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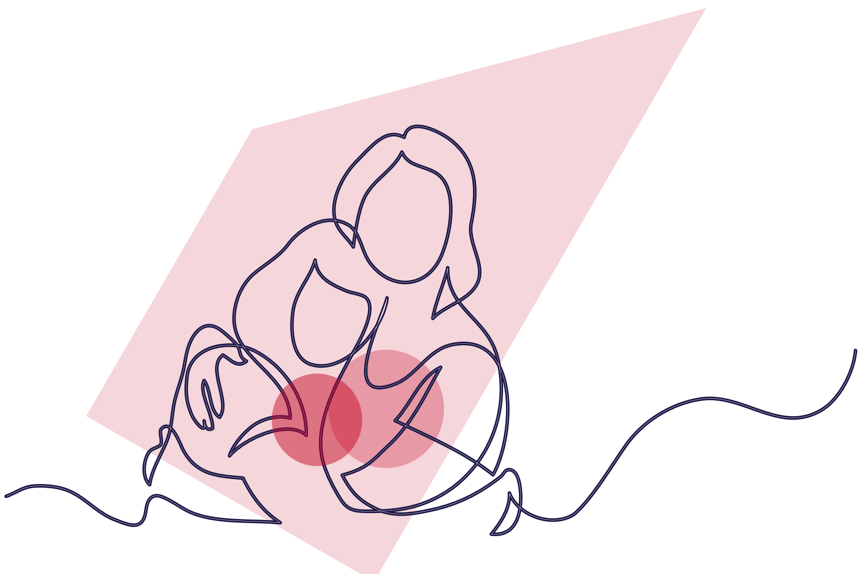
BOOK OF STORIES 3.0

CLIENT VULNERABILITY – THE CHALLENGE FOR ADVISERS



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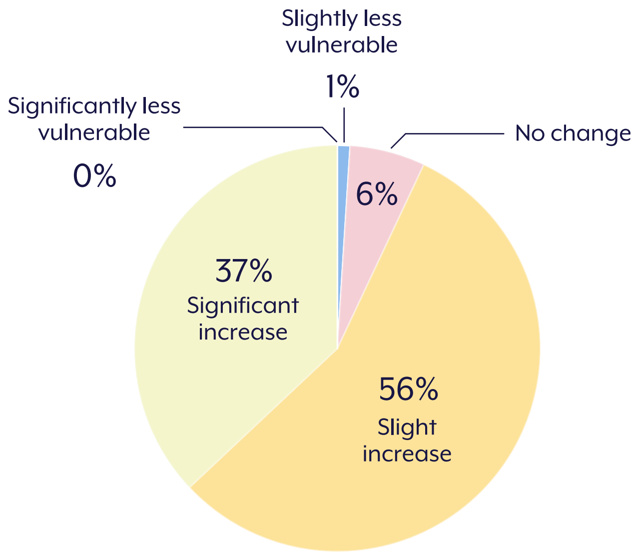
CONTENTS

The almost unanimous view of advisers is that the pandemic increased the levels of vulnerability among their clients. Recent research suggests that the aftermath of the pandemic and the war in Ukraine – and the associated market volatility and elevated inflation – will increase client vulnerability even further. As a result, it is increasingly important for advisers to identify which of their clients are vulnerable and act accordingly.

The pandemic tended to make many clients more vulnerable by isolating them from friends and family, making sickness and mortality much more salient parts of all our lives – especially among the elderly – and making them materially poorer or worried about the prospects of poverty.

Some 93% of advisers reported an increase in vulnerability between November 2020 and November 2021, according to our survey, with over a third (37%) saying that the increase was 'significant'. A quarter of advisers said that clients had been under greater financial pressure.

Proportion of advisers who feel their clients are more or less vulnerable over the past year



How, if at all, would you describe your clients' vulnerability over the last 12 months, compared to pre-Covid? Base: 200 financial advisers

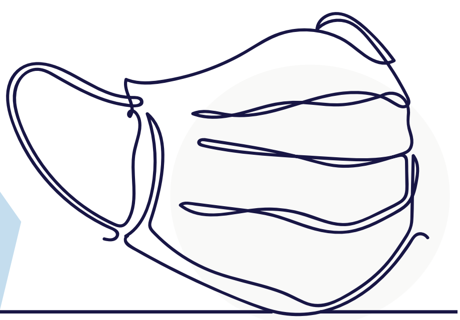
But the pandemic has also driven the subject of vulnerability – especially mental health issues – further into the open and made them more acceptable subjects to discuss. This seems to be the case even among older generations whose general attitude to such situations might have been to keep calm and carry on. The regulator has also been placing more emphasis on the issue of vulnerable clients in recent years and made it a central theme of the new Consumer Duty initiative. Advisers and providers will have to take greater pains to recognise and act on client vulnerability.

