

PS12/3

Financial Services Authority

Distribution of retail investments: RDR Adviser Charging – treatment of legacy assets

feedback to CP11/26 and final guidance

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This Policy Statement reports on the main issues arising from Consultation Paper 11/26 (*Distribution of retail investments: RDR Adviser Charging – treatment of legacy assets*) and publishes final guidance.

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Copies of this Policy Statement are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

ABI	Association of British Insurers
AIFA	Association of Independent Financial Advisers
CBA	Cost benefit analysis
COBS	Conduct of Business sourcebook
CP	Consultation Paper
FSMA	Financial Services and Markets Act 2000
GPP	Group personal pension scheme
IFA	Independent Financial Adviser
IMA	Investment Management Association
ISA	Individual Savings Account
PERG	Perimeter Guidance Manual
PS	Policy Statement
RAO	Financial Services and Markets Act 2000 (Regulated Activities Order) 2001
RDR	Retail Distribution Review
TISA	Tax Incentivised Savings Association

1

Overview

- 1.1 This Policy Statement (PS) follows CP11/26¹, which covered the treatment of ‘legacy assets’ under the Retail Distribution Review (RDR) adviser charging rules. By ‘legacy assets’, we mean retail investment products purchased by a retail client before the RDR rules come into effect on 31 December 2012 and which the client is still holding when the rules are in force.
- 1.2 The PS gives feedback on the responses to CP11/26 and explains the approach we have adopted in the final guidance on the treatment of legacy assets, which is contained in Appendix 1.

Background

- 1.3 The final rules on adviser charging under the RDR were published in March 2010, in Policy Statement (PS) 10/6.² The adviser charging rules are contained in new sections 6.1A and 6.1B of the Conduct of Business sourcebook (COBS) and an important element of the new rules is a ban on firms receiving or paying commission in relation to personal recommendations to retail customers on retail investment products. These RDR rules will apply to advice given on or after 31 December 2012.
- 1.4 The issue of how to treat legacy assets is not relevant for group personal pension schemes (GPPs), as the rules in PS10/10³ on consultancy charging allow additional commission to be paid after 2012 for pre-RDR schemes, where new members join the scheme or contributions are increased for existing members. Commission cannot be paid for schemes set up post-RDR, irrespective of whether or not advice is provided.
- 1.5 In response to queries on how the ban on new commission will affect the continued payment of trail commission on pre-RDR assets, we published CP11/26 in November 2011, with draft guidance on whether there has been a personal recommendation in various situations. We received around 80 responses to the CP. Many of these asked for additional

1 CP11/26 *Distribution of retail investments: RDR Adviser Charging – treatment of legacy assets* (November 2011).

2 PS10/6 *Distribution of retail investments: Delivering the RDR – feedback to CP09/18 and final rules* (March 2010).

3 PS10/10 *Delivering the Retail Distribution Review: Corporate pensions – feedback to CP09/31 and final rules* (June 2010).

guidance on how the adviser charging rules interact with the rules we made in September 2011 confirming that trail commission can continue on pre-RDR assets and laying down requirements for re-registration of trail commission where a client chooses to move to a new adviser.

- 1.6 The final guidance in Appendix 1 has been extended to include guidance in COBS 6 on the interaction between the rules on trail commission and adviser charges.

Monitoring the implementation of the new rules and changes in the market pre-RDR

- 1.7 As part of our supervisory work we will review the implementation of the new adviser charging rules, and will also monitor changes in the market leading up to the implementation of the rules at the end of this year, such as significant increases in the sale of particular products that could indicate non-compliance with the rules on suitability and the client's best interests. Once the RDR rules have come into force, we will take action if we see firms acting in a way that could lead to consumer detriment; for example, recommending retention of higher charging products so they can continue to receive trail commission. We will also monitor the overall level of trail commission in the market, to check whether it is reducing or remaining at current levels.

Equality and diversity issues

- 1.8 As noted in CP11/26, we have assessed the equality and diversity impact of our proposals and do not believe that they will give rise to any issues. Respondents to CP11/26 did not comment on this point.

Structure of this PS

- 1.9 The PS chapters cover:
- Chapter 1 – overview;
 - Chapter 2 – summary of feedback to CP11/26 and the approach we have adopted in the final guidance on the treatment of legacy assets; and
 - Chapter 3 – cost benefit analysis.

Timetable

- 1.10** The guidance in Appendix 1 will come into force on 31 December 2012, at the same time as the main RDR adviser charging rules.

Who should read this PS?

- 1.11** This PS will be of interest to firms advising on retail investment products and to product providers offering these products. Consumers will also be interested in the approach firms will need to follow when dealing with legacy assets.

