

JFSC PUBLISHES PROPOSALS ON FINANCIAL ADVICE FEES

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INTRODUCTION

In August 2011 the Jersey Financial Services Commission ("the JFSC"; "the Commission") released an interim position paper setting out proposals relating to its Review of Financial Advice ("the RFA").

The proposals include significant changes to the remuneration of financial advisers, with commissions paid by product providers to be outlawed and replaced with a transparent, upfront pricing structure.

BACKGROUND

The UK Financial Services Authority has recently concluded a review of the retail distribution of financial products and advice ("the RDR"). Flowing from it are a series of rules, due to come into force at the end of 2012, which will require UK advisory firms to clarify their pricing structure; to clearly describe their services as either independent or restricted; and require individual advisers to adhere to consistent professional standards, including a code of ethics.

The JFSC's position paper represents the first step of the Jersey response to the UK RDR. Significant changes are envisaged to correct the Commission's '*concerns with respect to the investment advice industry*', which are heightened by the absence in the Jersey market of a financial ombudsman, investor compensation scheme or statutory cooling-off periods.

The RDR's key aims were:

1. Increasing the professional standards of all retail investment advisers;
2. Improving the clarity with which firms describe their services to consumers (independent and restricted advice);
3. Addressing the potential for adviser remuneration (initial and trail commissions) to bias advice; and
4. Improving the sustainability of the market (financial resources).

If implemented, the JFSC's proposals would have a significant effect on the regulation of professional standards and adviser remuneration in Jersey (largely mirroring the FSA's new rules in these areas), while not making substantial changes to the existing regulatory framework covering the description of services to consumers and market sustainability. The proposals would affect all persons and entities providing class C and class D investment advice.

CHANGES TO REMUNERATION

By far the most controversial area of the proposed reforms relates to adviser remuneration. The Commission notes that, under the present system, registered persons giving financial advice will earn different amounts of money depending on which product and provider they recommend. This is said to create '*the potential for remuneration to distort client outcomes*.' In addressing the issue, the Commission hopes to reduce the '*risk to the public of financial loss due to incompetence, dishonesty or malpractice of persons carrying on the business of financial services in or from within Jersey*.'

The proposed changes to remuneration mirror closely those in the RDR. These provide that all firms and individuals giving retail investment advice (including those providing only restricted advice) will be required to:

1. Set their own charging structure;
2. Ensure that their charging structure properly reflects the level of service which they provide;
3. Disclose charges to consumers upfront, using some form of price list or tariff; and
4. Deliver an ongoing service when an ongoing fee is levied, unless the product is a regular payment one. The nature of the services which the client is entitled to receive in exchange for ongoing payment must be made clear.

The RFA has made plain its opposition to commissions paid by product providers and, in particular, 'soft' or non-monetary commissions. These are certain to go, and the prohibition will be strict – none will be permitted, even if it is intended that all or part of the money is to be rebated to the retail client. Replacing them will be a transparent pricing structure in which all the money paid to investment advisors is routed through upfront 'adviser charges', agreed with clients in advance.

While the Jersey Investment Business regulatory framework has required the disclosure of all associated fees and charges by registered persons since 2001, the Commission is clearly of the view that this provision has been ineffective in removing the potential for conflicts of interest between investment advisers and their clients.

Trail commission

'Trail commission' will still be receivable post-2014, provided that the relevant product was sold before 31 December 2013. Where a product is amended post-2014 to the extent that it becomes a new product, or the client is required to sign a new product contract, trail commission will no longer be permitted.

BRIEFING

If a client changes the registered person from whom it receives investment advice, re-registration of trail commission will be permitted where provided for by the contract between the product provider and the previous investment adviser. The new adviser will be required to inform the client of the nature and extent of the commission, and will also be required to provide an ongoing service in return for its receipt, *regardless of whether or not the original contract allowed for this as a condition of transfer.*

Long-term insurance contracts

Firms selling long-term insurance contracts defined as investments will be permitted to continue to do so after the RFA is implemented without having to apply the above changes to adviser charging. While this mirrors the FSA's proposals, there is at present no firm definition of long-term insurance in Jersey – expect guidance on this issue before 2014.

Billing method not prescribed

The Commission does not intend to prescribe the basis on which investment advisers charge for their services (e.g. by fixed fee, hourly rate or percentage of funds invested). Further, it will remain open to advisers to charge an ongoing fee without providing an ongoing service where a client wishes to spread the cost of initial advice by making regular payments.

PROFESSIONAL STANDARDS

The JFSC adopts the FSA's proposals on raising professional standards in the provision of investment advice, but takes the view that the existing regulatory structure means that some of the UK changes are unnecessary in Jersey. While therefore a new ethical code is not envisaged, and only cosmetic alterations to CPD requirements are proposed, the Commission does intend to raise the standard of qualification required of investment employees. A new qualification standard will be imposed equivalent in level to the first year of an undergraduate degree, or suitable equivalent vocational qualifications. From 2014, all investment employees will also have to hold a statement of professional standing ("SPS") from a suitably accredited body.

WHAT NEXT?

The proposals are currently open for consultation. Responses are expected from the Personal Finance Society, the Jersey Bankers Association, the Chartered Institute for Securities and Investments, Jersey Finance Limited and other interested parties. The deadline for responses is 31 October 2011.

Amendments to the regulatory framework arising from the RFA are due to come into force on 1 January 2014. The FSA's parallel requirements will be introduced a year earlier; investment providers dealing with UK investment advisers may therefore be required to alter their fee arrangements sooner rather than later.

The JFSC has also stated that it will be vigilant against attempts by investment advisers to encourage their clients to engage in transactions with unnecessary frequency prior to the implementation date in order to generate additional commission before the new rules come in.

For further information on the RDR Advisory Services at Stephen Platt & Associates LLP contact Stephen Platt or Chris Usher

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