Consumer Research 52

Financial Services Authority

# Quality of advice process in firms offering financial advice: findings of mystery shopping research

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# Foreword

Between January and April 2006 the Financial Services Authority (FSA) carried out supervisory thematic work looking at the way a sample of independent financial advice firms were taking account of Treating Customers Fairly (TCF) focusing on the way advice is given by firms. The sample included a range of different sized firms and comprised:

- FSA visits to 55 firms; and
- 50 separate mystery shops conducted by Research International, an independent external research agency.

This piece of thematic work looked at how financial advice firms could improve their advice processes and reduce the risk of mis-selling. It was one of the largest pieces of thematic work undertaken by the FSA and studied how advice is given, identifying some of the underlying factors that can lead to repeated episodes of mis-selling.

This paper focuses on the results of the mystery shopping. However, based on the results of both the visit and mystery shopping work, the FSA has also produced a separate report for advisers setting out its findings and highlighting examples of good practice, referred to as a cluster report (http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/advice.pdf).

We found many examples of good practice. These have been used to develop composite case studies and detail some of the examples to the industry to help firms improve. However, in a disappointing number of the firms we reviewed, we identified significant flaws in the advice process which may result in consumer detriment.

TCF is not a 'one-size-fits-all' concept 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.

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# 1. Methodology

## 1.1. FSA mystery shopping methodology

The mystery shops were primarily designed to determine how firms ensure that their customers are treated fairly and to measure the quality of the advice process within the firms. They were also designed to enable identification of the key elements that make up the difference in practices between firms providing good quality advice and firms providing poorer quality advice. They also highlighted both good and poor practices among retail investment firms.

By posing as genuine investors, each mystery customer contacted an adviser and arranged for both a preliminary interview and advice appointment. The premise of each shop was that each customer was either seeking advice due to a 'life changing' event requiring a financial review, or they were allocated one of three specific scenarios.

The life changing events used were:

- New employment or promotion – increase in salary
- Divorce - asset sharing or income payments
- Redundancy – lump sum pay off
- Retirement – lump sum received
- Inheritance – lump sum received

The scenarios used were:

- Shopper had a surplus lump sum or a regular premium to invest for growth for a specific goal and time length.
- Shopper had a lump sum or a regular monthly surplus sum and an outstanding mortgage or other debt/liability.
- Shopper is post-retirement age with a lump sum or regular amounts to invest for additional income.

The shoppers attended their appointments and subsequently completed a detailed questionnaire based on their experiences of the appointment and the adviser.

Each shopper was encouraged to ask the adviser for documentation to support their recommendation, including customer specific illustrations and suitability letters.

Ultimately, to ensure consistency, the results from each mystery shop were analysed by FSA staff and assessed under the following categories:

- Impartiality of advisers
- Assessing customer needs
- Recommendations
- Communication

The analysis was designed to capture:

- Qualitative data by way of examples of good and poor practice to determine indications that the advice process treated customers fairly.

- Quantitative data on each of the assessment criteria mentioned above to measure the quality of advice.

We envisaged that the quantitative data would be captured by using the questionnaire, fact-finding process and recordings as a whole. However, early in the process it became clear that the shopper questionnaires did not always accurately reflect the shop - so these were simply used as a guide to potential issues. In any event, recordings together with any documentation supplied by the adviser provided the key source of analysis.

## 1.2. Research International mystery shopping methodology

We commissioned an agency called Research International (RI) to conduct the study using trained mystery shoppers. The mystery shoppers were recruited and trained by the agency. Shoppers were selected from an extensive panel based on their suitability for the scenarios and were given a detailed briefing on the requirements of the task and the overall project objectives by the field manager. Each shopper was also provided with a set of detailed guidelines created by RI and the FSA project team.

The sample mix consisted of large, medium and small retail investment firms and incorporated a geographic spread of the UK. The list of firms to shop was provided to the agency by the FSA, based on the proximity to the shoppers employed in the study. To minimise delays in fieldwork each shopper was provided with a number of potential firms to visit.

The sample incorporated a mix of firms where a fee or payment by commission would be applicable.

**The visits**

Shoppers called their assigned firm(s) and requested a face-to-face meeting with the adviser.

