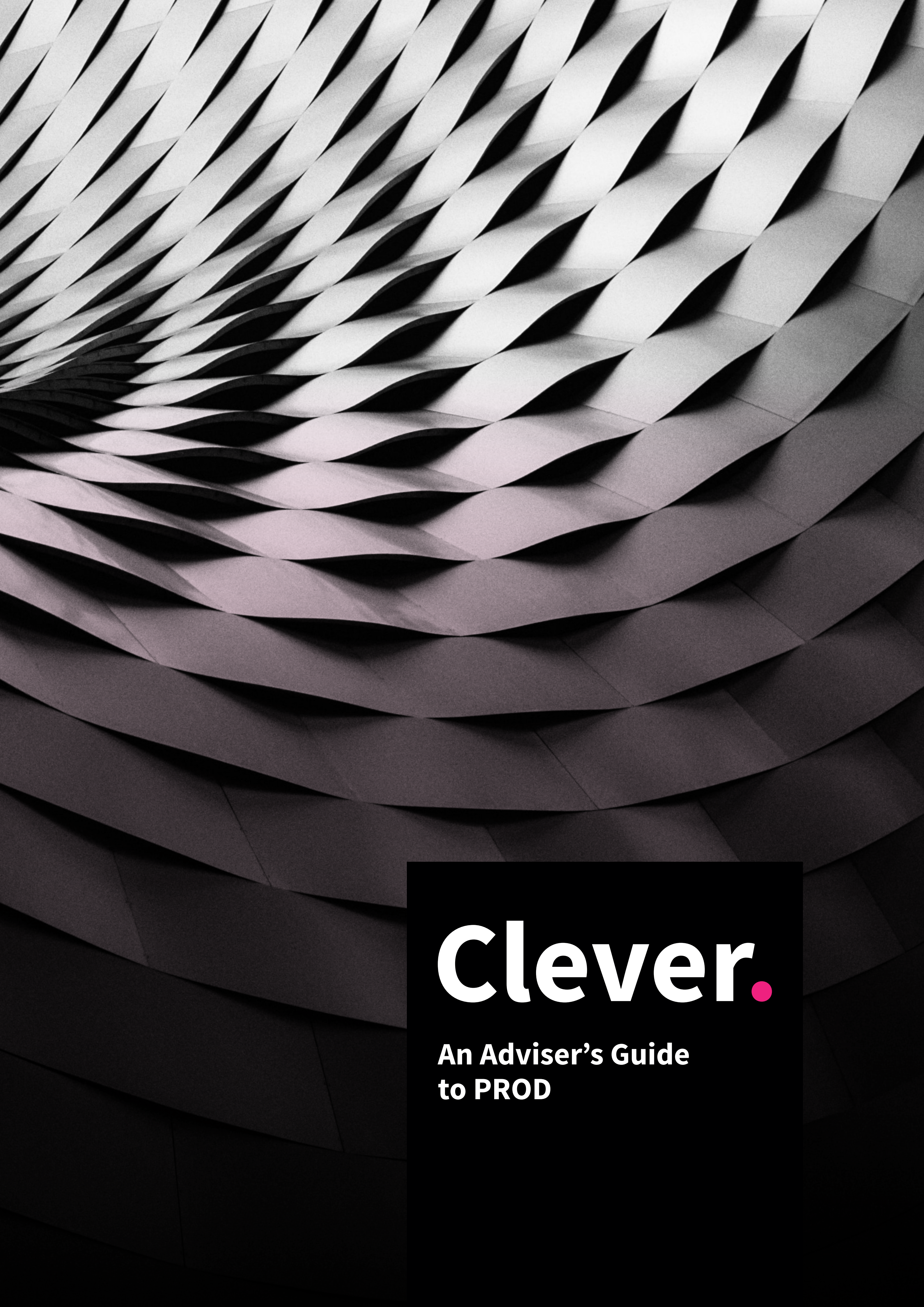

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An Adviser's Guide to PROD

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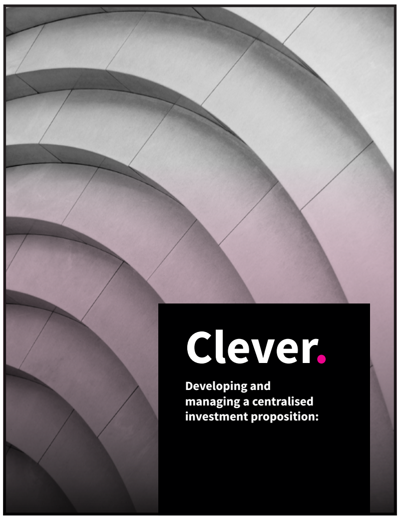

Developing and managing a centralised investment proposition

Mifid II Explained

7 Proven ways to grow your advisory business

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Introduction.

For many financial planners, the past few years has been particularly trying, as the financial services industry has been hit with an unprecedented wave of new legislation.

January saw MiFID II come into force while the summer was sparked off by the nit-picking necessities of GDPR. But if all that wasn't enough, sneaking in on the back of MiFID II was one more crucial piece of the legislative puzzle, and one whose importance and impact seem to have gone unnoticed by many – PROD.

What is PROD?

Designed by the UK Financial Conduct Authority ("FCA") to ensure compliance with MiFID II, PROD – or 'Product Intervention and Product Governance Sourcebook' to give it its full name – is part rulebook, part template, and is aimed at ensuring full compliance under MiFID II, as well as tightening the design and sale of other products, such as Centralised Investment Propositions ("CIPs"). Its priority is 'good product governance' which can be further divided into three main areas:

1. Products should clearly meet the needs of one (or more) identifiable target market/s.
2. Products should be sold to those identifiable target markets via the appropriate distribution channels.
3. Products should deliver appropriate client outcomes.

These guidelines affect two groups within the financial sector: product manufacturers (providers) and product distributors (advisers), or possibly three if we include platforms – and require that there is a clear and auditable dialogue between at least the two primary groups.

It is a process-focussed piece of regulation that, if used as intended, will leave a trail of fully evidenced decisions as to why you have selected that particular product for that particular market and the basis on which you believe it best delivers client outcomes. Equally, the manufacturers have to detail who their product is intended for, and it is this constant note-taking and comparison between one side of the equation and the other, that is designed to equal success.

