

Speech by Sheila Nicoll, Director of the Conduct Policy Division, FSA  
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Conducting Business with Consumers – Delivering the best outcomes  
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Thank you Ladies and Gentlemen. I am delighted to have been invited to speak here, and to re-establish some long standing acquaintances (I am not willing to admit to how long it is since I first met your Chairman and Deputy Chairman, I would just say that we must have been very young!) I am conscious, however, that this is the first time that many of you will have seen me with a 'regulator' billing. I hope not to disappoint those who looked at the programme and saw 'regulator' and thought it a perfect opportunity for a conference siesta after the excitement of the Treasury Minister and the Chief Economist.

Firstly, I would like to thank The Tax Incentivised Savings Association (TISA), its executive and the Board for inviting me to speak to you at this important event. I particularly appreciate the opportunity to speak to such a wide cross-section of the financial services community. Indeed, looking at the delegate list, there is scarcely a financial services sector which is not represented here. That is a testament to the appeal of TISA and the issues that you cover.

I would like to turn for a moment to what being Conduct Policy Director at the FSA actually means. This is not only because I think this helps explain a number of organisational changes we have made recently but more importantly it helps to explain the direction of thinking within the FSA and the implications that this might have for you.

By 'conduct' we mean looking at how firms conduct themselves with their customers. Much of the focus in this context is on consumer aspects, or retail customers, because that is where the greatest risks lie. That is what I intend to focus on today, but within the term we also include what might traditionally have been called 'wholesale conduct' – best execution, for example.

My role is a newly created one and I share responsibility for our conduct agenda with Dan Waters, whose previous division has been split in two, ensuring that there is increased senior-level focus on conduct issues. Dan's Conduct Risk Division provides specialist risk scanning and identification capabilities and specialist support to supervision divisions to tackle emerging and crystallized risk. My Conduct Policy Division feeds into the risk identification, but more particularly provides mitigation through creating, maintaining and, where necessary, modifying our existing rules and sourcebooks. Our specialist knowledge of the rules informs the outcomes testing and thematic work undertaken by Dan's division as well as being a specialist resource available to the whole of the FSA.

Generally, regulation is viewed as being split between 'conduct' and 'prudential', and discussions often focus on the balance between the two. Before the recent crisis the headline grabbing news was often about conduct issues where consumers were losing out – endowments, split caps, precipice bonds and with-profits shortfalls. In the past two years, that attention has been switched to firms' capital and solvency position. As a regulator it is important that we deal with both. Indeed the separation of conduct and prudential issues is something of a false distinction: both are ultimately of benefit to society.

On a practical level, the distinction between conduct issues and prudential ones are not as clear cut. It was, at least partly, a failure of conduct in the US (the way mortgages were sold), which led to a very substantial over-extension of credit to mortgage holders, which in turn led to the funding issues we have been grappling with over recent years. Here in the UK, mortgage arrears, bank charges and PPI all have both prudential and conduct aspects. The recent reforms suggested in our recent Discussion Paper on the Mortgage Market Review had strong elements both of prudential and conduct.

This thinking is reflected in our new organisational structure, creating two business units focusing on risk and supervision. Specialist conduct, prudential and sectoral expertise sits

within our Risk Business Unit and supports the supervisory divisions in order to deliver an effective integrated supervisory approach.

Turning to the specific issues facing us, the conduct area has had a very full agenda and even what has happened since I joined the division on 1 October 2009 gives an indication of the breadth of the Conduct Policy issues we are dealing with. In the last six weeks, we have:

- published our Mortgage Market Review Discussion Paper, which starts the discussion on a package of fundamental reforms to the mortgage market;
- implemented our Banking Conduct Regime, which includes the new Payment Services Regulations and our new Banking Conduct of Business (BCOBS) rules;
- contributed to our publication of our findings on financial promotions and quality of advice for structured products;
- written to the relevant parts of the industry about the use of projections; and
- collected over 400 responses on the Retail Distribution Review Consultation Paper that we published in June.

### **Retail Distribution Review**

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I would like to turn now to one of our most significant areas of policy reform – the way retail investment products are distributed, otherwise known as the Retail Distribution Review (RDR). I know that a number of you will be very familiar with our work in this area – indeed I know that a number of you have responded in some detail to our June Consultation Paper. We thank you for that and are actively considering the responses as I speak.

I have to say, however, that I find it disappointing that even though our discussions on this subject have been going on for over three years (and there has been intensive involvement of the industry as our thinking has developed) there are still signs of denial, or misplaced wishful thinking that this might all go away – whether based on changes of personnel within the FSA, discussions about the wider political agenda, constraints that might be put on us as a result of EU obligations, or questioning of our powers.

