

2 November 2009

Dr Aileen Jones  
Retail Policy & Conduct Risk Division  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Dear Aileen,

**CP09/18 Distribution of retail investments: Delivering the RDR**

The IMA represents the UK-based investment management industry. Our Members include independent investment managers, the investment management arms of retail banks, life insurers and investment banks, and the in-house managers of occupational pension schemes. They are responsible for the management of over £3 trillion of funds, including authorised investment funds, institutional funds, private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. authorised unit trusts and open-ended investment companies).

It is in their capacity as providers of authorised funds that our Members have a keen interest in these proposals. Also, some of our members run investment trust savings schemes.

We support fully the intention behind the review to improve the consumer experience in seeking and obtaining investment advice. This work is particularly welcome at a time of uncertainty in the financial markets and a shift, throughout Europe, toward the need for consumers to take greater responsibility for their long term savings needs. It is becoming increasingly important that consumers can access a wide range of products that are presented to them in a readily understandable way that is clear, fair, transparent and without bias. In short, providers of advice, of whatever form, should be firmly on the side of the consumer.

We believe the key to this is the raising of standards of professionalism within the advice-giving industry so that consumers can be confident that they will receive a service appropriate to their needs and that is on their side. Clear disclosures are important in evidencing this professionalism, but will not alone lead to the outcomes the FSA seeks. We therefore support fully the proposals concerning qualifications and competences contained within the CP, but have a residual concern about the potential loss of experienced advisers in the short-term.

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Equally, we support improved transparency of charges. However, as the FSA is aware, the proposals regarding adviser charging present certain challenges to the authorised funds sector. We have detailed these within our attached response. Importantly, we have reservations about potential costs and whether the proposed changes will actually benefit consumers in the medium to long term. We do not identify one solution to the challenges presented, not least because our members may choose different solutions as between managers and funds. Rather we have identified the issues, costs and potential consumer detriment the FSA will have to consider in drafting the rules that will apply to this sector. It is essential that any new requirements do not allow some sectors to offer benefits to advisers that other sectors cannot. A level playing field between retail investment products is paramount.

The CP makes reference, in a number of places in the document, to proposed thematic work examining aspects of the platform business model. We welcome these proposals and suggest that the FSA delays decisions on new rules pending completion of that work, which should take full account of the wide range of offerings that fall under the generic label "platforms". The FSA should then consult further with the industry on any proposals.

Additionally, we have concerns that the RDR proposes detailed regulatory requirements on a sector already subject to European legislation, particularly MiFID and UCITS, and that further regulatory developments are in train which will touch on RDR issues. The Commission's PRIPs proposals and CESR consultations on *Inducements* and *Understanding the definition of advice under MiFID* are examples of this. Moreover, the FSA's proposed rules would apply to a UK adviser but not a non-UK adviser, even where the clients of both are UK investors.

The FSA should not put our members at a competitive disadvantage by requiring them to maintain RDR based charging systems that do not apply to non-UK investment firms and to incur significant cost in unwinding or revising RDR systems as a consequence of European legislative change. We would urge the FSA to take account of European developments in setting timescales for implementation and to undertake a gap analysis of the RDR proposals against these developments.

We would welcome the opportunity to discuss the comments and recommendations contained in our response with you at any time.

Yours sincerely

A handwritten signature in black ink that reads "Julie Patterson". The signature is written in a cursive, flowing style.

Julie Patterson  
Director, Authorised Funds and Tax

## **Describing and disclosing advice services to consumers**

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

The IMA fully supports the FSA proposal to widen the range of products to which the new independence standard will apply. The range of retail products available to meet investors' savings and pensions needs has long made the UK packaged product regime not fit for purpose. The regime sets disclosure requirements that do not recognise the differences between life-based investment products and authorised funds, and it does not cover an increasing range of other products available to retail investors.

The fund management industry has long been subject to disclosure requirements arising from the UCITS Directive. Indeed, many other sale and disclosure requirements arise under European Directives rather than local rules, e.g. MiFID, IMD, Prospectus Directive etc.

However, it is not clear from the Consultative Paper how the various disclosure requirements will be applied post RDR. Will the products in the new and increased Retail Investment Products range be subject to the same or similar disclosure requirements that are currently part of the Packaged Product regime? This is particularly pertinent for authorised funds given the disclosure regime proposed to replace the Simplified Prospectus under UCITS IV – the “Key Information Document”.

