ADVISER BUSINESS REVIEW

Insight • Innovation • Inspiration

Regulatory Focus:
Staying Independent

in Association with ateb consulting

About ATEB

Approved by the FCA as a Skilled Person, ATEB was one of the first compliance consultancies in the UK and a founder member of the Association of Professional Compliance Consultants (APCC). ATEB has worked closely with various regulators including PIA, FSA and now the FCA. We provide regular compliance support consultancy and services to over 100 advisory firms ranging from Networks to Sole Traders. We don't simply cut and paste rules, we interpret them for our clients. We act at the cutting edge of compliance, checking hundreds of pension and investment client files each year. Our consultants engage in extensive systems and controls design to complement up-to-date regulatory feedback.

ATEB directors Steve Bailey and Huw Reynolds

Staying Independent

In this guide ATEB Consulting provides valuable insight into how advisory firms can continue to be designated as 'independent' financial planners and advisers.

What is the scope of this guide?

For many firms the majority of this booklet will be validation of what you already know about independence. We have however included some anecdotal evidence to help illustrate various points, based on our field visits, knowledge and firm audits. In parts the booklet may contain our general views and interpretation of the rules and as such it is not intended to be individual advice.

No surprises

The one thing that is reassuring however is that what we anticipated in the 3-4 years leading up to RDR has pretty much happened as planned. Although there have been some finer points that have come into play, mainly following the FCA thematic work around independence, the vast majority hasn't changed since the publication of the draft rules and guidance.

Defining Independence

An 'Independent' adviser must ensure that they really do act as such and are genuinely free from influence or restriction on what they can and do recommend.

Contrary to what you may have heard previously, the fundamental standards for independence are not that different to the standards that existed pre-RDR. Many have been saying that the standards for independent advice have increased; we are not convinced.

Apart from the requirement for Independent firms to consider a wider range of products than the previous 'packaged products' definition, and the removal of the 'whole of market requirement', the same principles of independence existed prior to RDR.

However, having asked countless IFAs for the post RDR definition of independent advice, not many have answered correctly.

In broad terms the new description of independent advice is that a personal recommendation, in relation to a Retail Investment Product (RIP), is based on a comprehensive and fair analysis of the relevant market; and is unbiased and unrestricted. If you cannot satisfy the requirements of independence, then you are, by default, restricted. If your firm cannot or will not ever recommend a product type or product provider, even if that product or provider would be suitable for the client, this would be restricted advice.

The FCA is now placing a greater emphasis on clarity for consumers. In our view, they simply want to be sure that firms are pretty much doing 'what they say on the tin' and not misleading clients. While the FCA is neutral on the issue of Independent versus Restricted, they have stated '…if a firm is holding out as being independent but this is not happening in practice then the client may suffer detriment'. The devil will be in the detail and if firms are truly acting independently without predetermined solutions then this will be reflected in their records, systems and controls.

The FCA has produced various support material to help firms understand what is required and we have summarised key material under our reading list. If you haven't watched the FCA video on delivering independence then we recommend that you do. In the short video, Rory Percival (Technical Specialist at the FCA) talks about Independence being a state of mind, he urges firms to keep an open mind and consider all options and explains it's not about creating an artificial spread of investments or platforms; it's about clients receiving the right advice. He confirms that advisers do not need to understand and review every possible product in the market comprehensively, rather a comprehensive review 'across the market'. He confirms that it is perfectly reasonable to filter the market to a shortlist and then to conduct research and due diligence on the short list or panel of products that you will recommend (see page 7).

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‘Indicators’ that you may not be Independent

As part of our approach to checking a firm’s independent status we look for ‘Indicators’ which could suggest that the firm is Restricted. Please note that these are simply ‘Indicators’ they are not conclusive or definitive as each case would need to be considered individually. Although not an exhaustive list, we have shared some of these ‘Indicators’ with you and these are shown right and are detailed on pages 8-13.

Some of the indicators ‘cross over’ but hopefully it will give you some idea of the potential Independence ‘Banana Skins’.

