the lang cat

FOR ADVISERS

IT'S ALL ABOUT YOU

TACKLING YOUR PS13/1 DUE DILIGENCE REQUIREMENTS

INTRODUCTION

To say that PS13/1[1] significantly increases the due diligence requirements of advisers when placing, or advising on the placement of, retail investment business on a platform is a polite understatement. In fairness, platforms themselves have a list of rules they must follow but PS13/1 puts the onus squarely on the the adviser firm to ask the right questions, review and record the answers - in the FCA's words to 'take reasonable steps' to 'satisfy itself' that the platform(s) they plan to use are playing by the rules.

If you are an adviser this presents a range of challenges.

There's an inherent ambiguity in the PS13/1 requirements (specifically as detailed in COBS 6.1E.9 and COBS 6.1F.1) which inevitably complicates compliance, so in this paper we take a brief look at what those requirements might mean in real terms. We're nothing if not practical at the lang cat, so we don't just present problems you were aware of and send you on your way. We make a suggestion for building the new requirements into your due diligence process in the form of a set of questions to ask platform providers – and yourself - as an appropriate and consistent starting point.

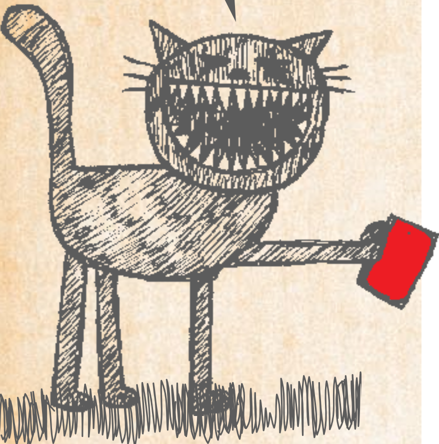
Let's get started by looking at the background and context.

PS13/1 – TREATING CUSTOMERS FAIRLY. BUT ADVISERS?

PS13/1 was as eagerly awaited in certain quarters as the arrival of Prince George (and took considerably longer having worked through numerous delays). Speculation had been swirling for months on how the principles of the RDR would translate to platforms with both platforms and advisers impatient for clarity from the FCA to enable some kind of progress.

1. Financial Conduct Authority Policy Statement PS13/1: Payments to platform service providers and cash rebates from providers to consumers (April 2013)

When publication finally came in April 2013 much of the content was as expected (the slow death of rebates and bundled pricing models) and some of it less so (that payments for advertising from providers to platforms could continue, albeit with caveats). Tucked away at the back however was a bit of a game changer - the statement that it is now the responsibility of the adviser to satisfy themselves (and ultimately the FCA) that any platform with whom they conduct business is following the rules. Because advisers don't have enough compliance worries.



Is YOUR platform of choice playing by the rules?

WHY THE ONUS ON ADVISERS?

One of the main objectives for PS13/1 is to drive competition, and therefore consumer choice, by limiting the influence of platform providers over distribution and adviser remuneration. In translating this to specific requirements on advisers (at least for the sections under discussion here) the FCA focuses largely on two key existing regulatory principles:

COBS Principle 6 Customer's interests

A firm must pay due regard to the interests of its customers and treat them fairly.

COBS Principle 7 Communication with clients

A firm must pay due regard to the information needs of its clients and communicate information to them in a way that is clear, fair and not misleading.

The new requirements themselves (which will come into force on 6 April 2014) place obligations on advisers around platform remuneration and the way a platform presents retail products.

1. PLATFORM REMUNERATION

Looking at the platform remuneration requirement first:

COBS 6.1E.9

A firm must not use a platform service as part of a personal recommendation to a retail client in relation to a retail investment product unless it has satisfied itself that the platform service provider, and its associates, only receive remuneration for business carried on in the UK which is permitted by the rules in this section.

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A selection of the 'rules in this section' are summarised here. A platform service provider...

COBS 6.1E.1

Must clearly disclose total platform charge to the customer in a durable format in good time ahead of the business being transacted. If this isn't possible, then as soon as is practical afterwards.

COBS 6.1E.2

Should present retail investment products to customers without bias, in line with Principles 6 and 7 (Customers' interests and Customer communications) and the client's best interests rule.

COBS 6.1E.3

Should not vary platform charges inappropriately according to provider or, where investment products are substitutable and competing, the type of product, in line with Principle 6 and client's best interests rule.

