REGULATION

Getting clear about disclosure

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The FCA recently conducted a suitability review of 656 IFAs and intermediary firms. The good news is that overall it found firms were indeed largely providing suitable advice. There were some variations with restricted firms and network members generally doing better than independent directly authorised firms.

It did, however, express general disappointment at the levels of disclosure being provided – with 69 per cent of network members offering acceptable levels while, again, the directly authorised firms performed worse – with only 46 per cent meeting expected standards.

Size matters

Size apparently matters when it comes to disclosure. Firms with two or fewer advisers scored a poor 42.2 per cent on acceptable disclosure measures while 63.9 per cent of firms with 25 advisers scored a more respectable – if not wholly satisfactory – 63.9 per cent. Mid-size firms performed the worst, at 41.8 per cent.

What does this mean to the industry, the regulator and to the army of analysts, commentators and consultants whose existence depends on such things? How did we get here in the first place? And what lessons can the industry learn?

The FCA was broadly "encouraged" by the results concerning the suitability of advice, finding many firms "going beyond" compliance. Should this be a surprise? In the heavily regulated market in which firms operate, rogue firms giving poor or unsuitable advice have long ago perished. Only the strong have survived – and that is a good thing you could say.

Being nit-picky, the FCA did highlight some issues with replacement business – with firms encouraging new investment that cost more than it delivered (in the short term at least one presumes) and that required clients – perhaps unwisely – to give up valuable guarantees without obvious gains. There were also some issues regarding too heavy reliance on risk profiling tools. Both of these, though, are somewhat subjective and I would question whether – given the scope of the review – the FCA was always in a position to question the details of advice or to really understand the risk appetites of clients or their investment needs through such broad analysis of random pieces of advice.

For the record, the FCA pulled 1,142 individual pieces of advice focused on pensions and investment personal recommendations delivered by firms to retail customers in 2015. Each file review focused on a specific personal recommendation. The year 2015 was chosen deliberately, to coincide with the changing landscape of the pensions reforms at the time. The focus was on the process of advice and its suitability rather than the outcomes of the investment and whether it proved to meet the client's objective. So, despite this and definitely not because of it, the overall results on suitability were pleasing.

Rules on conduct

Disclosure appeared to be quite another matter. The FCA found firms were broadly meeting rules on conduct disclosure and the information required for suitability reports, although some reports were too long or too complex. The key problems were with the disclosure of charging structures – in that these were often unclear, lacking fixed estimates of costs and IFA time. The FCA stated: "These are persistent issues, previously highlighted during the three stage RDR thematic review in 2014. We are disappointed that this continues to be an issue."

When the FCA is "disappointed", we should all start to worry. The resulting approach for now though is a relatively conciliatory one, where the focus will be on stepping up the FCA's communication with smaller independent firms.

Linda Woodall, director of financial advice at the FCA, said: "We recognise that it is hard for the small firm without a compliance department to get fully up to speed with the regulatory requirements and what they might look like in practice but that is where we have – and will continue with – our comprehensive communication arrangements."

As quoted in Financial Adviser, chartered financial planner Richard Ross, director of Chadwicks, said the low levels of acceptable disclosure within independent firms suggested a failure of communication from the FCA. He also said that the issue of complexity and length of suitability reports pointed to a general confusion over what is required by the FCA. He said: "In short, we need more specific guidance with good practice examples from the FCA."

Ms Woodall, however, added that the regulator does not have a preference for one business model over another. In other words, the regulator does not want to give prescriptive guidelines; it just wants firms to do better.

This is pretty typical of so many areas of regulation where the FCA seems to want to move away from prescriptive check-box regulation to a general encouragement to raise standards. This is compounded by the fact that in 2016, the year after this review took place, the FCA announced that it was doing away with the templates for the initial disclosure document – the combined IDD and services and costs disclosure document – key tools in making disclosure more effective in raising consumer awareness of cost and service.

The impact of this will not have been captured in this review, conducted a year earlier. We can perhaps assume that things have got even harder for the small firm without a compliance department to know exactly what is required.

Christopher Woolard, FCA director of strategy and competition, said at the time: "[This announcement] reflects our commitment to sustainable regulation and addresses disclosures that are not working for consumers – giving firms the freedom to communicate with their customers in a more flexible and open way."

For freedom to communicate one could read "freedom to get it wrong". This sounds fine in principle, but for small firms already struggling to understand and deliver what the FCA requires of them, the abolition of template documents and the lack of ready-made checklists of required information means the FCA appears to be compounding the problem. The FCA wants to push responsibility onto the firm while offering only very subjective advice on what will be acceptable.

So, with the clear stated intention of the FCA being to focus on disclosure of smaller IFAs and to get them to "lift their game", we must presume that the communicative supportive stance might be short lived.

Smaller IFAs

It is therefore vital that firms – with or without a compliance department – will need fully to understand the conduct of business (Cobs) – and insurance conduct of business (Icobs) and mortgage and home finance conduct of business (Mcobs) – requirements and to ensure that all the information the FCA expects is disclosed and understandable by the customer.

But who is to say which particular format is or is not acceptable? Firms need to make clear decisions on what "good" looks like, to create templates, formats, benchmarks and checking procedures to ensure this is delivered every time. If they do not, then rest assured the FCA will.

Firms cannot and should not wait for the FCA to visit and start pulling files – they should be monitoring files on an ongoing basis.

There are always two sides to the seeming relaxing of regulation. Move away from tick box, but get tough on those who do not deliver against those tick box checklists. Smaller firms would do well to spend limited and already stretched compliance budgets on defining templates for themselves then delivering monitoring and checking of files to ensure adherence.

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KEY POINTS

- The FCA recently conducted a suitability review of 656 IFAs and intermediary firms.
- It found low levels of acceptable disclosure within independent firms.
- Firms cannot and should not wait for the FCA to visit and start pulling files.