Good Practice Guide

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A good practice guide to adviser charging (and associated disclosure)

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This Good Practice Guide is part of a planned series of guides that are being developed for members in collaboration with experts in their field and the Financial Conduct Authority.

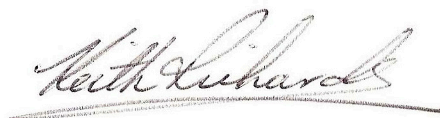
Foreword

Keith Richards
Chief Executive Officer,
the Personal Finance Society

One of the main objectives of the Retail Distribution Review was to eliminate product bias. Research had clearly identified a direct link between commission and product bias, so by banning commission on retail investment products the regulator was confident that the conflict would be removed resulting in increased confidence in the delivery of better consumer outcomes. The introduction of adviser charging was also intended to make it easier for consumers to understand the cost associated with both initial and ongoing advice.

Following early concerns from the regulator around adviser charging disclosure failings, the latest of three thematic reviews on the subject has found evidence of increasing professionalism and material improvements in the way firms disclose the cost of their advice. However, there remains scope for further improvements. In particular, the report identified that some firms are failing to provide individual clients with clear disclosure, in cash terms, of the ongoing charges they will be paying for.

This guide aims to provide practical guidance of good practice to help firms benchmark their own charging structures. By publishing this guide to adviser charging the Personal Finance Society hopes to plug the gap between regulatory guidance and pragmatic good practice. I hope you find it helpful.



Introduction

The Retail Distribution Review (RDR) rules were introduced on 31st December 2012 requiring retail investment advisers to charge an explicit fee for their services rather than receive commission generated from product recommendations.

Since then the regulator has conducted a number of thematic reviews and research exercises to assess progress, in terms of disclosure of adviser charging and related services, and has made a number of related public statements , some of which have resulted in the need for clarification that this good practice guidance seeks to address.

During this period, the FCA has also consistently maintained it is not, and has no plans to become a "price regulator", so the FCA should not and will not prescribe what specific advice costs should be. Specific charging models are a commercial decision for firms and depend on local competition and what clients will bear as reasonable or fair value.

So does this mean that firms can effectively charge what they want and how they want, leaving it to consumers to decide whether firms are giving value for money?

Well clearly no, as the regulator does have a role in monitoring firms in making what it sees as appropriate cost and service disclosures to clients and also has a remit to consider both fairness and proportionality of the cost and benefit of advice – if the cost of advice is £1,000 and a client has just £5,000 to invest then the cost of advice is likely to outweigh any potential benefit. Whilst it can be argued that it is not the role of the regulator to prevent clients from taking inappropriate actions such as the payment of disproportionately high fee levels, the inevitable complexity of some long-term financial decisions coupled with the asymmetry of knowledge between producer, intermediary and consumer, demonstrates a continuing need for an effective conduct regulator.

Such regulatory fairness is closely aligned with good consumer outcomes and will ultimately be determined by whether clients have had sufficient opportunity to understand specific charges against specified services. It is essential for clients to have a clear understanding of the level of charges and the nature of services on offer so they can make informed decisions about whether they meet their needs.

The FCA has also expressed a preference for flat fees, arguing it reduces conflict of interest risk to firms. The issue here is not necessarily an inherent dislike of a charge based on a percentage of assets invested, although the same percentage charge without a tiered charging structure applied to different sized funds is clearly problematic. It is one that reflects regulatory concerns over 'contingent charging'*, where advice charges are based purely on product sales, and the 'hangover' issue of cross-subsidy from the pre-RDR commission driven market.

The following sections of this paper are in response to members' requests for further commentary and clarification around good practice, leaving it ultimately to firms to ensure they comply with both the detail and the spirit of the regulators rules.

*Contingent charging is when a client only pays an adviser charge when they buy the recommended product. The FCA consider this to be a higher-risk approach than a time-cost charging model, due to the need to sell products to generate revenue. Whilst such bias, perceived or otherwise, doesn't necessarily result in poor client outcomes, it's important that consideration be given to eliminating any potential bias so there is no question of firms not working in their client's best interest. Firms continuing to operate contingent charging should ensure they have adequate controls in place to manage these risks.

Section 1: The rules and regulatory source material

Rules in respect of adviser charging, disclosure and the provision of related services were introduced by the FSA in an attempt to address the potential for adviser remuneration to distort consumer outcomes and the rules were initially detailed within FSA Policy Statement (PS) 10/6 – Distribution of retail Investments; Delivering the RDR – feedback to CP9/18 and final rules published in March 2010.

