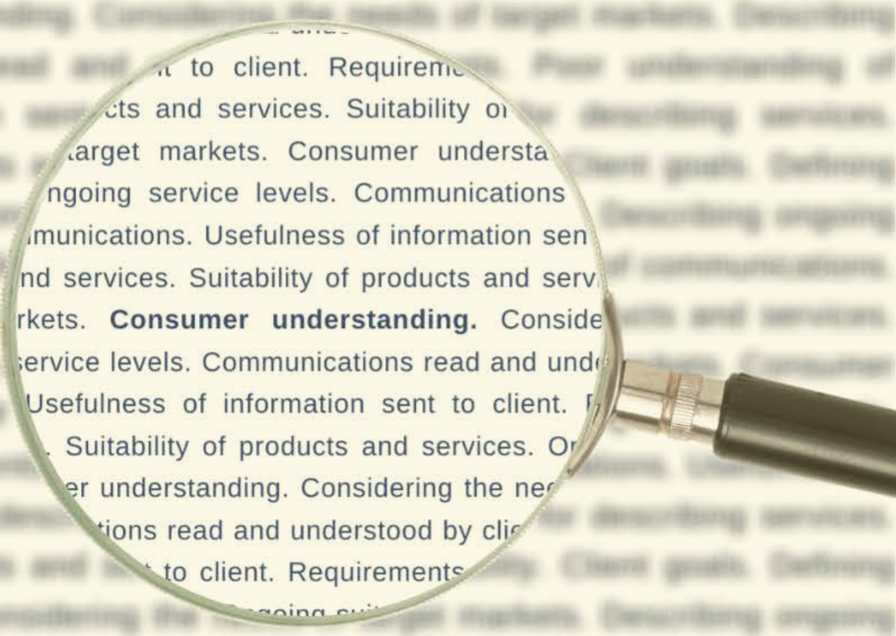
NEXTWEALTH

CONSUMER DUTY IMPLEMENTATION GUIDE

2. How are advice firms supporting consumer understanding?



AEGON

March 2023

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 support consumer understanding. It's a multi-dimensional area covering not just understanding the advice service, but also the benefits of recommended products and the link to meeting the client's financial objectives. The many detailed disclosure regulations still have to be followed, which at times may hinder rather than help. A focus on the client's wider financial wellbeing may help clients to understand their goals, picture their future selves and illustrate how the adviser is helping protect from foreseeable harm.

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

Contents

Introduction	4
Requirements for describing services	4
Products and services	5
Suitability of products and services	6
Ongoing suitability	6
Client goals	7
Defining target markets	8
Considering the needs of target markets	8
Describing ongoing service levels	9
Communications read and understood by clients	10
Client understanding of communications	12
Usefulness of information sent to clients	13
Conclusion	14

This is the second 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 articulate what they deliver to clients with clarity and fairness to all groups, including those with characteristics of vulnerability, in a way that supports good outcomes and avoids harm.

At a culture and governance level, the FCA is interested in how firms articulate (whether publicly or not) their purpose and values and how this aligns with obligations under the Consumer Duty.

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).

Requirements for describing services

Under its PS22/9 A New Consumer Duty paper, the FCA says: "The Duty sets a higher, clearer standard by requiring firms to ensure their products and services are fit for purpose and offer fair value, and to help consumers make effective choices or act in their interests."

Financial advice firms have a key role in helping avoid foreseeable harm and in making sure their clients are getting products and services, and associated support, that meets their needs and provides fair value.

Some firms will have a wider range of obligations under the new Duty than others. A financial planning firm providing holistic services and wealth management to clients on an ongoing basis has a larger set of responsibilities in delivering their service (for example in ensuring ongoing client fit and understanding) than a firm offering a simpler service with no add-ons. However, regardless of the service provided, it is key that it is described in a way that ensures the client understands what they will receive and the value it will deliver.

Products and services

In the next guide in this series, we will explore the types of information and data that firms may need to analyse whether their clients are achieving their expected outcomes or where adjustments need to be made.

From a client perspective, our research finds that whilst consumers currently report a broad level of satisfaction (7.7 out of 10) with the types of products their adviser recommends, there is room for improvement.

