Introduction

The following white paper was authored by Tony Slimmings, a Chartered financial planner and managing director of We Complement. It is intended to be read by regulated financial advisers and associated professional staff, not the general public.

It aims to provide a comprehensive reference point for regulated financial planning firms, which can be used by everyone involved in the delivery of financial planning and investment advice. As such, it is hoped that the document will help financial planners and advisers understand the processes, core beliefs and philosophy they need to adopt to deliver excellence.

The following paper examines the vital role that advice files have in the advice process. The issues of **suitability reports** and **advice processes** are dealt with in different whitepapers, which can be read to gain a deeper understanding of these important areas.

To start, it's necessary to look at why ensuring financial advisers evidence the suitability of their recommendations correctly is good for business. Good for business should not be confused with "best practice" or "best business sense"; "good for business" means just that.

The reason is simple: giving the wrong advice or failing to clearly evidence why recommendations are correct could reduce the company's bottom line. This is because failing to do either, or both, could result in a complaint being upheld, which could result in lost business and a significant increase in the cost of its Professional Indemnity Insurance (PII).

This is why an adviser's recommendations, as well as the solutions suggested and the rationale behind them, must always linked to the client's needs, objectives and financial position. Before we look at this in more detail, let's consider why it is so important for advisers to do this in a clear and uncomplicated way.

Clients may not be as educated in numeracy to the same level as advisers

It would be wrong to suggest clients are not intelligent people. That said, the charity **National Numeracy** reveals that less than 22% of working age adults in England have skills levels equivalent to GCSE "C" grade or above.

With this in mind, it is important to consider simple solutions that will help advisers stay on the right side of the suitability tracks. One way to achieve this is to ensure 10 important documents, listed below, are included in a client file, as these will help ensure that the adviser can demonstrate the robustness of their advice.

Furthermore, without a document in the file to evidence that a conversation or piece of research happened, any investigation into a complaint will assume it never took place – whether it did or not.

This is likely to result in a complaint being upheld, which in turn will lead to a loss of reputation and loss of business in the future. Against this backdrop, we need to now look at the 10 essential documents.

1. **Up-to-date "know your client" information**

   An adviser must be able to demonstrate that they have taken the trouble to get to know their client well, and that the files provide adequate levels of information. It's also important for advisers to update fact-finds and the relevant files when meetings take place, or when the circumstances or needs of clients change.

   One way to do this is to include hard and soft facts, as well as direct quotes made by the client. It is worth pointing out that the process of 'fact finding' is not just about collecting hard facts, it is a "deep dive" into the four "Ws". These are:

Who
Get to know clients in detail, including past experiences, future hopes, wider family and background.

Why
Really understand the client's motivation. For example, is there a real need driving them, or simply a desire.

When
What is the client's time horizon, and how does it fit with their long-term and short-term situation and aspirations.

What
Understand what it is the client wants to achieve (both in the short and long term).

One way to ensure this is to record plenty of "soft facts" during meetings with clients. Remember, making use of soft facts and recording them diligently could help ensure the Financial Ombudsman Service (FOS) rules in an adviser's favour.

A common mistake is to refer to meetings in a suitability report then not detail the meeting on a fact-find within the files. This too could result in a complaint being upheld.

When a fact-find is completed, remember to explain the client's objectives clearly and provide supporting notes, as this will support any recommendation made. Using SMART (Specific, Measurable, Attainable, Relevant and Time Bound) objectives can help.

Ensure the file contains a complete breakdown of the client's expenditure as this could help provide a much more robust defence against complaints. It will show a higher level of diligence that will always go in an adviser's favour.

Another excellent way of providing good client care while creating a solid defence against a complaint is to send a copy of the fact-find and supporting notes to the client. Doing this confirms that the notes are a true reflection of discussions, and asking a client to approve them will add an additional layer of defence.

It could also highlight a mistake that may otherwise be missed. For example, it may reveal that a client's name is Julie when the adviser thought it was Jane. If this was not picked up and a complaint is made against the adviser, the latter's defence of "I knew my client well" it is unlikely to be successful with the FOS.

Going to the trouble of typing the notes that are sent to the client for approval will avoid the client later claiming that they misread the adviser's handwriting – something that might result in a complaint being upheld.

