

## Issues around implementing the UK Financial Service Authority concept – for **independent** INVESTMENT ADVICE

Note: the FSA proposal does not attempt to cover risk advice or mortgage broking. Therefore, this proposal is discussing the use of the term INDEPENDENT in the context of investment advice.

### Text from the FSA's "Retail Distribution Review" November 2008.

There are three measures that we regard as most fundamental to delivering the market outcomes that we set out to achieve and which will materially alter and improve the interactions between consumers and the industry. These are to:

- improve the **clarity for consumers of the characteristics of different service types and the distinctions between them;**
- raise **professional standards;** and
- **reduce the conflicts of interest inherent in remuneration practices** and improve transparency of the cost of all advisory services.

### **Clarity of services**

- The regulatory landscape distinguishes between **investment** advice that is **independent** and **sales** services. Sales will include a spectrum of services ranging from advice that is not independent, through simplified advised and non-advised guided sales processes, to execution-only business. We intend to conduct consumer research to explore options for improving the way in which services are described and presented to consumers.
- Independent advice is truly independent: new requirements make clear that **independent advisers**, not just those advising on packaged products, **need to provide unbiased, unrestricted advice based on a comprehensive and fair analysis of relevant markets.**
- Clarity on the nature and distinction of different services allows Money Guidance services to provide clear guidance to those consumers seeking help on where to go for which type of investment services.

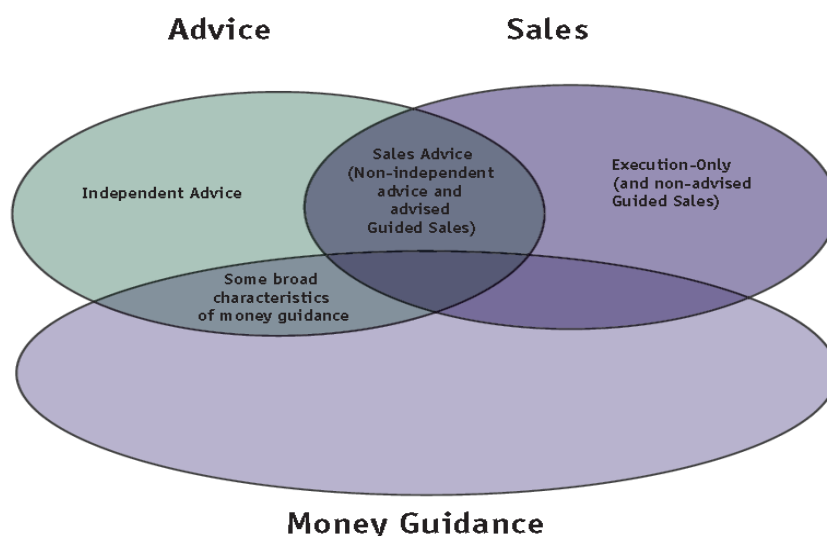
### **Remuneration**

- For independent advice to be perceived as truly independent, new requirements remove product provider influence over adviser remuneration and advisers are required to set their own charges for advice. Product providers not allowed to play any role in remuneration.
- Any payment for advisory services made through the customer's product or investment must be funded directly by a matching deduction from that product or investment made at the same time as that payment.
- For customers to understand clearly the different services being provided and to recognise the value of advice, separate disclosure is required of the costs of advisory services from product costs for both independent and non-independent advisory firms.

### **Professional standards**

- An overarching **Professional Standards Board**, with similar powers to standards boards in other professions, is established to provide a common framework for professional standards across all advice channels. Moreover, a principle is established to require the same competency levels for the same advice roles, whether providing independent or non-independent investment advice.
- For all investment advisers, there is a benchmark qualification of at least QCA level four, and possibly higher levels for designated specialists, but all individuals are encouraged to opt for higher levels to suit their specific needs.