Taking the guesswork, presumed or otherwise, out of the process means that while your responsibility might ratchet up, your results should also be more reliable than ever.

How (to) PROD

PROD has been met with much resentment from financial planners who believe they are already doing it. However, as is so often with financial regulation, it is not the doing that matters, it is the documenting of the doing. So, while getting on board with PROD may require some adjustment, it is certainly not unfamiliar territory. Remember to write everything down at every stage; your client fact-find and decision-making process needs to be fully documented in order to matter.

1 Define your target markets

While those financial planners without their own products or CIP can live relatively lightly under PROD, others must pay close attention.

However assiduously your clients are segmented now, get ready to redo it. For example, the temptation to use assets under management to segment your client base might seem logical but will make it almost impossible to undertake PROD correctly. The regulator is looking for corroboration between client, product and manufacturer from start to finish. Advisers should seek to segment by more uniting qualities, such as life-stage, so that whether your clients are young accumulators or those entering retirement, they will share similar financial goals.

Remember that behavioural finance helps refine and define the characters you are dealing with, so profiling personalities - not just purse-strings - can help reveal what kind of product is ideal for a client. Risk-averse individuals will not be a target market for a product that has a volatile strategy or history, while the more gung-ho among your client base will easily tire of overly-cautious invesment outcomes.

Once you've done the initial division, you can use your knowledge, initiative and imagination to segment clients further, such as those who work in a particular industry – agriculture, for example - or the self-employed. With your market clearly defined, you can then decide on an appropriate investment solution, whether a bespoke discretionary management approach would work best, or a managed portfolio service with all the technology that offers.