2. Risk questionnaire and supporting notes

While this might seem obvious, the risk questionnaire is essential as it dovetails into the investment solution being recommended. Additionally, the files must include diligent and comprehensive notes that were taken during the discussions with a client about risk, and the level that is appropriate for them.

Always remember that most risk profilers are not 100% effective in every case and have limitations. Good practice is to state these limitations in the report, perhaps by challenging any inconsistencies and linking the results to client comments. This again will add weight to an adviser's case and make the risk profile that's been chosen more robust.

If an adviser uses a risk profiling tool, it should be a starting point for further discussions that need to be recorded and held in the client file. These should clearly detail any discussion with the client to confirm their willingness, ability and need to invest at the agreed level.

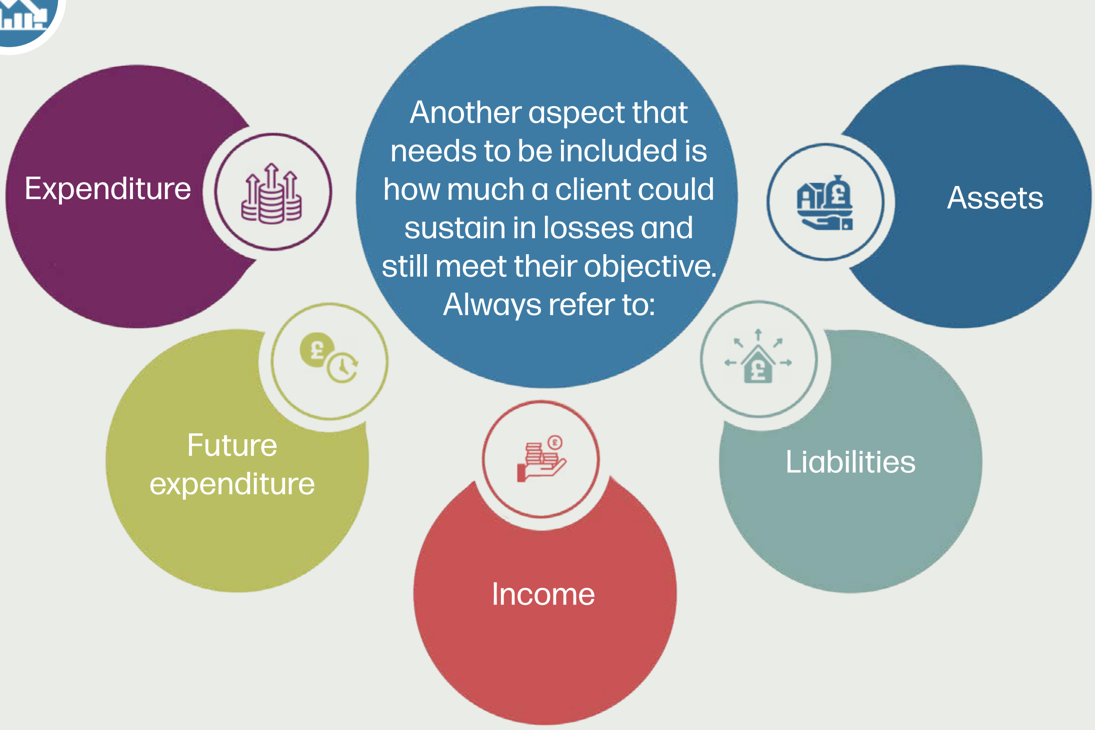
3. Capacity for loss

While attitude to risk is typically seen the most important factor when determining the most suitable solution for a client, it is more likely to be their capacity for loss. This should always be discussed in detail, recorded diligently and included in the client files.

While a client may have a certain risk tolerance, they may not be financially able to absorb any losses that occur from investing in a higher-risk solution. As such, it is vital to confirm that the client's financial circumstances fit with their attitude to risk and evidence it.

Some financial advisers use specific figures to evidence capacity for loss, for example stating: "you have three months' income in your accessible savings". Doing this adds important detail, which in turn, provides additional credibility to their research and subsequent rationale.

Linking this to the client's preference and explaining any capital requirements that may be needed over the next two to three years demonstrates a level of diligence that will go in an adviser's favour. This means that a compliance checker, or anyone investigating a recommendation, are more likely to decide in an adviser's favour.