Consumers are most satisfied when advisers set clear expectations, something that not only should be taken on board by advisers but that will also be a requirement under the Consumer Duty.

This can be augmented by advisers fully explaining their offering and what might be included, particularly in a more holistic financial planning service. For example, this may include cash flow modelling for some clients, while for others there may be retirement coaching at a specific time, or a focus on financial wellbeing. This could be particularly important at a major life event, such as getting married, getting divorced, a bereavement and so on.

Figure 1: Consumer satisfaction with their financial adviser

Advised clients score their advisers similarly on the communication received from the firm (7.7). Ensuring clarity, fairness and understanding are key aspects of client communication and will need to be demonstrated under the Consumer Duty.

We can see that there is plenty more that advisers can do to improve their client relationships.

This could include offering a 'menu' facility to include or exclude certain elements of financial planning, such as financial coaching. This may also vary according to which client segment the adviser designs specific services for and offers to, and whether those services can be bought as an add-on, or removed as relevant to reduce the cost to the client.

Action points:

- ☐ Consider offering a 'menu' facility to clients so they are only paying for services they specifically want and will benefit from.
- ☐ Ask more questions of clients when you are in client meetings so you know they are understanding what they want and need.
- ☐ Accept and seek constructive feedback – we rarely learn something important from things going well.

Suitability of products and services

The Consumer Duty is prompting firms to reconsider their process for assessing suitability of products and even their approach to investment management. An adviser at a three-adviser firm in Hertfordshire, said:

> *"Just having Consumer Duty out there in the ether has made us question some of our proposition for clients. Traditionally, we've appointed discretionary managers to run bespoke portfolios for the majority of the wealth we look after. This has brought it more into focus, we've started questioning if that's the right thing to do, because you pay a significant premium for that service. And sometimes the benefits are more with us than with the client."*

Perhaps more challenging is to get beyond satisfaction to the real benefits of financial planning and advice. Consumers describe the value of advice as peace of mind, trust and contribution to their wellbeing – you can translate that as having an adviser taking care of their money means the consumer doesn't have to.

That might mean firms giving more attention to how they articulate the value of advice and the work they do in the background.

One consumer, 34, with £400,000 to £600,000 in investible 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."*

Another consumer, 41, with £250,000 to £400,000 of investible assets, said:

> *"We want our money to grow, and our adviser understands that. We understand that there are ups and downs, but he reminds us that these are long-term investments. We're satisfied with the performance of the investments as he clearly wants to make money from them as well."*

Having trust in an adviser is necessary for clients to feel more comfortable with the suitability of recommended products and services, no matter how much the performance of the underlying fund fluctuates, which given the recent volatility we have seen through and since the pandemic is a salient point.

One consumer, 33, with £250,000 to £400,000 of investible assets, said:

> *"The value of having an IFA is having someone look after and make your money work for you. If it wasn't working, I would definitely not hesitate in questioning what was going on and looking for other advice, but I honestly don't know how I'd know if things weren't going in the right direction. I understand they're long-term investments, so I'd trust him [my IFA] to put things right."*

Ongoing suitability

One of the key aspects of the Consumer Duty that is essential for advisers to be ready for is the need to ensure that the product they have recommended for their client is not just suitable at the point of sale but, if the advice is ongoing, continues to be suitable over the life of the product and the relationship with the client.

Action points:

- ☐ Look for improvements in how your firm articulates what it does for clients and the work that goes on in the background, outside of the review meetings that the client experiences
- ☐ Make sure your idea of how you add value to your client relationship is in sync with what your client feels is valuable.
- ☐ Build trust by ensuring your clients understand the products they are investing in, or at least understand as much as they want to about them.
- ☐ Ensure the firm's review process supports clients' ongoing needs and changing circumstances, avoiding newly foreseeable harm, and that clients maintain a good level of understanding of the products and services they receive.

Client goals

The introduction of Consumer Duty has highlighted that more needs to be done to match the suitability of investment products and pensions with shifting client goals and preferences. Advisers recognise there can be an over-reliance on centralised investment propositions, potentially impacting the suitability of on-going investment recommendations.

A director of a 10-adviser firm in the Midlands, said:

"The bulk of the market does not reappraise investment performance versus a sensible metric, and I think we need to be looking at performance of investment portfolios at annual reviews versus relative metrics, and we need to be appraising other options and moving clients around much more.

