

# Application of conduct of business rules to customer categories

COB Rules <sup>1</sup>	Market Counterparties	Intermediate customers	Private customers
<b>1 Application and general provisions</b>	yes	yes	yes
<b>2 Rules of general application</b>			
Fair and clear communication	no	yes, but limited	yes
Inducements and soft commission	yes, but limited	yes	yes
Reliance on others	yes, but limited	yes	yes
<b>3 Financial promotion</b>			
Application	no	yes, but limited relevance	yes
Purpose	no	yes, but limited relevance	yes
Matters covered	no	yes, but limited relevance	yes
Territorial scope	no	yes, but limited relevance	yes
Exemptions	no	yes, but limited relevance	yes
Confirmation of compliance	no	yes, but limited relevance	yes
Records	no	yes, but limited relevance	yes
Form and content of financial promotions	no	yes, but limited relevance	yes
Direct offer financial promotions	no	no	yes
Unsolicited real-time financial promotions	no	yes, but limited relevance	yes
Unregulated collective investment schemes	no	yes, but limited relevance	yes
Approval of financial promotions of an overseas person	no	no	yes
Additional requirements for financial promotions for an overseas life office which has no permanent place of business in the UK	no	no	ye
The Internet and other electronic media	no	yes, but limited relevance	yes
<b>4 Accepting customers</b>			
[Customer status]	yes	yes	yes
Terms of business and customer agreements	no	yes	yes
Exclusion of liability	no	yes	yes
<b>5 Advising/Selling</b>			
Polarisation and disclosure of polarisation status	no	no	yes
Know your customer	no	yes	yes
Suitability	no	yes	yes
Note			
1 As set out in the draft Conduct of Business Sourcebook.			

COB Rules <sup>1</sup>	Market Counterparties	Intermediate customers	Private customers
Customers' understanding of risk	no	no	yes
Information about the firm	no	yes	yes
Disclosure of charges, remuneration and commission	no	no	yes
[Reasonable charges]	no	no	no
Customers introduced to clearing firms by overseas brokers	no	yes	yes
<b>6 Disclosure about products</b>			
General requirement for key features	no	no	yes
Packaged products – delivery of key features	no	no	yes
Packaged products – post-sale confirmation	no	no	yes
Key features – special situations	no	no	yes
Key features – life policies, schemes and ISA cash deposit components	no	no	yes
With-profits guides	no	no	yes
Projections	no	no	yes
Cancellation	no	no	yes
Insurance contracts – product disclosure	no	no	yes
<b>7 Dealing and managing</b>			
Conflict of interest and material interest	partial <sup>2</sup>	yes	yes
Churning and switching	partial	yes	yes
Dealing ahead	partial	yes	yes
Customer order priority	partial	yes	yes
[Best execution]	partial	yes, but opt out allowed	yes
[Timely execution]	partial	yes	yes
Allocation	partial	yes	yes
Realisation of a private customers' assets	no	no	yes
Customer borrowing	no	no	yes
Margin requirements	no	no	yes
Unquoted or suspended securities	no	no	yes
Personal account dealing	no	yes	yes
Dealing records	partial	yes	yes
<b>8 Customer reporting</b>			
Contract/confirmation notes	no	yes, but flexibility	yes
Account/portfolio statements	no	yes, but flexibility	yes
<b>9 Customer assets</b>			
Client assets general application	yes	yes	yes
Custody	yes, but modification allowed	yes, but modification allowed	yes
Mandates	yes	yes	yes
Client money	yes, but opt out or modification allowed	yes, but opt out or modification allowed	yes
Collateral	yes	yes	yes
Default provisions	yes	yes	yes
Notes			
1 As set out in the draft Conduct of Business Sourcebook.			
2 The partial application to business with market counterparties of rules in sections 2 and 7 is dependent on the outcome of this consultation, and would apply only for the purpose of protecting the underlying customers of an authorised firm.			

# Cost benefit analysis (CBA) of changes in proposed COBS

This Annex contains the results of CBA work which has been carried out on those areas of the COBS rules and guidance where changes have been proposed which could result in additional costs for firms of more than minimal significance. In some cases our analysis of the proposed changes has led us to the conclusion that any additional compliance costs are actually of minimal significance and therefore that a full CBA is not needed for those changes.

## 1 Cost benefit analysis of the record keeping requirements in COBS

### Introduction

- 1.1 The purpose of Cost Benefit Analysis (CBA) is to assess, in quantitative terms where possible, and in qualitative terms where not, the economic costs and benefits of a proposed new policy. Any CBA of a new regulatory proposal seeks to compare the new regulatory environment with the old. For the purposes of this CBA, we have specifically focussed on the real incremental changes that will arise as a result of changes made to the record keeping requirements in the Conduct of Business Sourcebook.

### Changes in the record keeping requirements

- 1.2 The incremental changes to the record keeping requirements contained in the draft COBS have been captured in tabular form in the Annex to this CBA. Here we have briefly summarised these changes:
  - For pension-transfers and opt-outs the minimum retention period stays 'indefinite'.
  - For other life and pensions business the minimum retention period is 6 years.<sup>1</sup> For SFA regulated firms this is a doubling in the minimum retention period.

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<sup>1</sup> In this CBA the term to 'other life and pensions business' refers to life and pensions business excluding pension-transfers and opt-outs.

For IMRO regulated firms this is a doubling of the minimum retention period for all records, other than dealing and allocation records. For the dealing and allocation records of IMRO regulated firms this raises the minimum retention period by a year.

- For unit trusts and securities business the minimum retention period is 3 years. For PIA regulated firms this is a halving of the minimum retention period. For the dealing and allocation records of IMRO related firms this lowers the minimum retention period by 2 years.

## Costs

### Compliance costs

- 1.3 For firms currently authorised by IMRO the 6 year record keeping requirements proposed in COBS for other life and pensions business means that records (other than dealing and allocation records) will have to be kept for 3 more years than currently required. However, for reasons listed below the FSA believes that this change should not lead to significant incremental costs being incurred by the firms.
  - a) Only a small proportion of the business transacted by these firms relates to life and pensions products. Based on the experience of frontline supervisors, the FSA's understanding is that no more than 5% of the business transacted by IMRO regulated firms relates to life and pensions.
  - b) Most of these firms use non-paper storage methods and keep records ad-infinitum (even without being subject to a regulatory obligation to do so). Based on the experience of frontline supervisors, FSA's understanding is that 70% of these firms now keep most of their records in non-paper form and that these firms account for 90% of transactions.
  - c) Market participants also say that it helps them with issues related to the Inland Revenue to store certain records electronically for longer than the minimum retention period. However, because it is not cost-efficient to sift through records and retain some while discarding others, firms tend to keep all records beyond their minimum retention period.
- 1.4 For firms currently authorised by SFA the 6 year record keeping requirements proposed in COBS for other life and pensions business means that records will have to be kept for 3 years more than currently required. However, for reasons listed below the FSA believes that this change will not lead to significant incremental costs being incurred by the firms.

SFA's membership rules stipulate that SFA regulated firms should derive no more than 10% of their total revenue from life and pensions transactions. This implies that even for SFA firms active in the life and pensions, this change does not effect the vast majority of their records.

