
IFA Platforms – The move from fund supermarkets to wraps

**A report by
CWC Research
For
JPMorgan FundsHub**

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CWC Research

CWC Research specialises in providing data and consultancy to insurers, investment managers, re-insurers and consultants dealing in the IFA market. We are a member of the Training Design Studio Network, an organisation that provides a broad range of training and other services to the financial services industry.

Our knowledge of this marketplace and the personnel working in it enables us to provide customers with qualitative data of unrivalled quality concerning current and future behaviours and help both providers, re-insurers and IFAs with advice on product, distribution and administration.

For further details please contact:

Clive Waller, senior partner:
+44 (0) 1730 269629
clive@cwcresearch.co.uk

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For further details please contact:

David Moffat, Marketing Director
+44 (0) 20 7743 6700
david.moffat@fundshub.com



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Research Methodology

This report is based on a survey of 100 IFAs at 84 outlets. The sample is based on a model supplied by Matrix Data that mirrors the IFA population in terms of sector and location but significantly skewed upwards in size. Ninety five per cent of the interviews were carried out face-to-face.

In view of the complexity of wrap products and the uncertainty of the market post de-polarisation, we prepared a scenario paper with input from providers outlining potential outcomes. This process enables respondents to assimilate information in advance of interviews and establishes a minimum level of common understanding across the sample. We have used this process successfully in the past.

CWC Research employs an interview structure adopted from the recruitment and selection industry to test answers provided. Where possible, we ask for examples of past behaviour to confirm the accuracy of responses.

Where we are looking at decisions that will be made in the future, we introduce questions on all subjects that we believe will influence future decisions. This will often result in different conclusions than indicated by initial responses.

In addition, we continue to research over time and monitor actual changes against those forecast. Experience gives us confidence in the validity and robustness of our unique approach.

The fieldwork was carried out between April and June 2003.

Background

The IFA channel is currently suffering the most hostile trading conditions since it was established following the Financial Services Act 1986. It has suffered a series of blows, the most serious being the collapse in consumer confidence in endowment mortgage products, the 80% drop in with-profits bond sales and the impact of stakeholder pricing on pensions business.

The growth areas for IFAs have been re-broking term assurance, pensions draw-down and SIPP and re-writing old group personal pensions as stakeholder friendly schemes. The medium term problem for IFAs is that none of these involve finding new clients.

From the traditional insurer viewpoint, churning of pensions and protection business can hardly be profitable.

In addition, we are arguably only emerging from the worst bear market since 1973/4.

At the same time costs have increased due to:

- the impact of regulation and
- greater costs of administration, a result of greater product diversity and provider service problems, specifically new business processing and obtaining valuations.

Whilst the extreme proposals of CP121 have been dropped in favour of the friendlier CP166, de-polarisation will result in significant changes in distribution involving both providers and the larger intermediaries.

This is certain to force change in the channel as a whole. IFAs will find it necessary to re-engineer in order to reduce costs of both administration and distribution to compete with insurers and banks that will be able to offer the products of multiple providers whilst benefiting from scale.

Whilst many IFAs may remain independent, the larger firms will create single and multi-tie arms in order to increase efficiency and increase revenues from providers.

There are already indications that serious players in the market see fund supermarkets and wrap accounts as a significant part of the solution. They offer the potential for real cuts in operating costs. In addition, they offer the perception of independence where the intermediary is tied or multi-tied.

Executive Summary

Use of Fund Supermarkets

Over 70% of respondents in our sample use fund supermarkets (FSMs). On average, 50% of appropriate business is placed through FSMs

Fidelity, Cofunds and Skandia are the leading providers with Selestia and Transact making some impact.

The top selections criteria for FSMs are: Fund choice, charges, re-registration, free switching and consolidated reporting.

Fund Supermarket Scope

IFAs are evenly divided between those who want to access to 100 – 500 funds and 10 – 29 managers and those who want access to the whole market

Access to Fund Supermarkets

A third of IFAs do not believe there is a minimum asset requirement before recommending FSMs; 20% see a minimum of £10-£24,999, a third see a minimum of £25,000, effectively treating FSM as a premium product.

Just over a third do not believe in a minimum investment; 70% see a minimum between £2,500 and £10,000, effectively covering ISA business; some 2.5% want to see a minimum investment in excess of £10,000.

Product Range

Virtually all IFAs wish to see life bonds, unit and investment trusts and pension funds available, 85% require cash funds, 75% would like money market accounts, guaranteed products and with profit bonds included.

Fund Supermarket Brand

40% of respondents favour a non-provider brand such as Cofunds, 30% a major investment provider brand, 30% own brand, whereas only 10% want an insurer brand.

The use of own brand SIPP or small SIPP providers has given IFAs confidence in their own brand.

Potential for Wrap Accounts

In excess of 90% of IFAs are aware of wrap accounts
Of these, over 90% believe wrap is relevant to their business
Over 90% believe that wrap business will grow considerably

Investment Vehicles

All respondents require unit trusts, investment trusts and cash. Over 80% want equities and fixed interest securities (although virtually none advise on them) and nearly 80% would like commercial property.

Tax Wrappers

All want ISA, PEP and Personal Pensions. Over 85% would like Executive Pension Plans and offshore bonds.

Additional Products

40% would like mortgage products on the platform and 40% protection products.

The vast majority do not yet see opportunities to extending their services into a broader range such as general insurance.

Worksite Platforms

A small number of pensions specialists and benefit consultants see opportunities using worksite platforms to improve employee benefits and expand product range.

Client Migration

Two large IFAs are planning a full migration to FSM/wrap this year. Only then will we be able to observe the logistics of this process.

Initial Investment in a Wrap

It is important to understand how clients might accept a wrap proposition initially. Just over 10% believe clients will start the account with less than 30% of investable assets, the balance are spread between 30%-60%, 60%-90% and over 90%.

IFAs will need a clear proposition that demonstrates benefits and security and a strategy to migrate clients to wrap

Minimum Initial Investment

Just over 20% do not see the need for a minimum, nearly 50% feel the minimum should accommodate ISA levels, whereas just over 30% see an entry level in excess of £25,000.

Pricing and Commission

Total Annual Fee

40% of respondents would like to see an annual fee of 1.5%, a third between 1% and 1.25%, and nearly 20% expect 1.75 to 2.0%.

Annual IFA Commission

80% of respondents expect 0.5% per annum, around 10% expect 0.75%, a similar amount, 1%.

Initial Commission

Nearly 80% expect initial commission. Over 80% of these would anticipate 3%, the norm for unit trust and ISA business now.

Initial Charge

Over 50% would accept an initial charge. There is a polarity of views, with the majority of these being divided between >1% at one extreme and <2% at the other.

A small element would accept an absolute amount, say £100, for set up costs.

Future Fee/Commission Models

We can conclude that most IFAs expect to receive the same as now on new sales, taking little or no account of transfers in. We can further assume that they do not anticipate fully transparent pricing.

Very few IFAs work on a fee basis today, although many regard commission offset as such. Not only would most IFAs struggle financially if they were to move to a non indemnified basis, they would equally struggle to persuade clients to pay fees of anything like the levels of current commissions.

Re-registration will play a major part. Those IFAs that persuade clients to re-register large portions of their portfolios will be well equipped to manage the change.

Investment Advice

The majority of IFAs see the provision of investment advice as a core part of their proposition. 85% give advice based on their own competence; less than 40% have any form of investment qualification. About a third will consider outsourcing if investment qualifications become mandatory.

There is a fear amongst a significant portion that without the provision of investment advice, their proposition will have too little value.

The Future of Wrap Accounts

IFAs quote the drivers for wrap as high back office costs, followed by poor provider systems, competition, regulation and customer requirement.

When asked why wrap had failed to develop in the UK yet, the main reasons given were lack of wrap managers, lack of knowledge and reluctance to change.

We believe that wrap will develop quickly once a major provider enters the market and will benefit further from re-engineering following de-polarisation.

De-polarisation

Virtually all IFAs intend to remain independent; some 20% are considering a multi-tie operation running alongside. Single ties are not favoured currently.

IFA turnover and profitability are suffering in current markets; it is likely that many smaller firms will be forced to multi-tie, merge or go out of business.

If they do multi-tie, IFAs appear to favour the very biggest providers.

