

07/11

Financial Services Authority

**Responsibilities
of providers and
distributors for
the fair treatment
of customers**

Feedback on DP06/4

July 2007



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This Policy Statement reports on the main issues arising from Discussion Paper 06/4
The responsibilities of providers and distribution for the fair treatment of customers.

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order line: 0845 608 2372.

1 The responsibilities of providers and distributors: Overview

- 1.1 In September 2006 we published Discussion Paper 06/4: *The responsibilities of providers and distributors for the fair treatment of customers* (the DP). The DP set out our view of the respective regulatory responsibilities of providers and distributors to treat customers fairly. It included an overarching Statement of responsibilities for providers and distributors (Statement) and five case studies detailing sector specific scenarios.
- 1.2 The DP also set out four questions for discussion:
- Q1: Do you agree that this Statement accurately reflects the respective responsibilities of providers and distributors under the Principles?
 - Q2: Do you consider that firms are already acting in line with obligations referred to in this Statement?
 - Q3: Where a firm is not yet meeting the obligations referred to in the Statement, what is the likely cost to the firm of bringing their activities into line?
 - Q4: Do you agree that we are the right body to publish this Statement?
- 1.3 We received more than 60¹ responses to the DP. Respondents included firms and trade associations operating in the following sectors: investment banking, asset management, mortgage, banking/building society, insurance and financial advice. We also received responses from Which?, the FSA's Small Business Practitioner Panel, the Financial Ombudsman Service and several non-authorised companies. In this Policy Statement (PS) we summarise and comment on the responses to the DP.
- 1.4 As with all aspects of the Treating Customers Fairly (TCF) initiative, our approach in the DP was principles based. We set out our view of what the Principles for Businesses (Principles) mean in relation to the responsibilities of providers and distributors, and did not propose any new rules. This is consistent with our move towards greater reliance on Principles as opposed to detailed rules.² As we have

1 We received 60 separate responses, one of which was a joint response from five entities.

2 See 'Principles-based regulation – focusing on the outcomes that matter' (23 April 2007).

explained elsewhere, we see real benefits to customers in tipping the balance of our regulation more towards principles and away from prescription. We believe that a more principles-based approach will help to align good business practice in firms and markets with our own statutory objectives.³

- 1.5 Responses to the DP focused primarily on the first question (see paragraph 1.2 above). The responses indicated a broad consensus that our description in the DP of the respective responsibilities under the Principles is accurate. Insofar as issues and concerns were raised, many seem to stem not from any substantive disagreement with the Statement, but from an over- (or an under-) interpretation of what we were requiring of firms. Some respondents seem to have interpreted our comments about what they ‘should’ or ‘may’ do in appropriate circumstances as stipulations of what they ‘must’ do in all circumstances. Conversely, other respondents seem to have interpreted the Statement as exhaustive of what they are expected to do. We also recognise that some of the language used in the Statement needed clarification.
- 1.6 Given this broad consensus, and given the general view that greater clarity from us in this area is useful, we are publishing a revised Statement of Responsibilities as a Regulatory Guide (the Guide) (see Appendix 1). This PS includes an account of how we have responded to the concerns and issues raised by respondents. The Guide contains additional explanatory information to deal with the key concerns raised by respondents, and we have made it shorter so as to more clearly focus on the high-level responsibilities. We have also revised wording that seemed to cause the most misunderstanding. In line with our principles-based approach, the Guide does not provide a detailed explanation of what actions firms need to take to meet their responsibilities. It sets out responsibilities at a high level and leaves it to firms to consider for themselves how they should best fulfil these responsibilities. The Guide is guidance issued under section 157 of the Financial Services and Markets Act 2000 (FSMA).
- 1.7 In light of the responses to the DP and a more principles based approach, we do not intend to publish any case studies. The case studies in the DP were intended to cover non-typical and/or complex situations where we felt that additional clarification may be helpful. They were not, as some respondents assumed, meant to represent or cover the typical situation in a sector. We believe that the Guide should now be sufficient for firms to interpret what is required of them without the need for case studies. The case studies in the DP, though helpful in facilitating discussion, do not form part of the guidance we are now publishing.
- 1.8 That said, we recognise that there may be some difficult or complex areas where case studies (or at least additional clarification of what we expect of firms) may be helpful. So we intend to consider on a case by case basis whether further clarification is required in any particular area, and, if so, what the best form for that clarification is. This may mean further guidance or case studies from us, or industry specific solutions developed by trade associations (see paragraph 2.30 below).

3 See ‘Treating Customers fairly – towards fair outcomes for consumers’ (July 2006).

4 PS07/11 – Providers and distributors: fair treatment of customers (July 2007)

2 Responses to questions in DP06/4

2.1 We are grateful to the respondents for giving us their views. We have set out a full list of respondents in Appendix 2.

Q1: Do you agree that this Statement accurately reflects the respective responsibilities of providers and distributors under the Principles?

2.2 Responses to the DP indicated a broad consensus that our description in the DP of the respective responsibilities under the Principles is accurate. There were, however, a range of issues and concerns raised by respondents.

2.3 One respondent felt that more could be done to make it clear that the Statement applied to services as well as products. Some respondents questioned whether it is appropriate to generalise across financial services – can, for example, the same statement embody responsibilities for retail structured products and mortgages when the distribution chains are so different?

2.4 A related concern was that the relationship between distributors and providers is much more fluid, varied and complex than implied in the Statement and that in reality there is not a rigid distinction between provider and distributor. One respondent argued that the definition of ‘provider’ should be narrower. Another argued that the labels ‘provider’ and ‘distributor’ should be removed and instead we should stipulate that responsibilities flow from actual roles or functions undertaken in a transaction.

2.5 Some respondents, in contrast, wanted more clarity and certainty on the precise responsibilities of providers and distributors. Their concern was that, absent greater clarity and specificity, responsibilities may fall through the gap between providers and distributors.

