



# Independent & Restricted Advice

This paper is the second in a series of papers that the Personal Finance Society (PFS) is producing under the **Professional Direction** title. It represents the PFS interpretation of the rules as far as we have been able to ascertain them. It is not definitive and we expect further clarification to emerge over time. The paper has no formal or regulatory status and is intended solely to assist members in understanding the new rules.

#### Disclaimer

Every attempt has been made to ensure the accuracy of this text at the time of going to print (September 2011). However no liability can be accepted for any loss incurred in any way whatsoever by any person acting or refraining from action as a result of the information contained in this document.





# introduction

From 31st December 2012, a new set of rules will apply to how firms giving investment advice to retail clients can describe their services. This paper is aimed at providing a better understanding of the terms 'Independent' and 'Restricted' so that firms and individual advisers can make an informed choice about their business going forward.

As a professional body with members drawn from across the adviser community, the aim of the PFS is to provide members with an impartial interpretation and a better understanding of the new rules. The Society seeks to ensure that any decisions that members make are for the right professional and commercial reasons, and not because of misunderstanding or lack of clarity.

Now that the final rules have been made it is appropriate to consider how to apply those rules in practice and we have included examples which we hope will aid understanding of this significant element of the Retail Distribution Review (RDR).

In order to create as much of a common understanding as possible, we have consulted a range of interested parties, including professional and trade bodies, and the Financial Services Authority.

**With over 29,000 members, the Personal Finance Society** is the leading professional body for the financial planning profession in the UK. The PFS takes an active role in setting standards of professionalism and our members commit to the highest standards of professionalism by keeping their technical knowledge up to date and by adhering to a respected code of ethics.

The PFS is part of the Chartered Insurance Institute, which is the world's largest professional body for insurance and financial services, with over 100,000 members in 150 countries. Established in 1873 and a Chartered body since 1912, the CII's mission statement is 'Protecting the public by guiding the profession'.



# In brief, the changes are:

- if you declare yourself to be an independent adviser you will need to consider a broader range of products (beyond packaged products);
- an independent adviser will need to provide unbiased, unrestricted advice based on a comprehensive and fair analysis of the relevant market; and
- all advisers will have to inform their clients before providing advice, whether they provide 'independent or 'restricted' advice'.<sup>1</sup>

## Key points to note:

- Whether a firm decides to offer Independent or Restricted advice, the same requirements regarding qualifications and adviser charging will apply to that firm and its advisers.
- It is the **firm** who actually provides the advice to the client which could be Independent or Restricted, or both. However the nature of the advice is also assessed at personal recommendation level.
- A key question to ask when determining status is whether a firm **cannot** or **will not** ever recommend a product type or a product provider, even if that product or that product provider would be suitable for a client.
- **Stock-broking and wealth management** firms advising retail clients on products such as ETFs, Structured Capital at Risk or UCIS, will be drawn into the regulatory regime of the financial adviser. This means that they too will be subject to the requirements for Level 4 qualifications, Independence and Adviser Charging.
- It is expected that many IFA firms will be able to carry on business much as they do at present. The new rules do not require firms or advisers to explore every single product and every single investment option for every single client on every single occasion. However firms would be well advised to review their current business model against the new requirements.

<sup>1</sup> FSA Factsheet SFDF057 09/10  
Improving your understanding  
of the Retail Distribution Review  
(RDR) – Independent and  
Restricted advice



# the rules

“The new rules have been made and are final.  
They will come into force on 31 December 2012.”<sup>2</sup>

## The ‘rule’ is<sup>3</sup>:

- (1) A *firm* must not hold itself out to a *retail client* as acting independently unless the only *personal recommendations* in relation to *retail investment products* it offers to that *retail client* are:
- (a) based on a comprehensive and fair analysis of the relevant market; and
  - (b) unbiased and unrestricted.

Remember, it is the **firm** who actually provides the advice to the client which could be Independent or Restricted, or both.

## Independent advice is :

a *personal recommendation* to a *retail client* in relation to a *retail investment product* where the *personal recommendation* provided meets the requirements of the *rule* on independent advice (COBS 6.2A.3R).

## Restricted advice is :

- (a) a *personal recommendation* to a *retail client* in relation to a *retail investment product* which is not *independent advice*; or
- (b) *basic advice*.

## For clarification :

a ‘personal recommendation’ is

‘a recommendation that is *advice on investments*, or *advice on a home finance transaction* and is presented as suitable for the person to whom it is made, or is based on a consideration of the circumstances of that person.’

a ‘retail client’ is

‘(other than in relation to the *provision of basic advice on stakeholder products*) in accordance with COBS 3.4.1 R, a client who is neither a *professional client* or an *eligible counterparty*.’

