The potential for wrap services in the UK

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CHAPTER 1 EXECUTIVE SUMMARY

This briefing investigates the development of wrap products at a global level, considers their potential for growth in the UK and Europe, and assesses IFA attitudes towards the concept in the UK.

Key findings of the work are as follows:

- wrap services have the potential to change the relationship between financial advisers and their clients, by moving away from commissions paid per transaction to fees based on regular advice and money management;
- such services have enjoyed strong development already in some countries, notably the USA and Australia, and the growth in open architecture and financial supermarket propositions in Europe theoretically paves the way for the development of wrap services whereby the products of different providers are packaged together into individualized financial services solutions;
- in Australia, many of the leading financial services providers, including AMP, Macquarie and Westpac, offer wrap services, generally by means of the independent financial advisory channel which plays an important role in the distribution of investment products in that country;
- the main stimulants to the development of wrap products in the UK are regulatory change, investor appetite, enabling technology and new entrant activity;
- the crucial factor is regulatory change, because the FSA is pushing the industry to move from commission- to fee-based advice. Wrap services offer a way to meet this demand;
- elsewhere in Europe, the future of wrap services will largely depend on the distribution channels in use and on customers' attitudes;
- the increasing sophistication of individual investors in Europe and the growing likelihood of their contracting multiple products across the savings and investments spectrum from a variety of providers potentially creates an environment in which wrap products can prosper;
- moreover, the increasing availability, effectiveness and security of the technology underpinning wrap services should encourage financial services institutions to offer such services, and encourage customers to use them;

- increasing customer interest in independent / advisory and multi-tied distribution channels, especially in countries such as France, Germany and Italy where they are relatively under-developed, should also be a positive development for wrap services;

- innovators in the financial services sector, notably Barclays (Open Plan), Egg, Intelligent Finance and a number of fund supermarkets in the UK, are also helping to prepare the path for the introduction of wrap services;

- however, it would be unrealistic to expect wrap services to develop in Europe, especially continental Europe excluding the UK, to the same extent or as quickly as they have developed in the USA and Australia as there are significant barriers to overcome;

- Datamonitor's research into the attitudes of IFAs in the UK towards the wrap concept supports a cautious view regarding the potential for their success in this country;

- of the 100 IFAs surveyed, including both large and small entities, only 21 per cent claimed to have heard of the wrap proposition, as defined by Datamonitor and FundsHub in this briefing;

- however, 39 per cent of those who do know how these services work and would be interested in offering them, would be prepared to manage clients' assets themselves, an arrangement analogous to that which prevails in Australia;

- there was also no clear consensus on the investment categories that IFAs would view as being of prime importance in the context of wrap propositions - when offered the choice of mutual funds, direct equities, bonds and property, 30 per cent of respondents declared that all of these should be included with 22 per cent citing direct equities as the crucial component and 11 per cent citing mutual funds;

- a more encouraging finding was that in the post-CP121 and Sandler environment, almost half of the IFAs interviewed declared that they would envisage offering products incorporating flexible annual charging such as wrap structures in future;

- indeed, in the UK at least, a number of providers are already gearing up to launch wrap services later in 2002, notably AMP, which is currently building a new version of its online funds supermarket, Ample, and Killik & Co., which is aiming to attract investors in the middle ground between high net worth individuals and the mass affluent, with a minimum of £200,000 to invest.

CHAPTER 2 THE EVOLUTION OF WRAP SERVICES

2.1 USA

Wrap services were first developed in the USA in the 1970s, for wealthier clients who wish to manage their finances through a professional intermediary. Their advantages, then as now, were to ensure that customers received professional advice that served their interests rather than the advisers' interests. As direct equities formed a larger part of investors' portfolios in the USA than elsewhere, so they formed a larger part of the wrap service. Because advisers are paid on a percentage of the value of the assets in the wrap service, they had no incentive to encourage frequent trading in order to generate broking commissions. This system could be worthwhile to customers with relatively complex portfolios because the fees were significantly higher (as much as 3 per cent) than managed mutual funds.

A second version of the wrap service appeared in the 1990s, termed the "mutual fund wrap" in contrast to the earlier "consultant wrap". Here, investments are placed in brand-name mutual funds, whereas the consultant wrap tended to place funds in equities and institutional money managers. These were initially limited to the fund managers' own funds, but have now expanded to cover third-party funds as well. The fees for both types of wrap have fallen as well, encouraging their take-up. Cerulli Associates estimate that the average fee paid for a consultant wrap is now 2.1 per cent, compared to 1.25 per cent for a mutual fund wrap. The entry level for a consultant wrap is still high, at a minimum of $100,000, compared to $10,000 for a mutual fund wrap. As wrap services have become gained flexibility and reduced their costs, they have attracted investments very fast. Consultant wraps now hold over $200bn, while the newer mutual fund wraps have been catching up with them, and are already worth about half that amount.

There are other aspects of wrap services in the USA which differ from those in other countries:

- the underlying assets are more commonly invested in fixed interest products, such as CDs, as well as in equities. Internationally, mutual fund wraps are more common;
- the assets are often held in the investor' name, which makes it more costly to administrate and makes transactions take longer. In Australia, assets are held in nominees' names, reducing both costs and transaction times.

One example of the expansion of wrap services comes from Skandia Asset Management, which recently announced a strategic initiative that focuses the company on its most profitable areas, of which wrap products are one. The service offers access to funds from different providers as well as bonds, savings and equities, depending on the level of risk an individual is willing to take. Altogether, wrap products and mutual funds make up more than 50 per cent of sales in the independent broker-dealer channel and Skandia is currently one of the largest vendors of investment products to the independent broker-dealer channel worldwide. Skandia was one of the first providers in the US to introduce the concept of 'multi-manager' funds, which makes many of the world's best money managers available to investors.

