Financial Conduct Authority

Thematic Review TR14/5

Supervising retail investment advice: Delivering independent advice

March 2014

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1. Executive summary

Background

We introduced the Retail Distribution Review (RDR) to improve outcomes for consumers by enhancing standards of professionalism, removing key biases, and ensuring the cost of advice is clear. Central to this was the banning of commission and a requirement that financial advisers operate as either 'restricted', where they are only able to recommend certain products and/or providers, or 'independent', where they are able to consider all types of retail investment products.

We are currently carrying out a three-stage thematic review to assess how firms have implemented the RDR requirements. We published the findings from the first stage of the review in July 2013.[1] This acknowledged the considerable progress firms had made in implementing the new requirements[2] and highlighted areas where further improvements were necessary. To support firms we provided examples of good and poor practice and produced a two-page factsheet for advisers.[3]

We have recently completed the second stage of our thematic review which focused on two key areas:

- whether firms that are describing themselves as independent are acting independently in practice
- whether firms are complying with the disclosure requirements

A separate report outlining how firms are meeting the disclosure requirements will be published shortly.

We have been in an ongoing discussion with the industry to understand how firms have responded to the new requirements and are providing support where necessary. One of the key themes coming out of these discussions is in relation to the practicalities of meeting the new independence requirements.

This report has been produced in response to requests from the industry for further clarity. In this review, we have included a number of examples of good and poor practice as previous feedback suggests firms find this format useful. We have split the information into sections so

1 Thematic Review 13/05: Supervising retail investment advice: how firms are implementing the RDR (TR13/5) http://www.fca.org.uk/static/documents/thematic-reviews/tr13-05.pdf

2 Unless indicated otherwise, the rules referred to in this paper are those that came into force on 31 December 2012. This paper does not contain all of the rules and guidance in the Handbook relevant for independent and restricted advice. For all relevant rules and guidance, firms should refer to the Handbook (in particular, COBS 6.2A).

3 FCA factsheet No. 007: Disclosing your firm's charges and services http://www.fca.org.uk/your-fca/documents/fca-factsheet-no-007

that firms can focus on the areas that are most relevant to their business model.

We have also produced a video summarising the key issues to provide further clarification:

http://www.fca.org.uk/news/tr14-5-supervising-retail-investment-firms

We are committed to providing firms with clarity on the standards we expect. We therefore feel it is appropriate to draw on the results from our thematic review, as well as the previous guidance we have published in this area, to help firms better understand the requirements for delivering independent advice.

Independent advice

The 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.[4] In providing independent advice, a firm should not be restricted by product provider and should objectively consider all types of retail investment products (RIPs) which are capable of meeting the investment needs and objectives of a retail client.[5]

We are focusing this report solely on the standard for independent advice to respond to the industry's desire for greater clarification on how to meet these requirements. It is not because we have a preference for this approach. We see benefits to both independent and restricted services depending on the needs of the client and we believe there is a place for both business models in the market.

There are also requirements that apply specifically to restricted firms, mainly in relation to how they disclose and explain the nature of the firm's restriction to their clients. We clarified our requirements in this area in the report and factsheet that we published following the first stage of our thematic review (see 1.1).

Helping the market work better for consumers

For the RDR to succeed in increasing transparency and competition, it is important that consumers are clear on the type of service they will receive and that the service they are promised is then delivered.

If a firm describes itself as independent, clients are entitled to expect that the adviser will undertake a comprehensive analysis of the whole of the market before recommending an appropriate solution for their needs. By 'comprehensive' we mean a comprehensive review across the market and not that every product in the market has to be reviewed comprehensively.

If a firm gave the impression they were independent but failed to deliver an independent service, there is the risk of consumers being mis-led or suffering financial loss.

4 Unless otherwise indicated, 'client' is used in this document to mean 'retail client'.

5 Finalised Guidance: 12/15 – Retail Distribution Review: independent and restricted advice' (FG12/15)
http://www.fsa.gov.uk/static/pubs/guidance/fg12-15.pdf
This report does not constitute any changes to the existing guidance and should not be seen as a replacement to FG 12/15; rather, the aim of this document is to provide practical examples to demonstrate how firms are meeting – or failing to meet – the rules.