In many instances (though far from all) the period for which firms keep records will be 6 years from the date of breach of term/ date of breach of contract/date of breach of duty of care/date of breach of fiduciary duty, etc. Prudence might suggest that a firm keeps records available to itself for the relevant limitation period. Thus in practical terms the extension of the record keeping period may not be material.

The FSA consulted with SFA regulated firms on this issue. SFA regulatees were of the view that doubling the record keeping requirement would not impose significant incremental costs on them either because the volume of their other life and pensions business was very small or because they currently keep records of other life and pensions transactions for at least 6 years.

- 1.5 For PIA, SIB and RPB regulated firms the new 6 year requirement should not lead to incremental costs as these firms already have to adhere to a similar requirement.<sup>2</sup>

### Consumer protection

- 1.6 For firms currently authorised by IMRO the 3 year record keeping requirements proposed in COBS for unit trusts and securities business means that dealing and allocation records have to be kept for 2 years less than currently required. However for reasons listed below the FSA believes that this change is unlikely to lead to consumers suffering a loss (in the degree of protection that the record keeping requirements provide them).
- 1.7 The existing IMRO records related to unit trust and securities business are of little use unless consumers make complaints or errors are identified and investigated for their initial occurrence and effects. The FSA estimates that in the unit trust area complaints represent 0.05% of new sales and 0.005% of all unit holdings. Corresponding figures for securities are expected to be even lower.
- 1.8 FSA regulators' experience suggests that only once or twice a year are records more than 3 years old are used for investigations.
- 1.9 As mentioned before, most IMRO regulated firms use non-paper storage methods and keep records ad-infinitum (even without being subject to a regulatory obligation to do so). Based on the experience of frontline supervisors, FSA's understanding is that 70% of these firms now keep most of their records in non-paper form and that these firms account for 90% of transactions.
- 1.10 For firms currently authorised by PIA the 3 year record keeping requirements proposed in COBS for unit trusts and securities business means that records

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<sup>2</sup> For a brief discussion of why the RPBs' regulatees are unlikely to incur significant incremental costs, please refer to paragraphs 3, 4 and 5 of the Annex.

have to be kept for 3 years less than currently required. However, for reasons listed below, the FSA believes that this change is unlikely to lead to consumers suffering a loss (in the degree of protection that the record keeping requirements provide them).

The experiences of PIA supervisors suggest that records more than three years old would rarely be called for by supervisors. In the recent past there have been instances where the PIA supervisors have needed to review business more than three years old – such as the pensions misselling review and the FSAVC review – the lack of records has not prevented such a review by the FSA.<sup>3</sup>

Most large product providers were till the mid-1990s regulated by LAUTRO which had a 3 year record keeping requirement. FSA supervisory staff who used to work for LAUTRO are of the view that this 3 year requirement did not cause supervisory problems under LAUTRO's regime.

PIA supervisors also believe most firms tend to keep records beyond the (current) minimum retention period because:

- firms find it expensive to operate a procedure for identifying records of more than a certain age and destroying them; and
- the pensions misselling review has highlighted the usefulness of keeping records for longer than legally required.

## Benefits

- 1.11 Record keeping requirements are, in part, a consumer protection measure. Therefore, raising these requirements (as in other life and pensions business for SFA and IMRO regulatees) should improve consumer protection.

However given that:

- IMRO firms for the most part seem to be retaining records indefinitely, and
- SFA firms are few in number and account for a very small amount of life and pensions business,

it is unlikely that significant incremental benefits will arise due to this policy change.

- 1.12 Storing records might impose compliance costs for firms. Therefore, lowering the record keeping requirement for PIA and IMRO regulated firms involved in unit trust and securities business might allow these firms to save on compliance costs. But as indicated in the previous section these firms seem to

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<sup>3</sup> It might be the case that for firms keeping records longer than they are legally required to is more cost effective. This is because if firms do not keep records, and either the FSA decides to conduct a review or a customer files a complaint with the ombudsman, the firm will need to reconstruct the records as best it can. This will lead to costs being incurred. So, cost minimisation might dictate that firms retain records for longer than the regulator requires them to.

find it cost-efficient to keep records for longer than required to do so. Consequently, it is unlikely that this regulatory change will lead to regulatees being able to reduce compliance costs.

Firms that are regulated by one or more of the SROs and/ or the RPBs might be able to save on compliance costs. At present, the SROs and RPBs have different minimum retention periods (please refer to tables in the Annex for more on this). Establishing a single set of record keeping requirements will eliminate the need to comply with multiple regulatory regimes.

A uniform record keeping requirements (for a given product category) means that compliance costs incurred by a firm (for a given transaction) do not vary across firms. In essence, a uniform record keeping requirements means fewer regulator-induced distortions in the cost structures faced by the firms. All other things being equal, this should improve the efficiency of competition in the industry.

### Conclusion

- 1.13 The changes in the record keeping requirements proposed by the Conduct of Benefit Sourcebook seem unlikely to impose significant incremental costs on the industry or consumers. Due to the same reasons significant incremental benefits are unlikely to arise for firms and consumers. However, eliminating the present diversity in record keeping requirements might lower compliance costs for firms which have to adhere to multiple regulatory regimes. Uniformity across product categories in the record keeping requirements should improve the efficiency of competition in the industry.

### Tables

- 1.14 The following tables seek to explain the proposed changes in the record keeping requirements. Please note that the current SRO rules do not read across easily to the COBS rules. Hence we have made a number of generalisations in these tables. The tables are intended to be a high-level guide to the major incremental changes made to the record keeping requirements.
- 1.15 Please note that tables are intended to capture proposed changes. Since the record keeping requirements related to pension-transfers and opt-outs have not changed, these categories are not discussed in the tables. Similarly, record keeping requirements for client assets (at least six years from the termination of the trust relationship) are unchanged and hence have not been mentioned in the tables.

Table 1: changes for PIA regulatees			
Subject	Current requirement	COBS rule #	Proposed COBS requirement
Indirect benefits	Records relating to indirect benefits should be kept for 6 years.	2.2.16R (2)	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 6 years.</li> </ul>
Financial promotion	Records related to promotions had to be kept for 6 years. The record keeping requirements do not apply to deposit takers or general insurers.	3.71R	<ul style="list-style-type: none"> <li>Records of financial promotions for life and pensions products should be kept for 6 years (including non-life pension); and</li> <li>3 years for all others.</li> <li>The record keeping requirements do not apply to deposit takers or general insurers.</li> </ul>
Cancellation	Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions) for 6 years.	6.12.32R	<ul style="list-style-type: none"> <li>Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions): for 6 years for life and pension agreements (including non-life pension); and</li> <li>3 years for non-life agreements.</li> </ul>
Projections	Record of projections issued to a customer must be kept for 6 years.	6.11.15R	<ul style="list-style-type: none"> <li>Record of projections issued to a customer must be kept for 6 years for life and pension business (including non-life pension); and</li> <li>3 years in all other cases.</li> </ul>
Customer agreements	6 years	4.2.11	6 years for life and pension business (including non-life pension) and 3 years for non-life (whichever is the longest category encompassed within an agreement).
Customer borrowing	N/A	7.9.7	<ul style="list-style-type: none"> <li>3 years</li> </ul>
Customer order execution requirements	6 years	7.14.6	<ul style="list-style-type: none"> <li>3 years</li> </ul>

**Table 1 continued**

Subject	Current requirement	COBS rule #	Proposed COBS requirement
Confirmation of transactions	6 years	8.1.14	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
Periodic statements	6 years	8.2.8	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
Know your customer	6 years	5.2.7	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Suitability	6 years	5.3.22	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Allocation	6 years	7.7	3 years as no life products involved.

