **[Note 40] [Note 41]** which is authorised and regulated by the Financial Services Authority. [Name of *firm*'s] FSA Register number is [ ].

[Name of *firm's*] permitted business is [ ] **[Note 43]** [Name of *appointed representative* or *tied agent*] is regulated in [an EEA state or the United Kingdom] **[Note 42]**

You can check this on the FSA's Register by visiting the FSA's website www.fsa.gov.uk/register or by contacting the FSA on 0845 606 1234. **[Note 42]**

6 Loans and ownership [Note 45]

[[XXX plc] owns [YY]% of our share capital]

[[XXX plc] provides us with loan finance of £[YY] per year.]

[[XXX] (or we) have [YY]% of the voting rights in [ZZZ].] **[Note 45][Note 46] [Note 47][Note 48][Note 49][Note 50]**

7 What to do if you have a complaint [Note 39]

If you wish to register a complaint, please contact us:

…in writing	Write to [ABC Financial Services], [Complaints Department, 123 Any Street, Some Town, ST21 7QB].
… by phone	Telephone [0121 100 1234]. **[Note 41]**

If you cannot settle your complaint with us, you may be entitled to refer it to the Financial Ombudsman Service. **[Note 52] [Note 53] [Note 54]**

8 Are we covered by the Financial Services Compensation Scheme (FSCS)? [Note 39] [Note 55] [Note 56]

We are covered by the FSCS. You may be entitled to compensation from the scheme if we cannot meet our obligations. This depends on the type of business and the circumstances of the claim.

Investment
Most types of investment business are covered up to a maximum limit of £50,000.

Insurance
Insurance advising and arranging is covered for 90% of the claim, without any upper limit.

[or] **[Note 57] [Note 58]**

For compulsory classes of insurance, insurance advising and arranging is covered for 100% of the claim, without any upper limit.

[Mortgages] [and] [and Home Purchase Plans] [Equity Release Products] [Note 13]
[Mortgage], [and] [Home purchase] [and] [Equity release] advising and arranging is covered up to a maximum limit of £50,000.

Further information about compensation scheme arrangements is available from the FSCS.

[Note 59] Message from the Financial Services Authority

Think carefully about this information before deciding whether you want to go ahead.

If you are at all unsure about which equity release product is right for you, you should ask your adviser to make a recommendation.

[Note 60] Think carefully about the product and services you need. [We can only offer services in relation to Islamic home purchase plans and cannot provide advice on standard mortgages.] [If you want [information][or][advice] on standard mortgages, please ask.]

The following notes do not form part of the *combined initial disclosure document.*

Note 1 – permission to use the keyfacts logo: the *Financial Services Authority* has developed a common keyfacts logo to be used on significant pieces of information directed to *clients*. The keyfacts logo and the text 'about our services and costs' may only be used and positioned as shown in the *combined initial disclosure document* (see *COBS* 6.3.4R). The logo may be re-sized and re-coloured. It may only be used if it is reasonably prominent and its proportions are not distorted. A specimen of the keyfacts logo can be obtained from the *FSA* website http://www.fsa.gov.uk/pubs/other/keyfacts_logo.

Note 2 – insert the *firm's, appointed representative's* or *tied agent's* name (either the name under which it is *authorised* or the name under which it trades). A corporate logo or logos may be included. If an individual who is employed or engaged by an *appointed representative* or *tied agent* provides the information, the individual should not put his or her own name on the *combined initial disclosure document*.

Note 3 – insert the head office and/or if ~~more~~ appropriate the principal place of business from which the *firm, appointed representative* or *tied agent* expects to conduct business (this can include a *branch*) with *clients*. (An *appointed representative* or *tied agent* should not include the name and address of the *authorised firm* instead of its own.)

Section 2: Whose products do we offer? And Section 3: Which services will we provide you with?

Note 4 – a *firm* should describe the services that it expects to provide to, the particular *client*. For services in relation to:

- *investments* ~~*packaged products*~~ – the *firm* should select, for example by ticking, the box(es) which are appropriate for the service that it expects to provide to the *client*. This needs to be done only in relation to the service the firm is offering to a particular *client*. More than one box can be selected if more than one service is being offered to a particular *client*. If more than one box is selected, the *firm* should clearly explain the different nature of the services by adding text to this section, such that the explanation of the services the *firm* offers under this section is fair, clear and not misleading. Do not remove boxes that are not selected.

  The *firm* should tick the first box in section 2 if it will be providing *independent advice.*

  The *firm* should tick the second box in section 2 if it will be providing *restricted advice*, including *basic advice* (on *stakeholder products*).
- the *firm* should tick the third box in section 2 if it will not be providing advice ~~the *firm* should select, for example by ticking, one box~~.
- *non-investment insurance contracts* – the *firm* should select more than one box if the scope of the service or the type of service it provides varies by type of contract (e.g. if it deals with a single *insurance undertaking* for motor insurance and a range of *insurance undertakings* for household insurance). If more than one box is selected, the *firm* should specify which box relates to which type of *non-investment insurance contract*, by adding text to the *combined initial disclosure document*. *Firms* should not omit the boxes not selected.
- *equity release transactions* – the *firm* should select a maximum of two boxes within this section. *Firms* should not omit the boxes not selected.

~~**Note 5** – if a *firm* indicates that it will give *basic advice* then the first box in section 2 should~~

~~not be ticked as the *firm* will not be doing so on the basis of *personal recommendations* from the whole market.~~

Note 6 – if the *combined initial disclosure document* is provided by an *appointed representative* or *tied agent*, the service described should be that offered by the *appointed representative* or *tied agent*.

Note 7 – insert "can" if the *firm's* range of products is determined by any contractual obligation. This does not apply where a *product provider*, *insurer*, *lender*, *home purchase provider* or *home reversion provider* is selling its own products.

Note A – if the *firm* selects this box and the *firm* does not consider *all retail investment products*, the *firm* should include an explanation of the types of products it does consider, in a way that meets the fair, clear and not misleading rule. For example, if a *firm* only considers ethical and socially responsible investments, this should be explained here.

Note B– if the *firm* selects this box, it will be offering:

(a) products from a limited number of companies; or
(b) products of a single company or single group of companies; or
(c) its own products (e.g. where the *firm* is a *product provider* offering only its own products, or is part of a *product provider* offering only the products sold under that part's trading name); or
(d) *basic advice* on *stakeholder products*.

The *firm* should replace the preceding text with the relevant text as set out below. If the *firm* does not select this box, then no amendments should be made to the preceding text.

(a)	"Restricted advice – We will advise and make a recommendation for you after we have assessed your needs. We [can] **[Note a]** only offer products from a limited number of companies. You may ask us for a list of the companies whose products we offer" **[Note b]**.
(b)	"Restricted advice – We will advise and make a recommendation for you after we have assessed your needs. We [can] **[Note a]** only offer products from [name of provider]" or if the provider has only one product the firm should amend the text to the singular, for example "We [can] **[Note a]** only offer a pension from [name of provider]"
(c)	"Restricted advice – We will advise and make a recommendation for you after we have assessed your needs. We only offer our own products"
(d)	"Restricted advice – We will provide basic advice on a limited range of stakeholder products and in order to do this we will ask some questions about your income, savings and other circumstances, but we will not conduct a full assessment of your needs or offer advice on whether a non-stakeholder product may be more suitable." **[Note c]**: "We [can] **[Note a]** offer products from a single stakeholder product provider"; or "We [can] **[Note a]** offer products from a limited number of stakeholder product providers You may ask us for a list of the companies whose products we offer" **[Note b]**; or "We only offer our own stakeholder products"

[Note a] – insert "can" if the *firm's* range of products is determined by any contractual obligation.
[Note b] – the list of products will be the range of *retail investment products* that is appropriate having regard to the services that the firm is providing, or may provide, to the client. For services provided in relation to non-investment insurance contracts, this is the list required by ICOBS 4.1.6R(2).
[Note c] – the *firm* should insert one of the three statements, whichever is relevant. ~~**Note 8** – a *firm* should only include these words if it offers whole of market *personal recommendations* and it owns or operates products that fall within the relevant market (e.g. a *SIPP*). *Firms* that are conducting cross border business and holding themselves out as whole of market, should include such free text as is necessary to explain in a way that meets the *fair, clear and not misleading rule* and the *clients best interest rule*, what whole of market means in that context.~~

~~**Note 9** – a *firm* should only include these words if it offers limited range *personal recommendations* and it owns or operates products that fall within the relevant range (e.g. a *SIPP*).~~

Note 10 – if the *insurance intermediary* or *insurer* deals with a different *insurance undertaking* for different types of *non-investment insurance contracts*, it should identify all the *insurance undertakings* and specify the type of contract to which they relate on the *combined initial disclosure document*. This only needs to be done in relation to the service it is offering a particular *client*. For example, "we can only offer products from ABC Insurance for motor insurance and ABC Insurance for household insurance".

Note 11 – if the *firm* selects this box, it will be offering the products of one provider for a particular product type. It should therefore follow the format specified in (1) below except when offering its own products, in which case it should follow (2) instead. In the case of *non-investment insurance contracts*, where the *firm* is providing a service in relation to different types of insurance, this box covers the situation where it is offering a particular type of insurance from a single *insurance undertaking*.

(1) Insert the name of the provider, namely the *product provider* for *packaged products*, the *insurance undertaking(s)* for *non-investment insurance contracts*, the *lender* for *regulated mortgage contracts* and *regulated lifetime mortgage contracts* and the *home reversion provider* for *home reversion plans*. For example: "We can only offer products from [name of *product provider*]". For *non-investment insurance contracts* the type of insurance offered should also be included. For example: "We only offer ABC's household insurance and ABC's motor insurance." If the provider has only one product, the *firm* should amend the text to the singular – for example: "We can only offer a mortgage from [name of lender]". If the *firm* does not offer all of the *home finance transactions* generally available from that provider, it should insert the words "a limited range of" as shown in the specimen.

(2) If the *firm* is a *product provider* offering only its own products, or is part of a *product provider* offering only the products sold under that part's trading name, it should use this alternative text.

