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## REGULATORY IMPACT ASSESSMENT

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### PROPOSED CHANGES TO SECONDARY LEGISLATION UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000

#### PURPOSE AND INTENDED EFFECT

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- 1 The objective of the changes is:
  - **Item 1. To facilitate the provision of investment advice and other debt-related support by Citizens Advice Bureaux and similar advice centres.** In particular to enable non-profit making advice centres whose principal financial services activity is debt advice (a) to provide generic financial advice, (b) to refer and/or introduce clients to financial advisers which have been authorised by the Financial Services Authority (FSA), (c) to provide specific financial advice to clients in particular circumstances, and (d) to make financial promotions to clients in particular circumstances, in all cases without the advice centres being subject to the financial promotion regime, as long as the advice and other support they provide is independent and clients are not charged.
  - **Item 2. To facilitate the promotion by employers of improved pensions uptake by employees.** In particular to enable employers to make real time and non-real time promotions to employees which relate to group personal pension schemes and to stakeholder pension schemes, without the employers being subject to the financial promotion regime, in circumstances where (a) employers make a financial contribution to the pensions they are promoting and disclose the size and nature of this contribution, (b) written promotional material informs employees of their right to seek independent advice from FSA-authorized persons, and (c) employers do not make a direct financial gain from making promotions.
  - **Item 3. To clarify and narrow the scope of which particular activities are considered to be financial promotions and hence need to be undertaken or approved by persons authorised by the FSA.** In particular to reduce the scope of the financial promotion regime at the margin, including (a) to ease the regulation of communications between bodies corporate and their members and creditors, (b) to ease the regulation of promotions covering more than one activity, (c) to ease the regulation of introductions to FSA authorised persons and appointed representatives, (d) to ease the regulation of promotions by companies whose securities are admitted to a market which is not subject to regulation under the Financial Services and Markets Act 2000 ('FSMA'), (e) to ease the regulation of promotions made to overseas investors and UK high net worth companies at the same time, (f) to clarify that employers promoting share options as part of employee share schemes remain outside the scope of financial services regulation, and (g) to clarify that only mere conduits for a communication and not other persons are outside the scope of financial services regulation.

- **Item 4. To increase the range of investments which can be made by occupational pension fund trustees without involvement of an FSA authorised person, and to ease restrictions on the provision of advice to occupational pension fund trustees.** In particular (a) to enable unauthorised occupational pension fund trustees to invest in pooled investment vehicles and contracts of insurance in addition to the products in which they are already permitted to invest without the involvement of an FSA authorised person, (b) to require unauthorised occupational pension fund trustees to obtain and consider independent advice rather than requiring them to act in accordance with it, and (c) to enable such advice to be provided by professional firms which operate under Part XX of FSMA.
- **Item 5. To clarify and withdraw the boundary of which particular activities are considered to be regulated activities and hence need to be undertaken by persons authorised by the FSA.** In particular (a) to broaden at the margin the exclusion from financial services regulation which currently applies to dealing in investments as principal, and (b) to enable unauthorised trustees to arrange for assets to be held by custodians and sub-custodians without themselves needing to be authorised by the FSA.
- **Item 6. To provide continued certainty to those engaging in electricity balancing and settlement activities that they are not subject to financial services regulation.** In particular to extend the existing exemption from financial services regulation applying to certain investment activities including investment advice associated with the balancing and settlement activities of the New Electricity Trading Arrangements (NETA), which applies in England and Wales, so that this exemption also applies in Scotland when NETA is superseded by the British Electricity Trading and Transmission Arrangements (BETTA).
- **Item 7. To enable the FSA to undertake certain regulatory functions more effectively.** In particular (a) to enable FSA notices to take effect when they are received, where it is essential to take immediate action, (b) to enable independent actuaries appointed to assist with the FSA's regulatory functions to be permitted at their discretion to disclose confidential information to the FSA which they come across outside their remit, where disclosure would help the FSA or actuary to discharge their responsibilities, and (c) to upgrade the authorisation requirements applying to Swiss insurance companies, including in relation to 'close links', and to improve the FSA's application of capital requirements to Swiss insurance companies.
- **Item 8. To ease the regulation of open-ended investment companies (OEICs).** In particular (a) to enable the FSA to issue written notices to OEICs rather than decision notices in certain circumstances, (b) to remove a requirement for the FSA to publish certain notifications in the London and Edinburgh Gazettes, (c) to enable the authorised corporate director of an OEIC to dispense with annual general meetings (AGMs) after giving 60 days' notice, (d) to enable new OEICs not to provide for AGMs, and (e) to enable the authorised corporate director of an OEIC to appoint other directors and to employ auditors where AGMs have been dispensed with, such directors being removable by ordinary resolution in an Extraordinary General Meeting (EGM).

2 These proposals are being considered in one regulatory impact assessment because all will be implemented by changes to secondary legislation relating to the boundary of financial services regulation. Guidance provided by the FSA and/or by the Government may supplement these legislative changes in some places. Moreover, all the proposals were consulted upon in one consultation document.

