





Distributor Funds – Defining the Principles for Good Consumer Outcomes



**FSA update on
distributor-influenced funds**

27 September 2011

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Agenda

- **The expected impact of the RDR on distributor-influenced funds (DIFs):**
 - adviser charging; and
 - independence
- **Product intervention**



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Adviser charging



- **Adviser firms...**
 - set their own charges for their services;
 - disclose those charges to customers up front; and
 - provide ongoing service in return for any ongoing charges
- **Product providers...**
 - banned from offering commission for advised sales;
 - allowed to deduct adviser charges from products; but
 - cannot advance charges to adviser firms

Adviser charging in practice



- **We expect adviser charging to work as follows:**
 - each adviser firm will determine and use an appropriate charging structure;
 - they can adopt a standard price tariff to do this; and
 - before advising a customer, an adviser would make clear what services they will provide and how they will be remunerated
- **Adviser charges must not vary according to the product or provider**



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The impact on DIFs (1)



For distributors selling their own DIF:

- all amounts paid to the firm are to be included in adviser charging, whether for fund governance or advice;
- distributors must not receive more in adviser charging for recommending DIFs compared to substitutable investments; and
- vertically-integrated firms recommending their own DIF are also subject to the adviser charging rules

The impact on DIFs (2)



Where the DIF is available to other adviser firms:

- charges for fund governance will be part of the provider charge (as they are not received by any part of these firms)

For all adviser firms:

- providers cannot pre-determine adviser charges for distributors



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The impact on DIFs (3)



For all distributors:

- as ongoing remuneration can only be taken where an ongoing service is provided:
 - the amount paid for fund governance would cover an ongoing service; but
 - firms would need to think what other charges are appropriate if portfolios are reviewed centrally within the fund

Giving independent advice



Under the RDR, independent advice is:

unbiased, unrestricted, based on a comprehensive and fair analysis of the relevant market

The range of products an independent adviser will need to consider will change:

- currently only needs to consider packaged products;
- the new requirements apply to a wider range of products (including investment trusts)



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Independent advice on DIFs



- We expect it to be difficult for firms to prove DIF advice is unbiased or independent
- Firms will need to demonstrate that recommending their own DIF gives an outcome which is at least comparable to other solutions in the market
- We will have concerns if a significant amount of an independent firm's business is in their own DIF

Restricted advice on DIFs



- Advice that does not meet the requirements to be independent will be regarded as restricted
- Advisory firms with DIFs may even consider changing to a restricted basis
- DIFs sold on a restricted advice basis must still comply with the rules on:
 - suitability;
 - adviser charging; and
 - managing conflicts of interest



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Product intervention - in summary



- This is a change in regulatory approach
- Previously we had a focus on the point-of-sale...
- ... but this has not stopped waves of consumer detriment arising from particular products
- Traditional regulatory tools help but do not always correct the underlying market failure
- So we need to intervene more in product development and governance

What is product intervention?



- Supervisory scrutiny of firms' arrangements for product governance
- New rules to set expectations for product governance
- Actions to limit the supply of:
 - potentially 'toxic' products; or
 - niche products becoming 'toxic' by reaching the wrong people



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Product intervention and DIFs



- UCITS are already subject to product regulation but...
- ... DIFs have particular features that make them of concern to us
- In particular, firms should be thinking about:
 - product governance structure;
 - conflicts of interest;
 - target markets;
 - stress testing;
 - commercial viability; and
 - value for money


Conclusion



- The FSA still has concerns in this market
- All firms involved should seek to offer good customer outcomes:
 - providers should consider the risks inherent in the product structure and how they may be managed; and
 - adviser firms should consider how to incorporate changes under the RDR



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