HYMANS ROBERTSON

INVESTMENT SERVICES

Consumer Duty and Centralised Investment Proposition (CIP) – The 5 ‘must haves’

Consumer Duty has, understandably, commanded significant time and attention from all UK advised retail industry participants – providers and advisers alike.

As with many aspects of FCA regulation, the breadth and depth of the Duty means that its application is wide and subject to some interpretation. As a result, it can be hard for advisers to ‘see the wood for the trees’ in establishing what the Duty means for their central investment propositions (CIP), alongside any actions required. Time is now of the essence (the Duty comes into force on the 31st July 2023).

Hymans Robertson Investment Services (HRIS) uses its institutional resources to deliver the highest quality model portfolio services (MPS), working closely with a small number of UK adviser firms. In supporting clients in preparing for the Duty, we have identified a simple 5-part consumer duty “CIP checklist”.

In our view, advisers should ask their providers (or, if in-house solutions are used, look towards internal teams) to evidence these 5 aspects – observing the often quoted mantra of “if it is not written down, it does not exist”. Recording this documentation is important so that advisers can demonstrate that they have fulfilled their obligations in recommending or overseeing clients’ investment solutions.

1

A value for money (VfM) framework and assessment

2

Evidence of target market documentation AND robust future scenario testing, to avoid ‘foreseeable harm’

3

Communications – what, when and have they been tested?

4

Documented CIP roles and responsibilities – who is the manufacturer?

5

Due diligence – ask for the ‘how’ as well as the ‘what’.

The 5 considerations in more detail

1

A value for money (VfM) framework and assessment

Although VfM assessments have been used by the fund industry for a little while now, their requirement from an MPS and advised model perspective is relatively recent.

The model portfolio manager should now have a VfM policy in place, which outlines the methodology by which it will measure Value for Money on an ongoing basis – in our view, the policy should be the first 'ask' to be made by advisers.

The MPS VfM assessments that follow are likely to involve a pre-set scorecard methodology. This will account for obvious deliverables such as performance and cost but will also include an assessment of the wider benefits that clients receive (for example, informative communications, reporting or perhaps returns forecasts or risk-based data which can assist in planning outcomes or understanding risk).

In simple terms, advisers should ask to see the VfM framework that the investments or MPS provider has in place, as well as its actual assessment against these considerations, on an ongoing basis. Higher quality investment providers will update their VfM statements on at least an annual basis.

2

Evidence of target market documentation AND robust scenario testing, to avoid 'foreseeable harm'

As part of PROD, most MPS providers or advised model users have a clear definition of 'Target Markets' for their investment portfolios. This will outline aspects such as the types of investors for which a model portfolio is suitable, alongside their risk appetite, time horizon and so on. There is nothing new here and most MPS providers or in-house investment managers will provide these to advisers recommending the investment solution(s) an ongoing basis.

Whilst shared target market definitions are a relatively well trodden path, in our opinion evidenced **portfolio scenario testing** is far patchier – but just as important. In addition to the target market assessment, the Duty puts a greater emphasis on portfolio stress and scenario testing. In particular, the Duty is clear in asking the MPS provider and adviser to evidence how they have done their bit to 'avoid foreseeable harm'.

We would expect advisers to see, for example, analysis showing how MPS portfolios have been tested across multiple future different economic scenarios, as well as how the investment process checks, on an ongoing basis, that portfolios remain appropriate given the specific risk target being sought. This is likely to require in-house quantitative analytical capability – often referred to as 'stochastic optimisation and forecasting' - on the part of the investment manager. Relying on 'a gut feel' from an experienced individual or investment committee is unlikely to cut the mustard!

3

Communications – what, when and have they been tested?

From an end-client perspective, communications related to the make-up and performance of investments and markets (both backward and forward looking) can add huge value. High quality communications help individuals to maintain confidence during times of stress and provides important context in making key decisions alongside their adviser – including, for example, aspects such as the impact of inflation on their plans, the timing of retirement, or the implications of withdrawing or adding to investments. The Duty makes it clear that providers and advisers should reflect on and account for behavioural aspects when interacting with clients.

The demand of investment managers and providers here should be two-fold. **Firstly**, clear documentation should outline what communications will be delivered as part of the MPS service (and with what frequency). **Secondly**, and just as importantly, MPS provider should be working with you to evidence that its communications are appropriate for retail end-client consumption. This should account for aspects as simple as whether the content is written in 'plain English' and is sufficiently jargon free. It also needs to be tested for application and relevance. All too often in the past, providers have delivered broad topical or technical market analysis, from which it is very hard to draw out the 'so what' impact for individuals' portfolios.

4

Documented CIP roles and responsibilities – who is the manufacturer?

The Duty has given further clarity as to the expectations of investments 'Manufacturers' and 'Distributors'.

Without getting into compliance detail, many adviser firms are likely to want to avoid being inadvertently classified as being 'Manufacturer' of the investment solutions they are using and / or recommending. This is because being a 'Manufacturer' involves additional responsibilities, governance, and ongoing documentation (for example documenting aspects such as product testing).

Advisers without discretionary permissions, adopting advisory models for their CIP, or (for example) blending multiple outsourced solutions for their clients could find themselves defined as being a 'Manufacturer'. If advisers are outsourcing investments single solutions (e.g. MPS) to clients they should ask their MPS provider with documentation clearly outlining roles and responsibilities. For example, the MPS provider should be clear that they are entirely responsible for asset class and fund selection decisions taken within the models (amongst other aspects). This will demonstrate and document that the adviser's role remains one of 'Distributor', alongside the MPS provider as 'Manufacturer'.

5

Due diligence – ask for the 'how' as well as the 'what'.

In simple terms, the Duty is clear that advisers should be undertaking and documenting appropriate due diligence of their investments (including MPS) providers. If multiple solutions are used within a firm's CIP, or by different advisers within a firm, it should be clear what the role and target market for each is.

Good providers will encourage and support this due diligence process, through openly sharing data and answering all questions as appropriate. Many, including HRIS, have extensive documentation, outlining policies, procedures, team structures and so on.

Advisers will be aware of the main pillars of standard due diligence which do not bear repetition here (from past performance, through to resourcing, due diligence on third party providers and suppliers, business continuity, team experience, strength of operational teams and so on).

However, if we were to pick up on any single aspect which doesn't receive the attention it deserves it would be asking not just for the 'what' of current or historic portfolio asset allocation, but rather an explanation as to 'how' it is arrived at.

Asset allocation is the single largest driver of investment risk and return and yet it is relatively common for MPS providers to 'buy it in' from third party vendors, with relatively limited awareness within the investment team of the underlying capital market assumptions involved and (in some instances) an incoherent link through to fund or security selection.

Asking the MPS provider for clear documentation, demonstrating how asset allocation was arrived at, tested and refined (including stress and scenario testing as above) and then linked to fund implementation will help sort out the "wheat from the chaff".

Hymans Robertson Investment Services (HRIS) is a retail discretionary fund manager (DFM), part of Hymans Robertson group. We specialise in providing discretionary model portfolio services to a select number of high-quality UK financial advice firms. Our aim is to bring a higher standard of service, institutional rigour and ultimately better client investment outcomes to the retail market.

HYMANS ROBERTSON INVESTMENT SERVICES

London | Birmingham | Glasgow | Edinburgh

T 020 7082 6000 | www.hymans.co.uk

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