

Section 4

The financial planning and advice process

Introduction

The relationship between the adviser and the client is formally defined by a number of legal elements, such as the law of agency and data protection legislation, which are described in Section 6 and in Section 4 of Unit 2 respectively.

It is also essential that the client should understand the terms on which any business will be transacted, and advisers are required to have a written agreement with the client, setting out the terms of business, the exact nature of which is described in Unit 2.

It is, however, vital that the relationship should also be one of mutual trust. This will be much more easily achieved if the adviser can show an understanding not only of the products that he sells, but of human nature and of the situations in which people find themselves – and both the perceived and real needs that they consequently have.

Part of this relationship of trust will be the confidentiality with which the adviser treats the customer's personal and financial information. Some confidentiality requirements are specified by legislation – for example the Data Protection Act 1998 – but an adviser should make it clear that all of the customer's information will be kept confidential at all times unless there is a legal requirement for it to be revealed.

An adviser must also be aware of all of the major consumer protection legislation that regulates his relationship with the client, much of which is described in Section 6 of this Unit and in Unit 2.

In this section, we will consider how advisers obtain the information they need from their clients, how they assess and structure that information to determine the most suitable products and services to recommend, and how they communicate effectively with their clients at all stages of the relationship.

Section 4 covers the topics in part 5 of the Unit 1 syllabus, ie the process of giving financial advice.

4.1 The saving pattern

There is a well-established pattern to the way in which most savers and investors build up and hold their assets. It begins with savers' attitudes to the need for liquidity and safety and then, as incomes and savings grow, moves gradually away from liquidity and towards an acceptance of greater risk.

The first stage in the *saving pattern* is cash; after that, a current account with a guarantee card is virtually as good as cash. People do not generally hold any other form of asset until their cash requirements are met. The next stage is secure, short-term investment such as instant access (or short-notice) bank and building society deposits.

With a sufficient balance in short-term savings, investors look next at products with less flexibility but a greater return, such as fixed-term bonds.

Further down the line, individuals may be attracted to products that offer greater long-term potential but at the risk of short-term loss. Shares and other equity-linked investments, such as unit trusts, are good examples. In times of stock market volatility, however, these investments may prove considerably less popular.

Similar patterns can be recognised in relation to other types of financial products, though perhaps to a less pronounced extent: for example, the first type of bank account that most people open is a personal current account, often out of necessity to enable receipt of their wages or salary. It is only later, as their financial situation improves, that they begin to use a wider range of accounts and other banking products. Similarly with insurance products, where the first experience is often of compulsory cover, particularly for motor insurance, and of holiday insurance.

In terms of borrowing, many people commence with short-term unsecured borrowing, by way of credit cards or personal loans, to pay for holidays or a car.

4.2 The financial lifecycle

In all of these examples, the pattern is determined to a greater or lesser extent by the market segment, or segments, into which the individuals fall. These can be categorised in a number of different ways: it is well established that the financial needs of individuals and families change as people pass through the different stages of life. While accepting that everyone is different, there are some broad statements that can be made about a typical *financial lifecycle* as follows.

4.2.1 School-age young people

The very young may be attracted by small lump-sum or regular savings schemes; it is typical for accounts to be opened for young people by grandparents or other relatives, at birth or later as birthday gifts. National Savings and Investments products (including Premium Bonds) and building societies are popular homes for such savings. Stakeholder pensions can be opened on behalf of children, from birth onwards.

4.2.2 Teenagers and students

Few teenagers and students have any surplus income, although some who have started to work full-time or during holidays may be able to accumulate savings. Some may borrow to purchase a car or to fund a holiday. Many students now have to borrow to finance their college or university studies, mainly through special schemes established for that purpose.

4.2.3 Post-education young people

The ability to save increases for those young people in employment, with the possibility of higher incomes as careers progress. If they establish a home of their own (often initially by renting), their savings may be modest at first. Some may decide to save towards a deposit for a first home purchase. Short-term accessible saving schemes are their most likely choice. Many telephone-based and Internet-based financial services are aimed at this market.