(3) If the *firm* offers *home reversion plans* from only one *reversion provider*, and *lifetime mortgages* from only one *lender*, which is different from the *reversion provider*, then the *firm* should identify the *lender* and the *reversion provider* and specify the type of *equity release transaction* to which they relate. For example, "We can only offer lifetime mortgages from ABC Mortgages Ltd and home reversion plans from ABC

Reversions Ltd."

Note 12 – if the *firm* does not give *personal recommendations* advise or give personalised information on both types of *equity release transactions*, then it should indicate to the *client* the sector that the *firm* does not cover. However, if the *firm's* scope of service does not include *equity release transactions*, the last box ('We do not offer [lifetime mortgages] [home reversion plans]'), should be omitted.

Note 13 – in describing the services and products provided, *firms* should omit the text in brackets that do not apply and ensure that they describe accurately their activities with respect of the services and products that they offer, as follows:

(1) Headings and sub-headings:

a. If the *firm* offers both *regulated mortgage contracts* and *home purchase plans*, it should include the heading "Home Finance Products" in the *combined initial disclosure document* and describe the *regulated mortgage contracts* and *home purchase plans* that it offers under two separate sub-headings. The sub-headings ("Mortgages" and "Home Purchase Plans") should be numbered accordingly. If the *firm* only offers one of these two products, then the heading "Home Finance Products" should be omitted and the heading will read "Mortgages" or "Home Purchase Plans", as appropriate.

b. If the *firm* offers *equity release transactions*, then the heading "Home Finance Products" should be omitted and the heading will read "Equity Release Products" (even if the *firm* offers *equity release transactions* from only one sector).

(2) Describing the products:

a. If a *firm* gives *personal recommendations* or gives personalised information on lifetime mortgages, it should change "mortgage" to "lifetime mortgage"

b. If a *firm* gives *personal recommendations* or gives personalised information on home reversion plans, it should use the text in brackets relating to home reversion plans.

c. If the *firm* gives *personal recommendations* or gives personalised information on products from both equity release market sectors, then it should use the term 'equity release products' when referring to them collectively.

(3) Describing the provider: If a *firm* gives *personal recommendations* or gives personalised information on *home purchase plans* or *home reversion plans,* it should change "mortgage" to "product" and "lender" to "company" or "provider", as appropriate.

Note 14 – for services provided in relation to *home finance transactions*, this sentence is required only where a *firm* selects this service option. It may also be omitted if a *firm* chooses to list all of the *lenders*, *home purchase providers* and *home reversion providers* it offers *home finance transactions* from in the previous line, so long as the *firm* offers all of the products generally available from each.

Note 15 – this sentence is required only where a *firm* selects this service option. For services

provided in relation to *packaged products*, the list of products will be the range of *packaged products* that is appropriate having regard to the services that the *firm* is providing, or may provide, to the *client*. For services provided in relation to *non-investment insurance contracts*, this is the list required by *ICOBS* 4.1.6R(2).

Note 16 – if the *firm* does not select this box, it should alter the wording to say "a single group of companies" for *packaged products*, "a single insurer" for *non-investment insurance contracts*, "a single lender" for *regulated mortgage contracts* or *lifetime mortgages* and "a single company" (or "a single provider") for *home purchase plans* and *home reversion plans*. For example: "We only offer the products from a single group of companies" should replace the text in the specimen *combined initial disclosure document*.

Note 17 - the explanation of whose products the *firm* offers under this section should be fair, clear and not misleading. A *firm* should therefore enter, as free text, such further explanation as is needed of any additional factors that it considers to be relevant.

Section 2: Subsection on "Compliance with Islamic law" or other beliefs

Note 18 - This subsection is optional unless the *firm* holds itself, its *regulated mortgage contract* or *home purchase plan* products or services out as compliant with Islamic law in the *combined initial disclosure document*. If a *firm* includes this section it should describe it as Section 2 and renumber subsequent sections accordingly.

A *firm* that wishes to hold itself, its *regulated mortgage contract* or *home purchase plan* products or services out as compliant with religious or philosophical beliefs other than Islamic law in the *combined initial disclosure document* may also use the subsection in accordance with this note and modify the wording in the section to the extent appropriate.

Note 19 – A *firm* that carries on *home purchase activities* may omit the word "Islamic" from "Islamic home purchase plan(s)" if one or more *home purchase plans* within its scope of service is not held out as compliant with Islamic law. If "Islamic" is omitted, it should be omitted consistently throughout the document. However, a *firm* may omit the word "Islamic" in sections 5 and 8 without having to omit it throughout the document. A *firm* that wishes to hold itself, its products or services out as compliant with religious or philosophical belief other than Islamic law in the *combined disclosure document* may make appropriate amendments to references to "Islamic" and "Islamic law".

~~**Note 20** - a *firm* may include here a list of its services or the products on which advice is offered but if it chooses to do so the list should be fair, clear and not misleading and consist of only a factual description in summary form.~~

~~For example:~~

~~"We offer a full financial planning service or alternatively can provide specific advice on:~~

- ~~savings and investment,~~
- ~~protecting yourself and/or loved ones in the event of death, serious illness or disability,~~
- ~~retirement planning."~~

Section 4: What will you have to pay us for our services?

Note 20A – any reference in this section to "commission" means *commission* and *commission equivalent*.

Note 20B – *firms* that are not proposing to give *personal recommendations* on *packaged products* can amend this section accordingly. Those *firms* need not provide information regarding payment options but should provide at this section at least a statement explaining that the *client* will be told how much the *firm* will be paid before the *firm* carries out any business for the *client* and honour that undertaking. For example, "We will tell you how we get paid and the amount before we carry out any business for you."

Note 21 – *firms* should disclose all of the payment options that they will offer to the client, from the alternatives of *fee*, commission and/or a combination of both *fee* and commission.

Note 22 – *firms* holding themselves out as independent in accordance with COBS 6.2.15R are reminded that they are required to offer the fee option.

Note 23 – *firms* should include the headings: "**Paying by fee**", "**Paying by commission (through product charges)**" and "**Paying by a combination of fee and commission (through product charges)**". In addition, in accordance with the reference notes, a *firm* should provide an explanation in its own words relating to each option offered.

Additional text to be included under the heading "Paying by fee"

Note 24 – the text for describing a *firm's fee* charging arrangements is not prescribed, but should be clear and in plain language. This should commence with an explanation of the arrangements relating to the payment of *fees*, including any specific provision as to the timing for the payment of *fees*, the circumstances when *fees* will or will not be payable, (including where relevant payment of any "contingent" *fee*) and the arrangements for any commission paid in addition to *fees*.

For example:

"Whether you buy a product or not, you will pay us a fee for our advice and services, which will become payable on completion of our work. If we also receive commission from the product provider when you buy a product, we will pass on the full value of that commission to you in one or more ways. For example, we could reduce our fee; or reduce your product charges; or increase your investment amount; or refund the commission to you."

Example alternative text for the contingent fee – "If you buy a financial product, you will pay us a fee for our advice and services but if you do not buy a financial product, you will not have to pay us anything."

Note 25 – a *firm* should provide numerical statements of the amount or rate of its *fees* and these should be expressed in pounds sterling or another appropriate currency, where relevant. A *firm* may describe actual hourly rates where possible or typical hourly rates. If a *firm* describes typical rates it should undertake to provide the actual rate in writing before providing services (and honour that undertaking).

For example:

~~"Hourly Rate~~
~~We will confirm the rate we will charge in writing before beginning work. Our typical charges are:~~
~~Principal/Director/Partner £[XX-YY] per hour~~
~~Financial adviser £[XX-YY] per hour~~
~~Administration £[XX] per hour~~
~~We will tell you if you have to pay VAT."~~

~~"Lump sum~~
~~We will confirm what we will charge you in writing before beginning work. Our typical charges are:~~
~~Investments up to £[XX : YY]~~
~~Investments above £[XX : ZZ]~~
~~We will tell you if you have to pay VAT."~~

~~"Reviews~~
~~We will confirm what we will charge you in writing before beginning work. Our typical charges are:~~
~~Initial review : £[XX]~~
~~Annual review : £[YY]~~
~~We will tell you if you have to pay VAT."~~

~~"We may charge from £[XX] to advise and arrange a personal pension for you. We will confirm what we will charge you in writing before beginning work."~~

~~"We will confirm the rate we will charge in writing before beginning work and we will tell you if you have to pay VAT. You may ask us for an estimate of how much in total we might charge. You may also ask us not to exceed a given amount without checking with you first."~~

~~Additional text to be included under the heading "Paying by commission (through product charges)"~~

~~Note 26~~ ~~- the text for describing a *firm's* commission payment arrangements is not prescribed, but should be clear and in plain language. This should commence with an explanation of the arrangements relating to the payment of commission.~~

~~For example:~~

~~"If you buy a financial product, we will normally receive commission on the sale from the product provider. Although you pay nothing to us up front, that does not mean our service is free. You still pay us indirectly through product charges. Product charges pay for the product provider's own costs and any commission. These charges reduce the amount left for investment. If you buy direct, the product charges could be the same as when buying through an adviser, or they could be higher or lower."~~

~~Note 27~~ ~~- the *firm* should provide details of typical commission that might be received by the *firm* that reflect its actual business, together with an undertaking (which the *firm* should honour) to confirm the actual commission that will be received from any investments before the investment is completed. For example, a *firm* that does not have a significant weighting of business in any one area may provide examples showing commission for lump sum investments, whole life and pensions, whereas a pensions specialist may want to illustrate commission based purely on~~

pensions.

For example:

"The amount of commission we receive will vary depending on the amount you invest and (sometimes) how long you invest or your age."

For example,

- "If you invest £[XX] in an individual savings account (ISA) we would receive commission of [Y]% of the amount invested (£[ZZ]) and [AA]% of the value of the fund (roughly £[BB] every year).
- If you pay £[XX] a month into a personal pension (with a term of 25 years) then we would receive commission of £[YY].
- If you pay £[XX] towards a whole life policy then we would receive £[YY].

  We will tell you how much the commission will be before you complete an investment, but you may ask for this information earlier."

Note 28 - *firms* should indicate whether the commission includes payment for any ongoing service such as a periodic or ongoing review.

