SUMMER | 2013

Association of APFA Professional Financial Advisers

Expert Adviser

Weathering the storm

ALSO INSIDE:

Caroline Rookes on the Money Advice Service

Anthony Hilton reviews the Budget

RDR in practice

When the bond bubble bursts

Chairman's foreword

Welcome to the second edition of *Expert Adviser*. Since our last publication we've seen the retail distribution review (RDR) start and the FSA replaced by the FCA. Quite a rate of change for the industry.

It is still early days with the RDR and we're waiting to see clear-cut evidence of the effect on the profession. There have been some teething issues – we've heard from members about problems with reporting requirements, product provider readiness and VAT. I would hope that these will work themselves out as we get used to the new circumstances.

Overall, there seems to be a degree of relief to be doing rather than thinking about it. I hear that existing clients are, on the whole, accepting of new arrangements, but the impact on new business remains uncertain. We'll get a better picture of that as the year progresses. APFA has started to collect and publish data on the changes being brought about by the RDR (all on our website) so as to inform future policy and provide evidence for our positions.

The FCA came into being on 1 April. I recognise it will take some time for the new organisation to become the institution it aspires to be. But the big question is whether it will be materially different from its predecessor. At APFA we are hopeful it will be better.

APFA argued that the addition of a competition objective for the FCA should lead to it taking a more market oriented approach to all its work; that the FCA should work with the grain of markets and recognise the importance of enabling supply to meet demand.

There are some encouraging signs of the FCA thinking along these lines – the regulator seems to be developing a view that more rules are not always the answer. Placing an emphasis on understanding what has gone wrong; what caused the market failure and trying to address that.

A more market-based approach at the heart of the regulator's analysis and identification of solutions should lead to better outcomes for clients and regulated businesses. It won't be perfect, but we hope it will be an improvement.

Some other changes have been well signposted: spotting risks earlier, taking advantage of more sources of information to get a comprehensive picture of the market; and swifter action in reviewing potential risks. However, some things that APFA is keen to see are still unclear.

It will be important that the FCA has performance indicators that are objective and measurable so we know what progress has been made. We also need to see a fair allocation of the regulatory costs among the different financial services sectors.

Two significant changes in six months to the business environment for advisers is enough. It will take some time for both to settle down and for their impact to be fully felt. In the meantime, we will be working to secure more stability for the sector to enable advisers to get on with the real business of looking after their clients.

The Rt Hon Lord Deben

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The future is brighter than expected, says **Anthony Hilton**

"Financial advisers are doing quite well. The industry is in remarkably good shape given what has been done to it

Some of the world's most successful businesses have been launched in time of recession and the reason when one thinks about it is obvious. It is what is known as the flaw of averages.

National statistics tell us that the average family in this country has 1.7 children. No one argues with the figure, but the reality of course is that no one has 1.7 children: they have none, one, two, three or possibly more. But no one has exactly 1.7.

We should apply the same principle to the growth figures. In most quarters they tell us that the economy has been growing at some fraction below 1 per cent – something like 0.7 per cent is fairly typical these days. But the reality is that whatever the number reported as the average growth figure, it will not apply to the vast majority of businesses.

Economies are dynamic, in a permanent state of ebb and flow with the fortunes of the different parts always rising or falling. Regardless of what the average growth is, there will always be parts of the economy in decline by 1 or 5 or even 10 per cent and other parts growing at similarly different rates.

Confounding the sceptics

The trick is to be in a business in one of the growth sectors, as those that go on to survive and prosper generally are. Thus if you are positioned in the right sector it is possible to make money irrespective of the overall economic climate.

This is why currently financial advisers are doing quite well. The industry is in remarkably good shape given what has been done to it.

The country is saving again; the preoccupation of investors is moving from security towards performance; new business opportunities have been opened up in the pensions space with the arrival of automatic enrolment in the workplace.

This, so far, has confounded the sceptics with reported retention rates of over 90 per cent and has created a substantial advisory market for financial advisers.

Right direction

This is all good news – the more so as the traditional business model for the sector has just been tossed up into the air by the retail distribution review at the same time as compliance costs have gone through the roof.

There are not many parts of the financial services sector that could have weathered such a storm, let alone come through it positioned for growth.

There will no doubt be further bumps on the road, but the industry has much to congratulate itself for. It is moving forward, it is heading in the right direction and it is beginning to pick up speed. ●

Budget review

Anthony Hilton provides a summary of the proposed changes most likely to have an impact on the advisory community and its clients

Regulation

The government announced that across the entire regulatory system it is taking action to shift the balance of regulation in favour of private sector investment and growth.

This objective will also apply to the regulation of defined benefit pension schemes where recent economic conditions have put companies sponsoring such schemes under significant financial pressure.

At the same time, the government announced that the smoothing of the values of pension fund assets and liabilities will not be introduced for scheme funding valuations.

The government will provide The Pensions Regulator with a new objective to support scheme funding arrangements that are compatible with sustainable growth for the sponsoring employer, and fully consistent with the 2004 funding legislation. The precise wording will be supplied later in the spring.

Responding to the announcement, The Pensions Regulator said that the new objective would be incorporated in the current review of the code of practice for defined benefit pension funding.

In addition, it will shortly provide guidance to trustees in the context of current economic circumstances, including the flexibilities available to trustees and company sponsors in the current regime – particularly the freedom to choose the basis on which contribution levels and valuations are calculated.

Child trust funds

The government has bowed to pressure and is to consult on allowing savers with money trapped in child trust funds (CTF) to transfer it into junior ISAs.