Generally the first meeting with the adviser consisted of a discussion of the shopper's needs; therefore the majority of shoppers had to attend two appointments with the firm to receive full advice. Shoppers only took the sales process to the point of advice and were advised not to sign application forms or be cautious when signing any documents to ensure that they did not become tied in to any product or contract.

Shoppers had to request written confirmation of the advice within one week. If the shopper did not receive this document from the firm they contacted the adviser and asked for it once only.

All materials were forwarded to the FSA by the agency for inclusion in the final analysis.

# 2. Mystery shopping high-level results

## 2.1. Background

In reviewing the way advice is given, the mystery shopping exercise concentrated on the following areas:

- impartiality of advisers;
- assessment of customer needs;
- recommendations to customers; and
- communication.

The 'impartiality of advisers' reflects mainly how firms disclosed the nature and cost of their services. The focus was on whether each customer fully understood the options available to them as they were communicated to them. It also examined whether there was evidence of product bias.

The focus of the 'assessment of customer needs' and 'recommendations' work in the exercise has mainly been on customer objectives including attitude to risk, the assessment of their circumstances and the resultant advice.

Where advisers did not sufficiently assess customer needs, for example by failing to adequately establish their customer's attitude to risk or to explain the implications of limiting their advice to the customer's objectives, the advice process was deemed to be inadequate. This is because an inadequate assessment of client needs poses a significant risk to the provision of a suitable recommendation.

The mystery shopping exercise looked at communication from a wide perspective, considering the overall communication between adviser and customer, and not only as detailed in suitability letters. We considered whether communications were fair and pitched at a reasonable level.

## 2.2 Treating customers fairly: high-level results

The overall findings in terms of Treating Customers Fairly (TCF) indicate that the majority of firms in the sample evidenced some level of TCF (i.e. limited/moderate/significant). However, in most instances there were areas within the advice process that needed improvement.

Just over a third of firms in the sample had no or very limited examples of practices that focused on treating their customers fairly throughout the advice process. These firms also had elements of the sales and advice process that had a negative impact on the way advice was given.

Just over a quarter of the firms in our mystery shopping sample (14 out of 50) demonstrated significant evidence of TCF across all areas.

However, the majority of firms (36 out of 50) need to improve their TCF practices. An unacceptable number (21 out of 50) need to improve their practices to eradicate non-TCF elements from their advice process.

Our mystery shopping exercise indicates that the areas requiring the most improvement are the assessment of customer needs and the impartiality of advisers.

It is recognised that the results of each mystery shop may not be indicative of a culture within a firm. However, we believe that they do provide an indication of whether a specific advice process results in customers being treated fairly in the 'live' environment, and collectively they provide an indicator of issues prevalent in the market.

These indicators also represent examples of good or poor practice that we found had either a positive or negative affect on the advice process.

Just over a quarter of firms in our sample (14 out of 50) showed indications of TCF being at the centre of all of the areas of the sales and advice processes.

### Treating Customers Fairly

**2.2.1. Example of good practice**

The customer approached firm **A** with a surplus lump sum to invest for long-term growth.

The adviser carried out a full fact-find to identify any other needs for the customer, in addition to the customer's investment objective. The adviser wrote to all the existing providers to obtain details of the customer's various policies, including state benefit forecasts.

This, combined with the detailed Know Your Customer (KYC) information gathered, enabled the adviser to identify all areas of need and gave the customer an accurate picture of how these needs should be prioritised and addressed.

From the detailed KYC information, including discussions regarding attitude to risk, the customer was advised to contract back in to the State Second Pension (S2P) and invest the lump sum in an individual savings account (ISA). The need for the customer to contract in to the S2P could not have been identified if the advice and fact-find had been limited to investments. This recommendation also demonstrated that the adviser was considering the overall needs of the customer including in non-commission earning areas.

The adviser demonstrated consideration of alternative products and clearly justified the recommendation for an ISA over a pension so that the customer had the option of accessing cash if the funds were needed in the future (the customer mentioned a need for home improvements on a holiday home).