Last, but by no means least, always record the client's emotional tolerance to loss as well as their ability to absorb it in financial terms. If a loss is likely to cause emotional toil, then an adviser will need to consider very carefully whether that client should be in a higher-risk solution, even when they are financially robust enough to warrant it.

Going ahead regardless may not end well for the adviser if a complaint is made in the future.

4. **Cashflow modelling if appropriate**

While carrying out cashflow modelling is always good practice, the full report should be confined to the client file. While it is good practice to refer back to the report's findings to back up a recommendation and demonstrate reasoning, adding all of the report is likely to confuse a client.

If a client complains to the FOS that they did 'not understanding the advice', it is much more likely to succeed. Remember, cashflow modelling will show diligence on an adviser's part and help their defence if a complaint is made, but only if it is used sparingly so that the suitability report is clear.

Where switches are being recommended, good practice is to include the cost-benefit analysis, although ensure it adequately demonstrates to the client the material benefit of going ahead. Always keep this in the client's files, as if it is not in there, an investigation will assume that it didn't happen, regardless of whether it did or not.

5. Assessment of knowledge and experience

Assessing a client's knowledge and experience is important, as it helps back up an adviser's recommendations. That's why it must always be included in a client's case file.

Logically, if a consumer goes to an adviser for help, the adviser should assume they have minimal knowledge regarding pensions and investments. It is dangerous for an adviser or financial planner to assume that previous experience in investing demonstrates an understanding of how it works.

Holding a bond for 10 years, for example, does not evidence that the client understands investments, just that they have bought one. Understanding the client's knowledge and previous investment experience is critical to a recommendation, and could help explain a risk rating that is lower than their profile.

Not including this could significantly increase the chances of a complaint being upheld.

6. Research and analysis to back up a recommendation

Every adviser typically includes research and analysis in a client file, although that doesn't necessarily mean it is adequate. This is why it is vital to include every aspect of research and analysis in the client's files.

If an adviser only includes those elements of research they feel should be included it is likely to harm their defence if the recommendation is later investigated. Where research is held centrally, a signpost should be made to where the information can be found.

This is why having robust central research and proposition documents can save so much time, something that will be discussed in more detail later on in this white paper.

7. A clear and robust suitability report

Including a suitability report is one thing, including a clear, concise, well-written and robust suitability report is another. As We Complement specialise in producing the latter, please feel free to get in touch to find out how we help advisers protect, and enhance, their business.

8. Key features illustrations

Always ensure that the Key Features illustrations are included, and that they are accurate. As paraplanners, we have to go back to financial planners with surprising regularity because there are errors on the illustrations.

Good practice is to signpost to this document within the suitability report and not to lift elements and tables from these documents and include them in the report. Advisers that do this are running the risk of losing context, which could reduce the client's focus on the risk warnings within a complete and compliant document.

9. Anti-money laundering checks

It is essential to evidence all anti-money laundering checks, and to ensure everything is accurate and stands up to scrutiny. Furthermore, all the checks and relevant information must be held in the client's files.

Failing to do this could have dire implications for an adviser if a client's finances ever come under scrutiny by law enforcement agencies.

10. Client agreement and terms of business

Last but by no means least is the client agreement and terms of business. Failing to include this will result in the checking process being delayed and could result in questions being asked about an adviser's level of diligence.

A file should provide a story that's specific to each individual client, and justifies the recommendation being made. Getting it right could help increase business and enhance an adviser's reputation.

Not doing so could lead to customer complaints and have an adverse effect a company's reputation, resulting in a loss of future business. Furthermore, poor client files could make a financial practice's Professional Indemnity Insurance (PII) more costly, which could reduce profitability.

Regulatory guidance surrounding evidencing suitability.

In 2011, the then Financial Services Authority (FSA) issued guidance on assessing suitability as part of the work it had carried out and completed on risk profiling tools. Since then, the guidance has been developed and now touches every aspect of financial planning and advice.

While the rules haven't changed, additional regulations have been added that advisers must consider either now or in the near future. These include:

- Pension Freedoms
- MIDFID II
- Product Governance, Consumer Duty (July 2023)

Another example is the **'Defined Benefit Transfers'** document, although this area has been excluded from this guidance. The document is aimed at providing some guidance on how advice firms can evidence to the regulator that they are providing suitable advice and ensuring all the documentation to support the suitability of advice is included.

