

Good Practice Guide



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MAY 2017 UPDATE

Adviser research & due diligence on discretionary investment managers

In responding to members' requests, the PFS has commissioned this Good Practice Guide to help Adviser Firms develop their approach to due diligence (DD) on Discretionary Investment Managers (DIM's) and the service they provide.

The aim of this Guide is to assist member firms of all sizes address a challenging topic in an efficient and client-centric manner.

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Foreword



Keith Richards
Chief Executive, the Personal
Finance Society

For many advisory firms the run up to RDR involved a significant amount of soul searching and it was a catalyst for many to question, and focus, on the core components of their value proposition. One conclusion for many firms was that investment management was not an area where they had the necessary skills, experience or capacity in-house. Discretionary Investment Management (DIM) became a buzz word and a plethora of new DIM firms entered the market to court advisers, seeking to entrust considerable sums of their clients wealth.

However, for many advisory firms choosing a DIM partner was a steep learning curve. In the absence of a well-established due diligence model, some firms struggled to add the layer of additional cost that represented the best value for money for their clients. There was also a lack of clarity over contractual relationships in terms of what outsourcing actually means and the resultant obligations on the adviser firm. Research and due diligence, especially in relation to DIM, is a key area of attention for the Regulator.

As with any business partnership a careful audit trail documenting the research and due diligence steps taken is essential. But don't forget that an element of due diligence often boils down to intangibles such as culture and trust. You need to establish whether the approach of the discretionary manager is compatible with your own beliefs – is there a philosophical fit and could you realistically work with the people on a regular basis? Don't forget that both the adviser and any DIM both have suitability obligations to the same client, so it is essential there is documented clarity over who will be responsible for what. Working with a DIM does not mean the outsourcing of responsibility or advice liability.

This guide is focused on helping members understand good practice when conducting research and due diligence on discretionary investment managers, which I hope you will find of value. Don't forget that the process is equally applicable to regular reviews.



Section 1 – Introduction

In responding to members' requests, the PFS has commissioned this Good Practice Guide to help Adviser Firms develop their approach to due diligence (DD) on Discretionary Investment Managers (DIM's) and the service they provide.

When developing and offering services to their clients, it is expected that the same professional standards are applied by all Adviser Firms, irrespective of size and resource. The aim of this Guide is to assist member firms of all sizes address a challenging topic in an efficient and client-centric manner.

A great deal of confusion exists as to the allocation of responsibility between the adviser and DIM when jointly providing a service to the same client. In part, this may be due to DIMs being brought into the RDR towards the very end of the consultation phase leading to inconsistencies of approach. However, there was confusion way before this and Adviser Firms may have a legacy book of business that has been subject to minimal research and DD on the DIM provider. As long as clients continue to receive these services, Adviser Firms should ensure they fully understand the basis of the relationship and their resultant obligations. This guide works with the 'spirit' of RDR and the general guidance provided by the regulator but it is the application of members' professionalism, experience and knowledge of their client requirements that will allow them to develop their own DD process.

At a conference in London, Robert Taylor, Head of Wealth Management & Private Banking Team at the FCA introduced his speech with the following:

“We are here not just to understand what conduct* is, but to be taking these issues on board so that you can actually put your hands on your heart and say that you are doing everything to the highest standard possible, and that journey is never going to end. That journey is something we always have to be thinking about. What do we need to do better? What do we as an industry need to improve on?”

(Conduct Risk Briefing – November 2014).

*i.e. putting your clients at the heart of your business.

Developing a good DD process that is fully adopted and implemented within your business practice is essential as it contributes such a significant element to proper 'conduct' and ensuring positive client outcomes.

“Over the coming months and into next year, the subject of due diligence will continue to be on the agenda and my hope is the industry generally and participants within the industry will continue to talk about what good due diligence looks like and to move everybody forward in that respect”.

(Rory Percival FCA Technical Specialist, October 2013)

Why DD is so important?

“We are looking at due diligence because when we undertook an exercise a little while ago to look at what are the root causes of unsuitable advice, of all the cases we have looked at over the last four or five years pretty much 100 per cent of unsuitable advice came back with one of three answers; inadequate due diligence was one of those. Due diligence, or at least inadequate due diligence, underpins a lot of the incidences of crystallised risk we've seen... You can rely on third party providers for factual information but not for opinion....; you have to come to your own view...”.