2.6 Several respondents questioned whether firms in a distribution chain should be able to contractually apportion responsibilities. If, for example, a distributor and provider jointly design a product, can they agree (and document) between themselves who has responsibility to the customer for product design? A view was expressed that firms are themselves best placed to determine the correct division of responsibilities. A number of firms, in particular wholesale firms, wanted clarification on the responsibilities of a provider to a customer where the provider does not have a relationship with customer.

Our response:

Onus on firms. The Statement is an example of principles-based regulation where we set out high level standards and outcomes. Firms will need to exercise judgement in interpreting how these apply to them. If, for example, a distribution model used by a firm does not fit squarely into the model in the DP, that does not mean that the DP does not apply to, or is not appropriate for, that firm. The onus is on the firm to interpret the DP in a way that makes sense for its particular circumstances and market conditions to achieve the desired outcomes, whether that firm provides services or products.

Responsibilities flowing from functions. We accept that there is a wide variety of relationships between distributors and providers, and that this should be reflected in the Guide. Indeed, one of the advantages of principles-based regulation is that we are able to draft materials that reflect this. We recognise, however, that use of the terms 'distributor' and 'provider' in the DP may have caused some confusion. We broadly agree with the proposition that responsibilities flow from actual roles or functions undertaken in a transaction. Although we are retaining the terms 'provider' and 'distributor' (as they are helpful in a broad sense in delineating responsibilities and facilitating discussion) we make it clear in the Guide that responsibilities generally flow from role or function.

Firms apportioning responsibility between themselves. As for firms apportioning responsibility between themselves, a firm cannot contract out of, or delegate, its regulatory responsibilities including under the Principles⁴. That said, whether providers and distributors can agree how to apportion responsibilities between themselves will depend on the circumstances. In particular, it depends on the nature of the regulatory responsibility; the extent to which such an agreement would be reasonable; whether the arrangement is clear to both parties and properly recorded and the systems and controls used to monitor whether the agreement continues to be appropriate in the circumstances. Where, for example, a retail bank and investment bank are both involved in product design, it may in some circumstances be appropriate for them to apportion responsibility between themselves.

- 2.7 Some respondents queried whether the Statement prescribed new rules rather than merely articulating existing Principles, and questioned whether, if new rules are being created, the correct procedural requirements are being followed. Another issue raised was how the Statement relates to existing statutes, case law and regulations. In particular, the issue of compatibility with the Markets in Financial Instruments (MiFID) was raised. Some respondents were concerned about the implications for enforcement.
- 2.8 Other respondents questioned why the DP had not considered the responsibilities of consumers under the principle of caveat emptor (buyer beware). Indeed, a further issue that has been raised is how 'customer' is defined for the purposes of the Statement – and, in particular, whether 'customer' has the same definition as in the Handbook such that small and medium sized enterprises are covered. Another concern raised was the compatibility of the DP with the FSA's ongoing Retail Distribution Review. Finally, questions were raised on the impact of the Statement on international competitiveness.

4 See SYSC 3.2.4G.

Our response:

Status and Scope of the Guide. We are publishing the Guide as guidance under section 157 of FSMA. It will take the form of a regulatory guide. As such, it will be published alongside, but not in, the Handbook. In accordance with our legal requirements for publishing such guidance, we consulted widely before publishing it. As explained above, we carefully reviewed all responses received during the consultation period and we took these responses into account in drafting the Guide. We also gave careful consideration as to whether any further consultation or a cost benefit analysis was appropriate in light of FSA policy and determined that it was not.⁵ The Guide does not alter the application of the Principles, add any new rules to the Handbook, or replace or substitute applicable rules or guidance. Also, it is not a complete exposition of all of a provider's or distributor's responsibilities to the customer (or to each other). Rather, it articulates existing responsibilities in the Principles, detailed rules and guidance, in FSMA and subordinate legislation, and case law. A discussion on the responsibilities of consumers is beyond the scope of this DP⁶.

International compatibility. The Guide represents our view of responsibilities based on the law, regulation and other circumstances that exist as at the publication date (but this takes into account changes to the Handbook including to implement MiFID that have already been made or consulted on and are due to come into force on 1 November 2007.) In the DP we noted that the Statement was likely to be compatible with the requirements that will apply after implementation of MiFID but that we would keep developments of these requirements under review and revisit them in our feedback. We have done this, and the Guide has been drafted to be compatible with our current understanding of MiFID.

International competitiveness. With regard to international competitiveness, the Guide only applies to the same extent as the Principles and therefore only has any impact on international competitiveness to the same extent as the Principles. Overall our risk-based approach to regulation is seen as making a positive contribution to UK competitiveness and we do not expect the provisions in the Guide to undermine this.

Enforcement. In terms of enforcement, we will continue to bring enforcement actions on the basis of Principles or rules (including on the basis of Principles alone). This Guide is guidance issued under section 157 of FSMA. As such, it is not binding on those to whom FSMA and the rules apply and need not be followed in order to achieve compliance with rules or other requirements. There is no presumption that departing from this Guide indicates a breach of a rule. However, the Guide may be relevant in an enforcement context, for example to explain the regulatory context. If a person acts in accordance with the Guide in the circumstances contemplated by the Guide, then the FSA will not take action against that person in relation to the aspects of the rules to which the Guide relates

⁵ See *Principles-based regulation – focusing on the outcomes that matter* (published 23 April 2007).

⁶ For the FSA's position on consumer responsibility see http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0210_cm.shtml

Definition of 'customer'. With regard to defining 'customer', as we explain in the Guide, we use the term as a convenient name for the end-customer in the retail supply chain (which may include potential customers in a given case). However, it is important to note that the term 'customer' as used in the Principles or detailed rules themselves is a defined term in the FSA Handbook. This Guide does not seek to alter or affect any definitions within the Handbook. It therefore does cover small and medium sized enterprises to the same extent as these are covered by the term 'customer' in the Handbook.

