

FCA Positive Compliance Workshops (1 out 3)

A number of the Financial team have recently attended the FCA's Positive Compliance Workshop which concentrated on the topics of RDR and Centralised Investment Propositions (CIPs). As a result, we felt it would be useful over the next few "Financial Updates" to provide you with some feedback and pointers to where the FCA have concerns and what they are likely to be focusing on next year.

The FCA are looking to engage more with the advising community and following general questions and feedback from previous workshops, RDR and Centralised Investment Propositions were the two areas where advisers felt they needed clarity.

If you have not yet attended, we would recommend that you do as both presentations are informative and helpful, giving you the option of raising specific points direct with the regulator. The workshops are continuing up to March next year so still time to book through the FCA website.

Before sharing their thoughts on RDR and CIPs the following is a list of concerns that were highlighted, in no particular order:-

- Ability of independent advisers to demonstrate their independent status, and where applicable, are restricted advisers able to clearly disclose the nature of their restriction?
- Are advisers able to evidence that they are providing the agreed level of on-going client servicing?
- "Contingent charging" where adviser remuneration is influenced by whether a client agrees to a recommendation given is seen as "higher risk"
- FCA have seen an increase in applications for discretionary permissions. This is seen as an emerging risk. Are advisers suitably competent to provide such a service?
- "Shoe-horning" and "Churning" of replacement business into Centralised Investment Propositions without evidencing INDIVIDUAL suitable advice.
- Due Diligence and Research – thematic review to follow next year!

Pension Freedom – Post April 2015

Prior to the start of the workshop, myself and Richard Warrington took the opportunity to ask the regulator when further guidance would be available on their requirements post "pension freedom" in April 2015. This is obviously going to be a pivotal time in the retirement advice space and we are keen to ensure consumers are provided with an appropriate advice or guidance process and that members are kept informed accordingly.

The FCA indicated that they were awaiting further details from the government before they were able to provide any detailed guidance. They do believe that due to the tight timeframes there is a strong likelihood of initially poor consumer outcomes.

FCA Positive Compliance Workshops – RDR (2 out 3)

The morning session of the workshop focused on how successful firms have been at implementing the Retail Distribution Review (RDR) requirements, it provided delegates with guidance on the key RDR topics and also highlighted concerns where poor practice had been identified.

Attaining the Right Kind of CPD

Catherine Court delves into the matter of what Continuing Professional Development should comprise... Watch now

Since the introduction of RDR, the FCA have launched a three stage thematic review to assess firm's overall approach. The first stage was completed in July 2013 with paper TR13/5 "how firms are implementing RDR", the second in March 2014 with paper TR14/5 "delivering independent advice" and finally in April 2014, paper TR14/6 "being clear about the adviser charges and services.

As an introduction, the question put to the delegates was "How can you demonstrate compliance with RDR...what can you show me?"

Like complying with Treaty Customers Fairly, there is no model answer and evidence of meeting the RDR requirements should be embedded in your day to day business practices, systems and controls. There are however three main areas to focus on which are each detailed below:-

Professional Standards

As we know, advisers have needed to obtain Level 4 qualification standard to continue providing investment and pension advice post RDR and through Continuous Personal Development (CPD) be able to evidence on-going competency. This is confirmed with an annual Statement of Professional Standard (SPS).

To encompass the above requirements, the regulator felt that core to evidencing these standards is a robust Training & Competency file.

Good Practice: Examples were given as to the types of documentation that could be included:-

- CPD records
- Tests of technical knowledge
- File check reviews
- Client feedback (from an RDR perspective)
- Observation / role play records
- Evidence if risk management weighted toward areas of "higher risk" and/or "non-regular business"

Independent / Restricted

Adviser firms have been required since 2013 to describe their services as either independent or restricted. Currently 80% of the advising population have classed themselves as independent whilst the remaining 20% are restricted.

The regulator confirmed that:-

independent advice must be comprehensive and a fair analysis of the relevant market.

- it must be unbiased and unrestricted
- an independent adviser should be able to discuss/give advice on any retail investment product (RIP) should a client who walks through the door require it.
- If a specific RIP is deemed not suitable or inappropriate for a client, an adviser does not need to discuss it.

If a personal recommendation on a RIP does not meet the standard for independent advice, then it is restricted advice. However, restricted advice must meet the same suitability, inducement, adviser charging and professionalism standards as independent advice.

A current concern highlighted by the regulator was firms failing to clearly disclose the nature of their restriction, whether product or provider.

Good Practice: To help firms challenge their own processes and be comfortable that their advisory status is clear, the regulator offered some ideas and example of good practice:-

- Emphasise your professionalism (blow your own trumpet!) – why are you best?/ why are you independent?
- Provide the client with a copy of your advice process evidencing in depth research and a clear advice strategy
- Give example of your advice process in form of a typical “walk through”
- Test and record clients understanding of you and your process before proceeding.

Disclosure – Service Proposition and Charging

Further key elements of RDR was to remove the potential for advice bias, ban commission for advice and to improve transparency for consumers ensuring firms clearly communicated the nature and cost of their services

The initial disclosure documentation should initially be used for generic charge disclosure giving a potential client a “flavour of charging” and details of the service that can be provided. Later in the advice process however, more client specific charging should be confirmed as soon as is practical. (Financial have recently introduced the use of a Letter of Engagement)

In the RDR thematic review of March 2014, it was found that of the 118 firms reviewed, 73% of firms failed to correctly provide the required information on the cost of advice. Further failings

were identified in relation to the type of service offered and what on-going service they would provide.

During the session, the regulator expressed concern at the use of “contingent charging” and felt that there was the potential for the advice to be influenced if firms would only be remunerated by the take up of a new product or recommendation.