"Historically IFA firms have been wedded to a centralised investment proposition and it's very difficult to steer off that. I think it's quite easy to justify investment and investment portfolio risk, but now I think we need to appraise it.

"We're going to appraise the suitability of platforms based on target market. So, we're going to identify value for that client at the outset, but then also, we're going to appraise value for that client ongoing, and we're not going to be afraid of moving between platforms as value shifts and value changes."

Our research indicates that consumers are most satisfied with recommended products when they feel confident the adviser has understood their objectives and clearly explained the recommended approach.

One consumer, 40, with £250,000-£400,000 of investible assets, said:

"[Initially] we looked at my risk preferences...after discussing it with him, I did put some of it into high risk...he made me feel comfortable that even though the money that I would make off the ISA account wouldn't totally negate the high-risk amount that I had in there, it would be enough for me to not be concerned.

"Talking through things on a 'back to basics' level by showing me how the markets work, the platforms you can use, and the costs associated with each option and how that affects your tax meant I understood my choices and the gain I could make."

Tracking these goals is an important element of meeting both consumer expectations and the requirements under the Consumer Duty. One adviser uses a magnetic board where the clients write their goals and then once each goal is achieved, the counter is moved across a line. This visually allows both the clients and the adviser to 'see' where they are in relation to their goals.

There may be a way of doing this online, so that at any stage and from anywhere the client and the adviser can access the file to visually see where they are in relation to the client's goals.

Action points:

- ☐ Work closely with clients to define their goals and monitor progress towards them regularly to support good outcomes on an ongoing basis and address any potential foreseeable harm.
- ☐ Consider a 'back to basics' approach with clients. It's easy to get caught up in the complexities of financial terminology, but some people struggle to understand how even simple financial products work. Don't overestimate prior knowledge.

Defining target markets

Under the Consumer Duty, advisers will need to categorise clients into 'target markets' – where clients with similar needs and wants are grouped together with a proposition, service and product set defined specifically for each of these target markets.

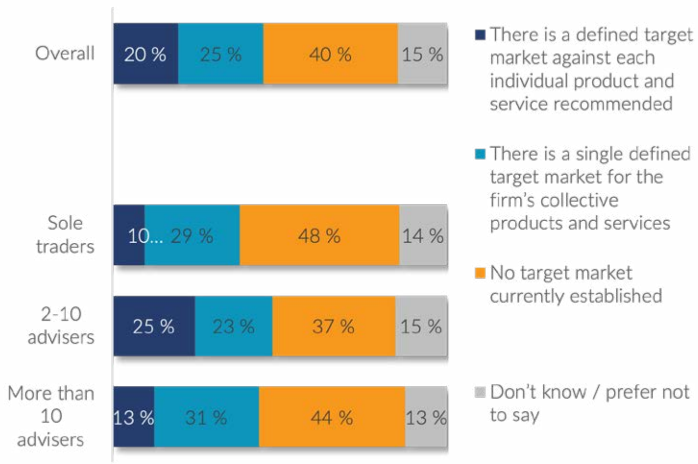
The target market definition can be narrow or as wide as, for example, 'wealthy clients seeking holistic financial advice'. What is important is that there is a consistent approach to delivering advice and planning to the target market, and that firms can demonstrate that products and services in both design and delivery match the needs of that market.

Many advice firms don't yet do this, at least not on a formal, demonstrable basis.

Two in five (40%) advice firms haven't defined target markets, which may be because it feels strange considering their desire to offer a bespoke service. This is common in smaller firms where it is less challenging to achieve a consistent approach. For example, nearly half (48%) of sole trader advisers have no target market currently established.

However, one in five (20%) of firms have already defined target markets against individual product and service recommendations, while one in four (25%) have a single defined target market for the firm's collective products and services.

Figure 2: Advice firm target market by number of advisers



One adviser in a two-adviser firm, said:

"I do not target a specific market but provide holistic advice and cover off all of these areas."

The story is similar at another three-adviser firm, where one of the advisers said: "We treat each client individually. We don't have target markets, nor do we lump clients together. It's bespoke in every case."