Retail Distribution Review. The Retail Distribution Review (RDR) project aims to find future industry solutions to address the root cause of perceived problems in the market for distribution of retail investment products. A Discussion Paper published on 27 June 2007 covered a number of areas which affect the relationship between providers and distributors in that sector, and how such relationships impact consumers. For example, the RDR considered the impact of payments between investment product providers and intermediaries, and whether these influence fair treatment of consumers. The Guide reflects, at a high level, the current regulatory responsibilities of providers and distributors. If the RDR does lead to regulatory change, we would reconsider the Guide in that light.

- 2.9 A frequently expressed concern related to what is expected of providers in the identification of the types of customer the product is likely to be suitable for (i.e. the target market). Some respondents were concerned that identifying a target market is impractical for some products where there are a broad range of customers. Others were concerned that our articulation of responsibilities did not reflect how firms actually identify target markets (e.g. they might identify a hypothetical market). Several respondents commented that an intermediary providing advice is better placed to determine which customers a product would be suitable for. Others were concerned that this could lead to providers intruding into the remit of the distributor. Another concern raised was that providers do not have sufficient market knowledge about customers and would not be able to obtain this from distributors. A comment was made about confidentiality legislation preventing access to this information. Some respondents felt that the DP gave too much detail on how the target market should be identified; others took the opposite view, and felt there was insufficient detail.
- 2.10 A variety of issues relating to stress testing were raised. Some respondents asked for more clarity on when stress testing is or is not appropriate and were concerned that we are expecting stress testing in situations where it is not needed. In particular, it was questioned whether firms are now required to stress test through the life of a product where there had been no express agreement to do so. One respondent recommended that we consider whether, and in what circumstances, it would be prepared to see firms providing potential investors with information on potential future returns. Another suggestion made was that stress testing should refer not just to financial stress-testing, but testing with consumers to see if products and contracts (and risks) are understood.

Our response:

Identifying a target market. When undertaking product design we would typically expect a firm to identify a target market. However, the way this should be done, and the level of detail that should be gone into, will depend on the nature of the product and its general risk profile. The onus is on the firm (not us) to determine the appropriate way to identify the target market. As we said in the DP, the provider may be able to meet this standard by identifying for whom the product is not suitable. It may also, where appropriate, be able to identify a range of alternative target markets, an extremely broad target market, or a hypothetical market. There may even be circumstances in which a firm could identify the whole market as its target market, although firms should be wary of using this as an alternative to giving due consideration to the issue of the target market. We do not see any conflict between the role of the provider in identifying a target market/type of customer and a distributor's role in assessing the suitability or appropriateness of a product. The processes and types of information involved are likely to be very different.

Stress testing. We recognise that the extent to which stress testing is required depends on the product. We also recognise that in some cases there may not be a need to stress-test – for example, where there is no variation in performance. This is, however, just an example, and it is the responsibility of the provider to consider whether to stress-test and if so, the extent of stress testing that is appropriate in light of the product, target market and any other relevant factors. It may in some cases be appropriate to test consumer understanding in addition to carrying out financial stress-testing. It should be apparent that we are not requiring any provider to stress-test through the life of a product where this would not be appropriate for the product.

- 2.11 Several respondents expressed concern about the scope of any expectation to provide information to distributors. Some wanted to know to what extent they could assume distributors understood what was given to them. Is it the case that if a provider takes reasonable steps to provide appropriate information to distributors, the responsibility then lies with the distributor to revert to the provider for more information, rather than on the provider to test whether sufficient information was given to a particular distributor (or distribution channel)? Another comment was that it is only the distributor who can know whether it understands the product or not and that more emphasis should be placed on the distributor to communicate whether or not it understands the product.
- 2.12 Another concern raised was that, under the Statement as drafted, consumers could end up receiving inaccurate information even if both the distributor and provider act in good faith. The concern was that distributors might believe they understand information when in fact they do not and/or providers might think they have given enough information when they have not.
- 2.13 One respondent was concerned that we should not treat high levels of training provided by some providers as the standard for all firms.

Our response:

The provision of information. One of the main concerns that prompted our investigation of product/provider responsibilities are problems at the interface between providers and distributors. Many distributors have expressed concern about poor quality of information supplied to them by providers. By the same token, we have been made aware of instances where distributors have failed adequately to process or query information supplied to them by providers. The Guide sets out high level responsibilities for both providers and distributors in this regard.

Overlapping standards. We recognise that there are overlapping standards on providers and distributors – on the provider to give information that is sufficient, appropriate and comprehensible, and on the distributor to ask for additional information where it needs additional information – and that providers would like more clarity on when they have discharged their responsibility. However, it is for the provider to determine how to meet the standard to provide information that is sufficient, appropriate and comprehensible in substance and form (and that is consistent with other specific requirements). A provider has a responsibility to consider what this means for specific products and distribution channels. We do not anticipate that providers will normally need to test the understanding of individual distributors (although in some cases this may be appropriate), but they may wish to undertake some testing to ensure that information is being understood, on average, by a particular distribution channel. The extent to which this needs to be done will vary depending on the product and the type of distributor. For example, where a provider manufactures a product to meet a distributor's own specification, the information that the distributor requires may be less.

Good practices. We accept the point that some firms may have practices which go beyond what is required by the Principles. We do not require other firms to match these different standards, so long as they are acting consistently with the Principles.

