TOPIC 20

# Conduct of business requirements I

## LEARNING OBJECTIVES

In Topics 14 and 15, we explored the process of advising clients: the main areas in which clients are likely to require advice, the need to gather detailed information and the factors to consider in formulating a recommendation. In this topic and Topic 21 we are going to consider the advice process from the regulatory perspective.

By the end of this topic, you should have an understanding of:

- the types of client identified in the FCA's Conduct of Business Sourcebook (COBS);
- the difference between independent and restricted advisers;
- execution-only business;
- rules relating to financial promotions, adviser charges, suitability of recommendation, and product disclosure;
- information that must be provided to clients regarding the firm, its services and charges;
- cooling-off periods, cancellation rights and reflective periods.

This topic covers Unit 2 syllabus learning outcomes U2.2 and U3.1–U3.10.

**THINK . . .**

The FCA's Conduct of Business rules are designed to ensure that customers get clear and accurate information that is appropriate to them, and that they are treated fairly. To focus your thoughts before you start work on this topic, think about the following:

- Customers for financial advice and products range from major businesses to an individual seeking advice on their pension. How might the different circumstances of clients affect the type of service and support that they need?

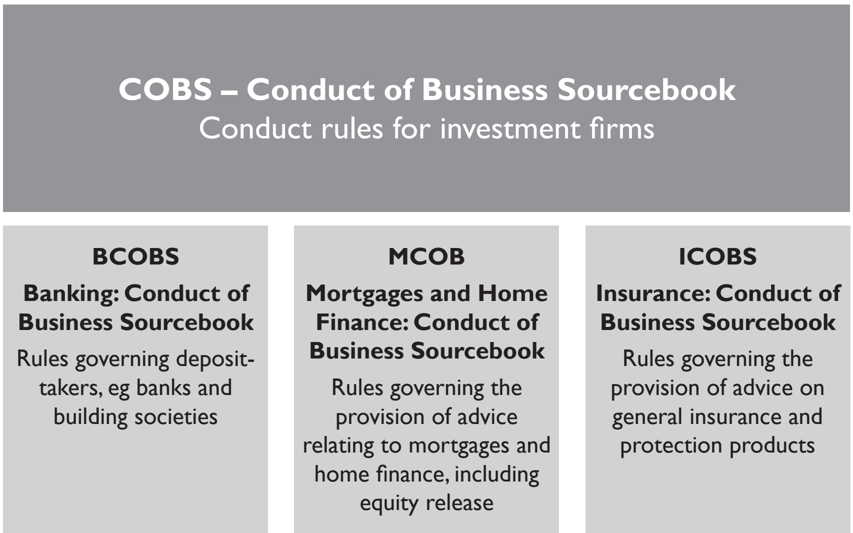
- Whenever you make a purchase, there is particular information that you need about that transaction before you commit to it. For example, what would you want to know if you were arranging for some building work to be done? When would you need to have that information in order to make an informed decision?

The same broad categories of information are required to help with most purchasing decisions, but a financial product that does not meet a client's need can prove even more costly in the long term than a building project that goes wrong. Hence the need for regulation at all stages of the advice and purchase process.

## 20.1 What are the Conduct of Business sourcebooks?

Regulations relating to the way in which advisers interact with clients are set out in the Business Standards section of the FCA Handbook. Within this section, there are a number of sourcebooks detailing the rules governing advice in specific areas. Figure 20.1 summarises the sourcebooks we will be considering. The remainder of this topic addresses the provisions of COBS, with Topic 21 considering BCOBS, MCOB and ICOBS.

**FIGURE 20.1 CONDUCT OF BUSINESS SOURCEBOOKS**




The FCA Handbook also contains a conduct of business sourcebook for claims management companies called CMCOB.

## 20.2 What are the types of client?

COBS sets out three types of client:

- eligible counterparties;
- professional clients;
- retail clients.

Different rules apply to dealings with each of these client groups.

### 20.2.1 Eligible counterparties

This category includes governments, central banks and financial institutions – the latter including firms such as banks, insurance companies, investment firms and collective investment funds. The eligible counterparty definition only applies to eligible counterparty business, which would include situations such as straightforward execution of transactions received or the purchase of shares, by a firm, for onward sale to the firm's clients. Due to the assumed level of knowledge and experience, clients in this category receive the lowest level of investor protection.

### 20.2.2 Professional clients

This category includes all the bodies that would otherwise be eligible counterparties, except for the fact that they require a higher level of service than would apply to 'eligible counterparty business' – for example, they require advice, in addition to execution of transactions.

It also includes other types of large client, particularly institutional investors whose main activity is investing in financial instruments. When dealing with professional clients, advisers can assume an adequate level of experience and knowledge and an ability to accept financial risks.

Clients can either be considered as professional clients on a *de facto* basis (ie they qualify by meeting various tests) or they opt to be treated as professional clients, in which case they are referred to as 'elective professional clients'.

### 20.2.3 Retail clients

This category provides the highest level of investor protection and comprises customers who do not fall into either of the previous two categories – especially customers who might be described as 'the person in the street' and who cannot be expected to have anything more than a basic general understanding of financial services.

