Going DA

By Phil Young,

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As presented to
Transact advisers

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I've spent much of my career providing support to Directly Authorised (DA) firms. I've also spent a fair chunk of it working in or with Networks.

In the late 90s I worked for Investment Strategies Ltd (ISL), which was regarded as a small network at the time with just 1000 advisers. It was owned by Bankhall, who then decided it didn't want a network any more, closed it down, merged with Sesame, the UK's largest network, who gave up their investment permissions and introduced the network's investment advisers to Intrinsic, which sold to Old Mutual which split from its parent, bought two nationals and a Discretionary Fund Manager, and rebranded them all as Quilter. Networks have been both in and out of fashion several times over the past 25 years.

When I was asked to write this guide, I saw it as an opportunity to add a bit of balance to the debate on the choice between joining a network or obtaining direct authorisation with the FCA. Avoiding the situation above, where advisers have been moved from one owner or Network to another, is one advantage of the latter. However, having briefly run a Network recently I understand just how tough a job that is, and the difficult decisions every network boss faces every day.

In my time providing support services, at threesixty, we took a steady stream of firms from Network to direct authorisation, which reflected a consistent theme throughout the 2000s and 2010s, of an industry move to direct authorisation as networks atrophied and shrank. In recent years networks have become more popular, attracting capital and repositioning themselves in the modern, often vertically integrated advice market.

Hopefully this guide will be useful to a wide range of people, including those already running an advice business and anyone thinking about setting up a new one.

Phil Young
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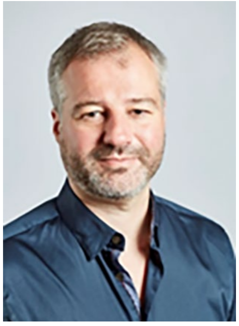

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1.1 What does the FCA think?

There is a perception that the FCA prefers to deal with a small number of very large regulated firms, as this is easier for them to supervise and manage. At the same time, the FCA have just launched a consultation on the use of Appointed Representatives (ARs) and expressed their concern that the Network model is failing to adequately protect consumers from harm.

It is impossible to draw any conclusions about what the FCA think you should do, and who they will 'go after' in future. Network models are now so diverse it is almost impossible to treat them as one. General insurance and investment management firms may take a very different approach to traditional adviser networks. They are very diverse business models all caught under the Network definition, and all are included in the FCA's latest consultation.

My advice is to ignore the conjecture around large or small businesses and simply choose the option which best fits your business based on the information available to you.

1.2 When Networks go wrong

The importance of making the right decision is never more apparent than when a Network goes bust. This is rare but has happened on a number of occasions, and it is enormously disruptive for the advisers within the Network. As both the agencies and the FCA licence and number belongs to the Network, not the AR, it leaves advisers unable to trade or place new business and unable to receive pipeline income due. It is difficult to escape this state of limbo, as quickly transferring to another Network is hard without FCA intervention, and impossible to get directly authorised in time.

2 Network v DA: Key Points to Compare

2.1 Capital adequacy

One of the most underrated advantages of being in a network is that the FCA's capital adequacy requirements do not apply to ARs. The capital adequacy requirement sits with the network rather than the AR. This makes becoming an AR attractive from a financial resources perspective, for two reasons:

1. Start-Up Capital

New start-ups often don't have much cash to spare. The rules on capital adequacy vary depending on your permissions, but for the majority of investment advisers it means the greater of £20,000 (E25,000 if you're MiFID firm) or 5% of your turnover. You don't have to think about your capital position at all as an AR from a regulatory perspective, although your network should consider your financial fitness to trade.

It is worth remembering that the network will need to fund its own capital position by retaining a percentage of the charges it takes from its members. It may also have to retain additional capital to offset any clawback liability from initial commission funded insurance advice. So, over the long-term, capital is built up, but not within the AR firm and it can't be recovered or commuted across to the AR when leaving the network.

2. Use of Debt

DA firms, especially smaller firms, are often prevented from using debt to finance acquisitions or other business development opportunities, because of the detrimental effect that the debt would have on their balance sheet.

Where the equity in another advice firm is purchased using a loan, the value of that equity in that business can be used to offset the debt, potentially making it neutral from a capital adequacy perspective. However, many small acquisitions are purchases of client banks, which is the main asset in the firm, rather than equity in the business itself. This is more cost effective for the buyer as it requires far less legal input and due diligence. Where the assets are purchased, the value of those assets cannot be used to offset against the debt on the balance sheet. As a result, few DA firms take on debt to buy small client banks.