Table 2: changes for SFA regulatees

Subject	Current requirement	COBS rule #	Proposed COBS requirement
Indirect benefits, and soft commission	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 3 years; and</li> <li>Records for soft commission for 3 years.</li> </ul>	2.2.16R (2) and 2.2.17R	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 6 years; and</li> <li>Records for soft commission for 3 years.</li> </ul>
Financial promotion	Records of financial promotions for life and pensions products should be kept for 3 years. The record keeping requirements do not apply to deposit takers or general insurers.	3.71R	<ul style="list-style-type: none"> <li>Records of financial promotions for life and pensions products should be kept for 6 years (including non-life pension); and</li> <li>3 years for all others.</li> <li>The record keeping requirements do not apply to deposit takers or general insurers.</li> </ul>
Cancellation	Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions) for 3 years.	6.12.32R	<ul style="list-style-type: none"> <li>Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions): for 6 years for life and pension agreements (including non-life pension); and</li> <li>3 years for non-life agreements.</li> </ul>
Projections	Record of projections issued to a customer must be kept for 3 years.	6.11.15R	<ul style="list-style-type: none"> <li>Record of projections issued to a customer must be kept for 6 years for life and pension business (including non-life pension); and</li> <li>3 years in all other cases.</li> </ul>
Customer agreements	3 years	4.2.11	6 years for life and pension business (including non-life pension) and 3 years for non-life (whichever is the longest category encompassed within an agreement).
Customer borrowing	3 years	7.9.7	<ul style="list-style-type: none"> <li>3 years</li> </ul>
Customer order execution requirements	3 years	7.14.6	<ul style="list-style-type: none"> <li>3 years</li> </ul>

**Table 2 continued**

<b>Subject</b>	<b>Current requirement</b>	<b>COBS rule #</b>	<b>Proposed COBS requirement</b>
Confirmation of transactions	3 years	8.1.14	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
Periodic statements	3 years	8.2.8	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
PA dealing	3 years	7.12	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Know your customer	3 years	5.2.7	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Suitability	3 years	5.3.22	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Allocation	3 years	7.7	3 years as no life products involved.
Periodic statements for UCITS operators	3 years	10.7.6	Dependent on decision for periodic statements generally (see 8.2.8 above). Likely decision: <ul style="list-style-type: none"> <li>• 3 years for non-life.</li> </ul>
Permitted third parties	3 years	12.4.5	<ul style="list-style-type: none"> <li>• 3 years.</li> </ul>

Table 3: changes for SIB regulatees

Subject	Current requirement	COBS rule #	Proposed COBS requirement
Indirect benefits, and soft commission	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 6 years; and</li> <li>Records for soft commission for 6 years.</li> </ul>	2.2.16R (2) and 2.2.17R	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 6 years; and</li> <li>Records for soft commission for 3 years.</li> </ul>
Financial promotion	Records of financial promotions should be kept for 6 years. The record keeping requirements do not apply to deposit takers or general insurers.	3.71R	<ul style="list-style-type: none"> <li>Records of financial promotions for life and pensions products should be kept for 6 years (including non-life pension); and</li> <li>3 years for all others.</li> <li>The record keeping requirements do not apply to deposit takers or general insurers.</li> </ul>
Cancellation	Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions) for 6 years.	6.12.32R	<ul style="list-style-type: none"> <li>Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions): for 6 years for life and pension agreements (including non-life pension); and</li> <li>3 years for non-life agreements.</li> </ul>
Projections	Record of projections issued to a customer must be kept for 6 years.	6.11.15R	<ul style="list-style-type: none"> <li>Record of projections issued to a customer must be kept for 6 years for life and pension business (including non-life pension); and</li> <li>3 years in all other cases.</li> </ul>
Customer agreements	6 years	4.2.11	6 years for life and pension business (including non-life pension) and 3 years for non-life (whichever is the longest category encompassed within an agreement).
Customer borrowing	N/A	7.9.7	<ul style="list-style-type: none"> <li>3 years</li> </ul>
Customer order execution requirements	6 years	7.14.6	<ul style="list-style-type: none"> <li>3 years</li> </ul>

**Table 3 continued**

<b>Subject</b>	<b>Current requirement</b>	<b>COBS rule #</b>	<b>Proposed COBS requirement</b>
Confirmation of transactions	6 years	8.1.14	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
Periodic statements	6 years	8.2.8	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
PA dealing	6 years	7.12	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Know your customer	6 years	5.2.7	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Suitability	6 years	5.3.22	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Allocation	6 years	7.7	3 years as no life products involved.
Periodic statements for UCITS operators	6 years	10.7.6	Dependent on decision for periodic statements generally (see 8.2.8 above). Likely decision: <ul style="list-style-type: none"> <li>• 3 years for non-life.</li> </ul>
Permitted third parties	6 years	12.4.5	<ul style="list-style-type: none"> <li>• 3 years.</li> </ul>

Table 4: changes for IMRO regulatees

Subject	Current requirement	COBS rule #	Proposed COBS requirement
Indirect benefits, and soft commission	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 3 years; and</li> <li>Records for soft commission for 3 years.</li> </ul>	2.2.16R (2) and 2.2.17R	<ul style="list-style-type: none"> <li>Records relating to indirect benefits should be kept for 6 years; and</li> <li>Records for soft commission for 3 years.</li> </ul>
Financial promotion	Records of financial promotions for life and pensions products should be kept for 3 years. The record keeping requirements do not apply to deposit takers or general insurers.	3.71R	<ul style="list-style-type: none"> <li>Records of financial promotions for life and pensions products should be kept for 6 years (including non-life pension); and</li> <li>3 years for all others.</li> <li>The record keeping requirements do not apply to deposit takers or general insurers.</li> </ul>
Cancellation	Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions) for 3 years.	6.12.32R	<ul style="list-style-type: none"> <li>Where a notice of cancellation has been served on a firm (or its appointed representative or agent), the firm must keep records (which include a copy of the receipt of notice issued to the customer and the customer's original instructions): for 6 years for life and pension agreements (including non-life pension); and</li> <li>3 years for non-life agreements.</li> </ul>
Projections	Record of projections issued to a customer must be kept for 3 years.	6.11.15R	<ul style="list-style-type: none"> <li>Record of projections issued to a customer must be kept for 6 years for life and pension business (including non-life pension); and</li> <li>3 years in all other cases.</li> </ul>
Customer agreements	3 years	4.2.11	6 years for life and pension business (including non-life pension) and 3 years for non-life (whichever is the longest category encompassed within an agreement).
Customer borrowing	3 years	7.9.7	<ul style="list-style-type: none"> <li>3 years</li> </ul>
Customer order execution requirements	5 years	7.14.6	<ul style="list-style-type: none"> <li>3 years</li> </ul>