COBS 6.1E.4

Must only be remunerated for its platform service (and any other related services) by platform charges and must ensure that none of its associates accept any remuneration for those services.

COBS 6.1E.7

May seek and accept payments for specified, one off items, where these are reasonable and will not unduly influence the channelling of business.

COBS 6.1E.8

Must ensure that platform charges are clearly distinguished from product charges and from adviser charges with all of these being presented so that there is no actual or suggested offset of charges. Product charges should be such that no cash rebate is payable to the customer beyond what is permitted.

Source: COBS 6.1E Platform services: platform charges and using a platform service for advising

2. PRODUCT BIAS

And now the requirement on product bias:

COBS 6.1F.1

A firm which: (1) arranges for retail clients to buy retail investment products or makes personal recommendations to retail clients in relation to retail investment products; and (2) uses a platform service for that purpose; must take reasonable steps to ensure that it uses a platform service which presents its retail investment products without bias.

Essentially this all means that advisers have to satisfy themselves that the platforms they use play fair – transparent, agreed pricing for investors and no undue influence on how funds are presented or priced. Pretty much – as we've said - COBS Principles 6 and 7 but with specifics.

It's all in the customer's best interests and that can only be a good thing. But the devil is in the detail and it is the lack of detail that makes it difficult for advisers to ask the correct questions, fulfilling the FCA's expectations for due diligence.

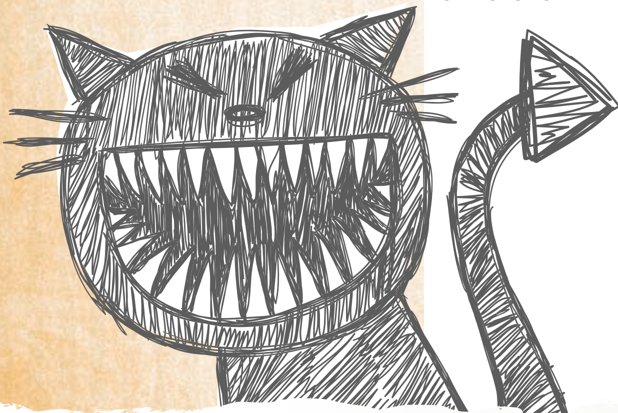
AN ASIDE: A LESSON FROM TR13/5?

While this next section is not part of the due diligence process, we think it's worth a look. Sometimes it helps to step back from an issue, just briefly, and see if things are any clearer. Admittedly in this case we're stepping from a Policy Statement to a Thematic Review but let's just see. TR13/5[2] is essentially a health check on how effectively adviser firms are implementing the RDR. Specifically it looks at communications with clients around the cost of advice, what this does and does not cover and the adviser's independence or otherwise.

One of the areas of ambiguity in PS13/1 is 6.1E.1 "A platform service provider must clearly disclose the total platform charge to the retail client in a durable medium in good time before the provision of designated investment business" Or as soon as possible afterwards. How do we know what constitutes 'good time' ?

TR13/5 makes a similar point around disclosing charges payable by the client, in clear cash terms "in good time before making a personal recommendation" (COBS 6.1A.24R, but noting COBS 6.1A.24AG) and provides a little more insight from consumer research carried out by NMG as part of the review.

THE DEVIL IS IN THE DETAIL



2. Financial Conduct Authority Thematic Review TR13/5 - Supervising retail investment advice: how firms are implementing the RDR (July 2013)

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The majority of firms provided a charging structure to their clients at the start of the initial meeting (not a fact finding meeting, more about introductions and 'discovery'). The research showed that consumers appreciated this: it made them feel more confident and informed. Where the adviser did not present the charging structure until the second meeting, along with recommendations, the FCA stated that this did not allow the consumer to be informed enough, early enough.

So, this gives us some context for 'timely' at least when providing clients with charging options. Clearly there is a difference between the advice relationship as a whole and platform investment recommendations but it does suggest that the FCA expects the client to have all of the relevant charging information (in cash terms) before, rather than alongside, a recommendation – and so an adviser will want to be confident that their platform service provider can support them in this.

SO, WHERE DO I START?

Right, let's get back to it. There is inherent ambiguity – similar to that we've just highlighted for COBS 6.1E.1 - across all the requirements for platforms on which advisers will have to satisfy themselves. Barring further amendments to PS13/1, it is likely that we will gain further detailed insight into the FCA's policy parameters and expectations only when adviser firms fall foul of them.