Since that time clarification has been sought from the FSA and subsequently the FCA by firms in respect of the application and interpretation of these rules. At the same time, the regulator has issued a number of fact sheets, research documents and reviews in an attempt to both assess market progress and provide further clarity in respect of adviser charging, disclosure and the provision of related services. The key documents are detailed below and we recommend you familiarise yourself with their content to ensure that your firm's charging structure/s are aligned accordingly.

Factsheets

FCA Factsheet No 10 – *Adviser charging* (published 5/9/2014)
http://www.fca.org.uk/your-fca/documents/fsa-factsheet-rdr-adviser-charging

FCA Factsheet No 007 – *Disclosing your firm' s charges and services* (published 5/9/2014)
http://www.fca.org.uk/your-fca/documents/fs-007-disclosing-your-firms-charges-and-services

Thematic Reviews

A 3 cycle Thematic Review has been conducted by the FCA to assess (amongst other things) progress in terms of disclosure of adviser charging and related services:

TR 13/5 – Cycle 1 – *Supervising retail investment advice: how firms are implementing the RDR* (published July 2013)
http://www.fca.org.uk/news/tr13-05-how-firms-are-implementing-the-rdr

The FCA concluded from this first cycle that firms had made progress in implementing the RDR, but identified some areas where they were failing to meet their requirements, particularly around adviser charging disclosure.

TR 14/6 – Cycle 2 – *Supervising Retail Investment Firms: being clear about adviser charges and services* (published 7/4/2014)
http://www.fca.org.uk/news/tr14-6-supervising-retail-investment-firms

http://www.fca.org.uk/news/thematic-reviews/tr14-6-supervising-retail-investment-firms (Video)

http://www.fca.org.uk/your-fca/documents/disclosure-assessment-template-excel (Assessment tool)

The FCA concluded from the second cycle they still had concerns about how firms were disclosing important information about charges and services, failings often related to areas of the disclosure requirements that they deemed fundamental to providing customers with clear information on the costs of advice. For example, many firms that based their adviser charge on a percentage of the funds invested were seen to be failing to disclose the charge in cash terms.

TR 14/21 – Cycle 3 *– Retail Investment advice – adviser charging and services* (published 16/12/2014)
http://www.fca.org.uk/static/documents/thematic-reviews/tr14-21.pdf

The third cycle conducted by the FCA was on the whole positive, stating in the introduction that “the findings from this review provide further evidence of the increasing professionalism of the financial advice sector”, pointing to a material improvement in the way firms were disclosing the cost of advice, scope of service and the nature of these services to clients. It also concluded that the ban on commission had increased competitive pressures on providers, seeing product prices falling to balance an increase in adviser charges. It did, however, identify scope for further disclosure improvements that this guide highlights in subsequent sections.

Consumer studies

The above thematic reviews have been supported by a number of independent consumer studies commissioned by the regulator, the most recent of which are as follows:

Adviser Charging and Scope of Service *– NMG Consulting* (published 25/7/2013 in support of TR 13/5)
http://www.fca.org.uk/your-fca/documents/nmg-rdr-consumer-research

Retail investment advice assessment of ongoing services *– A research report – NMG Consulting* (published 16/12/2014 in support of TR 14/6)
http://www.fca.org.uk/your-fca/documents/research/retail-investment-advice-assessment-of-ongoing-services

Section 2:
The Good Practice Guide

Process

This guide recommends members implement a process to help develop good practice, which could include the following:

1. Ensure you are familiar with the rules and regulator source material as detailed within Section 1 of the guide, paying particular attention to examples of good and poor practice so you can identify whether any corrective action is required by your firm.
2. Take advantage of the consumer research undertaken on behalf of the regulator or Personal Finance Society (in addition to that derived from your own clients). Consider key factors in consumer understanding of disclosure, to help ensure the client centric nature of your firm's charging structure, disclosure and related services.
3. Keep up to date with FCA, Personal Finance Society and industry commentary.
4. Understand the cost of your advice. Work out how much it costs you to deliver advice and run your service when calculating your fees – this will enable you to justify how your ongoing fees reflect the services you provide. Costs to consider and allocate across income generators within your firm should **include**:
    - All employee salaries (including support staff)
    - Remuneration to self employed advisers
    - Rent/cost of premises and other occupancy costs
    - Insurances (including Professional Indemnity)
    - Utilities
    - Accounting, legal and professional fees
    - Advertising and promotion
    - Web based development
    - Online sales and marketing
    - Interest and bank charges
    - Printing, stationery and postage
    - Telephone and Internet
    - Training
    - Business travel and accommodation
    - Vehicle operating expenses
    - Depreciation
    - All other expenses both fixed and variable.
5. Ensure you have an effective means of capturing client feedback and always look to re-design your proposition in the light of client experiences.
6. Regularly review your firm's charging structure, approach to disclosure and the provision of ongoing services, and in light of the above, ensure that it underpins both your firm's profitability and client understanding of value. It is not unusual for an effective charging structure that works for your firm and your clients, to evolve over several years.