‘basic advice’ is

‘in summary, providing advice on *stakeholder products* using a process that involves putting pre-scripted questions to a *retail client*’

a ‘retail investment product’ is

- (a) a *life policy*; or
  - (b) a *unit*; or
  - (c) a *stakeholder pension scheme*; or
  - (d) a *personal pension scheme*; or
  - (e) an interest in an *investment trust savings scheme*; or
  - (f) a *security* in an *investment trust*; or
  - (g) any other *designated investment* which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in the financial asset; or
  - (h) a *structured capital-at-risk product*;
- whether or not any of (a) to (h) are held within an *ISA* or a *CTF*.

The definitions of words in italics can be found in the Glossary of the FSA Handbook

The term ‘retail investment product’ will replace ‘packaged products’ in COBS 6 (independence rules). The definition of ‘retail investment’ will remain in the Handbook post-2012 as it is referred to in other areas of the Handbook. Retail investment products include not just packaged products, but also structured investment products, all investment trusts, unregulated collective investment schemes and any other investment that offers exposure to underlying assets, but in a packaged form which modifies that exposure compared with a direct holding in the financial asset.

<sup>2</sup> Financial Services Authority  
PS10/06 : Retail Distribution  
Review (Adviser Charging)  
Instrument 2010

<sup>3</sup> COBS 6.2A.3 R



## Independent Advice

We will spend most time on what the rules for 'Independence' require because any firm that does not meet these requirements will by default be providing advice that is 'Restricted'.

The FSA Handbook Glossary sets out a new definition for independent advice:

**“To be able to provide independent advice, firms would need to make recommendations based on a comprehensive and fair analysis of the relevant market, and to provide unbiased, unrestricted advice.”**

This is designed to reflect the idea of genuinely independent advice being free from any restrictions that could impact on the ability to recommend whatever is best for the customer.

The rules are at the **firm** and **personal recommendation** level, rather than the individual adviser level. In practice, advisers act on behalf of firms so in most cases it will be the adviser that is giving the personal recommendation.

## Restricted Advice

Advice which is not independent will need to be labelled as restricted advice. Restrictions may apply in terms of product providers or products.

Advisers who provide restricted advice are still required to meet FSA suitability requirements. They are also required to hold an appropriate Level 4 qualification, gap-filled as necessary, and apply Adviser Charging to their client work. Ongoing requirements for CPD and holding a Statement of Professional Standing (SPS) also apply.

The first draft of the rule COBS 6.2A.6R(3) required a firm that provides restricted advice to disclose whether it gives advice limited to retail investment products from a single company, a single group of companies or a limited number of companies.

However, it was pointed out to the FSA that firms may want to restrict their advice in other ways, such as by advising solely on certain products, so the FSA has amended the rule wording.

**“A firm is now required to disclose any form of restriction.”<sup>4</sup>**

This means that a firm will need to describe its advice as restricted if it does not consider particular types of products that could be suitable for its customers or potential customers.

### EXAMPLE

A firm decides not to include stakeholder pension schemes in its range of products.

Where a firm chooses to limit the products on which they advise to a certain range of investments, or limited number of providers they will be providing restricted advice.

The key question to ask is whether a firm **cannot** or **will not** recommend a product type or a product provider, even if that product or that product provider would be suitable for a client.

<sup>4</sup> Quarterly Consultation Paper  
10/22 (No. 26) pp 5.22



# restricted advice

## EXAMPLE

A firm chooses to restrict its services by not offering advice on Unregulated Collective Investment Schemes (UCIS).

The firm makes this decision on the grounds that:

- its clients have never required such an investment
- its clients' needs have always been met by other suitable products
- its clients do not require exposure to products which tend to have a high risk profile
- the firm has concerns about regulatory aspects of such investments.

However, the firm is approached by a client for whom a UCIS is appropriate. The exposure to the underlying investment would be appropriate for the client's portfolio. The client's attitude towards investment risk was appropriate for the investment risks of the scheme. This investment would play a relatively small part in their overall portfolio. Finally, the client has been investing over a long period and is well-informed and knowledgeable about investment markets.

The acid test is whether, considering a whole range of factors regarding the suitability of a UCIS for this client, the firm would (or could) advise the client on this matter.

If the firm **cannot** or **will not** advise on this product, regardless of its suitability for the client then its advice will be defined as restricted.

On the other hand, it is almost certainly the case that by their very nature this product is specialist and probably with limited application. A firm may advise on them rarely if ever. Indeed, the vast majority of clients are likely to find plenty of (more) suitable investment options in other funds and products.

Notwithstanding how rarely the situation arises, it is possible that if a client for whom this product would be suitable approached a firm, that firm **would** explore the various options at the time, undertaking a comprehensive and fair analysis of the relevant market, offering unbiased and unrestricted advice.