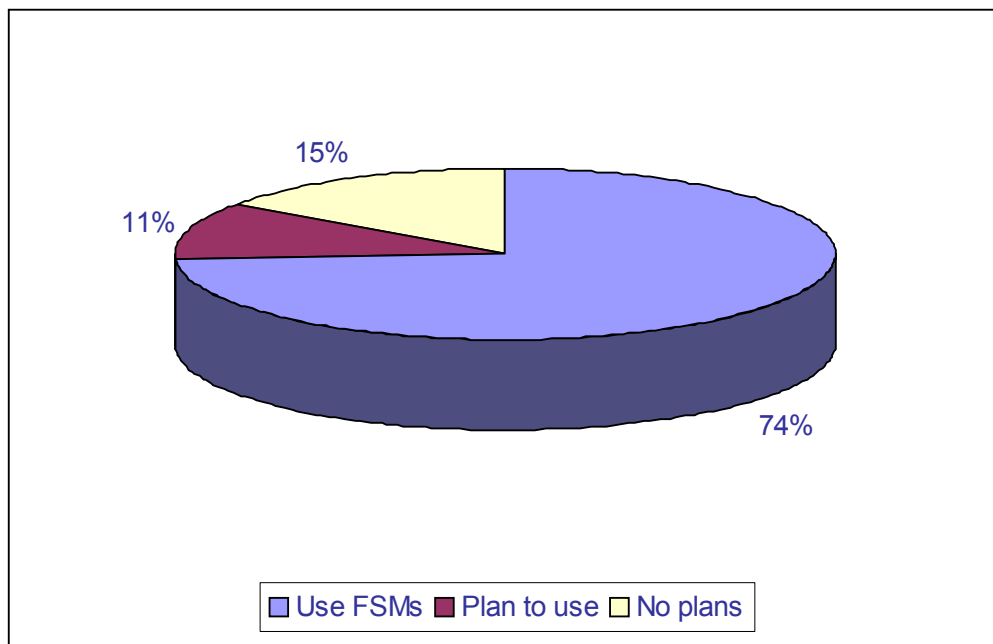
Section 1: Fund Supermarkets

1.1 Current usage of fund supermarkets

In order to forecast the likely use of wrap platforms in the UK intermediary market, it is necessary to follow the adoption of fund supermarkets (FSMs).

- In excess of 70% of respondents in our upwardly skewed sample who conduct investment business are using FSMs
- 50% of appropriate business is placed through FSMs
- 25% place in excess of 75% of business through FSMs

Table 1 Fund supermarket usage

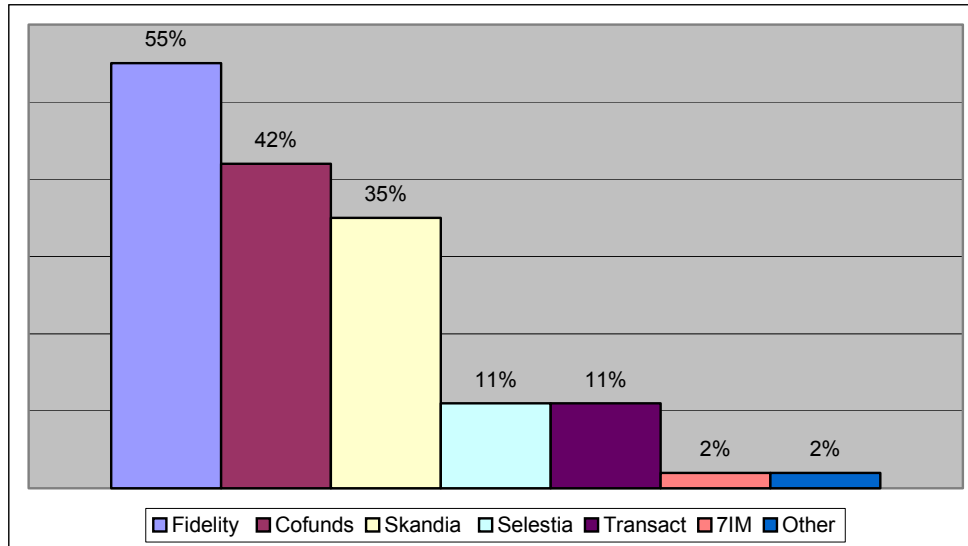


Investment business is, of course, at low levels and the majority of respondents are limited largely to ISA business.

1.2 Choice of fund supermarkets

Table 2 indicates which FSMs IFAs are using. This is not an indicator of volume, but a clue to the breadth of penetration of these products into the market.

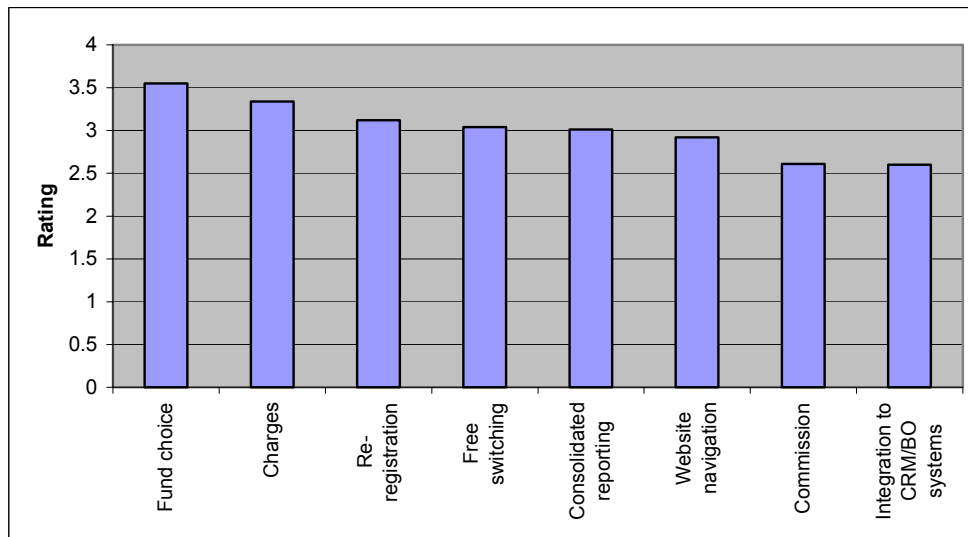
Table 2 Fund Supermarkets Used



1.3 Selection Criteria

From a list of criteria supplied by providers, we asked respondents to rate criteria in order of importance from “1” being essential to “4” being unimportant. Table 3 shows the leading criteria. The full list can be seen in appendix 1.

Table 3 IFAs rating of leading FSM selection criteria



If occasional and new users are eliminated, re-registration becomes equal second followed by consolidated reporting.

Brand is lowly rated. However, answers to later questions will challenge this response.

1.4 Scope

We need to know the scope that IFAs require from FSMs and subsequently wraps.

Ultimately, it may be that those who remain as IFAs will opt for full open architecture as this is ultimate independence. On the other hand, those choosing to tie or multi-tie may be willing to accept a limited range – which will be regarded, by themselves at least, as best of breed.

Virtually all IFAs intend to remain independent. Twenty per cent, the larger firms, will consider multi-tie alongside their IFA business. (CWC IFA Survey 2003 – De-polarisation). Other factors indicate that this will not be the case. However, answers to the following questions will be on the basis of current status in most if not all cases.

1.5 Preferred number of funds and fund managers

When we asked IFAs how many funds they would prefer within the FSM:

- Some 35% opted for 100-499 and a similar number opted for the whole market.

When asked about the number of fund management groups:

- Some 34% opted for 10-29, 23% for 30-50 and 39% for the market.

In each case, we see a split between those who want to limit options for ease of operation versus those who feel they need the market.

The thought process appears to be:

“I want to deal with a manageable number of funds and groups”

“How can I be sure that my favoured ones are available?”

“I must have access to the market”

Table 4 Number of funds preferred

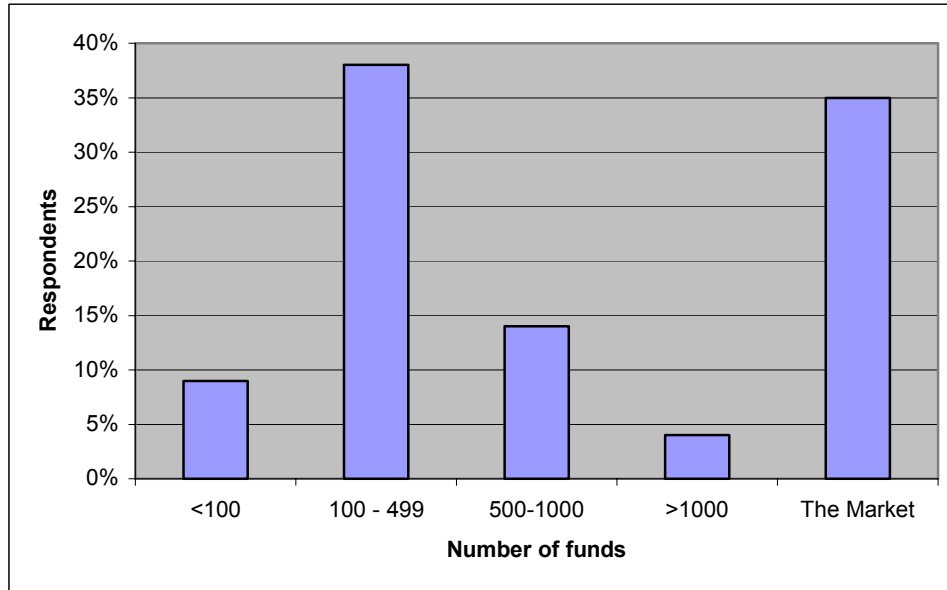
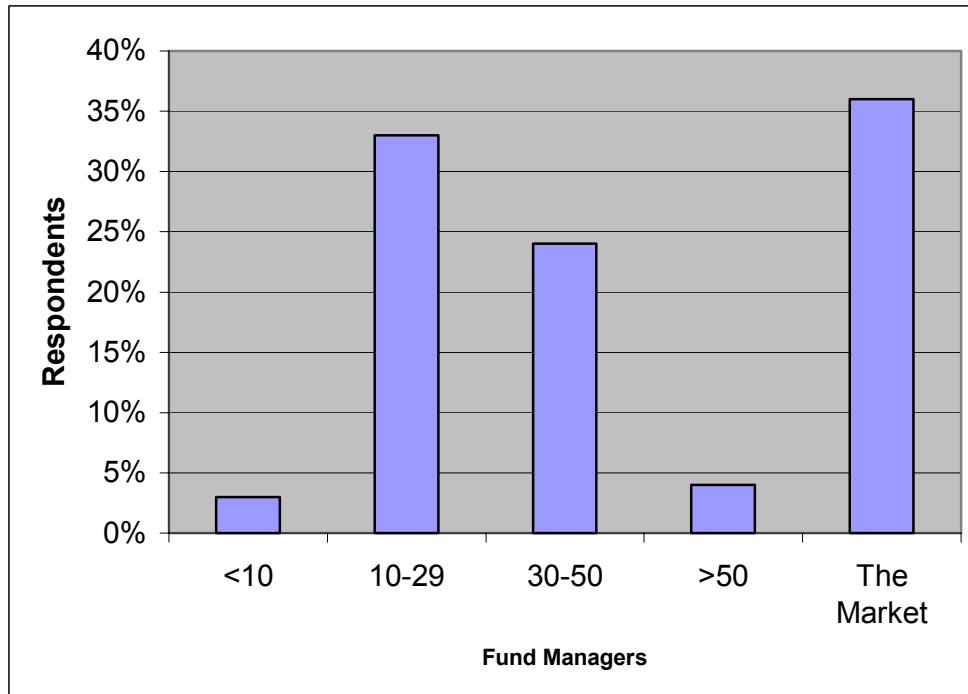