We note that the European Commission has produced a white paper concerning “Packaged Retail Investment Products” (PRIIPS) and the FSA has referenced that paper in its proposals for Retail Investment Products. It is, however, disappointing that the FSA proposals do not include Structured Deposits whereas the PRIIPS proposals do. We urge the FSA to reconsider this point.

Also, the FSA's proposed scope covers only investment trusts and not other investment companies listed under Chapter 15 of the Listing Rules, namely REITs and VCTs. No explanation is given as to why these have been excluded.

Finally, it is not clear to us whether item (g) of the draft definition of Retail Investment Products includes e.g. Life Bonds. We believe it should.

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

We agree with the FSA proposals for a new standard for independence although we question whether it is so very different from the existing definition. Is it not already the case that an integral part of an adviser's independent status is that he/she is required to look at “whole of market” when giving independent advice? This should already include a diverse range of products, including investment trusts and ETFs.

The issue here is not whether such products fall into the regime, or whether the regime has expanded, but rather whether the adviser is able to generate an income of any sort. This is addressed more fully in the section on Adviser Charging.

However, we recognise the need to future proof the regime against the introduction of new products or investment vehicles that are not yet specified. The general description of products with an investment element goes some way toward this, but further guidance is needed on the perimeters of "relevant markets".

Platforms can assist advisers in accessing a wider range of products for their clients. But, a possible consequence of the new, overt rules could be the concentration of independent advice in larger firms that can perform regular comparative analysis of the full range of "RIPs", with smaller advice firms adopting a non-independent model.

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

Since there is to be a distinction between independent and non-independent advice it is entirely appropriate that this should be made clear to investors. We agree with the new disclosure requirements. We question, however, the label "restricted". It is clear from the FSA's own research that none of the labels tested was widely understood. We question therefore why it is necessary to prescribe such a label. Instead the label "independent" (or any other word or label implying the same) should be allowed to be used only by those advisers who meet the criteria. The disclosure for non-independent advisers might then be along the lines of the wording proposed by the draft rules, but omitting the reference to "restricted".

We also think it important that advisers should clearly disclose the basis of their non-independence, i.e. whether it is through their employment by a larger organisation (for example some retail banks offer only a small number of providers' products) or because they have chosen to restrict themselves to a set part of the market. In the latter case, it should be made clear that the choice is their own and does not represent an endorsement from the product providers they have chosen to cover.

The FSA should also take account of other forms of advice delivery. Advice is not always given "face to face" and could arise through an online system for example. A requirement to deliver the description orally would be impractical in those circumstances.

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

The RDR proposals are apparently predicated on there being a clear difference between "Independent" advice and "Restricted" advice. It seems self-evident, therefore, that this distinction and a description of what it means should be clearly communicated to the consumer. If the FSA was not to mandate a form of words to describe non-independent advice we would be concerned that this could leave the way open for the description to be manipulated and thus mislead consumers as to the level of service offered. However, as noted above there is no need for the word "restricted" to be used. The FSA's own consumer research showed that it was not well understood. Also, the wording options for use by non-independent advisers will

need to be sufficiently wide to cover the range of ways in which advice may be non-independent.

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

No comment.

**Streamlined advice processes and non-advised services**

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

We doubt the necessity for the further stratification of advice services, particularly where non-independent advisers carry the same level of qualification and therefore competence in delivery of service to consumers.

We also have concerns generally about the concept of streamlined advice, not least because there is a fine line between such a system and “formula selling” whereby following a step-by-step procedure leads to a pre-determined outcome and the sale of a particular product.

We therefore, ask the FSA to re-examine the reasons for such a regime, especially in the light of European legislation and the new rules proposed by this CP.

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

Yes. It is essential that retail investors can have confidence in authorised financial advice. The historically low level of qualifications and weak ethical standards of a small subset of advisers (tied, multi-tied and “independent”) has on occasion caused detriment to the reputation of the industry and to investors.

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

We accept that Basic Advice should be retained if a clear need for such a service and associated products exists. Given that the nature of the service is very limited in what it can offer we agree that it should be made clear to consumers that they are receiving basic advice, that it is therefore restricted, and what that implies for the consumer.

However, the FSA should also consider the wider issues considered by the recent Treasury paper “Reforming Financial Markets” and possible distortions in the market arising through the retention of Basic Advice alongside other forms of advice. For example, some elements of the RDR proposals, such as adviser charging, should be applied to Basic Advice to avoid bias.

## **Incentives and Charging**

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

We welcome the aim of removing the influence of commission from the decision making process in giving financial advice to consumers. We also welcome the proposal that advisory firms should set out their charging structure through a tariff which is clear and transparent to the consumer and that payment for ongoing advisory services should be agreed with the consumer. However, we have some concerns about whether the consumer is best placed to understand such a charging structure and has sufficient knowledge to negotiate within it.