It is expected that most financial services customers will fall into this category.

**FIGURE 20.2 CLIENT CATEGORIES**


## 20.3 What are the different categories of adviser?

Advisers are grouped into one of two categories: independent advisers and restricted advisers.

To be able to describe itself to clients as an independent financial adviser, a firm (or individual adviser) must assess a sufficient range of relevant products available on the market that must:

- be sufficiently diverse with regard to their type and issuers, or product providers, to ensure that the client's investment objectives can be suitably met; and
- not be limited to relevant products issued or provided by the firm itself or by entities having close links with the firm, or other entities with which the firm has such close legal or economic relationships, including contractual relationships, as to present a risk of impairing the independent basis of the advice given.

*Source*: FCA (no date)

Any firm or adviser that does not meet the requirements to be 'independent' will, by default, be providing advice that is 'restricted'. This is designed to reflect the idea of genuinely independent advice being free from any restrictions that could impact on the ability to recommend whatever is best for the customer. The restrictions may relate either to the range of product providers that an adviser can recommend, or the range of individual products.

### 20.3.1 Independent advice

Independent advisers offer advice on a wide range of financial products and providers. An advice firm can call itself independent even if it only offers advice on a certain area.

For example, a firm could call itself independent while only offering advice on pensions. The firm would have to be able to advise on all pension product types and "would need to consider a sufficient range of pension products which were sufficiently diverse, in terms of their type and provider, to suitably meet the client's objectives".

The FCA Glossary defines a 'personal recommendation' as advice on investments, advice on conversion or transfer of pension benefits, or on a home finance transaction that is presented as suitable for the person for whom it is made, or is based on consideration of the circumstances of that person.

**DETERMINING WHICH REGULATORY RULES APPLY**

Firms that advise retail clients on any retail investment products are subject to the FCA rules that apply to those operating in a particular area of financial services. For instance, a firm that only advised on mortgages would fall under the FCA's COBS and MCOB rules. If the firm decided to start advising on protection products that could be used in conjunction with mortgages, they would also be subject to ICOBS rules, and their sales processes would need to be amended.

## The use of panels

The rules do not prohibit, or even restrict, the use of panels by firms wishing to operate as 'independent', but any panel should be sufficiently broad in its composition to enable the firm to make personal recommendations based on an assessment of a sufficient range of diverse and relevant products on the market. Any panel should be reviewed regularly and updated as necessary. The use of a panel must not materially disadvantage any client.

**PANEL**

A selection of providers who are known and trusted, based on their product range, charges and service level.

The firm must recognise that there may be clients for whom the panel does not work. It should therefore be possible for 'off-panel' advice to be available where a different product or product provider would provide a more suitable outcome for that client.

## The role of specialists

The rules relating to independent advice apply both at the level of the firm and of the personal recommendation. Every adviser working in a firm that describes its advice as independent needs to ensure that each personal recommendation meets the definition of independence.

This does not, however, prohibit firms from having advisers that specialise in certain areas, for example, investments, pension transfers or long-term care.

The key point to note is that specialists working for a firm that claims to offer independent advice must meet the independence rule in every personal recommendation they provide. If any specialists within a firm do not meet this requirement, the firm should not call itself independent.

**EXAMPLE: SPECIALISTS PROVIDING INDEPENDENT ADVICE**

A firm providing independent advice has three advisers, each with their own specialist area. The IHT specialist has a client for whom a personal pension might be appropriate. They consult the pension expert to seek their advice and guidance.

The personal recommendation provided to the client by the IHT expert would meet the independence rule provided that the recommendation of the pension expert would also meet the independence rule, as defined in section 20.3.

### 20.3.2 Restricted advice

Restricted advice could be summarised as anything that is not independent advice or basic advice. Restricted advisers generally focus on a limited selection of products or providers.

**PENSION AND INVESTMENT SCAMS**

The subject of pension and investment scams is detailed in section 10. One of the ways an individual can seek to protect themselves against a possible scam is to seek qualified financial advice from a financial adviser, whether independent or restricted. An accomplished financial adviser would be able to identify the warning signs of a scam and advise accordingly.

## 20.4 What is execution-only business?

The FCA expects that the majority of retail customers will receive qualified investment advice, involving a recommendation based on analysis of their needs and circumstances. There are situations where a customer may feel equipped to make their own investment decisions and proceed without advice – to proceed on an execution-only basis. Execution-only involves the customer telling the firm what they wish to do and the firm executing their wishes; no advice is given.

The FCA defines execution-only business as "a transaction executed by a firm upon the specific instruction of a client where the firm does not give advice on investments relating to the merits of the transaction and in relation to which the rules on the assessment of appropriateness do not apply".

This can be contrasted with:

- **qualified investment advice** – where an adviser makes a recommendation based on a full analysis of a customer's needs and circumstances; and
- **simplified advice** – where a streamlined or automated process is used to gather the personal and financial information on which advice is given.

Where investment business is undertaken on an execution-only basis, the customer instructs the adviser to effect a specific transaction on their behalf, detailing in full the nature of the product required.