Additional text to be included under the heading "Paying by a combination of fee and commission (through product charges)"

Note 29 - the text for describing a *firm's* arrangements for paying by a combination of *fee* and commission is not prescribed, but should be clear and in plain language. This should commence with an explanation of the arrangements relating to the payment of *fees*, including any specific provision as to the timing for the payment of *fees*, the circumstances as to when *fees* will or will not be payable, (including where relevant payment of any "contingent" *fee)* and the arrangements for any commission paid in addition to *fees*, together with an undertaking (which the *firm* should honour) to confirm the actual commission that will be received from any investments before the investment is completed.

For example:

"We will charge you a combination of fee and commission. The fee will not exceed the rates shown in this document. We will agree the rate we will charge before beginning work and we will tell you if you have to pay VAT. The fee will become payable on completion of our work. You may ask us for an estimate of how much in total we might charge. You may also ask us not to exceed a given amount without checking with you first. We will tell you how much the commission will be before you complete an investment, but you may ask for this information earlier."

"We charge a consultation fee of up to £[X], and, if you buy a financial product, we will also retain commission within the amounts set out in the section headed "**Paying by commission (through product charges)**"."

"We will charge you a combination of fees and commission. The actual amounts will depend on the service provided to you, but will be in line with the arrangements set out in the sections headed "**Paying by fee**" and "**Paying by commission (through product charges)**"."

~~"We charge an annual fee as described in the fee information set out above. If we arrange for you to purchase a financial product, then we will also retain commission which will be in line with the arrangements set out in the section headed "**Paying by commission (through product charges)**"."~~

~~**Note 30** – if *firms* offer a combination of *fee* and commission they can either:~~
~~(a) provide the detailed information relating to *fees* and commission, in which case *firms* should ensure that the information is provided in accordance with the guidance at the relevant Notes; or~~
~~(b) include an appropriate statement that refers the reader to the information provided under the headings of **"Paying by fee"** and **"Paying by commission (through product charges)"**.~~

~~**Note 31** - in order to comply with *COBS* 2.3.1R as qualified by *COBS* 2.3.2R, *firms* receiving non-monetary benefits may wish to disclose such benefits in summary form here, under the heading **"Other benefits we may receive".** If a *firm* does so, it should provide the undertaking described in *COBS* 2.3.2R(1) (to provide further details on request) in writing, in this section (and honour that undertaking). However, it is not the purpose of this section to provide significant or extensive explanation of non-monetary benefits such that it distracts from the wider purpose of the document.~~

~~For example:~~

~~"We advise on a range of products from a variety of firms; some of these firms provide us with annual training, which allows us to offer you a better service. This year we expect to receive in total [XX] hours worth of training from XYZ, ABC and DEF firms, predominantly from ABC. Some of the cost of this training may be passed to you as part of the total charges you pay should you chose a product provided by XYZ, ABC or DEF. Further information regarding these arrangements is available on request."~~

~~"ABC firm provides us with a specialised software CD-ROM and accompanying [XX] hours worth of training per annum. We use this software in processing your details when you apply for an investment product. Some of the cost of this software may be passed on to you as part of the total charges you pay ABC firm. Further information regarding this arrangement is available on request."~~

Note 20A - in this section, the *firm* should outline how it intends to charge its *clients* for the services provided. If the *firm* is not intending to provide a *personal recommendation* it should refer to the notes under 'Non-advised services' below. If the *firm* is intending to provide a *personal recommendation*, it should refer to the notes under 'Advised services'. If the *firm* is providing both a *personal recommendation* and 'non-advised' services, the *firm* should set out the charging arrangements for the non-advised and advised services separately, and make clear which charging arrangements apply to which service using appropriate sub-headings.

Note 20B –a *firm* should disclose all of the charging arrangements it offers its *clients*, from the alternatives of *adviser charge*, *fee*, *commission* or a combination.

Note 20C – if applicable, a *firm* should disclose to the *client* the possibility that other costs including taxes (for example VAT), related to transactions in connection with the *packaged*

product and that are not paid via the *firm* or imposed by it, may arise for the *client*.

Notes for non-advised services

Note 21 - any reference in this section to *"commission"* means *commission* and *commission equivalent*.

Note 22 – a *firm* that is not proposing to give *personal recommendations* on *packaged products* can amend this section accordingly. The *firm* need not provide information regarding payment options but should provide at this section at least a statement explaining that the *client* will be told how much the *firm* will be paid before the *firm* carries out any business for the *client* and honour that undertaking. For example, "We will tell you how we get paid and the amount before we carry out any business for you." If a *firm* chooses to provide the *client* with the total price in this section and any part of that price is to be paid in or represents an amount of foreign currency, the *firm* should provide an indication of the currency and the applicable currency conversion rates and costs.

Note 23 - in order to comply with *COBS* 2.3.1R as qualified by 2.3.2R, *firms* receiving non-monetary benefits may wish to disclose such benefits in summary form here, under the heading "**Other benefits we may receive**". If a *firm* does so, it should provide the undertaking described in *COBS* 2.3.2R(1) (to provide further details on request) in writing, in this section and honour that undertaking. However, it is not the purpose of this section to provide significant or extensive explanation of non-monetary benefits such that it distracts from the wider purpose of the document.

For example:
"We sell a range of products from a variety of firms; some of these firms provide us with annual training, which allows us to offer you a better service. This year we expect to receive in total [XX] hours worth of training from XYZ, ABC and DEF firms, predominantly from ABC. Some of the cost of this training may be passed to you as part of the total charges you pay should you choose a product provided by XYZ, ABC or DEF. Further information regarding these arrangements is available on request."

Notes for advised services

Note 24 – *firms* proposing to provide a *personal recommendation* on *packaged products* should use the following notes to provide information to the *client* on the *firm's* charging structure and the *client's* payment options.

Note 25 – a *firm* should include here its charging structure, outlining as closely as possible, the services that it offers and the charge for each service. The *firm* should ensure that this is presented in clear and plain language and, as far as practicable, uses cash terms.

Note 26 - the charging structure should be expressed in pounds sterling or, where relevant, another appropriate currency. Where a *firm's* charging structure is in non-cash terms, examples in cash terms should be used to illustrate how the charging structure will be applied in practice. Where a *firm* uses hourly rates in its charging structure, it should state whether the rates are actual or indicative and provide an approximate indication of the number of hours a particular service may take. If a *firm* chooses to provide the *client* with the total *adviser charge* in this section and any

part of that *adviser charge* is to be paid in or represents an amount of foreign currency, the *firm* should provide an indication of the currency and the applicable currency conversion rates and costs.

For example

Our charging structure

Service	Initial charge	Ongoing charge for twice yearly reviews
Review of your pension arrangements (pre-retirement)	Charged at £100 per hour (exc. VAT) - approx. 4-6 hours	
Advice on what to do with your pension fund (at retirement)	Charged at £130 per hour (exc. VAT) - approx. 2-3 hours	
Where to put your savings (for those with up to £25,000 to invest)	3% of your investment, if you go ahead with our recommendations	Service available on request for 0.5% of your investment per year

Note 27 - where a *firm* provides an ongoing service it should disclose the ongoing service that will be offered and that there will be an *adviser charge* for that service. The *firm* can also include in this section additional information the *client* would receive before the provision of the *personal recommendation* or related services.

For example

"There will be an additional charge for any ongoing work, such as periodic or ongoing reviews, we carry out on your behalf. We will confirm the rate, frequency and length of this ongoing service before beginning any ongoing service.

Note 28A - a *firm* must use the headings (i) "Your payment options" and (ii) the following sub-headings as applicable; "Settling your adviser charge in a single payment" and/or "Settling your adviser charge by instalments". A *firm* should outline the payment options offered to *clients* and any restrictions on these payment options. In addition, a *firm* should provide an explanation relating to each option offered in clear and plain language.

Note 28B - Additional text to be included under the heading "Settling your adviser charge in a single payment"

The text for describing how the *client* can settle the *adviser charge* through a single payment is not

prescribed, but should be clear and in plain language. This could commence with an explanation of the arrangements relating to the single payment of the *adviser charge*, including any specific provision as to the circumstances when an *adviser charge* will be payable, (including where relevant, payment of any "non-contingent" *adviser charge* (i.e. where the client will be charged even if they do not purchase a product)), the type of payments accepted by the *firm* and the timing for the payment of the *adviser charge*. For example:

"Whether you buy a product or not, you will pay us an adviser charge for our advice and services, which will become payable on completion of our work".
"You will be required to settle the payment of your adviser charge on completion of our work in [insert number of days] days. We accept cheque or card payments. We do/do not accept payment by cash. You will be provided with a receipt upon payment"

Note 28C - Additional text to be included under the heading "Settling your adviser charge by instalments"

This text should be included where a *firm* is offering payment of its *adviser charge* by instalments and no ongoing service is provided. *Firms* should make it clear that the option to pay by instalment does not relate to an ongoing service. A *firm* which offers the payment of an *adviser charge* over a period of time for ongoing services should use the text in **Note 30** below.
A firm should note that the option for *clients* to pay their *adviser charge* by instalments is only permitted where regular premium products are recommended (see *COBS 6.1.A.21)*. If a *firm* offers the option to pay the *adviser charge* by instalments, the *firm* must use the headings (i) "Settling your adviser charge by instalments" and (ii) the following sub-headings as applicable; "Paying by instalments through your recommended product" and/or "Paying by other arrangements".
The text for describing the option to pay for the *adviser charge* by instalments is not prescribed, but should be clear and in plain language. This should commence with an explanation of the arrangements relating to the payment of the *adviser charge* over time.