**Table 4 continued**

<b>Subject</b>	<b>Current requirement</b>	<b>COBS rule #</b>	<b>Proposed COBS requirement</b>
Confirmation of transactions	3 years	8.1.14	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
Periodic statements	3 years	8.2.8	<ul style="list-style-type: none"> <li>• 3 years</li> </ul>
PA dealing	3 years	7.12	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Know your customer	3 years	5.2.7	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Suitability	3 years	5.3.22	<ul style="list-style-type: none"> <li>• 3 years for non-life; and</li> <li>• 6 years for life and pension business (including non-life pension).</li> </ul>
Allocation	5 years	7.7	3 years as no life products involved.
Periodic statements for UCITS operators	3 years	10.7.6	Dependent on decision for periodic statements generally (see 8.2.8 above). Likely decision: <ul style="list-style-type: none"> <li>• 3 years for non-life.</li> </ul>
Permitted third parties	3 years	12.4.5	<ul style="list-style-type: none"> <li>• 3 years.</li> </ul>

**Table 5: minimum record retention periods at present for RPBs**

Name of RPB	PTs and OOs	Other life and pensions	Unit trusts/ securities
ICAEW	Indefinite	6 years	6 years
ICAS	Indefinite	6 years	6 years
ICAI	Indefinite	6 years	6 years
ACCA	Indefinite / 6 years	6 years	6 years
IOA	Until notified by IOA	6 years in future	6 years in future
LS	Indefinite	6 years	6 years
LSS	Indefinite	10 years	10 years

- 1.16 After N2 it is likely that the RPB regulatees will be subject to the COBS record keeping requirements. As is obvious from the table above, other than for pensions transfers and opt-outs, COBS' record keeping requirements are not an increment on the RPB's current requirements.
- 1.17 For pension transfers and opt-puts ACCA regulatees will face an increase in the minimum record retention period. For reasons mentioned below, the FSA is of the view that this increase in the minimum record retention period will not impose a significant incremental cost for these firms.
- 1.18 Appendix 4 of ACCA's Investment Business Regulations requires retention of records indefinitely for execution-only pension transfer and opt-out transactions. It appears that for non-execution-only transfers and opt-outs the minimum retention period is 6 years. All ACCA regulatees (taken together) conduct less than 10 pension-transfer and opt-out transactions per annum. Non-execution-only transfers and opt-outs are even fewer than this. Hence, the indefinite record keeping requirement proposed by COBS is unlikely to lead to significant incremental costs for ACCA regulatees.

## **2 Terms of business and customer agreements (COB 4.2.4 and COB 4.2.6)**

- 2.1 Subject to certain exclusions, COBS requires that customer agreements be entered into where, for a private customer, the firm carries out discretionary management, or business which involves contingent liability transactions, stock-lending or underwriting. The customer's written consent must be obtained. In all other circumstances COBS requires that all customers receive

terms of business. These do not need to be signed by the customer to indicate acceptance.

- 2.2 The SFA rules do not require terms of business to be sent, referring only to the requirement to effect two-way customer agreements in certain circumstances. This new provision will therefore require firms which are currently subject to the SFA rules to issue terms of business. We believe this is an important element of establishing legal certainty in the business between firm and customer, and that most customers, whether private or intermediate, would welcome the requirement for the firm to clarify the basis on which their business relationship is constructed.
- 2.3 The provision of terms of business in all cases would create compliance costs for the firms identified. However we also believe that it is normal business practice for such firms to document the basis of the relationship with their clients. Cases where firms need to create and issue new terms of business should be limited.
- 2.4 We have therefore concluded that compliance costs arising are of minimal significance, and have not subjected this proposal to full cost benefit analysis.

### **3 Exclusions of liability (COB 4.3)**

- 3.1 The proposal is that firms should not be able contract out of obligations or liabilities to clients via oral communication. This matches a similar prohibition regarding written exclusions of liability. The provision is new for all firms.
- 3.2 This measure, which prohibits undesirable actions by firms, does not generate any tangible compliance costs. This additional prohibition should make clients' contractual positions with firms more certain. The market is unaffected, other than that the measure should provide a further spur to high business standards.
- 3.3 We therefore believe that there are no cost implications of this proposal, and have therefore not subjected it to full cost benefit analysis.

### **4 Status disclosure (COB 5.1)**

- 4.1 The proposal is that discretionary managers should disclose their status under polarisation to all customers, including intermediates.
- 4.2 As it is proposed that such disclosure may be given orally, we do not believe the proposal will generate compliance costs. We have therefore not subjected it to full cost benefit analysis.

## 5 Suitability (COB 5.3)

- 5.1 The proposal involves the extension of the suitability requirement to customers which are both **discretionary** and **intermediate**. The provision is already reflected in both SFA and PIA rules. Only firms currently subject to the IMRO rules with customers in this category will be affected.
- 5.2 Where such a firm has customers which are both discretionary and intermediate (this could include charities, corporate bodies and local authorities), the firm will need to implement systems to ensure that decisions taken for the client are suitable in the context of the information known about that client. The firm will need to be able to document and record this decision, and to monitor compliance with the requirement on an on-going basis.
- 5.3 The majority of investment management firms currently regulated by IMRO (i.e. around 400 firms) manage portfolios for intermediate clients on a discretionary basis. Depending on the number of such clients a firm has, these costs could in theory be significant. There would be a need to document and record the suitability judgement, thus generating procedural and one-off systems costs. There would be some ongoing internal compliance costs to reflect internal monitoring of the requirement.
- 5.4 Our supervision experience indicates however that these firms will already tend in practice to ensure transactions are suitable for the customer, in line with agreed investment objectives of that client, irrespective of whether regulatory obligations exist. Moreover these firms are also likely to be providing services to other clients where the suitability requirement already applies. The cost impact for such firms therefore revolves on the extension of procedures which already exist in-house, rather than the creation of new processes and documentation from scratch.
- 5.5 The new provision effectively fills a relatively small gap in protection for this class of customer. In all other cases (e.g. occupational pension scheme operators, unit trust trustees, clients of firms currently subject to the SFA and PIA rules) the protection is already provided. Clients obtain greater confidence in arrangements which provide an element of suitability protection, particularly given the wide variety within the intermediate category. The new arrangements for customer classification should mean that customers who think the protections are not worth the costs can opt out accordingly.
- 5.6 We believe that for the firms concerned, these costs will be of minimal significance. We have therefore not subjected the proposal to full cost benefit analysis.

