Financial Conduct Authority

Supervision review report: Acquiring clients from other firms

February 2017

We have carried out this work in the context of the existing UK and EU framework. We will keep it under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

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Introduction

This report presents the findings of our recent review of investment advisory firms' practices when acquiring clients from other firms.

We did this review to assess how firms treat the clients they acquire from advisory firms or client banks. Acquisition activity in the investment advice market has increased since the introduction of the Retail Distribution Review (RDR) in December 2012.

The review focused on :

- communications provided to clients at the point of acquisition
- integration of clients into the new service proposition
- suitability of replacement business recommendations

From an initial nine firms identified as acquiring clients from other firms we carried out a targeted review of six of them. We know this sample may not be representative of the wider market, but want to share our findings so that firms can consider the key points raised when acquiring new clients.

Background

Over recent years, how firms provide services to clients has been changing. More firms are using a Centralised Investment Proposition (CIP)[1] and offering 'in-house' investment solutions. If these solutions are not suitable for everyone, firms are at risk of providing unsuitable advice. The introduction of adviser charging rules in the RDR has greatly affected how firms provide and charge for ongoing services.

Who does this affect?

This report is relevant to:

- All advisory firms acquiring new clients from other advisory firms. This includes clients acquired from the client banks of individual advisers or other firms and those firms purchasing a whole legal entity.
- All firms that facilitate payment of adviser charges, including retail investment product providers and platform service providers.

This report will also be of interest to consumer groups and trade bodies.

1 Centralised Investment Proposition is a standardised approach to providing investment advice. See FG12/16 'Assessing suitability: Replacement business and centralised investment propositions' (July 2012) for more information.

What we did

We reviewed the activities of six advisory firms which had recently acquired clients through the purchase of another legal entity or through acquiring another firm's client bank. With a focus on the points set out in the introduction to this report, we analysed firms' pre-acquisition approach and post-acquisition processes and procedures.

We also assessed (for replacement business) if the needs of individual clients were being appropriately considered when recommendations to transfer or switch investments were made.

We assessed firms by:

- reviewing documents and client files
- interviewing relevant staff

Key findings

While we did see some good practices, we were disappointed overall that none of the firms assessed were able to consistently show that clients' needs were suitably considered. We found that, while firms focused on the commercial benefits, they did not focus enough on how clients were impacted by the acquisition.

Where firms had clearly considered potential disadvantages to clients and designed their practices to mitigate these, this approach was not consistent across all of the aspects we assessed. This resulted in a potential detriment for clients whose needs had not been appropriately considered.

Our outcomes testing of replacement business did not indicate widespread common themes of unsuitability. However, we did identify individual areas requiring improvement for many of the firms assessed.

Detailed findings

Communications to clients

Firms must treat their clients fairly, pay due regard to their information needs and communicate information to them in a way which is clear, fair and not misleading.[2] For all of the firms assessed, we considered the communications to clients did not provide enough information to meet these requirements.

2 Principle 6 – A firm must pay due regard to the interests of its customers and treat them fairly.
Principle 7 – A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

We found that:

- details of the services offered by the new firm and the associated level of charges were not provided to clients at the start of the relationship
- differences between the service offered by the new firm/adviser and that provided by the previous firm/adviser were not explained (eg differences in frequency of reviews or rebalancing exercises)
- clients were not told about any difference to the tax (VAT) status of the ongoing service charge
- clients were not told they could opt-out of any ongoing service the acquiring firm intended to provide
- where historic advice responsibility was not taken over by the new firm, clients were not told about this, and
- clients were not told how they could complain about advice given by the original firm

Whenever there is a change to a firm providing services, or a change to the services themselves, firms are reminded they must act in the client's best interests and provide information to the client which is fair, clear and not misleading.

Client agreements

We also found that firms did not always recognise where the contract between the original firm and the client did not allow ongoing services provided and charged for to be transferred to the acquiring firm.

Acquiring firms must obtain the client's agreement before providing and charging for their services. Firms should comply with the requirements of COBS 8.1.3R and the adviser charging disclosure rules in COBS 6.1A. These Handbook rules include the requirement on firms to disclose the total adviser charges payable and the services to be provided for those charges. Additionally, firms must ensure they comply with their legal obligations under the contract and relevant unfair terms legislation.[3]

During our review we discovered firms had acquired client banks in circumstances where the original client agreement to provide and charge for ongoing services was no longer valid for any services offered by the new firm. This was because the original agreement was between only the outgoing firm and the client and so the new firm was not party to it. Where a new agreement was required, firms did not always ensure they had the client's agreement before arranging for facilitated adviser charges to be redirected to their own bank accounts.

Some firms planned to have a meeting with their new clients soon after the acquisition to offer a new client agreement. However we found examples where the new client agreement had not been entered into before services were provided to the client or before adviser charges were transferred to the new firm. This approach made us consider whether a firm had complied with the requirement to have a client's consent before actually providing those services.

Many of the acquiring firms assessed wrote to clients to inform them that the services provided and charges would stay the same as their previous advisers', without giving any further details.

3 The Unfair Terms in Consumer Contracts Regulations 1999 and the Consumer Rights Act 2015

In these instances, firms appeared to believe that they could rely on the disclosure provided by the original firm without attempting to meet the requirements placed on them by the adviser charge disclosure rules.

We did see instances of new clients receiving some information in the days after the acquisition which also asked them to contact the firm if they did not wish to proceed with the service. However the information was often not detailed enough to meet the adviser charge requirements. For example, the information provided did not include details of the services the firm intended to provide, the specific monetary amount of the ongoing charge to the client and, where applicable, how this charge may change if it was calculated as a percentage of invested assets.