In the US, as in Australia, wrap products are offered by product providers to independent brokers and dealers who then provide advisory services to their clients. The reason why wrap services are popular in the US lies in high investor sophistication. Moreover, both Australia and the US have a high concentration of independent advisors that acts as a further stimulant to the development of wrap products as these can be the most suitable distribution channel.

Skandia does not manage the funds itself, but, rather, aggregates the funds of a number of managers, including Alliance Capital, Deutsche Asset Management, INVESCO Funds and ProFunds Advisors. The company is a typical example of a wrap product provider, since it mainly offers services to financial advisors, who in turn service their clients.

2.2 Australia

A distinctive characteristic of the wealth management market in Australia is the existence of wrap products and master trusts. These allow individuals to have a single service incorporating different products, including bank deposits, property funds, bonds, equities and other investment vehicles. On a simplistic level these are 'product menus' offering a consolidated access point, a form of financial services shop including information tracking and presentation of these investments. However, they can also offer sophisticated management systems and advisory services that facilitate a total wealth management solution. These services will offer management and advice of all investment types including pensions and insurance. Macquarie, Westpac and Suncorp Metway are examples of providers of these types of services.

The main reason for the popularity of wrap services in Australia is the high level of investor sophistication combined with the popularity of IFA (independent financial adviser) services. Indeed, wrap services are mainly offered by means of IFAs, who then offer the wrap service together with advice to their clients. In general, wrap products are available to all, but are mainly used by the upper mass market and high net worth individuals. This is because the wrap service is transaction-based rather than fee-based and, therefore, for small investments the costs would be extremely high. The service is mainly used by investors with more than $75,000 although, in some cases, those with $10,000-15,000 can also use the service.

Competitors in wrap products and master trusts

Master trusts are primarily offered through investment banks, retail banks and asset managers. Master trusts are a way of administering investment portfolios giving access to a range of different investments vehicles through one consolidated reporting document and one trustee. They can be discretionary or non-discretionary. Wrap products offer more sophisticated services and access to wholesale prices. They are similar to master trusts but include a wider range of assets such as shares, managed funds, property and cash holdings, managed on a consolidated administration system. The complexity of this system makes them relatively expensive, thus they are only really viable for individuals within the upper levels of the wealth spectrum. Both products are fee-based.

Examples of providers of wrap products and master trusts offered to the IFAs include:

- AMP – (http://www.amp.com.au) the *My Portfolio* service provides a complete picture of clients' assets. Clients can view all their assets and liabilities including AMP products such as investment funds, superannuation and investment accounts, financial products from other institutions, other assets such as personal possessions or investments, insurance, and loans or other liabilities.

- Asgard;

- Godfrey Pembroke – (http://www.godfreypembroke.com.au) one of Australia's premier financial planning organizations, offering investment, superannuation and insurance options and related taxation services. The network of over 190 consultants offers financial planning services to a wide range of clients including individual investors, small businesses and corporations.

- Macquarie – (http://www.macquarie.com.au/adviser/business/wrap/index.htm) Macquarie Portfolio Services is a provider of wrap account solutions to financial intermediaries and advisory dealer groups. The company specializes in superannuation, pension and non-superannuation administration solutions for the back office and practice management needs. Macquarie's wrap account allows its clients to take clients' portfolios online with the internet as the interface, to transact and report on their investments. At the same time, clients can benefit from flexible investment choice and consolidated performance and tax reporting on their entire portfolio. Initial set up and ongoing training support for advisers and back office staff are available to ensure that they are utilizing the service in the most beneficial way.

- Westpac.

2.3 South Africa

The unit trust industry has been one of the great success stories of the South African financial services market over the past decade. Assets under management have grown from approximately R5bn ten years ago to R125.3bn in Q1 2001, of which close to 85 per cent was accounted for by retail investors. In the period 1995-2000 alone, assets under management increased at a compound annual growth rate of 30.7 per cent. Moreover, over the last decade there has also been exponential growth in the range of funds available, increasing from a handful to nearly 350, as well as the breadth of sectors and geographies that they cover.

One of the key drivers of growth in the retail mutual funds sector has been the development of wrap funds, which emerged onto the investment scene after 1998 as a means of offering some protection against market volatility through spreading funds over several unit trusts rather than a single fund. With wrap funds the client is essentially deciding only on the level of risk he or she is willing to take with the rest being managed by the fund managers.

However, the introduction of capital gains tax in October 2001 has brought about an adverse change in the environment for wrap funds as investors are liable to be taxed each time they switch fund within a wrap structure. As such, fund managers have offered investors the opportunity to invest in “funds of funds” in which switches between individual funds are invisible and, therefore, not liable for capital gains tax. Indeed, many fund providers have converted wrap propositions to “funds of funds” in order to circumvent this tax loophole. For example, BoE Asset Management, formerly a leading provider of wrap structures, has followed this approach.

CHAPTER 3 DEFINING THE FUTURE SHAPE OF WRAP SERVICES IN THE UK

A wrap service is a way of managing clients' assets within a single portfolio, and where clients pay a fee to their advisor based on the value of the assets contained within the wrap. It enables clients and advisers to view the assets as a whole, regardless of the tax vehicles through which they are invested, and it means that advisers have no incentive to sell an inappropriate product because it carries a higher commission than a more suitable one. The underlying assets can be invested in a range of tax vehicles (e.g. pensions and ISAs) and asset classes (e.g. multi-manager funds, equities, property and cash), as long as they can be managed as a whole.

