

16 January 2012

Ms Jenny Frost
Conduct Policy Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Jenny,

CP11/26 Distribution of retail investments: treatment of legacy assets

The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around £3.9 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies). It is as managers of authorised funds, which are distributed through a number of intermediated channels, that our members are interested in the outcome of this consultation. From 31 December 2012, new investments into retail funds from that date may be subject to the new adviser charging rules and all investments received before that date will be administered as legacy assets.

It is most important that all participants in the process understand their role and obligations arising from giving advice, processing orders, paying commissions and/or charges, and managing investments. It is equally important that any systems and procedures devised to meet the inherent challenges arising from the change are well-designed and fully tested.

IMA has from the outset supported the RDR's objectives of achieving greater transparency in the retail market and a better deal for consumers. However, it is our view that the proposals in this Consultation regarding the treatment of legacy assets could lead to a distortion of the market. They do not provide for a level playing field between different types of product and between different types of distributors. We remain concerned that the balance of competitive advantage will be shifted in such a way that will not benefit consumers. In fact, we are firmly of the view that the FSA's latest proposals in this CP will have the perverse effect of leading to increased costs and less transparency for consumers.

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Our concerns centre around the following issues:

- The guidance, as written, is ambiguous and requires further clarification over whether trail commission could, or should, be paid in a number of common situations. We urge the FSA to offer further clarification.
- Guidance offered to providers continues to fail to recognise the degree of intermediation in the market and the relative capabilities in carrying out checks on whether an advice event has taken place. We would remind the FSA that it is not possible for fund managers to ascertain whether advice has taken place and they cannot be expected to police the activities of other FSA-authorized firms.
- The absence of the introduction of a sunset clause after which legacy and trail commission ceases to be paid to advisers post 2012, together with the apparent treatment of underlying fund switches within wrapped products, is likely to lead to market distortion toward wrapped products. The key outcome should be no market distortion, and associated consumer detriment, brought about by different investments being treated differently. We call upon the FSA to ensure that this is achieved.

Our detailed response to each of the questions contained in the CP is attached. We would welcome the opportunity to discuss our comments with you.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Andy Maysey', with a long horizontal flourish extending to the right.

Andy Maysey
Senior Adviser – Retail Distribution

**CP11/26 Distribution of retail investments: RDR Adviser Charging –
treatment of legacy assets**

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, this is particularly important given the distinction between trail and legacy commission emphasised by the FSA in this CP. Generally, the payment of trail commission by fund managers is not subject to any change while the investment in a fund remains fixed. Legacy commission is a more relevant consideration for the insurance industry. The key outcome should be no market distortion brought about by different investments being treated differently, or more advantageously, post 31 December 2012.

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 draft guidance is helpful as far as it goes. However, it is disappointing that a number of the practical examples outlined in our previous submissions, and those discussed between the industry and the FSA over the past several months, do not appear in the draft guidance. Also, the draft leads to some anomalies which will need further clarification. We would urge the FSA to be clearer in its intent behind the guidance offered in the Amendments to the Perimeter Guidance Manual which describes circumstances which are, or are not, regulated under article 53 of the Regulated Activities Order.

For example, a number of recommendations in the table identify circumstances where the recommendation is not to invest or otherwise to leave the existing investment unchanged. These circumstances are identified as advising on investments and therefore regulated under article 53 of the RAO. Paragraph 2.13 of the CP, in referencing the RAO definition of advising on investments, states that, "*if the answer is "yes" the RDR ban on new commission applies and additional commission cannot be paid.*"

Where the advice to the consumer is to do nothing, which may be an entirely legitimate outcome of a review of a consumer's investments, it is not clear whether, since this is an advice event, the FSA is now saying that it should result in the cessation of trail commission on investments existing before the end of 2012.

Clearly, if the consumer does nothing to the investment, no additional commission would be applicable. Indeed, if the consumer does nothing, the provider would be unaware even of the possibility that advice may have been given, so would continue to pay trail in accordance with the existing agreement.

The FSA needs to clarify its intention behind this section of the guidance. An advice event has taken place but there has been no change in investment. Is the FSA now saying that the fact of the advice must lead to the cessation of any trail commission already in payment or is the current commission permitted to continue to be paid?

If the former, we would question the basis of this as a policy approach given that existing investments can otherwise continue to attract trail, and we would be very concerned if this change in approach gave rise to a further distortion between funds and other products. Also, for the funds industry it is not simply a matter of ceasing to make certain payments. It would necessitate either the existing investment being moved from the original share class to a new, non-trail paying share class, or the trail that would have been paid being used to purchase additional units on the investor's behalf, with the attendant tax and other considerations (including whether that is possible if the fund is held within an ISA or a pension wrapper).

