



professional direction paper

JUNE 2012

Independent & Restricted Advice

This paper is one of a series of papers that the PFS is producing under the **Professional Direction** title. This edition replaces paper 2 first issued in September 2011. It represents the PFS interpretation of the rules as far as we have been able to ascertain them and follows FSA final guidance on Independent and Restricted advice, published in June 2012. 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 (June 2012). 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 those giving investment advice to retail clients can describe their services.

In September 2011 we published a Professional Direction paper aimed at providing a better understanding of the terms Independent and Restricted so that firms can make an informed choice about their business going forward.

Since September there has been continued debate and interest around this subject which has resulted in further guidance from the FSA in June 2012. This revised Professional Direction paper has been produced to further clarify some of the outstanding issues and replaces the earlier version.

As a professional body with members drawn from across the adviser community, the PFS has no set agenda other than to provide members with improved understanding of the new rules. We seek to ensure that any decisions are made for the right professional and commercial reasons, and not because of misunderstanding or lack of clarity in application of the new rules.

Now that the final rules are in place 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 32,000 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 in the world, with over 107,000 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'.



executive summary

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'.¹

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.
- 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.
- Independence refers to the activity '**Advising on Packaged Products**' (to be 'Retail Investment Products' from 31st December 2012). A Retail Investment Adviser will not need to advise on **Securities** or **Derivatives** in order to hold themselves out as Independent.
- **Stock-broking and wealth management** firms advising retail clients on retail investment 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.

¹ 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 2012.²

The 'rule' is³:

- (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

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

³ COBS 6.2A.3 R



the rules

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- (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.

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'basic advice' is

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

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- (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.

The definition of a retail investment product is intentionally broad to ensure that all similar investment products sold to retail clients on an advised basis, including those yet to be developed, are subject to same relevant selling standards, for example adviser charging.

The FSA expects there to be very few types of investments sold to retail clients that would fall outside of the above definition and the characteristics of a particular product would need to be considered in order to determine whether it would be captured by the definition of 'retail investment product'.

Examples of financial instruments that are not retail investment products would include: a share in an individual company whose primary business is not investing in two or more financial assets (shares in investment trusts and OEICs are captured by the retail investment product definition); an individual fixed interest security; and an individual derivative where the exposure of the relevant asset is not modified in any way.⁴

⁴ FSA Finalised guidance RDR: Independent and Restricted advice June 2012



Independent Advice

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 new standard for independent advice is intended to ensure that such advice is genuinely free from bias towards particular solutions or any restrictions that would limit the range of solutions that firms can recommend to their clients.

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

‘Restricted advice’ is defined in the FSA’s Handbook glossary as:

- (a) *a personal recommendation to a retail investment client in relation to a retail investment product which is not independent advice; or*
- (b) *basic 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 even if they offer restricted advice. They are also required to hold an appropriate Level 4 qualification, and complete gap-fill where required, and apply Adviser Charging to their client work. Ongoing requirements for CPD and holding a Statement of Professional Standing (SPS) also apply.

A firm that provides restricted advice must explain the nature of the restriction in its written disclosure⁵. A firm must also provide oral disclosure if it engages in spoken interaction with a retail client⁶. 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.

Firms must be fair, clear and not misleading in their communications but the rules allow flexibility in how a firm describes the nature of their restricted advice services.

EXAMPLE: Describing restricted advice services

ABC Pension Planners only offer advice on Pensions and therefore cannot hold themselves out to be Independent Financial Advisers.

However, ABC Pension Planners can explain to their clients that they review the whole market for suitable pension products, so long as they are clear that advice is restricted to that area, and their communications are not misleading in any way.

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.⁷

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.

EXAMPLE: Product restriction

A firm decides not to consider stakeholder pension schemes.

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.

⁵ COBS 6.2A.6R

⁶ COBS 6.2A.9R

⁷ FSA Factsheet



independent/restricted advice

EXAMPLE: Product restriction

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 and its clients have concerns about regulatory and compensation aspects to 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.

