Jersey Financial Services Commission

FINDINGS OF MYSTERY SHOPPING RESEARCH

SUITABILITY OF ADVICE AND SALES PROCESS OF REGULATED INVESTMENT BUSINESSES

Issued: 2 February 2011

ACKNOWLEDGEMENTS

The Jersey Financial Services Commission (the **"Commission"**), was assisted in the design of the mystery shopping project and the interpretation of the results by Deloitte LLP. The views expressed in this report are those of the Commission. Deloitte LLP does not assume or accept or owe any responsibility or duty of care or liability to any person other than the Commission.

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Deloitte LLP managed GfK Mystery Shopping, an independent market research company, who recruited individuals to undertake the mystery shopping fieldwork.

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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 of investment business conducted in Jersey since March 1999.

1.1.2 Although the Commission's on-site examinations of investment businesses formally capture documented information about sales processes, the Commission wanted to supplement these on-site examinations with detailed insight into how the advice and sales process of regulated investment businesses is conducted in practice and viewed by consumers.

1.1.3 Accordingly, the Commission first decided to supplement its themed on-site examinations with a mystery shopping exercise in 2007, the report being published in May 2008. This report highlighted a number of key findings and identified a number of areas for improvement.

1.1.4 The Commission issued revised Codes of Practice for Investment Business (the **"Codes of Practice"**) in July 2008, and decided to repeat the mystery shopping exercise to see how the Codes of Practice are being followed in practice and whether lessons had been learned from the previous exercise.

1.1.5 Paragraph 2(2)(c) of the Financial Services (Jersey) Law 1998 defines that a person carries on investment business if the person gives investment advice, that is, the person gives to persons in their capacity as investors or potential investors advice on the merits of –

1.1.5.1 the purchase, sale, subscription for or underwriting of a particular investment, or

1.1.5.2 the exercise of a right conferred by an investment to acquire, dispose of, underwrite or convert the investment.

1.1.6 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.

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

1.1.7.1 To receive first-hand experience of shoppers on the advice and sales process of investment businesses as measured against best practice and the requirements of the Codes of Practice;

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

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

1.2 Methodology

1.2.1 This report covers a programme of mystery shopping which was based on two scenarios. These scenarios were for a potential investment of a lump sum of £120,000 (the **"lump sum scenario"**) and for a "health check" of the mystery shopper's current financial position including existing financial products (the **"health check scenario"**). These are different scenarios than those used in the previous mystery shopping exercise.

1.2.2 GfK Mystery Shopping conducted the fieldwork for this project. The Commission provided a list of 18 investment businesses in order to achieve at least 12 to 15 mystery shopping reports. From the list, 17 mystery shopping reports were received, nine of the lump sum scenario and eight of the health check scenario. Each of the mystery shoppers contacted their assigned companies by telephone or in person to arrange an initial face-to-face meeting at the offices of the financial adviser seeking advice on what to do with their potential lump sum investment or for advice on their current financial situation.

1.2.3 Typically, the first appointment consisted of a discussion of the shopper's needs and normally included a fact find exercise conducted by the adviser to establish the financial situation, attitude to risk and financial needs of the shopper. In eight of the mystery shops, this was followed by a second, and in one case a third, meeting to receive advice and a recommendation of which financial products and services would meet those needs. Where only one appointment was undertaken, the adviser provided recommendations either at the meeting, by post or by email.

1.2.4 The mystery shopping interviews were conducted between 1 March and 30 May 2010.

1.2.5 Specific feedback has been provided by the Commission to representatives of the 17 investment businesses where appointments with mystery shoppers took place.

1.3 Summary of key findings

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 are also included.

1.3.2 From the mystery shopping transcripts, observations on best practice and areas for improvement are identified and summarised below.

The advisers

1.3.3 The behaviour of the advisers 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.

1.3.4 Examples of best practice:

1.3.4.1 Advisers provided documentation, for example Terms of Business documents, business cards and other information about the firm that clearly stated that they were regulated by the Commission as required by the Codes of Practice, which state that a registered person *"must disclose on its stationery and advertising material that it is regulated by the Jersey Financial Services Commission"*;

1.3.4.2 Advisers informed shoppers verbally that they are regulated by the Commission;

1.3.4.3 Advisers provided information about their firm and the range of services offered either verbally and/or through providing a marketing brochure about the firm. Advisers did not merely refer the shopper to a Terms of Business document; and

1.3.4.4 Advisers demonstrated impartiality of advice by recommending investments or products where the adviser is unlikely to receive a fee or commission.

1.3.5 From the mystery shops conducted, areas identified for improvement were that:

1.3.5.1 Information about the firm and the range of services offered was not provided and the importance of the information included in the Terms of Business document was played down;

1.3.5.2 Where advice about products was from a restricted range of the available providers of products, the adviser did not ensure the shopper was aware of the nature and extent of the restriction and this information was not disclosed in writing as required by section 4.5 of the Codes of Practice; and

1.3.5.3 The shopper was not made aware of the option to pay for the investment advice by means of a fee as opposed to a commission based payment. Advisers did not make it clear that it is the consumer's choice nor explained any impact on product charges of each method of payment. The mystery shopping transcripts indicate a tendency by the financial advisers to lead shoppers towards commission based payments.

Assessment of customer needs

1.3.6 In all but one of the mystery shops, the adviser completed a fact find with the shopper or provided a questionnaire for the shopper to complete in their own time. The fact finding was generally comprehensive, but less so in the lump sum scenarios.

1.3.7 Examples of best practice:

1.3.7.1 A high level of information was sought including personal details (individual and household), income and expenditure, any financial products held, level of 'emergency funds' held, details of loans (both secured and unsecured) and whether the shopper had a written will;

1.3.7.2 An assessment of the shopper's attitude to risk with the use of a questionnaire or another risk assessment tool; and

1.3.7.3 Advisers determined if the shopper had an emergency fund/'rainy day' money and an assessment of whether a product was required to protect against loss of income or alternatively whether the shopper was willing and financially able (based on the available information) to lock his potential lump sum investment into products with fixed terms.

1.3.8 The main areas for improvement are as follows:

1.3.8.1 During the fact finding, only one adviser in the lump sum scenario and three advisers in the health check scenario carried out a full itemised assessment of the shopper's household income and expenditure;

1.3.8.2 Seven advisers did not explore the level of unsecured debt, such as credit card balances, overdrafts or car loans;

1.3.8.3 Over a quarter of the advisers did not carry out an assessment of the shopper's attitude to risk. Furthermore, the transcripts would suggest that many advisers assumed that the shoppers understood investment risk as they did not provide an explanation. In some cases the adviser's explanation of risk was unclear or incorrect; and

1.3.8.4 The assessment of financial objectives were broadly limited to determining whether the shopper wanted income or capital growth and for how long they were prepared to tie up their money. Very few of the advisers explored whether the shopper had any plans for the future, such as starting a family, which would have a marked impact on their financial circumstances.

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

Advice received

1.3.10 In only one lump sum scenario did the adviser make a recommendation that related to the financial needs of the shopper, other than specifically in relation to the investment of the lump sum. Advisers did not take into account the shopper's overall financial position, but only applied themselves to the investment of the lump sum. Conversely, in only one of the health check scenarios did the adviser not recommend a financial product.

