



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 that 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 deliver excellence to their clients.

The following paper examines the importance of creating suitability letters that are robust enough to stand up to scrutiny, yet concise enough to be understood by clients. Please note, to help with the readability of this white paper, suitability letters will also be referred to as “suitability reports”. In the context of this paper, they are the same thing.

To start, it is necessary to consider when the Financial Conduct Authority’s (FCA) says a suitability report needs to be written and presented to a client, and when it does not.



“Suitable” Suitability Reports.

The FCA handbook includes **COBS 9.4.1**, which states that a regulated financial advice firm must provide a suitability report whenever it makes a recommendation to a client. This must be done when the client:



- 1 Acquires a holding in, or sells all or part of a holding in:
 - A regulated collective investment scheme
 - An investment trust where the relevant shares have been or are to be acquired through an investment trust savings scheme
 - An investment trust where the relevant shares are to be held within an ISA that has been promoted as the means for investing in one or more specific investment trusts

- 2 Buys, sells, surrenders, converts or cancels rights under, or suspends contributions to, a personal pension scheme or a stakeholder pension scheme
- 3 Elects to make income withdrawals, an uncrystallised funds pension lump sum payment or purchase a short-term annuity
- 4 Enters into a pension opt-out.

A suitability report is not required if:

- 1 If the firm, acting as an investment manager for a retail client, makes a personal recommendation relating to a regulated collective investment scheme
- 2 If the client is habitually resident outside the United Kingdom and the client is not present in the United Kingdom at the time of acknowledging consent to the proposal form to which the personal recommendation relates
- 4 If the personal recommendation is to increase a regular premium to an existing contract
- 5 If the personal recommendation is to invest additional single premiums or single contributions to an existing packaged product to which a single premium or single contribution has previously been paid.

In addition, the FCA's **COBS 9.4.7** states that a suitability report must at the very least:



Specify, on the basis of the information obtained from the client, the client's demands and needs



Explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client

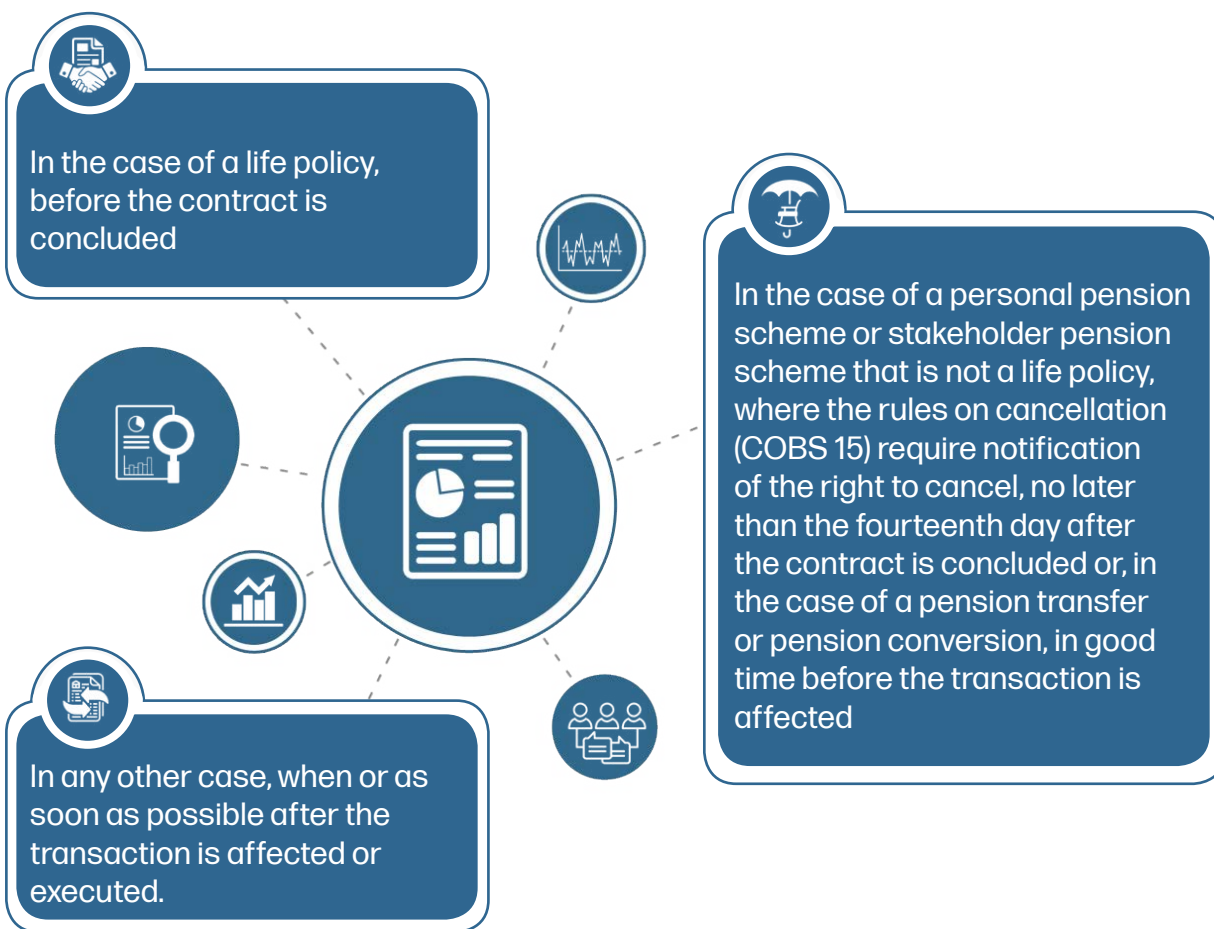


Explain any possible disadvantages of the transaction for the client



In the case of a life policy, include a personalised recommendation explaining why a particular life policy would best meet the client's demands and needs.

Furthermore, COBS 9.4.7 states that a suitability report needs to be provided to a client:



A further FCA requirement is that the suitability letter needs to be delivered in “durable medium”. This means the client can store the report so that it can be accessed for future reference.

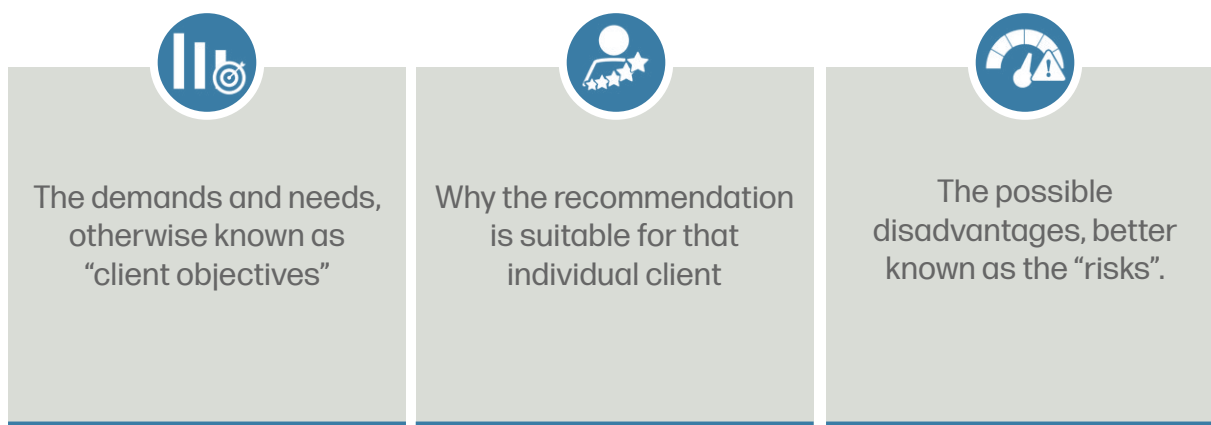
Furthermore, durable medium also means that an unchanged reproduction of the information contained within the report can be made. For more information on what a durable medium is, visit the **relevant section** in the FCA's handbook, which provides more detail.

The above is a summary of the rules around suitability letters given to clients, yet please remember that additional regulation applies to defined benefit (DB) pension transfers and opt outs. For example, there are time requirements for how long a suitability report should be stored by the advice firm.

Given that the forementioned points explain what needs to be included in a typical suitability letter, it begs the following question. Why do those in the financial services sector insist on supplying retail clients with overly long and unreadable bilge, created from templates that are filled with too many standard risk warnings?

Advisers who believe this is the only way to write a suitability report should consider the views of **Rory Percival**, a compliance consultant who also worked at the FCA. He has gone on the record as saying that he could turn any suitability letter into a two-page document that would still comply with COBS.

With this in mind, let's look at the three points that are needed in an effective, and compliant, suitability report, unless it includes a life product recommendation. According to COBs they are:



As already explained, while more complex cases need additional elements or guidance, for most businesses the above three points are all that's needed. Rory Percival once used an example of feedback from a firm's compliance officer to an adviser, which confirmed what was needed in a suitability report.

The following is a summary of the points highlighted by the compliance officer, as explained by Rory.

