NEXTWEALTH

CONSUMER DUTY IMPLEMENTATION GUIDE

3. How are advice firms evidencing and monitoring good outcomes?

AEGON

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Foreword from Aegon

The new Consumer Duty heralds in a whole new world of regulation across retail financial services. The new regulations and guidance are very wide ranging, touching all parts of our industry, but critically, often in very different ways. It will be essential for success that as an industry we work together, collaborating across the distribution chain. At Aegon, we're committed to working closely with advisers. It's only through that collaboration that the new Consumer Duty will deliver to its full potential, delivering benefits not just for consumers but for our industry.

As we approach the 31 July deadline, we know firms are working hard to deliver on implementation plans. Along the way, many questions are arising, with answers often open to different interpretations. So, it's really important to know not just what the FCA rules say, but also how peers across sectors of the industry are responding.

This is why we commissioned NextWealth to produce three guides around key elements of the new Consumer Duty. Importantly, we wanted NextWealth to share what they're hearing from advisers, including where and how business models or processes are changing as a result of the new Consumer Duty. In many regards, the actual advice itself may not have to change hugely – but the framework around that, including the evidence of good outcomes, will definitely have to change. We also believe NextWealth's insights into consumer thoughts, for example on the value of adviser services are also very enlightening and could help advisers improve how they position their services and explain their value.

This guide focuses on how advice firms can evidence and monitor good outcomes. As you'll read, designing the right suite of MI to suit the nature of the firm's business might not be easy. But gaining insights from clients as well as learning from market data could help advisers to not just demonstrate compliance with the Consumer Duty but also to build an even more relevant and valued service for their clients.

I've found it fascinating to read these guides. They give real insights into adviser and consumer thoughts. Not everything here represents Aegon's view, but that's not the point - You can read our thoughts on our new Consumer Duty adviser hub – aegon.co.uk/consumer-duty

If I were to add one comment to go with these guides, I'd point to something the FCA said recently in its paper on implementation. And that's 'avoid complacency'. It's really important that all of us, whatever role our firm plays, really asks ourselves if there's more we can do to deliver good customer outcomes.

I do hope you find these guides of interest.

Steven Cameron
Pensions Director, Aegon UK

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This is the third in our series of three guides helping advisers think through the challenges and opportunities in implementing changes in line with the new Consumer Duty rules.

The series shares insights from in-depth interviews with advice firms and advised clients, to explore how advisers are currently approaching these topics within their businesses and the changes they plan to introduce.

The new Consumer Duty rules are designed to increase the level of protection available to consumers and sets new expectations for the standard of care given by firms. Advice firms need to have implemented the new rules by July 31, 2023, as they relate to any products or services that are open to sale or renewal. The rules will come into force for all closed products or services by July 31, 2024.

The new Consumer Duty has four specific outcomes that the Financial Conduct Authority (FCA) rules relate to:

- Products and services
- Price and value
- Consumer understanding
- Consumer support

All four areas require advisers to monitor and regularly review what their clients are experiencing in practice and to act upon their findings to improve outcomes and avoid harm.

Firms will differ in their range of obligations under the new Duty. For example, a financial planning firm providing holistic services and wealth management to clients on an ongoing basis has more responsibilities in monitoring outcomes and evidencing value, than a firm providing a simple transactional service with no add-ons or ongoing advice fee.

This guide explores the ways in which advisers can ensure they evidence and monitor whether their services and recommendations are meeting the needs of their clients and avoiding foreseeable harm. We look at how firms are collecting and evidencing 'soft' data as well as hard facts, the frequency of suitability reviews, client feedback and how advisers can work with their platforms and providers to pull client data together.

We are basing the findings presented in this guide on quantitative and qualitative research conducted by NextWealth. This consisted of a quantitative survey of 327 financial advice professionals in August 2022, with a top-up survey of 102 financial advisers conducted in October 2022, and a quantitative survey of 302 consumers paying for on-going financial advice, conducted in September 2022. The report also references in-depth interviews with 10 financial advisers, representing a range of firms by geographic location and AUM and in-depth interviews with 10 advised customers and one focus group of 4 younger advised customers (aged 35-50).