Thus, just because a firm **tends not** to consider or recommend a particular investment as part of the typical advice process that firm is not forced to label itself as restricted.

The FSA has made it clear that firms offering restricted advice must still consider suitability above all else.

## Can a firm be Independent AND Restricted?

Yes, this is possible, but a firm cannot hold itself out to be independent if a restricted advice service is also available.

How a firm discloses its services to current or potential clients is important. It needs to be clear to the client whether or not they will be receiving independent or restricted advice and a firm name should not be misleading in any way; a firm name should **not** give the impression that independent advice is being offered when a restricted advice offering is also available.

In practice, firms offering both services will need very clearly defined processes and procedures.

## EXAMPLE

Juliet Bravo Financial Advisers, or Bravo 2 Zero Wealth Management, are company names that make no assertions about status and facilitate a business model that offers both options to clients.

## EXAMPLE

Delta Force Independent Financial Advisers would **not** be able to offer a restricted advice service.

## EXAMPLE

A network that has Appointed Representative (AR) firms which offer independent advice as well as AR firms that offer restricted advice would not be permitted to market itself as an IFA network.

A limited company that needs to change its name because it has 'independent' in its registered name does not need to apply for a new FSA authorisation but will need to complete a standard data change form. [http://www.fsa.gov.uk/pubs/guidance/gc11\\_20.pdf](http://www.fsa.gov.uk/pubs/guidance/gc11_20.pdf)



# independent or restricted?

## Can an Independent Firm offer focused advice?

There is no regulatory definition of focused advice but in certain circumstances advice on a particular product or specific need can be possible without jeopardising a firm's independence. The main consideration is that the limitation is clear up front and driven by the needs of the client.

For more information regarding focused advice and suitability, please refer to Annex 8 of the FSA's Retail Distribution Review FS 08/6 [http://www.fsa.gov.uk/pubs/discussion/fs08\\_06.pdf](http://www.fsa.gov.uk/pubs/discussion/fs08_06.pdf)

### EXAMPLE

A client approaches a firm for advice on investing its annual ISA allowance. The client only wants advice on this particular investment. It is the client's decision to restrict the scope of advice being offered and provided the advice on the ISA investment follows the 'comprehensive and fair analysis' rule, the advice is not restricted.

## Specialists

It's important to remember that the rules relating to independent advice are at the firm and personal recommendation level.

Every adviser working in a firm describing its advice as independent needs to ensure that each personal recommendation meets the definition of independence. This does not, however, prohibit, for example, firms having advisers specialising in certain areas. The key point to note is that for specialists to say they offer independent advice, each personal recommendation they give must meet the independence rule. If any specialists within a firm do not meet this requirement, the firm should not hold itself out as independent.

### EXAMPLE

A firm providing independent advice has 3 advisers, each with their own specialist area. The 'IHT specialist' has a client for whom a QROPS might be appropriate. He consults the pension expert to seek his advice and guidance. The result is that the personal recommendation provided to the client meets the independence rule. This does not therefore jeopardise the independence of the IHT specialist.

Please note that personal recommendations of the pension expert would also need to meet the independence rule for the firm to hold itself out as independent.

### EXAMPLE

A firm focuses its business on investment advice. It does not provide advice on life products or personal pensions. This firm would not be permitted to call itself independent.

See Q5 of "Top questions asked at the RDR roadshows" for a further example:  
[http://www.fsa.gov.uk/pubs/guidance/gc11\\_20.pdf](http://www.fsa.gov.uk/pubs/guidance/gc11_20.pdf)

Note: All advisers providing advice, whether independent or restricted, are expected to maintain their knowledge and competence across all areas set out in the FSA appropriate exam standards. Higher levels of expertise would build on this foundation knowledge.

## So what does widening the scope of advice mean in practice?

Widening the 'independent' regime to include advising on Exchange Traded Funds, Structured Capital at Risk Products and Unregulated Collective Investment Schemes etc., has extended the product range that independent advisers are required to consider beyond that of the current 'packaged product' regime.

What **has also** changed in practice, of much greater relevance and significance to the stock-broking and wealth management community, is that any firm advising retail clients on these products will be drawn into the regulatory regime of the financial adviser.

This means that they too will be subject to the requirements for Independence and Adviser Charging.



# independent or restricted?

## EXAMPLE

A firm only advises on direct shareholdings so currently falls outside the new regime. However, it now wishes to include Investment Trusts and Exchange Traded Funds in its client recommendations. Whilst these are equities, they fall within the definition of 'retail investment product'. The firm decides to include these products in its recommendations and therefore must take account of all of the implications of the Retail Distribution Review, including deciding whether to offer independent or restricted advice.

