

Distribution of retail investments: referrals to discretionary investment managers and adviser complaints reporting

July 2013



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We are asking for comments on this Consultation Paper by 4 October 2013.

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/consultation-papers/cp13-04-response-form.

Or in writing to:

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We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response 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 Rights Tribunal.

You can download this Consultation Paper from our website: www.fca.org.uk. Or contact our order line for paper copies: 0845 608 2372.

Abbreviations used in this paper

CBA	Cost benefit analysis
COBS	Conduct of Business sourcebook
CP	Consultation Paper
DIM	Discretionary investment manager
DISP	Dispute Resolution: Complaints sourcebook
FOS	Financial Ombudsman Service
FSMA	Financial Services and Markets Act 2000
GABRIEL	GATHERING Better Regulatory Information Electronically system
PS	Policy Statement
RIA	Retail Investment Adviser
RDR	Retail Distribution Review
SUP	Supervision Manual
TC	Training and Competence sourcebook

1. Overview

Introduction

- 1.1** We are publishing this Consultation Paper (CP) in response to questions we have received on how to apply the Retail Distribution Review (RDR) rules. Our proposals cover:
- Payments to advisers for referrals to discretionary investment managers (DIMs), which are banned for new business under the RDR rules. This paper clarifies what happens when an adviser recommends that a client places additional money with the same DIM from whom they receive payments following a pre-RDR referral.
 - Banning referral payments where an adviser firm does not provide personal recommendations to particular clients, but provides other services to them.
 - A minor amendment to the rules requiring complaints against individual advisers to be reported to us, to match the policy intention. This means that complaints concerning all activities when acting as a retail investment adviser – such as advice on shares and derivatives as well as retail investment products – should be included.
- 1.2** We make references in this CP to FSA Consultation Papers and Policy Statements. These documents can be found on the FSA website, which is no longer being updated, but is available at www.fsa.gov.uk.

New FCA approach

- 1.3** The proposals discussed in this CP should be considered with the new approach of the FCA. Our new approach to supervision, as set out on our website¹, assesses whether a firm is being run in a way that treats customers fairly. When firm-specific assessments are carried out, firms will need to answer the question *'does the firm have the interests of its customers and the integrity of the market at the heart of how the business is run?'*. As part of the new approach, we will expect firms to comply with the spirit of our rules as well as the letter, and adapt their business model accordingly.

Who does this consultation affect?

- 1.4** You should read this Consultation Paper if you are an adviser, discretionary investment manager or provider active in the retail investment market.

¹ Factsheet – How the FCA will supervise firms – www.fca.org.uk/static/fca/documents/factsheet.pdf

Is this of interest to consumers?

- 1.5** The proposals on referral payments may interest consumers and consumer bodies, as they will affect how firms interact with retail clients. Clarifying complaints reporting will mean that consumers can be more confident that we will be aware if their adviser's actions result in a complaint.

Context

- 1.6** Our proposals are intended to support our objectives of consumer protection, financial system integrity and effective competition in the interests of consumers.
- 1.7** For the proposals in Chapter 2, this will be achieved through clear adviser and discretionary investment charges, with advisers no longer being given payments by DIMs for new referrals.
- 1.8** For Chapter 3, making it clear that complaints reporting covers activities when acting as a retail investment adviser will help to raise professional standards. It will help us to protect consumers, as we will have more information alerting us to potentially poor advisers.

Equality and diversity issues

- 1.9** We have assessed the equality and diversity impact of our proposals and do not believe that they will give rise to any issues. However, we would welcome any comments you may have on this.

Next steps

What do you need to do next?

- 1.10** We want to know what you think of our proposals. Please send us your comments by 4 October 2013.

How?

- 1.11** Use the online response form on our website or write to us at the address on page 2.

What will we do?

- 1.12** We will consider your feedback. We intend to publish a Policy Statement by the end of the year.

2. RDR – payments for referrals to discretionary investment managers

Introduction

- 2.1** Rules banning referral payments by a discretionary investment manager to an adviser came into force on 31 December 2012. The ban applies where the adviser also provides personal recommendations to the client in question. When we consulted on those rules in CP12/27², we also asked:
- a.** whether respondents agreed that existing (pre-RDR) referral payments should be treated in a similar way to trail commission, so that advisers could not receive additional referral payments if they advised a client to add more money to their investments held with the DIM; and
 - b.** whether the ban on referral payments should be extended to cases where the adviser does not make personal recommendations to the client, but provides other services to them, such as passing on information from the DIM.
- 2.2** We are now consulting on draft rules on these two issues. Our proposals take into account the feedback we received to CP12/27, which is set out in Handbook Notice 125.³
- 2.3** If the rules are made following this consultation, we propose that they should come into force on 31 December 2014. In this paper we discuss the effects of our proposed rules.