Against this backdrop, it is time to look at what the "rules" are for retail investment products and advisory obligations next.

COBS 9.2R/COBS 9A.2R

The COBS 9.A.2R is for business carried out by investment firms that are authorised under the Markets in Financial Instruments Directive (MiFID) and COBS 9.2R is for non-MiFID businesses. The rules set out the following criteria:

- A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.
- When making a recommendation or managing a client's investments, a firm must obtain the necessary information regarding the client's circumstances.
- The financial adviser must have knowledge and experience in the investment field that is relevant to the specific type of designated investment or service.

The planner must fully understand their client's financial situation and investment objectives

Meeting these criteria "enable the firm to make the recommendation, or take the decision, which is suitable for the client". In simple terms, firms must take reasonable steps to ensure any personal recommendation and investment advice is suitable for their client.

Financial advice businesses and their planners need to understand the essential facts about the client. They must also have a reasonable basis for believing that the recommendation is suitable for the client's investment objectives.

While this includes time horizon for the investment, risk profile and the investment's purpose, it needs to also consider the client's capacity for loss (something this paper has already outlined). Furthermore, the financial adviser must consider whether the client has the necessary knowledge and experience to understand the risks associated with the recommended contract.

COBS 2.1.1R

Central to COBS 2.1.1R is the following statement that's contained within it:

> *"Firms must act honestly, fairly and professionally in accordance with the client's best interests."*

Put another way, putting the client at the heart of everything an advice firm does means that it will not go wrong. We will soon be looking at "consumer duty", which dovetails into this.

Principle 9

This states that a firm "must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment". Please note the words "reasonable care" to ensure advice is suitable.

That said, the Financial Conduct Authority (FCA) has been clear about the importance of obtaining the correct client outcomes. While advisers must have robust processes in place to help ensure the suitability of advice, they should always focus on achieving the right outcomes, rather than focusing on processes alone.

When it came into force on 3 January 2018, MiFID included a number of important changes to the rules in respect of suitability. This is different to COBS 9A, created as a new chapter in the FCA handbook to highlight additional requirements, which are:

- Checking the accuracy of client information
- Maintaining adequate and up-to-date "know your client" information when providing ongoing advice
- Retaining responsibility for automated advice
- Having a policy for determining who the suitability test should relate to
- Making sure suitability assessments are carried out "at least annually", but higher risk products require more scrutiny
- Ensuring a recommendation is not made if a suitable solution does not exist

Making sure suitability reports relate just to changes in services or investments of the client, where the service being provided involves periodic suitability assessments and reports

Assessing suitability when the recommendation is to buy, sell, or hold (the previous requirement was to buy or sell only)

Ensuring financial planning tools like risk profiling tools are fit for purpose.

Furthermore, when carrying out replacement business, all information on a client's existing arrangement must be collected and analysed, including costs and benefits. This ensures the firm can reasonably demonstrate the benefits of switching are greater than the costs.

Product Governance

The Product Governance rules, otherwise known as "PROD", is found under a newly established part of the FCA handbook known as the "Product Intervention and Product Governance Sourcebook". PROD means financial advice firms must ensure the following:

- Procedures are in place to assess the target market for products the firm advises on
- The firm's board is accountable
- An appropriate compliance oversight is in place
- The firm employs appropriately competent staff
- All relevant information on products from life offices and fund groups is obtained
- The firm always considers the impact of charges on clients.

Advisers and financial planners should also consider the financial strength of the product providers they decide to work with. Furthermore, they should also consider how efficient and reliable the provider is at the point of sale and beyond.

The firm should also consider the provider's targeted marketing and ensure that all investment solutions, platform and advisory services must be geared towards the correct client segments.

Consumer Duty

The FCA's Consumer Duty ensures that all firm's consistently place their customers interests at the heart of their business. The rules and guidance being introduced will come into force on a phased basis as follows:

For new and existing products or services that are open to sale or renewal, the rules come into force on 31 July 2023

For closed products or services, the rules come into force on 31 July 2024.

The rules require firms to consider the needs, characteristics and objectives of their customers, including those with characteristics of vulnerability. This includes how they behave at every stage of the customer journey.

