



The Association of Independent Financial Advisers

Response to DP 07/04 Review of the Prudential Rules for Personal Investment Firms

Introduction

AIFA is the trade association that represents UK regulated independent financial advisers (IFAs). Membership of AIFA is voluntary and on a corporate basis. AIFA currently represents over 80% of IFA firms in the UK.

IFA firms are the leading distribution channel for retail financial products in the UK. They generate over 65% of business by monetary value and are the major sector advising and arranging on investment products in the UK. As such, IFAs represent a dominant force in the maintenance of a competitive and dynamic retail financial services market.

It is notable that this DP focuses on advisory firms, primarily IFAs, rather than wider distribution. In the light of recent events in the credit markets and the consequential impact on larger financial institutions and their retail customers, the debate should encompass the stability of all financial institutions and the potential outcome of the failure of a major organisation on market confidence, consumers and compensation scheme levy payers.

General comments

Although DP 07/04 is intended to be discursive, the views expressed are quite disturbing and in parts, contradictory. The comments also demonstrate a lack of understanding of the culture of the IFA sector. The repeated inference that firms make conscious decisions on their propensity to mis-sell and that the capital they hold reflects this is extreme and does not address the real debate about the purpose and role of capital. The gross overuse by FSA of the term “mis-selling” in a public document (136 times in 42 pages) does little to help with wider reputational issues or put into perspective the far better complaint record of IFAs or the fact that the vast majority of “mis-selling” (i.e. pensions and mortgage endowments) has been done by direct sellers and not PIFs.

Ignoring the tone of the DP, the pervading belief that many of the smaller PIFs are under-capitalised and therefore present a higher risk of failure is worrying. The paper labours under two misconceptions: (1) low capital affects a firm's behaviour by putting financial pressure on advisers to chase high up front commission, leading to the risk of mis-selling and (2) where a firm cannot meet its liabilities, its failure creates liabilities that fall on the FSCS. Whilst we accept that there have been isolated cases, we have not seen any evidence to support either of these scenarios as being systemic in IFA firms.

If FSA believes that a culture of conscious and deliberate mis-selling is endemic, they would do well to examine some of the largest financial institutions where shareholder interests may well prevail over those of consumers. For example, we have seen major banks committed to the continued sale of poor value loan-related Payment Protection Insurance, despite the known consumer detriment, as it is a good profit generator for them.

Further, if this were the case, it would be a regulatory failing on a massive scale which would call into question FSA's focus and activity since inception. We would need to see a root and branch review of all regulatory approaches from the way firms are authorised to supervision to thematic reviews in order to understand how this failure had arisen.

The vast majority of IFAs are small businesses whose clients' interests are closely aligned to their own. They are generally risk averse and go to great lengths in trying to meet acceptable standards for fear of regulatory repercussions, let alone the fact they rely on long term relationships and client loyalty for their very livelihood.

The stated purpose of the paper is to consider prudential requirements that might deliver four outcomes:

1. Reduce the frequency of mis-selling and therefore the amount of consumer detriment.
2. Reduce the impact of mis-selling by mitigating consumer detriment through firms bearing the costs of their mis-selling.
3. Mitigating the impact of latent liabilities after a firm has left the market or defaulted, reducing consumer and levy-payer detriment.
4. Enable a firm to wind down in an orderly manner.

We summarise below how best to achieve these outcomes.

1. Higher professional and ethical standards combined with closer supervision by management. The RDR proposals should help deliver this outcome.
2. Risk-related capital based on clearly defined criteria.
3. Implementing an effective statute of limitations that will help quantify latent liabilities, making them more insurable.
4. Explore further the notion of an exit fund and also exit audits.

If firms are to be subject to higher capital it must be accompanied by a fair interpretation of the statute of limitations. The “six-year rule” is completely ineffective and is invariably overridden by the “three year rule”. A major concern is over the interpretation and the application of the clause “three years from the date on which he became aware (or ought reasonably to have become aware) that he had cause for complaint”.

FSA procedures for issuing detailed and individual warnings to mortgage endowment policyholders appear to go far beyond what one would expect for someone to “ought reasonably to have become aware” to start the three year clock ticking.

We believe that the AIFA’s ‘Stakes in the Ground’ initiative, which captures the practices, attitudes and environmental conditions in which business is conducted at a point in time, should be developed into an industry-wide project. It would operate under a Supervisory Board with consumer interests represented, so they too can identify and ‘approve’ current practices and raise any issues at the time. They would be part of the process, not the recipient of it. This should lead to fewer complaints and more willingness to accept a statute of limitations. It would also help with financial capability.