## So what is a 'relevant market'?

A 'relevant market' should comprise *all retail investment products* which are capable of meeting the investment needs and objectives of Retail Client.<sup>5</sup>

It is possible that a 'relevant market' can be limited by the investment needs and objectives of the client, however, these situations are likely to be rare and should be very much driven by the client.

Examples of relevant markets could be

- Ethical and socially responsible investments
- Islamic financial products.

A firm describing its advice as Independent would need to consider all *retail investment products* within the parameters of the relevant market.

## EXAMPLE

A firm providing only individual and group pensions advice is unlikely to be able to describe itself as independent.

This is because pension products are one of a number of ways of building a fund intended to provide for retirement. If the advice is limited to only looking at packaged pension products it means that other investment options which could help build a retirement fund are not being considered when they would be at least worthy of consideration, for a number of clients.

## EXAMPLE

A firm of Independent Financial Advisers is approached by a client requiring investment advice. The client has very strong ethical views and has asked for advice only on ethical and socially responsible investments. So long as the firm considers all retail investment products within those investment parameters, its independent status is unlikely to be jeopardised.

See Q8 of FSA's guidance "Top questions asked at the RDR roadshows" for a further example:  
[http://www.fsa.gov.uk/pubs/guidance/gc11\\_20.pdf](http://www.fsa.gov.uk/pubs/guidance/gc11_20.pdf)

## What exactly does 'comprehensive' mean?

We believe that many IFAs will be able to carry on business much as they do at present and the new rules do not and will not require firms or advisers to explore every single product and every single investment option for every single client on every single occasion.

Many advisers already undertake a comprehensive review of the market when preparing recommendations. Whilst advisers are not expected to be expert in every investment product, they should be aware of every type of retail investment product that is plausible for each client.

Independent advisers already have an obligation to be aware of the various products and product providers that are available in the marketplace and to consider the range of products available before making **suitable** recommendations to their clients.

**Suitability** is now and will remain the primary factor in advising clients. As now, a firm which cannot recommend a suitable product from its restricted range of products or product providers (i.e. tied or multi-tied) is not permitted to make a recommendation in that instance.

It is currently unacceptable to recommend the "least unsuitable" option, and this will not change.

**"It is not acceptable for a firm to make a recommendation for a product that most closely matches the needs of the consumer, from the restricted range of products they offer when that product is not suitable".<sup>6</sup>**

<sup>5</sup> COBS 6.2A.11 31/12/2012

<sup>6</sup> FSA Factsheet



# independent or restricted?

## Panels and Best Advice lists

All firms and advisers providing independent advice should have a good sense of what products and providers are available in the marketplace. That knowledge may be distilled into a panel or best advice list which summarises the outcomes of research undertaken in a particular area, such as personal pensions or UK equity investment funds.

Any panel or best advice list should be reviewed regularly and updated as necessary. A firm would need to ensure that any panel is sufficiently broad in its composition to enable the firm to make personal recommendations based on a comprehensive and fair analysis. The use of a panel must not materially disadvantage any client.<sup>7</sup>

Firms must consider their filtering process for including or excluding investments. The reasons why a product or product provider is excluded from a panel or best advice list should be fair and reasonable, and unbiased. When using a panel, a firm may exclude a certain type or class of product from the panel, if after review, there is valid reason, consistent with the clients best interests rule, for doing so.<sup>8</sup>

If a firm chooses a third party to conduct a fair and comprehensive analysis of its relevant market, the firm is responsible for ensuring that the criteria used by the third party are sufficient to meet the requirement. For example, criteria which selected providers on the basis of payment of a fee (or facilitation of adviser charges), whilst excluding those not paying a fee (or such facilitation), would not meet the comprehensive and fair analysis requirement.<sup>9</sup>

Furthermore, there should be a general recognition within the firm that there may be clients for whom the panel doesn't work. It should therefore be possible for advice "off panel" to be available where a different product or product provider would provide a more suitable outcome for that client.

### EXAMPLE

An IFA network has decided that structured products as a product range are too risky and too expensive for its normal client base.

As a product with specialist application it is possible for a firm to take this position and retain its independence **provided** that should one of the ARs take on a client for whom a structured product might be suitable, they are able to do so, for example, through a sign-off or pre-approval process provided by the network.

### EXAMPLE

A firm has decided that Exchange Traded Funds as a product range are unsuitable for its client base.

As ETFs cover a broad product range, with a wide range of features and a potentially wide general application, it is unlikely that a firm could take this position and remain independent.

So the new rules do not prohibit, or even restrict, the use of panels or best advice lists by firms wishing to hold themselves out as independent.

**"As is the case currently, advisers can use panels to help review the market and we do not expect a firm to review the market for a product which does not meet the client's needs and objectives."<sup>10</sup>**

## Platforms and Wraps

Going back to first principles, if it is the firm giving the advice that needs to meet the rules not the platform, it therefore remains important for the firm to be clear about who is taking responsibility for the advice.

