



The Association of Independent Financial Advisers

Response to CP 07/23 Organisational systems and controls – extending the common platform

1. Introduction

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 80% of IFA firms in the UK.

IFA firms are the leading distribution channel for retail financial products in the UK. They generate over 65% of business by monetary value and are the major sector advising and arranging on investment products in the UK. As such, IFAs represent a dominant force in the maintenance of a competitive and dynamic retail financial services market.

2. Key comments

The extension of MiFID

The CP lacks a rigorous analysis of the benefits to be gained by extending the MiFID beyond its current scope. We do not argue that such a move is inappropriate but suggest that the utility of such a move is unproven. The CP does not present evidence for why such a move benefits firms or their clients, how any benefits will be quantified and over what time-period they will be realised.

FSA should consider the comments of DG Markt's Head of Unit, Karel Van Hulle, who has publicly stated his concern about member states "rushing to implement MiFID" and extending it too quickly beyond "narrowly defined boundaries". In his view, MiFID is still a new Directive and he expressed concern about the unintended consequences accrued in too swift an extension into other parts of the market not specified by the Directive.

Our comment would be that the case for extending the common platform is "unproven" and that FSA should conduct a far more rigorous analysis before

pressing ahead. This will give firms the comfort of implementing proposals that have been tested. It will also allow FSA to assemble more evidence against which to test the results of the proposals when a post-implementation review (PIR) is held.

The role of technology

FSA invested in technology to help small firms construct their own handbook. AIFA supported this move and has found that it has delivered benefits to member firms.

We would encourage FSA to continue to invest in this approach. We have long worried that a desire for “regulatory elegance” would lead to a position where simplicity of approach took precedence over the need of firms for specific and detailed rules and / or guidance.

The drive for simplicity can result in significant unintended consequences and we would counsel FSA to resist any solutions which leave firms more exposed to risk. A complex handbook is not necessarily a bad thing if it provides firms with the information they need to operate a better business – technological solutions can help manage the detail and deliver a specific handbook for firms’ needs.

The role of guidance

This CP clearly demonstrates the greater emphasis being placed on “guidance”. Given the MPBR transition FSA should consider a communication exercise for smaller firms on the role and regulatory status of the different types of “guidance”. Firms that have enjoyed the certainty of rules in the past, and who now find those rules expressed as guidance, will need a period of transition.

Further, those firms (such as in the mortgage and general insurance communities) who now find their regulatory agenda widened by the arrival of new “guidance” will benefit from greater clarity about how to approach such matters. Firms will worry that the risk-hurdle has been raised by these proposals and will wish to better understand the supervisory approach that will be taken and how best to respond.

AIFA will help through this period but FSA must also show leadership by better informing firms about the status of guidance, how supervisors will assess compliance, and, ideally, what the benefits are for firms of this guidance.

The need for clearer regulatory sign-posting

AIFA fully supports FSA’s move toward a more principles based regulatory regime. However, firms need help and support from the regulator during this transition – especially when the transition affects such matters as a “down

grading” of rules into guidance. Part of the regulator’s duties during this period is to effectively sign-post where changes are proposed and what the impact of those changes will be. We are deeply concerned that CP 07/23 fails this test. The title of the CP fails to convey its meaning, the text’s notation style is dense, and more worryingly, the impact on firms is unclear.

The target audience for the CP appears to be wholesale firms – but its impact will also be felt by retail firms.

Outsourcing and compliance

FSA will be aware that one result of MPBR, is the greater use of compliance consultancies of all shapes and sizes. AIFA has found a significant increase in the number of compliance firms wanting to be “approved” by us and would suggest FSA will find a similar clamour (NB AIFA does not approve compliance firms).

It is still the case that compliance consultancies vary in quality considerably and many are actually a barrier to firms reaching required standards, as their advice is so poor. One clear outcome of CP 07/23 will be an increase in firms wanting FSA to either regulate compliance providers or publish approved lists of compliance providers. We suggest more could be done in co-operation with, for instance, the Compliance Institute, to drive up standards. An alternative may be for FSA to publish its list of organisations regularly used to undertake “skilled persons reports”.

Transition period

We would suggest that the requirements laid on firms to meet these proposals will actually require a period of considerable transition. We feel that a 1st October date to have implemented the proposals is unrealistic and simply does not allow firms sufficient time.

Even in a benign economic environment the 1st October date would be significantly ambitious, given the current market turmoil we feel that a much longer transition period is needed and would recommend 1st October 2009.

3. Answers to specific questions

Q1: Do you agree with our proposal to extend the common platform to non-scope firms predominantly as guidance and disapply SYSC 2 and 3 to them? If not, please tell us why.