High level principles of good practice for adviser charging and disclosure

- Consumers have always understood that there is a cost associated with advice, but its positioning is key. Consideration should be given to disclosing on the assumption that clients have no industry knowledge and that their inherent understanding of adviser charges and services is weak
- Disclosure documents should promote consumer engagement by ensuring communication is 'clear, fair and not misleading'. Consideration should be given to:
  - Documents written in font size that makes it easy for people to read and not mistake for 'terms and conditions'
  - Services and charges displayed together to facilitate easy read across and reconciliation of information
  - The avoidance of dense paragraphs of text and consider effective use of tables and diagrams
  - The use of bold text, colour and/or highlighting to draw out key information
  - Keeping the document to four pages or less
- Charging structures need to be communicated to clients up front and in writing and total charges must be disclosed and agreed as soon as they are known and is practicable
- It should be made clear to any client (prospective or otherwise) exactly when they will start to incur adviser charges and whether there are any charges relating to an initial consultation
- Charges shouldn't vary for different providers or for different products that could both be suitable for the customer's needs
- Where multiple methods are used to calculate a fee, clarity is needed in respect of when each method will apply
- Off-setting of costs, for example an engagement fee to cover costs where a consumer doesn't implement advice given, needs to be clearly communicated
- Ongoing charges can only be made in respect of ongoing services or in respect of initial charges and/or ongoing services that relate to a product into which a client is making regular payments
- Ongoing charges need to be in respect of a genuine ongoing service – "Most of Firm D's clients had agreed to take up its premium ongoing advice service. However it charged all of its remaining clients for a retainer service that consisted of administrative services it was required to undertake regardless and a vague commitment to be available to answer minor client queries. We did not think this represented a genuine ongoing service" (source: FCA TR 14/21, page 14). Whilst clearly a degree of subjectivity comes into play when deciding what constitutes an ongoing service, you might reasonably conclude one that is proactively provided and tangible in nature is more likely to be 'fair, clear and not misleading'
- Clients should be made aware that they can cancel an ongoing service and charge should they wish and how they should go about doing so
- Consideration should be given to a detailed breakdown of the features included within an ongoing service, the frequency with which they would take place and whether they would be instigated proactively or following a prompt from the client. It should be made clear whether potential outcomes that could arise from an ongoing review are included in the ongoing adviser charge or not. Where they are not, a clear breakdown of the costs of these additional services should be displayed in cash terms
- We have seen examples of good practice where firms ask their clients whether they believe a service proposition they are receiving represents value for money. Understanding whether there are elements of a service more valued than others is useful knowledge in honing a proposition over time.

Initial 'generic' disclosure

The FCA sees the initial generic disclosure document as an important enabler that allows clients to compare the cost of different advisers and shop around if they wish. It should be sent to the client before the advice process starts and should be used to talk through at next meeting to allow and prompt the client to ask questions and seek clarification. The initial disclosure document should contain details of both services and related adviser charges.

A common concern of advisers at this stage of disclosure is that prospective clients will simply focus on cost and not value, new clients having little against which to assess value. Even those consumers used to dealing with regulated financial advisers may need some further help in understanding value in the more transparent post-RDR world. To help mitigate this, consideration should be given to:

- Providing a checklist of what a potential client ought to know prior to committing to work with an adviser
- Out-lining the process for initial advice as this can help mitigate some of the surprise over the cost of advice on first seeing the charges, especially for consumers who have never taken regulated advice before
- The use of case studies, especially those that contrast the cost of advice with examples of specific levels of financial benefit.

EXAMPLE

Background

Graeme, a retired business owner and his wife Carol were referred to XYZ Financial Services by a friend. They had a combined estate worth circa £2.7m and had a number of different conflicting priorities and concerns. So far the advice they had received from various professionals lacked any cohesion. They wanted to create a plan that allowed them to help their grandchildren with university fees, getting established in their careers and their first homes.

Additionally they wanted to help their own children by way of loans if required. They were worried about how to protect the legacy from any unforeseen situations the children or grandchildren may face like divorce or bankruptcy. They were also looking to simplify how they managed their wealth.

Our approach

The process took a few months to build a complete understanding of Graeme and Carol's requirements. It was important to provide Graeme and Carol with information enabling them to make informed decisions about their own financial future and their legacy as well as showing them the impact certain decisions would have on their future cash flow and tax status.