The move follows the government's decision to scrap the £250 payment to newborn children, which was the corner stone of the CTF. This created the impression that there was no growth left in the sector, which meant that fund managers had little incentive

> **The government will provide The Pensions Regulator with a new objective to support scheme funding arrangements that are compatible with sustainable growth for the sponsoring employer**

to provide the best returns on the invested funds – and in addition, some providers had put through sharply increased charges.

Surveys suggested that most of the funds invested were in index trackers but paying fees more in line with those charged by active managers.

It is estimated that there is around £4.9 billion currently invested in CTFs.

Equitable

The Chancellor announced a pay-out to victims of the Equitable Life collapse who had been left out of early settlements. Earlier the coalition had promised to pay a total of £1.5 billion to those affected by the crash but it had incurred criticism because of the slow pace of settlement.

Under this latest measure, policyholders over the age of 60 who bought annuities before 1 September 1992 will receive a one-off payment of £10,000.

AIM

Having highlighted the move in the Autumn Statement last year, the government confirmed that companies listed on the Alternative Investment Market (AIM) and other equity markets like the ICAP Securities and Derivatives Exchange for small and medium enterprises (SMEs) will become eligible for inclusion in ISAs.

The Chancellor's intention is to speed up the flow of capital into smaller company equities and help more AIM listed stocks gain visibility and make the growth market more attractive to more investors.

The news will be welcome to those individuals – about 16 per cent of the ISA total by assets – who prefer to trade individual stocks through ISAs rather than by managed funds because it considerably increases the range of options open to them. There are 1,096 companies on AIM compared to 1,318 equity securities on the main market. But under European law it seems likely that the shares listed on similar SME exchanges across Europe would also be eligible for inclusion.

The Budget then made this segment more attractive when the Chancellor announced that stamp duty would no longer be levied on AIM transactions. This was a direct response to lobbying by the stock exchange, which has recently been highlighting the need for AIM to be developed further as a source of equity growth capital for young and expanding companies.

The other advantage of AIM investment which has been in place for some years is that shares held for two years enjoy exemption from inheritance tax. This exemption looks set to continue.

Corporation tax

Corporation tax was cut to 20 per cent with effect from 2015 and the special rate for smaller companies was abolished.

The move was seen as increasing the attractiveness of the UK as a place for inward investment and bringing more clarity and certainty to the UK tax regime, particularly when combined with confirmation of the General Anti-Abuse Rule (and the UK's commitment to participating in the OECD project on international taxation).

Earlier surveys had suggested that as many as two thirds of the nation's tax advisers regarded the uncertainty following the public rows over the small amount of corporation tax paid by Starbucks and Amazon as a deterrent to overseas companies increasing their investment here.

A further side-effect of the change is to make incorporation a more attractive alternative to partnerships. This, along with an increasingly wary attitude from HMRC towards the use of partnerships, coupled with the Chancellor's announcement of a consultation on their use, suggest that they fall from favour.

The Chancellor said they would remove the presumption of self-employment for limited liability partnership partners to uncover cases of disguised employment.

The government will also consult "to counter the artificial allocation of profits to partners to achieve tax advantage".

On a more positive note, the British Venture Capital Association welcomed the fact that the Treasury is now committed to make changes to limited partnerships so that they can be used more effectively for private equity investments.

SEIS relief

Capital Gains Tax (CGT) relief for Seed Enterprise Investment Schemes (SEIS) is to be extended for a further two years. The Chancellor said that investors would be able to claim capital gains tax relief amounting to 50 per cent of the gain recognised in 2012-2013 provided the money was reinvested in seed companies either in that tax year or the one following.

Previously CGT exemption was only available on gains realised on 2012-13 and re-invested in the same year.

To qualify as an SEIS investment the company must have less than £200,000 of assets and no more than 25 employees. The maximum a company can raise under the SEIS is £150,000 and the maximum individuals are allowed to invest is £100,000.

Currently, capital gains of up to £28,000 can be completely extinguished by investing in SEIS in contrast to investment in Venture Capital Trusts and Enterprise Investment Schemes where the CGT is only deferred by investing into another scheme.

Even when the capital gains tax relief expires, SEIS investors are still eligible for 50 per cent relief against income tax, which is 20 per cent more than the allowance for EIS investment.

Social enterprise

The Chancellor announced his intention to make changes to the tax system designed to stimulate investment in social enterprises – though the nature of these changes was not spelled out.

The intention is to address the anomaly that there are tax breaks for many areas of risk capital investment, and tax breaks for charitable donations but no tax breaks for those who wish to invest risk capital in a business whose primary aim is to improve society.

Social investment has received a significant boost in recent times with the creation of Big Society Capital, the world's first social investment bank, which has £600 million to lend. This has led to a significant strengthening of the social investment sector and

> **"Investors have been quick to respond to the relaxation in income drawdown rates ratified in the Budget**

resulted in 58 per cent of social enterprises growing their businesses last year compared to 28 per cent of SMEs.

In briefings, the government has indicated that it hopes the tax relief will encourage the wealth management community to take up a range of new investment opportunities with tangible social benefits alongside investment returns.

Stamp duty on funds

The government has abolished the requirement of UK authorised funds to pay stamp duty reserve tax when they acquire UK-based securities.

As the tax was a charge on the funds, not on the management company, the result should be a small improvement in investor returns.

Residential property in SIPPs

The government is looking again at the feasibility of getting some residential property into SIPPs via the conversion of unused commercial space on the high street.