- 2.14 A frequently raised issue was the scope and extent of the expectation on a provider to 'consider keeping the quality of its distribution under review at a strategic, high level'. The DP stated this 'could include consideration of sales volume in relation to expected size of the target market and of whether a distribution channel is no longer appropriate to the product being sold'. We also said that a 'provider should act when it has concerns, for example by ceasing to use that distribution channel'. Respondents interpreted this provision in a variety of ways and it appears that a number of respondents read into it more than was actually there. Some interpreted this as meaning they were expected to 'police' or monitor individual distributors or to intrude into the client-adviser relationship. One respondent, for example, wondered if we were imposing a requirement on providers to subject distributors to a knowledge test. Others thought this unrealistic and impractical in light of how markets actually work. Another area of concern was the implication for collecting information – some respondents thought they had insufficient information and no realistic means of accessing what was needed from distributors. Others wanted more specificity on what should be collected and whether firms, generally, are currently collecting enough data. Some respondents took issue with the idea of considering sales volume – arguing that in their industry this would not provide any useful indication of the quality of distribution. Others wanted more detail on the

ways in which they should keep distribution under review. One firm commented that there are a wide range of metrics that firms could use to see if actual customers are in line with the target group and that this should be reflected in the DP. Other respondents questioned how they could keep distribution under review where a provider does not select particular distributors (and may not even be able to refuse business from a particular distributor) or where a provider cannot prevent an intermediary from taking a different or new approach to distribution i.e. it could start direct mailing. It was also questioned how this worked in the case of platforms (e.g. wraps).

- 2.15 Similar concerns arose from our stating that firms should ‘monitor the end result’. Several respondents said they were unclear how ‘deep’ the monitoring of the end result should be and wanted more clarity on what was expected of them. Others said that our expectations about what this entails are unrealistic and impractical in light of how the market actually works. Some respondents thought this expectation a radical departure from current practice. Other concerns related to the practicality of how firms could do the monitoring. Some respondents wanted to know what information they would need to collect. Others said they did not collect, and did not have access to, the necessary information. A particular concern was that providers have insufficient information to assess if products are ending up with the ‘right type of customer’.
- 2.16 Another view expressed was that the DP did not go far enough and that providers should be obliged to inform customers where a product does not perform as expected. Several respondents in the wholesale sector said the onus to monitor a product’s performance should only be on a provider during the offer period rather than throughout the life of the product.
- 2.17 Several respondents suggested that providers could be given a whistleblower responsibility with respect to their distributors.
- 2.18 Several respondents were worried that we were saying certain products (examples given were Payment Protection Insurance and sub-prime loans) can only be sold with advice or that providers must stipulate to distributors that certain products should only be sold with advice. It was argued that it is not realistic in many circumstances for a provider to decide whether or not a product should be sold with advice. One respondent recommended that providers should set as the ‘default’ option that advice will be necessary.

Our response:

Keeping ‘quality of distribution under review’ and ‘monitoring the end result’. It is apparent that a significant number of respondents over-interpreted what we meant by ‘keeping quality of distribution under review at a strategic, high level’ and by ‘monitoring the end result’. We have therefore removed these phrases from the Guide and instead use language which we think better clarifies what we expect of firms. For example, we removed the phrase ‘keeping distribution under review’. We now say that a firm should review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged for the distribution of its products or services given the target market. This involves collecting and analysing appropriate Management Information (MI) so that the firm can detect patterns in distribution as compared with

the planned target market, and can assess the performance of the distribution channels through which its products or services are being distributed.

We note that our expectations in this regard correspond to what we would expect of any firm concerned about its reputation. It should also be apparent that firms are not being required to review or monitor (or 'police') the performance of individual distributors, nor are providers required to collect the same level of detailed MI as a distributor.

Whistleblowing. Whether providers should have a whistleblower function, as some respondents have suggested, is beyond the scope of this paper. However, all firms may consider whistleblowing to the FSA where they have sufficient concerns to do so.

Advised or non-advised sales. As should be clear in the Guide, we are not prescribing when a distributor should or should not sell with advice. Nor are we prescribing any requirements on providers in this regard. That said, a provider, in selecting a distribution channel, should consider whether a product is one where customers would be wise to seek advice.

Platforms/wraps. Our position is that the responsibilities of providers and distributors, as set out in the Guide, do not change because there is a platform (e.g. wraps, fund supermarkets). However, several respondents asked for more clarity on the responsibilities where a platform is involved. We acknowledge that there may be additional complexities where a platform is involved. Accordingly, we plan to investigate the different scenarios that may arise and publish further material for discussion. On 27 June 2007 we published DP07/2 on platforms. After the Guide is published, we will make additional material on provider and distributor responsibilities where there is a platform available on the DP07/2 page of the website. We anticipate that we will invite comments on this additional material alongside the rest of the material in DP07/2.

- 2.19 A number of respondents were concerned about our saying that providers should consider communicating to the customer contractual 'breakpoints'. Several respondents asked for clarification on what is required regarding contractual breakpoints – in particular, they wanted more specificity on when they are required to communicate 'breakpoints'. A concern was expressed that, in the context of the structured retail products sector, an obligation on the provider to consider communicating contractual breakpoints would cut across existing contractual agreements. They also raised the issue of administration costs being passed on to consumers. Some respondents said that in the mortgage sector there are no existing regulatory requirements for providers to contact the clients in these circumstances, and it was questioned whether this is a new obligation. Some intermediary firms argued that customers should be able to require that the intermediary (rather than the customer) receives this information to allow a full level of service to be provided by the intermediary.
- 2.20 Several respondents asked for more detail on the respective post-sale responsibilities to orphan clients.

Our response:

Contractual breakpoints. In the DP we stated a firm should communicate contractual breakpoints in certain circumstances, and we retain the same language in the Guide. We are not prescribing when (or if) firms should communicate contractual breakpoints. We are clear in the Guide that what a firm should do depends on the circumstances; but in many cases we would anticipate that a firm would consider notification to be appropriate.

Other miscellaneous situations. As noted above, we have taken a principles-based approach. We therefore recognise that there are many specific issues that are not covered directly by the DP. In such situations, we expect firms to consider for themselves how to apply the Principles and rules as set out in the Guide.

- 2.21 Several respondents took issue with our saying that a distributor ‘should consider’ whether it will distribute a product if it does not understand it properly, and argued that a distributor definitely should not distribute products it does not understand.
- 2.22 Some respondents argued that advisers should be able to advise and arrange products without having to scrutinise them. They further argue that firms should be able to operate on a ‘reasonable reliance’ basis where they can rely upon information put in the public domain – especially by other regulated firms (i.e. they would like a ‘safe harbour for distributors).
- 2.23 Another issue raised related to a responsibility of the distributor to question providers where they are not clear about information. The concern is that providers may not be able to handle requests for information and that providers may in consequence reduce the number of firms through which they distribute their products.