3 These objectives will be achieved by:

- **Item 1. Providing non-profit making advice centres with an exemption from the Financial Promotion Order<sup>1</sup>**, subject to the conditions outlined above. This will enable advice centres to provide debt-related advice and other assistance, for example with form-filling and referrals to FSA-authorized persons, whilst remaining outside the scope of the financial promotion regime.
- **Item 2. Providing employers with an exemption from the Financial Promotion Order**, subject to the conditions outlined above. This could be supplemented by guidance. This would make it easier for employers to promote the uptake of pensions to their employees, whilst remaining outside the scope of the financial promotion regime.
- **Item 3. Making a range of amendments to the Financial Promotion Order.** These changes would enable firms to engage in a wider range of promotional activities without needing to secure the approval of an FSA-authorized person for a promotion.
- **Item 4. Amending the Business Order<sup>2</sup>** to increase the range of investments which can be made by occupational pension fund trustees without the involvement of an FSA authorized person, and to ease restrictions on the provision of advice to occupational pension fund trustees. These changes would enable occupational pension fund trustees to invest in a wider range of instruments, to take advice from a wider range of sources and to question that advice where appropriate.
- **Item 5. Making a small number of amendments to the Regulated Activities Order<sup>3</sup>.** These changes would enable certain dealing in investments as principal to take place without requiring FSA authorisation, and would enable trustees to arrange for assets to be held by custodians and sub-custodians without trustees themselves needing to secure authorisation by the FSA.
- **Item 6. Amending the Exemption Order<sup>4</sup>** to replace the existing exemption relating to NETA with an exemption relating to BETTA which covers the same activities in the same circumstances and applies to the same types of party. This should enable the current electricity trading arrangements to continue to operate smoothly when NETA is superseded by BETTA.

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<sup>1</sup> Financial Services and Markets Act 2000 (Financial Promotion) Order 2001, SI 2001/1335 (as amended).

<sup>2</sup> Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001, SI 2001/1177 (as amended).

<sup>3</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/3544 (as amended).

<sup>4</sup> Financial Services and Markets Act 2000 (Exemption) Order 2001, SI 2001/1201 (as amended).

- **Item 7. Amending the Service of Notices Regulations<sup>5</sup>** to enable FSA notices to take effect when received when it is essential to take immediate action, **amending the Disclosure of Information Regulations<sup>6</sup>** to enable independent actuaries to pass information to the FSA as outlined above, and **amending the Variation of Threshold Conditions Order<sup>7</sup>** to modify the regulation of Swiss insurance companies as outlined above. These changes should enable the FSA to operate more effectively in relation to authorisation requirements, when investigating and assessing compliance with regulatory requirements, and when taking enforcement action.
- **Item 8. Amending the OEIC Regulations<sup>8</sup>.** This would enable OEICs to dispense with AGMs and to conduct the business which used to be undertaken via AGMs by more efficient means instead, and would enable the FSA to regulate OEICs more efficiently by easing the requirements placed upon the FSA.

4 Those mainly affected by the changes are:

- **Item 1. Non profit-making advice centres and their clients.** There are currently some 2,800 Citizens Advice Bureau outlets in the UK and adviceUK has a membership of around 1,000 independent information and advice centres. Non profit-making advice centres will benefit from greater legislative certainty and as a result might engage more in providing advice and related assistance on debt management to their clients, and the number of clients seeking this form of assistance might rise as a result. Persons currently authorised by the FSA are unlikely to be affected directly by these changes as the proposed exemption from financial services regulation would not apply to them, and the clients of non profit-making advice centres in many circumstances currently do not access advice from persons authorised by the FSA, i.e. the proposals should not result in business transferring from persons authorised by the FSA to non-profit making advice centres. Persons currently authorised by the FSA may be affected indirectly if they receive more referrals from non-profit making advice centres in future, and might benefit indirectly if the clients of non profit-making advice centres are able to manage their debts more effectively in future. 7 per cent of households have four or more credit commitments or are in arrears on household bill payments<sup>9</sup>, and 6.9 million families report some difficulties in meeting their debt repayments<sup>10</sup>.
- **Item 2. Employers who provide advice about group personal pension schemes and stakeholder pension schemes, and their employees.** Employers are more likely to promote the uptake of pensions more actively to their employees, and the number of employees seeking advice on pensions-related issues might rise as a result. Persons authorised by the FSA might be affected indirectly as the increased promotion of pensions in the workplace might lead to employers making more referrals to FSA authorised persons where employees seek individual advice. Persons authorised by the

<sup>5</sup> Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001, SI 2001/1420.

<sup>6</sup> Financial Services and Markets Act 2000 (Disclosure of Information by Prescribed Persons) Regulations 2001, SI 2001/1857.

<sup>7</sup> Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001, SI 2001/2507.

<sup>8</sup> Financial Services and Markets Act 2000 (Open-Ended Investment Companies) Regulations 2001, SI 2001/1228.

<sup>9</sup> "Over-indebtedness in Britain", a report for the DTI by Elaine Kempson, September 2002.

<sup>10</sup> ONS Omnibus Survey, September 2003.

FSA would also be affected indirectly if the uptake of pensions by employees rose, as whenever an employee takes up a pension there will always be an FSA authorised person involved somewhere in the sale process. 76 per cent of private sector employers with 20 or more staff offer stakeholder pension schemes, and 41 per cent offer group private pension schemes<sup>11</sup>.