Table 5 Number of fund managers preferred



1.6 What assets should a client have to merit investment in a fund supermarket?

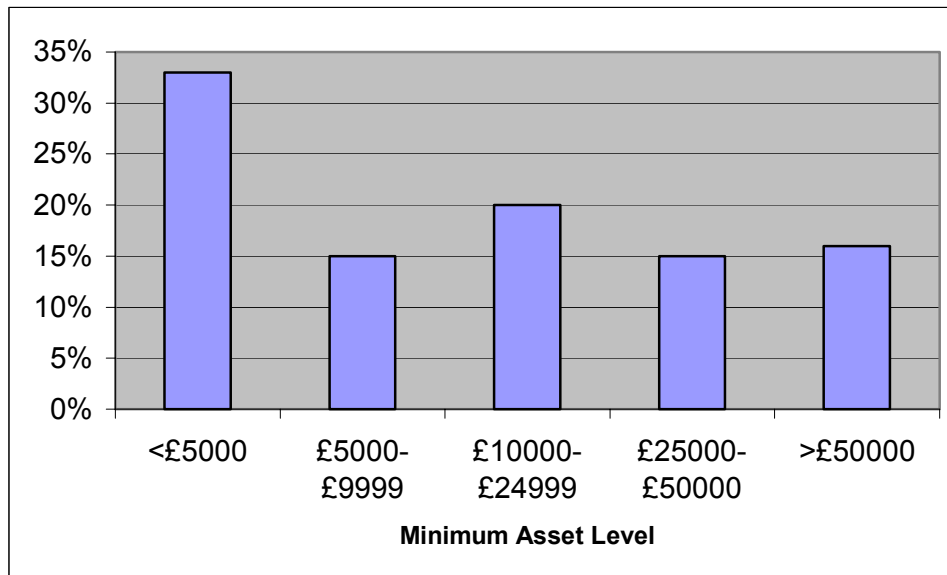
This question and the next are highly relevant to the customer proposition. There are those who believe that FSMs are a product for higher worth clients. This may be merely gut feel or a genuine strategy. If the latter, the “Fortnum and Mason” approach by 7IM may be appropriate.

Others see FSMs as the logical approach to streamlining of processes to drive down costs to themselves and their customers and will opt for a “Tesco” model.

They might argue that an FSM is a commodity product and, therefore, cost, scope and functionality are the only differentiators.

- Some 33% do not believe in a minimum asset level. At the other end of the scale, a similar proportion feels that the client should have assets over £25,000.
- Some respondents make the point that they selected a high entry level as they only deal with clients with a given level of assets.

Table 6 Minimum client asset level for fund supermarket



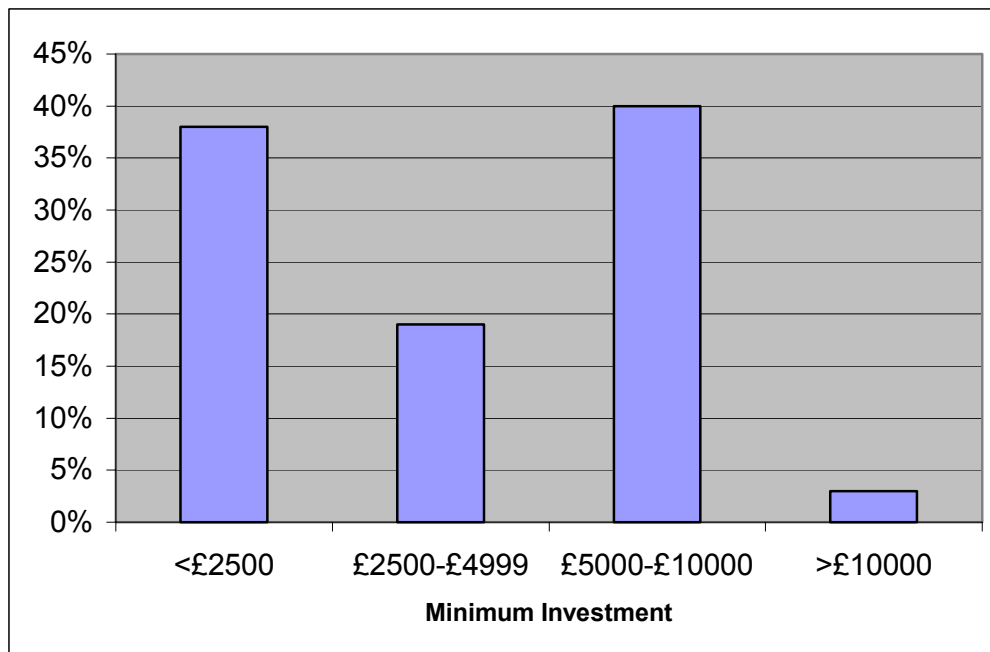
We believe that it would be a mistake for IFAs to adopt two processes, traditional for smaller clients and FSM for those of higher worth. This will have a negative impact on the cost savings and serve little advantage.

In addition, where a premium product is selected, there must be clear value to the customer.

1.7 What is the minimum investment in a fund supermarket

- Nearly 40% believe that there should be no minimum investment. A similar number pitch the minimum investment around the single ISA level.

Table 7 Minimum individual investment in fund supermarkets



1.8 Fund Supermarket Range

In the current immature market there is a range of opinion about what products should be available on the platform.

Probably the majority of IFAs are not aware of the products potentially available on a wrap platform. We included a range of products suggested by providers that is more expansive than that available from all but a couple of niche providers today.

Table 8 Products IFAs want in fund supermarkets

Unit linked bonds	95%
Unit trusts and OEICs	100%
Investment trusts	95%
Pension funds	95%
Cash funds	85%
Money market accounts	75%
Guaranteed/protected funds	75%
Unitised/institutional with profits	75%

1.9 Nature of brand

We asked respondents whether they preferred a unit trust brand such as Fidelity, an insurer brand such as Standard Life, a non-provider brand such as Cofunds or their own brand.

Table 9 Preferred nature of brand

Major Investment provider	30%
Major Insurer	10%
Non-provider Brand	40%
Own brand	30%

The range of responses demands some conjecture.

It is clear from their comments that some of those opting for a major unit trust brand felt that this was required to strengthen the proposition.

Those opting for a non-provider brand valued the lack of potential competition and were confident in their own proposition.

The surprising result is the very low response for an insurance company brand.

This may be due to the fact that there is no major customer brand in the market today (whilst Skandia has a highly successful IFA brand, it is not a customer brand in the UK). It could possibly be that IFAs associate traditional providers with bad press and poor service. We cannot be certain.

Perhaps more importantly, a few expressed concerns that traditional providers might use existing systems that are currently failing to deliver. One can sympathise with such a view. It was felt that any attempt to launch FSMs on unsatisfactory platforms will be an expensive mistake.

Those who have developed own brand SIPPs are aware that their brand has real value with the client. It is probable that where a client is willing to place £250,000 plus in a SIPP, they will be equally be happy to put the major part of investable assets in that adviser's wrap account.

- Nearly 75% of respondents would wish to have flexibility to brand the screen.

