

Finalised guidance

Simplified advice

March 2012



Contents

1.	Introduction.....	1
2.	Overview.....	2
3.	Background.....	3
4.	Advising on investments – regulatory regime.....	7
5.	Further considerations in designing a simplified advice process.....	17

1 Introduction

- 1.1 A well-functioning retail advice market needs different delivery mechanisms to be fully effective for the broad range of potential investors. There could be benefits from a well-designed, low-cost method of meeting consumers' straightforward investment advice needs. The challenge is to ensure that such methods will deliver good outcomes for those consumers.
- 1.2 Some firms and trade associations have been designing and piloting simplified advice processes, and have talked to us about the issues they have faced. To assist the industry in its wish to offer simplified advice services, this Finalised Guidance Paper provides additional guidance on certain aspects of the regulatory regime.

2 Overview

What is simplified advice?

- 2.1 'Simplified advice' is not a defined term in the Handbook, but has been adopted to describe streamlined advice processes which aim to address straightforward needs of consumers. It is used to mean a limited form of advice, in that it is focused on one or more specific needs and does not involve analysis of the consumer's circumstances that are not directly relevant to those needs. The outcome of a simplified advice process may be a specific product recommendation.
- 2.2 The simplified advice models which have been shared with us are typically automated, process-driven advice services, which could be delivered over the internet, face-to-face or over the telephone. They are not being designed to provide advice on a consumer's existing financial products. It is in the context of these types of advice models that questions have been asked, and which this guidance aims to address.
- 2.3 This guidance is targeted at simplified advice processes which recommend retail investment products. From a regulatory perspective, simplified advice is a form of 'restricted advice'¹ because it does not consider all retail investment products that may be suitable for consumers. So it needs to comply with the requirements for restricted advice.
- 2.4 Based on the above description of the service, a simplified advice process may be appropriate for consumers who:
- a) have their priority needs met, that is, they do not need to reduce existing debt, they have adequate access to liquid cash (i.e. savings), and have any core protection needs met²;
 - b) have some disposable income or capital that they wish to invest; and
 - c) do not want a holistic assessment of their financial situation, but rather advice on a specific investment need.
- 2.5 Simplified advice has some similar characteristics to 'focused advice'. Focused advice is also not defined in the Handbook, but is a term commonly used to describe a situation where the client requests that a firm only gives personal recommendations relating to a specific need, designated investment or certain assets. The two are similar in that the advice process is focused on one or more specific needs. The key difference between focused advice and simplified advice is that the former involves the client stipulating the boundaries of the service they wish to receive.³ With automated simplified advice

¹ Restricted advice is defined as (a) a personal recommendation to a retail client in relation to a retail investment product which is not independent advice; or (b) basic advice.

² Refer to paragraphs 4.23 to 4.25 and 5.10, for further detail on consumers' priority needs.

³ Another difference is that focused advice could meet the definition of restricted advice or independent advice. To meet the standard for independent advice, it would need to be based on a fair and comprehensive analysis of those products that are capable of meeting the clients stated investment objectives and needs.

processes, the firm is setting out the boundaries of the service it provides. This is relevant when considering how suitability can be assessed in a simplified advice process (see Section 4).

Purpose of this guidance

- 2.6 The aim of this guidance is to reduce any perceived regulatory uncertainties that may be discouraging firms from offering simplified advice services. It outlines how the regulatory regime applies to such processes, and our expectations of such services, focusing on the issues raised by the industry.
- 2.7 This paper is structured as follows:
- Section 3 outlines the background to this document, including our regulatory approach;
 - Section 4 covers certain aspects of the regulatory regime for advising on investments, and provides additional guidance on specific rules for simplified advice; and
 - Section 5 summarises some of the high-level standards and guidance which firms should pay particular regard to when designing and delivering simplified advice, and considers what these standards mean for both the design of the advice process itself and for choosing or developing an appropriate product suite.
- 2.8 The focus of this guidance is simplified advice on retail investment products, as this is what we have been asked about. If firms choose to recommend other products through simplified advice processes, for example protection products, they must ensure they comply with the relevant rules for selling those products. If firms identify specific issues regarding a wider product suite, we will address them on an individual basis.
- 2.9 This paper only mentions a sub-set of the rules that are applicable for simplified advice. The rules mentioned here are covered to either provide general context or because they are relevant for the specific guidance. For all of the relevant rules, firms should refer to the Handbook.

3 Background

- 3.1 As part of the Retail Distribution Review (RDR), we looked at whether the investment advice needs of low and middle income earners were being met by the market, and recognised the potential benefits of streamlined advice processes.⁴ Our RDR publications discussed the case for simplified advice, and asked for feedback on various aspects. We confirmed that simplified advice processes could be developed and implemented within the current regulatory regime, and that we were not going to create

⁴ Throughout the RDR, the concept of streamlined advice took on numerous working titles – including primary advice, guided sales, and, finally, simplified advice.

a new regime. We included our initial thinking on this in an annex to the Feedback Statement (FS08/6).