1.3.11 Examples of best practice:

1.3.11.1 Product recommendations made were tied back to the shopper's risk profile, financial objectives and, if applicable, the period that they were prepared to restrict access to their money.

1.3.11.2 The product, how it works and the associated fees and charges were explained in a clear and jargon free manner.

1.3.12 Areas identified for improvement were as follows:

1.3.12.1 Few advisers explicitly related their product recommendations to the shopper's risk profile, financial objectives and, where applicable, the period that they were prepared to restrict access to this money;

1.3.12.2 Advisers in the lump sum scenario who recommended that the shopper should split their lump sum between products did not explain the reasons for the split;

1.3.12.3 Very few advisers provided the shoppers with personal illustrations for the products they were recommending. Without personal illustrations, customers are more likely to misunderstand or be confused about the monetary impact of variables, such as fees and charges, applicable to their funds; and

1.3.12.4 Only one adviser explained to the shopper that the advice given was limited advice in the lump sum scenario, i.e. solely in relation to the investment of a lump sum, rather than advice relating to the shopper's overall financial position. Customers should be clear whether the advice they are receiving relates solely to the original objective of their visit or whether the adviser's recommendations are in relation to all the financial needs identified by the fact find process.

Documentation/sales literature received

1.3.13 Documentation and sales literature is an area of weakness among most financial advisers that were mystery shopped.

1.3.14 The Codes of Practice state that "where a registered person is responsible for providing advice or exercising discretion for its clients, it must be able to demonstrate in writing that the advice or exercise of discretion is suitable for that client having regard to:

- *The facts disclosed by that client;*
- *The terms of any agreement with that client; and*
- *Any other relevant facts about the client of which the registered person is, or reasonable should be, aware."*

1.3.15 The Codes of Practice also state that "where a registered person is responsible for providing advice it must make available to its client, in a comprehensive and timely manner, appropriate information so as to allow the client to make an informed investment decision."

1.3.16 Examples of best practice:

1.3.16.1 Comprehensive and appropriate information about the products recommended for the shoppers was provided in the form of a 'suitability letter' from their financial adviser; and

1.3.16.2 Suitability letters include reference to:

1.3.16.2.1 an outline of the shopper's current financial position;

1.3.16.2.2 an outline of the shopper's attitude to risk;

1.3.16.2.3 an outline of the shopper's financial objectives, including liquidity requirements;

1.3.16.2.4 product recommendation(s);

1.3.16.2.5 information on the products, such as key facts documentation;

1.3.16.2.6 information regarding associated risks; and

1.3.16.2.7 information of associated costs and fees.

1.3.17 Areas for improvement:

1.3.17.1 Advisers did not provide customers with comprehensive suitability letters meaning customers are less informed about the appropriateness of the adviser's recommendations and are not given the opportunity to identify any areas where they might wish to seek further clarification.

Other information

1.3.18 Four mystery shoppers experienced some problems arranging an appointment with the financial advisers.

2 BACKGROUND

2.1 What is mystery shopping?

2.1.1 The Market Research Society (**"MRS"**) 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 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. Transcripts of the recordings were used to assist with the analysis of the mystery shopping visits.

2.2 Research Objectives

2.2.1 Although the Commission's on-site supervision examinations formally capture documented information about sales processes, the Commission wanted to supplement these on-site examinations with detailed insight into how the advice and sales process of regulated investment businesses is conducted in practice and viewed by consumers.

2.2.2 Consequently, in 2010, the Commission decided to supplement its on-site themed examinations with a mystery shopping exercise and appointed Deloitte LLP to act on its behalf.

2.2.3 Specifically, the Commission's objectives in undertaking the mystery shopping exercise were:

2.2.3.1 To receive first-hand experience of shoppers on the advice and sales process of investment businesses as measured against best practice and the requirements of the revised Investment Business Codes of Practice (the **"Codes of Practice"**) issued in July 2008;

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

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

2.2.4 As with 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 on-site thematic work is to share experiences as to how different firms seek to meet the requirements of the regulatory regime.

2.3 Research Methodology

2.3.1 The Commission provided Deloitte LLP with a list of 18 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 LLP with two scenarios. These scenarios were for a potential investment of a lump sum of £120,000 (the **"lump sum scenario"**) and for a "health check" of the mystery shopper's current financial position including existing financial products (the **"health check scenario"**). The Commission and Deloitte LLP together agreed an 'ideal profile' of the mystery shopper for each scenario.

2.3.3 The ideal profile of a mystery shopper for the lump sum scenario was that individuals should have:

2.3.3.1 An average income;

2.3.3.2 A mortgage of approximately five times income;

2.3.3.3 No savings or investments; and

2.3.3.4 A possible requirement in the medium term, for which they would require access to some of the funds.

2.3.4 The ideal profile of a mystery shopper for the health check scenario was that individuals should have:

2.3.4.1 An average income;

2.3.4.2 Dependants;

2.3.4.3 A mortgage of approximately two times income;

2.3.4.4 At least two existing financial products, e.g. life assurance, pension, critical illness covers, mortgage protection, etc; and

2.3.4.5 Some savings and investments.

2.3.5 GfK Mystery Shopping, an independent market research agency, whom Deloitte LLP selected to conduct the mystery shopping fieldwork, recruited the mystery shoppers. In each of the mystery shop scenarios, the shoppers used their real personal details at all times as well as their real financial details.

2.3.6 As a consequence of the limited pool of mystery shoppers in Jersey many of the people used did not completely fit the ideal profile. As an example, whilst it would have been ideal for all mystery shoppers to have a mortgage, only seven did. However, valuable evidence was nevertheless collected to meet the objectives of the exercise, namely evaluating suitability of advice and communication to investors.

The mystery shop visits

2.3.7 The Commission selected 18 investment businesses and allocated each to either the lump sum scenario or the health check scenario. From these, 17 usable mystery shopping reports were received. One mystery shopping report was deemed unusable for the purposes of this exercise, as the shopper stated at the first interview that they wanted to generate funds for a particular purpose rather than requesting a 'health check' of their current financial position. Another mystery shopper completed only the first interview with the adviser because they felt uncomfortable about having to provide documentary evidence of the products they held. The Commission has included information from this shopper on the basis of the first interview only. As the adviser requested a second meeting and it was the shopper that declined, where the Commission has analysed the number of interviews undertaken, this was included as two.

2.3.8 Each of the mystery shoppers contacted their assigned companies by telephone, or in person, 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 or for advice on their current financial situation.

2.3.9 Typically the first appointment consisted of a discussion of the shopper's financial situation and normally included a fact find exercise to establish the financial situation of the shopper, their attitude to risk and to identify their financial needs. In eight of the mystery shops, this was followed by a second, and in one case a third, meeting to receive advice and a recommendation on what financial products and services would meet those needs. Where only one meeting was undertaken the adviser provided recommendations either at the meeting, by post or by email.

2.3.10 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:

2.3.10.1 The adviser;

2.3.10.2 Assessment of customer needs;

2.3.10.3 Advice received; and

2.3.10.4 Documentation/sales literature.

2.3.11 The mystery shopping appointments were conducted between 1 March and 31 May 2010. The appointments were held with only one or two financial advisers from each business and therefore may not be indicative of the general standard of a firm's sales process.