2

RDR Adviser Charging – treatment of legacy assets

Introduction

- 2.1** The RDR rules will prevent the payment of commission for new advice, and we confirmed in CP11/26 that we did not propose to relax this ban. However, we accepted that guidance would be helpful to firms in complying with the ban. The draft guidance we consulted on in CP11/26 set out typical recommendations and whether they will be regulated as ‘advising on investments’ under article 53 of the Regulated Activities Order (RAO).
- 2.2** We received responses to the CP from trade bodies, insurers, banks, independent financial advisers (IFAs), fund managers, wealth managers, platforms, consultants and the Financial Services Consumer Panel.
- 2.3** Many of the responses asked for additional guidance on how the ban on commission for post-RDR advice will interact with the rules we made in September 2011⁴, which confirm that payment of trail commission can continue on pre-RDR assets. Some showed a misunderstanding of how the rules would apply, and thought that any new advice on a pre-RDR product would always lead to all commission on the whole product automatically being switched off, which is not the case. Others supported our approach whereby advice on top-ups/increases to regular payments into pre-RDR investments could only be paid for through adviser charges and not commission. However, there was confusion on cases where new advice leads to no changes being made to a product, and also where the advice relates to fund switching within a life insurance product such as an investment bond. The final guidance covers these points and a few others.

⁴ Instrument 2011/54, dated 22 September 2011. See also Handbook Notice 115 – paragraphs 4.2 onwards – for feedback on consultation.

Summary of feedback to CP11/26 and the approach adopted in the final guidance

- 2.4 Respondents generally agreed that it would be helpful to have guidance on when the ban on new commission would and would not apply. However, many respondents thought there was a need for additional guidance on the interaction between continued payment of trail commission and the ban on new commission for post-RDR advice. There were a number of helpful suggestions for specific situations that should be covered by new guidance.
- 2.5 Some respondents thought that providers should continue to be able to pay commission on changes to pre-RDR products following post-RDR advice. As stated in CP11/26, we do not propose to relax the ban on new commission for post-RDR advice, as we consider that this would lead to commission bias persisting in the market. However, having considered carefully the comments on specific situations contained in the responses, we have added guidance to COBS 6 to complement the guidance we consulted on in the Perimeter Guidance Manual (PERG).

General

- 2.6 In view of the misunderstanding of the effect of the adviser charging rules shown in some of the responses we received from firms, we think it is worth repeating the basic position on non-advised changes and offsetting trail commission against adviser charges.

Changes that take place without new advice post-RDR

- 2.7 Some firms asked what should happen where changes take place automatically in accordance with an agreement between the adviser and client pre-RDR. For example, regular payments are increased automatically by, say, 5% every year, or there is automatic rebalancing of a portfolio at set intervals, with no new advice post-RDR. Given that the adviser charging rules apply only where a personal recommendation on a retail investment product is given to a retail client, commission can continue to be paid on any increases to the investment or on fund switches where no new advice is provided. We have not added guidance on this, as it is clear from the rules that the adviser charging rules do not apply where no advice is provided. Providers and advisers will need to agree how they will ensure that commission is only paid where advice is not provided.
- 2.8 As noted in PS10/6, we have not consulted to date on any changes to non-advised services. However, we said that we would keep this under review: in particular, we would look to see whether firms exploit the distinction between advised and non-advised services in a way that is likely to lead to poor consumer outcomes.

Additional remuneration for post-RDR advice and the ability to offset trail commission against adviser charges

- 2.9** When considering the new guidance, it should not be forgotten that additional commission cannot be paid or received for providing personal recommendations, which must be paid for through adviser charges. Some firms have suggested that it should be acceptable to agree with the client that whatever is being received by the adviser as commission pre-RDR should simply be reclassified as adviser charges. This would not meet the requirement for an adviser to have a standard charging structure set by the adviser himself or herself and to give this to the client before providing any advice post-RDR. It would also not be acceptable for adviser charges to vary inappropriately for substitutable products, to reflect different levels of commission received pre-RDR.
- 2.10** However, an adviser who is receiving trail commission for pre-RDR advice or transactions can agree with the client that he or she will rebate the commission to the client as part of a new adviser charging agreement with that client, given that the commission relates to pre-RDR advice or transactions. COBS 6.1A.4R does not allow new commission to be accepted for advice, even if the adviser intends to refund the commission to the client, but this applies to commission for post-RDR advice, and does not prevent commission for pre-RDR advice or transactions being rebated to the client.
- 2.11** New guidance in COBS 6.1A.4AAG(3) and (4) reinforces this.

New guidance in COBS 6

- 2.12** The new guidance we have added to COBS 6.1A covers the following.

Cases where trail commission can continue to be paid

- 2.13** There were a number of queries on how the rules would affect the payment of trail commission in cases where new advice does not lead to a change to the product or investment amount, or leads to a reduction in the level of the pre-RDR investment or regular payments.
- 2.14** New guidance in COBS 6.1A.4AAG says that a firm may continue to accept commission after 30 December 2012 if there is a clear link between the commission payment and an investment in a retail investment product that was made by the retail client following a personal recommendation made, or a transaction executed, on or before 30 December 2012. The guidance gives the following examples of cases where a personal recommendation relating to a pre-RDR investment does not lead to an additional investment into the product:
- no change to the product;
 - a reduction in the investment amount or the level of regular payments;

- a change from accumulation units to income units or vice versa; or
- fund switches within a ‘life policy’ as defined in our Handbook glossary.

