THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Your reference: CP 09/18

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Dear Dr Jones

CP 09/18, *Distribution of retail investments: Delivering the RDR*

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on Consultation Paper 09/18, *Distribution of retail investments: Delivering the RDR.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW REPRESENTATION

ICAEW REP 112/09

DISTRIBUTION OF RETAIL INVESTMENTS: DELIVERING THE RDR

Memorandum of comment submitted in October 2009 by The Institute of Chartered Accountants in England and Wales, in response to the Financial Services Authority consultation paper CP 09/18 *Distribution of retail investments: Delivering the RDR, published* in June 2009.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on Consultation Paper CP 09/18 *Distribution of retail investments: Delivering the RDR,* published by the Financial Services Authority.

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

4. The ICAEW Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues and challenges facing the financial services industry, acting in the public interest and free from vested interests. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector.

MAJOR POINTS

Support for the initiative

5. The ICAEW supports any initiative that is capable of improving the efficiency of retail investment markets and that protects the interests of retail consumers. The review of the retail investments sector needs to focus on practical ways to generate trust and confidence by raising standards of professionalism within a regulatory framework that allows providers to operate profitable business models on a sustainable basis. In context of this broad objective, we welcome the review of retail distribution and in general terms support the ideas and principles that have been articulated in this consultation paper.

6. The market for retail financial services is not homogeneous and performance across the sector has been mixed. Regulatory change needs to be proportionate and should reflect the mixed performance across the retail investments sector. Different segments of the market require different types of business model so that the retail investments sector can deliver differentiated propositions to meet the needs of different consumer segments on a profitable, long term basis. A consistent and simple regulatory approach is required to enable consumers to easily understand the differences between different types of distribution model and so that providers can operate profitably in a challenging economic environment.

7. We believe it is important to retain an international perspective as other countries have had similar problems to those experienced in the UK retail investments sector. Although performance has been mixed, in many respects the UK retail investments market has been relatively successful in comparison to many overseas markets, with the UK having a relatively highly developed independent advisory sector when compared with other European countries. We also believe it is important to consider how other countries have tackled demand side issues by raising levels of financial capability, encouraging people to take advice on their personal finances, save for retirement and to act responsibly.

8. We favour an evolutionary approach to regulatory change and it is important that regulation builds on the positive trends that have already emerged in the retail sector. We do not believe

that regulation should raise the cost of supplying services and products to retail customers during an exceptionally challenging environment, which would reduce the supply of professional, independent advice to less affluent customers and to those living in rural areas.

9. We believe the interpretation of the concepts and application of the principles contained in the consultation needs careful consideration so that the transition to the new regulatory landscape can be achieved without having a detrimental impact on the supply chain. We believe that if the proposals are implemented as currently formulated, they will result in higher costs and, in the short to medium term, to a reduction in the supply of advice as advisers exit the market. There is a very real danger that advisers will look to recover higher costs by migrating to serve more affluent segments of the market, thus leaving a gap in provision of advice to the middle and less affluent segments, particularly in rural areas. Unless progress is made in finding ways to offset costs (for example by the more widespread use of platforms and / or propositions that maintain quality but provide lower cost propositions, such as envisaged in simplified advice), we believe the proposals will fail on their market access objective.

10. As a general rule, market failure and / or the perception of lower standards in one segment of the market tends to undermine confidence in the whole of the supply chain. We therefore believe that regulation needs to be applied on a consistent basis across the whole of the retail financial services sector, to include basic advice, simplified advice and non-advised sales models. To deliver sustainable improvements in the retail investments sector providers and consumers need to act responsibly, supported by better information and better regulation.

11. More detail is required to clarify what in practical terms is meant by the core concepts contained in the consultation, such as the terms ' relevant market ' and 'restricted advice'. The key challenge is how to translate the principles into workable reality in ways that will not have a detrimental impact on the cost and supply of services and products, both during the transitional period and in the longer term. Consumers need to easily understand the key differences between different distribution channels so they are able to evaluate the advantages and disadvantages between the different distribution models. Regulatory change needs to deliver a simple and engaging message to a confused and disengaged consumer marketplace and more work is required in connection with this objective. We also believe that further consideration is needed to assess the implications of the proposals in connection with firms that advise on and arrange direct investment in equities, gilts and other listed securities.