- 3.2 Several trade associations and firms have explained their simplified advice propositions to us, and asked us to make it clearer how these services fit within the regulatory regime. They have also discussed with us the barriers they see in implementing such services.
- 3.3 Since we published the Consultation Paper on the RDR (CP09/18) we have had many meetings with industry and consumer bodies to discuss issues around the provision of simplified advice, or services akin to simplified advice. These meetings have included: one-to-one discussions with firms which have an interest in developing simplified advice models; participation in round-tables and workshops to discuss the relevant issues; and, discussions with trade associations whose members have an interest in a simplified advice proposition. These meetings have identified a number of areas where firms would welcome guidance.
- 3.4 Early discussions focused on the issue of whether simplified advice processes would involve giving regulated advice, or whether they could be designed as a non-advised process. At a fairly early stage, the industry reached its own conclusion that simplified advice, as envisaged, was likely to involve giving regulated advice. Subsequent discussions have concentrated on the issues covered in detail in this paper, but we have also considered the following points:
- (a) the trade-offs between providing an appropriate degree of consumer protection through regulation and the costs that regulation imposes on the consumer, which may deter interaction with financial services;
 - (b) whether ‘simplified advice’ is actually the right name for a service of the sort proposed, which does involve regulated advice, or whether the name will potentially be misleading to consumers;
 - (c) how a modified form of Basic Advice could work in response to suggested consumer needs;
 - (d) the potential linkages between the work of the Money Advice Service and simplified advice processes;
 - (e) whether the designer of a simplified advice process needs to be qualified to give regulated investment advice;
 - (f) the circumstances when a simplified advice process would not be appropriate, including, for example, auto-enrolment;
 - (g) why it is that firms are not offering simplified advice services today, when a number of the regulatory requirements that are said to be preventing simplified advice are not currently in force;
 - (h) the need for hand-offs from a simplified advice process to other forms of interaction with the customer;
 - (i) whether the FSA should formally approve simplified advice processes/models; and,

(j) how prescriptive the FSA should be, both on products and more generally.

- 3.5 Some of the perceived barriers to simplified advice raised by firms relate to existing rules, and so are unrelated to the RDR. These are centred on the application of the suitability rules and how these will be applied by regulators, the courts and the Financial Ombudsman Service.
- 3.6 A specific issue the industry raised in relation to suitability is the extent to which firms are required to consider a consumer's existing product holdings. This paper provides further guidance on our expectations in this area, and on assessing a consumer's broader financial situation.
- 3.7 Some in the industry think the RDR adviser charging rules and professional standards have introduced further regulatory barriers to the implementation of simplified advice services.
- 3.8 Firms should be aware that the adviser charging and professionalism requirements do not apply to Basic Advice⁵, which remains an option for firms who want to provide streamlined advice (see COBS 9.6 and COBS 9 Annex 1 and 2). This exemption from these RDR requirements is considered appropriate because many of the safeguards for consumers are in the products sold through Basic Advice – stakeholder products have charge caps and simple terms. With simplified advice, firms have the flexibility to decide their own product suite, but they must comply with the same rules as for all other retail investment advice.
- 3.9 One factor raised by commentators is the size of the potential benefits of simplified advice processes. Access to investment products and investment advice by many low and middle income consumers have been long-running topics of debate, with concerns raised that the RDR may widen, or at least not contribute to the narrowing of, the 'savings' gap.
- 3.10 As investment advice – whether simplified or not – is not free; the benefits to consumers of receiving it need to at least match the cost of the service, and for many consumers there may be few benefits. This is because investment products and services are only likely to be suitable for people who have savings established and who would not be better advised to repay debt. Data from National Savings and Investments suggest that 49 percent of the population do not have enough money to cope in an emergency.⁶ So, we consider that the size of the potential market for a simplified advice service for investment products (as opposed to savings products) may not be as large as many in the industry suggest. Some firms have said they would include non-investment products in their product suite, but the regulatory issues discussed in this paper are limited to the investment advice regulatory regime.
- 3.11 We are not convinced, as some commentators appear to be, that the RDR will mean that many consumers who want and need advice will not be able to access it. The adviser charging rules will make the price of advice more explicit, and there may be consumers who are currently receiving advice that decide not to seek advice in the future, when the price of the service becomes clear and

⁵ When a firm provides basic advice on a stakeholder product, it must not hold itself out as giving independent advice, but, nevertheless, a firm may still use the facilities and stationery it uses for other business in respect of which it does hold itself out as acting or advising independently (COBS 9.6.17R).

⁶ Press Release: Britons suffer savings cushion shortage, National Savings and Investments (26 June 2011).

they compare this with the benefits they derive, but they would still be able to access investment advice should they want to. If consumers cannot afford an upfront payment for advice when purchasing a regular contribution product, they will be able to pay back the charge as regular payments over time through the product.

- 3.12 The availability of simplified advice services would not guarantee take-up by consumers. There are a number of reasons, other than availability, which may deter consumers from accessing investment advice, including a lack of awareness and engagement in finances, the inability to judge the quality of advice, and a generalised lack of trust in financial advice, the inability to understand advice, and a lack of willingness to accept any or much risk of loss, or to tie up money.
- 3.13 Other relevant factors in considering the demand for simplified advice include the role of the Money Advice Service and the implications of auto-enrolment into qualifying pension schemes. Consumers who use the Money Advice Service might be more likely subsequently to access regulated investment advice. With the introduction of auto-enrolment from 2012, more consumers are expected to participate in pension saving which, for many, will start to address their saving for retirement needs and this may absorb any capability that they have to save.

Regulatory approach

- 3.14 Simplified advice processes have the potential to meet the wants and needs of those consumers who might benefit from investment advice but who can't, or do not want to, pay for full advice. It is important for a well-functioning market that there are a range of services to meet the needs of different types of investors. However, the risk of consumer detriment from poor advice and mis-selling exists as much for simplified advice as for full advice and could be greater.
- 3.15 Our aim is to ensure that we have a regulatory regime for retail investment advice which provides for an appropriate level of consumer protection, and within which firms can offer simplified advice processes if they think this is an attractive proposition for them and their clients. Our other priorities are (i) to ensure that our rules are compatible with EU law, and (ii) that our regulatory approach maintains sufficient flexibility so that firms are able to develop individual solutions which suit their business models and target market.
- 3.16 On the last of these points, it is for the industry to design and deliver simplified advice offerings; the industry is in the best position to understand what drives demand and the commercial realities of providing such a service.
- 3.17 We have been exploring the issues raised by the industry in implementing simplified advice. We have not changed our overall position as a result of these considerations – simplified advice needs to comply with the same regulatory requirements as full advice.

