



# RDR and Trail Commission

When will this tale – or trail – end?

Financial Services

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## When will this tale – or trail – end?

We seem to have been talking about the Retail Distribution Review (RDR) and trail commission for an awfully long time. You would have thought, with the publication of the final rules last month, that all the "i"s had been dotted and all the "t"s had been crossed. But, alas, it would appear not. There is one particular aspect – one very important aspect for providers and advisers – that still appears to be causing some anxiety.

The final rules, published in early November, reflect the FSA's long-standing policy intention that trail commission can continue to be paid after the end of 2012 for pre-RDR advice, and that advice post-RDR must be paid for by way of adviser charges.

And then, in the middle of November, Consultation Paper CP11/26 was issued to address the question of legacy commission. The FSA acknowledge that the terms 'trail commission' and 'legacy commission' have meant different things in other contexts, and it is therefore worth repeating here their meanings in CP11/26:

- Trail commission – ongoing commission that is payable for advice provided pre-RDR
- Legacy commission – additional commission that might have become payable in relation to legacy assets (that is, an asset which was originally purchased as a result of advice given pre-RDR) where there has been a change or addition to the product or investment post-RDR.

Consideration of legacy commission naturally leads on to the question of what constitutes advice and what does not constitute advice. CP11/26 addresses this by proposing amendments to the Perimeter Guidance Manual in which they identify a whole range of typical recommendations and then set out whether each is deemed to constitute advice or not.

**The FSA acknowledge that the terms 'trail commission' and 'legacy commission' have meant different things**

So let's consider a recommendation to pay an additional lump sum into a particular fund (where the investment was originally advised on pre-RDR). The recommendation to pay the additional lump sum is clearly advice. And the FSA's intention here is clear – that adviser charging applies to the additional investment though trail commission

can continue to be paid on the original investment. An easy principle to understand and an easy principle to accept in many ways ... were it not for the practical implications such as amendments to product providers' systems.

With serious IT costs prompting providers to consider removing the option for customers to make additional contributions to pre-RDR products, the ABI protests that this ban on legacy commission will potentially create a bias away from top-ups into existing products, thereby raising the likelihood of unfair customer outcomes. Whilst potentially a credible argument, it is unlikely, however, to carry sway with the FSA who are sticking to their guns and arguing the other way around; that allowing such legacy commission would potentially create a systemic bias towards top-ups into existing products. Indeed, the FSA's position is reinforced by the final rules which, after all, are based on post-RDR advice being paid for by way of adviser charges (even though trail commission can continue to be paid after the end of 2012 for pre-RDR advice).

But, much more importantly, where does this all leave fund switching? Few would argue with the assertion made in CP11/26 that a recommendation to switch funds within an investment constitutes advice. There is no new money involved here and so there doesn't appear to be any 'additional commission' that might become payable (which is how legacy commission has been defined in CP11/26). Providers and advisers might take the view that the trail commission can continue. If only the FSA's final rules and Consultation Paper CP11/26 were that clear.

The FSA's final rules are based on clearly separating pre-RDR advice (continuation of trail commission) and post-RDR advice (adviser charging). One wonders how fund switching on an existing investment, which is post-RDR advice, might fit into that.

And nor does CP11/26 make anything clearer. Indeed, rather ominously, there is talk of "buying new units" being effectively the purchase of a new product; and adviser charging applying on "the product becoming a different product"; and also the definition of legacy commission refers



to “a change to the investment”. Confusing language maybe, but a little worrying nonetheless.

Could the FSA possibly intend for trail commission to cease on a fund switch? If that were the case then it would potentially create a bias away from advising clients on the funds in their existing investments. And, arguably, it may be but a small step for the FSA to extend their logic and conclude that a recommendation to leave the funds as they are constitutes advice and therefore leads to the cessation of trail commission.

**The ABI protests that this ban on legacy commission will potentially create a bias away from top-ups into existing products**

The FSA's policy intentions need to be made clear, and these intentions need to be clearly and explicitly reflected in the rules and the guidance. Whilst CP11/26 does state that 'trail commission for pre-RDR advice can continue to be paid until it ends naturally', this is too important an issue to be left to interpretation.

Strong engagement from industry in the consultation process is essential in order to achieve the clarity that all participants require.

## HOW BDO CAN HELP YOU MAKE THE MOST OF THE RDR

### What we can do

We can offer a fully managed solution to addressing the changes under RDR, help identify the key areas that you need to address and provide expert assistance where needed.

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## WHY BDO

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- We provide services to clients in 119 countries and have teams in all the major financial services centres
- Our clients range from domestic financial services firms to complex global financial services groups. We therefore bring a unique view to the issues faced by firms across the whole distribution chain in responding to RDR challenges.

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