Consultation Paper

10/8**

Financial Services Authority

Pure protection sales by retail investment firms:

remuneration transparency and the COBS/ICOBS election

March 2010

FSA®

Financial Services Authority

Contents

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by Monday 28 June.

Comments may be sent by electronic submission using the form on the FSA's website at (www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10_08_response.shtml).

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1 Overview

1.1 This Consultation Paper (CP) sets out proposals for pure protection[1] sales by investment advisers. In summary, we are proposing the following new rules:

- Retail investment firms must explain how they are remunerated for pure protection services associated with investment advice and disclose the amount of commission they receive if the customer then purchases a pure protection product. This applies to either personal recommendations for pure protection or arranging the sale of pure protection products.
- Amending our rules to allow firms who elect to sell pure protection under the Conduct of Business Sourcebook (COBS), rather than the Insurance Conduct of Business Sourcebook (ICOBS), to continue to do so after the Retail Distribution Review (RDR) is implemented without having to apply the rules on Adviser Charging to their pure protection sales.

1.2 We also give an update on our thinking on reading-across RDR 'independent' and 'restricted' labels.

1.3 We are grateful to the firms and trade associations who have provided us with information as we have developed these proposals.

Background

1.4 We have been considering over the past year what impact the RDR will have on pure protection sales and, given that many retail investment firms also sell pure protection, whether we need to make changes to our approach to regulating pure protection in light of the RDR. In CP09/18, we set out the close links between the investment and pure protection advice markets and identified possible areas of risk for consumers if we did not make any changes to our regulatory approach for pure protection, but implemented the RDR for investment advice.

1 Critical illness cover, income protection and non-investment life insurance.

1.5 In CP09/31, published in December 2009, we set out some of our conclusions on read-across, noting that we did not see a case for introducing Adviser Charging for pure protection sales, because it would not address the key problems that we observe in these markets for consumers (although firms may apply Adviser Charging to their pure protection sales if they wish.) We noted that there may be some merit in reading-across the 'independent' and 'restricted' labels, which will be required for investment advice, and we asked a question about how enhanced professional standards might be appropriate for pure protection sales. A further update on these read-across issues is given in Chapter 3.

1.6 In addition to these conclusions on read-across, we have identified two issues that arise from the RDR that we think need to be addressed in relation to the sale of pure protection by retail investment firms. This chapter describes our proposals.

Outline of proposals

1.7 First, we have considered the impact of the new RDR rules on the option currently in place that allows firms to elect to sell pure protection under the COBS rather than ICOBS rules. Consistent with our decision not to introduce Adviser Charging rules for sales under ICOBS, we are proposing to allow firms to elect to apply the COBS rules to their pure protection sales, without requiring them to apply the Adviser Charging rules to those sales.

1.8 Our second proposal relates to remuneration transparency. When a customer is paying an adviser charge for investment advice and the firm also arranges or gives advice on pure protection, the customer may believe that the cost of the pure protection advice is included in that adviser charge, when in fact the adviser may earn additional commission income from the pure protection sale. If the customer understands that the adviser is remunerated separately by the provider for the pure protection sale, it may alter their perception of the value of the adviser charge. The RDR will introduce changes that aim to ensure consumers purchasing investment advice have a clear understanding of what they are paying for – a lack of transparency in associated pure protection sales and advice could undermine this. As a consequence, we are proposing that all firms explain how they are remunerated for pure protection services associated with investment advice and disclose the amount of commission received if the customer then purchases a pure protection product.

1.9 We have also set out an alternative proposal that requires retail investment firms to disclose the commission on all their pure protection sales. This captures more sales than necessary to meet our policy objectives, but firms may prefer a more straightforward rule that requires disclosure depending on the firm's permission, rather than one based on the relationship with a particular customer. We are seeking feedback on whether this option is preferable.

Who should read this paper?

1.10 This CP will be of interest to firms who give both investment advice and advice on pure protection products or arrange their sale. It will also be of interest to pure protection providers.

1.11 The update on RDR read-across will be of interest to all pure protection advisers.

1.12 Consumer representative groups will be interested in the proposal on remuneration transparency, as its objective is to put consumers in a better position to understand the adviser charge that they agree with their adviser and the amount the adviser is paid by the provider for advising or arranging pure protection sales.

Timetable

1.13 Responses to this consultation should reach us by Monday, 28 June. We expect to issue a Policy Statement with final rules in September. However, we will be mindful of the review of the Insurance Mediation Directive (IMD) and consider how possible changes at a European level may impact our proposals and timetable.