4 Advising on investments – regulatory regime

- 4.1 This section covers certain aspects of the regulatory regime for advising on investments, and provides additional guidance on specific rules relevant to simplified advice. The additional guidance on specific rules is included in text boxes for ease of reference.
- 4.2 This paper focuses on what the regulatory regime will be after the implementation of the RDR rules, but highlights where this is different from the current regulatory regime.
- 4.3 The rules discussed here apply if regulated investment advice is a part of the firm's simplified proposition. The Perimeter Guidance Manual (PERG) contains questions and answers on when advice on investments is regulated by the FSA (see 8.24 to 8.30 and 13.3 Q19-Q20). The following outlines the key points in identifying what constitutes a personal recommendation on retail investment products (or packaged products).

What constitutes a personal recommendation?

- 4.4 A personal recommendation is defined in our Handbook glossary and follows the Markets in Financial Instruments Directive (MiFID) definition, though it is sometimes used in the Handbook in relation to non-MiFID products. There are three main elements to a personal recommendation:
- there must be a recommendation;
 - 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 a particular investment.⁷
- 4.5 A recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public. A 'distribution channel' is one through which information is, or is likely to become, publicly available because a large number of people have access to it. Advice about financial instruments in a newspaper, journal, magazine, publication, internet communication or radio or television broadcast should not normally amount to a personal recommendation.

Is a personal recommendation the same as regulated advice?

- 4.6 The regulated activity of advising on investments ('regulated advice') is wider in scope than investment advice under the Markets in Financial Instruments Directive (MiFID). This is because MiFID advice requires a recommendation to be of a personal nature whereas UK legislation does not. So, for example, if you provide recommendations to the public generally this is not a personal recommendation but it could still amount to the regulated activity of advising on investments.

⁷ PERG 13.3 Q19

- 4.7 A personal recommendation is, therefore, a ‘sub-set’ of the regulated activity of advising on investments.

What is a retail investment product?

- 4.8 The Handbook changes as a result of the RDR include the new term ‘retail investment product’, to which the Adviser Charging and independence requirements apply. The Training and Competence requirements will also use this term.
- 4.9 Retail investment product is defined as:
- (a) a life policy; or
 - (b) a unit; or
 - (c) a stakeholder pension scheme; or
 - (d) a personal pension scheme; or
 - (e) an interest in an investment trust savings scheme; or
 - (f) a security in an investment trust; or
 - (g) any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in a financial asset; or
 - (h) a structured capital-at-risk product;
- whether or not any of a) to h) are held within an ISA or a child trust fund (CTF).
- 4.10 The current independent advice and professional standards, amongst others, refer to the term ‘packaged products’⁸, which is a narrower range of products than that of retail investment products.

⁸ (a) a life policy;
(b) a unit in a regulated collective investment scheme;
(c) an interest in an investment trust savings scheme;
(d) a stakeholder pension scheme;
(e) a personal pension scheme;
whether or not (in the case of (a), (b) or (c)) held within an ISA or a CTF and whether or not the packaged product is also a stakeholder product.

Suitability rules

- 4.11 Personal recommendations provided through a simplified advice process must comply with the suitability requirements (COBS 9.2).
- 4.12 The suitability rules, amongst other things, require a firm to take reasonable steps to ensure that a personal recommendation is suitable for its client. To do this, a firm must obtain from the client information necessary to understand the essential facts about him and have a reasonable basis for believing that the recommendation:
- (a) meets his investment objectives;
 - (b) is such that he can financially bear any related investment risk consistent with his investment objectives; and
 - (c) is such that he has the necessary experience and knowledge to understand the risks involved.
- 4.13 The suitability standard is flexible relating to the type of service, the product and the client. As such, there is already scope for firms to design simplified advice processes that are capable of meeting it. For example, the suitability test is qualified by reference to ‘the nature and the extent of the service provided’, and the information which must be obtained is qualified by the condition ‘where relevant’. The information ‘necessary’ to obtain will vary from case to case, and may vary enormously. For instance, the more complex and high risk the product, the higher the threshold of required information.
- 4.14 The extent of the suitability assessment required by a firm may be limited by the service requested by their client. For example, where a client instructs a firm only to give personal recommendations relating to an identified portion of his/her assets or in relation to the desirability of investing in a specific investment, without reviewing the client’s entire portfolio, the suitability assessment could involve a narrower review, focusing on the client’s objectives, financial situation and knowledge in relation to that particular portion of assets or specific instrument.

- 4.15 *The suitability standards for simplified advice are the same as for all other forms of retail investment advice.*
- 4.16 *With an automated simplified advice process, the firm is setting the boundaries of the service it provides. A client agreeing to go through a simplified advice service does not absolve a firm from its obligation to make sure that personal recommendations on designated investments are suitable, even if the limitations of the service have been clearly explained. However, certain circumstances may reduce the degree of detail that a firm needs to obtain in relation to a client’s existing investments in order to be able to recommend they purchase a new investment product.*
- 4.17 *It is unlikely that a firm will be able to ensure that a recommendation to sell or transfer an investment product is suitable through a simplified advice process.*
- 4.18 *An automated simplified advice process may ask a client whether they want their existing investments (if they have any) to be considered in terms of (i) whether they are still suitable, or (ii) whether they*

would influence the suitability of a recommendation to purchase a new product. If the client indicates that they do not want either (i), or (ii), and the firm has reason for believing that the client understands the implications of this decision, the extent of information required on a client's existing investments may be reduced. If the client indicates that they would like (i) or (ii), or they are unclear on what they want or the implications of this decision, they should exit from the simplified advice process and be referred on as appropriate.