Given our comments above, we would suggest FSA has not proven the case to extend the common platform. This is not to say that we are against the move but have not had a strong case presented as to the costs and benefits of the move.

We are also concerned about how elongated the handbook is becoming through the addition of so much extra text as guidance. Our comments about the need to allow firms to have certainty are particularly appropriate here.

Given that FSA can support the proposals with a thorough cost / benefit analysis, the remainder of our answers support the move – with caveats as appropriate to each answer.

Q2: Do you agree with our proposal to extend the common platform provisions on business continuity to non-scope firms as guidance? If not, please tell us why.

We are broadly in agreement.

Q3: Do you agree with our proposal not to extend the SYSC 4 accounting requirements to non-scope firms? If not, please tell us why.

Yes we agree. The current twice-yearly RMAR submissions are sufficient.

Q4: Do you agree with our proposal to extend this monitoring rule to non-scope firms as guidance only? If not, please tell us why.

No. This should be excluded altogether as it is unnecessary. The current TCF obligations suffice.

Q5: Do you agree with our proposal to extend SYSC 4.2.1 to non-scope firms as guidance and disapply the current SYSC 3 provisions?

Yes.

Q6: Do you agree that we should extend this guidance on segregation of duties to non-scope firms? If not, please tell us why.

Where applicable, we do not object to this guidance being applied, but it must be proportionate. It should be borne in mind that, for some small firms, it would be impractical and unrealistic for no one individual to be completely free to bind the firm as suggested in Paragraph 3.4.(page 12). Fair and sensible application of the guidance will be key to its success. If the proposals are adopted, non-MiFID

firms will see 'guidance' put in place instead of rules. We are concerned about how much weight the 'guidance' will have and any powers of enforcement that may result and seek further clarification.

Q7: Do you agree with our proposal to extend as guidance the provision that firms ensure relevant persons are aware of the procedures they must follow to discharge their responsibilities? If not, please tell us why.

Yes.

Q8: Do you agree with our proposal to extend SYSC 5.1.14 to non-scope firms as guidance? If not, please tell us why.

The concept is fine but the practicality of following such guidance and its relevance for many smaller retail firms give us cause for concern. Any application of such guidance should, again, be proportionate.

Q9: Do you agree with our compliance proposals? If not, please tell us why.

We agree with these proposals.

Q10: Do you agree with our proposed guidance on internal audit? If not, please tell us why.

The key is that the internal audit function should be applied 'where appropriate and proportionate'. It must be recognised that setting up an internal audit department which is separate and independent from other functions and activities would not be appropriate or beneficial for many small and even medium-sized firms.

Q11: Do you agree with our proposed guidance on risk control? If not, please tell us why.

The tone of SYSC 3.2.10G is actually quite different to SYSC 7 in that where 'it **may** be appropriate [to set up a separate risk assessment function] (SYSC 3.2.10G) SYSC 7.1.6 R states that a firm **must** [... establish and maintain a risk management function that operates independently etc...]. To say that these two pieces of guidance are substantially the same ignores the impact of the change in regulatory tone, especially on a small retail business. We would fully support a retail firm's right and moreover, its responsibility, to determine how appropriate it would be to set up a separate risk assessment function etc. To say that a firm 'must' do so without making clear just how much weight the Guidance will carry, and at which point in a firm's development its business discretion may be over-

ridden by FSA supervision, risks creating ambiguity and confusion post 1st October. The unintended consequence of pursuing a swift and elegant 'intelligent copy-out' of MiFID could be difficulties for the regulator and firms alike if the impact of this and similar moves on all sectors regulated by FSA, not just wholesale, is not fully thought through.

Q12: Do you agree with our proposed rule that, where outsourcing a critical or important function, a firm must remain responsible for discharging its regulatory obligations? If not, please tell us why.

We agree that firms must remain responsible and this is in the main achieved through appropriate due diligence, e.g. when selecting and using a particular provider's Platform(s). Although we are not aware of firms being under any illusion that they could discharge regulatory responsibilities (e.g. the fact sheet for small firms *Using a Compliance Consultant* states quite clearly 'You cannot contract out your regulatory obligations ...') we do not object to 8.1.6R being applied to non-scope firms.

Q13 Do you agree with our proposal to apply these SYSC 8 provisions as guidance for non-scope firms? If not, please tell us why.

Yes.

Chapter 7 – Record-Keeping

Q14: Do you agree with our proposal to extend the high level record keeping provisions in SYSC 9.1.1R to non-scope firms and disapply the current provisions? If not, please tell us why.