## **6 Suitability (COB 5.3.13R)**

- 6.1 This proposal requires the issue of a suitability letter to a private customer where there has been a recommendation by the firm regarding a packaged product.
- 6.2 The rules of SFA and IMRO currently require the production of a 'reason why' letter where the transaction involves a life or pension policy. The PIA rules currently require reason why letters in all cases.
- 6.3 The COBS proposal will require suitability letters to be sent where other packaged products, i.e. unit trusts and investment trust savings schemes, are involved in recommendations by firms currently subject to the SFA and IMRO rules. This will result in additional compliance costs for such firms, in the production and transmission of the letter.
- 6.4 We think, however, that these costs should be limited in their effect as they will relate to the production of the letter only (not the suitability judgement which is already required). Moreover they will be applicable only in a minority of transactions carried out by the firms concerned, as most business of this kind will be within the context of a discretionary portfolio (where the suitability letter requirement will not apply).
- 6.5 We believe therefore that these costs will be of minimal significance to the firms concerned, and we have therefore not subjected the proposal to full cost benefit analysis.

## **7 Making post-sale confirmation voluntary**

- 7.1 Under COB 6.3 R it is proposed that post-sale confirmation in relation to packaged products be voluntary rather than, as now, mandatory. As the text of the CP makes clear, the following assessment focuses on savings to firms and we will later need to assess any detriment to consumers in the light of our programme of consumer research.

Qualitative assessment of market impacts		
Effect	Cost or Benefit	Importance
<b>Direct costs</b>		
Ongoing supervision of those companies that choose to issue PSC.	Cost	Minor
<b>Compliance costs</b>		
One-off costs of altering computer systems should be relatively small assuming possible to simply switch off PSC.	Cost	Low – not material given level of firms' other costs
Ongoing cost savings from fewer staff and management supervision time.	Benefit	Low – not material given level of firms' other costs
Ongoing cost savings from less postage, administration, stationery.	Benefit	Low – not material given level of firms' other costs
<b>Quantity of the goods sold</b>		
Unlikely to be affected. Product pricing influenced by pre-sale disclosure and competitive forces, not by presence or absence of PSC. Effect on numbers cooling off or persistency should be very small. Any effect on sales volumes likely to be positive (i.e. an increase, but negligible).	Benefit (if any)	Minor
<b>Quality of the goods offered</b>		
Unlikely to be affected. Product features and terms influenced by pre-sale disclosure and competitive forces. Lack of PSC means cost savings (= cheaper products for consumers or more profit for providers).	Benefit (if any)	Minor
<b>Variety of products offered</b>		
Unlikely to be affected. Selection of products on offer influenced by consumer needs and competitive forces. Lack of PSC costs will not influence decision to continue with or withdraw particular product.	Neutral	N/A
<b>Efficiency of competition</b>		
Removal of PSC should not reduce or increase competition. Competitive forces are more influenced by pre-sale disclosure, IFA lobbying and trade press surveys (and soon FSA league tables).	Neutral	N/A

## Direct and compliance cost summary

The table below shows one-off costs and the discounted present value of future costs and benefits. The results show that there would be a significant saving in compliance costs.

Costs		Benefits	
Nature	Value	Nature	Value
Direct Costs	£200,000	Reduction in Compliance Costs	
Compliance Costs			
(one-off systems changes)	£1,000,000		
		Staff Savings	£7,000,000
		Management time	£1,500,000
		Stationery etc	£30,000,000
<b>Total Costs: £1.2m</b>		<b>Total Benefits: £38.5m</b>	
<b>Net Benefits: £37.3m</b>			

1. All ongoing costs and savings discounted at 8% p.a. for five years.
2. Assumes policy sales and variations of 5 million a year (= 1998 ABI figures).
3. Assumes that 50 life offices stop issuing post-sale confirmation (= 50% of the 100 active life offices submitting returns to PIA's '5 Years On' disclosure survey).
4. Direct Costs assume half-day supervision visits to 50 life offices per year, plus allowance for maintaining rules, total say £50K a year.
5. One-off systems costs assumed at £20K times 50 life offices (should be relatively simple to switch off post-sale part of systems).
6. Compliance staff savings assumed at one person per life office at £35K each, total say £1.75m a year.
7. Compliance management supervision savings assumed at one-tenth of a person at £75K each, total say £375K a year.
8. Compliance savings in stationery, postage, computer time assumed at £3 a policy, total say £7.5m a year.

## 8 Cancellation and withdrawal – Section 6.7

### Cost benefit review

8.1 With regard to the proposals set out in section 6.7 of the rules for:

- the change from a voluntary cancellation regime to a mandatory one for ISA cash deposit components;
- the right to withdraw for EISs, ISAs and PEPs; and

- replacing the right to cancel (which applies currently in respect of transfers from money purchase occupational schemes) with the right to withdraw (i.e. a form of delayed entry through use of the cancellation substitute in Table COB 6.7(3)R) in circumstances where a customer is purchasing a pension policy or pension contract using the transfer value from any occupational pension scheme;

the FSA considers the costs for firms of implementing these changes overall is negligible or neutral since the changes essentially reflect a continuation of the existing statutory and voluntary regimes.

#### **Right to withdraw – Enterprise Investment Schemes, ISAs and PEPs**

- 8.2 Firms currently regulated under the IMRO regime and those PIA regulated firms that have adopted the IMRO rules are required to offer a right to withdraw to customers purchasing EIS, ISA or PEP products. Other firms are not required to offer this protection.
- 8.3 The FSA proposes to change the rules such that all firms providing EIS, ISA or PEP products may provide the right to withdraw (delay entry) on a voluntary basis. The proposed rules require that all firms make a prominent disclosure where this protection is not provided.
- 8.4 The FSA believes that this change will not result in costs of more than minimal significance for firms or remove significant protections for their customers. Firms may choose to reduce their costs by removing this protection. However we believe that the requirement to disclose means that customers will be free to choose the products of firms that continue to offer the right to withdraw.

#### **Right to withdraw – pension transfers**

- 8.5 Members of money purchase occupational pension schemes who choose to transfer their pension funds to a individual pension contract are currently offered the right to cancel the transfer up to 30 days after receipt of the transfer amount. Members of defined benefit (final salary) schemes currently have no right to cancel.
- 8.6 In compliance with the EU 3rd life directive, the FSA proposes that all members of occupational pension schemes, whether money purchase or defined benefit, effect their right to cancel through the right to withdraw provisions. The proposed rules would require firms to offer customers the right to withdraw, through use of the cancellation substitute for all pension transfers, for a 14 day period commencing immediately after the recommendation is made or the transfer request instructions were signed.
- 8.7 These proposals overcome a significant problem with the current rules on post sale cancellation that apply to transfers from money purchase schemes. In informal consultation with product providers the FSA understands that a

consequence of the current post-sale regime is that the timing of cancellation can often make it difficult for customers to get back to their original scheme on the same basis as before. However, the FSA believes that a pre-sale regime is of benefit to customers as this allows them to consider the transaction carefully before the transfer out of occupational scheme can take place. The costs of making a wrong decision are potentially very high. Rules providing for a right to withdraw therefore address the current problems associated with transfers from money purchase schemes and extend an important protection to those transferring from defined benefit schemes.