We worked with a number of different professionals during this time to ensure the plan was fully aligned to their wishes and delivered the goals that were important to them.

The outcome

We were able to meet all of their objectives, significantly reducing Graeme and Carol's income tax liabilities in the process. A number of trusts were established and investment portfolios built to reduce both the amount of risk and cost in achieving their objectives. As they had surplus income we advised them to regularly gift into one of the trusts. They were delighted with the results. Not only was there an immediate reduction in IHT of over £200,000, but a further reduction of over £10,000 each year through the ongoing gifting. We were also able to cap the IHT liability on a further substantial portion of their wealth. Our advice enabled Graeme and Carol to have peace of mind that their money was being well looked after and that they had provided the legacy they wanted to for their family.

The cost

Graeme and Carol paid an initial adviser charge of XXXXX and an ongoing adviser charge of XXXX for the provision of ongoing investment management advice in respect of the investment portfolios established. Comparing these charges with the benefits secured, Graeme and Carol commented " we are delighted with the advice provided by XYZ Financial Services and look forward to our future dealings with all at the firm".

Content based on the following source material

http://www.pruadviser.co.uk/new_pdf_folder/GENB11806.PDF

- Costs for focused advice may be a stepping stone to 'full advice' if the process provides a client with sufficient evidence of value to engage further with the advice process
- Timing of adviser charges should be addressed at initial 'generic' disclosure stage – for example, providing a generic timeline of a typical customer relationship, with payment points noted against various stages of the advice process might help consumers understand what they pay for and when they are liable.

Disclosure of services

- The nature of services (initial and ongoing), their scope & the nature of any restrictions should be clear
- Where 'restricted', firms should always include this word in documentation
- Where 'restricted', the nature of that restriction should always be made explicit. For example, restricted advice may be based on breadth of advice, range of products, types of product, market, platform and/or investment strategy.

EXAMPLE

We will advise and make a recommendation for you after we have assessed your needs. We can only offer products from a limited number of companies. You may ask us for a list of companies whose products we offer at any time.

Disclosure of adviser charges

- Where using a % charge, any initial charge and ongoing charge should be communicated in cash terms.

EXAMPLE

An initial (one off) charge of 1% of funds under management (minimum fee £500)

For example an initial fee of £1,000 for establishing funds under management of £100,000

0.75% per annum of funds under management (minimum fee £500)

For example a fee of £1,125 for funds under management of £150,000

- Where a % charge is used, it should be acknowledged that there is a risk that poor consumer outcomes could take place and steps taken by firms to identify and manage the risk
- Where a % charge is used, the issue of the ongoing validity/viability of a charging model that effectively cross-subsidises the cost of advice to clients with small investments by charging clients with larger investments more (in cash terms) should be addressed, for example through the use of tiered charging structures
- Where using an hourly rate, clarification around the number of hours the service is likely to require should be included. Whilst it is sometimes difficult to assess this before work commences, good practice includes some means of clarification such as pointers or case studies to enable the client to develop an informed opinion so they can reasonably assess value
- Where using an hourly rate, it is good practice to clarify any basis on which the hours and/or rate may vary.

EXAMPLE

Our average charge to a new client based on a £50,000 investment is:
Administrator – 5 hours at £25 per hour = £125
Research Planner – 4 hours at £75 per hour = £300
Adviser – 4 hours at £150 per hour = £600

Average cost for a new £50,000 investment = £1,025

Our average charge to a new client based on a £100,000 investment is:
Administrator – 7 hours at 325 per hour = £175
Research Planner – 8 hours at £75 per hour = £600
Adviser – 8 hours at £150 per hour = £1,200

Average cost for a new £100,000 investment = £1,975

- Whilst ranges of adviser charge are helpful, wide ranges may prevent a client from understanding the likely fee. Good practice includes examples of charges within such a range

EXAMPLE

Financial Planning

Analysis, recommendation report and if appropriate, subsequent implementation of recommendations.

Minimum fee £500; Maximum fee £7,500

For example, a fee of £1,500 for the analysis of three pensions, subsequent recommendations and, if appropriate, the implementation of changes to your pensions.

For example, a fee of £7,500 for the analysis of existing holdings, subsequent recommendations to include a wide range of tax-efficient solutions and, if appropriate, the implementation of the investment strategy.

- We suggest you only quote the types of charges you actually use. If you don't offer a particular type of charge, inclusion is likely to confuse and increase the length of any disclosure document
- Generic disclosure should also communicate the fact that a personalised quote will be provided before the customer is liable for any charges.

