TOPIC 14

Understanding and satisfying customer needs

LEARNING OBJECTIVES

Up until now we have concentrated on understanding the economic context within which financial advisers operate and the range of products available. Our focus now turns to the process of giving financial advice. This process is tightly regulated, and we will look at the regulatory requirements in Topic 20. At this point, we are going to look at the different stages involved and how advisers gather the information they need in order to formulate recommendations and (hopefully) obtain business.

By the end of this topic, you should have an understanding of:

- typical financial needs at different stages of the life cycle;
- the ‘hard facts’ recorded in a factfind;
- how to establish a client’s plans, needs, attitudes and preferences;
- preparing and presenting recommendations;
- how to complete a sale;
- after-sales care.

This topic covers the Unit 1 syllabus learning outcomes U5.1–U5.7.

THINK . . .

The process of buying a financial product might be familiar to you from the client’s perspective. Have you ever had a meeting with a financial adviser and completed a factfind? If so:

- What kind of information were you asked to provide? Were you surprised by the amount of detail required?
- Did you feel confident that the adviser understood you and your circumstances? What did the adviser do to gain your trust? If you didn’t feel confident, why was that?

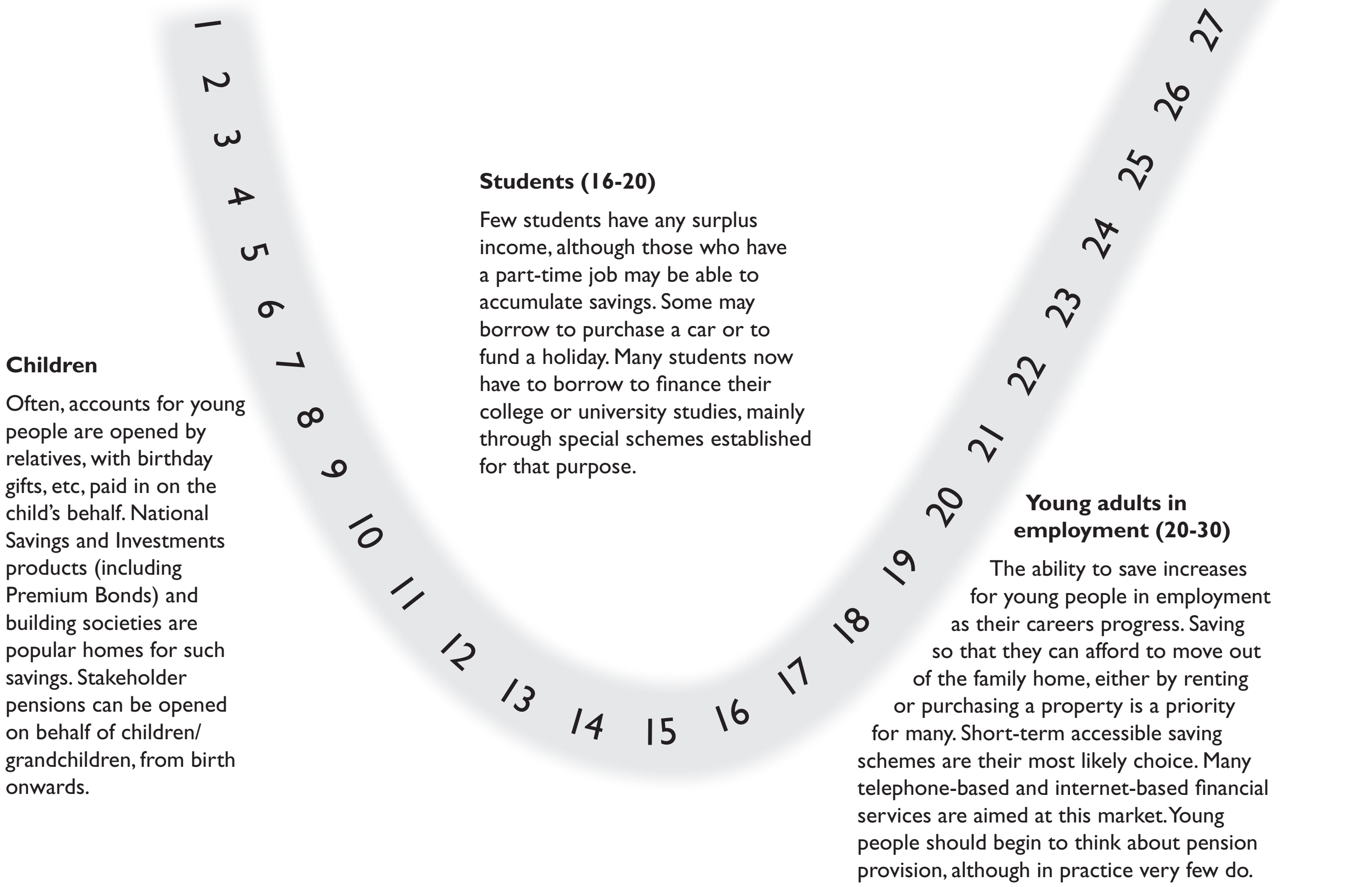
If you've never been in this situation, think about the kind of information that you would need to know to gain a clear picture of a client's financial situation and objectives.

