

# **GUIDANCE NOTE – Conduct of Business ‘step by step’ guidance for Class 2 licenceholders with sub-class (3) & (7) permissions**

## **1 Background**

- 1.1 This Guidance Note is intended to provide assistance to the licenceholder in meeting the standards required by the Commission in Part 6 – Conduct of Business of the Financial Services Rule Book 2011 when providing protection, investment or pension advice to prospective or existing clients.
- 1.2 The Commission acknowledges that the licenceholder services a wide range of clients and it is therefore necessary to implement a structured advisory process which is both compliant with the regulatory requirements and appropriate to the business being undertaken.
- 1.3 This Guidance Note seeks to highlight what the Commission expects from the licenceholder in providing advice to clients and the documentation that needs to be collated and evidenced on files in order to demonstrate that the licenceholder has acted within a compliant manner with the client's best interests in mind.
- 1.4 It must be emphasised that this guidance is not prescriptive and that the licenceholder may adopt other appropriate measures to those set out in this Guidance Note, including policies and procedures which may already be in place, provided that the licenceholder can demonstrate that such measures also achieve compliance with the regulatory requirements.
- 1.5 All licenceholders that are permitted to give investment advice (i.e. those that hold a Class 2 sub-class (7) authorisation) will be expected to be able to clearly demonstrate to the Commission, with documented evidence, the basis on which recommendations and advice have been made to clients and is deemed suitable for the client in question.
- 1.6 The Commission views the use of “mirror funds” to fall under existing licence parameters i.e. if the licenceholder's licence conditions does not permit it to advise on the underlying fund then it will not be able to advise on the mirror fund.
- 1.7 The licenceholder needs to demonstrate on-going continuous professional development for all financial advisers which is relevant to their roles and in line with the Commission's training and competency framework, which can be found on the Commission's website - [www.fsc.gov.im](http://www.fsc.gov.im)
- 1.8 The licenceholder needs to ensure that the products recommended fall within the terms of its licence.

## **2 Client File Reviews**

- 2.1 The Commission lists below the documentary evidence it expects to see on a client file (or held electronically), from the initial contact with a client to the execution of the transaction:

### Initial contact/stage 1

1. Details of contact between the licenceholder and the prospective/existing client. For example, was this a direct approach

from a prospective new client, a referral, introduction or part of an annual review conducted by the licenceholder? (Rule 6.29)

2. Evidence that the licenceholder has taken steps to establish whether the client is a retail investor (rule 6.39).
3. Documentary evidence to demonstrate that the client has been provided with terms of business (to be signed by the client and a copy held on file (rules 6.2, 6.25, 6.38 & 6.40).
4. A business card should also be provided, although this is currently not a regulatory requirement.
5. Terms of business or client agreement must comply with rules 6.38, 6.39, 6.40 & 6.41.
6. A client agreement with a retail investor should be easy to understand, not likely to be misunderstood and not deprive the client of any rights which he would have had if the agreement or terms had not existed. Also in relation to any fees payable by the client to the licenceholder it must detail the basis of the calculation; the notice required for any increase of fees which should not be less than one month; the method of payment (e.g. deduction from income or capital belonging to a client or billing); the frequency of payment; and whether or not any fees payable are to supplement or be abated by any remuneration receivable by the licenceholder in connection with transactions effected by the licenceholder with or for the client (rule 6.41).
7. Documentary evidence on file to demonstrate that suitable and appropriate KYC/AML/CFT requirements have been met in accordance with the Proceeds of Crime (Money Laundering) Code 2010, the Prevention of Terrorist Financing Code 2011 and the AML and Countering the Financing of Terrorism Handbook and rules 6.2, 6.25 & 6.29.
8. Details of the risk assessment of the client in accordance with Part 3 of the Proceeds of Crime (Money Laundering) Code 2010 and the Prevention of Terrorist Financing Code 2011.
9. A completed client factfind or profile, which must be signed by the client, to demonstrate and capture the client's current circumstances. This should be completed in full or where a client does not wish to disclose information on a particular section, this section must be annotated accordingly. The client should also be advised that the licenceholder can only provide advice in relation to the information provided by the client. A licenceholder must find out enough about a retail investor's personal and financial circumstances, investment objectives, attitude to risk and time horizons to enable it to act properly for a retail investor in investment matters. A copy of the signed client factfind should be provided to the client and a copy retained on the client file. Appropriate care should also be taken when providing advice to elderly clients (rules 6.2, 6.25, 6.29 & 6.35).
10. Where a client undertakes further business within a 12 month period the factfind should be annotated accordingly to capture any changes. If any further business is to be transacted more than 12 months after the initial advice, a new factfind should be completed prior to any advice being given and a copy of the signed client factfind should be provided to the client and a copy retained on the client file (rules 6.25 & 6.29).