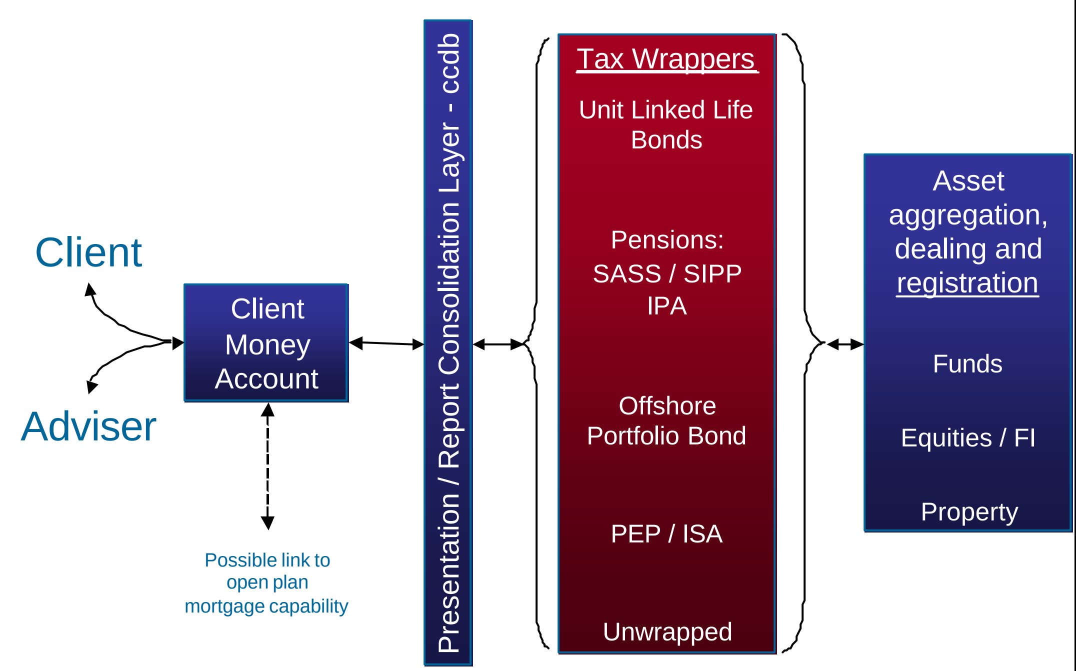
In theory, there is nothing to prevent IFAs from managing their clients' portfolios through a wrap service presently: the obstacle is that most clients' portfolios have been built up piecemeal, in different tax vehicles and asset classes, and they cannot be managed through a single computer system. This means that it is cumbersome to view the portfolio as a whole, and that changes to it must be made through each vehicle. If a portfolio can be managed through a single IT platform, then a truly efficient wrap service can be introduced. However, the IT challenge is to develop a platform that can:

- present the whole portfolio in a usable way to both IFAs and their clients;
- combine inputs and outputs from the different tax vehicles and other assets such as directly-held equities;
- send instructions for transactions to be made in the underlying assets, regardless of the vehicles.

In the UK, a wrap service such as this would be handled by IFAs with their clients, to maximize the benefits of the various tax vehicles and decide on the priorities for asset allocation by risk and timescale. The wrap service itself would be run by a major distributor, such as an insurer or asset manager, with whom clients would probably have the core of their portfolios (e.g. their pensions). The initial branding of the front-end of the service could be in the name of the distributor, co-branded with the IFA or possibly branded under the IFA's name alone, albeit with common functionality.

A possible operational model for wrap products in the UK is illustrated in the graphic below. As in Australia, assets would be held in nominee accounts not in the name of the client, to save costs and increase speed of transactions.

Figure 1: Wrap services – operational model



Source: Datamonitor, FundsHub

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This model could be extended in the future with additional services:

- to include banking products, especially mortgages, on the offset principle;
- to cover the full rage of financial needs, such as protection insurance, planning for school fees or inheritance;
- to help IFAs to administer clients' self-assessment tax returns.

These extensions would both be logical developments of the role of an IFA handling a client's portfolio as a whole and enable them to charge higher annual fees in return for adding more value to the clients.

CHAPTER 4 IS THE TIME RIGHT FOR WRAP SERVICES IN THE UK?

4.1 Introduction

At present, wrap services, as they exist in the USA and Australia, are not prevalent in the UK. However, there are a number of factors that may potentially encourage their development, namely:

- regulatory change;
- investor appetite;
- enabling technology;
- new entrant activity.

The following sections deal with each of these in turn.

4.2 Regulatory change

The prime factor that makes wrap services topical is pressure from the Financial Services Authority (FSA) to reform the market for financial advice in the UK (see its discussion document on depolarization, CP121). The underlying concern of the FSA is that customers have received bad advice, and bad value for money, through the system of commissions. This produces two perverse effects in particular:

- advisers recommend products that earn them the best commission, rather than meeting the clients' needs best;
- product providers pay high commission at the start of a contract (front-loading) with allow trail commission to deter IFAs from "churning" their customers' investments. While this keeps the advisers hungry for new business, it means that customers who switch from a product such as a pension after a few years, perhaps through a change in employment, often receive poor returns on their investment.

The challenge is therefore to convince clients that they should pay a fee for the services if an IFA or other adviser, and that they should pay this regularly, not as a one-off payment when beginning a pension or other product for the first time.

Wrap services offer one solution to this problem:

- the flat fee means that IFAs have no incentive to offer anything other than the best advice that they can provide. This fee is typically about 2 per cent of the assets in a wrap, which is higher than the government's preferred 1 per cent for stakeholder pensions, but lower than some managed mutual funds. However, the wrap approach allows IFAs to add much greater value to their advice because they can manage the whole of a client's portfolio, enabling them to justify the extra cost;

- the nature of a wrap service is that it continues over time. Thus the IFA receives a regular income through a continuing relationship, and avoids the problem of constantly having to find income from transactional business.

The potential for wrap services to extend into other banking and tax matters are logical developments from this that would extend the value of advice received by a client and deepen the relationship, justifying a slightly higher annual fee and increasing the chances of renewal each year.