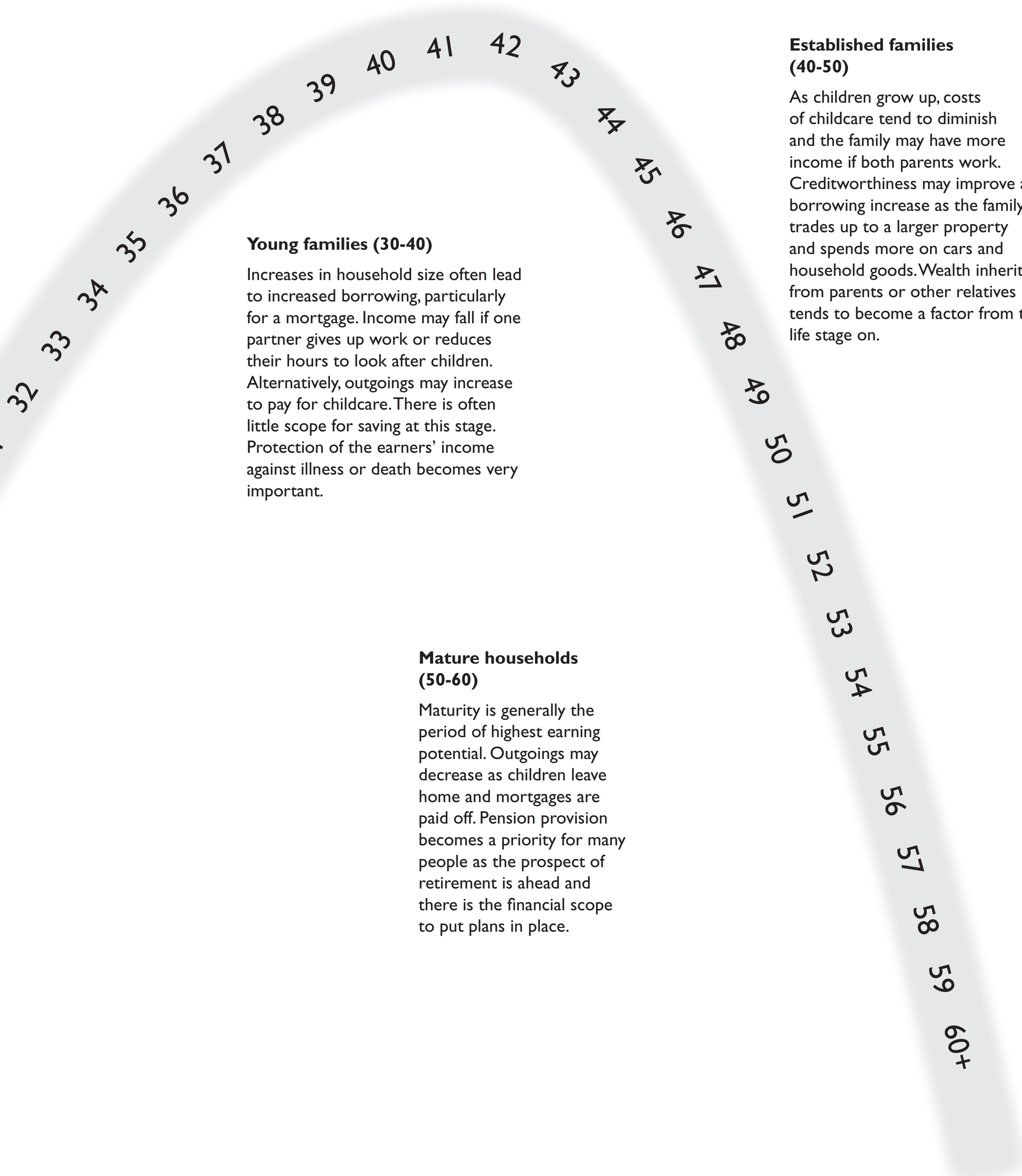
14.1 Beginning the process

Providing appropriate, ethical financial advice is not simply a matter of understanding the features of all the products that we have studied so far in this course – although product knowledge is important. An understanding of the regulatory and legal duties imposed on financial advisers is critical too: later in your studies, we will look at contract law and agency law (Topic 16), data protection (Topic 24) and consumer protection (Topic 25). The regulation of firms, individuals and the advice process is covered in Topics 18, 20 and 21.

The precise financial needs of clients vary from person to person, but it is possible to identify financial needs that are typically associated with the life stage that an individual is in, and from there to establish the type of products that might be relevant to them. Demonstrating an understanding of the situations in which clients might find themselves over the course of their life, and the real or perceived financial needs that they might have as a result, is an important factor in developing the client's trust. Maintaining confidentiality is another.

FIGURE 14.1 THE FINANCIAL LIFE CYCLE





Young families (30-40)

Increases in household size often lead to increased borrowing, particularly for a mortgage. Income may fall if one partner gives up work or reduces their hours to look after children. Alternatively, outgoings may increase to pay for childcare. There is often little scope for saving at this stage. Protection of the earners' income against illness or death becomes very important.

Established families (40-50)

As children grow up, costs of childcare tend to diminish and the family may have more income if both parents work. Creditworthiness may improve and borrowing increase as the family trades up to a larger property and spends more on cars and household goods. Wealth inherited from parents or other relatives tends to become a factor from this life stage on.

Mature households (50-60)

