

VIEWPOINT

2012: the year of regulation?

2012 will see a perfect storm of regulatory change coming down on the wealth management community. Following on the coattails of a frenetic end to 2011 when we have had 5 Policy Statements and Consultation Papers from the FSA on RDR alone, there is a welter of new and revised regulations in the offing, not all of it from the UK. FATCA hurls towards us from the US, the purpose of which is to ensure that no matter where US citizens are, they report all their income. The US is therefore, tasking all financial institutions to report back income on US persons to the US Internal Revenue Service.

We have to accept the possibility that other countries will follow the US lead, on the well-known tit-for-tat principle. The cost to the industry cannot be underestimated.

In Europe, MIFID 2 has appeared in draft to be debated by the EU late in 2012, but won't come into effect until the end of 2014 or later. It seeks to ban commissions for independent advisers but not restricted – which could bring it into conflict with our own RDR (which seeks to ban commission for all advisers), set to take effect in 2013. Technically speaking, MIFID is a 'maximum harmonisation' Directive, so in theory the Financial Services Authority shouldn't go 'further' than MIFID, but expect some vigorous lobbying and exploration of opt-outs from the FSA.

There are also massive changes coming in the pensions world and there are the new platform regulations trailing close behind RDR. Indeed a theme for 2012 could well be that of a 'need for a regulatory breather'. With so much disruption coming up you might question just how much can the industry cope with? No matter how good these changes are, they add cost and ultimately it's the client who will end up paying for it. The individual changes on their own may well be worthy, but when everything is added together the scale of the change is immense and a potentially destructive burden for some firms. We really need some joined up thinking that looks at the totality of the issues facing the financial services industry to ensure that the overall result will be a stronger industry producing better consumer outcomes.

The fact that we are now just over one year away from RDR and we're still awaiting some detailed guidance and decisions on key issues is a little disappointing. In the first quarter of 2012 we would hope to see the FSA clarify any remaining issues so the industry can have clarity and take appropriate actions.

An area which we expect to see more focus on in 2012 is whether or not a financial adviser is independent or restricted. At a recent road show Raymond James presented to several hundred advisers. One of the questions we asked was, 'How many of you will remain independent when RDR comes in?' Nearly all of the IFAs attending said they intended to remain independent. Whilst we understand the desire to remain independent we're not sure how many have thought through the implications or the costs of doing so. In the past, independence meant not being tied to any one company and offering products from across the market. Under the new rules, independence will simply be a function of the range of products an adviser can comment on - which is a significant gear change for the industry and it's unlikely that the FSA will change this definition. The bar for independence is being set really high, and it will be difficult for all advisers to meet it. When IFAs start to engage, then we think you'll start to see people questioning if they need to be independent or not.

A branch off from this is quite how "restricted" will be defined. We expect a few inventive people in the industry will attempt to define 'restrictive' in a very attractive and elegant way. In the future an independent will be a generalist – your financial GP, if you like. When you need specialist advice – the financial equivalent of a heart surgeon, perhaps – you'll go to a restricted adviser. Ultimately, the practitioners will be in the right boxes, but with very unfortunate, possibly misleading, labels. As an industry we need to make sure that whatever language is used clients are clear about what is meant. No-one, least of all our new regulator, wants a situation where consumers are confused as to the meanings of restricted and independent advice.

VIEWPOINT

And at the end of the day, does this label really matter? Is it what we should focus on? And will clients understand or care about the difference? What matters is that investment professionals can articulate and deliver their investment service and proposition to their clients. We think it's more important that advisers are well qualified for the service they offer and demonstrate this by holding a statement of professional standing from a recognized professional body.

An aspect of the new platform regulations where we are keen to see clarity from the regulator is on the practicalities of rebating in units versus cash. We believe that clients will be negatively impacted if rebates are made in units. First, for the client to achieve value, the holding must be sold, which triggers a trade charge (often in excess of the value of the units) as well as a potential CGT event. Second, it presents reregistration problems. Often firms cannot accept holdings below a certain amount as it presents practical issues, which means these unit rebates often can't be transferred. Unit rebating is inelegant and cumbersome for the end investor and will precipitate additional cost with no additional value. The system works the way it is, and as they say 'if it's not broken, don't fix it' (or 'if it works, don't bugger about with it!'). The FSA is now looking around the world to see the way in which it's done elsewhere, so we look forward to hearing more from them on this issue in 2012.