You need to state the basis on which you are working for that client

No, this is not true and does not need to be included. If a financial adviser has provided the initial disclosure document and the terms of business, and these have been agreed with the client, it clearly sets out the basis on which service is being provided. This does not need to be repeated in the suitability report.

You need to confirm the client's circumstances

A common trap is to believe that it is necessary to gild the lily when covering a client's circumstances. For example, an adviser might include in a suitability letter written for the author of this whitepaper:



“Tony you are 58, a managing director earning £50,000, married to Joanne who's a retired teacher with a pension of £20,000 and you have two mature nondependent children”.

It is likely any client who reads a suitability report containing this level of information will wonder why all the information is included. In reality, it is not needed as it is only repeating the points already contained within the fact-find and meeting notes.

That said, if the information adds useful information about the client's circumstances and objectives, then it is good practice – but it is not needed!

You must state the client's attitude to risk and capacity for loss in the suitability report

Correct, these would need to be in the suitability report as they help to demonstrate why the solution recommended is suitable for the client.

The investment strategy needs to be clearly stated in every subsequent report to the client

This is not necessarily correct. If an adviser has a series of reports for the client, as long as this is clear to the client the adviser will not need to repeat what they have already stated.

If there are sections that apply to a client's past and current situation, such as the firm's approach to selecting funds or its centralised investment proposition, the adviser does not need to repeat it in full.

Instead, they can summarise it or refer back to a previous letter. Remember, the aim is to provide a clear report that the client will want to read, not a multi-page, wordy document that will fill the client with dread when they even think about reading it.

Producing a long, wordy and complicated suitability report will not work in an adviser's favour if the client makes a complaint later on.

You need to state the fund platform recommended and why you selected it

A suitability letter must always include this as it comes under the “why it is suitable for that individual client” category of a suitability report, as mentioned earlier in this white paper.

This not only includes why a certain platform is correct for the client, as it should not be a default position and must be relevant to the client, but also why that particular platform was chosen.

You need to set out alternative products considered but rejected

This is a myth as it is not necessary. This whole section does not need to be included.

You need to clearly state all product charges in the suitability report

Strictly speaking an adviser does not need to put product charges in a suitability report. Financial advisers will have the product information that will cover the charges.

All that said, from a client's perspective there might be situations where the combination of charges is complex. For example, there might be platform charges, adviser charges, product or fund charges, and if all of these are disclosed in different places within the product information, it could be difficult for a client to assimilate.

This could be particularly true if the charges are also quoted in different formats, as they often are.

Good practice means a suitability report should include a summary of the charges. One way to provide this is to include a simple table that lists each of the different areas of charges and totals them up.

You need to include cost comparison for replacement business.

Compliance offers will expect to see this in a suitability report. Higher costs do not necessarily mean a recommendation to transfer is wrong, but the adviser must provide a good reason why paying more is right for the client.

Higher costs for replacement business would be seen as a disadvantage. If the cost is lower, this will probably be one of the reasons it's suitable.

You need reference to documents such as KIIDs and KFDs.

Strictly speaking, this is not needed. That said, as there is a lot of interaction between a suitability report and disclosure, doing so will be seen as good practice.

Specific risk profiles of recommended investment funds

This is essential. It is what paraplanners and compliance checkers expect to see and forms the basis of why a recommended investment fund is suitable for this client. While this is an obvious statement, the client's risk profile must match the level of risk the investment is exposed to.

Explaining how the recommended investments affect the client's tax position (and what must be reported to HM Revenue & Customs)

Generally speaking, including some of this information could be helpful. It is probably not necessary to explain the taxation of the investment as it is typically covered in the product information.

However, if the investment disadvantages the client in terms of taxation, then this will need to be covered in the suitability report. Furthermore, any tax that is relevant to a particular client will need to be included.

Risk warnings need to be clearly stated

Absolutely. If there is a potential disadvantage it must be explained, although think about how you do this. Don't adopt a scattergun approach - if they don't apply, don't put them in.

All too often financial advisers include a page that is filled with standard risk warnings, some of which will apply to the client or investment and some of them won't. Consider the risk warnings that are relevant to the client and make sure you focus on those.

It is probably asking too much to make risk warnings personal to the individual client, but an adviser should consider how they could make the warnings more relevant to that client.

State the importance of reviews and their costs

It is up to the individual financial advice firm whether it provides a personal review or not. Offering reviews is not automatically "good practice".

There will be some clients where a transactional process is the most suitable approach. That said, care should be taken.

If a solution is not self-rebalancing, for example, not having reviews could be a disadvantage because it will impact whether the advice to use it is suitable or not. This means the adviser will need to flag up the importance of reviews to ensure the portfolio stays aligned to the client's attitude to risk over the long term.

