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Investment advice and platforms:

Good and poor practice report

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1 Introduction

1.1 This guide sets out good and poor practice when providing investment advice and using platforms. It aims to help intermediary firms to understand ways of meeting of rules and Principles as well as risks and practices to avoid. For the purposes of this guide, good practice means either effective compliance with our rules and principles, or exceeding them.

1.2 This guide refers to examples seen during the thematic review on investment advice and platforms and should be read in conjunction with the report on the findings[1] of this project. Firms can find more information on our position on this subject in Discussion Paper DP07/2[2], Feedback Statement FS08/1[3] and in our summary factsheet.[4] There are further examples of good practice in DP07/2. More detail on our wider view on platforms and the Retail Distribution Review (RDR) can be found at [weblink] including a new discussion paper on platforms which updates our thinking on this subject.

1.3 The guide is divided into three sections:

- quality of advice;
- systems and controls; and
- disclosure.

The good and poor practice examples are prefaced by summary key risks firms need to guard against. These examples and the risks are not exhaustive and relate specifically to investment advice when using a platform; they do not cover general investment advice risks unrelated to platforms or specific risks that may apply in individual firms. The good practice examples are simply that – examples; firms can meet our rules and Principles in different ways. For information about the status of Handbook guidance and supporting material, please refer to our statement on ‘Giving guidance and the status of guidance’.[5]

1 http://www.fsa.gov.uk/pubs/other/rdr_project_findings.pdf

2 http://www.fsa.gov.uk/pages/Library/Policy/DP/2007/07_02.shtml

3 http://www.fsa.gov.uk/pages/Library/Policy/DP/2008/fs08_01.shtml

4 http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/factsheet_wraps.pdf

5 This guide consists of supporting material, the status of which is explained at: http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2009guidance.shtml

2 Good and poor practice: quality of advice

Costs

2.1 Key risks include but are not limited to:

- incurring unnecessarily high overall costs for the client (product, platform and adviser) with a more expensive portfolio advice service[6] when a simpler, lower cost option would effectively meet the client's needs and objectives; and
- incurring unnecessarily high platform costs when the same level and quality of advice or service could be delivered at lower cost.

Examples of good practice

The firm negotiated special terms with the platform operator for individual clients where the standard terms would have been detrimental and potentially unsuitable.

Another firm had identified four 'key components which … combine to create the potential for enhanced long term returns ... on a client by client basis … :

1. a focus on cost reduction;
2. a focus on maximising tax efficiency;
3. the identification of an accepted target return; and
4. setting realistic expectations of future returns.'

The firm explicitly focused on reducing portfolio costs and this was demonstrated in practice by the platform-based portfolios they recommended.

Examples of poor practice

The firm did not take into account the platform's flat annual administration fee when recommending investments to clients with smaller sums to invest and the comparatively greater impact this charge had on the investment. This risked cases of unsuitable advice and we saw this in practice. See also the comments in the platforms alignment and due diligence section (page 7).

Another firm recommended a more expensive platform in order to access a particular specialist fund. However, this fund was not used for a valid reason and the client's objectives could have been met using a lower cost platform and a different fund.

6 'Portfolio advice service' is an expression we used in the DP (paragraphs 5.16 to 5.20) to mean an ongoing investment advice service that did not amount to discretionary portfolio management. It typically involves recommending a range of investments to meet an asset allocation and reviewing this on a periodic basis.

Attitude to risk (ATR)

2.2 Key risks include but are not limited to:

- failing to accurately record the client's ATR through unquestioning use of risk profiling tools (the tool may not always obtain the correct answer for the individual client; for example, where the investment term is particularly short);
- failing to recommend an asset allocation that is suitable to the client's ATR and personal circumstances through unquestioning use of platform tools (tools may not always derive the correct answer for every client circumstance);
- using model portfolios as a default position and failing to adapt them, where required, or adopt a bespoke approach, in order to be suitable for individual client circumstances; and
- failing to explain the need for ongoing reviews and putting in place these reviews when an asset allocation approach[7] is recommended.