Finally, your platform solution and advice services, such as cashflow planning, structuring remuneration or inheritance tax guidance, will come to the fore and should, at the end of this planning, match perfectly with your clients' initial requirements.

2 Select the product

Once you have narrowed down your target market, you are in a well-informed position to identify the product of their dreams, ensuring diligent analysis to keep PROD happy.

Consider the product management structure. A chaotic or controversial one may prove a barrier to consistent results, such as volatility levels and performance criteria, making examination of the product's progress crucial.

It is the product's histories, both financial and regulatory, that will help you understand if it is likely to meet specific client outcomes. Serious consideration must be taken of any breaches or reportable events that might undermine trust and performance.

3 Check the manufacturer's target market

Your clients are segmented, an investment solution has been selected, and a product has been identified. Now it's time to make sure this equation adds up from the other side. With the manufacturer lying at one end of the equation, and you at the other, both parties must work together and agree the expected investment outcomes. This is the key to satisfying PROD.

Understanding the manufacturer's intentions means that you have assessed all the angles. You must ask yourself if this relationship really can work for all parties? Is the manufacturer happy that you have selected their product for your clients? Any doubts by either party are a red flag. Look deeply at the manufacturer's investment knowledge and experience of the targeted client, alongside the client's risk/reward profile.

Probably the best question to ask yourself is - who is the product *suitable* for? Good intentions mean very little when a mis-match is clear. Don't be afraid to return to the drawing board.

PROD and CIPs

Although it is a keystone product for many financial planners, beware the impact of PROD on your CIP. Under the rulings, you are now considered a manufacturer as well as a distributor, and you must disclose this to your clients. You will have to ruthlessly examine your own proposition as meticulously as you would an outside agency, which includes generating a process for identifying and managing the risks, stress-testing and scenario analysis, both good and bad.

Problems with PROD

Despite the best intentions of PROD, many of which exist to protect the financial planner, the troubles with it are manifold.

From problems of perception to issues with implementation, PROD has provoked an industry-wide outcry against what is seen as a ruling borne out of punitive mistrust.

According to a study by the lang cat and global software company Iress in late 2018, 20% of advisers did not even know of PROD, while 62% of those who did know of it were unable to evidence compliance.

Awareness aside, there are other issues which stalk PROD.

1 Non-compliance

While ignorance may have provided at least some defence up to now, beware. The FCA's soft-pedalling is set to change gear.

Director of competition, Mary Stark, has raised the very real possibility of a fee review, while regulatory expert Rory Percival asserts that "PROD will become quite a focus for the regulator at that point, because the study will establish it is not a competitive market".

It is critical that financial planners understand that complying with PROD *will work* for them, not against them, and possibly in more ways than one.

While MiFID II may have legitimately overwhelmed compliance teams, don't let that be an excuse. Complacency is a killer across the board, and further research from Iress found that 80% of advisers were unaware of the enforcement actions that could come their way from the FCA if they show resistance to PROD.

“All firms who have been through the process with us have said that the changes have given them greater certainty and confidence about their business and reasurance that their business model is right for the clients.”

2 Regulation fatigue

If you feel weighed down by even more regulation, then Steve Bailey, director of leading compliance consultancy, ATEB Consulting (“ATEB”), has a sympathetic ear. After all, understanding and implementing the thousands of pages of regulation on top of complex day jobs is a very big ask indeed. But he does have positive news, and asks that financial planners take heart from the fact that not all is as onerous as it seems.

Steve Bailey says, *“Having done numerous MiFID II and other projects, our experience is that the changes often aren’t as bad as they appear. The industry is also good at scaremongering and we often take a more pragmatic view focusing on the priorities. All firms who have been through the process with us have said that the changes have given them greater certainty and confidence about their business and reassurance that their business model is right for the clients.”*

So, wherever possible, look for the positives in the increased paperwork and how it will benefit you and your clients. Hopefully it will guide your business in an increasingly improved, client-centric direction.

