Quality of Advice Process in Firms Offering Financial Advice

Considerations for Treating Customers Fairly

July 2006

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Introduction

- This thematic work was undertaken to see what further help firms offering financial advice need to improve their advice processes and reduce the risk of mis-selling. We looked at the way the firms were taking account of Treating Customers Fairly (TCF) within the advice process. While it is the outcome of the advice process that is important in that customers receive suitable advice, we focused on the aspects of giving advice which are critical to achieving this.
- One of the largest pieces of thematic work we have undertaken at the FSA focused on the advice-generating processes within a representative sample of 50 financial advice firms which were visited, 528 transactions which were reviewed and 50 financial advice firms which were mystery shopped. The sample ranged from very small firms with two advisers to large national firms.
- The work also looked at a small number of high street banks and product providers. While this sample was small, some of our findings were similar to those from financial advice firms. We suggest that firms in these sectors review the results as well.
- From the information gathered during the visits and the mystery shopping exercise, we assessed the extent to which firms demonstrated TCF throughout the advice process and collected examples of good and poor TCF practices used by firms. Our approach varied depending on the way the firm operates. Our overall findings, key messages for the industry and a toolkit of examples of good practice which firms can consider, where appropriate, against their business model are set out in this report.
- We found many examples of good practice, particularly in the smaller firms. We used these to develop composite case studies as well as detailing some of the examples to the industry to help firms improve. However, in an unacceptable number of firms we reviewed, we identified significant flaws in the advice process which may result in consumer detriment.
- As we have always said, TCF is not a 'one-size-fits-all' approach and it is for senior management to decide what TCF means for their particular firm. Generally, the good and poor practice that we report here is to help firms and their management make that decision: we think the good practice is likely to help a firm treat its customers fairly and the poor practice is likely to get in the way of a firm doing so. Where we report good or poor practice which concerns compliance with or breaches of detailed rules which impact on fair outcomes for customers, firms must of course comply with those detailed rules. Other Principles, as well as 6 (which requires firms to pay due regard to the interest of it's customers and treat them fairly), are relevant when taking a rounded view of what the fair treatment of customers means.

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TCF considerations for quality of advice (1)

Key messages for firms

- The management of firms, including partners, principals and sole traders, are responsible for considering how to take the following into account to address any issues within your firm. How you do this will vary according to your business model. An adviser or any other member of staff involved in the advice process should also consider the messages below in relation to their day-to-day work.

Quality of advisers

- Your recruitment process – is it robust enough to ensure that you are recruiting good advisers?
- Qualifications – are they appropriate for the advice your advisers provide to customers?
- Gaps in skills and knowledge – do you have a mechanism in place to identify gaps in skills and knowledge of your advisers? Do you assess the quality of training undertaken by your advisers? Do your advisers keep up to date on tax and benefits? Do they know how to assess affordability?
- Training & Competence (T&C) strategy – do you have a T&C strategy that you regularly follow and review?

Impartiality of advisers

- Do you monitor advisers' sales to assess any potential for product and commission bias? Do your advisers consider non-commission-earning recommendations for customers?
- Do you have controls in place to ensure that your remuneration structure does not encourage inappropriate sales?
- Have you considered performance-related incentives where remuneration is dependent on advisers meeting company standards through agreed key performance measures (e.g. persistency, complaints, replacement contracts, file reviews)?

TCF considerations for quality of advice (2)

Key messages for firms

Assessing customer needs

- Advice – do advisers agree with the customer the areas that advice will be provided on? If it is agreed that advice limited to one or more needs (‘limited advice’) will be provided, do advisers collect sufficient ‘know you customer’ information (including areas such as affordability/debt) to assess suitability on that limited area? Do advisers explain any potential limitations and risks as a result of the advice being limited?
- Customer details – are your advisers capturing all pertinent customer details including customer needs and objectives, attitude to risk, affordability, tax status and entitlement to state benefits?
- Changes in circumstances – is consideration given to future change in customers’ circumstances?
- Customer needs – is the customer asking for a product or service that does not suit their needs? Does your customer need to buy a product? Are you identifying and prioritising other significant needs?
- Attitude to risk – do advisers take time to discuss and explore risk and manage your customers’ expectations in relation to risk and reward?