Research limitations

2.3.12 The project was required to complete a minimum of 12 to 15 mystery shops from a list of 18 firms provided by the Commission. In a small island like Jersey the pool of mystery shoppers from which to recruit suitable assessors is limited. In the event, 17 usable mystery shops were completed. This relatively small number of mystery shop interviews makes this a qualitative research project. As such, the findings are not statistically reliable, but where appropriate, the number of instances where an observation is made is noted. The findings provide an overview of the sales process adopted by individual advisers within the firms visited.

3 KEY FINDINGS

This section summarises the key findings from the mystery shopping feedback for the lump sum and health check 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.

The Advisers

This section reviews the activities of the adviser under three main headings:

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;

Commission or fees - considers whether the adviser told the shopper 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;

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

3.1 Introducing the firm

3.1.1 The Codes of Practice state that a registered person "must disclose on its stationery and in advertising material that it is regulated by the Jersey Financial Services Commission".

3.1.2 16 investment business advisers supplied a copy of their Terms of Business and 15 advisers supplied a business card. All Terms of Business documents given to the mystery shoppers disclosed that the Commission regulates the firms.

3.1.3 Two of the 17 firms provided product literature to shoppers. One brochure, for one of the investment business own products, did not disclose that the Commission regulates the firm.

3.1.4 Whilst it is no longer a requirement to inform shoppers verbally, six firms did explicitly state that they are regulated by the Commission.

3.1.5 Five of the 17 firms told the mystery shoppers something about their firm and the services offered. In other cases the shopper was directed to the Terms of Business document for a description of the firm.

3.1.6 In some instances, whilst the adviser provided a Terms of Business, they played down the relevance and importance of the document.

> **"...and that's our Terms of Business, for what it's worth."**
>
> *Health check scenario*

> **"It will be very boring, but it will explain what we do..."**
>
> *Lump sum scenario*

3.1.7 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, other than in one instance where the adviser noted that any product they recommend would firstly have to be quality assessed by an internal department of their organisation.

3.2 Commission or fees

3.2.1 None of the advisers informed the mystery shoppers verbally that they could pay a fee for financial services rather than a commission. Without this information, consumers are unable to compare and determine which method of payment is best for them.

3.2.2 The Terms of Business document of 14 firms made reference to the ability to pay by fee rather than commission.

3.2.3 In some Terms of Business documents the wording is not clear in outlining that there is a choice for the mystery shopper, but implies that payment by fee was only available in situations where the adviser would not receive a commission.

> **In circumstances where the work that we undertake does not attract a commission we may make charges to you...**
>
> *Health check scenario*

3.2.4 In other cases, the wording could be taken to read that the payment of a fee is at the discretion of the adviser, not the shopper.

> **Alternatively, we may charge a fee which is then payable by the Client.**
>
> *Health check scenario*

3.2.5 From the transcripts and the Terms of Business documents, overall it appears that the advisers led the mystery shoppers towards commission, whether by refraining to make the shopper completely aware of the fee option or by emphasising the benefits associated with commission based fees.

3.2.6 As an example, in some instances the advisers offered partial rebates where they would forego some of their commission so that the shopper would have more to invest.

> **Allocation Rate = 102.25%. Your allocation has been increased by: 2.25% due to Commission Given Up by your Adviser.**
>
> *Lump sum scenario*

3.2.7 Based on the transcripts, the impact on product charges, if any, of paying a fee for financial services does not appear to have been discussed with the mystery shoppers, nor is it reflected in any of the Terms of Business documents.

3.2.8 Furthermore, none of the advisers explained clearly and explicitly how commission worked, increasing the potential for misunderstanding. As an example, in one case the adviser did not inform the mystery shopper that the product provider would pay the adviser's commission by subtracting it from the shopper's lump sum investment.

> **"[We] will receive from [the product provider] 5%... that is paid by [the product provider]"**
>
> ***Lump sum scenario***

3.2.9 A good example of where an adviser was clear about charges is one instance where the recommendation was for a product provided by the adviser's own firm. Whilst it would have been easy to hide the fact the fees are built into the rate of return of the product, the adviser still ensured the mystery shopper was made aware of and fully understood how the product provider (the adviser's own company) generated their fees.

> **"There is ... an inbuilt cost of 4%. You just don't see it at all because what we tell you, 7.5% [interest] is there for you because it's probably done 7.75%. But no, that is when we take our bit.**
>
> ***Lump sum scenario***

3.3 Impartiality of advisers

3.3.1 In four of the nine lump sum scenarios, advisers demonstrated impartiality (that is, they did not restrict their recommendations to those where they would receive commission/a fee), for example by suggesting to shoppers that they consider paying off existing debt, such as their mortgage, or that they should put some of their lump sum into a savings account.

3.3.2 In one instance during the initial meeting the adviser outlined the view that it would be advisable for the shopper to consider paying off an outstanding unsecured loan. Whilst the shopper did not express an interest in reducing their debt, this advice was not part of the final recommendation received at the second meeting. This may have resulted in the shopper, on the recommendation of the adviser, using their funds in a manner that is not in their best interests.

3.3.3 In the majority of the health check scenarios there was little or no opportunity for an adviser to show impartiality, as the mystery shopper did not have funds to invest. However, in one of the health check scenarios the adviser demonstrated impartiality by advising the shopper to leave any existing cash deposit in place.

3.3.4 A small number of shoppers commented that they felt the focus of the meetings was on the selling of products rather than completely and independently assessing the shopper's financial position and providing recommendations based on their needs.

> **"He asked me how much I could afford... £400...and he seemed eager to spend every last penny of this."**
>
> ***Health check scenario***

Assessment of customer needs

This section presents the results of the fact finds that were conducted. It explores:

Assessment of financial situation - the completeness of these assessments and whether there was a difference between the lump sum and health check scenarios in terms of the thoroughness of the assessment of the financial situation conducted;

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

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

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

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

3.4 Assessment of financial situation

3.4.1 The Codes of Practice state "where a registered person is responsible for providing advice to or exercising discretion for its clients, it must obtain, document and maintain any information about the circumstances (both financial and otherwise) and investment objectives of the client that are relevant to the services to be provided."

3.4.2 The depth of the assessment made by the advisers varied. In the majority of the mystery shopping interviews, the adviser collected information on the shopper's household financial situation and financial products held during the first interview or, in two cases, the adviser asked the mystery shopper to complete the fact find in advance.

3.4.3 In one instance the adviser asked the shopper to complete the fact find after the recommendation had been made and in another case there was no assessment of the shopper's financial situation other than to determine the value of the lump sum.

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

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

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

3.4.4.3 Health status (smoker/non smoker, general fitness).

3.4.5 In addition, eight shoppers were asked if they had a will. In four instances where the shopper either had no will, or their personal circumstances had changed since it was written, they were advised to think about writing or updating their will.

3.4.6 Limited fact finding of the mystery shopper's financial situation took place in two of the lump sum investment scenarios and in two of the health check 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.