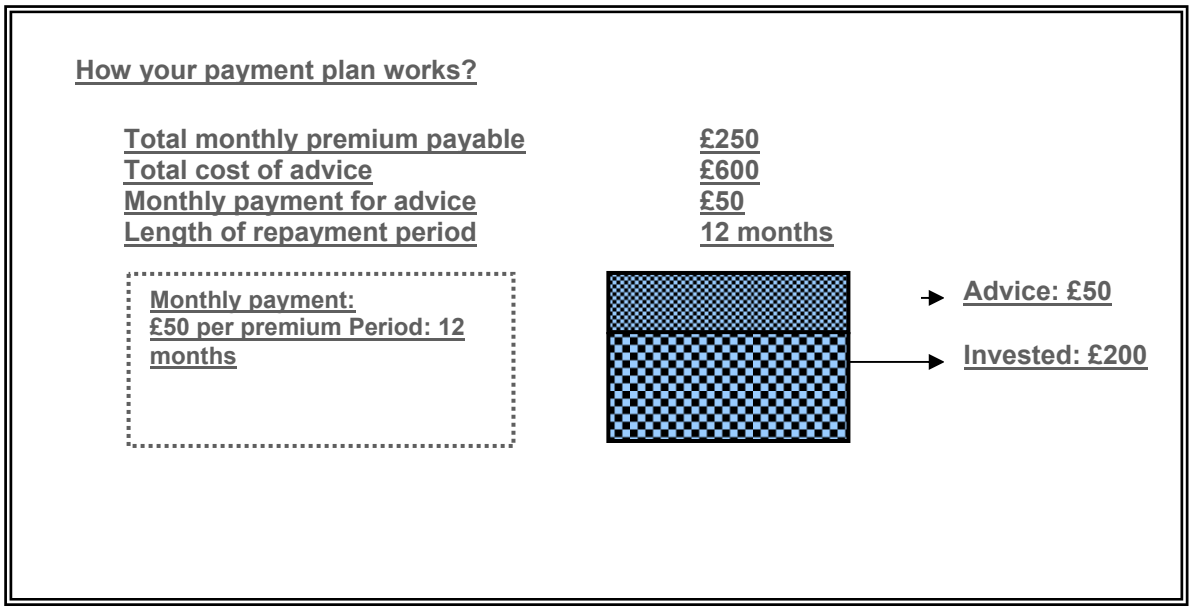
Note 28D - Additional text to be included under the heading "Paying by instalments through your recommended product"

A *firm* which offers the *client* the option to have the *adviser charge* facilitated through a *retail investment product* should include this heading. The text for describing a *client's* option to pay by instalment through the recommended *retail investment product* is not prescribed, but should be clear and in plain language. This could commence with an explanation of the arrangements including any specific provision as to the circumstances when this option is permitted/not permitted and the frequency and period over which this arrangement will operate. A *firm* could consider the use of graphical representations to ensure that the *client* understands what they are paying for; how much they are required to pay and how frequently.

For example

"If you buy a financial product, you can choose to have your adviser charge deducted from the product through instalments. Although you pay nothing to us up front, that does not mean that our service is free. You still pay us indirectly through deductions from the amount you pay into your product. These deductions will pay towards settling the adviser charge. These deductions could reduce the amount left for investment".

and



With the following text:

"You have chosen to pay for the advice you have received today through instalments. These instalments will be deducted from the premium you pay each month and allocated towards settling the adviser charge. For example, the total cost of advice is £600. You have been recommended a regular premium product of which £250 will be paid each month. £50 will be taken from this amount to pay off your adviser charge over 12 months. The remaining £200 will be invested during this time. At the end of this period the adviser charge would have been settled in full. From month 13 the full £250 will be invested".

Note 28E - Additional text to be included under the heading "Paying through other arrangements"

Where a *firm* is offering the option to pay its *adviser charge* by instalments through arrangements other than facilitating payment through the recommended *retail investment product*, it must use the heading "Paying through other arrangements". The text for describing the client's option to pay through other arrangements is not prescribed, but should be in clear and plain language. This could commence with an explanation of the option to pay through other arrangements and how this could work in practice.

Note 29 - Keeping up with your payments

This text is not prescribed but a *firm* must include the heading "Keeping up with your payments" if it is offering the *client* the option to pay by instalments. In this section the *firm* should outline the implications for the *client* if they fail to keep up with their payments before the *adviser charge* has been paid, including if its recommended product is cancelled before the *adviser charge* is paid.

Note 30 – Payment for ongoing services

If a *firm* provides an ongoing service to the client for which there is an *adviser charge* payable over a period of time, the *firm* must include the heading "Payment for ongoing services". The text for describing how the client pays for ongoing service is not prescribed but should be in clear and

plain language and should also include the nature of the service to be provided.

For example
"We have a range of ongoing services we can provide to ensure that your personal recommendation is reviewed frequently and remains relevant to your changing circumstances. The frequency of the charge will depend on the service you choose and is usually made by direct debit on the 1st of every month. Ask you adviser for more details"

"We offer an ongoing service where we review your account every 3 months and inform you of new recommendations or changes that may be relevant to your circumstances. This service is provided at a charge of [insert charge here] per month and can be either deducted from your investment or paid by direct debit. This service can be cancelled at any time. Please ask your adviser for more details"

Note 31 - in order to comply with *COBS* 2.3.1R as qualified by 2.3.2R, a *firm* receiving a benefit, in relation to the facilitation of the payment of an *adviser charge* may wish to disclose such benefits in summary form here, under the heading "**Other benefits we may receive**"**.** If a *firm* does so, it should provide the undertaking described in *COBS* 2.3.2R(1) (to provide further details on request) in writing, in this section and honour that undertaking.

For example

"ABC firm provides us with a specialised software CD-ROM and accompanying [XX] hours worth of training per annum. We use this software in processing your details when you apply for an investment product and wish to facilitate the payment of the adviser charge through deductions from your investment. Some of the cost of this software may be passed on to you as part of the total charges you pay ABC firm. Further information regarding this arrangement is available on request."

Note 32 – if the *customer* will be charged a *fee* for *insurance mediation activities* in connection with *non-investment insurance contracts*, insert a plain language description of what each *fee* is for and when each *fee* is payable. This should include any *fees* for *advising on* or *arranging* a *non-investment insurance contract* and any *fees* over the life of the contract, for example, for mid-term adjustments. If a *firm* does not charge a *fee* the text in the first box should be abbreviated to 'A fee'. If the *firm* is offering more than one type of service in connection with *non-investment insurance contracts*, the *firm* may aggregate the *fees* over all the services provided, and (if that is the case) identify the services for which there is no *fee.*

Note 33 – if the *firm* receives commission instead of, or in addition to, *fees* from the *client* for services relating to *home finance transactions*, it should insert a plain language explanation of this (see specimen for a plain language example). If the *firm* will pay over to the *client* any commission the *firm* receives, it may refer to that fact here.

Note 34 – insert a plain language description of when any *fees* are payable for services relating to *home finance transactions*. This description could include, for example, a cash amount, a percentage of the loan or reversion amount or the amount per hour, as appropriate. However, where a cash amount is not disclosed, one or more examples of the cash amount should be included. If a *firm* offers more than one pricing option in relation to *equity release transactions*, it should specify the pricing policy for each of them. For example, "A fee of £[XX] payable at the outset and £[YY] when you apply for a lifetime mortgage and £[ZZ] when

you apply for a home reversion plan". If a *firm* does not charge a *fee*, the text for the second box should be abbreviated to 'A fee'.

Note 35 – omit this part of the *combined initial disclosure document* on 'Refund of fees' if the *firm* has indicated that there will be "No fee" for services in relation to *home finance transactions* or that any *fee* will be payable only if the product completes.

Note 36 – *firms* may select as many boxes as appropriate.

Note 37 – insert a short, plain language description of the circumstances in which the *fee* for services in relation to *home finance transactions*-is refundable or not refundable as described. If the refund policy is different depending on the *equity release transaction* in question, the *firm* should specify the refund policy for each of them. For example, "A refund of £[XX] if your lifetime mortgage application falls through and a refund of £[YY] if your home reversion plan application falls through."

Note 38 – a *firm* may delete this line if it does not offer a partial refund for services in relation to *home finance transactions* in any circumstances.

Section 5: Who regulates us?

Note 39 – the *firm* may omit this section for services relating to *packaged products* if the *firm* has, on first contact with the *client*, provided the *client* with its *client agreement* which contains that information. This section may be omitted for services relating to *non-investment insurance contracts* if the information covered by this section is not required by *ICOBS* or is required by *ICOBS* but is provided to the *customer* by some other means. This section may be omitted for services relating to *home finance transactions* in accordance with *MCOB* 4.4.1R(3). If this section is omitted, the other sections of the *combined initial disclosure document* should be renumbered accordingly.

Note 40 – if the *firm's* address on the *FSA Register* differs from that given on the *combined initial disclosure document* under Note 5, the address on the *FSA Register* should be given in this section. If the address is the same as that given under Note 5 it should be repeated in this section.

Note 41 – where the *authorised firm* trades under a different name from that under which it is *authorised*, it should include the name under which it is *authorised* and listed in the *FSA Register*. It may also include its trading name(s) if it wishes.

Note 42 – an *incoming EEA firm* will need to modify this section if it chooses to use this *combined initial disclosure document* (see *GEN* 4 Annex 1R(2)). A *tied agent* that is regulated in an *EEA State* other than the *United Kingdom* will similarly need to modify this section.

Note 43 – insert a short, plain language description of the business for which the *firm* has a *permission* which relates to the service it is providing.

Note 44 – where the information is provided by an *appointed representative* or *tied agent*, the *appointed representative* or *tied agent* should use this text instead. The *appointed representative* or *tied agent* should give details of the *authorised firm(s)* that is its *principal(s)*

for each type of service that it is providing to a particular *client*.

Section 6: Loans and ownership

Note 45 – omit this section where there are no relevant loan or ownership arrangements under the following notes or if the *firm* is an *insurer* selling its own *non-investment insurance contracts*. If this section is omitted the other sections of the *combined initial disclosure document* should be renumbered accordingly. If the *firm* is not providing services in relation to *packaged products*, the heading of this section should be changed to 'Ownership'. Where the information is provided by an *appointed representative* or *tied agent*, it should cover loans made to or by that *appointed representative* or *tied agent* or holdings in, or held by, that *appointed representative* or *tied agent* as appropriate.

Notes 46, 47 and 48 apply only to a *firm* making a *personal recommendation*, *dealing in*, or *arranging* in relation to *packaged products*.

Note 46 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *firm* which is held by a provider or *operator* of a *packaged product* or by the parent of the provider or *operator*.

Note 47 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of a provider or *operator* of a *packaged product* which is held by the *firm*.

Note 48 – insert, in the *firm's* own words, a short description of any *credit* provided to the *firm* by a *product provider* (other than *commission* due to the *firm* in accordance with an indemnity claw-back arrangement) or by any *undertaking* in the *immediate group* of the *product provider* where the amount of the *credit* exceeds 10 per cent of the share and loan capital of the *firm*.