Earlier rules to put residential property in SIPPs were hastily abandoned before implementation once this was seen as a way of buying a house with full tax relief on the purchase price. But this move is seen as a way of putting fresh capital into decaying high streets and converting redundant commercial property into usable rental space.

Income drawdown

Investors have been quick to respond to the relaxation in income drawdown rates ratified in the Budget.

The change in the rules means that those choosing to release retirement income via capped drawdown rather than taking out a regular annuity can access funds equivalent to 120 per cent of the equivalent annuity income.

This is likely to have a positive impact on the market for income drawdown products.

Friend, not foe

Caroline Rookes, chief executive of the Money Advice Service, tells **Anthony Hilton** how collaboration is key to delivering improved financial literacy

For an organisation designed to be on the side of the angels, the Money Advice Service (MSA) ruffled a lot of feathers in its first years of operation.

In theory, who could object to a body whose sole purpose was to make people's lives better by improving their financial knowledge and understanding? In practice, the new kid on the block did not explain itself as well as it could have, and at times seemed to exceed its brief.

In particular, some in the independent financial advisory community felt they were being called upon to fund an organisation which seemed to be competing with them.

But things have changed and today there is a new hand on the wheel and a new style of driving. Chief executive Tony Hobman – whose high level of pay also fuelled resentment – left last year. Chairman Gerard Lemos – who had publicly written about his frustration at the continued misunderstanding, "wilful or otherwise", among advisers about the work of the MAS, has announced his intention to step down in September.

Since the turn of the year the direction of the organisation has been in the hands of the recently appointed Caroline Rookes.

Reform credentials

Rookes' career could scarcely be a better fit. After taking a degree at Lancaster University she started her working life in a benefits office as part of her induction into what was then known as the Department of Health and Social Security. She moved subsequently to the Inland Revenue, now HMRC, in 1999 and held the senior posts of director of charities; and director of savings, pensions and share schemes. While there she led the major simplification of the pension's tax regime, which was hailed by many in the industry – a notably hard bunch of people to please – as an excellent piece of work.

But perhaps more than anyone else she is the architect of automatic enrolment and NEST, the new second pension. It was she, as director of private pensions at the DWP, who took the recommendations on private pension reform prepared by Lord Turner and the Pension Commission and turned it into a policy, followed by legislation, which required employers to enrol their staff automatically into a pension scheme. She then created the blueprint and oversaw the creation of the infrastructure now known as the NEST pension scheme to deliver on the vision.

> **"The future is about earning the respect of the other players and organisations already active in the space**

She has therefore been at the heart of the most significant reforms in the savings market in the last 20 years and her decision to leave the Civil Service and take on the Money Advice Service was very much grounded in an acute awareness of the problems and chaos in people's lives caused by their lack of financial understanding – coupled with a desire to do something about it.

She is aware of the criticisms, but naturally enough it is the future, not the past, which concerns her. She acknowledges that the MAS was perhaps not as transparent in its early days as it might have been and this led to a lack of clarity and understanding in the wider community about its role and objectives, but sees no point on dwelling on it.

Collaboration focus

Going forward, the style is going to be different. Instead, the future is about collaboration and earning the respect of the other players and organisations already active in the space. A primary aim is to define best practice, share information and work with and through others to deliver improved financial literacy.

In fairness the organisation, which was created out of the FSA's Consumer Finance Education Body back in 2010, has also achieved considerable success. More than 2.5 million people have accessed information provided by it and eight out of 10 claims to have found what they were looking for, with seven out of 10 acting on the information.

The latest performance figures to be published shortly show a further large jump in the numbers and prompt Rookes to say that it has come out significantly ahead on all its key performance indicators. So they clearly are doing something right. Even the promotional campaign – which wound up some advisers who worried about its cost – has been very successful in creating the brand awareness without which the organisation cannot possibly succeed.

She is also determined to hold out an olive branch to the advisory community. She is happy for her organisation to refer people to the financial adviser sector when that is required and wants very much to explore with APFA ways in which the two bodies can work better together.

Her organisation exists to provide free, impartial generic financial advice; a part of this is having an effective means of handing on people to a paid adviser when that is what they need.

She has also taken steps to inject more fairness into the funding. Under the original system, financial advisers paid the bulk of the costs, though much of the guidance was in areas like mortgages – the providers of which got off relatively lightly.

Discussions are continuing, but as an interim measure the amount from advisers has been cut by 40 per cent. Meanwhile, greater efficiency means spending overall is down on last year at just under £80 million, split between its joint responsibilities, with roughly half for generic advice and half for the provision of debt advice. Most of the debt budget is in fact passed through to other service providers. The Citizens Advice Service, for example, is funded by MAS to the tune of £23 million and some £7 million goes to others like it.

Demand and supply

It may well be anyway that funding becomes less of an issue going forward, if only because the financial industry will have bigger things to worry about.

The MAS actually gets its money via the budget of the Financial Conduct Authority and though £80 million sounds a lot, it will appear less so in the context of the £700 million plus which the latter body and its

> **“ Rookes is happy for her organisation to refer people to the financial adviser sector when that is required**

sister organisation the Prudential Regulation Authority are projected to cost – an amount, please note, which will no longer be mitigated by the several hundred million of fines levied annually on wrongdoers. George Osborne has decided these should henceforth go direct to the Treasury.

People should also complain less when they see they are getting value for the money. On the debt side, not only are far more people – in excess of 120,000 in nine months last year – being helped for the same amount of money that the government used to provide, but the levels of satisfaction are remarkably high. Nine out of 10 have taken action on the back of the advice they were given, eight out of 10 have begun to reduce their debt levels and seven in 10 no longer have creditors chasing them.