- **Item 3. Persons making financial promotions.** The FSMA financial promotion regime will be clarified at the margin and the scope of this regime will be reduced at the margin. This should place a number of financial promotions outside the scope of financial services regulation. This may in turn lead to an increase in the scale of such promotional activity at the margin, and might indirectly affect the recipients of promotions as well as the providers.
- **Item 4. Occupational pension fund trustees and professional firms operating under Part XX of FSMA.** Occupational pension fund trustees will be able to invest in a wider range of instruments, in particular pooled investment vehicles and contracts of insurance without the involvement of an FSA authorised person. Indirectly this should benefit the providers of those instruments and should have positive implications for occupational pension fund performance. Occupational pension fund trustees will be able to obtain advice from Part XX firms, which may result in more advice being obtained from this source and more competition in the provision of advice. Occupational pension fund trustees will be able to question advice where appropriate and this might possibly raise the quality of advice provided and the quality of decision-making at the margin. The Occupational Pensions Regulatory Authority has indicated that there are currently around 94,000 occupational pension fund trustees. The FSA has indicated that about 17,000 professional firms currently operate under Part XX of FSMA.
- **Item 5. Shareholders dealing in investments as principal in certain circumstances, trustees, custodians and sub-custodians.** In particular circumstances shareholders will be able to solicit others with a view to acquiring more shares without being regarded as carrying on the regulated activity of dealing as principal. This is likely to apply in a limited range of circumstances. As a result the extent of this activity might rise in future at the margin, although any changes are likely to be small. Those engaging in this activity might benefit from avoiding the costs and implications of securing authorisation from the FSA. Trustees will be able to arrange for assets to be held by custodians and sub-custodians without needing to secure FSA authorisation themselves. This might lead to trustees making greater use of custodians and sub-custodians, which may indirectly enable trustees to manage assets more efficiently, and indirectly affect beneficiaries and other parties to the trusts in question, including by having a positive impact on the security of assets. The FSA has indicated that there are currently just over 2,300 authorised custodians and sub-custodians.

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<sup>11</sup> "Key Facts Compendium", Department for Work and Pensions, October 2004.

- **Item 6. The Balancing and Settlement Code (BSC) parties of NETA and BETTA.** The NETA exemption supports the smooth functioning of electricity balancing and settlement activities and avoids the need for dual regulation by Ofgem and by the FSA. This geographical scope of NETA is due to be extended to cover Scotland with the introduction of BETTA, and the NETA exemption from FSMA will be extended accordingly. As a result all BSC parties engaging in balancing and settlement activities should continue to benefit from the same exemptions as now, and their activities should be unaffected. Parties based in Scotland which currently do not participate in NETA should gain by being able to participate in BETTA on the same terms and conditions as other BSC parties. This should support the smooth running of BETTA. Ofgem has indicated that 164 BSC parties are currently registered under NETA and have also been registered under BETTA. Ofgem has explained that at least 3 more parties (from Scotland) are currently registered under BETTA and that up to 5 more parties (from Northern Ireland) are expected to register under BETTA.
- **Item 7. The FSA, independent actuaries, Swiss insurance companies, and those engaging in regulated financial services activities generally.** Some notices served by the FSA will take effect immediately, improving the effectiveness of enforcement action. This would affect all those subject to such notices plus investors, consumers and other regulated parties who might be connected to the recipient of such notices. Around 15 FSA notices are served per year in relation to the FSA's own-initiative variation of permission power which need to take effect immediately. Actuaries will be able to disclose more information to the FSA when assisting with the FSA's regulatory activities, and this should improve the effectiveness of FSA investigations at the margin. This would have indirect implications for those who might be subject to an FSA investigation plus any connected consumers and investors. Independent actuaries would be permitted to make disclosures to the FSA in circumstances where such disclosures would not otherwise be permitted, and making these disclosures might help the actuary discharge their functions under FSMA. The FSA does not make widespread use of actuaries to assist with its regulatory activities. Swiss insurance companies applying to be authorised by the FSA would need to provide marginally more information than is currently the case, especially in relation to 'close links'. Swiss insurance companies should not be subject to additional capital requirements.
- **Item 8. OEICs and the FSA.** OEICs will be able to dispense with AGMs and to conduct the business previously undertaken at AGMs via other more efficient means. This should improve the operational efficiency of OEICs and would indirectly affect OEIC shareholders. The FSA would be able to regulate OEICs more efficiently. Authorised unit trusts might be affected indirectly as OEICs would be regulated more similarly to authorised unit trusts, facilitating competition between these investment vehicles. The FSA has indicated that there are currently 305 OEICs and 987 authorised unit trusts.

- **In all cases, those who advise others on the boundary of financial services regulation, such as law firms.** The changes outlined above will affect the boundary of financial services regulation, and those providing advice on where the boundary of financial services legislation lies and on how persons might act accordingly would need to gain a firm understanding of the changes made.

## BACKGROUND

5 These changes are related to two features of the financial services regulation framework.

- Firstly, unauthorised firms or individuals carrying on regulated activities or making financial promotions risk civil or criminal sanctions where they act in breach of FSMA requirements. In the case of marketing financial products, the costs to an unauthorised person of obtaining approval for a communication made by someone who is authorised by the FSA might not be insignificant.
- Secondly, the definition of what constitutes the boundary of regulation in some cases might appear to be complicated and/or unclear.