2 Proposed changes

2.1 Our proposals apply to firms that give both investment advice and provide advised and non-advised services for pure protection. They do not apply to firms who sell or advise on pure protection but do not give investment advice.

2.2 Throughout, we use the term 'pure protection services' to refer to either making personal recommendations on pure protection products or arranging the sale of pure protection products.

Selling pure protection under COBS

2.3 Since June 2007, firms have been able to elect to sell pure protection products under the COBS rules, instead of the ICOBS rules. Firms are required to keep a record of this election but are not required to report to us which rulebook they elect to comply with. We do not have our own data on the number of firms that elect to sell under COBS. According to an informal survey by the Association of Independent Financial Advisers (AIFA) of some of its members (in late 2008), it appears that approximately 40% of pure protection sales by retail investment firms is under ICOBS, and 60% is under COBS. Some providers have told us that they estimate 80% of their intermediated sales of pure protection sales are under COBS rules.

2.4 If we make no changes to the election, firms who elect to sell pure protection under COBS will have to apply all the COBS rules, including Adviser Charging, after December 2012. We believe that there is a case for making a change that allows firms to elect to sell pure protection under COBS, but does not require them to apply the rules on Adviser Charging (and so they will be able to continue to receive commission for those pure protection sales).

2.5 This is consistent with the approach we set out in CP09/31, which explained that we do not believe remuneration structures are a key driver of the problems we see arising for consumers with pure protection sales. Since we do not believe that continuing to receive commission on pure protection sales is currently of material detriment to consumers, we cannot identify at present any consumer detriment that would arise from allowing firms to apply the COBS rules to their pure protection sales, but not the Adviser Charging rules.

2.6 If we do not make this change, many firms may want to switch from COBS to ICOBS so they can continue to receive commission on their pure protection sales. The differences between the COBS and ICOBS rulebooks are limited (with the exception of Adviser Charging) and many firms successfully operate both regimes at present. However, since we cannot currently identify any consumer detriment that would arise from allowing firms to apply the COBS rules but not the Adviser Charging rules, we believe that we should make this rule change so that firms can avoid these costs altogether. Firms can still opt to apply the Adviser Charging rules to their pure protection advice if they wish.

Q1: Do you agree that we should change our rules that allow firms to elect to sell pure protection under COBS so that they can do so without applying the Adviser Charging rules to their pure protection business?

Commission disclosure

2.7 We are not proposing any new requirements regarding how firms can be remunerated for their pure protection sales. Firms may adopt fee or commission-based remuneration models. However, we think there is a case for requiring increased transparency about remuneration where pure protection services are provided to a consumer who will receive investment advice from the firm or who has received investment advice in the previous 12 months. There is currently no requirement in ICOBS for firms selling pure protection to consumers to explain how they are remunerated or disclose the amount of commission they receive for selling pure protection products. Our view has been that the consumer is most interested in the total amount of premium they must pay, rather than how the firm is paid or the amount it receives. However, when a consumer is paying an adviser charge for investment advice and is also receiving pure protection services, they may believe that the adviser charge covers all the services provided. If they understand that the firm is remunerated separately by the provider for the pure protection sale, it may alter their perception of the value of the adviser charge.

2.8 To address this problem, we are proposing that, before services are provided, firms must explain how they will be remunerated for pure protection services and if they will receive any commission from the provider in the event that a pure protection policy is purchased. The actual amount of commission should be disclosed at the earliest practicable opportunity, so that the customer can understand the cost of the overall service, including the services covered by the adviser charge.

2.9 The objective is that the customer understands what the adviser charge covers, which minimises the risk of the customer having the mistaken impression that the adviser charge covers all the services provided and that no other remuneration is received.

2.10 The proposal encompasses both advised and non-advised sales of pure protection (although we understand that non-advised sales associated with investment advice are relatively rare).

2.11 Our intention is that the proposed rules will apply to sales under ICOBS or COBS. This assumes that the proposed change to the COBS/ICOBS election is adopted. We have used this assumption throughout this section.

2.12 It should be noted that, although we do not have a requirement to disclose commission on pure protection sales in our ICOBS rules, guidance in ICOBS (following the position in common law) states that if the customer asks what the firm's remuneration is, the firm must tell them.[2] Firms should therefore already have the facility to disclose commission when asked.