There are ways around this but the legal and tax costs of restructuring a business to achieve this can sometimes be prohibitive for small firms. Over the years a number of DA firms have restructured their business to include a non-regulated holding company which is used as the vehicle to hold debt, thus avoiding it having to be factored into the regulated business's capital adequacy requirements. ARs have no such problem and can take on debt to acquire client banks without the need for a holding company. Some networks encourage this by offering development loans to members and keeping clients within the network by encouraging an active internal market for acquisitions.

2.2 Capital value

Many business owners wish to create capital value in their own firm. There is a common perception that AR firms are less attractive to buyers than DA firms. This can sometimes be true, but the reasons are not commonly understood.

Networks have historically been protective over client ownership, and for retention purposes many made exit terms as abrasive, time-consuming and costly as possible. Some of these are outlined under Contractual Restrictions below, and include clauses around ownership of clients, client files and data, and control over fee and commission income, during and post, network membership. Any buyer would want to understand the details of any restrictive contractual terms between the Network and the AR before acquiring. This is an added step which means some may be put off Network firms, as many of the problematic clauses are broadly drafted and hard to quantify.

Networks can make the extraction of client data from their own back-office system extremely difficult when leaving the Network, and sometimes impossible. It is worth considering the process for an exit before joining a Network.

Some Networks offer their own buy out schemes which would compete with any external bidder. A network acquiring its own AR has the added advantage of having all the information it needs to undertake full regulatory and financial diligence due to the oversight it has as part of its supervisory obligations.

These added complexities often put buyers off, but for those prepared to find the right firm, acquiring an Appointed Representative of a network could be attractive. As the regulatory liability is left behind with the network, there is a limit to the amount of risk any buyer is taking provided they do not inherit it through any terms included in the contract between the AR and the network. This contract will need careful consideration and review by a purchaser, and it is another reason you should review it carefully with one eye on an exit before joining a Network.

> “It is worth considering the process for an exit before joining a Network”

2.3 Professional Indemnity Insurance (PII)

PII has always had an unhealthy influence over the advice market. In recent times, a difficult PII market has driven a number of firms towards Networks due to an inability to obtain adequate cover whilst directly authorised, most commonly because of concerns over occupational pension transfers.

It is worth considering how PII works within a Network versus Direct Authorisation.

Directly authorised firms purchase PII through a broker, many of whom have one or a very small number of insurers they commonly work with due to the relatively small numbers of insurers offering PII to financial advisers at any one time. When the market is 'soft', there is sufficient competition to keep premiums relatively low. This might be 1.5-2% of turnover. With a lack of capacity, as we've seen in recent years, comes a lack of competition as insurers reduce their own exposure to the advice sector rather than take new risk on. In turn, advice businesses are forced to stay with the same insurer and broker just to keep continuity of cover, rather than shop around.

In a 'hard' market it is usually increasing premiums which attract the headlines, but other factors are also at play. Most DA firms will recognise these problems in the current PII market, and have been faced with a deteriorating position in some, if not all, of the areas mentioned opposite.

Excess

A higher excess should reduce your premium. However, the FCA set a standard excess limit of £5000 for advice firms and excesses above this amount trigger a requirement to hold additional capital on top of their minimum regulatory capital adequacy requirements.

Exclusions

Many firms who have advised on occupational pension transfers in recent years will have seen cover for that advice excluded from their policy, but exclusions often go well beyond pension transfers. Due to the desire to reduce risk in the advice market, insurers are commonly excluding advice on investments with liquidity issues such as property funds, Woodford funds and peer to peer lending. Where there are exclusions on a policy, the firm is required to make an assessment as to how much additional capital to hold, subject to a minimum amount.

Limitation of Cover

Many insurers have brought the total amount of cover available down from the £1.85m regulatory requirement to as low as £500,000 in an attempt to reduce their exposure. Again, this triggers a requirement on the firm to hold further capital.

Networks are faced with exactly the same position as a DA firm when negotiating the best possible PII terms on behalf of themselves and their members. Their scale does mean that they are more likely to find past advice which an insurer would like to exclude. However, their scale also means that they might be a significant, long-term profitable customer for the broker and insurer, who would want to find a way to offer them terms which they might not offer to a small DA business. There is some evidence that larger firms are able to reduce the premium as a percentage of turnover, where turnover is in excess of £10m, but they may also be in a far stronger capital position where high excesses in return for holding greater regulatory capital is manageable. A number of large firms and networks now have layered cover, with multiple insurers covering different parts of their advice liabilities, to meet their regulatory requirements. Again, this is unlikely to be something a small firm could achieve.