2.15 The Association of British Insurers (ABI) and Association of Independent Financial Advisers (AIFA) supported the continuation of trail commission where there is fund switching within a life product. In contrast, the Investment Management Association (IMA) was concerned that there would be an unlevel playing field if we allowed fund switches within life products to continue to attract trail commission, in contrast to switches between funds outside such products. However, given that the trail commission relates to the product as a whole, we consider that the ban on new commission post-RDR does not affect the payment of trail where the product itself is unchanged, with no new money being paid into it. The data available so far does not show an increasing trend for advisers to recommend that clients take out life products allowing fund switching such as investment bonds. Our supervisory work will review implementation of the new adviser charging rules, and will also scrutinise changes in the market leading up to implementation of the rules at the end of this year. This will include review of changes in the market pre-RDR, such as significant increases in the sale of particular products that could indicate non-compliance with the rules on suitability and the client’s best interests. Once the RDR rules have come into force, we will take action if we see firms acting in a way that could lead to consumer detriment; for example, recommending the retention of higher charging products so they can continue to receive trail commission. We will also monitor the overall level of trail commission in the market, to check whether it is reducing or remaining at current levels.

Top-ups and increases in regular payments

2.16 The new guidance confirms the position we stated in CP11/26, that additional commission cannot be paid on top-ups into a retail investment product, or on increases to regular payments into a product (COBS 6.1A.4AAG(3)). However, trail commission can continue to be paid on the investment amount resulting from pre-RDR advice or a pre-RDR transaction, and also on the previous level of regular payments. For example:

- a) New payment into a life policy or unit trust** – The client has an investment of £10,000 and is advised post-RDR to pay another £10,000 into the investment. Trail commission can continue to be paid on the original £10,000 but the new advice can only be paid for through adviser charges, with no additional commission on the new investment.
- b) Increase to the regular payments into a life policy or unit trust** – The client pays £100 a month into the product, and receives advice post-RDR to increase this to £200. Trail commission can continue to be paid on £100 a month, but the new advice can only be paid for through adviser charges and not through additional commission.

Changes to PERG

- 2.17** In CP11/26 we consulted on a draft section of PERG guidance, setting out typical recommendations on investments and whether these recommendations will be advising on investments for the purposes of article 53 of the Regulated Activities Order (RAO).
- 2.18** We have not changed the examples we consulted on. However, we have added one new example, covering the case where one person gifts an investment to another person. The example says that this is not advice, because it does not involve advice on buying, selling, subscribing for or underwriting an investment.
- 2.19** Some of the responses asked whether advice on corporate actions (such as fund mergers or transfers) would be regulated advice. We have not added a new example to the PERG section. Advice on fund mergers or transfers that includes a recommendation to do nothing or sell the investment is regulated advice and comes under the examples already in the PERG guidance, i.e. advice to sell or not to sell an investment. The position on trail commission where the advice is to do nothing is covered in paragraphs 2.13 to 2.15.

Issues not covered in the new guidance

- 2.20** We also received requests for clarification on the following points:
- **Non-discretionary manager moves to adviser charging** – If the manager moves to adviser charging for the whole of a client's portfolio, can the trail commission on pre-RDR investments be rebated to the client? The answer is yes, if the commission relates to pre-RDR advice or transactions, or post-RDR advice is covered by the new guidance in COBS 6.1A.4AAG(1) and (2). Additional commission cannot be received for new advice in other cases, including changes to investments following advice.
 - **Re-registration of assets from one platform to another** – There were a number of comments that this should always constitute advice and be subject to adviser charging, given that the new platform may have a different cost structure and may also not have the same share classes that funds can be transferred into. This would also avoid conflict with the preparation of new industry standards for re-registration led by the Tax Incentivised Savings Association (TISA), as the transferring platform will not be in a position to inform the receiving platform whether parts of a particular investment were made pre-RDR and so can continue to attract commission.

The guidance in PERG we consulted on states that re-registration is unlikely to be advice, because normally it will not involve buying and selling the investments held on the original platform. However, if the advice includes advice on moving some or all of the client's funds into a different particular investment or fund, this will be subject to adviser charging. We have not added guidance on how platforms should distinguish between advised and non-advised sales – it is up to individual platforms to decide the approach they will adopt.

