Jersey Financial Services Commission

FINDINGS OF MYSTERY SHOPPING RESEARCH.

SUITABILITY OF ADVICE AND SALES PROCESS OF REGULATED INVESTMENT BUSINESSES

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Any comments on the contents of this paper would be welcomed. We would also be happy to address any concerns or questions that the reader may have in this respect.

Copies of the report can be downloaded from the publications section of the Commission's website – www.jerseyfsc.org/investment_business/on_site_thematic_examinations/index.asp

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1 Executive Summary

1.1 Introduction

1.1.1 The Jersey Financial Services Commission (the **"Commission"**) has been responsible for the regulation and supervision of investment business since March 1999. Though the Commission's routine supervision examinations formally capture documented information about sales processes, the Commission wanted to supplement these examinations with detailed insight into how the advice and sales process of regulated investment businesses is conducted in practice.

1.1.2 Further, the Commission's recent experience in relation to Alternate Insurance Services Limited had given the Commission cause for concern as to the quality of financial advice provided by regulated investment businesses.

1.1.3 Consequently, in 2007, the Commission decided to supplement its themed examination on suitability of advice and communication to investors with a mystery shopping exercise.

1.1.4 Whilst this was the first mystery shopping exercise undertaken by the Commission, the UK Financial Services Authority has carried out various mystery shopping exercises over the past few years to obtain a detailed insight into the way financial products are sold to consumers.

1.1.5 The Attorney General granted authority under Article 34 of the Regulation of Investigatory Powers (Jersey) Law 2005 for the mystery shopping exercise to take place, which enabled the shoppers to record the appointments without the knowledge of the advisers, and transcripts of the recordings were used to assist with the analysis of the mystery shopping visits.

1.1.6 The Commission's objectives in undertaking the mystery shopping exercise were:

1.1.6.1 To provide first hand experience of the advice and sales process of investment businesses as measured against best practice and the requirements of the current Investment Business Codes of Practice (the **"Codes"**) issued in March 2001;

1.1.6.2 To enable the Commission to highlight to the investment business industry areas of good and bad practice; and

1.1.6.3 To provide the investment businesses that were examined with specific and actionable feedback.

1.2 Methodology

1.2.1 This report is based on a programme of mystery shopping of two investment scenarios. These scenarios were for potential investments for a lump sum of £100,000 ("scenario one") and £8,000 ("scenario two").

1.2.2 The fieldwork for this project was conducted by GfK Mystery Shopping. The Commission provided a list of 27 investment businesses in order to achieve at least 12-15 mystery shopping reports. From these 13 mystery shopping reports were received, six of scenario one and seven of scenario two Each of the mystery shoppers contacted their assigned companies by telephone to arrange an initial face-to-face meeting at the adviser's offices seeking advice on what to do with their potential lump sum investment.

1.2.3 The first appointment consisted of a discussion of the shopper's needs and typically included a fact find exercise to establish the financial situation of the shopper, their attitude to risk and their financial needs. This was usually followed by a second visit to receive advice and a recommendation on what financial products and services would meet those needs.

1.2.4 Each of the appointments were recorded and transcripts of the recordings were used to assist with the analysis of the mystery shopping visits.

1.2.5 The mystery shopping interviews were conducted between November 2007 and January 2008.

1.3 Summary of key findings and recommendations for improvements

1.3.1 Findings from the mystery shopping transcripts were reviewed in relation to the behaviour of the adviser, the assessment of customer needs made, the advice received and the documentation/sales literature received by the mystery shopper. Some observations from the mystery shoppers were also included.

1.3.2 From the mystery shopping transcripts observations on how firms seek to comply with the Codes, examples of best practice and areas for improvement were identified and these are summarised below.

The adviser

1.3.3 A common problem experienced by the mystery shoppers was the difficulty in arranging the initial and subsequent interviews with financial advisers. Though the shoppers for both scenarios experienced this problem, feedback from the shoppers shows that the difficulty was more prevalent among those with the £8,000 investment scenario. Those shoppers with the lower investment scenario felt that in some cases, they were experiencing difficulties in arranging a meeting because their lump investment was considered too small for the adviser's attention.

1.3.4 The behaviour of the adviser was considered in relation to how they introduced themselves and their firm, how they explained the methods available for paying for services and whether they demonstrated that they would recommend products where there was no financial incentive (that is, either a fee or commission) for them to do so.

1.3.5 Examples of compliance with regulatory requirements and best practice were found among advisers who:

1.3.5.1 Clearly stated that they were regulated by the Commission (four out of 13 shops) as required by the Commission's Codes which state that a registered person "must inform its clients that it is regulated by the Commission in the carrying on of investment business";

1.3.5.2 Provided information about the firm and the range of services offered either verbally and/or through providing a marketing brochure about the firm (three out of 13 shops); and

1.3.5.3 Demonstrated impartiality of advice where recommendations were made to invest some or all of the potential lump sums in products where the adviser was unlikely to receive a fee or commission for the recommendation (seven out of 13 shops).

