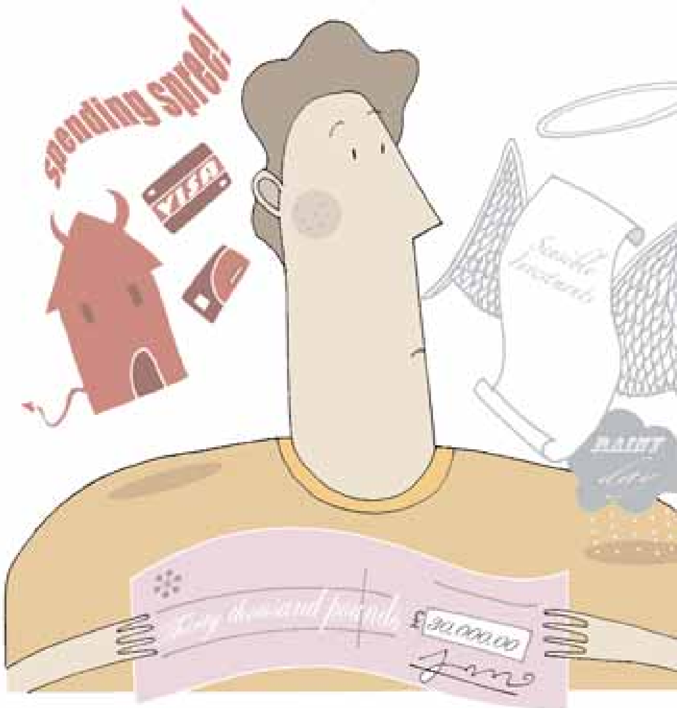
Financial advisers in the spotlight

What would you do with £30,000? We reveal what some financial advisers tell you to do and whether their advice is worthwhile



If you have a lump sum, you must weigh up whether to pay off debts such as mortgages or invest the money

If you received a decent five-figure lump sum – from an inheritance or windfall, for example – what would you do? Splurge on something extravagant, invest it, pay off your debts or put it aside for a rainy day? The choice can be bewildering.

Like many things financial, there isn't a right or wrong answer. Much depends on your personal circumstances, how much risk you are prepared to take and when you might need the money. Unless you are a confident investor, we advise you to take financial advice, but that brings another set of problems. Where should you go and how do you know you can trust the advice?

What the rules are

When selling insurance, investments, pensions or mortgages, financial advisers must follow rules laid down by the Financial Services Authority (FSA). The following are some of the most important.

First impressions

At the time we carried out our research, all financial advisers had to give customers two documents and explain them in detail. These are called Keyfacts of Costs and Keyfacts of Services and give details about how the adviser's costs compare with the market average and whether they are tied or independent financial advisers (IFAs). Tied advisers can recommend products from only a small number of providers; independent advisers can recommend from the whole market. Unfortunately, after November, it will no longer be compulsory for advisers to provide these particular documents, although they will still be legally required to give the details in some format.

Fact finding

All advisers, whether they are tied or independent, must collect enough information about you to properly assess your circumstances and financial needs in order to make a suitable recommendation. This is called the 'fact find'. Among other things, they must go through your income and outgoings to establish how much you can afford to spend on financial products, find out your short-term and long-term aims and what your current and future financial commitments might be. From 1 November, advisers must also establish whether you have the experience and knowledge to understand the risks involved in any proposal they make.

It's crucial that advisers find out how much risk you are prepared to take

Attitude to risk

It's crucial that advisers find out how much risk you are prepared to take. This is so that they don't recommend investment funds that might expose you to more risk than you are comfortable with. They should go through the various risk levels with you, from 'no risk' to 'high risk', and explain what each means. They must also find out whether you have any money you could access in an emergency and for how long you can afford to invest.

Recommendation

For some investment products, advisers must put their recommendation in writing and give you a Keyfacts document that gives the pros and cons and explains the charges and how they affect your investment.

OUR RESEARCH

Every year Which? sends out researchers to test the quality of advice given by financial advisers. The visits are recorded and analysed by our in-house money experts. We are the only consumer organisation to do this and we've been reporting on the results for 20 years. This year we revisited the thorny issue of investment advice.

During April and May this year, eight researchers posed as individuals who had received an inheritance of around £30,000 and wanted advice on how to make the money work for them. They weren't saving for anything in particular but did have some debts – a mortgage and a personal loan. Our field workers, most of whom were in their mid-50s to early 60s, were cautious and novice investors with no other investments or savings apart from an 'emergency' fund of about £3,000. We visited 21 independent financial advisers (IFAs) and tied advisers from two branches of the following nine banks and building societies: Abbey, Barclays, Bradford & Bingley, Halifax, HSBC, Lloyds/TSB, Nationwide, NatWest and the Royal Bank of Scotland. We also visited one adviser from the Co-operative Bank.