For an execution-only transaction, the adviser's duty of care to fully explain the nature of the transaction and risks involved does not apply. The customer is entirely responsible for their own choice.

It is expected that only a small proportion of any adviser's cases would be on an execution-only basis.

**EXECUTION ONLY**

A transaction executed upon a client's specific instruction, where the firm gives no advice and the rules on assessing appropriateness do not apply.

**THE NEED FOR CLEAR AND CREDIBLE EVIDENCE**

The Financial Ombudsman Service (FOS) has highlighted that complaints relating to execution-only business often result from the customer believing they had received advice and not realising they have taken out an investment on an execution-only basis. The FOS has indicated that it expects firms to be able to provide 'clear and credible' evidence that a transaction was conducted on an execution-only basis. This would involve obtaining a signed statement from the customer confirming that:

- they are aware that business is being transacted on an execution-only basis;
- they have not asked for or received advice;
- the decision to take out the investment is theirs alone;
- the adviser (and/or the firm they represent) takes no responsibility for the suitability of the investment.

A different situation arises where an adviser provides advice to a client, but the client wishes to carry out a transaction that contravenes the advice given (sometimes referred to as an 'insistent' customer). In this situation, the adviser should require the client to sign to confirm that they are acting against the advice provided.

### Appropriateness test

In some cases, when a business engaged in execution-only investment sales deals with 'complex' products such as alternative investment funds, spread-betting contracts, and structured products that embed a derivative, the business has to perform an 'appropriateness' test for 'non-advised sales'.

This test determines whether the consumer has the necessary 'knowledge and experience' to understand the risks involved in the transaction. These provisions can be found in FCA COBS 10 (non-MiFID and non-insurance-based investment products provisions) and COBS 10A Appropriateness (MiFID and insurance-based investment products provisions).

## 20.5 What are the rules relating to financial promotions?

A financial promotion is defined in COBS as an "invitation or inducement to engage in investment activity". This includes:

- advertisements in all forms of media;
- telephone calls;
- marketing during personal visits to clients;
- presentations to groups.

Financial promotions can be 'communicated' only if they have been prepared, or approved, by an authorised person.

There is a distinction between:

- **real-time financial promotions** (non-written financial promotions), such as personal visits and telephone conversations; and
- **non-real-time financial promotions** (written financial promotions), such as newspaper advertisements and those on internet sites.

The overall principle is that financial promotions to retail clients and professional clients must give a clear and adequate description of the product or service and be clear, fair and not misleading. In the case of retail clients, this means specifically that information supplied must:

- be accurate, including the requirement not to emphasise potential benefits without giving a fair and prominent indication of the risks;

- be understandable by an 'average' member of the group it is aimed at;
- not disguise or obscure important terms or warnings;
- contain the name of the conduct regulator (the FCA) in the case of direct offer advertisements.

**FINANCIAL PROMOTION**

An invitation or inducement to engage in investment activity.

Figure 20.3 sets out the rules relating to financial promotions.

**FIGURE 20.3 RULES RELATING TO FINANCIAL PROMOTIONS**

**Comparisons**

- Comparisons with other products must be meaningful, and presented in a fair and balanced way.
- Markets in Financial Instruments Directive (MiFID) firms are subject to additional requirements to detail the source of information and the assumptions made in the comparison.

**Past performance**

- Past performance information must not be the most prominent part of a promotion.
- It must be made clear that it refers to the past, and it must contain a warning that past performance is not necessarily a reliable indicator of future results.
- Past performance data must be based on at least five years (or the period since the investment commenced, if less, but must not relate to a period of less than one year).

**Unsolicited promotions (ie non-written 'cold calls')**

- Permitted only in relation to certain investments, including packaged products, such as life assurance policies and unit trusts. Not permitted in relation to higher-volatility funds (which use gearing) or life policies with links to such funds, due to the increased investment risk involved. Cold calls are not permitted in relation to mortgage contracts.
- Unsolicited telephone calls or visits must only be made at 'an appropriate time of the day'. Within the industry, this is generally taken to mean between 9am and 9pm Monday to Saturday.
- The caller must check that the recipient is happy to proceed with the call.
- The caller must also give a contact point to any client with whom they arrange an appointment.

**ADVERTISING STANDARDS AUTHORITY**

In addition to abiding by the rules laid down in industry-specific regulations, advertisements for financial services and financial products (whether delivered via print, broadcast media, eg TV and radio, or non-broadcast media, eg online) must meet the standards laid down by the Advertising Standards Authority (ASA).

All advertisements should be:

- **legal**, ie containing nothing that breaks the law, or incites anyone to do so, and omitting nothing that the law requires;
- **decent**, ie containing nothing that is likely to cause serious or widespread offence, judged by current prevailing standards of decency;
- **honest**, ie not exploiting the credulity, lack of knowledge or inexperience of consumers;
- **truthful**, ie not misleading by inaccuracy, ambiguity, exaggeration, omission or any other means.

In relation to 'decency', particular care should be taken with sensitive issues such as race, religion, sex or disability.