For example they might want their own brand on the screen in front of the individual client whereas a client brand would be more appropriate in a worksite situation. Those that do not want this facility feel that their brand will not have the weight of a provider brand and are probably unlikely to consider worksite marketing.

The nature of the brand linked with the customer proposition is seen as fundamental to the success of a wrap product. The FSM/wrap proposition will be a hard one for many investors to understand. Trust and security will be all; in some instances the trust will stem from the IFA; in others, the strength of a strong provider brand will be requisite.

Section 2: The Potential for Wrap

There is no agreed definition of a wrap account. For the purposes of this research, we defined a wrap account simply as a form of financial supermarket with access to a very broad range of products around some or all of which, tax wrappers could be placed.

2.1 Potential for wrap accounts

Datamonitor's research of 2002 indicated that nearly 80% of IFAs were unaware of wrap. Today:

- Nearly 95% of respondents said that they were aware of wrap accounts
- Of these 92% believe wrap is relevant to their business
- Over 90% believe that wrap business will grow considerably

The growth in awareness is in part due to the growth of fund supermarkets, the marketing efforts of those already in the market and the interest now shown by the trade press. However, the rate of growth indicates that it is an exciting proposition. What our respondents say certainly confirms that.

Experience in the US and Australia indicate that there will be few successful providers. This research suggests that the UK will be the same.

It is likely that interest will increase as soon as a major brand provider launches a wrap product. This will stimulate competitor activity and further stimulate IFA interest.

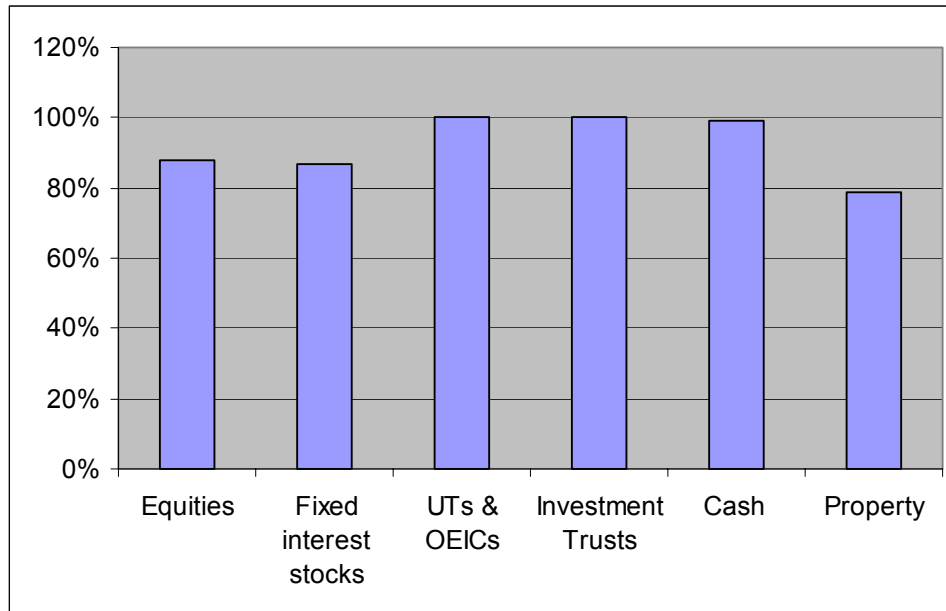
We will look at the drivers below. However, it is already clear that those who ignore wrap accounts as a developing market area are taking a considerable risk.

2.2 What investment vehicles do IFAs want in wraps?

All respondents expect unit trusts, OEICs and cash to be available. There is a dilemma concerning non-collectives.

Few IFAs are authorised to advise on ordinary shares or fixed interest securities. As such there is an initial reaction to exclude them from the platform. We pointed out that they did not need to advise on them for inclusion on the platform. This interjection accounts for the higher rating.

Table 10 What do IFAs want on the wrap platform



For the majority of IFAs and customers the exclusion of non-collectives, at least as for the day 1 proposition, will not be a great concern. However for the client who does own and wishes to retain them, there are issues:

- The ability of the platform to offer CGT and IHT computations may become a criterion
- Portfolio construction tools are only of value if the whole portfolio is included, hence the ability to value other assets outside the wrap may become important
- The disentanglement of planning and investment advice will become an issue. While IFAs will continue to offer financial planning advice, many, even offered a comprehensive tool-kit, will be less comfortable in offering investment advice in the future
- Property and, potentially, chattels may also be included in some form, if only for valuation and planning purposes

We believe that the fast growing SIPP market will have significant impact on the development of wrap products in the UK.

- The SIPP is to all intents and purposes a partial wrap product
- For many, it will represent the major part of their non-property assets
- Those IFAs comfortable with SIPP should be equally comfortable with wrap

SIPP tells us a great deal about how IFAs see branding

- Specialist IFAs favour niche, no-brand SIPP managers
- Generalist IFAs tend to prefer big brand

2.3 What wrappers do they want?

- All respondents want ISA, PEP and Personal Pensions;
- 87% want Executive Personal Pensions and offshore wrappers.

2.4 What additional products do they want?

The majority of respondents had not considered the possibility of including non-investment products on the platform. In order to gain an initial impression, we restricted our question to mortgage and protection products

- Some 40% of respondents said they would like mortgage products on the platform
- Some 45% would like protection products.

We once more felt that respondent's answers were based on what they do and how they work today. Indeed some were surprised that we should consider that they would contemplate non-investment or pension products.

We believe that this will change as de-polarisation forces IFAs to consider re-engineering:

- As wrap platforms develop, it is likely that some intermediaries will see opportunities in extending their services to include a broad range of general insurance products from motor and household through to holiday and pet insurance
- The ability to leverage more business from existing customers at low cost could be an important factor for survival in the new world post-polarisation

2.5 Worksite Platforms

Development of worksite platforms has stimulated interest in distribution in the workplace.

Research we have carried out in this area shows that some specialist benefit consultants and pensions IFAs are keen to develop this opportunity and are already exploring provider and third party platforms. Open architecture wrap platforms combined with appropriate human resource software should drive this channel forward.

Our questioning on screen branding and extension of product range indicates that a small number of IFAs see an opportunity.

Since benefit consultants tend not to be users of FSMs and may not see wrap platforms as relevant, providers may benefit from activity in this area.

The continuing migration from defined benefit schemes to defined contribution schemes should increase interest in the wrap account as a good worksite platform.

A multi-manager approach will give the employee a degree of empowerment. To this can be added a menu of benefits plus secondary insurance and possibly banking products on favourable terms. This would be seen as an attractive employee benefit.

2.6 Client migration

The benefits of wrap are only optimised if all investment assets are included on the platform. However, to suggest this to a client requires some consideration. In our experience, relatively few clients use a single consultant to advise on every aspect of their financial affairs, although advisers may not be aware of this. They may use two or more advisers; others will fail to inform the adviser of all assets. This complicates the wrap sale.

The logistics of migrating clients from traditional investment to wrap will be demanding in both consultant and administration resources.

2.7 What proportion of total investment assets will clients invest?

In view of the above, it is important to get a feel for how the client might react.

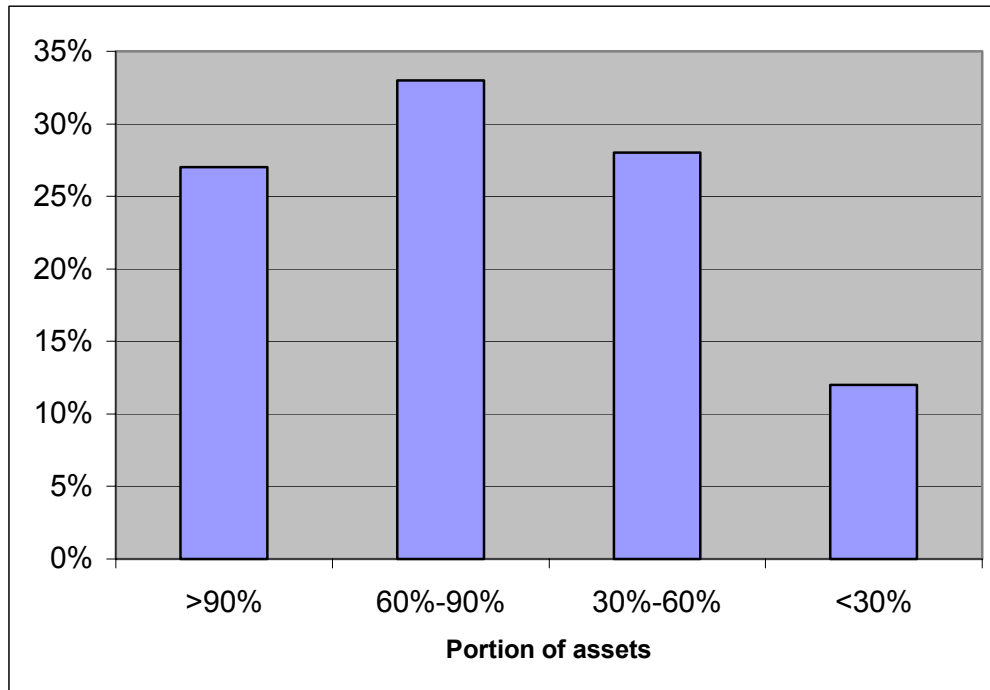
We asked IFAs how much of their investable assets clients would move into a wrap initially; would they embrace the philosophy fully and move everything across in order to gain the full benefit or would they merely put a toe in the water and test the proposition?