Indicators of restricted advice

- ✗ Order Taking or Cherry Picking
- ✗ No documented Investment Process
- ✗ Wholesale RIP exclusions
- ✗ A ‘one size fits all’ Platform or Centralised Investment Proposition
- ✗ Non-RIP solutions being ignored
- ✗ Contingent style charging structure
- ✗ Payments from someone other than your client
- ✗ Unable or unwilling to give advice
- ✗ Single-minded views
- ✗ Promoting irrelevant features
- ✗ Over reliance on ‘Sticky’ support
- ✗ Poor Research

So what does Independence look like?

We often use the term 'self-regulating' because it's the firm that will determine the outcome of any FCA visit, no one else. We would urge firms not to overlook the regulator's desire to see firms conform to the new standards.

If you really want to be Independent then our advice is simple:

- Don't take referral fees or any third party payment that is linked to a product or service;
- Keep an open mind when you fact-find and offer solutions;
- Create a fee structure that means that you get paid regardless of the advice outcome;
- Ensure that any obligation, ownership, finance or something 'sticky' does not prevent the firm from providing a personal recommendation which is unbiased and unrestricted;
- Don't offer pre-determined and default solutions;
- Always explain the virtues of holistic advice to clients;
- Maintain up-to-date CPD across the market;
- Ensure that your systems are transparent and well documented.

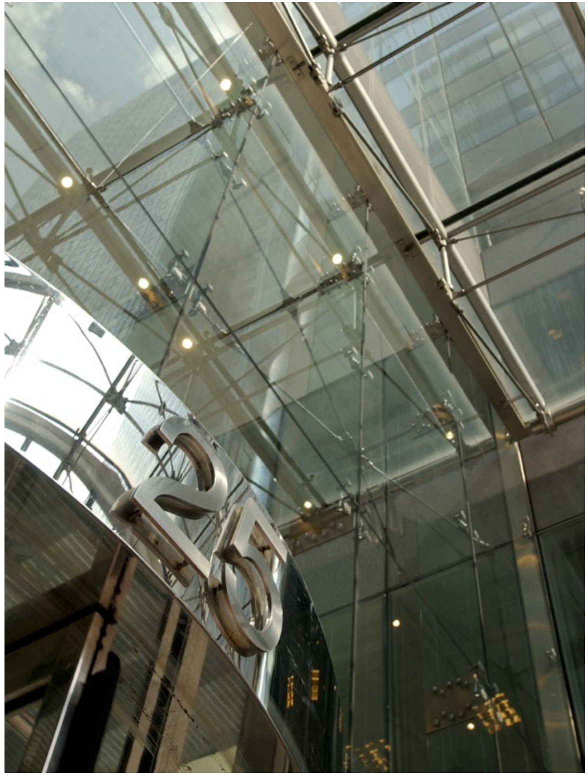
The FCA are on record as stating that firms have had more than adequate time to comply with the rules and they will consider referrals to enforcement for non-compliance. Remember platforms and centralised investment propositions are not 'Retail Investment Products' so they would be part of a solution rather than the solution. So please bear in mind that just because you are an honest adviser and investing your clients' monies in a wide range of underlying funds selected from the universe, it doesn't automatically make you Independent.

A final thought just to illustrate the importance of good quality systems and controls. Think about the scenario where you have say a ten adviser firm that has allowed a 'free spirited approach' to independence and all its self-employed advisers approach things differently. Then based on the banana skins highlighted in this booklet the firm now has 120 (10x12) potential banana skins that could default into Restricted. If just one of its advisers is Restricted then they all are. As the three musketeers would say "all for one, one for all"

We hope this booklet gives you comfort and confirms that you are indeed acting independently. Alternatively the content may be a trigger to make modifications so that your services truly reflect those of an Independent Adviser or simply change the description of your services to Restricted.

FCA video on independence

In the FCA video on independence, Clinton Askew (above left), director of Citywide Financial Partners and member of the FCA's Smaller Business Practitioner Panel, interviews Rory Percival (above right), Technical Specialist at the FCA, about the regulator's independence requirements. Click here to view FCA video.