Recommendations, including research

- Are advisers carrying out research to identify the most appropriate product and provider and then clearly explaining to the customer why the particular product and provider have been chosen over and above others?
- Do the recommendations fit with the customer objectives and circumstances, taking account of factors such as debt levels, tax status, entitlement to state benefits, affordability, attitude to risk, etc?
- Is appropriate consideration given to areas where no product would be sold e.g. emergency cash funds, debt repayment?
- Are advisers making a clear distinction between offering ‘full advice’ and ‘limited advice’? Is suitability considered on a case-by-case basis in the context of each individual customer without the assumption that a ‘limited advice’ approach would be suitable for everybody?
- In analysing the customer's situation are advisers identifying other key areas of need that may exist and, where the customer agrees on ‘limited advice’, highlighting the implications of not addressing them?

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TCF considerations for quality of advice (3)

Key messages for firms

Communications to customers

- Format and content of suitability letters:
  - Are they clear and easy to understand (‘jargon-free’)?
  - Are they tailored to individual customers?
  - Do they clearly explain why the product and provider have been recommended?
  - Do they highlight the risks associated with the recommendation?
  - Do they provide a balanced view?

Post-sale

- General after-sales service – if you use customer service surveys do you recognise that a customer may be satisfied with the service, but this may not necessarily mean the customer has been treated fairly?
- Where you have committed to carrying out regular reviews for customers are you offering this in practice and delivering on your promise?

Corporate culture / Systems and controls

- Are you meeting your senior management responsibilities for setting the TCF culture and standards throughout your firm and ensuring these are put into practice?
- Monitoring of advisers – are you reviewing the quality of the information in the customers’ files and the advice given as well as reviewing whether your process has been followed?
- Do you consider the role and responsibilities of your supervisors in terms of their spans of control, frequency of one-to-ones between adviser and supervisor, ability to develop advisers and the frequency and quality of the monitoring of performance measures?
- Do you have management information that will allow you to measure whether standards are being met in relation to TCF and quality of advice? Do you act on this information when standards are not met?
- Do you ensure your advisers consider sound record-keeping to be an integral part of the advice process?

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Our findings (1)

Treating Customers Fairly in relation to quality of advice

Nearly all firms recognise TCF applies to the advice process but there is scope for improvement in all areas impacting on the quality of advice.

Quality of advisers

- While approximately two thirds of firms had appropriate training and competence (T&C) procedures in place for their advisers, approximately a third of firms still did not. This had an impact on the quality of advice provided to customers in that half of all advisers in such firms provided unsuitable recommendations to customers.
- Approximately a third of firms encouraged advisers to continue their own development (e.g. further study, exams, etc) to help improve the quality of advisers' knowledge. However, advanced qualifications did not unequivocally result in a better quality of advice being offered to customers. Firms need adequate T&C schemes to support and develop advisers so they can apply their technical knowledge to practical situations.
- In a quarter of firms gaps in training needs were not being identified or filled with appropriate quality training.

Impartiality of advisers

- Impartiality was shown by approximately a third of firms in their recommendations of suitable products that do not generate commission or through their offer of commission sacrifice where the commission paid was not proportionate to the work carried out.
- Approximately a third of mystery-shopped firms holding themselves out as independent did not offer customers a genuine option of paying a fee and only approximately half of firms clearly explained the fees and commission statement ("menu") or cost of their services. In approximately half of the shops where firms offered fees they actively dissuaded customers from pursuing that option.

Our findings (2)

Treating Customers Fairly in relation to quality of advice

Assessment of customer needs

- Over half of firms did not overall obtain adequate Know Your Customer information prior to the recommendation. Key areas needing improvement include affordability, customer needs and objectives.
- The customer's attitude to risk was adequately established in over three quarters of the customer files reviewed on visits. In the rest, the assessment either did not occur or was inadequate. In approximately two thirds of mystery shops, the explanation of risk was inadequate or unclear.

Recommendations to customers

- Not enough advisers consider non-commission-earning recommendations, such as repayment of debt, as a priority. Under a third of firms' advisers provided non-commission-earning advice before recommending other investment products and recommending customers repay some debt. Such firms demonstrated that their advisers considered the customers' wider circumstances, showing that customers' interests were paramount.
- Almost all firms held themselves out as offering a full-advice service but only a third of firms undertook a full review of customers' needs and objectives.