The commission-based business model has led to a situation where the consumer generally believes that advice is free, even where the amount of commission paid to the adviser is disclosed to them in post-sale disclosure documents. The RDR proposals are, essentially, asking consumers to move from a place where they believe advice and purchase of investment products is free, to a situation where they will need, and are sufficiently motivated:

- to understand the difference between independent and non-independent advice;
- to understand whether they are receiving a full, simplified or basic advice service and what that means;
- to value the service so that they can assess whether the amount they are being asked to pay, according to the tariff, is reasonable; and
- to understand the costs and charging structure of the recommended products so that they can agree the mechanism of payment.

We consider that there is a fundamental asymmetry of understanding, relative empowerment and motivation in the relationship with the adviser, which the adviser charging proposals will not and cannot address. The proposals in relation to increased professionalism and enforcement of those professional standards are likely to have a greater effect. Also, if the strong and welcome statements made in paragraph 4.7 of the CP, such as:

*“While adviser firms may be used to receiving greater amounts of remuneration from some product providers than others, we do not expect to see such variations replicated in the charging structures that adviser firms adopt for themselves”*

*“Adviser charges should not vary inappropriately according to the type of product offered”*

*“Adviser recommendations should not be influenced by the existence of terms or facilities offered by product providers to collect adviser charges”,*

are reflected fully in rules (not guidance) and monitored and enforced by the FSA, this could lead to real change in the adviser-consumer dynamic.

We recognise that, at the more sophisticated level of the market, consumers are experienced in paying for advice and services through fee arrangements. However, the FSA should consider whether some additional help and guidance should be made

available to those consumers who will be faced with a more complex environment in the future so that they can understand and operate more effectively within it.

The FSA should note, however, that there appears to be no concrete information available on how much advisers would be seeking to charge for their services. Research has estimated that the cost of a full fact-find, for example, could be as much as £750 and this may not, of course, necessarily result in advice to purchase any fee-generating product (advice to settle outstanding debts may be appropriate advice at that time, for example). It is also understood that in the fund management space advisers may seek to charge up to 1% a year.

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

We agree with the FSA's overarching objective of achieving remuneration arrangements that allow competitive forces to work in favour of the consumer. The incidence of provider firms being able to increase market share through the manipulation of commission has led to a number of well-documented incidents of consumer detriment. Examples include pension and endowment mis-selling and bias towards those products offering high commission rates and, axiomatically, lower returns.

The FSA should not, however, avoid the fact that such mis-selling or excessive commission taking is as a result of consumers being advised to purchase a product which is unsuitable for them or which results in the adviser receiving more commission and the consumer less by way of investment return. Mis-selling has always been in contravention of the rules and whilst differentiation of commission rates may be a contributory factor, it is not the whole cause. The mis-selling of any product would call into question the adviser's fitness and propriety and we remind the FSA that an adviser's continuing authorisation is dependant upon its meeting the standards enforced by the FSA.

An important outcome following implementation of the RDR should be a level playing field across the financial industry, affording equal choice for the consumer. The RDR envisages a system where the initial cost of advice is met either by direct payment of a fee by the consumer at point of advice or through a deduction from the initial investment. It is essential, to preserve the equality of competition, that these options (apart from that permitted for regular premium contracts or regular contribution investments – see below) remain the only methods available for consumers to pay adviser charges.

We, therefore, fully support the FSA's proposed prohibition of factoring as a method of advancing payments to advisers. However, there seems to be some inconsistency in the way the prohibition is proposed to be applied. For example, it seems that Networks would still be able to factor fees for their appointed representatives, as would advisers with ties to banks. It is important that the FSA reviews this issue to achieve consistency throughout the market.

Authorised fund investments are not made by regular *premiums* (where regular payments are made into an ISA, for example), but by a series of regular single payments. Therefore the intended exception to the "no ongoing service, no ongoing

fee” envisaged by the proposals should be applicable to not just regular premium products, but also to regular contribution investments.

### Authorised Fund Managers

The FSA is asking the authorised funds industry to make changes to a system of rebating some of the annual management charge (AMC) which, to date, has not led to any consumer detriment arising through mis-selling or excessive commission-taking. Indeed, manipulation of commission to increase market share is not a feature of the fund management industry. Initial charges are fixed and transparent to the investor. Given the AMC is fixed and must cover the costs of managing the fund, the amount of rebated AMC is automatically capped. The AMC is transparent to the investor and cannot be varied significantly without unit holder vote. Moreover, the interests of the manager and investor are aligned as an increased AMC leads to reduced fund returns, which are disclosed and subject to public comparisons and comment.