Treatment of legacy business

- 2.4** In PS10/6⁴ we said that adviser firms should not be allowed to receive commission set by DIMs for recommending their services, just as they cannot receive commission set by product providers for recommending their products. However, we received queries on this from firms, so we consulted on amendments to ensure the rules clearly reflected our policy intention.
- 2.5** The consultation did not include draft rules on 'legacy' (pre-RDR) business. Instead, we asked a general question on whether we should treat such business in a similar way to the legacy guidance for trail commission set out in COBS 6.1A.4AAG. The feedback to that question was generally positive, and we followed up the consultation with informal consultation of trade and consumer bodies on four possible options. These were:

² CP12/27 Quarterly Consultation Paper No. 34 (October 2012) : www.fsa.gov.uk/library/policy/cp/2012/12-27.shtml

³ Handbook Notice 125 (December 2012): www.fsa.gov.uk/static/pubs/handbook/hb-notice125.pdf

⁴ PS10/6 *Distribution of retail investments: Delivering the RDR – feedback to CP09/18 and final rules* (March 2010).

1. Switch off all referral payments following a transitional period.
 2. Allow referral payments for pre-RDR referrals to continue, with payments being banned for post-RDR top-ups resulting from the adviser recommending that the client should pay more money into the investments held with the DIM.
 3. Allow referral payments to continue on the original investments, but switch them off following fund switches. This would be similar to the position under the legacy guidance for trail commission.
 4. Allow payments to continue for pre-RDR referrals, but reduce the level of payments if a recommendation was made post-RDR to pay more money into the investments held with the DIM.
- 2.6 We then carried out a survey of firms (both DIMs and adviser firms) on the first three options above. We reduced the number of options for the survey to the first three. The fourth option would have a less desirable outcome than the others, in that it would allow referral payments for top-ups to pre-RDR investments to continue indefinitely. And we received feedback during the informal consultation of trade bodies that it would be helpful to narrow the number of options for consultation.
- 2.7 Details of the results of the survey are set out in the cost benefit analysis (CBA). However, the responses showed the DIMs that replied to the survey made no or very few referral payments, while the amounts of income involved for the adviser firms that receive referral payments is very small.
- 2.8 The draft rules in Appendix 1 are based on the second option. They would ban new referral payments for top-ups into pre-RDR investments from the date they came into force, so would not affect payments on top-ups into pre-RDR investments made before that date. This option has the least impact on both DIMs and adviser firms, based on the survey responses. It will allow advisers to continue to receive payments for pre-RDR referrals, while being less complex for DIMs to administer than stopping referral payments following fund switches.

Q1: Do you agree that referral payments for pre-RDR referrals to discretionary investment managers should continue, with new payments on top-ups being banned?

Referral payments where no personal recommendations are provided but the adviser provides other services to the client

- 2.9 In CP12/27 we asked whether we should ban referral payments where an adviser firm does not make personal recommendations to that particular client, but provides other services to them. Such services could include (on a regular or occasional basis) providing the client with market research, or passing information from the DIM to the client. Only three respondents (out of 18) disagreed. Others supported our proposal, as they thought this would stop firms from getting round the ban on referral payments and also clarify the adviser's remuneration for the consumer.
- 2.10 The draft rules in Appendix 1 Annex A include an amendment to COBS 6.1A.6R(3), to refer to 'personal recommendations or other services in relation to retail investment products'.

This would only apply to firms within the scope of the RDR because they provide advice to retail clients on retail investment products.

- 2.11** COBS 6.1A.1R(1) has been amended to make clear that Section 6.1A applies to a firm which makes personal recommendations generally, even if it does not provide personal recommendations to a specific client. It does this by referring to personal recommendations in the plural. So the amendment referring to 'other services' would not apply to firms offering only non-advised services or to pure introductions, where the introducer has no further contact with the client. Referral payments in these circumstances can continue.
- 2.12** Payments not banned by the new rule will continue to be subject to the client's best interests rule (COBS 2.1.1R) and the inducements rules (COBS 2.3). To comply with the inducements rules, both the DIM and the adviser firm would need to ensure that they meet certain tests before paying or accepting such payments. This includes being able to demonstrate that the payment does not impair compliance with the firm's duty to act in the best interests of the client and, where relevant, is designed to enhance the quality of the service to the client and is clearly disclosed (COBS 2.3.1R).

Q2: Do you agree with our proposal to ban adviser firms from receiving referral payments if they do not make personal recommendations to particular clients but provide other services to them?

Q3: Do you have any comments on the referral payment rules in Appendix 1 Annex A?