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Our findings (3)

Treating Customers Fairly in relation to quality of advice

Communication

- The suitability letter, in particular, is an area which requires significant improvement in over half of firms.
- Suitability letters issued to customers were often insufficient in terms of providing the customer with a tailored, clear and concise record, highlighting the key points and risks associated with the recommendation made. Risk warnings were often inadequate and did not provide the customer with a balanced view of the product.
- Over half of firms did not explain any potential limitations and risks as a result of the advice provided being limited.

Post-Sale

- Where firms offered customers a regular review as per their Terms of Business, almost all firms carried out that review in practice although some customers who were promised a regular review were not offered it.
- Approximately half of firms re-assessed customer needs due to environmental factors (e.g. benefits, taxation, changes in legislation, etc) or new products in the market, but it was only carried out for around a fifth of customers. There was no clear rationale for the inconsistent practice in these firms.

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Our findings (4)

Treating Customers Fairly in relation to quality of advice

Corporate culture / Systems and controls

- Approximately half of firms did not monitor the quality of advice given. In particular they did not use management information to monitor advice practices, complaints handling and persistency. It was also common for firms that obtained some form of management information not to act on it. This highlighted the failure by senior management to identify key issues and risks in relation to the quality of advice.

- In approximately two thirds of firms where concerns were identified in systems and controls and in the monitoring of the quality of advice, this appeared to be directly reflected in the suitability of recommendations being provided to customers.

- In nearly two thirds of the customer files reviewed, information relating to the advice process was either missing or unclear.

Our findings – examples

(1) Treating Customers Fairly: approximately half of firms failed to demonstrate that TCF was being fully implemented into the day to day business of the firm.

These are some examples of how individual firms have shown that TCF is being implemented into their day-to-day business practices:

- TCF included in all reports to the board, highlighting firm issues and FSA communications. These are also sent to advisers. This helps ensure TCF is always at the forefront of the advisers' minds when advising customers.
- A firm has taken on board the FSA's TCF communications and in embracing the general concepts has developed its TCF paper and gap analysis through which the firm had identified weaknesses and taken action to improve them.
- A firm believes that TCF starts with the first contact with customers. At the initial meeting potential customers receive a detailed presentation from the firm on the services that are offered. This ensures that the customer understands the service and scope of advice being offered.

Here are some examples of firms that have failed to fully appreciate the meaning of TCF:

- TCF was considered at senior management level. However, there was a failure to cascade this adequately to other staff, who were unclear of its relevance to them.
- The concept of TCF was not taken on board by senior management, who failed to understand that TCF applies to all firms, irrespective of their size or market.
- One firm's TCF report was only partially completed, and there were no real signs that the points highlighted had been acted upon.
- One firm had not reviewed the sales process in light of TCF and had not undertaken any gap analysis work or identified any gaps which need to be filled.

Our findings – examples

(2) Quality of Advisers: approximately a third of firms did not have adequate T&C procedures in place and a quarter of firms failed to focus on identifying training needs or filling these appropriately with quality training.

These are examples of how some firms have demonstrated T&C procedures appropriate for the advice they provide:

- The firm takes a risk-based approach to supervision of advisers with advisers assessed against a number of key performance indicators (KPIs) including complaints, qualifications and knowledge. This determines the level of supervision required.
- One firm conducted a full and detailed analysis of complaints when it received them to establish the real cause of the complaint and to address any lessons learned with advisers.
- Firms making regular use of external resources to provide relevant technical training to their staff.
- File reviews with follow-up remedial action being undertaken in a timely manner.
- Advice on high-risk products is restricted to a small number of specialist advisers within the firm with an internal referral procedure.
- The firm completes a training needs analysis on an annual basis with each adviser which sets out the Continuing Professional Development (CPD) for the year and is reviewed at regular one-to-one meetings along with business written.
- One firm's advisers were required to undertake and pass a test to maintain their licence to sell products. Those advisers who did not pass the test had their licence to advise withdrawn. Consequently advisers who were not competent and maintaining their competence would be unable to give advice.

But not all firms have appropriate T&C procedures in place which allow them to meet their TCF obligations. Here are some examples:

- TCF training for advisers has not taken place and the content of any such training has not been considered yet.
- Although the firm has a formal T&C scheme in place, there is little evidence this is being implemented in the day-to-day running of the firm.
- Training and ongoing CPD is left to each individual adviser to decide what is appropriate. No assessment is undertaken to identify gaps in the advisers' knowledge in order to establish development needs and areas where relevant training is required.
- CPD predominantly takes the form of reading publications or attending seminars with no indication of how this has benefited the advisers in their day-to-day roles as no relevance checks took place.
- As a result of the firm not applying a consistent approach, each adviser works to a different standard. This has resulted in wide discrepancies in the quality of advisers.
- The supervisor's product and technical knowledge is lacking. So supervisors are unable to challenge the suitability or quality of the advice given.
- The firm focuses on CPD hours rather than the quality and relevance of the CPD being undertaken, so the skills and knowledge gap may not be met appropriately.