Evidencing and monitoring requirements

In the FCA's non-Handbook Guidance for firms on the Consumer Duty (https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf), three key expectations are set for the monitoring of consumer outcomes:

1. That advice firms (as well as other business in the chain) identify and manage any risks to good outcomes
2. That advisers spot where consumers, or groups of consumers including those with vulnerabilities, are getting poor outcomes and understand the reasons for this
3. That firms have processes in place to adapt and change to address any risks or issues and prevent them happening again in future.

Most financial advice firms of course are already focussed on helping clients achieve their desired outcomes.

However the Consumer Duty requirements outlined above represent a step change from the TCF rules in measurement to evidence that firms are doing the right things and are identifying and taking action when outcomes are not as expected. Here, data becomes critical, at both a firm and industry level.

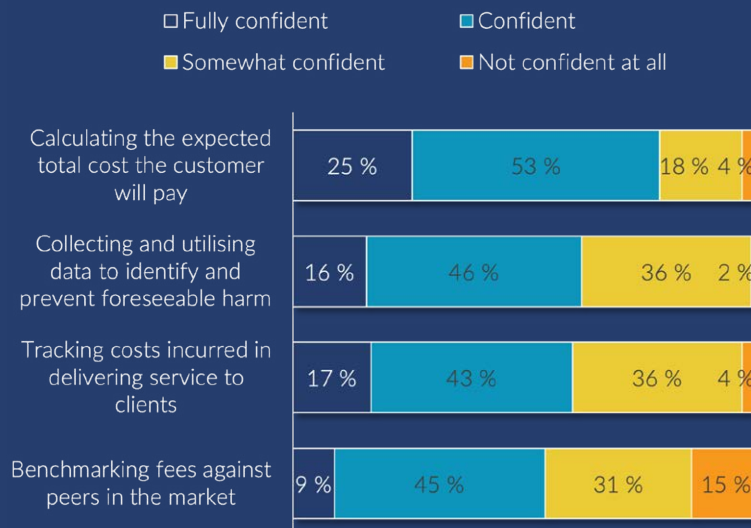
Advisers will need to increase their focus on creating audit trails for decisions and actions taken on behalf of clients, and use tools to improve their oversight of client outcomes.

Adviser confidence in using data as evidence

As illustrated in the chart below, only 16% of advisers are fully confident in their ability to collect and utilise data to identify and prevent foreseeable harm. In addition, adviser confidence is not as high as it could be when it comes to meeting other evidence requirements for Consumer Duty:

- Only one quarter of financial advisers are fully confident that they can calculate the expected total cost the customer will pay, despite this being required by MiFID II. A further 53% are confident.
- 60% of financial advisers are fully confident or confident that they can track costs incurred in delivering service to clients. Yet, this may become a key ingredient to evidencing value – to the regulator if not to clients.
- Only 9% are fully confident they are able to benchmark fees and charges.

Figure 1: Adviser confidence



We expect that these numbers will have increased since the research was conducted, as firms have increased their focus on monitoring and evidence. We also expect to see increasing use of tools and portals, and back-office functionality to collate and report client data.

Creating a new data strategy to monitor outcomes and identify issues can seem daunting. However, the FCA recognise that firms of different sizes and capabilities will vary in their capacity to analyse client data. Small and medium-sized advice firms are less likely to have a data officer, or a sophisticated data strategy.

There are types of information that firms of all sizes can collect and review to do the best job they can in monitoring that they are delivering good outcomes. And indeed, as alluded to in the FCA's non-Handbook Guidance, it is likely that firms will use management information to inform other elements of their business, such as sales.

Some monitoring will take place across all clients; other monitoring activities might look at representative samples of the client base. Similarly, some activities will be ongoing where others can be carried out at certain intervals.

Action points:

- ☐ Review the MI capabilities at your firm that are currently used to generate sales and revenue. Can some of those capabilities also be used to monitor outcomes?
- ☐ How is the firm using data to design propositions aimed at different client segments? What changes need to be made in order to monitor outcomes for those segments?
- ☐ Does the firm have a written strategy to gather information that helps monitor client outcomes? Has a frequency been agreed to review that strategy and make improvements to ensure all Consumer Duty bases are covered?

