The FSA means business

With the publication of CP09/18 'Distribution of retail investments – Delivering the RDR', the FSA has shown that its statements indicating a firmer hand are not just rhetoric.

The FSA is determined to stamp out commission bias and the consultation paper sets out exactly how it aims to do this; by banning commission entirely – a step that many thought the Authority would baulk at. Not only do the proposals ban provider-determined commission payments to IFAs, but also to multi-tied and tied advisers under a system known as 'adviser charging'.

Advisers will be banned from receiving provider-determined commission in the proposals, and providers will also be banned from paying it – so rebating will also be banned as a consequence. This should open the way for clean transparent products, and for any discounts an adviser can negotiate being applied to the product.

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The FSA has also revised its thoughts on inducements. Training programmes that are not available to a wide range of adviser firms will not be allowed. Benefits which an advisory business relies on, such as asset allocation tools and customer relationship management systems, will have to be paid for.

Provider factoring is also ruled out, so providers will not be able to pay adviser charges to the adviser upfront and recoup the charge from the client later. However, non-provider firms could provide factoring services and this might ease cash flow problems for many firms stuck in the initial commission trap. These proposals on inducements effectively remove significant cost savings for advisers and should bring to an end decades of provider influence.

Previous proposals that adviser charges could be deducted from premiums, or made through the product, opened up myriad possibilities. However, the FSA has cleverly channelled the market into a series of processes designed to stifle any chance of by-passing the ban on provider determined commissions. Providers will be required to clearly identify and separate adviser charges and product charges. So, products offering allocations of more than 100% will be banned because the regulator suspects such products could conceal commission.

Perhaps the most wide reaching change in the paper is the proposal that providers are to be responsible for monitoring the levels and payment of adviser charges paid through their products. This one rule is set to change the relationship between IFAs and providers irrevocably.

Under the proposals, providers are expected to decline requests for extreme adviser charges and then inform the FSA. At the same time, providers will not be allowed to market the level of adviser charges they would accept to avoid remuneration bias. However, advisers will soon discover the upper limits in various client and product combinations. So, to avoid adviser opportunism when setting charges, advisers will not be able to charge more for recommending one company over another and they won't be allowed to vary their charges inappropriately from one product to another.

To reinforce the principle that advisers should be paid for the services they provide rather than by the product or provider they recommend, adviser firms will be required to decide in advance how much they plan to charge for different types of service. They will have to present this in the form of a service menu, and then discuss these charges with clients.

Advisers may still be allowed to receive upfront payments, if agreed, direct from a client. This will obviously require some negotiation, and there do not seem to be any of the curbs on excess that are associated with charges taken through products.

For those advisers who like the trail commission model, the FSA wants advisers to levy an ongoing charge only where it pays for an ongoing investment review or service. However it will allow an ongoing agreed adviser charge where regular payments are made into a product.

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In a clear signal of the direction it wishes advice to take, the FSA has extended the range of products to be fully considered by IFAs to include investment trusts, ETFs and structured products.

Professional standards

The FSA's objective to inspire consumer confidence and build trust so that financial advice is seen as being on a par with other professions seems a laudable aim. Part of this process is the policy of increasing the minimum qualification to the new Qualifications and Credit Framework (QCF) level 4 or effectively diploma level.

The new standard is roughly the equivalent of the first year of a university degree, but the FSA envisages raising the bar long term. Despite the protests of some advisers who feel unwilling to take the exams and may well leave the industry, there will be no 'grandfathering' provision. And those who wish to start taking existing QCF level 4 qualifications immediately can do so.

For those unsure of the wisdom of starting now, the consultation paper makes much of its 'no regrets' clause, which means that advisers who take exams before the benchmark qualifications are published, but are building towards the required level, will be able to use structured CPD to gap fill and comply fully. It is unclear what this means precisely. An adviser who has achieved Diploma or even Advanced Diploma status may still be required to take exams in those areas where they have gaps. So someone who has no exam passes in pensions, for example, may have to take a pensions paper. And nobody will have a level 4 qualification in Regulation and Ethics. So it is possible that all advisers – however well qualified under the existing system – may need to take at least one exam and possibly more. Clarification is awaited.

Those who dislike exams but feel they have the requisite knowledge can choose to undergo 'rigorous' oral tests instead. The assessments will be monitored by the qualification awarding bodies and candidates will be examined to the same standard as those sitting written exams. This is a transitional arrangement and will not be open to new advisers.

The new qualifications will include the following core subjects:

- Regulation and ethics;
- Personal taxation;
- Investment principles and risk;
- Practical application of technical knowledge.

The Financial Services Skills Council has started the consultation on the new exam standards. It will produce and maintain a revised list of appropriate qualifications and the examination providers will create the new qualifications. Practising advisers must attain the qualifications by the end of 2012, but all new advisers will have to work towards the qualifications from 2010.

CPD will be as important as the increased qualifications benchmarks. Advisers will have to do a minimum of 35 hours in a year or 100 hours in a three-year period with 60% to 70% structured CPD – lectures, tutorials, workshops – and the remainder unstructured reading and research.

The RDR really does seem more likely to produce a revolution in the market place through advisers charging and the requirement for tougher qualifications than any previous such initiative. It remains to be seen how far the practice will follow the proposals.

www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_18.shtml