12. The proposals to raise standards of professionalism in respect of qualifications, mandatory CPD and an overarching ethical code should help to restore confidence in the retail investments sector. Subject to our comments more generally, we believe that the proposals will help to establish personal financial planning as a valued discipline in its own right, and will help to raise professionalism across the retail financial services sector. High standards of professionalism are required from all that carry fiduciary responsibility and disaggregating the cost of advice from the cost of product will, in the longer term, help in this process. All stakeholders need to work on a collaborative basis moving forward. Professionalism is at the heart of our ethos and we believe that the ICAEW has a valuable role to play in progressing this aspect of the RDR. Higher levels of financial literacy are required if the RDR is to meet its objectives. A high profile publicity campaign is required so that the general public understands what is happening with the RDR, the nature and importance of what is being proposed, and the improvements the regulatory changes are intended to deliver.

RESPONSES TO SPECIFIC QUESTIONS

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

13. In general terms, we agree with the proposals to extend the range of products to which the new standards of independence will apply so that advisers will have to consider all commonly available products that are capable of delivering the same or similar outcomes to retail packaged products. Independent advisers therefore need to evaluate the suitability of

exchange traded funds and other low-cost options. Greater harmonisation and consistency across national boundaries is to be encouraged as this should help stimulate competition and raise levels of consumer understanding over the longer term. If these proposals are to be successful, the extended range of products needs to be clearly defined on a consistent, long term basis across the financial services sector. However, we have concerns regarding the breadth and depth of knowledge that is required to assess the suitability of more complex products and believe that this aspect of the proposals requires more detailed consideration moving forward.

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

14. We believe the concept of independent financial advice, in practical terms, revolves around the issue that an independent adviser acts on behalf of a client and is obligated to act on an objective basis in a client's best interest. To fulfil the nature of that relationship, an independent financial adviser must be provide competent, objective advice that is free of bias and which is not subject to the influence or control of product providers. This approach captures the essence of the fiduciary relationship that exists between adviser and client, which is at the heart of all professional advisory relationships. An independent financial adviser therefore needs to undertake a fair and comprehensive analysis, where appropriate, of all commonly available retail investment products in the context of the circumstances at the time advice is provided.

15. In general terms, we agree with the proposals for the new standard of independence so that independent advisers will be required to make recommendations that are based on a comprehensive and fair analysis of the relevant market, which is unbiased and consistent with the long term best interest of consumers. However, more detailed guidance is required to establish a clear understanding of what in practical terms is meant by the terminology. Concepts need to be easily understood and applied on a consistent basis across the financial services sector and communicated in terms that can be both understood and valued by the general public. The application of the revised definitions needs to be capable of being translated within business models that can deliver affordable, profitable independent financial advice to broad segment of the population, not just to the affluent.

16. Further consideration is required to refine the conceptual nature of the proposals so that the working definitions can be translated into a practical propositions that are valued and accessible to a broad market. In that regard, concepts such as 'relevant market' and 'restricted advice' need to be clearly defined so that their application does not undermine the availability of high quality, independent advice services. We believe that platforms will provide an important facilitative mechanism in this process.

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

17. Consumers need to fully understand the differences and limitations between the various types of advice model. However, we do not believe that the term 'restricted advice' will lead to consumer confidence as the word 'restricted' implies that advice may not be of a high quality, as opposed to being limited in the range of products offered. There should therefore be a requirement to explain the scope of the advice given but in this respect we believe that the proposed terminology needs further consideration.

18. The proposals to raise standards of professionalism in respect of both qualifications, mandatory CPD and an overarching ethical code should raise standards more generally, provided that they are applied and enforced on a consistent basis. However, as regards to the proposals for disclosure we believe that the nature of the fiduciary relationship should be made explicitly clear from outset, and that the disclosure requirements should also provide a clear explanation of the level of qualifications held by those responsible for providing advice.

This information needs to be communicated in a simple, comprehensible and consistent format to all customers in advance, both orally and in writing.

Q4: Do you think we should introduce a mandatory form of words for firms to use when explaining restricted advice?

19. Under a principles based framework, we believe that some scope should be given to explain the nature of the advice given but that guidance is required so that there is consistency as regards to minimum requirements.

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

20. We support the proposals to remove the GPP exemption.

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

21. A primary objective of the RDR is to create a simple regulatory framework, which consumers can easily understand and therefore trust. With this in mind, a single framework covering the whole market would seem to be preferable and that simplified processes should be encapsulated within a single, generic heading. There is a danger that if all of the proposals contained in the consultation are applied in their current format, the costs of advice will increase and the supply of advice will reduce. There should be scope for further development for delivering lower-cost products and advice processes. We therefore believe that further discussions are required with all stakeholders with the objective of exploring ways to deliver low cost solutions that are capable of engaging the mass market .