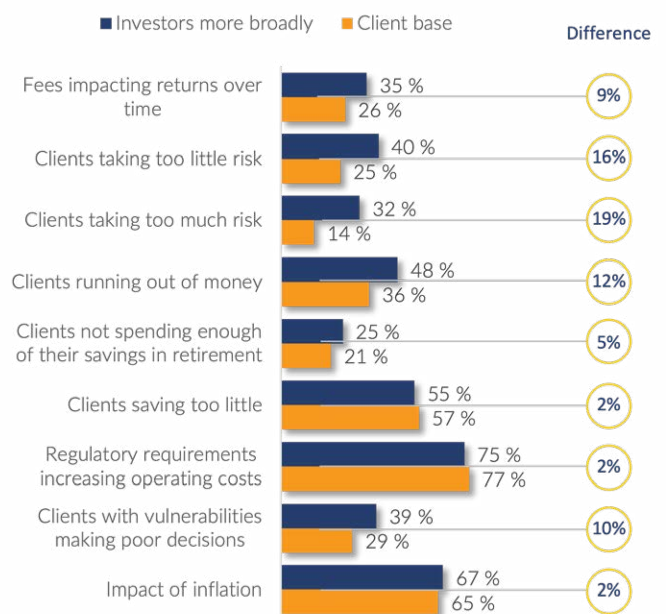
Identifying foreseeable risks to good client outcomes

Advisers need to be alert to any possible risks and foreseeable harm to good client outcomes.

In research carried out by NextWealth, advisers were asked to consider what manner of foreseeable harm they perceived to be a risk for the general population of UK investors, as well as what stood out when they looked at their own client base.

Currently at the top of advisers' watch lists are concerns about regulatory and inflationary costs causing harm to their clients. Low growth and high inflation impacts consumer portfolios and adds pressure to ongoing fees. This is a concern for 65% of advisers questioned when it comes to their clients, rising to 67% for the wider world of investors.

Figure 2: Financial adviser key concerns



Foreseeable harm: Regulatory requirements

We were interested to learn that the biggest concern cited by advisers (77%) is the impact of increasing operating costs due to rising regulatory and compliance costs, falling to 75% for the wider investing public. Whilst understandably top of the majority of advice firms' headaches, and a contributing factor to the overall cost of delivering advice, this is not directly a foreseeable harm for clients.

Foreseeable harm: fees impacting returns

Advisers see the effect of lower growth and higher inflation creating the perfect storm, when charges are factored into the share of the gains clients might be making on their portfolios. Even so, the impact of fees on returns is a lesser worry for advisers when it comes to clients (26%) and slightly more of a worry for advisers when it comes to UK investors more broadly (35%).

An adviser from a three-adviser firm in Hertfordshire, said: *"We spend all our time saying it's not about charges, but charges are a huge issue in a low growth era, as inflation starts to become a factor."*

Advisers also worry about clients not saving enough – 55% have this concern for clients versus 57% for investors generally.

Foreseeable harm: risk profiles and good outcomes

The area of biggest difference in concern about foreseeable harm between an adviser's own clients and investors more broadly is related to risk. A quarter (25%) are concerned about their clients taking too little risk relative to the returns they need to meet their goals, rising to 40% for investors as a whole. A staple of the initial meetings with clients is the attitude to risk questionnaires, but several advisers expressed concern that these lead to clients taking less risk than they need to.

Still, financial advisers seem to believe that their ability to coach their clients to understand their risk profile is a key area where they add value.

A managing director of a 15-adviser firm in London, said:

"I think there's a danger around red-flags and de-risking too much and that comes down to regulation, where you fill out a risk profiler, the risk profiler then puts you into a hole and you then give that client a portfolio. That's really dangerous.

"There should be a conversation with the client where you say 'you said you are balanced risk investor. But here's the pros and cons of having more equity, more volatility, how would you feel if this or that happens? Because managing risk is going to get a better outcome, longer term.' That's the reality."

Support from product providers and platforms in identifying possible harms

The NextWealth interviews uncovered a sentiment amongst advisers that platforms can play a more active role in identifying poor outcomes and in preventing foreseeable harm. Platforms can employ their data analytics to nudge advisers to act when needed, perhaps if a charge looks out of line.