The firm and each adviser must ensure that any personal recommendation to invest via a platform is suitable and must first take into account whether being on a platform at all is in each individual client's best interests.

An adviser giving independent advice must be able to demonstrate why using a particular platform is suitable for an individual client, and this involves not just looking at one platform over another but also looking off-platform when appropriate to do so.

Although in theory, an independent firm may be able to use a single platform for the majority of its clients, the firm would need to consider very carefully its choice of platform and the impact that this would have on the firm's ability to meet independence rules.

<sup>7</sup> COBS 6.2A.18 31/12/2012

<sup>8</sup> COBS 6.2A.19 31/12/2012

<sup>9</sup> COBS 6.2A.20 31/12/2012

<sup>10</sup> FSA Factsheet



# independent or restricted?

“In practice and in the current platform market, which is changing on a frequent basis, we feel an adviser with a wide range of clients should not take the view that a single platform will be the right solution for the majority of its clients.”<sup>11</sup>

## Using one platform for *all* clients

At present, platforms generally have access to a very wide range of CIS funds, but usually a much more limited range of other packaged products such as investment bonds, personal pensions and SIPPs. In order for a firm to restrict itself to one platform and use it for all its clients, it would need to find a platform that offered a range of products that covered the whole packaged product market, and keep this under continual review.

“We think that it is likely to be very rare, if possible at all, that a firm could use one platform for all clients and meet the independence rule.”<sup>12</sup>

### EXAMPLE

A platform has a limited choice of life and pensions products. It would therefore not be possible for an adviser to use this platform alone for **all** its clients needing a life or pension product and have independent status.

## Using one platform for the *majority* of clients

“This is a much more likely scenario than the one above, because the independent adviser firm is considering off-platform solutions where this is suitable for all or part of a client’s portfolio, or using another platform if this is in the client’s best interests.”<sup>13</sup>

The platform adopted would need to be competitive in terms of charges and features, for this to be viewed as an appropriate approach to enable the firm to cater for the majority of its clients. There are probably going to be other clients for whom the platform is not suitable, hence the potential need for recommending products off-platform.

### EXAMPLE

An IFA firm has conducted due diligence of the platform marketplace and has decided that one particular platform is the most suitable for the majority of its clients, based on a wide range of factors, including cost, availability of funds and various administrative facilities.

However, an adviser has met a client with no previous financial arrangements who wishes to contribute £100 per month to an ISA and £100 per month to a pension.

The facilities of the wrap platform are not appropriate to this client. The costs of the platform itself and the incremental costs of the pension wrapper on the platform make the total costs significantly greater for this client than they would be with an individual ISA and a stakeholder pension. The adviser recommends that this client does not use the wrap platform and arranges the contracts off-platform. In these circumstances, the firm is not likely to jeopardise its independent status.

## Using more than one platform

A firm may want to offer different levels of service to different categories of client and effective segmentation can be a beneficial approach (following good due diligence). A firm would need to consider each client individually and ensure that any clients, for whom a platform was not suitable, were handled appropriately.

FSA has published examples of good and poor practice on the use of platforms in PS11/9, Annex 3 [www.fsa.gov.uk/pubs/policy/ps11\\_09.pdf](http://www.fsa.gov.uk/pubs/policy/ps11_09.pdf)

<sup>11</sup> FSA PS11/9 Platforms: delivering the RDR and other issues for platforms and nominee related services

<sup>12</sup> FSA PS11/9 Platforms: Annex 3

<sup>13</sup> FSA PS11/9 Platforms: Annex 3



# independent or restricted?

## Use of Model Portfolios & Discretionary Investment Services

Despite the fact that model portfolios would not normally be classified as a retail investment product and discretionary investment services are generally outside the scope of the RDR, there are circumstances where their use could impact on a firm's independence.

As stated previously, each personal recommendation to every client needs to meet the independence rule. A firm giving independent advice would need to be able to show that, in giving a personal recommendation to invest in a model portfolio, they have considered all retail investment products that might be suitable for that client. If they decided that investing in certain assets would be in the client's best interests, and their risk appetite matched that of one of the model portfolios, they would then need to look at whether the portfolio as a whole was suitable for the client.

If, for any reason a model portfolio cannot be varied, or it is held in a product wrapper, it may in fact be classed as a 'retail investment product' in and of itself. COBS 6.2A.14G states that a personal recommendation on a retail investment product that invests in a number of underlying investments would not of itself meet the requirements for providing unbiased and unrestricted advice even if the retail investment product invests in a wide range of underlying investments. So where model portfolios are structured as described above, they should be considered alongside other retail investment products when making a personal recommendation.