- Answers are spread fairly evenly between 30%-60% through to over 90%.
- Of those who are currently recommending wrap, responses vary from “We find it very hard” to “We have no problem”.

It is clear that the proposition to the client must be very transparent and there can be no doubt whatsoever about the security of the underlying assets.

Historically, high worth customers have been happy to accept discretionary management and use nominee accounts; they have generally accepted the advice of their stockbroker or bank. This may be the case today. The success of own brand SIPP suggests that it is.

Table 11 What portion of assets will clients initially invest?



However, it is possible that the mass affluent may want the perceived security of a big brand in respect of the portal.

IFAs tend to be confident people – they have to be; however, to ask a client to invest considerable assets via some form of portal may well be hard if confidence is not supported by a well presented case.

It is our belief that if the presentation of the proposition is not carefully thought through, failure could result. Providers may wish to help IFAs in creating their wider marketing proposition.

2.8 Minimum investment to open wrap

The question of how much the initial investment should be encompasses two important issues.

- Should the wrap be opened with a significant transfer of assets to gain much of the overall benefits or with the next transaction, possibly the annual ISA?
- Once the decision to move to wrap has been made, how will the logistics of the migration be handled?

Table 12 What is the minimum investment to start a wrap account?



Again there is no consensus.

- Some 45% see no reason for any significant minimum, thus including the single ISA opportunity
- Just over 15% opt for a minimum of over £50,000, seeing wrap as a premium proposition

A workable strategy would appear to be the selling of the concept at the annual meeting and accepting that one ISA may be the starting point. Once monies grow and the benefits become increasingly apparent, it should become easier to move existing investments across.

Where a high initial investment is required either because of a high provider minimum or because of the IFA's own strategy, the sale is likely to be more complex.

In the case of a larger IFA, the former might well be adopted in view of the logistics of migration even if the premium proposition alternative is preferred.

2.9 Pricing and Commission

Since the FSA published CP 121, the debate on commission versus fees has developed considerably. The dropping of the defined payment system (where the IFA would have had to agree a fee basis in advance) softened the issue to some degree. However, the nature of the menu approach under which the IFA will be able to offer a range (not yet finalised by the FSA) of charging options and the resultant clarity of disclosure to the customer will be significant factor in the post de-polarisation commission/pricing model.

The issues are:

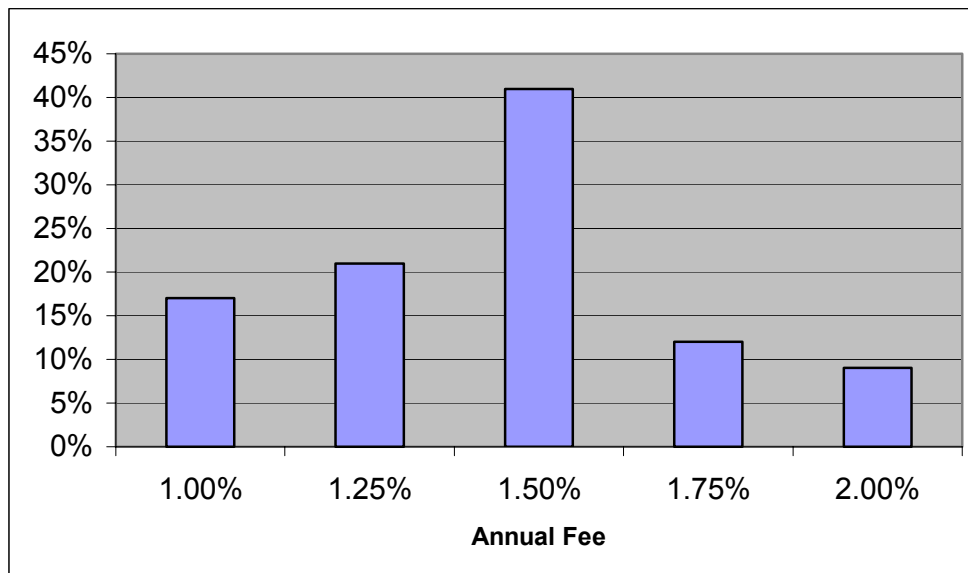
- Will clients accept a fee-based model?
- Can IFAs obtain the capital to manage the change?

In this section, we attempt to define IFAs current requirements.

2.10 Annual Fee

We asked IFAs what the total annual management fee should be out of which their own fee would be paid. The results are show in table 13

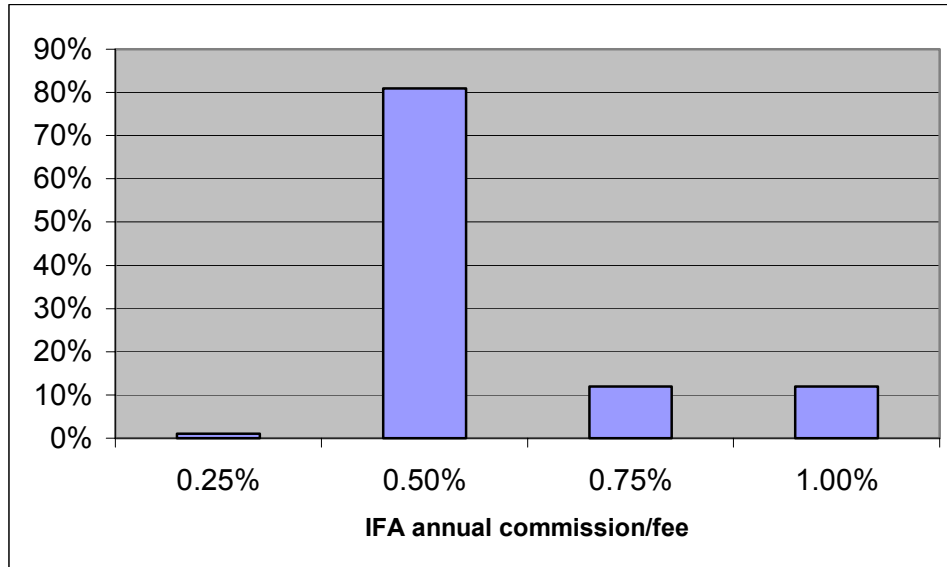
Table 13 Annual management fee



2.11 IFA Commission / fee

We then asked what they felt their fee should be. The results are shown in table 14.

Table 14 IFA annual commission / fee

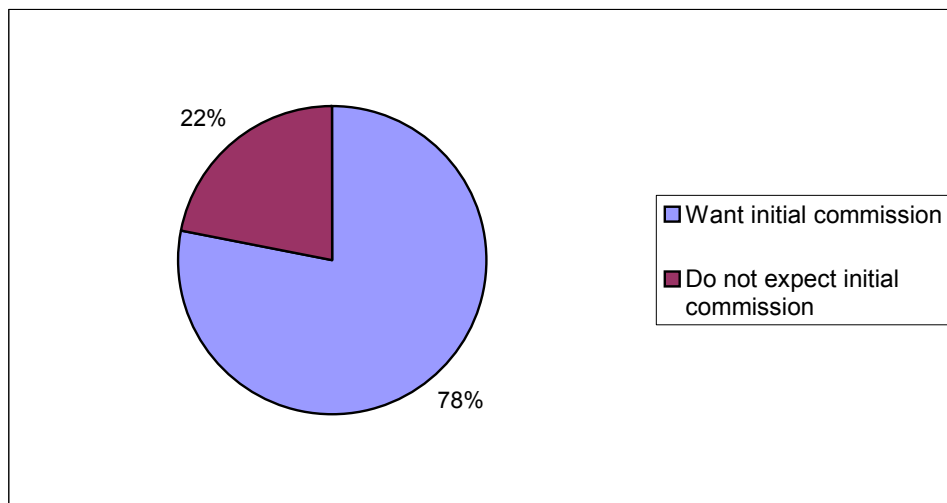


It may be no coincidence that the current industry trail level is 0.5% today. There is a concern that they are not taken into account substantial transfers-in. The remainder were, perhaps optimistically, split between 0.75% and 1.0%.