3.4.7 From the transcripts, it appears that during the fact find, only four advisers undertook a comprehensive assessment of the shopper's total income and total expenditure, that is to say that both income and outgoings were itemised. In a further eight cases, the adviser only partially assessed this by asking a general question to ascertain whether total income per month was equal to or greater than total expenditure per month.

> **"…and on a month to month basis ... you get by? Ends meet nicely?"**
>
> ***Lump sum scenario***

3.4.8 All but one of the advisers established, either directly or indirectly, whether the shopper had a mortgage. However seven of the shoppers were not asked if they had any loans, other than a mortgage. Furthermore where the adviser asked about other loans, in some cases the generic nature of the advisers' questions meant that shoppers might not have realised that they were also referring to things like outstanding credit card balances or bank overdrafts in addition to secured lending.

> **"...so no borrowing at all now?"**
>
> ***Lump sum scenario***

3.4.9 Where the adviser does not fully assess the shopper's level of debt, it increases the risk that the product recommendation is unsuitable for the shopper's current financial circumstances. For example, the adviser may recommend an investment of the lump sum when it would have been more beneficial for the mystery shopper to reduce their debt burden. Furthermore, unless the adviser picks up on any associated loan repayments and/ or charges in an assessment of the shopper's outgoings, there is a risk that the affordability of the product(s) recommended is not appropriate to the mystery shopper.

3.4.10 A number of mystery shoppers noted that they felt the advisers concentrated on certain products rather than assessing the shopper's complete financial situation.

> **"She (the adviser) seemed to jump on the RATS idea and concentrate on that alone."**
>
> ***Health check scenario***

3.4.11 The following two tables (one for each of the lump sum and health check scenarios) show a relative evaluation of the shopper's financial situation as conducted by each adviser. The number of variables assessed by the adviser (as shown in the key) and the comprehensiveness of the assessment of each variable is the basis of the evaluation. The variables are not weighted.

Relative assessment of advisers' assessment of financial situation Lump sum scenario			
Company name	**H**	**M**	**L**
Firm A		✓	
Firm B	✓		
Firm C			✓
Firm D	✓		
Firm E	No evidence of an assessment		
Firm F		✓	
Firm G		✓	
Firm H		✓	
Firm I		✓	

Relative assessment of advisers' assessment of financial situation Health check scenario			
Company name	**H**	**M**	**L**
Firm J			✓
Firm K	✓		
Firm L	✓		
Firm M		✓	
Firm N	✓		
Firm O	✓		
Firm P			✓
Firm Q	✓		

Key:

High (H) – the adviser obtained a high level of information including most, if not all, of the following: personal details (individual and household), income and expenditure, financial products held, emergency funds held, loans, will written.

Medium (M) – the adviser obtained a medium level of information including some of the following: personal details (individual and household), income and expenditure, financial products held, emergency funds held, loans, will written.

Low (L) – the adviser collected a low level of information, generally restricted to some personal details and existing financial products held.

3.4.12 Whilst these findings indicate that a generally comprehensive assessment of the shoppers' financial situation took place in most cases, it does highlight a marked difference between the two scenarios. The results indicate that a shopper is more likely to receive a review that encompasses their entire financial situation and consequently receive a more informed recommendation when they request a financial 'health check'.

3.4.13 The results may also suggest that where a shopper informs the adviser that they have a lump sum to invest, the lump sum investment becomes the focus of the adviser's attention and the shopper's wider financial circumstances are not properly considered. Whilst a shopper may be specifically asking for investment advice in respect of a lump sum, advisers should still assess the shopper's financial situation, as it may not be in the best interests of the shopper to invest all of the funds.

3.5 Affordability

3.5.1 Ten of the advisers enquired as to whether the shopper had emergency funds/'rainy day' money. Some advisers recommended that the shopper should consider holding a specific figure in an instant access account, e.g. £5,000, but gave no explanation as to why they deemed the given figure to be appropriate.

3.5.2 Other advisers allowed the shopper to make their own judgement as to whether the money they had put aside was sufficient for their needs and in only one case did an adviser provide a basis for this recommendation.

> **"…my general advice would be to keep back about six month's expenses, expenditure as a safety net."**
>
> ***Health check scenario***

3.5.3 A comparison between the two scenarios shows that two thirds of advisers asked about emergency funds in the lump sum scenario, whereas only half of those in the health check scenario did so. This is somewhat surprising given the very nature of a financial health check, as one would expect emergency funds to be a key element of a shopper's financial 'health'.

3.6 Attitude to risk

3.6.1 In 12 of the mystery shopping interviews, the advisers spent time exploring with the shoppers their attitude to risk. The most common method used was to ask the shopper to complete a questionnaire to ascertain a risk rating based on the answers given. The comprehensiveness of the risk assessments varied widely across the shops from the use of independent online risk assessments to relatively simple methods, such as asking the shopper what their attitude to investment was on a scale of 1 (cautious) to 5 (speculative).

3.6.2 Based on the transcripts, in five of the mystery shops, no risk assessment was made.

3.6.3 In one instance, the shopper completed the risk assessment after the adviser made the product recommendations to the shopper. As a direct consequence the products recommended were low risk, but the results of the shopper's assessment ascertained that the shopper would be more inclined to invest in medium risk products.

3.6.4 In another case, the shopper completed a risk assessment questionnaire resulting in a low risk profile for the shopper. The shopper queried the rating with the adviser, expressing the opinion that they saw themselves as having a more 'moderate' attitude to risk. The adviser was happy to change the shopper's risk assessment upon which recommendations were then made. Where recommendations are not based on an assessment of the shopper's attitude to risk, but rather the shopper's own perception of their attitude to risk, this could result in the recommendation of products that are unsuitable for the shopper.

3.6.5 Many firms, even whilst using a risk assessment questionnaire, did not adequately explain investment risk to the shoppers. This is supported by comments made by mystery shoppers.

> **"The adviser did not explain to me the different types of risk awareness, just let me complete the questionnaire"**
>
> ***Health check scenario***

3.6.6 There were also a number of instances where the adviser's explanation of risk were likely to cause misunderstanding and had the potential to confuse or mislead the shoppers.

> **"How can I explain it [high risk]? ...if you buy something in the sales, there is more of a chance there is going to be something wrong with it."**
>
> ***Lump sum scenario***

3.6.7 In another instance, the adviser outlined the greater potential return of more risky products, but omitted to tell the shopper that consequently these products also carry a greater potential for loss.

> **"Generally speaking, the higher the risk, potentially the higher the gain."**
>
> ***Lump sum scenario***

3.6.8 However, from the transcripts, there were some good examples of the advisers clearly explaining risk, the relationship between risk and reward and, as shown in the example below, the benefits of a diversified portfolio.

> **"...the more diversified you are making it [the investment] the less the risk is to your money, because you are not putting all your eggs into one basket."**
>
> ***Lump sum scenario***

3.7 Financial objectives

3.7.1 The assessment of the financial objectives of the lump sum investment scenario shoppers was generally limited and in a number of cases the adviser assumed the shopper wanted capital growth, as opposed to an income from the investment. In most cases the adviser assessed how long the shoppers were prepared to invest their money for without having access to it, but there were a number of advisers who recommended a length of time and did not gain clarification from the shoppers that they were comfortable with the time period.