Examples of good practice

An adviser used a risk profiler that indicated the client was medium risk. However he discussed risk with the client in more detail and they agreed that the client was in fact a cautious investor and the adviser proceeded on this basis.

In another fee-based financial planning firm, the adviser had established that the client was cautious. However, the adviser had also established that a slightly higher rate of return was needed in order to achieve the income the client needed in retirement. After discussion, the client said she wanted to take the slightly higher level of risk as it was important to her to have a better chance of meeting her objectives.

Examples of poor practice

The firm used model portfolios that were run centrally using a platform. There had been inadequate training resulting in unsuitable cases where they did not meet the client's ATR or personal circumstances; for example, recommending the firm's standard portfolio (designed for the medium to long term) for a term of three years.

In another firm, the adviser used a risk profiler that indicated the client was medium risk but the client had stated that he was a cautious investor. The adviser ignored the client's stated view and used the profiler results as the basis for the recommendations.

7 i.e. where a range of different asset class funds, or funds of different risk ratings, are recommended to meet a certain ATR. Over time, such a portfolio may become unbalanced and unsuitable unless reviewed and potentially rebalanced.

Switching[8]

2.3 Key risks include but are not limited to:

- failing to consider cost and performance issues between the existing and proposed investments and recommending a switch that is not in the client's best interests; and
- failing to consider or give added credit to options, benefits or guarantees of existing investments.

Examples of good practice

When advising one client, the adviser reviewed in detail existing investments held by the client. She provided the client with a report covering the existing investments, setting out the options and the pros and cons of each. Some were switched onto the platform for appropriate reasons whilst others were kept off-platform.

An adviser in another firm advised a client with a wide range of existing investments. The adviser focused on ensuring switching costs were low by re-registering existing investments where appropriate and reducing his own charge in light of the significant sums involved. The overall costs were no more than previously and the client was now receiving ongoing advice without additional ongoing costs.

Examples of poor practice

The client was a cautious investor with a comparatively small pension fund with three years until retirement. The pension had a reduction in yield (RIY) of 1% pa. The adviser recommended switching to a platform-based pension with a range of investment funds and an ongoing service to review these over time. The new arrangement had an RIY of over 3% pa and we did not consider the recommendation to be in the client's best interests nor to have met his objectives.

Another firm used a centralised platform-based investment proposition for many of their clients. In one case, the client was looking for investment flexibility and the adviser recommended switching the existing pension into the SIPP operated by the platform the firm had adopted. However, the existing pension was already a SIPP and the new arrangement involved unnecessary higher charges for no additional benefit.

8 This relates to any situation where one product is replaced by another. This can include pension switches, encashing and reinvesting investment bonds or unit trusts/OEICs.

3 Good and poor practice: systems and controls

Platforms alignment and due diligence

3.1 Key risks include but are not limited to:

- inadequately considering the platform market or the type of client the firm advises or the services to be provided such that these three elements are not aligned. This risks unsuitable advice, for example, on the grounds of unnecessary costs; and
- inadequate due diligence on the platform operator such that the required services cannot be delivered effectively.

Examples of good practice

The firm, a national IFA, started the process of designing a new investment proposition by undertaking market research with its clients. It then reviewed the market to decide on the most appropriate platform to be able to deliver the proposition most effectively for its clients and for the firm. It was necessary to negotiate the development of special functionality with the chosen platform in order to be able to deliver the proposition they had designed.

Some firms adopted more than one platform where this allowed them to offer services more cost effectively to different types of client; for example, a platform with no fixed annual administration fee for clients with smaller sums to invest.

Examples of poor practice

The firm did not undertake an impartial review of the platforms market. Their due diligence records largely consisted of material and comparisons produced by the platform on the firm's behalf which used assumptions that showed the platform in a good light but were not relevant to the IFA firm or the services it provided its clients.

Another firm had been using the same platform for several years but had not undertaken adequate reviews of the market since. For some time, the managing director (who was the primary adviser) had had concerns about the platform they had adopted (and concerns that it was no longer the best option for his clients) but had not reviewed the market and his decision to use this platform.