Unregulated Collective Investment Schemes (UCIS)

It is almost certainly the case that by their very nature UCIS are specialist products and probably with limited application. A firm may advise on them rarely if ever. Indeed, the vast majority of clients, because of their age, income bracket, existing portfolio and attitude to risk find plenty of (more) suitable investment options in other funds and products.

The FSA proposes to consult on new rules for UCIS during 2012. It is expected that this will make clear their expectations that UCIS will be suitable for very few clients, if any. Currently FSA requirements already limit the categories of investors to whom UCIS can be marketed (see COBS4.12). A firm's independent status will not be affected if it never recommends these products because it deems them to be unsuitable for its clients.⁸

Notwithstanding how rarely the situation arises, it is possible to be very clear 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 a restricted adviser.

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 for their different segmented business models.

EXAMPLE: Independent and restricted advice

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: Independent advice

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

⁸ FSA Finalised guidance RDR: Independent and Restricted advice June 2012



independent or restricted?

EXAMPLE: Restricted advice

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

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 solely driven by the needs of the client and is clear from the outset.

For more information regarding focused advice and suitability, please refer to Annex 8 of the Retail Distribution Review FS 08/6 http://www.fsa.gov.uk/pubs/discussion/fs08_06.pdf

EXAMPLE: Focused advice

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.

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

Widening the 'independent' regime to include Structured Capital at Risk Products, Unregulated Collective Investment Schemes and all investment in Investment Trusts (not just those in investment trust saving 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.

EXAMPLE: Investment Trusts

A firm only advises on direct shareholdings so currently falls outside this discussion. However, it wishes to include Investment Trusts in its client recommendations.

Whilst these are equities, they fall within the definitions 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

EXAMPLE: Securities

Chris & Sons Financial Planners hold FSA permissions to advise on Packaged Products and Securities and up until Dec 2012 is able to provide advice to individuals on direct shareholdings. From 31st December 2012 they will cease advice in this area as their financial adviser will not hold an appropriate Level 4 qualification to advise on Securities.

This will not affect the firm's ability to call themselves independent as independence applies to advising on Packaged/Retail Investment Products only.

For further information on FSA Permissions and qualification requirements relating to Securities and Derivatives, please refer to the PFS Professional Direction: RDR-Clarity around FSA Permissions and Statements of Professional Standing:

http://www.thepfs.org/downloaddata/CII_6642-Permissions-Clarity-paper-v3.pdf



independent or restricted?

‘Comprehensive and Fair Analysis’ and ‘Unbiased and Unrestricted’

The following section looks at what is meant by ‘comprehensive’ and looks at scenarios where certain product types may be excluded from consideration and where firms may specialise in certain areas.

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, including products such as collective investment schemes that are manufactured outside the UK, but are widely available to UK consumers.

However, it may be possible for a firm to conclude for many clients, early on in the advice process, that certain product types, for example UCIS (further FSA consultation expected in 2012) are not going to be suitable, and therefore not consider these product types further for those 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”⁹

EXAMPLE: Structured products

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: ETFs

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 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.¹⁰

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
- Trusts and charities
- Annuities and pension drawdown.

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

⁹ FSA factsheet

¹⁰ COBS 6.2A.11 31/12/2012



independent or restricted?

EXAMPLE: Pensions advice

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 the future. 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: Ethical investments

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.

If a firm chooses to specialise in a particular relevant market, *'it should not hold itself out as acting independently in a broader sense. For example, a firm "Greenfield", which specialises in ethical and socially responsible investment, should not hold itself out as "Greenfield Independent Financial Advisers". "Greenfield – providing independent advice on ethical products" may be acceptable (COBS 6.2A.4G(2))*¹¹

EXAMPLE: Islamic products

A firm chooses to specialise in a relevant market – e.g. Islamic products. So long as all *retail investment products* within the market for Islamic products are considered when making personal recommendations, it may be acceptable for the firm to hold itself out as providing independent advice on Islamic products.