Regardless of whether a model portfolio is flexible or not, to recommend it, advisers need to understand how it is made up to ensure that it is suitable for their client.

Where a firm uses a platform provider where its model portfolios can only use the tax wrappers of a single provider, it is unlikely that advice to invest in a model portfolio would be deemed independent. Whether or not the independence rules are met depends on a number of things including:

- The structure of the tax wrapper
- How many other platforms the firm is using and how many of its clients are recommended to use the services of the platform (in which case the guidance on platforms is relevant).

Firms should also note that receipt of any incentives for investing clients in model portfolios could create a conflict of interest which might make it difficult to demonstrate independence. This could also be non-compliant with the adviser charging rules

When using the services of a discretionary investment management service it is important to ascertain who is making the personal recommendation and taking responsibility for the investment advice. Where it is the adviser and the contracted service is purely to manage the investment in accordance with the adviser's instructions, then it is the firm and its adviser that needs to determine whether the advice meets the independence criteria.

Alternatively, some firms may undertake the financial planning aspects of the service but outsource the investment advice and management of the client's assets. In this case it may not always be clear who is giving the personal recommendation.

In either scenario, a firm should, however, ascertain whether the service their clients are being referred to is restricted. A referral to a restricted service would not in itself impact on a firm's independence as it would not be a personal recommendation. (The key issue is that all of the **personal recommendations** of the independent firm need to meet the independence criteria).

As stated previously, suitability is paramount and an independent firm should only recommend a particular DIM service if that is in the best interests of the client. So, an independent firm would need to satisfy itself that this is indeed the case through a good understanding of the DIM service (including whether they only offer a restricted range of model portfolios).

Due to the complexity and variety of business models in the market, it has not been possible to ascertain precisely how and when the use of third party services might impact on an advisory firm's independence in all eventualities. We will continue to seek further clarity and guidance from the FSA, particularly in the use of DIMs and certain model portfolios.



# independent or restricted?

## What about firms with Distributor Influenced Funds?

There is currently no FSA definition of a Distributor Influenced Fund, but for FSA's position on DIFs, please refer to their factsheet [http://www.fsa.gov.uk/pubs/other/dist\\_inf\\_factsheet.pdf](http://www.fsa.gov.uk/pubs/other/dist_inf_factsheet.pdf)

The FSA also refers to DIFs in the RDR Policy Statement, pg 28, paragraph 4.11.

DIFs have been described by the market as:

'Distributor-influenced funds are created for the clients of a particular distributor, typically an adviser firm. They could be designed on a bespoke basis for the distributor or they could be set up using an existing fund that is tailored for the distributor. Fund administration and management is outsourced to other firms but the distributor may have a degree of influence over the fund (short of day-to-day asset selection). It may be, for example, that the distributor is able to:

- influence the hiring (or removal) of the delegated investment manager;
- create accountability of the investment adviser by attending investment committees; or
- appoint (or remove) the Authorised Corporate Director.<sup>14</sup>

However, it is possible that a firm's independent adviser status could be constrained by any or all of the following:

- a high volume of client investment into the firm's DIF
- a requirement, usually set by the Authorised Corporate Director to ensure certain minimum investment in-flows are met to ensure availability of the fund (which may influence advice to invest in a fund to ensure that the target is met)
- a requirement to ensure certain continuing investment in-flows are met to ensure continued viability of the fund

It is possible to envisage a firm maintaining its independent status subject to it ensuring that any real or potential conflicts of interest are managed effectively. A process which follows that set out where a firm is owned by a product provider may be effective.

However, following the principles set out earlier, a firm with just three funds Income, Balanced and Growth into which all clients are invested, with no alternative offering, may find it difficult to demonstrate independence.

It should be noted that the FSA has clarified its rules on firms receiving additional income from their DIFs in their June 2011 RDR newsletter <http://www.fsa.gov.uk/pubs/newsletters/rdr2.pdf>

## What if a firm does not allow an adviser to sell certain products?

It is relevant **who** is setting the restriction and **what** happens as a result of that restriction.

### EXAMPLE

A newly qualified adviser is not permitted to advise on capped and flexible drawdown without consulting with a more experienced adviser within the firm. The firm requires the advice to be provided under the guidance of the more experienced adviser. As the firm has a process for ensuring that the client still does receive Independent advice, by involving a more experienced adviser within the firm, the restriction placed will not affect the firm's independent status.

### EXAMPLE

A Network does not allow its Appointed Representative (AR) member firms to recommend Unregulated Collective Investment Schemes (UCIS).

However, one of the network's ARs has met a client for whom a UCIS is the most suitable of the full range of investment options available.

In practice, much will depend on the nature of the relationship between the AR and the network. It is likely that the contractual agreement between the two parties, or other notifications, will set out the member firm's obligations.

