



The Arculus Review: Lifting the Burden of Regulation

AIFA Response

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AIFA is the trade association that represents UK regulated independent financial advisers (IFAs). Membership of AIFA is voluntary and on a corporate basis. AIFA currently represents over 70% of IFA firms in the UK.

IFA firms are the leading distribution channel for retail financial products in the UK. They generate over 60% of business by monetary value and are the major sector advising and arranging private pensions in the UK (see annex 1). As such, IFAs represent a dominant force in the maintenance of a competitive and dynamic retail financial services market.

AIFA welcomes the opportunity to respond to the Arculus Review. Although AIFA is a non-partisan trade body, we welcome any parties' efforts to lift the burden of regulation for UK businesses. AIFA represents one of the most heavily regulated professions; our members experience constant, and often simultaneous, regulatory change by the FSA, European Union and UK Parliament.

AIFA has consulted with its elected council prior to submitting this response.

KEY ISSUES

AIFA has identified the following key issues that we believe that Arculus Review should consider, when examining regulation in the financial sector:

- The Financial Ombudsman Service
- The Interaction between UK Regulation & EU Legislation

THE FINANCIAL OMBUDSMAN SERVICE

Despite this high volume of business, complaints against IFA firms are relatively low (see annex 2) and even where they are referred to the Ombudsman, less than one in five are upheld. As IFAs are in the main very small firms, their exposure to and dealing with FOS are very limited and there can be years between cases. They do not have dedicated complaint handlers and often become emotionally involved with a case as they feel their personal integrity is being questioned. As such, we feel that the Ombudsman service needs to recognise the difference in dealing with small intermediary firms and set up a separate division, replicating the success that FSA has had with its Small Firms Division initiative.

The FOS works on the principle of what is “fair and reasonable” but in our members’ experiences, this does not always appear to reflect a two-way application. Members report that FOS has become more process-driven, legalistic and has lost sight of its “arbitration and resolution” ethos. It must be remembered that Ombudsman schemes should provide a cheaper, more approachable, and less “blame oriented” process than the courts or there is little point in their existence. We have concerns that FOS is drifting away from these ideals.

Small Firms

We believe that it would help if FOS had a small firms division which

- could assist such businesses in understanding how the Ombudsman Scheme works,
- provide guidance on how to handle individual cases,
- were transparent about the information, and processes, used internally to train staff (so that firms may also learn from them),
- ensure that policy issues in relation to small firms are properly highlighted and deal with complaints against such firms with a full understanding of how such businesses operate.

Summary dismissal of complaints

FOS should in any event publicise its dismissals on the basis of DISP 3.3.1(1-4) and explain in more detail the criteria it uses for this purpose. This would make FOS more accountable and make it easier for our members to judge when they should seek dismissal of a complaint on these grounds. Equally, those assisting complainants could see the types of situation where referring a case to FOS would be pointless.

FOS should also publish information on the number of cases dismissed as frivolous or vexatious (if any). Examples demonstrating the interpretation of these terms would also be helpful.

Time-bars and the absence of a long-stop in Financial Ombudsman Rules

Small firms are particularly badly affected by the absence of any long-stop in the time-barring rules. They are currently exposed to complaints relating to events 19 years ago. Few can keep records for anything like that long. While the analogy with the Limitation Act is incomplete, it makes sense to have a length of time beyond which complaints cannot be made. It may be appropriate to have a different rule for product providers because they have to keep records relating to an ongoing product. However, for advisers, there should be some form of backstop which should not be more than 15 years and realistically shorter than that; for example, 10 years. Beyond that time, memories fade and complaints cannot be effectively investigated. Currently, too many complaints are upheld against firms who do not have the records to defend themselves properly.

As the RDR Discussion Papers point out, the continued exposure of firms to ancient claims merely exposes the FSCS to further claims against incorporated firms and clouds the retirement years of those who have not incorporated.

IFAs would not expect a repetition of DISP 2.3.6's extension of the time to complain. The three year limit in DISP 2.3 should run from the date on which a reasonable customer would appreciate that there was a problem with his investment or the purpose for which it was set up.