Notes 49 and 50 apply to an *insurance intermediary* providing services in relation to *non-investment insurance contracts*.

Note 49 – insert, in the *insurance intermediary's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *insurance intermediary* which is held by an *insurance undertaking* or by the parent of an *insurance undertaking*.

Note 50 – insert, in the *insurance intermediary's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of an *insurance undertaking* which is held by the *insurance intermediary*.

Section 7: What to do if you have a complaint

Note 51 – if different to the address in Note 3, give the address and telephone number which is to be used by *clients* wishing to complain.

Note 52 – this text may be omitted for *non-investment insurance contracts* if the *insurance intermediary* or *insurer* is aware that a *commercial customer* would not be an *eligible complainant*.

Note 53 – if the *combined initial disclosure document* is provided by an *authorised professional firm* which is exclusively carrying on *non-mainstream regulated activities*, the *authorised professional firm* should delete this sentence and refer to the alternative complaints handling arrangements.

Note 54 – if the *firm* is carrying on an activity from an establishment which is outside the *United Kingdom* it should make clear that the *Financial Ombudsman Service* will not be available. The *firm* may refer to any similar complaints scheme that may be applicable.

Section 8: Are we covered by the Financial Services Compensation Scheme (FSCS)?

Note 55 – when an *incoming EEA firm* provides the *combined initial disclosure document*, it should modify this section as appropriate.

Note 56- when a *firm* which is not a *participant firm* provides the *combined initial disclosure document*, it should answer this question 'No' and should state the amount of cover provided (if any) and from whom further information about the compensation arrangements may be obtained.

Note 57 – where the *insurance intermediary* or *insurer* provides a service in relation to a compulsory class of insurance, such as *employers' liability insurance*, it should use this alternative text.

Note 58 – where the *insurance intermediary* or *insurer* provides a service in relation to a contract which covers both a compulsory class of insurance and a class of insurance which is not compulsory, it should indicate the level of compensation that applies to each class.

Home finance products warning

Note 59 – this warning box should be added when the *firm* sells *lifetime mortgages* or home reversion plans or both.

Note 60 – a *firm* should only include this paragraph if the services to which the *combined initial disclosure document* relates include *home purchase activities*. If the *firm* does not carry on *regulated mortgage activities*, it should include the second sentence and delete the third. If the *firm* carries on *regulated mortgage activities* as well as *home purchase activities* it should omit the second sentence and include the third.

…

9.6.6A G A *firm* will meet the requirements in respect of its obligation to provide written disclosure in the *rules* on describing the breadth of advice (*COBS* 6.2A.5R) and content and wording of disclosure *(COBS* 6.2A.6R) by providing its *basic advice* initial disclosure information.

…

9.6.8 R If a *firm's* initial contact with a *retail client* is not face to face, it must:

(1) inform the *client* at the outset:

(a) …

~~(b)~~ ~~whether the *firm* will select from, or deal with, *stakeholder products* from a single provider, or from more than one provider;~~

~~(c)~~ … (b)

~~(d)~~ … (c)

(2) … ~~;~~.

(3) if the contact is by spoken interaction, provide the *client* with the disclosure required by the *rules* on additional oral disclosure for firms providing restricted advice *(COBS* 6.2A.9R).

…

9.6.17 R (1) ~~When a *firm* provides *basic advice* on a *stakeholder product*, it must not hold itself out as giving independent advice.~~ [deleted]

(2) ~~Nevertheless,~~ When a *firm* provides *basic advice* on a *stakeholder product*, a *firm* may ~~still~~ use the facilities and stationery it uses for other business in respect of which it does hold itself out as acting or advising independently.

…

9 Annex 1 R **Basic advice initial disclosure document**

…

Information that comprises the following:	
…	
2.	~~a statement as to whether the *range of stakeholder products* on which advice will be given comprises products from a single *stakeholder product* provider, or a limited number of *stakeholder product* providers;~~ [deleted]
…	
5.	a statement disclosing any product provider loans (where such credit exceeds 10% of share and loan capital) and direct or indirect ownership (where that ownership exceeds 10% of share capital or voting power) either by, or of, a single *product provider* or *operator*; (See also notes ~~20-23~~ 32–35 in *COBS* 6 Annex 1G and notes ~~33-38~~ 45-50 of *COBS* 6 Annex 2)~~.~~
6.	~~A~~ a description of the arrangements concerning complaints and the circumstances in which the *retail client* can refer the matter to the *Financial Ombudsman Service*; (See also notes ~~24-25~~ 36–37 in *COBS* 6 Annex 1G and notes ~~39-42~~ 51–54 of *COBS* 6 Annex 2)~~.~~
7	a description of the circumstances and the extent to which firm is covered by the compensation scheme and the retail client will be entitled to compensation from the compensation scheme~~.~~; (See also notes ~~26-27~~ 38–39 of *COBS* 6 Annex 1G and notes ~~43-46~~ 55-58 of *COBS* 6 Annex 2)~~.~~
8.	any relevant disclosure required by the *rules* on describing the breadth of advice (*COBS* 6.2A.5R) and content and wording of disclosure (*COBS* 6.2A.6R).
…	

18.1 Trustee Firms

…

Application of COBS to trustee firms

18.1.2 R The provisions of *COBS* in the table do not apply to a *trustee firm* to which this section applies:

COBS	**Description**
6.1A	Adviser charging and remuneration
6.1B	Product provider requirements relating to adviser charging and remuneration
~~6.2~~	~~Describing the breadth of a firm's advice on investments~~
6.2A	Describing advice services
…	

…

18.2 Energy market activity and oil market activity

Energy market activity and oil market activity - MiFID business

18.2.1 R The provisions of *COBS* in the table do not apply in relation to any *energy market activity* or *oil market activity* carried on by a *firm* which is *MiFID or equivalent third country business*:

COBS	**Description**
6.1A	Adviser charging and remuneration
6.1B	Product provider requirements relating to adviser charging and remuneration
~~6.2~~	~~Describing the breadth of a firm's advice on investments~~
6.2A	Describing advice services
…	

…

18.3 Corporate finance business

Corporate finance business - MiFID business

18.3.1 R The provisions of *COBS* in the table do not apply in respect of any *corporate finance business* carried on by a *firm* which is *MiFID or equivalent third country business*:

COBS	**Description**
6.1A	Adviser charging and remuneration
6.1B	Product provider requirements relating to adviser charging

	and remuneration
~~6.2~~	~~Describing the breadth of a firm's advice on investments~~
6.2A	Describing advice services
…	

…

18.4 Stock lending activity

18.4.1 R The provisions of *COBS* in the table do not apply in relation to any *stock lending activity* carried on by a *firm* which is *MiFID or equivalent third country business*:

COBS	**Description**
6.1A	Adviser charging and remuneration
6.1B	Product provider requirements relating to adviser charging and remuneration
~~6.2~~	~~Describing the breadth of a firm's advice on investments~~
6.2A	Describing advice services
…	

Sch 1 Record keeping requirements

…

1.3G

Handbook reference	**Subject of record**	**Contents of record**	**When record must be made**	**Retention period**
…				
COBS 6.1A.24R	Adviser charging and remuneration	(1) the *firm's* charging structure; (2) the total adviser charge payable by each retail client; (3) where the total *adviser charge* paid by a *retail*	(1) when the charging structure is first used; (2) from the date of disclosure; (3) from the date of disclo-sure;	See *COBS* 6.1A.24R(1) to (3)

		client has varied materially from the charge indicated for that service in the *firm's* charging structure and the reasons for that difference.		
~~*COBS* 6.2.12R~~	~~Information about the *firm*, services and information: *packaged products*~~	~~*Scope* and *range* of *packaged products*~~	~~*Firm's scope* and range – from date on which superseded by more up-to-date record~~ ~~*Client*-specific records – from date of communication of *personal recommendation*~~	~~5 years~~ ~~5 years~~
…				

Appendix B

Draft amended notification to the European Commission

Notification and justification for amending certain requirements relating to the market for packaged products under Article 4 of Directive 2006/73/EC ("Level 2 Directive") implementing Directive 2004/39/EC ("Level 1 Directive")

This draft amendment relates to policies to be consulted on in June 2009, as part of the Financial Services Authority's "Retail Distribution Review"

1. The UK previously notified the Commission of its requirements on firms relating to the market for packaged products, regarding:

   a) the accuracy of representations about the nature of the service offered;

   b) information about products; and

   c) information about the costs of services.

2. We are proposing some changes to our policy approach in regard to **a)** and **c)** and, as a result, plan to update our notifications under Article 4 as explained in this paper. In order to be clear about precisely what changes we are making, we are not revoking our previous notifications[1], but will set out amendments to them in this paper.

3. Unless otherwise indicated, references in this paper to new requirements relate to the FSA's draft rules in Consultation Paper 09/18[2].

Update to Section 1: background description of the relevant UK market and risks

4. Our previous notification explained how, at present, the UK uses the description "packaged products" to mean units in regulated collective investment schemes (which include units in UCITS and certain non-UCITS retail schemes), shares in investment trusts (in certain situations)[3], life assurance policies with an investment component and certain types of pension product. Our "packaged product" rules currently apply in regard to all of these products, reflecting the widespread substitutability in the UK of investments that are within the scope of MiFID and those that are not.

5. At the time of our previous notification, the Commission had already highlighted the risk that differential regimes in such circumstances run the risk of competitive distortion, and this point is now being explored further through the Commission's work on Packaged Retail Investment Products[4].

---

[1] '*Notification and justification for retention of certain requirements relating to the market for packaged products under Article 4 of Directive 2006/73/EC ("Level 2 Directive") implementing Directive 2004/39/EC ("Level 1 Directive")'* is available from HM Treasury together with the UK's notification relating to the use of dealing commissions (please see from page 10 onwards of the document, currently available at: http://www.hm-treasury.gov.uk/d/mifid_article4_notification170907.pdf)

[2] *Consultation Paper 09/18 Distribution of retail investments: Delivering the RDR* (June 2009)

[3] As explained in our current notification, investment trusts are only treated as packaged products when sold through a dedicated service, as opposed to a more general equity brokerage service

[4] '*Communication from the Commission to the European Parliament and the Council: Packaged Retail Investment Products'*, 30 April 2009, http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm

6. With this in mind, we have given further consideration to recent product developments in the UK market, and have observed the increasing substitutability of certain products outside our current definition with those that we do classify as "packaged products". We propose to modernise our current approach, applying the amended rules discussed in this paper slightly more widely to cover "retail investment products" more generally, including structured retail investment products, structured retail deposits, unregulated collective investment schemes (including those that are exchange traded) and those investment trusts not currently captured, as well as the products that we currently classify as "packaged products". This change seeks to reflect the overall approach put forward by the Commission in its Packaged Retail Investment Products work.