- 8.8 The FSA does not believe that the proposed changes will impose costs of more than minimal significance on firms or customers. Firms will already be familiar with the right to withdraw (using the cancellation substitute) as it currently applies to the purchase of pension annuities. Therefore the additional costs of providing this protection for defined benefit transfers are believed to be minor. The change to the rules as they apply to transfers from money purchase schemes is not expected to result in significant incremental costs. Some cost savings may occur as the current difficulties in dealing with the cancellation regime are removed. Clearly, if trustees wait for 14 days before starting their work then payment would be 14 days later than at present and hence there would be a cost to investors. However the FSA does not believe that trustees would introduce this delay. It usually takes considerably longer than 14 days to transfer the monies from an occupational scheme once the transfer instructions have been received. Trustees are therefore unlikely to need additional time to allow for the right to withdraw.

#### **Right to cancel – ISA cash deposit components**

- 8.9 There are no rules that currently require the cash deposit components of ISAs to be offered with a right to cancel. The FSA proposes to make the right to cancel mandatory but does not believe that this will result in costs of more than minimal significance for firms.
- 8.10 It is the FSA's understanding that firms will already be familiar with the simplified cancellation regime through their compliance with the current voluntary Banking Code. Whilst not all firms follow the Code, many who do not opt to provide their own form of cooling-off for customers. This suggests that costs cannot be extreme and that customers are not selecting against those firms which currently provide a right to cancel.

## **9 Allocation (COB 7.7.5)**

- 9.1 The COBS rules on allocation of a series of transactions in designated investments require that allocation should take place promptly, or at the latest within one business day of the transaction being executed, unless the firm has

agreed with an intermediate customer that the allocation period may extend to five business days.

- 9.2 This proposal takes forward, in part, a relaxation in the current IMRO rules which applies a longer allocation period to transaction in overseas securities than to those in UK securities. The original IMRO provision was designed to provide some element of flexibility in relation to the allocation of aggregated transactions concerning securities in companies incorporated outside the UK where timely information and price feeds may not be readily available and markets may be relatively illiquid. However under the new rules construction, a relaxation of the one business day standard will be afforded where the firm has specifically agreed with an intermediate customer that allocation, of either UK or overseas securities, may be carried out over an extended period, rather than a blanket extension being applied to all transactions and all customers.
- 9.3 As well as aiming to ensure common standards of business practice amongst firms active in this area, the requirement is also designed to minimise the possibility that a firm might use the longer period afforded to allocate the stock in a way not advantageous to the customer(s) concerned. We believe this ensures reasonable protection of the interests of all affected private customers.
- 9.4 Whilst this standardisation of approach implies a change in the time available for allocation for certain IMRO firms, we do not believe the effect would create significant additional costs for those businesses, for the following reasons:
- the majority of deals done on such markets will involve intermediate rather than private customers. In the case of intermediate customers, the firm will be able to agree with the customer that the allocation period may be up to 5 days;
  - the requirement to allocate refers to the amount of stock the firm has managed to obtain in a particular trade, not the entire order. Thus if the market where the order has been placed suffers liquidity or other problems so that the full quantity of the order is not immediately available, the firm has to ensure that it allocates promptly, or at the latest within one business day of the transaction, the amount of stock that it knows it has been able to obtain. There is no requirement on the firm to allocate stock which it has not got;
  - the requirement for the prompt allocation of transactions in overseas securities undertaken for and on behalf of private customers already exists in the SFA and PIA rules. Our supervision experience suggests that SFA firms, which we believe also carry on significant business on overseas markets for private customers, have not experienced practical problems in complying with this requirement.
- 9.5 On balance, therefore, we think that there should be the presumption of prompt allocation in all cases where private clients are involved, and that **any** additional

costs to those firms which have to meet this requirement for the first time will be of minimal significance. We have therefore not subjected the proposal to full cost benefit analysis.

## **10 Customer borrowing (COB 7.9)**

- 10.1 This proposal involves the adoption within COBS of customer borrowing provisions currently in the SFA rules. The provision requires that a firm only lend money or extend credit to a private customer where it is satisfied this is suitable for the customer, and that the customer has consented in writing to the maximum amount of the loan and the applicable interests and fees. This requirement does not apply to settlement delays where the firm pays for the customer, to the firm covering a customer's margin call for a period no longer than five business days or for a longer period where the firm is aware that the customer has given instructions to a relevant third party to make a payment to meet the margin call.
- 10.2 There are currently no regulatory prohibitions to borrowing arrangements in the IMRO and PIA rules and so firms currently subject to those rules which wished to extend credit under the COBS regime would need to demonstrate suitability and back this up with records and the client's written consent.
- 10.3 In the limited circumstances where this rule would apply, we believe that establishing suitability of the loan would be a minimal extension of the main suitability obligation – the basic information to form that judgement should in the main have already been gathered from the client. Documenting the decision would not require significant effort. There would be an additional cost to the firm in obtaining the client's written consent, but this could be achieved relatively easily via letter or side agreement.
- 10.4 We believe that the extension of these provisions to other firms is unlikely to lead per se to any growth in the market. Firms will either be inclined to offer their clients the possibility of credit or not. If they do, then the provisions ensure the basis of borrowing is suitable for the client and that it is properly documented. This adds confidence for the consumer.
- 10.5 We believe the costs of extending the requirements are of minimal significance to the firms involved. We have therefore not subjected this proposal to a full cost benefit analysis.

## **11 Confirmation of transaction (COBS 8.1.5(2) and (3))**

- 11.1 In the case of business where the requirement to send periodic statements (COBS 8.2) applies, the effect of these two rules is to allow either the firm or the customer to take the initiative in requesting that confirmations are not sent out after each transaction. The IMRO rules and the PIA rules (for certain types of

business) already provide this option for customers. The COBS approach extends this facility to other customers, and to firms themselves. However where the firm takes the initiative, COBS has built in additional safeguards to ensure the customer has the ability to insist upon the provision of a confirmation if he wishes, and the firm is required to ensure the customer is aware of his rights in this regard.

- 11.2 In cases where the customer has requested not to receive confirmations he will need to write to the firm or sign the firm's documentation as appropriate. The firm would have the minor expense of generating such documentation for these cases. There would be some element of postage/transmission on either side. We believe that in practice firms tend to document such arrangements already, even where it has not been a regulatory requirement. Where customers opt not to receive confirmations, the firm should experience some minor cost savings in production.
- 11.3 Many discretionary clients may be more comfortable with receiving key information on a regular periodic basis than a confirmation after each and every transaction. As well as making this option more available to customers, the proposals allow the firm to be proactive in suggesting alternative options to customers, thus allowing greater flexibility of operation, as customers themselves may take the initiative less often.
- 11.4 Whilst there might be minor costs in some cases in configuring the more frequent periodic statements required, this is likely to be more than offset by the cost savings in both production and postage (or electronic transfer) of not sending confirmations after every transaction. If the firm does not believe the cost savings would offset the costs, it would not need to offer the option unilaterally
- 11.5 The frequency of periodic statements in these circumstances is set at quarterly. This represents a quicker time-scale than current rule requirements, but most firms now supply information on at least a quarterly basis, if not more frequently. Firms are therefore unlikely to have to increase significantly the frequency of periodic statements in practice. Clients should not find any diminution in the quality or relevance of the information to be provided, albeit in a different time-scale. The market should benefit in terms of the additional flexibility for firms' operations.
- 11.6 We believe that where these options are taken up, firms will be able to benefit from some cost reduction, and that consumers will not suffer. We therefore have not subjected this proposal to full cost benefit analysis.