As well as delivering good customer outcomes, firms will need to understand and evidence whether those outcomes are being met. The key point is that there will be a focus on client interests and outcomes that goes beyond compliance and the rules.

As such, there will be new "cross cutting" rules, which will enhance the standards of conduct expected by the FCA. These rules will require financial practices to:

- Avoid causing foreseeable harm to retail clients
- Enable and support retail clients to pursue their financial objectives
- Act in good faith towards retail clients.

To help achieve this, the FCA has set out four outcomes that provides details on how the watchdog believes firms should act, and the client relationship that should then follow. These are:

1. **Fair value** - consumers pay a price for products and services that represents fair value. Poor value products and services are removed from markets leading to fewer upheld complaints about poor value and unexpected fees or charges.

2. **Suitable products and services** - consumers are sold and receive products and services that have been designed to meet their needs, characteristics and objectives. This is expected to lead to a reduction in the number of upheld complaints about products and services not working as expected.

3. **Suitable treatment** - consumers receive good customer service leading to a reduction in upheld complaints about switching, cancellation and service levels. The aim of this is that clients have higher levels of satisfaction with the service they receive.

4. **Confidence** - consumers increase their confidence in financial services markets and are equipped with the right information to make effective, timely and properly informed decisions about products and services.

The FCA expects firms to monitor and regularly review the outcomes that their customers are experiencing. Additionally, advice practices must ensure that the products and services they provide are delivering the outcomes expected and are in line with the Consumer Duty.

Companies must identify where products and services are leading to poor outcomes or harm to consumers. To achieve this, firms will need to identify sources of data that will allow them to assess client outcomes and whether they are providing results that are consistent and meet their obligations.

By monitoring these outcomes firms can see where consumers are getting poor outcomes and understand the root cause. This means that they can adapt or change their processes, products, services, policies or practises to address issues as appropriate.

The firm will also be able to demonstrate how they have identified and addressed issues leading to poor outcomes. Some information firms might want to consider for monitoring purposes includes:

File Reviews	T&C Records	Complaints
Customer Feedback	Business Persistency	Behavioural Insights

An advice firm's board should consider the data it has collected annually as a minimum. It must assess the data so that it can see whether it is consistently delivering good outcomes for clients that meet the Consumer Duty requirements.

Businesses should be acting now to decide what, if any, changes they need to make to ensure the practice will meet its new obligations. It is recommended that a Consumer Duty action plan is put into place, which prompts the business to consider how it can demonstrate that it puts client welfare at the heart of everything it does.

Furthermore, the plan should consider how a financial practice can demonstrate that it only offers products and services that are fit for purpose and provide fair value.

As the above demonstrates, there are many regulations and rules that financial practices will need to consider and adhere to. Now that these have been covered, it is necessary to look at the practicalities of making sure any advice provided stays on the right side of "suitable".

Holistic Advice versus Limited Advice

The suitability test depends on the nature and extent of the service a firm is providing to its client. If it is providing holistic advice, the level of "know your client" information needs to be extensive and any recommendation must be suitable based on an analysis of the client's full circumstances.

Where the nature and extent of the service is limited, for example, where an adviser is providing advice to invest into a new ISA only, then the suitability test needs to be considered in this context. As a result the level of "know your client" information collected is more limited.

Suitability and Disclosure come under different rules

When reviewing client files, suitability and disclosure come under different rules, which means that the FCA will assess them separately.

If a suitability report has content that may be misleading, it would be considered a "disclosure failing", which would not necessarily mean that the advice was unsuitable. The client may still have walked away with a recommendation for the right investment solution even though the report contained misleading content.

Advice is never straightforward or a one size fits all. Advisers have many investment options available to them and what one adviser might recommend the other may not. This does not make one recommendation more or less suitable than the other.

There may be something specific about a client's circumstances that means the adviser considers some options would be better than others. Where a recommended option is more expensive, for example, there needs to be a good reason for this with robust rationale and justification provided to demonstrate it is relevant to the client.

An investment may be considered suitable as long as there isn't a demonstrably better alternative. The FCA's stance is that it would only deem a case unsuitable if it can be demonstrated that a better alternative exists.