Developments in retail investment products

7. The need to cover this wider range of products is demonstrated by their growing importance in the market:

- Structured products have been a popular choice for investors looking for security for their capital investment in the difficult market environment. There is no single, uniform definition of a structured product but a common feature is a guarantee offered on the capital invested if held to maturity. According to Arete Consulting, the total UK retail structured products market is worth around £35bn[5], comprising approximately 116 products available to UK investors. Sales have increased from £5,449m in 2003 to £8,120m in 2008. Banks are the main distributors of structured products, but recently increased sales by independent financial advisers may have been driving the higher volumes of structured products sales.

- Investment trusts are listed companies that invest in a wide variety of securities, but at present they are frequently not considered as "packaged products" because they are sold through general equity brokerage services. In September 2008, the Association of Investment Companies, the trade body that represents the majority of listed investment trust companies reported that there were 451 listed investment companies in the UK, with a total market capitalisation of £62bn and a total net asset value of £89bn (around 97% of which was investment trusts). There were 10,000 investment trust sales in the UK in 2007/08 while the value of investment trusts held through individual savings accounts (ISAs) has increased from £1,583m in 2004 to £2,087m in 2008[6].

Structure of the UK market: distribution and associated risks

8. In our current notification we explain, in some detail, the structure of the UK market, including the significant reliance of UK consumers on personal recommendations from advisers (both as part of independent and non-independent advice services) and the problem of so-called 'principal/agent' risks, which can arise from the way in which advisers are remunerated in the UK market and can lead to risks of bias in recommendations made to clients. These structural factors remain of significant

[5] GBP denominated products only; not including institutional, offshore or private banking. Arete Consulting provides paid-for data via its website, www.structuredretailproducts.com

[6] *Saving and Investing for the Long Term*, Mintel, February 2009

relevance in the UK, and we now aim to introduce more effective tools for tackling the risks already identified:

- *reliance of UK consumers on personal recommendations:* as identified in our current notification, UK consumers continue to rely on advisers to a greater extent than in many other member states, receiving independent or non-independent advice in a significant majority of cases. For example, in the period April 2007 to March 2008 almost two thirds (64%) of all retail investment product sales were on an advised basis[7].

- *principal/agent risk present in the UK:* the risk of remuneration bias distorting advice, explained in our current notification, remains of great concern in the UK. For example, research from CRA International commissioned by ABI found evidence of bias to recommend a particular type of product and also bias to recommend particular providers depending on the commission paid[8]. More recently, the Chairman of the Financial Services Consumer Panel reported on industry research showing that "firms can achieve a 70% increase in sales by a 10% increase in commission"[9], which indicates the continuing scale of the problem.

9. Given the continuing importance of these structural factors, it is important for us to attempt to tackle the issues identified in our current notification as effectively as possible. The arguments below reflect and explain our reasons for pursuing different approaches to those in our original notification, highlighting the evidence we now have that alternative approaches are more likely to be effective, or are now more viable than in the past.

Update to Section 2: the requirements covered by this notification

A – The accuracy of representations about the nature of the service offered

Amending our approach to the way that firms that give personal recommendations describe their services

10. At present, our rules specify two conditions that firms must meet if they wish to hold themselves out at 'independent' – a firm may only do so if it: a) advises on products from the whole market (or the whole of a market sector) (the "**whole of market requirement**"); and b) offers its clients the opportunity to pay for the advice solely by fee and, if a client chooses to do so, transfers to the client the value of any commission received (the "**fee option requirements**").

11. We now plan to move away from our current fee option requirements as part of a wider change to our approach to dealing with the risk of recommendations being

[7] *Retail Investments - Product Sales Data Trends Report*, FSA, September 2008, available at http://www.fsa.gov.uk/pubs/other/psd_trends_invest.pdf. Retail investment products covered in the data include pensions (personal, occupational, annuities and income drawdown), investment bonds, unit trusts, OEICs, investment trusts, structured capital-at-risk products, endowments, equity ISAs, and long-term care insurance.

[8] *Study of intermediary remuneration: A report for the Association of British Insurers,* CRA International, February 2005 (commented on by the author at http://news.bbc.co.uk/1/hi/programmes/moneybox/4545811.stm)

[9] Research from the Association of British Insurers referenced by John Howard, FSA Annual Public Meeting, July 2007 http://www.fsa.gov.uk/pages/Library/Corporate/Meetings/howard_07.shtml

biased as a result of the receipt of commission. In the next section of this paper we set out our new overall approach to information about the costs of services. (In the light of the changes we are proposing in the next section, we no longer anticipate that it will be proportionate to maintain a separate fee option requirement in relation to independent advice – please see the next section for further information on this.)

12. To address the risk of clients not understanding the nature of the service they receive, it remains important for us to set out, explicitly, what is required from firms that hold themselves out as "independent". However, consumer research indicates that the current advice framework in the UK remains characterised by a good deal of confusion[10]. Consumers participating in this research, which we published last year, initially referred to any advice they received as being received from an independent financial adviser, even when provided by a tied bank employee. The absence of any consistent terminology for non-independent firms to use to describe their advice may have contributed to this particular area of confusion, as consumers receiving non-independent advice from tied bank employees would not specifically be told that they were receiving restricted advice.

13. To deliver a clearer distinction for consumers between independent advice and other, restricted forms of advice, our amended rules require that firms giving personal recommendations on investments to retail clients make clear, using the following terms, whether their advice will be:

- "independent" if they base their personal recommendations for each client on a comprehensive and fair analysis[11] of the relevant market[12], which is both unbiased and unrestricted (a "**requirement to analyse the market comprehensively and fairly**") – this is similar to our current whole of market requirement; **or**
- "restricted", in which case they would need to make clear the nature of the restrictions on their service ("**requirement to make clear that advice is restricted**").

14. Following on from these requirements, if a firm offers both types of services we would also require it to make the differences clear and it would not be allowed to hold itself out as acting independently for its business as a whole.

15. This amended approach is designed to strengthen the distinctions between services available, to address the risk of consumers being misled about the services on offer. The updated approach, requiring firms to analyse the market comprehensively and fairly, also reflects the innovation and development that has occurred in the UK market. As many firms are choosing to adopt business models that involve performing some aspects of research and analysis centrally, rather than reviewing the whole

[10] *Exploration of consumer attitudes and behaviour with regard to financial advice and the implications of RDR proposals*, commissioned from GfK by the Financial Services Consumer Panel, January 2008 (available at http://www.fs-cp.org.uk/pdf/rdr_report.pdf)

[11] This would also bring our requirements more closely into line with language used in the Insurance Mediation Directive (Directive 2002/92/EC) - Article 12 describes the standards an insurance intermediary must meet when he informs the customer that he gives his advice on the basis of a fair analysis

[12] Where a firm provides independent advice in respect of a "relevant market" that does not include all retail investment products, the firm would be required to set out an explanation of its relevant market

market for each client individually, the new approach is designed to be more meaningful and appropriate, and also more easily communicated to firms than our current whole of market requirement.

In what way would the amended requirements be additional to those in the Level 2 Directive?

16. Our amended requirements fit with the Directive in broadly the same way as our current requirements. Articles 19(2) and (3) of the Level 1 Directive, together with the Level 2 provisions implementing them, require firms to inform clients about their services in a way that is fair, clear and not misleading and with appropriate information in a comprehensible form. The requirements to analyse the market comprehensively and fairly and to make clear that advice is restricted can be seen as an application of these principles to the way in which the concept of an independent adviser is generally understood in the UK market. We therefore believe our approach is entirely compatible with MiFID requirements for firms to provide appropriate information on their services in a comprehensible form.

17. As under our current approach, the amended requirement does not seek to create distinct investment services of firms that are 'independent' or ‘restricted’, but seeks to ensure that particular distribution models are correctly represented and understood, in a way that our consumer testing has indicated that consumers can understand. We therefore continue to notify our amended rules in this area on a precautionary basis, in case they are deemed to impose additional requirements beyond the Level 2 measures implementing Article 19.

Specific risks to investor protection not adequately addressed by the Level 2 Directive

18. As with our current notification, our amended requirements seek to address the risk of clients not understanding the nature of the services they receive, reflecting the evidence of our consumer research that significant consumer confusions remains at present. In addition, we believe that the requirements to analyse the market comprehensively and fairly and to make clear that advice is restricted are consistent with MiFID, and that it provides greater certainty for firms in the UK if the FSA to has clear rules on this point.

19. The high level "fair, clear and not misleading" principle in Article 19(2) of the Level 1 Directive and the requirement for “appropriate information … in a comprehensible form” in Article 19(3) set out the principles that firms need to meet, but in practice there is a need for effective and consistent application of these principles in the UK market, to tackle the risk of investor misunderstanding remaining.

20. Our original notification explained how earlier regulations in the UK limited the services that adviser firms could offer and created a strong focus on the question of whether or not firms offer “independent” advice. With this in mind, we felt the need to retain rules relating to the definition of “independent”. However, we now believe that the absence of a defined term for non-independent advice may also be causing confusion, as firms that provided restricted services can simply avoid the question of whether their services are independent. Research has highlighted the practical problem that independent financial adviser – or ‘IFA’– is ‘a handy catch-all term to

refer to financial advice'[13], supporting the need for an equivalent, standardised description for non-independent advice.

21. Our approach continues to reflect the importance of independent advice, with the introduction of requirements relating to the term "restricted advice" reflecting the need for consumers to understand whether any advice on offer to them is independent or restricted. The significant risks associated with poor consumer understanding, and the challenges associated with financial capability in the UK[14], mean that it will be important for the FSA to raise awareness of the types of advice – and for this purpose having standardised terminology for both services is essential.