We expect firms to put their clients at the heart of their business. This involves firms considering the potential impact of their business model – including how they are trying to make money – on consumers, and ensuring that their own interests are not prioritised over those of their clients. When applied to independence, this concept of placing consumers at the heart of the business means that a genuinely independent firm considers the relevant products that suit each individual client and provides unbiased and unrestricted advice.

We do not see the independence requirements as an exercise that firms should complete primarily to satisfy us. We see the independence standard as a key element of the RDR, which firms should focus on to deliver fair outcomes to their clients.

What we did

We have now completed the second stage of our thematic review. We requested information from 113 firms from a cross-section of the industry and carried out follow-up assessments on a sample of them. The review focused on:

- **Independence** – Are firms that are describing themselves as independent offering an independent service in practice?
- **Disclosure** - Are firms being clear with consumers about their charges, the scope of their service (i.e. independent or restricted) and the nature of the services they provide, both initially and (if applicable) on an ongoing basis?

This report sets out our findings on independence. We will publish a separate report with the results of how firms are meeting the disclosure requirements shortly.

Our findings

Our review found that a significant number of firms appear to understand the new requirements and there were no indications that these firms were acting in any way other than independently in practice.

However, our results, and through our discussions with the industry, have identified areas where it may be helpful to firms to clarify our requirements. We also identified some firms that had not engaged with our previous guidance and wider communications on delivering independent advice. We want to provide further support to the industry in understanding the independence requirements and how to apply them in practice. We have also talked to firms and key trade bodies to better understand the industry's perspective on these issues.

This report clarifies our requirements in key areas and includes examples of good and poor practice.

Supporting firms

We believe that delivering genuinely independent advice is an achievable outcome for any firm that would like to offer an independent service, regardless of their size.[6] However, some firms consider the independence requirements to be overly complex and problematic, so we want to ensure our requirements are understood.

All independent firms should read this report and the following publications to be sure they are meeting our independence requirements:

- *Finalised Guidance: 12/15 – Retail Distribution Review: independent and restricted advice* (FG12/15)[7]
- *TR13/5 Supervising retail investment advice: how firms are implementing the RDR*[8]
- FCA factsheet 007: *Disclosing your firm's charges and services*[9]
- We have also created a video on this topic that firms may find useful[10]

The rules themselves are covered in COBS 6.2A.

Next steps

We are planning to carry out a third stage of our thematic review to ensure that firms have acted on our feedback. This is due to begin in second half of 2014.

If we identify any firms that are holding themselves out as independent but are not meeting the requirements, we will consider what further regulatory action is necessary.

6 A large proportion of the firms included in our thematic review were smaller firms and some of the examples of good practice highlighted in this report were identified in smaller firms.

7 http://www.fsa.gov.uk/static/pubs/guidance/fg12-15.pdf

8 http://www.fca.org.uk/static/documents/thematic-reviews/tr13-05.pdf

9 http://www.fca.org.uk/your-fca/documents/fca-factsheet-no-007

10 http://www.fca.org.uk/news/tr14-5-supervising-retail-investment-firms

2. What is independent advice?

Independent advice is defined in our Handbook as *'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)'.*

The requirements of the rule (or standard) for independent advice are that the personal recommendation is:

a. ' based on a comprehensive and fair analysis of the relevant market; and

b. unbiased and unrestricted.'

The standard for independent advice is intended to ensure that such advice is genuinely free from bias towards particular solutions, and that there are no restrictions limiting the range of solutions that firms can recommend to their clients.

In practice, this is not too different from the pre-RDR independence requirements. The key change in independence requirements is that the range of products that advisers must be willing and able to advise on has widened from 'packaged products' to a newly defined category of 'retail investment products' (RIPs) sold to retail clients.

Firms should note that 'comprehensive' means a comprehensive review across the market and not that every product in the market has to be reviewed comprehensively. Although we expect firms to consider all investment solutions available in the market, we do not require them to carry out detailed due diligence on every product and/ or provider. We expect firms to carry out research on the whole of the market to identify the solution(s) that are in the client's best interests, then conduct detailed due diligence on the recommended solution(s).

For example, if a self-invested pension plan (SIPP) was suitable for a particular client, we expect the adviser to research the SIPP market, then carry out due diligence on the selected SIPP. In relation to the platform market, we expect firms to carry out research and draw up a shortlist of platform providers, then carry out due diligence on the shortlist.

Clients should be given accurate information on the type of service an adviser offers so they can choose the most appropriate adviser for them.

