

Financial Services Authority

Consultation Response

RDR Adviser Charging - Treatment of Legacy Assets - CP11/26



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1 EXECUTIVE SUMMARY

The treatment of pre-RDR policies and assets has been an area where our clients have significant questions, and which the FSA's existing policy statements on RDR have provided insufficient clarity. We therefore welcome the FSA's proposal to provide additional guidance on this area. However the guidance consulted on in CP11/26 provides only narrow "legalistic" guidance. It does not address the many complex operational issues that providers will face, indeed in some cases it appears to make these more complex. The estimated costs of supporting adviser charging have (as we predicted in our response to CP09/18) increased, and we believe that addressing the full impact of the guidance will involve providers in additional costs, both one-off and ongoing.

Since our first consultation response on CP09/18 we have consistently supported the FSA's objective of improving consumer outcomes by separating the market for financial services advice from the market for financial services provision. However the likely consumer outcomes from the current proposals do not appear to have been fully thought through. For instance, whilst we recognise the desire to avoid employers having to negotiate consultancy charging for existing GPP schemes to enroll new members in 2013, allowing commission without a sunset clause on such policies risks significant detriment as commission on pay increases etc eats into retirement savings. We continue to believe that only a total ban on commission, covering both investment and protection business, and whether arising from advice or not will fully deliver the FSA's vision; and that the current half measures will result in continuing consumer confusion, diminish the benefits to consumers, and increase the costs to the industry.

With providers having only 349 days from the closing date of this consultation to develop, test and deploy systems to implement further decisions arising from this consultation (even ignoring end of year change freezes, which in reality will significantly reduce this time). We therefore strongly urge the FSA to respond to this consultation and publish any additional guidance or rules as quickly as possible, and to ensure that any changes take the simplest path compatible with good consumer outcomes.

2 INTRODUCTION

As an enterprise architecture consultancy specialising solely in Financial Services, Altus has extensive experience working with clients in the LP&I sector. With practical involvement in both system and business issues throughout the sales process we welcome this opportunity to respond to the FSA's latest consultation paper on the Retail Distribution Review.

Our focus is primarily on the operational aspects of financial services and we have sought in the following sub-sections to answer those questions raised in CP11/26 where we feel our experience and expertise particularly qualifies us to do so.

3 RESPONSE TO QUESTIONS

Q1: Do you agree that it would be helpful to have guidance on when the ban on new commission does and does not apply, to ensure consistency of approach across the industry? If not, please explain why.

Yes.

Q2: If your answer to Q1 is 'yes', do you have any comments on the draft guidance in Appendix 1? If you have suggestions for changes, please explain what you think these should be and why.

The guidance in Appendix 1 provides guidance on the interpretation whether particular scenarios constitute the specified activity "advising on investments". From this perspective we believe little in the proposed table at PERG 8.29.7 would be considered novel or controversial.

CP11/26 is written as if COBS 6.1A.4(R) and 6.1B.5(R) impact "advised sales" only, but the text of COBS 6.1B.5(R), clearly states commission may not be paid in relation to any personal recommendation, and makes no distinction about whether that recommendation relates to a sale or not. The guidance in Appendix 1 makes it clear that there a large number of "personal recommendations" which involve nothing that looks like a "sale", e.g. "I recommend that you decrease the regular payments you are making ...".

We believe additional clarity is required on whether the FSA intends to impact only "sales" (i.e. new increases in money paid into policies, as described in CP11/26, where for instance 2.3(a) says COBS "ban the payment or receipt of new 'legacy commission'") or intends to follow the COBS rules as published (which prevent payment of commission on any payment arising from an advice event, even if the advice didn't constitute a sale, and make no distinction between (or mention of!) "legacy" or "trail" commission).

Q3: In particular, do you think that there are any other specific situations or particular examples where guidance might be helpful? If you have suggestions for changes, please explain what you think these should be and why.

There are several scenarios where the proposed guidance is helpful for determining if an activity is the specified activity of "advising on investments", but this knowledge does not help understand how the post-RDR ban on commission will apply.