For example, the contract might allow the network to introduce a ban on advising on a particular product, or impose higher standards of competence, if and when it felt necessary.

Where such a contract term exists and is enforced, that AR would have to describe its services as restricted.

Even if, the AR referred the client to an independent firm who *could* make the recommendation, the onward referral would not be enough to allow the AR to call itself independent. By definition the AR from whom the client is seeking advice is not considering the whole of the market.

<sup>14</sup> FSA Factsheet SFDFS038 10/08



# independent or restricted?

It is clear that the status of any firm, whether Directly Authorised (DA) or Appointed Representative (AR), is determined by that firm and the approach it takes to providing personal recommendations at both product and product provider level.

## EXAMPLE

An AR of a directly authorised firm specialises in advising high net worth individuals on investment and tax planning schemes. The clients are usually employed in the City, often in fund management or other investment roles, and have net personal wealth in excess of £5m.

The DA firm contractually prevents its ARs from advising on VCTs, EISs and Film Partnerships unless they undertake specified training and are assessed as competent in this area.

The AR has met the firm's higher T&C requirements and meets the criteria for independent in all other areas. It will therefore be able to describe its services as independent. However, the **directly authorised** firm and ARs who are subject to the contractual restriction will have to describe their advice as restricted, which means neither can hold themselves out as independent, and secondly, they need to disclose that they give restricted advice and the nature of that restriction.

## EXAMPLE

An AR is required by its network to refer pension withdrawal cases to Head Office. If that referral is for sign-off or pre-approval, with the AR still actually delivering the personal recommendation, then the AR's advice can still be independent.

## EXAMPLE

A firm has a client with complex pension arrangements. The firm decides to refer the client to third party specialists who provides the personal recommendation. In this example the firm would be unable to hold itself out as independent as it will have offered a restricted advice service to one of its clients.

## EXAMPLE

A small directly authorised firm has no pension specialist qualified to advise on transfers from occupational schemes. Any clients requiring advice in this area are referred to a specialist firm who takes full responsibility for the advice.

As this is an area where the FSA require higher professional standards beyond those for 'retail investment advice' and occupational pension schemes are not retail investment products, this referral would not in itself jeopardise a firm's independent status.

## Can my firm be Independent if it is owned by a product provider?

Having a product provider as owner or part-owner of a business would not, as now, necessarily affect a firm's status as independent.

The first question to ask is whether the company ownership confers any restrictions on its actions, whether at firm or at individual adviser level.

Some restrictions might be contractual, such as a formal requirement to sell that company's products, in which case, the firm would not meet the criteria for independence.

Firms should also consider their remuneration policies to ensure that staff (whether advisers or managers) are not expected or encouraged to favour the owner's own products.

Firms should also monitor the sales of their owners' products, considering the circumstances of the sales and ensuring suitability.

A well-constructed and researched best advice list or panel with impartial selection criteria and the opportunity to go off panel if the short-listed products are unsuitable will also provide reassurance that the advice process is indeed Independent.

However, as stated previously, simply having access to a range of investment funds under a restricted product range does not confer independence.



# independent or restricted?

## EXAMPLE

An adviser is only permitted to sell Investment Bonds offered by his or her own product provider company. Even though the fund choice within the Investment Bond gives the option of selecting from a wide range of funds from different investment houses, the firm is providing restricted advice.

## What if my firm is unable to deal with a particular product provider?

Status will depend on the product provider in question and on the reason for the limitation.

If there is a wide range of alternative product providers offering equally suitable products then independence status should not be affected.

## EXAMPLE

A product provider refuses to grant a firm an agency which means the personal pension products, which might be suitable for its clients, cannot be transacted through the firm. However, as there is a wide range of other equally suitable personal pension providers from which a suitable product could be recommended, independent status is not affected.

If, however, notwithstanding the fact that business may not be placed with a particular product provider, a firm or adviser knows that this firm offers the most suitable product for its client, then recommending the “least unsuitable” option from those available is **not** the right way to proceed.

## What if my firm is unable to advise on products for reasons outside its immediate control?

## EXAMPLE

A Professional Indemnity insurer has imposed a restriction on a firm’s activities, such that advice on Structured Products would not be covered by its PI policy. The firm prohibits advice on these products until they can be covered by its PI policy and would therefore be offering restricted advice.

Note: An exclusion imposed by a PI insurer may not actually prevent a firm from giving advice on the excluded area. It is likely to mean instead that if there were any claim in relation to that advice it would not be covered by the insurance policy. A commercial decision would need to be taken by the firm as to whether or not to advise on the excluded product, and if so, the FSA would require the firm to ensure that adequate capital resources were in place to cover the risk exposed by the lack of PII.

