

QUALITY OF ADVICE BY INTERMEDIARIES

The FSA has published much material recently on the quality of advice processes, which is highly relevant to all types of retail intermediary. The FSA treats this area as a key part of its Treating Customers Fairly (TCF) initiative. For mortgage advice in particular, the FSA has warned firms that it expects them to show a significant improvement, but financial advisers should also take note of the various best practice points and case studies.

A recent thematic review of 50 investment/financial advisers found:

- 72% of firms were assessed as making progress towards having appropriate advice processes in place, 60% still have more to do to in order to improve the quality of their advice processes.
- The remaining 28% of firms have only made limited progress, and these firms showed failings throughout a significant part of their advice processes.
- 90% gathered relevant management information about their businesses, but just under a third of these firms were not actively analysing and using that information to review their processes;
- 72% of firms failed overall to demonstrate adequate systems and controls to monitor their advice process, with many of them not adequately considering findings from their review of customer files as part of their management information.
- 58% of firms demonstrated that they gathered sufficient Know Your Customer information when assessing customer needs.
- 70% of firms failed to consistently produce clear, fair and not misleading suitability letters;
- 80% of firms that provided focused advice (40 of the 50) failed to consistently make their customers adequately aware of the implications and consequences of receiving such advice.
- 84% of firms offered and conducted regular reviews of their customers.

1. KEY POINTS

The FSA considers that the quality of advice processes includes all of the following areas:

- management controls;
- assessment of customer needs and affordability;
- recommendations including product research;
- quality of advisers (training and competence and recruitment procedures);
- communications with customers;
- post sale.

1.1 Management Controls

The recent FSA survey showed that 90% of investment firms gathered relevant management information about their businesses, but far too many of these firms were not actively analysing and using that information to review their processes. It also found that 72% of firms failed overall to demonstrate adequate systems and controls to monitor their advice process, with many of them not adequately considering findings from their review of customer files as part of their management information.

This is a key area under the TCF initiative. Management controls and management information (MI) are areas that the FSA has highlighted repeatedly as being weak in many firms. Many firms do collect management information, but fail to use it. They either do not analyse it at all, or do not analyse it effectively. Often, the results are not used to improve the business.

Firms need to be able to demonstrate adequate systems and controls to monitor their advice process; many firms need to adequately consider findings from their review of customer files as part of their management information.

Action Point – Monitoring of files should consider the quality of the information – both to and from the firm to the customer. A complete file is only a start. Issues highlighted by file checking or complaints received should be followed up by remedial actions, action plans and input into adviser learning and development plans.

1.2 Assessment of customer needs and affordability

1.2.1 Mortgage and Loan Advice

Affordability is absolutely critical for firms offering mortgage or credit advice to customers. A recent review of mortgage brokers found that almost half of the small firms visited and three quarters of firms that received a mystery shop did not adequately assess both income and expenditure because they did not consider information about customers' outgoings and their general expenditure. When making a recommendation, firms must check that a customer can afford to enter into a regulated mortgage contact.

The question of mortgages where the end date is after the normal or stated retirement date is one of concern. In such cases firms must be documenting how their clients will afford repayments into retirement and where a client's response is to continue to work, firms should consider how likely this is in relation to their client's occupation and make their recommendations accordingly.

Best Practice Point – firms should use both an income and expenditure questionnaire for customers, supported by documentary evidence including bank statements, credit card statements etc.

Action Point: Firms should be able to show that they have taken into account all the reasonable “what ifs” when assessing affordability of a loan. Consider asking for pension details when a loan term exceeds retirement date.

1.2.2 Other Areas of Investment Advice

The recent FSA thematic exercise showed that only 58% of firms demonstrated that they gathered sufficient Know Your Customer information when assessing customer needs. However, this means that 42% of firms do not gather sufficient information about their customer to assess their needs.

Areas of improvement that are needed:

- identifying and recording customers' needs and objectives;
- establishing and recording customers' attitude to risk; and
- exploring all areas of financial needs when giving full advice

1.3 Recommendations including product research

There are significant weaknesses in this area for mortgage business. Recent results from an FSA thematic investigation of mortgage brokers showed:

- a high number of files on higher risk products such as interest only, sub-prime and self certification did not demonstrate suitability;
- the majority of firms involved in selling these products also failed to adequately monitor the quality of the advice provided;
- for interest only cases, in just over half of cases there was no planned repayment strategy in place to repay the outstanding capital;
- for sub-prime cases, in around a third of cases firms were still failing to gather sufficient information about the customer's credit history to support the recommendation of a sub-prime product and were unable to explain why the product was appropriate;
- for self-certification cases, in just over half of cases it had not been made clear why a self-certification mortgage was appropriate compared to a full status product.