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

22. We believe that if confidence is to be restored, professional standards should apply to all processes that are subject to regulation. A failure and / or lack of confidence in one area of the market tends to pollute and undermine confidence across the entire sector. Professional standards should apply across all segments of the financial services market but need to be applied in ways that enable providers to deliver differentiated propositions that can accommodate the needs of different segments of the market on a profitable, long term basis.

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

23. Basic advice can serve a useful role in respect of delivering a type of service that is capable of meeting the needs of a particular section of the market. However, as referred to above, we believe that all advice regimes should be subject to professional standards and should be incorporated within a cohesive retail financial services that sits comfortably with state benefits and taxation regime. If the RDR is to meet its objectives, this holistic approach needs to be easily understood and consistent if it is to create trust and be valued over the longer term.

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

24. In general terms, we support the principle of adviser charging and believe that drawing a clear line between the cost of advice from the cost of product represents a positive step that will help to restore levels of consumer trust and reduce product bias. We believe that the terms of the business relationship should be communicated clearly and simply in advance, both orally and in writing, and that disclosure should include all issues relating to charging and payment in respect of advice, product and implementation.

25. More detailed guidance is required as regards how the proposals will be implemented in practice. We have concerns over the practical implications of implementing adviser and product charging and the administration thereof, particularly in respect of legacy business during the transitional period and once the new regime has been fully implemented. We

believe considerable care will be required to ensure that organisations throughout the supply chain are able to operate on a profitable basis, and that the proposals do not increase the costs of delivering advice and products within a challenging economic and financial environment.

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

26. In general terms, we agree with the proposals in connection with product providers and that the suggested principles approach appears reasonable. It should be optional for product providers to provide facilities for customers to cover the costs of adviser charging by having a proportional charge deducted from their products, and it would appear reasonable for product providers to take some responsibility for monitoring the level of adviser charges that have been deducted in these circumstances. However, it should be for the adviser firms themselves, subject to oversight of the FSA and OFT, to ensure that charges are fair and reasonable in relation to the value of advice given and products sold.

27. We have concerns that the transition will prove costly to administer as providers have, in general terms, been used to paying commissions for many years and will have to accommodate dealing with both legacy and new regime business. In this regard, we repeat our comments as above. The process will need to be managed on an evolutionary basis within a transitional time-scale that is capable of accommodating substantial change during a challenging economic and financial environment. We therefore believe that all stakeholders will need to work closely on a collaborative basis during the transitional period for the implementation of the proposals to deliver the key objectives of the RDR.

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

28. We agree that it is right to draw special attention to the particular conditions that exist within vertically-integrated firms, and that in context of the objectives of the RDR the proposals on dealing with issues relating to adviser charging within this segment of the market are broadly appropriate. We believe that there is greater scope within the disclosure requirements to highlight areas where there are potential conflicts of interest, both within vertically-integrated firms and elsewhere within the supply chain.

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

29. We note that the FSA's chosen approach is an adaptation of the current disclosure regime, including changes to Key Features illustrations pending detailed consideration until the results emerge from the European Commission's work on the Key Information Document and PRIP's. We are broadly supportive of this approach but would prefer to comment when the FSA is able to articulate its specific proposals in this area.

30. We believe that Key Features need to be communicated in a simple and comprehensible way so that consumers can easily identify the costs of advice, costs of products and combined effect of the respective and combined charges, where it is appropriate. We would encourage the FSA to consider a broad range of consumer circumstances and practical considerations in order to ensure that the proposed detailed disclosure rules and guidance help the industry to focus on delivering information that is clear, transparent and comprehensible and meaningful to consumers.

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

31. Advisers should be remunerated primarily in the form of fixed salary, with bonus and other incentives constructed so that outcomes are consistent with the longer term best interests of consumers and with the long term sustainability of business models. Broad measures of performance need to be applied to reflect the quality of advice not the volume of product sales designed to drive broad measures of competence and which can also accommodate the shift from commission based system to adviser charging and recurring income streams.

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

32. We agree that adviser charging should be applied where individual advice is given on GPP's as it is important to ensure that adviser charging is applied consistently across the board.

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

33. Technology has a key role to play in enabling the industry to offer accessible, affordable propositions that can be delivered on a profitable long term basis, and in this context platforms have a key role to play. We believe that regulation needs to recognise the service rather than product nature of platforms and should focus on issues such as ability to access whole of market propositions, transferability between platforms, transparency of charges and contractual arrangements. We acknowledge the important work that has been undertaken in this area and look forward to the FSA issuing further papers on these topics.