1.3.6 The above examples were not demonstrated in all of the mystery shops conducted and common areas identified for improvement were:

1.3.6.1 Advisers should inform their clients that they are regulated by the Commission. It should not be assumed (if it is) that customers are aware of the regulator because reference to the Commission is on the adviser's business card or the firm's marketing material;

1.3.6.2 Further information about the firm and the range of services offered should be provided to ensure that if advice about investments is being made from a restricted range of available providers of investments of the same type, that clients are aware of the nature and extent of that restriction and that they also receive this information in writing (paragraph 4.3 of the Codes) and;

1.3.6.3 The need for advisers to provide greater clarity that a customer can choose to pay a fee for financial services or commission based on the investment amount. The mystery shopping transcripts indicate that the shoppers were led towards commission.

Assessment of customer needs

1.3.7 A fact find was conducted in all but one of the mystery shops. However the depth of these varied and based on the transcripts it appears that a more detailed fact find was conducted when larger sums were potentially being invested.

1.3.8 Examples of compliance with regulatory requirements and best practice were found where:

1.3.8.1 A detailed assessment of the shoppers's financial situation was made. In addition to personal details it included information on the financial products held, the level of emergency funds held and major loans such as a mortgage or whether a will was made (seven out of 13 shops);

1.3.8.2 Assessing the shopper's attitude to risk, advisers not only made use of questionnaires and other risk assessment tools but they also spent time explaining the relationship between risk and reward. The use of questionnaires was more likely to occur in the £100,000 investment scenario (three of the six scenario one); and

1.3.8.3 Advisers established that the shopper had an emergency fund/'rainy day' money and were therefore willing and financially able (based on the available information) to lock their potential lump sum investment into a minimum five year plan.

1.3.9 Two main areas for improvement in practice were found. These were:

1.3.9.1 In the assessment of customer needs, other than verifying the level of mortgage debt held by the shoppers, none of the advisers explored in any detail the level of other debt, such as credit card balances or car loans, held by each of the shoppers; and

1.3.9.2 The assessment of financial objectives were broadly limited to determining whether the shopper wanted income or capital growth and how long they were prepared to tie their money up for. Except for one adviser there appears to have been little or no exploration with the shopper on the potential impact of a change of circumstances on their current financial objectives.

1.3.10 These two areas of weakness could result in customers receiving an inadequate assessment of their financial needs and potentially inappropriate advice for their current and short to medium term financial circumstances and objectives.

Advice received

1.3.11 There was a consistency of advice given in the £100,000 scenario with four of the six mystery shoppers in this scenario advised to place some or all of their lump sum in an investment bond. The advice given for the £8,000 scenario varied from savings accounts to fund investments.

1.3.12 Examples of compliance with regulatory requirements and best practice were found where:

1.3.12.1 The fact find was used to identify other financial needs of the shopper (five of the six £100,000 scenario and one of the seven £8,000 scenario); and

1.3.12.2 The product recommendations made were explicitly tied back to the shopper's risk profile, financial objectives and period that they were prepared to restrict their access to this money.

1.3.13 A common area identified for improvement was that Advisers did not explain if they were offering limited or full advice to shoppers. Customers should be clear whether the advice they are receiving related solely to the original objective of their visit or whether the advice is being given in relation to all the financial needs identified in the fact find.

Documentation/sales literature received

1.3.14 Using the information gathered from the transcripts and on feedback from the mystery shopper questionnaires, documentation and sales literature was found to be a general area of weakness among the financial advisers that were mystery shopped.

1.3.15 The Codes state that a registered person "must be able to demonstrate in writing that the advice or exercise of discretion is appropriate for a particular client, its stated risk profile and investment requirements".

1.3.16 The nearest examples of compliance with regulatory requirements and best practice were found where:

1.3.16.1 The mystery shopper received a suitability letter (two firms). However, in one instance the shopper received this approximately three weeks after the initial meeting and after they made a phone call to find out why it had not arrived when they had been told to expect it ; and

1.3.16.2 A mystery shopper received an Investment Policy Statement during their second meeting with their adviser (one firm).

1.3.17 Consequently a common area identified for improvement was the need for advisers to provide customers with suitability letters so that customers are more informed about the appropriateness of the adviser's recommendations for their needs and to give them an opportunity to identify those areas where they might wish to seek further clarification.

2 Background

2.1 What is mystery shopping?

2.1.1 The Market Research Society defines mystery shopping or 'mystery customer research' as:

"The use of individuals trained to experience and measure any customer service process, by acting as potential customers and in some way reporting back on their experience in a detailed and objective way."

2.1.2 Mystery shopping is a long-established research technique and is used extensively in many industry sectors, such as retail and many large financial services providers, to measure the quality of service provided.

2.1.3 Whilst this was the first mystery shopping exercise undertaken by the Commission, the UK Financial Services Authority has carried out various mystery shopping exercises over the past few years to obtain a detailed insight into the way financial products are sold to consumers.

2.1.4 The Attorney General granted authority under Article 34 of the Regulation of Investigatory Powers (Jersey) Law 2005 for the mystery shopping exercise to take place, which enabled the shoppers to record the appointments without the knowledge of the advisers, and transcripts of the recordings were used to assist with the analysis of the mystery shopping visits.

2.1.5 All investment businesses were notified at least twice, initially through a Dear CEO letter dated 16 March 2007 and at a Commission seminar held on 21 June 2007 that mystery shopping would be taking place.

2.2 Research Objectives

2.2.1 The aim of the Commission in conducting a series of themed on-site examinations is to concentrate on specific areas of conduct taken across a segment of the industry in order to obtain an indication of the standards and approaches being applied. For 2007, one of the chosen themes was suitability of advice and communication to investors.