ILLUSTRATION JULIAN MOSEDALE

Did they follow the guidelines?

To assess the advisers, we looked at whether they followed all the rules correctly, collected all the facts they needed to make a recommendation and established the researchers' attitude to risk. We also looked at the recommendations they made and how this related to the given scenario.

How they started

All but two advisers handed out the Keyfacts documents correctly, but only seven out of 40 actually explained what they were. More importantly, seven of the tied advisers made misleading statements about the providers they could recommend, giving the idea that the choice was much larger than it was. One Barclays adviser said: 'We can look at all the companies out there,' a statement that is just not true.

Thirteen advisers (ten tied and three IFAs) also made misleading statements about costs and three of the IFAs had no discussion about costs at all. One IFA remarked: 'I'll get paid by whichever company it is. So as far as you're concerned you're not really paying for advice.' You'll always be charged, one way or another, as we'll show you next month in our report on paying for financial advice.

What facts they found

Although most advisers completed the fact find well, we were surprised at the number that didn't. Seven tied advisers and seven IFAs failed to complete the fact find to the standard we would expect. One IFA completed the first meeting in just ten minutes, but still seemed able to suggest investing the money in an investment bond, even though he hardly took any information.

One of our researchers told us: 'I had to bring up that I had a mortgage and loan,' while another said: 'I was surprised that he did not establish my financial position apart from asking what I had left [at the end of] each month.'

What their risk evaluation was

Given that our researchers went seeking investment advice, it was worrying that more than a quarter of the advisers failed to establish their attitude to risk correctly. Getting this wrong could be disastrous, as you could end up with investment funds that are too risky for you. However, we did like this IFA's comment on risk: 'When I say adventurous, I don't mean walking across the Grand Canyon on a piece of string – I mean putting some of [the investment] into equities.'

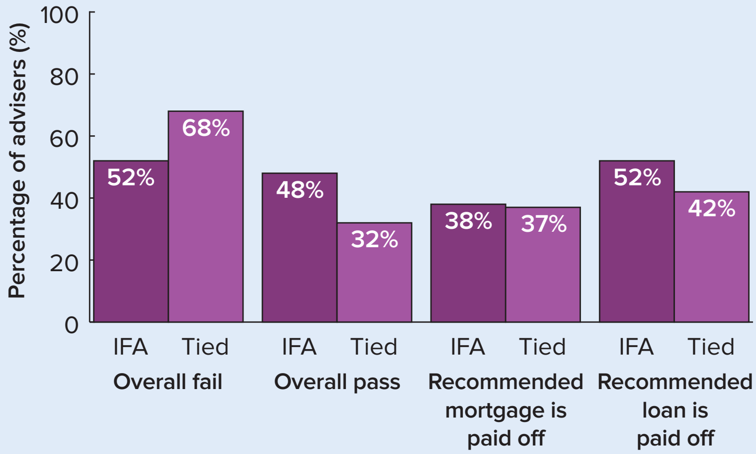
What they suggested

Given the scenario, we were disappointed to find how few of the advisers recommended paying off the debts before investing (see 'What to do with a windfall', p37, for more on this). Only 15 out of 40 advisers (seven tied and eight IFAs) recom-

Seven of the tied advisers made misleading statements about the providers they could recommend

Pass and fail rates

The graph shows the percentage of advisers who passed and failed our tests overall and the percentage that recommended paying off the mortgage and loan



Checklist

How to choose the right financial adviser

- **Go for an IFA** Despite the fact that just over half the IFAs failed to meet our benchmark for good advice, we still believe that, on the whole, you will receive better advice from an IFA than from a tied adviser. If nothing else, you will have more choice and won't necessarily pay any more.
- **Know your needs** Before you go looking, be clear about what type of advice you need and what you are expecting from the advice process. Are you looking for a complete financial overhaul, or are you looking to invest some money or save for retirement? If you give clear instructions, you'll get more from the whole process.
- **Call ahead** Ring at least three advisers. See 'Contacts', p36, for more details. Speak to advisers over the phone first and get a feel for how they work.
- **Experience counts** Ask how long the adviser has been in business and what qualifications they have. Look for an adviser with at least three years' experience and who has more qualifications than the minimum. See www.which.co.uk/money for more information.
- **Costs** Once you have explained what you want, ask the adviser to give you an idea of cost. If they aren't willing to do so, try someone else. See next month's *Which?* for our report on paying for financial advice.
- **Save time** Complete the fact find and send it back before the first meeting. This saves time, and therefore money.
- **Take the lead** Remember – you are the customer. If you are uncomfortable, look elsewhere.