- 4.19 The extent of information required on a client's existing investments may be reduced, in that the firm may not need to know certain details about these investments, such as the broad asset allocation, product types or country/sector exposure. This is because this specific information may not be relevant for the limited advice service being provided. To understand a client's regular financial commitments, firms should understand the level of any regular contribution products owned by a client. In order to recommend a tax-efficient investment solution, firms should understand whether clients (who are eligible) have used up their annual ISA allowance.
- 4.20 The implications of a client's existing investments not being considered in detail could include, for example, that the process:
- does not consider whether their existing investment products match their stated risk appetite;
 - only considers the objectives of investing the particular sum identified, and does not consider whether these objectives align with the client's broader financial objectives; and
 - will not take into consideration any implications the recommendation has for the diversification or balance of the client's broader portfolio.
- 4.21 Client understanding of the limitations of the service could be achieved through mechanisms such as timely alerts, by playing back answers to the client for confirmation (both during the process, and at the point that the recommendation is given), and filters throughout the process. For automated advice services, confirmation processes will need to be designed in a way that reflects how individuals typically interact with such screen-based systems, and should not allow, for example, clients to simply 'click through' important information.
- 4.22 In assessing the suitability of a personal recommendation being given to a client, firms should take into account any retail investment products that they have previously sold to that client, to the extent that they are relevant to the new personal recommendation.
- 4.23 To comply with the suitability rules (and Principle 6 and the client's best interests rule) firms should understand the type and level of clients' debt, and not recommend a retail investment product if a client would be better advised to repay debt rather than investing money. Similarly, firms should not recommend a retail investment product unless they have reason for believing that the client has adequate savings to access in an emergency. If a client has debt that they should repay or insufficient emergency savings, they should exit from the process and be referred on as appropriate.
- 4.24 A firm must obtain the necessary information to enable it to make the recommendation which is suitable for its client (COBS 9.2.1R). A firm may ask clients to make a judgement as to whether they

are able to cope with their existing level of debt or about the adequacy of their savings, but this would not, by itself, be sufficient to fulfil the firm's obligations under the suitability rules.

4.25 *A firm should determine for itself, in consideration of its process, product suite, and target market, what type and level of debt is acceptable and what level of emergency savings is adequate for an investment product to be suitable for a client.*

4.26 COBS 9.2.2R(2) says that the information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

4.27 *In assessing a client's investment objectives, it should be made clear that saving for retirement is an option. If a client indicates that they want to save for retirement, or the information given by the client suggests that they should be saving for retirement, and the product suite does not include an appropriate product, the client should exit from the process. Clients should be advised to seek advice if they are uncertain of their retirement needs or would like to discuss their retirement plans.*

4.28 The process can allow for the client acquiring the knowledge necessary to understand the investment risks for the purposes of the suitability assessment. For example, in relation to very simple products, a risk warning may be sufficient to ensure that the client has sufficient knowledge relating to the risk of an investment services or financial instrument, as long as the firm has a reasonable basis for believing that the client has read and understood it.

4.29 Firms should refer to our guidance on assessing suitability (FG11/05)⁹ and consider the implications this may have for their simplified advice processes. This guidance considers how firms establish and check the level of investment risk that retail clients are willing and able to take; the potential causes of failures to provide investment selections that meet the risk a client is willing and able to take; and the role played by risk-profiling and asset-allocation tools, as well as the providers of these tools.

4.30 FG11/05 says that firms that rely on risk-profiling tools need to ensure they are actively mitigating any limitations of the tool through the suitability assessment and 'know your client' process. We consider that 'know your client' is possible in a simplified advice process using the fact-finding questions around the risk profiling tool. Ways of mitigating the risk of inaccurate risk-profiling could include the system checking for contradictory answers and playing back responses for client confirmation.

⁹ FG11/05: Assessing Suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection, March 2011.

Adviser charging

- 4.31 Simplified advice, like all forms of regulated investment advice, must comply with the adviser charging and remuneration rules (COBS 6.1A)¹⁰ once the RDR rules come into force.
- 4.32 These rules, introduced through the RDR, require that personal recommendations, and related services, provided to retail clients in respect of a retail investment product, be paid for by adviser charges. They ban commission, remuneration, or benefits of any kind in relation to personal recommendations. Related services may include arranging or executing a transaction which has been recommended to a retail client by the firm, an associate or another firm in the same group, or conducting administrative tasks associated with that transaction (COBS 6.1A.6G).
- 4.33 If the firm is the retail investment product provider, the firm must ensure that the level of its adviser charges is at least reasonably representative of the services associated with making the personal recommendation (COBS 6.1A.9R).
- 4.34 Firms must determine and use an appropriate charging structure for calculating its adviser charge for each retail client (COBS 6.1A.11R). They must not use a charging structure which conceals the amount or purpose of any of its adviser charges from a retail client (COBS 6.1A.14R). Adviser charges can be contingent on the client going through with the recommendation.
- 4.35 A firm must disclose its charging structure to a retail client in writing, in good time before making the personal recommendation (or providing related services) (COBS 6.1A.17R). To meet their responsibilities under Principle 7 (Communications with clients), firms should ensure that their charging structure is disclosed in a way which is clear, fair and not misleading.