Our response: As noted above, one of the main concerns that prompted our investigation of provider/distributor responsibilities is the interface between providers and distributors. We do not intend to be prescriptive in our approach to addressing this concern and the Statement was drafted accordingly. However, adherence to the Principles should mean that providers ensure the information they give to distributors is sufficiently comprehensible to enable them to understand it enough to give advice (where advice is given). If it is not, distributors should request further information from the provider, and the provider should reconsider whether the initial information supplied was adequate.

- 2.24 Some respondents were concerned that we were saying advisers should consider, in addition to price and terms, factors such as efficiency and reliability in selection of a provider. It was questioned whether this means advisers should log all incidents of poor administration by providers, or whether advisers must ask clients if reliability and efficiency matter to them. It was also questioned how these factors could be taken into account where clients are highly price sensitive and therefore primarily (or exclusively) interested in price.

Our response: As with other provisions in the Statement, we are not prescribing what firms must do. Efficiency and reliability are given as examples of factors that could be considered where information on this is available to the distributor.

- 2.25 Several respondents wanted it clarified that a firm should not be held responsible if customers do not respond to an offer of on-going service, irrespective of what was agreed at the time of advice.

Our response: Nothing in the Statement is inconsistent with this. We note, however, that firms should consider what would be the appropriate steps to take in this regard, taking into account, for example, why the customer did not respond to the offer.

Q2: Do you consider that firms are already acting in line with the obligations referred to in this Statement?

- 2.26 Just under half (47%) of respondents expressed broad agreement that firms are already acting in line with the obligations. Over a third (33%) of respondents felt they were not in a position to comment while a minority (20%) disagreed. Some disagreed because, in their view, the Statement does not accurately reflect respective responsibilities. Others disagreed because they felt that others in the supply chain were not meeting their responsibilities. For example, several distributors argued that providers do not act in line with their obligations when providing them with information.

Our response: The issues and concerns which caused firms to answer this question in the negative are addressed in Q1 (see paragraphs 2.2-2.26 above).

Q3: Where a firm is not yet meeting the obligations referred to in the Statement, what is the likely cost to the firm of bringing their activities into line?

- 2.27 Most respondents felt they were either not in a position to comment or did not respond to this question. The main reason given for this was the fact that firms had not undertaken a thorough investigation of this and were therefore not in a position to make an informed judgement.
- 2.28 A number of respondents said there would be minimal costs, arguing that they were already in compliance with the Principles and would therefore only need to vary their operations minimally.
- 2.29 Some respondents, however, said there would be significant costs. In particular, firms thought that it would be particularly costly to meet the following responsibilities: monitoring of the end-result, keeping distribution channels under review, collecting and analysing management information (and providing the management information to demonstrate compliance), stress testing through the life of a product, and reviewing/renegotiating of existing contracts.

Our response: We did not receive enough information to form a view on what the typical cost to different types of firms would be. However, the feedback on significant costs was specific to the above areas, where we believe the respondents over-interpreted what is required of firms. We have amended the Guide to give greater clarity on what we expect from firms in these areas, and our feedback on those amendments shows that the earlier concerns over a potential increase to costs in these areas have subsided.

Q4: Do you agree that we are the right body to publish this Statement?

- 2.30 Most respondents agreed that we are the right body. Those saying we were not the right body (which was only a small minority) argued that industry guidance would be more appropriate.

Our response: We are aware of current initiatives by some trade associations to help their members better understand how responsibilities are divided between different firms in the distribution chain in their specific sectors, and we welcome them. In some cases these initiatives are joint efforts by trade associations which represent providers and distributors respectively. However, we do not think that industry action alone will lead to the change in firms' behaviour that we think is needed in this area. This is because trade association activity is unlikely to cover the whole of the financial services sector. We also consider that, without our intervention, at least at a high level, trade associations will have no baseline on which to build their efforts. We do, however, view our work as complementary to trade association efforts, and would be happy to see a combination of our work in this area and industry initiatives leading to fairer outcomes for consumers.

Regulatory Guide

PROVIDERS AND DISTRIBUTORS REGULATORY GUIDE INSTRUMENT 2007

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) (Guidance) of the Financial Services and Markets Act 2000.

Commencement

- B. This instrument comes into force on 16 July 2007.

General guidance for providers and distributors

- C. General guidance on the responsibilities of providers and distributors for the fair treatment of customers is made in the form of the Annex to this instrument. This guidance is a Regulatory Guide and does not form part of the Handbook.

Notes

- D. In the Annex to this instrument, the “notes” (indicated by “Note”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- E. This instrument may be cited as the Providers and Distributors Regulatory Guide Instrument 2007.
- F. The Regulatory Guide in the Annex to this instrument may be cited as The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (or RPPD).

By order of the Guidance Committee
12 July 2007

Annex

The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)

This Annex sets out the text of the new Regulatory Guide “The Responsibilities of Providers and Distributors for the Fair Treatment of Customers”. All the text is new and is not shown underlined.

Introduction

- 1.1 In this Regulatory Guide ("Guide") we give our view on what the combination of Principles for Businesses ("the Principles") and detailed rules require respectively of providers and distributors in certain circumstances to treat customers fairly. However, it is not, and does not seek to be, a complete exposition of all of a provider's or a distributor's responsibilities to the customer or to each other; nor does it alter, replace or substitute applicable Principles, rules, guidance or law, such as those relating to unfair contract terms (Note (1)).
- 1.2 A customer's experience should not be affected by whether a product or service was provided and distributed by a single institution or by two or more institutions.
- 1.3 This Guide is guidance issued under section 157 of the Financial Services and Markets Act 2000 ("the Act"). As such, it is not binding on those to whom the Act and rules apply and need not be followed in order to achieve compliance with rules or other requirements. There is no presumption that departing from this Guide indicates a breach of a rule. However, the Guide may be relevant in an enforcement context, for example to explain the regulatory context. If a person acts in accordance with the Guide in the circumstances contemplated by the Guide, then the FSA will not take action against that person in relation to the aspects of the rules to which the Guide relates. The Guide will also be a useful tool for supervisors, particularly when they deal with TCF issues at firms. Supervisors may use the Guide in their discussions with firms. The issues it covers will continue to be dealt with in our supervision work as they are now, for example in the risk assessment framework we use for supervising firms (ARROW) or in pieces of focused thematic work.