The next step is to map demand and supply – to work out which parts of the country have the biggest debt problems and allocate counselling and debt management services to where they are most needed. After that it will seek to develop an agreed and consistent approach to be adopted by all the different organisations in the field.

Currently one of the issues is that there is no common ground between the many different providers of counselling, which means the quality of advice can be variable.

The year ahead

And so to the future. Ask Rookes what success looks like and she talks of a world where there are fewer financial scandals because consumers are more financially savvy and alert to the risks; where fewer people run up unmanageable debts through reckless borrowing; where children leave school with an understanding of the basic elements of finance; and where people save sensibly for retirement.

But she also knows that such a day is a long way off and, meanwhile, with rising inflation, minimal pay increases, the squeeze on welfare payments and the prospect at some point of sharply higher interest rates the problems particularly on the debt side could easily get worse before they get better.

The big initiative for this year is a strategy on financial capability – what is meant by it, how it can be measured and how changes in it can be recorded – as a prelude to setting out to deliver it.

Given the MAS has a brief to improve such capability it wants to create common understanding of what is meant by it and by using behavioural economics to develop a broader understanding of why people behave as they do.

Rookes hopes also, through evidence gathering and discussion, to use the development process as a mechanism to get to know the other leading organisations in the field, to find the common ground between them and to create a joint understanding, which will help them in the future to share more and collaborate.

As part of this project, MAS will seek to measure and then create a baseline assessment of the levels of financial capability in the country. This will build on work done back in 2005-06 by the Financial Services Authority and will become a regular feature of the MAS work so it can monitor how much progress it is making towards its goals.

At a recent conference, one fund manager spoke of the glittering future he saw for the financial advisory community dealing with high-end customers in a fee-based world. But he also conceded that there would be many millions of people for whom paid-for advice was not an option and never would be because it was not economic. These millions still badly needed guidance, particularly the young and those with families.

These are some of the people whom the MAS were designed to help and, under Rookes, are becoming ever better positioned to do so. ●

Regulation update

Michelle McGagh looks at the significant changes afoot in the industry and what they might mean for advisers

This year will mark a number of significant changes for advisers, not just in the implementation of the retail distribution review (RDR) but also in the recent shift from the Financial Services Authority (FSA) to the Financial Conduct Authority (FCA).

The regulator has been eagerly mapping out just what its plans will be, and crucially won't be, when the signage and stationery are changed to the FCA. Despite much noise about the FCA's power to scrap products, chief executive Martin Wheatley has said product pre-approval is not its aim.

Said Wheatley: "Not only is it near impossible, but this would stop the industry innovating and creating."

However, the FCA will be putting in place new rules to protect consumers, including dealing with 'super

complaints' – multiple complaints from consumer bodies about a single damaging product or practice.

It is also keen to make the process of regulation clearer and help highlight problems within the market by publishing more information about firms, individuals and markets and details of why it rejects or withdraws authorisations and the amount of redress paid out by companies.

Complying with RDR

The new regulator may be keen to get a better overview of the financial services sector and publish more general information, but it doesn't mean that it will turn the spotlight from advisers.

The regulator has announced its intention to conduct four thematic reviews to ensure the implementation

"UCIS is just one pension area where the FCA is getting tougher

of the RDR is a success, focusing on professionalism, charging structures, description of advice and non-advised sales.

The supervision team will conduct the reviews in three cycles, using a different sample of firms each time, and at the end of the cycle it will publish guidance on good and poor practice.

In February, the FSA sent out questionnaires to 50 advice firms asking for details about their charging structures and how they describe their services. Following the completion of the questionnaires, 20 firms will be chosen for more detailed visits.

The review of firms is not meant to catch advisers out but aims to be 'supportive', according to FCA technical specialist Rory Percival.

"We want to find out what firms are doing, and provide as many good practice examples as early as we can to help the industry apply the rules appropriately," he says. "The focus is on disclosure. Disclosure becomes pre-eminently important when the only person who can make the judgement about value for money is the client."

Part of the transition to the new rules also includes disclosure of professional standards data. All firms had to submit the details of each adviser's qualifications and accredited body membership by 29 January, but by mid-February 15 per cent of advisers had still not submitted the data, putting them in breach of regulatory rules.

Six-month ceasefire

The implementation of RDR cannot be expected to go 100 per cent smoothly and the regulator is waiting for bumps in the road. In that spirit it has said it will not take action against advisers for the first six months of 2013 when it comes to its four thematic reviews.

However, if the FCA finds a company is deliberately flouting the rules then it will take action.

Stress on suitability

Suitability and mis-selling are buzz-words for the regulator and it has launched a number of probes in different areas of financial services already this year to ensure clients are receiving suitable advice.

The FCA has warned advisers who outsource investment to discretionary fund managers (DFM) that they are at risk of mis-selling due to a mis-match in the risk profiles of clients and the portfolios they are invested into.

Percival said that advisers and DFMs needed to be clearer on what their suitability obligations to clients were and risk-profiling should be done by either the DFM or the adviser.

When it comes to investment, unregulated collective investment schemes (UCIS) have not left the headlines and it is clear that when it comes to suitability the FCA is sure that UCIS are only suitable for a small minority of investors.

The main problem has been the use of UCIS as SIPP investments and the FCA has said it is investigating advisers over unsuitable advice, urging clients to transfer assets into the unregulated funds.