On the Raymond James wish list for 2012 is industry wide clarity and transparency of pricing. We would like to see a consistent, 'clean' share class for every fund that is offered on every platform in the UK. A clean share class would mimic the properties of an institutional share class, except that it would be for retail investors. We believe institutional share classes should be the new norm – but they've got to be consistent across the market, the confusion would be terminal if not. If certain platforms or providers did get their own deal for a separate share class, what would happen when clients transfer? We believe we need to see one share class only and hope this will happen in 2012.

As everyone is aware, the first phase of RDR becomes operational in the first quarter of 2013. But clarifications on some aspects have been kicked in to the long grass, and will be resolved within the year. There's a huge bucket containing the number of FSA papers that continue to be generated – as mentioned, five in November alone. We are looking forward to clarification. We would suggest that it would be nice if all questions were answered by the end of the first quarter. That way firms in the wealth management community can get on with adapting their businesses to the new rules and get on with running a business, and not be forced to adapt it again because of rule changes.

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VIEWPOINT

A way to differentiate 'model advisers'

The Retail Distribution Review is the most far reaching regulatory change to hit the advisory world for a generation. After 2012 all advisers will follow the 'New Model Adviser' approach and won't therefore be 'New'. Does this mean they will have to call themselves 'Model Advisers' thereafter? And how will 'Model Advisers' differentiate themselves in 2013? Well one way for the more investment orientated adviser will be to offer their own in-house discretionary management solution.

Everyone is aware of the trend to outsourcing to discretionary management, but we and our friends at threesixty services have been seeing an increasing trend towards firms offering their own in-house solution to their higher net worth clients. There are very clear drivers for this; by doing it in-house the advisers can retain greater control, offer superior client service, secure more of the value chain for their benefit and increase business value.

So what needs to be in place to be able to offer the service in-house? First of all there needs to be an individual with the relevant knowledge and experience. In the post RDR world this means at least a level 4 investment management exam. The CISI and the CFA are two of the leading examination bodies and they can provide direction on what exams are best, and any exemptions that might apply for advisers with financial planning qualifications.

Then there needs to be appropriate FSA authorisation and permissions for 'investment management' in place. A variation in permissions is necessary if these aren't already in place and whilst for many larger firms this won't be difficult, it will probably mean an increase in capital and more onerous capital adequacy reporting. The firm will also need to have in place compliance, supervision, monitoring and client agreements specific to the discretionary investment management function.

Of course, the firm will also have to have appropriate systems and controls in place, but much of the work can be outsourced to a back and middle office provider, or a wrap platform. One of the difficult areas to watch out for though is reporting. The FSA's reporting requirements for discretionary management are quite different to the advisory world. Best practice dictates that performance should be shown on a time weighted basis and measured against a relevant benchmark. It's really important to choose a provider that can produce this level of reporting to avoid falling foul of the regulator.

HNW clients typically have awareness of the need for security of their assets - there have been a number of fines from the FSA for errors in client money handling recently, so it's important to offer a strong custodian, ideally with additional insurance protection. It's also important to ensure that cash accounts are well managed and ideally diversified across a number of banks. Clearly there's a lot to think about so thorough due diligence of any provider is essential.

However, there are alternatives to increasing your firm's permissions to include discretionary management but still have an in-house solution. Options such as the Professional Partner business model offered by Raymond James are designed for financial planning and professional practices looking to develop their own in house discretionary investment management service. Professional Partner includes compliance, supervision, FSA registration, professional indemnity cover and a middle and back-office service designed to meet the needs of discretionary investment managers. This offers a great way to get your discretionary management solution off the ground quickly and without all the initial costs inherent in direct authorisation. Talk to us now and you could soon be on your way to becoming a 'New Model Adviser' for the post RDR world.

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