Cost benefit analysis

- 2.13** Sections 138I and 138J of the Financial Services and Markets Act (FSMA) requires us to publish a cost benefit analysis (CBA) when proposing draft rules and when making rules that are significantly different from the draft consulted on. In particular, we are required to publish an analysis of the costs, together with an analysis of the benefits and an estimate of those costs and of those benefits.
- 2.14** However, if we believe that these costs or benefits cannot reasonably be estimated or it is not reasonably practicable to produce an estimate, we do not need to give one, as long as we explain why not.
- 2.15** Finally, no CBA is required if we consider there will be no increase in costs or there will be a cost increase of minimal significance.
- 2.16** Our approach to CBA considers the following incremental impacts of our proposals:
- the direct costs to us
 - the compliance costs to firms
 - the market impacts, and
 - the benefits.

2.17 The CBA compares the overall position if the proposed regulatory changes are applied and the overall position if they are not (i.e. the baseline).

2.18 In relation to legacy referral payments, the appropriate baseline would be the *status quo*; whereby these payments, as well as additional payments on top-ups, may continue indefinitely. Payments in relation to new referrals would remain banned under COBS 6.1A.6R(3), which came into force on 31 December 2012, following consultation in CP12/27 (the FSA's October 2012 Quarterly Consultation Paper).

Direct costs to the FCA

2.19 We consider that there will not be any additional costs for us going beyond normal ongoing supervision costs.

Compliance costs for firms

2.20 To research the costs and the impact of the first three options set out in paragraph 2.5, we carried out a survey of DIMs and adviser firms. This was sent to 95 DIMs and 126 adviser firms, and we received replies from 27 DIMs (including some firms which operate as both a DIM and an adviser) and 37 adviser firms.

2.21 It is reasonable to assume that the firms who responded to our survey represent those who are most likely to be affected by a policy on legacy referral payments. The non-responding firms are unlikely to be affected, particularly given the follow-up reminder and deadline extension we offered them. Of the firms who have responded, only 12 adviser firms and 18 DIMs indicated that they still have some legacy referral business (henceforth referred to as 'affected firms').

2.22 To assess the cost impact, we asked the affected firms to estimate the one-off and annual costs they would face from each of the three proposed options (see paragraph 2.5 for details of each option). We also asked DIMs to provide their firm's total annual expenditure and the annual expenditure attributed to legacy referrals for the financial year 2011/12. We asked firms receiving legacy referral payments (adviser firms and some DIMs) to provide their firm's total annual income and the income received from legacy referrals.

2.23 The responses to the survey questions allowed us to estimate the proportion of their business associated with legacy referrals. For those receiving legacy referral fees, the median of these payments accounted for just 0.8% of their firm's annual income. For the DIMs paying out referral fees, this accounted for 3.5% of their annual expenditure. So, even for the small number of firms affected by the proposed rule change, their legacy referral arrangements are a relatively small part of their overall business.

2.24 For all the proposed options, most of the affected firms indicated that the costs would be zero or minimal.

2.25 In particular, the option proposed in this CP (option 2) would result in the lowest cost burden for all affected firms. Specifically, as a one-off cost, the median for DIMs was £10,000 and zero for adviser firms. In terms of ongoing annual costs, the median was £5,000 and zero, for affected DIMs and adviser firms respectively.

2.26 Therefore, the overall direct costs for firms, with legacy referral business, are likely to be relatively small.

The impact on the market

- 2.27** To assess the relative impact of our three proposals on firms' business strategies, we asked the survey respondents to rank each of the proposed options by order of the impact on their business.
- 2.28** The combined survey responses indicated that option 2, the policy proposed in this CP, was deemed to have the lowest overall impact on the firms' business strategy. This was followed by option 3 and option 1 respectively.
- 2.29** According to our survey, the aggregate value of fees from legacy referrals was around £23m in the financial year 2011/12. This figure is likely to have gone down since and will continue to diminish, as more consumers switch to post-RDR investments. For our proposed policy option, the foregone fees on these top-ups are likely to be just a fraction of the £23m.
- 2.30** We therefore do not expect there to be any material impact on the market arising from our proposals, given that they would affect a small proportion of the retail investment advice sector and that even affected firms generally pay or receive very small relative amounts of referral fees.
- 2.31** However, our proposal is likely to provide competition benefits for customers who are still paying referral fees. This is because the *status quo* may influence advisers' selection of DIMs, rather than considering the full range of suitable products.