However, no IFA company or network is capable of developing the IT platform needed to run an effective wrap service. This can only be financed by major providers, and they too must be able to see a benefit for wrap services to be created. The main benefit to them is in supporting a fee-driven IFA channel. Insurers, and to a lesser extent asset managers, depend on the IFA channel because they have reduced their direct sales forces drastically. Banks have become a major channel for some, through such tie-ups as Norwich Union and Royal Bank of Scotland, and Legal & General and Barclays. But such deals are limited by their status as tied agents, offering advice about one provider only, whereas many customers want independent advice about a full range of providers. Secondly, bank staff are often less specialized, fitting in better with the "1 per cent world" of low-cost advice, which is unsuitable both for IFAs seeking higher revenues and clients with larger portfolios. Insurers must find a way to continue to distribute through a higher-cost IFA channel – and even find a way to keep this channel alive.

An additional advantage to an insurer is that while an IT-based wrap service can contain any product that can be presented to it in compatible software, it would be easier (and therefore cheaper) if the core investments and tax vehicles came from the same provider; this creates an incentive for cross-selling.

4.3 Investor appetite

With customers showing an increasing propensity towards multiple product holdings, especially within the investment arena, there is reason to believe that demand can be stimulated for wrap-like services, especially for wealthier clientele. Indeed, incumbent financial institutions are, in effect, courting their clients with the concept by offering them the full range of investment products, from deposit-based savings through life insurance, pensions and mutual funds to direct equity investment.

Clearly, there are benefits for consumers in that the holistic view of individual finances offered by the wrap concept should make their management that much easier. However, whether wrap structures can be extended as a mass market concept is open to question given their relative sophistication, the expense incurred in managing them and the length of time that it takes to migrate significant proportions of this market to a markedly different proposition.

4.4 Enabling technology

The development of wrap services in Europe may also be encouraged by the fact that the technology that underpins the provision of such propositions is advancing constantly. The increasing availability, effectiveness and security of this technology should together conspire to both encourage financial services institutions to offer such services and customers to avail themselves of them. However, while technological advances are a stimulant of wrap services in one sense, the legacy of out-dated technology used by both financial institutions and their intermediaries could also threaten to retard their introduction.

The development of product wrapping services is likely to be increasingly enhanced by the increasing availability of advanced portfolio management and analytics tools from technology vendors such as Brainpower. These products sit in the 'business logic' layer of a bank's fund management infrastructure, and will contain aggregation modules that will allow for internal aggregation of product data from the institution's back office product administration systems. This information can then be presented to the advisor as part of a single front-end interface which can then be supported by decision support tools, market data feeds and customer relationship management software, allowing the advisor to take a holistic approach to managing the customer's portfolio as well as offer targeted and timely advice based on the customer's investment profile.

4.5 New entrant activity

Finally, there are grounds for claiming that competitor activity is likely to stimulate interest in and demand for wrap propositions. For example, leading innovators in the UK, such as Barclays, Egg and Intelligent Finance, have already introduced services that may be said to represent precursors to fully-fledged wrap solutions. Propositions such as Barclays' Open Plan (originally developed by Woolwich) and Intelligent Finance allow the balances on investment and lending products to be offset against each other. While not the same as a wrap service, as they do not bring together the products of different providers, these do, at least, introduce the concept of switching funds between separate products. Egg, on the other hand, offers an Internet-only financial services portfolio, embracing the full range of retail financial products, some of which it hosts on behalf of other providers as is the case with its fund supermarket.

CHAPTER 5 THE EUROPEAN CONTEXT

5.1 Introduction

What are the prospects for wrap services in the rest of Europe? The key factor of regulatory pressure in the UK is not currently present elsewhere in Europe; there have been reforms to force greater disclosure of commissions in Ireland and the Netherlands, which have been felt more by non-life insurers than life offices. This section reviews the prospects in Europe through two other major topics, before the final section examines attitudes of the all-important IFA channel towards wrap services in the UK. The two key topics discussed here are:

- current distribution channels;
- consumer attitudes.

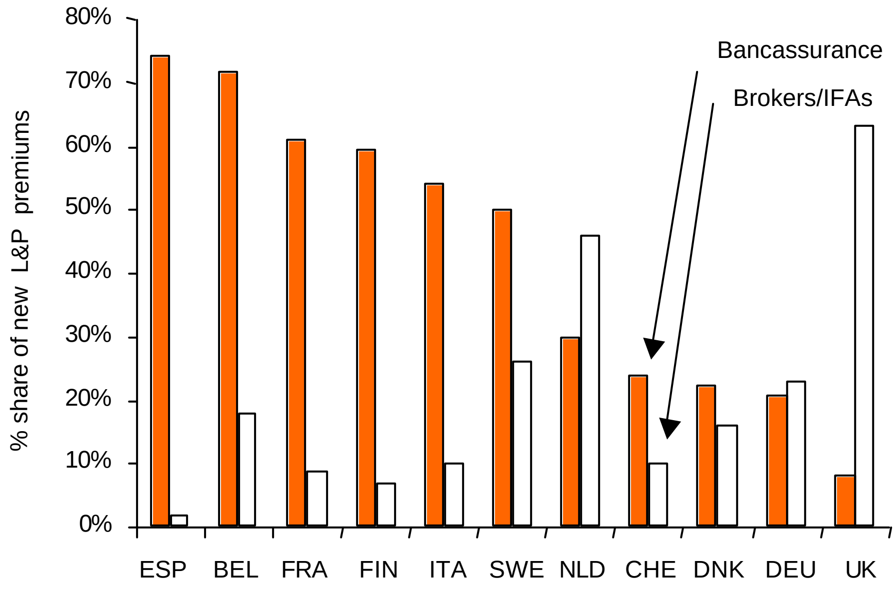
5.2 Life and pensions distribution in Europe

Independent / multi-tied distribution

In Australia, South Africa and the US, the acceptance of wrap propositions and similar structures has been encouraged by the prominent role that independent intermediaries play in the distribution structure of the retail financial services industry in those countries. If independent distribution is expected to be a key driver for the take-up of wrap products in Europe then this may be characterized as both a stimulant and an impediment.