- **Advice to reinvest dividends** – The PERG guidance includes the example: ‘Dividends are reinvested into an *investment* without advice being given’. This is not advice, and does not come under adviser charging. Conversely, advice to the client to reinvest dividends into a particular investment will be a personal recommendation, and so commission cannot be paid on the dividends if the advice is provided post-RDR, although it can continue on the original investment. We have not added further guidance on this.
- **Providers and platforms should be able to rely on advisers to inform them if there has been advice** – There were several comments that providers and platforms have no way of telling whether advice has been provided, and will need to rely on advisers to inform them. We have not included any guidance on this point – firms and platforms are free to decide for themselves how they will ensure that commission is not paid for advice.
- **Whether the original adviser can continue to receive trail commission if advice is given by a new adviser or a fund switch is made** – If trail commission has not been re-registered to a new adviser, the provider can continue to pay trail commission to the original adviser until the investment is sold, as new advice by the new adviser will come under an adviser charging agreement with the client. This could lead to a client continuing to have trail commission deducted from the investment for the pre-RDR advice or transaction, while paying adviser charges for new post-RDR advice. However, if there is a fund switch post-RDR (other than within a life product) the sale of one fund and purchase of another will automatically lead to the trail commission ceasing, as commission cannot be paid on a product purchased as a result of post-RDR advice. If initial commission is outstanding, the contract between the original adviser and client should cover what will happen if the investment is sold.
- **Advisers should be required to remind clients of trail commission they are receiving and discuss with them why an existing product may be better than a cheaper post-RDR alternative which does not pay commission** – The Consumer Panel and one insurer suggested that communications to customers should cover existing trail commission on a product. We have not added specific guidance on this point, as we consider that the overarching requirement in COBS 4.2.1R for communications to clients to be clear, fair and not misleading and Principle 6 require firms to deal openly and honestly with their clients. In addition, the product disclosure rules, as amended recently, require providers facilitating payment of new or increased adviser charges to give retail clients ‘sufficient information for the retail client to be able to understand the likely effect of that facilitation’. Sufficient information should include the effect of all charges on the product.⁵ The suitability rules in COBS 9 already require advisers to consider the suitability of their recommendations, for example, COBS 9.2.1R says that ‘a firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client’. COBS 6.1A.16G says that, to meet its responsibilities

⁵ We consulted in CP 11/03 on a requirement for providers to provide a new key features illustration if new or increased adviser charges were to be facilitated through the product, but decided, in the light of consultation responses, to make a high level rule requiring firms to give retail clients ‘sufficient information’ to be able to understand the likely effect of the facilitation. Final rules were published in November 2011 with PS11/14.

under the client's best interests rule and Principle 6 (customer's interests), a firm should consider whether a personal recommendation is likely to be of value to the retail client when the total charges the client is likely to be required to pay are taken into account.

Trail commission and the rules on re-registration of commission

2.21 The rules we made in September 2011⁶, setting out the conditions applying where trail commission is re-registered, require an ongoing service to be provided by the new adviser where the client has chosen to move to a different adviser (this requirement does not apply to bulk transfers of business, e.g. where an adviser retires and sells his business to another firm). Some trade bodies and firms have asked whether it is acceptable for this service to include advice, given that firms are banned from receiving commission for post-RDR advice. The ABI has also pointed out that the new rules in COBS 6.1A.4AR, which allow firms to continue to receive trail commission, include as one of the conditions that 'the personal recommendation was made on or before 30 December 2012'. So the rule does not include cases where the original sale was non-advised.

2.22 We have not amended the rule to refer to non-advised transactions, since the adviser charging rules apply only to advice, and if no new advice is provided post-RDR a firm can carry on receiving trail and additional commission.⁷ However, the new COBS 6.1A.4AAG, explained in paragraphs 2.12 to 2.16, refers to both personal recommendations and transactions made on or before 30 December 2012. The position for different situations is as follows:

- a) **Trail commission is re-registered to a new adviser following the client's decision to move to that adviser** – If the new adviser decides to seek re-registration of the trail commission on the client's investments, an ongoing service (unspecified) must be provided by the adviser in return for the trail commission, and the amount of commission must be disclosed to the client. As the client has decided to move to a new adviser, there will need to be an adviser charging agreement put in place covering the services to be provided and the charges that will be made for those services. The re-registered trail commission will need to be disclosed to the client, and can form part of the new adviser charging agreement, as the new adviser can – if he or she wishes – offset the trail commission against the new adviser charges. In that situation, the adviser will be providing advice on the client's investments in return for adviser charges, including the investment on which trail commission is being paid, so advice will not be specifically linked to the trail commission. This follows from the rules that are already in place.

⁶ Instrument 2011/54. Feedback on the consultation in CP10/22 was contained in Handbook Notice 115 of December 2011, paragraphs 4.2 onwards.

⁷ As we said in PS10/6 – paragraph 4.37 – we decided that we should not apply adviser charging to non-advised services at this stage, but will take action if we find evidence of consumer detriment as a result of making no changes to our rules for non-advised services. Our supervisory strategy will include checks that firms are not manipulating sales in an attempt to avoid adviser charging.

- b) **Trail commission is re-registered when the original sale was non-advised⁸** – The new requirement for an ongoing service does not apply, but if the firm to which the commission has been re-registered gives advice to the client post-RDR, the adviser charging rules apply, and the new COBS 6.1A.4AAG may be relevant. If the re-registration follows a bulk transfer of business, the receiving firm may not contact the clients, or may choose to contact only some of them – the adviser charging rules will only apply if the firm contacts clients and offers advice.
- c) **The original firm that provided advice or sold the product on a non-advised basis now provides new advice post-RDR** – The adviser charging rules apply to the new advice, and the new COBS 6.1A.4AAG may be relevant.