"It's definitely an area that I've become much more conscious of over the years."

FINANCIAL ADVISER

93%

of advisers reported an increase in vulnerability between November 2020 and November 2021.



THE IMPACT OF SHARPLY RISING INFLATION ON VULNERABILITY

Inflation is part of the pandemic's aftermath and is affecting most people – although in different ways. The cost-of-living crisis has been exacerbated world shortages and bottlenecks causing extra strains and shortages that are now feeding through into every sector. Energy bills have been rising and will affect everyone despite the government's initiative. Such price increases and other inflationary pressures are already testing the financial resilience of many clients.

The various generations are feeling the impact of the cost-of-living crisis differently – much as they experienced the impact of the pandemic in a range of ways. Those with families are especially affected by the cost-of-living crisis, which will impact on people more generally as they feel the squeeze.

Advisers should recognise the strains that the cost-of-living crisis will have on families and how members will be vulnerable in different ways. It is at times like these that skilled and empathetic advisers come into their own to create real value for their clients.

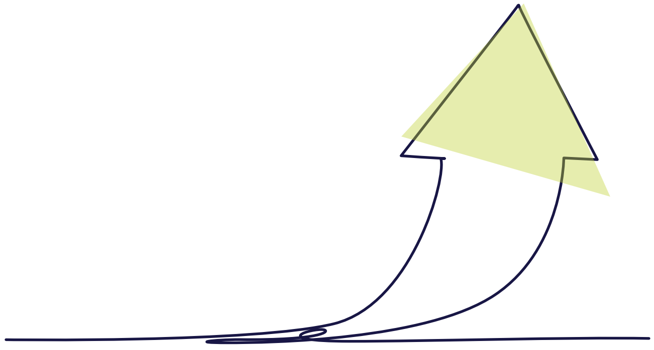
"Comparing client reviews now with last March, there's energy prices, petrol and everything's going up. It's now a different conversation because they're probably paying about £2,000 more than they were just in energy bills. Where's that coming from? And if the client hasn't considered that, well it could lead to mental health problems."

FINANCIAL ADVISER

IMPACT OF INFLATION ON VULNERABILITY OF YOUNGER GENERATIONS

Younger generations, who typically depend for their income from work (and/or benefits), are vulnerable to rising costs, which will affect them in several ways.

- Lower income families will be especially hit by rising costs not being matched by rising earnings or benefits. Families subsisting at or below average earnings may be contemplating the classic dilemma of eat or heat as both food prices and home heating bills escalate spectacularly: transport costs are likely to inhibit all but essential travel; mortgage and rental costs may rise faster than expected as interest rates and property prices increase.
- Higher income families won't be immune from the impact of inflation. With a few exceptions, most middle- and higher-income families will be increasingly vulnerable to rising interest rates, school fees, energy, and travel costs as well as rising prices in all other areas of their lives.
- Students are faced with huge repayment costs for their loans which are RPI linked (although capped this year) and with much lower repayment thresholds.
- Business owners are already facing depressed demand for products and services, combined with higher costs and serious supply interruptions. Many businesses are expected to go through challenging times with less financial resilience than they had at the start of the pandemic; some will not survive.



IMPACT OF INFLATION ON THE VULNERABILITY OF OLDER BABY BOOMERS AND THE 'SILENT GENERATION'

Increased vulnerability was traditionally associated with clients' growing older. Often this concern is justified but many times it isn't. Nevertheless, there are specific reasons why older clients might be directly or indirectly affected by the cost-of-living crisis and the associated financial environment in ways that could make them more vulnerable, and advisers need to be alert to this.

- Even defined benefit and State Pension incomes mostly won't keep pace with the rising cost of living – at least in the short run.
- Inflation is already eroding the values of clients' wealth, especially where it is in cash. Rising interest rates may look as if they will help – as indeed they will – but only a little. And the increase in interest rates still won't provide savers with a positive real return from their bank or building society accounts, especially after tax.
- Investment returns have already proved to be volatile and may well turn out to be even more so, if past performance in times of relatively high and fluctuating inflation are any guide. Drawing capital and income down in times of volatile stock markets can prove hazardous – or at least very unnerving.
- One outcome could be for older investors to seek the apparent security of cash deposits, especially with the rise in nominal interest rates. Shares and property offer the prospect of long-term real returns, but there are likely to be short term falls in portfolio values.