As a result of this purchasing power, it could be that the cost of PII within a Network is cheaper than the equivalent if DA. However, you need to understand how your Network's PII cover has been structured, not simply the premium.

Networks typically operate with a 'block policy' which covers not only all current advice given, but all past liability. You not only need to know how your premium is calculated now, but how they recover a contribution to that premium from members who retire or leave and the implications for you should you leave the Network.

For example, they might have a separate policy which covers leavers. They might ask for a future contribution from all Network leavers based on a set formula. They might pursue the costs of any excess payable from all Network leavers through contract or Personal Guarantee. These actions all help keep down the cost of PII to members who remain in the Network. However, they also need to be considered for your own firm when you leave.

Should you agree to indemnify the Network for future costs, including excesses, you will not be in control of what those excesses might be in future years. Some large firms have excesses of £100,000, for example.

"You not only need to know how your premium is calculated now, but how they recover a contribution to that premium"

2.4 Liability and Personal Guarantees

We have already discussed how PII is a significant consideration in a difficult market. It is also worth considering what other personal risks you might be exposed to depending on whether you are DA or an AR.

You will be required to meet your statutory obligations as a director whether you are a board member of a DA or AR firm. There is a perception, however, that AR firms and directors are more sheltered from regulatory risk than their DA equivalents.

There is some truth in this. Neither AR firm directors nor advisers are visible under the FCA's Senior Managers and Certification Regime. This is by accident rather than by design as the relevant legislation does not currently allow the Regime to apply to ARs, but it is also fair to say that the FCA's first point of contact is with the Network itself, as principal, rather than ARs. The Network is directly responsible for meeting the regulatory obligations of its ARs and the Network is also responsible for receiving and handling all regulatory complaints. There are plenty of occasions where ARs have been interviewed by the FCA, but it is the Network who are responsible for managing any regulatory enforcement issues and paying any fines.

This situation is muddied, however, by the use of contractual obligations and Personal Guarantees. Most, if not all, Network contracts have an obligation on directors of the AR to pay out on any future costs incurred as a result of advice given by the AR firm in perpetuity. This is typically enforced using a Personal Guarantee on all directors which applies until death, so that the winding up of the AR firm is not the end of the liability as it is for a DA firm.

This is where the common myth that financial advisers have 'liability until death' comes from. There is no such liability from a regulatory perspective. Provided a DA company is properly wound down, which includes cessation of permissions from the FCA, the individual directors and shareholders do not retain any future liability, except in highly unusual circumstances. An AR firm and its directors, however, accept that liability by contract with a Network and this is a legal rather than regulatory matter.

This liability goes on even once the AR leaves the Network. At this point the Network generates no income from the former AR and there is no ongoing relationship to protect. There is little incentive to act in the interests of the former AR where that conflicts with the interests of the Network. Claims might be settled and paid out by the Network which the AR would normally defend, and the Network may lose its PII or accept a far higher excess, so the former AR has no ability to cap future losses. For that reason it is worth exploring what run off cover might be available should this be required, but it is an additional and unquantifiable future cost worth factoring in.

This can be a real worry for business owners when joining a Network, but one which many do not even identify. It has become an accepted norm that all Networks require Personal Guarantees, so if a Network is the only solution there is little alternative but to agree to it.

2.5 Flexibility

One of the common reasons quoted for going DA is the greater flexibility and freedom it offers. These concepts are very easy to sell to Network firms when you're pitching for DA services. However, I can vouch for the fact that sometimes the controls and constraints put in place by a Network stop business owners from making impulsive, high-risk decisions.

When a number of Networks stopped allowing occupational pension transfers, for example, the market was awash with firms who were desperate to continue advising in this area, despite the inevitable long-term consequences. 'Freedom' and 'flexibility' can be attractive to those who have difficulty accepting challenge.

There are some areas where complete flexibility will be impossible in a Network, simply because of the risks and constraints of the operating model, and we explore some of these below.

2.5.1 Permissions

If you are in a Network, it is the Network rather than your own AR business which holds the regulatory permissions required for you to advise. This means you are limited to the activities their permissions allow them to undertake and anything out of scope requires them to apply for new permissions for the whole Network. Beyond regulatory permissions, many Networks operate an additional adviser 'licensing' system, which controls which advisers can or cannot advise in a specific area even if their regulatory permissions allow it. For example, a Network may have the ability to advise on occupational pension transfers, but only allow a select number of advisers who have undertaken additional qualifications, CPD and testing the ability to advise in this area.