2.2.2 Though the Commission's supervision examinations formally capture documented information about sales processes, the Commission wanted to supplement these examinations with detailed insight into how the advice and sales process of regulated investment businesses is conducted in practice.

2.2.3 Consequently, in 2007, the Commission decided to supplement its themed examinations with a mystery shopping exercise and appointed Deloitte & Touche LLP to act on its behalf.

2.2.4 The on-site work conducted as part of these two exercises consisted of:

2.2.4.1 Commission themed examinations of 10 firms in relation to suitability of advice and communication to investors; and

2.2.4.2 A programme of 13 mystery shops managed on behalf of the Commission by Deloitte & Touche LLP.

2.2.5 Specifically, the Commission's objectives in undertaking the themed examination programme and mystery shopping exercise were:-

2.2.5.1 To provide first hand experience of the advice and sales process of investment businesses as measured against best practice and the requirements of the current Investment Business Codes of Practice (the "Codes") issued in March 2001;

2.2.5.2 To enable the Commission to highlight to the investment business industry areas of good and bad practice; and

2.2.5.3 To provide the investment businesses that were examined with specific and actionable feedback.

2.2.6 As with all on-site examinations, a firm is assessed in terms of its compliance with the relevant Laws, Orders and Codes of Practice. The objective in publishing summary findings from a programme of themed examinations is to share experiences as to how different firms seek to meet the requirements of the regulatory regime and to highlight the difficulties that are sometimes incurred.

2.3 Research Methodology

2.3.1 The Commission provided Deloitte & Touche LLP with a list of 27 investment businesses that are registered to give investment advice ranging from small independent financial advisers to large retail Banks.

2.3.2 The Commission also provided Deloitte & Touche LLP with samples of two investment scenarios. These scenarios were for potential investments for a lump sum of £100,000 ("scenario one") and £8,000 ("scenario two"). For each scenario an 'ideal profile' of the mystery shopper/individual customer was agreed between the Commission and Deloitte & Touche LLP.

2.3.3 The ideal profile of shoppers for scenario one was that individuals should have:-

2.3.3.1 An average income,

2.3.3.2 Dependants,

2.3.3.3 A mortgage of at least approximately 3 times income,

2.3.3.4 Some savings and investments,

2.3.3.5 A future life plan that could change their financial needs, such as starting a family, or school/university fees for children.

2.3.4 The ideal profile of shoppers for scenario two was that individuals should have:

2.3.4.1 An average income,

2.3.4.2 No dependants,

2.3.4.3 Little or no mortgage,

2.3.4.4 No pension,

2.3.4.5 No/little savings and investments,

2.3.4.6 Some debt such as car loan and/or credit card which is not paid off in full each month.

2.3.5 Given the limited pool of mystery shoppers in Jersey, individuals were recruited by GfK Mystery Shopping, an independent market research agency, whom Deloitte & Touche LLP selected to conduct the mystery shopping fieldwork. In each of the mystery shop scenarios, the shoppers used their real personal details at all times as well as their real financial details.

2.4 The mystery shop visits

2.4.1 Investment businesses were selected and allocated at random to either scenario one or two. From these, 13 mystery shopping reports were received. Each of the mystery shoppers contacted their assigned companies by telephone to arrange an initial face-to-face meeting at the adviser's offices seeking advice on what to do with their potential lump sum investment.

2.4.2 The first appointment consisted of a discussion of the shopper's needs and typically included a fact find exercise to establish the financial situation of the shopper, their attitude to risk and their financial needs. This was usually followed by a second visit to receive advice and a recommendation of which financial products and services would meet those needs.

2.4.3 The mystery shoppers completed a detailed questionnaire based on their experiences of the appointment and the adviser. Each of the appointments was recorded by the shopper without the knowledge of the adviser. Transcripts of the recordings were used to assist with the analysis of the mystery shops, which were assessed under the following categories:-

2.4.3.1 Impartiality of advisers;

2.4.3.2 Assessment of customer needs;

2.4.3.3 Advice received; and

2.4.3.4 Documentation/Sales literature.

2.4.4 The mystery shopping appointments were conducted between November 2007 and January 2008. The Commission recognises that appointments were held with only one financial adviser from each business and therefore may not be indicative of the general standard of the firm's sales process.

2.4.5 As mentioned above, in conjunction with the mystery shopper exercise, the Commission undertook ten themed examinations and in these cases, a self-assessment questionnaire covering a range of questions, which addressed the above areas, was circulated to investment businesses. Reponses to the questionnaires were analysed and on-site examinations were conducted during 2007.

2.4.6 The majority of findings from the themed examinations undertaken by the Commission mirrored those identified within the mystery shopping exercise in respect to assessment of customer needs, advice received and documentation/sales literature.

2.4.7 Other findings that the Commission identified from the themed examinations are set out within a separate report published by the Commission entitled On-Site Examination Themed Programme 2007 – Summary Findings

3 Key Findings – The Advisor

This section summarises the key findings from the mystery shopping feedback for the £100,000 and £8,000 investment scenarios and covers findings relating to the adviser, assessment of customer needs, the advice received and the documentation/sales literature received. Some observations from the mystery shoppers are also included.

