focus on suitability

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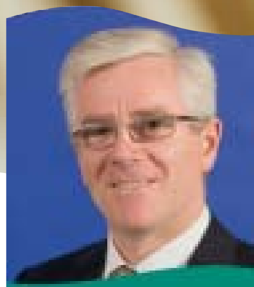

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Peter Jordan assesses the impact of two recent FSA publications on the suitability of advice.

Reading the RDR feedback paper you could be left thinking that there is plenty of time, maybe until after the London 2012 Olympics, to ensure the higher standards of advice hinted at in the paper are being met. Indeed some are suggesting that as we are likely to go through a review of the FSA and a general election before the framework is finalised there is little to be concerned about at this stage.

Recent events, however, may suggest that higher standards are already required; the FSA, empowered by Treating Customers Fairly (TCF), is making immediate progress with a more prescriptive approach which will provide very clear guidance in order to raise standards of advice. Although the first few TCF fines have made it clear that advice needs to be suitable (and that it is important to be able to subsequently provide evidence that any advice was suitable), two recent documents on pension switching and broker OEICs are starting to establish some advice boundaries for financial advisers. These will have a profound impact on the selection of platform partners and the provision of investment advice.

pension switching report

The thematic review of pension switching, which has encouraged the FSA to direct 4,500 firms to review their pension switch cases, provides some very clear guidance. It is likely to have far reaching consequences. It is reasonable to presume the guidance is relevant for just about any type of switch business and will be reflected in subsequent reviews – such as the ongoing review of platforms and wraps (themselves substantial beneficiaries of pensions switches and re-registration business).

With many financial advisers seeing restructuring and consolidation as increasingly important areas of business in the aftermath of the credit crunch, it is critical that this document is assessed and the consequences considered.

Within the review, advice given in 16% of cases was considered unsuitable for a variety of reasons. **Figure 1** details the problems with the advice provided and **figure 2** outlines the key guidance for advice.

figure 1
analysis of cases receiving unsuitable advice

Advice issue	Incidence (% of unsuitable cases)
Unnecessary additional costs	65%
Funds not suited to attitude to risk and circumstances	40%
Additional costs not justified or explained	35%
No investment review process put in place	26%
Failure to consider whether the ceding scheme could meet the customer's needs without switching	26%
Not ascertaining whether the new scheme was more expensive	26%
Failing to explain why a product/provider was recommended	22%
Stakeholder pension would have met needs	21%
Failing to provide adequate evidence of customer needs	20%
Failure to explain benefits foregone by switching eg GAR	14%

Source: Quality Advice on Pension Switching, December 2008.

> "At a time when much of our attention has been occupied by the Retail Distribution Review (RDR) feedback paper, there have been some very significant developments that have passed almost unnoticed"

figure 2
key guidance for advice in the report

- Financial advisers must assess customer's attitude to risk and personal circumstances and take sufficient account of the nature and overall level of the investments recommended, the investment term, the customer's investment knowledge and experience, and the need to diversify portfolios.
- Where an asset allocation approach has been recommended, the portfolio needs to be reviewed periodically and rebalanced where necessary to ensure it continues to be suitable.
- If a switch gives rise to additional costs these must be explained and justified. They are unlikely to be justified by additional investment flexibility if this isn't utilised. If the costs are justified by the potential for additional performance then how this will be achieved needs to be clearly demonstrated.

distributor influenced funds

Meanwhile, the factsheet on distributor influenced funds may make it difficult to justify the use of broker OEICs if they give rise to extra costs. While views will vary, this has placed a strong focus on investment costs, conflicts of interest and the suitability of advice.

Taking this guidance into account, many advisers may be encouraged to review their position on broker OEICs. While it should still be possible to operate within the guidance, the compromises required may encourage advisers to consider alternatives, such as pre-defined portfolios. In many respects this debate could come full circle with many advisers perceiving that the type of portfolio management technology provided by Selestia Investment Solutions is now more attractive than brokers OEICs.

summary

Nobody should be left in any doubt by either of these documents regarding the importance of cost and investment process. A consistent and objective investment process with an advice trail should be the minimum requirement for any platform partner.

In many respects the tide is now turning against the old type of trading platforms that tend to be more expensive, more complicated and with a greater focus on providing excessively wide investment choice, rather than achieving the sharpest possible prices backed by an industry-leading investment process.

If you have not yet fully investigated the power of the Selestia Investment Solutions investment platform, then please contact your Skandia consultant to take a look at how you get 2009 off to a flying start with a system which will help provide real compliance peace of mind. Alternatively visit **www.skandia.co.uk/fasite/**