3.7.2 In only one instance did an adviser discuss the capital growth aspirations of the shopper to determine what growth meant to the shopper and whether their expectations were realistic.

> **"So you are effectively just looking for a return above inflation...sort of around 5 [or] 6%. You are not chasing 10%... "**
>
> *Lump sum scenario*

3.7.3 Whilst many advisers discussed with the shopper the potential impact of a change in circumstances, it was generally restricted to providing cover for events outside of the shopper's control, for example life assurance in the event of their death, rather than the shopper's aspirations for the future.

3.7.4 Seven advisers discussed with the shoppers their plans for the future and how their financial priorities may need to change now to allow their future plans to be achieved. However, these discussions generally centred on plans for retirement and children going to university.

> **"..if you are looking at paying ... university fees, I know they are babies now, but doing something now makes it possible then."**
>
> *Lump sum scenario*

> **"Is there anything that you need to save for in the future?"**
>
> *Health check scenario*

3.8 Other findings

3.8.1 None of the mystery shoppers were asked to conduct their interviews on an 'execution only' basis, that is, no shopper was asked to sign a statement to say that they received no advice and that their investment decision and/ or product selection was made of their own volition.

3.8.2 The table below shows that the proportion of advisers who requested a second (or third) meeting with the shopper was just over half of all mystery shops. The benefits of holding at least a second interview include allowing the adviser sufficient time to make a considered recommendation, allowing the adviser to explain the recommendation to the shopper and to give the shopper the opportunity to consider and to ask questions about the recommendation.

	One meeting	**Two meetings**	**Three meetings**
Lump sum scenario	3	5	1
Health check scenario	5	3	-
Total	**8**	**8**	**1**

Advice received

This section presents the findings relating to specific areas that were identified during the fact finding process and includes:

Financial needs identified - explores whether the advisers identified financial needs, other than to invest funds;

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;

Consistency in lump sum recommendations – considers any similarities in the recommendations given by the advisers in the lump sum scenario;

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

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

3.9 Financial needs identified

3.9.1 The transcripts of the mystery shops show that in only one lump sum scenario did the adviser make a recommendation that related to the financial needs of the shopper generally, other than solely in relation to the investment of the lump sum. This may have been because the shoppers in the lump sum scenario did not require any other financial products, however the results shown in section 3.4 suggest that it is more likely a consequence of the lack of a comprehensive assessment of the shoppers' financial situations.

3.9.2 In comparison, the table overleaf shows the products recommended to mystery shoppers who requested a health check. The results suggest that where a shopper has a lump sum of cash, the advisers generally focused on advice in respect of the lump sum, perhaps to the detriment of the shopper's wider financial situation and needs.

3.9.3 There was further evidence that advisers tended to focus on lump sums. In one health check scenario, the shopper had a relatively small lump sum held in a low interest account. The adviser's recommendations focussed solely on these funds and did not include any advice to purchase any other products. This was the only adviser in the health check scenarios not to recommend other products.

3.9.4 Given the ability of advisers to generate further income from reviewing a shopper's total needs rather than just the assessment of a lump sum investment, it is difficult to understand why they are not conducting a fuller assessment of needs. It may be due to a perception that the benefit versus the cost of advising on a lump sum is greater than that of conducting a health check.

3.9.5 The table below shows the financial needs considered and recommended in the health check scenario. It does not attempt to make an assessment on whether the advice was suitable.

	Pensions	**Critical Illness**	**Life Assurance**	**Income Protection**
Firm J	C	N	N	N
Firm K	R	R	R	R
Firm L	C	R	R	N
Firm M	C	R	R	C
Firm N	R	R	R	C
Firm P	R	C	C	N
Firm Q	R	N	C	C

Key:

N = Not Considered: The adviser did not consider whether the product would be appropriate for the shopper.

C = Considered: The adviser considered whether the product would be appropriate for the shopper, but made no recommendation to purchase.

R =Recommended: The adviser considered whether the product would be appropriate for the shopper and recommended that the shopper should consider purchasing the product.

3.9.6 Other than to generally consider current pension arrangements, three advisers made a recommendation to specifically change an existing product. In all three cases the advice was to replace existing life assurance cover with policies that included an element of critical illness cover, the rational being that their current life assurance plans only pay out on death, but that it would be more beneficial to have a product that paid out on both death or upon the diagnosis of a critical illness.

3.9.7 The Commission identified that one of the areas of interest was on advice that shoppers may receive in relation to their mortgage. Set out below is the advice, if any, received by shoppers in relation to a mortgage in both the lump sum and health check scenarios.

3.9.8 At the time of the visits, the Bank of England base rate was at an all time low of 0.5%. Many people with mortgages with interest rates that track the base rate will have experienced a considerable reduction in their monthly repayments, since the rate began to fall from 5.25% in October 2008. Those individuals may consequently have experienced an increase in their disposable income per month and be faced with a decision on how to use it.

3.9.9 Seven of the mystery shoppers had a mortgage. The others shoppers were either renting property or owned their property mortgage free.

3.9.10 One of the shoppers had an outstanding mortgage of approximately £180,000 on a fixed rate of interest with two and a half years of the term remaining. The adviser recommended that they put £24,000 into a two year fixed term deposit account to allow for the option of reducing the balance of the mortgage once the fixed term had expired. This shows impartiality on behalf of the adviser as they would not generate any commission on the basis of this recommendation.

3.9.11 Conversely, one mystery shopper was advised not to use their lump sum to reduce the outstanding balance of their mortgage on the basis that mortgage rates at the time of the meeting were historically low. However, it appeared from the transcripts that the adviser made this suggestion without ascertaining the interest rate that the shopper was paying on their mortgage. Without determining the interest rate of the mortgage the adviser could not have assessed whether it was better to pay off the mortgage or invest the lump sum.

> **"...it doesn't make financial sense to pay the mortgage off because you are borrowing on the cheap at the moment..."**
>
> ***Lump sum scenario***

3.9.12 One adviser asked the mystery shopper whether they had considered the option of reducing their mortgage. The mystery shopper advised that they did not want to use their lump sum to do so. Advice surrounding the potential reduction of the outstanding mortgage balance did not feature in the adviser's recommendation. This means that the adviser may have been making recommendations on the wants of the mystery shopper rather than what was best for the shopper financially.

3.9.13 Another example of impartiality was shown in one of the health check scenarios where the mystery shopper held £30,000 in premium bonds and indicated that they were looking to purchase a property in the near future. The adviser informed the mystery shopper that whilst this was not the best place to generate a return, given the future plans for the funds, it was probably not worth looking to move the funds.

> **"...it is your wish along with your partner to purchase a property in the not too distant future and whilst the £30,000 will not be enough, I understand that your partner also has some monies which will help to serve as a deposit for a mortgage facility and it is probably best not to disturb this at present."**
>
> ***Health check scenario***

3.9.14 In another health check scenario, the mystery shopper outlined their plans to move to a larger property. The shopper also noted that their monthly income exceeded their expenditure by approximately £1,000. The adviser recommended that the shopper look to reduce their existing debt in the short term to increase flexibility when the time came to obtain a larger mortgage.