4.2.4 Young families

Although statistics indicate that fewer young people today get married, many still form relationships and raise families. This often leads to increased borrowing, particularly for a mortgage. At the same time, income may be reduced if one partner gives up work to look after children or, alternatively, outgoings may increase if a childminder is employed. Similar factors affect the growing number of one-parent families. Whatever the situation, there is often little scope for savings at this stage. Protection of the earners' income against illness or death becomes very important. Young people should also begin to think about pension provision, although in practice very few do.

4.2.5 Established families

As families settle into an established lifestyle, they tend to become better off financially. There may be a return to a two-income situation. People often trade up to a larger house, increasing their borrowing accordingly. Creditworthiness may improve, enabling greater borrowing for cars and household goods. This is also the beginning of the time when wealth may be increased by the receipt of inheritances from the estates of parents or other relatives.

4.2.6 Mature households

Maturity is generally the period of highest earning potential and outgoings may also decrease as children leave home and mortgages may be paid off. At this stage, pension provision becomes a priority for many people as they begin to realise that they may not have as high an income in retirement as they had hoped.

4.2.7 Retirement

Prior to retirement, most people's financial planning is centred on converting income into lump sums (or lump sums into bigger lump sums). At retirement, when income from employment ceases, the focus changes: the requirement is now to produce income from capital. Other factors also become more relevant: the need to prepare for possible inheritance tax liabilities should be considered. Similarly the cost of health care, and possibly of long-term care in old age, may become an issue.

Age or time of life is not, of course, by any means the only way in which market segments can be defined, but it has been analysed in detail to give an illustration of the concept. Other breakdowns are possible, for instance, by the level of annual income or by an individual's attitude to investment risk. Both of these characteristics can contribute to determining the appropriate financial product for a particular investor or borrower.

4.3 Gathering information

Regulations that were first introduced by the Financial Services Act 1986, and which now continue to operate under the Financial Services and Markets Act 2000, oblige advisers to ensure that any advice offered is suitable for the client, based on the client's circumstances, experience, needs and objectives. Advisers must be able to identify the client's needs, which are the starting point for the sales process.

Most, if not all, advisers will complete a comprehensive computer or paper-based *factfind* to obtain their client's details. An adviser's responsibility during the factfind is to define the client's needs and objectives quickly and accurately.

To gather appropriate information it is necessary to ask questions in respect of the following:

- ◆ the client's financial situation;
- ◆ the client's existing and future needs;
- ◆ their ability to provide for them;
- ◆ their attitude towards providing for them;
- ◆ the client's objectives;
- ◆ the client's knowledge and experience of investment (where relevant to the service the adviser will provide). This will support an assessment of the client's ability to understand and accept investment risks.

This means, in practice, that any factfind should look at both the client's circumstances and preferences.

4.3.1 Client's circumstances

These relate to three main areas: personal details; financial details; objectives.

4.3.1.1 Personal and family details

Current personal and family situation information includes the details of all of the people who may need to be included in the planning exercise, together with any constraints that may apply. The following basic information will be needed.

- ◆ *Name and address*: full name of the client, along with their contact address and telephone number.
- ◆ *Date and place of birth*: dates of birth for all those included in the factfind. The client's place of birth may be important for underwriting or taxation reasons, but any hint of racial discrimination must be avoided.
- ◆ *Marital status*: the use of the word 'marital' in this context now carries a wider meaning than in earlier generations, and may include single, married, civil partners, cohabiting, divorced, widowed, etc. It is usually preferable to have both partners of a relationship involved in the financial planning process, since the decisions made will often affect both partners. Some clients, however, prefer to keep their financial affairs separate.
- ◆ *Family details*: the client's family details are important for a number of reasons:
 - there may be family members who are, or who will be, financially dependent on the client;
 - the client may become the beneficiary of gifts or trusts;
 - the client may wish to become a donor, now or in the future;
 - from a marketing viewpoint, there may be an opportunity for referrals to family members.
- ◆ The most important group of family members is usually the children. In order to give appropriate advice about protection against death and disability, as well as about savings for school or university fees for example, it is necessary to know how old the children are. This may include children from previous relationships.

