Financial Conduct Authority

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Assessing Suitability: Research and Due Diligence of Products and Services Thematic Review (TR16/1)

Lead regulator: FCA

Date of assessment: 22/02/2016

Commencement date: February 2016

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? All regulated advisory firms in the UK

The research and due diligence of products and services Thematic Review[1] was undertaken as a result of our previous thematic work which highlighted instances of consumer harm, due to the poor quality of an advisory firm's research. The work undertaken in this area identified the main drivers of poor customer outcomes as:

(i) Due diligence
(ii) incorrect risk profiling and;
(iii) Costs in relation to replacement business under the recommendation of an adviser.[2]

Background

The term "*Research and Due Diligence*" is used in the Thematic Report to refer to the process carried out by an advisory firm in assessing:
(a) the nature of the investment
(b) its risk and benefits and;
(c) the provider.

The three key elements (above) allow an advisory firm to judge whether the solution recommended by the adviser is suitable.

A 'reasonable' level of research and due diligence will differ between advisory firms as it will be dependent on the adviser's recommendation and the client needs.

The objective of conducting/undertaking research and due diligence is, in theory, the same across different investments, services and providers. However, the time and effort committed

[1] https://www.fca.org.uk/publication/thematic-reviews/tr16-01.pdf
[2] Further information on (i) and (ii) can be found in FG11/5.3 and FG12/16 respectively.

towards undertaking research and due diligence may vary between advisory firms. For example, it would take less time to assess a product from a familiar provider (i.e. an existing relationship) investing in familiar assets than assessing a product from a provider which the advisory firm is not familiar (i.e. no previous relationship exists) with and/or which invests in assets the advisory firm has not researched before.

Firms can, as part of their research and due diligence process, consider/include factual information provided by other EEA-regulated firms in areas such as asset allocation; however, firms should not rely on the provider's opinion in areas such investment risk levels**.**

Scope and methodology

We assessed 13 advisory firms in order to understand how firms undertake research and due diligence on products and services. Our review involved an assessment of the sampled firm's research and due diligence processes. The assessment involved interviewing staff (where appropriate) during our on-site visits. No individual file reviews were conducted as part of the review.

Whilst the review was focused on advisory firms we also visited seven external research and due diligence consultancy firms and a further three product/service providers in order to understand the wider market. We did not assess compliance with our rules for these firms.

Thematic Review Findings

We found varying degrees of good practice in respect of research and due diligence being undertaken by advisory firms. A key driver of good research and due diligence could be attributed to the existence of an effective corporate culture of challenge. Although corporate culture is both intangible and, as such, does not have a clear measurable objective underpinning it, the best performing firms had either in-built challenge in the research and due diligence process and/or individuals with the appropriate knowledge; skills and expertise to provide challenge the advisory firm's approach. Our review identified that the research and due diligence processes were weaker amongst those firms with a poor corporate governance culture of challenge.

Action/s Taken/Mitigating Action/s:

- *Attestations:* Three firms were required to attest in relation to the effectiveness of their research and due diligence processes
- *Past Business Review*: A firm was instructed to complete a past business review

Which type of business will be affected? How many are estimated to be affected?

Regulated advisory firms – 6000

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2016	10	-0.288	0	0

Please set out the impact to business clearly with a breakdown of costs and benefits

We do not envisage that the published TR16/1 report or its findings have resulted in any significant additional work for firms beyond what is required to comply with existing rules. The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) 1.24 states that a firm, when advising, should consider (1) the nature of the product/service offered

by the provider and how they fit with the customer's needs and risk appetite and (2) the impact the selection of the provider could have on the customer in terms of charges or financial strength of the provider or, where information is available to the distributor, how efficiently and reliably the provider will deal with the distributor or customer at the point of sale or at such times as when queries/complaints arise, claims are made, or a product reaches maturity.
Taking the content of the RPPD 1.24[3] into consideration, firms will familiarise themselves and may choose to conduct a gap analysis of their existing processes against our published observations in TR16/1 and this would not be overly burdensome on advisory firms. In addition, firms may choose to continue with their existing research and due diligence processes and/or strengthen their existing systems as appropriate.

Conclusion:
The review did not identify any systematic risks and/or rule breaches that would require further investigation across the industry or at an individual advisory firm.
Note – for the cost estimate below we have assumed the report will be applied by experienced compliance staff at an estimated rate of £48/hour. The 2016 Robert Half salary guide estimates that a compliance manager in the risk and compliance function of a financial services company based in London earns between £70,000 and £104,000 per annum. Based on working 8 hours per day for 260 days each year our rate equates to £100,000 per annum and is therefore considered a suitably prudent figure for the purposes of our estimates.

We expect that all of the approximately 6000 regulated advisory firms would find it helpful to familiarise themselves with the six page thematic report at a total cost of £288,000. We would expect that the report would take approximately 1hr to read, digest, and disseminate to any relevant members of staff, and, if necessary, update the relevant procedures to reflect the report[4].

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

The level of detail to which individual measures are scored is set to the nearest £100k. This means that where the total cost of measures is estimated at less than £50k they are scored as zero (both as EANDCB and BIT score) for reporting purposes.

Link to Robert Half salary centre: https://www.roberthalf.co.uk/news-insights/salary-centre-2016

[3] https://www.handbook.fca.org.uk/handbook/document/rppd/RPPD_Full_20160321.pdf

[4] We arrived at our estimate based on the following calculation. The six page thematic report contains approximately 2000 words. The speed of reading technical text is 50-100 words per minute based on EFTEC (2013), “Evaluating the cost savings to business revised EA guidance - method paper” the time remaining to digest, disseminate the information and if necessary update the relevant procedures is based on our broader supervisory knowledge of how firms respond to our thematic reports and also on supervisory conversations with firms about their procedures relating to this specific issue.