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# Guiding the Profession on RDR



## The FSA's Retail Distribution Review: A Background

June 2009

### Summary

The FSA has been undertaking a detailed review of advice and distribution for some time alongside its ongoing work on introducing more principles-based regulation. This document provides a background on the development of the proposals.

- Concerns over retail distribution of investment products: 2006
- Retail Distribution Review discussion paper, July 2007
- The Edinburgh Declaration, March-April 2008
- RDR Interim Feedback Statement, April 2008
- Professionalism Work: 2008
- Final Feedback Statement, November 2008
- "Delivering the RDR" Consultation Paper, June 2009

**Please note that this document does not give the views of the PFS or CII Group.** For a PFS/CII view, see our press release.<sup>1</sup>

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<sup>1</sup> <http://www.thepfs.org/app/mediacentre/release.aspx?v=2008&endstem=1&id=47>

## 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".<sup>2</sup>

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 was severely lacking and needed decisive and coordinated action by both the regulator and the industry.

## Retail Distribution Review Discussion Paper, June 2007

In June 2007, the FSA published the *Retail Distribution Review Discussion Paper*.<sup>3</sup> It summarised the findings of the five working groups which had been meeting through the year, highlighted issues around poor quality of financial advice, commission bias, and the overall need to improve professional standards generally.

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

1. Quality of financial advice and professional standards need to increase significantly;
2. Both industry and regulatory change is needed;
3. Solutions proposed could increase the cost of full financial advice; and
4. 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:

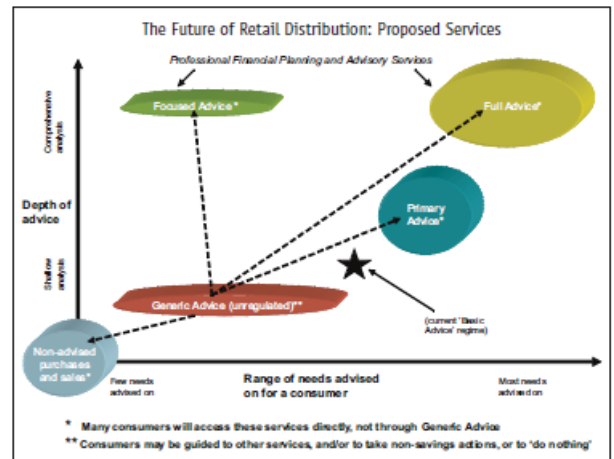
### Market segmentation

The paper proposed to address these outcomes by creating a new clearly labelled segmentation of the 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,
- General Financial Advice and
- Professional Financial Planners for complex work.

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



### Professionalism and Reputation

Of those who advise and sell these products, both on an advised and non-advised basis.

<sup>2</sup> [http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0916\\_cm.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0916_cm.shtml)

<sup>3</sup> [http://www.fsa.gov.uk/pages/Library/Policy/DP/2007/07\\_01.shtml](http://www.fsa.gov.uk/pages/Library/Policy/DP/2007/07_01.shtml)

## Adviser Remuneration

Whether through commission or some sort of 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).

### “Edinburgh Declaration”, March-April 2008

The Discussion paper generated considerable discussion and debate around its various themes. 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 proceeded to work with like-minded organisations including corporates and other professional bodies in developing an industry-wide view on introducing a “step change” in the professionalism of those who advise and sell these products.

The CII’s view was supported by its members, which were surveyed several times between Autumn 2007 and Spring 2009.<sup>4</sup>

This convergence of industry views resulted in the *Edinburgh Declaration*, a joint statement of principles between four leading professional bodies including the CII.<sup>5</sup> This declaration demonstrated to the FSA the amount of industry backing for such step-change.

### RDR Interim Feedback Statement, April 2008

The FSA *Interim Feedback Statement*<sup>6</sup> 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"><li>▪ “Guided Sales:” assisted by staff</li><li>▪ “Execution Only:” no assistance</li></ul> |
| Generic Financial Advice        | Money Guidance  |

**Note:** this is our comparative interpretation of the FSA texts

<sup>4</sup> 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>

<sup>5</sup> [http://www.thepfs.org/downloaddata/Edinburgh\\_declaration\\_4Apr08.pdf](http://www.thepfs.org/downloaddata/Edinburgh_declaration_4Apr08.pdf)

<sup>6</sup> [http://www.fsa.gov.uk/pubs/discussion/rdr\\_interim\\_report.pdf](http://www.fsa.gov.uk/pubs/discussion/rdr_interim_report.pdf)

### 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*<sup>7</sup> of all the financial services professional bodies to develop 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.

