Retail Distribution Review

Questions & Answers

April 2014

Retail Distribution Review (“RDR”) – Questions & Answers

An introduction to Retail Distribution Review

On 31 December 2012, the UK Financial Services Authority (FSA) changed the rules about how Financial Advisers describe their services and the way UK consumers pay for them. These changes are commonly referred to as the ‘Retail Distribution Review’ or simply ‘RDR’.

In summary, the main aims of RDR:

- address the potential for commission to distort consumer outcomes (commission-bias)
- improve the clarity with which firms describe their services to consumers
- increase the professional standard of investment advisers

The main RDR changes apply to FSA regulated firms when making advised sales to UK retail clients. The FSA define a retail client as “a client who is neither a professional client nor an eligible counterparty”

What do the new rules mean?

The new rules are designed to clarify to the investor:

- what services are offered; and
- how much they’ll be charged for those services.

In some cases, financial advisers are paid by means of commission from product providers such as First State Investments.

Payments from product providers to financial advisers in relation to UK retail clients are no longer permitted when new financial advice is provided.

When dealing with UK retail clients, instead of receiving commission, financial advisers have to agree charges upfront directly with the client for any new financial advice.

What is ‘commission’?

- Commission is a payment made by financial product providers, e.g. First State Investments.
- Commission is typically built into the product charges – e.g. the ‘initial charge’ and the ‘annual management charge’ (AMC).
- Commission generally comes in two forms: initial and trail (also known as ‘renewal’ and/or 'ongoing’)
- The amount of commission paid varies between products and providers.

What is First State Investments’ approach?

One of the main challenges facing product providers is how to separate and appropriately deal with business received pre-RDR (before 31 December 2012) from post-RDR business. Pre-RDR business is sometimes referred to as ‘legacy’ business.

Commission can no longer be paid on advised business to UK retail clients. As a result, many fund managers are offering ‘RDR-ready’ share classes. These new share classes are ‘clean’ in terms of commission and platform administration charges. Since RDR-ready share classes do not pay commission, the management fee is typically lower than an equivalent commission-paying share class.

First State Investments ICVC offers a range of Class B shares that do not pay commission and therefore generally have a lower annual management charge than the equivalent Class A shares. Class B shares have a higher minimum investment requirement than Class A shares.

The minimum investment for Class B shares is £500,000/€500,000/$500,000.

If a client with a financial adviser holds Class A shares, their financial adviser may recommend they convert their investments to the equivalent Class B shares. If this is the case we will waive the minimum investment requirement.

UK retail clients may also be able to invest in Class B shares through other financial service providers such as fund platforms or fund supermarkets.

A list of financial service providers that offer First State Investments' Class B shares to UK retail clients is available online at www.firststate.co.uk

First State Global Umbrella Fund offers a range of Class III shares that do not pay commission and therefore generally have a lower annual management charge than the equivalent Class I shares. Class III shares have a higher minimum investment requirement than Class I shares.

The minimum investment for Class III shares is $5,000,000. If a client with a financial adviser holds Class I shares, their financial adviser may recommend they convert their investments to the equivalent Class III shares (where available). If this is the case we will waive the minimum investment requirement.

How does the Retail Distribution Review affect investments with First State Investments?

The impact of the Retail Distribution Review varies according to how the client invests with First State Investments.

If a client invests directly, without a financial adviser

If a client invests directly with First State Investments and does not have a financial adviser then they are unaffected by the Retail Distribution Review.

Investments (including regular savings payments) no longer incur an initial charge, unless the investment is into any of our soft-closed funds. For funds that are soft-closed an initial charge of 4% still applies. Soft-closed funds are funds that have ceased to take any new investment in order to protect existing investors. In order to discourage new investment, we apply the 4% initial charge.

If a client invests with a financial adviser

If a client invests with a financial adviser we may have applied an initial charge of up to 4% of which up to 3% would have been passed on to the financial adviser as commission.

We are no longer allowed to pay financial advisers commission on new advised lump sum investments or top ups in respect of UK retail clients, and therefore, regardless of whether the client is a UK client or not, we do not apply any initial charges except for funds which are soft-closed. For funds that are soft-closed, the initial charge of 4% still applies.

Any trail commission paid to a financial adviser before 31 December 2012 will continue on the same basis subject to FSA regulations, unless the client instructs us to stop it.

If a financial adviser is dealing for a client without providing financial advice (i.e. on an execution only basis), they may still be able to receive initial commission of up to 3%. If this is the case we will apply an initial charge equal to the amount of commission requested by the financial adviser.

The financial adviser will have to declare on the application form that an advice event has not taken place.

Regular savings

The FSA regulations require that regular savings plans are treated differently dependent upon when they were set up, and whether advice was received.

Advised regular savings plan in place prior to 31 December 2012

We will continue to apply an initial charge on regular savings plans set up prior to 31 December 2012. The initial charge will be equivalent to the initial commission paid to the financial adviser. The exception is soft-closed funds where an initial charge of 4% is applied and the amount is retained by First State Investments.

We will continue to pay trail commission in respect of your regular investments. However, should the client increase the amount they invest through their regular savings plan or change the fund in which they invest, we will only pay commission on the shareholding held prior to the change. No commission will be paid in respect of the regular investments from the time of the change. If the regular savings plan is reduced, commission will be paid only in respect of the regular investments at the lesser amount.

New advised regular savings plan in place from 31 December 2012

We do not apply an initial charge on regular savings set up on or after 31 December 2012. The exception is soft-closed funds where an initial charge of 4% is applied and the amount is retained by First State Investments. No trail commission will be paid on any advised investments made on regular savings plans set up from 31 December 2012.

Non-advised regular savings plan in place from 31 December 2012

In the case of a UK retail client where the financial adviser is dealing without providing financial advice (i.e. on an execution only basis), the financial adviser may be entitled to receive initial commission on the regular savings plan set up on or after 31 December of up to 3%. We currently apply an initial charge equivalent to the initial commission paid to the financial adviser. The exception is soft-closed funds where an initial charge of 4% is applied and the amount is retained by First State Investments.

Trail commission paid to the financial adviser before 31 December 2012 will continue on that basis subject to FSA regulations unless the client instructs us to stop it.

Where can clients get more information?

If you invest directly into one of First State's funds then you may already have received a letter with information about the Retail Distribution Review.

All enquiries to First State Investments should be directed to enquiries@firststate.co.uk or by calling the Client Services team on 0800 587 4141

Financial advisers are well placed to explain how the changes will affect clients and their investments.

The FSA has also produced a consumer guide which is a useful tool that highlights the new rules. The guide can be downloaded from the FSA's website http://www.fsa.gov.uk/static/pubs/consumer_info/rdr-consumer-guide.pdf