Action points:

- ☐ To monitor these and other foreseeable harms, advice firms can engage with some of the types of information and reviews proposed in the FCA's non-Handbook Guidance such as:
- ☐ File reviews: firms may select a representative sample of client files to review as a scheduled regular activity to analyse client outcomes and map those against the firm's expectations. For retirement clients, for example, the firm might examine whether drawdown rates are matching expected ranges.
- ☐ Compliance reports: the FCA suggest a regular review of compliance reports to check if standards are being met in terms of good outcomes for consumers
- ☐ Process reviews: reviewing whether processes and policies are effective in delivering good outcomes for clients.

Further guidance on the types of information and data that firms can use is available in FCA's non-Handbook Guidance for firms on the Consumer Duty, paragraph 11.33: (https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf)

The value of client segmentation

Client segmentation has been a hot topic for advisers for many years. On paper it makes good sense but in practice it can be tricky to implement and deliver. Our research finds that 40% of advisers do not yet have a formally defined, demonstrable target market, in some cases because it feels at odds with the desire to treat each client on an individual, bespoke basis.

Segmentation is often considered from the adviser's perspective. The Consumer Duty makes it clear that advice firms also need to consider client needs and preferences. For example, some may only want or need advice on specific issues rather than a holistic service. Similarly, some clients may not need or want regular contact or may be happier with online meetings rather than in person. 38% of advisers say that their segmentation already recognises the client's preferred servicing model and, again, we expect this to increase.

Advisers don't have to segment their service, however they need to be confident that the service they are offering is appropriate for the needs and preferences of different types of clients.

With a defined target market(s), firms can more easily demonstrate an agreed process, product range and fee structure to follow, even if the specific outcome is bespoke to that client.

Management information can then be considered for that target market to ensure that products and services are targeted as intended and are continuing to meet the needs of those groups.

Clients with vulnerabilities

The FCA guidance is clear that firms need to have monitoring plans in place that will identify where distinct groups, such as clients with characteristics of vulnerability, get worse outcomes than other clients. If this is found to be the case, the firm should have processes in place to adapt and change practices to address instances of poorer outcomes.

Approaches to segmentation

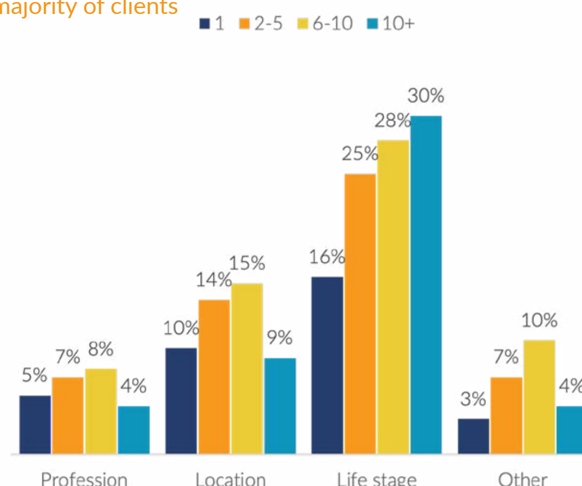
Aside from the level of investible assets, advice firms who currently segment their client base are most likely to define segments based on either life stage, complexity of needs or servicing requirements.

One adviser said:

"So, client segmentation, it's something I think we need to do a bit more work on to be more about life stages, rather than, you know, generic. That is something I want to work on is looking at the clients that we've got, and what life stage and what it is they're looking for.

"So, we tailor our service a bit more to them to work a bit better. And then maybe somebody who's in the younger stages of life may need a lighter touch, you know, that's what I think Consumer Duty pushes us to be a bit more analytical over. And also, how to understand what clients want. And then also understanding that if we make changes that it's working – getting that client feedback."

Figure 3: Common factors/segments which characterise the majority of clients



Some firms adopt other criteria such as origin of wealth and adviser specialism, which can help match client needs to the most appropriate service.

Segmentation by origin of wealth

This involves matching products, services, and communications to how the client perceives and values their wealth, and what behaviours they have around their wealth.

A managing director of a 19-adviser firm in London, said:

"The first part of our approach is about identifying the clients that we work with...business owners, entrepreneurs for example...then asking them: 'what are the things you like, that you value that we do for you?' And 'what are the things that you would like us to do that we don't do?'."

Segmentation by adviser specialism

As well as segmenting clients specifically, some firms are looking at the specialisms of their advisers within the business to see how they can meet the specific needs of their clients.

