Ensuring good governance throughout the product life-cycle: A financial planner's view

Nick Bamford

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Informed Choice Ltd, Sundial House, 20 High Street, Cranleigh, Surrey, GU6 8AE, UK
Tel: +44 (0)1483 274566; E-mail: nick@icfp.co.uk

Nick Bamford

***Nick Bamford** is Executive Director of Informed Choice Ltd, a family owned and managed firm of Chartered Financial Planners based in Cranleigh, Surrey. Nick has been an independent financial adviser for 27 years and delivers financial planning and advice services to a wide range of consumers. Nick works mainly with members of the baby boomer generation who have complex and pressing planning needs, and who often are sandwiched between generations (having children and parents to consider) with retirement at the front of their minds. Nick has a BA Hons Degree in Financial Services from Napier University, Edinburgh and an Advanced Diploma in Risk Management. He spoke on the subject of good governance throughout the product life-cycle at the Infoline Compliance Monitoring & Assurance Strategy 2016 Conference as a panel member in London in September 2016.*

Abstract

Chartered financial planner status is a relatively new concept in UK financial services. Practitioners have a higher standard of qualification (QCF level 6) than the baseline entry level required by the Financial Conduct Authority Rules which is set at QCF level 4 Diploma. Many chartered financial planners charge explicit fees to their client where advice is not dependent upon the implementation of a financial product: this advice will often be supported by a full and comprehensive financial plan, often supported by lifetime cash flow forecasting. Where a financial product is needed as part of a solution aimed at achieving client goals and objectives, most chartered financial planners will select such product solutions from the whole of the market. They will satisfy the FCA definition of 'independent'.

Keywords: product life-cycle, chartered financial planner, suitability, governance, know your customer, TCF

At the coal face

The financial planner has a vital role to play in the long-term financial future of the client. Readers might wonder what role, if any, the financial planner has in ensuring good governance in the retail investment product life-cycle. This author believes that they have an important role to play.

As a financial planner, a retail investment product is not the most important thing in the way we deliver our professional services to a client, but is not unimportant; we need to put it into perspective. The most important thing we do is to provide financial planning advice, typically in the form of a full financial plan. This may involve advice about a retail investment product but it does not have to. It may involve advice about a retail investment product already owned by the client, for example recommending investment fund switches to make the plan more suitable for the client's needs.

Suitability is an essential word for financial planners. It is not about selecting the 'best' product. There is far too much subjectivity involved for us to use the word 'best'. Suitable is a much more appropriate way to describe how we select products.

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Poor governance in the product life-cycle: an example

'It seems to me to be the case that this investment is simply a device for changing my money into someone else's money!'

A new client of this author's organisation is an intelligent and successful man. He has been prudent all his working life and built a robust net wealth position for himself and his family. He has had some experience of investing and takes a moderate view of investment risk. He is also the victim of poor governance in the product cycle.

For many years he has saved for retirement using a Self Invested Personal Pension (SIPP) arrangement. Initially this was invested in a range of authorised and regulated collective investment funds. In the early years of his SIPP a review would have shown a mix of investment assets including cash and a collection of equity, fixed income and commercial property funds, and on examination a range of investment funds that would have matched his 'moderate' attitude and appetite for risk, reward and volatility. The investment performance of the SIPP and its underlying investments was acceptable for a man with his world view.

It hurts to say so but his mistake was that he was too trusting. He felt that his adviser had his best interests at heart. The client did not want to take an active part in the investment process and therefore he was delegating that job to his adviser. Some years back the adviser recommended wholesale change to the client. He convinced his client that there was a better way to invest. This better way to invest involved the selling of the various authorised and regulated funds and the purchase of a number of unauthorised investment funds (UCIS) invested in foreign property schemes and a waste to energy investment again outside the UK.

The client has lost a lot of money. The value of the UCIS investments has fallen significantly or disappeared altogether. At best they are totally illiquid making withdrawals of benefits pretty much impossible.

He has also failed in a claim to the Financial Ombudsman Scheme (FOS). FOS believes that the investments he was sold inside his SIPP were suitable for him. They have accepted the advisers defence that the client was an experienced and sophisticated investor and that the UCIS funds were inline with his moderate appetite for risk. FOS is so magnificently wrong in its determination that it is exasperating to relate this story.

It is however, in this author's view, a good example of what can happen when governance goes wrong or is absent in the advisory space.

How can we as financial planners ensure that we exercise good governance throughout the product lifecycle?

This author believes that there are a number of steps a financial planner can take to ensure that they will always deliver suitable retail investment product advice.

Target marketing

If we target a clearly defined market segment with our client facing proposition, we can ensure that we build the foundation for good governance throughout the product life-cycle. When this author speaks to groups of advisers he often find a reasonable percentage of the audience are trying to deliver their proposition to a broad church of people.

This author believes it is better to identify a target market that possesses similar attributes so that we, as financial planners, can better get to know their needs and wants. This will help us to ensure that any product solutions we offer clearly line up with those identified needs and wants.