4.36 *The charging structure should be disclosed, along with the basis (if any) upon which the rates may vary (including the circumstances in which there will be no charge), at the point that the retail client starts going through the advice process. This may be after a short screening process, where clients have been assessed to determine if they are likely to be suitable for the process or not.*

- 4.37 The total adviser charge payable to the firm for the service must be disclosed and agreed with the retail client as early as practicable (COBS 6.1A.24R (2)(b)). This disclosure must meet a number of other conditions, for example, it must be in cash terms and be in a durable medium or through a website, if the website conditions are satisfied. If the process results in a personal recommendation, which is implemented elsewhere in the firm or group, adviser charging rules will still apply.¹¹

4.38 *If the adviser charge varies depending on the type of recommendation, 'as early as practicable' for the disclosure of the actual charge is likely to be at the point where the personal recommendation is made.*

¹⁰ The adviser charging rules do not apply to a firm giving advice, or providing services, to an employer in connection with a group personal pension scheme or group stakeholder pension scheme. These rules also do not apply when a firm is giving basic advice in accordance with the basic advice rules.

¹¹ As these are services related to the personal recommendation, so are covered by the adviser charging rules (COBS 6.1A.6G(1)).

This is the second stage in the disclosure of adviser charges, the first being the disclosure of the charging structure at the start of the process.

- 4.39 In order to meet its responsibilities under the client's best interests rule and Principle 6 (Customers' interests), a firm should consider whether the personal recommendation is likely to be of value to the retail client when the total charges the retail client is likely to be required to pay are taken into account (COBS 6.1A.16G). To meet its responsibilities under Principle 7 (Communications with clients), firms should consider whether their charging structure can be easily understood by their target market, in particular if it sells commission¹² and non-commission attracting products through simplified advice. Firms who also sell products that could attract commission through simplified advice could choose to operate a fee-only charging model.

Professional standards

- 4.40 An automated process can provide advice in and of itself, with the firm providing the automated service being responsible for that advice, including whether it is suitable. A firm may choose to have an employee support clients through their simplified advice process, and the role of that employee can be considered separately from the advice given by the automated process, if they do not have the ability to influence that advice.
- 4.41 There are three main options available to firms in considering the role of an individual to support a simplified advice process, which are that:
- there is no individual involved in the provision of the advice, so it is provided wholly through an automated system;
 - a competent adviser takes the client through the process, or is at hand to answer questions as the client goes through the process, and discusses the merits of the personal recommendation; and
 - the client has access to an individual who can answer questions of a factual manner and help clients through the process, but does not give advice or discuss the merits of the personal recommendation with the client (and therefore does not give regulated advice).
- 4.42 We have asked for detailed information on the specifics of the advice process and the role of the individual which would justify a lower qualification requirement. But we have not been convinced of the need for, or desirability of, a partially qualified or less competent adviser to give personal recommendations to retail customers through a simplified advice process.

Advice provided through a fully automated advice system (option 1)

- 4.43 If a firm wishes to provide advice through a fully automated advice system, i.e., one in which the customer will not at any stage in the process have the opportunity of discussion with an employee, then the design of this system is of critical importance.

¹² For example, a protection product.

- 4.44 We consider that the design, testing and review of the operation of such a system is likely to be more complex than the design of procedures to provide advice to customers face-to-face, or over the telephone. We would expect the work that firms would need to do if they wished to use such systems to reflect this.
- 4.45 In practice, the design of such systems would need to involve competent individuals with expertise in a number of different areas, including IT specialists. However, given that the purpose of the system would be to provide advice on investments, we would expect that a fully qualified retail investment adviser would be involved in the design process from the beginning and would confirm that the system was fit for purpose before it entered into use. By ‘fully qualified’ we mean that they meet the Training and Competence (TC) standards of a retail investment adviser, as outlined in paragraphs 4.47 and 4.48, but, if they have no direct customer contact, they may not necessarily be approved for the customer controlled function CF30 status.

Individuals who give personal recommendations (option 2)

- 4.46 The second of the options, where an individual is involved who provides personal recommendations on retail investment products, could be delivered through an automated system with support provided over the telephone or face-to-face, or directly over the telephone or face-to-face. The individual must meet the Training and Competence (TC) standards of a retail investment adviser. These requirements are summarised below. They must also be approved for the customer controlled function CF30 status.
- 4.47 Firms must ensure that, after the implementation of the RDR rules, their retail investment advisers:
- hold an appropriate qualification as set out in TC Appendix 4E including qualification gap fill where required;
 - undertake a minimum of 35 hours of continued professional development per annum; and
 - hold a Statement of Professional Standing (SPS) issued by an accredited body.
- 4.48 The current requirements, which will apply until the RDR rules come into force, are that firms ensure their retail investment advisers:
- hold an appropriate qualification as set out in TC Appendix 4E; and
 - maintain competence.
- 4.49 In addition, retail investment advisers must now, and after the RDR rules are implemented, comply with the Statements of Practice for Approved Persons.

Individuals who do not give personal recommendations (option 3)

- 4.50 The third of the options involves an individual providing some support and information to clients, but does not provide regulated advice. This individual must not provide personal recommendations if they do not meet the TC standards of a retail investment adviser. Whether the individual provides personal

recommendations or not depends on what they say, how it is delivered, and the scope that they have to influence the process. It may be possible for the individual to give reassurance on the system and process without giving personal recommendations. This individual should have the knowledge and expertise to recognise when a client needs to be referred to a retail investment adviser.