In providing independent advice, a firm must not be restricted by product or provider, and should be able to objectively consider all types of retail investment products that are capable of meeting the investment needs and objectives of a retail client.[11]

11 Finalised Guidance: 12/15 – Retail Distribution Review: independent and restricted advice (FG 12/15).

One firm summed this up very well: 'independence is a state of mind – you just need to keep an open mind and consider all the options'.

If a firm is offering an independent service, clients would expect the advice to be **'unbiased and unrestricted'**, and they would expect advisers to consider all solutions that would be potentially suitable for their needs (i.e. based on a **'comprehensive and fair analysis'** of the market).

The independence requirements are there to ensure that clients that have been promised an independent service receive an independent advice service in practice. This is not an exercise to meet our requirements, but a vital part of providing clients with the level of service they have been led to expect.

So firms should not just consider what they need to do to meet the independence requirements, they should also consider what the overarching principle(s) behind the rules are trying to achieve. If firms put their clients at the heart of their business, keep an open mind and consider all options for their clients, independence should follow naturally.

3.
Our RDR thematic review

What we did

We requested information from 113 firms from a cross-section of the industry. We asked all firms in our sample to complete an online questionnaire and submit a copy of their disclosure documents. We also asked independent firms to send us a copy of their new business records.

We assessed this information and then undertook follow-up visits and telephone calls with a number of firms to carry out a more in-depth review. Our findings are summarised in the annex to this report.

What we found

Of the 113 firms that were included in our thematic review, 88 firms stated that they offered independent advice.

To assess whether the independent firms in our sample were likely to be meeting our requirements, we designed a set of 'potential indicators of non-compliance' based on the limited information we had available. These indicators did not definitively show whether firms were offering a truly independent service or not, but were used to highlight the firms we felt were at a higher risk of not meeting our requirements. For example, firms that were placing a very high proportion of business on a single platform, or with a limited number of providers.

We then selected a sample of these firms to carry out a more in-depth review. The results of our initial review identified a number of firms where we needed more information to determine if they were meeting our requirements or not.

After talking to the firms, we found that some were in practice meeting the requirements but others were failing to meet our requirements. The most common failings were:

- Firms not considering and/or not having the ability to advise on all retail investment products (RIPs).
- Firms adopting a single platform and not carrying out sufficient research and due diligence on the other options available and/or not considering off-platform investments.
- Advisers referring clients to other advisers (either externally or within their own firm) for advice on certain RIPs (e.g. income drawdown).

- Networks failing to ensure that all appointed representatives (ARs) are meeting the independence requirements (e.g. ARs that were biased towards the use of a distributor influenced fund).

Next steps

All firms that were included in our sample have received a feedback letter outlining our findings. Where firms are falling short of the independence requirements (or where we have doubts over their independence) we have requested that they take appropriate action. This could either be to amend their processes to ensure they are meeting the independence requirements, or some firms have decided to change their business model to a restricted service.

A small number of firms where we had more significant concerns may be asked to attest to making the required changes.

4.
Guides for firms

During the first two stages of our RDR thematic review we identified various examples of good and poor practice.[12] We have outlined these to provide practical examples of firms meeting, or failing to meet, our expectations and to provide some context around our requirements.

We have divided this section of the report into areas where there appears to be uncertainty for firms and where we have identified issues. However, the key requirements and messages are consistent and we believe the most important factors are that firms keep an open mind when considering the options and focus on the needs of their clients.

Providing advice on all retail investment products (RIPs)

A firm should only hold itself out as giving independent advice if it is prepared, willing and able to provide advice on all types of RIPs that may be suitable for their clients.

We do not expect firms to actually recommend all products, but it must consider all options for their clients. A firm can, after considering the market, take the view that certain RIPs are unlikely to be suitable for their client base. However, firms should keep an open mind and keep this under review as products and clients change.

A number of firms believe that non-mainstream pooled investments (NMPIs), including unregulated collective investment schemes (UCIS), are not in scope of the RDR. These products are in scope, but advisers must take into account the marketing restriction rules in COBS 4.12.

NMPIs are niche, risky products almost certainly inappropriate for ordinary retail investors. They are more likely to be suitable for promotion to professional or institutional investors, and to those retail clients who meet the criteria to be treated as sophisticated or high net worth investors.[13]

Unless the client meets the criteria in one of the categories in COBS 4.12, the Promotion of Collective Investment Schemes (Exemptions) Order or the Financial Promotion Order, the product should not be considered as part of the relevant market.