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

34. To ensure transparency and comparability between different products and distribution channels, non-advised sales should be subject to full disclosure. If full disclosure were not applied on a consistent basis across all distribution models, charges on packaged products distributed via non-advised services could result in opaque product charging, with associated detrimental impact on consumers and negative implications for more transparent, advised sales processes.

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

35. We welcome the concept of an overall ethical code. The ICAEW has had such a code for many years and members have found it very useful in dealing with matters that are cannot be reduced to a black and white set of rules.

36. Our ethical code is combined with a framework of threats and safeguards. So a situation could arise that potentially offends against the code, but this can possibly be overcome by the introduction of safeguards. As an example from the accountancy world, a firm might find itself acting for two clients in respect of the same matter. This potential conflict of interest could be resolved by declaring the matter to both clients and seeking their agreement to a way forward. We would advocate the use of such a framework for investment advisers. For example, draft principle number 5 refers to managing conflicts of interest, but there is no mention of the disclosure of such conflicts. Given that one of the drivers of the RDR was the perceived conflict in receiving commission, we are surprised that disclosure of any conflict is not given greater prominence. Also, we are not sure why there is a need to add 'relevant' in this item: if it is not relevant it is not a conflict of interest.

37. We have mapped our code against the proposed code and can see a match for most items. The one where no match arises is that we have a principle of confidentiality. This includes the point that information obtained as a result of professional relationships should not be used for personal advantage. We would suggest that a similar principle is included for investment advisers.

38. We have an overriding requirement to act in the public interest, which is an approach that would be a useful addition to the proposed code. In our view, it would be necessary for each professional body to amplify the basic principles to the particular services that its members provide. We do not believe that it would be sufficient to just have the principles as the entire code.

39. We also suggest that the requirements of BS ISO 22222:2005, ‘Personal financial planning - requirements for personal financial planners’ be considered. This would assist with providing greater consistency.

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

40. We agree that CPD is a vital element in the promotion of high-quality advice and behaviour within the financial services industry. In our view, CPD policy needs to be set in the context that is must cover a wide range of persons undertaking different roles at differing levels of complexity and seniority. To be effective, CPD must be able to accommodate this diversity and breadth, focussing on ensuring that the particular competencies required to fulfil the particular demands of a specific role on an ongoing and revisable basis. In our view, the rationale or educational basis for distinguishing between ‘structured’ and ‘unstructured’ activity has broken and that the use of the terms is therefore inappropriate. The electronic/digital age has turned upside down the nature of what is a course or what is formal learning. In a learner-centric culture, it is better to focus on CPD techniques which work for the individual, rather than on the arbitrary allocation of activities between different learning modes. An individual’s development needs could be met entirely by ‘unstructured’ means.

41. For the reasons referred to above, we do not favour a prescriptive approach to CPD that mandates a specific allocation of CPD hours as ‘structured‘ or ‘unstructured‘ hours basis. The amount of time required to maintain competence will vary from year to year and will differ according to particular circumstances and nature of the competencies required to fulfil any given job. We believe therefore that CPD should be determined on an individual basis and subject to the monitoring of the professional bodies and firms.

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

42. We believe that it would be inconsistent not to extend the same principles to pure protection products. However, the introduction of these principles should be applied so that the implementation of these principles does not result in increasing the costs of products and services or limiting access to advice. The nature of these products implies that their distribution may lend itself more readily to a low-cost, basic advice regime that is supported by efficient, modern technology.

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

43. We have received feedback from members and other stakeholders operating in the retail investment markets and in consideration of that feedback do not believe that the cost-benefit analysis has fully considered the implications on market access. We believe the cost and time-scale required to adapt business models to meet the requirements of the proposals has been underestimated and that the analysis lacks the level of detail required to fully assess the impact on individual firms operating in different segments of the market. The experience of our members indicates it takes 3 to 5 years to manage the transition away from a commission based model along the lines outlined in the proposals, and that the capital and other resources required to make that transition have not been fully reflected in the cost-benefit analysis.

44. We believe a more flexible approach in respect of the implementation of certain aspects of the proposals is required and in that connection 3 to 5 years represents a more realistic time-scale. This more flexible approach would provide a more effective framework for enabling legacy business to be more fully integrated within the new distribution model, thus reducing costs and minimising consumer confusion over the medium and longer-term. The application of a 3 to 5 year transitional period would assist the industry to access capital and to be better

equipped to manage the strategic and practical implications within the context of a challenging economic and financial environment, thus reducing the potential for unintended consequences and consumer detriment.

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