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Financial Services Authority guidance on assessing suitability

On 6 January 2011, the Financial Services Authority (**FSA**) in the UK issued a guidance on "**Assessing suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection**". The guidance is prompted by the level of unsuitable advice (and quality of private client discretionary management services) that the FSA has seen in the market and it looks at:

- how firms establish and check the level of investment risk that retail customers are willing and able to take (in the wider context of the overall suitability assessment);
- the potential causes of failures to provide investment selections that meet the risk a customer is willing and able to take; and
- role played by risk profiling and asset allocation tools, as well as the providers of these tools.

The guidance provides examples of good and poor practice to help firms reduce the risk of making unsuitable investment advice and selections. In particular, the FSA reminded firms should ensure:

- they have a robust process for assessing the risk a customer is willing and able to take, including:
  - assessing a customer's capacity for loss;
  - identifying customers that are best suited to placing their money in cash deposits because they are unwilling or unable to accept the risk of loss of capital;
  - appropriately interpreting customer responses to questions (particularly where firms rely on tool with sensitive scoring) and not attributing inappropriate weighting to certain answers;
- tools, where used, are fit for purpose and any limitations recognised and mitigated;
- any questions and answers that are used to establish the risk a customer is willing and able to take, and descriptions used to check this, are fair, clear and not misleading;
- they have a robust and flexible process for ensuring investment selections are suitable given all aspects of a customer's investment objectives and financial situation (including the risk they are willing and able to take) as well as their knowledge and experience;
- they understand the nature and risks of products or assets selected for customers; and

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- they engage customers in a suitability assessment process (including risk-profiling) which acts in the best interests of those customers.

The FSA expects all types of firms to consider whether they need to improve the way they assess and check the risk a customer is willing and able to take and so ensure they make suitable investment selections. The FSA encourages providers of risk profiling and asset allocation tools to take action to address any potential weaknesses in their tools. The FSA indicates that they expect to see improvements in the standards of advice and private client discretionary management, and will continue to take tough action where they identify poor practice.

The UK Conduct of Business sourcebook (**COBS**) 9.2.1R requires a firm to take reasonable steps to ensure that a personal recommendation, or decision to trade, is suitable for its customers. COBS 9.2.2R requires firms, among other things, to take account of a customer's preferences regarding risk taking, their risk profile and ensure they are able financially to bear any related investment risks consistent with their investment objectives.

Similar suitability requirements can be found in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**SFC**) in Hong Kong (paragraph 5.1, 5.2 and 5.3 of the SFC Code of Conduct). The reminders and examples of good and bad practice highlighted in the FSA's guidance will therefore provide some useful guidance to firms in Hong Kong on how to avoid providing unsuitable investment advice and selections to retail investors.

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