3.1 Activities of the adviser

3.1.1 **Introducing the firm** - examines the extent to which advisers explained to the shopper the range of services that the firm provided, how the firm was regulated and whether they were restricted in the range of product providers that they could advise on;

3.1.2 **Commission or fees** - considers whether the shopper was told that they could pay for the adviser's services through commission or by payment of a fee and how clearly the two methods were explained;

3.1.3 **Impartiality of advisers** - notes if advisers would recommend products for which they would not receive a fee/commission.

3.2 Introducing the firm

3.2.1 The current Codes state that a registered person "must inform its clients that it is regulated by the Commission in the carrying on of investment business".

3.2.2 Three of the thirteen firms told the mystery shoppers something about their firm and the services offered. This was usually supported with a brochure which described the firm and which the shopper was given to read themselves. Eleven of the thirteen investment business advisers supplied a business card. Four firms explicitly said that they are regulated by the Commission.

3.2.3 For the majority of the mystery shoppers, it was only through reading the business card that they were aware that the firm was regulated by the Commission.

3.2.4 Based on the transcripts from the mystery shops, none of the advisers said that their advice would be limited to a restricted range of available product providers of investments of the same type.

3.3 Commission or fees

3.3.1 There was a lack of awareness among the mystery shoppers after the appointments that they could pay a fee for financial services rather than commission based on the investment amount. Advisers did not always inform the shopper that they could pay for their services by fee. When the option to pay by fee was mentioned, it was not discussed in detail. Instead, shoppers appeared to be led towards commission. In some instances, the 'benefits' of commission were mentioned such as rate rebates (where the adviser would forego some of their commission so that the shopper would have more of their initial investment to invest) and 100% allocation of money being mentioned. Based on the transcripts, how product charges would be affected under a fee payment does not appear to have been discussed with the mystery shoppers.

> ***"… our costs… could be paid from the product provider or you could pay us separately".***
> **Firm B, £100,000 investment**

3.3.2 Some advisers clearly explained how commission worked so there was limited opportunity for misunderstanding to arise on how this would impact on the amount invested.

> ***"They deduct the charges, they keep 1% [the provider], they give us 3%".***
> **Firm J, £8,000 investment**

3.3.3 However, in some instances, the adviser's lack of clarity had the potential to mislead the shopper by omission so that the shopper might not be aware that the adviser receives payment from the commission paid by the shopper.

> ***"… you would have a 4% charge to buy into that fund. That is a one off charge… you are paying for the expertise of these fund managers".***
> **Firm H, £8,000 investment**

3.3.4 The potential for misunderstanding is further demonstrated in one instance where it was suggested that commission was paid to the adviser by the provider but it was not made explicit that this would be deducted from the shopper's lump sum investment.

> ***"… any company we do business with we get a one-off fee from them".***
> **Firm E, £100,000 investment**

3.4 Impartiality of advisers

3.4.1 In seven of the thirteen mystery shops, advisers demonstrated impartiality (that is, that they did not restrict their recommendations to those where they would receive commission/a fee), by suggesting to shoppers that they put some or all of their lump sum into an instant access or notice savings account. This occurred in four of the £8,000 investment scenarios and in three of the £100,000 investment scenarios.

4 Key Findings - Assessment of customer needs

4.1 Results of the Fact finds

4.1.1 **Assessment of financial situation** - the completeness of these assessments and whether there was a relationship between the value of the potential investments and the thoroughness of the assessment of the financial situation conducted;

4.1.2 **Affordability** - the extent to which advisers ascertained that the shoppers had some emergency cash available;

4.1.3 **Attitude to risk** - the time advisers spent explaining risk and in making sure that the shoppers understood the concept;

4.1.4 **Financial objectives** - considers whether the adviser assessed what the shoppers understood about the terms capital growth and income; and

4.1.5 **Other findings** - comments if behaviour occurred that are not examples of best practice.

4.2 Assessment of financial situation

4.2.1 The Codes state "where a registered person is responsible for providing advice for its clients, it must seek from them information regarding their financial situation, investment experience and objectives as regards the services requested".

4.2.2 The depth of the assessment made by the advisers varied. In the majority of the mystery shopping interviews, detailed information on the shopper's household financial situation and financial products held was collected. In five instances there was little information collected beyond personal details.

4.2.3 The format of the questioning indicates that the majority of advisers were using a pro-forma questionnaire or equivalent. Subsequently, there was a consistency in the range of questions asked by each of the advisers and the information captured typically included:

4.2.3.1 Personal information (name, address, marital status, dependants, employment, annual personal and household income);

4.2.3.2 The financial products held (pensions, savings and investments, mortgage, life assurance, other protection); and

4.2.3.3 Health status (smoker/non smoker).

4.2.4 In addition, shoppers in two of the £100,000 investment scenarios were asked if they had a will. In both instances the shopper was directed to think about updating their will as their personal circumstances had changed since it was made.

4.2.5 Limited fact finding of the individual's financial situation took place in four of the £8,000 investment scenarios and in one of the £100,000 investment scenarios. In each of these cases, the information collected related primarily to personal details with only very limited information collected about the individual's financial situation. This occurred even when the adviser said that they were going to collect information about their financial situation.

> *"… to get a picture of yourself and your husband and you know, your current situation".*
>
> **Firm I, £8,000 investment**

4.2.6 From the transcript reviewed, it appears that during this fact find, a complete assessment of the shopper's total income and total expenditure was not made.