Benefits

- 2.32** This policy would only impact a small proportion of the market and most of the affected firms have noted that the implementation costs would be minimal.
- 2.33** Our proposals are in line with the RDR objective of clarifying charges for consumers. Firms that responded to the survey also saw the following benefits:
- simplicity and transparency for clients, including a better understanding of what they are paying for
 - greater fairness for clients, particularly those who may not realise they are paying the adviser through the DIM's charges, and
 - reducing potential bias when the adviser is selecting a DIM to recommend, as the level of referral payments will no longer be a possible factor influencing the selection of the DIM.

Q4: Do you have any comments on our analysis of the costs and benefits in relation to our proposals on payments for referrals to discretionary investment managers?

3. Retail investment adviser complaints reporting

Background

- 3.1** Under the RDR we introduced a range of requirements for firms focusing on the professional standards of their retail investment advisers. The requirements include attaining qualifications as evidence of meeting initial standards and then complying with ongoing behaviour standards and carrying out regular continuing professional development activities. Firms are also required to alert us to competence or behaviour issues among their advisers and to inform us about complaints received in relation to their advisers.
- 3.2** This chapter sets out a proposed adjustment to the rules requiring firms to inform us about complaints at the level of their individual retail investment advisers. The rules were published in a Policy Statement in November 2011.⁵ The two complementary rules took effect on 31 December 2012 and require a firm to provide us with information on complaints about matters relating to the retail investment activities carried out by its retail investment advisers. They require:
- a regular, six-monthly complaints report (including nil returns), and
 - an ongoing notification that is triggered in the event an adviser is subject to three upheld complaints within 12 months or to one complaint paying more than £50,000 redress.
- 3.3** The changes were introduced to help inform supervisory activity in support of the RDR outcome to achieve 'standards of professionalism that inspire consumer confidence and build trust'. One way to achieve this would be for us to identify any problem advisers more quickly.
- 3.4** We intended to capture complaints relating to all activities carried out as a retail investment adviser. In practice, certain activities, such as advising on securities and/or derivatives that are not classified as retail investments are not captured in the rules. In addition '*retail investment activities*' does not include two aspects of the definition of retail investment products, introduced as part of the RDR rules.⁶
- 3.5** If the adjustments to the rules are made following this consultation, we propose that they should come into force in early 2014.

⁵ PS11/13 *Data Collection: Retail Mediation Activities Return and complaints data – feedback to CP11/8 and final rules.*

⁶ The two specific aspects of the Glossary definition of Retail Investment Product are:

- a security in an investment trust;
- 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.

Why are we doing this?

- 3.6** We believe that overall we should adjust the rules in the interests of consumer protection. Adjusting the rules to refer to activities carried out when acting as a retail investment adviser will align the scope of all the RDR professionalism rules to the same individuals and the activities they carry out. This will ensure that advisers are subject to the same standards and scrutiny – for example, if they advise on collective investment schemes or on shares or derivatives. We are concerned that if we do not make the proposed adjustment, poor quality advisers that specialise in shares or derivatives (for example) could fall under our radar and the clients of these advisers could suffer.
- 3.7** Advice on shares and derivatives is an area of concern for us in terms of advice suitability and we have taken enforcement action in this area in the past. We have published a number of final notices against firms, including specific cases of poor advice for penny shares and contracts for differences.⁷

The proposed changes

- 3.8** We will adjust the rules to ask for information to be provided to us on the basis of the wording ‘complaints about matters relating to activities carried out by any one employee when acting as a retail investment adviser’.
- 3.9** This would therefore include advising on securities and/or derivatives and/or retail investment products and/or Friendly Society tax-exempt policies and/or advising and dealing in securities and/or derivatives.

How will we use this data?

- 3.10** We are relying more on data than we have done previously, to help us make quicker, bolder decisions and take action earlier. We will use the enhanced data to improve our ability to monitor individual retail investment advisers. This applies both at the point their firms apply for them to become approved by the FCA, in cases when advisers take up employment with a new firm, and on an ongoing basis after they have become approved.

What are the costs and benefits?

- 3.11** The requirements on us to carry out cost benefit analysis and our approach are explained in Chapter 2. The appropriate baseline for this scenario would be where no changes were made to the rules on complaints. In this case, experience has shown us the way the rules are applied suggests there is some ambiguity. Some firms report on all complaints relating to activities carried out in the capacity of a retail investment adviser, while other firms may not include non-retail investments.

⁷ Final notices are published on the FCA website and several cases can be viewed at the following links: [Examples 1](#), [Examples 2](#).

Direct costs to the FCA

3.12 Costs to the FCA include adjusting the web pages, editing a Gabriel⁸ reporting screen and dealing with some additional complaint alerts. These costs will be minor and they will be absorbed within business as usual budgets.