One firm told us they would refund any adviser charges collected since acquisition if a client later informed them that they had not wished to receive advisory services. But the firm implemented this policy of refund without demonstrating that all of the required information had been provided to the client upon acquisition, or that reasonable attempts had been made to get a response from the client. Other firms had not provided sufficient information, made reasonable attempts to get a response or maintained a policy of refunding facilitated adviser charges transferred before confirmation of the client's agreement had been established.

Provider facilitation of adviser charges

Our existing rules require retail investment providers and platform service providers to obtain and validate instructions from a retail client in relation to an adviser charge they offer to facilitate. Where the acquiring advisory firm had not established the client's agreement to the adviser charge, it wasn't clear to us how the provider firm could have obtained and validated the client instructions.

Firms providing this service are reminded of the requirement in COBS 6.1B.9R(1) for a client's instructions to be obtained and validated before facilitating the payment of adviser charges. Where a facilitated payment will be redirected to a different advisory firm we expect firms to ensure instructions have been obtained and validated from the client.

Service integration

Where firms have a strategy for acquisitions, we expect this to be clear and well defined. To deliver a robust quality of service to their clients, this strategy should fit the firm's capabilities in the short term when first integrating clients, and also for the longer term service(s) they offer.

Some firms told us of difficulties they had faced to meet the intended service standards for acquired clients because of inadequate planning or resources.

Clients may also be charged for ongoing services they did not receive because:

- the firm had no contact details for them
- those contact details were incorrect
- the clients were unresponsive to offered services

Ongoing adviser charges can only be received by a firm that is providing a proactive ongoing service to a client. This means that, where a firm is aware that the ongoing service is not, or cannot, be provided to an individual client, it should ensure that the ongoing charges are stopped and, where appropriate, refunds made. Where possible, the firm should let the client know when it plans to take any of these actions.

In other cases, the service provided to clients by the original firm was different to the service offered by the new firm. Some firms had considered the impact on the client of the transition to a new service and had aimed to address potential issues, for example by:

- scheduling clients' annual reviews in line with the original firm's schedule to ensure clients did not have a gap of more than 12 months between annual reviews

- carrying out rebalancing exercises for a group of acquired clients more frequently than the acquiring firm would normally provide to match the service levels provided by the original firm

Conflicts of interest

Our existing rules[4] require firms to consider whether the structure of the payments offered to vendors in the period leading up to the acquisition could be an inducement to the vendor. The rules also require firms to consider if this payment structure creates bias towards particular investments, putting them in breach of the adviser charging rules.

We saw instances where the acquiring firm offered to pay more money when clients held specific investments.

Adviser remuneration structured to incentivise personal recommendations to a firm's clients to take a particular course of action can also create a conflict of interest.

In some of the firms we assessed, adviser remuneration was calculated partly in line with the level of initial adviser charges generated for replacement business. Where firms did this, there was a risk of unsuitable advice.

Firms should have appropriate systems and controls in place to ensure advisers act in the best interests of the client.[5]

Appropriate charging structures

A firm must determine and use an appropriate charging structure for calculating its adviser charge for each retail client.[6] It must disclose its charging structure to a retail client in writing in good time before making a personal recommendation (or providing related services).[7]

Additionally, a firm's charging schedule should reflect, as closely as practicable, the total adviser charge to be paid. For example, a wide range of charges should not be used.

We found that some firms allowed advisers discretion when applying discounts. This means that, the firm's schedule of fees may no longer be representative of the actual charges incurred by clients. In other cases, firms did not monitor the frequency of discounts and so did not know if their schedule of fees was wholly representative.

Many firms did not have a clear policy of charging for replacement business, with decisions being left to individual advisers. Additionally, some firms were not always clear, to both internal staff and external clients, on whether a charge will apply if a recommendation is made to the client to withdraw from a current investment and invest in a different investment product. It is important that charges are disclosed to clients before services are provided and the charges are incurred.

4 See, for example, COBS 2.3 (Inducements) and COBS 6.1A (Adviser charging and remuneration).

5 FG13/1 'Risks to customers from financial incentives' (January 2013), provides more information.

6 COBS 6.1A.11R – requirement to use an appropriate charging structure.

7 COBS 6.1A.17R – requirement to disclose charging structure.

Suitability of replacement business

To ensure it is acting in the client's best interests, where a firm's advice is to switch or transfer an existing investment to a new investment, we expect it to carry out a cost comparison between the two solutions.[8] One cost a client may incur is a contingent initial adviser charge, levied if the client goes ahead with the new recommendation.

Some of the firm client files we reviewed raised concern that firms may not always be considering the impact of contingent initial adviser charges on the future value of client investments.

We expect all relevant costs incurred by the client to be considered in determining the suitability of the recommendation to switch or transfer investment business (see COBS 6.1A.16G).

Other relevant information

We published FG12/16 'Assessing suitability: Replacement business and centralised investment propositions' in July 2012.

We have not repeated all that guidance in this report. However the guidance remains valid and relevant for firms which are recommending clients switch or transfer their investments post-acquisition.

Next steps

Following our review we provided feedback to the firms assessed, setting out areas for improvement. All firms involved in the project have since taken action to improve their practices.

We expect all other relevant firms to now consider the content of this report and assess whether they need to improve their own practices and procedures.

8 FG12/16 'Assessing suitability: Replacement business and centralised investment propositions' (July 2012) confirms the expectation to compare costs.

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