Improving the quality of your advice process – Assessment of Customer Needs

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This factsheet is for you if:

- you provide financial advice to retail clients (known as 'private customers' under the old Conduct of Business rules).

This is the third of a series of factsheets on quality of advice. The factsheets focus on the different areas of the advice process that we reviewed in the firms visited and mystery shopped during the **Investment Quality of Advice Processes II** project. In addition to this factsheets we have published two others, one focusing on **quality of advisers** and the second focusing on **impartiality of advisers**. Both these factsheets highlight examples of good and poor practice.

The examples outlined in this factsheet are designed to help firms consider their own processes for assessing customers' needs. There may be other ways of achieving the same outcomes and complying with our rules and principles and you should consider the relevance of these examples to your business, as you may choose an alternative approach.

Customer information

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When making a personal recommendation to a customer, you must obtain all the necessary information for you to understand the essential facts about that customer that relate to the nature and extent of the service being provided. In addition to the basic customer details, you should consider the following:

- Financial situation – do you gather details of their income/expenditure, assets/liabilities and savings/investments?
- Investment objectives – do you assess their risk profile and establish the purposes of investment and period for which they wish to hold the investment?
- Knowledge and experience – do you gather information on the types and frequency of any previous transactions they have carried out and assess whether the customer understands the complexity and risks of the intended recommendation?

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- Impact of your advice – do you gather information of their tax status and entitlement to state benefits and consider the impact of the advice on these?

Assessing needs and objectives

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When assessing a customer's needs before making a recommendation, you should consider the following:

- **Areas of advice/need** – If the customer has more than one need, do you highlight and advise on all their needs, or do you stick with the need the customer has asked about? How do you warn them of advice being limited to one or more needs and the potential consequences of this? Do you assess the customer's affordability of the needs identified?
- **Risk profile** – Do you have a consistent way of assessing a customer's risk profile? Is the definition of risk categories you use clear and meaningful to the adviser and the customer? Do you explore the customer's attitude to risk across their different objectives? Do your advisers understand how to use a customer's risk profile in practice when recommending a product and any underlying funds for investment?
- **Change in circumstances** – when reviewing an existing customer, do you ensure information you hold on them is up to date to reflect any changes in their circumstances such as employment, income, tax status, health, investment objective, attitude to risk? Do you consider whether previous recommendations remain suitable after these changes?

Examples of good practice:

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- **Firm A's** policy was for its advisers to complete a new fact find at every meeting with customers to ensure that information on their customers was consistently kept up to date. This information enabled the advisers to carry out a re-valuation of the customer's holdings and a re-assessment of their affordability and continuing suitability each time.
- The customer initially questioned the need to divulge full details of her personal and financial circumstances to the adviser at **Firm B**, saying that she only wanted a "one-off thing", but the adviser effectively overcame her objections by stressing the importance of knowing a customer's financial situation in full, even if the customer only wanted advice in one specific area so that he could take into account their full circumstances.
- **Firm C** did not solely rely on existing investments to assess a customer's attitude to risk ("ATR") as the firm was mindful that the customer may have been poorly advised in the past. Instead it carried out a full re-assessment of the customer's ATR during all interviews, and made reference to their existing investments to establish whether the customer's ATR had changed or there were discrepancies between the re-assessed ATR and the existing investments.

- The adviser at **Firm D** made sure he understood the customer's needs and objectives, including their importance to the customer and time-scales for achieving them, so that he could evaluate all options. Before making a recommendation the adviser obtained full information about the customer's credit status and loan information so that he could consider repayment and consolidation of loans as part of a savings strategy.

Examples of poor practice:

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- Whilst **Firm E's** stated policy was that it would review all potential financial planning needs of its customers, all files reviewed evidenced focused advice. The firm had not investigated why this was the case and whether its advisers were adequately emphasising the importance and benefits of full advice to their customers. Furthermore the firm had failed to identify that its advisers would only consider customers' needs that fell within the advisers' own area of expertise, and were not referring them elsewhere to receive advice on their other needs.
- **Firm F** had no clear policy on how ATR should be established; it used a scale of 1 to 10, without a clear definition of the categories. One adviser said he would deem 'low risk' to be between categories 1 to 3 and another adviser said he considered it to be between categories 1 to 4. The firm's compliance officer confirmed that they were aware that there could be inconsistencies with advisers' understanding of the ATR scale but had done nothing to address this.
- The customer approached the adviser at **Firm G** seeking advice on whether or not to invest a lump sum of £50,000. The adviser assessed the customer's attitude to risk by asking the client: "1 = Gilts, 10 = China, so where do you see yourself?"
- The adviser at **Firm H**, proceeding on a full advice basis, failed to adequately explore all areas of financial needs with the customer, who had approached him with £300 per month to invest for growth. The adviser asked a number of questions about the customer's circumstances but failed to adequately record that information at the time. Instead the adviser gave the customer a copy of the fact find to complete at the end of the second interview, after making his recommendation to take out an ISA and a Critical Illness Cover policy.