Where firms promote NMPIs, they should ensure this is done in accordance with the rules in COBS 4.12.

12 We have also included examples from wider Supervisory work.

13 Consultation Paper 12/19: 'Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes' (CP 12/19) http://www.fsa.gov.uk/static/pubs/cp/cp12-19.pdf

Example of good practice

Firm A had an advice process that involved using whole of market based tools for each RIP. These were available to all advisers to help them review the whole of the market effectively and efficiently.

This is good practice, as rather than simply telling advisers that they should consider all RIPs then leaving them to do this on their own, the firm had made a significant effort to provide them with the tools to help them do so.

Example of poor practice

Firm B was not willing to provide advice on structured investments. Through discussions with the firm it became evident that the adviser was unwilling to recommend these products on the basis that he did not fully understand how the products and underlying investments worked.

We would expect advisers to have sufficient knowledge of each product type to identify if it was potentially suitable for a client. Once the potential need is identified, the adviser should then have the knowledge and ability to carry out further work to identify a suitable product and make the recommendation, if appropriate.

If an adviser does not have sufficient knowledge of a certain product we agree they should not recommend them. However, this adviser should not hold himself out to be independent as he does not have the knowledge and ability to identify if a particular product type is potentially suitable for a client.

Example of poor practice

Firm C told us that they provided advice on all investments but then added that they did not advise on annuities but referred clients to another firm specialising in annuities instead. As this firm was not willing and able to advise on all RIPs in practice it did not meet the independence rule.

Key points for firms to consider

- Is each adviser in your firm willing and able to advise on all RIPs?
- Are there any products you have 'excluded', either formally or informally, as unsuitable for your client base? If so, do you review this on a regular basis and keep an open mind about possible changes to the products and new clients?

What is a 'relevant market'?

For advice to be independent it has to be *'based on a comprehensive and fair analysis of the **relevant market**'*. So it is important that firms understand what we mean by a 'relevant market'.

A relevant market is defined as 'all retail investment products which are capable of meeting the investment needs and objectives of a retail client'.[14] If a firm can identify a relevant market across all of its clients then it can hold itself out as independent in relation to that narrower relevant market.[15]

The requirement refers to the needs and objectives of the client and not product categories that the firm wants to advise on, so for example, pensions are not a relevant market. Examples where a relevant market may be applicable are ethical investments, Islamic financial instruments and pension decumulation.

Example of poor practice

Firm D (a discretionary investment management company) considered that it was independent as it advised (in relation to its advisory managed portfolios) on what it referred to as 'investments'. In practice this included collective investment schemes but did not include life and pension contracts.

This did not meet the definition of the relevant market as the products it advised on were not focused on the clients' needs and objectives but rather product categories.

Referrals to another adviser

We have seen cases where firms refer clients to another advisory firm if they are unable to meet a client's needs. Similarly, one adviser in a firm may routinely refer certain clients to another adviser in the firm if they do not have the experience or expertise required. Where advisers are unable or unwilling to advise on certain RIPs then these arrangements would not meet the independence rule.

Every adviser in an independent firm must give advice that meets the independence rule if the firm holds itself out as being independent[16]. This is because clients are entitled to reasonably expect the adviser they are dealing with to provide them with an independent service. Furthermore, if an adviser does not have the knowledge and ability to advise on all RIPs there is a risk that they might not be in a position to identify when a particular product is potentially suitable for the client. It is possible to have some advisers providing independent advice in a firm alongside others providing restricted advice. This means the firm must not hold itself out as being independent.

Not only does this mean that independent firms should have the ability to provide advice on all RIPs without referring the client to another firm, it also means that each adviser within any

14 COBS 6.2A.11G.

15 For example, a firm could refer to itself as 'XYZ Ltd – providing independent advice on ethical products'.

16 Paragraph 6.8 of Finalised Guidance: 12/15 – Retail Distribution Review: independent and restricted advice (FG 12/15)

given firm should have the ability to provide advice on all RIPs, i.e. every adviser within a firm must be willing and able to advise on all RIPs.

However, it is possible for an adviser to seek expertise from another (either internal or external), as long as they are in a position to provide the final advice to the client.

