

Special Issue

Update on FSA Retail Distribution Review

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PAPERLESS NETWORK

WELCOME TO a Special Issue of BusinessNet

I hope you will enjoy reading this special issue of BusinessNet. We consider the content to be extremely important for all our members and we hope you will take the time to read, digest and email us your thoughts.

This FSA paper is going to change the way our industry goes forward in the future and we hope our members will help shape that future.

*Junior Sobowale
Chief Executive Officer*

Update on FSA Retail Distribution Review (RDR)

A Summary of the FSA Review Paper

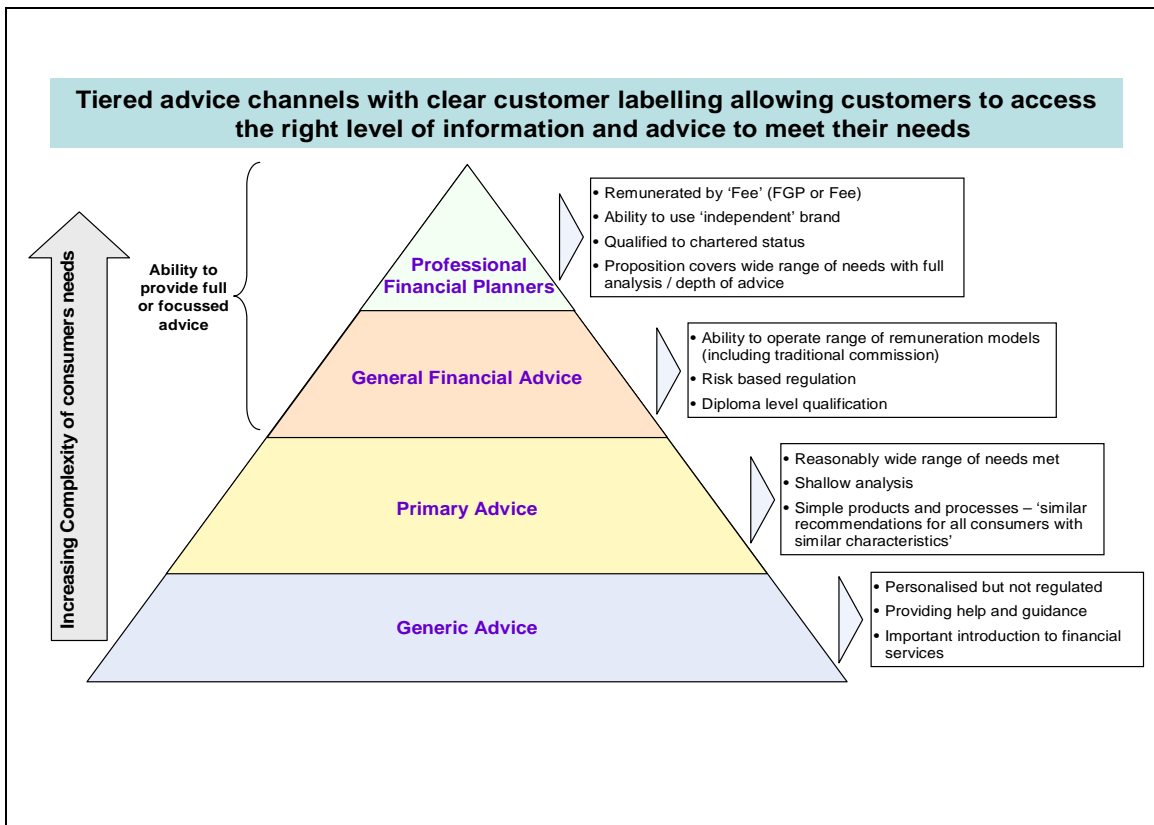
Firstly, we encourage all members to read the actual Review paper itself so you are aware of all the points raised in detail.

The paper starts with the largely unsubstantiated premise that the current distribution model is broken and presents the idea that it wants 'industry-led solutions' to the FSA defined problem.

The overall thrust of the proposals is to create a segmented advisory sector, containing professional, general and primary elements; improved professionalism across the board supported by higher qualifications; and a requirement for firms to be better capitalised.

The FSA is proposing that the market be divided into three areas:-

1. **Professional financial planners** - will require Chartered or Certified status. It is proposed that the only businesses able to claim to be "professional" will be fee-charging. While trail-fees may be allowable, clients will be able to turn these off and have the money added to their contract.
2. **General financial advisers** - would not be allowed to call themselves "independent" because, according to the FSA, 'these firms would not be free from the conflicts of interest that arise from commission-based remuneration'. The FSA is also likely to demand these firms hold far higher levels of capital than currently needed.
3. **Primary advice** - proposals for this new type of advice favour the banks. They would not need to offer "best advice" as it is proposed that their advice would be limited to a set of 'simple products' with no price cap. This seems a potential recipe for mis-selling by those who receive most FOS complaints already.



There is a focus on remuneration, revolving primarily around the concept of Customer Agreed Remuneration (CAR). CAR has not been specifically defined nor has the practicality been explored in any depth, but it appears to be able to deliver something pretty close to commission. Use of the term "independent" is being linked firstly to type of remuneration, rather than scope of advice.

It suggests that the term '**independent**' may apply only to higher qualified advisers who offer only CAR services and asks whether any firm operating a CAR model should be able to describe themselves as "independent". This would include multi-tied and potentially even tied firms!!?

