Contents

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 places the new consumer duty rules at the heart of building an investment proposition. As the Financial Conduct Authority (FCA) is extremely keen to ensure consumers receive value for money, it has released its new FG22/5 Consumer Duty guidance paper, which comes into force after 31 July 2023.

With this in mind, it is imperative that financial planning firms now look to add the guidance paper's core principles and make sure they are central to the business's proposition. The FCA's paper has four outcomes that provide a suite of rules outlining how financial practices and their advisers should conduct themselves with clients.

The four areas are as follows:

Governance of products and services	Consumer understanding
Price and value	Consumer support.

As such, financial practices should ensure the following 10 actions are implemented and made central to their business ethos:

1. Put consumers at the heart of their business and focus on delivering good outcomes for customers.
2. Provide products and services that are designed to meet customers' needs, provide fair value and help customers achieve their financial objectives. Additionally, make sure their products and solutions do not cause clients any financial harm.
3. Communicate and engage with clients so that they can make effective, timely and properly informed decisions about financial products. This also helps clients take responsibility for their actions and decisions.
4. Make sure that there is not a desire by advisers to exploit their client's behavioural biases, lack of knowledge or characteristics of vulnerability.

5 Support their clients to ensure that everyone the company works with fully understands and benefits from the products and services they buy.

6 Always act in the client's best interests and not place unreasonable barriers to an outcome the client is looking to achieve.

7 Consider the needs of their customers at all times. This includes understanding why a client might be behaving in a certain way at each stage of the product and service lifecycle.

8 Understand what "real" client outcomes look like, so that the interests of clients are always central to the business's culture and embedded throughout the organisation.

9 Monitor and regularly review the outcomes that their customers are experiencing in practice and take action to address any risks to good customer outcomes.

9 Ensure that the company's board or equivalent governing body takes full responsibility for properly embedded the new consumer duty rules within the firm. Furthermore, making them accountable for the outcomes their customers are experiencing, in line with their accountability under the Senior Managers and Certification Regime (SM&CR).

We Complement has used the above 10 points to develop an investment advice process that helps financial planners and advisers deliver a set of robust, repeatable and reliable investment solutions to clients.

They have been developed following rigorous research within the marketplace and form a strategic response to the FCA's treating customers fairly initiative, as well as the retail distribution review. It will help you, as a financial planner or adviser, adopt an investment advice process that will be focused and consistent.

Additionally, it will help reduce regulatory risk, deliver a competitive client service proposition and can be overseen by your business's investment committee. We believe there is a distinct advantage to both the client and your business in providing guidelines and controls around investment advice. This is because it makes sure that any advice provided is given in a consistent, controlled and efficient manner.

All that said, we also understand that each of your clients is different, so there will be some occasions where following pre-defined client information gathering processes and set criteria may not be suitable. This could be especially true where a better outcome might be achieved by alternative means.

As an "investment process" is likely to provide the best outcome for clients most of the time, it is essential that one is written and everyone within the company become familiar with it. It should include the following:

Engagement	Client segmentation	Understanding of risk
Analysis	Investment solutions	Implementation
	Monitoring	

Once written, the investment committee should then control the investment process when it meets half yearly (or as needed). Changes to this process should only be made by the committee.

Let's now look at each section of the investment process in greater detail.

1. Engagement

Investment Philosophy

An investment philosophy is the overall set of principles or strategies that guides and steers the adviser or planner's investment decisions. It helps them simplify a complex industry so that they can concentrate on developing a strong relationship with the client. It also ensures the adviser has peace of mind that they are doing the best to protect and grow the client's assets.

While investment performance hinges on many factors outside of an adviser or planner's control, most notably the return on markets, they can control other factors. These are typically the ones deemed to be most important when creating and managing portfolios, such as the investment company used, the types of funds or assets invested in and the cost of doing so.

It is important an adviser or planner can justify the investment decisions to their clients, and explain clearly why their money was invested in a particular way. As such, the business's philosophy should succinctly summarise the approach taken and why.

Examples of core principles that underpin your investment process and philosophy include:

A belief in investing, not speculating. While speculating can be fun, investment capital should not be used to speculate.