Example of good practice

Firm E had an income drawdown specialist. All advisers had sufficient knowledge to identify when a client would potentially have the need for income drawdown and were able to provide advice to clients, but typically sought additional support from the product expert.

The adviser would arrange a second meeting where both he and the expert met with the client to discuss the various options available. If it was established that income drawdown was an appropriate option, the adviser would carry out the research and draft the suitability report, both of which were checked by the expert. The adviser then had a final meeting with the client where he provided the final advice.

This is good practice as the financial adviser sought advice from a product expert but was able to provide advice to the client without referring him to another adviser.

Example of poor practice

Firm F operated a licensing agreement with their advisers for certain high risk products. Where a particular adviser identified that his client had a need for a product that he was not permitted to advise on, he would refer the client to another adviser in the firm.

This does not meet the independence rule as this adviser was not willing and able to advise on certain RIPs.

However, it is possible to operate a licensing agreement and still meet the independence requirements, as long as all advisers are permitted to provide advice on all RIPs. For example, we came across a firm that also operated a licensing agreement but rather than prohibiting advisers without the relevant licences from providing advice on high risk products, it permitted the adviser to recommend the high risk product(s) subject to a pre-sale suitability assessment. This was identified as good practice and is in line with the independence requirements.

Key points for firms to consider

- Is each adviser in your firm willing and able to advise on all RIPs?
- If you have specialists or advisers that are experts in certain areas, do you have processes in place to ensure that all advisers are willing and able to advise on all RIPs?
- If you operate a licensing arrangement (or similar), have you considered the impact this could have on each adviser's ability to meet the independence requirements?

Panels

A firm can use research to distil the product market into a panel and then select a product from the panel when giving independent advice. Firms 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
- reviewed regularly
- used in a way that does not materially disadvantage any retail client[17]

It is possible for a firm to use a panel and remain independent so long as the panel has been constructed based on a review of the whole of the market and the advisers keep an open mind and consider all options (both off and on panel) for individual clients. This does not mean that advisers need to carry out a whole of market review for each individual client unless they have identified that an on-panel solution is not appropriate. When narrowing down the products and providers to be included on the panel, the firm must carry out a 'comprehensive and fair analysis' of the market and should consider all RIPs in the first instance.

It is then acceptable for a firm to decide which products or providers to include and/or exclude from their panel depending on their client base. It is important that the panel is reviewed regularly and that all advisers are aware of what products and/or providers are not on the panel, so that they can identify when an off-panel solution may be appropriate. To enable them to do so, all advisers must maintain the ability to advise on all RIPs (even if they are not currently on the panel) and keep an open mind about using alternatives if this is right for individual clients.

Example of good practice
Firm G used a panel for the majority (but not all) of its recommendations. The panel had been constructed by reviewing the whole of the market and contained a wide range of products and providers.

The panel contained a list of products and providers that had been pre-approved (e.g. central research and due diligence had been carried out). Advisers had the ability to recommend 'off-panel' solutions, but these were subject to pre-sale checks and minimum research and due diligence standards.

Example of poor practice
Firm H had constructed a panel of products that they felt would meet the needs of the majority of clients. They explained that if they were really struggling to find a suitable product they would consider recommending an off-panel solution. However, the advisers were unsure of how they would do this in practice and did not appear to have access to any tools to help with this. So we felt the firm may not be in a position to recommend an appropriate investment solution to all clients.

17 See COBS 6.2A.18G.

Key points to consider if your firm uses a panel(s)

- Do you use the whole of the market as a starting point when designing your panel(s)?
- Do you review your panel(s) regularly and update them as appropriate?
- What do you do to make sure that all advisers consider off-panel solutions where these may be in the best interests of a client?

Platforms[18]

Firms offering an independent service can use platforms as long as they are aware of the limitations of their selected platform(s) and are willing and able to advise off-platform where necessary.

Firms must also take reasonable steps to ensure it uses a platform that presents RIPs without bias[19] and satisfy themselves that the platform provider only receives remuneration for business carried on in the UK that is permitted by the rules.[20]

Using one platform for all clients

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. A firm that wanted to do so would have to find a platform that offered a range of products covering the whole of the retail investment product market (or the whole of a sector of that market). It would also need to keep this range under continual review to ensure that it remained whole of market.

