IMA Inducements Guidelines

Introduction

The 2014 FCA Finalised guidance on inducements (FG14/1 – Supervising retail investment advice: inducements and conflicts of interest (the FCA Guidance)) has generated a great deal of discussion about the FCA’s expectations and the impact on existing practice in the area of benefits provided by authorised fund managers (AFMs) to parties in the distribution chain. At the request of its members, the IMA has developed this document to reflect the intent of the FCA Guidance and to do so in a sector specific context.

Industry Guidelines

This document provides sector specific industry guidelines to IMA member firms which are AFMs. It includes descriptions of good practice in the area of benefits provided by AFMs to parties in the distribution chain (such as financial advisers and discretionary fund managers). Member firms remain responsible for their own compliance and the IMA does not accept responsibility or liability of any kind in relation to the contents of these guidelines or the uses to which they are put.

Regulatory context

AFMs should compete for consumers’ investment on the basis of the quality and price of their products, without inappropriately influencing intermediaries. This fair competition objective is supported by Principle 8 of the FCA’s Principles for Businesses: “A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client”.

Principle 8 is buttressed by rules and guidance in the Conduct of Business Sourcebook, in particular COBS 2.3, the Inducements rules. The FCA Guidance supplements Handbook guidance at COBS 2.3.14 G, aimed at the sale of retail investment products and, therefore, the relationship between product providers and other UK regulated entities that provide advice or exercise discretion in respect of the investments of UK retail consumers.

Members should also note the disclosure requirements set out at COBS 2.3.1 R (2)(b).

Although the FCA Guidance was issued following FCA thematic work focussed on life insurers and advisory firms, and so reflects that sector in much of its language and examples, as issued it is directly applicable to all providers of retail investment products, including AFMs.

The Bribery Act 2010 is also applicable. Serious Fraud Office guidance on business expenditure recognises that bona fide hospitality or promotional or other legitimate business expenditure is recognised as an established and important part of doing business. It is also the case, however, that bribes are sometimes disguised as legitimate business expenditure and this risk must be addressed in all areas of business.
High level requirements

Any services or entertainment paid for by AFMs must be designed to enhance the quality of the service to the end customers and should not impair the ability of the firm to act in the best interests of its client.

Payments for any event should not be at a level where they could influence a reasonable individual to channel business toward a particular AFM. Reflecting the rationale for issuing the FCA Guidance, firms should be careful to ensure that payments for events provided by them are not influenced by a desire to avoid the intended prohibitions on payments introduced by the Retail Distribution Review (RDR). The FCA made it clear that some of the providers that it looked at (not being AFMs) appeared to have altered their behaviour in light of the RDR in ways which sought to reduce the impact of the commission ban by altering the value of other payments, or creating new payments, where this was not justified for proper business purposes and therefore not consistent with compliance with Principle 8 and the Inducements rules. Such patent avoidance techniques are unacceptable. Firms should consider whether their training events and marketing activities, in the broadest sense of the word, have been expanded at the request of distributors.

But even absent the RDR avoidance issue which triggered the FCA thematic review, members should be alert to an underlying theme of the FCA Guidance – that the word “designed” in the test is material. Ex post facto rationalisations – reverse engineering, if you will – do not reflect the priorities which are inherent in the rule. So, to put it at its worst to emphasise the point, the FCA would not expect members to decide to arrange a golf event to which they invite distributors and then seek to discover what is the minimum training or specific product discussion to ensure compliance sign-off.

This notion of overarching rationale being to enhance the quality of service to clients reflects the post-RDR world – inducements are banned expect for certain exceptions. Whilst that may not be a comprehensive legal statement, it does reflect the changed stance of the FCA towards inducements.

Events should be planned, and participants invited, for proper business purposes, with attention devoted to the outcome expected from the event and how this would enhance customer outcomes.

Payments should not be linked to business volume in any way, including in ways that either reward firms or individuals for the amount of sales achieved, or encourage them to sell more to receive other benefits.

Records should be sufficient to enable the AFM to review and assess the nature and value of services and entertainment provided at both firm and individual level, and to demonstrate how they were designed to enhance customer outcomes.

Firms should have a policy covering contributions to the cost of client events and entertainment (including where these are organised by a third party). This policy should be approved at a senior level and subject to periodic review.

The next challenge that firms must address is whether the quantum of benefit involved in some prizes, events or entertainment may be of such worth that it cannot be justified. The quantum may
need to be measured over a time period, as frequent receipt of mid-size payments or benefits may be perceived to be as or more risky in terms of detriment to consumer outcomes.

The quantum should also be measured on a substitution basis. In this regard, the face value of tickets to social or sporting events would be an inadequate measure. An obvious example would be the provision of tickets where the inability of any distributor to get hold of that ticket or to get hold of that ticket at anything other than a hugely inflated price shows the inadequacy of merely considering the cost to the firm or the face value cost of the ticket.

Paragraph 2.37 of the FCA Guidance lists certain key characteristics that the FCA regards as evidencing compliance with the reasonable value test and other requirements of the Inducements rules. Any planned event should be judged against these characteristics. The absence or presence of any of the characteristics may not be fatal, but they should be understood as key indicators of regulatory risk. In this regard, the references to events occurring outside the UK and to the need for the payment to relate to business purposes have been the cause of debate amongst firms as to what is or is not now allowed. The specific example that has been raised with us is whether the costs of due diligence visits by distributors to managers based overseas can be paid for by providers. Our understanding is that the FCA would question why a provider (and the distributor) would consider it reasonable to cover the costs of a distributor’s due diligence process in any event, whether overseas or in the UK, given that undertaking due diligence is an obligation on the distributor. More generally, our understanding is that the FCA’s firm position is that payment for any event which takes place outside the UK is unlikely to be compliant. Similarly, whilst ‘business purposes’ is a wide term, embracing many relational activities, the more social in nature an event (or part of an event), in contrast to an event more ostensibly and immediately identifiable as training or education, the more a firm must be assured that it can articulate the appropriateness of that event in terms of consumer outcomes and proportionality. In every case, as said above, the event must have been designed to enhance the quality of the service to end customers and not have the potential to impair the ability of the firm providing or receiving the benefit from acting in the best interests of the client. This requirement is set out in the Inducement rules and is an area where the FCA has said it found numerous incidences of non-compliance in the course of its thematic review.