Maturity is generally the period of highest earning potential. Outgoings may decrease as children leave home and mortgages are paid off. Pension provision becomes a priority for many people as the prospect of retirement is ahead and there is the financial scope to put plans in place.

Retirement (60+)

Prior to retirement, most people's financial planning is centred on converting income into lump sums (or increasing 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. The need to prepare for possible inheritance tax liabilities should be considered. The cost of healthcare, and possibly of long-term care in old age, may become an issue.

CHECK YOUR UNDERSTANDING 1

Use the knowledge of financial products that you have gained so far in your studies to complete the table below.

Stage in life	Financial needs	Suitable products
School-age young people	Somewhere to save their pocket money and gifts from relatives.	
Teenagers and students	Somewhere to put their earnings from a part-time job. Borrowing to buy a car. Borrowing to fund education.	
Post-education young people	Savings for a deposit for a house. Protection against loss of income due to illness. Loan to buy house.	
Young families	Protection against loss of income due to illness. Life cover protection for dependants. Bigger house. Provision for retirement.	
Established families	Planning for retirement. Protection against loss of income (bigger mortgage and pension commitments). Life cover protection (for children still at home). Savings/investments over long term for surplus income and/or inheritances.	
Mature households	Planning for retirement. Savings and investments over the medium term to be accessible at retirement.	
Retirement	Creating as much income as possible from pension plans and savings policies. Realising capital from property. Possible long-term care needs.	

There is a well-established pattern to the way in which most savers and investors build up and hold their assets (summarised in Figure 14.2). It begins with savers' attitudes to the need for liquidity and safety and then, as income 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 debit 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.

