

The FSA's Retail Distribution Review:

A Background

Updated: April 2010

Summary

The FSA has been undertaking a detailed review of the advice and sale of retail investment products for some time, aimed at improving public trust and confidence in the market and avoiding recurrences of the mis-selling scandals of the last decade. This document provides a background on the development of the proposals.

- Scope of the RDR
- Concerns over retail distribution of investment products: 2006
- General market developments: segmentation and remuneration
- Professionalism and reputation
- Detailed Proposals across successive FSA papers 2007-now
- Stakeholder Views: Where Are We Now?

Scope: What sorts of products are included in the RDR?

The RDR concerns the advice and distribution of *retail investment products*. These include:

- collective investment schemes (both regulated and unregulated)
- life assurance policies with an investment component;
- all investments in investment trusts, including investment savings trust schemes;
- certain types of pensions (not group personal pensions); and
- structured investment products

The RDR also applies to all *regulated advice* and any sales guidance concerning these and related products. So technically, advice given on other related savings products such as basic cash deposits and Cash ISAs also falls within the scope of the RDR. In a consultation in late 2009, the FSA consulted on extending at least part of the RDR proposals to group personal pensions; and pure protection products (see below).

Read-across to other sectors: there has also been discussion throughout the RDR process of the possibility of supplanting some of the proposals to other sectors such as mortgage distribution, and a Mortgage Market Review undertaken by the FSA starting in October 2009 explored this possibility.

Concerns over retail distribution of investment products: 2006

In September 2006, some of the FSA's concerns about the nature of the retail investment business market were summarised succinctly by its then chairman Callum McCarthy in his famous Gleneagles speech where he described this market as "broke".¹

This pushed the regulator into the review, strongly supported by many stakeholders both within the industry and outside of it who felt that overall public confidence in the retail investment market was severely lacking following some mis-selling scandals, and it needed decisive and coordinated action by both the regulator and the industry.

RDR Discussion Paper 07/1: Market Segmentation, Remuneration, etc

In June 2007, the FSA published the *Retail Distribution Review Discussion Paper*.² It summarised the findings of the review of the retail investment distribution market, namely five working groups which had been meeting through the year. It highlighted issues namely the poor quality of financial advice, commission bias, and the overall need to improve more generally the professional standards of those advising on or selling retail investment products.

The paper proposed a fundamental shake-up of the retail investment distribution market. It came from the starting point that:

- There is considerable confusion among consumers over what "advice" and "independent" actually mean in practice;
- The quality of financial advice and professional standards of those who distribute these products need to increase significantly;
- Solutions proposed could increase the cost of full financial advice; and
- There needs to be an economical way to deliver simple advice on simple products to more consumers.

The discussion paper centred around the following key areas:

Market Segmentation and Distributor Status

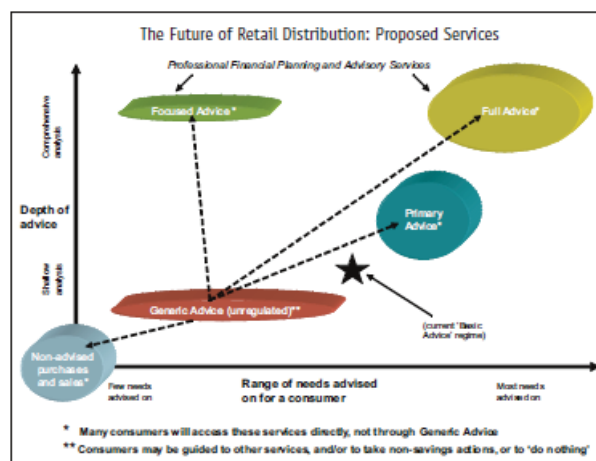
What is "advice"? What sorts of products should only be sold with advice? What does "independent" mean? What sorts of products should an independent adviser be able to advise on, to be described as such?

The paper proposed to address these outcomes by creating a new clearly labelled segmentation of the retail investment advice market matched with appropriate regulation. The extent to which the individual recommendations offer more or less well-defined options varies significantly throughout the paper

The paper envisaged a multi-tiered approach of investment product distribution with different standards of professionalism applied across each tier:

- Primary Advice for basic financial issues,

Retail Investment Distributor Categories, RDR Discussion Paper, June 2007 (p.19)



¹ http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0916_cm.shtml

² http://www.fsa.gov.uk/pages/Library/Policy/DP/2007/07_01.shtml

- General Financial Advice and
- Professional Financial Planners for complex work.