Considering the needs of target markets

This may not be an approach that can continue unchallenged as the Consumer Duty will require advice firms to demonstrate that they have considered the needs of their target market and that they have designed services accordingly and are delivering value to clients in that target market. With a defined target market, firms have a framework against which to deliver and monitor that the service provided is appropriate for the needs, characteristics and objectives of that market, even if the specific outcome is bespoke to individual clients.

Firms are looking to do more to segment the client base to better frame their target market, focus the proposition and provide greater value. Conversations with advisers revealed two main approaches that are likely to be followed in building more specific client segmentations (which will be discussed in more detail in Guide 3).

Action points:

- ☐ Look at your client base and see where groups of people have specific similarities, in age, life stage, origin of wealth and/or product requirements and if you can align your services to these.
- ☐ Helping clients individually should never be overlooked by segmentation, but when you say you are offering each client a bespoke service, are you really? Ask this question to see where patterns are emerging

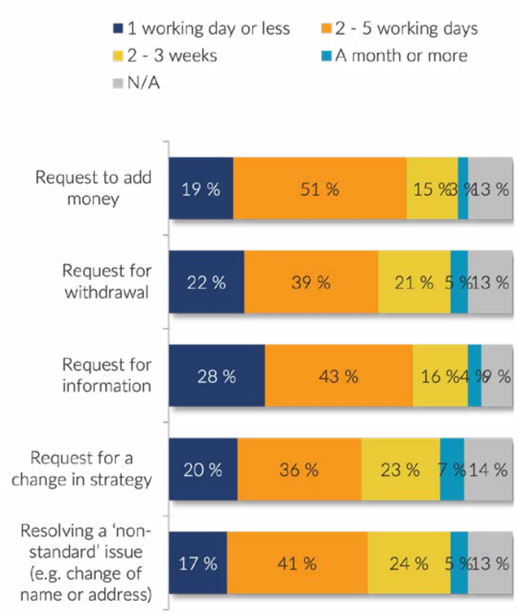
AEGON

Describing ongoing service levels

Advisers want to be able to design a client journey as part of the service they offer, so they are able to articulate to clients exactly what to expect and when.

When clients ask advisers for withdrawals, to add money to a product or for information, the speed with which the request is resolved can say a lot about how the adviser approaches certain aspects of the client relationship. For most queries, clients said the majority of requests were resolved within a week.

Figure 3: Time to resolve requests



When the request was to add money, the majority (51%) of requests were resolved within two to three days. This falls to 39% of requests to withdraw money resolved in this timescale, but this can represent delays on the part of the provider as well as the adviser's response rate.

Requests for information are dealt with the fastest, with 28% of these being completed within one working day or less. Overall, although consumers feel that requests can be carried out more quickly, they are satisfied with efforts made by their adviser to obtain information.

One consumer, 36, with £250,000 to £400,000 of investible assets, said:

"When we ask for things, they're not quick enough as you would like...this is the problem with it being in person, but we're used to everything online. We wanted to withdraw some money. It's quite a lengthy process, he has to come over, we have to review documents.

"So, it's not something like doing a simple bank transfer on your phone. It does take at least a week. If there was a way that that could be cut down a little bit. But I just don't see how it's possible. Obviously, he's busy seeing other clients and then trying to fit us in when he can. It's just not always possible."

There is no question consumers highly value the support offered to them by their advisers, not least because they have an 'always on' perception of their advisers – they feel their adviser is constantly working on their behalf and to their benefit.

As in many other areas of delivering advice, managing client expectations through clear communications is a vital part of good ongoing service.

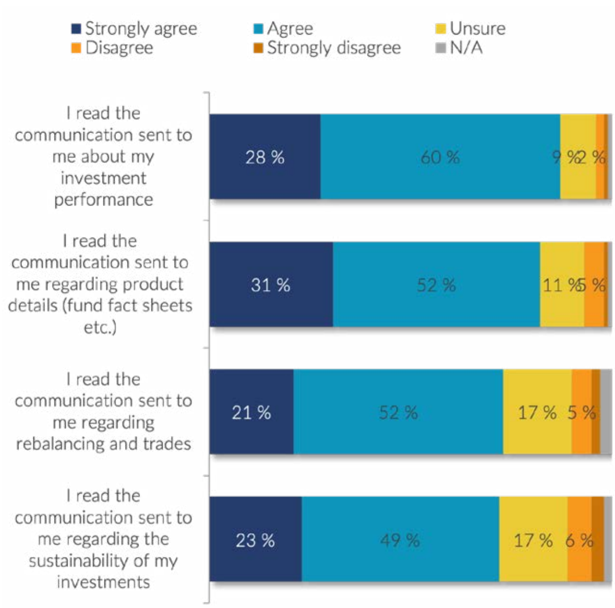
Communications read and understood by clients

