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“A perfection of means, and confusion of aims, seems to be our main problem”

Albert Einstein

Introduction

Does the label on the tin properly reflect what's inside the tin?

This chapter will confirm the difference between the Independent and Restricted labels and the implications of each.

It is my belief that the titles need amending and my aim in this chapter is to prompt or at least add to, the debate about the issues arising from the definition of each status.

Definition of Independent Advice

There is no succinct definition of what comprises Independent Advice. Criteria for independent status set down by the FSA does not aid clarity.

To be Independent you need to:

- provide unbiased and unrestricted advice
- be equipped to give comprehensive and fair analysis of 'relevant' markets
- inform each client individually about services, current and future charges before they incur any charges
- have pricing structures that are compatible with impartial advice
- inform clients before you provide advice that you provide independent advice.

The main difference to the old world is that the scope of products an independent adviser should be competent and able to advise upon has extended from where it was to include all “retail investment products”. Amongst others the main notable additions are “Investment Trusts, VCTs, ETFs, unregulated collective investment schemes.”

The questions a firm should therefore ask themselves are:

- which of these additional products are appropriate to segments of my client bank?
- how much time and cost is incurred in attaining and maintaining qualifications and undertaking the research for those clients to whom these products are relevant?
- How will this extra cost be covered?
 - divide the cost by the handful of clients to whom the research is relevant?
 - or
 - spread it across the whole client base, meaning that in effect the majority of clients to whom these products are not relevant end up cross-subsidising the narrow field of clients who benefit from the work undertaken ?

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Let's say the annual cost to a business of maintaining its "additional" competence and ability to advise on these alternative investments is £5,000.

It has 150 clients, with 50 being regarded as having more complex and sophisticated needs.

Economies of scale may make it a worthwhile exercise to load the 50 "sophisticated" clients' fees with the costs. This is probably a price worth paying at a rate of an extra £100 per client.

If the firm takes a view to spread the costs across all 150 they may charge each client an extra £33 per annum.

A firm needs to decide whether it feels fair to add to fees to cater for a technical competence which will never be of benefit to the majority of clients paying the extra fee.

Risk

Esoteric and unregulated products carry sufficiently high levels of risk to cause the regulator to urge advisers to proceed with great caution when evaluating their suitability for clients.

Do advisers fully understand the products and can they properly articulate the benefits and risks to a client to be sure that they understand them sufficiently to make an informed decision?

If professional indemnity insurance cannot be put in place, what warning does that sound for advisers who may find complaints against them upheld if clients subsequently claim not have understood the risks they were taking etc.

Some firms will never have advised on these products and are unlikely to in the future as nearly all their clients have no need for them or any appetite for the risks involved.

Because of their target market most of these contracts may be regarded as "not relevant" to their clients, which means independent status is still achievable.

They would still need to maintain a level of competence to demonstrate an up to date awareness of those contracts and others arriving on the market. This would be at a cost which still needs to be factored into pricing levels.

Claiming independent status by relying on the likelihood that esoteric products will "never" be relevant to their client base creates a risk of failing to spot the time when such a product would be appropriate to a client's needs.

If a restriction was defined then this cost needn't be incurred and the risk wouldn't apply.

Restricted

Let us look at what the title means rather than be distracted by its unpopularity.

It applies to anyone or business that does not maintain competence, the ability and willingness to advise upon the full range of regulated and unregulated investment products.

For example an adviser who says that Film Trusts, and VCT's are not relevant to their market could be:

- a restricted adviser if they do not maintain the ability to advise upon them and refer to someone qualified if the need arises

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- an independent adviser if they maintain competence and the ability to advise upon these even though they have never needed to in the past or likely to in the future.

Where a firm or adviser chooses to limit the scope of products they are able to advise upon then they have to explain up front in what way their advice is restricted.

So who is independent?

The majority of IFAs practising in 2012 who wish to retain independent status need to get fully up to speed with the unregulated market. The majority of advisers who continue to do what they have always done in line with the old rules are by default “restricted” advisers but as yet most haven’t declared the fact.

Single platform strategy – any impact on independent status?

An article in Citywire in September 2010 referred to comments made by Rory Percival:

The Financial Services Authority (FSA) has said advisers can use just one platform post-retail distribution review and still be classed as independent if they have a homogenous client base.

However, advisers with a diverse range of clients will need to use more than one platform if they are to avoid being classed as restricted.

The FSA’s Rory Percival said advisers with a homogenous client bank could use just one suitable platform, although they would need to make sure they considered a variety of wrappers from across the market to remain independent.

“We’ve taken a pragmatic approach” he said. “You don’t need to consider a separate platform for every customer but if you have a diverse range of customers then a single proposition on a single platform won’t be appropriate”.

The clear message here is that independence does not depend upon the number of platforms employed, but on the ability to cater for the legitimate and comprehensive needs of a client bank.

The adviser whose clients have common traits and needs does not need to spread investments across a series of platforms or be seen to use more than one platform for the sake of it

Due diligence on the platform which provides best value for money and service is a prerequisite for selection of the company’s preferred supplier. However, as long as the adviser utilises off-platform solutions to complete the suite of investment administration services at their disposal, the selection of a single predominant platform is a justifiable strategy.

In my view it is entirely appropriate to state that “I use this platform for most of the investment needs of most, if not all of my clients and use niche platforms of off-platform solutions for needs which cannot be addressed by a platform”

Most true platforms will have access to ETF’s, Investment Trusts, Pension Wrapper, ISA, OEIC, Bonds, Shares etc. If however the preferred platform did not have for example Investment Trusts, Guaranteed Products or ETF’s then the firm must have alternative options along with routes to other esoteric products as and when relevant.