In what way are the risks of particular importance in the circumstances of the market structure in the UK?

22. Our current notification under Article 4 includes information about the market structure operating in the UK and, in particular, highlights both the reliance of consumers on advisers, for independent or restricted advice, and the difficulties that consumers face in understanding the different services on offer to them. This is further supported by the more recent consumer research, referenced earlier, which evidences our concern that the consumer confusion about the current advice framework in the UK remains significant.

23. The structural issues we have identified create significant obstacles to consumers receiving information that will reasonably enable them to understand the nature and risks of the investment services they engage. These circumstances continue to drive our approach to the way that firms that give personal recommendations should describe their services. Our amended approach is designed to better reflect and deal with the risks to consumers, introducing a corresponding requirement relating to non-independent advice to better tackle the problems of consumer understanding that have arisen in the UK advice market.

Why is this approach proportionate?

24. This approach recognises concern in the UK that consumers are currently unable to effectively distinguish between independent advice and alternative services on offer to them, despite earlier attempts to achieve this. In reinforcing the MiFID principle that firms must communicate in a manner that is fair, clear and not misleading, the amended requirements do not involve significant additional burdens for firms.

25. Rather than attempting to deal with the risk of consumers being misled about the services on offer by placing restriction on the business models that firms can provide, the amended requirements offer a proportionate approach to achieving the outcome envisaged in Articles 19(2) and (3). The requirement to analyse the market comprehensively and fairly only applies where firms choose to advertise or conduct

[13] *Exploration of consumer attitudes and behaviour with regard to financial advice and the implications of RDR proposals*, commissioned from GfK by the Financial Services Consumer Panel, January 2008 (available at http://www.fs-cp.org.uk/pdf/rdr_report.pdf)

[14] See for example *'Levels of Financial Capability in the UK: Results of a baseline survey'* prepared for the FSA by Personal Finance Research Centre, University of Bristol in March 2006, available at http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf

their services under a particular label, meaning that firms are given the flexibility to operate their business on other models if they choose. We commissioned IFF Research to conduct qualitative consumer research aimed at identifying possible labels for non-independent advice that might be effective in communicating to consumers the restricted nature of the advice, before bringing forward the requirement to make clear that advice is restricted[15].

The rights of investment firms under Article 31 and 32 of Directive 2004/39/EC

26. As with our current notification under Article 4, these requirements would not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Level 1 Directive. This is because the FSA will not apply them to firms exercising rights under Article 31 and will only apply them to firms exercising rights under Article 32 in the circumstances contemplated in Article 32(7).

C – Information about the costs of services

Amending our approach to dealing with the risk of recommendations being biased as a result of the receipt of commission

27. Our current approach to addressing the risk of bias attempts to place significant reliance on the role of commission disclosure in tackling principal/agent problems in the UK advice market. Section C of our current notification contains a requirement relating to information about the costs of services, whereby we make firms disclose, explicitly, the amount of commission they receive in connection with a transaction or, where the firms is in the same immediate group as the product provider, they disclose a comparable figure known as 'commission equivalent' (the "**requirement to disclose hard commission or commission equivalent**"). As already been mentioned, we also place a related requirement on firms describing themselves as independent to offer consumers the option to pay by fee instead of commission.

28. Overall, this approach has not been successful in the way that we had hoped at reducing the focus of competition in the industry on the amounts of commission paid to investment intermediaries by product providers (leading to product bias or provider bias). Developments in remuneration mechanisms available from the industry have also occurred, which make alternative options for dealing with the risk more viable, and as a result we are proposing to amend our approach to dealing with the risks of recommendations being biased as a result of the receipt of commission.

29. We now seek to tackle the risk of product provider remuneration bias much more simply and directly than under our current, disclosure-based approach. Our new approach is to require that a firm must only be remunerated for making a personal recommendation to a retail client (and any other services provided in connection with it) by charges agreed between itself and the client (a "**requirement for adviser firms to determine their own adviser charges**"). Adviser firms would not be allowed to solicit or accept other commissions (or other payments or benefits) in relation to giving a personal recommendation, even if they intended to pass the benefits on to the client, and regardless of whether the product they were recommending was

[15] *Describing advice services and adviser charging* (June 2009) www.fsa.gov.uk/pubs/consumer-research/crpr78.pdf

manufactured inside or outside of the UK. Firms could, however, receive adviser charges in the form of deductions from their clients' investments.

30. This new approach is similar to the fee option requirement described earlier, which we currently apply to adviser firms that describe their services as 'independent'. However, under the new requirement proposed – which would apply to all adviser firms, whether or not they offered independent advice[16] – firms can agree with their clients a range of different mechanisms for collecting their charges. This includes being able to have the charges deducted from clients' investments, similarly to the current system whereby product providers deduct commissions from clients' investments to pay to advisers, ensuring consistency with the Directive.

31. Our concerns about the potential for commission to bias advice are by no means confined to the independent advice sector. Various past mis-selling cases in the UK have involved some firms in non-independent advice channels, including cases relating to precipice bonds, mortgage endowments and life assurance bonds. For example, we previously fined a bancassurer in regard to investment advice that was overly concentrated on particular products, as well as writing to the chief executive officers of firms that had previously been appointed representatives about a potentially inappropriate concentration of recommendations[17]. This case also provides an example of the substitutability, for many consumers in the UK, of different types of investment products (such as ISAs and life assurance bonds), highlighting the risk of remuneration bias occurring that relates to the *type* of product a firm recommends (which may arise even when a firm is advising from amongst the products of a single product provider). This reinforces the relevance of our proposals for non-independent advice as well as for independent advice.

32. In order to counter the principal/agent problems that exist in the UK, which create significant risk of advice being biased by commission, our new requirements are designed to ensure that, regardless of the type of advice being offered, a firm's remuneration would not be determined by the product provider that it recommended a product from. Adviser firms would no longer be able to recommend any products that automatically pay them particular commissions, in association with making the recommendation.

33. This approach to charging is described as 'adviser charging' in our new rules. It is designed to deliver a more effective approach than is achieved under our current rules to tackling the potential for commission payments to bias advice. Unlike with the current fee option requirement relating to 'independent' advice, firms will have choice, in practice, as to how they receive payment (for example, where their current practices do not risk creating bias, a commission-based firm could be remunerated on an equivalent basis to the present situation, receiving a percentage of a client's investment in return for their services).

[16] For the avoidance of doubt, the UK wishes to make clear that its new requirements relating to adviser charging would alter the obligations on firms that give advice rather than amending the definition of advice, set out in MiFID. So, for example, MiFID-driven conduct of business requirements, such as those on the suitability of advice, would apply even if the firm breached these additional requirements relating to adviser charging.

[17] A 'Dear CEO' letter on a review of former appointed representative firms, July 2003, is published at http://www.fsa.gov.uk/pubs/ceo/ceo_letter_25jul03.pdf

34. Our adviser charging requirements are designed to create a more effective solution to the principal/agent problems in the UK investment advice market, which we currently attempt to address through our requirement to disclose hard commission or commission equivalent. (This amendment to Section C of our notification applies only in relation to services that involve retail clients receiving a personal recommendation on retail investment products. We do not propose to amend Section C of our notification in relation to non-advised services, where we believe our existing rules on disclosure of commission and commission equivalent are more appropriate.)

Additional supporting requirements

35. As a corollary to the requirement on adviser firms, we will also place a requirement on UK firms that provide retail investment products[18] to retail clients that bans them from offering predetermined amounts of commission (or other payments or benefits) to UK adviser firms in relation to recommending their products. This will ensure that our rules tackle both the inappropriate payment and the inappropriate receipt of provider-determined commissions (an "**equivalent requirement on product providers**"), mirroring the general approach of Article 26 of the Level 2 Directive, which applies both where firms pay and where they are paid fees and commissions.

36. To achieve effective delivery of this approach, we would also introduce a number of supplementary rules to make sure that particular practices do not undermine our new approach ("**requirements relating to the practical application of adviser charging**"). These are included in this notification for completeness, but relate directly to the requirements already discussed:

- where a firm is offering a personal recommendation to a retail client, it must:
    - not set or operate an adviser charging structure that is likely to conceal the amount or purpose of any of its adviser charges from a retail client, and must not recommend a product with charges presented in such a way as to appear to offset any adviser charges that are payable (e.g. deferred product charges for an initial period give the impression that no money needs to be paid to the adviser firm);
    - devise a charging structure, disclose it to clients and explain to them any deviation from this structure, for example where they have requested non-standard services. (Firms would still have flexibility about what charging structures to adopt and how to disclose them; for example they could give clients a very detailed price tariff, or alternatively give much broader price ranges and then provide bespoke quotes.) This requirement aims to make sure that: our adviser charging proposals are not undermined by firms putting in place charging structures that perpetuate bias; that adviser charges are clear to clients; and that consumer detriment does not occur as a result of the introduction of adviser charging;

[18] Most providers of retail investment products are not subject to MiFID, but as a minority are – such as some structured product providers – our rules for product providers are included in this notification for the avoidance of doubt. To the extent that MiFID product providers conduct advice business, they will – like any other firms firm – be captured by our requirements with regard to adviser firms.

- make clear the total adviser charge payable in cash terms; as close as practicable to the time that it makes the personal recommendation or, where it can be calculated earlier, to the time when it can first calculate the amount of the adviser charge[19];

- where a product provider firm is collecting adviser charges from investments to pass to an adviser firm, it must:
  - validate the instructions it receives to pay adviser charges and monitor the impact of the charges responsibly, as well as offering reasonable flexibility in terms of the adviser charges it facilitates (to ensure that the adviser firm, not the product provider, is determining the charges payable);
  - not pay out adviser charges over a materially different time period, or on a materially different basis of another kind, to that in which it recovers them from the client[20];
- more generally, product providers must:
  - not advertise on the basis of the adviser charges that an adviser firm could receive, when recommending the firm's products or related services (e.g. not to advertise any 'decency limits' that they operate, beyond which they will require further validation of charges to be paid);
  - make clear the distinction between their product charges and any adviser charges payable, and not present their product charges in a way that may appear to offset any adviser charges that are payable (e.g. by charging negative product charges for an initial period, giving the impression that no money needs to be paid to the adviser firm).