Checking your independence

	OBSERVATIONS	INDICATORS	ACTION
Order Taking or Cherry Picking	Many firms shortcut the need to 'wade through' a full fact find and instead 'Order Take' or 'Cherry Pick'. Typically, they do this by explaining that the advice will be conveniently limited to one or more areas and document that the client declined advice across all potential areas of need. Are you a holistic financial planner or an order taker?	If the firm leads the client to just consider limited areas, this is likely to be Simplified Advice (broadly a form of Restricted Advice where the firm stipulates restrictive boundaries to the service). High percentages of clients that receive limited advice could be an 'Indicator' that advice is being Restricted.	Firms should give a clear unambiguous explanation as to the benefits and implications of gathering full information and examination of all relevant financial areas. Clients can of course define the service by requesting the firm focus on one or more areas of need.
No documented Investment Process	From what we can see on our travels most firms don't have a tailored documented investment process or if one exists it is either too basic or its application is inconsistent. By 'Investment Process' we mean a written procedure that clearly demonstrates to a third party how you make your advice decisions. The investment process links in with segmentation; trigger questions and different high level propositions (for example: fully bespoke, model portfolio, DFM, passive, managed etc.) to meet the different potential needs of your clients.	Without a clearly defined written investment process independence is unlikely to be transparent to a third party and if the firm cannot prove independence then it will naturally default into Restricted Advice.	Whilst the existence of a written process is important it's the application and monitoring of the process that is vital. Please therefore ensure that you have this covered; it's a big task if done correctly, so don't underestimate its significance.

	OBSERVATIONS	INDICATORS	ACTION
Wholesale RIP exclusions	All recommendations will be driven by client needs and it may be possible for a firm to conclude for many clients, early on in the advice process, that certain product types are not going to be suitable, and therefore not consider these product types further for those clients. Some independent firms however, have chosen to avoid certain products almost on a 'wholesale' basis having taken the general view that they do not match the needs of their client base.	The FCA does not expect a firm to actually recommend all products captured by the broad definition of retail investment product as a matter of course but expects firms to at least consider them. Therefore, whilst in theory you can remain independent by excluding certain products centrally (for example unregulated investments) the approach of 'wholesale exclusion' could be an indicator of Restricted Advice.	Firms should however keep an open mind and be careful not to adopt a wholesale exclusion without good reason. If discounting is done centrally then care should be taken so as not to materially disadvantage an individual customer. All decisions should be kept under review as circumstances can change and advisers should maintain their knowledge in areas across the market.
A 'One size fits all' Platform or Centralised Investment Proposition	Most firms appear to be finding a sensible balance here and we see a wide variation of RIP's being recommended by firms with usually two or three platforms or centralised investment propositions being adopted for different reasons together with off-platform solutions. This makes sense because to our knowledge there isn't as yet a single platform that accepts sufficiently high numbers of different RIP's. However we have heard a small number of firms say 'it's easier for the firm if we place everyone onto one platform'. The FCA refers to this poor practice as 'Shoehorning'.	Remember being independent is not about what is right for the firm it's about the client's needs. Ignoring wider alternative potential solutions could be an indicator of Restricted Advice.	Assuming that your firm's investment process is independent and you have similar clients with similar needs then it is possible that the bulk of these could find themselves on the firm's main platform however, it is highly likely that you will need other solutions too. Firms should keep an open mind and be careful not to 'push' clients on to a particular platform without good reason. All decisions should be kept under review.

	OBSERVATIONS	INDICATORS	ACTION
Non-RIP solutions being ignored	We check hundreds of files each month for independent firms and we see very little reference to non-RIP solutions such as National Savings.	In providing unrestricted advice a firm should consider relevant financial products other than retail investment products which are capable of meeting the investment needs and objectives of a retail client, examples of which could include National Savings and Investments products and cash deposit ISAs. Ignoring 'Non-RIP potential solutions' could be an indicator of Restricted Advice.	The FCA does not expect a firm to recommend non-RIP solutions to simply make up the quota however, firms should at least be making reference as to why they have been discounted, not necessarily in the suitability report, but certainly as part of the product analysis/research process. We suggest that the firm's systems and records make clear reference to wider non-RIP solutions and where they have been discounted the reason is clear from the client file.
Contingent style charging structure	Some firms only get paid initial fees when they arrange and implement a new product and whilst the RDR removed the 'Product and Provider Bias' it did not remove 'Transaction Bias'. I'm sure that a charging structure that simply 'maps' from the commissions (pre-RDR) to fees (post-RDR) is not really what the regulator had in mind!	There is an argument that the advisers operating these charging structures have an incentive (bias) towards recommending a transfer which could be an indicator of Restricted Advice and may not always be in the client's best interests.	Can you really afford to offer your advice for nothing? Are you really keeping an open mind by only getting paid when the client agrees to a product switch? Our advice is simple; create a charging structure that is completely indifferent as to which route you take and don't let different potential client outcomes determine how much you get paid.