In an email to advisers, the FCA said it was concerned that advisers were transferring pension assets into the investments without proper assessment. It said it was investigating a number of firms and had sought to stop them transferring clients into UCIS with a change in permission.

Peering at pensions

UCIS is just one pension area where the FCA is getting tougher. It has teamed up with The Pensions Regulator, HM Revenue & Customs, the Home Office and the Serious Fraud Office, among others, to launch a 'predators stalk your pension' consumer advertising campaign.

The adverts are aimed at raising awareness of pension liberation schemes and how savers can become victims of fraud. The campaign follows a number of warnings to consumers about firms offering liberation services.

Companies that help consumers turn their pension into income in more legal ways will not escape scrutiny either. The FCA has launched an annuity investigation that will look at the level of detriment consumers suffer by failing to shop around for an annuity and whether firms' processes inhibit shopping around.

As part of the review it will conduct a pricing survey of all annuity providers and compare the annuity rates available to consumers through different channels.

Passive conundrum

One area that has been greatly debated by advisers when it comes to suitability is whether the exclusive use of passive funds is in keeping with the RDR rules.

The FCA has now clarified its stance on this area, stating that advisers must start investment with a whole-of-market outlook and only invest consumers in passive funds if it is suitable. However, it said that firms should not assume that passive investments are suitable for all clients.

Firms that use mainly passive investments should be able to evidence why other investments would not be more suitable.

The FCA said: "The firm would need to be able to advise on investments other than passive investments if that would be in the best interests of a particular client. To do this, its advisers would need to maintain an awareness of what is and is not included in the panel, so they can identify clients for whom, if necessary, an off-panel solution would be suitable."

Wrap U-turn

The war of words over cash rebates on platforms and wraps is still rumbling on and the regulator seems to be even further from a solution after talks with HMRC.

There had been rumours that the FCA would make a concession on its platform cash rebate ban to allow cash rebates to be made for amounts less than £1 a month.

> "The war of words over cash rebates on platforms and wraps is still rumbling on

This 'de minimis' amount would be allowed to be paid to client accounts in cash rather than fund units, due to the administrative burden of rebating small amounts of units.

However, following talks with HMRC in January it is believed the regulator is now considering a complete U-turn and banning unit rebates because they would be taxed by HMRC. Rebate fund payments will be subject to the basic rate of income tax that will be deducted from trail commission, and higher rate taxpayers will have to pay the increased tax through self-assessment.

This tax will mean that many of the existing fund platforms charging high AMCs and rebating them to clients will become more uncompetitive.

Ben Yearsley, head of investment research at Charles Stanley Direct, says: "The simplest option for investors is to invest in clean units now, paying explicit platform fees on top... Not only will the client's annual costs be lower and performance boosted, but there is no tax implication or bill either."

Costly compensation

The Financial Services Compensation Scheme (FSCS) is doing little to endear itself to advisers after sticking with its plan to raise the investment intermediary threshold from £100 million to £150 million, meaning more of the compensation burden will fall on advisers.

The FSCS and the regulator ignored calls to completely overhaul the compensation funding system. However, there was a victory for advisers after the FSA agreed to consult on providers who are supervised by the FCA's counterpart, the Prudential Regulation Authority, contributing to a collective resource that would pay out should compensation thresholds be breached.

APFA said that it was "disappointed" the FCA did not announce a "more sensible threshold for investment intermediaries".

In order to bring the FSCS to task, APFA has called on the National Audit Office to look at the 'blank cheque' budget of the FSCS after it almost doubled its budget for compensation recovery from £3.9 million in 2012/13 to £7.7 million for the current year.

The FSCS has also announced that it will run a new £3 million advertising campaign on print, radio and online that will start this year and end in March 2014. It will be aimed at reassuring consumers that their savings are safe.

Ombudsman charges

The FSCS isn't the only organisation that advisers will be paying out more to. The Financial Ombudsman Scheme has proposed raising its budget by £89 million from £191 million in 2012 to £280 million for 2013. The increase in budget is due to the influx of payment protection insurance cases, which has become the most complained about product ever.

The proposals include raising the standard case fee for individual firms from £500 to £550 and increasing the total amount it levies firms from £17.7 million to £23 million. However, the number of free cases each adviser business will receive will increase from three to 25.

Good news on MAS

And it is good news when it comes to the cost of the Money Advice Service. Advisers were facing a bill of £4.6 million to fund the government advice service, now the FCA is consulting on a fairer distribution of the cost.

The funding system was based on the FCA funding blocks, with advisers paying 10 per cent of the £46.5 million cost, but the FCA proposes to move to a new system, which will be based more on how consumers use the service. APFA is pressing for prompt action on reducing advisers' bills.

Plotting a new course: life under RDR

Tim Cooper looks at the reactions to the retail distribution review across the financial community and explains how advisers have adjusted to it

The retail distribution review (RDR) has arguably made financial advice one of the riskiest businesses to run, but by keeping advice services simple and ensuring advice is on-going, advisers can still thrive in this transitioning market.

Since the rules came into effect at the end of last year, two crucial tasks for advisers have been getting clients to sign new RDR-friendly service agreements and making sure that propositions show fully transparent charges in all areas.

For the less well prepared, these challenges might have taken their focus away from the other important changes required to adapt their businesses.

Brett Davidson, chief executive of consultants FP Advance, says: "It is all about the business model; demonstrating value in the proposition, identifying the right customers, differentiation, pricing, and whether adviser skills are up to scratch. There is a long list."

Advisers that have ignored these issues could be facing an uphill struggle.