I want to be clear today that we remain committed and resolute in addressing the problems we see persisting in the market and in our approach to dealing with them.

[▲ Back to top](#)

This means a package of measures designed to ensure that consumers understand the service they are receiving and that it comes at a cost. We want to remove the influence of product providers over the remuneration of advisers and ensure that the perception, and indeed reality, of bias is removed. We also intend to raise standards of professionalism and behaviour through the application of higher qualification requirements and a code of ethics for those advising on investment products.

I am concerned about suggestions that we might not have considered our EU obligations. I can assure you that we have kept our colleagues in Brussels informed throughout the formulation of our thinking and continue to do so. In particular, for example, we have sought to align our product definitions with the direction of travel being taken in Brussels on Packaged Retail Investment Products.

I wanted to take this opportunity to clarify a couple of points. We know, for example, that there is some concern among advisers that customers are reluctant to pay for advice up-front and that our proposals for adviser charging will drive away consumers who cannot afford up-front fees. That is not our intention and to deal with this we have said specifically that the charge for advice can still come out of the product. In contrast to much of what we see now, that charge will be agreed with the consumer, rather than offered by the product provider,

just as it would with other professional service providers, like most solicitors, accountants, etc. But any ongoing charge must relate to an ongoing service.

We are conscious that this aspect has raised some issues for the funds sector, which have been very clearly explained to us by Investment Management Association (IMA) and by others. I think there are a number of potential ways through some of these issues, including the potential use of platforms, to which I will return shortly.

I would also like to comment on the application of higher professional standards. We remain fully committed to raising qualification standards to level 4 and are driving forward the development of new qualifications for new entrants. Meanwhile, existing advisers who are not already at or above level 4 should be getting on with their studies and those with existing qualifications need to start thinking about topping up their continuing professional development.

A word of caution for those who might think that they may successfully challenge our ability to raise qualification levels. I want to reiterate that our proposals are legal. We have the power to change our requirements if it is in the interests of protecting consumers, and we are entitled to remove an individual's licence to trade if we deem them not to be competent.

We understand that there is apprehension in some quarters about formal exams and I will repeat now that we continue to listen to alternative proposals. But we must, of course, be satisfied that alternatives deliver the step change we want and stand up to consumer scrutiny.

The next stage will be that next month we will publish a Consultation Paper on the governance arrangements surrounding the raising of professional standards for advisers. The paper will also cover the read across of the RDR proposals to advice on pure protection products, and our views of the impact on Group Personal Pensions. But I won't say a great deal more on this subject, so as not to deprive you of the pleasure of reading our consultation document.

We will then be making rules in the areas of charging and advice in March 2010.

Before moving on, I want to pause to give a very clear warning to advisers who may be looking to flout our reforms or who may seek to maximise their own profit and rewards before our rule changes take effect, while not paying appropriate regard to the interests of their customers. We have heard that some firms, both providers and advisers, may see the period between now and implementation as an opportunity to build up business with trail commission to get round our proposals, or to suggest products in which they receive very high remuneration but which may not be the most appropriate for the consumer. Any such sales still need to meet our rules on suitability, appropriateness and so on. We will take a very dim view of such detrimental behaviours and it is our intention to do some thematic work in the lead-up to the end of 2012 to make sure that consumers aren't losing out.

## **Platforms**

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This brings me to another area on which we share an interest with many in the room – Platforms. Platforms are a good example of innovation in the financial services market. They fuse a number of elements of services and products with technology to bring forward a new kind of proposition, which is already having a significant impact on the retail market. We believe they can provide a useful service to consumers and firms and can support improvements in the quality of advice and administration that customers receive. They may also have a key role to play in helping to deliver adviser charging.

We are also acutely conscious that the term 'platform' applies to a wide range of products and services, which are not uniform and which may have different issues associated with them. We have been doing a lot of work over recent months on ensuring that we fully understand the different characteristics of platforms and are very conscious of the need not to take a 'one size fits all' approach in this part of the market. The issues surrounding an

open architecture administration platform are quite different from those relating to a guided architecture platform service leading to using a restricted range of investments. We all need to understand the different incentives and remuneration structures that apply and consider what they mean for the end investor.

Conversely, it is clear that a number of the RDR proposals will have an effect on many platforms. We will also consider if additional rules and guidance are required for the operation and use of platform services. This will include an examination of the way in which platform operators are remunerated, the inducements they provide to adviser firms, the provision of data on product sales and the levels of adviser charging, and the use of platforms by independent advisers. The issue of remuneration is not a simple one, particularly as platforms provide services to a variety of parties. At the very least, for example, where platforms receive payments from fund managers and other product providers, we need to know and be able to explain what it is for – administration services, distribution services or a combination of both?

