Financial Conduct Authority

Thematic Review TR14/6

Supervising retail investment firms: being clear about adviser charges and services

April 2014

Contents

1	Executive summary	3
2	Findings	5
3	Impact of findings	7
4	Next steps	8

Annexes

1	Overview of thematic review	9
2	Detailed breakdown of failings	10

1. Executive summary

1.1 Background

We introduced the Retail Distribution Review (RDR) to improve outcomes for consumers, by enhancing professionalism standards, removing key biases and ensuring the costs of advice are clear. Central to this was the banning of commission for advice and a requirement that financial advisers operate as either 'restricted' or 'independent'.

The RDR also introduced new disclosure requirements[1] to improve transparency for consumers. These disclosure requirements play a crucial role in allowing firms to clearly communicate the nature and the cost of their services and providing clients with the information necessary to make informed decisions. It means that consumers can clearly understand and compare the costs and services of prospective firms at an early stage of the process, over time improving competition in the market.

We are currently carrying out a three-stage thematic review to assess how firms have implemented the RDR. We published the findings from the first stage of the review in July 2013.[2] This acknowledged the progress firms had made in implementing the new requirements 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]

After publishing our findings and these supporting materials for advisers, we expected standards to improve.

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, and
- whether firms are complying with the disclosure requirements

We published a report on our independence requirements on 20 March 2014, along with a video on this topic.[4] So this report will focus on the disclosure requirements and the failings we identified.

1 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 6.1A and COBS 6.2A).

2 Thematic Review 13/05 *Supervising retail investment advice: how firms are implementing the RDR.* www.fca.org.uk/static/documents/thematic-reviews/tr13-05.pdf

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

4 www.fca.org.uk/news/thematic-reviews/tr14-5-supervising-retail-investment-firms

The results from the second stage of our review show that a high proportion of firms are failing to give their clients the key information required under the RDR. We are concerned that the extent of these failings may lead to poor outcomes for consumers. It is important that firms take note of our findings and act promptly to ensure they are meeting our expectations and delivering good outcomes.

To help firms meet our requirements, our video provides an overview of the key disclosure requirements:
www.fca.org.uk/news/thematic-reviews/tr14-6-supervising-retail-investment-firms

1.2 What we did

We have now completed the second stage of our thematic review. We asked for information from 113 firms from a cross-section of the industry and carried out follow-up assessments on a sample of them. A more detailed summary of how we carried out the thematic review is set out in annex 1.

This report focuses on our findings in relation to the disclosure requirements.

1.3 What we found

We found that a high proportion of firms are failing to correctly disclose to clients the cost of their advice, the type of service they offer (i.e. independent or restricted), and the nature of the ongoing service they provide. In particular, 73% of firms failed to provide the required generic information on how they charge for advice and/or failed to clearly confirm the specific cost of advice to their individual clients in a timely manner. For example, fewer than half (42%) of firms surveyed gave their clients clear upfront generic information on how much advice might cost, and only half of the firms surveyed clearly explained how much advice would cost clients as individuals.

In our view, the level of non-compliance we identified and the failure of firms to meet their regulatory requirements is unacceptable.

The findings are particularly disappointing as the disclosure requirements are clear and should be relatively straightforward for firms to implement.

While we identified similar failings in the first cycle of our thematic review, we acknowledged that at that stage the disclosure requirements were relatively new. We then provided further clarification to the industry to support firms in making the required changes. Our thematic report set out the key issues for firms to consider and contained good and poor practice to assist firms in checking whether they were meeting our requirements. We also published a two-page factsheet on the disclosure requirements and sent a copy to all relevant firms.

We believe that by the start of the second stage of our review, firms had had sufficient time to prepare for and then implement the required changes. So it is concerning that firms are continuing to repeat the failings highlighted in the thematic report published after the first stage of the project.

As a result it is likely we will refer two firms – one financial adviser and one wealth manager – with egregious failings in the second stage of our RDR review to our Enforcement and Financial Crime Division.

2. Findings

We assessed a statistically significant sample of firms and have concluded that firms have not made an acceptable level of progress in meeting the RDR disclosure requirements.