The FCA is pushing for better and continuing communication between advisers and clients as part of the Consumer Duty, but from the NextWealth research it appears there is a lot more to do in this area than some advisers may realise. For example, advisers think less than half of the information provided to end clients is useful, while less than half of consumers surveyed said they fully understood any of the communication they received from advisers.

A core part of Consumer Duty is to test whether communications are understood by customers. The NextWealth research found consumers are most likely to read communications about investment performance and product details. This is an important part of the requirement to achieve good outcomes, because if clients don't understand what they are investing in and why, whether it is a direct investment product or via a pension, then the ability to achieve a good outcome for the client is diminished.

For example, 88% of consumers said they read communications about their investment performance, and 83% of consumers said they read the communications about the product details and fund factsheets. Rebalancing trades communications were only read by 73% of clients, with just 72% reading information about the sustainability of their investments.

Figure 4: Consumer Communications



Part of the problem is the length of the documents and the reams of information clients need to wade through to get to the nuggets they really need to know.

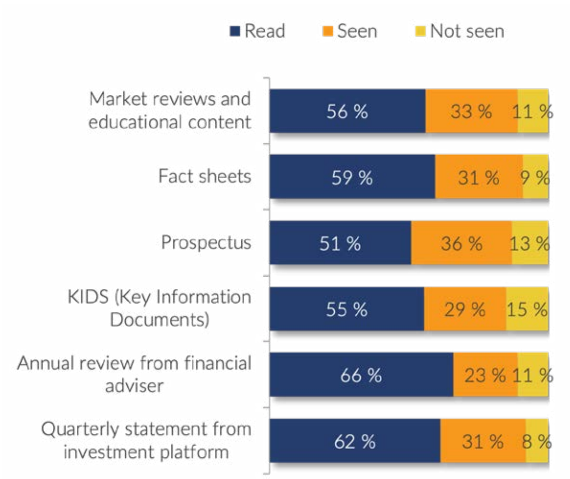
One consumer, 34, with £250,000 to £400,000 of investible assets, said:

> *"It's all there, what my savings are, and my investments and things like that, but actually, this is a 10-page document. And it's hard to find where all that information is, so I don't really bother to try.*
>
> *"I'm just happy to see how much they've invested, what the rate of growth is, and whether I've lost anything."*

This last comment is indicative of how many clients will view the information sent to them. There is clearly scope for the key information in each of these documents to be separated out so clients can see at-a-glance what they need to know through a lens of what really interests them. This is something that could be determined relatively easily with focused surveys – which again need to be short and not overbearing – so the client communications can be more streamlined and efficient, saving both clients and their advisers' time.

Even so, at least half of clients said they read the communications sent to them. Most read the annual review and quarterly statement. It is unlikely that over half of clients are reading KIDS. This sort of result is typical of consumer surveys - the exact results are less important than relative results.

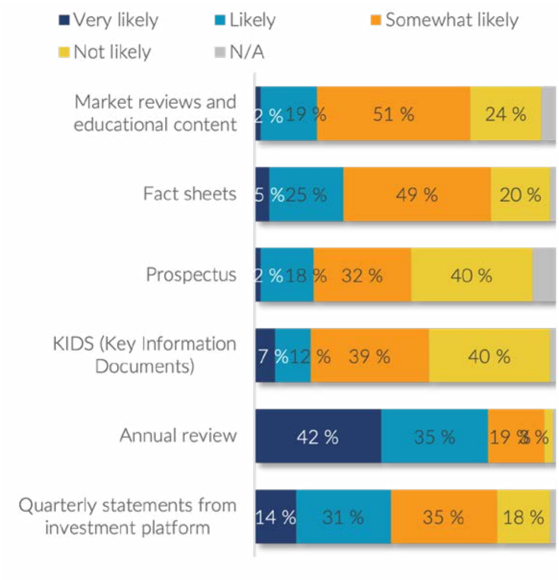
Figure 5: Type of communications read by consumers



In NextWealth's qualitative research, they asked consumers to bring examples of the communications they receive. This allowed them to compare the findings from the quantitative feedback with qualitative insight. Clients all brought annual review documents and statements from their adviser or platform.