It is important you clarify what you will be excluded from advising on or what additional requirements you will need to meet for certain advice areas, before joining the Network. This also includes clients with existing products which need to be reviewed. For example, you might have previously advised on EIS' to a small number of clients and whilst you are comfortable not recommending this product in future, you need to understand how to approach questions about this, such as when to disinvest, from existing clients going forward.

New regulatory permissions are created from time to time, and will need to be applied for, and the Networks PI insurer will also have a say in which areas they will permit advice, through exclusions on the policy.

One specific issue worth mentioning here is that you cannot have your own discretionary investment management permissions in a Network. The Network can obtain these permissions but would be responsible for managing the money. So if your ultimate aim is to manage client money under your own discretionary permissions, this cannot be done as an AR of a Network.

As a directly authorised firm you will have control over which permissions you hold but there is increasing pressure from the regulator to remove permissions that aren't being used and seen as superfluous, and PII terms may create further limits on your scope of activities.

2.5.2 Investment, Product and Platform Proposition

The evolution of Networks over the past decade has resulted in many of them imposing their own centralised Investment Proposition on their members, rather than allowing them to create their own. Based on my own experience of running a Network, I can honestly say it is extremely difficult, if not impossible, to allow members to have a full and unfettered choice of products and investment propositions when you are liable for the advice given. Restricting choice can be perceived as an overly authoritarian approach, but it is driven by two major concerns for Networks:

1. Revenue and value creation through an in-house investment proposition

Larger Nationals and Networks have for some time generated the significant profits from investment management, which is of greater value than the profits they make through the charges to ARs for their Network service. Investment management at scale is extremely lucrative and works at a fixed cost, unlike the provision of Network services, and it is also extremely attractive to institutional investors and future acquirers of the Network. Many Networks incentivise advisers to use their own investment proposition, through favourable loans, future buy-outs or by making it a compliance requirement. Some also have their own, often white labelled, platform which they may mandate or encourage members to use as they generate revenue from the platform fees.

2. Risk

Risk mitigation plays a major part in any business with multiple advisers. Advisers within Networks operate with greater autonomy than employed advisers within a single firm. Controlling and understanding what advice is being given by 100+ advisers at any given time is extremely difficult. It is far more practical and efficient to offer a Centralised Investment Proposition managed by the Network with sufficient optionality to allow for different advice propositions, than to allow every AR to create their own and check each one individually.

As a DA firm you are in complete control of your Investment Proposition, now and in the future, although that doesn't appeal to everyone. If joining a Network, it is extremely important to consider what limitations will be imposed on your investment choice and if you are comfortable to use a Network Centralised Investment Proposition then this should be one of your key points of comparison, and diligence, when choosing which one to join.

> "It is extremely important to consider what limitations will be imposed on your investment choice"

2.5.3 Technology

Technology, and in particular the back office system, has become one of the major points of differentiation between Networks in recent years. It was relatively unusual for a network to mandate any particular form of technology a decade ago, however most Networks now do this to be able to manage ARs efficiently and it is integral to their compliance and risk regimes.

Network advisers both love and loathe the technology they use. If you are considering joining a Network, technology is a key issue you should spend time investigating. Do your own research, and speak to advisers and AR owners who are not simply referred to you by the Network as they will invariably be the most positive.

One advantage of mandated technology is that the Network will usually be able to secure a discounted rate on the technology due to their purchasing power, and where you purchase the software through them rather than from the software supplier direct. Networks may also mark up the cost of the technology and keep margin themselves to cover some of their own costs.

Some support services companies also offer discounts, although it is rare that they are discounted as heavily when you purchase them direct from the software manufacturer.

Where the Network offers their own technology it can be even cheaper, but the technology does not come with you when you leave the Network and it is typically harder to extract client data.

You should be especially concerned about any future exit when joining a Network which uses proprietary technology.

One point on proprietary Network software is worth bearing in mind when reviewing it. Much of it was initially developed to facilitate a product or investment purchase, for example the use of an in-house DFM, and as a result they often miss some of the more generic Customer Relationship Management functions that mass market suppliers like Intelliflo and IRESS provide.

Where technology is not mandated, it may still need to be approved by the Network. They may offer some optionality with a narrow selection of tools you can use.

In addition to the back office you should also ask about the position of the Network on:

- Attitude to Risk Profiling
- Digital signature software
- Client portals, secure messaging and email encryption
- Document Management Systems
- Product and fund research
- Report writing software
- Use of social media, newsletters, and digital marketing

2.6 Cost

2.6.1 Regulatory Costs

The financial barriers to entry to establish an advice firm remains relatively low. If you want to go DA there is a one-off fee of £1500 payable to the FCA on submission of the application. This may be increased to £2500 in future.