- 4.51 The individual will need to avoid making any judgement on the suitability of one or more products. In addition, they should not steer the consumer down particular paths within the process, for example, by explicitly or implicitly encouraging the consumer to answer questions in a certain way. Any information or generic advice of this sort, which has the ability to influence the outcome of the advice process, may mean that the individual is viewed as giving regulated advice.
- 4.52 The Perimeter Guidance Manual contains guidance on the role of a person involved in guiding a client through a decision tree, which is relevant for simplified advice. PERG 8.26.3 G states: 'In the FSA's view, guiding a person through a decision tree should not, of itself, involve advice within the meaning of article 53 (it should be generic advice). For example, helping a person to understand what the questions or options are and how to determine which option applies to his particular circumstances. But a recommendation that the person concerned should, if the results of using the decision tree so indicate, buy (for example) a stakeholder personal pension from a particular provider (or any other particular investment) would be advice for the purpose of article 53.' PERG 4.6.21 to 4.6.22 contains guidance on scripted questioning for mortgage contracts which is also relevant in determining whether an individual involved in a simplified advice process gives a personal recommendation.
- 4.53 If the simplified advice process is designed so that an individual involved is not giving regulated advice, the firm should ensure that there are appropriate systems and controls in place to prevent that individual from straying into regulated advice or influencing the recommendations provided by the process. We consider that it will be particularly difficult for a firm to manage the risk that an individual will give advice if they are talking clients through the process, either over the phone or in a face-to-face situation, as opposed to providing ad-hoc help on using the system at the request of a client.
- 4.54 Simplified advice processes introduce a risk of systemic mis-selling. We have concluded at this stage that it is not appropriate to introduce any further requirements, such as additional competence requirements for those individuals who design the process, as a firm's senior management are responsible for ensuring the firm's systems and controls are adequate. We believe that this should be sufficient to ensure that the process, including any system, is designed so that clients receive suitable advice.

Disclosure of simplified advice services

- 4.55 We expect that simplified advice processes will fall into the category of restricted advice after the RDR rules come into force, as the products available are likely to be limited to one or more particular product providers, and particular types of products will be ruled out. If a firm provides simplified advice (which is restricted advice), in addition to independent advice, it should not hold itself out as providing independent advice for its business as a whole (refer COBS 6.2A.4G).

4.56 The key disclosure requirements for restricted advice are that:

- A firm must disclose in writing to a retail client, in good time before the provision of its services, that its advice will be restricted, and the nature of that restriction. If a firm provides independent advice as well, it must clearly explain the difference between this and its restricted advice (COBS 6.2A.5R and COBS 6.2A.6R).
- A firm must provide this disclosure information in a durable medium or through a website (if it does not constitute a durable medium) provided the website conditions are satisfied (COBS 6.2A.7R).
- To meet its disclosure obligations, a firm could use a services and costs disclosure document or a combined initial disclosure document (COBS 6.2A.8G).
- And if a firm provides restricted advice and engages in spoken interaction with the retail client, they must also disclose orally in good time before the provision of services that it provides restricted advice, and the nature of that restriction (COBS 6.2A.9R).

4.57 *We would expect the firm's disclosure of its simplified advice service, in combination with questions designed to understand what type of advice clients want, to enable clients to understand the limitations of the service so that they can make an informed decision of their advice needs.*

4.58 *This will likely require firms to explain the differences between the types of advice they offer. If firms also choose to describe other types of advice services available in the market (such as independent advice), they should do so in a way which is fair, clear and not misleading. Firms should not try to steer clients to a particular advice service if it is likely to prove inadequate for their needs, or simply because the service is cheaper for the firm to provide.*

Complaints and redress

4.59 The Dispute Resolution: Complaints (DISP) sourcebook sets out the rules for complaints handling by firms and the jurisdiction of the Financial Ombudsman Service (FOS). The rules require firms to deal with consumer complaints promptly and fairly in the first instance and provide a final response to the consumer within eight weeks. If the consumer remains dissatisfied with the firm's response, they can complain to the FOS. These rules apply unchanged to complaints arising from a simplified advice process.

4.60 The Compensation (COMP) sourcebook sets out the rules and guidance that allow the Financial Services Compensation Scheme (FSCS) to pay compensation. The rules specify who is eligible to receive compensation, in what circumstances and the limits on how much compensation can be paid. Consumers receiving advice through a simplified process may have recourse to the FSCS when a firm is unable, or likely to be unable, to pay claims against it.

4.61 The FOS's decisions are based on what it believes is fair and reasonable in the individual circumstances of each case. Their rules require the ombudsman to take into account FSA's rules and

guidance (which will include this guidance), and also good industry practice; see this from its website on simplified advice¹³:

"Simplified advice" processes must comply with the same regulatory requirements as those involving full advice – including the requirement that the advice has to be "suitable". But in any complaints we might receive, we would judge the advice in the specific context in which it was given. So we would not expect a "full fact-finding" exercise. But we would look at the questions asked and the options open to the particular consumer concerned.

Where the "simplified advice" involves an automated process, we would look – as part of our consideration of any complaint – at whether there was a good record of the information the consumer gave and the choices they made.'

5 Further considerations in designing a simplified advice process

- 5.1 As highlighted in our Product Intervention Discussion Paper (DP11/01) and Feedback Statement (FS11/3), certain product features and sales processes can interact with consumer behavioural traits in ways that make it difficult for consumers to protect their own interests. Information disclosure alone has proven inadequate to avoid mis-selling. This is why we have adopted a more intrusive and interventionist regulatory approach. In designing a simplified advice service we expect firms to pay due regard to all aspects of the process, rather than relying on information disclosure.
- 5.2 This section summarises some of the high-level standards and guidance which firms should consider in designing and delivering simplified advice. We also consider here what these standards, and specific rules where relevant, mean for both the design of the advice process itself and for choosing or developing an appropriate product suite. This section is not an exhaustive summary of a firm's responsibilities.

