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FCA Finalised Guidance to Clarify Financial Advice Boundaries

Following a guidance consultation last summer, the Financial Conduct Authority last week issued its finalised guidance to clarify the boundaries between what is and what is not a personal recommendation in the investment market: <http://www.fca.org.uk/news/fg15-01>

- For advice to be regulated, it must relate to a specific investment and must be given to the person in their capacity as an investor or potential investor.
- The regulator provides examples to illustrate the difference between advice and information, and the distinctions for generic financial advice.
- Following the feedback received from the market, the FCA have strengthened their initial proposals, including amending the terminology, simplifying its communication, providing extra examples and introduced a definitive glossary of terms.

Next Steps:

- The guidance paper published this month represents the FCA's final considered viewpoint of the regulated advice boundary.
- The FCA will consult in the upcoming months on proposals to replace the ABI Code on Retirement Choices.

Purpose of the Finalised Guidance

The paper is an attempt to bring together into one place a summary of the existing UK and European position in relation to investment advice, and provide examples to explain their application in practice.

Defining investment advice: the existing regulatory regime

As set out in the initial consultation, insight into the advice boundaries comes from existing UK and EU regulation, especially the Markets in Financial Instruments Directive (MiFID) as well as the UK's Article 53 of the Regulated Activities Order (RAO).

The MiFID three-point test

Investment advice under MiFID involves the provision of personal recommendations to a customer, either upon the customer's request or on the firm's initiative, in respect of one or more transactions relating to MiFID financial instruments. It comprises three main elements:

- there must be a recommendation that is made to a person in their capacity as an investor or potential investor, or in their capacity as an agent for an investor or personal investor
- the recommendation must be presented as suitable for the person to whom it is made or based on the investor's circumstances, and
- the recommendation must relate to taking certain steps in respect of a particular investment.

The Personal Finance Society

Personal recommendation

Given the importance of the concept of a personal recommendation as a key indicator as to whether the interaction with the customer constitutes a personal recommendation, the Finalised Guidance sets out the five key elements drawn from MiFID and the RAO that help to test whether this had occurred:

Summary of the recommendation five-point test (note that this is a PFS summary of pp.14-18)

The Recommendation is...	Explanations
<p>...Not just information It has an element of opinion or judgment on the part of the recommender.</p>	<p>It can be either explicit or implicit:</p> <ul style="list-style-type: none"> For the latter, a statement such as “people like you would buy this product” or “I would buy that product if I were you” classifies as an implicit recommendation.
<p>...Directed at an investor or potential investor Or an agent thereof.</p>	<p>Note the distinction between:</p> <ul style="list-style-type: none"> investment advice and corporate finance advice
<p>...In relation to transaction(s) of financial instruments</p>	<ul style="list-style-type: none"> This entails instruments set out in MiFID as well as general financial services It could apply to recommending either a firm or a service
<p>...Presented as suitable The recommender is obliged to ensure (and be able to demonstrate) that the personal recommendation is suitable for the customer.</p>	<p>Three-point test:</p> <ul style="list-style-type: none"> meets their investment objectives; is such that they can financially bear any related investment risk consistent with their investment objectives; and is such that they have the necessary experience and knowledge to understand the risks involved. <p>“Presented” could be explicit or otherwise. An implicit recommendation could be <i>presented</i> in such a way as to reasonably cause the customer to conclude that it is suitable to them. Eg “people like you would buy this product.”</p>
<p>...Is directed specifically for that customer It is “issued other than through exclusive distribution channels or to the public” Firms need to assess recommendations delivered through the internet.</p>	<ul style="list-style-type: none"> In relation to automated sales processes, there are a range of factors that might help determine whether an internet-based filtering tool constitutes a personal recommendation. This includes the context of questioning, the stage in the questioning at which an opinion is offered, the role played by the questioner, the questioning outcome, and who designs the questions. In relation to advice through the public media, MiFID contains a specific exemption allowing such content aimed at the general public to be given without it being classed as a personal recommendation. This journalistic exemption would not apply if it was a message sent to an individual in a personalised manner.

Generic advice versus regulated advice

Generic advice is a broad (and confusing to many) term that covers advice that does not relate to a specific investment or does not otherwise meet one of the other characteristics described above and so is not a regulated activity.

However, when generic advice is given with regulated advice (for example, a personal recommendation on a retail investment), the generic advice becomes part of the regulated advice. So, advice that purports to be generic may in fact be regulated depending on the context and the overall circumstances (p.11, para.3.7).

Decision trees

Some online services use decision trees as a key element of their processes. Decision trees involve using a form of sequenced, scripted, questions prepared in advance to gather information from a customer with a view to either providing a personal recommendation or regulated advice or facilitating the customer selecting a financial instrument themselves. For a decision tree *not* to constitute a personal recommendation:

the decision tree and, where relevant, the person asking the question it contains, would need to avoid making any judgement or assessment that would result in a single product or a list of products being identified as suitable for a customer, whether as a result of information that the customer provides or otherwise (p.12, para.3.10).

So therefore, we think the key considerations are:

- whether the decision tree process is limited to assisting a person to make his own choice of product; and
- whether the decision tree process is likely to be perceived by the customer as assisting them to make their own choice of product, taking into account the features that the customer regards as important.

The regulator had altered its guidance in this area after respondents called for further clarification, suggesting that a process which provides a list of suggested products would constitute a personal recommendation.

Information versus investment advice

For advice to be regulated at all, it must relate to a specific investment and must be given to the person in their capacity as an investor or potential investor, or in their capacity as agent for an investor or potential investor, and relate to the merits of them buying, selling, subscribing for or underwriting (or exercising rights to acquire, dispose of or underwrite) the investment (p.11, para.3.6).