In a few countries, notably Ireland, the Netherlands and Sweden as well as the UK, independent distributors account for a high proportion of the sales of investment products. Indeed, they are important as an advisory channel for the mass affluent and mass markets, and so it can be assumed that in these countries wrap services have greater potential to develop into an important part of the financial offering.

Figure 2: In the UK, Netherlands and Sweden IFAs are an important distribution channel , 2000



Source: Datamonitor Life and Pensions Database 2001 DATAMONITOR

However, in most continental European countries IFAs represent a smaller share of the market. Rather, bank branches and tied distributors dominate the customer interface with the result that there may be limited interest in the wrap concept.

That said, there is some evidence for growing demand for independent or quasi-independent channels where they have not developed thus far. For example, in Italy, some *societá d'intermediazione mobiliare* (SIMs) fulfill this role while in France there is a growing sector of *sociétés de gestion de portefeuille*. Similarly, in Germany, brokers are increasing their market share of life insurance and pensions products.

Even in those few countries in which independent intermediaries do play a significant role, it is debatable whether they are as sophisticated as their counterparts in Australia, South Africa and the US. Of particular note is the fact that genuinely high net worth customers are far more likely to use a private bank for advisory services than a traditional independent distributor.

It is possible that IT-based wrap services will spread to continental Europe in future, although only when providers judge that the market is ready for their acceptance. For example, Egg has entered the French market by means of its 100 per cent acquisition of Zebank, a local Internet financial services created during the Internet bubble which its founders could not make profitable. This acquisition will provide it with a new platform to distribute its banking and financial services products in France more cheaply than by starting from scratch. Moreover, it aims to extend the financial services product range in line with its UK offering, aiming to offer better value for money and flexibility. In a few years time, if UK operators are running successful wrap services, they might follow this example and launch them in Europe through their continental parents or subsidiaries.

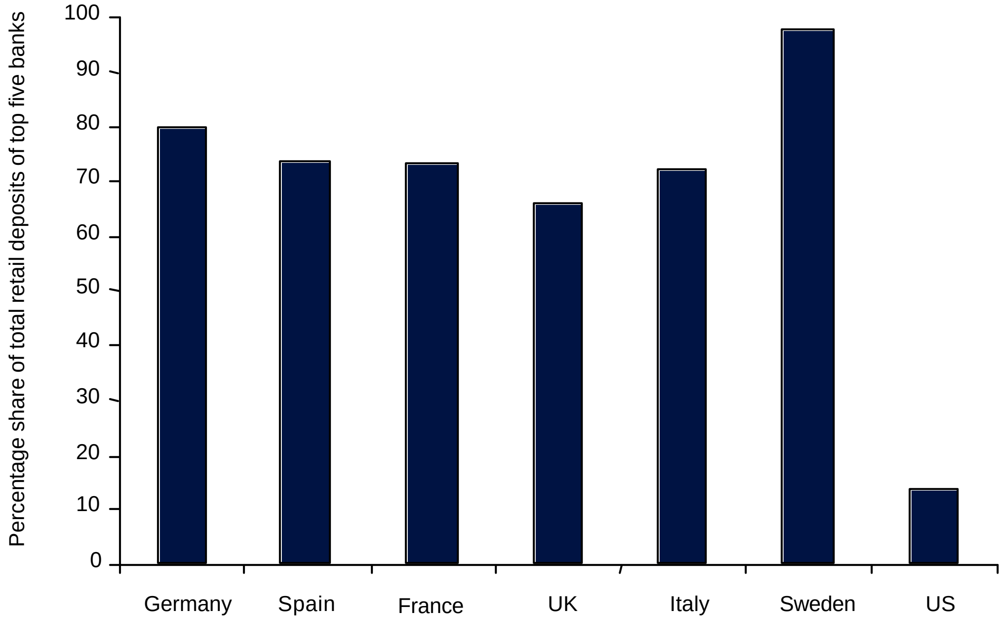
Tied services and bank distribution

Another way to look at the influence of distribution channels and their potential impact on wrap services is through the level of concentration in a market. In a fragmented market, such as the US, consumers have relationships with a large number of providers. This could mean that consumers are attracted to wrap services by their ability to manage their multiple relationships in the least time-consuming way. On the other hand it could mean that consumers reject the idea of being sold the products of one supplier because they are accustomed to having multiple suppliers.

Conversely, in financial services markets that are less fragmented, as in Europe, consumers are likely to have relationships with fewer suppliers but the relationships that they do have are likely to be deeper. While potential demand for wrap services may be lessened since these relationships are easier to manage, European consumers should be more receptive to having their portfolio managed as a whole and to cross selling.

The graphic below measures market concentration in banking by showing the percentage share of total retail deposits held by the top five banks in the US and in European countries. It illustrates the fragmented nature of the US market and the concentrated nature of the European markets. For example, in the US the top five banks hold only a 14 per cent share of total retail deposits compared to a 98 per cent share in Sweden and an 80 per cent share in Germany (treating the Sparkassen as a single entity).

Figure 3: Total share of retail deposits of the top five banks (2001)