Professionalism and Reputation

Whether standards of professionalism for those who distribute and especially advise on retail investment products should be improved in such a manner as to inspire consumer confidence and build trust. Much of this briefing will focus on this particular work strand.

Adviser Remuneration

There was a strong consensus among stakeholders that bias stemming from distributor remuneration especially commission played a major part in the poor performance of the retail investment market, and increased transparency has been proved to be a suboptimal solution. Therefore a key element of the RDR is how to introduce a more transparent and value-based remuneration such as direct charging process.

The FSA invited feedback to its proposals by year-end, and over 1000 responses were subsequently received (the highest number of responses the FSA has received to any consultation to date).

Professionalism & Reputation

An important component of the RDR from the outset was the professionalism and reputation of those who distribute retail investment products, both on an advised and non-advised basis. The initial RDR Discussion paper DP-07/1 explored the idea of improving the technical skills of practitioners, which in turn sparked industry discussion of wider aspects of professionalism such as ethics, discipline and ongoing learning.

The CII played a lead role from the start around the professionalism and reputation work strand. Following the deadline of the discussion paper response:

- it first commissioned and submitted a detailed study of professionalism and reputation of financial practitioners
- it first published a series of position papers around the theme of improving public trust and confidence by bringing about a step change the standards of those who advise and sell retail investment products.³
- It published its response to the FSA DP, which set out in one place its full views.⁴ The document was published in advance of the FSA due date, and formed the basis of subsequent work with like-minded organisations including corporates and other professional bodies in developing an industry-wide view on achieving this step change.
- The CII's view was supported by its members, which were surveyed several times between Autumn 2007 and Spring 2009.⁵
- This convergence of industry views resulted in the *Edinburgh Declaration*, a joint statement of principles between four leading professional bodies including the CII.⁶ This declaration demonstrated to the FSA the amount of industry backing for such step-change.

³ The series of five position papers was published by the CII between September and November 2007
<http://www.thepfs.org/pages/memberservices/RDR/professionalism.aspx#Position>

⁴ <http://www.thepfs.org/pages/memberservices/RDR/professionalism.aspx#DPR>

⁵ Surveys were conducted in September and November 2007, April and October 2008, and May 2009. For detailed results of these surveys, see <http://www.thepfs.org/pages/memberservices/RDR/professionalism.aspx#Survey>

⁶ http://www.thepfs.org/downloaddata/Edinburgh_declaration_4Apr08.pdf

RDR Interim Feedback Statement, April 2008

The FSA *Interim Feedback Statement*⁷ described a new segmentation of the distribution market matched with appropriate regulation. It set out the FSA's emerging thinking on the RDR following responses from the industry and other stakeholders:

Simpler Financial Advice landscape:

Consisting of **advice**, **sales** and **money guidance**. "Sales" is in-turn divided into "**guided sales**" whereby customers go through an information-providing process which leads to the sale of a product; and "**execution only**" which means the customer simply buys the product unassisted. Money guidance is further to the recommendations of the Thoresen Review of Generic Financial Advice that was completed in March 2008.

July 2007 Discussion Paper	April 2008 Feedback Statement
Professional Financial Planning	Financial Advice
General Financial Advice	
Primary Advice	Sales <ul style="list-style-type: none">▪ "Guided Sales:" assisted by staff▪ "Execution Only:" no assistance
Generic Financial Advice	Money Guidance

Note: this is our comparative interpretation of the FSA texts

Proposed Benchmark Qualification:

The regulator noted significant agreement that there should be a benchmark qualification for financial advisers and this should be set at the Diploma level (or equivalent). This reflected the interests set out in the *Edinburgh Declaration*.

Explore the package of professionalism:

Acknowledging the importance of skills, knowledge, expertise and ethical behaviour as key to quality of advice, the regulator welcomed *The Edinburgh Declaration* and hoped these "stimulate progress towards industry-wide agreement." The FSA hoped to facilitate further discussions on this involving a wider groups such as corporates, to discuss amongst other things, the issue of mandatory professional body membership.

Challenges to the industry:

The paper sets out a three-fold challenge to the industry to:

- change business models away from how much advisers are paid;
- develop and agree a common framework for professional standards; and
- present propositions for new sales services, and "challenging firms to make the case for FSA action to help implement their ideas in a way that delivers better outcomes for customers".