Higher qualifications are being proposed and could present a big challenge for some IFAs.

The RDR is a Discussion Document **NOT** a Consultation Paper. This means that the FSA is able to float all kinds of ideas without having done the cost benefit analysis which it must do before any changes can be considered. Many of the more "blue sky" suggestions will not stand up to analysis whilst others will simply prove impractical.

The RDR is open for responses until 31 December 2007. Feedback on the responses, possibly in the form of a Consultation Paper will be issued in the second Quarter of 2008. After that the timing is unclear except that the FSA has given assurances that any changes which do take place will be brought in gradually. Our best guess is that we could see some being brought in during 2010.

We see lots of opportunities for Virtual Net and its member firms but believe many of the RDR suggestions currently espoused are simply wrong in their thinking. As they say, it is what you get if you allow a committee to design something. But it is important we support the good elements within it, and help influence and shape the way forward.

We believe that all of our members can fit easily within the Professional financial planner category with some sensible changes and additions, and support from the network and professional bodies – at least until the year 2013!

Virtual Net Key Comments

General

As IFA's Virtual Net believe we and our clients have a lot to gain from the increased emphasis on professionalism. Whilst it will be a long time before Chartered Status becomes the norm (driven mainly by an increase in educational qualifications of new entrants going forward), and many of us will never aspire to it for a variety of reasons, the overall impact will be positive.

Equally we have nothing to fear from transparency of charges and disclosure. IFA clients have had commission and/or fees set out clearly to them in pounds and pence terms at the time of every sale for a long time now, and on top commission details are sent post sale along with a specific cancellation notice with regards to commission. We think the documentation should be simplified but the overall progress has been positive for the IFA market share of new business.

Specifically

1. To be called an **"Independent"** adviser in our opinion you must have experience in the advice market, work for the client and have freedom from potential provider bias. So the the criteria should be quite clear.
 - a. You must have access to the whole marketplace of product solutions;
 - b. You must agree remuneration with your client and this can be commission, fees or any other agreed payments (CAR); and
 - c. You must have the qualifications necessary to trade as a "Professional Financial Planner" or Professional Financial Planner (Designate)."

2. **Capital Adequacy** (or "prudential requirements") must be increased substantially both for adviser firms with 1-25 advisers up from the current level of £10,000; and for firms above that level from the general 13/52 rule we see now.

Increased financial requirements for advisory businesses will not only help establish more appropriate barriers to entry, but provide the capability for them to meet liabilities even after ceasing to trade. £50,000 is not an unreasonable minimum, with existing firms given 2 years to achieve this level and applicable to new applicant firms with immediate effect.

In allowing for proper capitalisation of the adviser, some further consideration is warranted to explore the clients' assets being advised on to be included within the assets of the adviser firm (if recurring income streams attached) rather than that of the manufacturers.

All existing providers in the industry should be levied a one off charge to help to capitalise the sector (see below) and this could be used to support claims against previous money invested (and lost) because advisers stop trading.

3. **A Product\ Advice Levy** should be set up to be a fund that the FSCS can call on if an adviser firm closes down and, after taking its' own assets into account, this still leaves a shortfall. We need to consider a scheme similar to the ABTA bond scheme. This particular funding should be an arrangement paid for by the general public through a small contribution every time a product (loan, mortgage, pension etc) is issued. Ultimately this levy will help towards better capitalisation of the advice sector of the financial services industry.

4. **Grandfathering** into the Professional Financial Planner category should be allowed for all of those people currently trading as Independent Financial Advisers. Over a period of 3 years, with an annual assessment equivalent to 33% of progress to the ultimate qualification level, advisers through

continuous assessment (as per A-level work or current graduate study work), would effectively be transitioned across.

These people in transition could be called "Professional Financial Planner (Designate)" and if they fail any examination section/module they can go back and re-sit, but with the overall timescale being 3 years for completion.

There should be no exemption for other professionals wanting to provide advice in this area unless they are fully appropriately qualified.

5. We believe the FSA should introduce a form of **Licensing** into the marketplace. This will mean both licensing advisers to be approved to sell\ advice on various product and advice types, and then licensing the product solutions to match across the adviser license groupings. So the regulator, the FSA, will take some accountability for product licensing which we think it necessary to help instil consumer confidence in the industry and help simplify the whole process.

6. **Customer Agreed Remuneration** (CAR) we believe is a good way forward. We agree with the paper when it says "We might re-define the term fee-based to mean any advisory remuneration derived in discussion with the customer and not influenced by the product provider."

7. There should only be two categories of advisers providing advice to clients:

General Financial Advisers (the current FSA proposed categories of general financial advisers and primary advice rolled together but with basic level qualifications) and

Professional Financial Advisers (including Professional Financial Planner (Designates))

And then a "generic help" category for those not providing advice but simply providing information with no actual access to completing a transaction, e.g. HR departments, debt counsellors. This should exclude professional service companies, or individuals such as accountants or solicitors wanting to provide financial advice.

8. **Professional Financial Advisers** we believe is an important category and no individual should be able to enter this category until they have achieved 2 years experience of providing advice to clients. Until that time they could be classed as a "Professional Financial Planner (Designate)" if they have the other necessary requirements and if they are working within a firm of independent advisers that have the designation.

Comments & Feedback

If you have any questions, comments or feedback regarding any of the issues highlighted in this issue of **BusinessNet**, please let us know by email at marketing@vneurope.com

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