Base: Total retail deposits 2001

Source: Datamonitor FINTAB 2001

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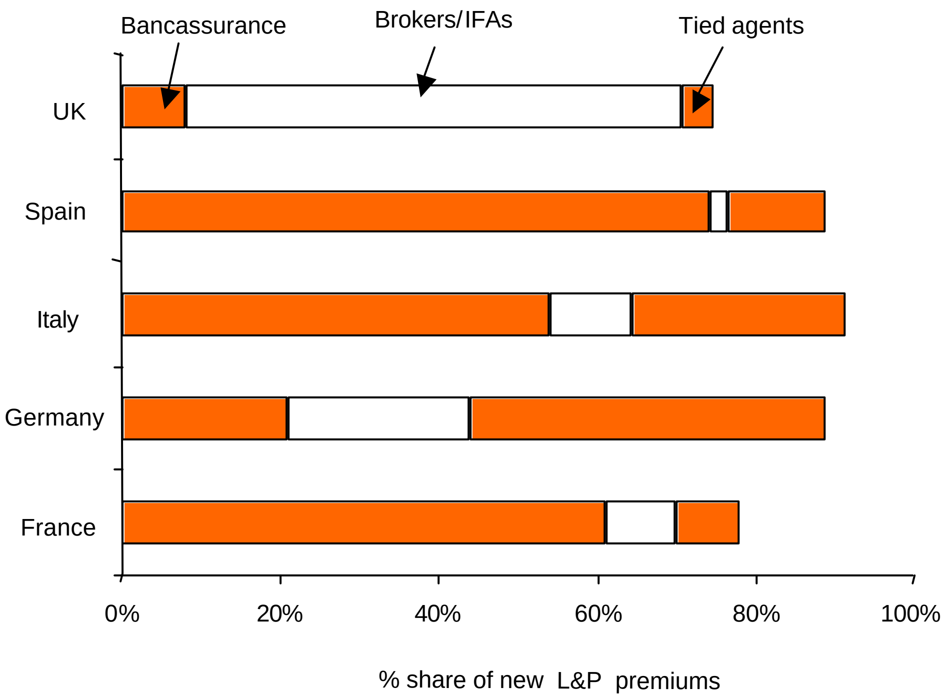
Moreover, the low level of demand for independent financial advice in most European countries, noted above, is likely to hold back the provision of wrap services. In many European countries, including France, Germany, Italy and Spain, tied agents vie with bank branches for the lion's share of business in the life, investments and pensions market and in their tied capacity, there is less rationale for them to offer wrap services than for independent advisers.

Figure 4: Tied agents still play an important role in some European countries, 2000



Source: Datamonitor Life and Pensions Database 2001 DATAMONITOR

5.3 Consumer conservatism and demand

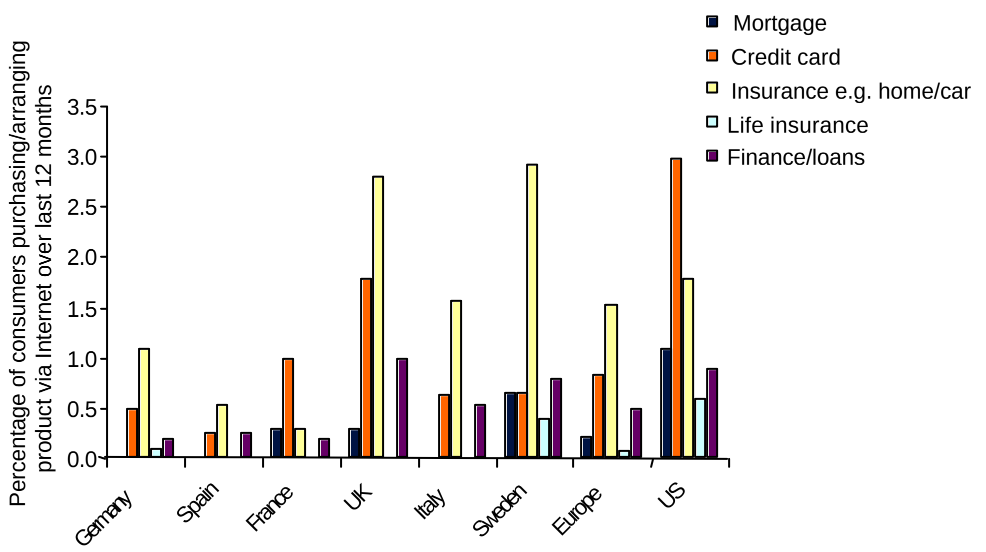
Another factor that may act as a significant impediment in the use of IT-based wrap services in Europe is the generally conservative attitude of consumers, especially towards the Internet. According to the results of Datamonitor's 2001 IMPACT survey, consumers either purchasing or arranging financial products online in Europe remain firmly in the minority. Of the products displayed below only, non-life insurance (e.g. home / car) is the only one where more than 1 per cent of European consumers have purchased or arranged services online.

Moreover, in all cases other than non-life insurance and finance / loans, more US consumers have used the Internet to purchase or arrange financial products and services over the last 12 months than have their counterparts in Europe. Sweden and the UK represent the most developed European markets in terms of percentage of consumers purchasing or arranging these financial products or services via the Internet. This indicates that apart from these two countries, consumers in the rest of

Europe are still some way from using the Internet in a genuinely sophisticated fashion for financial services.

Whilst the proportion of consumers who now *manage* their products or services online may be higher than the proportion of consumers who *purchased* them online, these findings still suggest that the number of consumers in continental Europe willing to take up wrap services is likely to be low.

Figure 5: Consumers purchasing / arranging financial services online remain firmly in the minority