Explanation of pure protection remuneration

2.13 The draft rules require firms to take reasonable steps to ensure that the customer understands how firms are remunerated for pure protection sales associated with investment advice. They further clarify that if the firm gives information about the adviser charge as part of an oral discussion, they must also give the information about pure protection remuneration orally. For firms who currently sell pure protection under COBS, these new rules replace the existing COBS 6.1.9R, which requires information to be provided on costs and associated charges.

Pure protection sales and advice 'associated' with investment advice

2.14 Our draft rules require advisers to explain remuneration and disclose commission where pure protection services are 'associated' with investment advice. Our proposed guidance explains that 'associated' means circumstances where the firm is likely to agree an adviser charge for investment advice with the customer or if it has done so in the previous 12 months.

2.15 This would exclude, for example, circumstances where firms are arranging a mortgage and also arranging a term assurance sale for the customer, where the firm has not agreed an adviser charge for investment advice within the previous 12 months. In these circumstances, it is reasonable for the firm to conclude that it is not likely to agree an adviser charge, since the purpose of the customer's interaction with the firm is the purchase of a mortgage and associated pure protection contract. It includes circumstances where the purpose of the customer's approach to the firm is to seek investment advice, and the firm and the customer then begin discussing adviser charges.

2.16 We recognise that the draft rules may include some transactions where there is a limited risk of the consumer linking the pure protection service with the adviser charge, because it is nearing the end of the 12 month period since an adviser charge was agreed. However, we believe this is less burdensome for firms than having a rule that is more open to different interpretations of when commission should be disclosed and more proportionate than a rule that is not time limited. We would welcome feedback on alternative ways of capturing pure protection services 'associated' with investments that meet our objectives.

2 ICOBS 4.4.3 G (2)

2.17 If firms find it difficult to identify the transactions for which they are required to disclose commission, they may choose to disclose commission for all their transactions. The cost benefit analysis is based on the premise that many providers will adopt this approach when facilitating disclosure by intermediaries where it is the lowest cost for them. We have also set out an alternative option below that would require retail investment firms to disclose commission for all their pure protection sales.

Commission equivalent and disclosure of indicative adviser charges

2.18 Bancassurers and other insurance providers who directly distribute their own products, where no commission is paid, should explain in the same circumstances as those outlined above how the customer will pay for pure protection services. The draft rules also require that they disclose a commission equivalent figure that represents the cost of advice and/or distribution (referring to the existing COBS rules on commission equivalent disclosure). Again, the objective is that the customer can understand the cost of the overall service, including the services covered by the adviser charge for investment advice.

2.19 Our draft rules allow an alternative option for insurance providers that personally recommend their own products. They may choose between disclosing an indicative adviser charge or a commission equivalent figure. The indicative adviser charge must be at least reasonably representative of the services associated with making the personal recommendation. So, providers can use the same methodology for calculating adviser charges for investments and pure protection, but they only need to disclose the figure for pure protection, rather than requiring the customer to pay the charge upfront.

Alternative option: disclosure according to a firm's permissions

2.20 We recognise that some firms may prefer to adopt an approach of always complying with the proposed remuneration transparency rules when they provide pure protection services because it will be more straightforward than identifying particular transactions based on whether or not an adviser charge is likely to be agreed or has been agreed in the previous 12 months.

2.21 Given this, as an alternative, we could make the rule itself simpler by requiring remuneration transparency for all pure protection transactions carried out by firms who give investment advice and provide pure protection services. That is, if the firm has permission to give investment advice and also advises on and arranges pure protection sales, they have to explain remuneration and disclose commission on all their pure protection sales.

2.22 The drawback of this approach is that it will capture transactions that are not in any way linked to investment advice. For example, for a firm that has both investment advisers and mortgage brokers who do not give investment advice, the mortgage brokers would be obliged to disclose commission on any pure protection sale because the rule applies to the firm not the adviser. It may also be a more costly option for firms, as they will be required to explain how they are remunerated

for all their pure protection transactions, rather than just those associated with investment advice.

2.23 We would be interested to hear from firms and other stakeholders about whether a simple rule, based on the permissions held by the firm, would be preferable to rules that only require disclosure where the pure protection service is associated with investment advice.

Summary

2.24 To summarise, our proposal is that advisers providing pure protection services in association with investment advice:

- explain before they provide services to the customer how they are remunerated for pure protection services; and,
- where relevant, explain if they will receive commission from the product provider in the event the customer purchases a pure protection contract; and
- disclose any commission received or (for product providers) disclose commission equivalent or an indicative adviser charge as close as practicable to the sale of the pure protection contract.