Many of the advisers simply didn't consider paying off the debts

mended paying off the mortgage and 19 out of 40 (eight tied and 11 IFAs) recommended paying off the loan.

A few advisers gave our researchers reasoned arguments for why they should not pay off the debts (usually because they were convinced they could get a better return by investing the money), but many simply didn't even consider it. Some didn't find out about the mortgage and loan because their fact finding was so poor.

Of the advisers who did recommend paying off the debts, most suggested that the balance be invested into a stocks and shares Isa and that the money freed up by paying off the debts should also be invested in Isas.

A few of the advisers suggested increasing the amount of money our researchers could have access to in the event of an emergency. Three or four times their monthly income seemed to be the amount most often suggested. Several suggested that this 'emergency fund' be invested in cash Isas to get the best return.

When it came to investing, the main options that advisers suggested were either pooled investments such as unit trusts or open-ended investment companies (Oeics) or investment bonds (see 'What to do with a windfall', opposite). Investment bonds can pay as much as 6 or 7 per cent commission, whereas unit trusts normally pay 3 to 5 per cent. Almost half of the advisers out of the 40 (11 tied and eight IFAs) suggested investing most of the money into unit trusts or Oeics. Over a quarter (six tied and six IFAs) suggested investment bonds.

Verdict

The advice our researchers received this year was better than last year: 48 per cent of IFAs (compared with 34 per cent last year) and 32 per cent of tied advisers (compared with 16 per cent last year) passed all the benchmarks for giving good advice (see graph, p35, for details). However, it is still shocking that more than half failed – all the more reason why you should choose an adviser very carefully.

DO-IT-YOURSELF FINANCES

Manage your money

Our book *Be Your Own Financial Adviser will* show you how to identify your key financial goals and avoid unnecessary risk, creating a plan to meet all your financial needs.
To order a copy at the special price of £10.99 (£1 off the RRP plus free p&p), call **01903 828557** or email your details to **mailorders@lbsltd.co.uk** and quote FAW1007 and ISBN 978 1 84490 012 1.

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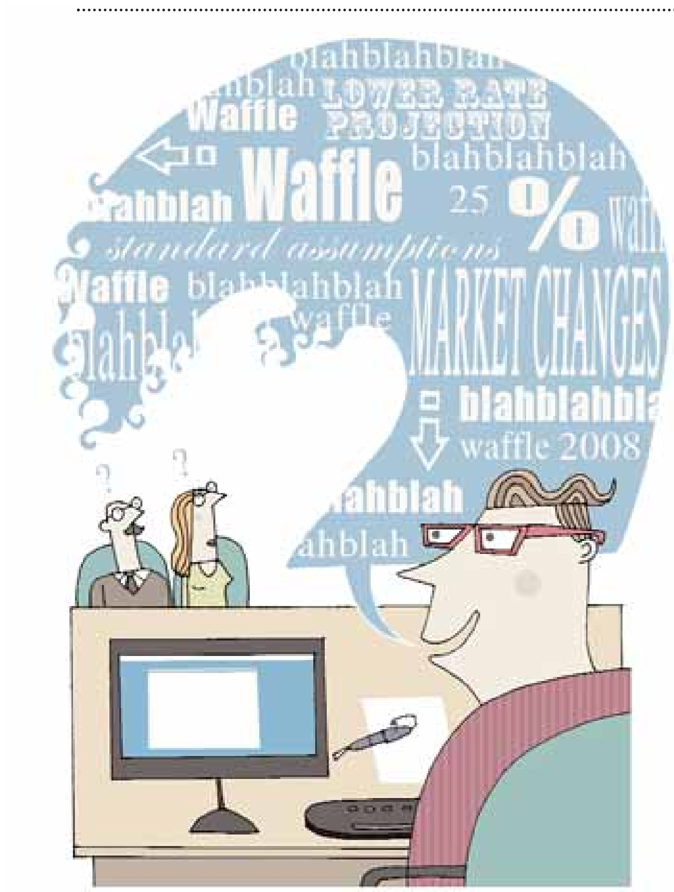

Several researchers found that advisers' language contained too much confusing financial jargon

Judging the experience

What did our researchers have to say about the financial advisers?

The researchers we use for mystery shopping reports are ordinary consumers, not financial experts. Therefore, their experiences may well be very similar to those of many of our members.

We asked them how they felt about the various aspects of service they received when getting investment advice.

Feelings were decidedly mixed. Comments ranged from: 'I felt very confident with him and certainly felt trust – would like to use him for real,' to: 'I felt this adviser waffled a lot – flitting from one thing to another, speaking his thoughts and saying things like "no, forget that", which I found confusing.'