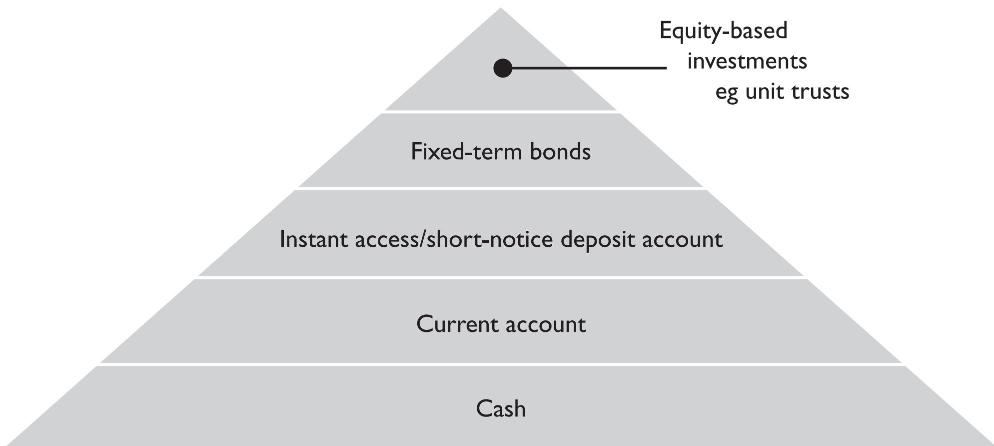
With a sufficient balance in short-term savings, investors look next at products with less flexibility but a greater return, such as fixed-term bonds.

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 begin with short-term unsecured borrowing, by way of credit cards or personal loans, to pay for holidays or a car.

FIGURE 14.2 THE SAVINGS PATTERN



14.2 What is a factfind?

Advisers must take reasonable steps to ensure that any advice offered is suitable for the client, based on the client's circumstances, relevant knowledge and experience, financial situation and objectives. This requirement was first established by the Financial Services Act 1986 and continues under the Financial Services and Markets Act 2000 and FCA rules (COBS 9.2.2R).

Advisers build a clear picture of a client's circumstances, experience, needs and objectives by obtaining personal and financial information about the client through a fact-finding process. FCA rules do not prescribe the method by which advisers obtain information from clients. Firms design a process which meets the FCA's requirements for assessing suitability, taking account of the market in which they transact business. Advisers record the information they obtain from the client through factfinding in a document often referred to as a factfind. Fees for services that the adviser intends to provide to the client are usually disclosed and agreed prior to the factfind.

To gather appropriate information, it is necessary to ask questions in respect of the client's:

- financial situation;
- existing and future needs;
- ability to provide for them;
- attitude towards providing for them;
- objectives;
- 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 their preferences.

14.3 Establishing the customer's situation

The following basic information is needed.

14.3.1 Personal and family details

- **Full name, 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 to establish domicile.

- **Marital status** – 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 couples, 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 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.

14.3.2 Financial situation

- **Employment status** – 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 their status is part-time or full-time, temporary or permanent, as well as gaining details of the client's profession or trade.
- **Income and benefits** – it is often useful to establish an exact breakdown of income by its component parts, eg basic, commission, bonus and overtime, together with the average level of overall earnings (net profits in the case of self-employed clients). 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.
- **Previous and/or additional employment** – details of previous employment (especially if the client has preserved pension entitlement), share-option schemes, profit-related pay schemes, details of additional employment. It may be helpful to obtain copies of payslips, P60s, tax returns and notices of tax coding.
- **Income and expenditure** – analysing a client's income and expenditure makes it possible to identify more easily the implications of, for instance, 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.

Calculating a household's income is usually relatively straightforward. 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. It is usually more difficult to pin down how much is spent on, for example, food and drink, holidays or cars.

Assets

The adviser should obtain details of all the client's assets, from their home (if they own it) to all their various bank accounts. Depending on the type of asset, the following details are required:

- 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.

Liabilities

The following information should be obtained in relation to the client's borrowing:

- 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.