Allocations of over 100% (negative charges)

- 2.23 The rules published with PS10/6 in March 2010 include a rule, in COBS 6.1B.7R, which requires a product provider to ‘take reasonable steps to ensure that its retail investment product charges are not structured so that they could mislead or conceal from a retail client the distinction between those charges and any adviser charges payable in respect of its retail investment product’. Guidance in COBS 6.1B.8G relating to that rule says ‘a firm should not offer to invest more than 100% of the client’s investment’.
- 2.24 The ABI, and some individual insurers, have asked for a waiver from the guidance so that allocations of over 100% could continue for top-ups to pre-RDR products where the insurer is not facilitating payment of adviser charges, on the basis that there will not be any confusion between product and adviser charges. Some of the insurers gave examples of legacy products with allocations of over 100%, where they considered that consumers would be adversely affected if top-ups could not be on the same basis, as the options available under the original policy conditions would not be available, and applying the ban might lead to lower amounts being paid into the investment than before.
- 2.25 We consider that allocations of over 100% could result in a potential client being misled even if adviser charges are not being facilitated. While adjusting the allocation up or down can be a convenient lever to accommodate flexible commission options, it can also be used as part of a complex charging structure to make it appear that a consumer is getting ‘money for nothing’. So we remain concerned that allowing allocations of over 100% can be used to mislead consumers on the actual level of charges and the amount being invested.
- 2.26 It is not possible to grant a waiver from guidance (as a waiver can only be granted from a rule). However, guidance is not binding, it is intended to illustrate ways (but not the only ways) in which a firm can comply with the relevant rules. If a firm has complied with the rule to which the guidance relates, it does not matter whether it has also complied with the guidance. This means firms that currently have policies with allocations of over 100% have the option of allowing top-ups on pre-RDR products on the same basis if they can show

⁸ For obvious reasons, we would expect the number of non-advised transactions carried out by an adviser firm to be low.

they comply with COBS 6.1B.7R, i.e. they can show that their retail investment product charges are not structured so that they could mislead or conceal from a retail client the distinction between those charges and any adviser charges payable. However, we remain concerned that allocations of over 100% can be used to mislead consumers on the actual level of charges and the amount being invested.

3

Cost benefit analysis

- 3.1** In CP11/26, we noted that when we prepared the cost benefit analysis (CBA) in PS10/6, using cost figures given to us by firms following consultation in CP09/18, it was based on the rule banning new commission for all new advice on or after 31 December 2012, and not on any relaxation of that rule. We said we did not consider that the proposed guidance would give rise to incremental costs for firms, as we had already estimated the costs and benefits associated with the adviser charging rules in the CBA conducted for CP09/18 and PS10/6.
- 3.2** In CP11/26, we also indicated that even if firms did not take into account the costs of systems changes to comply with the RDR rules for legacy business when responding to CP09/18, firms would be able to avoid systems changes by making cash rebates to customers. We noted that at that stage we did not propose to ban cash rebates by providers to consumers, although our preference was to do so following further work, and that this could help providers avoid additional costs to comply with the RDR rules for legacy business.
- 3.3** Following feedback from the industry, we now provide new estimates of the potential costs associated with this guidance. We conduct a CBA for general guidance when costs are identified that were not formally considered when we consulted on the rule or the Principle the guidance relates to.
- 3.4** In PS10/06⁹, covering the RDR as a whole, we estimated one-off costs to be £605m to £750m and ongoing costs to be £170m to £205m. We presented evidence of detriment amounting to in the region of £225m per annum, with £60m of pension detriment.
- 3.5** In CP11/26 we asked:

Q4: Do you have any comments on our analysis of the costs and benefits?

⁹ PS10/6, *Distribution of retail investments: Delivering the RDR – Feedback to CP09/18 and final rules*, (March 2010).

Summary of responses

- 3.6** The ABI, the Association of Financial Mutuals (AFM) and Investment and Life Assurance Group, and also some individual insurers, did not agree that the new guidance and policy position set out in the CP would not lead to incremental costs for firms compared to the costs set out in the original RDR CBA. Other trade bodies had no comments, or said there would be additional costs if our intention was to remove trail commission earlier than previously understood, which is not the case.
- 3.7** In particular, the ABI said they had not factored into their response to the original RDR CBA the costs of amending legacy systems to remove commission for top-ups and other changes, even though the rules very clearly ban receipt and payment of commission for advice post-RDR. The ABI and provider firms also indicated that the option of making cash rebates to consumers was not an effective solution to avoid systems changes and that they would need to invest in changing their systems even if cash rebates were available.
- 3.8** Based on information received from industry, we estimate that the additional compliance costs – if all insurers changed all their legacy systems to allow top-ups/increases without commission being paid – to be £460m. However, we know from discussions with experts and the industry that insurers will only amend legacy systems for larger/more profitable books of business and, in particular, for the somewhat limited number of products where top-ups are likely.
- 3.9** As a consequence of not all systems being upgraded, some consumers may incur higher costs, as they may be charged twice (i.e. they will pay adviser charges, and at the same time commission will not be ‘switched off’ on the top-up but will be retained by the provider). However, some of these costs may be avoided because the adviser will need to take product costs into account to provide suitable advice, and to act in the client’s best interests. Unless it is in the client’s interests to pay the new money into the existing product, for example, because of a guarantee not available with a new product, suitable advice may be to pay additional money into a new product that does not pay commission, or indeed to sell the existing product and invest both old and new money into a different product.
- 3.10** In addition, the responses to CP11/26 (and so the figures quoted above) assume that the rules do not allow fund switches within a life insurance product to continue to attract trail commission. The new guidance makes it clear that this is allowed, because the trail commission relates to the product as a whole and not to individual funds within it. Taking the payment of commission on fund switches into account, firms’ estimated compliance costs will be lower, although we would need further information from firms to calculate the size of the change.
- 3.11** The benefit of maintaining the ban of commission on top-ups is to mitigate the risk of detriment that could arise from consumers not being advised to switch product when it would be in the consumer’s interest to move the investment into a new, non-commission paying product. Consumers holding long-term investments, such as pensions, are most likely to face this risk.