4.3.1.2 Financial situation

The information required will include the following.

4.3.1.2.1 Employment details

Is the client employed, self-employed, unemployed or retired? If the client is a director or a partner, it may be necessary to delve deeper and establish basic information about their business arrangements.

It also helps to know whether they are part-time or full-time, temporary or permanent, as well as gaining details of the client's profession or trade.

Details of the client's income and benefits package (or net profit, if self-employed) will need to be established. It is often useful to ascertain an exact breakdown of income by its component parts, eg basic, commission, bonus and overtime, together with the average level of overall earnings. Similarly, an adviser must establish the exact nature of benefits provided, eg private medical insurance, company cars, pension and/or death-in-service details, subsidised loans etc.

Additional information that may be required will include details of previous employment (especially if the client has preserved pension entitlement), details of share-option schemes or profit-related pay schemes, or even details of additional employment. It may be helpful to obtain copies of payslips, P60s, tax returns and notices of tax coding.

4.3.1.2.2 Income and expenditure

By analysing a client's income and expenditure, it is possible to identify more easily the implications of, say, premature death on the family income and spending patterns. It is also possible to identify any 'surplus' income that could be used to fund the purchase of any additional products recommended.

To calculate a household's income is usually relatively straightforward. An analysis of clients' expenditure can be more difficult: certain items are easily determined, ie those paid by standing order such as rent and some household bills. Other items will cause a degree of difficulty – or even embarrassment – when trying to pin down how much is spent on, for example, food and drink, holidays or motoring.

4.3.1.2.3 Assets

For each of the client's assets, from their home (if they own it) to all their various bank accounts, some or all of the following details, as appropriate, should be obtained:

- ◆ ownership, ie single ownership or jointly owned;
- ◆ purpose of the investment;
- ◆ type of investment, eg property, deposit in a bank account, pension policy or fund;
- ◆ size of original investment and date;
- ◆ current value and/or projected future value;
- ◆ rate of return (if any);
- ◆ type of return, eg capital growth or income, and whether that return is fixed, guaranteed or variable;
- ◆ tax status of the investment or other asset;
- ◆ options available and/or penalties;
- ◆ sum assured and/or lives assured and maturity dates;
- ◆ name of the institution providing the asset.

4.3.1.2.4 Liabilities

The relevant information with regard to certain borrowing liabilities includes the following:

- ◆ lender;
- ◆ amount of loan;
- ◆ balance outstanding;
- ◆ original term and term remaining;
- ◆ type of loan, eg secured, unsecured (and if secured, on what);
- ◆ amount of monthly or other periodic payment;
- ◆ rate of interest;
- ◆ repayment method;
- ◆ protection of capital or payments.

Clients are often unaware of the details of any arrangements that they have. It is an adviser's responsibility to try to obtain this information and clients should be asked, wherever possible, to bring all relevant details with them.

4.3.1.3 Plans and objectives

This part of the factfind is substantially different from the other two parts: the personal and family details and the financial situation are concerned with the gathering of *hard facts*, ie about tangible items and people. The client's plans and objectives tend to be more intangible in nature: here the aim is to find out 'why?', 'how?' or 'do you feel that?', in other words, to discover the client's feelings about what they have, what they want and where they want to go from a financial point of view. These are known as *soft facts*.

Advisers need to know the following:

- ◆ how the clients feel about their current arrangements – or lack of them – in each area;
- ◆ their objectives within each area, now and in the future;
- ◆ why they have certain arrangements, or goals or views;
- ◆ their willingness to take action in each area;
- ◆ the likelihood of change in their situation.

