

Direct line:  
Local fax:  
Email:



14 June 2011

Our Ref:

Your Ref:

Dear CEO

**This letter requires your immediate attention. It asks you to respond to the FSA by 9 August 2011.**

### **Wealth management review**

We have recently reviewed the suitability of client portfolios in a sample of firms in the wealth management industry. We have identified significant, widespread failings, which we are concerned may also be prevalent in firms outside our sample. In this letter we explain the issues we have identified and ask you to consider whether your firm meets – and can demonstrate that it meets – our suitability requirements.

### **Results from our review**

- 14 out of 16 firms were judged to pose a high or medium-high risk of detriment to their customers, based on the number of client files which had a high risk of unsuitability or where the suitability could not be determined.
- Overall, 79% of files reviewed had a high risk of unsuitability or the suitability could not be determined.
- 67% of the files reviewed were not consistent with one or more of the following: the firm's house models; the client's documented attitude to risk; and the client's investment objectives.

We are involved in ongoing regulatory action with these firms to mitigate these risks. However, as a result of our findings some firms have already put in place major rectification programmes.

## **Key areas of concern**

Several key areas of concern have arisen from our review, particularly the inability of firms to demonstrate that client portfolios and/or portfolio holdings were suitable.

For example, we saw:

### **An inability to demonstrate suitability because of:**

- an absence of basic know-your-customer (KYC) information;
- out-of-date KYC information;
- inadequate risk-profiling;\*
- some firms not implementing MiFID client classification requirements;
- the lack of a record of clients' financial situation (assets, source and extent of income, financial commitments); and,
- the failure to obtain sufficient (or any) information on client knowledge, experience and objectives.

### **Risk of unsuitability due – in summary – to:**

- inconsistencies between portfolios and the client's attitude to risk; and
- inconsistencies between portfolios and the client's investment objective, investment horizon and/or agreed mandate.

We also had concerns that firms were not taking reasonable care to organise and control their affairs responsibly and effectively, using adequate risk-management systems.

## **Focus of review**

The review sampled 16 wealth management firms which provide advisory and/or discretionary investment management services, predominantly to retail clients. Firms in the wealth management industry are not homogenous, with differing business models, service offerings, client acquisition strategies, delivery channels, corporate objectives and legacies. So we drew on a wide range of firms – from major international private banks to those which are domestically focused and privately held.

The key focus of the review was to assess suitability of client portfolios against documented client information, which includes, but is not limited to, the client's knowledge and experience, financial situation and investment objectives.

We expect firms to take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable (for further details on this and related requirements, Appendix 1 contains a summary of some of the relevant Handbook obligations). These findings give rise

---

\* See FG11/05 *Assessing suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection*

[http://www.fsa.gov.uk/pubs/guidance/fg11\\_05.pdf](http://www.fsa.gov.uk/pubs/guidance/fg11_05.pdf)

to concerns that there is an unacceptable risk of customers of wealth management firms experiencing unfavourable outcomes. While underlying drivers of poor outcomes have not been a major focus of our work to date, the failings we have seen may point to deficiencies in the management and control architecture of firms.

### **What you need to do next**

Please respond to acknowledge that you have read and understood the content of this letter and considered the implications for your firm. Please submit your response by 9 August 2011 to [wealthmanagement@fsa.gov.uk](mailto:wealthmanagement@fsa.gov.uk) copying in your FSA supervisor/Firm Contact Centre. Please state your Firm Registration Number (FRN) in the subject box.

In order to satisfy yourself that you are currently meeting our suitability requirements and to mitigate the risk of future non-compliance, we expect that you will want to consider the client information contained in your client files and if it is likely to satisfy your obligations regarding customers' desired investment portfolios. If you have not recently assessed the suitability of your client files, you may want to consider:

- sampling a meaningful number of client files;
- assessing whether files have relevant, meaningful, accurate and up-to-date client information;
- the depth, breadth and quality of client information; and
- whether the client portfolios, and the current holdings in client portfolios, are suitable, based on the documented client information you hold.

If, in the course of reviewing your client files, you identify problems, root causes or compliance failures, we would expect you to have regard to Principle 6 (Customers' interests) and consider whether you ought to act on your own initiative with regard to the position of customers who may have suffered detriment from, or been potentially disadvantaged by such factors.

Please note that the contents of this letter do not prevent or in any other way limit the FSA from investigating and taking any action in respect of any matter against any firm either before 9 August 2011 or after in relation to the subject matter in this letter, where we consider it appropriate in the light of any particular facts.

You should be aware that we consider suitability – and the ability to demonstrate it – a key area of risk in this sector and wealth management businesses can expect to see continuing and increasing supervisory focus on these issues in the year ahead.

Yours sincerely

A handwritten signature in black ink that reads "Margaret Cole". The signature is written in a cursive, flowing style.

**Margaret Cole**  
**Managing Director, Conduct Business Unit**  
**Financial Services Authority**

## Appendix 1; Key Principles and rules

Principle 1 Integrity: A firm must conduct its business with integrity.

Principle 2 Skill, care and diligence: A firm must conduct its business with due skill, care and diligence.

Principle 3 Management and control: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Principle 6 Customers' interests: A firm must pay due regard to the interests of its customers and treat them fairly.

Principle 9 Customers: relationships of trust: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.

### COBS 2.1.1R

(1) A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).

(2) This rule applies in relation to designated investment business carried on:

- (a) for a retail client; and
- (b) in relation to MiFID or equivalent third country business, for any other client.

[Note: article 19(1) of MiFID]

### COBS 9.2.1R

(1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.

(2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:

- (a) knowledge and experience in the investment field relevant to the specific type of designate project governance and responsibilities d investment or service;
- (b) financial situation; and
- (c) investment objectives;

so as to enable the firm to make the recommendation, or take the decision, which is suitable for him.

[Note: article 19(4) of MiFID, article 12(2) of the Insurance Mediation Directive]

### COBS 9.2.2R

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

- (a) meets his investment objectives;

(b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and

(c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

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

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

[Note: articles 35(1), (3) and (4) of the MiFID implementing Directive]

#### COBS 9.2.3R

The information regarding a client's knowledge and experience in the investment field includes, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved, information on:

(1) the types of service, transaction and designated investment with which the client is familiar;

(2) the nature, volume, frequency of the client's transactions in designated investments and the period over which they have been carried out;

(3) the level of education, profession or relevant former profession of the client.

[Note: article 37(1) of the MiFID implementing Directive]

#### COBS 9.2.6R

If a firm does not obtain the necessary information to assess suitability, it must not make a personal recommendation to the client or take a decision to trade for him.

[Note: article 35(5) of the MiFID implementing Directive]

#### COBS 9.2.7G

Although a firm may not be permitted to make a personal recommendation or take a decision to trade because it does not have the necessary information, its client may still ask the firm to provide another service such as, for example, to arrange a deal or to deal as agent for the client. If this happens, the firm should ensure that it receives written confirmation of the instructions. The firm should also bear in mind the client's best interests rule and any obligation it may have under the rules relating to appropriateness when providing the different service (see COBS 10R, Appropriateness (for non-advised services)).

#### SYSC 9.1.1R

A firm must arrange for orderly records to be kept of its business and internal organisation, including all services and transactions undertaken by it, which must be sufficient to enable the FSA or any other relevant competent authority under MiFID to monitor the firm's compliance with the requirements under the regulatory system, and in particular to ascertain

that the firm has complied with all obligations with respect to clients.  
[Note: article 13(6) of MiFID and article 5(1)(f) of the MiFID implementing Directive].