The adviser provided very clear and concise explanations of the recommended products during the meeting, enabling the customer to understand why the recommendation was suitable and how it fitted with their circumstances.

Following each meeting the adviser produced a suitability letter in plain language. The letters, sent to the customer both prior to and after the second meeting, provided the customer with a written record of what had been discussed and made recommendations as to the next steps.

By providing the customer with a written recommendation, the adviser ensured that the customer had sufficient information to consider it. This meant the customer could make an informed decision about the recommendation or go back and question any aspect of the advice that was unclear.

**2.2.2. Example of poor practice**

The customer, a widow, approached firm **B** with a lump sum of £15,000 to invest following retirement, for which the adviser recommended an investment bond.

The adviser's fact-finding lacked depth. The adviser did not ask about the customer's income (this was volunteered at the end of the meeting); it was not established if the investment was for income or growth; and long-term care needs were not discussed. Therefore the adviser did not gather sufficient information to demonstrate that his recommendation was suitable for the customer's overall needs and circumstances.

It was established that the customer had an endowment mortgage which would mature in two years but it was not established if there was a shortfall. Due to the lack of KYC information the adviser did not identify any other areas of need which may have been of higher priority than investment and could not demonstrate that the recommendation was suitable for the customer's needs and circumstances (as these were not fully established).

Attitude to risk was not explained to the customer and the adviser just stated it was measured on a scale of 1-10 and that the customer was probably 'about half way'. Since the customer's attitude to risk was not adequately established the adviser could not be sure that the recommendation had met it; therefore the recommendation may not have been suitable.

The adviser did not consider advising the customer to pay off their mortgage and no other investment options, other than bonds, were considered. Therefore it was not clear if the adviser had obtained sufficient information.

The adviser recommended a Managed Distribution Fund which was explained by saying it invested in various asset classes but the adviser neither explained what the asset classes were or in what proportion they would be invested. No risk warnings were given to the customer - this would prevent her from making an informed decision as to the suitability of the recommendation as she was not given a balanced description of the bond.

The brief recommendation letter suggested writing the policy in trust. However, this was not discussed at the earlier meeting and it was not clear who the beneficiaries would be or the potential risks of this course of action.

# 3. Findings and key messages

## 3.1. Impartiality of advisers

### 3.1.1. Overall conclusions

There was evidence to suggest that some advisers in our sample were not disclosing the cost of their services in a transparent fashion. This deprives the customer of the opportunity to compare the services a firm offers and have a clear choice on how they pay for any advice.

A small number of mystery shops also demonstrated bias towards investing in a new product without appropriate consideration of repaying some or all of an existing mortgage or other debt.

Just under a third of firms in our mystery shopping (16 out of 50) did not offer customers a genuine option of paying by fee but held themselves out as being independent. Only just over half of firms (27 out of 50) clearly explained their menu or cost of their services.

There were also poor descriptions of how commission affects the customer. In some instances it was suggested that commission was paid directly by the provider and not out of product charges and a there was a lack of explanation as to how product charges would be affected under a fee option.

## Impartiality of advisers

### 3.1.2. Examples of good practice

- Adviser **C** explained to the customer that he was independent and what this meant, and stressed that the firm made recommendations and did not leave the customer with a series of choices. The initial disclosure document (IDD) and menu were discussed in detail so that the customer fully understood the service being provided. The adviser explained the payment options and stated if fees were the preferred route then a separate fee agreement would be needed. He also explained that if the customer opted for a combination of fees and commission the firm would hold the money in a fees account which would be used to offset against future reviews, and would be repaid if the customer requested. Or if there was a shortfall the customer would be invoiced for difference. This enabled the customer to understand the service available to them and their different remuneration options.

- Adviser **D** explained the difference between fees and commission and clearly conveyed that commission was taken from the investment charges. The adviser's clear and fair explanation of this enabled the customer to understand how the different remuneration options worked and gave him an idea as to whether the payment of fees or commission would be preferable. The adviser explained that the firm's Terms of Business did not require a review of any plans arranged and that the onus was on the customer to contact the adviser for a review to ensure that recommendation continued to meet requirements. This meant that the customer would have been fully aware of the role they took in any ongoing relationship.