Financial impact

The one thing all advisers are watching closely is the effect of RDR on cashflow and profit. As well as changing the way some products are remunerated – which could affect cashflow – the new regulations are increasing the costs of running advisory businesses.

Adviser Taylor Oliver responded to this pressure by increasing its fees to 1 per cent for new clients with up to £500,000 to invest; 0.75 per cent for up to £1 million, and 0.5 per cent for £1 million plus – with effect from 1 January. The firm also set a minimum fee for new clients of £1,500 a year.

Louise Oliver, partner at the firm, says: "We are going through one of the hardest times for the industry. Even though we have been fee based since 2003, the key now is to take on the right clients and not waste time with unprofitable ones.

> The key now is to take on the right clients and not waste time with unprofitable ones

"The risks and cost of running a financial planning business have gone up. With the RDR's new reporting requirements, and cost of demonstrating your independence, it has become one of the riskiest businesses to run.

"The Financial Conduct Authority (FCA) wants us to consider a wide range of products. Now if we recommend a structured product, an enterprise investment scheme or venture capital trust, we may have to pick up the phone to our professional indemnity (PI) insurers. They may or may not cover us. When our PI renews, I suspect the cost will go up, or there will be a long list of exclusions."

If the PI insurer did exclude an investment, Oliver says she would probably run it without the cover and get the client to sign a disclaimer.

Louise Claro, managing director at Multiplex, says it was a rush last year to make sure all her advisers had the right qualifications. Now she is focusing her attention on the RDR's new continuing professional development (CPD) structure, particularly in relation to the independence requirements.

Claro says: "Multiplex advisers will remain independent, so my main concern is making sure that CPD is focused and relevant to the space they operate in; and on the product areas they may previously not have considered [in order to meet whole of market requirements]."

Charging conundrum

There is also wide-ranging debate over the new system of adviser charging facilitation (ACF). Some advisers claim the RDR's focus on transparency enables them to provide a simpler, 'cleaner'

A new model for the new environment

Prudential's **Russell Warwick** on getting the business model right in a post-RDR world

What key areas of the business must advisers strictly monitor in order to ensure that their new business model is working correctly?

One of the most important things to monitor is cashflow. The adviser remuneration and income model has been turned on its head so it's vital to understand whether the new proposition is delivering against the assumptions made when it was put together.

Alongside this, a clear understanding of where costs are incurred within an adviser's business is critical, particularly for services that are being offered on an ongoing basis.

Last but not least, making sure the ongoing service proposition delivers fair and demonstrable "value for money" when viewed through a client's eyes is crucial if advisers want it to stand the test of scrutiny from them. If clients don't believe the ongoing service offers value for money they won't continue to pay, and with ongoing service being an integral part of the business model, getting this right is essential.

What tweaks to pricing structures do you believe advisers will make over the coming year as their new business models settle?

This may well vary between business models. For independent advisers dealing with more wealthy customers, I think we'll see pricing and remuneration structures moving more in line with how solicitors and accountants charge clients – a charging proposition of fixed fees instead of fees as a percentage of investment/premium and contingent charges.

Clearly many advisers charge this way already, but this looks set to grow as post-RDR we're seeing more advisers who serve the higher end of the market charging in this way. However, for restricted advice where business models are built more heavily around an adviser's own investment funds and model portfolios, I think we will see a continuation of fees expressed as a percentage of the investment or premium, as this better complements the manufacturing aspect of their business model.

What should advisers do if clients are not willing to pay a fee for advice?

Increasingly I think the answer to this will be advisers adapting business models to offer a broader range of services, including non-advised propositions. In practice, many advisers already provide ad hoc, non-advised support to individual clients and we are certainly seeing growth in adviser firms being willing and able to service clients in this way, particularly in the decumulation sector of the market.

In the future, I expect to see advisers offering such services on a more formal basis – another proposition that they're able to provide to support the needs of their individual clients. However, when considering this, it's important to make sure you have clear separation between what's an advised service and what's a non-advised service – masquerading an advised service as a non-advised service is simply not an option. ●

Russell Warwick is distribution change director at Prudential.

offering, while others complain that the ACF system is fiddly as each provider and platform administers it differently. Many new 'clean' RDR-friendly share classes are actually more expensive than other versions, making it hard for advisers to recommend them.

Claro says some of the providers' systems have not been able to cope with the switch to ACF.

"I don't understand how I was ready, yet many providers and platforms were not," she says. "They can't get their rebates correct and yet their illustrations are pivotal to the advice process. I have not been using certain providers that have had teething problems in the first weeks. I lost confidence in what I would previously have seen as leading players."

Davidson says problems with ACF could get worse: "People are still out there doing much the same as they did before and clients will keep buying it," he says. "It doesn't mean there aren't issues they need to work on, but it will have an impact over three or four years, not six months."

> **"Under RDR, those who can simplify the way they work will do better than ever before**

Some believe that ACF is so flawed that the regulators will eventually have to scrap it, forcing clients to pay upfront fees, which many are reluctant to do.

Simplifying life

Rod Milne, joint managing director at HFS Milbourne, says RDR is proving to be a good opportunity for well-prepared firms that already have an ongoing service model.

He says: "Financial advisers that are moving into this space for the first time have an uphill battle financially. They will be devoting their resources to increasing recurring income to a level where they can afford to remain in business. By definition, they will not be able to invest in other things to move themselves ahead.

"Because of RDR, clients at the lower end of the scale that small financial advisers have been dealing with may not be willing to pay fees for advice. So financial advisers will have to gravitate towards the top end of the market.