Our findings – examples

(3) Assessment of Customer Needs: over half of firms did not overall obtain adequate customer information including affordability, needs and objectives before making a recommendation.

These are examples of how some firms assess customer needs to help ensure they provide good quality advice to customers:

- Fact-finds were comprehensive and listed in order of priority: the customer's financial priorities, their objectives and what they expected from their investment portfolios. They also included questions around provision for premature death, disability and income in retirement, enabling the adviser to identify areas of need in order of priority.
- The KYC gathered included an assessment of the customer's knowledge, risk tolerance and experience of using investment products to help support the customer's attitude to risk.
- A married couple wanted advice on a personal pension transfer. From the information obtained and assessed the adviser highlighted an inheritance tax liability to the customers. While the adviser did not provide advice on mitigating the liability at this stage, he provided sufficient information to allow the customers to consider this matter as a priority need and invited them to contact him or their solicitor to discuss further.
- A customer wanted to make a lump-sum investment. During the fact-finding process the adviser identified that the customer's mortgage term ran beyond his anticipated retirement age and his level of emergency funds was low. As a result these were highlighted as priority needs to the customer.
- Advisers use appropriate visual aids to engage customers when prioritising their needs, explaining the dynamics of portfolio structure (asset allocation) and assessing the customer's attitude to risk
- Tax allowances were taken into account, demonstrating consideration of environmental factors.
- State Pension Forecasts were obtained and regular consultations with the customer's tax and legal advisers took place to establish fully the customer’s situation and the existence of wills and trusts before providing advice to the customer.

These are examples of how some firms did not demonstrate TCF being applied due to their failings when assessing customer needs:

- One firm did not assess the customer’s expenditure and the fact-find simply stated as being ‘within income’. So the firm could not demonstrate the customer’s affordability for the product or payment method recommended.
- Onus on completing KYC was placed on the customer, with the firm not confirming the accuracy.
- Details of existing products were not recorded in the fact-find or suitability letter when advice included the encashing and replacing them.
- One adviser did not request State Pension Forecasts when providing pension advice to customers, or wait to receive full details of an endowment projection before providing advice on possible encashment, and therefore did not obtain key information relevant to this customer.
- A customer’s attitude to risk was assessed at the outset of the relationship but was not then re-assessed for subsequent advice.
- Advice was given on inheritance tax or joint couple tax allowances but information was only available on one customer. This meant only one customer’s needs were being assessed where the advice provided would affect both parties.
- An adviser did not establish how much, why, or for how long the customer needed income or for what purpose it was required.

Our finding – examples

(4) Communication: suitability letters require significant improvement for most firms as over half of firms provided customers with a poor standard of letter.

These are examples of how some firms' suitability letters provided the customer with clear and concise information:

- Where a portfolio of investments was being recommended, the suitability letter provided a breakdown of investments, key information on each particular investment and the reasons behind each recommendation.
- Suitability letters were written in plain language and illustrated with simple diagrams / pie charts which made it easier for the customer to understand their overall financial position and the concepts behind how products and markets work.
- Making use of bold text to highlight to the customer the key risks and charges associated with the recommendation.
- Providing a summary of and making appropriate reference to the customer's existing investments within the suitability letter for the firm to illustrate that the advice provided by the adviser had taken these into account.
- Explanations in plain language of the relationship between risk and reward clearly explaining the customer's attitude to risk, how this has been established and why.

But the majority of suitability letters lacked relevant information and clarity:

- Suitability letters did not demonstrate a clear link between the customer's needs and attitude to risk and the products recommended. They also did not adequately explain the risks, charges and penalties associated with a recommendation.
- An over-reliance on centrally drafted suitability letters, with no tailoring to the customer's individual circumstances and objectives.
- Unclear recommendations which provided the customer with a number of options. In these circumstances, it was unclear whether the firm was making a recommendation to the customer or setting out the available options placing the onus on the customer to choose.
- Suitability letters containing a number of generic, technical and standard paragraphs which were not relevant to the advice being given thus potentially misleading or confusing the customer.
- Where a recommendation was made to surrender a customer's existing investment, the suitability letter did not explain the penalties incurred or the implications of surrendering the investment.
- Suitability letters being viewed as a compliance necessity, rather than an explanation of the reasons for the recommendation for the customer to review.