4.2.7 Though advisers established that the mystery shoppers had some contingency funds, they did not explore what debt commitments were held. Other than mortgage debt, limited information, if any, was collected on the amount of debt held by the mystery shoppers. In four interviews the shoppers were asked if they had any loans, other than their mortgage. The generic nature of this question meant that shoppers might not have realised that they should include outstanding credit card balances or bank overdrafts. This lack of exploration of the level of debt held by the consumer could result in a weaker assessment of the affordability and suitability of the recommendations that are subsequently made. Lacking this complete picture of the financial situation of the shoppers, potentially the advisers might not provide the most appropriate advice for the individuals' circumstances, such as, advising them to pay off some or all of their debts before investing the balance of their lump sum.

4.2.8 A relative assessment is shown overleaf of the advisers' assessment of the shoppers' financial situation in the two tables below. For the purposes of this assessment, if detailed information was collected about the shoppers' financial situation, but excluded determining the overall level of debt, this was still treated as a high level of information obtained.

Relative assessment of advisers' assessment of financial situation £100,000 scenario			
Company name	**H**	**M**	**L**
Firm A	√		
Firm B	√		
Firm C	√		
Firm D		√	
Firm E	√		
Firm F			√

Relative assessment of advisers' assessment of financial situation £8,000 scenario			
Company name	**H**	**M**	**L**
Firm G			√
Firm H			√
Firm I			√
Firm J	√		
Firm K	√		
Firm L			√
Firm M	√		

Key:

High ("H") level of information obtained – collection of information on personal details (individual and household), financial products held, emergency funds held, loans, will written.

Medium ("M") level of information obtained – collection of information on personal details, emergency funds, and where the transcript suggests that further information was collected when the first appointment was arranged by telephone.

Low ("L") level of information obtained – collection of information on personal details and access to emergency funds only.

4.2.9 These findings indicate that though the level of collecting information on an individual's situation is generally strong, there are some gaps. From the information available in the transcripts, it appears that a more detailed fact find is conducted when larger sums are potentially being invested.

4.3 Affordability

4.3.1 The majority of advisers established how much each of the shoppers had as an emergency fund/'rainy day' money. Some advisers recommended that the shopper should consider having 5-10% of their income easily accessible.

> *"…normally for instance keep about 10% of your money in an emergency fund".*
> **Firm B, £100,000 investment**

4.3.2 Advisers were more likely to recommend that the shopper keep some or all of their potential investment in cash, where the investment sum was £8,000. However, as the debt situation of the shopper had not been explored, it is difficult to state whether this was appropriate advice for the individual's circumstances.

> ***"…if you are living one month to the next… what you need is access to that money [£8,000] in an emergency".***
> **Firm L, £8,000 investment**

4.3.3 In only one instance did an adviser clarify how much income tax the shopper was currently paying, though this was not explicitly followed up (the adviser appeared to suggest how to avoid paying tax on the £100,000 investment being made, by not declaring it).

4.4 Attitude to risk

4.4.1 In the majority of the mystery shopping interviews, the advisers spent time exploring with the shoppers their attitude to risk and explaining the relationship between risk and reward and the benefit of a diversified portfolio. Based on the transcripts, in three of the mystery shops, no risk assessment was made.

4.4.2 One adviser thought that their bank had no suitable products for the shopper and suggested that they consider the bank's online saving account.

4.4.3 Shoppers with £100,000 to invest were more likely to be asked to complete a risk questionnaire and receive a risk rating based on the assessment of that questionnaire (three out of six shops).

> ***"…this is a risk questionnaire so now we are getting down to what you actually want to do with this money"***
> **Firm C, £100,000 investment**

4.4.4 For those shoppers with £8,000, they were generally asked what their attitude to risk was, so that it was established in principle rather than through a detailed questionnaire (five out of seven shops). In this scenario, to help the shopper understand risk, individuals were asked how secure they wanted their money to be and bank/building society saving accounts were used as illustrations of a 'safe' investment.

> ***"…your attitude to risk … do you want to be fairly cautious or sort of medium?"***
> **Firm L, £8,000 investment**

4.5 Financial objectives

4.5.1 The assessment of the financial objectives of the shoppers was limited and this was essentially restricted to determining whether the individuals wanted income or capital growth and how long they were prepared to invest their money for without having access to it. Against this background, all but one of the shoppers said they had a growth objective over a three to five year investment period. These growth aspirations were not explicitly discussed or identified by any of the financial advisers to determine what growth meant to the shoppers or if their expectations were realistic.

4.5.2 Where the shoppers stated that they wanted income, the advisers did not establish the level of income that the shoppers were hoping for. For example, even when the shopper said that they did not think the income would be high, the adviser did not explore this comment further to find out what a 'high income' was in the shopper's terms.

4.5.3 Though the advisers touched upon the potential impact of a change in circumstances such as losing a job or death, only one adviser explored in detail the shopper's aspirations for the future and how a change in circumstances might require a readjustment of financial priorities.

4.5.4 One adviser established that the shopper planned to move to a bigger house in three to five years and to have children within the next five years.

> ***"… you are going to obviously have some expenses in the future. You are going to have a bigger mortgage. … if you are planning to have children then your income will drop dramatically …"***
> **Firm E, £100,000**

4.6 Other findings

4.6.1 The range of financial needs identified during the fact finds is covered more fully in section 5.2 'Key Findings - Advice received'.