2.25 The rules apply to advised or non-advised sales of pure protection associated with investment advice, which are sales of pure protection under either COBS or ICOBS.

2.26 We believe our proposals for increased transparency will put the customer in a better position to evaluate the adviser charge in the context of all the services they are receiving. Understanding the amount of additional remuneration that their adviser will receive on top of the adviser charge may put some customers in a better position to negotiate the adviser charge or seek a reduction of the premium.

2.27 Firms who currently choose to sell pure protection under the COBS rules will already be disclosing commission under those rules. These firms need to ensure that they adequately explain how they are remunerated for pure protection advice before they provide services. This must be done orally where information about the adviser charge is given orally.

2.28 To be clear, we are not proposing any changes to remuneration transparency for ICOBS sales other than where pure protection sales are associated with investment advice. The need for the change proposed arises specifically because of the RDR – in other circumstances, there is no change in our view that the consumer is most interested in the total premium that they will pay. We have applied the same principle to COBS sales and so we are proposing to remove the requirement for commission disclosure for pure protection sold under COBS where these sales are not associated with investment advice, whether it is an advised or non-advised sale.

2.29 We have, however, outlined an alternative option, which requires an explanation of remuneration to be given, and commission to be disclosed, depending on whether the firm has permission to give investment advice and also provides pure protection services. This restricts firms' options, but may be simpler as it is less open to different interpretations of the circumstances in which commission should be disclosed.

Q2: Do you agree with our proposals for increased remuneration transparency for sales of pure protection products associated with investment advice?

Q3. Do you think our alternative proposal to require remuneration transparency according to the permissions held by a firm, rather than the circumstances of the transaction, is preferable?

Q4. Do you have any comments on our draft rules and guidance, particularly our guidance on the circumstances when a pure protection service is considered to be associated with investment advice?

3 Next steps

Consultation deadline

3.1 Responses to this consultation should reach us by Monday 28 June. We expect to issue a Policy Statement with final rules in September. Our intention is that firms will have to be compliant at the same time as the new RDR rules, by the end of 2012. We are, however, mindful of the review of the IMD and will consider how possible changes at a European level may impact our proposals and timetable.

RDR read-across to pure protection

'Independent' and 'restricted' labels

3.2 We indicated in CP09/31 that we would give further consideration to reading-across RDR labelling to pure protection. We have reassessed this in light of the results of our ICOBS Post Implementation Review (PIR) work, which included a review of a random sample of telephone sales for 11 firms selling critical illness cover and income protection, and associated consumer research. This confirmed that too many consumers have a limited and incorrect understanding of the cover and other features of their policies. In our view this creates a significant risk of poor outcomes. In our research work, we found that a common failing among advisers was inadequate explanation of the extent and limitations of cover. We will be publishing a summary of our findings in due course. Our priorities now for pure protection are to deal with these issues – and we recognise that they will not be addressed by introducing a new labelling regime. We are therefore not planning to consult on read-across of RDR labelling in the near future. We will keep the issue under review, recognising it is relevant both for investment advisers and mortgage advisers.

Professionalism

3.3 We have asked an open question in CP09/31 on whether we should apply increased professional standards to pure protection advisers. We are now considering the feedback received and will publish a summary of feedback in June.

3.4 We will analyse the need for action in this area in the context of the problems with adviser explanations of cover mentioned above. Increased professional requirements

could be a way of raising adviser standards and one of the possible options for improving outcomes for consumers.

Other work on pure protection

3.5 We noted in CP09/31 that although we do not see a case for introducing Adviser Charging to pure protection sales, where we see new patterns of commission-driven sales arising that are of detriment to consumers, we will act. Our Financial Risk Outlook for 2010[3] outlined an emerging trend of intermediaries, particularly mortgage intermediaries, seeking to increase sales of other products, including pure protection products. We are concerned that the movement of intermediaries into product areas where they have little or no experience could give rise to conduct risks. As a result, we will be reviewing the sales standards of pure protection products by mortgage intermediaries.

3 Financial Risk Outlook 2010, FSA, P.61.

4 Consultation questions

Q.1 Do you agree that we should change our rules that allow firms to elect to sell pure protection under COBS so that they can do so without applying the Adviser Charging rules to their pure protection business?

Q.2 Do you agree with our proposals for increased remuneration transparency for sales of pure protection products associated with investment advice?