The 15 year long-stop rule available in the courts should also apply to financial advice. We do not believe that the long term nature of certain financial products automatically makes them a ‘special case’. Where information has been regularly provided throughout the term of a contract, any problems emerging will become evident and there should be some consumer responsibility to act on that knowledge. After fifteen years, the changes in economic and regulatory environments are extensive, personal memory and records are either unreliable or unavailable, making judgements regarding the suitability of the initial advice extremely difficult to assess and subjective. Advice given at the point of sale could have been perfectly appropriate and in line with the then current practice. Episodes of ‘mis-selling’, owe more to retrospection and as such, cannot be predicted.

Overall, any increase in capital has to prove its worth otherwise its main effect could be a reduction of choice for consumers without rectifying the actual problem. In our view, FSA needs to re-evaluate its views on the role that capital has to play in addressing some of their concerns and clearly define the problem that a higher level of capital for IFA firms will resolve. Any substantial increases to the minimum level would have to be phased in over a three to five year period.

It is important to remember that for PIFs who are not subject to the full MiFID regime but have opted in to MiFID (and are undertaking IMD business), the capital requirement increases to €25,000 (approximately £17,500) and it would

appear difficult for FSA to justify increasing the requirement for non-MiFID firms above this level, should changes be considered necessary.

Specific questions

Chapter 2 – Background to the PIF sector and current regulatory requirements

Q1: Do you agree that this is the correct scope for our review or should we include MiFID PIFs?

The paper does not differentiate between full MiFID firms and Article 3 CAD exempt firms. In fact surprisingly, it makes no reference to the latter at all. Following guidance earlier this year from FSA and AIFA, several hundred PIFs who do not automatically fall within the scope of MiFID but are providing investment advice to clients in other EEA states, have opted into MiFID and we expect more to follow. This does not however mean they are subject to the CRD. Virtually all of the firms opting in to MiFID undertake insurance (life and pensions) business and as they will have PII cover to meet IMD prudential requirements, the capital requirement for the majority of these firms will be €25,000 – approximately £17,500. The question of scope is therefore more complex than presented. We would think it unlikely that FSA would wish to impose prudential requirements higher than MiFID on any PIFs so any review of non-MiFID requirements would need to take account of the requirement for A3CAD exempt firms and not just those subject to the CRD.

Chapter 3 – Market failure analysis

Q2: What is your view of our analysis of the market failures in the PIFs sector for advice?

We do not agree with the analysis. First, information asymmetry is inherent in virtually all professional services. The reason people seek advice from a qualified professional is because they are not sufficiently knowledgeable about financial matters or the range of potential solutions to their individual needs and want advice from those with the relevant expertise. Whilst we wish to see better informed and more confident consumers, we cannot expect many to achieve the level of knowledge and understanding of financial planning and associated products as a qualified adviser. What is most important is that consumers understand the nature and cost of the service that is being offered and can trust the advice they are being given.

There is much complexity in the current UK financial environment. Taxation and law, state benefits and complex personal circumstances do little to ameliorate the challenges faced by advisers and their clients. Information asymmetry is and will remain a feature of retail financial services; if buying financial products was risk

free and simple, consumers would not need the protection of regulation. In our view, information asymmetry is not market failure but a feature of the market that exists. To help close the gap, we need to address the imbalance through improved financial capability, fair value products that offer clear benefits, professional standards from those providing advisory services, a clear separation between advice and sales and effective regulation supported by an improved disclosure regime. Only with a combined effort will consumers have confidence in financial services.

The reference to commission as a conflict of interest is more debatable. There is an underlying assumption that the current commission structure leads to provider and product bias and disadvantages consumers. These assumptions have not been properly investigated and there is currently no substantive evidence to support or quantify consumer detriment.

The scenario set out in 3.3 to 3.6 of an adviser recommending that a customer opts out of her employer's pension scheme in favour of a commission-generating personal pension is historic and bears little reference to today's practice or regulation, (COBS 19.1). It should also be noted that the vast majority of opt-out advice came from the now long departed direct sales forces that were incentivised by remuneration led sales targets.

However, we accept the perception that commission generates bias is widespread outside of the sector and if commission is to be seen as an acceptable method of payment, transparency and consumer understanding need to be improved. The Retail Distribution Review is examining commission structures and alternatives such as Customer Agreed Remuneration and the outcomes of the review need to be considered alongside any changes to prudential requirements.