It seems counter-intuitive that the FSA's focus for our sector should be on trail commission arrangements when the most egregious examples of commission bias have occurred in the initial commissions offered in certain sectors/by certain providers.

The FSA proposals for adviser charging, and how they apply to authorised funds, present fund managers with a number of challenges and would not deliver a demonstrable benefit to the consumer. In fact, as described below, the consumer will suffer from increased costs of investing.

Moreover, for the fund sector, potential benefits will be limited due to the territorial limitation of the proposed rules. UK investors can, as a matter of European law, invest in non-UK UCITS and seek advice from non-UK advisers.

### *Multiple share classes*

In the CP the FSA acknowledges that fund managers cannot vary the ongoing deductions made from a fund for particular consumers without creating separate share classes. The CP goes on to suggest that the proposed rules could allow fund managers to choose to offer a reasonable range of share classes to support different levels of ongoing adviser charges.

The challenges presented to the sector by this proposal are as follows:-

- It is unclear what a “reasonable number” of share classes might be. FSA officials have mentioned to IMA the figure of 5 or 6, but some firms believe they would need to offer over 20 share classes to meet the flexibility of their business models for ongoing adviser payments.
- Multiple share classes are expensive to establish and administer, not only for the manager, but also along the distribution chain. Industry research indicates that establishment costs are high (see the Appendix for more details) and ongoing costs would have to be met even if the share class was not utilised.
- There is a serious risk of investors ending up in the wrong share class.

- Unless there was a standard set of share classes across the industry, investors would not readily be able to switch funds or switch platforms. And even if there was a standard set, it could not be imposed on incoming UCITS.
- Importantly, multiple share classes would not actually deliver the FSA's aim. For example, an investor would not be able to agree with his adviser that it will receive up to £X a year and no more.

#### *Client cash accounts/holdings*

The FSA also suggests that fund managers might choose to rely upon third parties, such as platforms, to help collect ongoing adviser charges through consumer cash accounts. This is an option which may seem initially attractive as, if the commission rebate goes direct to the investor, the power dynamic will appear to have moved in the right direction. Indeed, many platform operators are devising systems to meet this need. However, we question whether the FSA has the wish, or the locus, to drive distribution through platforms, a point we presume is being considered as part of the FSA's ongoing review of platforms.

Also, and very importantly from the investor's perspective, it will unquestionably lead to additional costs. The cash flows arising from the current rebated AMC arrangements are treated for VAT purposes as exempt as they are viewed as delayed payments for a financial transaction related to a particular product, which is exempt under EU VAT legislation. The proposed rules will describe rebated AMC amounts as payments and will stipulate that they cannot be received by the adviser unless they relate to agreed ongoing services provided to the investor. Whatever the nature of those services (whether advice or a form of administration), under EU VAT legislation they are chargeable. However the impact of that VAT charge (at present 15% but expected to increase next year) is split between the adviser and the investor, it will create an additional, material cost. Moreover, if the rules require the rebated AMC in future to be described as a payment from the fund via the manager, there is a concern that for tax purposes it could be viewed as income in the hands of the investor and taxed accordingly (i.e. at 20%, 40% or 50%). Again, this would be a material dis-benefit for consumers and complex to administer.

From some platforms' perspective there may also be a question whether the way in which they operate, or propose to operate, cash accounts amounts to deposit-taking. If a platform were required to apply for permission to take deposits and to comply with all the attendant regulation, this would result in significant increases to its costs. If the way in which a platform operates cash accounts is not deposit-taking, there must instead be a question as to whether the activity requires permission to hold client money.

#### *Unit redemptions*

The CP mentions the possibility of redemptions of units to generate cash. Whether performed in isolation or in the context of the operation of a client cash account with unit redemptions used to top up the account if the balance is insufficient in any period to meet agreed adviser payments, this could give rise to a further cost. Operationally, the fixed costs of processing and settling a unit deal mean that small deals give rise to net costs, not benefits. Also, if the investor needs to manage his capital gains tax threshold in that year, unit redemptions – which in this context would amount to asset sales forced on the consumer by the regulator – will give rise

to a tax charge of 18%. This problem is not just a concern for high net worth investors. It will also impact the many smaller investors each year who happen to need to dispose of some assets for personal reasons.