Older clients could be vulnerable to temptations to react irrationally or rashly to these pressures. Advisers need to be on hand to prevent such potential financial disasters.

CASE STUDIES IN VULNERABILITY

The older generations will look on their younger relatives and will often want to help them. In the UK alone, some £5trn is expected to pass from baby boomers to younger generations in the coming years. It is important for advisers to recognise that both the older and younger generations are likely to be vulnerable in some measure in this situation. For example:

HELPING CLIENTS MAKE GOOD DECISIONS ABOUT LIFETIME GIFTS

Older clients might want to provide younger relatives with more capital or income than they can afford to give away without endangering their own standard of living. They may, of course, be prepared to make such sacrifices, at least up to a point. The adviser needs to be able to discuss the possible implications of these actions to prevent an emotional decision having unexpected consequences.

IDENTIFYING WHERE GIFTS WOULD BE A MISTAKE

The use to which the younger family members think they might put the capital or income might not stand too much scrutiny. In some cases, a loan – possibly to be written off later – may be a safer option than a large gift, although it may not have tax benefits. In some instances, it might be wiser for an adviser to suggest that a particular client should think very carefully before making any large transfers to a potential beneficiary.

A financial adviser can ask probing questions and raise issues that a parent or other relative might find embarrassing, inhibiting or potentially likely to offend the younger family member. In most cases, the problem is lack of planning; failure to think through the implications of the situation or excessive optimism. The situation can be especially tense where an older relative is being asked to prop up a failing business.

Providing advice in these circumstances requires tact, empathy, persistence, and business nous. The adviser needs to recognise the family dynamics, each individual's thinking, and emotions and especially what makes them vulnerable to emotional demands.

"We've had a client recently where the son is the power of attorney and the son is manipulating his mother and has got his mum to change the will."

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Advisers are often well-placed to bring all the key members of a family together for a conversation about the implications of a client making a gift and how it might affect their financial security. The adviser can introduce the possibilities of alternative strategies for the family as a whole to discuss such as a smaller gift, a series of transfers, a loan or possibly postponing the issue for a time until circumstances look clearer and more promising.

DECIDING WHO IS VULNERABLE

The FCA has defined a vulnerable person as "someone who, due to their personal circumstances, is especially susceptible to harm – especially when a firm is not acting with appropriate levels of care."

Some advisers start with the assumption that everyone is potentially in the category.

"Our approach is try and see all clients as being vulnerable and then work back from there."

FINANCIAL ADVISER

And it is certainly true that everyone has the potential to make irrational decisions about money or indeed many aspects of life. Vulnerability is not confined to the elderly or sick, and advisers need to be particularly sensitive to these possibilities. But the danger of this rather blanket approach is that 'vulnerable' loses some of its value and meaning so that advisers cease to identify the key issues.

Some clients need much more care with explanations and provision of information as well as having family members of friends to attend meetings. Some clients have physical disabilities that advisers must have the imagination and sensitivity to perceive and adjust their planning for. Some clients, for example, are hard of hearing, others find reading documents difficult, and some people have short attention spans. These characteristics are not always obvious, and clients may not volunteer information about their difficulties; so, advisers need to be on the look-out for these possibilities.

Almost everyone is susceptible to scams – regardless of age and experience:

"Even younger people are getting financially scammed through emails, Bitcoin scams, general banking fraud, and their emails getting hacked. They may be individuals who are extremely clever, but it can still knock them for six; they don't think that they're going to be a victim of things like this."

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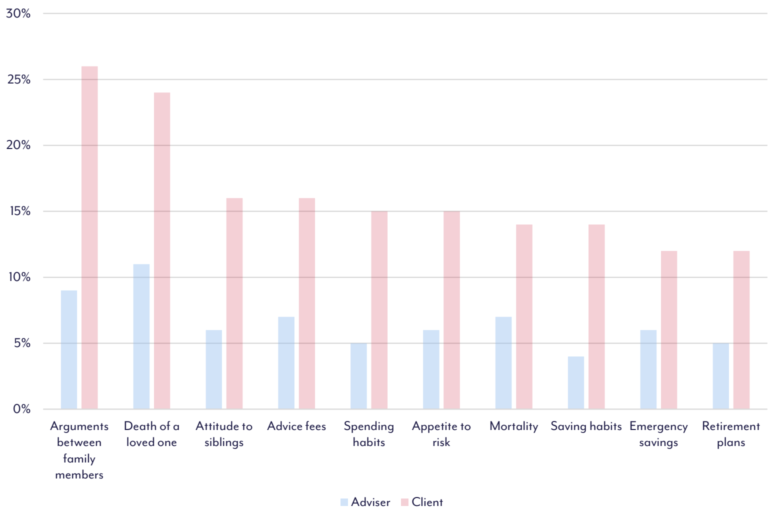
SUBJECTS THAT CLIENTS FIND UNCOMFORTABLE TO DISCUSS

