



Understanding Asset Allocation Tools Executive Summary

In DP07/2, the FSA have raised serious questions over the extent to which advisers understand how asset allocation tools actually work.

Over the past eight months, Adviser Forum has been examining the issues advisers need to be aware of when selecting investment planning tools. Such tools cover a wide range of areas therefore, the initial phase has considered Attitude to Risk Questionnaires (ATRQ's) and Asset Allocation tools only. The purpose of this exercise has been to gain a more detailed understanding as to how these work in order to enable advisers to have a greater understanding of the variation between different tools and what factors affect the outputs that are generated.

Tools and advice

The use of Risk Profiling and Allocation tools has become an integral part of the advice process. For example, risk profiling questionnaires have become embedded within the fact finding process. Investment advice is now almost certainly using asset allocation modelling tools to help the adviser determine where the client should be invested and that the recommended portfolio is in line with their attitude to risk.

The Regulator's views:

DP 07/2 "Platforms: the role of wraps and fund supermarkets" makes specific reference to the role that investment planning tools are now playing part in the advice process and identifies the following issues:

- ◇ Advisers are ultimately responsible for any recommendations based upon the outputs of these tools.
- ◇ Training and education of advisers is paramount where such tools are being used to assist in the advice process.
- ◇ Regulator is concerned that customers could be disadvantaged if advisers fail to use tools properly.
- ◇ Tool suppliers have a responsibility to ensure that advisers understand how their tools operate.

Good Practice

Until now there has been little, if any, guidance to assist advisers and tool suppliers in their understanding of the requirements and responsibilities of the parties involved in using and developing investment planning tools.

The recommendations set out in the "**Good Practice Notes: Attitude to Risk and Asset Allocation Tools**" have been produced as a result of industry collaboration and co-operation involving leading Adviser Firms, Life Offices, Wrap Providers and Software Suppliers, and is intended to create a Good Practice approach that organisations using or delivering such tools can refer to.

The Good Practice Notes include guidance on:

- ◆ What an advisers' due diligence process should include when assessing which tool is the best fit for their business e.g. who has the tool been developed by, has it been modified in any way, what economic assumptions have been used and how does the risk profile link to the recommended asset allocation model?
- ◆ Framework for a Tools Fact Sheet that outlines the basic information tools providers need to make available to advisers. The document suggests a format which can be used by tools suppliers to assist them in meeting the need to educate users about the tools that they are using.
- ◆ The procedures that tool providers need to have in place to ensure that advisers are notified of any changes to the tool e.g. what changes must be declared to advisers and what process should be followed to communicate these.

Further Details

The full Guidance Notes can be found at www.adviserforum.org/goodpracticenotes/default.asp

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COMING NEXT:

In the coming months, Adviser Forum will be developing similar guidance on stochastic modelling and fund selection tools for advisers.