In addition, there are annual fees to the FCA and FSCS levies to pay. If Directly Authorised this can be calculated for your firm using this calculator.

A typical firm might pay:

- 1.7-1.9% turnover for regulatory fees
- 1.5% to 3% turnover for PII (it will be at the lower end when you first become DA as there is no historic advice to insure)
- £115 initially then £70pa for a Legal Entity Identifier
- £60pa for Data Protection Licence

Networks will incur regulatory fees and pass them on to you either directly by invoice or deduction of revenue. There is little difference if you are in a Network to the total cost of regulatory fees but some Networks will allow ARs to spread this cost, interest free, throughout the year rather than pay in one instalment. This has proven to be beneficial to some ARs in recent years due to the use of ad hoc interim levies for FSCS levies which has caught a number of firms out. The interim levies are something all firms should offer provision for.

Remember, there is also the cost of holding the relevant regulatory capital for DA firms.

2.6.2 Support Costs

Most DA firms still contract in some form of external support for their business, in particular where they need help with research and compliance. This is because most advice firms are too small to warrant full-time staff undertaking these roles. Outsourcing can be fairly flexible, agreed at a fixed price, and the total cost is commensurate with the size and complexity of the business.

The cost of compliance personnel has inflated in recent years. Indicative salary levels are £35,000 for a file reviewer, £50,000 for a compliance manager/ supervisor and upwards of £60,000 for Compliance Directors who hold all the relevant Senior Manager functions. Experienced Compliance Directors in large firms such as Networks are often paid in excess of £100,000.

There is an advantage to outsourcing, whether it is through a Network or a Support Service firm as these costs are shared amongst a large number of firms, however it does result in less personalisation of the service compared to an employed role. You can take it from me that any Network or Support Service who claims to offer a fully ‘bespoke’ service is either lying or doesn’t have enough firms to look after.

In my experience, a DA firm with multiple advisers will typically pay £500 to £600 per month for support services, including one or two audits per annum on top of desk-based support. It is unusual to pay more than £20,000 per annum when outsourcing as larger firms will typically hire full-time resources in-house and outsource more specialist functions once they reach a certain size.

It’s advisable for larger firms to retain some form of external support as this will support the ‘three lines of defence’ model which most adopt, with the external consultancy providing a report to the board on the effectiveness of the internal compliance function as the third, and most independent, line of defence.

2.7 Agencies and Fee Income Payments

DA firms are responsible for setting up their own agencies with platforms and providers, and receiving, reconciling and distributing the income paid through each. It can take time to set up a lot of agencies but once established they belong to the firm. Origo have created a service which allows you to create a number of agencies online in one electronic submission.

In contrast, a Network will own the agency used to pay income through to AR firms and advisers, and reconcile this at source. Whilst this could save you time, there is likely to be a delay in receiving the funds into your bank account, and the threat of suspending income payments is the main device a Network has to discipline an AR. There is also a potential delay if you wish to use a provider who does not have an agency with the Network and their legal team need to agree and sign it.

Should you leave the Network you will need to set up your own agencies, and income will continue to be paid to the Network until either each client agrees to transfer payments to the new agency, in case of an Adviser Charge, or a Novation Agreement in the case of any commission, such as trail commission. That Novation Agreement will usually state that in return for moving future commission payments away from the Network and to the DA firm, the DA firm accepts liability for any future payment liability, such as a clawback of commission. A bulk novation can work for commission payments, because the contract for commission is between the Network and the Provider. For adviser charges this is not the case, as the agreement is between the client and the advice firm. As a result, bulk novation is not possible and each individual client needs to give consent to moving the payment. Platforms and providers usually want to see some evidence this has happened before changing the payee.

2.8 Resources

The costs of a Network do give you access to some resources a small start-up firm might struggle to resource. This might be because they require specialist expertise, or simply because they do not warrant employing another member of staff to service them.

The key ones are:

> "DA firms must reconcile all income coming into their business"

2.8.1 Fee and Commission Management

DA firms must reconcile all income coming into their business. The bigger the firm, and the more diverse the range of range of products, platforms and payment types used, the more time-consuming this process becomes. Fortunately, modern back office systems make this easier, especially where they can receive income statements as an XML message and automatically match payments to your system. This requires some investment in time to set up and maintain, but the long-term benefits are enormous to a growing business.