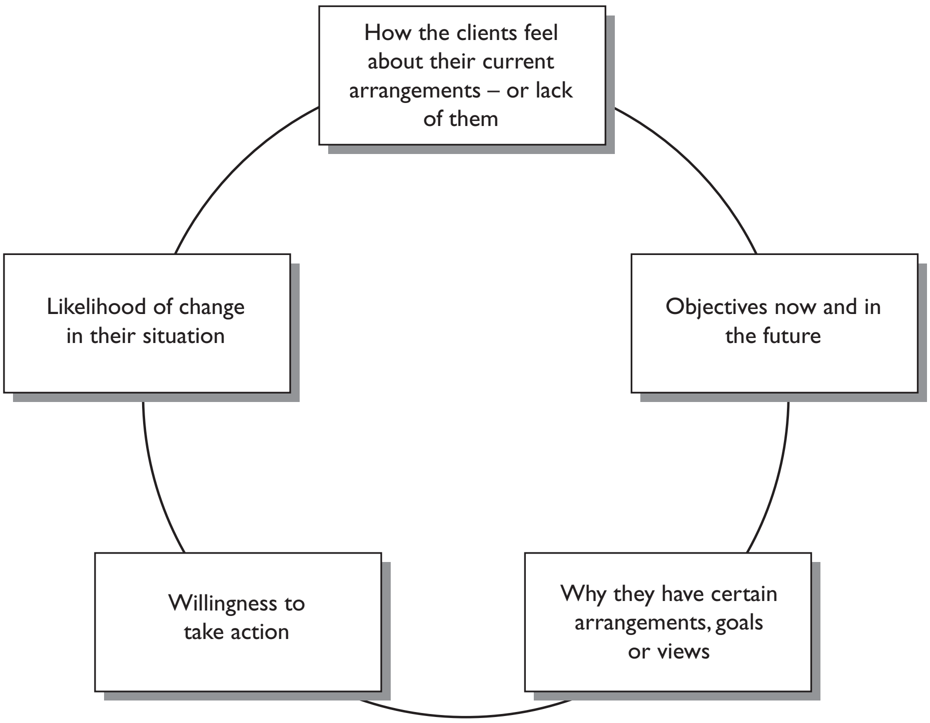
Clients are often unaware of the details of any arrangements that they have. It is an adviser's responsibility to try to obtain this information, and clients should be asked to bring full details with them.

14.4 Understanding plans and objectives

Completing the first two sections of the factfind – the personal and family details and the financial situation – involves gathering hard facts, ie about tangible items and people. The client's plans and objectives tend to be more intangible; 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.

Figure 14.3 summarises the soft facts that the adviser needs to establish for each area.

FIGURE 14.3 KEY 'SOFT FACTS' REQUIRED IN A FACTFIND



In order to find out about a person's plans and objectives, the adviser needs to ask the following kinds of question.

What are your plans for retirement? What provisions have you currently got in place?

How do you feel about current levels of performance from your investments?

What savings goals do you have?

What are your views about making financial gifts to your family?

Knowing the client's feelings about their situation, their aspirations for the future and their existing arrangements will help build understanding in a number of ways:

- Discovering the reasons behind the client's existing arrangements may in turn indicate the client's level of understanding of their finances.
- Determining the level of the client's interest in their situation will indicate their motivation to improve their situation and the likelihood of their taking action.
- Ascertaining the client's views on a number of possible alternative solutions will help in constructing acceptable recommendations.

In order to find out how a person feels about improving their financial situation, the adviser needs to ask questions like these:

Based on the arrangements you currently have, how would your partner manage financially in the event of your death?

If accident or illness prevented you from working for a period of time, how would that impact on your financial plans?

14.5 Establishing attitudes and preferences

It is essential to establish the client's attitude to risk when making recommendations. The client must understand what the risk involved in a proposal is. This may involve providing explanations to distinguish between the degrees of risk – for example, whether there is a risk to the capital that is invested, the fact that the value of an investment may fall as well as rise, and that the amount of income or capital growth may not be guaranteed. 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, but the adviser must make sure the client is aware that inflation will cause the value of the investment to fall and explore their attitude towards this risk. A client's attitude to risk is often assessed by psychometric testing, with a risk score being allocated from the answers given.

Another important factor, linked to risk, is a client's 'capacity for loss'. The FCA describes this as "the client's ability to absorb falls in the value of their investment". If any loss of capital would have a materially detrimental effect on the client's standard of living, this should be taken into account in assessing the risk that they are able to take.