Types of Inducement

Case studies can be problematic precisely because their very description may lead to formularic or mechanistic reliance on rules of thumb which can only ever be poor proxies for the test of whether something is designed to enhance the quality of the service to end-customers. The following examples cover broader areas where the FCA Guidance is of relevance.

Corporate sponsorship

Some larger AFMs, or AFMs that are part of larger groups, have sponsored major sporting or social events. As part of the sponsorship deals, it is common for the sponsor to have access to tickets and special facilities at these events. For the purpose of assessing the value of corporate entertainment provided at sponsored events, AFMs should concentrate on the value to their guests, rather than the cost to the AFM.
For example, an AFM might be part of a financial group that sponsors a major golf tournament from its global advertising budget. As part of that sponsorship package, the AFM might have access to free or reduced price tickets and a hospitality tent. In considering the potential for any corporate hospitality provided at the sponsored event to have an inappropriate influence on a guest, the total amount spent by the group on sponsorship is irrelevant. But the fact that the AFM was able to acquire tickets for nothing or at a reduced rate is equally irrelevant. In this case (and in other cases) the relevant value is the value the recipient puts on the hospitality received, as it is this value which has the potential to influence his future actions. The most appropriate way to assess this value is to base it on the current market rate, i.e. the cost of buying it on the open market (e.g. over the internet) at that point in time. Decisions about reasonableness will follow on from this. To be clear, corporate sponsorship is not the focus of the FCA Guidance, nor impliedly questioned by it. But to the extent that sponsorship packages have hospitality benefits bundled with them, members will need to consider in what circumstances and to whom these can be offered.

**Product training**

The provision by AFMs of product training or updates to intermediaries able to distribute their funds is an important factor in enabling those intermediaries to enhance the service they provide to their clients. Hospitality, entertainment and prize competitions may form part of events based around training sessions, subject to the reasonableness test and other factors set out above.

For example, an AFM might arrange and pay for a training day at a venue with conference facilities at which a range of sessions would be made available to advisory firms able to sell their funds. These sessions might include market opinion, economic analysis and regulatory updates, as well as product specific information. Such sessions could be beneficial to independent financial advisers. They might also be beneficial to advisers or others employed at an advisory firm with a restricted panel including the AFM’s products if the content of the sessions includes relevant new information. This might consist of changes to the asset class weightings in a multi-asset fund or an update from the portfolio manager of an emerging markets fund explaining his view of different markets and the reasons for changes in his portfolio.

There are instances where product providers will group together and organise an event where each presents regarding their products to a group of advisers. Advisory firms benefit from a time saving by hearing from a variety of product providers within a single event. Product providers benefit from sharing costs and gain exposure to a greater number of advisory firms, including those that may not attend an event organised by a single product provider. For example, an unregulated third party (a marketing and events agency) might organise a national road show for a number of AFMs at which advisory firms were able to gain insights on broad economic themes and specific product detail in a structured environment. The cost of the road show could be split between the AFMs based on presenting time at the events.

In such circumstances, the providers involved should apply their own internal policies regarding total cost and proportionate contributions on the basis the event constitutes “training”; and similarly apply their own internal policies regarding total cost and proportionate contributions in respect of any associated hospitality.
The FCA Guidance makes it clear that any training offered by providers should be made available to all advisers who could sell the products covered, even if on a first come first served basis.

Distributor events

It is quite common for intermediaries to arrange conferences or other events and to invite different product providers to take part. Such events can be a useful way for advisers and others to get access to a number of product providers in one place over a short period of time, enhancing their knowledge of available products and their ability to serve their clients better.

For example, an AFM might be invited to a conference organised by a financial adviser network. The AFM will be one of a number of product providers invited (including other AFMs, life insurance companies and banks providing structured products). The audience might consist of individual advisers from the network, paraplanners responsible for product assessment and maybe even some of the network’s clients. Each product provider would have the opportunity to deliver a presentation on the features of its products and to mingle with the audience and answer questions or arrange further contact. The AFM, along with the other product providers invited, might contribute to the cost of the event, with its contribution calculated according to the time allotted to it for its presentation. In such a scenario, the AFM should actively assess whether the contribution asked for by the network is proportionate, bearing in mind that the FCA Guidance states that the network should pay a significant majority of the overall cost, and that notions that this is 51% are at odds with the FCA language. Product providers should not cover the costs of the adviser network’s staff time during the conference.

Exhibition stands

An appropriately staffed exhibition stand can enable one-to-one engagement with advisers, where AFMs can respond to questions and disseminate a range of product or economic literature. But any payment for a stand at an event organised by an advisory firm would we understand be unlikely to be viewed by the FCA as constituting an acceptable benefit, on the grounds that an adviser firm should only be able to recover costs related to the “active participation” of providers, and attending and networking would not be sufficient to constitute active participation.

Charity events

In instances where an advisory firm is running a charitable event, such as a charity golf day, it can be reasonable for an AFM to make a donation to the charity, but not to contribute towards the cost of the event itself.

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