Compliance costs to firms

3.13 We recognise that there may be costs to some firms in collecting and reporting the data to us as a result of the rule adjustment. Based on our analysis arising from CP11/08 from 2011 we believe that most respondents interpreted our proposals as we intended – that complaints relating to activities carried out when acting as a retail investment adviser would be included.

3.14 In our CBA in CP11/08 we noted that the costs to firms from reporting complaints at the level of their individual advisers as part of the RDR would be minimal. Therefore, our initial hypothesis in preparing for this consultation was that the proposed adjustment to the existing rules would mean relatively much smaller costs than when the rules were introduced. This is because we expected them to have a non-material impact on a minority of firms and advisers.

3.15 We wanted to validate this hypothesis and we also could not be sure that a small proportion of these incurred costs might have to be incurred again in a few cases where firms are not set up to report on all complaints. We have therefore carried out further investigations among industry bodies and firms, including those that we believe advise on securities or derivatives that are not also retail investments. We also reviewed the early data that we received from firms under the new complaints rules.

3.16 Initially we reviewed our 2012 adviser research⁹ that helped us to understand the size and shape of the market that might be affected by the adjustment to the rules. Analysis of the data suggests that there are two categories of firms that might be affected.

- **Category A:** this group is made up of advisers who only advise on, or advise and deal in securities and/or derivatives that are not also retail investments. For example, they advise on shares but do not also advise on collective investment schemes. We estimate that there are around 20-80 firms and fewer than 0.5% of advisers – around 100 to 200 individuals – in this category. Some of these firms may already be reporting under the new rules, in line with the intent of the policy. The firms that are not reporting will see the greatest impact from the proposed adjustment.
- **Category B:** this group is made up of advisers who advise on, or advise and deal in securities and/or derivatives as well as other retail investments. Our research estimated that this group contains in the region of 10% of advisers or 3,000 individuals. We believe that many of these firms are already reporting under the new rules, in line with the intent of the policy. The firms that are not reporting will need to extend the scope and so will see some effects, although we would expect this to be limited.

3.17 We contacted firms, trade and professional bodies that we believed would be most affected by the adjustment to the rules. This included discussions, emailed questions to members of an industry training and competence strategy group¹⁰ and an online survey among firms.

⁸ GABRIEL is the main FCA reporting system that firms use to provide regular reporting including complaints.

⁹ FSA commissioned research which is due to be published during the consultation period.

¹⁰ The Training and Competence Strategy Group is an industry-led group that encourages dialogue and good practice amongst members and is made of up training and competence managers from 20-30 firms across different sectors. Member firms account for around 20% of the retail investment adviser population.

- 3.18** Trade and professional bodies did not believe that there would be a significant impact from making the adjustment. Responses from the firms within the strategy group confirmed this. Their advisers included those advising on retail investments, the wider definition of retail investment products as well as shares and derivatives. More than half of the group firms responded and in all cases they indicated that there would be no impact on their firm.
- 3.19** The firm survey was sent to 100 firms, 20 of which were Category A firms and 80 were Category B firms. We received 68 responses, of which 45 had advisers advising on shares and/or derivatives. Most of these also advised on retail investment products.
- 3.20** Our findings from this analysis support our initial hypothesis, that the proposed adjustment to the rules will only have a small impact on the few firms that will be affected at all. No firms responding to our firm survey indicated that the amendments would have a significant impact. The majority, 87%, had interpreted the rule to include the activities of a retail investment adviser. The 13% that had interpreted the rule not to include all adviser activities – so they were excluding complaints arising from advice on shares and/or derivatives – said either there would be no impact or no significant impact. There was no significant difference in responses between Category A and B firms.
- 3.21** Based on complaints reporting and related information received from firms, it is also apparent that other firms are already reporting in line with the intent of the rules. For example, they are including advice on shares in the form of direct equity investments.
- 3.22** We conclude that in practice the majority are reporting data to us as we intended. Where this is not the case we do not believe that the adjustment will cause firms to incur any significant costs.

The impact on the market

- 3.23** We do not expect there to be any significant impacts from our proposals, given that they affect only a small proportion of the market and the firms affected do not anticipate a significant impact. Even for the small number of firms and advisers affected, it is unlikely that this would lead to significant changes in market behaviour or exit from the market. It would potentially only affect the behaviour of some advisers, in that they would take a more cautious approach to avoid risking poor advice that could lead to consumer complaints against them.
- 3.24** We believe that the amendment to the complaints rules also ensures a consistent approach to all firms, as it removes the anomaly whereby complaints arising from certain activities such as advising on shares would not be reported.

Benefits

- 3.25** As stated in Chapter 2, we are not required to quantify the benefits where the costs are deemed to be of minimal significance. This policy amendment would lead to negligible costs to firms.
- 3.26** However, we believe that this amendment is likely to result in the following benefits:
- Consumer protection in this area would improve, due to the assurance that complaints would be reported to the FCA.
 - Firms would benefit from the clarity in the complaints they are required to report, given that there is some ambiguity with the current rules.

