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FCA THEMATIC REVIEW: WEALTH MANAGEMENT FIRMS AND PRIVATE BANKS

In December 2015, the FCA published their Thematic Review on the Suitability of investment portfolios at Wealth Management Firms and Private Banks (the "**Report**"). In the Report the FCA has presented its findings from the assessment of over 150 files collected from 15 firms in regards to the suitability of retail investment portfolios to investors. The Report features examples of good and poor practice to help firms better understand the standards the regulator expects of them. Below we have provided summaries of some of these examples in each relevant category, as examined by the FCA.

The information provided will be relevant to all firms that provide discretionary and/or advisory portfolio management services to customers.

AREA	GOOD PRACTICE	POOR PRACTICE
GOVERNANCE AND CONTROL ENVIRONMENT	A close working relationship between compliance and senior management. For example, active involvement in the compliance committee by the CEO in regards to monitoring portfolio suitability was recognised as good practice by the FCA.	Some firms showed a lack of back book review by senior management, whereby they failed to address gaps in information regarding the suitability of their customers. This showed disengagement and dis-involvement by senior management.
PUTTING OVERSIGHT ARRANGEMENTS IN PLACE	Firms should have control mechanisms put in place in order to ensure that customer portfolios remain suitable. Customer information should be updated at least every 12 to 18 months.	The monitoring process at one firm had no measures in place to remind investment managers to update client details hence causing general issues with recorded information.
CARRYING OUT EFFECTIVE MONITORING	One firm had a system in place for conducting quarterly outcomes analysis across portfolios seeking to identify outliers on performance and volatility. This provided useful information that allowed the firm to identify whether particular portfolios were not performing in line with expectations, which might not have been picked up through individual file reviews.	Two firms did not undertake monitoring of suitability within customer investment portfolios by the compliance function, independently of the first line of defence. This resulted in them not being able to demonstrate whether particular customer portfolios were suitable.
KEEPING CUSTOMER INFORMATION	Firms should regularly update customer information by proactively engaging	Some firms had not regularly updated customer information, and in some instances the information

UP TO DATE	customers. some firms had particular systems in place to support this process.	had not been updated for several years and appeared out of date. This may create risks in regards to portfolios becoming inconsistent with customers' risk appetite and therefore being unsuitable for them.
INVESTMENT OBJECTIVES	Firms should be able able to clearly demonstrate their customers' objectives across all of their files. For example, the information on file should include the level of income needed and the frequency of payments to be made.	A customer's objective was recorded as both growth and income. However, it was unclear what level of income was needed and how regularly the income was to be paid. This causes inconsistency in information which in some cases lead to portfolios not being attached with any specific purpose.
RISK APPETITE	Firms should review their customers' risk appetite on an annual basis. For example, some firms reviewed by the FCA had annually updated the information held on file and considered whether any adjustments were necessary to each portfolio.	The information on one firm's customer file confirmed that the customer could not sustain any loss of income and capital. Regardless, the firm wrote to the given customer requesting that they reconsider and subsequently increased their risk appetite and the risk of their investment portfolio accordingly. It was unclear why the firm persisted in this way and this may have resulted in an unsuitable portfolio.
MATCHING THE CUSTOMER'S PORTFOLIO WITH RISK APPETITE	Firms should document and monitor their customers' documentation for any deviations from the house model. Such mechanisms minimise and manage the risk of unsuitability.	A customer's portfolio held a high proportion of cash holdings. Their file contained no explanation why this differed from the model portfolio approach the firm generally adopted or the target allocation. This resulted in their risk classifications not matching their investment holdings.
INVESTMENT TIME HORIZON	Firms should annually review their customers' investment time horizon.	Some of the reviewed firms had not been recording their customers' investment time horizon at all. The length of time for which customers want to invest for is a key suitability indicator and the lack of collecting such information increases the risk of

		customer portfolios being unsuitable.
RESTRICTION ON PORTFOLIOS	Firms should embed technology controls to manage the risk of customer restrictions being breached.	At the time a customer had agreed to open a discretionary portfolio management account, the information on file indicated no restrictions were to be applied to the investment types to be held within the portfolio. Three years later a restriction was placed on the account that no investments in armaments were to be held in the account. One year after that, an internal file note indicated the portfolio had no restriction applied to it. This led to a lack of clarity in regards to whether a restriction was to be applied.
CAPACITY FOR LOSS	Firms should review their customers' capacity for loss on an annual basis.	Many firms within the FCA sample had failed to demonstrate from the information on file whether they had considered a customer's capacity for loss at all.
TURNOVER	Firms should be able to show how they manage the conflict of interest that can arise when they generate income from transaction charges. For example, one firm's transactions showed annual turnover ranging from 4% to 35% across all of the files that the FCA had reviewed. This appeared suitable and in the customers' best interests. It was noted the firm did not apply transaction costs and rebated commissions received from third parties to the customer accounts.	One firm's transactions showed different levels of turnover across all of the files, which ranged from 47% to 196%. It was unclear why the frequency of transactions was necessary and whether these were executed in the best interests of customers. The given firm earned revenues from this activity.