The ASA can take action against individuals and organisations whose advertising contravenes its rules, from requiring an advertisement to be amended or withdrawn, to taking legal action.

## 20.6 What are the rules relating to adviser charges?

Historically, many investment advisers charged for their services, in full or in part, through the receipt of a commission payment from the providers of products they recommended. This led to concerns that advice could be 'skewed' in favour of providers or products that offered the highest commission rates.

Since 1 January 2013, a firm advising on investment business must only be remunerated for its services by adviser charges; it is no longer allowed to receive commission from the product providers for the products it recommends.

!

**COMMISSION ON INSURANCE SALES**

While commission is not permitted in relation to investment business, an insurance company can still pay commission in relation to sales of insurance such as term assurance and income protection.

Furthermore, it must not accept any other commissions or benefit of any kind from any other party, even if it intends to refund the payment or pass some or all of the benefits to the client.

- The charging structure must represent fair value and should be based on the service provided, rather than the product/provider recommended.
- Charges should be explained as part of the initial disclosures to a customer.
- Any continuing charges can only be made where the customer has agreed to these and where the service for which these charges are levied is actually provided.

The firm can determine its charging structure for its services. This can be a standard charging structure that applies to all clients, based on an hourly rate, or can be based on a percentage of the amount being invested, but the firm must pay due regard to the client's best interests.

The charging structure must be clear, fair and not misleading and not conceal in any way the amount or purpose of any of its adviser charges from the client. For example, a firm cannot make arrangements for amounts in excess of its adviser charge to be deducted from a client's investment, even if it is with the intention of making a cash refund of some or all of it to the client at a later date.

The firm must ensure that the charging structure it discloses to its client at the outset reflects as closely as possible the total charges that are to be paid. If the firm's charging structure is based on hourly rates, it must state whether the rates are 'indicative' or actual and provide an approximate indication of the number of hours that the provision of each service is likely to require.

A firm cannot use an adviser charging structure that entails payments by the client over a period of time unless the service being provided is ongoing and this is disclosed to the client at the outset. The client must be provided with a right to cancel the service, without penalty and without having to give a reason. The FCA is eager to ensure that any ongoing service that is charged for is actually delivered by the adviser.

The firm must provide details of its charges during the initial disclosures and, once the final charges are known, it may include the information about total adviser charges in a suitability report.

## 20.7 What information must be provided at the outset?

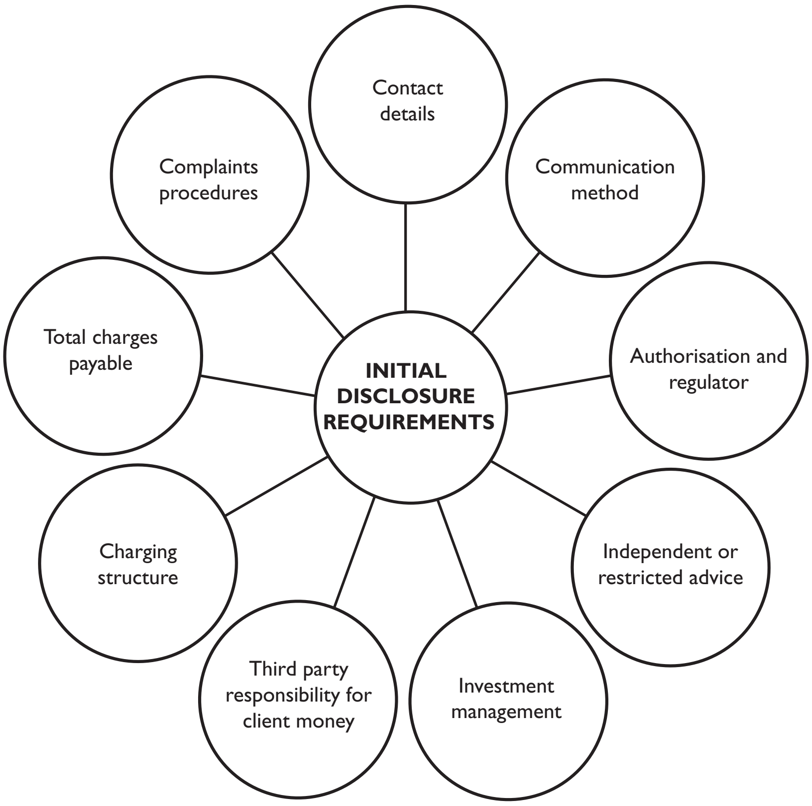
Before any business is discussed, the adviser must disclose to the client certain information about themselves, the services they provide and the costs of those services. The information which must be provided and confirmed in writing includes the following:

- **Contact information** – the name and address of the firm and contact details necessary to enable a client to communicate effectively with the firm.
- **Communication** – the methods of communication used between the firm and the client.
- **Authorisation** – a statement of the fact that the firm is authorised and the name of the regulator that has authorised it (the FCA if in the UK; otherwise, the name of the competent authority that has authorised the firm – ie in relation to MiFID business).
- **Advice type** – whether the advice being provided is independent or restricted, and if restricted, the nature of the restriction. If a firm offers both, it must clearly explain the different nature of the independent advice and restricted advice services.
- **Investment management** – if the firm manages investments on behalf of a client, the method and frequency of investment evaluation, details of any delegation of the discretionary management of all or part of the client's portfolio, and the types of designated investments that may be included in the client's portfolio.
- **Client money or investments** – if the firm holds designated investments or client money for a retail client, that that money may be held by a third party on behalf of the firm, responsibility of the firm for any acts or omissions of that third party, and the consequences of the insolvency of that third party.
- **Charging structure/method** – this may be in the form of a list of the advisory services offered with the associated indicative charges which will be used for calculating the charge for each service.
- **Charges payable** – the total adviser charge payable by a client in cash terms (or equivalent). If payments are to be made over a period of time, the firm must include the amount and frequency of each payment due, and the implications for the client if a retail investment product is cancelled before the adviser charge is paid.

- **Details of complaints procedures, including FOS and FSCS** – the firm must make available to a client who has used or intends to use their services details of their complaints procedures and explain the protections offered by the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Service (FOS). We cover both of these in Topic 25.

Clients must be notified in good time of any material change to the services the firm is providing to that client. For existing clients, the firm need not treat each of several transactions as separate, but does need to ensure that the client has received all relevant information in respect of a subsequent transaction, such as details of product charges that differ from those disclosed for a previous transaction.

**FIGURE 20.4 SUMMARY OF INITIAL DISCLOSURE REQUIREMENTS**




## 20.8 When is a written client agreement required?

If a firm carries out designated investment business, other than advising on packaged investment products, the firm must enter into a written basic agreement with the client, setting out the essential rights and obligations of the firm and the client.

Designated investment business is dealing in investment assets directly on behalf of a client, as opposed to selling packaged investment products. It often involves making investment decisions on behalf of the client, exercising discretion as to investment choice and switching from one to another without having to gain the client's individual agreement for every separate transaction.

**DESIGNATED INVESTMENT BUSINESS**

Dealing in investment assets directly on behalf of a client.

The types of product involved may include equities, options and futures contracts. A client agreement is not usually required for packaged investments, such as life assurance policies and personal pensions, although these may well be used as part of the whole arrangement alongside the higher-risk instruments. In addition to providing the client with information about the firm and its services (as listed in section 20.7), the client must be given, in the form of a client agreement, the terms upon which the adviser is to operate in respect of the client's investments. This will include investment range and limits.

**CHECK YOUR UNDERSTANDING 1**

Thinking back to Topic 16, which of the legal concepts you studied is particularly relevant to the process of carrying out designated investment business, ie acting on the client's behalf?

## 20.9 What are the suitability requirements?

An adviser, whether independent or restricted, will make a personal recommendation. They must not make a personal recommendation unless they are satisfied that the recommendation is suitable. This means the adviser must have fully ascertained the client's personal and financial circumstances relevant to the services that the adviser has agreed to provide.

### 20.9.1 Establishing the client's circumstances

As we saw in Topic 14, the start point is to complete a confidential client information questionnaire or 'factfind', which will capture a range of information. That information must be retained for a specified period of time, depending on the nature of the product recommended. In practice, advisers retain information in all cases for as long as they believe they might be required to justify the advice and recommendations given. Retaining the information will help the firm to deal with complaints, provide an audit trail for advice and provide evidence of compliance with regulatory requirements.

Once the factfind is completed, the adviser can formulate their recommendations. To ensure that recommendations are suitable, the adviser needs to consider a number of factors, such as ensuring that the recommendation:

- meets current and likely future needs;

- is affordable, both initially and on an ongoing basis;
- is consistent with the customer's risk profile;
- is flexible, to take account of future changes.

**CHECK YOUR UNDERSTANDING 2**

How well can you remember the information that needs to be collected in a factfind and the reasons for it? Try to answer the following questions – you'll need to think back to the topics you studied earlier.

a) Why is it important to know the country where a person was born?

b) Why is it important to find out how many dependants a client has, and their ages?

c) What does an adviser need to know in relation to a client's plans and objectives?

### 20.9.2 Risks

The suitability rules specifically require advisers to take all reasonable steps to ensure that the client understands the nature of any risks implicit in the product proposed. Examples of risks that might need to be discussed include:

- whether or not the customer's capital will be returned in full;
- the extent to which income levels from an investment may vary or the circumstances in which no income may be paid at all;
- the factors on which a customer's income from a pension product will depend;
- any factors that might affect a customer's ability to make a claim on a protection product;
- whether or not the level of life cover is sustainable for the duration of the term without an increase in premiums.

The nature and extent of the discussion will depend on the client's experience and knowledge of the type of product under consideration. In assessing the suitability of any recommendations, the adviser must be sure to first establish the client's attitude to risk and capacity for loss.

**ATTITUDE TO RISK**

The extent to which a customer can cope psychologically with a lack of guarantees in respect of capital values and their feelings on fluctuating returns/income levels. Sometimes referred to as a customer's risk appetite or risk tolerance.