Personal Investment Firms (PIFs) tend to keep records for far longer than they are obliged to as the lack of an effective statute of limitations, and a legal long-stop, means that they could have to deal with a regulatory complaint at any time.

The professional indemnity insurance industry also imposes record keeping requirements on firms that go beyond those established by the regulator.

The proposed record keeping requirements are unlikely to make much difference to current practice. We suggest that FSA maintains its focus on this matter through the Retail Distribution Review.

Q15: Do you agree with our proposal to extend the SYSC 9

guidance on providing records in English to non-scope firms and disapply the existing provisions? If not, please tell us why.

We agree. FSA must have ready access to records in English.

Q16: Do you agree with our proposal to delete the record-keeping provisions in INPRU (INV) 3, 5 and 13? If not, please tell us why.

No objections.

Chapter 8 – Conflicts of interest

Q17: Do you agree with the modification of the SYSC 10.1.8R requirement for insurance mediation activity?

We wonder why COB provisions have been referred to (para 8.3, p21) as they were superseded in November last year, but apart from that have no comment to make.

Q18: Do you believe disclosure in a durable medium would be too disruptive to established practice in other areas?

AIFA believes that it is necessary for firms to manage their conflicts of interest, have a robust policy which is regularly reviewed, and seek to bring potential conflicts to the attention of their consumers. An essential part of this process is to identify those conflicts which are material and those which are not.

Given the requirements to manage conflicts of interest (Principle 8), and to treat customer fairly (Principle 6), more focus should be given to disclosing those conflicts that are material, in a way that is appropriate for the consumer. Inappropriate means of disclosure can be disruptive.

Q19: Do you agree with our proposal on conflicts of interest? If not, please tell us why.

We agree that a conflict identified is not necessarily a conflict managed, but, for small firms, we would argue that it is more than half-way to being managed. Moreover, TCF Outcome 1 (Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture) would not be met if conflicts of interest were not managed. A new rule changing the status of disclosure is not in keeping with the move towards more principles-based regulation and is not necessary. TCF Outcome 1 and Principle 8 are again sufficient.

Q20: Do you agree with our proposal to extend SYSC 10 to non-scope firms that produce investment research? If you do not, please tell us why.

This affects our members indirectly, so our concern is for integrity to be maintained in this area.

Q21: Do you agree with our analysis of the impact on section 150 rights of action? If not, please tell us why.

We agree. As S150 still covers COBS, the facility remains for a 'private person' to bring action.

Chapter 9 – Apportionment and oversight

Q22: Do you agree with our proposal to disapply SYSC 2 and CF8 and to extend SYSC 4.3 to those non-scope firms which have at least one governing function under the approved persons regime? If not, please tell us why.

Although the proposal aims to give non-MiFID firms greater flexibility, SYSC 4.3.2R(1) involves producing annual written reports on various matters covered in SYSC 6 and 7 which does not currently have to happen. It could be more burdensome for a firm to comply with SYSC 4.3 than for a CF8 to meet his or her responsibilities to FSA's satisfaction as at present. The unintended consequence of this proposal could be more paperwork and confusion as to accountability for various apportionment and oversight functions. We do not agree with disapplying CF8 at the moment.

SYSC 4.4.1R (8) states that the Apportionment of Responsibilities rule applies to sole traders. Further clarification of how a sole trader should interpret the rule would be appreciated.

Chapter 10 – PRIN and client categorisation

Q23: Do you agree that we should continue to allow firms conducting business other than designated investment business to classify clients as eligible counterparties for the purpose of the application of PRIN? If not, please tell us why.

Our only comment is that where a client is an elective as opposed to a per se eligible counterparty, a firm should evidence clearly that the client has opted to be treated in this way.

Q24: Do you have any comments on the nature and scale of the costs and benefits arising from our proposals?

The proposals include clauses stating provisions are to be applied proportionately to firms 'taking into account the nature, size and complexity of their activities'. This is a welcome stance in theory. However, definitions of 'proportionate' may differ between sections of the industry and the regulator. Costs may be incurred debating this issue and regulatory uncertainty at this point in the economic cycle will not be welcomed by firms who were warned by FSA to 'brace themselves' in this year's Financial Risk Outlook.

We wish to see firms being given the benefit of the doubt and being supported where they are clearly attempting to interpret Guidance responsibly and with TCF consumer outcomes in mind.

Q25: Do you agree with our view that areas not covered here are not material for CBA? If not, can you identify which changes you think will have material impacts and are not covered by our analysis?

We have no further comments to make here.

**AIFA
March 2008**