In the meantime advisers will have to use their own judgement and adopt a common sense approach that takes account of the spirit and intent behind the new rules. And in fact, a recent speech by FCA Chief Executive Mark Wheatley highlights the judgement led approach as a desired feature of the new regulatory system. He talks about a "regulatory system placing far more emphasis on good judgement and less on narrow compliance with a set of rules. Hopefully to a culture where the 'ethic of care' – doing what is right takes precedent over the 'ethic of obedient' – doing what is allowed."

In that spirit, here is one suggested approach to PS13/1 due diligence which was first presented in the lang cat's September 2013 Guide to Platform Pricing. It's not the only approach you could take, but we're getting feedback that it seems a sensible and realistic one which helps structure responses and facilitates some consistency.

It's a two stage approach.

STAGE 1: THREE BASIC QUESTIONS TO ASK YOUR PLATFORM PROVIDER

Q1 Do you or your associates receive any remuneration in respect of business issued post-RDR which could, in any sense, be construed to contravene the letter or spirit of COBS as amended by PS13/1?

Q2 Do you receive any form of remuneration from retail product providers?

Q3 If so, how do you ensure this remuneration does not create bias in the way you present retail investment products on your platform?

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These questions are belt and braces, asking your platform provider to confirm in explicit terms that they do meet the standards required of them under COBS 6.1E.9 and COBS 6.1F.1.

Question 1 is a closed question and you might reasonably expect every platform service provider to either answer it with a yes or to provide some standard information about their remuneration model.

To counterbalance this, Questions 2 and 3 pick into the detail a little more and give any platform that does receive remuneration from retail product providers the opportunity to define their interpretation of the PS13/1 requirements and be transparent about how they are meeting them.

The answers will go into your file of platform research, creating a consistent picture across the platforms with whom you place business. On the face of it, this may seem to satisfy your due diligence requirements around remuneration and product bias. But in practice we think it's unlikely to be enough. With phrases such as 'reasonable steps' and 'know or ought to know' cropping up at various points in the COBS amendments, should things get sticky it's hard to imagine the FCA accepting 'but they said so…' as an absolute defence.

Which brings us to…

STAGE 2: STRESS TEST THE ANSWERS WITH YOUR ACTUAL EXPERIENCE OF EACH PLATFORM

Q1 When you go online, are you directed towards certain investments, especially proprietary ones?

Q2 Are all funds presented alphabetically, except for certain 'focus' funds?

Q3 Are adverts disproportionally eye catching compared to the rest of the webpage?

Q4 Does your broker consultant/ contact point you towards certain wrappers/ funds? Is their remuneration affected by the retail investment products you choose on the platform?

Q5 Is the process of choosing one particular route noticeably easier than other routes?

This is where the 'ought to know' aspect comes into play based on knowledge and experience. These are the questions you ask yourself - the aspects that may either make you uncomfortable in the context of COBS 6.1E.9 and COBS 6.1F.1, or confirm that all is as it should be.

These are subjective, and personal judgement calls, but for any situation where you feel the answer to a question is 'Yes' it is incumbent upon you to express concern to the platform and perhaps your compliance service provider. Again this should all be documented and filed for reference whatever the outcome.

CONCLUSION

Let's be clear - our two stage approach is by no means intended as decision making research. It's one suggested starting point to capture comparable responses across a range of platform providers and achieve some consistency in due diligence.

It is also worth emphasising that the FCA has not endorsed or suggested a question set. Our view that the questions we've proposed may be an appropriate starting point is based on anecdotal feedback to the lang cat platform pricing report, where they were first raised. We're sure there will be others that work just as well but these are ours and we're sharing them with you because we think it's the right thing to do. Let's get the discussion started and see what other ideas crop up.

Looking to the not so distant future, PS13/1 and subsequent FCA publications highlight the likely read across of equivalent requirements around remuneration and product bias to SIPP, insured business and DFMs meaning that challenging providers on their policies and practices in these areas will potentially become business as usual on a much broader basis.

So it seems as good a time as any to start building in this extra layer of due diligence and rise to the challenge – now placed clearly by the FCA at adviser doors' - ensuring that clients' best interests continue to come first.

Leave a comment at langcatfinancial.com/2013/11/ps131-due-diligence

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