2.12 Initial commission

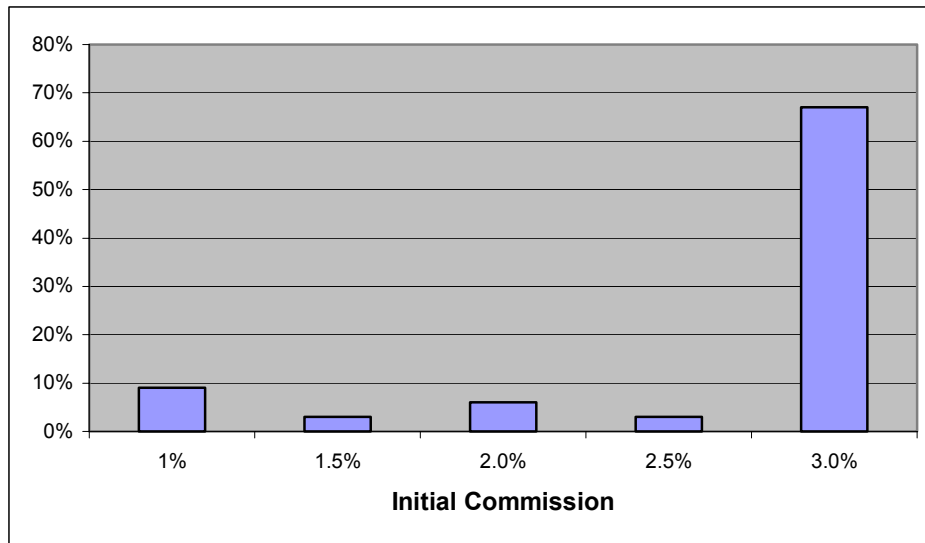
We asked IFAs whether they would expect initial commission on new wrap sales.

Table 15 Do IFAs want initial commission



We then asked those that did, how much they expected. The majority said that the commission would be a maximum of the figure quoted subject to the amount of work.

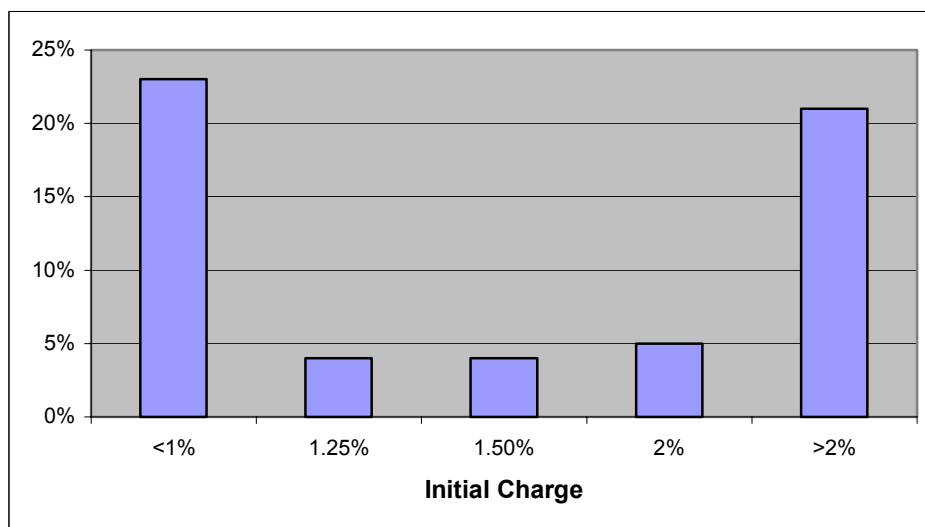
Table 16 Initial commission responses



A handful expect to receive the same commission that they get today e.g. 7% on with-profit bonds. Virtually all assume that initial commission will be indemnified as it is today.

We asked respondents if an initial charge is acceptable

Table 17 Amount of initial charge



There is concern about the charge being for anything other than for financing initial commission. If the charge is to recoup administration costs, there is a suggestion that it should be an absolute figure, say £100.

2.14 Future commission/fee models

- About 20% of IFAs appear to accept that there will be a drop in overall charging levels
- 50% of these expect the provider to make the sacrifice rather than themselves.

The answers above indicate that whilst IFAs see the attraction of wrap, they are reluctant to move away from the current pricing model.

Earlier research tells us that a significant proportion of IFAs have moved to trail commission, - 3% on all single premium investment products, with ½% trail. This, they argue, removes product bias and establishes value in the business.

However, there are many who still take maximum initial commission. This is commonly the case with the larger sales forces and self employed consultants who may not benefit from trail in the long term. Such businesses will struggle to change.

It is difficult to forecast the impact of re-registration. Those IFAs that are successful in persuading clients to re-register existing investments into their wrap, almost certainly including much that they have not sold or given advice on, will do well, but may depend on their anticipated remuneration.

An additional complication is where certain fund groups are now seeking to levy re-registration charges of up to £25 per holding. Only when this occurs, will we see how much they are willing to lower the levels of commission / fee they take (assuming the market allows flexibility).

It will be a concern for consumers and regulators if the cost benefits of wrap are not passed on to the clients.

If some IFAs take current initial and trail commission levels for on investment portfolios where they have not and do not add value, it is likely that the wrap concept will be condemned by the media.

If there is a requirement for full transparency that precludes indemnified commission there must be doubt about the ability of IFAs to manage the change.

It is our understanding that at least some providers intend to continue indemnified front-end commission. Presumably those providers tying intermediaries will do so. If this is the case, providers offering a fully transparent contract may be disadvantaged. Fee charging will be covered more below.

2.15 Fee Option

- 12.5% are concerned at having to offer a fee option
- The average level of fee-based business is 34% of income, but the vast majority is commission offset.
- 80% do not have a target for fee business
- Nearly 80% have no fear of a fee option as they currently offer this alternative. They do not see the menu as a threat

Apart from benefit consultants, very few IFAs work on a true fee basis where the client is overtly invoiced for the cost of work.

Commission offset is an easy option. If this option is not available, we do not believe that many firms would rapidly or successfully transition from dependence on initial commission. It is not just a question of operating capital, though this can be an issue in its own right. The vast majority of client will not pay fees for financial planning advice.

Section 3: Investment Advice

The FSA and Sandler have expressed concern about the quality of investment advice offered by advisors. Wrap platforms offer the alternative of outsourcing investment advice via the platform. However, many IFAs see the provision of investment advice as crucial to their proposition.

However, some of the focused or market aware IFAs understand that investment advice is not what they are good at and are already outsourcing or intending to do so. In this section, in order to understand how they might operate in the future, we look at what competence advisors have, whether they employ experts or outsource, whether they will outsource in the future and whether they use portfolio-planning tools.

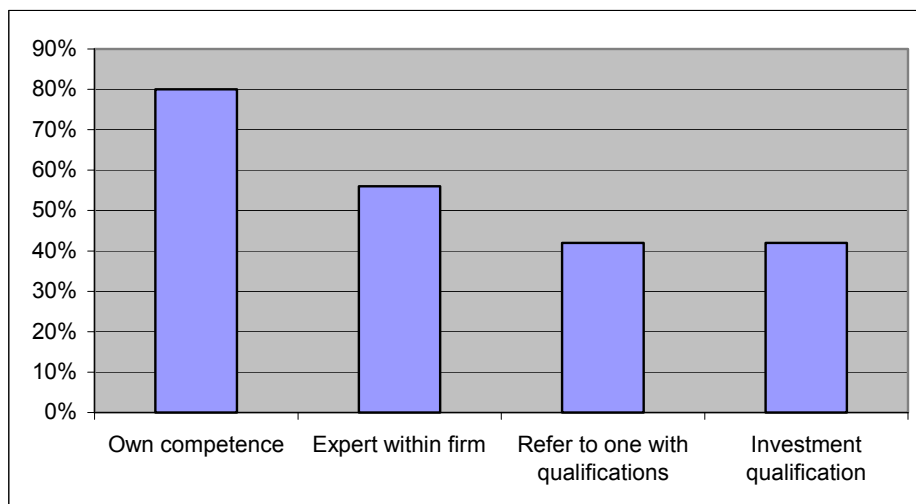
Whilst we cannot comment on the quality of advice offered, the proportion of IFAs holding even basic investment qualification is very low. Nonetheless, three-quarters believe that qualifications will become mandatory over time.

Table 18 shows the results for the top half after excluding non and small investment IFAs. If we include all who write any investment business, 85% advise on own competence 33% have any qualification.

This throws up some interesting questions. To date, the majority of investment management has been delegated to insurers via with-profits, managed funds and endowment contracts.

The growth of external fund links and SIPP managers confirms that IFAs are moving away from insurers as investment managers. As this has occurred, they have started to advise on individual fund selection rather than delegate this to the provider managed fund manager. In effect, they have become the investment manager by default.

Table 18 Investment competence issues



There will be reluctance as many IFAs regard investment management as part of their core competence, regardless of qualification or formal training. Many have felt that they have benefited from meeting fund managers. Whether it is the content of the meetings or the feel good factor that is the greater benefit, is a matter for conjecture.

It seems likely, however, that IFAs will have to employ qualified people ultimately, an expensive prospect, or outsource. Whether they outsource via a wrap platform or opt for manager of managers or fund of funds will be interesting to see. This is an area to monitor.

We have some concern that there are those who believe portfolio-planning tools will make an expert out of a novice. Such tools have tremendous potential for reducing the workload of the investment adviser and improving the overall service offered to the client. However, they do not enable the layperson to become an expert and even the best designed are potentially open to mis-interpretation and mis-use.