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<sup>7</sup> <http://www.fsa.gov.uk/Pages/About/What/rdr/group/index.shtml>

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 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).<sup>8</sup> This clarified the FSA's emerging thinking on most of the work strands and set out next steps:

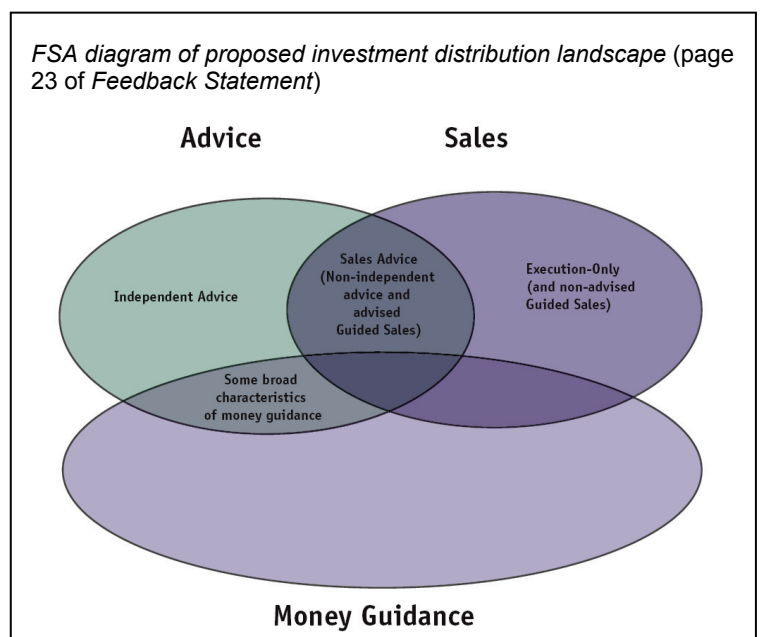
### 1. Clarity of services:

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

*FSA diagram of proposed investment distribution landscape (page 23 of Feedback Statement)*



<sup>8</sup> [http://www.fsa.gov.uk/pubs/discussion/fs08\\_06.pdf](http://www.fsa.gov.uk/pubs/discussion/fs08_06.pdf)

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

### “Delivering the RDR” Consultation Paper, June 2009

On 25 July 2009, the FSA published its *Consultation Paper* CP09/18 on the Retail Distribution Review.<sup>9</sup> 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 sets 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 proposes the following:

- to expand the scope of investment products included within the RDR;
- 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.

The CII and PFS have published information for members on the consultation document: an overview of the consultation paper proposals;<sup>10</sup> a closer look at the proposals and their implications;<sup>11</sup> and press releases outlining our views.<sup>12</sup>

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<sup>9</sup> [http://www.fsa.gov.uk/pubs/cp/cp09\\_18.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf)

## Interpretation of Retail Investment Distribution Labelling

| Advice   |   | "Streamlined Advice"   | Sales  |
|--|---|--|--|
| <p><b>Independent Advice</b></p> <ul style="list-style-type: none"> <li>▪ Fair analysis of the market</li> <li>▪ Written disclosure of independent status</li> <li>▪ Adviser charging</li> <li>▪ Professionalism proposals: Level 4 qual'n, CPD, etc.</li> </ul> | <p><b>Restricted Advice</b></p> <ul style="list-style-type: none"> <li>• Limited part of the market</li> <li>• Written and oral disclosure of restrictions</li> <li>• Adviser charging</li> <li>• Professionalism proposals: : Level 4 qual'n, CPD, etc.</li> </ul> | <p><b>"Simplified Advice"</b></p> <ul style="list-style-type: none"> <li>• Can be either Independent or Restricted in terms of market coverage.</li> <li>• Involves personalised recommendation</li> <li>• Would require Level 4 qual'n (to be confirmed)</li> <li>• Would require Adviser Charging.</li> </ul> <p><b>Basic Advice</b></p> <ul style="list-style-type: none"> <li>• Scripted questions, but full assessment not carried out</li> <li>• advice on stakeholder savings/investment products only</li> <li>• No qualification. No adviser charging.</li> </ul> | <p><b>Execution-Only</b></p> <ul style="list-style-type: none"> <li>• No major handbook changes</li> </ul> |

**Note:** this is our interpretation of the FSA text

## Independent versus Restricted Advice

|  | Independent Advice  | Restricted Advice  |
|--|---|--|
| Scope of advice  | Comprehensive and fair analysis of the <i>relevant</i> market<br><br><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<br>(to be issued to the consumer prior to providing the service) | Written disclosure of independent status  | Written disclosure of restricted status<br><br>Scripted oral disclosure of the nature of products provided |
| Raised professional standards  | QCF Level 4 qualification<br>CPD, other   | QCF Level 4 qualification<br>CPD, other  |
| Adviser charging structure   | Yes   | Yes  |

**Note:** this is our interpretation of the FSA text

<sup>10</sup> [http://www.thepfs.org/pfsimages/rdr/FSA\\_RDR\\_CP09-18websummary.pdf](http://www.thepfs.org/pfsimages/rdr/FSA_RDR_CP09-18websummary.pdf)

<sup>11</sup> <http://www.cii.co.uk/downloaddata/closerlookdoc09.pdf>

<sup>12</sup> CII: <http://www.cii.co.uk/app/news/default.aspx?endstem=1&id=942>; PFS: <http://www.thepfs.org/app/mediacentre/release.aspx?v=2009&endstem=1&id=69>