Q.3 Do you think our alternative proposal to require remuneration transparency according to the permissions held by a firm, rather than the circumstances of the transaction, is preferable?

Q.4 Do you have any comments on our draft rules and guidance, particularly our guidance on the circumstances when a pure protection service is considered to be associated with investment advice?

Q.5 Do you have any comments on our cost benefit analysis?

5 Cost benefit analysis

5.1 Sections 155 and 157 of FSMA require us to perform a cost benefit analysis (CBA) of our proposed requirements and publish the results. Specifically, we are required to publish 'an estimate of the costs together with an analysis of the benefits'.

5.2 The proposals analysed are:

- Amending our rules to allow advisers who elect to sell pure protection under the Conduct of Business Sourcebook (COBS), rather than the Insurance Conduct of Business Sourcebook (ICOBS), to continue to do so after the Retail Distribution Review (RDR) is implemented without having to apply the rules on Adviser Charging to their pure protection sales.
- Requiring retail investment firms to explain how they are remunerated for pure protection services associated with investment advice and disclose the amount of commission if the customer then purchases a pure protection product.

5.3 Firms that sell pure protection products and also give investment advice will be affected by the rules. We estimate up to 3,500 non-bank intermediaries selling pure protection products and also giving investment advice, 36 banks and building societies, and 68 product providers may be affected.[4]

5.4 To assess the impact of the proposed changes on firms, we held discussions with AIFA, the Association of British Insurers (ABI) and a number of intermediary firms in this market.

COBS/ICOBS election

5.5 Our proposal is to allow firms to elect to sell pure protection under COBS, without requiring them to apply the rules on Adviser Charging (so they will be able to continue to receive commission for those pure protection sales).

4 These figures are taken from FSA Product Sales Data, Retail Mediation Activities Returns for 2009, and Insurers' Annual Return for 2008.

Direct costs to the FSA

5.6 The amendments proposed will not result in material incremental costs to the FSA. There might be some costs of implementing the new rule but we expect them to be minimal.

Compliance costs incurred by firms

5.7 There are no compliance costs for firms as they will be allowed to continue their current practices of selling pure protection under COBS rules. If we did not make this change, firms currently selling under COBS would either have to introduce Adviser Charging for those sales, or switch to compliance with ICOBS.

Benefits of the proposal

5.8 The change will enable firms to avoid incurring costs of introducing Adviser Charging for their pure protection sales under COBS or switching to compliance with ICOBS. Firms can avoid having to switch to a different rulebook, having to familiarise themselves with a different set of rules and implementing slightly different requirements for their pure protection sales.

Commission disclosure

5.9 Our proposals require firms to:

- explain how they are remunerated for pure protection services associated with investment advice and indicate if they will be paid commission if the customer purchases a pure protection product; and
- disclose – at a point as close as is practicable to the time that the pure protection services are provided – the amount of commission to be paid.

5.10 The changes proposed in this CP are a consequence of the introduction of the RDR rules, published in PS10/6, *Distribution of retail investments: Delivering the RDR – feedback to CP09/18 and final rules*. Our intention is to implement the rules at the same time as the new RDR rules, so firms will already be making changes to their businesses to comply with those rules. This means that firms will be able to integrate the changes they need to make for this proposal into their changes for the RDR.

Direct costs to the FSA

5.11 The amendments proposed will result in minimal incremental costs to the FSA. Supervisors will incorporate the new rule into the existing process.

Compliance costs incurred by intermediary firms (IFAs, banks and building societies) providing pure protection services associated with investment advice

5.12 Since June 2007, firms have been able to elect to sell pure protection products under the COBS rules, instead of the ICOBS rules. Firms selling pure protection under COBS already have to disclose commission or commission equivalent. We expect

that these firms will continue to do this for all pure protection sales, rather than changing their processes to disclose in the specific circumstances where the sale is associated with investment advice. Some providers also include commission amounts in the documents they provide to customers regardless of whether the sale was under COBS or ICOBS.

5.13 We do not have our own data on the number of firms that elect to sell under COBS because, although firms are required to keep a record of this, they are not required to report to us which rulebook they elect to comply with. According to an informal AIFA survey of some of its members (in late 2008), it appears that approximately 40% of pure protection sales by retail investment firms are under ICOBS, and 60% are under COBS. Some providers have told us that they estimate 80% of their intermediated sales of pure protection sales are under COBS rules.