Base: All respondents

Source: Datamonitor IMPACT 2001

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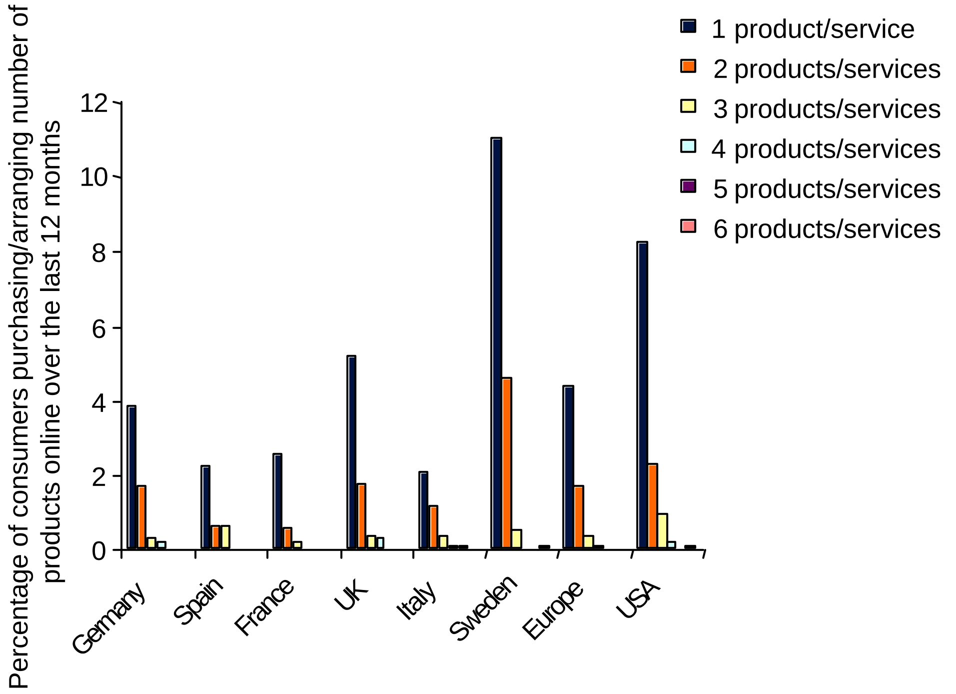
A further determinant of the demand for wrap services will be the range of online and, most importantly, active accounts that consumers hold. IMPACT 2001 shows that fewer than 2 per cent of European consumers purchased or arranged two or more financial products or services online in 2001. Products and services included in the analysis are banking services, mortgages, credit cards, investment / securities trading, home / car insurance, life insurance, and finance / loans. Sweden leads the field here, though only 4.7 per cent of them arranged two or more financial products or services online in 2001.

Figure 6: Multiple purchase or arrangement of on-line financial services remains rare



Base: All respondents

Source: Datamonitor IMPACT 2001

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CHAPTER 6 DEVELOPING THE IFA CHANNEL

6.1 Introduction

The rationale for developing IT-enabled wrap services in the UK will be strong if the FSA's depolarization review does split advisers into one group of low-cost, tied or multi-tied advisers giving basic advice, and a second group of higher-cost, more sophisticated advisers handling wealthier clients. However, just because the rationale is clear does not mean that these services will take off, because two major challenges to the launch of wrap services in the UK will remain:

- the cost of development;
- the attitudes of IFAs towards wrap services.

6.2 Cost

The potential costs involved in developing wrap services will act as a deterrent to their growth. The main cost issues are as follows:

- third party / vendor payments (if the service is hosted or supplied by a third party / vendor*)*: the exact pricing arrangement will depend on the vendor and institution concerned. However, it is likely to involve an initial payment as well as ongoing payments determined by the number of customer registrations, data required etc. These ongoing payments put the greatest pressure on a provider's ability to achieve the required ROI;
- providing customer support: particularly in the early stages, but throughout the life of the service as well, there will be a need for some form of customer support whether online, via the phone or face-to-face. There may be a specific need for advisors to be able to train customers to use the services in the same way that some banks currently offer in-branch training for the use of Internet banking services;
- extensive marketing campaigns: again, particularly in the early stages, there will be a need for an extensive marketing campaign utilizing both online and offline means.

A significant number of providers will have to be convinced of the financial viability of developing wrap services, which will itself be dependent upon the rate at which they are taken up, for them to become widely available.

6.3 IFA attitudes

The following analysis is drawn from a survey of 100 IFAs in the UK, including both large and small firms, carried out by Datamonitor in May 2002. The aims of the survey were as follows:

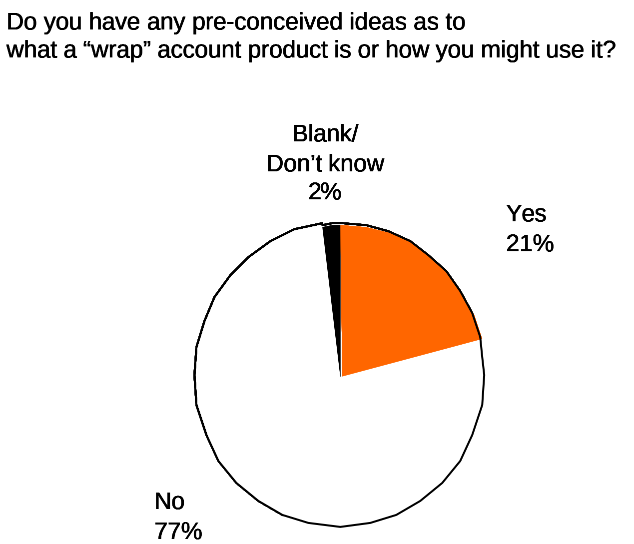
- to assess the extent to which IFAs have any pre-conceived ideas as to what a wrap service is or how they might use it;
- to ascertain whether IFAs would want to provide the on-going investment advice in managing their clients' assets through wrap products or whether they would look to outsource this to others;
- to investigate which assets IFAs would see as being critical for inclusion in a wrap fund (e.g. cash, mutual funds, direct equity or bond investment, property etc.);
- and, finally, to evaluate whether, post-CP121 and the Sandler review, IFAs would want to move to products like wrap services that allow flexible annual charging.

The following sections deal with each of these issues.

Most IFAs have not heard of the wrap concept

The majority (about 77 per cent) of the IFAs surveyed in the UK are not familiar with the wrap concept at all, and only 21 per cent know what it is. This shows that although savings and investments distribution in both Australia and the UK is dominated by IFAs, the countries differ in terms of the type of products offered by IFAs, as well as the role of IFAs. While in Australia, IFAs are taking on a more active role in managing client assets, in the UK IFAs typically limit themselves to the provision of advice about, and the sale of, specific products . Clearly, the wrap concept is new to many of them.