IFAs beat tied advisers again

In terms of scores, IFAs came out as favourite, with ten rated 'very good' for overall impression and eight rated 'very good' for the advice itself.

Only two tied advisers mustered a 'very good' mark in either category. Interestingly, however, three of the IFAs that our researchers marked as very good didn't pass our benchmark for good advice.

Almost half of the advisers (11 tied and eight IFAs) got the definite thumbs down from our researchers, who said they would not use them again.

One of the key problems our researchers found was that advisers weren't asking enough questions. 'The adviser made too many assumptions,' said one. 'He did not ask me anything about my incomings or out-goings. He didn't even know I had a loan or credit cards.' Another was disappointed by the lack of questioning, even though he was happy with the overall outcome. 'I felt he should have asked more questions regarding our circumstances,' he told us. 'However, the final documentation appears to be well researched and overall he seems very knowledgeable.'

And even some of those who felt the advisers asked enough questions were left wondering where the actual advice came in. 'Despite the adviser's thorough investigation of me, he will not recommend a particular course of action until I've decided whether I want to repay the mortgage and loan or invest,' said one. For more on choosing an adviser, see 'Checklist', p35.

What to do with a windfall

Pay off debts, pay in for a rainy day or pay up for investments – the choice is yours

Advisers who recommended that our researchers pay off their debts were in the minority, but was that the right advice for those with a lump sum to invest?

Short-term debt

Almost half the advisers (19 out of 40) recommended paying off short-term debt like personal loans and credit cards. Personal loans, store cards and credit cards are more expensive debt and therefore your money would have to work very hard indeed to beat the return you would get by paying these debts off. Paying off short-term debt also frees up more money, as monthly repayments on this type of debt are usually high.

It's well worth paying off card debt

Paying off your mortgage

Just over a third of the advisers recommended paying off the mortgage, but we felt, given the scenario, that these advisers gave the right advice. A powerful argument, which many of them used, is that by paying off your debts you are getting a guaranteed return on your money. For example, if the interest rate you pay on your mortgage is 6 per cent, you would have to get a guaranteed return on any money you invest of 6 per cent to match the return you would get if you paid your mortgage off.

Should you pay off the mortgage first?

If you are a taxpayer, after tax, the real return would have to be more than this because returns on savings accounts (except Isas) are taxed. A basic-rate taxpayer would have to get a gross return of 7.5 per cent, and a higher-rate taxpayer 10 per cent, to match paying off a mortgage with a 6 per cent interest rate.

If interest rates are low, you might think your money doesn't have to work so hard. The problem is that if mortgage interest rates are low, so are savings rates, so you are no better off.

Stocks and shares

There are very few (if any) ways of getting a guaranteed return of 7.5 per cent on your money, so that's when you have to start taking risks if you want to beat the return you would get by paying off your mortgage.

Many of the advisers who didn't recommend paying off the debts recommended investing in stocks and shares because traditionally they give a much higher rate of return than cash deposits.

Over the past five years, the FTSE100 index (which measures the performance of the top 100 UK companies) has grown by around 60 per cent. However, among the good years are the years when stock markets fell and if you happened to need your money during those downturns, you could have lost out.

Investing in the stock market can get you a better return, but you have to be prepared to stick out the lows and to invest for at least seven to ten years. If there is a chance that you might need the money before then, consider very carefully before investing.

You must also consider the impact of charges. Collective (or pooled) investments such as unit trusts, Oeics and investment trusts have charges that can eat into your return. Investment bonds, which 12 of our advisers recommended, have even higher charges, meaning a higher return is needed.

If you wanted to beat a return of 6 per cent, you would need a gross return of 3 to 6 per cent higher than this to take account of charges and tax – more if you are a higher-rate taxpayer. Ask your adviser how feasible it would be to expect 9 to 12 per cent returns every year from the investment funds they recommend. To get that return, you need to look at higher-risk funds.

In the end, the questions you must ask yourself if you find yourself in this situation are: 'How long can I invest the money for?' and 'How much risk am I prepared to take?'

Stocks and shares may give a high return but are more risky

By paying off debts you are getting a guaranteed return on your money

Do you really need them?

Thankfully, the best advice can sometimes be free

For less complex financial products, such as credit cards, car, house or travel insurance, cash Isas or savings accounts, Which? Best Buys are all you need to help you choose (see 'Money monitor', p40, and www.which.co.uk/money).

However, for products such as investments, mortgages, pensions and protection insurance, you should see an adviser unless you are confident that you understand the market and are happy to do your own research.

Remember that if you buy direct, you can't later complain to the Financial Ombudsman Service if the product turns out to be unsuitable for you.