Furthermore, actively engaging with a reputable compliance consultancy is not just a way to ensure you are doing everything right. It may also uncover what you could be doing better.

3 Whose job is it anyway?

Isn’t it strange how something so vague could be so divisive?

The problems with PROD are acute and identifying where you fall on its spectrum can be difficult. Firstly, it splits the audience three ways, depending on whether you are a platform, a distributor or an adviser, meaning that the buck could stop with any of those, or a combination. This opens up channels ripe for dispute, while some of the traditional company keystones such as CIPs, or whether to use a discretionary investment manager, can cause additional confusion.

ATEB believes there is a misunderstanding of roles – particularly where:

1. Adviser firms design their own in-house portfolios.
2. A firm offers discretionary investment managers (DIM).

Steve Bailey says, *“with current legislation remaining in force, the picture is far from clear for some financial planners”.*

Although a financial planner would traditionally be seen as a distributor, under PROD those advice firms who design, create and develop their own portfolios are now manufacturers, and as such, need to understand and meet their obligations from a different perspective.

Pointing out that the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) is still in force, Bailey goes on to clarify the unique dilemma facing those financial planners;

“If there are firms who ‘package investments together’ into in-house portfolios they would be considered, under RPPD, a provider. RPPD sets out two types of provider, a ‘retail manufacturer’ and a ‘pure manufacturer’. ATEB believe that firms who develop in-house portfolios would be considered a ‘retail manufacturer’ under PROD and therefore, as a manufacturer, a proportionate application of the PROD rules would apply.

"While the direct advice may be easy to understand, when applied to live advising the waters get a little muddier, particularly regarding 'end clients,' which is critical to giving a discretionary investment manager their identity under PROD."

Quoting from the legislation itself, Bailey explains;

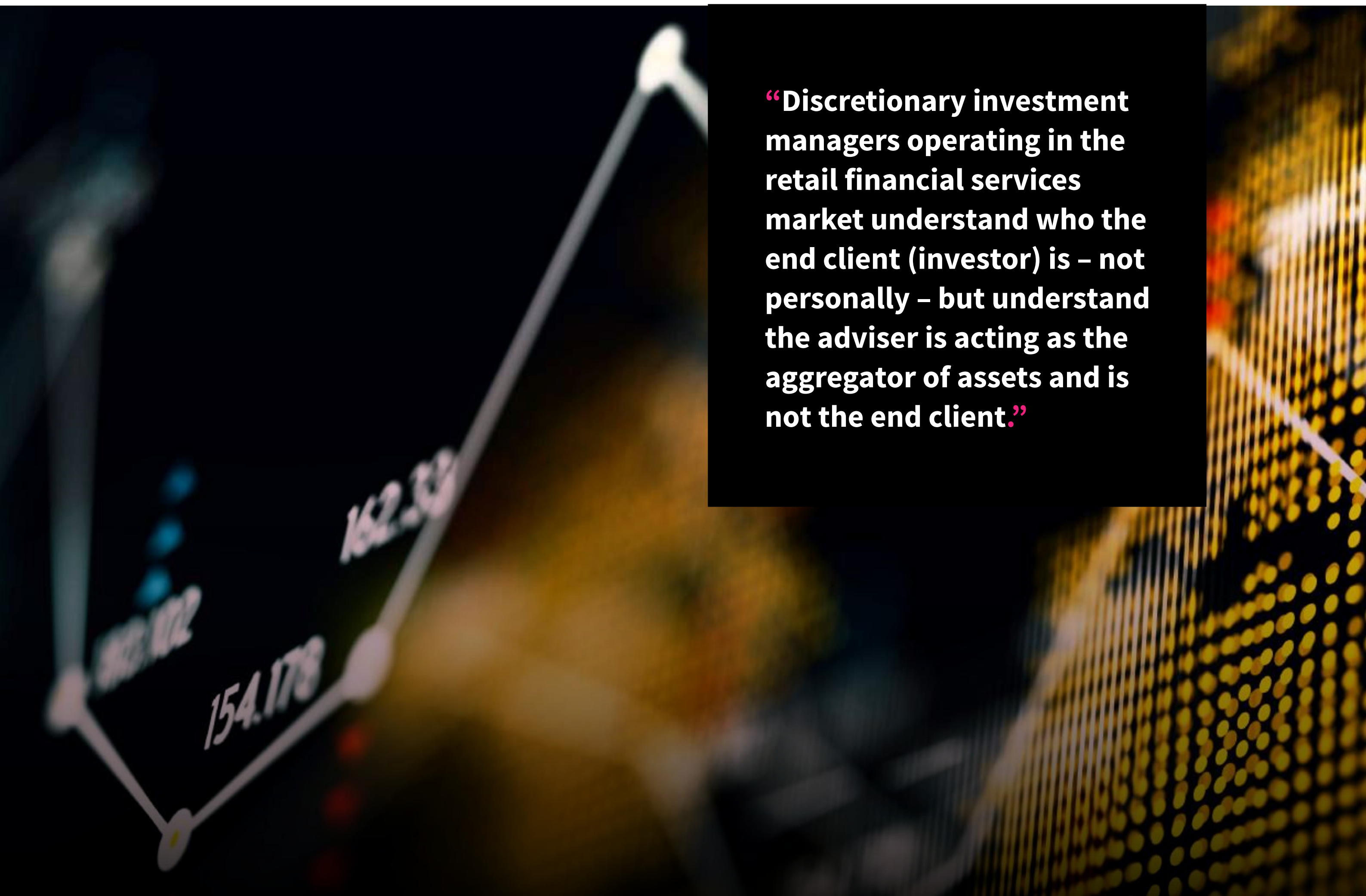
"PROD 3.3.32 states' that a firm which distributes financial instruments to clients which are not end clients, must consider whether it is undertaking a manufacturing role and, if so, comply with PROD 3.2."