"Those clients will expect higher service, which takes more resource. Generally, it means these smaller firms are disappearing and that will gather pace. Even for firms like mine, with 20 staff, our days might be numbered. We will probably [be acquired by] a bigger group or platform."

As well as the much-discussed potential for acquisition and recruitment, another opportunity is a marked surge in enquiries from potential new clients whose adviser

has exited the market. Talking to professional connections and boosting marketing efforts is a good way to capture this market.

Simon Boulter, director of BoulterBowen, agrees that, despite the niggles, RDR is making life simpler.

"We put all our funds onto one platform, Pershing, and use clean funds," he says. "The platform pays us ACF out of the client portfolio. It means we are scaleable because we have taken away the complexity around the remuneration.

"Under RDR, those who can simplify the way they work will do better than ever before. The ones who used to charge 5 per cent for a bond and every five years review and replace it at another 5 per cent will find that way of life impossible.

"Advisers who have changed their charging structure and relate that to the value they deliver will do better than ever."

Equipping advisers post-RDR

Stuart Wilson explains the resources that LV= is making available to advisers

RDR has imposed a multitude of new burdens on advisers and our primary concern is that the challenges of the transition don't inflict lasting damage on the professional adviser community.

Many advisers have been restructuring their business models in the countdown to RDR but, for most, the greatest challenge will be the need to focus on business management skills, at a time when the regulators are increasing scrutiny on the core, technical skills.

At LV=, we decided a good way to assist the advisory community would be to bring together all the information, tools and guides needed to grow a retirement business, in an easily accessible and readily deployable format. Hence, we created the LV= Adviser Retirement Centre (ARC), a wealth of resources that are completely generic. We don't talk about LV= or attempt to sell our products – the information is purely to help advisers grow their businesses, not to promote ours.

Available resources

The ARC comprises three key sections – marketing, commercial and technical. The marketing section contains articles, press ads, direct mail letters and flyers, seminar presentations, posters, web content, marketing guides, sales aids, case studies and more – everything an adviser needs to market their business. All resources are completely generic and produced by marketing professionals.

The commercial section contains the information an adviser needs to develop their business strategically and tactically. It includes articles on building professional connections and developing an effective advice proposition; this section is constantly being added to on a wide range of commercial issues.

At the real heart of the business lies the technical section. This area includes market focus reports, in-depth studies on key retirement issues (like the role of fixed term annuities and the impact of mortality credit on drawdown after age 75) as well as specialist technical guides on a range of subjects.

Easy access

The ARC is available to all advisers and registering to use the site is easy. Just go to http://retirementcentre.lv.com/register and complete the simple form. You will be emailed a password straight away for instant access and you can change your password later if you wish.

Once logged in, you have full use of the site and we encourage our users to interact with us by posting comments on our blog entries, replies to our Question of the Week and also by following our ARC Twitter account (@marketing_peas).

We hope that this initiative will contribute to creating a strong, professional and effective advisory community and we welcome your feedback.

Stuart Wilson is head of intermediary marketing, retirement solutions at LV=.

Fair and balanced regulation

To create a secure business environment that provides financial advice at a reasonable cost, the FCA must consider the needs of financial advisers and ensure the burdens being placed on them are proportionate. **Michelle McGagh** looks at the various APFA initiatives underway to monitor RDR implementation

The retail distribution review (RDR) may have been at the forefront of advisers' minds for the past few years, but its implementation doesn't bring with it a perfect industry and there are still many hills to climb for the Association of Professional Financial Advisers (APFA).

In order for consumers to prepare fully for their financial futures, they need to be supported by advisers working in a secure business environment, delivering advice at a reasonable cost.

Although there are still concerns about the cost impact of the RDR on both adviser businesses and consumers, there are additional cost pressures that firms are being placed under.

It is understandable that at times advisers feel that they are carrying the weight of industry costs on their shoulders and APFA is committed to ensuring costs are proportionate to adviser business size and the risk they pose to the market.

Chris Hannant, APFA policy director, says the organisation is in talks with the regulator to secure regulatory dividends for advisory firms in a number of areas.

A close eye on RDR

Monitoring of RDR implementation will be a priority for APFA. It has recently completed the collection of a large swathe of adviser data that will allow APFA to benchmark adviser numbers, average profits and revenue of adviser firms.

"We have published a benchmark after collecting information about the industry and statistics about advisers' profits and revenue, so we can say 'this is what the industry looks like before RDR'," says Hannant. "We will then collect the same numbers in future so we can see what is happening in the industry.

"This is the industry in numbers and it is the first time someone has done that."

The figures show the average number of advising staff per firm has dropped from 5.1 in 2011 to 4.6 in 2012. Business revenue is also down slightly from £2,155 million in 2011 to £2,153 million in 2012.

> **"It is understandable that at times advisers feel that they are carrying the weight of industry costs on their shoulders**

Hannant said the fall in these figures shows a drop-off in adviser numbers before the RDR; and preparation for RDR with investment by firms in new processes and qualifications hitting company finances.

Looking forward, Hannant says: "I expect the number of advisers to fall further, but I'm not sure about profits and revenues – there will be an element of bounce, but we do not know what reaction the public will have to new business models."

Hannant is hoping that he can predict an overall positive outcome from RDR when it comes to regulation.

"As part of the RDR we have been campaigning for regulatory dividends. If RDR improves adviser standards then the [new regulator] Financial Conduct Authority will need to worry less about advice and it should cost less to regulate – those cost savings should be passed on to advisers," he says.