4.6.2 In the majority of mystery shops, advisers conducted their fact finding before suggesting products to the shopper. In three instances the adviser described in general terms the type of products they could offer, before completing the fact find. Indeed, it does not appear from the available information in the transcript that a fact find was conducted at one firm.

4.6.3 No mystery shoppers were advised to conduct their adviser interview on an 'execution only' basis (that is, the shopper was asked to sign a statement to say that they received no advice and that their investment decision was made of their own volition) in this project.

5 Key Findings - Advice received

5.1 Results of the fact finds – Specific areas

5.1.1 **Financial needs identified during the fact find** - explores whether other financial needs were identified;

5.1.2 **Rationale given for final recommendation** - to identify if product recommendations are made with reference to the output from the fact find and if any recommendations are made that appear to be influenced by the commission that the investment business/adviser would receive from the product provider;

5.1.3 **Consistency in recommendations made –** explores the variety of recommendations that were made for each scenario and highlights any product types that were common to several shops;

5.1.4 **Clarity of product explanation** - the ease with which the shopper said they understood the products being presented, whether penalties had been discussed; and

5.1.5 **Other information** - presents individual comments made by the shopper on the scenario that they had just completed.

5.2 Financial needs identified during fact find

5.2.1 An assessment of the mystery shopping transcripts shows that identifying other financial needs mainly occurred during the fact finds for the £100,000 investment scenario. This was less likely to occur in the £8,000 investment scenario.

5.2.2 Only one firm identified additional financial needs for a shopper in the £8,000 investment scenario. In this instance, the adviser recommended that the shopper consider life assurance as they had no protection provision for their family.

5.2.3 In five of the six £100,000 investment scenarios, additional financial needs were identified and these are summarised in the table below. These needs related to pensions and life assurance, including life assurance in relation to protecting mortgage repayments.

Financial needs identified during fact find £100,000 scenario						
Company name	**Bonds**	**Pensions**	**Life Assurance**	**Life Assurance (Mortgage)**	**Savings plan**	**Critical Illness**
Firm A		√	√			
Firm B		√	√	√		
Firm C		√		√	√	√
Firm D		√ to increase contributions				
Firm E		√				
Firm F						

5.2.4 No recommendations were made to switch from existing financial holdings in either the £100,000 or the £8,000 investment scenario.

5.2.5 One of the mystery shoppers had a fixed rate, interest only mortgage of approximately £250,000 and was advised to maintain the existing mortgage as they were receiving tax relief on the interest and to consider reviewing the type of mortgage held when the fixed rate period ended, perhaps to a capital and interest mortgage. It was also suggested that they might wish to put some of their lump sum investment in a notice account which they could access if the decision was made to reduce the mortgage capital at the end of the fixed rate period.

> ***"…it might be worth … the balance being left on a deposit to run alongside your fixed account and then when your fixed account matures then making a capital reduction, changing your monthly repayments at that stage from interest only to capital and interest".***
> **Firm A, £100,000 investment**

5.2.6 Another shopper who had a capital and interest repayment mortgage of £310,000 had an adviser who said that they would explore on their behalf whether there was a benefit to the shopper in switching to an interest only mortgage as they were likely to obtain better tax relief than they would on their current mortgage. The rationale for this advice was that tax relief is only given on the amount of interest being paid, as with a repayment mortgage the amount of interest being paid is falling over the mortgage term thereby reducing the amount of tax relief being received.

> ***"…if you want to … you can go onto an interest only mortgage. I will look into it I am just saying, it might not be the best advice for you".***
> **Firm E, £100,000 investment**

5.3 Rationale given for final product recommendations

5.3.1 In the majority of mystery shops the adviser made it clear that their product recommendation was made taking into account the individual's risk profile, financial objectives and period that they were willing to invest for without accessing their money. Mystery shopper feedback also supports this finding as shoppers said that they understood how the product recommended matched their needs.

> ***"…aim of what I am prepared to do here is to try and outperform slightly your bank account so that your money is not at risk but you are getting a better return on your money that you would by just putting it in the bank".***
> **Firm A, £100,000 investment**

5.3.2 Additional benefits relating to the product recommendation, where applicable, were highlighted to the shopper. These included:

5.3.2.1 Commission rebate (where the adviser would not take the full commission on the product but would 'refund' it to the consumer);

5.3.2.2 No exit penalties/charges;

5.3.2.3 Free switches;

5.3.2.4 Easy access to money; and

5.3.2.5 The option to guarantee level of return in a with profits policy.

> *"... as time goes on, you can switch free of charge".*
> **Firm C, £100,000 investment**

5.4 Consistency in recommendations made

5.4.1 In the £100,000 investment scenario, there was consistency in the advice given by advisers to the mystery shoppers. In four out of six mystery shops, the advice given was to invest the money in an investment bond. In each case, the adviser had obtained a personal illustration, key facts document and other explanatory material for the shopper. In two of the investment businesses, the shopper had more than one investment bond provider illustrated to them, while in the other two firms, both of whom were independent financial advisers, only one provider option was given.

5.4.2 In three of the four investment bond recommendations, a personal illustration was provided for a particular product provider. Though this was the most mentioned provider for this investment, only one adviser said that this was the provider that they would recommend on the basis that they had always found them to be a good firm.

5.4.3 In one of the six £100,000 investment scenarios the shopper was advised not to put all their lump sum into an investment bond but to also consider placing £40,000 to £50,000 in an easy access account.

