

# Preliminary Discussion Paper



## **Principal Issues of a More Principle Based Regime**

The FSA is proposing to implement a regime in which there are fewer rules and more principles. This should allow firms to find more ways than one of meeting the required outcomes and in turn therefore provide a less prescriptive environment than is currently the case. With the current rulebook in excess of a thousand pages, it is clearly necessary to endeavour to reduce this both in size and perhaps more importantly make the content more relevant and manageable. One of the main problems is the wide range of firms covered by the Handbook, which makes it very difficult to pull out the relevant rules.

A more principle based regime is therefore evidently desirable and particularly relevant for the international wholesale business undertaken in the UK. However when addressing the non wholesale business, first of all it is necessary to appreciate that such firms are from homogenous either in the services that they offer, their business model or their client/customer base. “Non wholesale” therefore ranges from the product provider/product sale model of the IFA community, commonly referred to as retail, through the execution only internet broking sites and on to the personalised portfolio management service for the high net worth individual. Some of these firms are capitalised but many are not and from the current consultation on the funding of the FSCS, failures in the uncapitalised sectors are high. Referring to them all as “retail” results in these differences not having sufficient visibility and yet this is an essential part of considering where and how principles are relevant to this business.

There are therefore a number of issues that needs to be considered at the start for the non-wholesale firms and the main ones are as follows:-

- i) If the industry is to move to a principle based regime, then the supervisory teams will also need to understand how to regulate in such an environment both when visiting firms and when undertaking desk top supervision. There is a need amongst supervisors to appreciate different interpretations and to move away from the check list mentality.
- ii) A common view will need to be achieved between the FSA and the Financial Services Ombudsman on how to make judgements in a more principle based regime. FOS has a different remit to the FSA and the result of this is firms can abide by FSA requirements but still find that the complainant can win their case at FOS. A move to a more principle based regime will inevitably increase the jeopardy to firms unless the FOS and the FSA can agree common standards, interpretations and the recognition of judgement.
- iii) Trade associations will be required to write more guidance for their member firms on how to apply the principles. Such guidance however will not be as

secure a safe harbour for their firms as rules which are on a statutory basis, not all relevant firms are members of a trade association, and the cost for such an ongoing exercise will be substantial either requiring firms to pay greater subscriptions to the trade associations or the TAs pulling back from other work.

- iv) Writing such guidance will inevitably change the role of trade associations. Although at present APCIMS probably issues more assistance and help, letters, notes and booklets to its members than most trade associations, this is done against a demand from members and not as a result of being required to do so by the FSA.
- v) In a recent discussion with our members, it became very clear that firms were not necessarily in favour of a trade association having a duty to write guidance. Firms consider the a TA should be taking up issues with the regulator and that there would be clear conflicts between writing guidance as required by a regulator and taking up regulatory concerns with that same regulator.
- vi) When a firm has difficulties it is common for at least a proportion of the problem to be laid at the compliance officer's door. This can range from the obvious culpability of not ensuring correct implementation and compliance with requirements, through to not whistle blowing. In a principle based regime, compliance officers are likely to be more exposed and our survey to-date shows that they view a principle regime with greater concern than the front office.
- vii) With failure rate already high in some parts of the non-wholesale sector with an existing detailed rulebook, one can only anticipate that such failures would increase under a principle based regime where these firms no longer have the current degree of prescription.
- viii) In such a heterogeneous section of the financial services community it is difficult to see how any one area of rule reduction could be appropriate for the entire group of firms.
- ix) There are costs associated with moving to a principles based regime and these need to be fully assessed at the outset of the project.

Having raised these points we recognise that it is not impossible to resolve them. However we feel that it is particularly important that they are addressed in advance rather than picked up as a consequence following a move to a more principle environment. We would anticipate that an agreement with FOS is not without difficulty, but unless there is such an agreement the arrival of MiFID coupled with the undertaking not to gold plate in itself presents the regulators and regulated with a more principles regime environment.

### **The Role of MiFID Connect**

The role of MiFID Connect in seeking to write industry guidance is a helpful template in which APCIMS is actively participating and is indeed one of the founder members. Nevertheless, the cost of MiFID Connect is high and arguably has only been maintained at

its current level because the associated law firm anticipates that they will be able to gain substantial post MiFID business as a consequence of their involvement with the project.

### **Splitting the Advice Permission**

Considering further the variability within the non-wholesale sector, we believe that there could be some real merit in splitting this sector up into its constituent parts. At present, the FSA's advice permission covers a very broad range of different business models. Therefore advice for a product sale and advice with investment management are in the same category, yet the relationship with the client, the ongoing nature of the service offered and related responsibilities and the firm's business structure is very different. We therefore would first of all suggest that consideration is given to splitting the advice permission into two - that is advice with investment management is one permission and advice with product sale is another permission. Advice with investment management is evidently more easily linked to the more principled regime proposal than the advice with product sale model.

### **Subdividing Further**

Splitting advice in this way could result in an evident anomaly whereby a large number of IFAs apparently are left with a very large rulebook. It would therefore be necessary to adjust their rulebook accordingly. For example, a scenario can be envisaged such that these firms are then offered a choice between being regulated for the sale of simple product only or being regulated for a wider range of products and services but having to be capitalised better as a consequence and the rule book and permissions adjusted accordingly.

### **The Advice Spectrum**

Firms who offer advice will now be categorised in one of the following options:-

- a) Advice with investment management – firms would be subject to MiFID and CRD; would include private client firms; potential for moving towards a more principles based regime.
- b) Advice with product sale of a range of products – firms would be out of MiFID and CRD; would include the broader based firms in the IFA community; some capitalisation required; some options for principles.
- c) Advice with simple product sales – firms would be out of MiFID and CRD; would include the more limited IFA firms and others; would not necessarily be more capitalised than at present; restrictions on what they sell; rules based.

### **The APCIMS Firms**

As a general rule, APCIMS firms would be identified into the category of giving advice with investment management – that is they would have a long term relationship with the client. Where this occurs, then as a first consideration we would consider that the areas where moves could be taken to introduce a more principle regime as:

- Disclosure – such as disclosure of risk, commission and other transparency issues
- Best execution including best execution policies
- Portfolio risk modelling
- Conflicts of interest
- Financial Promotion

This list is evidently limited and currently consultation is taking place within our community to flesh it out.