If a firm has a variety of client types wanting a whole range of services including transactional advice then a broader range of solutions may be required with probably more than one platform /

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supermarket solution as an option. Some may have 3 segments and a platform / supermarket per segment.

Challenges of portfolio management

The true benefit of delivering effective portfolio administration through an on-line platform giving access to a universe of funds means is that the drawbacks of the old world steam driven systems are avoided, such as:

- asset allocation slipping out of kilter with their attitude to risk;
- being unable to enter or exit the market as quickly as needed;
- tax allowances being over-looked or missed; delays in getting information and information going missing;
- by working with a variety of providers who operate different systems, procedures and forms there are increased risks of potential delays and errors.

Independence versus restricted - What's in a title?

Although over the last few years we have seen many advisers drop the word "independence" from their titles in favour of Wealth Managers, Financial Planners, Life Planners etc.

Much of the market would want to operate as they always have done, but do not want to be referred to as Restricted. The title and the uncertainty of what constitutes restricted is acting as a barrier. There is a danger with the current definitions that:

- firms operate inappropriately under the title of independence and get fined
- all clients get charged an additional premium for a status that is determined by an ability to advise on products they will never want or need
- a few clients have to pay a highly inflated price for that extra expertise, which may be fair but questionable value to them.

In essence whilst many consumers do not think "I need Life Planning or a full Financial Review" the most informative titles are the actual service offerings of a firm, whether they are limited in their product choice or not, should actually be the secondary consideration. So titles like:

- Wealth Planners
- Life Planners
- Certified / Chartered Financial Planners
- Retirement Specialists
- Pension Specialists
- Mortgage Advisors
- Long Term Care Advisors etc.

are probably more informative.

The secondary factor is whether the advice is based on electing to use a focussed range of solutions or the broadest possible range of solutions.

It would be a big change to lose the title of independence from the market. But, for a long time clients have had a mixed understanding of what this actually means.

To many it simply means a firm that is owned by people other than a provider.

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I also think it would be useful to change the word Independent so as to force the Professional Marketplace to think through what it is they think is truly best for their clients, without a simple default to an old established title.

We should at least look at different titles from “restricted” that sits comfortably with the market and that will then free more firms and advisers up to decide what is actually the best model for them and their clients. What titles would you suggest as a subset to the Service Offerings that are marketed?

- Is tied ok as it has been that way since the 1980s?
- What would you call restricted where the adviser maintains their old model of using panels and limited routes to market which they review periodically with an openness to the whole of market but not the more esoteric products?
- What would you call restricted where a firm does determine a very defined set of solutions that cannot be altered by the business for a period of time? i.e. Multi-tie?

My view

We could change the labels from say Independent to Universal, Restricted to Focussed and keep the terms Multi-tie & Tied as one option.

I think a simpler way may be to keep the Independent banner, but revert to the old definition but clearly state an allowance to use a single platform for service driven propositions and separate out the right and qualification to advise on any non-regulated / esoteric products.

I would define Independent Advice or a new title as:

- providing unbiased and impartial advice (not limited to asset backed investments)
- be equipped to give comprehensive and fair analysis of all regulated products and savings accounts
- inform each client individually about services, current and future charges before they incur any charges
- have pricing structures that are compatible with impartial advice, not purely linked to asset backed investments i.e. solely FUM based
- inform clients before you provide advice that you provide independent advice.

I would have it clarified that an Independent firm can operate a single platform strategy where it is used to deliver a more efficient service for a segment of clients whose primary need is a financial planning or wealth management service. Any product wrappers not available via that platform of choice should be available through other chosen sources rather than be excluded as options.

A firm can operate panels for their product solutions.

All platforms and panel choices should be subject to a due diligence review at least annually.

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Advice on non-regulated products should be barred from the Independent Market and only carried out by a separate specialist firm, unless a firm has the necessary PI cover and specific additional qualifications to be able to advise on them.

There is then an opportunity for a small group of out-sourced specialists to provide this service. In other words to advise on these types of contract is an additional license that has to be earned and maintained, but its absence does not disqualify an adviser / firm from being Independent.

Payments consistent with impartial advice

The final qualification for Independence would be that the fees charged are not based purely on the wealth invested in asset backed investments, i.e. FUM but on a basis that ensures true impartiality of advice.

Going back to chapter 9, this would require a slightly more sophisticated approach to fee charging that considers a range of factors such as:

- Frequency of meetings and location
- Funds invested and how they are managed
- Other assets / wealth advised upon (cash / property)
- Range of solutions / products maintained and being advised upon
- Tax saved
- Cash-flow planning

Whilst a reasonable weighting may be applied to Funds under Management, this really shouldn't be the sole measure as it does the colour the perspective and motivation of the adviser however much we would like to think otherwise. The fee may still be collected from the Funds Under Management but not purely defined by the Funds Under Management.

Summary

The term restricted needs to go, a new definition of Independence needs to be created with special qualifications and licenses for firms that want to advise on non-regulated products required.

With this position I believe most advisers would and could remain Independent unless they enter into some contractual arrangements that limits their flexibility to advise such as under a multi-tie or tied arrangement.

Clients will get a more efficient service, with less risk and cost if advisers can operate on a limited platform and product panel approach. It reduces the impact of the twin viruses of inconsistency and variability. If they chose not to undertake annual diligence and entertain the possibility of a switch of platform / product then they by definition are multi-tie or tied, otherwise they retain Independence.

Would love to hear your thoughts as a reader?