> **"You mentioned that you were planning to move, although not within the next 3 years. In order to facilitate additional lending it would be sensible to reduce the debt of the mortgage - therefore increasing equity... Bearing in mind the interest levels on the personal loans are higher than the mortgage, I would suggest clearing them first."**
>
> ***Health check scenario***

3.9.15 In the one instance where a shopper had a mortgage the adviser established the shopper's current interest rate and expressed the opinion that it was "not bad", presumably in comparison to interest rates available on the market and made no further mention of it. In similar circumstances, the adviser enquired as to the outstanding balance and remaining term of the shopper's mortgage as part of the fact find, but made no comment at the time or in the recommendation.

3.9.16 In one instance where the shopper owned a property but was mortgage free the adviser suggested that the mystery shopper should consider downsizing or remortgaging the property to generate funds to meet their financial needs.

3.10 Rationale given for final product recommendations

3.10.1 Whilst the vast majority of shoppers believed the advice was appropriate to their needs and circumstances, one must bear in mind that this is only their perception of the advice received. From reviewing the transcripts it is apparent that in only three of the nine lump sum scenarios did the adviser explicitly outline that their product recommendation was made taking into account the shopper's risk profile, financial objectives and the period that they were willing to invest for without accessing their money.

> **"..., this product is recommended as you require capital growth over the medium to long term and are prepared to take some risk with the original capital in order to achieve better potential returns than at present."**
>
> ***Lump sum scenario***

> **"..., [the product] meet[s] your requirements in terms of protecting your investment against loss, exposing you to lower levels of risk, while supporting your desire for capital growth with periodic access to capital. "**
>
> ***Lump sum scenario***

3.10.2 In general, the advisers outlined the additional benefits relating to the product recommendation to the shopper where applicable. These included:

3.10.2.1 Commission rebate (where the adviser would not take the full commission available from the product but would 'refund' a proportion of it to the consumer);

3.10.2.2 No exit penalties/charges;

3.10.2.3 Free switches;

3.10.2.4 Easy access to money; and

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

3.11 Consistency in lump sum recommendations

3.11.1 The below analysis provides a comparison of the recommendations made by the advisers for the investment of funds, or otherwise, in the lump sum scenario. Financial needs identified, for example protection products, are covered in section 3.9.

Company name	Product recommendation(s)	Reason for recommendation
Firm A	£110,000 in a fixed term deposit (6 yr); or (no risk to capital)	Investment recommended on the basis of term willing to invest and capital security.
	£110,000 in a fixed term deposit (6 yr) (low risk to capital)	Investment recommended on the basis of term willing to invest and a low level of risk to capital.
	£10,000 to remain in cash	For possible short term cash requirements.
Firm B (Shopper stated amount to invest was £148,000)	£28,000 to pay-off unsecured loan	To clear debt.
	£5,000 in a deposit account	To be held as emergency funds.
	£100,000 in an investment bond	Investment recommended on the basis of the shopper's medium to low risk rating.
	£15,000 in a collective investment account	Investment recommended to provide a better return than deposit accounts, whilst maintaining accessibility to the funds.
Firm C	£66,000 in two 'growing up' bonds	Investment recommended to provide funds for supporting future plans for children's university education.
	£30,000 in an investment bond	Investment recommended on the basis of being a medium term investment.
	£24,000 in a deposit account	Recommended to allow for an element of outstanding mortgage debt to be paid off after fixed rate term expires.
Firm D	£100,000 in an investment portfolio / fund of funds	Investment recommended on basis of medium risk rating.

Company name	Product recommendation(s)	Reason for recommendation
	£20,000 in an instant savings account	To be held as emergency funds.
Firm E	£120,000 in a fixed term deposit (3.5 yr); or	Investment recommended on basis of capital security.
	£120,000 in a fixed term deposit (5 yr)	Investment recommended on basis of capital security.
Firm F	£60,000 in an investment bond / flexible investment plan	Investment recommended on the basis of low level of risk, desire to grow capital and periodic access to funds.
	£60,000 in an investment portfolio / fund; or	Investment recommended on the basis of low level of risk, desire to grow capital and periodic access to funds.
	£20,000 in an investment fund (by reducing investment in other products)	Investment recommended as an option if the shopper wanted to maintain access to some funds without penalty.
Firm G (Shopper stated amount to invest was £55,000)	£55,000 in an investment fund	Investment recommended to provide a potentially better return than current deposit account and to guarantee capital.
Firm H	£120,000 in an investment Portfolio / fund	Investment recommended to allow level of risk taken to be flexible over time and access to funds unrestricted.
Firm I	£100,000 in an investment bond	Investment recommended to provide capital growth over the medium to long term based on shopper's risk appetite.
	£20,000 in an investment fund	Investment recommended to provide flexibility in terns of access to funds

3.11.2 The analysis above shows that in three of the nine mystery shops the advisers' recommendation included alternative investment options for the shopper. In one shop the alternative provided to the shopper was a choice based on the length of time they were willing to invest, in another the shopper was required to decide whether they were willing to accept an element of risk to their capital and in the third instance an additional investment option was recommended if the shopper wanted to have access to their funds without incurring a penalty charge.

3.11.3 In only three instances did the adviser recommend that the shopper place all of the lump sum into a single investment. In all other shops the adviser recommended shoppers to either split their funds between products, place a proportion of their money in a deposit account and / or to reduce existing debt.

> **"First of all I would say keep a little bit [of the funds] back as an emergency [sic]... It is always a good idea that if you need to sort of get to you know, a few hundred pounds or a thousand pounds whatever, that you can call on it from really instant savings."**
>
> ***Lump sum scenario***

3.11.4 All but one of the advisers supported their recommendation with some form of explanatory literature, such as product prospectuses and key facts documents. In the one instance where the adviser did not provide supporting material, it was stated that a meeting would be arranged with an investment manager once the shopper had made a decision to invest the funds.

> **"When you are ready to progress the preparation of a home for these funds I will arrange a meeting with [the investment manager]"**
>
> ***Lump sum scenario***

3.11.5 Seven advisers provided the mystery shopper with a personal illustration for at least one of the products they were recommending. Personal illustrations help shoppers to understand how the terms and conditions of the product specifically apply to their money. For example, fees and charges are shown in pounds as they will apply to the shopper's lump sum, rather than being expressed as a general percentage of any investment amount. Where shoppers are not provided with personal illustrations, it increases the risk that shopper will not fully understand the product before investing.

3.11.6 An analysis of the products recommended in the health check scenario is shown in section 3.9.

3.12 Clarity of product explanations

3.12.1 The following table shows the shoppers' perception of the clarity of the advisers' product explanations in the lump sum scenario.

Company name	Risks, penalties and charges made clear	Fully understood product explanation
Firm A	✓	✓
Firm B	✓	✗
Firm C	✓	✓
Firm D	✓	✓
Firm E	✓	✓
Firm F	✓	✓
Firm G	✓	✗
Firm H	✓	✓
Firm I	✓	✓

Source: Mystery Shopper feedback

3.12.2 All but one of the mystery shoppers who carried out the lump sum scenario thought that the risks, penalties and charges associated with the products being recommended were clearly explained. However from the transcripts in some cases it does not appear that the advisers discussed these with the shopper and on that basis one must assume that at best, details were included in supporting literature or at worst that the shopper only assumed that they had been made aware of all risks, penalties and charges.