Having knowledge of their feelings about their situation and their existing arrangements will help build on understanding of clients in a number of ways:

- ◆ by discovering the reasons behind the client's existing arrangements, which may in turn indicate the client's level of understanding of their finances;
- ◆ by determining the level of the client's interest in their situation, their level of motivation towards improving their situation and the likelihood of their taking action;
- ◆ by ascertaining the client's views on a number of possible alternative solutions will help in constructing acceptable recommendations.

4.3.2 Attitude to risk

As well as the soft facts, additional information is needed to ascertain correctly the client's attitude to risk, or *risk profile*. It is essential to take full account of this attitude when giving recommendations to a client and attitude to risk will differ from client to client.

The client must understand what the risk is, which may mean providing explanations, for example to distinguish between the degrees of risk. There is, for example, risk to the capital that is invested: the value of an investment may fall as well as rise; the amount of income or capital growth may not be guaranteed. The client's attitude towards this must be explored. Historically, many so-called low-risk investments, such as bank or building society accounts, have provided a safe haven and a relatively stable level of income, although inflation will cause the value of the investment to fall.

4.3.3 Client preferences

It is important to take note of a client's stated preferences, but advisers should also be aware of their own duty of care: this means recognising that, whilst clients may have a clear view on what they want to do, their appreciation of what they *ought* to do can be less than clear. This means that advisers may have an 'educational' role in helping clients to explore their own financial circumstances and to make the right choices.

4.4 Identifying and agreeing needs and objectives

We can categorise an individual's financial needs and objectives into the following five areas:

- ◆ protecting dependants from the financial effects of either a loss of income or a need to meet extra outgoings in the event of premature death;
- ◆ protecting self and dependants from the financial effects of losing the ability to earn income in the long term;
- ◆ providing an income in retirement, sufficient to maintain a reasonable standard of living;

- ◆ wanting to increase and/or to protect the value of money saved or invested; wanting to increase income from existing savings or investments; wanting to build up some savings in the first place;
- ◆ saving tax.

In seeking to assess any of these areas, an adviser should look for examples of typical things that clients either do wrong or fail to do at all. This might include:

- ◆ a young family, with little or no savings, relying solely on mortgage protection cover as their only form of life assurance. It would repay the mortgage but is not designed to meet the ongoing costs of running the house and bringing up the family;
- ◆ a low level of life assurance premiums being paid, suggesting that cover might need to be increased for the required protection to be adequate;
- ◆ unnecessarily large amounts being held on deposit in banks and building society accounts over the long term and so not gaining access to better returns available elsewhere;
- ◆ substantial taxable investment income being received by an individual who pays higher rate income tax;
- ◆ a non-taxpayer holding investments where tax on interest received cannot be reclaimed;
- ◆ too many small holdings of shares over a wide range of companies causing administration and monitoring difficulties;
- ◆ a married couple owning most of their assets in an individual's sole name and paying more tax as a result;
- ◆ no pension contributions being paid, or very small pension contributions as a percentage of total earnings, which will mean being dependent upon state benefits unless action is taken;
- ◆ people aged over 65 who have their age-related tax allowances reduced because of their income;
- ◆ people who have not made a valid will, whose assets on death may, therefore, not be distributed as desired.

The adviser's role is to define the client's needs and objectives accurately, to enable him to see the key issues facing him and to recommend and discuss a priority order for the client's action.

4.4.1 Agreeing order of priority

Failing to establish a priority order with the client can result in a client ignoring an adviser's recommendations. The client's priorities may well differ from those that the adviser feels appropriate, and so the process is one of discussion and agreement rather than straightforward selection by any single person. In the end, however, deciding a plan of action and agreeing its priority order remains the client's decision, assisted by the adviser's recommendations.