The third area of consideration, that of complaints, provides no evidence of a link between the number of complaints and firms defaulting. In fact, the number of complaints received by PIFs is a mere fraction of those received by providers and bancassurers. The averages quoted are not weighted and therefore present a false impression. As the paper states, 90% received 13 or fewer complaints. The Ombudsman also reported that in 2006/07 only 12 % of all complaints were generated by IFAs, 82% of regulated firms had no complaints referred to them and 11% had just 1 or 2. The vast majority of these are small IFA firms. FSA also confirmed that 86% of PIFs paid no redress in 2005/2006.

The costs that fall on current IFA firms to meet compensation payments for departed firms are the result of the profile of a typical IFA business. Unlike large provider firms, most IFA firms are mortal i.e., they do not always outlive their founders. This mortality does not indicate market failure; it is the nature of intermediary business. The FSCS has confirmed that a high percentage of claims relating to the advisory sector are against firms who have legitimately

departed the industry well before any claims against them materialise and the DP provides data to support this.

Chapter 4 – Can prudential rules reduce the frequency of mis-selling?

Q3: Do you agree with our analysis of the role of capital resources requirements and PII in reducing mis-selling?

No. We do not believe that capital and PII requirements influence behaviour or have any strong correlation with mis-selling. Poor advice stems more from incompetence and bad management, both of which are covered by FSA rules and addressed through other regulatory tools. The RDR proposals are looking to raise professional standards, a proposal we support and where FSA should focus its attention.

The current capital requirement has been in place since it was introduced by PIA so there are arguments for reviewing it and also for adopting a graduated approach to capital. It does seem rather illogical for the same £10,000 flat rate requirement to apply to sole trader firms and those with up to 25 advisers and a potential turnover of £3-4 million. However, the debate on capital cannot be held in isolation. Sustainable businesses need capital, effective PII and some certainty over their liabilities.

IFAs are moving steadily towards sustainable remuneration structures. The suggestion that financial advisers set out to mis-sell deliberately or give unsuitable advice and then hold funds in order to compensate clients is not supported by any evidence. Although most IFA firms hold more than £10,000 for sound business reasons, it is not known whether the insolvency rate of IFAs is any greater than that of other businesses but FSA is not a zero failure regulator and there should be an acceptable degree of failure.

The assertion that the risks of individual firms are not considered by PII insurers and brokers is also contradicted by our own research. Members of the AIFA PII forum confirmed that typical PI underwriters will in the first instance identify the type of portfolio they want on their book and this decision determines whether or not they are interested in a particular firm. The degree of scrutiny will then depend on the type and size of IFA being underwritten; the larger the risk, the more in depth the underwriting. A firm's soundness would then be assessed by considering factors such as their management of compliance, income stream (a concern if declining but also if rapidly increasing – can they cope with the compliance?), number of years in business, back income over ten years, stability of the business, particular specialisms or types of advice which may be high risk. The PII market's main concern is that a firm is stable and competent. It trusts that capitalisation is monitored by the regulator via RMARs. Firms with a bad claims experience will have problems getting PI cover even when the current

market is 'soft'. This being the case, there seems little incentive for a firm to 'mis-sell' under the assumption that any claims will be dealt with by their PII.

We therefore dispute the view that PI insurers do not consider the risks or set premiums accordingly. This is further evidenced by the swiftness with which insurers act as soon as they detect early signs of potential claims. This is evident now in the secured loan and sub-prime mortgage markets where it is increasingly difficult to obtain any cover for business written in Payment Protection Insurance and self-certification mortgages.

Q4: What is your view on the use of risk-based requirements?

In principle, we support a risk-based financial resource requirement provided that any higher minimum requirement can be negotiated down. We do not agree with the comments relating to MiFID firms as there is no reference to the requirements for PIFs who opt-in to MiFID and become A3 CAD exempt firms. We do agree that MiFID requirements could affect behaviour and if FSA set the minimum capital in excess of €25,000 then many more firms would be likely to opt-in. If FSA wished to gold plate these requirements it would need to justify its position.

Q5: Which parameters do you consider are the best predictors of the frequency of mis-selling?