#### *Monitoring of adviser charging by providers*

It is disappointing that the FSA's proposals in this area do not recognise the degree of intermediation in the market place. In particular, they do not recognise that fund managers often do not know who the advisers are, let alone the end-investors. And they certainly have absolutely no way of knowing whether those investors have received ongoing services from their adviser or the nature of those services. They therefore cannot make any judgement about the value of those services or whether the adviser payments are proportionate to that value.

The degree of intermediation in the market place and the limited information that fund managers have about the way in which their funds are used was debated extensively as part of the FSA's TCF initiative and resulted in the FSA issuing fund-specific guidance in January 2008. That guidance recognises the maximum that fund managers can reasonably be expected to do in monitoring business flows. To require managers to monitor adviser payments as suggested by the CP is unrealistic and unreasonable, and therefore unacceptable.

#### Legacy book

We have concerns regarding the proposals for grandfathering the payment of trail commission on business written before December 2012, when the rules are proposed to come into effect. These proposals have implications as follows:

- There is a danger that advisers will write a considerable amount of business that will generate trail commission to ensure that they will have a income stream post 2012;
- This would, in turn, lead to a disincentive to review existing portfolios;
- Product providers and platforms would have to operate two sets of books – legacy and post-2012 – for an unlimited period.

We suggest the FSA considers the merits of a defined transitional period of a few years, beyond which the new adviser charging rules should apply.

There are also questions about the boundary of legacy business. For example:

- If a client has an active regular savings plan, do they need to start investing in a different share class post the implementation of the RDR?
- Does a client switching from one sub-fund to another constitute new business?
- Does a fund merger constitute new business?
- Does a pension transfer constitute new business?
- Does a client moving from one administration platform to another constitute new business?
- If moving platforms is not considered new business, how can this be identified if in specie transfers are not supported?

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

The majority of our members agree with the proposals insofar as they are described. However, we would ask the FSA to clarify the definition of vertically-integrated firms. It is not clear, for example, whether the proposals apply to a fund manager that is part of a group but operates independently within the group and that has its own distribution arrangements. Such entities should not be caught by the definition.

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

Yes. The fund sector has always supported transparency of the amount of the AMC rebated to remunerate advisers and appropriate disclosure.

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

We note the views reflected at paragraph 4.51 of the CP that remuneration of advisers is subject to significant regulatory oversight as part of TCF. That is true for all firms dealing with consumers. Nevertheless, there are detailed rules amplifying how that principle should be applied in certain circumstances, not least as regards the operation of authorised funds. Also, had the principle alone had sufficient bite, one would not have expected to see the volume of mis-selling and product bias that is apparent among a subset of advisers.

We therefore support the inclusion of rules relating to adviser remuneration to support those proposed for adviser charging. We suggest that there should be a rule requiring “firms to have clear, documented procedures for setting remuneration, including appropriate measures to tackle conflicts of interest”. Also, there should be guidance to accompany that rule based on the statements in paragraph 4.52.

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

No comment.

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

We look forward to the completion of the FSA's thematic supervisory review examining whether detailed requirements would now be appropriate for the platforms market. We would suggest that the FSA should consider the following as possible areas for attention:

Barriers

The majority of advisers now have established relationships with platforms and utilise their services as a component of their business activity. However, this has led to an element of capture, whereby advisers find it difficult to move business from

platform to platform. Automated asset re-registration is not yet universally available, which limits flexibility for the consumer. We would note, though, that a re-registration solution is currently under discussion and development by the industry.

Platforms of all sorts are responsible for an increasing market share of the fund distribution chain. In relation to funds distributed into the mass retail market, our members commonly report that platforms now represent a significant proportion of this business. Many platforms are making changes to their business models, such as the establishment of cash accounts, which would meet the adviser charging requirements for fund managers and make it more attractive to distribute solely through the platform proposition.

The IMA recognises that platforms have a key role to play in adviser charging. However, competition is important in the marketplace. The RDR proposals should encourage competition and not effectively force advisers to use particular platform offerings.

### Communication

As referenced above, the increasing intermediation of the market has led to a situation where fund managers are increasingly distanced from the end-investor. As a consequence they find it difficult to be sure that appropriate information is communicated. When UCITS IV and the outcome of the MiFID review are implemented, the FSA will need to review requirements on disclosures to consumers. The FSA should also consider whether the provision of information to providers whose products are sold/bought via platforms (e.g. whether advised or not, and if so by whom; whether bought direct or unit-linked business, held in an ISA, held in a SIPP etc) is universally sufficient to allow fund managers to meet their TCF obligations.