- Adviser **E** outlined a portfolio of investment products for a customer. The customer also wanted to buy a car in the next year and anticipated that this would cost around £10,000. The customer said that they would take out a loan for this and the adviser explained that loan interest would probably be more than any investment return and said that she would be "effectively buying her own money" if she went down that route. The adviser therefore recommended a high interest deposit account for a portion of the available capital.

### 3.1.3. Examples of poor practice

- When discussing remuneration options at the end of the meeting, adviser **F** stated, "You don't pay me a fee, they [the provider] will pay me commission, so to speak". The customer replied "That is best because if you are being paid on the commission on what I do, you will make sure I will do well because it is your money too." The adviser said, "Precisely" and the discussion was left at that. The customer was not given the choice of paying by fee or made aware that this choice was available. The customer may have believed that remuneration via commission will ensure that the adviser gave the most suitable advice.

- Adviser **H** did not give the customer an IDD or Combined Initial Disclosure Document (CIDD)[1]. It was therefore possible that the customer may not have understood the service being offered by the firm or been able to compare it to others in the market. The menu and Terms of Business were given at the end of the first meeting (after the recommendation had been made) but were not explained. The menu listed two payment options: fees or a combination of fees and commission - which were not explained or discussed. Prior to being given the menu, the customer enquired as to the cost of advice to which the adviser stated that it was free and the provider would pay commission, saying "it doesn't cost you anything". The adviser went on to add that the customer could pay via fees, a combination of commission and fees or commission but did not explain how this worked in practice. This third option of commission only was not stated on the menu. Due to the adviser's lack of explanation, the customer was likely to be unaware what remuneration options were available. The adviser also gave the customer inaccurate and misleading information relating to how commission is paid and what effect this has on the customer's investment. The product illustration given to the customer at the second meeting showed that initial commission of 6.5% would be paid to the adviser's firm. However, the firm's menu stated that their maximum charge was 4.8% of the amount invested. The 'cost of advice' page of the illustration was not discussed with the customer, although the other five pages were. The adviser was not open and honest about his remuneration for this advice and therefore the customer may not have been aware of how much the advice was costing her or that it exceeded the firm's maximum for this product.

- Adviser **I** strongly advised against paying off any of the mortgage with the customer's available £50,000. He convinced the customer that he wanted to invest rather than pay off the mortgage, when this was not the initial case at all. The £50,000 could have been applied to paying off the customer's outstanding loan or some of the mortgage. This course of action would have provided a monthly surplus, which the customer could have used to address potential shortfalls in other areas. However, the whole process concentrated solely on commission-earning investments and so the shopper could well have been severely disadvantaged by not discussing the shortfalls in key areas. After it was established that the customer was a cautious investor the adviser explained that the greater the risk the customer was willing to take, the greater the potential return and suggested the customer might want to increase his initial cautious approach to something a little higher. This may have left the customer open to the potential risk of greater losses than they were prepared to accept, without fully understanding the implications of the course of action.

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- [1] Key facts about our services – also called an initial disclosure document or IDD
- Key facts about the costs of our services – also called the menu or fees and commission statement

### 3.1.4. Key messages

It is important for firms to identify any weaknesses within their remuneration policy which could conflict with advisers treating customers fairly in providing good quality and suitable advice. It is also important for senior management to have a clear understanding of the potential risks posed by any commission-related remuneration package, and put in place measures to mitigate those risks. Systems and controls should be robust and enable firms to identify any potential product or commission bias and to put in place appropriate procedures to implement any necessary remedial action.

Firms should clearly and fairly disclose their services, offering customers the opportunity to decide if the service and methods of payment are right for their circumstances and objectives.

## 3.2. Assessment of customer needs

### 3.2.1 Overall conclusions

Where firms in our sample are offering advice on only specific customer objectives, they are neither explaining the implications of this to their customers nor gathering sufficient KYC information to make a suitable recommendation even in those areas.

In almost half of the mystery shops (23 out of 50) there was evidence that advisers gave advice before any relevant or in-depth fact-finding. There is a considerable risk that this advice will be unsuitable.

Just over a quarter of firms in the sample (13 out of 50) established customers' attitude to risk ambiguously and some (4 out of 50) did not establish it at all.