- 3.12** We recognise that there are risks of poor outcomes for customers with legacy products, though we believe that these risks are ones we can monitor and supervise. In particular, we will monitor sales pre-RDR to check whether there is an increase in advisers recommending their clients to purchase new products allowing subsequent fund switching within the product. Once the RDR rules have come into force, we will monitor recommendations to retain legacy products with trail commission (rather than recommending cheaper products without commission) and the level of trail commission in the market, to check whether it is reducing or remaining at current levels.

Annex 1

List of non-confidential respondents to CP11/26

Abbey Life Assurance Company

AEGON

A J Bell

Alan Boswell & Company

Alpha Financial Planning & Wealth Management

Altus

Anthony Etkind & Co

Anthony Mackintosh & Associates

Appropriate Advice

Association of British Insurers

Association of Financial Mutuals

Association of Independent Financial Advisers

Aviva

A W D Chase de Vere

AXA Wealth

Bank of New York Mellon

Border Insurance Services

British Bankers' Association

Calver Groom
Capita Life & Pensions Regulated Services
Cofunds
David Burnell Financial Services
D Burling
Duncan Lawrie
ea Consulting Group
Eldon Financial Planning
Evan Owen
F&C
Financial Services Consumer Panel
Foster Denovo
Friends Life
Grosvenor Consultancy
Guy Benson
IFA Centre
International Financial Data Services
Invesco Perpetual
Investment & Life Assurance Group
Investment Management Association
Investment Risk Management
J M Glendinning (Life and Pensions)
J P Morgan
LEBC Group
Legal & General
Liontrust Fund Partners
Lloyds Banking Group

M&G Group
Malcolm Coury
Manor IFA
Money Matters (North East)
MoneyScience Investment Consultancy
Munro Partnership
M R Financial Services
Navigant Consulting (Europe)
Neptune Investment Management
NFU Mutual
November Financial Services
Pearson Jones
Protection & Investment
Prudential
Rathbones
Resources Compliance
Sampson West
Scottish Life
Sesame Bankhall Group
Society of Pension Consultants
St James's Place
Star Financial Planning
Tax Incentivised Savings Association
Tenet Group
Throgmorton Financial Services
UBS AG Wealth Management UK
UK Platform Group

Wade Financial Services

Warby Wealth Management

Watermead Financial

Wesleyan Assurance Society

West Riding Personal Financial Solutions

Wishart Wealth

Zurich Financial Services

We also received five confidential responses.

Annex 2

Compatibility statement

Introduction

1. In this annex we set out our view on how the final guidance published with this PS is compatible with our general duties under Section 2 of FSMA and our regulatory objectives set out in Sections 3 to 6 of FSMA. We also outline how the guidance is consistent with the principles of good regulation (also in Section 2 of FSMA), to which we must ‘have regard’.

Compatibility with our statutory objectives

2. The guidance contained in Appendix 1 is designed to help us meet our statutory objectives of maintaining confidence in the financial system and securing the appropriate degree of protection for consumers. We do not consider that it has any significant impact on our financial crime or financial stability objectives.

Market confidence

3. The new guidance supports the new RDR rules, which are intended to remove product provider influence over adviser remuneration and improve the clarity of services offered by advisers.

Consumer protection

4. We consider that our decision to provide guidance on applying the ban on new commission, rather than relaxing it, will provide appropriate protection for consumers and avoid commission payments for advice continuing for an indefinite period.

Compatibility with the principles of good regulation

5. Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation.

The need to use our resources in the most efficient and economic way

6. We consider that the guidance will provide clarity for both firms and FSA supervisors on applying the RDR ban on new commission, and so allow effective implementation of the RDR rules.

The responsibility of those who manage the affairs of authorised persons

7. The guidance does not interfere in any way with the responsibility of firms' senior management.

The principle that a burden or restriction that is imposed should be proportionate to the benefits

8. As explained in Chapter 3, we have reviewed the CBA carried out for CP09/18 and PS10/6 in the light of comments we received from the ABI, the AFM and individual insurers on the CBA. The estimated additional costs to the industry for amending legacy systems to remove commission, based on information given to us by insurers, are £461m.
9. Based on discussions with the industry, insurers will only amend legacy systems for larger, more profitable business. Therefore, we consider the cost estimate of £461m, which firms would incur if they were to change all of their legacy systems to remove commission for top-ups to pre-RDR products, to be an overestimate.