The provision of this information, as a “look through” to the distributor, would help with business efficiency, but would also assist with delivery of TCF by all parties. Note that both the commercial concerns of distributors and Data Protection Act provisions would likely preclude such information from including details about individual end-investors.

### Capacity

Platforms operate under a number of different business models. These are not always immediately clear to the end-investor. Indeed, not all terms of business make that capacity clear to the product provider either, and some do not agree terms of business with product providers. Platforms of all types should be required to disclose the capacity in which they are acting (i.e. whether as agent or principal) and if an agent, whether they are acting on behalf of the investor, the adviser or the product provider.

### Regulation

Regulation should be fully cognisant of the lack of homogeneity in platform business models. The capacity in which they operate and their charging structures are key, and differentiating, features, as are whether they offer risk allocation tools or give greater prominence to a subset of funds. Platforms do not just act as utilities; many

act more like distributors, or even restricted advisers. Given the above points, and the range of platform types, and their FSA-permitted activities, the FSA should consider as part of its review of platforms whether there needs to be greater clarity about how regulatory requirements apply, to support transparency in the retail marketplace.

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

We understand that some members who offer discretionary investment management services to “retail investors” (i.e. wealth management) have been told by FSA officials that their activities might be caught by these proposals. We question this suggestion. Where the mandate with a client refers only to discretionary management services, rules relating to the provision of advice cannot and should not have an impact.

The RDR concerns the advice market and adviser services to retail customers. There would be merit in the FSA understanding how remuneration of non-advising parts of the distribution landscape work (including platforms). But that should be the subject of a quite separate fact-finding exercise. Advice aside, the mechanics of distribution of retail products (whether via internet-based systems, aggregators, shelf space for product literature etc.) has costs associated with it. It is rational for bulk purchasers to receive higher AMC rebates or equivalents (i.e. for providers to bear reduced margins for higher volume business). This is an entirely separate matter to the remuneration of advice.

Increasing proportions of retail investment business are now being purchased through internet based propositions. Consumers will, we trust, become increasingly self-directed as their skills increase. Execution-only service providers could have an increasing role to play, and payments to them are transaction based. We would urge the FSA to take account of this in any further fact-finding work it undertakes in this area.

We would encourage the FSA to undertake this work as any disconnect in the rules for advised or non-advised intermediation could lead to unintentional lacunae. Also, consumers will likely be confused by the different charging mechanisms that apply.

**Professional standards for Advisers**

We welcome the proposals in the CP concerning professional standards for advisers. We consider that raising professional standards for retail financial advice is a timely opportunity to improve consumer confidence and trust in the industry.

We also support the proposed step change in raising professional standards by requiring all advisers to achieve mandatory level 4 qualifications. However, we do not consider it to be fair or consistent with accepted good practice by the exam regulator(s) to disregard all previous attainment and believe a transitional arrangement for practitioners who hold qualifications taken in good faith, such as the IMC, should be permitted. There is also a residual concern about potential loss of experienced advisers in the short term.

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

The draft model Code of Ethics appears to be a good starting point for further PSB/FSA consideration and consultation. It also appears consistent with the FSA's current principles and similar to those already applied by the professional and awarding bodies for their members.

Defining what is meant by common ethical and behavioural standards will be useful for firms when approving staff as being competent under the FSA's T&C requirements. However, the challenges will be to ensure the Code does not lead to unnecessary dual regulation and to monitor the application of those ethical standards across the industry. The PSB will need to work with the professional bodies and to emphasise the possible consequences of unethical practices.

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

The principles proposed for an overarching CPD standard for investment advisers appear to be consistent with the current schemes operated by the main awarding bodies and by some employers. They therefore offer a good starting point for further PSB/FSA consideration and consultation. Particular issues that we suggest need further consideration are:

- Enforcement of CPD - can qualitative assessments, such as relevance to role, be given more weight relative to the widely-used quantitative measures? CPD activity needs to be consistent with the individual's job role/training needs and not undertaken as an easy way to acquire sufficient CPD points.
- Which organisation(s) should have overall responsibility for monitoring CPD e.g. the employer, professional/awarding body or the PSB/FSA? If this responsibility is shared, how can this be best achieved without causing confusion or duplication?
- Can the main awarding bodies recognise each others' CPD monitoring?
- Some of the existing CPD schemes operated by the professional/awarding bodies are strongly linked to their own training provisions and can therefore limit choice.
- How to encourage good CPD practice; for example advanced planning and objective setting, timely records and substantive assessments of added-value.
- How precisely should CPD activity be used to cover good standards of ethical behaviour if at all?
- The individual's/firm's ability to fund CPD, including resources and making time available, can all act as a barrier to the quality and effectiveness of CPD.
- Could any compulsory CPD scheme introduced for advisers be transferred to other functions within financial services, if it were to be seen as the benchmark for the rest of the industry?