The applicable rules

- 1.4 Under the Principles (Note (2)), providers and distributors of products and services have various responsibilities that have an impact on customers. Detailed rules within the FSA Handbook further specify what these responsibilities are in certain defined circumstances.
- 1.5 The Principles apply to all authorised firms. This Guide looks particularly to the following Principles (Note (3)):
 - Principle 2 ('A firm must conduct its business with due skill, care and diligence');
 - Principle 3 ('A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems');

- Principle 6 ('A firm must pay due regard to the interests of its customers and treat them fairly'); and
- Principle 7 ('A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading').

1.6 What a firm has to do to meet the requirements of a Principle will depend on the circumstances, including the riskiness or complexity of the product or portfolio, who the firm is dealing with (another firm or a customer, for example) and the financial sophistication of the target market (Note (4)). Firms should bear all of these factors in mind in order to interpret the requirements of the Principles in a way that is proportionate. The responsibilities described in this Guide apply to the extent that the Principles themselves apply.

Scope

1.7 This Guide is intended to be relevant to all regulated firms involved in the supply of products or services to retail customers. Although we have drafted it to be of particular relevance where there is more than one firm in the supply chain, many of the responsibilities described in the Guide are also relevant where there is only one firm involved in providing and distributing a product or service. Our intention is not to change the existing responsibilities of providers or distributors in delivering fair outcomes for consumers. Rather, it is to articulate the existing regulatory responsibilities. Nor does this Guide seek to determine or change whether or how consumers can seek redress in any individual case or from which firm in the supply chain. This Guide does not determine or change whether or how one firm in a distribution chain may seek redress from another firm; this too will depend on the circumstances of the case.

1.8 The supply chain may not comprise only authorised firms, but this Guide does not deal with the position where an unauthorised firm is involved unless expressly stated otherwise. Where there is a non-U.K. element to the supply chain, the Guide only applies to the extent that the Principles themselves apply.

1.9 This Guide is not intended to imply that a firm must take on the regulatory responsibilities of other firms in the distribution chain nor that there is a requirement for any firm to 'police' any other firm in the chain.

Interpretation

1.10 In this Guide we use 'must' where an action is required by a Principle or detailed Rule. We use 'should' where we think a firm ought to consider a particular action (not specified in a Principle or Rule) at a reasonably high level to comply with a Principle (not that they should follow a detailed a prescribed course of action). We use 'may' where an action is only one of a number of ways of complying with a Principle.

1.11 Where we refer to the 'customer' in this Guide we use it as a convenient name for the end-customer in the retail supply chain (which may include potential customers). However, it is important to note that the term 'customer' as used in the Principles or

detailed rules themselves is a defined term in the FSA Handbook. This Guide does not seek to alter or affect any definitions within the Handbook.

- 1.12 We use 'provider' to include persons who offer services such as portfolio management (through distributors or otherwise) as well as those who develop, manage or package products such as life insurance, general insurance or investment products or who develop or enter into home finance transactions (i.e. mortgages, home reversion plans and home purchase plans).
- 1.13 We use 'distributor' to mean those persons who then make up the rest of the supply chain taking the product or service to the customer. This could include, for example, financial advisers, third party administrators, appointed representatives, banks, building societies, and those who sell insurance as a secondary part of their business.

The responsibilities

- 1.14 Providers and distributors should consider the impact of their action (or inaction) on the customer in various stages of the product life-cycle, or the various stages of provision of the service (Note (5)). Depending on the precise nature of a firm's business, this could mean addressing the fair treatment of customers at the following stages: design and governance; identifying target markets; marketing and promotion; sales and advice processes; after-sales information and service; and complaints handling. This Guide gives our view of the respective responsibilities of providers and distributors under the Principles during the product life cycle or while the service is provided.
- 1.15 In this Guide we have distinguished between providers and distributors. While we consider the labels 'provider' and 'distributor' useful for the purposes of this Guide, we recognise that responsibilities flow from the actual roles or functions undertaken in a transaction, and firms should take this into account in considering their responsibilities under the Principles. In considering which responsibilities apply to it, a firm should consider the functions and roles that it undertakes in the product life-cycle. Whether a particular role or function is fulfilled by the distributor or provider (or both) may vary based on the product or service, or particular arrangements in place, and it may be possible for a firm to act as both provider and distributor at the same time in respect of different products or services. For example:
- (1) It is possible that a provider creates a product or service to meet criteria or designs specified by a distributor. In such instances, many of the responsibilities fall to the commissioning distributor, as 'retail manufacturer' of the product (Note 6)) or service (Note 7)), rather than the 'pure manufacturer' of the commissioned product or service. Of course, if what the pure manufacturer delivers fails to meet the agreed specification, the retail manufacturer may seek its own redress under the contract between them or the applicable law. That said, the pure manufacturer must act with due skill, care and diligence in accordance with Principle 2 and, where it conducts a regulated activity for the underlying customer (for example, it enters into a contract with a customer), must treat that customer fairly. Other Principles and detailed rules may also apply.