Where customers were investing for income or growth, the purpose and amount of income or the target growth and timeframe were rarely established.

In a few cases, there was also evidence to suggest that firms were inadequately assessing income and expenditure. This was thrown into sharp relief due to some customers having recently been made redundant and others investing for additional income. This could impact both on assessing affordability of the recommendation and its suitability.

### Assessment of customer needs

### 3.2.2 Examples of good practice

- Adviser **J** explained attitude to risk on-screen with the assistance of a numbered scale, a description of how various products might fit within this scale and also explained the impact of the length of time an investment is held. This provided the customer with a clear understanding of not only their personal risk profile but also the risk profile of the products and how the timescale of an investment could impact on the risk. The adviser established that the customer was cautious following detailed discussions and easy-to-understand descriptions of the various risk profiles. The adviser also took the time to ascertain the future risk appetite of the customer as their circumstances and priorities could change over time. The adviser's subsequent recommendation was in line with this risk profile (which had been clearly established to ensure suitability) and the customer had been given sufficient information and clear explanations in order to make an informed decision.

- Adviser **K** asked the customer if she wanted a full financial review or to limit advice to a particular objective. The customer decided to have advice solely in relation to her investment objective. The adviser proceeded to do a full fact-find (covering areas such as pension provision, protection and mortgage) and made it clear to the customer that the advice was limited to investments but that shortfalls had been identified in other areas, which were explained. The customer was advised to revisit these areas as soon as it was practical and affordable. Therefore, even though the advice was limited to investments, the adviser still examined other areas of financial planning for the customer to make her aware of further needs and collected information that enabled a well-informed suitable recommendation for the customer's investment objective.

- Adviser **L** asked the customer to explain his requirements, which were to invest a lump sum of money for retirement planning. The adviser proceeded to obtain KYC information on all areas of financial planning. After completion of the KYC process the adviser recommended that income protection should be a priority for this customer. The adviser confirmed the customer's objectives prior to making the recommendation enabling the customer to reconsider his priorities and come to an informed decision as to how to proceed. The adviser was able to identify other areas of need (deemed to be a higher priority) which may otherwise have been overlooked if the advice process was limited to one particular objective.

- A full and thorough KYC process enabled adviser **M** to establish that the customer wished to invest to provide funds for her son going to university. A full discussion was held with the customer as to whether they needed access to any of the capital in the short term and an amount for an emergency fund was agreed. The timescale of the investment was discussed fully and the adviser confirmed that the customer was happy with the amount and understood the potential penalties for encashing the investment.

**3.2.3. Examples of poor practice**

- The customer approached adviser **N** seeking advice as to whether to invest an inheritance of £50,000. The customer also expressed an interest in paying off some of his existing mortgage. The adviser's KYC questioning and recommendations concentrated solely on the investment of the customer's £50,000. The fact-find did cover other areas including protection and pensions provision but in no depth. The suitability letter stated that the firm gave 'comprehensive advice' based on complete financial needs. The customer had no pension provision but did have mortgage life cover. This did not prompt the adviser into any kind of discussion regarding the adequacy of protection, although the customer was a single man with no dependants, and he had life cover but no critical illness cover or income protection. The lack of pension provision and income protection was not investigated nor addressed. The fact-finding and KYC process were inadequately conducted as the adviser appeared only to want to investigate what he could do with the shopper's £50,000 in investment terms. The weak fact-finding process meant that KYC information was limited to the areas that the adviser wished to discuss. And although the adviser was purporting to offer this service to the customer, the lack of holistic financial planning appeared to leave the customer with an inaccurate picture of his financial status and needs.