In paragraph 2.14 of the CP the FSA suggests two questions that firms should ask themselves to ascertain whether commission can continue to be paid to the adviser. These questions should appear in the proposed guidance itself, and it should be made clear that it is the adviser's responsibility to provide the appropriate instruction to product providers and platforms, and to communicate any consequential changes to the consumer (such as the fact that their investment in a particular fund may now be in a new share class or split between different share classes). Given the degree of intermediation in the retail market place, it is very often the case that the fund manager does not know who the adviser or consumer is. Therefore, fund managers cannot be expected to answer the questions, but only to have systems to act on the basis of the instructions given.

It will be the case that fund managers (and platforms and third party administrators) will administer the continued payment, or cessation, of trail as a response to a "flag" or "trigger" on their systems following an order from an adviser. The guidance should explicitly recognise that all parties in the chain can do no more than have processes in place to "ask the question" and to act on the answer. They cannot be expected to second guess the instruction they receive, but must rely upon the accuracy of the information provided by the adviser, which is an FSA-authorized firm.

Finally, we note that the guidance contained in Annex B identifies that a recommendation to re-register investments from one platform to another is not advice *per se*. We agree with this statement, but would flag that there are likely to be practical issues for the receiving platform, which may not accommodate for each fund in the client's portfolio the same share classes as the ceding platform, and which would not be able to replicate existing splits between legacy and new business without significant correspondence with the ceding platform and substantial manual intervention. The cost of this would likely outweigh much of or all the benefit of re-registration. Therefore, we urge the FSA to develop additional guidance in this area.

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.

Please see the answer to the question above. We urge the FSA to make it clearer in the guidance itself that for investments into funds in accordance with advice given before the end of 2012 (which might have included regular additional investments or regular portfolio rebalancing, for example), trail can continue to be paid. It is only where there are transactions arising as a result of a new advice event that trail cannot be paid on the new amounts invested. And when this happens, the guidance

also needs to be clear about precisely what if any existing trail must cease, in both lump sum and regular savings scenarios.

The FSA seems to be implying that trail can no longer be paid on any investments that remain in place. Surely, it is only on new investment amounts that trail cannot be paid? As noted above, for the funds industry, this will potentially mean someone's total investment in one fund being split across two different share classes. The guidance needs to recognise that it must fall to the adviser to inform the client of this and to deal with any queries they may have on future statements of holdings.

We set out below some examples to demonstrate some expected outcomes

Example 1

Product	Client assets	Recommendation post RDR	Outcome
ISA	Fund A	Additional purchase	Fund A (new investment) - Adviser charging applicable Fund A (Legacy holding) - No change
	Fund B	No change	Fund B – No change

Example 2

Product	Client assets	Recommendation post RDR	Outcome
ISA	Fund A	50% Switch into Fund C	Fund A (remaining Legacy holding) - No change
	Fund B	No change	Fund B – No change
	Fund C	Switch from Fund A	Fund C - Adviser charging applicable.

Example 3

Product	Client assets	Recommendation post RDR	Outcome
	Fund A	Move Fund A into an ISA	No change in investment (only in tax administration), so trail can continue to be paid?
	Fund B	No change	Fund B – No change
ISA	Fund A	Switch from Fund A	Fund A - Adviser charging now applicable.

Absent the introduction of a "sunset" clause, after which all trail and legacy commission ceases to be paid to advisers, it is likely that in future additional examples will arise, on which the industry will need to seek clarification from the FSA. It is not in consumers' interests for different firms or sectors to adopt fundamentally different approaches to similar investment or product scenarios. We call on the FSA to ensure that does not happen.

Q4: Do you have any comments on our analysis of the costs.

It is inevitable that costs will be incurred, particularly through the devising and installation of systems and procedures to meet these requirements.

The FSA should also be aware that many firms have already begun to develop and install systems and procedures in anticipation of the RDR implementation date of the end of 2012. Indeed, their FSA supervisors have been demanding they do so. But in order to do this work, they have had to make a number of assumptions based upon FSA guidance issued to date. It would be unreasonable, and costly, should those systems require modification or re-engineering if the outcome of this consultation were to be very different from the direction of previous advice. Also, it would put in doubt the ability for the systems to be properly tested and fully operational by that date.