Ignoring the inappropriate terminology used, if FSA is looking for criteria on which to measure risk in order to set capital, FSA should set clearly defined criteria for firms to measure against (a regulatory dashboard) and those meeting the requirements get the regulatory dividend. Whilst there would need to be some basics such as turnover, the range of key performance indicators should focus on regulatory track record, standards of management, systems and controls, T&C, level of qualifications and supervision, membership of trade and professional bodies. Capital should not be related to any particular category of adviser firm or penalise firms who have a large back book as this will not encourage sustainability. Neither should firms be automatically viewed as higher risk because they deal in particular products. Basically, better managed and professionally run firms should receive the dividends, irrespective of the nature of the service. This will deliver better outcomes to all consumers, not just those being served by an elite group.

Q6: What is your view on the use of capital resources requirements as a means of mitigating the risks to consumers arising from the remuneration method, professional standards and, additionally, for primary advisers, a limited range of products?

We do not believe that a lower capital resource requirement would provide sufficient incentive for firms to radically change its business model. As the paper

states 73% of firms have over twice the minimum (which at £20,000 is more than the requirement for A3CAD firms) and 41% have over 5 times. An AIFA survey conducted in November 2007 supports the fact that the majority of firms have more capital than required. It also confirmed that firms hold higher capital for a number of reasons but primarily because it makes good business sense. It is therefore illogical to offer lower capital as an incentive to change behaviour.

With regard to adviser categories, we do not support Primary Advice and have stated our views on PFP/GFA categories in our response to DP 07/1.

Q7: Is reform of underwriting processes by insurers, so that PII premiums are priced to reflect more closely PIFs' mis-selling risks, feasible?

In light of the FSA's views, we consulted with the PII market in order to be sure that we understood their underwriting processes. The evidence we gathered by speaking to both underwriters and brokers contradicts the DP's assumptions. PI underwriters use their own underwriting formulae to assess risk across a broad range of factors including turnover, back book, business type, business model, claims/complaints record, management and oversight, adviser qualifications. They may also look at a firm's compliance records as part of this assessment. Underwriters look at each case using their own base rate and consider what a firm is doing and how they are doing it with closer scrutiny on higher risk areas.

Q8: Is the current practice of writing insurance policies on a claims-made basis a significant barrier to reform of underwriting processes?

At our meeting with representatives of the PI market, we discussed whether there was any appetite or interest in insuring on other than a claims-made basis and we received a resounding no.

Chapter 5 – Reducing the impact of mis-selling on a going concern basis

Q9: Do you agree with our analysis of the possible drivers of the amount of capital that PIFs choose to hold?

No. We find FSA's narrow focus and complete lack of understanding of small businesses quite remarkable. We have undertaken our own research which identified the following reasons for holding higher capital:

- 71% - good business sense
- 53% - meet unexpected expenditure
- 45% - build reserves for investment/expansion/acquisition
- 30% - smooth volatility of income
- **9% - provides a cushion to meet compensation claims**
- 3% - security against conducting high risk business

NB Firms could give more than one answer.

We believe that a reasonable number of firms have an excess on their PI policy over £5,000 which requires them to hold higher capital. However, the paper gives no indication of the percentage of firms to whom this applies yet we believe this is likely to be one of the main drivers. For example, the 9% of survey respondents who see it as a means of meeting potential claims are probably firms holding mandatory higher capital.

Q10: What is your view on the use of capital resources requirements as a means of mitigating the impact of misselling on a going concern basis?

Before being in a position to answer this question, FSA needs to undertake a more thorough analysis of the firms that have defaulted over the past 5 or more years because they were unable to meet claims. They need to establish the reasons for the failure and to quantify the amount of capital that would have been needed to keep them afloat. Without more detailed information it is difficult to assess the extent of the problem or make a recommendation on whether or how capital might act as a means of mitigating failure. It should be remembered that the FSA does not operate a zero failure regime and capital should not be set at a level that attempts to remove all risk of failure.

The paper quotes two firms that failed, Millfield and Berkley Berry Birch, both of which were EBR firms, yet the focus of the discussions has been on small firms. These firms had complex corporate structures with cross-holdings and 'paper guarantees'. It is FSA's responsibility to ensure that firms have adequate solvency and adopt transparent accounting procedures.

The paper states that:

- *there is no real evidence of a link between a PIF receiving a large number complaints and falling into default (3.11) and*
- *of approximately 1,400 non-MiFID PIFs the FSCS has ruled in default since 2001, over 1,000 left authorisation more than three years before the default ruling (3.16)*
- *79% of firms declared in default by the FSCS had ceased to be authorised more than two years previously (6.6)*

These statements appear to support the argument that the level of capital has little to do with defaults or the impact on the FSCS.