- At the initial stages of the discussion establishing attitude to risk, the customer stated that they were risk averse and did not want to lose any money. Adviser **O** stated "if you want a better return you need to look at slightly higher risk". After discussions they agreed on a 'modest' attitude to risk (defined by the adviser as 'low to medium'). However, the adviser stated in the suitability letter that the customer's attitude to risk was 'medium'. The adviser did not seem to accept the true risk profile of the customer and persuaded him to increase it and the final attitude to risk recorded by the adviser was not consistent with discussions with the customer. Either of these could result in the customer receiving a recommendation inconsistent with his true risk profile which would be unsuitable.
- A customer, who was retired, had £40,000 to invest from an inheritance. She was looking to invest to create an additional income stream. Adviser **P** obtained basic KYC information but did not gather detailed information in relation to the customer's specific needs. For example, the adviser did not establish how much, why, or for how long the customer needed the income or for what purpose it was required. Therefore, the adviser did not give a recommendation that was fully tailored to the customer's needs. It was assumed the customer was a non-taxpayer. However, the customer was in receipt of a state pension and had several other investment holdings which may have incurred other tax liabilities - this was not discussed.
- Adviser **Q** identified that the customer had an existing investment bond. Prior to obtaining any KYC information the adviser recommended investing the lump sum available into the existing policy (which he would take over the servicing rights for) or encashing the investment and investing the total funds into a new plan with potentially lower charges. ISAs were not referred to, nor was any kind of emergency fund. The only fact-find carried out in relation to the customer's protection needs was an enquiry from the adviser as to whether the customers' existing Whole of Life plans could be encashed. The adviser did not appear to provide the customer with adequate advice as he did not have sufficient information in order to consider all areas of financial planning.

### 3.2.4. Key messages

Before giving advice to customers, firms should take reasonable steps to be clear about what the customer can afford, what they are trying to achieve, their attitude to risk and that they understand and accept the risks that they will take on. Firms should also take reasonable care to ensure their KYC methodology and procedures capture key customer information.

Firms should consider whether their fact-finding is detailed enough when addressing each specific area of need and whether, where a particular need is identified, further probing may be necessary. Firms should also explain clearly when the advice they offer is solely in relation to the identified area of need and the implications of this.

Firms should also take reasonable care to ensure that the features of the recommended product are in accordance with the customer's objectives. Firm's KYC procedures and methodology should be robust enough to identify the most suitable recommendation for their customers and to eliminate the risk of not understanding or omitting to consider all factors relevant to an individual.

Firms should also consider how they explain and establish customer attitude to risk across all their objectives, taking into account the experience of the customer and their level of understanding.

## 3.3. Recommendations

### 3.3.1. Overall conclusions

Only one-third of shops in the mystery shop sample (16 out of 50) were able to fully demonstrate a fair sales process and adequate recommendation.

Due to the inadequate assessment of customer attitude to risk, the lack of depth in the fact-finding process and advisers not explaining the implications of restricting their advice to the customer's objectives, just under two-thirds of shops in the sample (29 out of 50) were not able to fully demonstrate a full and fair recommendation process.

The remaining fifth of recommendations in the mystery shop sample (5 out of 50) were either made with a cursory assessment of client needs or an inadequate assessment of attitude to risk. In these instances, there is a serious risk that the deficiencies in the advice process could lead to consumer detriment.

Half of firms in our mystery shopping sample (25 out of 50) provided non-commission earning advice prior to recommendations for other investment products and a small minority (5 out of 50) considered whether customers should repay either some or all of their debt.

In a number of mystery shops (9 out of 50) no apparent consideration was given to utilisation of tax allowances and less tax-efficient, potentially higher commission earning, advice was given. Furthermore, a small number of firms (5 out of 50) provided inaccurate or outdated tax information.

Over half of the firms in our sample (28 out of 50) drew customers' attention to the need for will and inheritance tax planning.

## Recommendations

### 3.3.2. Examples of good practice

- The customer had a lump sum to invest and an outstanding mortgage. Adviser **R** explained that if the customer was going to use the money to invest the return would have to be greater than the mortgage interest to make it worthwhile and that this would involve some degree of risk. The adviser established that the customer had a cautious attitude to risk so the he recommended paying the lump sum towards the mortgage rather than investing it, and using the money saved from the monthly mortgage payment for investment. This advice seemed to be in the best interest of the customer and in line with customer's cautious attitude to risk. This also demonstrated that the advice was not driven by commission, or limited to one area of financial planning.