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

It may be argued that greater consumer protection and higher standards are required in giving investment over protection advice. But distinctions will not necessarily be easily understood by the consumer, who would expect a consistently high standard to apply across the whole distribution landscape. It will make it more difficult to sell the message to the general public if standards in only part of the financial planning service are being raised.

The key to consumer confidence centres, therefore, around the competence and qualification of the adviser. We recognise also that protection products are relatively simple and are sold in a highly competitive market where any form of bias should be easy to identify.

Equally the nature of the products could lead to a distribution process akin to a basic advice regime supported by modern IT solutions

Therefore we are of the view that proposals contained in the RDR pertaining to qualification and status should be applied equally to such other areas of the financial services industry as soon as practicable.

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

It is very difficult to comment upon the cost benefit analysis without further and more detailed information about the estimates used in compiling the analysis.

What is clear, however, is that the FSA has based much of its analysis on two unreliable sources.

The first is a survey of compliance costs and changes to business models carried out by Deloitte, in which the FSA acknowledges that the estimates may be subject to a margin of error.

The second is a report by Oxera concerning an "Assessment of the benefits of the FSA suitability letter", which we would argue is not directly relevant, and in which the FSA advises assumptions should be treated as indicative.

Moreover, there is a significant difficulty in assessing costs for providers and for platforms/advisers until it is clear what actual requirements will flow from the issues raised in the RDR. For example, a requirement to offer multiple share classes would generate considerable costs for all parties, including the cost of investor confusion, with little benefit since such a requirement would not actually meet the objectives of the RDR.

### AUTHORISED FUNDS: OPERATING MULTIPLE SHARE CLASSES

There are a number of operational issues and costs involved in the operation of multiple share classes.

A number of managers run “gross” and “net” share classes to achieve more optimal outcomes for investors with different tax statuses. The costs described below then come into play. ***However, whether an investor is eligible to receive gross is a relatively straightforward question, whereas ensuring investors are invested in the correct share classes depending on personal agreements between them and their advisers is not.*** Also, the costs that arise due to the complexity of multiple share classes are not linear; that is, each additional share class adds an increasing multiple of costs.

#### Pricing systems

The UK’s fund tax regime is a key factor in the complexity of the daily pricing of Authorised Funds.

Authorised Funds generally have an exemption from capital gains tax, but pay corporation tax at 20% on income net of expenses or withhold tax at 20% on income distributions. It is therefore imperative that at each pricing point the split between capital and income is calculated precisely, in accordance with the SORP. In particular, funds using derivative instruments may need to give consideration to each instrument to decide, on the basis of its construction and use, whether it generates capital or income or both, and to allocate its return accordingly in the accounting and pricing systems.

Moreover, the daily price of the fund must accurately reflect tax due by the fund itself on net income or by withholding tax on distributions. The former applies to “Equity” funds. The latter applies to:

- “Bond” funds – which are 60% or more invested in interest-bearing assets;
- “Tax Elected Funds” or “TEFs” – which distribute a mixture of dividends (on which there is no withholding) and interest (on which there is withholding); and
- “Property Authorised Investment Funds” or “PAIFs” – which are 60% or more invested in real estate and property income distributing vehicles, and which distribute a mixture of rental income (on which there is withholding), interest and dividends.

Multiple share class pricing systems calculate and store the ratio of the value of each class and then apportion the daily change in value in that ratio. Bond funds have to track gross and net NAVs because, regardless of the classes offered, the apportionment has to be performed gross. Adjustments are then made to cater for class-specific items such as issues/cancellations and management fees.

Each class has its own tax provision, and there is normally a fund level tax provision. It is sometimes necessary to eliminate differences that arise between the fund level and the sum of the class level provisions by adjusting the provisions in each class. The degree of automation of this varies, but skilled oversight and intervention is always required. The tax provisions vary in complexity but may have to take account of overseas treaty rates and the reliefs and offsets that arise, the allocation of expense relief within each class's provision and the allocation of the tax provision or relief between revenue and capital.

It may be necessary to take account of class-specific currency hedging contracts, to apportion the return from the hedge contracts between capital and revenue, and then to pass through another iteration of the tax provision and expense relief process.