Where a regular premium is increased as a result of post-RDR advice it has long been clear that the investment from the increase in the premium (the delta) would have to be made in a way that did not pay legacy or trail commission (e.g. by using a "clean fee" share class for a CIS). It is also clear that trail commission can continue to be paid on units already purchased before the change in premium. It's unclear what should happen to units purchased after the change in premium from the portion of the

premium that already existed. The logic of the scenario “I recommend that you keep making the same regular payments” is that the entire premium after the change is the subject of the advice, and therefore no trail commission may be earned on any units purchased after the change. This is not how “tranching” works on many provider systems (where only the change in the premium would be considered a new tranche which could have commission controlled separately from the original tranche). Changing this tranching would require significant changes to provider systems and processes, the cost of which may not always be worthwhile, resulting in existing products being closed to increments.

We are also concerned about consumer outcomes from non-advised changes in premium. A reasonable case is a consumer making regular payments into a personal pension (originally sold via advice). Knowing that, post-RDR, they would have to pay the adviser for advice, they may decide to make “obvious” changes (e.g. a small increase in premium following a pay rise) themselves by contacting the provider. In this case the sale is non-advised and commission can continue. Depending on how the provider operates this commission will be paid either to the client’s current adviser or may be retained by the provider. We are concerned that the consumer acting logically and providing for their retirement will be disadvantaged – paying more for units that pay commission without having received any service. Indeed they may end up indirectly (and unknowingly) paying the adviser – the very thing they set out to avoid. We see no justification for allowing commission on such execution only changes and believe they should be banned.

We agree that advice to switch between funds is advice and should result in the funds purchased as a result of that switch to be free of trail commission. This is relatively easy to obtain for unwrapped funds, where commission-free unit classes etc. are available to be purchased on the “buy” leg of the transaction. However we are unclear what the FSA intends to happen on products where the commission is calculated at the product level, but is earned from trail commission on funds. Can the commission continue on whole fund value or do providers have to distinguish “pre-RDR” and “post-RDR” units (which may be of exactly the same unit class, ISIN etc., if fund managers do not provide new “clean fee” unit classes)?

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

The consultation paper itself notes that several providers have commented that the costs allowed for in the CBA in PS10/6 are not a full reflection of the costs involved in turning off commission in the way envisaged in the consultation paper. Even if this was due to those providers misunderstanding the impact of CP09/18, it’s hard to see how the FSA can safely rely on a cost-benefit analysis performed two years ago before the considerable volume of work the industry has done to fully understand the system impacts.

Furthermore, whilst we agree that “I recommend you keep making the same regular payments” constitutes advice, the logical conclusion of this is that the provider should be informed and future premiums handled in a way that no trail commission results. This would require providers to be made aware of such “no change” advice, which they have not been informed of before. We don’t believe this was envisaged in CP09/18 and do not believe it has been reflected in the cost benefit analysis. Indeed, in many cases where an adviser performs an overall financial review and then advises the customer makes a change on one product they are (implicitly or explicitly) recommending no change on other products that the customer may have. The regulations logically require such implicit “no change” recommendations are to be made explicit so they can be communicated to providers, imposing additional costs on advisers.

We are concerned that by allowing commission on non-advised transactions post-RDR but not on advised transactions will result in additional costs of determining and tracking this status. This is likely to be tricky, as in the post-RDR world we would expect customers to self-service more of their transactions (to avoid paying advisers for administration services). We would not want to see providers assuming that self-service transactions are non-advised, and believe it may be difficult for providers to reliably determine whether a customer has been advised or not. We note that, subject to

their terms of business with advisers, providers may choose not to pay out commission on post-RDR execution only transactions, avoiding this problem. However we consider that this commission is unnecessary (and presents a clear avenue for potential abuse by unscrupulous advisers), and that a ban would provide better consumer outcomes, greater consumer confidence and reduced implementation costs for the industry.

4 ABOUT ALTUS

Altus is a business and systems solutions company focused exclusively on the needs of the financial services industry. Our practical experience of both the business of financial services and the supporting IT systems means that we can help solve the right problems with the right technology. Our mission is to be at the forefront of the networked financial services business of the future.

Our team has extensive experience across a wide range of financial services activities, and are highly skilled and enthusiastic. Our client list includes some of the largest financial services companies in the UK and Europe.

Further details are available from our website at www.altus.co.uk or by contacting us.



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