The desirability of facilitating innovation

10. We do not expect the guidance to hinder innovation.

The international character of financial services and markets and the desirability of maintaining the competitive position of the UK

11. We do not consider the guidance to adversely affect the competitive position of the UK.

The need to minimise the adverse effects on competition

12. We do not consider the guidance to have a material effect on competition.

The desirability of facilitating competition

13. We do not consider the guidance to have a material effect on competition.

Acting in a way that we consider most appropriate for the purpose of meeting our statutory objectives

14. The guidance contained in Appendix 1 is designed to help us meet the objectives of the RDR. So, we consider that the approach we have adopted remains the most appropriate for meeting our statutory objectives.

Appendix 1

Made Handbook text

**RETAIL DISTRIBUTION REVIEW (ADVISER CHARGING NO 4)
INSTRUMENT 2012**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 145 (Financial promotion rules);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 31 December 2012.

Amendments to the Handbook

- D. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex A to this instrument.

Amendments to material outside the Handbook

- E. The Perimeter Guidance manual (PERG) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Retail Distribution Review (Adviser Charging No 4) Instrument 2012.

By order of the Board
23 February 2012

Annex A

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

6.1A Adviser charging and remuneration

Application – Who? What?

6.1A.1 R ...

6.1A.1A G Guidance on the regulated activity of advising in relation to a new or existing investment can be found in PERG 8.24 to PERG 8.29. Although the guidance in PERG 8.29.7G relates to advising on investments under article 53 of the Regulated Activities Order, exactly the same answers apply to a personal recommendation because the examples given relate to the relationship between a firm and a particular client and advice given to that specific client. A firm wishing to know when it will be giving advice but not making a personal recommendation should refer to PERG 13.3.

...

Requirement to be paid through adviser charges

...

6.1A.4A R A *firm* and its *associates* may:

- (1) solicit and accept a commission, remuneration or benefit of any kind in the circumstances set out in COBS 6.1A.4R if:
 - (a) the *personal recommendation* was made on or before 30 December 2012;
 - (b) the solicitation and acceptance of the commission, remuneration or benefit of any kind was permitted by the *rules* in force on 30 December 2012;
 - (c) the contract under which the right to receive the commission, remuneration or benefit of any kind was entered into on or before 30 December 2012;
 - (d) the terms of that contract as at 30 December 2012 included the right to receive the commission, remuneration or benefit of any kind; and
 - (e) the *retail client* enters into the transaction in respect of which the *personal recommendation* was given within a reasonable time of the *personal recommendation* being given; and

- (2) enter into an arrangement under which the right to receive the commission, remuneration or benefit of any kind in (1) is transferred to that *firm* or its *associate*.

6.1A.4AA G (1) A *firm* may continue to accept a commission, remuneration or benefit of any kind after 30 December 2012 if there is a clear link between the payment and an investment in a *retail investment product* which was made by the *retail client* following a *personal recommendation* made, or a transaction executed, on or before 30 December 2012. This is the case even if the *firm* makes a *personal recommendation* to the same *retail client* after 30 December 2012 to the extent that the continued payment can properly be regarded as linked to the pre 31 December 2012 *personal recommendation* or transaction, rather than the new *personal recommendation*. Of course this is dependent upon the terms of the contract contemplating the continued receipt of such payments.

- (2) Examples of circumstances where a commission, remuneration or benefit is clearly linked to the retention of an investment in a *retail investment product* and can therefore continue to be accepted include (in each case where the terms of the contract contemplate a continued payment of the kind referred to in (1)):

- (a) no change is made to the *retail client's* investment in the relevant *retail investment product*;
- (b) the *retail client's* investment in, or regular contribution to, the relevant *retail investment product* is reduced; the *firm* may continue to accept the payment associated with the reduced investment amount;
- (c) the *retail client's* investment in the relevant *retail investment product* is transferred from accumulation *units* to income *units* or vice versa;
- (d) the *retail client* transfers all or part of his investment between funds within a *life policy*.

- (3) If a *firm* makes a *personal recommendation* to a *retail client* and wishes to:

- (a) receive remuneration for that *personal recommendation* in addition to any commission, remuneration or benefit of any kind it receives in the circumstances contemplated by (1); or
- (b) be paid additional amounts for any actions which are linked to a new amount invested by the *retail client* in the relevant *retail investment product*;

it should only be paid those additional amounts for that *personal recommendation* or for those actions by *adviser charges*.

- (4) A firm may offset against any *adviser charges* which are payable by the *retail client* any commission, remuneration or benefit of any kind it receives in the circumstances contemplated in (1).

...

6.1B Retail investment product provider and platform service provider requirements relating to adviser charging and remuneration

Application – Who? What?

6.1B.1 R ...

6.1B.1A G Guidance on the regulated activity of advising in relation to a new or existing *investment* can be found in PERG 8.24 to PERG 8.29. Although the guidance in PERG 8.29.7G relates to *advising on investments* under article 53 of the *Regulated Activities Order*, exactly the same answers apply to a *personal recommendation* because the examples given relate to the relationship between a *firm* and a particular *client* and advice given to that specific *client*. A *firm* wishing to know when it will be giving advice but not making a *personal recommendation* should refer to PERG 13.3.

...

Requirement not to offer commissions

...