"Discretionary investment managers operating in the retail financial services market understand who the end client (investor) is – not personally – but understand the adviser is acting as the aggregator of assets and is not the end client."

"Where the discretionary investment manager does not have a direct contractual arrangement with the end client (investor), they will struggle to argue they are distributors and therefore it would suggest they are manufacturers."

But while Bailey maintains that financial planners need to understand their role and its implications, he also understands the challenges facing advisers who may still be uncertain as to where they stand.

"It doesn't help if they are being told something to the contrary by their own advisers," Bailey says, echoing a feeling throughout the sector that with room for such margins of error, it is simple to see how PROD's objective instructions may fall down in the real world."



"Discretionary investment managers operating in the retail financial services market understand who the end client (investor) is – not personally – but understand the adviser is acting as the aggregator of assets and is not the end client."

The Future of PROD

For many financial planners, 2018 was a particularly dreadful year in the financial services sector, which was hit by an unprecedented wave of new legislation.

Although the regulator has been relatively generous with its low-key legislative approach to PROD, it is clear that it is gearing up to use it in a multi-pronged assault on the industry, both in terms of compliance and competition, and time is running out for advisers who wish to remain either oblivious or impervious to it.

Implementing it at this stage will help you not only meet the regulatory requirements but will also assist you in clarifying and potentially improving the value you offer to your clients.

With widespread rumblings that the industry has lost its competitive edge, PROD is a tool designed to push you to be as proactive as possible in delivering the very best value to your clients.

Superlative product selection, manufacturer analysis and client analysis may seem like petty hoops to jump through (again), but don't make the mistake of thinking that PROD is just a box-ticking exercise. At this stage of the game, it's a preface to a wider assessment of just how much better you can become.