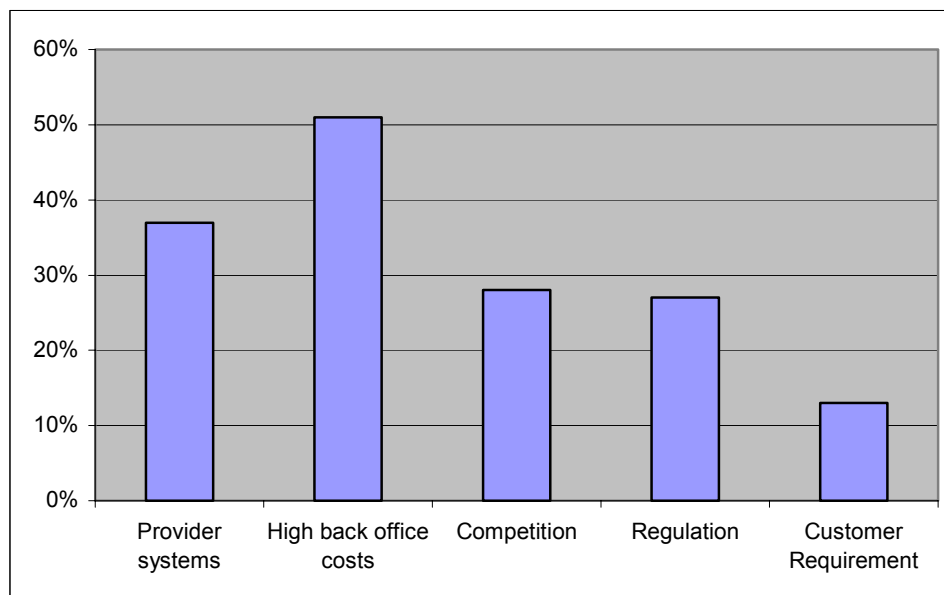
This concern was expressed by a number of respondents.

Section 4: The Future of the Wrap Account Market

4.1 What will the drivers be?

We have already seen that awareness of wrap has grown to over 90% and that 90% of these see wrap as relevant to their business. We need to know what will make it happen. Table 19 shows the results from an IFAs perspective.

Table 19 What will drive the wrap market?



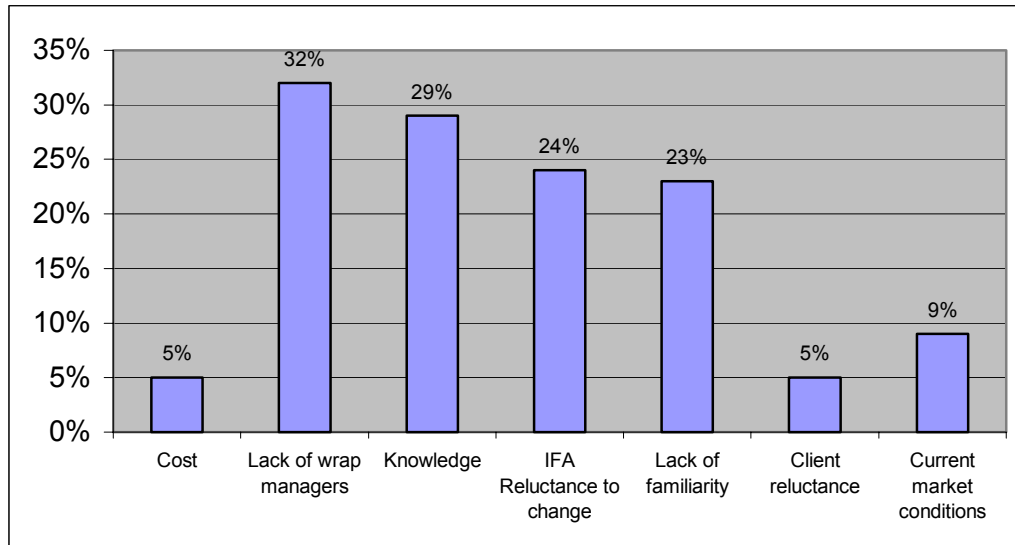
We then asked IFAs why they thought that it had not happened yet. The replies are shown in table 20.

Our view is that a major provider is needed to drive change and overcome IFAs reluctance to move from the traditional way that they do business, especially in the mass affluent market. This will happen shortly.

However, we feel de-polarisation will be the ultimate driver since changes will occur that will change the industry dynamics and force change for survival, the greatest motivator.

Most importantly: over 50% of IFAs feel that they will use only one provider. The remainder are unlikely to use more than two.

Table 20 Why have wrap accounts not taken off?



This implies, as with FSMs, that there will be only a handful of successful players and huge entry barriers as there will be a great reluctance to move from one provider to another.

4.2 Provider/IFA relationships and provider selection

In view of the fact that most IFAs are likely to use only one or two providers, the sales process could be crucial.

The selection processes currently adopted may prove revealing.

- Only a third of IFAs use panels
- Of these, many are, in effect, white lists. The consultant has great discretion
- In 94% of cases, he or she makes the final decision as to which provider is used
- Over 80% of IFAs want a relationship with a broker consultant.

Much as they condemn the majority as useless, IFAs do value good broker consultants and we have to believe that they are influential.

The impact of the current selection process on wrap providers is twofold:

- IFAs have moved away from selection process
- Wrap demands the adoption of process – a cultural change for many IFAs
- Whilst the major intermediaries will deal at senior management level within the wrap providers, the vast majority of IFAs are small to medium in size and without this reach
- As such, we believe that highly competent broker consultants and sales managers or specialist sales technical teams will play a considerable part in the success or failure of the provider

Section 5: De-polarisation and IFA Viability

It is likely that de-polarisation will drive re-engineering within IFA businesses to bear down on costs. In turn this may well also drive forward the move to FSM and wrap platforms.

5.1 De-polarisation Options

- 99% of respondents intend to continue as a IFAs
- 25% will consider an additional multi-tie

Our sample is underweight in network members. Nonetheless, we were surprised at the hostility expressed towards networks by members and non-members alike.

If networks intend to drag members into multi-ties, they may find that they will only do so kicking and screaming. Open architecture wrap may be a solution, or at least a partial appeasement. However, it appears that the need to be independent is greater at this end of the market.

5.2 Single tie option

There is very little interest in single tying. Zurich's change in strategy to offer to tie part of a business would appear to confirm this.

However, some 30% of respondents said that they would consider a single tie with open architecture wrap.

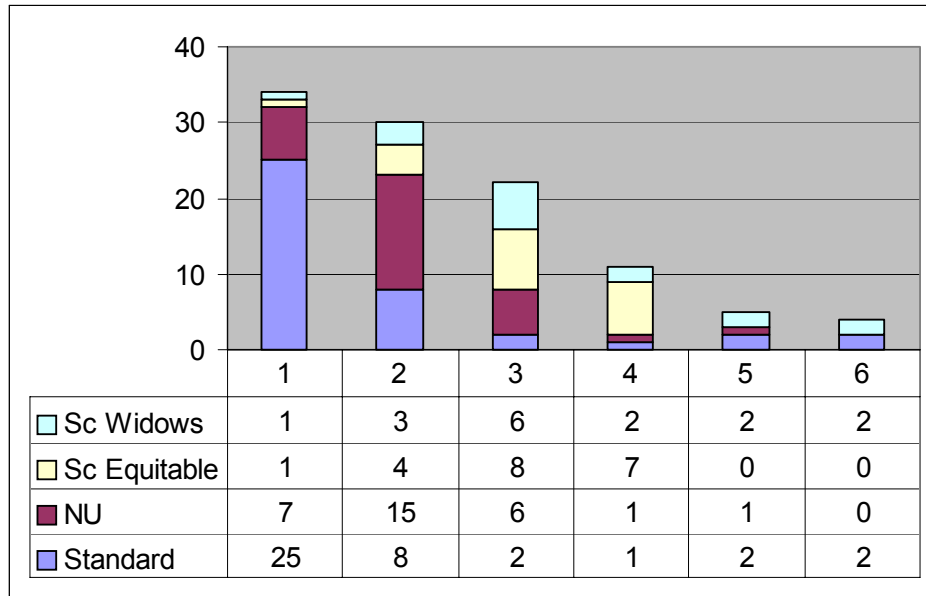
5.3 Multi-tie criteria and provider preferences

We asked IFAs which providers they would favour if they were to multi-tie to up to six. The results are shown in table 21. Column one indicates providers chosen first, column two second and so on. Big brands are much favoured with Standard Life dominant.

Niche providers are rarely mentioned. It is assumed that big brands will carry competitive annuity and protection products.

The ability of at least one of the providers to access a very broad range of fund managers is important to many. This may account for the prominence of Scottish Widows with their Frank Russell alliance.