37. Where a product provider makes a personal recommendation to a client in relation to a product manufactured or supplied by it (or any of its associates in the same immediate group) it should still be capable of meeting the requirements we have discussed above. In these circumstances, we want to ensure that a vertically integrated firm is not able to appear to provide 'free' advice services, by loading all of its charges into its products. So, we propose that such firms must ensure that their adviser charges are broadly representative of the services associated with adviser services (a "**requirement to ensure there is a level playing field between integrated and non-integrated firms"**).

38. Finally, we propose a requirement to make clear that, where a firm's adviser charges are payable over time, its clients can expect an ongoing service, and the nature of this

[19] The need for this sort of 'hard' or actual disclosure of payments to advisers is explained in detailed in Section C of our current notification - *Information about the costs of services (hard disclosure of commission and commission equivalent)*

[20] *'Association of British Insurers Research Paper 6: Customer Agreed Remuneration'* by CRA International, January 2008, highlighted the potential for a system of customer agreed remuneration to reduce the potential for provider bias only on the assumption that "provider bias does not re-emerge through competition focusing on factoring rates and decency levels" (available at http://www.abi.org.uk/BookShop/ResearchReports/CRA%20Final%20CAR%20Report.pdf)

service should be made clear[21] (a "**requirement to provide ongoing services in return for ongoing charges**"). This reflects not only our desire to ensure that adviser charges are clear to clients, but also our concern that adviser charges are designed in accordance with the best interests of clients and (where received through providers) to enhance the quality of the service to the client. Where no ongoing service is provided to the client in return, it is not at all clear that an ongoing payment to an adviser firm from a client's investments meets this requirement (although an exception can be made where advice relates to a product that the client will only contribute to over time, as the ability to pay adviser charges over time may allow such clients to afford advice in the first place).

In what way would the amended requirements be additional to those in the Level 2 Directive?

39. The Level 2 provisions under MiFID Article 19 do not deal explicitly with the types of charging structures a firm must offer. However, the requirement for firms to determine their own charges – and associated requirements discussed in this section – could be seen as going beyond MiFID by addressing the way that charges can be set within the scope of Article 26 of the Level 2 Directive.

40. Article 26 requires that fees, commission and non-monetary benefits provided to a firm by third parties do not impair compliance with the firm's duty to act in the best interests of the client. It is our view that current remuneration structures commonly in use in the UK market have grown up in conflict with the ideas behind Article 26, as the ability to set high commissions to be paid to adviser firms is used by product providers as a tool for securing distribution of their products.

41. Arguably, a requirement for adviser firms to determine their own charges (and the associated requirements discussed in this section) could therefore be seen as outside the scope of the Article 4 notification requirement and compatible with measures necessary for the implementation of the Directive. The requirements discussed are also consistent with, and reinforce, the approach outlined in Recital 39 of the Level 2 Directive, that commission payments should only be seen as designed to enhance the quality of the service to the client if the advice is not biased as a result. As noted earlier, we are not seeking to constrain the firms and clients from choosing to have adviser charges paid through deductions from clients' investments. However, we are including these requirements in our notification on a precautionary basis, in case they are deemed to be within the scope of Article 4.

Specific risks to investor protection not adequately addressed by the Level 2 Directive

42. The risks arising from principal/agent problems in the UK market are great, owing to the significant reliance of retail clients on intermediary firms to make personal recommendations about investments. As it can be difficult to establish whether bias has arisen in personal recommendations made to clients - and the incentives that may lead to commission bias are powerful - implementing the principle in Recital 39 in practice requires specific measures in order to be effective.

[21] In practice, this 'ongoing services' could take a number of different forms – such as the provision of an annual review for a basic portfolio through to much more sophisticated and frequent advice or discretionary management services.

43. Our attempts to address the risk of bias through disclosure to consumers have not been effective and our consumer research suggests that disclosure alone is unlikely to be effective in addressing the risk in future. Given this, a requirement on adviser firms to set their own charges (and associated requirements discussed in this section) appear necessary to address the conflict between current remuneration structures in use in the UK market with Article 26 of the Level 2 Directive.

In what way are the risks of particular importance in the circumstances of the market structure in the UK?

44. The significant reliance of retail clients on adviser firms, in regard to personal recommendations about investments, is an important feature of the UK market structure. Within this context, the potential impact of product providers influencing recommendations made, due to their control of intermediary remuneration, is great.

45. While in the past we had hoped to rely upon consumer awareness of the commissions being paid to their advisers to mitigate the risk of remuneration bias affecting recommendations made, our understanding of consumer behaviour and financial capability confirms that UK consumers currently struggle to understand how their adviser is paid. For example, research indicates that many consumers thought that the advice did not cost them anything - reflecting a misunderstanding about how commission payments currently operate and a lack of recognition that the payments could decrease the value of their investment[22]- and that the amount paid as commission would be small, therefore having little impact[23].

46. With consumers shown to be unable to comprehend and make use of information designed to assist them in challenging their advisers about the remuneration paid to them, it is clear that a more direct approach is needed. In order to deliver a successful implementation of the requirement that remuneration paid to a firm giving personal recommendations does not impair compliance with its duty to act in the best interests of the client, we need to constrain the potential for recommendations to be influenced by product providers through remuneration paid to intermediaries.

47. Overall, our amended approach is designed to significantly reduce the potential for product provider bias, and hence enable us to deliver a successful implementation of the Directive. The supporting requirements put forward relating to the practical application of adviser charging reflect the various practices that are of concern (or that could be of concern following the introduction of adviser charging) in the UK market. In order to illustrate some these concerns, we include the following examples (and while they do not all necessarily relate to MiFID business, the need to avoid creating competitive distortions means that the new requirements would be applied across retail investments products generally):

- *Widely differential commissions being paid:* The significant differences between typical commissions paid on certain life assurance based investments and

[22] *Consumer Research 64: Depolarisation Disclosure*, prepared for the FSA by GfK NOP, February 2008 (available at http://www.fsa.gov.uk/pubs/consumer-research/crpr64.pdf)

[23] *Consumer Research 65a: Services and costs disclosure - Qualitative research with potential and recent purchasers of financial products*, prepared for the FSA by BMRB Social Research, February 2008 (available at http://www.fsa.gov.uk/pubs/consumer-research/crpr65a.pdf)

potentially competing collective investment scheme mean that the potential for commissions to bias advice is fully evident. For example, when last published in November 2007, the market average adviser commission rate in the UK for a regular premium endowment was more than two-thirds more than for a regular contribution collective investment scheme[24]. With commission rates on competing products continuing to diverge, it is apparent that our approach to tackling the significant principal/agent problem in the UK has not been successful, and that the potential for commission to bias advice in the UK remains high.

- *Negative product charges:* In the UK, historically, some costs associated with the sale of life assurance unit-linked products were recovered by the insurer retaining a percentage of the client's investment (with the percentage left to be invested known as the 'allocation rate'). However, a practice has arisen in regard to some insurance-based investments to offer products that invest (or appear to invest) at the start of the product's term, more money than a customer has given the firm, with greater charges imposed later in the life of the product. This reflects the history and structure of the UK life assurance market where, typically, the sales focus is on the initial selling price and takes advantage of consumers' lack of financial capability to see the impact over the life of the policy. Products with negative charges (i.e. greater than 100% initial allocation rates) enable adviser remuneration to be taken without appearing to impact the customer's investment, meaning that product providers may be able to influence adviser recommendations by offering products with higher allocations. We therefore propose to stop providers from offering products with negative charging, to reduce the potential for provider bias.

- *Influence arising from product provider 'decency limits':* In December 2008, we published the results of a thematic review of advice in relation to pension switching. As some insurers already offer flexibility for adviser firms to select their own charges, which are deducted from the client's investment over an agreed timeframe, the review was able to highlight both the potential importance of product providers' controls on the amounts or adviser remuneration that can be taken and the need for product providers to give adviser firms information on the likely effects of the levels and shapes of remuneration chosen on the client's investment yield[25]. The large sums or percentages which some product providers tolerate as deductions mean that we remain concerned that advisers may be incentivised to make recommendations that are not in clients' best interests.

48. We would also support our requirements with supervisory efforts focused on ensuring that firms could not 'work around' the requirements: for example by ensuring that firms do not accept inducements in other forms that are not allowable under the requirements of Article 26 of the Level 2 Directive.

Why is this approach proportionate?

49. Our proposal to make firms set their own charges deliberately leaves firms with choice as to how they structure their fees or commissions – e.g. their charges could be

[24] Market average commission rates were calculated at 40% and 24%, respectively, and published on the FSA's website at the time for firms to use in disclosure documents.

[25] *'Quality of advice on pension switching: A report on the findings of a thematic review'*, FSA, December 2008

payable in cash or deducted from an investment. At the same time, product providers would continue to be able to offer different prices for their products, allowing competition to operate effectively. In granting such freedoms, we are confident of creating a proportionate approach, to tackle the problem of product provider influence over intermediary recommendations.

50. The viability of this approach is already demonstrated by some firms in the industry, as the past year has seen growing interest amongst firms in business models where advisers determine their own charges, instead of their being set by product providers. In particular, we have seen the growth of 'factory-gate pricing' amongst insurers, where a product provider sets the cost of a product and an intermediary sets a charge for their service separately, but the intermediary's charge can then be deducted from the client's investment over an agreed timeframe[26]. Industry research also suggests that a system where advisers set their own charges is seen by the insurance industry as commercially viable[27].

The rights of investment firms under Article 31 and 32 of Directive 2004/39/EC

51. As with our current notification under Article 4, these requirements would not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Level 1 Directive. This is because the FSA will not apply them to firms exercising rights under Article 31 and will only apply them to firms exercising rights under Article 32 in the circumstances contemplated in Article 32(7).

[26] Of the top 20 life assurance firms (based on total UK net premiums, the Association of British Insurers, 2006) approximately 10 operate some form of factory-gate pricing or similar remuneration system.

[27] *Research Paper 6: Customer agreed remuneration - research into the market impact of encouraging customer agreed remuneration*, Report by CRA International for the Association of British Insurers, January 2008 (available at http://www.abi.org.uk/BookShop/ResearchReports/CRA%20Final%20CAR%20Report.pdf)

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