See Q8 of FSA's guidance "Top questions asked at the RDR roadshows" for a further example: http://www.fsa.gov.uk/pubs/guidance/fg12_05.pdf

Specialists

It's important here 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 the independence rule, the firm should not hold itself out as independent.

EXAMPLE: Specialist advice

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 specialist to seek his advice and guidance. The result is that the personal recommendation provided by the 'IHT' specialist to the client meets the independence rule. This does not therefore jeopardise the independence of the IHT specialist.

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

EXAMPLE: Investment advice

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 FSA's guidance "Top questions asked at the RDR roadshows" for a further example: http://www.fsa.gov.uk/pubs/guidance/fg12_05.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.

¹¹ FSA Finalised guidance RDR: Independent and Restricted advice June 2012



independent or restricted?

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: USP and ASP

A newly qualified adviser is not permitted to advise on USP or ASP without consulting with an 'in house' specialist adviser. The firm takes the view that such advice requires greater expertise and that it should be provided under the guidance of a more experienced adviser within the firm.

As the firm has a process for ensuring that the client still does receive Independent advice, by involving a specialist adviser within the firm, the restriction placed will not affect the firm's independent status.

EXAMPLE: UCIS

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.

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 advice at product and product provider level.

EXAMPLE: T&C requirements

An AR of a firm specialises in complex estate and inheritance tax planning schemes. The clients are usually approaching retirement, employed in the City, often in fund management or other investment roles, and have net personal wealth in excess of £5m.

The 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 independence 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 two things 1) they cannot hold themselves out as independent, and 2) they need to disclose that they give restricted advice and the nature of that restriction.

EXAMPLE: T&C requirements

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 can still be independent.

EXAMPLE: Pension transfers

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 would not in itself jeopardise a firm's independent status.



independent or restricted?

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 this case, it is unlikely that a firm would meet the criteria for independence.

Firms should in particular consider their remuneration policies to ensure that staff (whether advisers or managers) are not expected or encouraged to favour the owner's own products. A 'better than best' approach is often employed in this situation.

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, note that simply having access to a range of investment funds under a restricted product range does not confer independence.

EXAMPLE: Restricted advice

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 a 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 would not be affected.

EXAMPLE: Agency

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 my 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: Professional Indemnity

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.

An exclusion imposed by a PI insurer may not actually prevent a firm from giving advice in that range. 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, it would be required by FSA to ensure that adequate capital resources were in place to cover the risk exposed by the lack of PII.



independent or restricted?

Advice Tools and Investment Strategies

This section discusses how the use of different tools and strategies may influence the ability of a firm to meet the standard for independent advice.

Panels or Best Advice lists

All firms and advisers providing independent advice should have a good sense of what products and providers are available in the market place. That knowledge may be distilled into a best advice list or panel 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.¹²

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.¹³

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.¹⁴

Furthermore, a firm that provides independent advice needs to be able to advise off-panel if that would be in the best interests of a particular client. To do this, its advisers should maintain an awareness of what is and is not included in the panel, so they can identify clients for whom an off-panel solution would be suitable.

EXAMPLE: Ethical products

An independent firm is approached by a client interested only in ethical investments. The firm uses a panel that does not have ethical products. However, the firm reviews the market and advises the client on suitable ethical products for their needs and objectives. In this case, the firm's independence should not be jeopardised.

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.'¹⁵

Platforms and Wraps

Going back to first principles, it is the firm giving the advice that needs to meet the rules not the platform, and it therefore remains important for the firm to take 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.

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.¹⁶

¹² COBS 6.2A.19 31/12/2012

¹³ COBS 6.2A.19 31/12/2012

¹⁴ COBS 6.2A.20 31/12/2012

¹⁵ FSA Factsheet

¹⁶ FSA PS11/9 Platforms: delivering the RDR and other issues for platforms and nominee related services



independent or restricted?