## What about GPPs?

IFA firms currently providing advice on GPPs, including group SIPPs and group Stakeholder, are permitted to advise employees on the selected scheme only, without jeopardising their independent status. The new rules applicable to group pensions have been carried forward.

Paragraph (1) [of rule 6.2A.3R] does not apply to group personal pension schemes if a firm discloses information to a client in accordance with the rule on group personal pension schemes (COBS 6.3.21R).

Therefore, firms operating in the group pensions market can still describe their advice as independent provided they follow the above rules.



# independent or restricted?

## Disclosure

All firms providing advice must disclose to each client, what type of advice they will receive: Independent or Restricted advice.

This will enable consumers to know upfront whether they are being offered independent advice or restricted advice.

The FSA considered creating a set of 'mandated' words to be used but following consultation concluded it would be difficult for this to reflect the range of possible business models and to leave it to individual firms to ensure that they disclose:

- (a) that it provides restricted advice and
- (b) the nature of the restriction.

**"In addition, firms who offer restricted advice will be required to provide oral disclosure, to enable consumers to understand the nature of the service. Advisers offering restricted advice will be required to orally disclose the fact that they provide restricted advice together with the nature of that restriction in good time, before providing the service."<sup>15</sup>**

The FSA has amended the Services and Costs Disclosure Document (SCDD) and the Combined Initial Disclosure Document (CIDD). Firms who wish to use these documents will be able to satisfy the new written disclosure requirement by completing the document in line with the notes.

The amended disclosure documents and accompanying notes will be in the version of the FSA Handbook that comes into force after 31 December 2012.

<sup>15</sup> FSA Factsheet



Many advisers receive client referrals from other professionals, most of whom require the adviser to have independent status. Below are extracts relating to the requirements from two of the main bodies. There are other bodies based in Scotland and Northern Ireland who are likely to have similar requirements.

## Referrals from accountants

Below is a summary from ICAEW Code of Ethics – for further information please go to:

<http://www.icaew.com/en/members/regulations-and-guidance/regulations-and-guidance>

When considering referrals of investment business ('introductions') or the establishment of investment business agencies, professional accountants in public practice must look at how the introduction is made and also what type of investment the client is considering (such as life assurance and pensions, unit trusts, shares, mortgages or general insurance). A regulated introduction can only be made under the terms of the Financial Services and Markets Act 2000 by a firm which is licensed by ICAEW as a Designated Professional Body ('DPB') (a licensed firm) or a firm which is authorised by the Financial Services Authority ('authorised'). Such introductions can only be made to those authorised firms who can give independent advice. However, unauthorised/unlicensed firms can provide information to a client about a third party provided no recommendation is made.

## Referrals from Solicitors

Firms must always act in the best interests of their clients. This means that they must refer clients to independent financial advisers for investment advice.

Where clients require advice etc. on investing in an asset that can rise or fall in value—for example, an endowment policy, life insurance with an investment element, or a pension policy—**rule 9.03(6)** of the Solicitors' Code of Conduct 2007 (the **Code**) states that they must only be referred to independent intermediaries authorised to give investment advice.

"Independent intermediary" has never been a defined term. However, for the purposes of the Code the view of the SRA is that "independent intermediary" has the same meaning as the Financial Services Authority gives to "independent financial advisers". An independent financial adviser is an adviser who is able to advise on products from across the whole of the market and offers the consumer the option of paying fees. Advisers who advise from across the whole of the market but do not offer the option of paying fees will not be able to call themselves "independent".

Source: **SRA Guidance** July 2009

It should be noted that following the introduction of the Legal Services Act there is closer collaboration between law firms and financial planners including the emergence of joint ventures. This, combined with the fact that many existing relationships may be jeopardised by the new standards for independence created by the FSA, has encouraged dialogue between numerous stakeholders, which may lead to a change in policy post RDR. We will keep members updated with any developments.



# conclusion

## To conclude:

- Many IFA firms today will need to consider carefully whether their post RDR business model will meet the new Independent requirements.
- Restricted advice should not be confused with 'Tied' or 'Multi-tied' – it can be very different
- It is important that the broad rules are understood as firms transition their business models post RDR.
- Firms need to consider the importance of rules and the impact of any contractual or third party arrangements they currently have in place.
- Firms and advisers need to decide which model is right for them and suits their business.



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The Personal Finance Society is the professional body for the financial planning profession in the UK. The PFS takes an active role in setting standards of professionalism and our members commit to the highest standards of professionalism by keeping their technical knowledge up to date and by adhering to a respected code of ethics.

Part of the Chartered Insurance Institute we have been helping to facilitate debate on all aspects of the various consultation phases of the RDR. As the industry's main professional body, the CII seeks to guide the profession through this process and help ensure the result enhances consumer confidence.