(Rory Percival FCA Technical Specialist, 30 September 2014)

Section 2 – The issues

Confusion persists in the post RDR world. There is confusion between advice on ‘products’ and discretionary investment management ‘services’. There is confusion relating to the application of RDR adviser charging and independence rules to the former but not the latter. Add to this the challenges to both advisers and DIMs of the perennial tension between commercial considerations and relationships on the one hand and compliance with duties to clients and regulations on the other. All these ingredients have created a complex set of dynamics for the retail end of the investment distribution chain.

In particular, the FCA and firms are increasingly aware of, and concerned about, the ‘suitability gap’. The language may not always be precise but the spirit of the message is clear:

“Where a firm refers investment selections to a discretionary manager, both the introducing firm and the discretionary management firm have obligations to ensure that a personal recommendation or a decision to trade is suitable for the client. The obligations on each party will depend upon the nature and extent of the respective service provided. Both parties should be clear on their respective service, and ensure they meet the corresponding suitability obligations. If either or both parties are not clear, there is a risk that clients may receive unsuitable advice and/or have their portfolios managed inappropriately”.

(FSA July 2012, FG; Assessing Suitability: Replacement Business and Centralised Investment Process, para 4.8, p18)

“...clients can benefit from more structured and better researched investments and firms can benefit from efficiencies in the management of risks associated with investment selection” but the FCA is concerned about ‘shoe-horning’ and additional costs. (FSA July 2012, FG; Assessing Suitability: Replacement Business and Central Investment Process, para 2.3, p4).

“Both the DIM and adviser have suitability obligations to the same client... But it needs to be clear who is doing what”.

(Rory Percival, FCA Technical Specialist February 2013)

The Problems

There are a number of common misapprehensions, confusions and regulatory tensions in play:

“DIM” not “DFM” – service not product

- COBS 9 suitability obligations on DIM decisions to trade are much the same as those on an adviser’s personal recommendations/advice
- FCA remain concerned about clients falling between two stools – i.e. the suitability gap
- Is the DIM providing a service to the client, a service to the adviser or are they the investment manager of a product?

Referral, not “outsourcing”

- The common parlance is very misleading. Referral to a DIM is rarely “outsourcing”, this is impossible unless the adviser has ‘managing investment permissions’.

Independent v Restricted

- RDR/COBS 6.2A applies to personal recommendations/advice on ‘Retail Investment Products’ only, not referral to a DIM (unless a model portfolio is predictable such that the adviser is effectively recommending particular funds offered by DIM) (FSA FG June 2012 ‘Independent and restricted advice’ (“Independence Guidance”))
- Independence Guidance confirms referral to a DIM does not need to be based on comprehensive or fair analysis of the market. “However, the firm should undertake sufficient due diligence on a DIM before recommending it to a client, so that it can make a judgment about whether it is the right solution for the client”. However, the FCA has shown willing to rely on the ‘spirit of RDR’ and you should apply your professional judgment on how wide your research should extend into the DIM market.

Adviser charge

- Ongoing services for ongoing charges.*

Provider/Intermediary Agreements v ‘model terms of business’

- Conflicts between client’s best interests and commercial relationships and interests must be managed
- CIP guidance refers to three broad structures firms use when working with third party DIMs (direct contractual relationship between DIM and client, adviser delegates/outsources management to DIM, or contract between DIM and adviser as agent of client)
- But ‘agent as client’ arrangement under COBS 2.4 is undone if DIM agrees with the adviser in writing to treat investor as its client
- Yet a direct client agreement is required under COBS 8. As the DIM, with the adviser, has suitability obligations, it often accepts the client as its own.

Risk (mis)matching

- Risk profiling tools for KYC by advisers for financial planning purposes – even if consistent throughout, are only part of the service
- If inconsistent, the ATR will not match the risk ratings of the DIM’s suite of model portfolios
- That may then be run by investment managers (often alongside unitised funds) with little regard for the individual investor, and potentially using underlying funds with another risk rating altogether
- The adviser is responsible for the use of any ‘tools’ in the provision of their service. “It is important to highlight that the firms providing the advice or discretionary management remain responsible for assessing suitability, even if they use a tool provided by a third party as part of assessing the risk a client is willing and able to take” (FG, Assessing Suitability, 5.1 March 2011).