Professionalism work following Interim Feedback Statement

Following the progress made by the CII and other like-minded professional bodies to agree the *Edinburgh Declaration* statement of principles, the FSA formed and chaired a *Professionalism Working Group*⁸ of all the financial services professional bodies to develop

⁷ http://www.fsa.gov.uk/pubs/discussion/rdr_interim_report.pdf

⁸ <http://www.fsa.gov.uk/Pages/About/What/rdr/group/index.shtml>

proposals in these areas. It met several times under the independent chairmanship of Michael Foot between June and October 2008.

The Group took as its starting point the view that public trust and confidence goes to the heart of retail financial services; and long-term improvement of this is central to achieving the RDR objectives. It believed that a step-change in the professionalism of all financial advisers (be they independent or otherwise) was necessary, in terms of raising both levels of qualifications and raising standards of behaviour.

The Group adopted a series of recommendations in October 2008, many of which were adopted or received a favourable response in the FSA final feedback statement:

1. An Independent Professional Standards Board (IPSB) should be set up as soon as possible. To support the required “step-change” in standards, the IPSB from the outset should:
 - oversee new minimum qualifications for investment advisers;
 - create and oversee a new Code of Ethics and deal with breaches;
 - be responsible for setting and enforcing new consistent minimum standards for Continuing Professional Development (CPD);
 - promote public awareness of the new arrangements and what the public can expect from an investment adviser;
 - liaise closely with FSA over the latter’s monitoring and enforcement of the new standards.

The IPSB should initially be a sub-committee of the FSA Board but should develop into a fully independent Board, with a Chair and Directors who are themselves independent of the industry.

After a period, the IPSB may then seek its own statutory powers and become fully independent, outside the FSA. At this point, if it is within the IPSB’s legal powers, the IPSB should require all PFAs to have a relationship with it through a recognised professional body. The balance of responsibilities between the IPSB and FSA would need to be reviewed.

2. As soon as practicable, the minimum qualification level for an investment adviser should be raised to QCA Level 4 Diploma or equivalent and the IPSB should subsequently raise this to degree-equivalence level.
3. Where existing investment advisers have an existing relevant qualification at Level 4 or above, any gap between that and the new requirement should be filled by additional CPD.
4. It needs to be easier for the public to find suitably qualified investment adviser. The FSA Register should be revamped and made more consumer-friendly.
5. Investment advisers should have to obtain and display a Practising Certificate. Work should begin when the FSA’s RDR proposals are generally endorsed:
 - the new qualification should start to be taught by mid-2010;
 - the new Code of Ethics and the new CPD requirements should be introduced as soon as practicable in 2010
 - existing investment advisers who need to transition should do so by the end of 2012, though they could continue to the end of 2014 under supervision;
6. IPSB should follow FSA good practice in areas such as cost-benefit analysis and consultation. The IPSB should play a positive role for the whole financial advice industry.

Final Feedback Statement, November 2008

In November 2008, the FSA published its final *Feedback Statement* (FS 08/6).⁹ This clarified the FSA's emerging thinking on most of the work strands and set out next steps:

1. Clarity of services:

The FSA distinguishes between independent advice that offers independent unbiased and unrestricted advice based on a "comprehensive and fair analysis of relevant markets"; a new middle category called sales advice which is non-independent advice and "advised guided sales"; and sales which covers all non-advised services. The regulator also suggests a closer link with Money Guidance.

2. Remuneration:

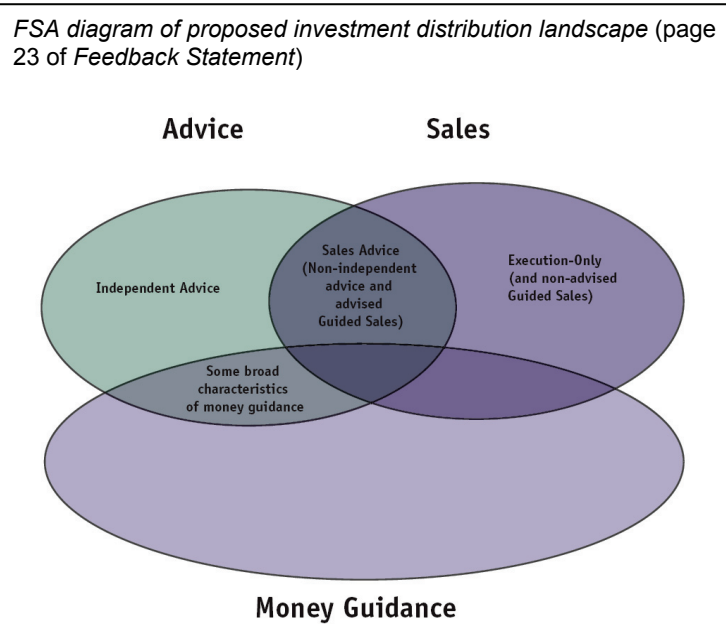
The regulator proposes to create new requirements, including disclosure rules, to remove provider influence over remuneration for advisers especially in the "independent adviser" category but also, where appropriate, non-independent advisers as well. Suggested measures include:

- setting rules on how independent advisory firms can establish charges,
- disclosure of costs of product and advice services, and
- the extent to which providers can determine price commission on products.
- the regulator will conduct consumer research and consult on disclosure, charging and other remuneration requirements for non-independent sales advice in addition to their independent counterparts.

3. Professionalism Proposals:

The FSA feedback statement sets out and adopts most of the findings of a Professionalism Working Group that was established in the summer in which the PFS was involved. The regulator will consult on introducing a step-change in professional standards to all advisers, both independent and otherwise:

- **The creation of an independent Professional Standards Board (PSB):** this new body would exist separate from the professional bodies and provide the consumer with a clear and independent underpinning of standards for financial advice. This would be set up initially as a sub-committee of the FSA Board and may eventually evolve to an independent body with its own statutory powers.
- **Raising the minimum qualification level:** for financial advisers to QCF/OfQual Level 4 Diploma or equivalent. This is further to the unanimous call within the Professionalism Working Group to raise requirements and standards across the sector, echoed in for example strong and consistent support from members in successive CII RDR surveys. The CII published a paper in professionalism in May



⁹ http://www.fsa.gov.uk/pubs/discussion/fs08_06.pdf

2009 setting out the different elements that this new benchmark qualification should include.¹⁰

- **Introducing a Step Change in Professionalism:** through measures such as new Continuing Professional Development standards; a code of conduct; and exploring the use of Practising Certificates for financial advisers. The issue of mandatory professional body.

Consultation Paper 09/18: Delivering the RDR, June 2009

On 25 July 2009, the FSA published its *Consultation Paper* CP09/18 on the Retail Distribution Review.¹¹ This finally set out detailed measures of the RDR including draft changes to the FSA Handbook, and asks for comments on the regulator's plans.

The FSA consultation paper set out the regulator's proposals for improving the UK retail investment market in terms of how and from whom investment products are sold, how the distribution is paid for, and other issues such as professional standards.

This consultation proposed the following:

- to expand the scope of investment products included within the RDR;
- improve the clarity with which firms describe their services to consumers; and
- address the potential for adviser remuneration to distort consumer outcomes by banning commission and introducing adviser charging; and
- increasing the professional standards of advisers.

Independent versus Restricted Advice

	Independent Advice	Restricted Advice
Scope of advice	Comprehensive and fair analysis of the <i>relevant</i> market <i>Relevant</i> = "comprising all of the retail investment products that are capable of meeting the investment needs and objectives of the consumer"	Single or limited range of products
Disclosure requirements (to be issued to the consumer prior to providing the service)	Written disclosure of independent status	Written disclosure of restricted status Scripted oral disclosure of the nature of products provided
Raised professional standards	QCF Level 4 qualification CPD, other	QCF Level 4 qualification CPD, other
Adviser charging structure	Yes	Yes

Note: this is our interpretation of the FSA text

In October 2009, the CII Group published its detailed response, which focused particularly on the professionalism package.¹²

¹⁰ <http://www.cii.co.uk/downloaddata/PPLLevel4FINAL29May2009.pdf>

¹¹ http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf

¹² http://www.thepfs.org/downloaddata/CII_Response_FSACP09-18_RDR_SUMMARY.pdf

Consultation Paper 09/31: RDR Professionalism, Group Pensions and Pure Protection”, December 2009

In December 2009 the FSA issued consultation CP09/31 on professionalism, corporate pensions and possible read-across of the RDR to pure protection advice.

- In an effort to embed professionalism into the retail investment advice sector, the FSA propose making membership of a professional body a “safe harbour” for advisers needing to comply with revised Handbook requirements.
- To deliver professional body governance, the FSA has opted for “an internal FSA model,” rather than the CII’s proposal for an Independent Professional Standards Board.
- The FSA sketches out how it would oversee professional bodies to ensure they meet a consistent framework (with appropriate standards for qualifications, ethics and CPD delivery).
- The FSA takes forward its work to raise the benchmark qualification for investment advisers. It clarifies some earlier confusion about the qualification size and level, and details the FSA’s “no-regrets” policy for existing advisers.
- The option of alternative assessments is also being developed, with other methodologies beyond oral assessment considered, provided they strict criteria.
- Corporate pensions: the FSA propose to introduce into the corporate pensions market “consultancy charging” (previously called “arranger charging”) to take effect at the end of 2012.
- Pure protection: the FSA is considering applying some of the principles from the RDR to the pure protection market. Some areas where there might be read-across are professionalism and service labelling.