The key failings were:

- **Firms are required to provide clients with generic information at the outset followed by confirmation of how much the advice will cost them as individuals. 73% of firms failed to provide the required information in at least one of these areas:**
  - **58% of firms failed to give clients clear upfront generic information on how much their advice might cost.** The generic disclosure document is key in ensuring that clients have a clear understanding of the firm's charging structure, so they have an idea of the likely cost of advice at an early stage. This should include information such as how they typically charge for advice (for example, a percentage of the amount invested, an hourly rate or a fixed fee), and the level of the fees. If a firm is charging a percentage of the amount invested it is important it includes examples in cash terms, and if it is charging an hourly rate it must provide an approximate indication of the number of hours that the provision of each service is likely to require. Clients should be able to use the document to compare the cost of different advisers and shop around if they wish.
  - **50% of firms failed to give clients clear confirmation of how much the advice would cost them specifically as individuals.** It is important that firms provide details of the cost of advice to each individual client in a clear and timely manner to ensure they understand the costs in relation to their particular situation before they are committed to paying any fees.
- **58% of firms failed to meet other important requirements in relation to the disclosure of their charges.** For example, failing to highlight that ongoing charges may fluctuate and/or failing to make it clear when charges will be incurred.
- **31% of firms that operated a restricted model failed to make it clear to their clients that they were offering a restricted service and/or failed to provide clients with a clear description of the nature of their restriction.** It is important that firms provide a clear explanation of the scope of service they offer, and the nature of any restrictions, at an early stage. This is key in assisting consumers in making an informed choice about whether they feel the service offered is appropriate for their needs.

- **34% of firms failed to give clients a clear explanation of the service they offer in return for an ongoing fee and/or their right to cancel this service at any time.** In addition to disclosing the cost of the ongoing service, it is important that consumers understand what service they can expect to receive in return for the ongoing fee. It is important the description is jargon-free and explained in a manner that a typical retail client would understand.

A more detailed summary of the most common failings is set out in annex 2.[5]

We analysed the results by firm size (number of retail investment advisers) and type of firm (see Annex 1). We did not identify any significant correlations between the level of compliance and the size or type of firm. In general, the failings appear to be widespread across the industry[6], although wealth managers[7] and private banks performed even more poorly in nearly all respects.

5 Please note this list is not exhaustive and it is important that firms refer to our Handbook to ensure they are meeting all requirements.

6 One potential exception was the category of 'Banks, Building Societies & Life Insurers' who had complied with the vast majority of the disclosure requirements. However, we did not have enough firms in this category within our sample for the results to be statistically reliable.

7 Wealth managers in this context is not a Handbook defined term but used to cover firms whose primary focus is providing discretionary investment management but which also provide other services (for example, advisory managed or advisory dealing services) which are subject to the RDR adviser charging rules.

3.
Impact of findings

We are concerned that the extent of these failings may lead to poor outcomes for consumers.

One of the main aims of the RDR was to increase transparency by improving the clarity of the information firms provide to their clients through their disclosure documents. The generic disclosure document should help clients understand how much the advice is likely to cost them and the service they can expect to receive in return (e.g. whether the firm is providing an independent or a restricted service). The client-specific disclosure document should then provide clients with the cost of advice for their particular circumstances, and the service that the firm has agreed to provide (including what they will provide in terms of an ongoing service, if applicable).

The failings identified by our review suggest some consumers could be unaware of, or even mis-led, in relation to the cost of advice (both initial and ongoing), the type of service offered by a firm (including whether it's independent or restricted), the nature of a firm's restriction (if applicable), or the service they can expect to receive in return for the ongoing fee.

Another desired outcome of the RDR was to introduce remuneration arrangements that allow competitive forces to work in favour of consumers. For this to be achieved, consumers (or third parties acting on their behalf) need to have the ability to research the market and shop around. This will only be achieved if firms provide clear disclosure documents that consumers can use to help them make informed choices.

4. Next steps

We will be carrying out a third cycle of our thematic review to ensure firms have acted on our feedback. This is due to commence in the third quarter of 2014.