5.14 From our discussions with AIFA and intermediary firms, we found that one possible area that may result in a relatively significant cost is the increased length of time required for the advice process. Our draft rules require that firms take reasonable steps to ensure the customer understands how the firm will be remunerated for pure protection advice. They also require that where firms explain Adviser Charging orally, the information about pure protection remuneration is also given orally. As most pure protection sales are carried out face-to-face, we expect the majority of firms will need to give the explanation orally. There is no requirement in either COBS or ICOBS that they do this at present (the current requirement in COBS is only for written disclosure). Although we would expect that many firms will see this as a requisite part of helping their customers to understand the adviser charge, some firms may not necessarily give this explanation in the absence of a rule.

5.15 Although it is very difficult to gauge how much interaction a firm will have with customers due to differing levels of consumer engagement, estimates of an additional two to three minutes per customer have been made.[5] This additional work will be done by financial advisers whose average annual salary has been estimated as £45,000 including a standard overhead of 30% in accordance with the FSA's Standard Cost Model (SCM).[6] Therefore we estimate the incremental costs to firms to be £1 – £1.50 per customer. Given the latest available data on sales, there were approximately 1,560,000 pure protection transactions in 2008 (this excludes mortgage related sales as these are not captured by our proposals).[7] We estimate that approximately 83% of these pure protection sales were carried out by financial advisers, brokers, banks and building societies.[8] We have excluded sales through other channels, as these will not be sold through firms that also give investment advice. So, as a result of this proposal, the overall costs to intermediary firms will be in the region of £1.2m – £1.9m per year.

5 These estimates of incremental time are broadly in line with the estimates reported in CP07/11 *Insurance Selling and Administration*. We note that understanding the amount of additional remuneration that their adviser will receive on top of the adviser charge may encourage some customers to negotiate the adviser charge, so the overall sales time could increase significantly. However, in the short to medium-term we do not expect a significant number of customers to take the opportunity to renegotiate the adviser charge or a discount on the premium.

6 Real Assurance 2006 study on administrative burdens and the estimates used in the RDR analysis (PS 10/6 *Distribution of retail investments: Delivering the RDR – feedback to CP09/18 and final rules*).

7 The FSA does not collect data on sales of all three pure protection products, so we have used transaction data from Swiss Re's Term Health Watch 2009. This reports transaction data for 2008.

8 We have taken this figure from our PSD, which gives us the percentage of sales by these firms for CIC, CIC sold as a rider benefit and IP.

5.16 However, these estimates represent an upper bound for compliance costs, as we are unable to identify from existing data which of these sales are made by firms who also sell investments, so it overestimates the costs in this respect. The estimate also does not take into account the fact that some customers will buy more than one product at the same time.

5.17 In our discussions, intermediary firms indicated that, as firms will need to change their disclosure documentation to implement the RDR rules, the additional cost of adding an extra paragraph to deal with pure protection remuneration will be insignificant. Similarly, firms are likely to integrate the training required to implement these proposals into their RDR training programmes and the costs of doing so will be insignificant.

5.18 Firms' compliance monitoring will be revised to accommodate RDR changes and we expect that firms will integrate the monitoring of this new proposal into their new compliance programme at minimal additional cost. Discussions with a number of intermediary firms in this market have confirmed that these are sensible assumptions in relation to costs.

Compliance costs incurred by providers (including bancassurers) selling their own pure protection products associated with investment advice

5.19 Providers (including bancassurers) selling their own pure protection products will need to disclose a commission equivalent or indicative adviser charge when they sell their products in association with investment advice. We are not aware of any providers, other than bancassurers, who fall into this category (and are not already disclosing commission equivalent under COBS). Bancassurers already disclose a commission equivalent figure for their investment sales and firms have indicated that the costs of applying the same system to their pure protection sales would not be onerous. The estimate for extending their commission equivalent disclosure is included in the figures for provider costs.

Compliance costs incurred by providers

5.20 Providers currently facilitate disclosure of the cash amount of commission paid to advisers for those firms selling under COBS. Some providers choose to set up their systems to allow advisers to disclose for all pure protection sales, rather than discriminating between which intermediary firms sell under COBS or ICOBS.

5.21 The ABI has assisted us in estimating provider costs by taking some initial soundings from providers, covering approximately 50% of the pure protection market. From this information, we expect the aggregate level of one-off provider costs to fall within a range of £10m to £20m. We would be interested in hearing from providers if these costs appear to be reasonably representative, or whether there are additional factors that we are not yet aware of.