> *"I would probably limit my investment if I was you to that £60,000 [in the investment bond]".*
> **Firm A, £100,000 investment**

5.4.4 Another shopper in the £100,000 scenario was advised to put their money on deposit given the market turmoil at the time of the interview (December 2007).

5.4.5 The range of products recommended to the shoppers in the £8,000 investment scenario was more varied ranging from a savings account to fund investments. These are summarised below.

Company name	Product recommendations	Reason for recommendation
Firm G	With profit bond recommended	With profit bond recommended as

Company name	Product recommendations	Reason for recommendation
	and a Nationwide savings account also mentioned.	offers potential to give a higher return if prepared to take some risk. Nationwide recommended because some good rates available and individual has easy access to money.
Firm H	Income fund or Unit Linked Deposit Fund.	It should offer a better return than a cash investment over 5 years.
Firm I	Advised by email in lieu of a second appointment to keep money in cash.	Cash was described as the most suitable option - "For now I suggest that holding your funds in cash would be the most suitable option and suggest that we arrange a further meeting in January to review the matter".
Firm J	Sarasin CI GlobalStar Sterling Balanced fund.	Investment recommended because it was "suitable for your needs and objectives" as determined from the record made of the shopper's attitude to risk and their investment requirements. This information was detailed in the shopper's 'Investment Advisory Report'.
Firm K	£5,000 in Perspective Managed Funds, £3,000 in possibly a fixed term bank account. Recommended to consider regular savings.	Investment in a fund offered the potential of a better return than cash savings, if shopper prepared to take an investment risk. The fixed term bank account offered access to money for a rainy day.
Firm L	Bank Notice Account recommended.	A notice account offered peace of mind and security by providing access to the cash if required in an emergency and reduced the possibility of the money being spent on a 'whim'.
Firm M	Skandia Collective Investment Account recommended. Zurich Investment Bond also looked at but not recommended due to higher charges.	It offered a diversified investment with moderate to adventurist risk (shopper defined himself as moderate risk taker) with low charges and no exit penalties.

5.5 Clarity of product explanations

5.5.1 The majority of the mystery shoppers thought that the charges and penalties associated with the products being recommended was clearly explained, though some commented that the amount of the penalty incurred was not stated. The majority of shoppers also thought that they fully understood the adviser's explanation of the product that was being recommended.

Assessment by mystery shopper of the clarity of the product explanations £100,000 scenario			
Company name	**Charges explained clearly**	**Penalties made clear**	**Fully understood product explanation**
Firm A	X	X	√
Firm B	√	√ but no value given	√
Firm C	√	√ but no value given	√
Firm D	Not applicable – shopper advised by phone to keep money in cash. No second interview held.		
Firm E	√	√	X
Firm F	N/A	N/A	N/A

Source: Mystery Shopper Feedback

Assessment by mystery shopper of the clarity of the product explanations £8,000 scenario			
Company name	**Charges explained clearly**	**Penalties made clear**	**Fully understood product explanation**
Firm G	N/A	√	X
Firm H	√	N/A	√
Firm I	N/A	N/A	N/A
Firm J	√	√	√
Firm K	N/A	N/A	N/A
Firm L	N/A	N/A	N/A
Firm M	X	√	√

Source: Mystery Shopper Feedback

5.6 Other information

5.6.1 Evidence from the transcripts indicates that advisers did not make it clear to the shoppers whether they were receiving full advice or whether the advice being given was limited to the discussion of investing the lump sum, when recommendations and personal illustrations were being discussed.

5.6.2 During the fact find, most advisers identified other financial needs of the mystery shoppers. As a result, one shopper commented that the adviser did not follow up on the need for life assurance identified in the first appointment other than to say that the with profits bond that was being recommended had life assurance. In contrast, another shopper received quotes for the life assurance identified through the fact find at their initial interview.

5.6.3 This illustrates how consumers can be confused about the type of advice that they will receive following a fact find that identifies other financial needs. Unless the adviser makes it clear that they are only advising the customer on their specific query (in this case, the lump sum), it is likely that consumers will expect the adviser to advise on the other financial needs that have also been identified, as was demonstrated in the above example.

> ***"… The adviser asked whether I had life assurance in my first meeting but did not follow this up with any recommendations in the second meeting".***
>
> **Mystery shopper on Firm E, £100,000 investment**

6 Key Findings - Documentation/Sales literature received

6.1 Level and appropriateness of the product literature received

6.1.1 **Suitability letter** - comments on how quickly the letter was sent out to the shoppers or whether one appears to have been provided to the mystery shoppers;

6.1.2 **Other documentation** - comments on whether other relevant documentation, such as, the key facts document and/or terms of business letter were received by the mystery shoppers.

6.2 Suitability letter

6.2.1 The Codes state that a registered person "must be able to demonstrate in writing that the advice or exercise of discretion is appropriate for a particular client, its stated risk profile and investment requirements".

6.2.2 At the time of writing this report only two out of 13 firms had sent suitability letters to the mystery shoppers.

6.2.3 The suitability letter from one firm was received almost three weeks after the initial meeting, following a phone call made by the shopper requesting the information that they had been told to expect from the investment business. The letter clearly linked its recommendations to the customer's needs and attitude to risk. The charges and risk associated with the recommended product were also clearly stated.