3.12.3 Only two of shoppers noted that they did not fully understand the adviser's explanation of the recommended product(s).

> **"I did not fully understand as I did not understand how the investment would be split"**
>
> ***Lump sum scenario***

> **"I did not understand the product."**
>
> ***Lump sum scenario***

3.12.4 The following table shows the shoppers' perception of the clarity of the advisers' product explanations in the health check scenario.

Company name	Risks, penalties and charges made clear	Fully understood product explanation
Firm J	✓	✓
Firm K	✗	✗
Firm L	✗	✓
Firm M	✓	✓
Firm N	✗	✓
Firm P	✓	✓
Firm Q	✓	✓

Source: Mystery Shopper feedback

3.12.5 Of the seven shoppers who carried out the health check scenario and received a recommendation, three stated that they either did not fully understand, or that the adviser did not inform them about the risks, penalties and charges associated with the products.

> **"He (the adviser) did not mention any fees or costs associated with the product..."**
>
> ***Health check scenario***

3.12.6 One shopper, who was recommended a life assurance with critical illness protection product, was the only shopper to state that they did not fully understand the product they would be buying.

> **"I understood what the product covered i.e. illness, death. But it wasn't explained what I would receive if a claim was to be made."**
>
> ***Health check scenario***

3.13 Other information

3.13.1 In only one instance did an adviser in the lump sum scenario specifically state that the advice they were giving was solely in relation to the lump sum investment. In the other results, no mention was made as to whether advice was full advice, i.e. taking into account the mystery shopper's complete financial circumstances, or was limited to advice on the best use of the lump sum.

> **"...this report is purely based on you investing a lump sum of money. Nothing else."**
>
> ***Lump sum scenario***

3.13.2 In the lump sum scenarios six of the advisers recommended that the shoppers split their lump sum between a number of investments and/or debt reduction and/or rainy day funds. However it was apparent in a number of cases that the adviser did not explain the reasons for the split of the funds.

3.13.3 One adviser recommended that the mystery shopper place £24,000 into a two year fixed term deposit account to allow for the option of reducing the balance of their existing mortgage once its fixed term had expired. The advisor provided no rationale for why a figure of £24,000 was recommended, as opposed to £54,000 which was available after the main needs of the shopper had been addressed. The mortgage was considerably in excess of £54,000.

3.13.4 In another instance, the adviser gave no explanation as to why it was recommended that the shopper split their lump sum equally between two similar products, even noting that the recommendation for the second product was "for the same reasons" as the first

Documentation/sales literature received

This section reviews the level and appropriateness of the product literature received and includes:

Suitability letter - comments on the format and content of the letter and how quickly they were sent out to the shoppers or whether one appears to have been provided to the mystery shoppers;

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.

3.14 Suitability letter

3.14.1 The Codes of Practice state that *"where a registered person is responsible for providing advice or exercising discretion for its clients, it must be able to demonstrate in writing that the advice or exercise of discretion is suitable for that client having regard to:*

- *The facts disclosed by that client;*
- *The terms of any agreement with that client; and*
- *Any other relevant facts about the client of which the registered person is, or reasonably should be, aware."*

3.14.2 The Codes of Practice state that *"where a registered person is responsible for providing advice it must make available to its client, in a comprehensive and timely manner, appropriate information so as to allow the client to make an informed investment decision."*

3.14.3 At the time of writing this report, eight out of the 16 firms where the adviser made a recommendation, had sent suitability letters to the mystery shoppers. Only one shopper experienced difficulty in obtaining a recommendation in a timely manner, and needed to call the adviser on more than one occasion requesting it.

> **"..I was not sure whether I was or was not going to receive any recommendations or follow-up advice in the post. This eventually arrived a few days later after much chasing of the adviser."**
>
> ***Health check scenario***

3.14.4 The format and content of the letters received by the shoppers ranged from firm to firm, from comprehensive formally bound and structured reports to, in one instance, a short informal email outlining the recommendation. The more formal suitability letters included:

3.14.4.1 an outline of the shopper's current financial position;

3.14.4.2 an outline of the shopper's attitude to risk;

3.14.4.3 an outline of the shopper's financial objectives, including liquidity requirements;

3.14.4.4 product recommendation(s);

3.14.4.5 information on the products, such as key facts documentation;

3.14.4.6 information regarding associated risks; and

3.14.4.7 information on associated costs and fees.

3.14.5 The clarity of the letters varied in terms of the linkage between the shoppers' needs, attitude to risk and, where applicable, length of time they were willing to invest. Only four of the letters explicitly stated why the adviser was recommending the products in relation to these variables.

> **"..., this product is recommended as you require capital growth over the medium to long term and are prepared to take some risk with the original capital in order to achieve better potential returns than at present."**
>
> ***Lump sum scenario***

3.14.6 Other letters were less explicit and referred either to the shopper's needs or their attitude to risk, but not both.

3.14.7 In one instance, the shopper had not completed a risk assessment, nor had the adviser established how long the shopper was willing to tie up their funds. As a direct consequence, the adviser's recommendation and explanation of the suitability of the product could not have been based on the shopper's risk profile and therefore may not have met the shopper's needs and objectives. However, the suitability letter outlined a recommendation based on a risk profile.

> **"If you could consider taking a medium term view of these monies, I will recommend funds based on your risk profile which could potentially provide a better return."**
>
> *Lump sum scenario*

3.14.8 Only four of the eight suitability letters referred to charges and fees associated with the recommended product(s), with only two of these explicitly stating them in the letter as opposed to referring the shopper to supporting literature, thus leaving room for misunderstanding and/or error as the shopper would be required to calculate charges and fees themselves.

3.15 Other documentation

3.15.1 Only one of the 17 mystery shoppers did not receive a Terms of Business document from the adviser they visited.

3.15.2 All except one of the mystery shoppers received some form of associated sales literature from the adviser visited.

3.15.3 Information provided to the shoppers included key facts documents, product comparison tables and other explanatory product provider material. Seven mystery shoppers received a personal illustration for at least one of the products the adviser was recommending.

3.15.4 In general the mystery shoppers commented positively on the sales literature they received. The shoppers were most complimentary where the products were described in a non-technical manner and where they were supported with illustrations.

> **"The literature I received was clear and customer friendly. The print was large enough and... the text was combined with tables, graphs and pictures, which made it easier to understand the subject."**
>
> *Lump sum scenario*

3.15.5 Conversely, comments were less positive where the product descriptions were not presented in a customer friendly manner.

> **"...The...documents were very well presented but difficult to understand if you did not know anything about investments and bonds. There were plenty of graphs and charts but ... the figures were tiny and almost impossible to read."**
>
> *Lump sum scenario*

Other findings

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

3.16 Observations from mystery shoppers

3.16.1 Four of the seventeen mystery shoppers noted some difficulty with arranging their initial appointment. The reason for the mystery shoppers' dissatisfaction in general was that the person answering the phone at the bank or investment firm was unable to deal with their request to arrange an appointment. The mystery shoppers who experienced difficulty were advised that they would receive a call-back to arrange the appointment and were unhappy with the time taken to receive a call-back. In one case their call was not returned.