Figure 7: The great majority of IFAs do not know what wrap accounts are

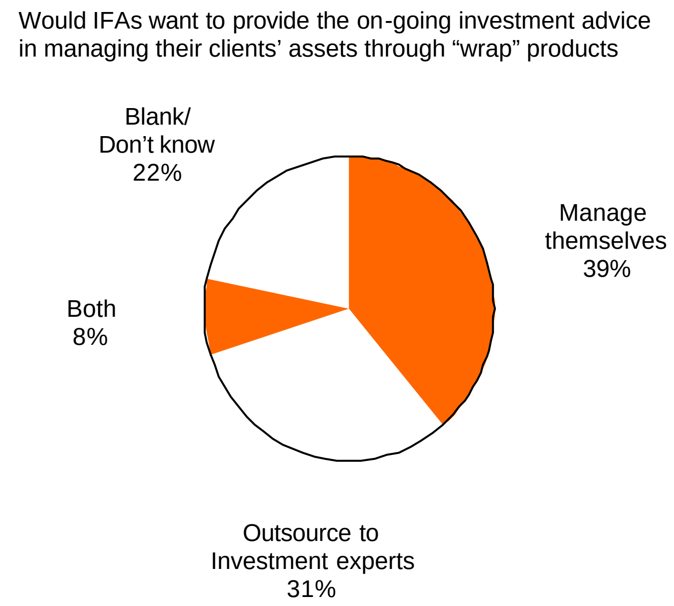


Source: Datamonitor's IFA Survey (May 2002) DATAMONITOR

39 per cent of wrap-aware IFAs would manage assets themselves

Although the majority of the IFAs in the UK are not aware of the wrap concept, it is interesting that about 39 per cent of those who do know how these services work and would be interested in offering them, would be prepared to manage clients' assets themselves. On the other hand, 31 per cent would prefer to outsource the management to external investment experts. This indicates that some IFAs in the UK do believe that they have the resources in-house to manage client assets and that they should be fulfilling this type of more advanced financial planning role in the future.

Figure 8: Most IFAs would prefer to manage client's assets themselves rather than outsource it to external experts



Source: Datamonitor's IFA Survey (May 2002) DATAMONITOR

IFA opinion is divided on the structure for wrap products

There was no clear consensus on the investment categories that IFAs would view as being of prime importance in the context of wrap propositions. When offered the choice of mutual funds, direct equities, bonds and property, 30 per cent of respondents declared that all of these should be included with 22 per cent citing direct equities as the crucial component and 11 per cent mutual funds. 19 per cent of respondents, on the other hand, had no opinion about the optimum composition of wrap products.

Table 1: Direct equity seems to be the crucial part of a wrap product

	Number of answers	% of respondents
a) Mutual funds	12	11%
b) Direct equities	24	22%
c) Bonds	6	5%
d) Property	8	7%
e) All of them	33	30%
f) Blanks / don't know	21	19%
g) Depends on the client and regulatory changes	5	5%
h) Too early to say	2	2%
Total answers	**111**	**100%**

Source: Datamonitor's IFA Survey (May 2002) DATAMONITOR

No IFA consensus on the future of flexible charging products

Finally, Datamonitor asked its sample of IFAs whether, in the post-CP121 and Sandler environment, they would envisage moving to products allowing flexible annual charging such as wrap accounts. Almost half of the IFAs interviewed declared that they would envisage offering products incorporating flexible annual charging such as wrap structures in future.

Table 2: Almost 50 per cent of IFAs would envisage offering wrap services to their clients

	Number of answers	% of respondents
a) Yes	48	48%
b) No	44	44%
c) Don't know/no response	8	8%
Total answers	**100**	**100%**

Source: Datamonitor's IFA Survey DATAMONITOR

In the light of the implications of CP121 and Sandler, this is to be expected. The former would entail the abolition of polarization of IFAs with these entities increasingly being multi-tied and owned by the companies who products they sell. It would also bring about changes in the way in which IFAs are remunerated with a shift away from initial commissions to on-going advance and renewal commissions. The latter, when published later in 2002, may well bring about the simplification of the regulation surrounding long-term investment products such as pensions, as well as the abolition of compulsory annuities. Evidently, each of these changes assists the development of an environment in which IFAs may feel more disposed towards offering wrap services.

Examples of wrap services offered by IFAs in the UK

Although awareness among UK IFAs is relatively low, a number of providers are planning the launch of wrap services in the near future. Indeed, an IFA-only wrap account service was established in the UK in 2001 by Inte-grated Financial Arrangements, a subsidiary of Australian-based Object Mastery Development. The service, called Transact, administers wrap accounts for IFAs on behalf of their clients. The Transact service differs from wrap accounts that may subsequently be introduced into the UK market in the sense that it does not offer discretionary advice. However, an important component of Transact's offering will be the fact that it charges the client a fee for the service and also pays the IFA for advising the client. In this way the IFA is not paid commission for any individual products sold, making the wrap account prospect even more attractive.

Moreover, AMP, the Australian financial services institution, is currently building a new version of its online funds supermarket, Ample, which it hopes to launch to IFAs later in 2002. Ample operates direct to consumers, but the venture aims to follow the Fidelity FundsNetwork model by providing an IFA channel. AMP is in the process of testing the funds supermarket on advisers ranging from its own tied sales force to IFAs. According to Ample, the company is currently talking to the IFAs to determine their opinion before developing a pilot version based on the types of wrap service that it offers in Australia. The company believes that it can use its Australian experience in the UK and offer solutions that could satisfy a growing appetite for wrap services in the UK.

Another company planning to launch wrap services in the UK is the private client stockbroker Killik & Co. Killik hopes that its wrap proposition will attract investors in the middle ground between high net worth individuals and the mass affluent, aiming its service at clients with a minimum of £200,000 to invest. The advantage, according to Killik, is that the wrap account would give investors access to investment managers who normally manage institutional accounts worth upwards of several million pounds. Killik will also act as an adviser of and administrator for the wrap account, and will remain independent of the investment managers themselves. While Killik will target clients directly with its wrap account service, it will also look into providing its service to other financial entities, including financial planners such as IFAs.