Of greater concern was on-going service propositions and whether clients understood the service to be provided, the cost was disclosed accordingly and that the promised service was actually delivered.

Good Practice: Again, to help firms ensure clarity over their charging structure and service proposition, ideas and examples of good practice were shared:-

- Use tables to make reading of cost v service easier
- Timelines that show when the client is liable for costs
- Examples – common and relevant to your client
- Test and record clients understanding of how you are paid

Letter of Engagement

A document showing specifically what the client will receive in return for the on-going fee

The regulator confirmed that the “unacceptable” findings from the above thematic review were likely to form the basis of further action. We would therefore ask members to consider and challenge their own RDR compliance.

FCA Positive Compliance Workshops – Centralised Investment Proposition / Replacement Business (3 out 3)

The afternoon session of the FCA Positive Compliance Workshop considered the use of Centralised Investment Propositions (CIPs) and Replacement Business.

Centralised Investment Propositions (CIPs)

A CIP - “a standard approach to providing investment advice, including how the client’s risk profile is assessed through to a centrally agreed investment solution”

The FSA originally identified some concerns in this area back in 2012 as part of their Retail Conduct Risk Outlook (2011/12) which were further confirmed during their thematic review. This identified 75% of advice provided by firms to be either unsuitable or unclear.

The main failings identified were evidence of “shoe-horning” into a “one size fits all” approach, “churning” where inadequate consideration was given for overall individual client benefit, and increased costs that did not provide actual additional client benefit.

Whilst the regulator confirmed these concerns remain, they did recognise there were potential benefits for both client and firm in operating a CIP and they felt suitability of such a proposition was driven by being able to demonstrate:-

- an appropriate due diligence and adoption process.
- evidencing individual suitability.

Due diligence and research was highlighted specifically as an increasing concern during the workshop with confirmation that it would form part of a thematic review during 2015.

Due Diligence, design and adoption

Good Practice: In order to evidence a robust process for the selection and introduction of a CIP, the following was suggested:-

- client segmentation – eg. AUM / client service required? / Life stage?
- design criteria – what type of proposition? What does CIP need to deliver? What service do you wish to provide? Type, level and cost of service generally required?
- reviewing the market – impartial.
- due diligence and selection
- integration

The above process would enable a firm to consider their existing and prospective client banks, establish the type and level of service they wish to provide and to identify the most suitable product and provider to achieve this.

Good Practice: The regulator shared some examples of CIP design as below which they felt would help evidence individual consideration and offer a solution appropriate for all clients:-

- availability of preferred fund panel for transactional clients
- choice of a low cost managed fund – low cost/ low service
- model portfolios – higher level of assets and investment experience
- DFM – bespoke service

As highlighted above, a robust research and due diligence process to identify an appropriate provider to house a CIP is thought by the regulator to be a key factor in being able to evidence client suitability. Consideration of the following criteria was suggested:-

- provider reputation / financial standing
- investment style / approach / performance
- approach to investment selection / due diligence
- charges
- funds, tax wrappers and other products
- functionality / additional tools
- support services

The integration of a CIP is also deemed an important element to a suitable advice process. This integration phase should include training and where required, recruitment of advisers, compliance staff and back office support. Consideration should be given to how the implementation of a CIP may affect existing systems and controls with the need to update and review these on a regular basis to identify future client risk. Client disclosure material should be updated accordingly and it was suggested that client understanding should be tested.

Risk and individual suitability

The use of a CIP, as with any investment, must also include a robust risk assessment process to establish the level of risk a client is willing and able to take. This will help determine the most appropriate solution available and the types of investment best suited to the client.

- risk profiling – use of “profiling technology” not a requirement, however can be useful. The output from such risk tools are only a guide, not the answer and should be challenged with wider discussion.
- risk description – what does this mean to the client? (not just a number)
- other factors – consideration for term, capacity for loss/other assets, standard of living.
- asset allocation – how has this been established for portfolio or range of risk specific portfolios?

Evidencing individual client advice when recommending a CIP remains a key indicator when the regulator assesses suitability. Therefore, there is a need for a structured and documented research process to consider a range of client solutions, a risk assessment process to ensure each and every client is invested according to their agreed level of risk and a suitability report that provides clear reasoning as to why the recommended CIP will meet the needs identified.

Replacement Business

Whilst the issues and concerns surrounding replacement business are relevant across the whole range of financial products, the very nature of providing a CIP does increase the likelihood of firms recommending an existing product to be replaced. The most common reasons to replace are changes to objectives, concerns over charging and/or performance, requirement for greater or specific investment choice, more favourable taxation and inconsistent or a change of risk.

The regulator found the following to be the main failings when reviewing replacement business:-

- poor consideration and relevant comparison of existing investments
- poor compliance challenge (internal / external)
- lack of control / sign-off process
- lack of pre approval

Good Practice: To help firms when conducting replacement business, the following process considerations were suggested:-

- identifying individual client specific needs through robust “know your client” process. Prioritisation and confirmation within suitability report
- charge comparison between existing and recommended – must be fair, appropriate, clear and comprehensive. Impact of adviser charging? Use of tables to ease client understanding.
- product consideration – why do you believe new arrangement will provide greater benefit. Will these off-set any exit or additional costs?
- performance – comparison to consider history (eg. 1,3 & 5 years), why new likely to outperform peers, period to retirement /disinvestment, whether erratic performance, quartile ranking, manager tenure.
- tax implications – on encashment, use of allowances, spreading disposal, appropriate wrapper?
- suitability report – must evidence needs and objectives, contain a comprehensive and relevant comparison and provide clear reasoning as to why the advice is suitable. What is the client benefit?

“Poor reporting does not always mean unsuitable advice but increases the risk of poor outcomes in terms of client clarify”