Figure 1



We consider in later chapters the more detailed characteristics of advice and sales services. For clarity the main differences from the simpler landscape put forward in the IR are:

- We will seek to **distinguish independent advice from sales and sales advice** (rather than having a sharp distinction between ‘advice’ and ‘sales’, where the latter comprised strictly non-advised services only).
- **The characteristics of independent advice are largely as we set out in the IR** (Interim Report) **for ‘advice’**: we want consumers to be able to see independent advice firms as being equipped to give comprehensive and fair analysis of their relevant markets and provide unbiased, unrestricted advice. In this way, we propose to **modernise the requirements that independent advisers have to meet in making suitable recommendations to their clients**.
- We are not requiring existing advice services (such as tied and multi-tied businesses) to change their business models, but we will want non-independent advice to be distinguishable for consumers from independent advice. We expect **the distinction (of independent advice) to derive from making the nature and scope of services clear for consumers** (with non-independent advisers making clear the limitations of their client propositions) and not from any differences in professional standards or remuneration practices. So, importantly, we are proposing to consult on requiring that those delivering non-independent advice services operate to similar high minimum professional standards, and have similar minimum qualifications, as apply to equivalent roles in the independent advice sector. And we are proposing changes to the way the costs of both independent and non-independent advisory services are set out for clients.
- We are emphasising that certain characteristics of Money Guidance services ought to form part of advice and sales processes, where relevant. For instance, where a ‘know your customer’ process is undertaken, and depending on its intended scope in individual circumstances, we might expect firms to give wider consideration to a client’s financial needs, for instance exploring the scope to rationalise their debts or ability to repay their debts. We recognise that this is already commonplace practice for many firms, but we want to emphasise in describing the regulatory landscape that it should not be necessary for all consumers to go through Money Guidance (if it proceeds) to receive certain services, and that these should be available in the regulated market too.

### ***The new standards we intend to consult on***

- 4.52 Starting afresh, we have considered how best to communicate the high standards that we expect of genuinely independent advisers. We want to make sure that our Handbook supports and enables independent advisory firms to design businesses that search out and deliver the solutions that meet their clients' needs. We propose to do this through **two outcome-focused principles for independence which we discuss further below**. We also give some examples of how these might apply to different types of firm. These examples are deliberately simplistic. In taking our proposals to consultation next June we will develop more complex examples to help firms to assess whether their business meets these principles.
- 4.53 **Principle 1: Be equipped to give comprehensive and fair analysis of their relevant markets.** We continue to believe that it is important for independent advisers to be able to review the whole market, to deliver genuinely independent advice. However, we recognise that the whole market means different things for different firms. **It is possible to provide independent advice even if a firm specialises in quite a narrow field, provided that the whole of the relevant market is considered independently.** When considering what can be classed as a relevant market, consideration needs to be given to whether a client could expect to receive a suitable outcome from elsewhere, the reason for taking advice and the degree of substitutability with other products or investment types. A product type such as a pension may be a relevant market, because some clients would not be able to obtain the outcome they require from any other type of product. However, a product such as an investment bond, would not be classed as a relevant market as there are a number of other products that are directly substitutable.
- 4.56 **Principle 2: Provide unbiased, unrestricted advice.** We would not expect independent advisory firms to be unreasonably restricted, or biased in any way, in the products or services they offer. This would mean firms should not have any form of contractual agreement with any service or product provider, nor should they have any other constraint or obligation (such as arrangements with other entities within the same group of companies) that might limit their ability to select the best solution for their clients. Furthermore, any product provider's actions, for example in giving system support or training, should not in any way be allowed to influence the advice given.
- 4.58 **We received several responses to the DP which suggested that an advisory firm should not be deemed to be independent if a product provider held any form of financial interest in that firm.** We have investigated a number of advisory firms that are currently owned or part-owned by providers to see whether they place a disproportionate amount of business with their parent. **We did not find evidence of a systemic cross-industry issue at present.** We are also mindful that in current economic conditions, and given our wider concerns with the sustainability of the sector, we should be cautious about acting to limit access to capital. **So we do not aim to prevent independent advisory firms from being financed, owned, or part owned, by product providers at present.** But we will want to keep this under review and monitor the situation more closely in future. In particular, we will want to be satisfied that firms have appropriate controls to prevent ownership or other financing arrangements translating into any form of restriction on the products and services that the firm might access in formulating recommendations for its clients.