It then provides specific examples:

- Advice to a customer to buy shares in ABC plc or to sell Treasury 10% 2014 stock is advice about a specific investment and so is regulated.
- Advice to buy shares in the oil sector or shares with exposure to a particular country is generic advice because it does not relate to a specific investment.
- Advice on whether to buy shares rather than debt is generic advice and is not regulated.
- Guiding someone through a decision tree where they make their own decision, would not normally be advising on investments.

Simplified advice

The paper reiterated its findings from the March 2012 guidance on simplified advice, setting out the requirements for firms developing such a model. It reminds the market that suitability, personal recommendation and professional standards are by and large the same as other forms of retail investment advice.

However there were some concerns that the market was disappointed that the FCA failed to address concerns about the way the Ombudsman will interpret complaints, and also that the FCA refused calls for greater clarification on liabilities and boundaries between information and advice.

Focused advice

There has been some speculation, particularly with the Government's pension reforms, about the regulator and especially the Ombudsman views. An absence of this concept in the guidance consultation attracted some criticism from the sector, and the final paper now contains some content specifically on this model, including this definition:

It is perfectly feasible, within both MIFID and our domestic regulatory framework, to provide a service that focuses on a specific need of the customer and which does not require the detailed factfind of a full advice offering (p.41, para.4.6).

It then provides some examples of how this might look in practice (p.41):

A customer who had straightforward requirements and was looking for advice on how to invest money in a stocks and shares ISA. In this situation the customer and intermediary could agree that the service provided would be focused on this one situation and would not include wider discussion of, say the customer's pensions or mortgage situation, or indeed of their other investments beyond assessing the attitude to risk and capacity for loss.

How does focused advice work? A customer might approach a firm with a specific objective, for example, to find out what they should do with their existing with-profits policy. The firm could agree with the customer that it will do so, although it should explain to the customer this will mean their other financial needs/objectives will not be addressed. In other words, the firm would need to outline the level of service they will provide and what they will not be providing – that way the customer is clear about the level of service they are receiving. If a customer believes they are getting a full financial review, this is what they should receive.

In relation to this last point, the guidance refers to duty of care with another example (finalised guidance para.4.12). The regulator is unable to provide more specific examples, as the existence of a duty of care depends on many different factors, including what is said or done by the adviser.

Despite some further information on simplified and focused advice, the market still thinks more clarity is needed:

- **The Association of British Insurers:** “the lack of clarity in the guidance will prevent firms developing simplified advice models to support the Government's pension reforms being introduced in April.”
- **Association of Professional Financial Advisers:** “it is useful to have all the rules in one place but I am disappointed the FCA has not gone further. The issue of the FOS still looms and I do not think this is a game changer for firms which want to develop new models.”

Summary of range of distribution models for retail investment products (FCA table: p.22)

	Without a personal recommendation			With a personal recommendation (PR)		
	Non-MiFID products	MiFID products	Non-complex products	Simplified advice	Focused advice	Full advice
Description	Execution and/or reception of and transmission of orders for (a) pensions or insurance-based investments; or (b) other non-MiFID products	Execution and/or reception of and transmission of orders for MiFID products or non-readily realisable securities, derivatives or warrants	Execution and/or reception of and transmission of non-complex MiFID products at the client's initiative	Provision of PRs where the firm sets out the limited nature of the service in line with the guidance provided on this issue either F2F, telephone or electronically	Deliberate limiting of the range of PRs sought by the client to suit their particular needs, eg to seek a PR on buying an ISA	Full regulated advice which may be independent or restricted and will consider the full range of the client's needs including their debt and protection needs
Training & Competency	N/A	N/A	N/A	QCF Level 4 for adviser and person designing system	QCF Level 4	QCF Level 4
Appropriateness Client has necessary experience/ knowledge to understand risks	No	Yes	No	No	No	No
Suitability (1) meets the client's investment objectives (2) client able to bear investment risks consistent with investment objectives (3) client has necessary knowledge and experience to understand risks	No	No	No	Yes: standard qualified by reference to the nature and extent of service provided. Information must be obtained is qualified by condition "where relevant", but process includes safeguards (eg to exit customers with more complex needs)	Yes: standard qualified by reference to the nature and extent of service provided. Information must be obtained is qualified by condition "where relevant", but this remains at the customer's instigation	Yes
Limited range of product solutions	As above	As above	As above	Yes: FCA would expect the product range to reflect the limited nature of the suitability assessment	Yes: access limited dependent on client requirements	Not if independent, but more or less limited if the advice is restricted
Adviser charging	No	No	No	Yes	Yes	Yes
FOS access	Yes	Yes	Yes	Yes: recognising nature of the service	Yes: recognising nature of the service	Yes
FSCS access	Yes	Yes	Yes	Yes	Yes	Yes

Key changes arising since the consultation

The FCA received 53 responses to its guidance consultation, and the final paper reflected the following key amends:

- amended the terminology regarding appropriateness to refer to financial instruments content in the Handbook;
- revised the Table in the finalised guidance to better reflect the different models of services offered, including Focused Advice;
- in relation to Decision Trees, the use of terminology in the finalised guidance was standardised when cross-referenced to passages elsewhere, in order to clarify especially how these Decision Trees may provide an implicit recommendation;
- stated that the circumstances of how a communication is presented to a customer will have a significant bearing on its interpretation. Firms will have to form a judgement based on the finalised guidance and the FCA Handbook on whether particular information and the way it is communicated is regulated advice or a personal recommendation; and
- amended the finalised guidance to reflect feedback that focused advice suggests that this type of advice is only suitable for smaller investors (para.4.6).