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.¹⁷

EXAMPLE: Restricted advice

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 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.¹⁸

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: Independent advice

A IFA firm has conducted due diligence of the platform market place 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

¹⁷ FSA PS11/9 Platforms: Annex 3
¹⁸ FSA PS11/9 Platforms: Annex 3



independent or restricted?

Model Portfolios

The FSA use the term ‘model portfolio’ to mean a pre constructed collection of designated investments, including some retail investment products, that meet a specific risk profile, sometimes offered with a periodic rebalancing of investments to maintain a consistent asset allocation.

If a firm is constructing its own model portfolios for use in providing independent advice, it should ensure that it bases its product selections on a comprehensive and fair analysis of relevant product markets. If a firm is using model portfolios constructed by a third party, it should ensure the criteria used by the third party are sufficient to allow the firm to meet the independent advice rules.¹⁹

Before recommending a model portfolio, a firm should consider the following:

- that each product within the portfolio is in line with a particular client’s preferences, for example with regard to ethical and socially responsible investments;
- that the model portfolio as a whole is suitable given the client’s attitude to risk;
- each product within the portfolio is suitable, in light of the client’s individual circumstances, taking into account any existing exposure to sectors or assets held within the portfolio.
- If any aspect of the model portfolio is not suitable or consistent with the client’s investment needs, then the model portfolio should either not be recommended or it should be tailored so that it is suitable. A firm should also consider the model portfolio as a whole when taking into account the best interests of the client, including ensuring, amongst other things, that the model portfolio charges are appropriate for each client’s circumstances.

In giving independent advice a firm should be able to recommend other investment solutions and advise on retail investment products not held in the model portfolios. A firm should not restrict its advice to certain model portfolios, or use them as the default option, even if they can be tailored.

Advisers should maintain an understanding of the make-up of any model portfolio used by their firm, as well as the situations in which the model portfolio would – or would not – be a suitable recommendation.

EXAMPLE: Model portfolios

An adviser is making investment recommendations to a client who already has existing investments in place, with high exposure in the IT sector. The adviser has selected a model portfolio that meets the client’s needs and objectives, as well as attitude to risk. However, on further investigation, the adviser discovers that the model portfolio offers substantial exposure to the IT sector. When added to the clients existing high exposure in this sector, the model portfolio becomes unsuitable. On the grounds of suitability, the adviser subsequently advises on products outside of the firm’s existing model portfolios. As the adviser can and does advise on products outside of the firm’s range of model portfolios, independence should not be affected.

EXAMPLE: Model portfolios

A client approaches a firm for investment advice. The adviser chooses from the firm’s extensive model portfolio range, without looking at other investment solutions or retail investment products available. This would jeopardise independent status as model portfolios should not be the default option when giving advice.

If however, the adviser reviews the market for other suitable investment solutions that could meet the client’s needs and objectives, but subsequently decides that the model portfolio is the most suitable option for the client, then independent status should not be affected.

¹⁹ FSA Finalised guidance RDR:
Independent and Restricted
advice June 2012



independent or restricted?

Discretionary Investment Services

The first point to remember is that the standard for independent advice only applies to personal recommendations on retail investment products.

Recommendation to use a DIM

Where an adviser has considered a client's personal circumstances and decided that a discretionary investment service is the right solution for them, this 'recommendation' would not normally be considered a 'personal recommendation'.

In addition to recommending a discretionary investment service, the adviser may also play a part in determining the discretionary mandate, or provide information to the discretionary investment manager (DIM) on the client's risk profile or investment objectives. The adviser may also have an ongoing relationship with the client, in which the investments managed by the DIM are just part of the client's overall financial situation that the adviser considers in their periodic reviews.

The standard for independent advice only applies to personal recommendations on retail investment products and recommendations above would not normally be considered 'personal recommendations', as they do not relate to one or more specific financial instruments.