*FOS ruling; Mr. J against HSBC Ref: DRN7413808, where HSBC ordered to repay trail fee/commission, with interest and a payment for distress caused, because they did not provide an ongoing service which the client had expected from outset

The Liabilities

By getting it wrong, firms expose themselves to claims and complaints when investments do not perform. The types and sources of the liabilities may surprise the firms, and their PI insurers.

- When the DIM adopts the client direct – thereby (apparently) de-risking the adviser’s business – it may struggle to discharge its duties to the individual investor to ensure a suitable portfolio and transactions, especially when running a model portfolio service. An agreement by which the adviser takes certain responsibilities may not be effective in responding to complaints by an investor. If the DIM’s performance drops, it could face a ‘bulk complaint’ from all the adviser’s clients.
- When the adviser acts as an agent of the client, aiming to keep control of the all-important client relationship, it will struggle to discharge its duties to ensure the suitability of what is, by definition, a discretionary service to be provided by the DIM. If the DIM agrees in writing with the adviser to treat the investor as its client, the ‘agent as client’ model breaks down and the DIM will find itself directly responsible for ensuring the suitability of its service to a client it may never have met.

The Solution

All this inevitably leads to confusion and uncertainty between DIM, adviser and client. The need to look beyond the DIM’s promotional material (including in-house due diligence packs) is essential, thus ensuring Terms of Business Agreements (TOBA) terms are clear, correct and understood by all. In turn, this should demonstrate clear responsibility for suitability and KYC. Careful analysis and thorough understanding of the DIM propositions, backed up by documentation which is fit for purpose is the absolute minimum required. Clients and the regulator, will not expect anything less.

Section 3 – The Good Practice Guide

The Process

This guide recommends the following process as good practice:

1. Establish Your Criteria
 - a. Know your client's and your own requirements
 - b. Understand your Firm's investment capabilities and resources.
 - c. Understand the variables in the DIM market
 - i) Style of Relationship
 - ii) The range of Operating Frameworks
 - iii) Investment Process Differentiators
 - iv) Your Specific Requirements
2. Research
3. Analysis
4. The Intangibles
5. Selection/Reconfirmation
6. Document the Agreement
7. Cascade down through both organisations and to clients
8. Ongoing systems & controls

1. Establish Your Criteria

The Regulatory Guide, "The Responsibilities of Providers and Distributors for the Fair Treatment of Customers" (FCA Handbook; RPPD, Issued under Section 139A of the Financial Services and Markets Act 2000, effective from 2007) sets out the regulator's framework of how two organisations deliver a service (or a product) to an end client. FCA Principles apply to all authorised firms but the regulator's Guide looks primarily at:

Principle 2 A firm must conduct its business with due skill, care and diligence

Principle 3 A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems

Principle 6 A firm must pay due regard to the interests of its customers and treat them fairly

Principle 7 A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

The design and delivery of the service they offer to clients is the responsibility of the adviser. Inviting a DIM to assist in delivering the service can be a sensible approach if an adviser is looking to enhance their investment offering. However, it is the adviser who must be clear at outset on what they are looking for and the operational framework upon which the service is provided. This will lead to a more structured approach to market research and the resulting DD process.

In this Good Practice Guide, we define Due Diligence (DD) as: “*The care a reasonable and prudent person (Adviser Firm) should take before entering into an agreement or a transaction with another party (the DIM). Gathering detailed, quality information over and above general marketing documentation is a fundamental part of the research process, in order to identify anything deemed material in the service or relationship. By using the same DD process systematically, advisers will be equipped to make an informed decision ensuring all the costs, benefits, known and potential risks are analysed and assessed against the Adviser Firm’s pre-defined criteria. This will lead to greater confidence in client outcomes meeting the identified client needs.*” In this process, the adviser can – to the extent reasonable – rely on facts provided by a third party firm but will need to test opinions.*

The definition starts with the premise that you are looking to enter into an agreement or transaction with a DIM. Therefore, the first question has to be – Why?

