

British regulator bans commissions

Philip Porado / June 29, 2009



Last week, the U.K.'s Financial Services Authority (FSA) issued rules that essentially codify a fee model for British investment advisors (IAs) and ban collection of commissions by IAs.

The rules will take effect in 2012.

The FSA's principles-based regulatory regime was savaged by investors, government officials and the media following its failure to catch or correct errant behaviour that led to the credit crisis-induced meltdown beginning last fall.

So the regulator responded with a clear-cut set of new standards aimed at raising the bar for financial advisors and scrutinizing how they are remunerated by the creators of investment products.

"The incentive trade-off between commission payments and suitability will be removed," the rules documents said. "All else being equal, this is expected to lead to an increase in the suitability of the products sold."

Under new rules covering compensation, advisors will be "required to set their own charges for advice" in an effort to remove "product provider influence over advisor remuneration." Both independent and captive advisory firms will be called upon to disclose the cost of advice separately from the underlying costs of investment products, according to the FSA's rules documents.

Consistent capital requirements will also be established for personal investment firms. Overall minimum capital requirements will be raised from £10,000 to £20,000, and expenditure-based requirements will be extended to every firm.

"Furthermore, firms will be required to hold additional capital, based on a sliding scale, as a provision against potential liability for any activities excluded by their professional indemnity insurance policies," the FSA said.

The regulator added that it will raise minimum qualification levels for advisors, institute a code of ethics and boost requirements for continuing professional development. The FSA is further considering the creation of a Professional Standards Board to oversee the implementation of the requirements.

Comment letters received by the FSA during the rules development phase indicated that some advisors may leave the business if barriers to entry are raised or income

potential is diminished. The FSA acknowledged this, but added it's unlikely there would be enough departures to restrict consumer choice.

"Regulatory requirements for advisors, in the form of training, competency standards and capital requirements, may constitute a barrier to entry," the regulator said.

"However, the high number of individual advisors still working in the industry seems to indicate that these may not be so significant as to give rise to a concentrated market."

(06/29/09)

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Originally published on Advisor.ca

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