4.61 In order to reinforce the distinctions between independent and non-independent forms of advice, we will explore how the different characteristics of non-independent services (for example, restricted access to products) can be more clearly communicated to clients. We emphasise that **we do not view independent advice as necessarily the best service for every consumer.**

## **Professional standards**

### *The issue*

4.63 A pivotal review objective is to have standards of professionalism amongst those who deliver services in the retail investment market that inspire consumer confidence and build trust. We aim to deliver this in three ways:

by improving the quality of advice being given to clients by raising minimum levels of competence, skills and knowledge;

**by improving the perception of the sector by establishing and enforcing common ethical and behavioural standards;** and

supporting these and wider RDR proposals and mitigating the potential risks from them, by implementing an agreed, visible and effective common framework for professional standards to govern standards of practice.

## **Proposals of the Professionalism Group**

4.69 We set terms of reference for this Group based on the key points raised in feedback to the DP. The Group was tasked with formulating ideas for a framework for professional standards across the full range of advisory services, but we accepted that, until we could give them certainty about how we intended to take forward the ideas in the IR to create a distinction between advice and sales, the Group should predominantly focus its attention on the independent advice sector. In its report, the Group used the term **'Professional Financial Advisor' (PFA)** as **a working title for individuals operating as independent advisers**, but this not a term we have any immediate intentions to adopt.

10 See footnote 5 in the Overview.

11 This group was independently chaired by Michael Foot, chairman of Promontory Financial Group (UK), and comprised senior representatives of the Financial Services Skills Council, the ifs School of Finance, the Chartered Insurance Institute, the Chartered Institute of Bankers in Scotland, the Securities and Investments Institute and the Institute of Financial Planning.

4.70 We have built on the Group's recommendations to propose changes to the professional standards that will apply to those advisers who are not independent. These proposals are explained further in Chapter 5 but in summary **we do not see any reason to apply different professional standards to individuals giving advice, whether in the independent advisory sector or otherwise, if they are performing essentially the same role.** So we anticipate that the same professional standards should apply to similar roles – but this does not necessarily mean that the same minimum standards would apply to all roles.

4.73 **Group's Proposal Area 1 – establishing an Independent Professional Standards Board (IPSB).**  
**The Group proposed that:**

**An IPSB to be set up as soon as possible, initially as a sub-committee of the FSA Board, but to be developed into a fully independent Board, with a Chair and majority of Board Directors who are themselves independent of the industry (and independent of any relevant professional or skills body).**

**After a period, the IPSB may then seek its own statutory powers and become fully independent, outside of the FSA. At this point, if it is within the IPSB's legal powers, the IPSB should require all PFAs to have a relationship with it through a Professional Body. The IPSB should follow FSA practice in areas such as cost benefit analysis and consultation when setting standards for the profession.**

**The IPSB should have a role across the whole investment advice sector.**

**4.75 Group's Proposal Area 2 – the IPSB will oversee new minimum qualification standards for Professional Financial Advisers.**

**4.77 Group's Proposal Area 3 – the IPSB will create and oversee a new Code of Ethics and deal with breaches.**

**4.79 Group's Proposal Area 4 – the IPSB should be responsible for setting and enforcing new consistent minimum standards for Continuing Professional Development (CPD).**

4.80 Our views on the Group's Proposal Area 4:

*Effective and consistent CPD is arguably as important as raising the benchmark knowledge requirement. **This does not necessarily mean more CPD**, and we support the Group's view that there are different ways to achieve the intended outcome of up-to-date relevant knowledge.*

*Paragraph 38 of the Group's report suggests that non-professional body members should pay the IPSB to monitor their observance of CPD requirements. We understand the intention of creating a level playing field, but recognise logistical challenges to delivering this through our fee levy. Further analysis is required to determine the legal and operational challenges associated with this suggestion.*