A compliance director of a 17-adviser firm in London, said:

"We're in the process of reviewing all clients to see where we should focus our attention in respect of our knowledge skills, experience specialisms so that we can provide the best service to those client segments...We're trying to make sure we can help quite a wide spectrum of clients but do it in a really efficient way that specifically taps into their needs."

Implementing a segmentation framework for new versus existing clients

On a more fundamental level, advisers may need to consider segmenting their existing clients and new clients, and then creating a subset of segmentation within each of these areas. This could become complex but defining this effectively is a sure way to allow advisers and the Consumer Duty champion within the firm to provide evidence of their approach to the board, or equivalent governing body, as well as the FCA.

A compliance manager at a 50-adviser nationwide firm, said:

"Regulations come in thick and fast sometimes...we didn't have a need to have segmentation frameworks before or set consistent charges...What seems clear, is that we need to justify our charges to any prospect coming to our business, whichever adviser they spoke to, they'd be offered the same fee package as it should be, so we can be sure that any future clients will receive consistent fees depending on, like, the level of their complexity.

"But we can't just say to all our existing clients, 'right, you're going up to this, you're going down to this, because that's our new framework' so it's a long process to align historic fee charging to our current, new structure. [Doing the segmentation] means we could confidently say that now about 95% of our clients are on our fee structure and we could confidently say that it's, you know, we provide value to our clients.

"Sometimes there are challenging conversations to align fees that might be out of kilter with our existing clients. And then the other element of it is that acquisitions are key to our growth strategy. And they often have very different fee charging structures. So, it's then saying, to those clients that move over, that they could potentially be on a higher fee structure...

"One of the businesses we just bought was a one-man band. And he couldn't provide the same amount of contact as we could, or as much choice in platforms and proactiveness with what we're recommending or around protection advice or estate planning advice. So, segmentation and knowing who our clients are and what we need to charge them according to need helps us to justify the higher fee within the added services, that they're getting from us."

Action points:

- ☐ If your firm hasn't formally segmented cleints, or has only previously done so on the basis of assets, can you evidence having considered the needs and preferences of the different types of clients you work with? Do you need to make adjustments to the service you're offering in order to address those differences?
- ☐ How is your firm using management information to monitor how well the products and services you're recommending for different types of clients are meeting the needs of those groups?
- ☐ What processes does your firm have in place to spot where certain groups, such as vulnerable clients, are getting poorer outcomes than other clients?

How does Consumer Duty impact on suitability?

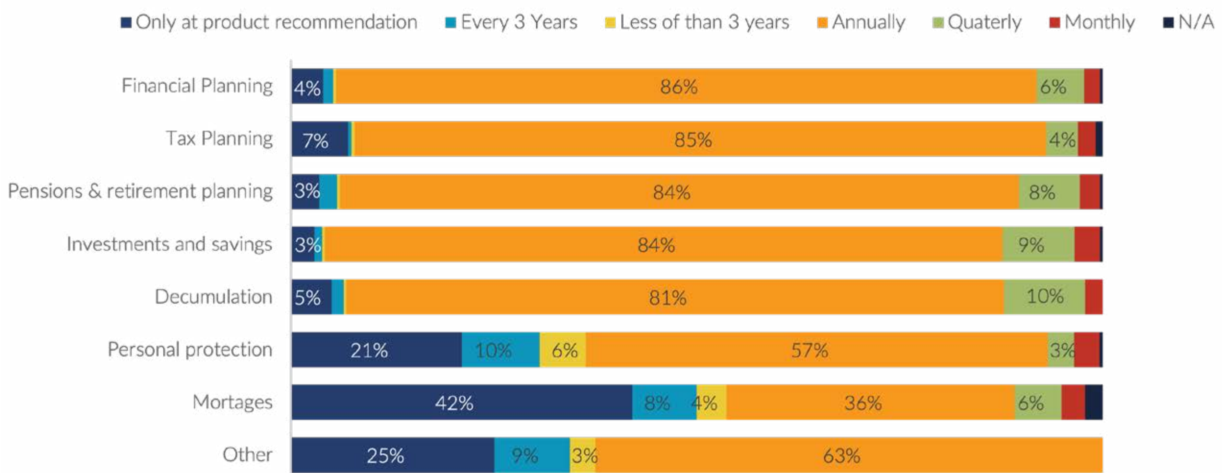
The guidance requires not only that firms are monitoring whether products and services meet the needs of clients and contribute to good outcomes, but where firms charge an ongoing fee that outcomes are monitored closely on an ongoing basis.