5.22 We understand that the impact of the proposals varies considerably depending on the firm's business model and what assumptions they make about how they will approach implementing the proposal. For example, some providers may facilitate adviser compliance with the new requirement by simply implementing disclosure for

all intermediary firms that sell pure protection and investments, without attempting to identify which particular transactions the disclosure requirements apply to. Other providers may choose to move to a model where they disclose commission only on those sales requested by the intermediary.

Alternative option: disclosure according to a firm's permissions

5.23 Providers indicated that it was important for there to be clarity over precisely when disclosure should be made and that it was preferable to have a requirement that applied to all the pure protection sales by retail investment firms. We have put forward an alterative proposal on this basis. A number of providers already disclose commission across all pure protection sales, without discriminating whether they are COBS or ICOBS sales. We expect that many will adopt a similar approach in relation to the proposed rules and so will disclose commission for all pure protection sales sold by retail investment firms. Since the majority of firms already disclose commission on their COBS sales, we do not expect this to cause difficulties for intermediaries.

5.24 The overall costs of this alternative option to intermediary firms are also in the region of £1.2m – £1.9m per year. However, it is less likely that this is an over-estimate for the alternative proposal. Although the estimate does not take into account the fact that some customers will buy more than one product at the same time, which is relevant to the estimate for both proposals, more transactions will be caught by the alternative proposal, resulting in more costs to intermediary firms.

Benefits of the proposal

5.25 Our proposals are designed to put customers in a better position to evaluate the adviser charge in the context of all the services they are receiving and their costs. Without making this change, it is possible that customers may misunderstand what their adviser charge covers. By understanding that their adviser receives additional remuneration if they purchase a pure protection product and knowing how much they will receive, customers are better placed to properly assess the value of the service being provided and the fee charged. The same applies to a scenario where a customer is paying an adviser charge for investment advice from a provider. Being given information about how they will pay for the pure protection services received will help them evaluate the overall value of the service.

5.26 Understanding the amount of additional remuneration that their adviser will receive on top of the adviser charge may encourage some customers to negotiate the adviser charge or seek a rebate of some of the commission through a reduced premium. However, in the short to medium-term we do not expect any significant number of customers to take this opportunity.

Q.5 Do you have any comments on our cost benefit analysis?

6 Compatibility statement

6.1 As required under Sections 155 and 157 of FSMA, here we set out how our proposals are compatible with our general duties under Section 2 of FSMA and the regulatory objectives set out in Sections 2 – 6 of FSMA. We also outline how our proposals are consistent with our principles of good regulation to which we must have regard.

Compatibility with our statutory objectives

Consumer protection

6.2 Our remuneration transparency proposals are designed to put consumers in a position to enable them to properly evaluate the adviser charge, helping them to understand what it covers and what additional sources of remuneration there are for the adviser. They may encourage some consumers to negotiate the adviser charge or a discount on the premium.

6.3 Our proposals to allow firms to elect sell pure protection under COBS without applying the Adviser Charging rules are consistent with our decision not to require Adviser Charging on pure protection sales, as we do not believe Adviser Charging will address the problems that we see arising for consumers with these products.

Compatibility with the principles of good regulation

6.4 Section 2(3) of FSMA requires us to consider certain principles when carrying out our general functions. We set out below how our approach supports these principles.

The need to use our resources in the most efficient and economic way

6.5 We have proposed the minimum necessary action to address the need for remuneration transparency for pure protection sales alongside investments.

6.6 The changes to the COBS/ICOBS election are a technical amendment that will enable firms to avoid the costs of changing their compliance systems to a different set of rules.

The responsibilities of those who manage the affairs of authorised persons

6.7 Our proposals do not impact on these responsibilities.

The restrictions we impose on the industry must be proportionate to the benefits that are expected to result from those restrictions

6.8 Our proposals in relation to remuneration transparency are the minimum necessary action to enable consumers to properly understand the value of the adviser charge. We have invited feedback on an alternative, which may be more straightforward for firms to implement.

6.9 The changes proposed to the COBS/ICOBS election are expected to save firms from the cost of switching to comply with a different set of conduct rules.

The desirability of facilitating innovation in connection with regulated activities

6.10 We do not believe our proposals will restrict innovation.

The international character of financial services and markets and the desirability of maintaining the competitive position of the UK

6.11 We do not believe the proposals will affect the competitive position of the UK.

The need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions and the desirability of facilitating competition between those who are subject to any form of regulation by the FSA

6.12 We do not believe the proposals will have an adverse effect on competition. All market participants who sell pure protection alongside investments will have to comply with remuneration transparency requirements.