**CHECK YOUR UNDERSTANDING 3**

In Topic 14 (section 14.5), we introduced the concept of the customer's 'capacity for loss'. Can you remember what this means and why it is important in the context of a discussion about the customer's risk appetite?

### 20.9.3 Suitability reports

Advisers must recommend the product or service that is most suitable for the client, based on the information supplied by the client and on anything else about the client of which the adviser should reasonably be aware. The recommendation must be solely in the best interests of the client and no account should ever be taken of the remuneration that may be payable to the adviser.

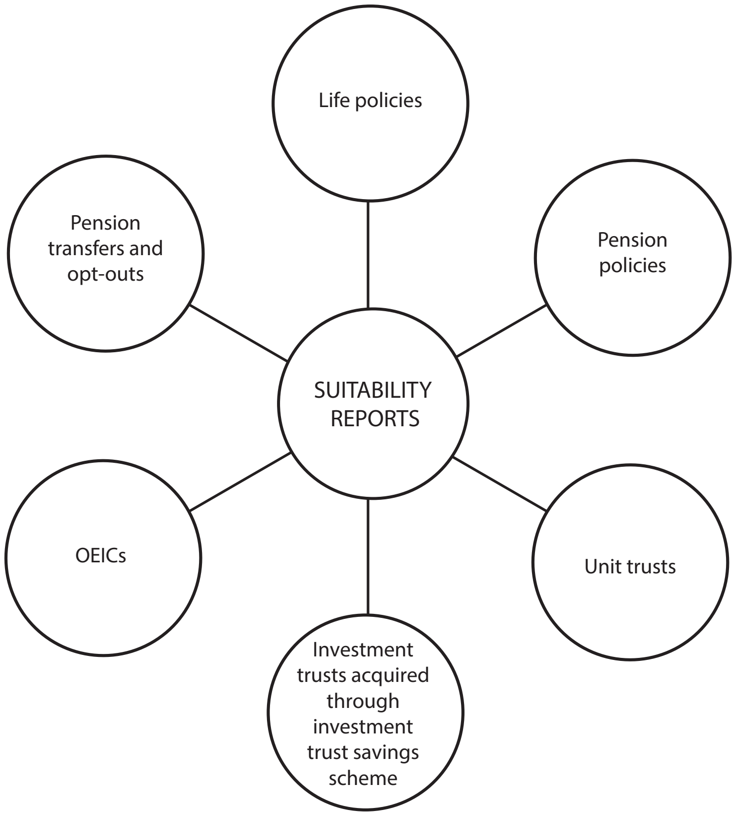
A suitability report explains why the particular product recommended is suitable for the client based on:

- their particular personal and financial circumstances;
- their needs and priorities as identified through the fact-finding process; and
- their attitude to risk (both in general terms and in relation to the specific recommendations made).

Figure 20.5 shows the products for which a suitability report is required. Note that the FCA does not require a suitability report to be provided in respect of mortgage advice, although many lenders will prepare one.

The report should also identify any potential disadvantages of the transaction for the client, such as any 'lock-in' period during which an investment cannot be encashed. It should be clear, concise and written in plain English, in line with the general FCA requirement for communications to be clear, fair and not misleading.

**FIGURE 20.5 PRODUCTS FOR WHICH SUITABILITY REPORTS ARE REQUIRED**




**SUITABILITY REPORT**

Explains clearly why a recommended product is suitable for a specific client, based on information identified through the factfind.

**TIMESCALES FOR ISSUING SUITABILITY REPORTS**

When providing investment advice to a retail client and in the case of life policies, a firm must, before the transaction is concluded, provide the client with a suitability report.

In the case of telephone selling, if, prior to the conclusion of the contract, the information is provided orally or in a durable medium other than paper, the suitability report for a life policy must be provided immediately after the conclusion of the life policy.

For a personal pension or stakeholder pension, where cancellation rights apply, the report must be sent no later than the fourteenth day after the contract is concluded.

In any other case, the report should be provided when or as soon as possible after the transaction is effected or executed.

## 20.10 Product disclosure

Advisers who advise on or sell packaged products (such as life policies, pension policies, unit trusts and investment trust saving schemes) must provide clients with written details of the key features of the product before the sale is concluded. Although it is the adviser's responsibility to provide the documents, the product providers usually prepare the papers. It is a requirement that key features documents should be of the same quality as the materials used for marketing purposes.

The rules on what must be included are very detailed, but, as a broad guide, a key features document must provide information about:

- the nature and complexity of the product;
- how it works;
- any limitations or minimum standards that must apply; and
- the material benefits and risks of buying or investing.

The purpose is to enable the client to make an informed decision about whether to proceed.

IN BRIEF

**CONTENT OF A KEY FEATURES DOCUMENT**

A key features document must include:

- a brief description of the product's aims;
- a brief description of how the product works;
- the key terms of the contract, including any consequences of failing to maintain the commitment or investment;
- the material risks involved;
- the arrangements for handling complaints about the product;

- that compensation is available from the FSCS;
- that a right to cancel or withdraw exists (or does not exist), and if it does, its duration, the conditions for exercising it, any amount the client might have to pay, and where the notice must be sent.