	OBSERVATIONS	INDICATORS	ACTION
Payments from someone other than your client	Some firms continue to pocket payments from third parties relating to a RIP or connected service. An example could relate to a commission from a provider of unregulated investment that is arranged within a SIPP or an introductory commission for referring a client to an annuity specialist.	Within the spirit of RDR firms should only get paid from their clients. So firms that receive third party payments (whether directly or indirectly) may well be breaching FCA rules. That aside, such arrangements have the potential to include bias and lead to poor consumer outcomes and could be an indicator of Restricted Advice.	Our advice is simple; create an 'amnesty of third party payments' by checking with all your advisers (particularly self-employed) what 'ancillary' payments (if any) they have received or are still receiving. Senior management should then decide what action is needed, which could include a third party payment prohibition. This maybe something that you would document within your conflicts of interest policy.
Unable or unwilling to give advice	Some firms choose not to advise on certain types of transactions, for example where the relative risk is considered too great or there is lack of knowledge in the firm or they feel that it would not be in clients' interests for them to give advice. If something is not in the client's best interests because for instance the cost of the firm's advice outweighs the benefits of the recommended product, then the firm can decline to act. However a firm that for example routinely refers its personal pension switching transactions to another firm will not meet the standard for independent advice.	If a firm cannot or will not advise on a particular type of retail investment product, and that product could potentially meet the investment needs and objectives of its new and existing clients, then its advice will not meet the standard for independent advice. High percentages of referrals to third parties could be an 'Indicator' that advice is being Restricted.	In relation to the activities of advising on pension transfers and opt-outs (requiring additional permissions) and long term care - which are activities requiring an appropriate qualification, the firm's independence is not affected where it cannot advise in these areas. Senior management should ensure the firm is able and willing to give unrestricted advice by implementation of robust systems, training and qualifications. CPD should reflect the fact that the firm is able to advise on wider RIP's even though it may not have recommended these areas previously.

	OBSERVATIONS	INDICATORS	ACTION
Single-minded views	Much of the advice given today is relatively subjective but when firms and individuals nail their colours so decisively to the advice mast then they really need the facts close to hand to support their views and actions. Strong singular views can sometimes cloud objective judgment. Examples can often be found in firms who predominately or exclusively use a particular platform, provider, product or even a passive investment strategy.	Let's consider the exclusive use of passive investment strategies as an example. When constructing a passive portfolio certain retail investment products would automatically be excluded for example structured products or investment trusts. So in theory the exclusive use of passive investments could be an indicator of Restricted Advice.	Without wanting to put a regulatory fly in the advice ointment, firms need to be mindful that the FCA has said to keep an open mind. As such in our example your documented research of investment strategies will need to be robust, fair and comprehensive and you should ensure that you have asked your clients sufficiently relevant and detailed questions to determine that the solutions are a suitable match to their requirements. Finally be prepared to offer something different if you need to.
Promoting irrelevant features	We sometimes see the firm's standard service proposition, literature and website promote features that are only offered by a particular platform. For example 'Access to all information on mobile devices' but with no alternative option to exclude these features for clients where they are not a requirement. As such the firm's 'Independent Offering' is broadly a copy and paste of the features offered by the main platform being used. Worryingly, we also have viewed some service propositions that openly promote and name the platform from outset.	Both Independence and suitability of advice is questionable from outset because some of the features being offered as standard are unlikely to be relevant for many clients. As well as being an indicator of Restricted Advice firms are likely to be pushing a predetermined default solution. Firms operating in this way could be 'shoe horning' and do not appear to be keeping an open mind.	Unless you are operating in one of the FCA named 'Relevant Markets' your propositions should be product and provider neutral and cater for all types of clients with different needs.

