Gem Briefing Note 11/1

February 2011

GEM Compliance Consulting

FSA Guidance - Assessing Suitability

Introduction

In January 2011, the FSA issued guidance consultation (GC11/01) ‘Assessing suitability: Establishing the risk a customer is willing and able to take in making a suitable investment selection’.

This guidance has been prompted by concerns on the level of unsuitable advice and quality of private client discretionary management services that the FSA has seen in the market. Around 50% of the cases reviewed where they considered advice was unsuitable related to issues on risks that the customer was willing and able to take.

The purpose of the FSA guidance is to help firms improve the standards by which they are providing such services to clients. Consultation on the guidance closed at the end of January.

Background to Guidance

The guidance relates to the FSA Conduct of Business rules and specifically COBS 9.2, which requires a firm ‘to take reasonable steps to ensure that a personal recommendation or decision to trade is suitable for its customers’. COBS 9.2.2R requires firms, among other things, ‘to take account of a customer’s preferences regarding risk taking, their risk profile and ensure they are able financially to bear any related investment risks consistent with their investment objectives’.

The guidance looks at:

- how firms establish and check the level of investment risk that retail customers are willing and able to take in the wider context of the overall suitablity assessment,
- the potential causes of failures to provide investment selections that meet the risk a customer is willing and able to take,
- the role played by risk profiling and asset allocation tools as well as the providers of these tools.

The FSA specifically uses the phrase ‘willing and able to take’ in relation to risk.

Key FSA Findings

The key findings of the guidance were concerns regarding firms:

- failing to collect and properly account for all the information relevant to assessing the risk a customer is willing and able to take,
- relying too much on risk profiling and asset allocation tools,
- having poor descriptions of attitudes to risk,
- failing to select suitable investments for the customer,
- having an inappropriate focus on the risk a customer is willing to take,
- not having a proper understanding of products and underlying assets,
- advisers understanding of their responsibilities when using tools.

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The FSA warns about adviser competence in relation to risk profiling tools and in particular the failure of advisers to appreciate the weaknesses that the FSA identified in the use of 9 out of 11 tools it assessed.

The guidance provides examples of good and poor practice to help firms reduce the risk of unsuitable advice and recommendations. It does not however prescribe how firms should assess suitability and customer risk.

Issues firms should consider

The FSA guidance reminds firms that they should ensure:

- they have a robust process for assessing the risk a customer is willing and able to take including
  - assessing a customer's capacity for loss,
  - identifying customers that are best suited to placing their money in cash deposits because they are unwilling or unable to accept the risk of loss of capital,
  - appropriately interpreting customer responses to questions particularly where firms rely on tools with sensitive scoring and not attributing inappropriate weighting to certain answers,
- tools, where used, are fit for purpose and any limitations recognised and mitigated,
- any questions and answers that are used to establish the risk a customer is willing and able to take, and descriptions used to check this, are fair, clear and not misleading,
- they have a robust and flexible process for ensuring investment sections are suitable given all aspects of a customers investment objectives and financial situation as well as their knowledge and experience,
- they and their advisers understand the nature and risks of products or assets selected for customers and,
- they engage customers in a suitability assessment process which acts in the best investment of those customers.

Next steps

The FSA expects all firms to assess whether they need to improve the way they assess and check suitability risks. They will continue to take tough action where they identify poor practice. Both firms and individuals could face disciplinary action for failing to take account of recent guidance.

The FSA summary on this and the consultation paper can be accessed at:

http://www.fsa.gov.uk/pages/Library/Policy/guidance_consultations/2011/11_01.shtml

This briefing note is intended as a summary only and is not full and/or firm specific advice. For further information and assistance on how you should comply, please contact Gillian Gallacher.

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