## **12 Periodic statements (COB 8.2.3 and 8.2.6(1)(b))**

- 12.1 The proposal requires that, where the business carried on renders the issue of a periodic statement appropriate, this should be supplied generally to all

customers. This approach would represent a change in approach to the SFA rules which currently do not require firms to supply non-discretionary non-private customers with such statements.

- 12.2 This change makes the treatment of such customers in this respect common with those of firms subject to the IMRO and PIA rules. Some compliance costs will be generated for the firms affected by the change, but these are likely to be minimal given that systems and procedures for the production of such statements will already be in existence.
- 12.3 In addition, as under existing rules, intermediate customers may opt out of receiving periodic statements altogether (without the need for the firm to document this arrangement in writing).
- 12.4 We therefore think that any compliance costs generated are of minimal significance and have not subjected this proposal to full cost benefit analysis.

## **13 Periodic statements (COB TABLE 8.2(1)E(2)(c))**

- 13.1 This provision requires that where a customer requests less frequent periodic statements, that request should be in writing. This provides both certainty and clarity for firm and client where non-standard arrangements are adopted.
- 13.2 In the limited number of cases where clients opt for less frequent periodic statements, the arrangement will need to be documented either in the terms of business or in a side letter or similar. Some minor costs to firms might therefore be generated. In practice, however, frequency of periodic statements will already be documented as part of the terms of business, and so significant costs to firms are unlikely to arise.
- 13.3 We have therefore concluded that any compliance costs are of minimal significance and have not subjected the proposal to full cost benefit analysis.

## **14 Custody rules**

- 14.1 Reconciliation

### *Nature of Change*

A change in the frequency of reconciliation for IMRO and PIA firms from a 6-monthly basis to every 25 days for custody assets which they do not physically hold (firms which are unable to obtain statements of client entitlements from unit trust managers and OEIC managers will be allowed to perform reconciliations once every 6 months. However, they will be expected to make reasonable efforts to obtain the statements).

Qualitative assessment of market impacts		
Effect	Cost or Benefit	Importance
<b>Direct costs</b>		
Ongoing supervision of these firms. However, it is envisaged that the greater the frequency with which firms reconcile, the greater the regulators' confidence in these firms and the less time spent, in the future, monitoring the firms. (1)	Cost	Minor
<b>Compliance costs</b>		
One-off systems cost for IMRO and PIA firms to ensure that their systems reconcile on a 25 -day basis. These firms already have the necessary systems for reconciliation therefore it is anticipated that the systems cost will be insignificant.	Cost	Minor
Ongoing manpower costs for IMRO and PIA firms i.e. additional manpower required to ensure that the reconciliations are performed every 25 days (including making 'reasonable attempts' to obtain statements from unit trust managers and OEIC managers). Manpower costs will be greater for those firms that perform the reconciliations on a manual basis which will tend to be smaller firms. (2)	Cost	Medium
<b>Quantity of the goods sold</b>		
Improved standard of custody service may increase consumer confidence in the service provided.	Benefit	Medium
Increased cost of custody in UK may shift business abroad. However, it is not envisaged that the increased operational cost for the firms would be so significant as to cause such a shift in business.	Cost	Negligible
<b>Quality of the goods offered</b>		
Improved quality of custody service offered, as more accurate information can be provided to the clients and problems can be more easily identified and rectified. Accurate records also ensure that in the event of a firm's default, the client's assets can be more easily transferred to another firm with a greater value of the client's assets still intact i.e. savings in liquidator's fees.	Benefit	Medium
<b>Variety of products offered</b>		
No effect.	–	–
<b>Efficiency of competition</b>		
No effect.	–	–

Cost benefit summary			
Costs		Benefits	
Nature	Value (£)	Nature	Value
Direct Costs (1)	20,000pa	Improved safety of custody assets and consistency of reconciliation across the market.  Increased consumer confidence in the custody service provided by firms.	Not quantifiable
Compliance Costs			Not quantifiable
Manpower (2)	580,000pa		
<b>Total Costs: 600,000pa</b>		<b>Total Benefits: Not quantifiable</b>	

#### Assumptions

1. There are approximately 600 IMRO and PIA firms which will have to comply with the frequency for the first time.
2. 60% of the 600 IMRO and PIA already perform reconciliation on a monthly or more frequent basis and they perform the reconciliation on an automated basis.
3. 20% of the firms which *do not* perform reconciliations on a monthly or more frequent basis, perform their twice yearly reconciliation on a manual basis.
4. The average line of stock held by firms that are affected by this change is 2500
5. 50% of all stock is held with a third party.
6. It takes on average one hour each month to reconcile 25 lines of stock.
7. Firms that perform manual reconciliations will spend on average an additional 50 hours per month (50% of 2500/25) complying with the requirement. As they already perform reconciliation on a twice-yearly basis, these hours will only be relevant 10 months in every year.
8. An average of one additional man-hour per month (i.e. 10 hours per annum as they already reconcile twice yearly) spent per firm in monitoring compliance with the requirement, at a salary of £20K per clerical staff per annum. Staff costs will be double to take account of overheads.
9. An average of one additional man-hour per annum spent by the FSA in monitoring each affected firm for compliance with this requirement at a salary of £30K per regulatory staff per annum.

## 15 Client Money rules

### 15.1 Client entitlements

#### *Nature of change*

This provision requires a firm to allocate client entitlements to each individual client record within five business days. This is a new provision – previously firms were only obliged to ensure client entitlements were paid into a client bank account within a certain time period (not allocated to the individual client). It reflects market practice and it is not anticipated that it would impact many firms. Although the need to allocate dividends was implied within the old regulatory regime by the need to be able to account to customers promptly, it has been translated into a more specific role with minor impact anticipated. Past experience has also highlighted that the prompt allocation of clients' entitlements ensures that in the event of the firm's default there is less likelihood of the liquidators incurring costs in recreating the records of entitlements thereby depleting the available monies.