6 These features have the effect that a cautious attitude may be taken by those who are unauthorised towards carrying on activities which are at or near the boundary of regulation. For example:

- A number of advice centres seem to have been reluctant to assist clients on financial services issues because of uncertainties about the scope of FSMA regulation.
- Many employers have been reluctant to promote the uptake of pensions because of uncertainties about whether they are subject to the financial promotion regime.
- Occupational pension fund trustees have been inclined to delegate asset allocation decisions to authorised fund managers. This may increase the likelihood of pension funds concentrating on certain types of investments such as quoted equities and gilts, and investing less than optimal amounts in other asset classes.
- Unauthorised firms may wish to consult professional advisers more frequently about the boundary of regulation.

7 The legislation governing the regulation of financial services in the UK is the Financial Services and Markets Act 2000 (FSMA). The changes will amend the statutory instruments under FSMA which define the boundary of regulation. Details of these statutory instruments are provided above.

## RISK ASSESSMENT

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8 These changes aim to address the following risks:

- **Item 1. Consumers and investors with debt management problems often find it difficult to access advice and other support** from persons authorised by the FSA, or find it difficult to access such advice and support easily and/or at reasonable cost to themselves given their circumstances. Advice centres have sometimes been reluctant to provide advice and support to these people because of the uncertainties about whether advice centres need to be authorised by the FSA. As a result consumers and investors are often not provided with debt management assistance. There is a risk that this would continue if the above-mentioned changes were not adopted.
- **Item 2: Many people are currently under-saving for retirement.** Employers have been reluctant to provide information about pensions to their employees because of the risks that if they make unlawful promotions they might be committing a criminal offence. Where employers have been willing to provide some information, in many cases they have been cautious about providing supplementary information for example in response to staff questions. If these issues were not addressed there is a risk that many people would continue to under-save for retirement.
- **Item 3: A number of financial promotions are not being made at present, or are being made subject to the expense of securing the approval of an FSA authorised person.** Investment opportunities might not be promoted to potential investors and consumers as a result, or might not be promoted as efficiently as might otherwise be the case, or the returns to investment might be lower as a result of the increased costs of promotion. There is a risk that these downsides might be perpetuated if the above-mentioned changes were not adopted.
- **Item 4: Occupational pension fund performance is subject to regulatory restrictions** as a result of which trustees might be investing in too narrow a range of instruments, might be taking advice from too narrow a range of sources, and might not be questioning that advice sufficiently. There is a risk that an opportunity to support improved occupation pension fund performance might be missed if the above-mentioned changes were not adopted.
- **Item 5: Trustees are restricted in how they hold the assets under their control.** As a result of trustees not being able to use custodians and sub-custodians (without trustees themselves needing to be authorised by the FSA), trustees might not be managing their assets as efficiently as might otherwise be the case, and those assets might not be held as securely as might otherwise be the case. These issues would not be addressed if the above-mentioned proposals were not adopted.

- **Item 6: Electricity Balancing and Settlement Code (BSC) parties are uncertain that, without a specific exemption, they do not need to secure FSA authorisation.** If BSC parties which are not authorised by the FSA engage in regulatory activities which are caught by FSMA then any related contracts might be unenforceable. In order to avoid this, authorisation from the FSA might be sought in addition to existing regulation by Ofgem, or BSC parties might not engage in certain balancing and settlement activities. This might have adverse implications for costs and for balancing the electricity grid. There is a risk that these adverse implications might surface unless the NETA exemption is updated to reflect the introduction of BETTA.
- **Item 7: The FSA's abilities to assess certain authorisation applications, to be kept informed of facts which are relevant to the FSA's functions, and to take certain enforcement actions are curtailed in some areas.** In particular the FSA has relatively limited powers to secure information from Swiss insurance companies which wish to be authorised, independent actuaries appointed to assist with the FSA's regulatory functions are restricted in what information they may disclose to the FSA, and FSA notices do not come into effect when they are received in instances where immediate action is needed. There is a risk that the FSA's effectiveness will continue to be impaired at the margin if the above-mentioned changes were not adopted.
- **Item 8: OEICs are subject to regulatory requirements which are costly but which provide limited if any investor protection, and which might have an adverse impact on competition in the collective investment scheme sector.** In particular the requirement for OEICs to hold AGMs is costly and the business reserved for AGMs could be conducted more efficiently via other means. Certain requirements placed on the FSA in relation to publishing OEIC notifications and serving OEIC notices serve a limited purpose and/or their purpose could be achieved more effectively via other means. There is a risk that these burdens would not be relieved if the above-mentioned changes were not adopted.

9 The following risks apply to the changes being made:

- **Item 1. There are potential risks that consumers or investors might receive inadequate, poor-quality or self-interested advice from advice centres.** In order to mitigate these risks a number of conditions have been attached to the exemption provided to advice centres: (a) advice centres should not be profit-making and should not benefit financially from assisting clients; (b) advice centres' principal financial services activity should be debt management advice; (c) the advice they provide should be free and independent; (d) the scope of the exemption from financial services regulation should relate closely to advice centres' areas of competence and experience. This exemption should be restricted in relation to financial promotions made by advice centres, and restricted further in relation to the provision of specific financial advice to clients; (e) advice centres should hold adequate levels of professional indemnity insurance cover, or a comparable guarantee, or advice centres should be a service provided by a local authority.