Principles for Businesses

- 5.3 Firms are reminded of the need to comply with all of the Principles for Businesses in designing and delivering simplified advice. The following are particularly relevant:
- Principle 3 (Management and control) is that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;
 - Principle 6 (Customer's interests) is that a firm must pay due regard to the interests of its customers and treat them fairly;

¹³ www.financial-ombudsman.org.uk/faq/businesses/answers/handle_cases_all.html

- Principle 7 (Communications with clients) is that 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; and
- Principle 9 (Customers' relationships of trust) is that a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

5.4 Firms should consider the Handbook guidance *Responsibilities of providers and distributors for the fair treatment of customers* (RPPD) in designing and delivering simplified advice. The following guidance is particularly relevant:

5.5 Paragraph 1.17: When undertaking product or service design, a firm:

- (1) should identify the target market, namely which types of customer the product or service is likely to be suitable (or not suitable) for;
- (2) should stress-test the product or service to identify how it might perform in a range of market environments and how the customer could be affected; and
- (3) should have in place systems and controls to manage adequately the risks posed by product or service design.

Paragraph 1.19: When providing information to customers, a firm:

- (1) should pay regard to its target market, including its likely level of financial capability;
- (2) should take account of what information the customer needs to understand the product or service, its purpose and the risks, and communicate information in a way that is clear, fair and not misleading; and
- (3) should have in place systems and controls to manage effectively the risks posed by providing information to customers.

Designing a simplified advice service

- 5.6 Firms will need to define a target market and understand the needs of the consumers in that market, to ensure that the simplified advice process they develop, including its product suite, is likely to meet these needs. It is the responsibility of the firm to foster consumers understanding of the issues and to elicit appropriate information.
- 5.7 Firms need to ensure that they are attracting and filtering consumers appropriately, so that only consumers for whom simplified advice is likely to be appropriate go through the process. We expect simplified advice models to have numerous drop-out points. In particular, these should occur where a consumer answers any question which indicates that the products in the suite are not suitable, for example because of their level of debt or emergency savings.

- 5.8 Consideration needs to be given to what will happen to consumers who are not appropriate for the process, including because a suitable product can not be recommended. It is not acceptable for a firm to recommend a product that most closely matches the needs of the consumer, from the restricted range offered, when that product is not suitable. We would expect to see many instances where no recommendation is made because the product suite does not include a product that meets the consumer's needs.
- 5.9 To help firms identify and mitigate risks when designing simplified advice processes, the following table highlights four features of a simplified advice model that could result in poor outcomes for consumers.

Features that could result in poor outcomes for consumers

The system does not allow clients to understand how the advice is limited, and what implications this may have.

To comply with the disclosure rules (COBS 6.2A.5R and 6.2A.6R) and Principle 7 (Communications with clients), firms should ensure that they disclose how their advice is restricted in a way which is clear, fair and not misleading.

The earlier guidance on suitability, i.e. circumstances where a firm may not need to understand details of a client's existing investments, is also relevant here.

Firms should ensure that the client understands at the start of the simplified advice process:

- the breadth of the service, and why it might, or might not, be appropriate for them, including whether or not they will receive any ongoing service;
- how it differs from full advice, and why they might need full advice; and
- what is expected of them throughout the process, including the need for them to provide accurate information.

The questions included in the process do not cover all of the information needed to establish the suitability of recommendations.

Firms must ensure that they obtain from clients all of the necessary information to make a suitable recommendation (COBS 9.2.1R and COBS 9.2.2R). A firm must not encourage a client not to provide information for the purposes of its assessment of suitability (COBS 9.2.4R).

The system should not, for example, rely solely on clients to judge whether the level of their debt, emergency savings or protection means that a retail investment product is suitable for them. Also, firms are not released from their obligation to ensure that the process results in a personal recommendation which is suitable even if a client is

asked to agree to accept that the process will not consider their existing investments, level of debt or access to liquid cash.

Refer to paragraphs 4.11 to 4.30 on suitability for a more detailed explanation of the requirements and additional guidance.

The questions are designed in a way which increases the possibility that incorrect information will be given or information will be misinterpreted.

For example:

- supporting information and explanation is insufficient to foster a genuine understanding (e.g. the process does not allow clients to appreciate the significance of questions around their pension provision);
- vague, unclear or misleading descriptions or illustrations are used to check the risk that a client is willing and able to take;
- the questions do not allow for all relevant answers; or
- the questions are asked in a leading way, so that clients are more likely to provide a particular answer.

Firms should take reasonable steps to minimise the risk that incorrect information will be given by clients due to misunderstanding or ambiguity. For example, a firm should clearly explain what it needs to know about a retail client's debt and consider using a range of alternative words (e.g. 'loans', 'student loans', 'borrowing', and 'other forms of credit') to ensure all relevant information is obtained.

The design of the system means that clients can inadvertently miss or deliberately skip important questions or information.

For example, it would be difficult for a firm to show compliance with the suitability rules if clients can easily skip:

- sections of questions which would be necessary to establish suitability;
- important information relating to the nature of the service; or
- specific questions in the process or in relation to the recommendation.

Consumer hierarchy of need

- 5.10 In order to meet its responsibilities under the client's best interests rule and Principle 6, and to comply with the suitability requirements, a firm should not recommend that a client purchase an investment product unless they have a reasonable basis for believing that they can afford the new commitment. This requires the firm to consider its client's level of indebtedness and access to liquid cash to meet an emergency (see paragraphs 4.23 to 4.25). In addition, a firm should make clear that its clients ought to consider whether they have any core protection needs which are not met and, if so, explain that the client should consider buying insurance cover instead of an investment product, or lower the amount of money to be invested. The firm should provide the client with the option of exiting the process at this point to address any protection needs, if the simplified advice process is not designed to do so.

