TISAtalks…RDR

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I THINK I HOPE I KNOW

A recent TISA event on the subject of suitability attracted wide interest from across the financial services marketplace. The seminar included an outline from the FCA indicating their expectations on how advisers, platforms and fund groups should operate in respect of suitability.

The particular issue of rebalancing is now under focus to ensure that it is diligently monitored and undertaken specifically for each client, avoiding processing through some form of modelling or automated procedure. This has specific relevance to centralised investment propositions and "replacement" business using model portfolios which have automated rebalancing features.

The FCA has warned that firms must make sure any rebalancing of clients' portfolios is "entirely mechanical" unless they have discretionary permissions. Rory Percival, of the FCA, said: "*If you rebalance and exercise any discretion or any thought process, and you rebalance without the customer's consent, then you can only do that if you have discretionary permission".*

He continued*: "You can, if you do it carefully, set it up so that it rebalances on a certain date and in a certain way, but the key point is to make that entirely mechanical. The agreement set out with the client at the beginning has to set out the time at which it will happen and the method and you have to keep to that religiously".*

It is therefore important to ensure there is a set date for any automated rebalancing, remembering that moving the date, perhaps due to market conditions, could cause problems. Advisers who do that risk falling out of their permissions, because they are exercising some thought process and in danger of making discretionary change.

Following the Retail Distribution Review (RDR) and the removal of commission, it is true that inappropriate replacement business should be a thing of the past and firms should ensure they have robust processes and controls in place to avoid this type of mis-selling. Ultimately, the adviser must be satisfied that any transaction is in the client's best interest and any recommendation to replace an investment must be justified.

There are a number of points to consider. The first is 'Suitability' - in all instances of investment advice, advisers must demonstrate that reasonable steps have been taken to ensure suitability. This includes objective consideration of the client's needs and circumstances, and attitude to risk; comprehensive analysis of the client's existing investments; detailed research of recommended investments.

The second is 'Know your Customer', information which must be comprehensive and include specific details of the client's needs and objectives.

Next is 'Analysis of existing investments'. Advisers must obtain whatever appropriate information is necessary on existing investments to support the reasons for the recommendation. Information used in the assessment must be accurate and reliable and come from documentation that has been produced by the product/fund provider or another reliable independent source.

Fourth is 'Comparison of benefits'. Existing investments must not be replaced without good reason and it is, therefore, essential for a comprehensive analysis to be carried out between the client's existing investments and the proposed solutions.

Lastly, 'Cost Considerations'. One of the most commonly stated reasons for switching product or fund is cost. Where the new investment is more expensive, it must be clear that the additional cost is justified because it will meet the client's other needs and objectives more closely than the existing arrangements. There must be a clear cost comparison on file and all associated costs must be considered.

There are some excellent additional pointers in The Consulting Consortium's recent newsletter.

The message is to approach rebalancing or replacing of business with caution and document clearly any reasons why and what method/process was used.

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