- Adviser **S** recommended placing part of the customer's available money into three different UK funds and two European funds. The adviser clearly explained the benefits of the recommended tax wrapper and the reasons for incorporating a range of different fund management styles, along with the flexibility to easily change funds. The adviser also explained why they had recommended income generating funds when the investor's objective was growth. The adviser recommended some of the available capital to be invested in an ISA wrapper with the remainder outside, with a view to shifting the money over to ISA over coming tax years. This recommendation demonstrated good tax planning (showing that the adviser took into account the customer's tax position) as well as being suitable for the customer's investment needs.

- The customer had a £15,000 lump sum to invest for her children's university costs. Adviser **T** recommended a Maxi ISA for each partner which gave the customer the option of adding to it in future and a Child Savings Plan for each child using the other £1,000. The adviser also made it clear that the customer and their partner had a potential inheritance tax and capital gains tax problem arising from investment properties. The adviser recommended looking to move some properties from the partner's to the customer's name to reduce the partner's potential capital gains tax (CGT) liability and utilise both allowances. This demonstrates consideration of all areas where financial planning and relevant recommendations might improve the overall position of the customer.

### 3.3.3. Examples of poor practice

- The customer had a lump sum and the final recommendation was to invest it all in an investment bond. In discussing the available investment options, adviser **U** stated that the customer could invest some of the capital in a stocks and shares ISA alongside the bond but questioned whether the customer would want the money in two places. It was also stated that the downside of an ISA was that there were no special [allocation] rates and that there were initial charges. This was in contrast to the additional allocation with a bond. The adviser stated that while the tax breaks were a little better with ISAs, the charging structure was prohibitive. No apparent consideration was given to diversification and the adviser did not give the customer a clear and fair picture of the options available. The customer may not have been able to make an informed decision as to the best way to invest the available capital.

- Adviser **V**, who had obtained minimal KYC information and did not establish the customer's attitude to risk, advised the customer to invest their available lump sum into a venture capital trust (VCT). The customer informed the adviser that he did not have an emergency fund so the adviser suggested putting the tax relief from the investment in a building society account. The adviser implied that tax relief would be paid as a lump sum on investment in the VCT so that it could be put in a deposit account straight away. The adviser did not assess the customer's circumstances adequately in order to establish how the tax relief would be given. The adviser failed to adequately explain the tax treatment (and how it would work in relation to the customer's circumstances), the potential risk to capital or the liquidity risk of this product. Therefore, the customer may not have fully understood how the product worked and may not have been able to make an informed decision. The adviser also failed to explain to the customer that tax relief would be withdrawn if he cancelled the investment within three years.

- Adviser **W** introduced and assessed attitude to risk using a four-point descriptive scale. The adviser also categorised the customer's existing investments using this scale. A 'low to medium' attitude to risk was agreed with the shopper and this was quantified and reiterated by the adviser at the end of the first meeting. The suitability letter stated in one place that the recommended investment should have a 'low to medium' risk and in other places that the shopper had a 'medium' risk attitude. The investment report was based on a 'medium' attitude to risk - leaning towards the higher side of medium - and the recommended funds were 90% in equities with 31% of these outside the UK.

#### 3.3.4. Key messages

Firms should take reasonable care that they have robust training and competence regimes that identify and fill the gaps in advisers' knowledge and skills. Senior management within firms should consider if their training and competence (T&C) procedures equip their advisers to give the most appropriate advice in a variety of situations allowing for both the customer's circumstances and priorities. Advisers should also be kept up to date with the tax and benefits regime. They also need to be able to assess a customer's real risk appetite.

Firms may wish to consider whether they need to improve their systems and controls so they can monitor the quality of advice being given by their staff, for example through management information.

## 3.4. Communication

#### 3.4.1. Overall conclusions

Just under three-quarters (37 out of 50) of firms in the sample provided customers with a CIDD or an IDD and menu.

Just over half of those that provided the documents also explained them in a clear and fair fashion.

Where suitability letters were provided, these were often not personalised, contained jargon and did not highlight 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 recommendation.

A fifth of firms in the mystery shopping sample (11 out of 50) communicated unfairly with their customers. Issues arose surrounding the oral representation of recent market performance and incorrect presentation of tax information and the general clarity and presentation of technical information.