However, recommending a discretionary investment service should not be the default investment solution. Under the Principles for Business, before recommending a discretionary investment service to a client, an adviser providing independent advice, should objectively consider the wide range of investment solutions available in the market.

Independence would be jeopardised where an adviser routinely uses one DIM as the default option for all investment advice.

EXAMPLE: Independent advice

An adviser is providing investment advice to a high net worth individual. The adviser provides advice on all areas of financial planning, including tax, trusts and investments. When giving investment advice, the adviser ascertains the client's attitude to risk, their needs and objectives and the appropriate tax wrappers. The adviser has also determined that a discretionary investment service is most suitable to the client.

The adviser has conducted the relevant due diligence when selecting the DIM and recommends the services to the client. As the adviser has recommended a DIM service, and not the retail investment products offered by the DIM, then the recommendation to use the DIM is not a personal recommendation and the standard for independence does not apply.

EXAMPLE: Restricted advice

An adviser firm has an investment proposition whereby all clients with investment needs are referred to one DIM. As the firm has restricted its offering in this way, by not providing any personal recommendations on investments, then independent status would be jeopardised.

'Personal recommendation' to use a DIM

If an adviser explicitly or implicitly recommends particular funds offered by a DIM, it is in effect recommending a particular investment. If a particular investment/fund is being recommended, then a recommendation to use the discretionary investment service would amount to a **'personal recommendation'** and the standard for independent advice would apply.

If an adviser recommends a retail investment product in which the underlying approach will be managed by the DIM, then the DIM is integral to that retail investment product. Therefore the advice to use the product and the DIM is a personal recommendation and must be suitable. The suitability report should discuss the advice as a whole and explain all charges that apply to the client, including those for the DIM.



independent or restricted?

EXAMPLE: Independent advice

An adviser is providing investment advice to a high net worth individual. The adviser provides advice on all areas of financial planning, including tax, trusts and investments. When giving investment advice, the adviser ascertains the client's attitude to risk, their needs and objectives and the appropriate tax wrappers. The adviser has also determined that an investment product/strategy offered by the discretionary investment service is most suitable to the client.

In this case, the adviser, in recommending the discretionary investment service, is actually recommending a particular investment offered by the DIM. Therefore, the recommendation to use the discretionary investment service would amount to a 'personal recommendation' and the rules applicable to personal recommendations would apply, including those for independent advice.

Selecting a DIM

A firm would not need to demonstrate that it has picked the DIM based on a comprehensive and fair analysis of the market, where the recommendation of the DIM did not amount to a personal recommendation. However, the firm should ensure that before recommending a DIM to a client, it has undertaken sufficient due diligence so that it can make a judgement about whether it is the right solution for the client.

Where the recommendation of the DIM is a personal recommendation, as with the use of platforms and model portfolios, all personal recommendations need to be based on a consideration of all retail investment products that might be suitable for the client and the suitability report should discuss the advice as a whole.

What about firms with Distributor-Influenced Funds?

'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.²⁰

However, it is thought 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

Where firms holding themselves out as independent want to recommend a DIF evidence would be required for each recommendation to show that advice is:

- suitable;
- made following a comprehensive and fair analysis of the relevant market in an unbiased and unrestricted manner;
- in the customer's best interests; and
- in accordance with conflicts of interest requirements.

Given the inherent conflicts of interest involved, the FSA question whether an independent firm could meet its obligations to act in the best interests of its client and provide advice in an unbiased manner if it recommends a DIF.

The FSA published finalised guidance on DIFs with points to consider for advisers.
http://www.fsa.gov.uk/static/pubs/guidance/fg12_04-adviser.pdf

What about GPPs?

The new rules applicable to GPPs are very clear.

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 GPP market (including group SIPPs and group Stakeholder) can still retain independence provided it follows the above rules.

²⁰ FSA Finalised guidance:
Distributor-influenced
funds February 2012



independent or restricted?