Advisers unsurprising mostly find it easier than their clients to talk about sensitive subjects in their clients' lives, especially those which relate to vulnerability like death or even spending habits. So, it's important to be especially careful and empathetic in conducting conversations around these areas.

Proportions of advisers and clients who feel that topics are uncomfortable to discuss



Clients: How comfortable, if at all, would you feel discussing the following topics with your financial adviser? Base: 1,021 general consumers who have previously or currently seek financial advice (Aged 18+)

Advisers: How comfortable, if at all, are you discussing the following topics with your clients? Base: 200 financial advisers (Aged 18+)

The two subjects that clients feel most uncomfortable talking about are disagreements between family members and the death of a loved one. Advisers also find these harder to discuss compared with other topics. It would make sense for advisers to think about the best strategies for raising and discussing these topics.

PROCEDURES AND PROCESSES

Firms require some core processes to help and support advisers in spotting and dealing with client vulnerabilities. Once an adviser or a member of the team has recognised a vulnerability in a client, it is essential to record the fact so that others – including the compliance department – act accordingly. Remember to make the comments in such a way that a client who reads them would not be offended or distressed – they have a right to see their files.

Initial identification of potential vulnerability could be trigger points associated with age, recent major events like a divorce or bereavement or physical disability that could mean needing to make special provision for reports and meetings.

"There are certain protocols in place in terms of the back-office systems; it highlights if the client is over the age of 75, that will trigger certain checks to be done... to ensure that you can identify, or at least record, why this client is not vulnerable."

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Recognising actual vulnerability is a key part of the fact-finding process:

"It could be anything: having a stressful period at work, going through a divorce. We need to be recognising vulnerability without necessarily making someone feel like they're vulnerable. So, we are soft fact gathering – as part of fact-finding. Sometimes it's very, very obvious. If someone's very elderly, and maybe have signs of dementia, there'd naturally be someone else there like a spouse or a child."

FINANCIAL ADVISER

"I've got clients with terminally ill partners. So, obviously, the terminally ill partner's vulnerable, but also they themselves are therefore vulnerable and could be vulnerable for a very long time."

FINANCIAL ADVISER

Regular reviews of clients' circumstances and conditions are essential to spot signs of vulnerability, and this might sometimes be more challenging in a telephone or video meeting.

"But it's not just a one-off, 'You're vulnerable,' or, 'You're not vulnerable,' that's part of the ongoing annual review as well and recognising where circumstances change."

FINANCIAL ADVISER

Some vulnerabilities associated with mental or physical ill-health may be obvious, although this is by no means always the case. Vulnerabilities linked to financial pressures, especially within the dynamics of a family are often less salient and even trickier to deal with. Equally, it is often the case that people who are vulnerable don't recognise the fact or are not prepared to admit it.

A tick box procedural approach can be a helpful starting point for identifying vulnerability. But it is never enough. Advisers and firms have to recognise that spotting vulnerability and dealing with it is hard and requires advisers to be sensitive and alert to their clients' feelings and needs.

"If you're a decent human being you will look after people and respect and recognise the signs when somebody doesn't fully understand what's going on."

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Making a record of a client's actual and potential vulnerability is essential for colleagues to be able to take over a case, as well as for compliance reasons.

"The tick box exercise in our back-office system ensures that you can identify, or at least record, why this client is or is not vulnerable."

FINANCIAL ADVISER

Acting for vulnerable clients can sometimes be even more challenging than identifying who they are. Partly this is because individual clients and their circumstances can be so varied.

"It's really difficult to define exactly how you're going to deal with vulnerable clients because each circumstance is so different."

FINANCIAL ADVISER

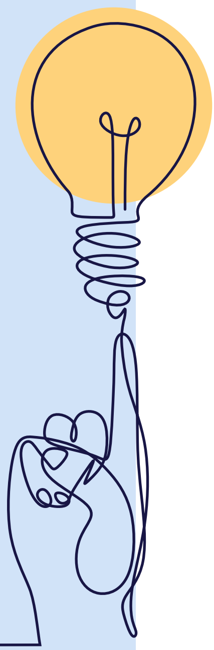
Advising vulnerable clients can also be very time-consuming and emotionally draining.