This confirms these are the most read and valued documents – and financial advisers agree the annual review is the communication clients are most likely to read, followed by the quarterly statement from the platform.

Figure 6: Likelihood of clients to read communications from the adviser's perspective



Even though clients said they read the annual review, in-depth interviews revealed that clients don't read this in depth as they are again put off by the volume and complexity of technical information. It leaves many clients overwhelmed, and they feel unqualified to decipher the information.

Instead, they look at the key information in the annual review which covers overall investment performance and then prefer to have conversations with their financial adviser who can relay the most important information to them directly with no effort on the client's part. At this point, if they have any concerns or queries, they can also directly ask questions.

One client, 50, with £250,000 to £400,000 of investible assets, said:

> *"I read my statements as that's got the important information in it that's good to see every so often. Other than that, I can usually get hold of my adviser whenever I need him if I need anything else doing or any other information."*

Action points:

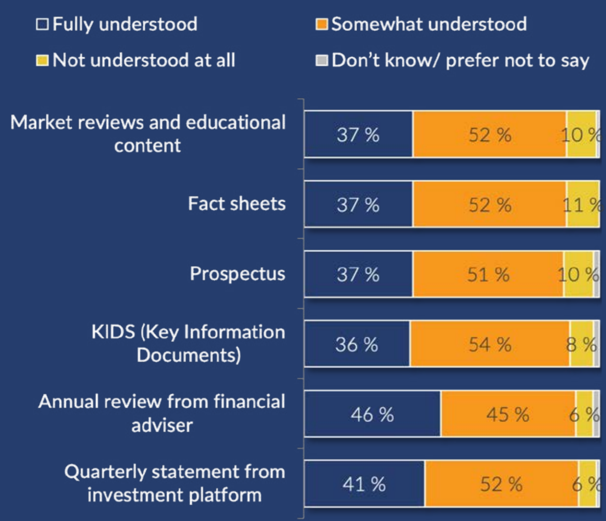
- ☐ Review all client communications and see where you can work to write them in plain English as much as possible.
- ☐ Consider working with an external content provider to help with the messaging and putting information in a clearer and more concise way.
- ☐ Bring out key points upfront

Client understanding of communications

Despite the large amount of information that advisers are required to send to their clients, less than half of consumers surveyed said they fully understood any of the communication received from financial advisers. This may seem low, but it is suspected that the real number is far lower, as behavioural bias means people prefer not to admit when they don't understand.

However, this is a worrying number and suggests more needs to be done to simplify the messaging in adviser-client communications. This is an action that probably needs to be led by advisers, as most clients will be reluctant to say identifiably what they understand and what they don't for fear of losing face, so even a client survey may not elicit sufficient information to address this.

Figure 7: Consumer understanding of communications



When they are not identified specifically, clients seem happy to outline what they would prefer to see in communications from their advisers. For example, one client, 60, with £400,000 to £600,000 of investible assets, said:

> *"I would be more interested to read it then if it were just simple reading. Or like a traffic light system, simple, not loads of figures."*

Another consumer, 33, with £250,000- £400,000 investible assets, said:

> *"I get overwhelmed by the amount of information I get. It would be good if my statement had a paragraph saying, 'you've invested X, this has grown by X amount, this is looking good', but there's no description about what has actually gone on in the time that the money's been invested. Numbers, they don't really make a lot of sense, I've always been more into words."*

Happily, this is something that isn't lost on some advisers, and they will do their best to help clients get more from the information they are being sent with summaries.