Retrospection

Finally, small firms are particularly vulnerable to FOS making decisions on the basis of retrospective standards. The objective of AIFA's Stakes in the Ground initiative was to address this concern and we would appreciate contributions from all sectors, including consumers, in developing this initiative further. In particular, firms are concerned that the failure of consumers to react to offers of subsequent advice is exposing them inappropriately to liability, or greater liability, than would otherwise be the case. Clear guidelines on capping liability would help greatly to protect smaller firms.

FOS's refusal to do the calculations

One final problem is FOS's continued refusal to do the calculations when it makes an award. Sir Michael Barnes in the 2006-2007 Annual Review at p. 75 drew attention to this problem and had been re-assured that it would not recur. It is still going on, placing great strain on small IFAs who do not have the resources to do the calculations themselves. Consumers are also in no position to check the calculations. As Sir Michael said:

"In my annual report last year, I drew attention to the problems that can arise for consumers, when ombudsmen make "formulaic" awards which require firms themselves to calculate the actual amount of compensation due to the consumer. I very much welcome the board's response to my concerns. I understand that steps are being taken in this area. In particular, the ombudsmen are now making greater effort to specify the exact amount of compensation awarded – wherever they have the specific detailed information needed for this calculation.

However, I am still receiving a number of complaints about redress calculations carried out following final decisions by ombudsmen. One pension case graphically illustrated the wide variations that can exist between the level of compensation that the parties understand the ombudsman to have awarded – and the actual amount payable when the final calculations have been made.

In the case in question, the consumer's financial advisers considered that the redress due was in the region of £130,000. The firm must have taken the same view, because shortly after the ombudsman issued the final decision, it offered the consumer £100,000 (the maximum amount binding on the firm). The consumer did not accept the firm's offer and instead held out for the higher amount estimated by her advisers. When the final (admittedly complicated) calculations were complete, the actual amount of compensation due was found to be only £25,700."

We share Sir Michael's concerns not only for consumers but for the firms that have to make the calculations.

THE INTERACTION BETWEEN REGULATION & EU LEGISLATION

The cost of implementing regulations in UK financial services is exacerbated because firms often have to implement regulations twice, after the FSA implement regulations and after the EU has created legislation on the same area, which has to be implemented again. In some cases, the review of the effectiveness of the implementation of directives is carried out by both the FSA and the European Commission, but not simultaneously; this means that the cost of the review is higher and the changes that result from the review of the directive add more costs to businesses. AIFA believes that, with more coordination between European Commission policy and FSA policy, significant savings can be made by financial firms.

AIFA's experience with the current, and previous, FSA and European Commission work programmes is that they tend to overlap, but over different years. The total cost of regulations originating from the EU is estimated at £46.9 billion¹. The FSA and European Commission's work both seem to work to a cycle, but the cycle for both run at different times.

An example of the FSA plan being out-of-sync to the EU Commission can be witnessed in the handling of the Insurance Mediation Directive (IMD). The UK was one of only four of the fifteen EU states to transpose the Directive into national legislation before the 15 January 2005 deadline. The regulations that evolved from the directive were more onerous than the requirements of the directive – it was gold plated. The one-off cost of implementing the IMD was estimated at £60 million, with a recurring cost of £90 million². Last year, the FSA conducted a review of its Insurance Conduct of Business (ICOB) rules for certain general insurance products. As a result, in December, the FSA removed most of the ICOB requirements that exceeded minimum IMD rules. This year the European Commission plans to review the IMD, which means that it is likely that there will be more changes to UK regulation and more costs to UK firms.

Unfortunately, the IMD is not an isolated example of double regulation in the same area. The FSA published the Retail Distribution Review (see annex 3), which proposes fundamental changes in the way that the financial advice profession can operate. The FSA plans to publish their interim policy document on the RDR in April. In our opinion, the European Commission's Green Paper in Retail Financial Services (see annex 4) and the European Commission's call for evidence on substitute retail investment products (annex 5) both have the same objectives as the RDR. The time line for the European enquiries and the FSA's RDR are not yet clear, but AIFA has not seen any attempts to coordinate the work of the FSA and the Commission.

¹ British Chamber of Commerce, *Burdens Barometer 2008*

² *ibid*