- The FCA would be able to identify poor quality advisers who currently fall under our radar, such as the poor quality advisers that specialise in shares or derivatives. Our supervision teams will have a fuller picture of adviser complaints and will be able to carry out more targeted supervisory actions. Our authorisations department will also have better information on which to base decisions to approve or reject adviser applications.

3.27 At the same time, firms reported that there might be certain benefits if the adjustment is made. Examples of these benefits would be:

- **For consumers:** making them more aware of how firms deal with complaints they receive and, if the firms use root-cause analysis, the firm would make appropriate changes to their policies, processes and procedures.
- **For firms:** adjusting the rule will avoid the need for firms to obtain and extract data, rewrite procedures and carry out training so that a subset of adviser complaints can be identified and reported.

Q5: Do you have any comments on our analysis of the costs and benefits in relation to the adjustment to the rules on adviser complaints?

Draft rules

3.28 The draft rules are set out in Appendix 1 Annex B.

Q6: Do you agree with our proposal to adjust the adviser complaints rules as described in Appendix 1 Annex B?

Annex 1

Compatibility with the general duties of the FCA

Introduction

1. We are required by section 138I(2)(d) of the Financial Services and Markets Act 2000 (FSMA) to explain why we believe our proposed rules are compatible with our strategic objective, advance one or more of our operational objectives, and have regard to the regulatory principles in s 3B of FSMA. We are also required by s 138K(2) of FSMA to state whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
2. This annex sets out our view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way that promotes effective competition in the interests of consumers (s 1B(4) of FSMA). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.

The FCA's objectives and regulatory principles

3. The proposals in this CP are primarily intended to advance our operational objectives of consumer protection, integrity of the financial system and effective competition.
4. For the proposals in Chapter 2, this will be achieved through transparency of adviser and discretionary investment charges, as advisers will no longer be able to receive additional payments from discretionary investment managers (DIMs), where a referral was made previously, and the adviser recommends the client to place more money with a DIM after the rules come into force.
5. For Chapter 3, making it clear that complaints reporting covers all the activities of retail investment advisers will provide greater protection for consumers, as the additional data will mean supervisors are alerted to potential problems with a particular adviser and can take action.
6. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well, because consumers and advisers will more easily be able to understand and compare adviser and DIM charges, and advisers will know that complaints related to all the advising and advising and dealing activities of retail investment advisers including advice on shares and derivatives will be reported to us.
7. When considering the proposals, we have had regard to the relevant regulatory principles set out in s 3B of FSMA, as explained below.

- The need to use our resources in the most efficient and economic way**
8. The proposals on referrals to DIMs will not affect how we use our resources. On complaints reporting, supervisors will receive some additional data from firms that advise on certain instruments such as shares and derivatives, but this will help supervisors to make the best use of their resources and target action at advisers shown by the data to potentially be providing poor advice.
- A burden or restriction should be proportionate to the benefits**
9. The ban on new referral payments to advisers will have minimal cost implications for firms and benefit consumers by making charges transparent. And the complaints reporting change will have little impact on firms, as shown by our cost benefit analysis, while ensuring consumers have better protection against advisers providing poor advice. So we consider the costs of the proposals to be proportionate to the benefits.
- Consumers should take responsibility for their decisions**
10. Our proposals on referrals to DIMs will provide greater transparency of adviser and DIM charges and help consumers to make informed decisions about the services they are offered. The change to the complaints reporting requirements is not directly relevant to this principle, as it is designed to alert supervisors to cases of poor advice by advisers. However, when considering the need for supervisory intervention we will consider the implications of this principle on a case-by-case basis. We recognise that a complaint may not be the fault of the adviser even where it is upheld by the firm.
- The responsibilities of senior management**
11. Our proposals on referrals to DIMs will require firms' senior management to ensure they implement the new requirements in a way that will achieve transparency of adviser and DIM charges for customers. And the adjustment to the complaints reporting requirements, to include advice on instruments such as shares and derivatives, should encourage senior management to take action where complaints show possible poor advice is being provided to their clients by a particular adviser.
- We should exercise our functions as transparently as possible**
12. We have engaged with the industry during the consultation, fulfilling this objective.
- Desirability of sustainable growth in the economy of the UK in the medium or long term**
13. Our proposals on referrals to DIMs are intended to make the operation of the discretionary investment market more transparent and open, which should encourage more effective competition and help to promote sustainable growth in the UK. The adjustment to the complaints rules supports our aim under RDR Professionalism to inspire consumer confidence and build trust. In turn, this should encourage greater consumer engagement with the advice sector.
- Desirability of exercising our functions in a way that recognises differences in the nature and objectives of businesses carried on by different persons**
14. When considering the proposals for consultation, we have taken into account the variety of firms operating in, or in conjunction with, the discretionary investment and advice markets.
15. In formulating these proposals, we had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on: (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s 1B(5)(b) of FSMA).