Choosing the right products for a simplified advice service

- 5.11 Although some commentators have suggested that the FSA should explicitly decide what products should be available through a simplified advice process, we have not yet seen a compelling argument that would lead us to consider intervening in the market in this way.
- 5.12 The product suite will need to correspond to the needs of each firm's target market, and be appropriate for its specific advice process. For example, we would not expect to see a high-risk product included in a simplified advice process aimed at retail clients with low levels of investable assets and no investment experience. Firms should undertake rigorous due diligence and consider their clients' interests when selecting the product suite to ensure that it is appropriate.
- 5.13 Also, the range should be adequate to ensure that clients are not steered towards one particular product if this product is unlikely to be suitable for most of the target market.
- 5.14 The specifics of the process will influence the product suite. For example, if the process does not ask about existing investment ISAs, we would not expect the product suite to include any retail investment products for which an investment ISA may be a reasonable substitute for a client, as any recommendation could not ensure that the retail client was receiving maximum tax advantage from their investments. Firms should consider the types of clients for whom the products are likely to be unsuitable, so that the advice process can be designed to avoid unsuitable sales.
- 5.15 It is unlikely that a 'one-size-fits-all' approach to the process and product suite will work for multiple market segments. However, it may be possible for a firm to have more than one range of products, each suited to a different target market, if (and only if) the process and supporting systems and controls ensure that the right clients progress down the right path.

Product characteristics

- 5.16 This section sets out aspects we expect a firm to take into consideration when developing a product suite, to meet its responsibilities under the client's best interests rule and Principle 6 (Customers' interests).

- 5.17 In identifying or developing products appropriate for the target market of a simplified advice process, firms should consider the following product characteristics (note that this is a non-exhaustive list):
- the complexity of each product, so that 1) the degree of complexity is appropriate for the target market, and 2) the process establishes suitability and allows clients to understand relevant product features and risks;
 - the minimum contribution rates and whether these are affordable for the target market;
 - the maximum contribution rates, to ensure that clients have appropriately diversified investments;
 - product charges should provide value for money (so, for instance, low value investments are not eroded by charges) and an appropriate structure (so early surrender charges are not used if the target market is not able to tie money up for the medium to long term);
 - access and flexibility, and the appropriateness of fixed-term products for the target market; and
 - the risk of each product, including the volatility, and whether this is consistent with the typical risk profiles of the target market.
- 5.18 Given the target markets described to us, which are typically consumers with low investable assets who have little or no investment experience, we would expect the products being recommended through simplified advice to be easy-to-understand, low-cost, flexible, and not high risk, with simple charging structures and straightforward outcomes. If the suite contains products which do not meet this description, we would expect firms to show that this is appropriate for the target market, and to demonstrate what systems and controls are in place to limit the recommendation of these products to only those for whom they are truly suitable.
- 5.19 Figure 3 of the Product Intervention Discussion Paper (DP11/01) listed some typical indicators of problematic product features, and these were replicated in the Feedback Statement (FS11/3). These features need to be viewed in the context of the particular product being scrutinised and do not necessarily mean that it is flawed. Despite this, clearly we would not expect to see products with such features in the suite of a simplified advice process.

Ongoing responsibilities

- 5.20 The Principles for Businesses and a number of detailed rules in the Handbook mean that firms have an ongoing responsibility to ensure that their simplified advice process and product suite continues to do as intended when designed, and continues to treat clients fairly.
- 5.21 The RPPD includes some relevant guidance for firms, for example:
- 1.20(2) – a firm should review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged, for the distribution of its products or services given the target market. This involves collecting and analysing appropriate Management

Information (MI) such that the firm can detect patterns in distribution as compared with the planned target market, and can assess the performance of the distribution channels through which its products or services are being distributed; and

- 1.20(3) – a firm should act when it has concerns, for example by ceasing to use a particular distribution channel.

- 5.22 Firms should refer to the RPPD for further guidance, but note that this is not a complete exposition of all of a provider's or a distributor's responsibilities to the client or to each other.
- 5.23 The Product Intervention Feedback Statement (FS11/3) stated our intention to take forward a single set of rules and guidance on product governance, including, for example, turning some or all of the TCF material (including RPPD) into rules, and will consider additional interventions going forward. This work will be relevant for the product suite for simplified advice, and for the service as a whole.
- 5.24 Firms should be mindful of their record-keeping obligations, in particular those set out in COBS 9.5. If a simplified advice process is automated and/or the assessment of suitability is limited in some way (with consent from a client), firms may wish to consider retaining records for longer than the time periods specified.

Supervision

- 5.25 The FSA's revised conduct strategy launched in 2010 outlined the shift to a more proactive and, consistent with Principle 11¹⁴, outcomes-focused style of supervision. In line with this approach, we expect firms to inform us if they intend to deliver a simplified advice service, and to provide any information requested, including why they believe the product suite is suitable for the intended market.
- 5.26 Firms should build systems to deliver simplified advice in the expectation that the FSA will want all of the data from that system to be reported to us. We expect to consult on collecting data on the volume and value of sales through a simplified advice process on a regular basis, should simplified advice be provided by firms. We will also consider consulting on proposals to collect other data, for example on the types of clients to whom these products are sold to, to ensure that the service is reaching its intended target market.

¹⁴ Principle 11 (Relations with regulators): A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.