### Communication

#### 3.4.2. Examples of good practice

- Adviser **X** provided very clear and concise explanations during the meetings, and spent time ensuring that the customer fully understood the reasons for the recommendations. Following the meeting the adviser produced a suitability letter written in plain language to back up what had been discussed and also made recommendations as to the next steps. This allowed the customer to prepare for the second meeting so she could ask questions on anything that was still not clear. The written communication also ensured that the customer had a record of the meeting which could be referred to whenever needed.

- Adviser **Y** issued a suitability letter that accurately reflected discussions with the customer. It reiterated the advice explained to the customer. It summarised the shopper's and spouse's current and future tax position and how they may be able to reduce the tax paid on their savings. The adviser also provided the shopper with a print-out of Cash ISA rates and cash deposit rates for consideration.

- The customer had a lump sum to invest and had an outstanding mortgage. Adviser **Z** said that if the customer was cautious, he should seek to repay the mortgage. The adviser explained that the investment may offer higher returns than 6%, but may be lower and explained, "that is the risk". Adviser **Z** fully explained his recommendations which were clear, fair and not misleading and also adequately conveyed the risks of the investment with particular reference to the more secure benefits of repaying the mortgage. The customer appeared to fully understand the adviser's explanations which were in plain language and so was able to make an informed decision.

### 3.4.3. Examples of poor practice

- In the suitability letter, Adviser **A1** recommended that the customer take out a stakeholder pension for each child. However, this was not discussed or referred to in the meeting and did not reflect the objectives of the customer. The adviser's communications were not clear as the suitability letter did not reflect what had been discussed with the customer during the meeting, which may have confused the customer.

- Firm **B1** provided the customer with a report offering an overview of the different funds. The fund descriptions appeared to be more of a technical guide for firm use and did not contain clear risk warnings. The adviser's oral communication was clear but did not emphasise any specific risk factors associated with the underlying investments or product. For instance, he did not explain that the 5% withdrawals from the recommended bond were tax deferred or could potentially erode the capital value of the investment itself. The adviser's comments about the early repayment of the mortgage were unfounded as the adviser simply stated that to pay off mortgage "was not the best thing to do" as his rate was competitive.

- Adviser **C1** recommended that the customer invest in a high risk product when it was known that he did not have an emergency fund. The adviser failed to explain the importance of an emergency fund to the customer and did not provide a balanced or accurate description of the product being recommended (including risk warnings). Therefore the lack of accurate information provided by the adviser would prevent the customer from making an informed decision.

- During the KYC process, the customer stated that she wanted to pay off the mortgage. She also queried whether it would be better to invest the available capital, to which adviser **D1** replied that it would depend on attitude to risk and stated, "You could make loads of money, double in five or six years". The customer's attitude to risk was not discussed or recorded prior to the production of the client specific illustration. During the second meeting, after discussion of the illustration, the adviser stated that customers fell into three categories - Cautious, Medium to Balanced and Adventurous - and that the recommendation of a property fund was low to medium so "I don't think there is any risk, it's just how much you can make this year". No suitability letter was provided and the adviser geared the whole process to advising on the investment of the capital in a bond invested 100% in property. The risks and benefits of the recommendation were explained to the shopper in such a way as to lead the shopper into the investment.

### 3.4.4. Key messages

When required to do so, firms should take reasonable care to provide suitability letters that are tailored to the customer, and that are clear, use plain language, highlight the risks associated with the recommendations and provide a balanced view. Providing overly long suitability letters will impede the customer's ability to adequately consider the recommendations being made. The suitability letters should also contain a summary of the main consequences and any possible disadvantages of the transaction.

When dealing with customers on a face-to-face basis firms should also take reasonable steps to ensure that they orally represent the risks and benefits of any recommendation in a clear, fair and balanced manner and take reasonable care to manage the expectations of their customers.

# 4. Other findings

## 4.1. Unapproved individual

One mystery shop identified an unapproved individual advising on investments. The advice given in the shop was of a poor standard and raised significant potential consumer detriment issues.

## 4.2. Failure to follow up

During the project there were instances where advisers failed to contact the mystery shoppers even though the shoppers had requested a follow-up appointment.

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