#### Pricing controls

A key control in multi-class systems is to compare how the different classes behave relative to each other. For example, the movement in a currency class relative to the base class can be reconciled via the exchange rate applied. Typically pricing staff will satisfy themselves that the daily divergence in the classes' prices can be justified given known differences in the features of each class. Such divergences should be tracked and explained over the long-run, too.

#### Pricing errors

Inevitably errors occur and need to be analysed to see if the fourth significant figure of each price of each class has been affected or if the error in any class has exceeded 50bps. When an error is corrected it is often necessary to recalculate the apportionment ratios from the time the error occurred and to adjust the relative values of each class to correct the ratios. The impact of any error and correction on the tax provision needs to be considered. Sometimes small errors affect the fourth significant figure because the price rounds to a different figure, and this becomes more likely with more classes.

#### Fund accounting

The accounting ledgers are generally held at fund level but any item that could be allocated specifically to a class needs to have a class-specific ledger. Where manual journal posting is required there is a risk of items being posted to the wrong class – human error occurs, with consequential re-working and re-pricing when the mistake is detected.

***All of the above has to take place within the limited pricing window available, and this window is often under pressure from the demands of administrators, platforms, funds of funds and Life Co.s, who need the prices confirmed in order to start running their own daily processes.***

#### Manager's box

The manager needs to consider flows at fund level in order to set the pricing basis, the swing or to consider any dilution levies that may be required. It needs to prepare and instruct issues or cancellations for each class, and to collate this data for

the fund-specific Stamp Duty Reserve Tax charge, which is itself a complex calculation and which is another factor impacting the daily fund price.

### Fund reports

Financial statements are produced at fund level but the manager's report carries comparative tables covering performance, high/low prices, distribution rates, net assets per share and units in issue. All these are required per class. This can lead to investors faced with pages and pages of tables and little hope of actually knowing which class applies to them.

### Other costs

In addition to the operational issues above, multi-share classes give rise to specific direct costs. The industry predominantly outsources pricing and fund accounting to a very small number of specialist providers. These third party fund accountants' rate cards are usually based, at least in part, on the number of classes and number of distributions.

Fund administration is also commonly outsourced, albeit to a larger (but still small) number of specialist providers. These third party administrators often charge a fixed fee per class.

These costs would be met by the fund and, therefore, directly by investors.

There are other significant ongoing costs, in publishing multiple prices, calculating and disclosing multiple fund yields, more complicated fund literature etc.

### Class confusion

There is a risk of investors being placed in the wrong class – codes are often distinguished by a single character or a consecutive number – human keying errors and form filling errors increase with the number of classes. It may be difficult to identify which class is actually most appropriate for an investor.

### Settlement

There would also be the direct cost of increased dealing volumes and smaller deal values. The costs of dealing and settlement are factors of the number of deals, not the size of them - one of the key benefits of deal aggregation. Indeed, if deals in certain share classes were frequently small and therefore the share class uneconomic for its investors, the manager would face a serious dilemma – to close the share class and risk the FSA criticising it for unintentionally influencing adviser remuneration or to maintain the share class and be vulnerable to the claim that it is not acting in the interests of investors.

### Flexibility

With current rebating arrangements the level of rebates can be regularly reviewed and altered where appropriate. By contrast share classes are fixed and in the absence of rebating terms cannot be amended easily.

### Re-registration

Re-registration is only possible in circumstances where the transferor operates the same share class as the transferee. Introducing multiple share classes would mean that it would be far more difficult to affect re-registrations as different distributors would be hosting different share classes. Furthermore, switching between share classes is difficult particularly for those Fund Managers who operate equalisation. In such circumstances it may be possible to effect such switches only on XD dates.

### Share class eligibility

With multiple share classes an investor will be allocated the appropriate share class at the time of their investment. This would depend on the type of distributor and remuneration arrangements agreed at the time. The investor may decide to change their adviser or move to a different platform. This may result in the investor becoming ineligible for the share class in which they initially invested. This can cause complications for the Fund Manager in arranging at the next possible opportunity for the investor's holding to be switched into an alternative share class.

***Multiple share classes can only result in material increased costs for investors and increased risks of errors.***

### Platforms and Share Classes

Platforms commonly are not prepared to accommodate more than one retail share class, and may stipulate that it should be the "net" share class (ie tax paid by the fund or tax withheld on distributions), which leaves exempt or non-tax paying investors in the wrong position. Those few Platforms that are willing to accept multiple share classes generally seek to levy an additional charge on fund managers to cover set up and operating costs.