If you want (and are able) to provide an in-house investment solution to the required standard of your clients’ expectations, you are unlikely to be looking to invite a DIM to help you.

Recognising the need suggests you can identify areas within your client investment proposition that might be enhanced if you were to invite a DIM to help and means you are already on the road to creating an effective DD process. Of course, there are other investment solutions that need to be considered at this stage of the exercise, such as the range of product-based solutions. This paper now assumes that, as a result of this initial consideration, the Adviser Firm has decided to consider a DIM-based solution.

1a. Know your client’s and your own requirements

It is appreciated that many clients, if not all, come to you for advice because they are not clear in what their requirements are. However, knowledge of your existing clients and your approach to financial planning will allow you to articulate criteria that will guide you in meeting your client’s requirements. Your client segmentation exercise may well allow you to identify groupings of clients with specific investment needs.

Examples might include – a highly personal investment service; confidence in a well-known financial institution; demonstrable value; or access to specialist investment areas.

Examples of areas your firm might consider when asking “*What am I looking to achieve by working with a DIM?*” may include – all investment risk associated with running portfolios to sit with the DIM; consistency of national service across all your offices; a strong relationship with senior personnel at the DIM and so on.

1b. Understand your firm’s investment capabilities and resources

A worthwhile exercise is an appraisal of your firm’s investment strengths and weaknesses. This is important as it helps establish the level of competency and resource available to run the ongoing systems and controls required when working with a DIM (in 1c (ii) below we look at different frameworks available). The greater your firm’s involvement on behalf of the client, the more responsibility stays with your firm and the greater the need for specific skills and experience. Alternatively, the more responsibility placed upon the DIM the more straightforward the ongoing monitoring can become.

*COBS 2.4.6 (2) A firm will be taken to be in compliance with any rule in this sourcebook that requires it to obtain information to the extent it can show it was reasonable for it to rely on information provided to it in writing by another person.

COBS 2.4.7 (1) In relying on COBS 2.4.6 R, a firm should take reasonable steps to establish that the other person providing written information is not connected with the firm and is competent to provide the information.

1c. Understand the variables in the DIM Market

These can now be considered to help identify the most appropriate solution;

i) The style of working relationship you feel is most appropriate between your firm and your chosen DIM(s) in order to deliver the service to your client(s)

- The relationship and service is an integral part of your overall client service offering with the DIM personnel attending client meetings, both initial and ongoing reviews. The client will see this as a partnership, with the DIM offering a specialist investment service.

Or

- The DIM is simply a provider of an investment solution with support to be called upon as and when required.

Additionally, do you have any other specific requirements you may have when working with your chosen DIM(s)?

ii) The Operating Framework. This is critical as it will dictate the resultant obligations and responsibilities of both parties

By identifying and agreeing your firm's and the chosen DIM(s) respective suitability obligations on a 'suitability matrix' (see overleaf) arrangements and terms of business can be put in place to ensure there is no 'suitability gap'.

In the market, there are variations on each of the models outlined below. Which one is right for your firm will depend upon a number of factors including your identified requirements and the strength and ability of your in-house team to provide the necessary systems and controls required. If you agree the DIM can rely upon your firm for the provision of client information, do not be surprised if the DIM wishes to conduct a DD service on your firm. This is good business practice.

Diminimis Suitability Matrix

		DIM Suitability		Investment Suitability			Ongoing Suitability		
		Appropriateness of DIM service for the client	Selection of DIM	Suitability of initial client portfolio construction	OR Suitability of portfolio selection	Suitability of transactions to portfolio mandate	On-going suitability of portfolio	Ongoing monitoring of DIM service	Ongoing monitoring of DIM selection
Model A Direct DIM engages the client as a retail client	Standard bespoke	Adviser	Adviser	DIM	N/A	DIM	DIM	Adviser	Adviser
Model B Hybrid DIM relies upon the client information and assessment by the adviser	(a) Standard bespoke	Adviser	Adviser	DIM	N/A	DIM	DIM	Adviser	Adviser
	(b) DIM relies upon the client information and assessment by the adviser AND portfolio selection	Adviser	Adviser	Adviser	Adviser	DIM	Adviser	Adviser	Adviser

Model A: The advisory firm arranges for the client to have a direct (contractual) relationship with the DIM.