We hear of advice firms being creative with their use of suitability reports to help their clients become more informed; making them more concise, using less jargon and in some cases video reports and executive summaries:

One adviser from a three-adviser firm in Hertfordshire, said:

> *"Unfortunately, they don't really read it. We know this, which is why **we always put in an executive summary**. And I even explained it to clients. I'm kind of over it. I know you're not going to read it. But at some point, someone you leave behind is going to read it and have to understand what happened. That's why I put the executive summary. We are pretty old fashioned. We will walk the client through a suitability report."*

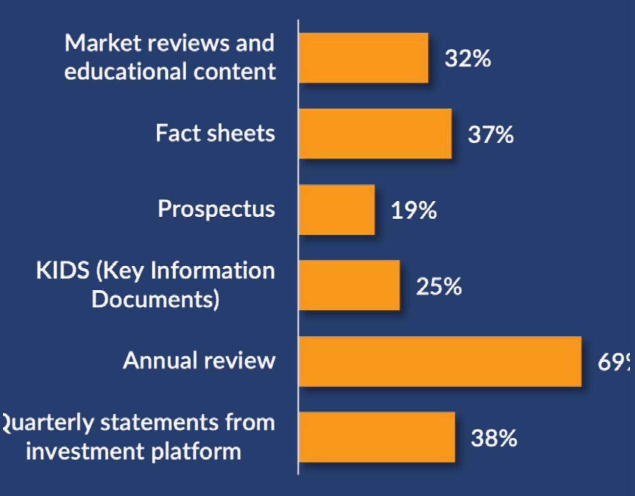
For those clients with some financial background, the reports are less daunting. One client, 58, with £400,000 to £600,000 of investible assets, said:

> *"I'm very happy with it, I completely understand what they're putting across, then again, do remember, I've got a little bit of a financial background as well. I think if you knew nothing about anything, you might look at it and get a bit confused."*

Usefulness of information sent to clients

Part of the issue with a client's reluctance to read the information sent to them by their adviser is down to the fact that even advisers feel that more than half of the information sent to clients isn't useful. Over two thirds (69%) of advisers believe the annual review is useful, but that figure drops to just 19% for the prospectus, and 25% for KIDs.

Figure 8: Usefulness of information



Advisers see the Consumer Duty as an opportunity to find ways of reduce the amount of disclosure they are required to make and are keen to simplify communications designed to enhance understanding. However, all existing disclosure rules do need followed and they would appreciate reassurance from the regulator that they won't be penalised for thinking creatively about presentational approaches.

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

> *"It depends on how serious the regulator is… they're saying they want simplification, communication that talks to the client, language that people are understanding. If I then give that to my client, what I would hope that I won't get into hot water for removing all the nonsense that adds no value. So, they need to be very clear about direction of travel, 'are you saying you want us to do this'? And when we do it, will we be judged positively?"*

Some platforms and asset managers are also engaging adviser and end-client focus groups to test their communications and approach.

Action points:

- ☐ Consider creating a focus-group of existing clients to help you tell whether the information you are sending out and the format it is created in is easy for them to understand.
- ☐ Use a cross-section of people – financially sophisticated, young, older, and from different socio-economic backgrounds to get the best results. If you choose people who will tell you what you want to hear rather than give you genuine feedback, you can miss the opportunity to improve your service.

Conclusion

Advice firms are already focused on drawing out their clients' hopes and goals and delivering a service that helps them reach those aspirations.

That's a significant evolution that we've seen in the decade or so since the Retail Distribution Review and the days of selling products to meet targets. The basic transactional financial advice model has widened to include other services that help clients understand and embrace their full financial situation and life objectives, with holistic planning, modelling tools and coaching.

Some clients will still expect to simply be sold a product. They may measure the value received based solely on that product's financial performance. They may find financial reports bewildering and struggle to engage with their wider financial picture.

There is still a disconnect between the information that clients have about their adviser's product recommendations and services, and their understanding of them.

That's where the financial education and communication piece comes in for advice firms to support their clients in making good choices about products and services to achieve their financial objectives, both now and as their circumstances evolve.

Consumer Duty will prompt advice firms to meet these challenges by improving how they articulate exactly what they do for clients and the value they deliver. And to improve not just the clarity of communications but to examine whether and to what extent it is likely to be understood by the clients intended to receive them.

There is also a lot to be said for streamlining communications for clients, something many advisers already try to do but are limited within the confines of the current FCA rules on disclosure. This too could change under the Consumer Duty.

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.

To sign up to our research panel, email **enquiries@nextwealth.co.uk**.

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.