The nature of the advice: limited or full and the specific costs

This should always be in the initial disclosure documents that an adviser provides to their client, so that everything is set out clearly up front. While there are different ways for firms and advisers to disclose their services and costs, producing a letter of engagement or a "personalised client agreement" is good practice.

This means that advisers have a "generic" initial disclosure document that is provided to the client. Then, after the fact-find is completed and the amount of work involved is understood, a letter of engagement is provided to the client, which explains the work that will be carried out and costs involved.

If the letter of engagement is clear and provided to the client up front, the adviser will not need to disclose their services or charges in the suitability report. Bear in mind the if the costs have many layers, and the adviser charge is one of those, it might be useful to provide a summary table for the client.

Now we have considered the thoughts and guidance provided by Rory Percival, we now need to look at practical ways advisers can create effective suitability reports.

Writing effective suitability reports is more straightforward than many advisers think

While it is likely that those working in compliance units are not ready for a two-page suitability report just yet, financial advisers can save a lot of time by using the following 10 points.



1. Keep it short

Most suitability reports are much longer than they need to be! The longer the report the more likely that it includes irrelevant details, repetition and is not written in a concise (and, so, understandable) way.

The FCA will be launching its consumer duty in July 2023, which means financial advisers must communicate and engage with clients in a way that allows the latter to make effective, timely and properly informed decisions.

This in turn, means that clients will take responsibility for their actions and decisions, something highlighted in the FCA's **FG22/5** guidance paper.



2. Use client objectives

Financial planners must use the client objectives to evidence the suitability, not a list of product features. An example of this might be: "you want to take your PCLS at age 55, have flexible income and leave funds to your family in the event of death".

Another example would be: "you told me you wanted a 'smoothed fund'".



3. Include capacity for loss

Most risk profiling tools on the market today purport to assess the client's attitude to risk, using volatility as a proxy for risk. While useful up to a point, many of these tools do not address the issue of capacity for loss or the client's investment experience.

The importance of covering both of the latter two adequately cannot be overstated. Remember, even when the risk profiling process seems fine, it may not be obvious how a particular portfolio matches that risk profile.

Ensure that this is made clear in your suitability report.



4. Use fund fact sheets wisely

Where an adviser is trying to evidence past performance, copying a chart or figures table from a fund fact sheet will probably confuse the client and add unnecessary length to the suitability report.

Fund fact sheets contain a lot of information as it is a regulatory requirement, both in terms of what is included and how it is presented. To help the client understand the suitability letter being presented to them, some advisers copy the element of the fund fact sheet that they believe provides the necessary information.

The issue with this is that it typically means that in terms of “compliance”, the data extracted is compromised. It is usually much better to refer to an enclosed fund fact sheet instead of extracting little snippets of its contents within a suitability report.



5. Include all the fund charges

Staying with past performance, advisers should always remember that most fund performance data does not include all of the fund charges. Furthermore, it will not include the plan, platform or adviser charges.

As these could significantly reduce the return of the investment being recommended, only quoting the headline annual returns is likely to be misleading.



6. Do not rely on templates

Using suitability report templates can be a great way to ensure consistency of planning advice. That said, many templates are simply not fit for purpose.

This is because the suitability reports they create includes excessive text as it is included in the template, rather than because it is relevant to the client. Even worse, advisers could omit relevant text because it is not in the template.

Worse still, many financial advisers are very good at creating shortcuts that leads to the ultimate cardinal sin: not amending details relating to the previous client that the same report was used for.



7. Be succinct with your recommendations

There is a saying that goes: “to a man with a hammer, every problem looks like a nail!”.

It is quite common to see recommendations for a product when a non-product solution should have been considered or used instead. Where a product is used in this situation, it is common to see superfluous text and rationale being used to “justify” the recommendation to use it.

Advisers may use comments like:

- A platform is a popular way to invest (so what?)
- You can keep all your investments in one place (not necessarily a benefit)
- The platform has competitive charges (that does not necessarily mean the lowest charges)
- You can access many funds through the platform (you can also access many funds without the platform, and that could also be more cost effective).

Any rationale used by advisers must be client-specific and differentiating. Remember, there is no rule requiring long lists of reasons why a recommendation is right, and definitely no reasons why it is not.


The golden rule is this: if there is one reason for a recommendation, then one reason is enough.



Get in touch

While compliance teams may not be ready for two page suitability reports just yet, it’s likely that with little common sense, advisers will be able to save an awful lot of paper from being wasted!

If you are looking for a review of your suitability report templates, and how they could be improved, then please get in touch.

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