One of the biggest changes was the proposal to abandon the establishment of an independent professional standards board to oversee the implementation of higher standards and ethics. Instead, the FSA proposed to oversee professional standards from within the FSA. The regulator said bringing the oversight in house would be a lower-cost option and would avoid the possible duplication that had concerned the industry.

It also said the decision was in keeping with the FSA's move to more intrusive supervision; it would be able to include oversight of professional standards and the ongoing maintenance of those standards as part of its enhanced supervisory role.

The December consultation paper also softened the FSA's stance on the need for all advisers to take written examinations to get to level four standard. The regulator said it would consider all proposals for providing an alternative, on the job-type assessment. Sheila Nicoll, the FSA's director of conduct policy, said: "We are more flexible regarding alternative assessments. We are willing to accept alternative assessments and consider proposals." She clarified that these alternatives might include e-learning or other forms of learning.

The CII published a detailed response to this consultation.¹³

FSA RDR Papers: Delivering the RDR, Pure Protection, Platforms, March 2010

In March 2010, the FSA published a suite of papers outlining their thinking and next steps for retail investment distribution under the Retail Distribution Review (RDR) as well as issues for platforms, pure protection.¹⁴ These papers comprised:

¹³ http://www.cii.co.uk/downloaddata/CII_Resp_FSA_CP09-31_Profm_14Mar2010.pdf

- **Policy Statement 10/6: Delivering the RDR** – sets out the FSA’s final decisions on retail investment advice including describing and disclosing advice services, remuneration, FSA supervision strategy and next steps;¹⁵
- **Discussion Paper 10/2: Platforms and Other Issues for Discussion** – seeks views on options on how the FSA should regulate platforms, either in supporting the RDR objectives or in addressing other issues as identified by thematic research.¹⁶
- **Consultation Paper 10/8: Pure Protection Sales by Retail Investment Firms** – proposes that firms offering pure protection policies as part of investment advice must explain how they are remunerated.¹⁷

Policy Statement 10/6: Delivering the RDR:

The Policy Statement takes forward the issues raised in mid-2008 in FSA CP09/18 on Delivering the RDR, and covers the following areas:

- describing and disclosing advice services to consumers, including the new standard for firms wishing to call themselves independent consumer access to advice, streamlined advice processes and non-advised services;
- adviser charging and inducements – FSA requirements for adviser firms, product providers and vertically integrated firms, and the FSA’s approach to non-advised services;
- the FSA’s strategy for supervising the new requirements, including during the transition; and
- a summary of new Cost Benefit Analysis.

Discussion Paper 10/2: Platforms and Other Issues for Discussion:

Given the increasing prominence of wrap platforms in the retail investments market, the FSA believes that special issues arise in this market warrant specific regulatory attention and explanation of how the RDR especially apply. It follows on from an earlier Discussion Paper¹⁸ in 2007, feedback statement FS08/1: Platforms and more principles-based regulation,¹⁹ as well as a *Thematic Review on Investment Advice and Platforms*.²⁰ The discussion paper DP10/2 on platforms explores:

- ways of ensuring that the RDR proposals are not undermined by wraps, particularly adviser charging;
- how platform providers should be remunerated for the services they provide in connection with advised sales. This is to prevent advisers switching investments as a result of indirect incentives that wraps may offer;
- the delivery of adviser charging through platforms, ensuring that the principles of investor choice are not undermined or restricted by the use of wraps; and
- the use of platforms by advisers providing independent or restricted advice.