> **"...I was told that someone from the local branch would contact me and make an appointment, but no one did."**
>
> ***Lump sum scenario***

4 CONCLUSION

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.

4.1 Performance of the advisers

4.1.1 The transcripts indicate that advisers need to improve the manner by which they inform consumers about their firm. Advisers should talk consumers through the services they offer rather than directing them to read a Terms of Business document which they may not read until after the first appointment, if at all.

4.1.2 Advisers should ensure that they make consumers aware of the option to pay for their services by means of an hourly or fixed fee and the impact this will have on the charging structure of the products purchased. Firms should not rely on consumers reading their Terms of Business documents to make them aware of this. Furthermore the wording contained in the Terms of Business documents should be of sufficient detail and clarity to enable the consumer to make an informed decision about how they wish to pay for products and services.

4.1.3 Advisers should explain clearly and in detail how they generate their income. Where the adviser does not outline how commission or charges are derived explicitly, the consumer may misunderstand and become confused when deciding whether to pay for products and services by a fee or a commission based payment method.

4.2 Assessment of customer needs

4.2.1 The Codes of Practice require advisers to document information about the circumstances (both financial and otherwise) and investment objectives of the client. Many firms need to increase the comprehensiveness of their fact finding. Where an adviser does not complete a comprehensive fact find it considerably reduces their ability to make suitable recommendations based on the consumer's financial circumstances and needs.

4.2.2 Likewise, advisers must undertake their fact finding at the appropriate time. If the adviser does not complete their fact finding before making recommendations, regardless of how comprehensive it is, the recommendations are likely to be inadequate and/ or inappropriate.

4.2.3 The transcripts indicate that many firms did not carry out a full assessment of the shoppers' monthly income and expenditure. In addition, the exploration of shoppers' unsecured debt, such as credit card balances and overdrafts, remains a gap when assessing a customer's financial position. Without comprehensively assessing the consumer's complete financial position, there is an increased risk that advice will be inappropriate to their needs.

4.2.4 Many advisers ascertained whether the mystery shoppers had money set aside as an emergency fund, or where they didn't, recommended that they set aside an amount as such. However, very few advisers made an assessment of whether the amount of the emergency fund was sufficient for the customer's needs.

4.2.5 There are a number of areas for improvement in relation to assessing customers' risk profiles. Advisers need to make sure that:

4.2.5.1 customers understand what investment risk is;

4.2.5.2 customers understand the relationship between risk and reward;

4.2.5.3 an assessment of a customer's attitude to risk is undertaken;

4.2.5.4 the assessment of a customer's attitude to risk is comprehensive;

4.2.5.5 the assessment of a customer's attitude to risk is made before products are recommended; and

4.2.5.6 risk assessments are not changed to fit with the customer's own perception of his attitude to risk.

4.2.6 Advisers should not assume that, where a customer has a lump sum to invest, they want capital growth as opposed to an income. In addition, an adviser's assessment of financial objectives needs to include the shopper's future life plans, such as starting a family or the intention to move to a larger property. Without fully assessing these plans, there is a risk that the adviser will provide inappropriate advice, for example locking funds away in a long term product, when there will be a need for the funds in the short to medium term.

4.3 Financial advice received

4.3.1 There was a marked difference between the two scenarios in respect of the financial advice received. Only one lump sum scenario shopper was advised to purchase a financial product in addition to advice on the investment of their lump sum. In comparison, all shoppers except one in the health check scenario were advised to purchase financial products. This suggests that where a shopper has a lump sum, advisers focus on the investment of it and not on the wider financial needs of the shopper, which consequently could result in needs not being identified and addressed.

4.3.2 In certain circumstances an adviser may give advice solely in relation to a lump sum. However, it was apparent from the transcripts that only one adviser made it clear to the shopper as to whether limited or full advice was offered. This could lead to shoppers' needs not being addressed.

4.3.3 There is room for improvement with regard to how advisers explain the rationale for their product recommendations. So that shoppers fully understand why an adviser has recommended a product, recommendations need to be clearly explained and explicitly linked, where applicable, to the customer's financial circumstances, their attitude to risk, their investment (or other) objectives and the time they are willing to invest for. Furthermore, where funds are split between one or more products, not only should the adviser outline the reasons for recommending each product, but they should also outline the reasons for split.

4.3.4 Seven advisers provided shoppers with personal illustrations for at least one of the products they were recommending. Firms should look to provide shoppers with this information to further improve their understanding of the products by showing them how variables such as fees, charges and interest, apply to the shopper's funds.

4.3.5 Nearly half of the shoppers had only one meeting with their adviser. The adviser either made recommendations at the end of the first interview or sent the recommendations to the shopper via post or email. Holding more than one meeting with a shopper increases the likelihood of the advice being appropriate by:

4.3.5.1 Increasing the amount of time an adviser has to consider the information collected during the fact find;

4.3.5.2 Increasing the likelihood that the shopper fully understands the recommendations as a result of having them explained to him in person; and

4.3.5.3 Allowing the shopper the opportunity to seek further clarification on any areas of the advice.

4.4 Documentation/sales literature

4.4.1 There was an increase in the number of shoppers that received suitability letters in this review (eight out of sixteen) in comparison to the results shown in the last report (two out of thirteen). However there is still room for improvement as only half of the shoppers had received a suitability letter at the time of writing this report.

4.4.2 The above observation refers only to the number of suitability letters received. From a review of the letters received by the shoppers, it is apparent that the quality and content also represent an area for development. Examples of best practice can be found in section three of the guidance note on the 'Suitability of Advice' issued by the Commission.

4.4.3 Where a consumer receives a suitability letter that follows the principles set out in the Commission's Guidance Note, they should not only be more well informed about the adviser's recommendations and why they are appropriate to them, but it also allows them the opportunity to identify any areas that they would like to question or discuss in more detail with the adviser.

APPENDIX A – MYSTERY SHOPS COMPLETED

The following table shows the scenario and number of visits carried out by shoppers for each of the investment businesses on the list of companies provided by the Commission. Below the table are comments in relation to two of the investment businesses.

Company	Scenario	No. of Meetings
Firm A	Lump sum	1
Firm B	Lump sum	3
Firm C	Lump sum	2
Firm D	Lump sum	2
Firm E	Lump sum	2
Firm F	Lump sum	2
Firm G	Lump sum	1
Firm H	Lump sum	1
Firm I	Lump sum	2
Firm J	Health check	2
Firm K	Health check	1
Firm L	Health check	1
Firm M	Health check	2
Firm N	Health check	1
Firm O	Health check	2
Firm P	Health check	1
Firm Q	Health check	1
Firm R	Health check	1

Firm O: The shopper completed only the first interview with the adviser because they felt uncomfortable about having to provide documentary evidence of the products they held. The Commission has included information from this shopper on the basis of the first interview only. As the adviser requested a second meeting and it was the shopper that declined, where the number of interviews undertaken has been analysed, this has been included as two.

Firm R: The mystery shopping report was deemed unusable for the purposes of the exercise, as the shopper stated at the first interview that they wanted to generate funds for a particular purpose rather than requesting a 'health check' of their current financial position.