Table 21 Favoured providers for multi-tie



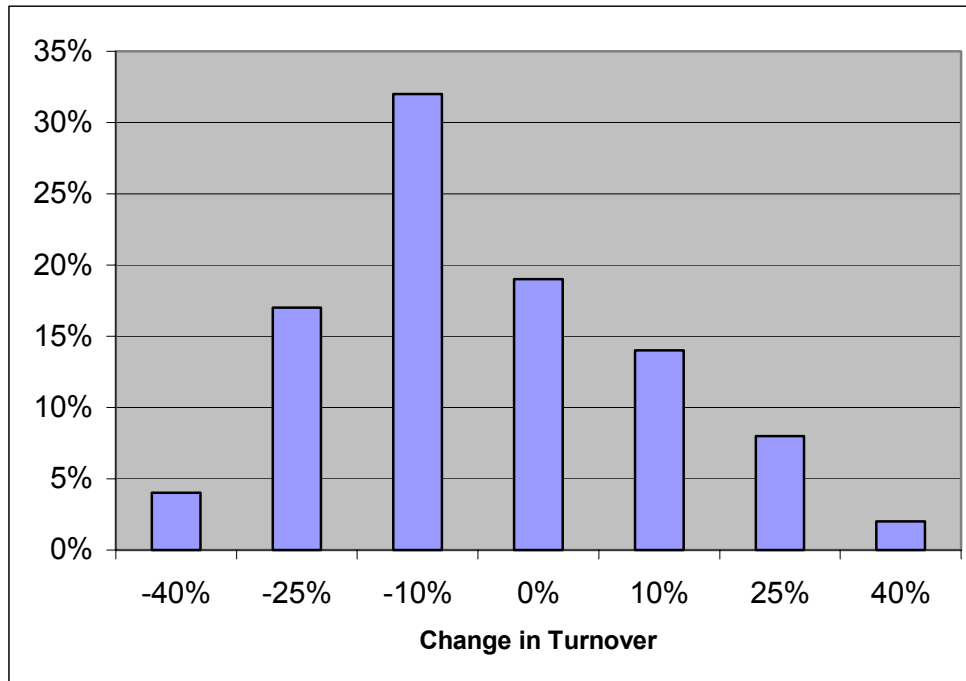
5.4 IFA Profitability

Profitability will play a big part in the decision on status. We asked IFAs what the trend had been in turnover over the past 12 to 24 months. Table 22 shows the responses. It is fair to assume that these responses are in many cases understated.

A third are concerned that multi-tied competitors may receive higher commission and two-thirds are concerned that they might offer enhanced products.

Whilst transparency may limit the enhancements that providers can offer, there is little doubt that at least some providers will be selective in the terms offered and that this will have impact on future market structure (see 5.6 – mergers, below).

Table 22 Profitability trends



5.5 Loss of IFA Status

- Some 55% of IFAs believe that they would lose 10% or less of their business if they lost or gave up IFA status.

This is far lower than in an earlier survey on de-polarisation and demonstrates a more pragmatic attitude by IFAs.

5.6 Mergers

- Nearly 40% of IFAs are looking to acquire, be acquired or merge

They are looking for critical mass, a stronger negotiating position and a reduction in costs. Any move by providers to further differentiate the terms offered to intermediaries will, no doubt, encourage more merger activity or the creation of formal or informal networks.

Considering these issues, it is likely that market forces will encourage more IFAs to multi-tie unless FSA rules relating to a level playing field preclude sufficiently attractive terms.

Section 6: Summary

Growth in the FSM market has been strong in market share terms within a depressed investment marketplace. This growth will continue as IFAs focus on cost reduction.

It is, perhaps, surprising that the major FSMs have not developed wrap facilities sooner. Since the wrap platform enables the IFA and investor to drive their own investment strategy regardless of product or taxation factors, it appears ridiculous not to include wrap.

It is possible to learn from the fast growing SIPP market. IFAs tend to want every option available – even when they use only a few most of the time. As such we expect to see wrap platforms with access to much wider ranges of funds and fund managers. Indeed, availability through wrap platform will become a key factor to new and growing fund managers.

It is likely that many advisers will employ those aspects of wrap accounts that sit closely with their current business model.

The change to a fee-based pricing model will require change in IFA practice and the acquisition of new competencies together with a change in customer behaviour, which may never happen.

The disentanglement of investment advice will similarly require a change in IFA behaviour for the majority. Whilst this may be driven by competitive factors, it is more likely that regulation will ultimately force the issue.

The trend for demanding lower costs is universal in investment business. Ultimately, history tells us that equity markets will recover. The future for wrap platforms looks extremely bright.

The major caveat is that there will eventually be fewer players; entry barriers will be very high, as intermediaries will only change wrap platforms reluctantly. If providers opt not to pursue their own wrap proposition, they will need a very clear non-wrap strategy.

Section 7: Future Developments

This paper is based on IFA responses to questions constructed by CWC Research with input from various interested providers.

However, as with all exercises in attempting to forecast the future, there are numerous factors that will help to define the future market place. Some of these are:

7.1 De-polarisation

The last consultation paper on de-polarisation, CP166, outlines the nature of the future market structure. Much detail is yet to be seen.

The detail of how intermediaries may operate an IFA together with multi-tie and/or tied operations is unknown. The detail will define, ultimately, the cost of so doing and therefore how many will follow this course.

Menu and the nature of disclosure will be important. If the disclosure documents are brief and whereby the customer is quite clear of all product charges and the IFA's remuneration, we anticipate a drift to fees, especially for larger investments.

7.2 Provider Strategy

We have seen providers acquiring IFAs or shares in IFAs.

It is likely that some providers will seek to maximise distribution by offering attractive terms to favoured intermediaries. This will be complicated as IFA firms merge to gain mass and negotiating clout.

Whilst we are confident that there will be a significant IFA market together with a new multi-tied market plus an increase, probably small, in single ties, it is impossible to forecast with any accuracy the shape of the future intermediary market.

7.3 Investment Competence

The subject of IFA qualifications continues to create much paper. Ultimately, it is likely that intermediaries conducting investment business will have to attain certain qualifications. This will encourage the dis-entanglement of investment advice from financial planning.

7.4 Wrap Providers

Initially there will be a plethora of wrap providers. We are confident that this will reduce over time to may be half a dozen.

The nature of their offerings will be a factor of their desired market positioning together with their existing product range, brand and systems. This will, no doubt, complicate the market at least until it matures over time.

7.5 The Consumer

The success of wrap products will depend on the consumer believing in the product in terms of benefits, costs and security. The media will have a significant role to play in guiding this opinion.

If there is doubts about the value of wrap products, it is likely take-up will be delayed, though likely not ultimately forestalled.

Appendix 1 Glossary

7IM	A wrap provider owned by Killik & Co, stockbrokers
Cofunds	An intermediary only fund supermarket provider owned by a group of fund managers
Fidelity	A major unit trust and fund supermarket provider
Selestia	An investment company owned by Old Mutual and offering a form of wrap
Skandia	Insurance and investment group focusing on a multi-manager approach
Transact	A wrap provider
Churning	The replacement of existing products with new creating new income
CP 121	The first consultation paper issued by the FSA on de-polarisation
CP 166	The second consultation paper on de-polarisation
Defined payments system	A defined payment system would have required an upfront agreement between the customer and the IFA which defined, in advance, the amount to be charged
De-polarisation	The removal of polarisation legislation established by FSA 1986
Financial Services Act 1986	The legislation introducing polarisation between intermediaries and product providers
FSA	The Financial Services Authority, the regulator of the financial services industry
Fund supermarket	Platforms enabling the buying and selling of a variety of investment funds on-line
Guaranteed products	Investment products linked to one or more stock market index (ces) usually guaranteeing a level of income
High net worth	Can be defined as those with liquid assets of over £250,000
Indemnity commission	Future streams of commission income are paid up front as an initial lump sum
ISA	Individual savings account
Mass affluent	Can be defined as those with liquid assets of £75,000 or more
Menu	A proposed document that will be given by advisor to client laying services and payment basis
Migration	The process of persuading clients to move to a fund supermarket or wrap

Multi-manager	A professional investment manager who takes the responsibility of selecting funds and fund managers for the investor
Multi-tie	Where an intermediary agrees to sell the product of two or more providers
Offset commission	Fees are calculated by advisor, but offset against introductory commission received, usually more
Offshore products	Investment policies written in a country with low tax rates for investments such as Luxembourg or Eire
Open architecture	Access to all products and funds via a portal
PEP	Personal equity plan, predecessor of ISA
Polarisation	The separation of independent advisors from those tied to one product provider
Portfolio planning tools	Investment aids available on-line from investment product providers
PP	Personal pension
Re-registration	Where investment products purchased in the past are re-registered under an FSM or wrap provider
SIPP	Self invested pension plan
Stakeholder pensions	CAT standard pensions products with charges limited to 1% per annum
Tax wrappers	Virtual wrappers placed around investments to create tax advantaged products
Trail commission	Income paid to an adviser year on year on client funds invested
Worksite platforms	On-line access for employee to pension and other benefits at the workplace

Appendix 2 Fund Supermarket Selection Criteria

Fund choice	3.55
Charges	3.34
Re-registration	3.12
Free switching	3.04
Consolidated reporting	3.01
Website navigation (ease of use)	2.92
Commission	2.61
Integration to customer relationship / back office systems	2.60
Pension fund availability	2.56
Tracking tools	2.56
Research tools	2.29
Market news	1.81
Supermarket brand	1.79
Bulk dealing facility	1.77
Website construction facility	1.73