Example of poor practice

Firm I had adopted a single platform as all clients' circumstances appeared to be fairly similar. However, on further investigation it became evident that the firm also advised the children of their main clients whose needs and circumstances were very different and recommended the same platform without adequately considering the different needs and circumstances of these individual clients.

This is poor practice as the firm recommended the same platform as they used for their main clients, without adequately considering if it was appropriate for these very different clients.

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. So even where the majority of a firm's clients have similar needs, there are probably going to be outlier clients, which means they may also need to recommend products off-platform.

The platform adopted would need to be competitive in terms of charges and features for this to be an appropriate approach.

18 The material in this section is based on that contained in FSA factsheet for firms who advise on or operate platforms.

19 COBS 6.1F.1R.

20 COBS6.1E.9R (from 6 April 2014).

Example of good practice

Firm J took on most of its clients as a result of referrals from existing clients. So it tended to deal with a defined category of clients but nevertheless remained mindful of the products available across the market. So, when a client had a particular individual need, they were able to recommend a product off-platform that was suitable for the client and was in their best interests.

For example, if a platform-based SIPP did not offer the option of individual commercial property purchase (or SIPPs available through the platform were uncompetitive in this respect) then the firm would recommend another SIPP where it was suitable for the client to invest in an individual commercial property.

Example of poor practice

Firm K used a single platform but had not assessed for which clients the platform-based services were – and were not – suitable. They used the platform routinely for all clients without adequate consideration of the clients' needs and personal circumstances. This risks unsuitable advice for some clients.

For example, where the platform has a fixed fee and the client's investment level is very low (so the flat fee has a disproportionate impact on the overall costs), or where it would have been in the client's best interests to have been recommended a particular investment that was not available on the platform.

Using one platform for some of their clients

A firm may want to use a single platform to offer a platform-based service to a segment of their client bank Here the firm has identified a defined category of clients and wishes to provide platform-based services to these clients. Clients for whom this service is not suitable should be handled differently (for example, using off-platform investments).

To ensure that recommendations are suitable, the firm would need to consider the individual needs and circumstances of clients within the defined segment of the client bank and identify outlier clients for whom the platform-based services would not be appropriate.

Example of good practice

Firm L had decided it wanted to provide a 'premier service' to clients over a certain level of investable assets. It had undertaken appropriate due diligence on which platform to adopt and considered which clients this approach would be suitable for, and which it would not.

Although this service and the platform used to underpin it proved to be suitable for most clients within this defined segment, it did not adopt a 'one-size-fits-all' approach. The firm continued to recommend products off-platform where the platform-based solution was not suitable for the individual client's needs and circumstances.

Example of poor practice

Firm M had adopted a particular platform to support the ongoing services it planned to offer to clients. However, it recommended platform-based investments with ongoing services to all clients irrespective of their individual needs and circumstances. This use of a single platform would be unlikely to be in the best interests of this wide range of clients.

The firm did not have a clear idea of when providing ongoing advice was in the client's best interests, and when it was not. The firm's management also did not put in place any controls (for example, guidance) on the recommendation of the platform-based services. So the firm risked recommending unnecessarily expensive platform-based services when, for example, a lower cost transactional service might have been in the best interests of some clients.

Using more than one platform

Where a firm has a diverse range of clients, it may be in the firm's interests, as well as the clients' best interests, to use more than one platform. The firm may also want to offer different levels of service to different categories of client.

We have set out before how clear segmentation of the client bank and effective matching of firm services and platform selection (following good due diligence) can be a beneficial approach. As with the other scenarios above, firms will need to consider each client individually and ensure that any outlier clients are handled appropriately.

Example of good practice

Firm N had a broad range of clients, from those with simple pensions and small investment needs to those with significant sums to invest. The firm had developed a range of services to meet the needs of the different clients it dealt with and had undertaken appropriate due diligence on platforms to ensure it adopted the right ones for itself and its clients.

It based the client segmentation on investable assets and, at the higher end, it adopted a platform with a wide range of products and services. For the next category of clients, it adopted a lower cost platform and a simpler service appropriate for these clients. It also felt that it had some clients whose needs were simple and did not require routine ongoing services (but offered advice on a reactive basis). It worked on a transactional basis for these clients.

It set out clearly which clients the services were most likely to be suitable for and it had processes in place to ensure that each client was considered individually and handled differently to the standard services where this was in the client's best interests. Its business monitoring was also based on ensuring the right outcomes were achieved for individual clients.