Model B: based on the MiFID rule ‘reliance on others’ (COBS 2.4.4); The advisory firm arranges for the client to have a direct (contractual) relationship with the DIM but the DIM relies on the client information provided, and an appropriateness assessment by the adviser. B (b) the DIM is also relying on the advisory firm to select the portfolio construction from a range of pre-defined strategies.

Diminimis Suitability Matrix continued

		DIM Suitability		Investment Suitability			Ongoing Suitability		
		Appropriateness of DIM service for the client	Selection of DIM	Suitability of initial client portfolio construction	Suitability of portfolio selection	Suitability of transactions to portfolio mandate	On-going suitability of portfolio	Ongoing monitoring of DIM service	Ongoing monitoring of DIM selection
Model C Agent as client DIM does not have a direct relationship with the underlying investor	MPS On Platform	Adviser	Adviser	Adviser	Adviser	DIM	Adviser	Adviser	Adviser
Model D Outsourced Solution	Standard	Adviser	Adviser	Adviser	Adviser	Adviser	Adviser	Adviser	Adviser

Model C: based on the ‘agent as client’ rule (COBS 2.4.3); The advisory firm arranges for the investment management to be carried out by the DIM but on the basis the client does not have a contractual relationship with the DIM. Instead, the DIM treats the advisory firm as its client, which is acting as the agent of the end investor. The advisor firm must have the appropriate authority from their client to be able to commit and bind them to the discretionary management agreement and thereby to appoint the DIM. In addition, it is highly recommended the adviser firm has the appropriate controls and oversight, along with the capacity and expertise, to meet their responsibilities. Additional responsibilities may apply if the adviser firm is treated as a professional client.

Model D: This is the only true ‘Outsourcing’ option. It can only be used by advisory firms who hold the relevant permissions for managing investment and delegate the investment management to the DIM. The responsibility for all aspects of the investment solution remains with the adviser firm*

**SYSC8; If a firm outsources critical or important operational functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the regulatory system.*

iii) Investment process differentiators

What style of investment management is appropriate for your clients, for example:

- Passive v Active
- Direct market securities v collective
- Benchmarks – absolute, relative, target rate of return.

Whilst all clients have individual needs, you may be able to segment certain groups of clients.

For example, a discretionary investment service that targets a specific blend of investment return and 'income' generation might be appropriate for clients who are in the 'at retirement' stage of their planning.

Depending on your own business and client base, you may be able to identify a number of distinct groups of clients that have specific investment needs.

iv) Your specific requirements

You may wish to consider the following examples, as well as other factors relevant to your firm and client base:

- Ensuring your selected DIM will be able to work in an efficient manner with your SIPP and offshore bond panel
- Is the use of the client's annual CGT allowance important? Who is going to ensure it is used?
- Does the same apply to the client's annual ISA allowance?
- Are you looking for a consistent service applied across all of your offices?
- Are you looking for a small boutique that offers a high level of personal service?

The more specific your requirements and applying the criteria consistently, the more straightforward the next stage will be.

2. Research

With regards to the extent of market research required, Independence Guidance sets out that referral to a DIM does not require an exhaustive search of the whole market. But an adviser needs to be in a position to make a “*judgement about whether it is the right solution for the client.*” You can therefore use your own professional judgement to decide how wide you wish to cast the net in selecting from the 80 or so of the PAM (Private Asset Management) members* active in providing various styles of investment services to clients of Adviser Firms.

Gathering information can be done in a variety of ways but the most common is via a Due Diligence Questionnaire (DDQ) or Request For Information (RFI). Having carried out the preceding steps, you now have a clear vision of your clients and your firm’s requirements, meaning your questions can be much more focused. You can explain these requirements at outset and ensure you receive responses from those DIMs that meet your identified criteria.

In terms of the information you would expect to cover about the potential DIMs, this stage of the process is similar to that which you might expect of a product DD approach. The broad headlines may be something like:

- Background to the DIM, their people, reputation, financial standing, structure, approach to TCF etc.
- More detail on their approach to investment management and performance.
- Administration and Operations.
- All fees/charges.
- Management Information (MI) requirements to pick up trends, e.g. how much business they get from Advisers as opposed to other sources
- Paperwork – for ease of use by you and the demands on your clients.