Within a Network, all of this is taken care of by a centralised team who will reconcile all monies received and make payments out to your AR firm on an agreed frequency. Some Networks will pay the relevant split of funds direct to each adviser's bank account based on rules you provide them with. If they can't, you may have to duplicate some of their centralised service to make your own payments. There is a significant difference in timeliness of payments between different Networks. With modern technology there is little reason a Network should not pay out weekly. They should not need to sit on income for more than a week unless the AR has provided insufficient data for the payment to match.

However, some Networks do hold AR income for a number of weeks, and this should be a key part of your diligence.

2.8.2 Compliance and Supervision

Whilst DA firms can outsource file review work and some elements of supervision, because a Network is fully responsible for these areas they should take full control over them. This means that when you are in a Network you can expect someone to chase you up on outstanding actions from file reviews, make sure your CPD records are up to date and collate KPI data. These are often thankless tasks, but the administration and chasing required to make sure compliance work is followed through is a significant task, and not something you can easily, or cost-effectively, outsource.

In DA firms where they outsource a lot of compliance, supervisory work and chasing up remedial action often falls to a senior manager who does not have the time to do this job properly. Ideally the follow up work is picked up by someone who does not have client responsibilities and is organised and thorough, with enough gravitas in the business to make sure action is taken.

One frustration Network members often express is that their compliance department does not provide pro-active assistance with individual cases to help get them through a file review. In reality, this would compromise the impartiality of the department if file reviewers became involved in individual cases which they then assess, so Network training should be provided in advance, using practical examples, rather than 'on the job' with real clients.

The judgements in several court cases show that Networks should not allow AR firms to appoint their own in-house supervisor. Regulatory supervision should be undertaken by Network staff, with day-to-day performance management undertaken by the AR firm.

If you wish to take on inexperienced advisers to train them up, it is especially important you discuss this with Networks as not all of them have the head office capability to provide proper supervisory support for new entrants.

All client complaints must be reported to and managed by the Network, and they will also need to approve all financial promotions. Firms generating high volumes of adverts, for example via social media, will need to understand the process and turnaround times to ensure that the Network can cope.

2.8.3 Regulatory Reporting

Networks are required to submit all regulatory returns on behalf of their members, so there is no need for an AR to submit financial or other regulatory returns. The Network may require this information for their own monitoring purposes, however.

DA firms have to do this themselves, and fully outsourcing it is not always practical. Whilst regular financial returns can be more tedious and frustrating than anything more significant, there are occasional requests for information with short timescales attached which can be more burdensome.

2.9 Network v DA Summary

There has always been a good number of firms and advisers in both Networks and Direct Authorisation, and sufficient competition, to keep the costs of each honest. The key trade-off is the convenience of a Network, which provides a lot of the back office support small and newer businesses need to get started, versus the creative control which DA firms enjoy.

Networks have always been seen as a stepping stone for many firms who have needed their support to grow to a scale where it makes both financial and wider business sense to move to direct authorisation.

As a result, Networks will have pricing and retention strategies designed to lock you in for longer than you might have originally planned for, and you will see throughout the points raised above that it is important that you consider the practicalities of any future exit should you decide to join a Network.

3 Going DA: Process and Paperwork

3.1 Contractual Restrictions and Exit Tactics

If you're applying for Direct Authorisation you are either leaving an employer to set up your own business or leaving a Network. There will inevitably be contractual issues which will influence how you leave and how you launch your business once authorised.

If you are an employee or self-employed adviser leaving a business, there will be restrictive covenants which dictate what you can do in future with existing clients of your current firm, as well as any staff you wish to bring with you. This has a financial consequence, as you will need to fund the business for a time without the revenue from your current client bank.

If you are a shareholder of your current firm there may be more stringent restrictive covenants than in an equivalent employee contract. It is, however, clear in these circumstances that you will be setting up a new company.

If you already have a business which is an AR of a Network, the relevant contractual restrictions will be in your AR Agreement. Whilst it is likely that you can take your clients with you, some Networks use tactics to make leaving the Network difficult once they become aware you are leaving, typically by holding back revenue due to the AR for as long as possible.

To avoid that issue some Network leavers have set up new companies, outside the Network, and applied for those new companies to become Directly Authorised, rather than take the existing AR firm DA. Once the new company is authorised they then simply move the clients from the AR firm to the DA firm, and the revenues are transferred across with minimal delay. The old AR is left in the Network and eventually left with no clients, staff or assets. This tactic has been used for many years by Network leavers although some AR Agreements may now prevent this.

Where possible, it is better to have a frank conversation with the Network about going DA, and agree to work together on it. Every Network has a flow of firms leaving to go DA so they should have plenty of experience managing the process.