-
16. The proposals on referrals to DIMs will increase the transparency of the way in which advisers and DIMs operate and, therefore, reduce the opportunities for financial crime. The change to the complaints reporting requirements will also ensure that supervisors are alerted to complaints regarding advice on all activities when acting as a retail investment adviser, which could relate to financial crime.

Expected effect on mutual societies

17. We expect our proposals to have little impact on mutual societies, as they affect advisers making referrals to DIMs, the DIMs themselves and firms whose advisers provide advice on certain instruments such as shares and derivatives. Such firms are unlikely to be mutual and we therefore do not believe that mutuals are over-represented among the firms affected.

Compatibility with the duty to promote effective competition in the interests of consumers

18. The proposals on referrals to DIMs will increase the transparency of adviser and DIM charges and encourage effective competition, as consumers will have a better understanding of what they are being asked to pay for the services offered and will be able to make comparisons between different firms more easily. The change to the complaints reporting requirement will mean that advisers providing poor advice on shares and derivatives are reported to us, and will encourage firms to take action to ensure their services are of good quality and meet their customers' needs.

Legislative and Regulatory Reform Act 2006 (LRR)

19. We are required, under the LRR, to have regard to the principles in the LRR and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions). We have engaged with firms throughout this process and consider that the proposals are proportionate to the potential market failures identified.

Annex 2

List of questions

- Q1:** Do you agree that referral payments for pre-RDR referrals to discretionary investment managers should continue, with new payments on top-ups being banned?
- Q2:** Do you agree with our proposal to ban adviser firms from receiving referral payments if they do not make personal recommendations to particular clients but provide other services to them?
- Q3:** Do you have any comments on the referral payment rules in Appendix 1 Annex A?
- Q4:** Do you have any comments on our analysis of the costs and benefits in relation to our proposals on payments for referrals to discretionary investment managers?
- Q5:** Do you have any comments on our analysis of the costs and benefits in relation to the adjustment to the rules on adviser complaints?
- Q6:** Do you agree with our proposal to adjust the adviser complaints rules as described in Appendix 1 Annex B?

Appendix 1

Draft Handbook text

**RETAIL DISTRIBUTION REVIEW (ADVISER CHARGING No 7) INSTRUMENT
2013****Powers exercised**

- A. The Financial Conduct Authority makes this instrument in the exercise of:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 137A (The FCA’s general rules);
 - (b) section 137T (General supplementary powers); and
 - (c) section 139A (Power of the FCA to give 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 138G (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*].

Amendments to the Handbook

- D. The Conduct of Business sourcebook (COBS) is amended in accordance with the Annex to this instrument

Citation

- E. This instrument may be cited as the Retail Distribution Review (Adviser Charging No 7) Instrument 2013.

By order of the FCA Board
[*date*]

Annex

Amendments to the Conduct of Business Sourcebook (COBS)

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

Application – Who? What?

- 6.1A.1 R (1) This section applies to a *firm* which makes ~~a *personal recommendation*~~ personal recommendations to ~~a *retail client*~~ retail clients in relation to ~~a *retail investment product*~~ retail investment products.

...

Requirement to be paid through adviser charges

- 6.1A.4 R Except as specified in *COBS* 6.1A.4AR, *COBS* 6.1A.4ABR, *COBS* 6.1A.4ACG and *COBS* 6.1A.4BR, a *firm* must:

...

- 6.1A.4A G ...
A

- 6.1A.4A B R A *firm* and its *associates* may solicit and accept a commission, remuneration or benefit of any kind from a *discretionary investment manager* in the circumstances in *COBS* 6.1A.4R if:

- (1) the *firm* or its *associates* recommended the *discretionary investment manager* to a *retail client* on or before 30 December 2012;
- (2) the solicitation and acceptance of the commission, remuneration or benefit of any kind was permitted by the *rules* in force on 30 December 2012;
- (3) the contract under which the right to receive the commission, remuneration or benefit of any kind was entered into on or before 30 December 2012;
- (4) the terms of that contract as at 30 December 2012 included the right to receive the commission, remuneration or benefit of any kind; and
- (5) the *retail client* agreed an investment mandate with the *discretionary investment manager* within a reasonable time of the recommendation to use the *discretionary investment manager* being made.

