the lang cat

AJBell Investcentre

Platform due diligence and PROD

You know how when you stare at certain words for long enough, they stop looking like real words? That's how I feel about the phrase 'due diligence'. We've all said it so many times that it's sort of lost meaning and now is just a sort of shorthand for 'picking stuff to use'. So, in this piece I thought we might try and reconnect with the process and remember what it's all about. Before I get going, it's instructive to remember that what we're talking about when picking a platform or a DFM or whatever isn't due diligence as it exists in, like, the proper world. That's a process that companies go through before investing in or buying other companies, and if advisers had to go to that depth on pretty much anything, you'd all be shutting up shop.

OK. So, let's address a few common misconceptions, and then get into how to construct a decent due diligence. Here are some things that you don't have to do:

1. You don't have to do an in-depth assessment of every provider in the market. If there are propositions that are obviously unsuitable then it's fine to discount them (but keep a note that you've done that).
2. You don't have to create a 200-page monster.
3. You don't have to pick the cheapest. Something that's cheap and unsuitable is still unsuitable.
4. You don't have to do huge tick-sheet grids of functionality. Most platform functionality has little or nothing to do with client suitability.
5. You don't have to insert a mini DD pack into every suitability report.
6. Outsource your DD. It's perfectly feasible to do it yourself.

In one sense, the lang cat house view on DD is that it can now really be boiled down to two killer questions. And here they are:

1. Is this platform a secure home for my clients' investments?
2. Does it allow me to deliver my service proposition to my clients and fulfil their financial plan?

I didn't say they were easy questions. As you pull at each one you will inevitably end up with lots of sub-questions, and they're valuable. It's by aligning the things you ask platforms to these two areas that you'll ensure you're concentrating on suitability; you'll stick to your agenda and not the agenda of a provider, or someone else.

Killer question 1 is all about financial strength and how likely the provider is to be around in the long term. This is notoriously difficult to assess: if you ask every platform whether they are committed to the long-term, guess what answer you get back. You'll need to decide on what your own criteria for this assessment are, and it's also something that is vital to monitor on an ongoing basis.

For killer question 2 you clearly need to have a clear understanding of what your own service proposition to your clients is in order to select the platforms and investment solutions that are best suited to meet these needs. And this is where the FCA's PROD handbook comes into play. Amongst many other rules (and they are rules, not guidance) 3.3.1 states that a distributor (i.e. adviser) must…

1) understand the financial instruments it distributes to clients;
2) assess the compatibility of the financial instruments with the needs of the clients to whom it distributes investment services, taking into account the manufacturer's identified target market of end clients; and
3) ensure that financial instruments are distributed only when this is in the best interests of the client

PROD 3.3.10 also states that Distributors (advisers) must identify the target market and their distribution strategy using:

1) the information obtained from manufacturers; and
2) information they have on their own clients.

Or to put it another way, you need to create a distribution strategy that meets the needs of your clients, you need to use information from the Manufacturers (Providers) to assess the compatibility of their solutions with these client needs, and you need to use a combination of this information and the knowledge you have on your own clients to ensure you make suitable recommendations.

As a result, we would humbly suggest that this is a good ‘starter for 10’ to do list if, or when you want to review your platform DD in line with PROD:

1. Who are your target client(s)? What services and solutions do they want and need? What services do you want to offer them? Think about it and write it down.
2. Review what platforms and investment solutions are best suited to meet these needs.
3. Record every decision you make. If you think that Platform A is plainly unsuitable because it smells of fish or something, then WRITE IT DOWN.
4. Make sure to do the exercise for each client segment you have. What works for one won’t necessarily work for another.
5. Have proper rationales. The fish thing in point 3 was a joke. Here are some things that aren’t reasonable to discount platforms on the basis of:
    a) They’re going to nick my clients
    b) I don’t like life companies
    c) The BDM flirted with my wife at the last golf day
6. Document your sources. If you use, for example, a fine resource like the lang cat’s free Platform Directory then keep a note of that. It’s fine to use free resources as long as you satisfy yourself that they’re up to date. Ours is.
7. Be wary of providers’ own DD documents. Most are brochures in hiding. They’re sometimes good for stats though.
8. Make it a formal document.
9. Discuss it and adopt it formally at a board meeting.
10. Have a named owner for the document and ideally have its maintenance as part of documented objectives for that owner (this helps show you’re taking it seriously)
11. Refresh it periodically – about 12-18 months should be fine, or when there’s a big change in the market.

Do that and, in our experience, you won’t go far wrong. Happy DD-ing...

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