- **Item 2. There are potential risks that employees might receive inadequate, poor-quality or self-interested advice from their employers.** In order to mitigate these risks a number of conditions have been attached to the exemption from financial services regulation provided to employers: (a) the exemption should apply in relation to group personal pension schemes and stakeholder pension schemes; (b) employers should make a financial contribution to the pensions they are promoting and should disclose the size and nature of their contributions; (c) employees should be informed of their ability to seek independent advice from persons authorised by the FSA when they receive written promotional materials; (d) employers should not make a direct financial benefit from making promotions; (e) employers should be encouraged by guidance not to provide specific advice to individuals; (f) employers should be encouraged by guidance to ensure that their representatives are competent and knowledgeable.
- **Item 3. There are potential risks that reducing the scope of the FSMA financial promotion regime at the margin might lead to financial promotions being made which ought to have been approved by a person authorised by the FSA for the sake of avoiding possible consumer or investor detriment.** To mitigate these risks changes to the FSMA financial promotion regime have been limited to largely technical areas where the scope for possible detriment is reduced.
- **Item 4. There are potential risks that unauthorised occupational pension fund trustees might ignore the advice they receive and make inappropriate investment decisions, or that they might act in accordance with advice provided by Part XX firms which is of an inadequate quality, or that they might invest in more risky instruments to the detriment of their funds.** Occupational pension fund trustees are subject to a general duty of care, however, and are unlikely to ignore expert advice without good reason. Enabling them to challenge expert advice might lead to higher-quality advice being provided in future. Part XX firms are professionally qualified, subject to the discipline of designated professional bodies. The risks that they will provide poor-quality advice are small. The wider range of instruments in which occupational pension fund trustees will be permitted to invest without the involvement of an FSA authorised person are generally no more risky than the current range of instruments in which they are permitted to invest.
- **Item 5. Minimal risks** are associated with allowing trustees to arrange for assets to be held by custodians and sub-custodians, where appropriate, and with allowing some shareholders not to be regarded as dealing in principal when engaging in a narrow range of dealing activities.
- **Item 6. There are potential risks of investor and consumer detriment from the provision of unregulated advice in relation to the balancing and settlement activities of NETA.** There has been no evidence of such detriment to date, nor any evidence suggesting that this exemption is subject to much, if any, use. Extending the NETA exemption to cover BETTA is unlikely to generate such risks. There are risks that if a balancing and settlement activity turns out to be an activity which ought to be regulated by the FSA, then the absence of an exemption from FSMA might render any associated contracts unenforceable. These risks are small, and would be eliminated by extending the NETA exemption to cover BETTA.

- **Item 7. Minimal risks** are associated with improvements to the service of notices by the FSA, with increasing independent actuaries' ability to disclose information where actuaries decide that this is appropriate, and with improving the FSA's regulatory treatment of Swiss insurance companies.
- **Item 8. There are potential risks that by dispensing with AGMs, OEIC shareholders will be in a weaker position to hold OEIC performance to account.** Any such risks would be mitigated by the fact that shareholders will be able to convene EGMs to address specific concerns as and when they arise. AGMs are generally not used to hold OEIC performance to account.

**In general, there are potential risks that these changes might be inconsistent with other government and/or regulatory initiatives,** for example those relating to the increased uptake of private pensions, and relating to improvements in financial capability. These changes are designed to complement all other related initiatives, however, and should not have any adverse implications for other initiatives.

## OPTIONS

### Not to legislate

10 Without legislative change, the various situations outlined would remain as they are. In particular the features of the financial services regulation framework outlined in paragraph 12.5 would continue to have the effects outlined in paragraph 12.6 and the consequent risks of possible detriment outlined in paragraph 12.7 would materialise.

### Non-legislative options

11 These are available to some extent. In particular, FSA guidance could interpret the boundary of regulation. On the other hand, guidance cannot define the law. Moreover, if the legislation which is interpreted by guidance specifies the boundary in a confusing way, guidance will not be able to mitigate that. The problems described above have arisen despite the existence and use of FSA guidance.

### Legislation

12 Paragraph 12.3 explains which legislative instruments would be used to address which of the objectives set out in this regulatory impact assessment.

## COSTS AND BENEFITS

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13 The costs and benefits below are of the changes to legislation compared with the option of not legislating.

14 The sectors affected will be:

- Non-profit making advice centres.
- Employers which provide workplace pensions.
- Firms which are not authorised by the FSA but are carrying on an activity at or near the boundary of regulation.
- Firms which are authorised by the FSA.
- Occupational pension fund trustees and trustees making use of custodians and sub-custodians.
- Professional firms operating under Part XX of FSMA, other legal and financial advisers, actuaries.
- Custodians and sub-custodians.
- Electricity Balancing and Settlement Code (BSC) parties.
- OEICs.