EXAMPLE

Following our initial discussion (for which there is no charge), there is a cost for our services. We offer a variety of methods by which we can be remunerated so that you can select the method that best suits your needs. We will discuss your payment options with you and answer any questions you have. We will not charge you until we have agreed with you how we are to be paid. We will also tell you if you have to pay any other costs that might arise in connection with the services we provide to you.

Disclosure of specific adviser charges

- After fact-finding, send client a 'terms of engagement' or similar document setting out the total cost
- Above principles in respect of initial disclosure should apply to disclosure of specific adviser charges
- This should be done as soon as practical, as clients should be made aware of any charges specific to their own situation before they commit to paying the fee
- Consideration should be given to how best to address the potential fear of 'writing a blank cheque', for example by including some commentary around the capping of charges.

Section 3: FCA file review template

Adviser charges and scope of service

https://www.fca.org.uk/static/documents/assessment-disclosure-template.pdf

Section 1 – Generic charging structure
Does your firm provide the client with a generic charging structure? 1) In writing? 2) In good time before making the personal recommendation (or related services)?
If your firm has a percentage based charging structure, does the disclosure include examples: 1) In cash terms for initial charges? 2) In cash terms for ongoing charges?
If using an hourly rate in your charging structure, does your disclosure include: 1) Whether the rates are indicative or actual hourly rates? 2) If indicative, the basis (if any) upon which the rates may vary? 3) Approximate indication of the number of hours that the provision of each service is likely to require?
Does your charging structure contain any descriptions with wide ranges that may prevent a client from understanding what the fees are likely to be?
If your firm uses a combination of two or more methods (i.e. percentage based charging, hourly rates, fixed fee) within your charging structure, is it clear to a client what basis would be used under which circumstances?
Section 2 – Client specific charging structure
Does your firm provide the client with details of the specific charge: 1) As soon as is practicable? 2) In a durable medium or through a website? 3) In total where the amount is payable over the period?
If your firm has a percentage based charging structure, does the specific disclosure include: 1) Cash terms for initial charges? 2) Cash terms for ongoing charges?
Is it clear from your disclosure documents at what stage the client becomes liable for the adviser charges, e.g. when he has agreed to advice services being provided, or only if he accepts the adviser's recommendations?
If your firm's ongoing fee is based on a percentage of the value of the investments, does your documentation disclose that the ongoing fee may increase as the fund grows?

Section 3 – Disclosure of charges – general

Is there any other aspect(s) of your disclosure of charges that you are concerned may: be non-compliant; or, materially affect a client's understanding of your firm's charging structure? **NB:** This applies to both the generic and the specific disclosure of charges.

Section 4 – Disclosure of scope of service

Does your firm disclose its scope of service:

1) In writing or through a website?
2) In good time before the provision of services?

Restricted firms

1) Does your firm use the term 'restricted advice' in its disclosure?
2) Does your firm clearly disclose the nature of the restriction (e.g. by product or provider)?
3) Is there any contradicting information about the nature of your firm's restriction?

Please compare the different disclosure documents and any information available on your firm's website.

Independent firms

1) Does your firm use the term 'independent advice' in your disclosure?
2) If your firm is 'independent with a narrower relevant market', is this clearly disclosed?

Section 5 – Disclosure of ongoing service

Does your firm's documentation clearly disclose what service a client will receive in return for the ongoing adviser charge (if applicable)?

Section 6 – Disclosure of services – general

Is there any other aspect(s) of the disclosure of your firm's services that you are concerned may: be non-compliant; or, materially affect a client's understanding of the services your firm offers?

Section 4: Adviser charging options

When deciding the most appropriate basis of charging, each stage of the advice process can be charged for in a number of different ways. There are no restrictions on the number of charging methods an advisory firm can adopt – the regulator has only cautioned that charges should not vary between clients for inappropriate reasons and should not be unnecessarily complex or opaque so as to inhibit client understanding.

Common charging methods include:

Option	Basis of charge	Description
Time-based	Per hour	Applied on the basis of hours spent
Task-based	Fixed charge	Involving a fixed charge for a particular activity e.g. financial planning report
Performance-based	Fixed or sliding scale % based fee	Applied when a pre-agreed performance result is achieved
Delivery-based	Fixed fee or % based fee	Based on the delivery of a particular agreed outcome or result
Retainer/ongoing service	Fixed fee	A fixed regular fee (e.g. monthly or quarterly) for retaining a firm's service in respect of tasks that represent a genuine value added service to the client
Portfolio-based	Fixed or sliding scale % based fee	Calculated as a percentage of the level of assets under advice