In a recent survey of advisers, 84% said they reviewed the suitability of pension and retirement planning, and investments and savings products annually. It falls to 57% of advisers reviewing personal protection products annually, and 36% review mortgage products annually.

"Suitability needs to track changes in risk, goals and preferences, as well as life circumstances. Consumers trust their IFAs to make the right choices about investment decisions, especially as their circumstances change."

Outsourced compliance specialist

Figure 4: Frequency of reviewing suitability



Source: How often does your firm typically review client suitability against desired outcomes for the following products and services? (NextWealth, Financial Advice Business Benchmarks Report 2022)

When the Consumer Duty comes into play, advisers will be expected to regularly monitor the suitability of products for clients receiving an ongoing service to ensure they aren't languishing in a product that they shouldn't be.

Firms currently talk about value in terms of the fee, but more can be done on benchmarking the suitability of investments ongoing.

"It's not about me giving you another 20 page document to sort of evidence, the costs. And it's about me, showing, and I think what's more important is what I show on the phone rather than repeat everything to you is ask you some pertinent questions, review your capacity, things that I know matter, capacity for loss, your attitude to investment risk, your investment knowledge, I don't need to tell you what, that's what I'm doing. But I need to I need to know as the professional adviser that I've looked at those things, and I can evidence on the fact that I've done that properly. I can evidence I've reviewed your plan. And I've tagged it will give you a one page summary, which says you've now got 60,000 pounds in your Isa. We've maximised the contributions this year without preventing you from hitting your spending goals and cash security goals for the next 12 months until we see each other again, the product is suitable. This is what it's costing you."

Outsourced compliance specialist

Action points:

- ☐ What data, MI and other intelligence is your firm using to monitor suitability of products and services on an ongoing basis?
- ☐ Does the firm have an agreed strategy to regularly review this information and take any action required as a result of those reviews?

The value of monitoring communication

An important element of adviser compliance with the Consumer Duty is effective client communication, as this is one of the best ways to be sure your clients are getting what they need from you and are satisfied with the services you are offering.

The FCA non-Handbook guidance proposes the use of formal and informal feedback from clients to identify trends and areas for improvement. Of course this is in addition to analysing actual outcomes and not a replacement.

Just over a third (34%) of advisers survey clients to find out whether they feel they are getting value from their advice or not.

A compliance director from a 17-adviser firm in London, said:

"One of the other gaps is that advisers don't collect customer feedback e.g. surveys - what's working for you, how's it going? Do you hear from us enough too much/too little? This could help show understanding of consumer needs more effectively.

"We're really trying to focus on feedback we can gauge from clients... not a perfunctory 'tell us what you thought of our service' but 'how does that feel? How do you feel that you are able to retire early?' And it's very, or can be, very specific to the client. But that's the sort of feedback we want to gauge."

Some consumers surveyed by NextWealth felt the level of communication they received from their adviser could be improved, particularly with regard to the level of ongoing personal contact, and this is important for monitoring ongoing suitability both of products and services delivered.

Firms may need to consider whether their ongoing service delivered for existing clients matches the depth of client engagement during the initial onboarding process.

Again a segmentation strategy can be helpful to systematically seek and process feedback from a sample of the client base.

A managing director of a 15-adviser firm in London, said:

"I think you don't need to survey every client. But I think if you can handle 10 or 20 clients, maybe from different groups, and from those different segments, ask those questions and be open to that feedback."

Action points:

- ☐ Could your firm do more to gather meaningful feedback from clients to improve understanding of their needs and identify areas for improvement?

Gauging client satisfaction

Addressing ongoing product suitability is one thing, but perhaps more challenging is how to get a better understanding of the level of client satisfaction and the true benefits of financial planning and advice. Consumers describe the value of advice as peace of mind, trust, and contribution to their wellbeing.