¹⁴ For more information on the implications of these proposals, see our briefing: *FSA RDR Papers: PS10/6, DP10/2 and CP10/8: A Closer Look at the Key Proposals* available on:

http://www.thepfs.org/downloaddata/FSA_Mar2010_RDRPapers_A_Closer_Look.pdf

¹⁵ http://www.fsa.gov.uk/pubs/policy/ps10_06.pdf

¹⁶ http://www.fsa.gov.uk/pubs/discussion/dp10_02.pdf

¹⁷ http://www.fsa.gov.uk/pubs/cp/cp10_08.pdf

¹⁸ http://www.fsa.gov.uk/pubs/discussion/dp07_02.pdf

¹⁹ http://www.fsa.gov.uk/pubs/discussion/fs08_01.pdf

²⁰ This took place in 2009 and reported in March 2010, see http://www.fsa.gov.uk/pubs/other/iap_findings.pdf

Items for discussion include transparency of charging, how platforms are remunerated by fund managers and platform-to-platform re-registration. The FSA has made it clear that re-registration has to be made possible by the RDR end-2012 deadline and that if automated re-registration is not possible by then, firms will have to use manual processes.

Consultation Paper 10/8: Pure Protection Sales by Retail Investment Firms:

The RDR also implicates retail investment firms transacting pure protection products associated with the investment advice. The regulator's CP09/18 in mid-2009 discussed the implications of the RDR on pure protection, and now the present consultation CP10/8 examines this complex issue and how remuneration should be treated:

- The FSA had previously considered whether commission from the sale of these products should also fall within the proposals for the RDR, if nothing else but to ensure some consistency in the same transaction in the eyes of consumers.
- The FSA's CP10/8 decides against simply transposing the adviser charging requirement and instead places a requirement for firms to explain how they are remunerated for pure protection services.

Pure protection, which encompasses critical illness cover, income protection and non-investment life insurance, the FSA has stopped short of proposing a ban on commission. Firms that sell both investment and protection products will therefore still be able to collect commission on the protection side. There are proposals in the paper however to ensure that consumers have a clear understanding of how the adviser is remunerated. Firms will also still be able to decide whether to sell protection under the COBS rather than the ICOBS regime.

The FSA is also still looking at the question of whether an adviser who chooses to use a single platform for all clients could be deemed "independent" under the definition of considering the whole of the market. As well as the platforms discussion, the FSA will, in the third quarter of this year, publish a consultation on whether the independent and restricted labels should be carried across into pure protection, on commission and corporate pensions and on the oversight of professionalism, ethics and ongoing continuous professional development.

Stakeholder Views: Where Are We Now?

There are still some details to sort out, hence the additional consultations and discussions coming later this year, however the overall position is that the distribution of retail financial products will change significantly after 2012. Firms should by now have ensured that all advisers who intend to continue offering advice post-2012 are well on the way to achieving level four qualification. They will also need to decide whether they are to offer "independent" or "restricted" advice.

Financial Services Consumer Panel: "...a huge step forward for consumers [...] At last, the distortion created by commission will be removed from investment advice. The FSA has stuck to its guns, and really has acted to protect consumers and improve the system. Once the new rules are in place, independent advice will have to be truly independent, and not undermined by any commission paid by the product provider. "

Association of Independent Financial Advisers: "The original intent of the RDR was far bolder than the announcements contained in today's publication. I see very little in it that will reach out to encourage more people to save more, invest for their future, or better protect themselves in an uncertain world. The reforms are largely focused on parts of the industry that were already in transition. AIFA is concerned about the substantial increase in the estimated costs of the measures proposed in the RDR."

Investment Management Association: welcome what had happened so far but still wanted clarification about how certain things would work in practice. In particular it wanted to understand how the FSA saw the adviser charging regime working in practice for the fund

management industry. Julie Patterson, director of authorised funds and taxation at IMA, said: "IMA has from the outset supported the FSA's overall aims. In particular, we agree that increased professionalism and transparency are key to delivering benefits to consumers, and that all forms of advisers should be appropriately qualified. We also welcome the FSA's recognition that fund managers cannot be expected to police services provided by advisers, but this is not the end of the story. There are more chapters to come, including how the industry is to manage the existing book of business alongside the new rules."

Association of Private Client Investment Managers & Stockbrokers: not happy with the RDR's definition of "independent" and how that relates to stockbrokers. It thinks the "independent" definition will mislead consumers and lead to riskier investment advice. "While there are some aspects of the FSA's RDR initiative that APCIMS supports, we believe that the concept of 'independent advice' is fundamentally flawed and contain the seeds of the next mis-selling crisis. Independence should be about firms providing advice which is driven solely by consideration of their clients' best interests and which is not influenced or controlled by the business needs of product providers. By setting up a divide between independent and restricted advice, where the former is inevitably seen as superior, the FSA is inadvertently promoting a regulatory culture which rewards being a 'jack of all trades but master of none' over the provision of specialist advice tailored to specific client needs. This will be especially true of those who wish to invest in a range of investments, including stocks and shares.