### Benefits

15 The following benefits are anticipated (these are not readily quantifiable):

- Advice centres will be able to provide financial advice and debt-related assistance to their clients with greater legislative certainty, to the benefit of the advice centres themselves and their clients alike. This may help the clients of advice centres manage their debts better. Advice centres would also be able to provide this advice and assistance without needing to be authorised by the FSA. If advice centres were to seek authorisation from the FSA and were treated similarly to independent financial advisers they would incur an initial £1,500 authorisation fee and annual fees which vary according to the number of advisers. If an advice centre used two advisers to provide financial advice this annual fee would be almost £2,500. If this initial authorisation fee was applied only to the members of adviceUK and to Citizens Advice Bureaux, total fees of £5.7m would be levied. If each of these advice centres used two advisers to provide financial advice total fees of £9.5m would be levied per annum from advice centres which are members of these two networks. Additional fees are associated with the Financial Ombudsman Service and Financial Services Compensation Scheme. In addition to fees advice centres would incur regulatory compliance costs which might also be sizeable. A rule of thumb is that the cost of compliance is four times the direct cost of FSA fees. A recent study<sup>12</sup> estimated that the median incremental compliance costs facing a firm are 1.6 per cent of that firm's non-regulatory operating costs. Additional one-off compliance costs might be incurred at the outset by advice centres as they determine what the

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<sup>12</sup> Costs of Compliance: A Report by Europe Economics, June 2003.

implications of FSA rules are for the way they operate, and how their operations might need to be modified as a result.

- Employees are likely to receive more information about pensions from their employers. This should help employees make more informed choices about pension provision. Employers would also be able to provide this advice and assistance without needing to be authorised by the FSA. As with advice centres, if employers were to seek authorisation from the FSA and were treated similarly to independent financial advisers they would incur an initial £1,500 authorisation fee and annual fees which vary according to the number of advisers. If an employer used one representative to provide financial advice this annual fee would be just over £1,500. Additional fees are associated with the Financial Ombudsman Service and with the Financial Services Compensation Scheme. In addition to fees, employers would incur regulatory compliance costs which might also be sizeable, as outlined above. Additional one-off compliance costs might be incurred at the outset by employees as they determine what the implications of FSA rules are for the way they operate, and how their operations might need to be modified as a result.
- At the margin it will be possible to make more flexible financial promotions, and it will be possible to make some promotions without needing to be authorised by the FSA or without needing to secure approval for the promotion from an FSA authorised person. The market for approval of financial promotions does not appear to be particularly liquid. In some cases approval is part of an investment bank's service for the particular transaction in question, and a separate discrete fee might not be charged. Some smaller corporate finance boutiques are understood to charge a flat fee of £25,000 for approval of a financial promotion.
- Occupational pension fund trustees will not be deterred from investing in certain asset classes by the need to secure FSA authorisation. This may lead to trustees investing in a broader portfolio of investments, with positive implications for occupational pension fund performance. Occupational pension fund trustees will be able to secure advice from a wider range of sources and to challenge that advice where appropriate. This increased competition in the supply of advice from a wider range of sources, some of which might have a lower cost base, may reduce the cost of securing advice and raise the quality of advice provided;
- Trustees will be able to arrange for assets to be held by custodians and sub-custodians without themselves needing to be authorised by the FSA. Those dealing in shares as principal in particular circumstances will be able to do so without needing to be authorised by the FSA.
- Those engaging in electricity balancing and settlement activities will be provided with continuing certainty that they will not need to secure authorisation from the FSA. If balancing and settlement parties wished to secure FSA authorisation to obtain legal certainty that contracts would always be enforceable then industry members have indicated that annual FSA fees of around £15,000 would be required, and annual compliance costs of between £50,000 and £150,000 would be incurred. Additional costs would be incurred at the outset understanding the implications of FSA rules on business operations, and it has been suggested that these costs might approach £90,000. Applying these figures to all electricity balancing and

settlement code parties implies that initial costs of £18m might affect the industry followed by annual costs of up to £28m.

- The FSA will be able to serve certain notices more effectively, actuaries will be able to disclose certain information to the FSA in particular circumstances, and the FSA will have improved powers to assess authorisation applications from Swiss insurance companies.
- OEICs will be able to dispense with AGMs and to conduct the business which would have been undertaken at an AGM via more efficient other means. The costs of holding an AGM usually range from £5,000 to £10,000, amounting to total costs of £3m for all OEICs.

## Costs

16 These changes are almost entirely deregulatory and would not generate new or additional regulatory costs, because the purpose of the changes is to:

- Clarify and simplify particular regulatory requirements, especially in relation to financial promotion, thereby reducing the need for certain promotions to be approved by FSA authorised persons.
- Provide greater regulatory certainty that a range of activities may be undertaken without the need to secure authorisation from the FSA. These activities would include those associated with electricity balancing and settlement.
- Redefine the boundary of regulation in a number of places, thereby reducing the application of regulatory requirements, including by allowing occupational pension fund trustees to invest in a wider range of instruments and to take advice from a wider range of sources, easing the regulation of OEICs, reducing the scope of the FSMA financial promotion regime in a number of areas, enabling trustees to arrange for assets to be held by custodians and sub-custodians, and enabling certain dealing as principal not to be regulated.
- Enable the FSA to operate more effectively, by improving the service of FSA notices, enabling actuaries to disclose information to the FSA in certain circumstances, not requiring the FSA to publish certain OEIC notifications, enabling the FSA in certain circumstances to issue written notices to OEICs rather than warning notices, and enabling the FSA to consider authorisation applications from Swiss insurance more effectively.