If a larger amount of capital is to be tied up in intermediary firms, it must be possible for firms to present a business case (based on their risk mitigation procedures, experience, and backed by robust management information) to be able to negotiate for a lower capital position, likened to the Bank of England regime and Basel 2. We would need both a simple and complex model for assessing capital for firms who are equipped to operate in this manner. We

would also expect to see a review of the rules around capital, its sources and its definition, for example how goodwill and embedded value such as recurring income can be evaluated and taken into account when calculating capital.

Q11: What is your view on our analysis of the problems of the PII market?

We agree with parts of the analysis but it does not go far enough. The UK PII market does not function in a way that favours IFA businesses. The mandatory minimum requirements are set by EU Directives which are unnecessarily high for smaller firms. The 'claims made' basis on which the insurance is underwritten offers little protection in times of need as once an insurer is aware of a potential issue, high excesses or exclusions are introduced, effectively negating or heavily reducing the protection that firms are paying to receive. This can be evidenced today. We are currently in a 'soft' market with plenty of capacity yet following recent FSA activity and media attention, the PI market is closing ranks and restricting cover for mortgage intermediaries, particularly those who have advised self-certification mortgages. The PI market is also highly volatile with capacity and pricing subject to wide-ranging and global influences.

Most IFAs treat PII as an unavoidable business expense that provides cover only for catastrophic events or extreme cases of negligence. Whilst IMD and MiFID mandate the requirement for PII, and insurance is underwritten on a year on year compounding basis, it offers very poor value and fragile protection.

We believe there are four issues that need to be addressed to establish a more effective PII regime.

- The level of protection required by IMD and MiFID. We have had lengthy discussions with both FSA and the European Commission about this issue and know that FSA shares our view that the level prescribed by IMD is too high for small firms. This is substantiated by the lower requirement applied to the few PIFs not subject to IMD. We would urge FSA to continue to pursue the Commission for a review of the requirements to allow a more flexible approach including capital trade-off.
- Adherence to the statute of limitations by FOS and the FSCS as would be applied in a court of law will limit the amount of risk an insurer takes on and make underwriting easier, therefore reducing both the cost and volatility of cover.
- A tougher approach to prevent retrospective decision-making by the Ombudsman. Today's regulatory and commercial practices and economic performance must not be used to judge advice given a decade ago or even longer.

- Development of an industry 'Stakes in the Ground' initiative.

Chapter 6 – Reducing the impact of mis-selling on a gone concern basis

Q12: Do you agree that these measures (run-off PII, segregated trust and a bonding requirement) could mitigate levy payer detriment and secure the other benefits identified? Have we identified the main issues around their feasibility?

We agree with FSA's analysis of why firms become gone concerns and that the problem of compensation costs against departed firms falling to the rest of the sector is a contentious matter. The reform of the funding of the FSCS will alleviate some of the financial pressure on PIFs by introducing a fairer distribution of costs but does not deal with the fundamental question of whether, and if so how, firms should have the means for dealing with any claims against them crystallising post de-authorisation.

The DP presents some interesting data regarding liabilities of firms that de-authorised following FSA enforcement action, where they have voluntarily ceased to trade and those that had retired. This confirms that those whose authorisation has been revoked by FSA tended to leave behind bigger liabilities than those that exit voluntarily. This does raise the question of FSA supervision and whether it is acting quickly and effectively where problems are first diagnosed. The DP also states that the heaviest burden on levy-payers arises from firms declared in default within two years of ceasing to be authorised. This must therefore be the area of focus when considering any form of mitigation. The objective of protecting levy payers is a just one and the three options put forward are worthy of debate.

Run-off PII

The first point to make is that FSA cannot control the market and run-off PII will only be available if market conditions permit. During the crisis years 2002-2004 it was simply unavailable. Whereas FSA can suspend an authorised firm from trading if it fails to obtain PI cover, how would it deal with a de-authorised firm that was unable to obtain run-off cover?

We discussed the potential for a mandatory PI run-off market with PII market representatives and were advised that in their view, its success would be dependent upon volumes, the number of people leaving the industry, period of cover etc. A concern raised was that if a firm's current insurer had to offer run-off on exit, this would deter new insurers coming into the market.

We discussed run-off PII to cover claims for fixed periods of up to 5 years after a firm exits. Views were that if at this stage the firm was clearly in trouble such a scheme would not avoid a systemic collapse. If it was an orderly wind up, run off may be available but on an annual renewable basis.