There is a world of difference between speculating and investing, and the processes we have developed reinforces the latter while looking to remove the gambling element from the investment.

Due to the overwhelming empirical evidence available (referred to throughout this document), we do not believe that there is any merit in market timing, and stock or fund selection. It is far more important to maintain a disciplined approach that helps clients achieve the goals they have set themselves.

People deem investment advice as a forecast – but it's not. In our opinion it is not possible to forecast the short-term value of any market with any accuracy. No one can – it is just speculation. This means that while a financial adviser or planner might have an opinion on what might happen, it should not be the basis for client advice.

The approach we are suggesting systemically tries to capture long-term market return, which is what matters. It is the long-term growth that markets deliver that helps clients achieve their goals.

Before recommending any investment solution, advisers should always cover a series of steps with clients. This is to ensure the latter understand the various risks associated with investing, why the investment is focused on asset allocation or fund selection, why an active, evidence-based or hybrid of these two is being chosen.

It is also essential that the adviser explains why monitoring the investment, periodic re-balances and possible reframing of portfolios is important to successful investing. This is especially true if the investment period is shorter, there has been a change in circum-stances or the client has changed their attitude to risk.

Before we look at these steps more closely, it's important to consider the issue of times-cale. This is because the adviser should always confirm the timescale over which clients intend to invest.

Historical evidence indicates that the longer the timescale the more likely it is that equity investments will outperform interest-generating investments, as time tends to smooth out the effect of positive and negative price movements.

As a result, the longer-term investor can have a greater degree of confidence that the reward, in terms of achieving increased returns via equity holdings, could be achieved.

It is also extremely important that clients hold sufficient accessible cash in an "emergen-cy fund" to cover unexpected expenditure. This is something adviser and planners must discuss with clients and include in their overall financial strategy.

The balance after this cash has been set aside should then be applied to a structured investment programme. Let's now look at the series of steps advisers and planners need to take.

Independent advice or restricted?

If an adviser choses to remain independent because they believe it is important not to be restricted at the point they recommend a product or fund, then we believe it must be made clear to clients. While a financial planner may believe that a certain type of investment is unsuitable for their client, maybe because of its structure or inherent risks, the client should still be made aware of it.

Furthermore, the adviser needs to explain where the investment may be relevant to the client's situation, and provide appropriate advice if the client already holds such investments.

When an adviser or planner selects from a restricted range of investments, it is equally as important for the client to understand why this is the best approach from them. For example, being restricted could mean that the adviser does not feel active funds are appropriate, or wants to only select from ethical investment using an Environmental, Social and Governance (ESG) framework.

This means that there will always be clients that will benefit from having a "restricted" specialist approach as it's exactly what they will be looking for.

Continuing Professional Development (CPD)

Financial advisers and planners should all be committed to maintaining their knowledge in every product area. As this typically forms part of their Continuing Professional Development (CPD) programme, they should promote it to clients as it demonstrates professionalism, competence and a commitment to providing excellence!

Conflicts of Interest

If an independent financial adviser has a contractual relationship that requires them to place business with a particular product or investment provider, they must disclose it to their client. If they do not, it will compromise their independence and create a conflict of interest.

Diversification, diversification, diversification!

One of the most important views to arise from modern portfolio theory is that investors should avoid concentrated sources of risk by holding a diversified portfolio. There are three primary factors that influence portfolio performance:

Asset allocation	Stock selection	Market timing

Diversification of an investment portfolio across a variety of low-correlated asset classes can help reduce overall risk when compared with, say, a portfolio that only includes bonds. As such, including a small investment into a higher risk fund that's within a completely different area into a portfolio comprising solely of UK bonds could reduce its overall level of risk.

This is because the behaviour of the higher risk fund differs to that of UK bonds in how it reacts to varying economic events. An effective combination of different asset classes can significantly reduce a portfolio's risk without reducing its potential for growth.

Cost is an important investment criteria

As mentioned in this white paper's introduction, the FCA has made focusing on price and value one of the four key pillars of its new FG22/5 final guidance document. The reason for this is simple: the authority believes that cost is a critical factor in selecting a product or investment fund.