Our findings – examples

(5) Corporate Culture / Systems and Control: over half of firms could not demonstrate that they adequately monitored the quality of advice and just under a half of firms had a lack of management information or did not act on it.

These are examples of the steps taken by some firms, to ensure that their systems and controls help them to provide a good quality of advice:

- Independent file reviews conducted and timely remedial action taken. Monthly one-to-one meetings held with advisers to monitor business written, verify quality of advice and measure progress towards learning and development objectives.
- KPIs measured regularly and discussed. Administrative staff trained to spot potential risks rather than relying on one supervisor to identify trends.
- Commission sacrifice encouraged so that advisers only take what the firm believed to be a reasonable amount for the work carried out, with the remaining monies rebated.
- Regular management information produced and acted upon, which is fed into the learning and development plans for staff. The culture within the firm promoted clear and measurable objectives, which resulted in continuous improvements in the quality of advice provided to customers.

But not all firms had systems and controls which allowed them to meet their TCF obligations and which could lead to poor quality of advice. Here are some examples:

- No management information was captured within the firm, including KPIs or persistency – resulting in the inability of senior management to identify any issues or concerns.
- Those in senior management had their own area of responsibility with no process to regularly discuss or review the firm’s strategy and performance as a collective management group to help ensure the firm was identifying and managing risks to their business and customers.
- The firm could only identify the business it had written by checking when it received payment for the advice on an accounts ledger. The firm was unable to identify the products being sold, any trends in selling practices or to have any control over the activities of its advisers.
- Monitoring of business was rejected for administrative errors only. Reviewing the quality of advice was not the main focus and, as a result, instances where poor quality of advice was provided were not identified.
- Management information was monitored but there was no evidence that issues identified were acted upon.

Conclusions (1)

- We found many examples of good practice when undertaking this work. However, in an unacceptable number of firms we reviewed, we identified significant flaws in the way advice was given, generating potential consumer detriment. Specifically, firms should consider the following:
  - **Training and competence –** the quality of the advice process is better in firms with robust training and competence regimes that identify and fill gaps in advisers' knowledge and skills;
  - **Processes for establishing customers' goals and risk appetite** – before giving advice, advisers should be clear about what the customer can afford, their objectives, their attitude to risk across different objectives and whether they understand and accept the risks they will take on;
  - **Production of clear suitability letters** – in confirming their recommendations to customers, advisers should ensure that their suitability letter is succinct but reflects the discussion with the customer, uses plain language, highlights the risks involved as well as the potential rewards and provides a balanced view. In some cases we found that firms completely failed to issue suitability letters, a breach of our rules;
  - **Systems and controls for monitoring the advice process** – around half of the firms surveyed could not demonstrate that they monitored the quality of advice given;
  - **Clarity on type of advice offered** – some firms need to be clearer in distinguishing between whether they are offering 'full advice' or 'limited advice' to a customer. Suitability should be considered on a case-by-case basis and it should not be assumed that a 'limited advice' approach would be suitable for all customers. Where it is agreed that advice limited to one or more needs will be provided, advisers should explain the potential limitations and risks of not receiving full advice to the customer; and
  - **Customers' options on paying for advice** – a significant number of mystery-shopped firms claiming to be independent did not offer customers an option of paying a fee for advice, as required by our rules. In some cases where fees were offered, customers were being dissuaded from taking this option.

Conclusions (2)

- Treating customers fairly must be integral to the philosophy of all staff within a firm and not just senior management. This is the only way to put customers at the centre of a firm's business. The significant number of areas where issues were identified strongly indicates that many firms have a lot of work to do to make this a reality.

- In addition and partly prompted by the findings of this thematic work, we will carry out a review to consider the regulatory implications of potential future models of retail distribution in the UK.

- We intend to publish more help for firms in some of the key areas that need addressing. In due course, we will repeat this work. We expect to see that firms have considered how they operate against the practice in this report, the case studies and the fact sheet which can be found on the TCF website (www.fsa.gov.uk/tcf) and make any improvements necessary. Through this the industry should have improved as a whole.