This author will offer his own firm's target market as an example:

- Location: GU6 postcode +10 miles. They live in and around our community in the Surrey Hills;

- Age: baby boomer generation born between 1946 and 1964;
- Family: they are typically sandwich generation with children and often elderly parents;
- Important concerns: they have retirement at the front of their mind either approaching it or in it;
- Complexity: their financial affairs are complex (if they were not why would they need us?);
- Position: they lack the time, inclination and/or skill to sort their finances out for themselves;
- Needs and wants: they want a whole list of things from their chosen financial planner, including clarity around the complex choices with which they are faced, and confidence in the decisions that they do make;
- Relationship: they are used to dealing with other professionals and used to paying fees for professional services;
- Technology: they are computer literate and use the internet for research;
- Fun: we want to engage with clients who are fully involved and engaged (fun helps them to do that!);
- Assets: they own property, have investable assets of circa £300,000+ and are usually without debt.

So the target market is the local baby boomer generation. The firm gets to the point where they know more about this group's problems than they do and can articulate their problems better than they can, which leads to the target market believing that the firm has the solutions they need.

Know your customer

The FCA has a reasonable expectation that a financial planner must 'obtain the necessary information from the client to be able to make a suitable recommendation'.[1] Unsurprisingly this involves gathering data from the client about their financial circumstances, their investment objectives and a number of items of information on issues relating to risk, including their attitude towards risk, capacity for loss, as well as knowledge and experience of investments.

This latter point, knowledge and experience of investments, is often quite challenging. Questions including 'Have you ever invested money before?' and 'What was your experience of doing so?' generally result in a confused answer. Consumers may well think of investing money purely in the sense of direct holdings in shares and not consider their personal pension pots for example, as an 'investment'.

Ask an investor to tell you what the FTSE 100 is and this will result in a variety of answers. Ask them to describe the risks associated with investing in Gilts and answers will vary from a blank stare to a technical analysis of coupons and running yields, this depending upon their relevant experience and knowledge.

The regulator is right to expect those in the sector to ask about these issues but absence of knowledge and absence of experience should not in itself result in no retail investment product recommendation being made but rather a greater degree of care being exercised by the adviser.

This is not just about the factual data that we gather. A form that shows a client's name, address, date of birth and National Insurance number is of course an essential part of knowing our customer, but more importantly, must surely be information of a subjective nature.

How do they feel about money? What does it do for them? What specific goals and objectives do they have? The financial planner may well end up knowing far more about their client than any other professional with whom that client engages, putting them in a strong position to determine what is most suitable for them.

Suitability

Research and due diligence is described by the FCA as a process to be carried out by the adviser in examining the nature of

any retail investment product, its risks and benefits and the standing of the product provider in order to determine the suitability of a recommendation.

Financial planners put great emphasis on the selection of both a suitable product and suitable product provider, considering areas such as the financial strength of the provider, administration standards of said provider, as well as the competitiveness of any product charges and availability of suitable investment funds.

This involves having a rigid approach to due diligence. Believing everything the marketing material says about the product without challenge has led to too many examples of poor consumer resolutions.

Treating customers fairly

What we want most of all is to ensure that the product offerings align with the Treating Customer Fairly Outcomes.

Outcome 1 – Consumers can be confident that they are dealing with firms where the fair treatment of the customers is central to the corporate culture.

Surely a given? Why would any firm *not* want to treat their customers fairly? It would surely result in such a poor reputation that they would struggle to acquire any new clients and those that they had would abandon ship at the first opportunity.

Within our firm if we make a mistake and that mistake results in a financial loss for the client, our aim will be to compensate the client even before they notice the error.

Outcome 2 – Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

This outcome lines up nicely with our own target marketing work. What products might the baby boomer generation need? There are a range of suitable products including ISAs and General Investment Accounts through to Inheritance Tax mitigation plans and flexi access drawdown pensions which meet the needs of the target market.

Outcome 3 – Consumers are provided with clear information and are kept appropriately informed before, during and after point of sale.

This is crucial in the financial planner role of good governance during the product cycle. It is also why the review process is so vital. A product that is suitable at the start of the client relationship needs to remain so and the review cycle is a good point at which to test this continued suitability.

We do need, however, to be sensitive to the subject of information overload. The client employs us, the financial planner, to ensure we know all there is to know about the financial product they have been recommended to buy. If the client fully understood everything why on earth would they need us?

Outcome 4 – Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Financial planners tend not to lose too much sleep over this outcome! Financial planners have relationships with clients that span decades. We meet them on a regular basis both professionally and within our community. We are around to see the outcome of the advice that we provide. That long-term relationship imposes a discipline on the advisory process that should not be underestimated.

Outcome 5 – Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.

This is in my view key to good governance. As financial planners, we know how these products perform. Not in terms of future investment returns, no one knows that of

course, but in terms of things such as product charges, availability of investment choice and accessibility when the client requires their money back. We also know how the product will perform in tax terms – well until the next government changes the rules of course!