Segregated trust to purchase run-off PII

Building funds within a segregated trust bank account with which to purchase run-off PI would not address the problems of availability either for firms in difficulty or adverse market conditions. Although funds would be ring fenced from any other claims, cash outside the trust would also be needed to meet excesses. There would be administrative costs of operating a segregated trust and regular assessments would be needed to monitor potential liability and cost of run-off cover, which could vary substantially over time. Overall, we do not consider this a workable option.

Bonding requirement

Of the proposals put forward, we believe a bonding requirement merits further exploration. But as stated in the DP, there is no indication of whether there would be insurers willing to offer bond schemes and our PII market representatives had no particular view as it was not their market.

Q13: Do you consider that, for long term products, the relevant product provider should take some responsibility for misselling claims?

Yes, we would welcome a move in this direction. We support FSA's recent guidance setting out provider and distributor responsibilities and its recognition of the AIFA and ABI publication that helps further define the areas of responsibility throughout a product lifecycle. This work has provided greater clarity of a provider's responsibility for design and stress-testing the products it produces and for the information, risk disclosures and guarantees that are presented to intermediaries and customers to be clear and not misleading. Advisers are responsible for understanding the product, the suitability of their recommendations and proper use of the literature provided to them.

But this welcome move has not led to any formal regulatory position on how liability could or should be divided in the event of a product 'failure'. Neither the FOS nor the FSCS recognises joint liability and it is not within their jurisdiction to make a judgment on liability or apportion costs in the event of a complaint about a product recommended by an intermediary that leads to compensation. Currently, the only course of action that an intermediary firm has to recover costs from a provider is through the courts under the Civil Liability (Contribution) Act. This is far from satisfactory and we would encourage FSA to undertake further work on enshrining responsibility into the regulatory framework.

Chapter 7 – Enabling firms to wind down in an orderly manner and the quality of capital and capital resources

Q14: Should the FSA require all PIFs to hold capital resources to cover their orderly wind down costs? Should this be an EBR? Do you agree with our view that, as there are different risks, the requirement should be additional to any capital resources requirements in respect of a firm's mis-selling risks? What

should be the number of weeks' expenditure applied and should this differentiate in any way between firms, for example on a size basis?

The rationale for retaining the current flat requirement of £10,000 is questionable in today's environment and as FSA has confirmed, the majority of firms hold far more than the requirement. That said, any increase to cover wind down costs needs to be justified and on a basis that meets clear objectives. There does not appear to be any substantive evidence of firms being unable to wind down and exit in a solvent and orderly manner, so we question whether this is a reason to impose EBR requirements on all firms. We suggest that FSA reconsiders what higher capital is trying to achieve. As stated previously, we are not opposed to consideration of an increase that combines all relevant factors, size of firm, turnover, risk and expenditure but we would not support an increase unless there are clearly defined objectives and benefits based on sound analysis, not speculation.

Q15: Should we introduce rules to increase the quality of capital used by PIFs to meet their capital resources requirements – for example, by restricting the amount of subordinated loans that are eligible? Are there any other options that would be appropriate to deal with this issue, such as changing the terms of subordinated loans?

Unless there is a correlation between firms that fail and those that have a high percentage of their capital requirement met by subordinated loans, we see no reason to change the rules. If a restriction on the use of subordinated loans is imposed it should not be for all firms but on a proportionate basis.

Q16 Do you agree that, if we set capital resources requirements for wind downs for all firms (including PIFs), we should also include adjustments to reflect the relative realisability of their assets and liabilities? To what extent do you consider that the approach reflected in existing rules on adjustments could be simplified?

We understand FSA's concern that capital should be readily realisable but any change to the accounting rules of fixed assets would again, need to be justified on the basis that PIFs using fixed assets to meet capital requirement present a greater risk of defaulting than those that do not.

Final thoughts

We believe FSA should give consideration to an exit audit on firms as part of an agreed wind-down process. This should be a published process, giving firms transparency of what FSA would want in terms of solvency and timescale. Firms would have the ability to negotiate terms based on their risk profile.

Firms choosing to hold more capital should have this counted as a positive on the 'regulatory dashboard'.

The real aim must be to ensure that there is a strong market for professional advice firms to buy and sell each other and be attractive to external investment or purchasers. This would reduce the number of firms closing down and exiting, leaving potential liabilities to fall to the FSCS. The RDR has the potential to help create the conditions to bring this about.

Is FSA trying to cure an historic legacy issue or willing to focus on the future?

AIFA – December 2007