### 20.10.1 What are key information documents?

A key information document (KID) must currently be provided if a customer is buying a packaged retail and insurance-based investment product (PRIIP). A PRIIP is defined as an investment where the amount repayable to the retail investor is subject to risk and fluctuation as a result of exposure to reference values or the performance of assets not directly held by the client; or an insurance-based product that is exposed to market fluctuations.

A PRIIPs KID is a short pre-sale disclosure document to give retail investors the necessary information to make an informed investment. It must include specific key information on an investment product in a prescribed way and in a standard format, so that retail investors can assess and compare products.

The key information to be disclosed in the PRIIPs KID includes:

- the nature and features of the product, including whether it is possible to lose capital;
- the costs and risk profile of the product;
- relevant performance information.

Table 20.1 summarises the types of product classified as PRIIPs, which will therefore require a KID.

**TABLE 20.1 PRODUCT TYPES – IS A KID REQUIRED?**

| Product type | Classified as PRIIP? |
|---|---|
| Derivatives | ✓ |
| Non-UCITS retail schemes (unit trusts, OEICs) | ✓ |
| Insurance-based investments eg unit-linked and with profit endowments | ✓ |
| Investment trusts | ✓ |

| | |
|---|---|
| Structured products and structured deposits | ✓ |
| Pension products | × |
| Deposits with no investment risk (eg bank and building society savings accounts) | × |
| Directly held shares, gilts and bonds | × |
| General insurance and protection-based insurance products with no surrender value | × |

PRIIPs is an EU regulation (currently embedded in the FCA Handbook) which aims to improve the transparency and comparability of investment products. The purpose of the requirements is to ensure that:

- there is consistency between the information that different providers make available to their customers;
- the information provided covers certain key relevant areas;
- the information is presented in an easy-to-understand manner;
- it is easier for investment customers to make meaningful comparisons between providers.

The KID must be no longer than three sides of A4 and the language used must be plain, concise and easy to understand. It must contain certain key information about the investment including:

- product name;
- name of the provider;
- main features;
- any possible risks;
- any return that could be gained by investing;
- costs and charges;
- details of the complaints procedure.

## Key investor information document (KIID)

An investor who is subscribing to a UCITS must currently be provided with a key investor information document (KIID). The purpose of the KIID is to summarise the key features and risks of the UCITS to provide investors with sufficient information to make an informed investment decision. The KIID is a two-page document that describes key fund information in concise and plain language.

The KIID is split into the following five sections:

- objectives and investment policy;
- risk and reward profile;
- charges;
- past performance;
- practical information.

The KIID contains a synthetic risk and reward indicator (SRRI) – a numerical scale from one to seven (low risk to high risk–reward potential), based on the volatility of a UCITS's past performance. The SRRI is intended to allow investors to easily compare investment products (Matheson, 2017).

KIIDs and KIDs provide important information about the fund, including its charges, risk rating and investment profile. The key difference is that PRIIPs KIDs show forward-looking performance scenarios, while UCITS KIIDs show actual historical performance data.

**FACTFIND**

The EU's PRIIPs regulation was controversial due in part to highly prescriptive and overly burdensome formatting requirements, and also in part to misleading information being presented to retail investors (as the KID prioritises comparability of (often very different) products rather than clear and useful information being highlighted).

It will be replaced by the UK Retail Disclosure Framework for Consumer Composite Investments (CCI), which will also bring UCITS into scope. The new framework will be proportionate and tailored to UK markets, balancing support for UK businesses with ensuring retail investors receive appropriate disclosure to make informed investment decisions.

HM Treasury intends to legislate for these changes in 2024, so you should keep an eye out for developments in this area.

For further information, you can visit: assets.publishing.service.gov.uk/media/655ca4c2544aea0019fb31aa/UK_Retail_Disclosure_Framework_Policy_Note__8211_.pdf.

## 20.11 Cooling off, cancellation rights and reflective periods

When a client buys a regulated packaged or insurance product, they have the right to change their mind and withdraw from the contract within a specified period, known as the cooling-off period. The provider is required to send the client a statutory cancellation notice, which explains the process.

The time period is usually either 14 or 30 days depending on the product type:

- For life and pensions policies, and contracts of insurance that are, or have elements of, a pure protection contract or payment protection, the period is 30 days.
- For investments or deposits and other insurances, the period is 14 days.

Binding mortgage offers trigger a seven-day reflection period. During this time the offer is binding on the lender, but the consumer can accept or reject the offer at any time.

The cooling-off period runs from the date when the contract begins or from the date on which the client receives contractual terms if this is later. The client can withdraw from the contract without penalty at any time during the cooling-off period, without any commitment or loss, by signing and returning the cancellation notice to the product provider.

Generally, the client will receive a full refund of any premiums paid if they cancel the contract during this period and this must be provided within 30 days of receipt of the cancellation notice. The exception to this is if the client invests in a lump-sum unit-linked investment (such as a unit trust, OEIC or investment bond), the money has been invested and the value of the investment has fallen. Under these circumstances, the client is entitled to a refund of the reduced investment; no charges can be taken but an adjustment can be made to reflect the fall in value of the investment. The aim is to prevent people cancelling due to falls in the market. This risk should be explained to the client before they enter into the contract.

