Enabling Client Suitability

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WDX CRM SOLUTIONS FOR WEALTH & INVESTMENT MANAGERS

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Investment managers must demonstrate to the FCA the process of exercising their duty of care towards clients.

Enabling Client Suitability

The Financial Conduct Authority (FCA) have a clear set of guidelines that require investment managers to demonstrate the exercise of their duty of care towards clients. All investment management firms recognise that protecting their client's interests is the major requirement in any private client investment management service offering. It goes without saying.

However in the eyes of the FCA it is not acceptable to simply give assurances that client interests are properly managed.

All private client investment managers must be able to demonstrate that they have;

Taken reasonable steps to ensure that any personal recommendation is suitable for its client.

This of course asserts implicitly that the manager knows what is reasonable as well as what is suitable and who the client is!

This apparently simple requirement is a major issue for most firms.

A client is a person or a body corporate that advice is being given to for a given service. The Conduct of Business (COB) rules require a clear distinction on this point. It is unfortunately common for private client investment managers to confuse the relationship they think they have with the legal ownership of a portfolio of assets. It is not unheard of for a portfolio of assets to be associated with multiple persons even though the mandate for that portfolio could only have been signed by one. Joint client relationships create the most confusion in this context where persons defined as the owner of a portfolio are in fact not the owner of all associated accounts. The scenarios that exist in many portfolio management systems include;

- A partner's ISA included within what is ostensibly a single person's portfolio
- An individual SIPP account combined with multiple accounts for more than one person
- A group of accounts owned separately by an individual and a body corporate being managed under the same portfolio mandate

While any of these scenarios may seem reasonable from the convenience of maintaining a good relationship with a wealthy individual and for efficiently managing a portfolio of assets, they are clearly problematic in the context of the suitability assessment. Across many firms the legacy of implementing portfolio management solutions that have not been designed to clearly 'understand' the client relationship means that even with a well implemented suitability process, compliance with the COB is undermined because the data structure is inadequate to demonstrate a real understanding of basic Know Your Client principles.

Simply expressed, if you cannot clearly identify who the client is, how can you then reasonably determine the necessary information regarding that client?

The COB states that to demonstrate that reasonable steps have been taken to ensure that advice is suitable, the responsible IM must have obtained all necessary information regarding the client's:

- Knowledge and experience in the investment field relevant to the service;
- Financial situation; and
- Investment objectives;

Without the necessary information the investment management firm cannot give any recommendation or advice

experience

Furthermore the IM must have obtained enough information to understand the essential facts about the client and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the service;

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

It is clearly problematic when the IM is unable to accurately distinguish who the ‘he’ is in this context.

Many suitability solutions confuse the requirement to monitor the current suitability of the portfolio with its published mandate and the suitability of the service or product to the actual circumstances of the client. Monitoring the assets composition of a portfolio against its asset allocation boundaries, and other risk parameters is a daily obligation. If the mandate itself is unsuitable to the client, that daily monitoring exercise becomes academic.

Even if the responsible manager is able to clearly define who their client is, there is still plenty of information to capture to fulfil on this statutory obligation to assess the suitability of a portfolio.

The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment(s), his preferences regarding risk taking, his risk profile, and the purposes of the investment.

The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

The amount of information required to be captured is somewhat open to interpretation and individual compliance managers may determine different levels of detail to be appropriate to different types of service across different firms. Some organisations will also be unwilling to place an additional burden on client facing business generators or may feel that extended questionnaires will put off clients and will tailor their questions accordingly.

Regardless, there is an obligation to capture a reasonable amount of detail across each of the above mentioned items in the context in which they make sense, to the satisfaction of the regulator.

This is another issue for many firms, as without an accurate data model, the capture of this data is complicated and will further challenge the simplicity of what is a new process for many IMs.

Without an accurate client data model the capture and regular reviewing of relevant data is complicated