One consumer, 34, with £400,000 to £600,000 of investable assets, said:

"One hundred million per cent I sleep at night because I know that they're in charge of it, and not me. If I had kept all the money in my bank and set things up myself, I'd be monitoring them daily, and be awake at night. So, the fact that it's out of sight, out of mind, they do their bit. That's all I want."

The difficulty with gauging client satisfaction through 'soft' data is that collecting and benchmarking this data is almost impossible. But that doesn't make it any less valuable to advisers when they are determining how satisfied their clients are. Up to this point, the primary evidence of value has been investment performance, but this will not be enough under the new rules.

So, more work needs to be done – which is likely to involve a lot of conversations – that will help advisers address a wider range of client satisfaction. But do remember that client satisfaction does not always equate to what the FCA would deem as 'good outcomes' – it's important to assess client satisfaction in a way that's more meaningful to the aims of the Consumer Duty.

How platforms can help

As well as helping advisers spot potential harms as we discussed above, by drawing attention to potential fee discrepancies, for example, there is a chance here for platforms to help advisers with management information and generating reports for advisers which will help with meeting their responsibilities under the Consumer Duty. But this is not something that will happen in isolation.

Advisers and the platforms they work with will need to discuss how the information they can provide can offer evidence that the company can use as evidence with the regulator, and perhaps most importantly, can boost client information and the understanding of outcomes and ongoing suitability.

Conclusion

"What gets measured gets managed" is a quote attributed to business thinker Peter Drucker, and it perfectly sums up the opportunity for advisers to improve services under the Consumer Duty. The focus on evidencing and on-going measurement against delivering good outcomes for clients, will force change, and it will be change for the better for consumers.

While much work needs to be done between now and the July implementation deadline, there is optimism that this work will herald a cultural change across our industry to collaborate to deliver better outcomes for clients. But measurement requires data and that is a huge challenge for our industry.

Benchmarks created by NextWealth – which are outlined in guide one - offer an important input to value assessments. Yes, more needs to be done to create these in a manner that the regulator and advisers are happy with, but this is a useful first step.

Advisers have a lot of responsibility under the Consumer Duty, but so do the third-party providers. Platforms, for example, are the custodians of the assets but also of data. They need to make better use of their data to nudge advisers to deliver better client outcomes and prevent foreseeable harm. They also need to provide more management information to asset managers and DFMs to ensure there is a target market fit for products.

However, financial advisers also need to think about what data they are capturing – and to focus more on soft data. Soft is hard – it's hard to measure soft facts but that doesn't mean it's not important. This research reveals that until now, financial advisers have relied mainly on investment performance to evidence value. This must change.

Investment performance is of course important. But the real value of financial planning and advice, according to clients, is peace of mind, a sense of financial wellbeing and as one of our consumer interviewees said, *"being able to sleep at night."*

Capturing this soft data and measuring progress on soft outcomes is not easy, but it needs to be done. With the effective use of tags in back-office systems, tracking time, writing down and reviewing progress against goals, there are a lot of things advisers can do to help their clients and provide a regulatory audit trail.

The Consumer Duty requires action across the supply chain to measure progress against outcomes, and it should have a positive impact on our industry. There is an exciting period ahead, as the industry – and advisers especially – look to continue charting the retail wealth management industry's progress with helping clients achieve positive outcomes.

About Aegon

In the UK Aegon is a leading provider of pensions, investments and protection. Our purpose is to help our nearly four million customers achieve a lifetime of financial security.

Aegon's roots go back more than 175 years – to the first half of the nineteenth century. Since then, Aegon has grown into an international company, with businesses in the Americas, Europe and Asia. Today, Aegon is one of the world's largest financial services organisations, providing life insurance, pensions and asset management.

Contact Susan.McDonald@aegon.co.uk for media enquiries. For more information visit aegon.co.uk/consumer-duty.

About NextWealth

NextWealth is a research, data and consulting business helping firms to adapt and thrive amid disruption. Our customers are platforms, asset managers, technology companies and financial-advice businesses.

We publish syndicated research reports and industry metrics, perform bespoke services and host public events and private roundtables.

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The NextWealth Directory lists and reviews all of the tech providers supporting financial advice businesses. It is free to use and already has over 1,400 reviews from people working in financial planning firms. From back office systems to cash flow modelling – we publish ratings and reviews. Read a review. Leave a review. nextwealthdirectory.co.uk.