We would encourage all firms to ensure they are complying with the RDR disclosure requirements. In addition to this report, firms should refer to our previous thematic report (including good and poor practice), the factsheet for advisers and the video on this topic available on our website.[8]

By the point the third cycle of our review takes place, firms will have had more than adequate time to comply with these rules. If we identify firms that are still failing to meet the disclosure requirements, we will consider what further regulatory tools are appropriate, including referrals to enforcement.

8 www.fca.org.uk/news/thematic-reviews/tr14-6-supervising-retail-investment-firms

Annex 1
Overview of thematic review

We requested information from 113 firms from a cross-section of the industry. The firms in our sample ranged from small financial advisers to networks and large national advisers, and banks. We also included a selection of wealth managers and private banks as well as firms where the provision of investment advice was not their main business (e.g. solicitors, accountants and general insurance brokers).

All firms in our sample were asked to complete an online questionnaire and to submit a copy of their disclosure documents. We also asked independent firms to send us a copy of their new business registers. We assessed this information and then carried out follow-up assessments with the firms where a more in-depth review was necessary.

Our review focused on two key areas.

- **Disclosure** – Are firms meeting the disclosure requirements for charges status (i.e. independent or restricted) and ongoing service proposition.

- **Independence** – Are firms that are holding themselves out as independent offering an independent service in practice?

This report focuses on our findings in relation to disclosure. We published a separate report outlining our findings and next steps in relation to the independence requirements on 20 March 2014.[9]

9 www.fca.org.uk/news/thematic-reviews/tr14-5-supervising-retail-investment-firms

Annex 2
Detailed breakdown of failings

Initial Disclosure documents

58% of firms failed to meet the requirements for disclosing their generic charging structure. The key issues for the firms surveyed were:

- Firms using a percentage-based charging structure did not provide examples in cash terms within their initial disclosure document (24% failed to disclose their initial fees and 30% failed to disclose their ongoing fees).
- 73% of firms that used an hourly rate did not provide an approximate indication of the number of hours that the provision of each service was likely to require.
- 62% of firms that used an indicative hourly rate did not provide the basis on which it may vary.
- 45% of firms that offered more than one option of calculating the fee within their charging structure did not made it clear what basis would be applied and when.

Client-specific disclosure

50% of firms failed to meet the requirements for disclosing the client-specific costs. The key issues for the firms surveyed were:

- Firms using a percentage-based charging structure did not disclose the fee in cash terms within their client-specific disclosure document (24% failed to disclose this in relation to initial fees whilst 41% failed to make the proper disclosure in relation to ongoing fees).
- 22% of firms surveyed did not appear to provide the client-specific disclosure as soon as practicable.
- 8% of firms surveyed did not disclose the client-specific charge in a durable medium. However, this failing was mainly concentrated within the Wealth Management and Private Banks' category, as 36% of these firms failed to provide any client-specific adviser charging disclosure.

'Other' charging issues

58% of firms failed to meet other important requirements in relation to the disclosure of their charges. The key issues for the firms surveyed were:

- 40% of firms using a percentage-based charging structure for their ongoing service failed to disclose that the fee would increase as the fund grows.
- 16% of firms surveyed did not make it clear when the client would start to incur charges.

Disclosure of restricted status

31% of firms failed to meet the requirements for disclosing their restricted status. The key issues for the firms surveyed were:

- 12% of restricted firms surveyed did not disclose, in a durable medium and/or in a timely manner, that they were restricted.
- 19% of restricted firms surveyed did not use the word 'restricted' in their disclosure.
- 23% of firms surveyed failed to clearly disclose the nature of the restriction.
- 15% of firms surveyed provided contradictory information on the nature of their restriction.

Disclosure of ongoing services

34% of firms failed to meet the requirements for disclosing their ongoing service. The key issues for the firms surveyed were:

- 20% of firms' documents failed to clearly disclose what service a client would receive in return for the ongoing fee.
- 18% of firms' documents failed to disclose that the client could cancel the ongoing service, or how they would go about doing so.
- 11% of firms surveyed did not appear to have a robust procedure for ensuring that they deliver the ongoing service that they have agreed with their clients.

Financial Conduct Authority

PUB REF: 004878

© Financial Conduct Authority 2014
25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
All rights reserved