3.2 Company Structure

Almost every DA firm is a Company Limited by Shares. This is because of the protection that a limited company offers in comparison to a sole trader or partnership, where the owners could still be subject to personal liability.

The main reason for not using a limited company is that sole traders who might otherwise struggle to fund the capital adequacy requirements can use their personal assets to meet the requirements. Limited Liability Partnerships can be used but are rare.

> "It is better to have a frank conversation with the Network about going DA, and agree to work together on it"

3.3 Forms and Documents

There is quite a bit of work to do before you are ready to fill in the forms.

Assuming you are Company Limited by Shares you will need to present:

- Articles of Association
- Evidence of shareholding
- Your business plan, outlining your proposition, charging and operating model, target market and marketing strategy
- Financial projections for your first 36 months of trading, which separate regulated and non-regulated income and demonstrate in the balance sheets that the regulatory capital adequacy requirement is satisfied. The forecasts must include:
    - monthly balance sheets
    - monthly profit and loss accounts
    - monthly cash flow
- A bank statement
- An organisation chart, assuming there is more than one staff member
- Your Professional Indemnity Insurance quotation
- Your Compliance Monitoring Programme, with information on who will be responsible for the relevant compliance and regulatory functions

If the firm has previously traded

You will also need to supply:

- Disclosure of significant events, with information about the firm's previous trading history
- Last full year's accounts
- Management accounts since the previous accounting year end

If you are opting into MiFID

MiFID firms need to provide similar but more detailed information using additional forms including:

- The MiFID annex form
- The MiFID supplement form
- The MiFID IT assessment form
- The MiFID retail checklist
- The MiFID authorisation form
- The MiFID members of the management body form
- Passporting form(s) if applicable

For individuals

Directors or partners of the firm will also need to submit a Form A for the FCA to assess their fitness and propriety as individuals. This should be accompanied by:

- Their full CV
- A skills gap analysis
- A Learning and Development Plan
- A Statement of Responsibilities

All investment advisers must also submit their up-to-date Statement of Professional Standing.

Other Documents

There are other documents which could be required depending on your circumstances, such as:

- ·Application for consumer credit activities
- Application for registration as a consumer buy-to-let firm
- Controllers' form, which provides information on any other companies or individuals that have a shareholding or position of influence on the firm
- Appointed Representative form, if any ARs are to be added

3.4 Submitting the FCA Application

Once the application is submitted the FCA will allocate a resource to process it. The timescales vary depending on how straightforward the application is and the availability of resources the FCA have at any given point in time. There can be backlogs in the Authorisations team at any given time due to any number of reasons, but they do eventually clear. You will hear an enormous range of timescales quoted for authorisation depending on who you ask. They vary wildly. The rule of thumb I used to quote years ago was six to eight weeks, but it's been as long as six months. The best advice I can give you is to not let the timescale drive your decision. It's a short time in the life of most businesses, and to give yourself as much time as possible by planning ahead.

Unless you explicitly request it in your application, the FCA will obtain references from current and previous employees when they want to unless you instruct them to wait for references until the end of the process. If you have not made your current employer or network aware of your application this will bring it to their attention.

You are unable to trade until your firm's application has been granted, however the individual applications will be reviewed and approved separately, and it is possible that not every individual will be approved at the same time. There may be reasons why some take longer, due to delays or problems with references or further questions the FCA may have.

You will receive your 'minded to approve' confirmation and agree a start date with the FCA. In the interim you should focus on preparing the business as fully as possible for launch by ensuring your client documentation is ready, your advice and investment proposition is written and finalised, and you have chosen the tools and technology you need to move forward. Some firms train staff on new back office systems very soon after submission of the application, and have forgotten much of what they learned by the time they are approved, so think about the best timing before booking in any practical training sessions.

3.5 Typical Problems with Applications

You will hear stories about firms who have had applications approved in a matter of weeks and those where the FCA have taken a year to approve them. Most can be taken with a pinch of salt. In reality, nobody wants to admit the real reasons for any significant delays, even if they know them.

3.5.1 FCA backlogs

One reason why delays can happen is FCA resourcing problems, which is well outside your control. The FCA Authorisations team has significant peaks and troughs in activity as well as a turnover of staff like any other organisation. These problems are impossible to predict.
If they have a backlog due to a significant increase in workload, or if the person handling your case leaves part way through their review of your application, there will be delays. One change which has been made at the FCA in recent times is to delay appointing a dedicated person to review your application until they are ready to commit time to it. This means that you might not have a single point of contact for some time, but the application could progress very quickly once an individual is allocated to your application.