Where to get information about PROD

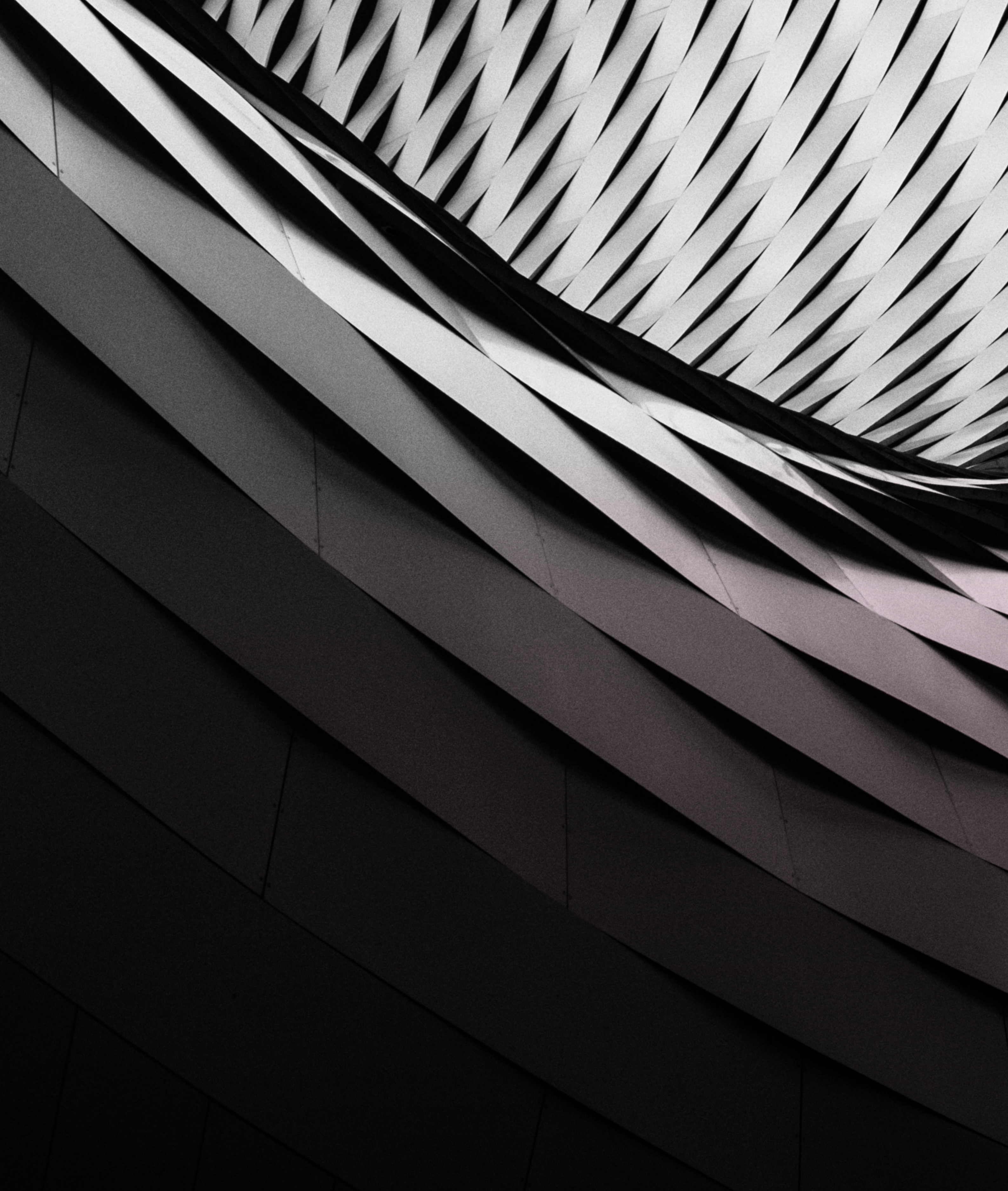
handbook.fca.org.uk/handbook/PROD.pdf

Acknowledgements

Steve Bailey, Director
ATEB Consulting

ATEB is one of the few compliance consultancies that can undertake FCA Conduct of Business Skilled Persons (Section 166) Reviews. Established in 1996, and one of the earliest compliance consultancies, ATEB provides pragmatic and hands-on support to IFAs, mortgage brokers and general insurance intermediaries.

atebconsulting.co.uk



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