4.5 Recommending solutions

Once an adviser has gathered all of the necessary information about the client's circumstances and preferences, has a clear appreciation of their ability to pay, and has obtained agreement on priorities, then the process of matching solutions to requirements can begin. The adviser's aim should be to help the client to:

- ◆ put the right amount of money...
- ◆ in the right form...
- ◆ in the right hands...
- ◆ at the right time.

In practice, these four aims mean that advisers will look in detail at a number of specific areas. These will include:

- ◆ *state benefits*: the nature and level of state benefits to which a client may be entitled;
- ◆ *existing arrangements*: there is no point in recommending products that satisfy needs already met by the client's existing arrangements or by state provision;
- ◆ *affordability*: any recommendations made must not, in terms of total cost, jeopardise the client's current and likely future financial situation;
- ◆ *taxation*: one purpose of the recommendations may be to mitigate tax but it is also important to ensure that any course of action recommended does not unnecessarily add to or create a tax burden;
- ◆ *risk*: there must be a close correlation between the risk inherent in the product recommended and the client's risk profile;

- ◆ *timescale*: the product recommended should meet the client's needs within a defined timescale;
- ◆ *flexibility*: recommendations should display the flexibility to deal with possible changes in the client's circumstances.

4.6 Implementing solutions

4.6.1 Presenting recommendations

When a solution is recommended to a client, it is vital that he understands exactly what it will do. The client needs to know why the particular recommendation is being made.

The first rule of presentation is to 'keep it simple': avoid using jargon and stick to the particular features that are relevant to the needs of the client, provided that a fair and accurate explanation is given.

For each type of product recommended, it is a good idea to have a planned way of presenting it. This ensures that the adviser covers all of the relevant details, some of which may be mandatory under the Financial Services and Markets Act 2000. It also helps the adviser to avoid irrelevant details that are of no interest to the client.

The best way to proceed is to go step by step through each product, at the client's pace. As each feature and its benefits are covered, the adviser should check that the client understands the benefits, perhaps by asking a few simple questions.

There are a number of steps that should always be included when presenting recommendations:

- ◆ the purpose of the product and the client's needs that the product will address;
- ◆ the benefits that the client will enjoy;
- ◆ the risks and limitations inherent in the product;
- ◆ any options that exist within the product that may be appropriate to the client;
- ◆ a summary of reasons why the product is being recommended.

For each product, part of the presentation should involve a 'features and benefits' analysis. This means going through the product and identifying each of its features, and then putting into simple terms what specific benefits these features provide to the client.

4.6.2 Handling objections

The first point in handling an objection is to 'qualify' it. This means finding out whether it is a real or a false objection and how important it is. This can be done by trying to understand the objection as specifically as possible, ie by clarifying exactly what the client means by what they are saying. A good way of doing this is by paraphrasing what the client has said: 'So what you're saying is...?'

Once the nature of the objection and its importance are clear, then an attempt can be made to solve the problem. If the problem lies in the client's understanding or interpretation of what he has heard, then it should be straightforward to solve. If the problem lies in something specific and the client is not willing to move, then the obstacle should be put into perspective and other compensating factors stressed.

The handling of objections or queries is another step in helping the client to buy something for which they have seen a clear need and of which they can now see the full benefit.

4.6.3 Obtaining commitment to buy

Obtaining a commitment from the client in the form of a completed application form will depend on how effectively all of the earlier stages of the sales process have been carried out. Attempting to close a sale too early is clearly not sensible, and deciding when to close a sale is determined by two factors: the reaction of the client and their understanding of the proposal.

Closing the sale simply involves asking the client if they are happy to set the wheels in motion and complete the application. Sometimes the client may expect the adviser to complete the form on their behalf. It is permissible to do this but only with the client's permission to do so. If the adviser does complete the proposal form, the client must read it through thoroughly, checking what has been written before he signs it.