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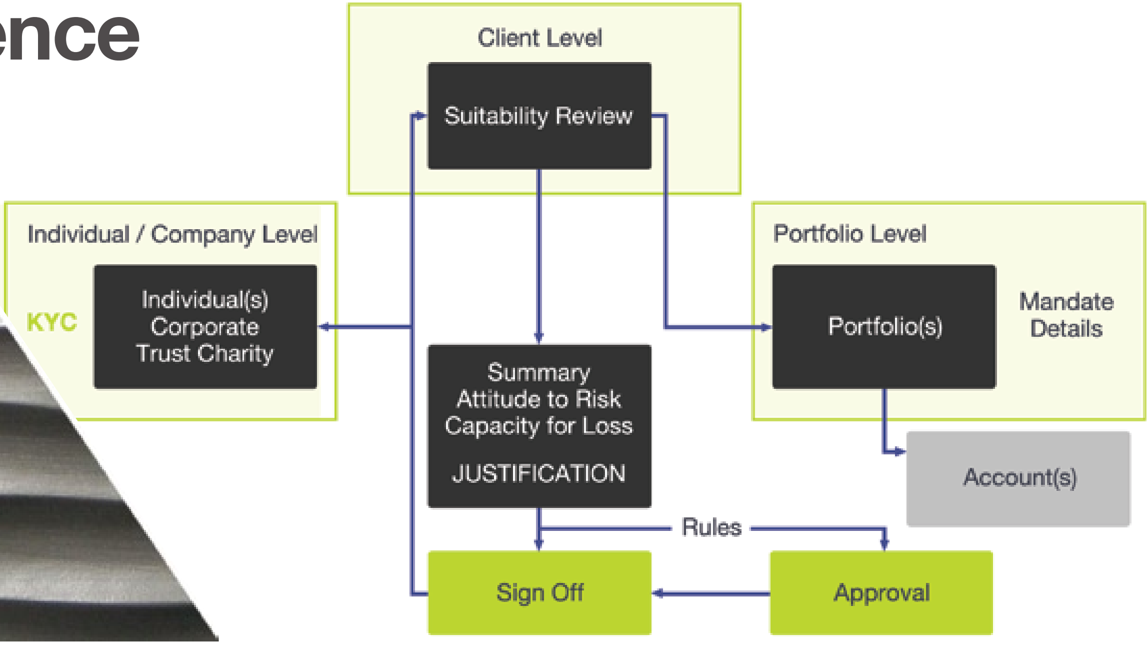

In particular data must be associated distinctly with;

- the client entity,
- all associated persons and
- any number of portfolios or products that the client is receiving advice on

It is rare for a portfolio management system to have this distinction clearly demarcated such that an IM is able to easily capture appropriate information as part of an intuitive business process.

The impact is then that the entire process is, over complicated at best and at worst is ineffective and doesn't in fact demonstrate a level of understanding commensurate with the requirement.

A firm is entitled to rely on the information provided by its clients unless it is aware that the information is manifestly out of date, inaccurate or incomplete. The real challenge for many firms who find themselves in the process of complying with the COB rules is that these are conversations that the client has not been confronted with in the past.

There are it seems two key challenges when collecting information from client's;

- Clients might be unwilling to disclose details of their personal wealth
- Clients may not appreciate the need to understand the risks they are taking both in terms of their tolerance and capacity for loss

In the past these 'difficult' topics may have been brushed aside.

However without the necessary information the investment management firm cannot give any recommendation or advice.

The right technology is not a nice to have feature, it is now an absolutely essential component

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The implication is of course that if a client or prospective client is unable or unwilling to provide sufficient information then the only recourse is to end that relationship, however valuable that relationship is or could be to the investment management firm.

If follows then that in order to establish and maintain a client relationship which involves any form of investment recommendation or advice, an investment manager has a responsibility to obtain and capture sufficient data to answer these questions and be able to demonstrate that reasonable steps were taken to ensure that the client's interests were met.

This apparently simple requirement, cannot be met effectively without appropriate technology which provides the following key features;

- The right data model which correctly distinguishes the person or body corporate as the legal entity that advice is being given to and can clearly differentiate the data entities to which the requisite attributes relate

- A flexible approach to data capture and form design that allows each organisation to define the right level of detail appropriate to its clients and service offerings

- A flexible approach to process definition and workflow enabling the efficient collaboration of tasks and data capture in the right place at the right time

- A powerful document generation tool to produce client facing letters, proposals and review forms so that client documentation is included in the evidence trail for the protection of both the client and the firm if in future the voracity of the suitability dialogue is disputed

Assessing suitability is a requirement for investment managers which they can no longer ignore. All firms engaged in giving investment advice to clients must provide their responsible managers with appropriate tools to support their suitability review obligations.

The right technology is not a nice to have feature, it is now an absolutely essential component that enables IMs to actually do their job. The consequences of not providing the right tools to investment managers are severe not only for the firm in question but for the IMs themselves.

execution

This apparently simple requirement cannot be met effectively without appropriate technology.

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WDX hits the spot.

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