17 It is possible that some costs might be generated in the following areas:

- If non-profit making advice centres choose to provide more advice and debt-related support to clients there might be resource implications for those advice centres, including perhaps in relation to the cost of professional indemnity insurance cover (although the exemption from financial services legislation provided to advice centres is designed to accord with their current areas of experience and competence, and this should have positive implications for the cost of professional indemnity insurance cover). Other advice centre services might be re-prioritised in order to accommodate any resource implications from providing more advice. Alternatively, advice centres might seek additional funding from their sources, or might seek to attract additional (voluntary) human resources,

perhaps from persons associated with the financial services industry. In summary it is difficult to predict and quantify the cost implications for advice centres. Any increase in costs experienced by advice centres would not be imposed by the exemption from financial services regulation which advice centres will be given, instead costs would arise from advice centres making use of the proposed regulatory freedoms. They are likely to do so only if the benefits of using these freedoms outweigh the costs.

- If employers promote the uptake of pensions more to their employees there might be resource implications for both employers and employees, for example in terms of staff time and resources taken to present and consider the information, in terms of the costs of producing any promotional material, written and oral, and in terms of ensuring that employer representatives are knowledgeable and competent. It is difficult to quantify these costs up front as they would depend upon the extent to which employers make use of their exemption from financial services regulation. As with advice centres, any rise in costs would not be imposed by the exemption provided from financial services but would arise from employers making use of their new regulatory freedoms. Employers are likely to do so where the benefits of using these freedoms outweigh the costs. The proposed exemption from financial services regulation has been kept clear in order to help minimise any costs of understanding the new measures.
- Some occupational pension fund trustees may incur costs if they need to improve their levels of financial knowledge and understanding in order to be in a position to challenge within reason the advice which they receive. These continual professional development costs are difficult to quantify.
- There may be costs to those who provide legal and other advice about the boundary of financial regulation and how persons might act accordingly. Persons authorised by the FSA might also incur costs in understanding the changes which will be made. The simplifications, clarifications and other changes being made will need to be understood and reflected in advice which is provided and decisions which are made. These costs are difficult to quantify.
- There may be costs to Swiss insurance companies which wish to make authorisation applications to the FSA as a result of more information being provided to the FSA, especially in relation to 'close links'. These costs would depend upon the circumstances applying to each individual Swiss insurance company, and might be negligible. The number of Swiss insurance companies seeking to apply for FSA authorisation in the future is likely to be small.

18 In summary the unavoidable costs associated with this package of changes to FSMA secondary legislation relate largely to the costs of understanding the revised legislation and its implications. Legislative changes have been kept as straightforward as possible in order to help minimise these costs. The other categories of costs which might be incurred are largely associated with advice centres, employers and occupational pension fund trustees making use of the new exemptions or other reductions in regulatory requirements which will apply to them. These freedoms are only likely to be used if the benefits of doing so to these bodies outweigh the costs. In conclusion, to the extent that costs will be generated by the proposed changes to FSMA secondary legislation, these costs should be outweighed by the benefits of these deregulatory reforms, especially when wider factors are taken into consideration such as the benefits of people managing their personal debt situation better, the benefits of employees making sounder decisions about investing in their pensions, and the benefits of improved occupational pension fund performance.

## **EQUITY AND FAIRNESS**

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19 The Government supports steps to increase access for all consumers to financial advice and planning. The intended impact of these changes is that more people will have access to financial advice, in particular those for whom advice would otherwise be unavailable.

20 In terms of equity, clients of advice centres tend to be poorer than average. For example, adviceUK estimates that 60 per cent of its members' clients belong to socio-economic categories D and E. Moreover, the assumption is that they would be unlikely to receive advice elsewhere about financial services, for example from a financial adviser, given that they will not generally be looking for advice on where to make new investments but for advice about problems with debt and with existing financial products.

21 In respect of employers, a DWP survey<sup>13</sup> of those of working age found that 26 per cent would seek information and advice about pensions from their employer, the second most likely route by which information and advice would be obtained.

## **SMALL FIRMS' IMPACT TEST**

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22 The changes to the regulation of occupational pension fund trustees will reduce the extent of regulation when investing in private equity which is the corporate form of many smaller firms. None of the other changes are likely to impact more materially on small firms. Indeed, to the extent that the boundary of regulation is clarified, small firms, which are less likely to have compliance specialists, should benefit to a greater extent.

## **COMPETITION ASSESSMENT**

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23 No impact is foreseen on the position of individual firms, in the sense that the changes apply to all those doing particular activities and are not specific to particular individual firms.

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<sup>13</sup> Pensions 2002: Public Attitude to Pensions and Saving for Retirement, Research Report 193 by Victoria Mayhew.

24 Positive impacts on competition could potentially arise from the removal of requirements to secure authorisation from the FSA, or from the reduction of regulatory requirements.