Acting in a way that we consider most appropriate for the purpose of meeting our statutory objectives

6.13 We have developed proposals that give the greatest possible range of options for implementing the requirements, to allow flexibility for firms with different business models. Overall we believe these proposals are the most appropriate for the purposes of meeting our objectives.

Draft rules

[RETAIL DISTRIBUTION REVIEW (PURE PROTECTION) INSTRUMENT 2010]

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making power);
(b) section 145 (Financial promotion rules);
(c) section 156 (General supplementary powers); and
(e) section 157(1) (Guidance); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

F. The Insurance Conduct of Business sourcebook (ICOBS) is amended in accordance with Annex C to this instrument.

Citation

G. This instrument may be cited as the [Retail Distribution Review (Pure Protection) Instrument 2010.]

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

indicative adviser charge	a cash equivalent figure which is indicative of the cost to the *pure protection contract* provider of the services associated with making a *personal recommendation* in relation to a *pure protection contract*.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text.

6.4.4A R If the *firm* or its *associate* is the *pure protection contract* provider, it may comply with *COBS* 6.4.3R(1)(b) and (c) by disclosing to the *consumer* an *indicative adviser charge* as an alternative to a *commission equivalent*.

6.4.4B R The *indicative adviser charge* must be at least reasonably representative of the services associated with making the *personal recommendation* in relation to the *pure protection contract*.

6.4.4C G An *indicative adviser charge* is likely to be reasonably representative of the services associated with making the *personal recommendation* if:

(1) the expected long term costs associated with making a *personal recommendation* and distributing the *pure protection contract* do not include the costs associated with manufacturing and administering the *pure protection contract*;

(2) the allocation of costs and profit to the *indicative adviser charge* and product charges is such that any cross-subsidisation is not significant in the long term; and

(3) were the *personal recommendation* and any related services to be provided by an unconnected *firm*, the level of the *indicative adviser charge* would be appropriate in the context of the service being provided by an unconnected *firm*.

Annex B

Amendments to the Insurance Conduct of Business Sourcebook (ICOBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1 Annex 1 Application (see ICOBS 1.1.2R)

…

Part 2

…

Pure protection contracts: election to apply COBS rules

3.1 R (1) This sourcebook (except for *ICOBS* 4.6) does not apply in relation to a *pure protection contract* to the extent that a *firm* has elected to comply with the Conduct of Business sourcebook (*COBS*) in respect of such business.

(2) Within the scope of such an election, a *firm* must:

(a) comply with the rest of the *Handbook* (except for *COBS* 6.1AR, *COBS* 6.1BR and *COBS* 6.1.9R) treating the *pure protection contract* as a *life policy* and a *designated investment,* and not as a *non-investment insurance contract*; and

(b) if applicable, also comply with *ICOBS* 4.6.

(3) A *firm* must make, and retain indefinitely, a record in a *durable medium* of such an election (and any reversal or amendment). The record must include the effective date and a precise description of the part of the *firm's* business to which the election applies.

After ICOBS 4.5 insert the following new section. The text is not underlined.

4.6 Commission disclosure for pure protection contracts sold with retail investment products

4.6.1 R This section applies to a *firm* if it has agreed an *adviser charge* with a *consumer* within the immediately preceding 12 months, or, it is likely to agree such an *adviser charge*, and it:

(1) makes a *personal recommendation* to a *consumer* in relation to a *pure protection contract*; or

(2) *arranges* for a *consumer* to enter into a *pure protection contract*.

4.6.2 R A *firm* must:

(1) in good time before the provision of its services, take reasonable steps to ensure that the *consumer* understands:

(a) how the *firm* is remunerated for its services in relation to *pure protection contracts;* and

(b) if applicable, that the *firm* will receive *commission* in relation to the *pure protection contract* in addition to the *firm's adviser charge*;

(2) as close as practicable to the time that it makes the *personal recommendation* or *arranges* the sale of the *pure protection contract*, comply with the following disclosure requirements, substituting *pure protection contract* for references to *packaged product*:

(a) *COBS* 6.4.3R; or

(b) *COBS* 6.4.4AR and *COBS* 6.4.4BR; and

(c) *COBS* 6.4.5R.

4.6.3 R If a *firm* expects to provide, or provides, information about its *adviser charge* orally, it must also provide the information required by *ICOBS* 4.6.2(1)(a) and *ICOBS* 4.6.2(1)(b) orally.

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