CFA UK is a member society of

28th January 2011

Paul Mountjoy
Conduct Risk Division
The Financial Services Authority
25 the North Colonnade
London E14 5HS

Dear Mr. Mountjoy,

The Chartered Financial Analyst Society of the UK (CFA UK) is pleased to respond to the FSA Guidance consultation on assessing suitability related to establishing customer risk and making a suitable investment selection. We welcome the FSA's approach to provide guidance on helping firms ensure that they deliver the appropriate client outcome regarding their investment selections.

The society represents CFA Institute members in the UK, most of whom work as front office investment professionals (managing portfolios, researching securities and advising on asset management). This response has been prepared by the CFA UK's Market Practices and Professional Standard Committee, in consultation with the CFA Institute, on behalf of the CFA UK membership. The society has not surveyed members in relation to this consultation, however, we make observations that we believe to be important and that we hope will be useful in informing the FSA when it comes to achieving its policy objectives.

<u>About CFA UK and CFA Institute</u>

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the chartered financial analyst (CFA) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of whom more than 90,000 hold the Chartered Financial Analyst® (CFA®) designation.

Proposed guidance on Assessing Suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection

The FSA's initiative is well timed. There are press reports of both small and large financial firms causing private clients to lose significant sums through unsuitable advice and investment selections. It would appear that these client losses may reflect motives that are driven more by revenue generation than client best interest. Worryingly, recent press reports have highlighted systemic failures in a large firm and a small firm that resulted in investor detriment rather than an isolated behaviour of unethical adviser. Of equal concern was that both firms were treated differently by the FSA given that the systemic nature of the client detriment appeared to be very similar.

Reports of failings on suitability and best advice bring the industry into poor repute and are to the detriment of those advisers and discretionary managers that do place client interest first and have the procedures in place to ensure that this happens.

CFA UK is concerned that trust and confidence in the financial services industry is at an all time low. Only through higher professional and ethical standards and holding those that act against their client interests to account, will trust and confidence be gradually restored. Trust in the financial sector will be a pre requisite for the success of auto enrolment into pensions, due to come into force from 2012.

We are pleased to see that the FSA has attempted to identify areas of poor practice as well as good practice in their Guidance Consultation; the latter a reflection of an emphasis on client outcome. We would make the following observations:

- we agree your poor practice example on page 12, where risk ratings are allocated subjectively, should be highlighted
- However, the subsequent examples where advisers have attempted to quantify risk have also been highlighted as poor practice, but we believe that a question that compares possible levels of returns while highlighting the extent of the downside of a more aggressive return objective is not poor practice
- If the FSA firmly believes that this question is poorly worded, the guidance would benefit from a suggested format for a question of this type that would fall into 'good practice'.
- An optimal tool to assess a customer's attitude to risk, would gather all of the information needed. However, we note that gathering only the information required by the assessment tool falls foul of good practice in the example on page 20.

We believe that it is good practice for advisers and asset managers to adhere to the principles set out in the CFAI Asset Manager Code and detail the relationship with the client using an Investment Policy Statement (IPS).

Asset Manager Code

Investors entrust their financial assets to investment professionals, who owe a duty to their clients to seek the best strategy possible based on due diligence in understanding the clients' goals, objectives, risk constraints, and needs. This duty applies equally to investment management firms and advisory firms, both of which should put their clients' best interests foremost.

The Asset Manager Code of Professional Conduct outlines the ethical and professional responsibilities of firms that manage assets on behalf of clients. It provides standards and supportive guidance based on general principles of conduct.

The Asset Manager Code of Professional Conduct states that managers have these responsibilities to their clients:

- To act in a professional and ethical manner at all times
- To act for the benefit of clients
- To act with independence and objectivity
- To act with skill, competence, and diligence
- To communicate with clients in a timely and accurate manner
- To uphold the rules governing capital markets

Investment Policy Statements (IPS)

The IPS serves as a strategic guide to the planning and implementation of an investment program. When implemented successfully, the IPS anticipates issues related to governance of the investment program, planning for appropriate asset allocation, implementing an investment program with internal and/or external managers, monitoring the results, risk management, and appropriate reporting. The IPS also establishes accountability for the various entities that may work on behalf of an investor. Perhaps most importantly, the IPS serves as a policy guide that can offer an objective course of action to be followed during periods of market disruption when emotional or instinctive responses might otherwise motivate less prudent actions.

We strongly support the use of IPS. The CFA Institute's "Elements of an Investment Policy Statement for Individual Investors" suggests desirable components of an IPS for a high-net-worth or individual investor. Not every element will be appropriate for every investor or every situation, and other components reflecting unique investor circumstances may be desirable for inclusion.

The IPS should be a highly customized document that is uniquely tailored to the preferences, attitudes, and situation of each investor. Templates that purport to offer convenience and ease in development of an IPS almost inevitably sacrifice consideration of individual factors that are highly relevant. The investment professional must thoroughly understand the investor's objectives, restrictions, tolerances, and preferences to be able to develop a truly useful policy guide.

This becomes important in assessing the number of factors that determine the appropriate investment selection for the client. Unlike standard economic theories, investors do not have a single risk profile and do not always practice asset integration. The evidence from behavioural finance indicates that investors are more concerned about gains and losses instead of risk and return. Furthermore, investors may not always have one risk profile; they may have several objectives each with its own risk profile and this is something a professional, client focused investment adviser should be able to identify and incorporate into any recommendation.

Understanding and meeting the clients' requirements appropriately requires the assessment of quantitative and qualitative factors.

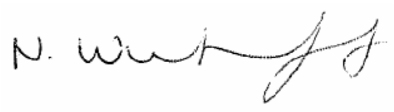
Conclusion

In conclusion, we are pleased that the FSA is recognising poor and good practices. However, in light of recent press reports about systemic failings within small and large firms, we believe that in addition to this Guidance Consultation, the FSA should also do more to inform consumers on what to look for in an adviser and/or asset manager. The FSA should encourage consumers to select investment firms that adhere to the highest professional and ethical standards, as demonstrated by the Asset Manager Code. Consumers seeking to invest should expect an IPS to be drawn up that sets out the relevant parameters, requirements and relevant factors that determines their investment selections. The IPS becomes an invaluable reference document for ensuring the client is content with their investment mandate.

Finally, we also propose that the FSA take a tougher stance for firms (regardless of their size) when significant consumer detriment arises. In this way firms that follow the highest professional standards will be supported by the regulator while increasing trust and confidence among consumers. Enabling consumers to obtain appropriate products, knowing these have been selected based on their interests rather than the interests of the firms providing the advice is paramount.

We trust that these comments are useful and would be pleased to meet the FSA to explain or to develop them for further with the policy team.

Yours,



Natalie WinterFrost, CFA FIA
Chair Professional Standards & Market Practices
Committee, CFA UK

Will Goodhart
Chief executive
CFA Society of the UK