Financial advisers and planners need to select companies with sufficient financial strength and adequate levels of service. That said, cost is one of the few known criteria at outset and, as such, has a demonstrable impact on future investment returns.

This is why it should inform an adviser's asset allocation strategy and fund selection criteria.

Investment Management Strategies

Appendix C provides academic evidence that on average and over time, active money management strategies based upon share picking or market timing techniques do not produce consistently superior results.

In fact, most evidence shows that active money managers underperform when compared to the average "market". This is due to relatively high operating costs and the cumulative effect of the mistakes made while trying to "beat" the market.

There is an interesting reason for this: there are so many highly skilled money managers using state of the art technology that in order to consistently beat the market, a money manager must time and time again beat all the other equally skilled professionals working to achieve the same thing.

As these money managers are, as a group, the market, this is an insurmountable challenge. This is why the correct course of action is to focus on diversification and asset allocation strategies, while at the same time, avoiding active fund management strategies.

It is understood that some financial advisers and planners will believe otherwise, and may have evidence to back their use of active funds, which are typically, more expensive. While this white paper's position is evidence-based, it would not want to suggest that a hybrid or active solution is inappropriate, merely that it must be supported by evidence.

Against this backdrop, it is now important to consider the potential advantages of using passive investments that are also based on evidence. Broadly speaking, these investments deliver four key benefits to clients:

Lower operating expenses.

Consistently maintained asset class exposures.

Lower turnover resulting in lower cost.

Better long-term returns by avoiding active trading mistakes.

The Importance of Rebalancing

Because asset classes grow at different rates of return, it is necessary to periodically rebalance a portfolio to maintain a target asset mix. By rebalancing regularly, advisers and planners are using a mindset of "buy low, sell high", which enhances the long-term return for the portfolio.

Without rebalancing, portfolios will tend to become more volatile over time.

Conclusions

As previously stated, evidence strongly suggests that active management strategies have not consistently added value for the individual investor. Furthermore, significant evidence shows that long-term investment objectives can be better achieved through the diversification of asset classes targeted towards the establishment of "efficient" portfolios based on a client's risk preference.

These goals can be best achieved by investing passively managed investments for the long term, supported by regular rebalancing to ensure that allocations stay within strategic parameters. It is important to remember so that even with passive investments an investor is still exposed to the fundamental risks inherent in the capital markets. These include:

- Past performance not being a guide to future performance.
- Tax relief on some investments being subject to change.
- Any assumptions made by the financial adviser, and returns quoted, are based on historical information. Actual returns from investments could be higher or lower than the level quoted.
- The value of investments go down as well as up..

2. Client Segmentation

It is important for financial advisers and planners to clearly state the level of service they intend to deliver to the clients they are dealing with, and how they expect to do this. The different levels of service being offered by an adviser or planner is typically based on a number of factors, which includes the amount of wealth invested and the time spent managing the investment.

This will influence the level of service being offered, although ultimately, it will be the client's choice about the level of service they require that will be the deciding factor. For example, an adviser may offer a "sub £200,000" range of investments and a "£200,000 plus" range, the latter being the point at which a full wealth management service if offered.

It is important to include this in the client agreement, which can be used to confirm the details of the service being provided. This is then agreed by the adviser and the client.

If the adviser feels the additional time and costs involved with balancing a full portfolio below £200,000 could deflect our time away from discussing more important core financial planning needs without little real additional investment value, then again say so.

The only variation to the above is when a client has a clear preference for a Socially Responsible Investment (SRI) approach, an ESG or a "smoothed investment". These exceptions will be dealt with later in this document.

The decision about which type of investment solution should be recommended to a client will typically be made later in the advice process. Normally, it will be after the adviser has completed the client discovery and analysed the latter's financial circumstances.

However, it is still important for the adviser to consider the degree of future involvement the client wishes to have with ongoing investment decisions early on in the advice process. Likewise, they should also consider the client's attitude to risk and the likely investment term.

