

Steve Dixon Associates Update

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TCF

Provider / Distributor

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The FSA issued its response to the discussions around DP06/04 in May 2007. This included a guidance note on the sharing of responsibilities between provider and distributor. Since then, there has been other seminars where the FSA have given more detail on how it sees these responsibilities shared.

1. Status of the guidance.

The “Regulatory Guide” is issued under Section 157 of FSMA 2000. As such, it is not binding on regulated firms however it can be used in an enforcement context and firms could use it as a “safe harbour”.

2. Provider / Distributor

Providers and distributor roles are defined by function rather than by who the individual firms are. Manufacturers of financial services may also be distributors of their own product and also other providers’ products. Equally, distributors could take on some of the roles of providers if they use wholesale products to derive a retail product. This is a useful development from the original discussion document and should allow greater flexibility in interpretation by firms and by the FSA in sharing out the responsibilities around TCF.

Providers and distributors can come to agreements about how they split their responsibilities to clients. However, this will only be possible in the right circumstances.

3. Provider responsibilities

The provider needs to:

- Identify the target market;
- Stress test the product or service to identify how it might perform in a range of market environments and how the customer is affected;
- Should have in place systems and controls to manage the risks caused by the product.

The provider needs to select its distribution channel carefully for the target market and for the product. This in itself may be contentious as many product providers will not want to tell IFA networks that they are not suitable distributors for some of their products.

It then must provide sufficient product information for both the distributor’s own training needs and for the needs of customers. Obviously the tests to apply here will be subjective. Is the literature comprehensible, appropriate and sufficient to enable an IFA to fully understand the product? Is the literature at the right level for the target market? At the same time, the provider will still have to provide the specified Key Features documents.

It needs to have management information in place to monitor sales and whether they are being made to the right target market. Again, this is subjective as some data (income or net wealth for example) may not be included in a normal application form for a life

Inside

- 1 Status of the guidance
- 1 Provider responsibilities
- 2 Distributor responsibilities
- 2 Our view

cover plan or for an ISA. It also needs to monitor the results of sales using some form of Key Performance Indicator.

The provider needs to communicate key contractual break-points. Examples are mentioned by FSA of guaranteed MVA free dates for with profits policies. This should only be done when appropriate. Boards will need to keep a very clear view of the materiality of any date and the benefits gained by customers from this date. They will also need to document why they are choosing to write on some events and not on others. We could also see an argument being made that too frequent correspondence on events that are not material may lower the chance that clients respond to those that are material.

Also, if the provider needs to communicate these dates, does the provider need to prove to enforcement staff that the client received the communication? We can imagine providers sending communications by recorded delivery with a "gone-away" process if this matter is taken too far.

4. Distributor responsibilities

The distributor needs:

- To have in place systems and controls to manage effectively the risks posed by financial promotions;
- In recommending a product, should act with due skill and diligence.

The distributor needs to think through whether it understands the product and all of possible downside risks and should ask for more training and / or information if it is unsure of any information provided.

It needs to match risk profile and customer needs against product and consider the provider's profile.

After the sale, the distributor needs to comply with contractual requirements from the client and should follow up on any representations (implied as well as explicit) that it made to the client on any service that it would provide. This, again, will be subjective especially

on matters such as reviewing fund performance or the with profits bonus prospects of providers. Many clients may think IFAs have a responsibility to do this without checking the terms of business letter or asking their IFA. The IFA, on the other hand, may only carry out this service for an additional advice fee.

The distributor must also pass communications between provider and client in a timely and accurate way.

5. How should this guide be interpreted?

We think this guide should not be interpreted to the last word. There is a deal of debate between enforcement staff and policy staff within FSA on how rigid some of these obligations should be met. We can imagine some enforcement staff using this document as a starting point and then ramping up the requirements by what they believe the best practice is in each field. They might be successful with some firms especially if those firms are feeling exposed on other regulatory matters.

There will be discussions about the requirements placed on small firms.

Obviously, this will be a developing subject and we wait to see how the document will be managed in real cases.

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