	OBSERVATIONS	INDICATORS	ACTION
Accepting 'Sticky' support	Platforms supply investment planning tools and other services to adviser firms. Examples could include tools such as 'fund x-rays', which firms can use to get a view of individual portfolio asset allocation and stock exposures by aggregating all portfolio holdings.	Provider and platform tools have a tendency to be 'Sticky' and can contain Guided Architecture (for example where the software provider has steered fund selection outcomes) both of which may be more aligned to third party interests rather than the client's and could be an indicator of Restricted Advice.	Independent firms should not have any kind of contractual agreement, or any other constraint or obligation, with any service or provider that would restrict their ability to act in their client's best interests and independently. We suggest that firms that feel their relationships are 'sticky' should review their processes carefully to ensure that provider systems support or training is not influencing the advice given in any way. In theory the firm should be able to work autonomously without the service, facility or platform.
Poor Research	Some firms may have the view that if they issue comprehensive due diligence questionnaires to the key platform providers then its 'job done'; however a word of caution, the FCA definition of Independence is inextricably linked to 'Products' and not 'Platforms'. Some platform providers only offer a single choice of product type or tax wrapper. Independent firms must take a 'fair and comprehensive' approach to the selection of products such as Investment Bonds, SIPPs and ISAs even if the underlying fund choice is based on the fund universe. Some panels (this could include model portfolios) are not sufficiently broad or reviewed regularly.	A poor use of a platform, panel or research tool can result in an outcome that is not in line with the client's best interests rule and principle and could be an indicator of 'Restricted Advice'	Research must be fair and comprehensive, unbiased and unrestricted. Firms must have a good knowledge of product features and risks and how they meet their clients' needs. The firm should conduct due diligence on any aspect of its research that it outsources to a third party and understand the limits of its current research facilities. Firms need to be able to demonstrate that clients are not materially disadvantaged by the use of a platform or panel. This is one of the reasons why timely file checks are essential.

Reading List

Stage 1 - Three-stage thematic review into RDR

In July 2013, the FCA started conducting a three-stage thematic review into RDR practices and the first stage of that review can be found here: http://www.fca.org.uk/static/documents/thematic-reviews/tr13-05.pdf

Stage 2 - Three-stage thematic review into RDR

This second stage focused on whether firms who describe their services as independent were offering an independent service in practice and how firms were disclosing their service proposition and charging structure to clients. The outcome of the second stage review can be found through various links:

TR14/5: Supervising retail investment firms: delivering independent advice

This FCA report helps provide clarity and includes examples of good and poor practice.
http://www.fca.org.uk/news/tr14-5-supervising-retail-investment-firms

FCA Video

There is also a video that provides useful information available here:
http://www.fca.org.uk/news/tr14-5-supervising-retail-investment-firms

Factsheet 009: Independent and restricted advice

There is also a Fact Sheet that provides useful information available here:
http://www.fca.org.uk/your-fca/documents/fs-009-independent-and-restricted-advice

TR14/6: Supervising retail investment firms: being clear about adviser charges and services

This is a report outlining how firms are meeting the disclosure requirements.
http://www.fca.org.uk/news/thematic-reviews/tr14-6-supervising-retail-investment-firms

Stage 3 - Three-stage thematic review into RDR

The third stage of the thematic review commenced in the third quarter of 2014. If the FCA find substantial failings in this stage it is likely that they will take further regulatory action.

Handbook Rules

The Conduct of Business Sourcebook (COBS) sets out the relevant rules. You can find them here http://fshandbook.info/FS/html/FCA/COBS/6

Further Information

In June 2012, the regulator published finalised guidance (FG12/15) on independent and restricted advice. This is an important document and can be found here http://www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg1215.
It provides an excellent start point for those trying to translate the rules into everyday best practice.

Another important document is the finalised guidance (FG12/16) concerning replacement business and centralised investment propositions here http://www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg1216

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