A firm offers restricted advice

If a financial practice is restricted, a recommended investment may not be the best on the market. Furthermore, it might also be considered expensive in comparison to others that are available in the whole market.

That said, this would not mean that anything offered through restricted advice is unsuitable. Where a firm has a restricted offering of investments, and the adviser discloses this fact to the client in good time using the firm's initial disclosure documents, it is deemed that the client will have been fully informed.

As such, if the client engages in the service provided by the firm, they are deemed to be doing so with a full understanding of these restrictions. Disclosing that advice is restricted "in good time" typically means before making a recommendation, such as during the initial meeting or fact-find.

If a firm does not have a suitable investment option due to its restrictions, it would not be appropriate for the adviser to recommend the next best option from the firm's range. For example, if a client wants to start building a retirement fund but the firm does not offer pensions, it would not be considered appropriate to recommend an ISA as the next best alternative.

Managing risk and meeting objectives

If a client cannot meet their objectives because of their circumstances and/or risk profile, the FCA would expect an adviser to discuss the options available in a bid to reach a compromise. This could mean the client has to consider options they had not thought of, such as taking more risk, retiring at a later date, living on a lower income or increasing pension contributions.

Whatever the outcome of such a conversation, it is important that the adviser clearly explains all of the potential disadvantages. Furthermore, these must be included in the suitability report with an understandable reason provided as to why the client's objectives cannot be met.

This might be, for example, because the client does not have the capacity for loss to accept more risk, meaning their objectives cannot be met.

Pension Freedoms

In 2015, most people aged 55 and over were provided with more choice about how they access their pension pot. This was because the Pension Freedoms legislation was introduced, which allowed those with certain types of pensions to choose how they withdrew money from their retirement fund.

That said, the changes brought with them new risks as well. As a result, many clients need increased support so that they can make good decisions about accessing their pension and to ensure they do it in the right way.

As a result of the legislation, financial planners need to pay particular attention to the following areas of pension advice:

Objectives

It is important to establish what the client wants to achieve and whether the recommendation can meet their objectives. If it does, the recommendation will meet suitability rules.

Sometimes the client's objectives can be conflicting, and it is the adviser's job to help them understand this so that the right decision is made. While an adviser may not always agree with their client's wishes, it is ultimately the client's money they are advising on.

A client may wish to take cash from a pension when they retire so that they can travel, buy a new car, carry out home improvements or have a higher level of income when they stop working. Advice to cash in a pension can be suitable so long as the adviser discusses the options with the client and corrects any factual errors that may have led to the client's decision.

If all of the following points are met during the discussion, recommending the client cash in the pension is typically suitable. These conditions are that:

- Cashing in the pension meets the client's objectives
- There is not a demonstrably better way to achieve the objectives
- The disadvantages of cashing in the pension are explained clearly
- The client has enough money to live on in retirement and can absorb the lost income the pension would have generated.

Pension and Investments

The legislation means that pensions should no longer be considered as primarily for retirement income as they are also tax-efficient investments. In almost all scenarios, a client's objective will be to make money when they invest.

As tax can work against this objective and effectively reduce the level of return, recommending a pension as a tax-efficient investment is likely to be a suitable recommendation, all other things being equal.

While other "tax-efficient" investments exist, such as a Venture Capital Trust (VCT) or Enterprise Investment Schemes (EIS), they are not likely to be unsuitable for most clients due to their risk level.

A Stocks and Shares ISA may also be suitable, although financial planners will have to clearly justify why this is a better solution than a tax-efficient pension. This could be particularly true if, for example, the client is aged 50 or more.

Last, but by no means least, advisers should also consider whether their client has any liabilities. The repayment of debt can also be considered a good "investment" in some instances, and taking cash from a pension pot to achieve this might be a suitable recommendation.

That said, the tax implications of doing this must be considered carefully.

Useful links

https://www.fca.org.uk/publication/finalised-guidance/fsa-fg11-05.pdf

https://www.handbook.fca.org.uk/handbook/COBS/9/?view=chapter

https://www.handbook.fca.org.uk/handbook/COBS/9A/?view=chapter

https://www.handbook.fca.org.uk/handbook/PROD/1/?view=chapter

https://www.handbook.fca.org.uk/handbook/COBS/9A/3.html

https://www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty