COMPLIANCE
CONSULTANT
0203 815 7939

Suitability Letter Construction List & Guide

With Investments Supplement

Note: While this guide is provided to give you the generic and generalised requirements, your own judgment is required to provide specific details relevant and pertinent to the client. No responsibility can be taken by **Compliance Consultant** in the failure of your inclusion of any area of regulatory requirements. If you have any queries, we can be contacted on 0203 815 7939.

Suitability Report Template

General Layout

Remember to use client's words and phrases recorded on Know Your Client documentation, Fact Find or file notes. Use **emboldened text** or SMALL CAPS to highlight risks, issues or significant special features (*colour should be avoided due to photocopying vagaries*).

A popular misconception amongst IFAs is that the suitability report has to 'round up' the whole process, discussions and background information that has occurred to date. It simply does not. It forms the final part of the process of telling the story and, from a compliance perspective, will be read in conjunction with the rest of the data and information contained, *(or omitted)*, within the file.

This is good news. It means you can legitimately take 'superfluous' information out of the suitability report and make it shorter and more client-friendly. Do not write overly long suitability reports as this may confuse the client in being able to discern between the suitability to their own circumstances and the product features: if required attach appendices or other sub-sections with technical or specialist explanations.

Simplistically, according to Rory Percival, formerly of the FCA, the Suitability Report only needs,

1. Demands and needs – "i.e. the client objectives"
2. Why it is suitable for that individual client
3. The possible disadvantages – "i.e. the risks"

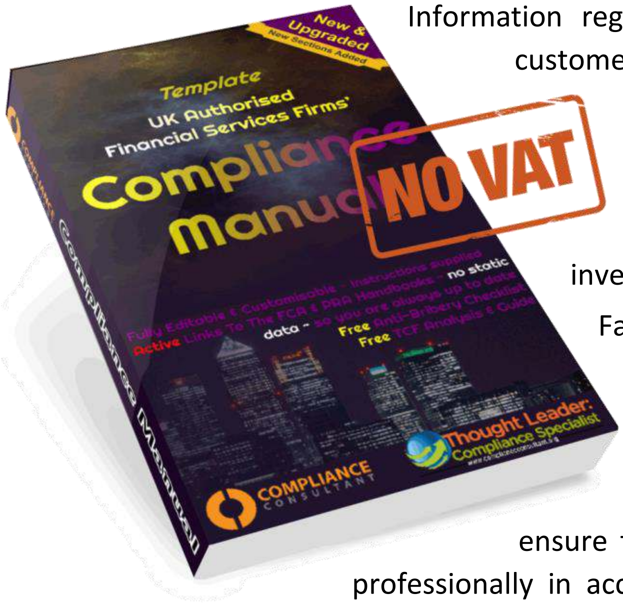
It can be considered good practice to send the report in advance of the second meeting. Report should include the following sections in all cases. One paragraph each but the order may be moved around to suit the circumstances.

Don't forget;

FCA Requirements are;

Firms must obtain from the customer such information as is necessary to understand the essential facts about them and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:

- meets the customer's investment objectives;
- **is such that the customer is able financially to bear any related investment risks consistent with their investment objectives; and**
- is such that the customer has the **necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of their portfolio**.



Manual Available at
http://bit.ly/CMonCC

Information regarding the investment objectives of a customer must include, where relevant, information on the length of time for which they wish to hold the investment, their preferences regarding risk taking, their risk profile, and the purposes of the investment.

Failure to obtain all the relevant information or evaluate it properly can lead to the recommended transaction or decision to trade being unsuitable for the customer. Overall, firms must ensure that they are acting honestly, fairly and professionally in accordance with the best interests of the customer and treat customers fairly.

And finally, the whole advice process is centered on a personal recommendation, the FCA definition of which is; *"a recommendation that is advice on investments, advice on conversion or transfer of pension benefits, or advice on a home finance transaction and is presented as suitable for the person to whom it is made, or is based on a consideration of the circumstances of that person."*

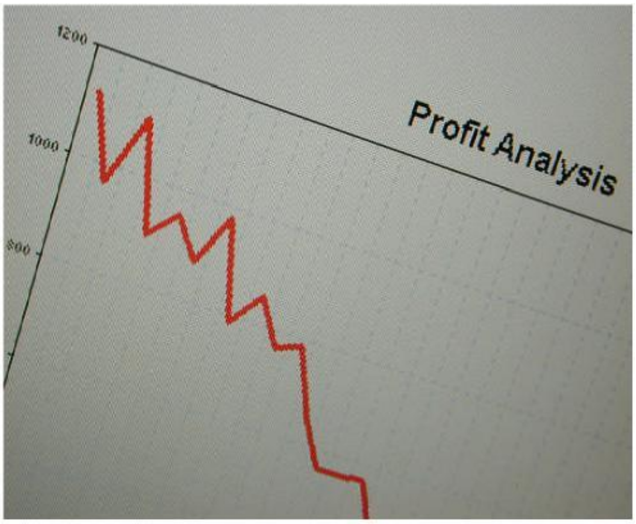
The Suitability Report, Right First Time?

Introduction

1. **Opening Paragraph** (setting the scene) - How did we come to be in this position of advising you. Any restricted advice or information withheld and warning. Don't start laying out the terms of service provision etc, this should be covered in the engagement letter, terms of business and IDD.

2. **Description of client's current circumstances** - What lifetime event has caused the review or request for consultancy. Please don't repeat the hard facts from the fact fund, refer to them as necessary, but the client knows what they have told you. Name, age, earnings, marital status, kids, house value and other hard facts are not necessary as this has already been declared in the KYC Doc or Fact Find. Refer to your preferred recording documents for types of fund, their underlying portfolios, provider/ manager strength and performance, experience, frequency etc.

3. **Client Aims & Objectives** – What do they hope to achieve with this planning, purpose of investment: amount sought, income or capital growth, investment timescale, accessibility etc., and why. Don't forget, Investment objectives are different to Financial Planning Priorities.



4. **Assessment of client ATR** (include detailed risk description). Risk description should match description from KYC/Fact Find or ATR assessment tool. Physical and/or mental ability to cope with potential capital loss. If the customer has had previous investment experience, how did they feel (*link to KYC/Fact Find notes*) about market fluctuations and gains/losses? How do you think inflation will change in the short/medium/long term? Assessment of global outlook/exchange rates if international funds to be used?

   - Minimal capital risk (inflation issue)
   - Some capital risk, perhaps a spread of low volatility investments and fixed interest securities.
   - High capital risk, perhaps a narrower spread of investments with high volatility and complex investment strategies

5. **Confirmation of affordability** – where the money is coming from, percentage invested v percentage on deposit. Refer to Assets held in Fact Find, possibly emergency fund retained.

6. **Investment Strategy** - If you've got a series of reports for the client, so long as it's clear to the client, you don't need to repeat everything you said first or second time around. And if there are sections that apply in both situations, for example, in a previous letter you might have explained your firm's approach to selecting funds, or to its centralised investment proposition, you don't need to repeat that in full in a subsequent letter. You might want to summarise it or refer back to a previous letter; that's fine. Think about what's going to be clear to the client.

Recommendation

7. **Research report.** outcome and reasons for selection over and above other similar products. You don't need to itemise why you have discounted certain products. Provider (or not) details – strength, size etc.

8. **Reference to documents such as KIIDs and KFDs** - Are not strictly speaking required, but as there is a lot of interaction and connection between a suitability report and disclosure, that's probably a good practice idea.

9. **Product Description**. From provider details. Can refer to provider documentation after brief description. Keep copy of documents provided (*or at least reference numbers*) in library, if used.

10. **Cost Comparison for any replacement business.** If the cost is higher, that's fine, so long as there is a good reason for that. The cost being higher for replacement business would be one of the disadvantages. If the cost is lower, the probability is that it is part of the reason why it's suitable. Make sure this follows your firm's process and you clearly show the ups and downs.

11. **Fund/platform recommended** - Not only why it is suitable at all to use a platform for that client; because that's not a default position, it has to be relevant to that particular client. Also, why that platform is the most suitable *(COBS 6.1E.9 and COBS 61F refers).*

12. **Suitability of Recommendation** – Why this will specifically benefit the client out of the reasons they have provided to you. What they will lose, reduce or stop receiving (e.g., interest?) by using or redeploying this amount of capital in this way.

13. **Client made aware of any particular issues**. Legal and Taxation aspects now and future. Risk profiles of recommended funds**.** Risk Warnings of specific funds. Withdrawal penalties, charges for transfer/switching funds etc.

14. **Trusts** – description / planning / why a particular trust over other options. Is the placing in trust required/necessary? Link to discussion in KYC/Fact Find.

15. **Cost of advice** – ***you don't need to put product charges in a suitability report***. You'll have the product information, which will cover off the charges. But think about it from the client's perspective. There may be situations where the combination of charges is quite complex. So you might have platform charges, adviser charges, product or fund charges and if there is disclosure in different places in the product information that can be quite difficult for a client to assimilate, particularly if they are quoted in different formats as they often are. So it would be a good practice approach to include a summary of what those charges are. Don't forget the review charges.

Sign off

16. **Type of service being provided** – one off or regular updates / meetings scheduled. Importance of regular reviews/rebalancing etc. It's not automatically good practice to offer reviews. There will be some clients where a transactional process would be the right thing. There is one scenario where not having reviews would be a potential disadvantage because it has an impact on whether the advice given now is suitable or not and that is where you have a solution that is not self-rebalancing

17. RIGHT TO CANCEL

18. Conclusion

Summary

From the above, you can probably see the extent by which reports could be potentially reduced in size and made more client-friendly. Good engagement letters and meeting notes on the file are an excellent way to help tell the client's story and provide some more information to support the suitability report from a compliance point of view.

We have worked with a number of advisory firms that each take advice from a range of compliance consultants and it is true the feedback we get from these consultants varies significantly. Some are considerably more pragmatic than others and, unfortunately, we see evidence of compliance consultants and support companies being a bit too 'over-cautious' with what they want to see included in a report.

If you suspect this might be the case with your own compliance advisers - and you have the ability to do so - it may be worth seeking a second opinion from an alternative compliance company just to make sure you're engaged with the right people.

References

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

https://www.fca.org.uk/publication/finalised-guidance/fg12-16.pdf

http://adviserbusinessreview.com/suitability-reports-percival-clarifies-regulator-expects/

https://www.fca.org.uk/publication/thematic-reviews/tr16-01.pdf

Suitability Report completion

Additional Investment Points

Are the client's objectives/needs clearly documented income/growth)?

Have the reasons why a unit trust/OEIC/ Bond Investment Trust has been recommended over other alternatives been clearly documented?

If an investment trust has been recommended has the client been made aware that, generally speaking, the risk/reward compared to similar unit trust/OEIC funds is greater because: -

- The value of shares in investment trusts are influenced by demand as well as the value of the underlying assets - Investment trusts frequently trade at a discount to Net Asset Value and the discount can widen if there are more sellers than buyers
- Investment Trusts can borrow to invest and this can increase the volatility.
- Has minimum investment term been specified? (i.e. – 5 years +)?

Does the suitability report provide an explanation of the following?

- Internal taxation of the investment
- Events that constitute a 'disposal' for CGT purpose
- Taxation of gains in the hands of the investor
- The annual CGT exemption
- That higher rate taxpayers will have a further liability on any dividend or interest distributions (regardless of whether paid out as income or re-invested to purchase new units)

If the recommendation involves a switch between funds does the suitability report:-

- Detail any penalties incurred and the CGT liability on disposal of units

- Provide sufficient evidence (particularly where there is a cost to the client on disposal) to demonstrate a likely financial advantage to the client
- Does the suitability report confirm the basis of ownership (single/joint)?

If income is required does the report document how this need has been met, the current income yield on the fund(s) recommended, and what this approximates to in monetary terms? Has the client been made aware income can fluctuate?

Are the following areas covered?

- Desired term
- Size of investment
- Affordability
- Any surrender penalties (if applicable)?
- If any existing contracts have been cancelled have the reasons why and been documented together with any disadvantages?

Has the clients ATR/CFL been described together with a summary of the discussions regarding risk/reward?

The FCA require a complete and thorough, Attitude To Risk Versus Capacity For Loss.

It is essential that your client file shows that attitude to risk (ATR) and capacity for loss (CFL) have been discussed and quantified with the client. The FCA frequently see instances where the two are confused, or where only one of these items has been properly or adequately addressed. In simple terms, ATR is emotional and CFL is factual.

Both of these things are intrinsically linked to the client's knowledge and experience as well. Someone that has prior experience of investing may have a higher risk profile than someone without any, particularly if they have been invested in turbulent markets in the past and experienced ‘losses' in their capital; even if a risk profiling questionnaire suggests both the experienced and inexperienced investor have the same risk score.

In essence, someone's past investment behaviour can be influential in the process, which is why relying on a risk profiling questionnaire without any further discussions around risk and experience is best avoided in most instances. If they have not actively or regularly invested into “Special situations funds”, “Emerging Markets”, or “Property” funds, what makes them suitable now?

Has the recommended fund split been documented together with confirmation as to how the overall asset allocation matches the clients ATR?

Is there confirmation of why the provider was selected, that matches the research?

Are the following risk warnings included?

- Past performance is not necessarily a guide to future performance
- Unit-linked:- Unit prices can fall as well as rise
- Property Fund or other illiquid investments warning

Has reference been made to the charges and cancellation sections of the KIID/KFD? If written on a limited advice basis have the warnings been included?

Linking your KYC/Fact Find, notes and suitability letter is key.
If your initial KYC documentation is missing some elements, how can you give advice?