There are a number of third party research and consultancy firms that collate factual information about DIMs, details of the service they provide and various approaches to the analysis of investment performance. These firms have an important part to play at this stage of the information gathering process. It is important to understand the difference between those firms which provide a factual ‘snapshot’ of the current position, and those that provide an analysis of the information both at the point at which the Adviser is looking to appoint a DIM as well as on an ongoing basis. Understanding if there is a commercial relationship between these firms and the DIMs, and an understanding of how their rating system works, will be important as the responsibility for the use of any output from these providers by the Adviser firm in the decision processes remains with the Adviser firm.

“...You can rely upon third party providers for factual information but not for opinion.”
(Rory Percival, FCA Technical Specialist, 30 September 2014).

It is now common practice for DIMs to provide their own RFI or DDQ documents to the extent they have now become part of a suite of marketing literature but remember that DIMs are not likely to be drawing attention to their weaknesses in such a document. However, it is hoped an industry standard will develop as the quality of adviser DD improves and DIMs respond to the more probing and relevant requests for information.

*224 current members in total (2014)

3. Analysis

An analysis of the information provided, assessed against your pre-determined list, will naturally narrow the number of DIMs you ask to complete a DDQ. However, the research process does not stop at this point. You need to get under the bonnet of the marketing blurb and be comfortable that the information provided covers everything you have requested and is factual, not just hyperbole.

This requires a meeting or series of meetings with a range of personnel at the DIM firm to question – and indeed challenge – the information if necessary. For example, the DDQ may state that they run specialist mandates such as ethical or AIM portfolios. What you need to assess at this stage is whether this is a core competency or are they simply being accommodating? If an aspect like this is important to you, do not be afraid to delve deeper.

4. The Intangibles

This process also allows you to address those intangible factors that are so important in your decision making process. Trust and mutual respect between the DIM and the Adviser Firm will be essential for a successful, relationship based service. This will be built and nurtured over time but means nothing if that trust is misplaced. At outset, the starting point is to get a firm basis to build on;

- Do I like the people?
- Am I comfortable inviting them to meetings with my clients?
- Is the culture compatible with my firm?
- Can I work with them?
- Can I trust them to honour my client relationship?
- Can they provide good references from other advisers they currently work with?

Answers to the above may become apparent over several meetings. Applying your professional judgement throughout should ensure there are no surprises once the business relationship is established.

5. Selection/Reconfirm

It is always a pleasure to give and receive good news. It would be very helpful to the DIM for you to explain why they have been selected. Some of this information may be very important for the ongoing monitoring and controls that will need to be put in place.

Whilst not such an enjoyable role, don't forget to relay the news to those DIM's not selected and again, if possible, help them by explaining why they were not chosen this time.

6. Document the Agreement: Terms of Business Agreement (TOBA)

It is good business practice for the full decision-making process to be documented, with specific points agreed clearly articulated and confirmed by both parties in writing.

The adviser firm should have a TOBA in place between them and the chosen DIM(s) that accurately records the Operating Framework (see 2 above) or Frameworks (if they wish to allow for options) adopted for their clients, and how the relevant Framework applicable will be clearly communicated to each client. It should also cover those aspects that are important to you and your firm. For example, a 'no cross marketing clause' is likely to be compulsory as will a service level agreement for future monitoring purposes identifying specific information and reporting frequency to be provided by the DIM.

With appropriate input or knowledge as to what should be included, as an adviser you may be able to create your own TOBA that can be used as a template to negotiate any conflicting or missing clauses in the DIM's standard intermediary agreement.

7. Communicate and cascade down through both organisations

It is very common for the whole research and selection process to have taken place between a limited number of people in both organisations. It is important to make clear ‘who is doing what’ so that all staff working within the relationship understand the basis that has been agreed and what is expected of them in providing a consistent approach to all clients.