- 6.1A.4A G (1) If a firm makes a recommendation of a discretionary investment manager to a retail client and wishes to:
- C
- (a) receive remuneration for that recommendation in addition to any commission, remuneration or benefit of any kind it receives in the circumstances contemplated by COBS 6.1A.4ABR; or
- (b) be paid additional amounts for any actions linked to a new amount invested by the retail client through the same discretionary investment manager;
- it should only be paid those additional amounts for that recommendation or for those actions by adviser charges.
- (2) A firm may offset against any adviser charges which are payable by the retail client any commission, remuneration or benefit of any kind it receives in the circumstances contemplated in COBS 6.1A.4ABR.

...

6.1A.6 R ‘Related service(s)’ for the purposes of COBS 6.1A includes:

...

- (3) recommending a *discretionary investment manager* to a *retail client* (to whom the *firm* provides *personal recommendations* ~~on~~ or other services in relation to retail investment products).

6.1A.6A G ‘Other services’ in COBS 6.1A.6R(3) includes:

- (1) providing information relating to retail investment products to the retail client, for example, general market research; or
- (2) passing on information from the discretionary investment manager to the retail client.

...

RETAIL DISTRIBUTION REVIEW (COMPLAINTS DATA) INSTRUMENT 2013**Powers exercised**

- A. The Financial Conduct Authority (“FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules); and
 - (2) section 137T (General supplementary powers).
- B. The rule-making powers listed above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*].

Amendments to the Handbook

- D. The Supervision manual (SUP) is amended in accordance with Annex A to this instrument.
- E. The Dispute Resolution: Complaints sourcebook (DISP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Retail Distribution Review (Complaints Data) Instrument 2013.

By order of the FCA Board
[*date*]

Annex A**Amendments to the Supervision manual (SUP)**

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

Ongoing alerts for retail adviser complaints

- 10A.14.24 R (1) A *firm* must notify the *FCA*, in the form set out in *SUP* 10 Annex 9R, where:
- (a) in any twelve-month period, it has upheld three *complaints* about matters relating to ~~the *retail investment activities*~~ activities carried out by any one employee when acting as a retail investment adviser; or
 - (b) it has upheld a *complaint* about matters relating to ~~the *retail investment activities*~~ activities carried out by any one employee when acting as a retail investment adviser, where the redress paid exceeds £50,000.

...

Annex B

Amendments to the Dispute Resolution: Complaints sourcebook (DISP)

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

- 1.10.2A R (1) Twice a year a *firm* must provide the *FCA* with a complete report concerning *complaints* received from *eligible complainants* about matters relating to ~~the *retail investment activities*~~ activities carried out by its employees when acting as retail investment advisers. The report must be set out in the format in *DISP* 1 Annex 1CR.
- (2) *DISP* 1 Annex 1CR requires (for the relevant reporting period) information about:
- (a) the total number of *complaints* received by the *firm* about matters relating to ~~the *retail investment activities*~~ activities carried out by its employees when acting as retail investment advisers;
 - (b) the total number of *complaints* closed by the *firm* about matters relating to ~~the *retail investment activities*~~ activities carried out by its employees when acting as retail investment advisers;
 - (c) the total number of *complaints* upheld by the *firm* about matters relating to ~~the *retail investment activities*~~ activities carried out by its employees when acting as retail investment advisers; and
 - (d) the total amount of redress paid in respect of *complaints* upheld during the reporting period about matters relating to ~~the *retail investment activities*~~ activities carried out by its employees when acting as retail investment advisers.

...

1.10.3 G ...

[**Note:** See *SUP* 10A.14.24 R for the ongoing duty to notify *complaints* about matters relating to ~~the *retail investment activities*~~ of a activities carried out by any employee when acting as a retail investment adviser].

...

Annex 1CR Illustration of the online reporting requirements, referred to in *DISP* 1.10.2AR

This annex belongs to *DISP* 1.10.2AR

**COMPLAINTS BY RETAIL INVESTMENT ADVISERS REPORTING / NIL
RETURN DECLARATION**

- 1 Does the data reported in this return cover *complaints* about matters relating to ~~the retail investment activities~~ activities carried out by one or more employees when acting as a retail investment adviser (RIA)? ~~Please~~ If 'Yes', then please list the individual reference numbers (IRNs) of all the RIAs included in this return.

Yes / No

...

NOTES ON THE COMPLETION OF THIS RETURN**Nil Returns**

If no *complaints* have been received during the reporting period or none of the *complaints* received is about matters relating to ~~the retail investment activities~~ activities carried out by an employee when acting as a retail investment adviser the *firm* may submit a NIL RETURN by clicking on the relevant box.



PUB REF: 004753

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