In particular, the client must be made aware of the consequences of *non-disclosure*. If the contract is later made void because of something that the client failed to disclose on the application form, then the whole process will have been a waste of time.

4.6.4 Documentation

Advisers also have a duty to explain the ancillary factors to clients such as the *cancellation notice*. This notice explains the client's right to withdraw from any arrangements within a defined period. Similarly, a *key features document* together with a client-specific *illustration* must be given to the client before the sale is closed. These documents provide the client with all the information he needs in order to make a decision. The client should also be provided with a product brochure explaining product details and features in full.

The business card that the client will have been given during the meeting gives him a clear route back to the adviser should there be any queries later on.

Detailed records of the transaction must be kept securely stored but accessible. For life policies and pension contracts, the retention period is five years but details of pension transfers, opt-outs and free-standing AVCs must be kept indefinitely. For other contracts (eg collective investment schemes) the retention period is three years.

(Note, however, that where MiFID business is involved, a uniform retention period of five years applies.)

4.6.5 After-sales care

Providing a professional service means more than selling a product to meet needs: it means ensuring that proper after-sales care is given and that reviews are carried out.

This will include ensuring that, where the acceptance procedure involves any delay, the client is kept fully informed. It will also mean dealing with other related matters such as direct debits, policy delivery, cancellation notices, standard reviews and any requests to alter the plan.

After these general areas, client servicing falls into two categories: proactive and reactive servicing.

4.6.5.1 Proactive servicing

Proactive servicing involves instigating action by contacting the client to discuss further needs.

This might be on a matter previously agreed, such as the next salary review, a job change, or even the taking up of recommendations of which the client was unable to take advantage originally.

Even where there is no known future event or requirement, it is a good idea to agree a time to review the client's position. At a review, an adviser can find out if there have been any changes to the client's circumstances and can update the appropriate records. By doing this, an adviser is in a strong position to identify opportunities to recommend new products appropriate to the client's needs, or to recommend changes to existing products.

4.6.5.2 Reactive servicing

Reactive servicing happens as the result of a request from the client, eg a request to discuss the recommendation after comments made in the media or by competitors. The client's circumstances might change unexpectedly, resulting in a request for advice.

The request may not be received directly from the client: it might be notification of non-payment of premiums or a request by the next of kin to sort out a death claim. In order to be fully prepared for all eventualities, clear and concise records must be maintained.

The keeping of all appropriate records will not only comply with the requirements of the Financial Services and Markets Act 2000, but can also lead to more business.

Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 4. Review the text if necessary.

Answers can be found at the end of this unit.

1. What is likely to be the main financial priority of a couple with a young family?
2. What is the main objective of completing a factfind?
3. List the employment details of a client that an adviser would normally need to ascertain.
4. What details should an adviser request in relation to loans?
5. What risks might apply to investment in a bank or building society deposit account?
6. List the factors that an adviser might take into account when deciding on an appropriate solution/product for a client.
7. The first stage in handling an objection should be to:
 - (a) qualify it.
 - (b) agree with it.
 - (c) quantify it.
8. What is proactive servicing?

Unit 1

Answers

1. Family protection, particularly the protection of income and assets against the effects of the death or illness of a breadwinner.
2. To define accurately the client's needs.
3. Whether the client is: employed, unemployed, self-employed, retired; part-time/full-time, permanent/temporary.

The details of their employer; nature of work; income (basic, overtime, bonuses, commission); benefits; pension scheme.
4. Lender, purpose of loan, balance outstanding, remaining term, secured/unsecured, interest rate, repayment method, repayment amounts.
5. Risk of loss due to collapse of bank/building society (small risk, some compensation available). Risk that interest rate falls below that expected. Risk of fall in capital value due to inflation.
6. State provision; client's existing arrangements; client's and product's tax position; client's risk profile; timescale of needs; flexibility required.
7. (a) qualify it.
8. Instigating action by contacting the client to discuss their continuing needs.

Unit 1