At the time the product purchase is made, the adviser must also explain whether the client is liable to pay any outstanding adviser charges if they decide not to proceed with the product and send back the signed cancellation notice.

**COOLING-OFF PERIOD**

A limited time during which a client can withdraw from the contract without penalty.

It is important that a firm can evidence that a cancellation notice is issued to a customer since, if they fail to do so, the customer can choose to cancel at any time and will not be liable for any loss (including a fall in investment value).

**RECORD-KEEPING**

The maintenance of clear and readily accessible records is vital at all stages of the relationship between financial services professionals, their clients and the FCA, from details of advertisements to information collected in factfinds, to the reasons for advice given and beyond. Record-keeping requirements for the different stages can be found at appropriate points within the Conduct of Business Sourcebook, with details of what must be kept and the minimum period for which it must be retained. The minimum retention period varies according to the type(s) of product recommended.

Records can be kept in any appropriate format, which includes computer storage, although the rules say that records stored on a computer must be "capable of being reproduced on paper in English". Firms are expected to take reasonable steps to protect their records from destruction, unauthorised access and alteration.

In addition to the record-keeping requirements that firms must observe to comply with COBS, there are rules relating to the prevention of money laundering and to the Data Protection Act 2018 (and UK General Data Protection Regulation). We will look at these in Topics 23 and 24 respectively.

**CHECK YOUR UNDERSTANDING 4**

For how long must records be retained for the following types of business? You will have to think back to the information you were given in Topic 14.

a) Pension transfers/opt-outs and free-standing additional voluntary contributions (AVCs).

b) Life policies, pension contracts and MiFID business.

c) All other products.

**THINK AGAIN . . .**

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- explain the difference between an eligible counterparty, a professional client and a retail client?
- explain the difference between independent advice and restricted advice?
- outline the rules relating to financial promotions?
- outline the rules relating to adviser charging?
- summarise the information that must be given to a client at the initial disclosure stage?
- describe the key considerations that must be taken into account in determining the suitability of a recommendation for a client?
- explain the client's statutory cancellation rights?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

## References

FCA (no date) *COBS 6.2B Describing advice services* [online]. Available at: www.handbook.fca.org.uk/handbook/COBS/6/2B.html

Matheson (2017) *Key investor information document Q&A* [pdf]. Available at: www.matheson.com/docs/default-source/asset-management---ucits-briefing-notes/key-investor-information-document-q-a---january-2017---ucits-briefing-note.pdf

## Test your knowledge

?

Use these questions to assess your learning for Topic 20. Review the text if necessary.

Answers can be found at the end of this book.

1) Which of the three categories of investor identified in COBS is provided with the highest level of regulatory protection?

2) If a client intends to purchase an investment product on an 'execution-only' basis, then:

   a) no recommendation is provided.

   b) no charges will be payable.

   c) they can only use an independent adviser.

   d) they will have to complete all the paperwork themselves.

3) A restricted adviser is one who:

   a) can only make recommendations based on the products of a single provider.

   b) has not passed all of the relevant exams to enable them to give independent advice.

   c) generally focuses on a limited selection of products or providers.

   d) can only give basic advice on stakeholder products.

4) A firm is keen to develop its mortgage business and has acquired a list of potential new customers from a marketing company. It plans to call the listed individuals in the evenings and at weekends. In what respects would this plan breach COBS rules on financial promotions?

5) Which of the following reflects the FCA's rules on adviser charging?

   a) Advisers may minimise the upfront cost of their services to clients by charging in instalments over a number of years.

   b) Advisers' charges must be based on hourly fees.

c) Advisers have discretion to determine their charging structures but they must pay due regard to the best interests of the client.

d) It is accepted that it is not possible to provide an estimate in advance of chargeable hours because of the potential complexity of some transactions.

6) When an adviser transacts designated investment business for a client, the basis or amount of the charges would normally be disclosed in which document?

a) The key features document.

b) The statutory cancellation notice.

c) The suitability report.

d) The client agreement letter.

7) An adviser must issue a key features or key information document and illustration prior to a sale being concluded for all of the following products, **except**:

a) gilt-edged securities.

b) life assurance.

c) stakeholder pensions.

d) unit trusts.

8) How long is the cooling-off period for pension policies?

a) 30 days from the date when the contract begins or from the date on which the client receives contractual terms, if this is later.

b) 14 days from the date when the contract begins or from the date on which the client receives contractual terms if this is later.

c) 14 days from the date when the cancellation notice is issued.

d) 30 days from the date when the cancellation notice is issued.

9) An adviser would not be required to prepare a suitability report in respect of a recommendation for a:

a) personal pension.

b) life insurance product.

c) mortgage.

d) unit trust.

10) Jane has cancelled an investment bond within the cancellation period but received less back than she invested. Why is this?

a) A withdrawal charge has been applied to her plan.

b) She invested a lump sum into a unit-linked plan.

c) A surrender charge has been applied to her plan.

d) She invested into a regular premium unit-linked plan.