3.5.2 Mistakes with the application

As with any form-filling exercise, the application is open to error and misinterpretation. Using a compliance firm to check and help complete the forms for you is a good way to ensure that the information is not only provided correctly but in a format that the FCA are familiar with. This should reduce the chances of unnecessary delays.

3.5.3 References and concerns over individuals

It is not uncommon for the FCA to receive negative references from previous employers, especially where the applicant's departure from the firm has been acrimonious. The FCA will need to consider any negative comments but where they are unfair or unjustified this should be resolved. If the concerns appear to be justified, and especially where they involve malpractice, significant delays can occur. This is not always easy to identify as the investigations often take place without the applicant's firm being notified. There are occasions where new firms have to remove a practising principal from their application in order to progress their application.

3.6 Post Authorisation

You will need your FCA numbers to apply for agencies and complete a number of administrative 'start-up' tasks. Most providers take their data about which firms are authorised from the FCA directly so there may be a slight delay before you appear on the FCA register.

> "You will need your FCA numbers to apply for agencies and complete a number of administrative 'start-up' tasks"

4 Appendix 1: Extra Network Diligence Questions

This is a list of questions which you may wish to ask Networks when considering which one to join.

Costs and Contract

- What are the costs to us to be part of your Network, both directly from the Network and to any third parties such as software suppliers? Are there any one-off costs?
- How do these costs vary dependent on number of advisers or turnover?
- Do you have any special terms with Network members which are below the list prices?
- How do you reconcile and pay out fees, what are the timescales and how often do you make payments?
- Can you make direct payments to advisers as well as the AR firm? If so, can we provide different split rules per adviser?
- What support do you provide moving existing agencies into the Network?
- Do you offer additional incentives such as development loans, referrals, or practice buy-out schemes? Please provide information.
- What restrictions or obligations do you include in the AR Agreement around client ownership or direct contact from the Network with clients, either during the term of the Agreement or after termination?
- Where does financial liability for poor advice or other faults sit for the firm, and its owners and directors, during the term of the Agreement or after termination?
- Do you impose Personal Guarantees on anyone?

Scope of Advice

Are there any products or areas of advice I would be excluded from within the Network or require a separate licence for? What is required to obtain those licences?

Do you have your own panels or centralised investment proposition? If so, please supply a copy. Are these mandated or encouraged in any way?

Network Performance

What service levels do you have in place for services, including pre-approvals, file review feedback and advertising approvals?

Do you compensate for persistent breach of these service levels?

Technology

What technology do you mandate, approve, re-sell or provide discounts for, including:

- Back office and fee reconciliation systems
- Attitude to Risk Profiling
- Digital signature software
- Client portals, secure messaging and email encryption
- Document Management Systems
- Product and fund research
- Report writing software
- Use of social media, newsletters and digital marketing

PII

Provide details of how your PII works and a copy of your current policy. Provide copies of your previous three years' PII cover including premium, excesses and exclusions.

Exit

What restrictions do you impose when leaving the Network?

What is required to take client data with me if I go DA?

Are there are financial implications should I go DA around my cashflow or future income? Do you suspend income payable to me? How do novations work?

What fees are payable post-exit? If I leave part way through a financial year how are any regulatory fees calculated, and will some be rebated?

Can I take all the technology used with me post-exit?

5 Appendix 2: FCA Application Checklist

Business plan

- Proposition
- Charging model
- Operating model
- Target market
- Marketing strategy

Financial projections first 36 months' trading

- Separate regulated and non-regulated income
    - Demonstrate capital adequacy requirement is met
    - Monthly balance sheets
    - Monthly profit and loss accounts
    - Monthly cash flow
- Articles of Association
- Evidence of shareholding
- Bank statement
- Organisation chart
- Professional Indemnity Insurance quotation
- Compliance Monitoring Programme

If the firm has previously traded

- Disclosure of significant events
- Last full year's accounts
- Management accounts since the previous accounting year end

If you are opting into MiFID

- The MiFID annex form
- The MiFID supplement form
- The MiFID IT assessment form
- The MiFID retail checklist
- The MiFID authorisation form
- The MiFID members of the management body form
- Passporting form(s) if applicable

For Directors

- Form A
- Their full CV
- A skills gap analysis
- A Learning and Development Plan
- A Statement of Responsibilities

For Investment Advisers

- Statement of Professional Standing

Other Documents as relevant

- Application for consumer credit activities
- Application for registration as a consumer buy-to-let firm
- Controllers' form
- Appointed Representative form

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Zero Support
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