- (2) It is also possible that a product manufacturer creates components that are later (and possibly without the component manufacturer's knowledge) subsumed into retail products designed and marketed to customers by 'retail manufacturers'. In such instances, the pure manufacturer may not have a contractual or other relationship with the underlying customer. The pure manufacturer may not be aware (nor is it necessarily the case that it ought to be aware) of whether the retail manufacturer is using the product for itself or for an underlying customer. However, the pure manufacturer should act with due skill, care and diligence in designing its products (Principle 2). The skill, care and diligence that are 'due' under Principle 2 will be determined taking all the circumstances into account. These may include the manufacturer's knowledge of whether the product or service is provided to a firm, rather than an underlying customer, and the information needs of the firm. In addition, the pure manufacturer will normally be obliged to communicate information to the retail manufacturer in a way that is not misleading (Principle 7) (Note (8)).

1.16 Whether providers and distributors can agree between themselves how to apportion responsibilities between themselves will depend on the circumstances. In particular, it depends on the nature of the regulatory responsibility, the extent to which such an agreement would be reasonable, whether the arrangement is clear to both parties and properly recorded and the systems and controls used to monitor whether the agreement continues to be appropriate in the circumstances.

Provider responsibilities (Note (9))

1.17 **When undertaking product or service design, Principles 2, 3 and 6 are particularly relevant.** In particular, a firm:

- (1) should identify the target market, namely which types of customer the product or service is likely to be suitable (or not suitable) for;
- (2) should stress-test the product or service to identify how it might perform in a range of market environments and how the customer could be affected;
- (3) should have in place systems and controls to manage adequately the risks posed by product or service design (Note (10)).

1.18 **When providing information to distributors, Principle 2 is particularly relevant.** In particular, a firm:

- (1) should make clear if that information is not intended for customer use;
- (2) should ensure the information is sufficient, appropriate and comprehensible in substance and form, including considering whether it will enable distributors to understand it enough to give suitable advice (where advice is given) and to extract any relevant information and communicate it to the end customer. As part of meeting this standard, the provider may wish to consider, with regard to each distribution channel or type of distributor, what information distributors of that type already have, their likely level of knowledge and understanding, their information needs and what form or medium would best

meet those needs (which could include discussions, written material or training as appropriate).

1.19 When providing information to customers (Note (11)), Principles 3, 6 and 7 are particularly relevant. In particular, a firm:

- (1) should pay regard to its target market, including its likely level of financial capability;
- (2) should take account of what information the customer needs to understand the product or service, its purpose and the risks, and communicate information in a way that is clear, fair and not misleading (Note (12));
- (3) should have in place systems and controls to manage effectively the risks posed by providing information to customers.

1.20 When selecting distribution channels, Principles 2, 6 and 7 are particularly relevant. In particular, a firm:

- (1) should decide whether this is a product where customers would be wise to seek advice;
- (2) should review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged for the distribution of its products or services given the target market. This involves collecting and analysing appropriate Management Information (MI) (Note (13)) such that the firm can detect patterns in distribution as compared with the planned target market, and can assess the performance of the distribution channels through which its products or services are being distributed;
- (3) should act when it has concerns, for example by ceasing to use a particular distribution channel.

1.21 In the area of post-sale responsibility, Principles 2, 6 and 7 are particularly important. In particular, a firm:

- (1) in supplying information direct to the customer, must ensure that the information is communicated in a way which is clear, fair and not misleading (Note (14));
- (2) should periodically review products whose performance may vary materially to check whether the product is continuing to meet the general needs of the target audience that it was designed for, or whether the product's performance will be significantly different from what the provider originally expected and communicated to the distributor or customer at the time of the sale (Note (15)). If this occurs, the provider should consider what action to take, such as whether and how to inform the customer of this (to the extent the customer could not reasonably have been aware) and of their option to seek advice, and whether to cease selling the product;

- (3) should communicate to the customer contractual 'breakpoints' such as the end of a long tie-in period that may have a material impact on a customer that the customer cannot reasonably be expected to recall or know about already;
- (4) should act fairly and promptly when handling claims or when paying out on a product that has been surrendered or reached maturity. In doing this, the provider should meet any reasonable customer expectations that it may have created with regard to the outcomes or how the process would be handled;
- (5) must establish, implement and maintain effective and transparent customer complaint-handling systems.

Distributor responsibilities

1.22 In the area of financial promotions, Principles 3, 6 and 7 are particularly relevant. In particular, a firm:

- (1) should have in place systems and controls to manage effectively the risks posed by financial promotions;
- (2) in passing on a promotion created by a provider, must act with due skill, care and diligence. A firm will not contravene the financial promotions rules where it communicates a promotion produced by another person provided the firm takes reasonable care to establish that another firm has confirmed compliance with the relevant detailed rules, amongst other matters (Note (16)).

1.23 When providing information at or before the point of sale to a customer, Principles 2, 6 and 7 are particularly relevant. In particular, a firm:

- (1) should consider, when passing provider materials to customers, whether it understands the information provided (Note (17));
- (2) should ask the provider to supply additional information or training where that seems necessary to understand the product or service adequately;
- (3) should not distribute the product or service if it does not understand it sufficiently, especially if it intends to provide advice;
- (4) when providing information to another distributor in a distribution chain, should consider how the further distributor will use the information, such as whether it will be given to customers. Firms should consider what information the further distributor requires and the likely level of knowledge and understanding of the further distributor and what medium may suit it best for the transmission of information.

1.24 When advising on selection of a provider, Principles 2 and 6 are particularly relevant (Note (18)). In particular, a firm:

- (1) should consider the nature of the products or services offered by the provider and how they fit with the customer's needs and risk appetite;

- (2) should consider what impact the selection of a given provider could have on the customer in terms of charges or the financial strength of the provider, or possibly, where information is available to the distributor, how efficiently and reliably the provider will deal with the distributor or customer at the point of sale (or subsequently, such as when queries/complaints arise, claims are made, or a product reaches maturity).