In the recent FCA Thematic Review – “TR14/21 Retail investment advice: Adviser charging and services”; December 2014 – whilst the disclosure of charges and understanding of the initial service increased professionalism in the financial advice sector the issue of clients’ suggested understanding of ongoing services and associated charges was raised as an area of concern. “Firms should therefore consider how they communicate information on ongoing services to their clients and how effectively it is understood.” The use of the suitability matrix may well help demonstrate to clients some of the vital work an adviser carries out ‘behind the scenes’ on behalf of their clients. This is important work carried out on their behalf that needs to be paid for.

8. Ongoing Systems and Controls

As mentioned previously, the systems and controls required will depend upon the Operating Framework chosen and any agreed are likely to be outlined in an appendix to the TOBA. Your requirements will develop from your work in section 1b above and should be explored in your discussions with your final panel of DIMs. For example, industry comparative benchmarks over specific timeframes may well be provided by the DIM as standard but other means of measuring performance will have significant cost implications. No matter which Operating Framework is chosen, the Adviser Firm needs to have in place ongoing monitoring and due diligence to ensure the selected DIM(s) remain suitable and the agreed ongoing service to the client is provided.

RPPD is very specific regarding ongoing client service and highlights a number of post advice responsibilities. FCA Principles 3 and 6 are particularly relevant. Specifically, a firm:

- Should comply with any contractual obligation it has to the customer, for example to provide ongoing advice or periodic reviews. In connection with this, it should also consider its responsibility to maintain adequate systems and controls to deliver on such reviews.
- Should consider any implied or express representation it made (during meetings, correspondence or promotional material, for example). Where a customer has reasonable expectations based on the prior statements of a distributor e.g. that performance will be monitored, these expectations should be met by the distributor.

Conclusion

Due Diligence (DD) is high on the FCA's agenda and is vital to ensure the right outcome for clients, as well as meet regulatory responsibilities.

This document shows the need for DD, specifically on a DIM service, to be carried out in a systematic way, understanding the need for it to be an end to end process. Starting with an outline of the needs to be met, gathering and analysing detailed information, documenting the agreement between the Adviser Firm and the DIM and ongoing monitoring to ensure the service is delivered as expected. This should be embedded in the adviser firm as standard business practice.

By doing so, the adviser will have demonstrated their professionalism leading to greater confidence in client outcomes and success measured by client satisfaction and retention.

DD on a service provider, specifically a DIM is not currently well-established in the retail financial services sector. There is certainly a significant time and resource commitment required by the adviser firm to execute the research and DD to a high standard. In publishing this Good Practice Guide we aim to assist members by providing an outline structure that can be adopted in a methodical way.

The WMA are bringing this to the attention of their members who provide investment services to the adviser community and their clients, looking at their own practice in supplying DD information to advisers. We also expect to see the development of specialist service providers who can support our members in this area in a cost effective manner.

Diminimis biography

David Gurr, the founding Director of Diminimis Ltd has a career in financial services spanning over 35 years, being primarily responsible for business development via key account management with financial advisers in the UK and Europe. As Managing Director, Head of UK Financial Intermediaries for Deutsche Bank Private Wealth Management, the role also included the stewardship of the discretionary investment business introduced by the intermediary.

David's recent work has been focussed on researching the DIM/Adviser market post RDR and the challenges facing the retail investment sector when two regulated entities provide a service to the same client. Researching, analysing and implementing a service proposition is significantly different to the approach used for a product but this is not widely appreciated. Acting as a catalyst, Diminimis is working with trade bodies, including the PFS, APFA and the WMA to try to establish an industry standard. This will help all in this part of the retail financial services including advisers, DIMs and product providers to demonstrate a client centric service in a compliant and cost effective manner. Diminimis can provide the full range of services as outlined in this Good Practice Guide to both advisers and product providers whose products accommodate discretionary services.

Robbie Constance has provided legal advice to Diminimis during its research and the development of its proposition.

Robbie is a Partner in the Regulatory Group at city law firm, RPC. He specialises in financial services regulation; principally in the wealth/asset management sectors, with a particular focus on retail investment business.

Robbie's non-contentious practice deals with (post) RDR implementation and business models. This includes governance reviews, drafting Terms of Business, and day-to-day risk management, conduct regulation and compliance advice.

www.diminimis.com