Specialist Activities

There are two specialist activities, relating to advising on investments, recognised in the FSA's training and competence regime:

- (a) advising on pension transfers and pension opt outs; and
- (b) advising on long term-care insurance contracts

Pension transfers and pension opt outs

A firm must have a separate permission to provide advice on pension transfers/opt outs and any adviser providing recommendations in this area must hold an appropriate qualification.

Any firm that does not hold the permission to provide advice in this area can still hold itself out as giving independent advice as the definition of retail investment product does not include occupational pension schemes.

Long term Care

Advising on long term care contracts requires a specialist qualification but not a separate permission. The FSA do not expect a firm holding itself out as providing independent advice to have an adviser who is qualified to advise on long term care insurance contracts, because it is a niche market requiring additional qualifications.

As with both of the specialist activities above, advisers who give independent advice should be able to identify clients for whom pension transfers/opt outs or long term care insurance contracts should be considered and be in a position to refer these clients onto someone who can provide advice in these areas.

Other referrals

Firms can also make internal or external referrals for advice on non retail investment products. If a firm does not provide any personal recommendations on retail investment products to a client, and refers them to another firm instead (for example, a firm that provides restricted advice), this will not affect its independent status.²¹

The FSA would expect firms to undertake sufficient due diligence on a service before recommending it to their clients to meet their obligation to treat customers fairly.

²¹ FSA Finalised guidance RDR:
Independent and restricted
advice June 2012



independent or restricted?

Disclosure

All firms providing advice should 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.

The FSA has amended the Services and Costs Disclosure Document (SCDD) and the Combined Initial Disclosure Document (CIDD) and these changes come into force from 31 December 2012. 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 disclosure documentation with accompanying notes will be in the version of the FSA Handbook in force after 31 December 2012.

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.²²



Referrals from accountants

The core principle underlying ICAEW's code on investment business referrals is that their members have to be objective and give objective advice. From that it follows that they can only make referrals to advisers who are in a position to be able to give objective advice themselves, otherwise sub-contracting would circumvent the code.

The ICAEW intends to retain the existing underlying approach to referrals, but to change the terminology to reflect the RDR structure of **independent** and **restricted** advice.

*Advisers who fall within the FSA's new definition of **independent** would, as before, be considered to be likely to be able to offer objective advice. **Independent** is now defined to include not only advisers who provide independent advice across all markets and all products, but also advisers who provide independent advice across all products in the relevant market.*

*If it is proposed to refer to a **restricted** adviser, the referring member will need to ensure that the client's needs would be addressed appropriately, including making an assessment that the **restricted** adviser has demonstrated that they are able to cover a large majority of the products and providers available in the market that is relevant to the client's needs.*

All changes to the Code of Ethics have to be approved by the ICAEW Board and its Council, and final confirmation of the revised code is expected in October 2012.

Source: ICAEW Code of Ethics

<http://www.icaew.com/en/technical/ethics/icaew-code-of-ethics/icaew-code-of-ethics-and-the-retail-distribution-review>

Referrals from Solicitors

The SRA states that solicitors must ensure that whenever they recommend that a client uses a particular person or business, that the recommendation is in the best interests of the client and that it does not compromise their independence.

If a client is likely to need advice on investments, such as life insurance with an investment element or pension policies, they should only be referred to an independent intermediary*.

Source: SRA Code of Conduct 2011 forms part of Edition 3 of the Handbook, which came into effect on 18 April 2012

<http://www.sra.org.uk/solicitors/handbook/code/part2/rule6/content.page>

***Please note: The SRA is reviewing its position and intends to consult shortly on a range of issues relating to financial advisers.**



conclusion

To conclude:

- Many IFA firms today will need to consider carefully whether their post RDR business model will meet the new Independence rules.
- Restricted advice should not be confused with 'Tied' or 'Multi-tied' – it can be very different.
- Independence relates to retail investment products. It does NOT need to include securities or derivatives.
- 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.