Conflicts of interest

3.2 Key risks include but are not limited to:

- conflicts of interest can influence – consciously or unconsciously – advisers to recommend platform-based investments when this is not in the best interests of individual clients;
- there may be a similar influence on senior management who in turn influence advisers (for example through training or remuneration structures) to over-sell platform-based investments; and
- failure to manage potential conflicts of interest may result in unsuitable outcomes for clients.

Examples of good practice

The firm had an Investment Committee (IC) which took responsibility for decisions on the investment approach including the selection of platforms. The IC's terms of reference included explicit reference to ensuring that decisions are made in the best interests of the clients, avoiding unreasonable pressure or influence from any product or service provider, avoiding any incentive to the firm or individual from any product or service provider, and alerting the IC chair and the firm's 'best practice officer' if any inducement was offered.

Another firm was concerned that using the portfolio planning tools that were available through the platform may result in a conflict of interest on the basis that they would be receiving valuable tools for free. Their approach to managing this conflict of interest was to subscribe to the financial planning tools separately.

Examples of poor practice

In one firm the managing director had close personal links with a particular platform operator, including a significant share option holding. These potential conflicts of interest were disclosed in the firm's terms of business but there had been no attempt to manage the conflicts in any way in line with Principle 8.

Another firm had a remuneration arrangement with the platform operator where the IFA firm received an increasing level of remuneration depending on the level of assets placed on the platform. We considered this to be a volume over-ride arrangement and a potential breach of our inducements rule.

Training and competence

3.3 Key risks include but are not limited to:

- failure to ensure advisers are adequately competent to provide the advice and services they deliver may result in unsuitable advice; and
- providing new services, using financial planning tools or advising on different types of investment may increase these risks without adequate training.

Examples of good practice

Some firms, once they had developed a new portfolio advice service, introduced this to the advisers through a series of training events and testing.

Other firms were involved with the platform 'super-user' group to help with their understanding of the platform and to comment on platform development.

Examples of poor practice

The firm managed model portfolios centrally and trained the advisers on the portfolios as a whole. However, it failed to adequately train the advisers on how the portfolios should be used; for example, how they should be used in particular client circumstances. In addition, it failed to train the advisers on the individual funds within the portfolios, in particular, the 'non-traditional'[9] investments which were used to a significant extent. The advisers we interviewed were unfamiliar with these investments and risked misinforming clients about them and recommending them inappropriately. We saw unsuitable advice in a significant number of cases.

The adviser in another firm generally undertook research on funds he recommended but did not always ensure he was competent in the markets in which the funds invested. There were instances where he recommended funds that invested in specialist markets readily available through the platform without understanding this market but merely going on the information supplied by the fund manager.[10]

9 Non-traditional' investments is a broad expression for investments where the investor cannot readily understand what will drive the returns or where the returns are not easily deduced, for example, by reference to a benchmark. This may include, for example, traded life policy investments, hedge funds and other funds where shorting is involved to a significant extent.

10 Adviser firms should refer to our position on product provider and distributor responsibilities (http://www.fsa.gov.uk/pubs/policy/ps07_11.pdf).

Provision of advice

3.4 Key risks include but are not limited to:

- advice processes are not adequately flexible to allow tailoring to individual clients, risking clients being inappropriately 'shoe-horned' into a pre-determined platform-based investment solution. For example, failing to adapt model portfolios when necessary to ensure the recommendation is suitable to an individual client's needs and circumstances; and
- a portfolio advice service that includes significant overall costs and results in the risk of unnecessarily high costs for some clients (for example, those whose needs and objectives are effectively met by a simpler, lower cost solution) or inappropriate switching of investments.

Examples of good practice

As part of the firm's new centralised, platform-based investment proposition, the firm had developed a detailed and informative approach to assessing a client's ATR:

1. a clearly written guide for the client explaining risk;
2. a risk profiling questionnaire to use as a starting point for discussion;
3. a 'risk spectrum' where the questionnaire result was plotted showing the approximate risk categories;
4. two-page risk profiles for each risk category providing detail on what the risk category may involve in practice including best and worst returns achieved in the past. The risk profile suggested by the questionnaire, and the ones above and below were discussed with the client to reach a final view; and
5. a summary of the types of investment that falls into each risk category.