<b>Qualitative assessment of market impacts</b>		
<b><i>Client Entitlements</i></b>		
<b>Effect</b>	<b>Cost or Benefit</b>	<b>Importance</b>
<b>Direct costs</b>		
Slight increase in the amount of time spent by regulators in monitoring the allocations. (1)	Cost	Minor
<b>Compliance costs</b>		
One-off systems cost to cater for the new requirement. However, this cost will be insignificant as firms already have the necessary systems for allocating client entitlements.	Cost	Minor
Ongoing costs in terms of manpower required to ensure timely compliance with the allocation of client entitlement requirement. (2)	Cost	Minor
<b>Quantity of the goods sold</b>		
The better protection afforded to clients in the more timely allocation of client entitlements could increase consumer confidence in the services provided by the firms which could lead to an increase in the volume of appropriate business.	Benefit	Minor
The increase in the firm's operational costs may lead to higher costs for the consumer and a possible reduction in the volume of business for the firm. However, our research suggests that the increase in the firm's operational costs will be minimal as a significant number of firms already allocate the client entitlements within 5 days.	Cost	Minor
<b>Quality of the goods offered</b>		
By ensuring that firms allocate entitlements to individual client records in a timely manner, clients are better protected in the event of the firm's default. Distribution of client money in such an event will be effected more quickly, offering savings in liquidator's fees.	Benefit	Major
<b>Variety of products offered</b>		
No effect	–	–
<b>Efficiency of competition</b>		
No effect	–	–

Cost benefit summary			
Costs		Benefits	
Nature	Value (£)	Nature	Value
Direct Costs (1)	3,700 pa (for the 10% of firms that will be affected)	Better protection for clients, particularly in the event of a firm's default, by the timely allocation of client entitlements.  Greater consumer confidence in the service provided by the firms and the safety of their monies.	Not quantifiable
Compliance Costs	29,000 pa (for the 10% of firms that will be affected)		Not quantifiable.
Manpower (2)			
<b>Total Costs: 32,700 pa</b>		<b>Total Benefits: Not quantifiable</b>	

#### Assumptions

1. There are approximately 1100 firms that handle client money.
2. 90% of firms that handle client money allocate client entitlements within 5 business days and would not be affected by this rule.
3. Each firm in monitoring compliance with the requirement, at a cost of £20K per clerical staff per annum will spend an average of one additional man-hour per month. Staff cost will be double to take account of overheads.
4. The FSA will spend an average of one additional man-hour per annum, per affected firm, in monitoring compliance with this requirement at a cost of £30K per regulatory staff per annum. Staff cost will be double to take account of overheads.

## 15.2 Client Money calculations

### *Nature of change*

There is a requirement for all firms holding client money to calculate a Client Money Requirement on a daily basis. This maintains existing policy for SFA firms but increases the frequency of the calculation for any IMRO and PIA firms holding client money (traditionally IMRO and PIA firms only calculated the requirement on a monthly/weekly basis depending on the nature of the account).

<b>Qualitative assessment of market impacts</b>		
<b><i>Client Money Calculations</i></b>		
<b>Effect</b>	<b>Cost or Benefit</b>	<b>Importance</b>
<b>Direct costs</b>		
Slight increase in the amount of time spent by regulators in monitoring the calculations. (1)	Cost	Minor
<b>Compliance costs</b>		
One-off systems cost for IMRO and PIA firms i.e. updating their systems to calculate client money on a daily as opposed to the current monthly basis. However, firms already have systems in place to enable the calculations to be carried out and thus should be able to increase the frequency of such calculation without incurring significant costs.	Cost	Minor
Ongoing costs of manpower necessary to ensure compliance with the daily calculation requirement. (2)	Cost	Medium
<b>Quantity of the goods sold</b>		
The better the protection afforded to clients, the greater the consumers' confidence in the services provided by the firms. This could result in an increase in the volume of appropriate business.	Benefit	Minor
Any significant increase in the firm's operational costs as a result of this requirement may lead to an increase in the cost of the service provided by the firm and consequently a reduction in the volume of the firm's business.	Cost	Minor
<b>Quality of the goods offered</b>		
Improved quality of service provided as daily calculations should provide better protection for all clients with client money balances held by IMRO and PIA firms. Experience has shown that firms that go into default tend to have inadequate records. By enforcing a daily calculation with a top up provision, any deficits in client money should be quickly identified and rectified before they reach a level that could threaten the firm's own capital resources and jeopardise it in the event of the firm's insolvency.	Benefit	Medium
<b>Variety of products offered</b>		
No effect	–	–
<b>Efficiency of competition</b>		
No effect	–	–

<b>Cost benefit summary</b>			
<b>Costs</b>		<b>Benefits</b>	
<b>Nature</b>	<b>Value (£)</b>	<b>Nature</b>	<b>Value</b>
Direct Costs (1)	21,500 pa	Improved quality of service provided and increased safety of client's money.	Not quantifiable
Compliance Costs	744,000 pa		
Manpower (2)			
<b>Total Costs: 765,500pa</b>		<b>Total Benefits: Not quantifiable</b>	

### **Assumptions**

1. There are approximately 650 firms affected by this change.
2. Each firm in monitoring compliance with the requirement, at a cost of £20K per clerical staff per annum will spend an average of one additional man-hour per week. Staff cost will be double to take account of overheads.
3. The FSA will spend an average of one additional man-hour per annum, per affected firm, in monitoring compliance with this requirement at a cost of £30K per regulatory staff per annum. Staff cost will be double to take account of overheads.

## **16 Unregulated collective investment schemes (COB 10.6.2)**

- 16.1 The proposal is that all firms which operate unregulated collective investment schemes should prepare and provide, if requested, scheme documents to a private customer who is a potential participant in the scheme. In this way the scheme documents record the basis on which the operator provides investment management services to a participant of the scheme.
- 16.2 This requirement currently exists in the IMRO rules, which regulate the majority of operators of unregulated schemes. Some operators are currently subject to the SFA rules (operation of unregulated schemes is not permitted under the PIA rules) and costs for such firms will in theory be generated by the requirement to produce this documentation.
- 16.3 Our supervision experience however indicates that industry practice involves the production of offer memoranda which fulfil much of the purpose of the scheme documents described in the proposed rule. We therefore believe that any costs involved in producing the additional information required by the rule will be of minimal significance for the firms concerned.
- 16.4 We have therefore not subjected the proposal to full cost benefit analysis.

# List of abbreviations

3LD	Third Life Directive
ABI	Association of British Insurers
Act	The Financial Services and Markets Act
BES	Business Expansion Scheme
Bill	The Financial Services and Markets Bill
CBA	Cost Benefit Analysis
CCA 1974	Consumer Credit Act 1974
CIS	Collective Investment Scheme
COBS	Conduct of Business Sourcebook
CP	Consultation Paper
EIS	Enterprise Investment Scheme
FIMBRA	Financial Intermediaries, Managers and Brokers Regulatory Association
FS Act	Financial Services Act 1986
FSA	Financial Services Authority
FSAVC	Free Standing Additional Voluntary Contribution
HAG	Handbook Advisory Group
HMT	Her Majesty's Treasury
ICA 1982	Insurance Companies Act 1982
IMRO	Investment Management Regulatory Organisation
ISA	Individual Savings Account
ISD	Investment Services Directive
ITSS	Investment Trust Savings Scheme
LAUTRO	Life Assurance and Unit Trust Regulatory Organisation
LR	Life Rules (in the context of the present cancellation regime)
N2	The date on which FSA assumes its full statutory power.

NLR	Non-Life Rules (in the context of the present cancellation regime)
OEIC	Open Ended Investment Company
OFT	Office of Fair Trading
OPRA	Occupational Pensions Regulatory Authority
OPS	Occupational Pension Scheme
PEP	Personal Equity Plan
PHI	Permanent Health Insurance
PIA	Personal Investment Authority
PSC	Post Sale Confirmation
RAO	Regulated Activities Order
RPB	Recognised Professional Body
SFA	Securities and Futures Authority
SIB	Securities and Investments Board
SIP	Statement of Investment Principles
SRO	Self Regulating Organisation
SSAS	Small Self Administered Scheme