Clients need to know what services they are going to receive from their financial planner. This is often detailed in an 'engagement letter' issued to the client by the planner after the completion of the discovery process where the planner has uncovered all the needs and wants of the client. Documenting the service level that the client can expect will ensure that the client is not expecting to receive a service that the financial planner is not expecting to be delivered.

Outcome 6 – Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Whose money is it? From time to time product providers do appear to be asking clients to jump through hoops to get their money. Sometimes there are good reasons for this, preventing fraud and scams for example, but on other occasions it can simply be poor administration service standards. The administration staff at product providers speak of 'agreed service standards' but these are generally internal standards rather than something agreed between provider and financial planner. Taking 15–30 working days to issue a discharge form for example, must surely constitute an unreasonable post-sale barrier.

Impact of the Retail Distribution Review (RDR)

The abolition of commission for advised sales of retail investment products has had a significant effect on the role of the financial planner in good governance throughout the product life-cycle. This author believes it has bought greater clarity to the way the consumer pays for financial planning services but has been a contributor to the so called 'advice gap' as well.

For those financial planners whose focus has been on advice and planning rather than product, it has added a greater professionalism in the way such services are delivered.

Higher qualification levels have also contributed to a better environment for consumers. The minimum qualification level is, in this author's opinion, still too low but there is evidence in a rising level of discretionary qualification improvement with financial planners seeking the aspirational QCF level associated with chartered financial planner status.

Clarity and higher levels of qualification are positive virtues in improving good governance throughout the product life-cycle.

The financial planner as a product manufacturer

Technology has changed the role of the financial planner. The wrap platform has created an environment in which the financial planner has effectively become part of the product manufacturing process. Historically product providers made available the tax wrapper (eg ISA or pension plan) and determined the availability of investment funds. The financial planner then became an important part of the distribution of that product.

The advent of wrap platforms and enormous range of choice in terms of investment funds, and indeed direct investments such as shares and bonds as well as commercial property has seen the role of the financial planner look somewhat like that of a product manager. Centralised investment propositions and the white labelling of the wrap platform enable a financial planner to create a bespoke retail investment product offering for their clients.

This places even greater importance on the financial planner in ensuring good governance throughout the product life-cycle. The FCA, quite rightly, do not want

to see clients 'shoehorned' into unsuitable products simply because it makes it easier and more profitable for the adviser.

That said, a good business case can be made for the financial planner using one wrap platform for a variety of clients, for example, the following non-exhaustive list shows the advantages to both client and financial planner of a one stop product offering.

Consumer advantages of financial planners using one wrap

- High level of client service efficiency: the adviser will have an intimate knowledge of the wrap and its strengths and weaknesses. Mistakes can be avoided as the adviser will be able to operate one process to carry out all of the following;
- Implement the client onto the platform;
- Buy and sell underlying investment assets;
- Be able to establish model portfolio functionality on that platform;
- Understand the process for topping-up investments;
- Generate valuation reports (typically by linking up with the financial planner back office system);
- Carry out x-ray analysis of portfolios in order to manage portfolio risk;
- Carry out tax calculations (typically Income Tax and CGT calculations);
- Educate clients on how to view their portfolio value 24/7;
- Keep client costs down by the efficiency of use;
- Access the whole of market for collective investment funds;
- Know and be familiar with the process for extracting client money from the wrap;
- Know and be familiar with the process for moving the client off the wrap platform.

Consumer disadvantages of financial planner using one wrap

- Some products might be cheaper on another wrap platform.

Wrap is a service proposition, not a product, but this author suspects that the regulator views it more as a product and seeks to measure its use as if it were a product.

Conclusions

As said at the start of this piece, financial planners have an important role to play in good governance. How can we avoid more clients of the type that have been quoted? We need a robust and effective regulatory system and in this author's view we are some way away from achieving this. The payouts from the Financial Services Compensation Scheme are evidence not of a robust regulatory environment but the opposite, regulatory failure. Financial planners and advisers can ensure good governance by having a logical approach to how they use retail investment products. Knowing who their target market is makes for a good start. Going to great lengths to know all that needs to be known about their target client both as a group and individually is a second good step. Open-mindedness is a virtue but challenging things is also important; a complex retail investment product full of risk-based assets marketed as a guaranteed low-risk product is surely worthy of a significant degree of challenge. Offering up the treating of customers, various outcomes and asking if a product is likely to satisfy those also seems a worthy endeavour on the part of the financial planner. Reviewing the product over time to ensure continued suitability is also an important responsibility for the financial planner. Good governance during the product life-cycle is a team-based game. There are roles for the product manufacturer, the regulator and that all important midfield role of the financial planner.

Reference

(1) Financial Conduct Authority, 'Assessing suitability', available at: www.fca.org.uk/firms/assessing-suitability (accessed 31st March, 2017).