It is important to take note of a client's stated preferences, but advisers have a duty of care: this means recognising that, while a client 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 an adviser may have an educational role in helping a client to explore their own financial circumstances and make the right choices.

As environmental considerations become more important to people, it may also be pertinent to find out their sustainability preferences, ie to what extent they would like to invest in environmentally sustainable products.

14.6 Identifying needs and objectives

Clients often have a range of financial needs, even when they approach an adviser with one particular need in mind. In order to give the most appropriate advice, advisers must be aware of the broad range of needs that clients might have – and must be able to recognise those needs even where clients themselves are not aware of them.

The FCA describes a vulnerable customer as someone who is especially susceptible to detriment as a result of their personal circumstances, particularly when a firm is not providing appropriate levels of care.

An individual may be vulnerable because of a wide range of circumstances including (but not limited to) physical or mental disability, poor health, or weak numeracy and literacy skills. Their vulnerability might be short term, for example because of a job loss, a recent bereavement or release following a prison sentence.

Firms have a responsibility to identify and deal appropriately with vulnerable customers, tailoring their service provision and the way they communicate to meet the specific needs of each vulnerable customer.

We can categorise an individual's financial needs and objectives into the five areas, summarised in Figure 14.4.

FIGURE 14.4 FIVE AREAS OF FINANCIAL NEED

1	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
2	Protecting self and dependants from the financial effects of losing the ability to earn income in the long term
3	Providing an income in retirement, sufficient to maintain a reasonable standard of living
4	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
5	Saving tax

Every client is different but, in general terms, an adviser should first seek to ensure that there is adequate protection of their lifestyle in the event of death or illness. Retirement planning would then be the next priority as it is effectively protecting income for a time when a person either does not want to or is no longer capable of working. Once the client's current and future positions are protected, attention can then be made to enhancements through savings and investment planning.

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 the following:

- 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 bank and building society accounts over the long term and so not gaining access to better returns available elsewhere.
- Substantial taxable savings/dividend income, in excess of allowances, being received by an individual who pays higher-rate income tax.
- A non-taxpayer holding investments where tax is taken while funds are invested and where the tax deducted cannot be reclaimed.

- A client with 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.
- A client not making any pension contributions, or making only very small pension contributions as a percentage of total earnings, which will mean being dependent upon state benefits unless action is taken.
- 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 the client to see the key issues facing them and to recommend and discuss a priority order for action.

14.7 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.

CHECK YOUR UNDERSTANDING 2

Read through the problem areas that an adviser might encounter, listed in column 1 below, and try to **match** them to the potential consequences for the client. The answer is provided at the back of this book.

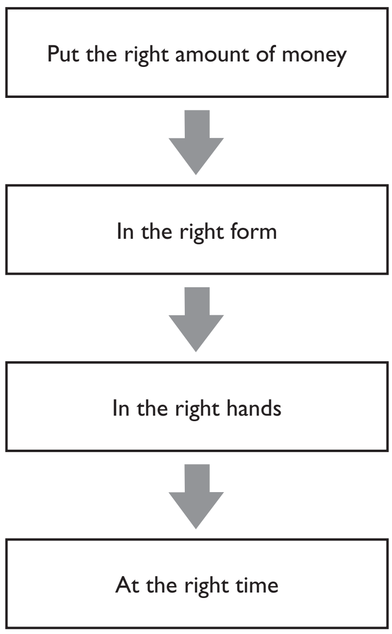
Problem relating to	Potential consequences
Income protection	Lack of diversification. Too much on deposit. Interest received less than inflation. High admin charges through too many small shareholdings. Failure to take advantage of tax-free alternatives.
Life assurance protection	Not taking advantage of tax reliefs, allowances and tax-free investments. Estate subject to IHT. Gifts not documented.

Pension provision	Employer will only pay income for a short period. Have to rely on savings and state benefits to pay mortgage and other borrowing, household expenses and living expenses, etc. May lose property if mortgage not paid. Credit record adversely affected if debts not paid.
Savings and investments	Low standard of living in old age. May have to sell house and trade down or move into rented property. Income from state benefits inadequate for heating, food bills, etc.
Tax planning	Mortgage may be paid off but fall in income may impair ability to meet household and living expenses; alternatively outgoings might increase to pay for childcare, housekeeping, etc.