6.1B.5A R A *firm* and its *associates* may:

- (1) offer and pay a commission, remuneration or benefit of any kind in the circumstances set out in COBS 6.1B.5R if:
 - (a) the *personal recommendation* was made on or before 30 December 2012;
 - (b) the offer and payment was permitted by the *rules* in force on 30 December 2012;
 - (c) the contract under which the right to receive the commission, remuneration or benefit of any kind was entered into on or before 30 December 2012;
 - (d) the terms of that contract as at 30 December 2012 included the right to receive the commission, remuneration or benefit of any kind; and
 - (e) the *retail client* enters into the transaction in respect of which the *personal recommendation* was given within a reasonable time of the *personal recommendation* being given; and

- (2) enter into an arrangement under which the right to receive the commission, remuneration or benefit of any kind in (1) is transferred to another *firm* or its *associate*.

6.1B.5B G A *firm* may continue paying commission, remuneration or benefits of any kind to another *firm* in relation to a *personal recommendation* made by that other *firm* in circumstances where that other *firm* may accept that commission, remuneration or benefit of any kind (see COBS 6.1A.4AR and COBS 6.1A.4AAG).

Annex B

Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text.

8.29 Advice must relate to the merits (of buying or selling a particular investment)

...

8.29.7 G Typical recommendations and whether they will be regulated as *advising on investments* under article 53 of the *Regulated Activities Order*. This table belongs to PERG 8.29.1G to PERG 8.29.6G.

<u>Recommendation</u>	<u>Regulated under article 53 or not?</u>
<u>I recommend that you take out the ABC investment.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of a particular <i>investment</i> which the <i>client</i> could buy.</u>
<u>I recommend that you do not take out the ABC investment.</u>	<u>Yes. This is advice which steers the <i>client</i> away from a particular <i>investment</i> which the <i>client</i> could have bought.</u>
<u>I recommend that you take out either the ABC investment or the DEF investment.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of more than one particular <i>investment</i> which the <i>client</i> could buy.</u>
<u>I recommend that you sell your ABC investment.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of a particular <i>investment</i> which the <i>client</i> could sell.</u>
<u>I recommend that you do not sell your ABC investment.</u>	<u>Yes. This is advice which steers the <i>client</i> away from a particular <i>investment</i> which the <i>client</i> could have sold.</u>
<u>I recommend that you transfer ownership of your ABC investment to your spouse.</u>	<u>Advising the <i>client</i> to gift an <i>investment</i> to another person will not be advice because it does not involve advice on buying, selling, subscribing for or underwriting an investment.</u>
<u>I recommend that you increase the regular payments you are making to your GHI fund*.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of acquiring further <i>units</i> in a particular fund.</u>
<u>I recommend that you decrease the regular payments you are making to</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of acquiring further <i>units</i> in a particular fund but advises</u>

<u>your GHI fund*.</u>	<u>against the <i>client</i> buying as many as he intended.</u>
<u>I recommend that you keep making the same regular payments to your GHI fund*.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of acquiring further <i>units</i> in a particular fund.</u>
<u>I recommend that you stop making the regular payments you are making to the GHI fund*.</u>	<u>Yes. This is advice which steers the <i>client</i> away from buying <i>units</i> in a particular fund which the <i>client</i> could have bought.</u>
<u>I recommend that you pay a lump sum into your GHI fund*.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of acquiring further <i>units</i> in a particular fund.</u>
<u>I recommend that you do not pay a lump sum into your GHI fund*.</u>	<u>Yes. This is advice which steers the <i>client</i> away from buying <i>units</i> in a particular fund which the <i>client</i> could have bought.</u>
<u>I recommend that you move part of your investment in the JKL <i>investment</i> from fund X into fund Y*.</u>	<u>Yes. This is advice which steers the <i>client</i> in the direction of selling <i>units</i> in a particular fund and buying <i>units</i> in another specific fund. Where the two funds are sub-funds of the same main fund it is still advice. The terms 'bought' and 'sold' are given a wide meaning and include any acquisition or disposal for valuable consideration.</u>
<u>I recommend that you move all of your investment in JKL <i>investment</i> from fund X into fund Y*.</u>	<u>Yes, for the same reason.</u>
<u>I recommend that you move your MNO <i>investment</i> from platform X and re-register it on platform Y.</u>	<u>This is unlikely to be advice because normally it will not involve buying and selling the <i>investment</i> held on the platform.</u>
<u>A <i>client</i> decides of his own accord to increase, decrease or temporarily suspend his regular payments or the payments are increased automatically into an <i>investment</i> without advice being given.</u>	<u>No. No advice is being given.</u>
<u>The <i>firm</i> is providing discretionary management services under a mandate and makes changes to a <i>client's investment</i> without providing</u>	<u>No. No advice is being given.</u>

<u>advice.</u>	
<u>Dividends are re-invested into an investment without advice being given.</u>	<u>No. No advice is being given.</u>
* <u>The same answer would apply where the fund is a <i>life policy</i> as rights under a <i>contract of insurance</i> are regulated <i>investments</i> under the <i>Act</i>. The position under a <i>personal pension scheme</i> is similar, as explained in more detail in <i>PERG</i> 12.3.</u>	

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