6.2.4 The other firm's letter was prepared promptly and was issued on the day following the second interview. The link between product recommendations and the customer's needs and attitude to risk are less explicit. The adviser gives a general statement that reads "I have selected the funds below based on my assessment of the level of investment risk you wish to take and your specific investment objectives" but does not state what these are.

6.2.5 One firm provided an Investment Policy Statement, which was discussed during the shopper's second meeting with the adviser. This Investment Policy Statement recorded the shopper's attitude to investment risk and loss, their performance objectives, the agreed means of evaluating the performance of the investments and the client and the firm's agreed responsibilities.

6.3 Other documentation

6.3.1 Only six of the 13 mystery shoppers said that they received a key facts document and/or terms of business letter from the adviser they visited.

Sales literature

6.3.2 Where a product recommendation was made, each of the mystery shoppers received a personal illustration, key facts documents and other explanatory product provider material.

Other findings

6.3.3 This section covers specific comments made by some of the mystery shoppers on the difficulty experienced in arranging an appointment with a financial adviser.

Observations from mystery shoppers

6.3.4 A common problem experienced by the mystery shoppers was the difficulty in arranging the initial and subsequent interviews with financial advisers. Though the shoppers for both scenarios experienced this problem, feedback from the shoppers shows that the difficulty was more prevalent among those with the £8,000 investment scenario.

6.3.5 Some of the mystery shoppers in the £8,000 investment scenario found it difficult to arrange initial and subsequent meetings with financial advisers. Some were left with the impression that the sum of money they wanted to invest was too small and therefore an adviser was reluctant to see them.

> ***"… The delay in receiving information was unacceptable. I still have not (had) any proposals other than to keep the income (sic) in cash. I would have lost a month's income by now".***
>
> **Mystery shopper, £8,000 investment**

> ***"…It seems clear from my appointments that these financial advisers have no interest in an investment of £8,000. I think Jersey is a wealthy island and that amount simply does not interest them".***
>
> **Mystery shopper, £8,000 investment**

6.3.6 If these views are an accurate perception of the situation for those with lower finances, this situation could result in a proportion of Jersey's population finding it difficult to access financial advice.

6.3.7 One £100,000 investment scenario shopper noted that they had received no information about the company and though a product recommendation was made, their overall impression was that the meetings held at the firm were too informal.

6.3.8 In contrast, in another shop for the £100,000 investment scenario the shopper was very happy with their experience and said that if they were investing they would choose to do so with the firm.

7 Areas for improvement

Based on the information collected from the mystery shopping interviews and transcripts, this section summarises potential areas for improvement in the advice process. It also identifies where the potential impact of adviser processes might result in inadequate or inappropriate advice for the consumer. Areas to improve consumer understanding of the process and the implications of the information they received are also considered, as appropriate.

7.1 Performance of the adviser

7.1.1 The transcripts and shopper feedback indicate areas for improvement relating to the manner and timing of when customers are told about:

7.1.1.1 Reference to the regulator;

7.1.1.2 The firm's services;

7.1.1.3 The cost of services provided; and

7.1.1.4 How those services can be paid for.

7.1.2 Advisers should provide consumers with a more detailed explanation of the difference between paying by fee and paying commission for products and services. This will help consumers make a more informed decision in selecting how they wish to pay for services while understanding the impact of that payment approach on the product(s) being bought.

7.2 Assessment of customer needs

7.2.1 The need for improvements in the fact finding process have been identified as the depth of the fact finding process varied. These are necessary if advisers are to demonstrate that they are fulfilling the requirements of the Codes. Where limited or incomplete fact finding takes place, consumers risk the potential of receiving inadequate or inappropriate advice for their circumstances.

7.2.2 The main gap identified in assessing customer needs was the lack of detailed information gathering on the level of debt held by the mystery shopper. If the mystery shopper had a mortgage, advisers established what the outstanding balance on the mortgage was. However, few advisers explored what other debt commitments the shopper had, such as credit card balances or car loans, which could impact on the financial advice appropriate for that individual. Even though the mystery shopper may have money set by for emergencies, they could still have loan commitments that they would be better off clearing with some of their lump sum available.

7.2.3 Limited probing of the shopper's financial objectives was identified in some instances. Potentially advisers may fail to identify future life changing events, such as plans to start a family in the short term, which would need to be factored into the advice being given. Greater exploration of consumers' financial objectives would reduce the risk of consumers receiving inadequate advice.

7.3 Financial advice received

7.3.1 It is not apparent from the transcripts that advisers made it clear whether they were offering limited or full advice. This has the potential to mislead consumers about the areas in which they would receive recommendations after the fact find has been completed.

7.3.2 If financial needs are identified, such as life assurance, and are not subsequently followed up, consumers might underestimate the importance of reviewing these needs and might not explore further how they might be met.

7.3.3 Given that in some instances the shopper's attitude to risk was established informally, there is an opportunity for advisers to adopt a more systematic approach to establishing attitude to risk in order to avoid making inappropriate recommendations.

7.4 Documentation/sales literature

7.4.1 The lack of suitability letters following the initial meeting indicates an area for improvement. The implication of this is that consumers would not have the opportunity to review the initial discussion held to determine if it reflected their understanding of what transpired. At the same time, it does not allow consumers the opportunity to identify areas that they would like to question or discuss in more detail with the adviser in a second or subsequent meeting.