14.8 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 objective is summarised in Figure 14.5.

FIGURE 14.5 THE ADVISER'S OBJECTIVE



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

- **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 and capacity for loss.
- **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.

It is a good idea to have a clear plan for how to present each recommendation to the client, not least because some details may be mandatory under the Financial Services and Markets Act 2000 and related FCA rules.

Explanations that should always be included are:

- 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. The adviser should check that the client understands, perhaps by asking a few simple questions.

14.9 Completing the sale

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.

HANDLING OBJECTIONS

The first point in handling an objection is to qualify it. This means finding out whether it is a genuine statement of concern about the recommendation or whether it is masking another issue that is on the client's mind. For example, if a client states "that is too expensive", is that the real issue or is it that the adviser has not really explained the need or the benefits of the recommendation?

If an objection is made, it is essential to understand 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 they have 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.

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. If the adviser does complete the proposal form, the client must read it thoroughly, checking what has been written before signing it.

In particular, the client must be made aware of the consequences of deliberate or reckless misrepresentation. If the contract is later made void because of information that the client misrepresented then the client may not be protected and could also incur a loss of premiums.

A key features document (or key information document 'KID' or key investor information document 'KIID', depending on the product sold), together with a key features illustration (for some products), must be given to the client before the sale is closed. These documents provide the client with all the information they need in order to make a decision. The client should also be provided with a product brochure explaining product details and features in full. The adviser must also explain the cancellation notice, which sets out the client's right to withdraw from any arrangements within a defined period.

The adviser should provide the client with their business card during the meeting. This gives the client a clear route back to the adviser should there be any queries later on.

RETENTION OF RECORDS

Once the arrangements have been put in place there is a regulatory requirement to keep records to demonstrate what advice and information was given and why.

Product type	Retention period
Life policies, pension contracts	5 years
Pension transfers, opt-outs, FSAVCs	Indefinite
MiFID-related business	5 years
Other eg mortgage related contracts	3 years

These retention periods relate to the FCA's conduct of business requirements, which we cover in more detail in Topic 20. There are other retention rules relating to the prevention of money laundering and to complaints handling – we look at these in Topics 23 and 25 respectively.

14.10 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.

14.10.1 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.

14.10.2 Reactive servicing

Reactive servicing happens as the result of a request from the client, for example 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 might 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. Keeping appropriate records will not only comply with the requirements of the Financial Services and Markets Act 2000, but may also lead to more business.

THINK AGAIN . . .

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- describe how financial needs typically change over the life cycle?
- outline the ‘hard facts’ that an adviser needs to obtain via a factfind?
- explain what other information an adviser needs to establish at the factfind stage?
- explain why it is important to understand a client’s attitude to risk?
- list five areas of financial need that should generally be explored?
- list the explanations that should always be included when presenting a recommendation?

Go back over any points you don’t understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

Test your knowledge

?

Use these questions to assess your learning for Topic 14. Review the text if necessary.

Answers can be found at the end of this book.

1) Which of the following would usually be a priority need for a client taking out their first mortgage?

   a) An emergency fund.

   b) Income protection.

   c) Medium-term investments.

   d) Pension planning.

2) Why is it important to establish a client's place of birth as part of the factfind?

3) Which of the following would normally be regarded as the priority financial need for a client who has surplus cash for the first time?

   a) A unit trust.

   b) An emergency fund.

   c) A stocks and shares ISA.

   d) A pension plan.

4) When completing a factfind for a client in relation to investment advice, which of the following should always be taken into account?

   The client's:

   a) levels of indebtedness.

   b) employment details.

   c) attitude to risk.

   d) mortgage arrangements.

5) Which of the following ought to be the highest financial priority for a retired couple?

   a) Pension accumulation.

   b) Protection advice.

   c) Generating income.

   d) Mortgage advice.

6) What is meant by 'capacity for loss' and why is it important?

7) List the factors that an adviser might take into account when deciding on an appropriate solution for a client.

8) List five points that should be included when presenting a recommendation to a client.

9) For how long must records relating to pension transfers be retained?

10) What is the difference between proactive and reactive servicing?