Another firm had a consultative 'client board' to advise the firm on improving services to clients.

Examples of poor practice

The firm had three different ATR scales (including a platform-based one) and it was unclear how the scales related to each other. The advisers did not have a consistent understanding of clients' ATR and how these may relate to investments.

Another firm used the centrally managed portfolios without adequately considering the individual circumstances of the client. There were cases where the advisers recommended, say, a cautious portfolio to a cautious investor without adequate consideration of the client's individual circumstances such as term of investment or knowledge and experience of investments.

Whole market

3.5 The key risk includes but is not limited to:

- considering the platform as the default option and inadequately considering the whole of market when advising individual clients. This risks unsuitable advice when a different product would have been in the client's best interests. The risk is more significant for life (e.g. investment bond) and pension (including SIPPs[11]) where the platform choice is often limited to one or a limited number of products.

Examples of good practice

Most firms used whole of market research tools to select products and funds.

One firm had negotiated a clause in their contract with the platform operator that they should use best endeavours to make a new fund accessible on the platform if the IFA firm wanted to use the fund as a result of their preferred funds research.

Example of poor practice

The firm considered the platform to be no more than an administrative function. This involved a failure to understand the nature of the platform and our whole of market requirement. They risked using the products on the platform in some cases where other products would have been in the clients' best interests. This was particularly relevant with a platform that only provides access to life and pension products from one provider.

11 Self invested personal pensions.

Oversight

3.6 Key risks include but are not limited to:

- failure to review the risk management and oversight functions when a firm is in transition to providing portfolio advice services and making changes in the light of the RDR. This risks failing to manage and monitor many of the risks stated elsewhere in this guide and hence may allow unsuitable advice; and
- failing to understand the key issues around platform use and failing to focus on the key outcomes such as suitability of advice and clear, fair and not misleading communications.

Examples of good practice

We did not find any examples of particularly good oversight arrangements in relation to investment advice using platforms. Oversight and risk management is a particular concern and firms need to consider their risk management and oversight arrangements, particularly when they are in the process of transitioning towards providing portfolio advice services and making changes in light of the RDR. Further details about our concerns can be found in the report on the project findings[12] and our factsheet[13] provides information about issues firms should be considering.

Examples of poor practice

In one firm the compliance officer was very focused on file reviews and did not see the wider implications of a firm that was now providing portfolio advice services rather than transactional advice. For example, the compliance officer did not have a clear view of what constituted suitable and unsuitable advice in this area. He also misunderstood the firm's own guidelines about when to use the investment proposition, hence possibly missing unsuitable cases.

In another firm we were initially told that the rate of file checking by an external consultant was 100% for all pensions and 20% for investments. This proved to be incorrect and the file checking amounted to 5% of switches. File checks focused on the completeness of the suitability report rather than suitability of advice to use investments using a platform.

12 http://www.fsa.gov.uk/pubs/other/rdr_project_findings.pdf

13 http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/factsheet_wraps.pdf

4 Good and poor practice: disclosure

4.1 Key risks include but are not limited to:

- failing to clearly explain the services being provided. For example, having a template suitability report that explains what ongoing services are to be provided which is contradicted by the terms of business which states that no ongoing services will be provided;
- failing to explain the overall costs – of the products/funds, the platform and the advice (initial and ongoing) – in a way that the client is likely to understand;
- failure to explain the disadvantages of the recommendation; for example, the inability to re-register assets away from the platform where this applies, and the implications of this; and
- failure to explain the need for reviews and rebalancing of portfolios when a spread of investments is recommended.

Examples of good practice

Most firms used the key features illustrations provided by the platform operators. These were usually correctly compiled (for example, using the fund charges of the funds recommended) and covered all costs – product/fund, platform and adviser charges.

Another firm that had developed a new investment proposition produced brochures that set out in a clear and accessible format what the proposition involved.

Examples of poor practice

Many firms stated in their suitability reports that ongoing services would be provided, but this was contradicted by the terms of business which stated no ongoing services would be provided.

All bar one firm failed to explain the re-registration restriction in their suitability reports (where this was applicable) and the implications.

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