The benefits of this approach to the client and financial advice businesses are:

A consistent approach to portfolio selection that ensures every client receives the same level of advice, irrespective of which adviser they deal with. This consistency, coupled with the clear audit trail provided by the attitude to risk assessment and the investment committee's reviews, also ensures that the advice can be justified at all times.

Ensuring rebalancing takes place so that the overall asset allocation of the investment remains appropriate for the client's attitude to risk.

3. Assessing Client Understanding of Risk

As part of the 'know your client' exercise, it is important that you collect and properly record all of the necessary information that is relevant to a client's attitude to risk. This includes the level of risk they would be willing and able to take, and research undertaken to ensure any recommended investment matches it.

For any investment recommendation to be suitable, an adviser must confirm the following three points:

- The investment being proposed is in line with the client's investment objectives. This means that the following information must be confirmed and recorded by the adviser:
  - The time horizon of the investment
  - The client's preference regarding risk-taking
  - The purpose of the investment.
- The client is able to financially stand any related investment risk that is consistent with their investment objectives.
- The client has the necessary knowledge and experience to understand the risks involved.

There will be three key elements to the assessment of a client's understanding of risk:

- Knowledge and experience of investments, which should form part of the fact-find.
- Capacity for loss, which should also be part of the fact-find. The issue of capacity for loss will be looked at in more detail shortly.
- Attitude to risk, which will typically be assessed using an appropriate risk questionnaire.

It is important that the above points are not covered in isolation. In other words, the adviser must assess each of them while considering the implications of the other points as well.

This allows the adviser to form a rounded assessment of the client's attitude to, and understanding of, the risks involved. Where any inconsistencies arise between the above points, they must be discussed with the client.

Knowledge and experience

A client's knowledge and experience should be clearly documented as part of the fact-find process. The adviser should also explain the risks in a clear and understandable way, and avoid the use of jargon.

These should then be considered carefully when deciding which investment or product is most suitable for the client. When assessing a client's knowledge and experience, an adviser should consider:

1. The types of service, transaction, products and investments that the client is familiar with.
2. The nature, volume and frequency of the client's transactions and the period over which they have been carried out.
3. The level of education, professional understanding or any former profession that might mean the client has a better grasp of investing and the risks involved.

On point three, it is important for advisers to ensure a client with a basic level of financial awareness receives information in a way that they can understand. The knowledge and experience assessment will be a key part of identifying what previous experience a client has.

It is vital that advisers do not assume that the client is aware of all the risks associated with a product if they already have the product in question, yet the risks have not yet materialised.

For example, some clients may have seen previous "precipice bonds" mature without incident. This might mean that they are unaware of the potential losses that could be incurred until their subsequent bonds matured and crystallised a loss. The same is true of people who bought endowment contracts in the 1980s and 1990s.

4. Capacity for loss

A key part of assessing attitude to risk is assessing a client's capacity for loss, which refers to their ability to financially absorb any fall in the value their investment might make. Any loss that is likely to be materially detrimental to the client's standard of living has to be taken into account when a recommendation is made.

Advisers should never assume that a client is willing to risk the loss of any capital, and should always discuss it in detail with them. There are four points a financial adviser should consider:

1. The client's ability to absorb falls in the value of their investment and whether the loss of capital would have a materially detrimental effect on their standard of living.
2. Whether the client has the knowledge and experience to understand the risks involved with what is being recommended.
3. Whether the risks are being explained to the client in a clear and understandable way.
4. The client's attitude to capital loss. This will always form part of the assessment made about their attitude to investment risk.

Ability to absorb capital loss

This key area must be clearly documented in the fact-find with details including investment objectives, timescales, and evidence of adequate emergency investments. This will help an adviser understand and evidence their client's current financial position and ability to absorb capital loss.

Once this has been recorded, it should be included in a suitability report together with the client's future aspirations. This then provides written evidence that all of these factors have been considered carefully by the adviser.

Knowledge and experience

A client's knowledge and experience should be clearly documented in the fact-find. Risks should also be clearly explained avoiding the use of jargon.

Attitude to capital loss

To assess a client's attitude to capital loss, there should be a process in place to identify clients who are best suited to cash deposits because they are unwilling or unable to accept the risk that comes with investing.

Attitude to risk (ATR)

Core to the overall investment process is the need to ensure that the client's attitude to risk is defined and understood by both the client and the adviser. Additionally, it must be considered when any investment decision is made.

Recommending investments that do not meet the client's attitude to risk may not deliver the necessary outcomes to achieve the client's goals. This is why it is imperative that advisers confirm:

- That the client understands the types of investment risks they may be exposed to.
- How much risk the client is prepared to accept when making their own investments, otherwise known as their "appetite for risk".

The adviser's role in both these aspects is key, and a recommendation should never be made until a clear understanding is gained.

Assessment of risk questionnaire

Financial advisers should explain in specific terms how they assess a client's understanding of risk, together with the process and system used. Using an appropriate series of psychometric questions designed by an appropriate risk analysis firm, such as FE or Defaqto, should help establish a client's base emotional attitude to risk.

This gives the adviser an objective starting point for a conversation about risk. That said, they should not simply accept the output of the risk profiling tool, and instead should go back through it with the client to confirm whether they understand and recognise its findings.

The adviser should also assess the client's financial circumstances, even though this conversation may take place at a later date. This is to verify whether the client is able to absorb the potential level of financial loss that they have indicated they would be prepared to accept.

If the client is accepting a potential loss that would, in the adviser's opinion, be too great for them to bear, this must be explained to them. Equally, when a client is unwilling to accept the amount of risk needed to meet their investment goals, this too should be included in the conversation about risk, together with other potential solutions.

Once this is done, clarification should be sought from the client that the attitude to risk level chosen is still appropriate, or re-commence the process based on the new findings.

Advisers should keep a record of how many clients fall within each risk definition, and how often the definition is changed after client consultation. The selection of your risk profiling tool should be governed by the investment committee.

5. Analysis

Product Selection

To begin this section, we will look at product selection. This is because financial advisers are expected to select the appropriate tax wrapper based on their client's circumstances, which are likely to be different in all cases.

For example, it would be expected that an adviser would look to use a client's ISA allowance each year before other investments.

Furthermore, advisers should consider a number of factors, such the level of service the client requires, including portfolio rebalancing and ongoing maintenance. Where this is the case, an investment platform will typically be used as it provides advisers with the flexibility to rebalance the client's entire portfolio, not just a single product.

Where suitable for the client, an investment platform is likely to be the most appropriate option. This is because they are normally governed by the investment committee and documented accordingly, either as part of this document or as is normal, a separate document.

Research tools

Advisers need to state which tools and product research tools they are using to select products and investments. This might include: Assureweb, Webline, Synaptics, FE Analytics and Selectapension.

Furthermore, the product type being used also need to be explained, examples of which are as follows:

Investments

- Unit linked Onshore and Offshore Bonds
- Unit Linked Savings Plans
- Unit Trusts and OEICS
- Offshore FCA Recognised Investments
- Investment Trusts
- ETFs

Pensions and Retirement

- Pensions including: Stakeholders, PPPs, SIPPs, SSASs
- Group Pensions including: Group Stakeholders and Group Personal Pensions
- Trustee Investment Plans
- Drawdown / Flexi-Access
- Third Way (Drawdown and Annuity)

Protection

- Life Protection – Term Assurance, Critical Illness
- Income Protection – Personal and Executive
- Group Life
- Private Medical Insurance
- Long-term Care (Immediate Payment)

Internal research

First, we will consider structured products. If advisers do or do not advise clients on structured products, they need to state it. Many advisers believe the additional counterparty risk and opaque nature of the underlying assets within these products provide unnecessary risks for additional questionable return.

Other advisers believe they can form part of a balanced investment solution. If advisers do use them, they should provide the evidence and an explanation of the level of counterparty risk they are considering, as well as the selection criteria and research tools used.

Securities

Many retail financial planners do NOT provide advice on securities, which do not fall under the definition of Retail Investment Products. If an adviser does or does not, they should simply say so.

Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCTs)

If advisers use either of these arrangements, they again need to explain this. For example, is the use of either an EIS or VCT subject to the clients meeting certain criteria? Would you only advise certain clients, and where might the products fit with other tax-efficient vehicles that may need to be considered first.

An adviser may only want to use these products with high net worth clients, or sophisticated investors who have a large enough Income Tax liability to make the risk worthwhile for the product's tax relief.

If this is the case, advisers need to consider what other tax-efficient investment vehicles are available, such as an ISA, pension or National Savings & Investment Premium Bonds.

It would probably be sensible to have surplus capital and the amount invested into an EIS or VCT should be relative to the overall value of their portfolio. It should be stated that the overall exposure to EIS and VCTs is no more than 10% of their overall portfolio.

The client is likely have a higher risk attitude towards investment risk, or a medium attitude of risk within which they can have some higher risk assets. Furthermore, they are likely to have a high capacity for loss in respect of an EIS. Again, stating what your minimum criteria on these scales should be stated.

The investment committee should consider each EIS and VCT opportunity in turn and should conduct research into these using independent research provided by appropriate research tools such as Tax Efficient Review or Allenbridge.

The committee should decide which EIS and VCT opportunities are appropriate and these should also ideally be signed off by Compliance Oversight.

Investment Trusts

Some adviser firms believe these products carry certain features that make them inherently higher risk than their unit trust (UT) counterparts. This is mainly because they are able to gear up and, as a result, may have liquidity issues.

Given the Woodford debacle, to simply state that liquidity issues are more likely to occur with an investment trust than a unit trust is unlikely to be a good enough reason to dismiss them, as was done in previous times.

If advisers believe investment trusts provide an investment opportunity and the closed nature of them can provide benefits in a falling or panicked market, this should be made clear. Furthermore, an explanation of the selection criteria adopted should be explained.

6. Investment Solutions

The governance of an adviser's investment solutions should be the responsibility of the investment committee. The following section highlights when and how variations from the selected models occur.

Individual Fund Selection

There are rare occasions where an adviser may need to select an individual fund for a client. This can occur, for example, when the client has a specific requirement for their portfolio that cannot be catered for through standard investment solutions.

Alternatively, there may be a need to use a product that cannot cater for your standard investment solutions. This might be because there is not a passive investment available within a specific existing product, such as an offshore bond.

On these occasions, advisers need to carry out full and diligent fund research using something similar to the process outlined below:

Step 1 – Risk and Volatility

Filter the number of investments based on the client's risk tolerance.

Step 2 – Asset Allocation

Ideally any fund selected should resemble your core asset allocations as closely as possible.

Step 3 – Charges

Wherever possible select a fund based on costs following Step 1 and 2.

Apply additional filters depending on the client's individual circumstances. These might include:

- **Risk Score**
- **Charges**
- **Yield**
- **Volatility**

In all cases though, advisers wanting to go outside the normal portfolio selection process must seek approval from the Investment Committee.

Discretionary Fund Management Service

It is very important that advisers only use discretionary managers when they are aligned to their overall investment philosophy. When selecting a discretionary manager, consider the following 10 questions:

1. Is there a proven willingness and ability to work within defined mandates?
2. How much experience do the fund managers have in constructing, and actively managing, multi-asset portfolios?
3. Is there an overreliance on one or two key individuals?

4. What is the fund manager's ability to understand and use a broad investment universe?

5. Is there is a proven ability to exploit alternative asset classes and advanced investment techniques where appropriate?

6. What is the investment process and is it credible, clearly defined and repeatable?

7. What is the pricing strategy, and is it clear and transparent with an estimated total expense ratio (TER)?

8. How accessible are the qualified fund managers to clients and the investment committee?

9. What are the security of manager and custodianship arrangements?

10. How strong and stable is the company financially, and is there any potential for instability relating to corporate actions?

Smoothed Investments

On occasions, advisers may have clients who want to adopt a regular withdrawal strategy, and as such, dampening short-term volatility may be appropriate. This could be available via a "with-profits" smoothed approach.

While these funds would probably not be normally suitable based on cost reasons alone, advisers could use this approach if it is clearly evidenced that a smoothed investment approach is appropriate for the client. Part of this evidence would need to include attitude to risk and capacity for loss.

Social Responsibility and Environmental, Social and Governance (ESG) investments

These investments offer an alternative for those looking to place their money into "socially conscious" or "environmentally responsible" investments. In recent years the choice of socially responsible and ESG funds has shot up as retail investors increasingly look to put their money into them.

There are two inherent goals offered by the investment funds: responsible investing and financial gain. That said, the two do not always go hand in hand.

Just because an investment touts itself as socially or environmentally responsible, it doesn't mean that it will provide investors with a good return. This is why an adviser should always provide an investor with an assessment of the financial outlook of the investment, even when the client appears to be more interested in the social or environmental responsibility.

When advisers deal with ESG or socially responsible funds, they must ensure the criteria they have used to meet the client's goals is explained in a clear and unambiguous way. While the list below is overly simple, it provides an idea of some of the filters that should be considered:

- Lower operating expenses
- Lower turnover resulting in lower cost
- Consistently maintained asset class exposures
- Better long-term returns by avoiding active trading mistakes
- Global asset allocation.

It is recommended that any adviser looking to use ESG funds or build a socially responsible portfolio carry out a full market review of all the options before applying relevant filters.

Implementation of recommendation

There is no obligation for clients to accept an adviser's recommendations or to use the adviser for the fulfilment of them. This can happen from time to time, so should be factored into every adviser's client agreement.

Once an adviser has received a client's agreement to proceed, it is important that they have a fully documented process to record this fact. The following is an example process that advisers may want to adopt:

1. Client instructs Adviser, then Client and Adviser sign and complete an Instruction Form.
2. The Instruction Form is passed to the appropriate paraplanner for processing. This includes instigation of Letters of Authority, any research that needs to be carried out or reports that need to be produced.
3. The client is issued with an email or letter confirming that the Instruction Form has been received and is being processed. This should include the expected time frame for processing.
4. Once the form has been processed, a follow-up email or letter should be sent to the client. The first version of the suitability report can also be sent to the client.
5. The client confirms suitability of advice by signing the suitability report, or the adviser amends the report and recommendations if necessary.

6. If necessary, a final suitability report or addendum letter is sent to the client explaining the agreed amendments.

8. The client signs the signs final suitability report if required, thus confirming willingness to proceed.

9. An email or letter confirming that the monies are now invested as instructed is sent to the client, and that any agreed fees have been deducted.

Monitoring

If an adviser is asked to monitor the investment and track it against their clients' financial objectives, this must be stated in the suitability report and client agreement. Furthermore, both should explain how frequently the reviews will take place.

An adviser may, for example, want to offer a review of their client's portfolio during the following events:

- Rebalancing
- Full financial review
- Client event-driven change
- Market event-driven change.

Rebalancing

Advisers may rebalance a client's portfolio at the agreed periodic review meeting or when the portfolio has moved significantly, such as more than 10% from the original allocation.

If you identify a need to rebalance at a review, you need to have a process to show it. This should include writing to the client informing them of the change required and asking them to return a signed instruction form before any transactions are carried out.

Full financial review

This is a full review where you may:

- Validate that fact-find information is still correct, including any events that have occurred since the last meeting
- Re-check that the client's goals and objectives remain the same, along with their attitude to risk and capacity for loss
- Review the performance of portfolio against the client's stated objectives and risk/loss profile
- Agree priorities and actions for the following period.

Client event-driven change

This may occur in circumstances where an event in the client's life drives a need for urgent attention to his or her portfolio. This need not require a face-to-face meeting, but if required the full financial review could be brought forward and credited against the next review due. These types of events could include:

- A need to revise life insurance due to changed family circumstances, or to withdraw capital
- Receipt of inheritance monies
- Unemployment or other loss of income.

Good financial planning means challenging and questioning a client's request for change, but there is often a need to make adjustments and take short term action. Again, an instruction form should be used where appropriate, and the fact-find should be updated promptly. In some circumstances a suitability report or non-advised sales form should also be completed.

Appendix C – Your Investment Approach

Core Belief

This is an example taken from a previous client's report, yours will be unique to you:

"Our core belief is that markets are 'efficient'. The efficient markets hypothesis holds that markets are full of people trying to make a profit by predicting the future values of securities based on freely available information.

"Many intelligent participants compete to trade at a profit. The price they strike in trading a share is the consensus of their opinions about the share's value. Since the price is the same for everyone, so is the value.

"So, the price the market strikes is based on all the available information about a share, everything the investors know that has happened in the past, and everything they predict will happen in the future.

"In this sense, markets assemble and evaluate information so effectively that the price of a share is usually our best estimate of its intrinsic value. Prices are not always perfectly correct, nor is that a condition for market efficiency. The consensus view of investors can temporarily result in prices well above or well below a share's intrinsic value.

"The only condition efficient markets require is that a disproportionate number of market participants do not consistently profit over other participants. Since 'mispricing' tend to occur in both directions and since managers seem to over- and underperform with random frequency when adjusted for risk and costs, markets seem to be efficient."

Approach to Investments

Example IFA's approach to investment is evidence-based. We start by adopting a high-level asset allocation based on the client's risk and return profile, which we arrive at through an assessment of their risk profile, capacity for loss and required risk to achieve financial goals, given the assets that are available to them.

We follow modern portfolio theory and subscribe to the efficient markets theory, as well as the Fama-French three-factor model (now extended to include other factors). The high-level split is between bonds and equities and this controls risk and thereby determines return. If clients want to make more money over time, they must move up the risk level.

The risk control is achieved using global short-dated bonds because these are less vulnerable to market interest rate changes. We also include index-linked gilts in this category. On equities we basically believe in long-term buy and hold (modified by the need to periodically rebalance to maintain the correct risk profile).

Based on the evidence, we buy main market global equities and tilt towards market factors where the evidence indicates there is a reasonable probability for extra returns by taking additional risk (book to market [Value] and smaller companies).

We also tilt to some factors where there is evidence that these can also generate extra returns (quality and momentum). We have adopted a global market capitalisation approach as this is supported by the weight of academic evidence. This approach is also particularly relevant in the UK where Brexit has had a significant impact on the UK economy but less so in global economic terms.

Diversification

We aim to diversify our portfolios. However, this should not be confused with the old adage of “not having all of one’s eggs in one basket”. The purpose of diversification is to blend asset classes that behave differently in different market conditions – that is, they have a low correlation to each other.

The benefits of having a well-diversified portfolio are that extra potential return can be achieved for the same risk, or the same return can be achieved at lower overall risk. Having modelled various other asset classes as diversifiers, we have decided to include property and gold because there is a demonstrable extra value in doing so.

Underlying portfolio structure

Consequently, our underlying investment selection structure is based on, and supported by, a substantial body of academic research into the sources of investment risk and return, which has reshaped portfolio theory and greatly improved understanding of the factors that drive performance.

Our approach is based on long-term research, which has shown that the most important factor in the performance of a portfolio is the asset allocation. This is the split between equities in the UK and overseas, fixed-interest stocks, property, and cash.

Over the longer term this has been shown to have a greater impact by a substantial margin on both risk and returns. The other factors that were examined included market timing and stock selection.

While instinct would suggest that these would be very significant, the research has shown that their impact is almost negligible other than over very short terms.

We also base our advice on an understanding of the relationship between risk and return as the two are inextricably linked. Over the longer term the more a client wishes to make, the more risk they must take. Equally the less risk a client wants to take, the lower the returns they must accept.

Individual sectors perform at different rates and so over time the weightings established at outset will be lost. This will result in the portfolio no longer corresponding to the asset allocation that is appropriate to the clients’ requirements.

The result of this is that it could expose them to either too much risk or even to too little.

The latter would give rise to potential underperformance. In order to remedy this, we recommend that the portfolio be regularly rebalanced to ensure that the correct profile is maintained.

Having studied the evidence, we do not generally believe that the added costs of active fund management are rewarded by extra returns. While some active fund managers have undoubtedly performed well in the past, it has also been shown that it is virtually impossible to predict which ones will do so in future. In view of this, our policy is to use passive and tracker funds wherever possible and only to use active funds where these are the only means of gaining access to a specific market sector.