1.25 **In the area of post-sale responsibility, Principles 3 and 6 are particularly relevant.** In particular, a firm:

- (1) should comply with any contractual obligation it has to the customer, for example to provide ongoing advice or periodic reviews. In connection with this, it should also consider its responsibility to maintain adequate systems and controls to deliver on such reviews;
- (2) should consider any implied or express representation it made (during meetings, correspondence or promotional material, for example). Where a customer has reasonable expectations based on the prior statements of a distributor, for example that performance will be monitored, the distributor should meet these expectations;
- (3) where involved in handling claims or paying out on a product that has been surrendered or reached maturity, should meet any reasonable expectations that the distributor has created in the customer's mind with regard to how the process would be handled;
- (4) must establish, implement and maintain effective and transparent customer complaint-handling systems;
- (5) should pass any communications received from customers (intended for or suited to providers to act upon) to providers in a timely and accurate way.

Notes:

- (1) The Guide represents our view based on the law, regulation and other circumstances that exist as at the publication date, but also takes into account changes to the Handbook including those to implement the Markets in Financial Instruments Directive (MiFID) that have already been made or consulted on and are due to come into force on 1 November 2007. (*Paragraph 1.1*)
- (2) The Principles are set out in PRIN 2. (*Paragraph 1.4*)
- (3) Of course, other Principles apply as appropriate. For example, under Principle 9, a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment. (*Paragraph 1.5*)
- (4) PRIN 1.2.1G. (*Paragraph 1.6*)

- (5) For example, many brokers and investment managers have on-going relationships with intermediaries by virtue of which their services are provided to the intermediary's underlying clients. (*Paragraph 1.14*)
- (6) For example, an insurer could be commissioned by a distributor to create a payment protection insurance product where the criteria for the product are specified by the distributor. (*Paragraph 1.15(1)*)
- (7) For example, a portfolio manager could be commissioned to develop a branded service specifically for a distributor where the criteria for the service are specified by the distributor. (*Paragraph 1.15(1)*)
- (8) Principle 2 may not apply to a pure manufacturer that is a MiFID investment firm in certain circumstances, for example in relation to eligible counterparty business: see PRIN 4 for further guidance. In some circumstances Principles 6 and 7 will apply even when the retail manufacturer is the only client of the pure manufacturer. (*Paragraph 1.15(2)*)
- (9) As explained in paragraph 1.15, although we use the terms 'provider' and 'distributor' we recognise that responsibilities flow from the actual roles or functions undertaken by a firm. (*Paragraph 1.17*)
- (10) For example, SYSC (Senior Management Arrangements, Systems and Controls). (*Paragraph 1.17(3)*)
- (11) This includes providing information to distributors for onward transmission to customers. (*Paragraph 1.19*)
- (12) For example, COBS 4 (Communicating with clients, including financial promotions); ICOB 3.8 (Form and content of non-investment financial promotions); MCOB 3.6 (Form and content of non-real time qualifying credit promotions); MCOB 3.8A (Form and content of financial promotions of home reversion plans); MCOB 2.2.6AR (Clear, fair and not misleading promotions for home purchase plans). (*Paragraph 1.19*)
- (13) See, for example, SYSC 3.2.11 -12. See also TCF cluster report on TCF considerations for Management Information:
http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/management_info.pdf
(*Paragraph 1.20(2)*)
- (14) For example, COBS 4 (Communicating with clients, including financial promotions), ICOB 2.2.3R (Clear, fair and not misleading communication), MCOB 2.2.6R (Clear, fair and not misleading communication). (*Paragraph 1.21(1)*)
- (15) For example, SYSC 3.2.11G (Management information); SYSC 3.2.17G (Business Strategy). (*Paragraph 1.21(2)*)
- (16) COBS 4.10.10R, ICOB 3.7.5R, MCOB 3.9.5R (Communicating a financial promotion where another firm has confirmed compliance). This exemption is not available in relation to MiFID or equivalent third country business.

(Paragraph 1.22(2))

- (17) For regulated activities other than designated investment business, a firm must take reasonable steps to communicate information in a way that is clear, fair and not misleading (e.g. ICOB 2.2.3R and MCOB 2.2.6R). In doing so, it may be reasonable for a distributor to rely on information produced by a provider unless the distributor is, or ought to be, aware of grounds to question its compliance. For designated investment business, a firm must ensure that any communication to a client is fair, clear and not misleading regardless of whether it has been produced by a provider (COBS 4.2.1R). The standard for designated investment business is an absolute standard, which does not permit reliance unless an exemption applies. *(Paragraph 1.23(1))*
- (18) These Principles are also relevant for non-advised sales, where there may be a need to consider a customer's needs and circumstances, for example see COBS 10 (Appropriateness (for non-advised services)), COBS 7.2.4R (Specifying demands and needs), ICOB 4.4 (Statement of demands and needs). *(Paragraph 1.24)*

Respondents

Abbey National plc
Aberdeen Asset Managers Ltd
Aegon
APCIMS
Association of Independent Financial Advisers
Association of British Insurers
Association of Mortgage Intermediaries
AXA Group
Britannia Building Society
British Bankers' Association
Building Societies Association
Canada Life
Cardif Pinnacle
Citigroup
Clarke Roxburgh
Corfunds
Council of Mortgage Lenders
David Severn Consulting
Fidelity
Financial Ombudsman Service
Freedom Finance
Friends Provident
GMAC-RFC Limited
Goldman Sachs International

Hargreaves Lansdown
HBOS plc
Hollydell Consulting
HSBC
IFA Consortium
Intermediary Mortgage Lenders Association
International Financial Data Services
International Underwriting Society
Investment Management Association
Kensington Group plc
Legal & General Group
Lloyds TSB
Mellon International
Morgan Stanley
Nationwide Building Society
Network Data Ltd
Norwich Union
Premier Asset Management
Prudential
Royal and Sun Alliance
Royal London
Schroders
Scottish Widows
Skandia
Small Business Practitioner Panel
SPC (The Society of Pension Consultants)
The Coaching Platform Ltd
The European Securitisation Forum/International Capital Market Assoc/International Swaps & Derivatives Assoc/The London Investment Banking Assoc/The Securities Industry & Financial Markets Assoc
The Institute of Insurance Brokers
TMS Financial Solutions Ltd
UK Actuarial Profession
Unum Provident
Which?

PUB REF: 001090

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