11. Detailed filenotes of all conversations/meetings the licenceholder has with the client to support the rationale for the advice provided (rules 6.25 & 6.29).
12. Details of all research undertaken by the licenceholder in reviewing the investment, protection or pension options available to the client (in particular, care should be exercised when offering advice on structured products and the inherent counterparty risk associated with these arrangements) (rules 6.30 & 6.31).
13. Details of alternative products reviewed and discounted by the licenceholder in relation to the advice provided and details of why these alternative products were discounted when making the final recommendation (rule 6.30). At this stage consideration should be given to appropriate diversification of investments for the client..
14. Evidence that the product/s to be recommended fall within the licenceholder's authorisation and that it is permitted to advise on such products (rules 6.2 & 6.25). Advice provided outwith licence permissions is a breach of the Financial Services Act 2008.
15. Details of why the surrender of an existing plan/policy to invest in another product is in the best interests of the client and that the client has been made fully aware of any associated charges this may attract (rules 6.2, 6.25, 6.30, 6.31 & 6.36). A full cost/benefit analysis should be evidenced to support the recommendation that the advice is in the best interests of the client.
16. Details of why switching from an existing pension arrangement to another pension arrangement is in the best interests of the client and that the client has been made fully aware of any associated charges this may attract (rules 6.25, 6.30, 6.31 & 6.36). A full cost/benefit analysis should be evidenced to support the recommendation that the advice is in the best interests of the client.
17. Copies of all illustrations or comparative quotes (where available) provided to the client to support the recommendation(s) being made (rules 6.25 & 6.30)
18. A copy of the research undertaken, product selection process and the reasons why letter must be retained on the clients' file (rule 6.34)

### Pre-sale/stage 2

19. Following the initial meeting and any necessary subsequent meetings, a comprehensive 'reason why' letter should be provided to the client and a copy retained on the client's file. This should be provided to the client prior to the client acquiring the investment in order for the client to be fully aware of the product(s) recommended and the rationale for the advice and how it meets their objectives. This will also ensure that the client is given sufficient time and information which they are able to understand to enable the client to make a balanced and informed decision (rules 6.30, 6.31, 6.34, 6.35 & 6.36).
20. The 'reason why' letter should be tailored to each individual client and should be written using plain, jargon-free English. A licenceholder must ensure that a retail investor is only recommended products suitable for

their circumstances (including attitude to risk, age and state of health). In accordance with rule 6.34, it must include -

- i. a summary of the client's financial position, including any limitations of information provided by the client;
- ii. a balanced rationale for the recommendations made, including details of the recommended products' characteristics and risks, and why those products are suitable for the particular client;
- iii. product literature or illustrations where available;
- iv. details as to whether each product has a cooling off period, and where there is no cooling off period, a statement informing the client of the risk of a substantial amount of their investment if they change their mind and decide, after starting the investment, not to continue with it;
- v. a cost benefit analysis of any switches or surrenders, or gearing and why these are in the best interests of the client; and
- vi. whether an annual review will or will not be undertaken on the investments.

It should explain clearly to the client why any recommendations are suitable for them, having regard to the client's personal and financial circumstances, their investment, protection or pension objectives and time horizon (including any period for which they may be willing to restrict access to their money) and diversification of the client's portfolio.

It should also clearly identify the costs for proceeding with the recommendation(s) in terms of charges, fees, any early surrender penalties or market value reduction factors. Any commission, or other payment, received by the licenceholder for the transaction must be disclosed to the client (rules 6.8, 6.30 & 6.34).

21. Ideally, the 'reason why' letter should be countersigned by the client (best practice).
22. A 'reason why' letter that fulfils the above requirements should not only result in the client being better informed about the appropriateness of an adviser's recommendations for their needs, but also give the client the opportunity to identify any areas where they may wish to seek further clarification at this stage in the process (rule 6.8).
- 23.

### Post sale/stage 3

24. Once a client has decided to proceed with the recommendations this should be carried out by the licenceholder in a timely manner and the policy document/contract note issued to the client immediately it is available from the product provider (rules 6.26 & 6.49).

### **3 Notes on Long Term Insurance and other underwritten products**

- 3.1 The Commission is aware that for some investment products that involve underwriting, such as long-term insurance contracts, it may not always be practicable for a licenceholder to provide the client with an accurate 'reason why' letter at an early stage in the advice process, as certain details (such as

the premium payable) may alter in the period between the recommendation being made and the policy going 'on-risk'. In such circumstances the Commission would find it acceptable for the 'reason why' letter to be provided to the client at a later stage in the process, although it should be issued to the client promptly once any variable details have been confirmed.

- 3.2 For investments that do not require underwriting, however, a licenceholder should provide a 'reason why letter' prior to the acquisition being secured and if this is not possible in the event of an execution only deal for instance, it should be issued as soon after the event as possible.

#### **4 Notes on portfolio advice services**

- 4.1 There has been a recent increase in financial advisers offering 'portfolio advice services' – ongoing investment advice services that do not amount to discretionary portfolio management, but typically involve recommending a portfolio of investments to meet an asset allocation and reviewing this on a periodic basis.
- 4.2 Where such services are offered, licenceholders need to take care that any recommendations for changes to the portfolio are agreed with clients to ensure that the services do not constitute discretionary management and therefore fall outside of its licence permissions.
- 4.3 There may be clients whose best interests are served by having a simpler, lower cost solution. Accordingly, licenceholders should consider the total cost of the solution recommended when assessing suitability, including product charges, adviser charges (initial and ongoing) and any platform charges. As with any investment, advisers must evidence on the client's file that any additional services add genuine value for that client.

***Financial Supervision Commission***

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