

# The Due Diligence Dilemma

Peter Strydom: July 2016



Due Diligence is a term that is being heard more and more in Financial Planning circles and which could well turn out to be a really important function and process in our interactions with Clients.

This article is by no means intended to be a Professional Reference Guide but merely a document that raises the awareness of the importance of credible Due Diligence processes and how and where in our practices they could impact.

Let's start by looking at one or two definitions, descriptions & applications:

- Due diligence is the process of systematically researching and verifying the accuracy of a statement. The term originated in the business world, where due diligence is required to validate financial statements. The goal of the process is to ensure that all stakeholders associated with a financial endeavor have the information they need to assess suitability & risk accurately.
- In a General Context: Measure of prudence, responsibility, and diligence that is expected from, and ordinarily exercised by, a reasonable and prudent person under a given set of circumstances
- In an Investment Context: Duty of the investor or Advisor to gather necessary information on actual or potential risks involved in an investment.
- In a Risk Profiling Context: Conducting a due diligence is essential in choosing an appropriate Risk Tolerance Tool. Regulators require advisors to be responsible for

the processes and tools they use in formulating advice and, due diligence questions could include:

- Is the test a psychometric test?
- Does it meet universally accepted psychometric standards?
- Does it have independent psychometric certification?

A search on the Internet will come up with many more definitions and commentaries relating to various areas of our advice processes where Due Diligence may have a relevance but, I think that I have made the point.

Some of the common terms that are used in a Due Diligence context include, research, verify, validate, assess risk, prudence, appropriate, applicable, suitable & responsible. These terms could well be used by an Arbitrator in couching and posing questions to Advisors where clients have filed a complaint.

I recently participated in an IFA forum where the subject of Due Diligence was raised and the general lack of understanding of both the concept and its importance in the minds of the facilitator and the attendees was alarming. Hence this article.

So, having got that off my chest, where should we as Financial Advisors be looking to apply credible Due Diligence processes so that we are able to validate, defend and justify any advice, products, strategies or solutions should the need arise.

Some areas where we should apply Due Diligence processes in our practice include:

- The Institutions with whom we do business
- The Risk Tolerance tool that we use
- The tools that we use in determining Needs & Objectives and illustrating the effects of volatility on an investment or retirement plan
- The software and the methodology that we use in matching a Client's Risk Profile to an appropriate investment
- The actuarial integrity of the planning tools that we use
- A clear understanding of the research and portfolio construction methodologies applicable to the investments that we recommend
- The Risk Products that we recommend
- The Financial Planning, CRM & client communication processes that we employ.

This is by no means an exhaustive list of the areas where I feel that a Due Diligence process could be applied and this list could well differ from one practice to another, all that I am saying is, "be aware of where you may be at risk when giving advice to clients".

As the regulatory environment evolves and as precedents are being set by determinations being handed down, we should realise that, more and more, as in other jurisdictions around the world where they have had to endure the challenges that are synonymous with changing regulations, we are heading into a far more litigious environment than at any time in the past and we, as Financial Planners, need to ensure that we have covered all of the bases in our advice processes.