- **Item 1: Enabling non-profit making advice centres to provide financial advice and other debt-related support might in theory mean that their clients seek less advice from other sources, in particular from financial advisers regulated by the FSA.** The particular changes proposed are designed to provide greater legal certainty to the existing position, however, rather than to generate a shift in client behaviour. Many of these clients are unable to access advice from persons authorised by the FSA, or are unable to do so simply and cheaply, i.e. there is a limited degree of potential overlap between the clients of advice centres and those seeking advice from FSA authorised persons. The exemption from financial services legislation provided to advice centres should apply in areas where advice centres have already developed experience and competence, and the conditions attached to this exemption should mean that advice centres do not compete on unfair grounds with persons authorised by the FSA. It is expected that advice centres will continue to refer their clients to persons authorised by the FSA in appropriate circumstances.
- **Item 2: Enabling employers to make financial promotions to employees about pensions might in theory mean that employees seek less advice from other sources, in particular from financial advisers regulated by the FSA.** In practice it is expected that employers will provide generic advice to employees on taking-up pensions, and will refer employees to FSA authorised persons when they are seeking specific financial advice relating to individual circumstances. The conditions attached to employers' exemption from financial services regulation are designed to ensure that employers' promotions complement the activities of FSA authorised persons rather than compete on unfair grounds against them. For example employers' written promotional material will explain that employees have a right to seek independent advice from FSA authorised persons. If employers succeed in promoting the increased uptake of pensions then more business would be undertaken by FSA authorised persons, as whenever a pension is taken up an FSA authorised person will always be involved somewhere in the process.
- **Item 3: Significant direct effects on competition are unlikely** to stem from clarifying and withdrawing at the margin the boundary of which particular activities are considered to be financial promotions.
- **Item 4: Competition amongst advisers and in other areas should be enhanced.** By enabling occupational pension fund trustees to invest in a wider range of instruments without the involvement of an FSA authorised person more competition might be generated amongst the providers of all instruments in which occupational pension fund trustees can invest. By enabling occupational pension fund trustees to seek advice from professional firms operating under Part XX of FSMA more competition might be generated amongst those who are in a position to advise occupational pension fund trustees.

- **Item 5: Significant direct effects on competition are unlikely** to stem from clarifying and withdrawing at the margin the boundary of which particular activities are considered to be regulated activities.
- **Item 6: Significant direct effects on competition are unlikely** to stem from providing continued certainty to those engaging in balancing and settlement activities that they are not subject to financial services regulation.
- **Item 7: Significant direct effects on competition are unlikely** to stem from enabling FSA notices to come into effect when they are received where it is essential to take immediate action. Although the disclosure provisions relating to independent actuaries appointed to assist with the FSA's regulatory functions would place actuaries in more of a similar position as other independent persons who have been appointed to assist the FSA, this is unlikely to have a significant effect on competition. Providing the FSA with improved powers to assess authorisation applications from Swiss insurance companies, especially in relation to 'close links', would bring the regulatory treatment of Swiss insurance companies in this regard closer to that of insurance companies from other companies. **The revised regulatory treatment of Swiss insurance companies would lead to more fair competition at the margin in the insurance sector.**
- **Item 8: OEICs should be able to compete on a fairer basis with authorised unit trusts.** Enabling OEICs to dispense with AGMs would enable OEICs to compete on more similar grounds with authorised unit trusts, which do not hold AGMs. Enabling the OEIC authorised corporate director to appoint other directors and to employ auditors would also bring the regulatory treatment of OEICs closer to that of authorised unit trusts.

## ENFORCEMENT AND SANCTIONS

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25 Enforcement of the changes will primarily be by the FSA. The FSA has a large range of sanctions at its disposal, including powers to levy fines or withdraw authorisation from regulated firms. The UK's law enforcement authorities and the courts would also have responsibilities for enforcement and the application of sanctions where breaches of legislation have occurred, especially more serious breaches.

## CONSULTATION

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26 There were 70 responses from interested parties on the 'Financial Services and Markets Act: two year review: Changes to secondary legislation' consultation document. The consultation period closed on 28 May 2004. The Government took due account of consultation responses in developing legislation set out in this document and held a number of additional discussions with some consultation respondents. Overall, the responses provided a sound basis to proceed with the changes. Consultation took place with the FSA and with the Takeovers Panel. Within the Government HM Treasury consulted with the Department for Trade and Industry and with the Department for Work and Pensions, including the Employer Task Force.

## MONITORING AND REVIEW

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27 The proposals for the changes set out in this regulatory impact assessment arose from a review of FSMA two years after it came into force. HM Treasury updates FSMA secondary legislation when it is appropriate to do so.

## SUMMARY AND RECOMMENDATION

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28 A number of changes will be made to the boundary of financial services regulation in order to:

- Facilitate the provision of investment advice and other debt-related support by Citizens Advice Bureaux and similar advice centres.
- Facilitate the promotion by employers of improved pensions uptake by employees.
- Clarify and withdraw the boundary of which particular activities are considered to be financial promotions and hence need to be undertaken or approved by persons authorised by the FSA.
- Increase the range of investments which can be made by occupational pension fund trustees without the involvement of an FSA authorised person, and ease restrictions on the provision of advice to occupational pension fund trustees.
- Clarify and withdraw the boundary of which particular activities are considered to be regulated activities and hence need to be undertaken by persons authorised by the FSA.
- Provide continued certainty to those engaging in electricity balancing and settlement activities that they are not subject to financial services regulation.
- Enable the FSA to undertake certain regulatory functions more effectively.
- Ease the regulation of open-ended investment companies (OEICs).

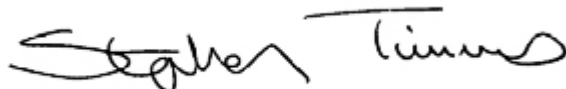
29 These changes will be implemented via secondary legislation under the Financial Services and Markets Act 2000.

## MINISTERIAL DECLARATION

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I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister, Stephen Timms MP, Financial Secretary to the Treasury.



Date: 25 November 2004

## CONTACT POINT

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