"I had a divorcee client who was in a really vulnerable mental state. I put huge amounts of time and effort into reassuring, explaining and helping this individual understand the situation. And now, a couple of years on from that, they are no longer vulnerable and have taken control of things again and so come out of that."

FINANCIAL ADVISER

THREE TIPS FOR HELPING VULNERABLE CLIENTS

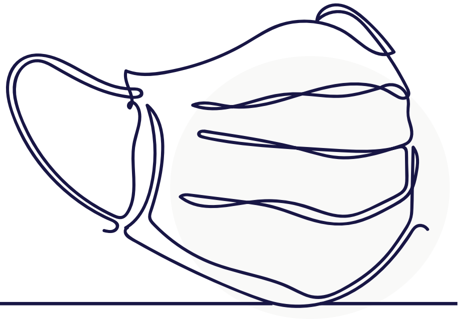
- Consider involving members of the client's family in meetings and correspondence, although initially broaching that possibility can be delicate in some cases. Try to get to know other members of the family early in the relationship with clients, so that the transition to bringing them into the advice process is natural and straightforward.
- Be especially careful in advising clients who might be vulnerable, where the risks they are facing are higher than the normal plain vanilla financial decisions. Defined benefit pension transfers are an obvious area for extreme caution for anyone, but even more so for someone who is facing redundancy or some other challenging life-stage. High risk investments are unlikely to make sense for certain types of vulnerable clients.
- Talk over such cases with colleagues who may be able to provide insights from their own experience as well as a sounding board for support.



VULNERABILITY IN 2022

The advice sector is likely to see many more cases of vulnerable clients over the next year or so as the cost-of-living crisis clashes with rising interest rates, fluctuating investments and a fragile economy. A difficult time lies ahead but advisers have yet another way in which to demonstrate their value by helping clients navigate through the challenges.

To find out how Charles Stanley can help you and your clients create a more secure financial future, contact ist@charles-stanley.co.uk



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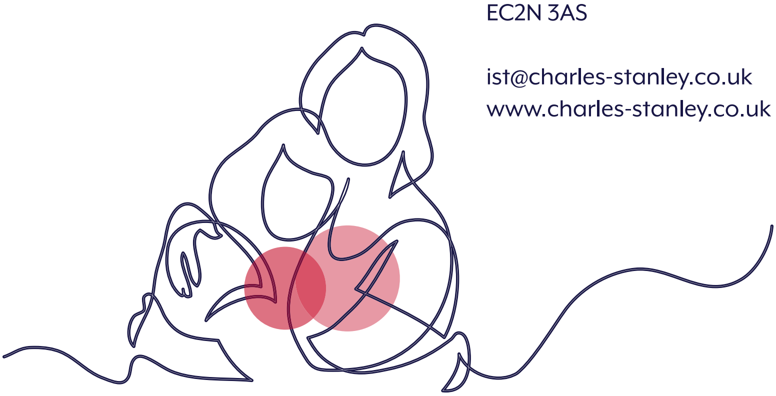

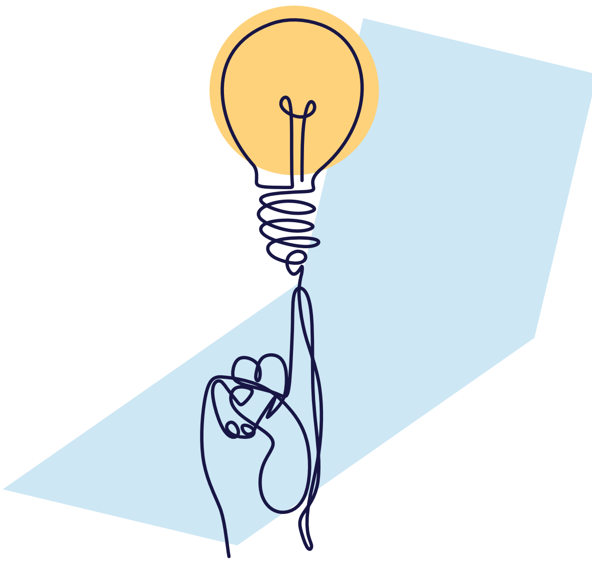

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CLIENT VULNERABILITY –
THE CHALLENGE FOR ADVISERS

Get in touch to discuss the topics raised or set up a meeting to understand how Charles Stanley can help you

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