Example of poor practice

Individual advisers within Firm O had adopted different platforms from each other. There was no consistent approach for providing services for clients. There was no clear understanding by advisers, or the compliance officer, about when their platform-based services were suitable and not suitable. This risked unsuitable advice, given the lack of understanding about the suitability issues.

Finally, there was the potential for costs for clients to be higher than would have been the case had the firm used platforms in a more focused and economic way.

The outcome we want is not about ensuring an artificial spread of investments to meet the independence rule, it is about advisers being mindful of the range of product and investment options across the whole market so firms can provide suitable advice to their clients. It is important for firms to be clear about which clients the overall solution – the platform, the products, funds and adviser services – are suitable for and in their best interests, and which are not.

Key points to consider if your firm uses platforms

- Have you undertaken appropriate research on the platform market before deciding which ones to adopt and is this reviewed periodically?
- Have you conducted robust due diligence on the selected platform(s) and is it reviewed periodically?
- Does your due diligence process include steps to ensure that the platform service(s) you use presents RIPs without bias and are you satisfied that the platform provider only receives remuneration for business carried on in the UK which is permitted by the rules?[21]
- Have you considered which platforms are appropriate for which clients, and which clients may be best off-platform?
- Are you aware of the limitations of the platforms you use (eg what products/providers are not available)?
- Do you have a process in place to enable your advisers to make recommendations both off-platform and via other platforms where this is in the best interests of clients?

Model portfolios

We use 'model portfolio' to mean a collection of funds with a certain asset allocation typically designed to meet a specific risk profile.

A firm can design and construct their own model portfolios or they can choose to use model portfolios that are constructed by a third party. Either way, independent firms need to ensure that the portfolios they use meet our requirements. For example, if firms have designed their own model portfolios it is important that these are constructed based on a comprehensive

21 In relation to the requirements of COBS 6.1F.1R. and COBS6.1E.9R (from 6 April 2014).

and fair analysis of the relevant markets As we set out earlier ‘comprehensive’ means a comprehensive review across the market and not that every product in the market has to be reviewed comprehensively.

If a firm adopts the model portfolios of a third party, they must ensure the criteria used by the third party would enable the firm to meet the independence requirements.

Independent firms should not use the model portfolios without considering the needs and circumstances of the individual clients. Firms need to keep an open mind and consider all the options for individual clients and not restrict their advice to the model portfolios.

Example of good practice
Firm P had designed a range of risk-rated model portfolios in light of their client bank and target market and they felt there would be one of these to suit the majority of clients depending on their needs and circumstances. If there was not a suitable option for a particular client, the adviser could tailor the underlying assets to suit a particular client.

However, the firm also recognised that in some situations a model portfolio would not be the most suitable option and they were able to provide examples where they had recommended different investments.

Example of good practice
Firm Q initially used research tools to distil the whole of the market into a shorter list on the basis of criteria that were relevant to the firm’s clients (for example, financial strength). The shorter list was then subject to detailed due diligence which resulted in a list of approved providers/funds. The firm also used an asset allocation created by a specialist consultancy firm appropriately mapped to the firm’s approach for assessing the client’s risk level. The approved funds were then used within the asset allocation approach.

The whole approach was reviewed quarterly as part of the firm’s investment committee approach. The firm generally used passive funds but ensured that the recommended investment was suitable for each individual client and did not assume passive investments were suitable for all its clients.

Example of poor practice

Firm R had designed a single model portfolio that they felt would suit all of their clients as they felt that all their clients had similar needs and risk tolerances (i.e. all of their clients were retirees and as such had a cautious attitude to risk and wanted to protect their capital).

The firm did not consider any other investment solutions as they felt their model portfolio was the best option available. When asked how they would deal with a new client that had a higher attitude to risk, they explained this had not happened in the past but if it did, they would likely refer them to another adviser.

This firm thought they were meeting the independence requirements as they had built their model portfolio from assessing all investments in the market that were suitable for cautious investors. However, they had then restricted their advice by not considering other options for clients when appropriate.

Key points to consider if your firm uses model portfolios

- Have the model portfolios you adopted been constructed on the basis of a comprehensive and fair analysis of the market?
- Do you have processes in place to ensure your advisers do not restrict their advice to the model portfolios, or recommend the model without considering the needs and circumstances of the individual client?
- Each time a model portfolio has been recommended, would it be clear that the model portfolio was in the individual client's best interests in light of other options available in the market?
- Are your advisers willing and able to recommend alternatives to the model portfolios and/or adapt a portfolio to suit the needs of an individual client?