Best Practice Point – firms should always make sure that they have a record of how the loan is to be repaid – particularly if it's an interest only loan – and that arrangements are in place to do this.

1.4 Staff Training and Development

The recent FSA survey findings show that over half of the firms visited (54%) did not have appropriate Training and Competence (T&C) procedures implemented and maintained. Only 50% of firms visited identified gaps in training needs of their advisers as part of their Training and Competence monitoring.

Firms should make sure that they have a written recruitment policy including qualifications, skills, knowledge and experience that must be met before an appointment is made. It should be established who has authority to waive any of these requirements for a particular candidate. Firms should assess the advisers' competence to appropriate standards to determine any gaps in knowledge, skills and experience. This should be reflected in the training and competence plan for the individual.

Best Practice Points

- Firms should conduct financial and credit checks on advisers to be satisfied of their fitness and propriety – this should certainly be done at outset and preferably regularly thereafter;
- firms should make sure that T&C plans are regularly reviewed, and that the activities of the advisers are related to their needs;

Action Points

- Make sure that the results of regular file checks are taken into account when reviewing the T&C plans of advisers;
- Document any areas of weakness in an action plan and review regularly;
- Where necessary test and re-test to ensure ongoing competency;
- Check qualifications and keep copies of certificates on file.

1.5 Communications with Customers

The FSA continues to be concerned about the quality of suitability letters. All communications with customers must be clear, fair and not misleading. In the recent thematic investigation 70% of firms failed to consistently produce clear, fair and not misleading suitability letters.

Common faults found include:

- no explanation of the reasons for switching between products or funds;
- letters are insufficiently personalised and contained jargon; and
- the risks and charges associated with the recommendation were not specified.

80% of firms reviewed in the thematic survey provided focused advice but failed to consistently make their customers adequately aware of the implications and consequences of receiving such advice. Firms that give focused advice to customers must make their customers adequately aware of the implications and risks of receiving such advice.

Action Point: Look at a sample customer letter and check it for jargon or technical terms. Consider the audience when sending out communications. The information must be sufficient and understandable and in language they can understand.

1.6 Post Sale

This is another key area of concern for the FSA under the TCF initiative. 84% of financial adviser/investment firms offered and conducted regular reviews of their customers (14% did not). 46% of firms showed evidence that customers' needs had been re-assessed due to environmental factors (e.g. changes in benefits allowances, taxation, or legislation) or new product launches.

Each review should consider the client's circumstances and whether there have been any changes or might be any changes, revisit their objectives, the assumptions that have been used in the planning process and their approach to risk. This should be an ongoing process regularly carried out.

2. IMPLICATIONS FOR FIRMS

The FSA has repeatedly warned retail firms about the importance it places on the TCF initiative and the quality of advice that customers receive. The survey results from its investigations of mortgage brokers and financial/investment advisers show that these warnings are not being taken seriously by many firms.

The FSA has said that it will continue to refer firms to enforcement, will seek banning orders as well as fines, and that these fines are intended to have a deterrent effect. Recent fines have been at levels that most small firms would find punitive.

3. NEXT STEPS

The FSA was sufficiently concerned about the findings of this survey (carried out between September and December 2007 with preliminary results published in March 2008 and full results published in August 2008) to launch its enhanced strategy in March 2008 to help small firms meet their TCF obligations. All financial advisers and mortgage intermediaries will be assessed as part of the strategy, as will general insurance firms selling high risk products. The aim is to provide firms with the assistance they need to ensure they are treating their customers fairly, and take action against those that are not.

Having appropriate advice processes in place is an important element in supporting delivery of the right outcomes for consumers when giving advice. Firms should be in no doubt about the consequences of not taking the TCF initiative seriously and getting the quality of advice processes right.

4. FURTHER INFORMATION

The FSA survey of advisers' results can be found at this link:

http://www.fsa.gov.uk/pages/Doing/small_firms/advisers/pdf/igap2.pdf

FSA quality of advice pages with further links for investment and financial advisers can be found at this link:

http://www.fsa.gov.uk/Pages/Doing/small_firms/advisers/quality_advice/index.shtml

The FSA has produced a fact sheet for advisers on the quality of advice which can be found at this link:

http://www.fsa.gov.uk/pages/Doing/small_firms/advisers/pdf/quality_of_advice.pdf

The FSA quality of advice for mortgage brokers, with further links, can be found at this link:

http://www.fsa.gov.uk/Pages/Doing/small_firms/mortgage/practice/advice/index.shtml

A case study of best practice for mortgage advisers can be found directly at this link:

http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/practice/advice/case1/index.shtml

Reference: RCUK/SHC/KG

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