Looking ahead, we plan to include in the RDR Policy Statement a chapter which will set out a number of ideas around our future approach to platform services, taking into account the RDR decisions. We will, of course, involve the industry in the discussion going forward.

### **Disclosure**

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We continue to be very interested in the quality of firms' disclosure. While we recognise the limits to disclosure as a regulatory tool, we think it is a very important aspect of the sales process. Our research showed that good quality disclosure material can be effective and that a significant and expensive change to our requirements is not necessary. Instead many firms need to improve their approach so that disclosure documents become effective consumer communications – in line with TCF – rather than exercises in tick-box compliance. Unfortunately our 2007 sample found that 85% of key features documents and simplified prospectuses did not meet the standard we expect.

To improve outcomes for consumers, we have worked with firms to communicate what we consider to be good and bad practice and this has produced a marked improvement in 70% of the key features documents and simplified prospectuses which we previously considered unsatisfactory.

Unfortunately many asset managers continue to fall short of the standard we expect. We will continue to monitor the quality of disclosures through our normal supervisory work and we will review another sample in 2010.

I would like to talk briefly about another subject which must be close to the hearts of many in this audience, and that is disclosure relating to ISAs, and in particular transfers from cash to stocks and shares ISAs. I know that one major reform as part of the 2007 ISA reforms was the ability to use previous years' cash ISA monies to invest in stocks and shares without it counting against the annual limit. In this case, we expect firms to make customers aware that while they can transfer in this direction, all monies subscribed to cash ISA count against the £3600 annual cash limit (or £5100 for those over 50), irrespective of the source of the funds.

Likewise, we expect any advice, literature or marketing campaigns relating to the transfer of funds from previous years' cash ISAs into a stocks and shares ISA, to make clear to the customer the additional risks involved with moving away from cash.

[▲ Back to top](#)

### **Banking**

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I would like to turn now from investments to retail banking. As many of you know, since 1 November, deposit takers have been subject to our new Banking Conduct Regime, which incorporates the Payment Services Regulations and the Banking Conduct of Business rules.

All cash ISA and cash Child Trust Fund providers will be required to comply with the provisions of this regime, including detailed conduct requirements on payments into and out of these accounts. Our Principles for Businesses now explicitly apply to deposit-takers and there are additional requirements, including those for post-sale service, which impose an obligation on firms to assist customers with switching or closing their account – a persistent problem in years past with respect to ISAs and other forms of savings accounts. In our BCOBS guidance, we have referenced the helpful joint BBA-BSA-TISA guidance, which I have to say is a model of how we think industry guidance should be.

Regarding these new rules, we appreciate the scale of changes required for many firms, especially to comply with the Payment Services Regulations. But we would remind you that compliance is compulsory. Our colleagues in the Conduct Risk and Supervision areas are already following up some areas where important new protections for consumers must be delivered.

### **Product regulation**

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Finally, I would like touch on product regulation. The Turner Review challenged the idea that we should avoid regulating products. More product regulation has also long been advocated by our Consumer Panel and other consumer groups who feel that the main tools we use at present – disclosure, regulation of the sales process and application of our Principles for Businesses – are not sufficient to deliver consumer protection. In any review of our approach to conduct regulation and supervision our approach to products has to be considered.

I think, however, that there have also been some misunderstandings about this and I wanted to clarify what is in our minds when we talk about product regulation. One form is familiar to many in the audience today – that is the authorisation of a product, like a regulated collective investment scheme, allied with a ban or restriction on marketing products which do not meet the criteria for authorisation.

But the term encompasses a much wider range of potential interventions than that. We have, for example, proposed in our Mortgage Market Review that certain types of products, such as self-certification mortgages, are banned and that lenders should not write business where there are multiple high-risk indicators (toxic risk combos). Equally, looking at firms' business models, as we are increasingly doing, both at the point of authorisation and on an ongoing basis, involves considering the products they are offering and who they are offering them to. And there are plenty of opportunities for firms to focus more carefully on product governance, post-sale quality assurance processes, stress testing and product performance analysis – in a similar way as has been happening in terms of the risk framework for asset and liability management.

As Hector Sants said earlier this month, we are now firmly into the realm of making judgements about judgements taken by firms and how they affect consumers. This does not just cover business models and incentives, but also the products that they sell.

I have very much enjoyed speaking to you today. I am conscious that I have sought to cover a lot of ground, and hope I have left enough time for some questions.

Thank you