Discretionary investment services

Firms holding themselves out as independent may recommend a discretionary investment management service to a client. The RDR independence rules do not normally apply if an adviser is referring a client to a discretionary investment management service because the recommendation is typically for a service rather than a RIP.

There are certain circumstances where the advice does constitute a personal recommendation in relation to a RIP and the independence rules do apply.[22] It is important that firms offering discretionary investment services familiarise themselves with the circumstances in which the

22 FG12/15, S 5.20: There may be circumstances in which a firm, by recommending a discretionary investment service, is in effect recommending a particular investment, for example if the adviser explicitly or implicitly recommends particular funds offered by a DIM. If this is the case, a recommendation to use a discretionary investment service would amount to a 'personal recommendation' and the rules applicable to personal recommendations would apply, including those for independent advice. Another example of a personal recommendation is where an adviser recommends a retail investment product in which the underlying investment approach will be managed by a DIM. In this case, the DIM is integral to that retail investment product, and the advice to use the product and the DIM must be suitable and the suitability report should discuss the advice as a whole and explain all charges that apply to the client, including those for the DIM.

independence rules apply, and where appropriate satisfy themselves that they are meeting our requirements.

If a firm is providing independent advice, it should objectively consider a wide range of investment solutions in the market before recommending a client use a discretionary investment service. Advisers should not recommend a discretionary investment management service without considering the needs and circumstances of the individual client. Where the recommendation to a discretionary investment manager (DIM) is not a personal recommendation, a firm would not need to demonstrate that it has picked the DIM based on a comprehensive and fair analysis of the market. The firm should undertake sufficient due diligence on a DIM before recommending it, so it can make a judgement about whether it is the right solution for the client.[23]

Example of good practice

Firm S was a firm of financial advisers that also had a discretionary investment management firm in the same group. The firm did not have any constraints on advisers about which clients should be referred to discretionary managers, nor any requirement that when this was the case then it should be the associated firm. The decision about which discretionary manager advisers would refer to was left to the advisers.

The firm had carried out a market review and created a short-list of approved discretionary managers to help, but advisers could use other firms if they wanted to, subject to their research being approved centrally. The firm was able to provide examples of cases where advisers had recommended discretionary investment managers other than the associated firm.

Example of poor practice

Firm T had been referring clients to the same discretionary manager for a number of years. They had found that the service provided by the firm had been very good and existing clients were very happy with the management of their investments. So the firm felt no need to review the choice.

This does not meet the requirement to objectively consider a wide range of investment solutions. We have also heard of firms taking a similar inappropriate approach with the choice of platform.

23 FG12/15 paragraph 5.19.

Key points to consider if your firm provides personal recommendations for clients in relation to discretionary investment services

- Have you considered a wide range of discretionary investment management service providers?
- Do you have processes in place to ensure your advisers do not restrict their advice to discretionary investment services, or recommend them without considering the needs and circumstances of the individual client?
- Each time a discretionary investment service has been recommended, would it be clear that the advice was in the individual client's best interests in light of the other investment solutions available in the market?

Annex 1
Findings from our thematic review

Of the 113 firms that were included in our thematic review, 88 firms stated that they offered independent advice.

The results of our initial review indicated that that there were two firms that we were certain were not meeting our requirements, and we had concerns that a further third (28) of these firms may not have been meeting our requirements. At this stage of our review, we did not have enough information to determine if the majority firms were independent or not.

We then carried out a more in-depth review of the business models and processes of 17 of the 28 firms, to assess whether they were meeting the requirements.

The findings were as follows:

- we were satisfied that six of the 17 firms were acting independently
- we concluded that six of the 17 firms were not acting independently[24]
- with four of these firms we had doubts about whether the firms were meeting the independence requirements (but did not have sufficient evidence to say this with certainty)
- there was one firm where we were unable to determine if they were meeting the requirements or not

So in addition to the two firms that we had initially identified as not meeting our requirements, ten of the 17 firms where we carried out further investigations were either not acting independently or we had doubts about their independence.

24 This is in addition to the two firms that we had established were not meeting our requirements without carrying out a more detailed assessment.

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