Campaigns reaping dividends

APFA is also pushing for reform of adviser reporting requirements and for an overhaul of the Financial

Services Compensation Scheme (FSCS) thresholds.

The issue with reporting requirements for the Retail Mediation Activities Return is that there are conflicting explanations on the requirements for information, and APFA is in discussion with the Financial Conduct Authority (FCA) to try and clarify what rules advisers must abide by.

The FSCS thresholds have been an ongoing problem for advisers who have been burdened with the cost of an increasing number of investment scandals. In January, the FSCS confirmed plans to raise the investment intermediary claim threshold from £100 million to £150 million, and rejected plans for a pre-funding model or a product levy.

APFA says the increase in the threshold was a "missed opportunity" to build a more stable FSCS funding model.

Hannant says the splitting of the FSA into the FCA and Prudential Regulation Authority (PRA) raises another concern for FSCS funding.

"The introduction of RDR means the UK is ahead of other countries and regulatory changes could start to decrease

Last year the FSA proposed setting up a retail pool funded by FCA regulated intermediaries and providers, which would be triggered should the companies breach their threshold. Under these plans, providers who fell under the PRA would not contribute to the pool.

Following industry outcry, the FSA launched a consultation on whether all companies should contribute to the pool of money.

"We have campaigned to get shared responsibility with providers in the event of a threshold breach," says Hannant.

The regulator is listening to APFA concerns and Hannant notes it has also been successful in its campaign to increase the number of fee-free Financial Ombudsman Service cases advisers are entitled to from three to 25. It has also succeeded in reducing the fees advisers must pay to support the Money Advice Service, with adviser annual funding dropping 93 per cent from £4.6 million to £300,000.

Long-stop campaign

APFA's flagship campaign to introduce a long-stop on advice is still in motion and has been debated in Parliament, leading to ministers recommending the regulator put the issue on its agenda, which has now happened.

Hannant says the key is to balance the stability of adviser businesses with consumer protection, but consumers must play their part.

"It does not have to be a straight cap on advice, it can be a cap depending on the type of product or the length of time the product is for. You could also extend the long-stop following reviews of the product," says Hannant.

"There is an onus on the consumer to keep things under review and make sure the products they buy are still meeting their expectations."

Overall, Hannant hopes APFA will build a strong relationship with the FCA and work with it to identify potential problems before they end up as another FSCS bill.

"I think the introduction of the FCA could work in the favour of advisers because if the FSA was more proactive and on the ball with things like Keydata and Arch Cru then the FSCS bill would have been lower," he says.

Although Europe will also play a key role in the direction of the new regulator, the introduction of RDR means the UK is ahead of other countries and regulatory changes could start to decrease.

Says Hannant: "It would be a significant prize for advisers; stability, so they can look after their clients and put their effort into financial planning rather than putting it into the next regulatory initiative."

How the regulator is providing tools for the financial adviser

By **Charles Counsell**, executive director automatic enrolment, The Pensions Regulator

At The Pensions Regulator we recognise the challenges and opportunities that automatic enrolment presents to financial advisers.

Earlier this year, our research into employer attitudes showed more than 75% of large, medium and small employers either had consulted, or planned to consult with, an external adviser. We know too that advisers are increasingly expecting to be asked by their clients to assist them in some way.

But our research across the range of advisers has shown there are still gaps in detailed understanding of the new duties. This includes areas such as which workers to assess, determining eligibility of workers and what earnings to assess, along with the need to register with The Pensions Regulator.

The regulator wants to ensure all advisers have a good understanding of automatic enrolment so they can make an informed decision on whether to provide advice on these matters or not.

Our work with advisers

A number of resources are available on our website to help advisers working with clients as they prepare for their staging date and ongoing responsibilities.

We have an industry liaison team, which is working with financial adviser networks, regional and national financial adviser firms, employee benefit consultants and their professional bodies to raise awareness and understanding and also help us to understand the propositions that are developing in the market place.

We are also engaging with other industry sectors key to auto enrolment, including pension scheme providers, administrators, payroll and software.

We are doing a range of activities to raise awareness of the new employer duties. We are developing information products aimed at medium employers as they prepare. Our work includes providing online tools, webinars, signposting employers to sources of expert advice and building capacity among advisers.

We are also working with bodies such as membership and trade associations to spread key messages, best practice and helpful information.

"Our research shows that employers of all sizes continue to believe that automatic enrolment is a good idea"

Key messages

A key message all financial advisers can share with clients is to check their staging date. We are still finding organisations that have made an assumption about when they are due to stage and have had a dash to the line to comply.

Another important message you can help us share is how vital it is to start planning early. Again and again, employers and their advisers are telling us they wished they had allowed more time. We have advised large and medium employers to allow 18 months to prepare for their new duties.

We also advise employers to decide which pension provider to use six months before their staging date. There is a lot of new business coming to providers in a short period and they all will need to prepare for this. Making a decision early and contracting with the scheme will help the employer avoid last-minute problems, which may restrict their options.

Our research shows that employers of all sizes continue to believe that automatic enrolment is a good idea, and are confident that they can be prepared on time. But we know there is no room for complacency.

Financial advisers can play an important role in the success of automatic enrolment – helping millions more people save for their retirement. ■

Find out more at www.thepensionsregulator.gov.uk/professionals.aspx

The Pensions Regulator

Leading the way to auto-enrolment

The arrival of pension fund auto-enrolment brought with it hopes for a significant increase in the provision of financial advice based on the workplace. By **Gill Wadsworth**

Providing workplace pensions looks set to prove a costly operation, as the government's reforms force all employers to auto-enrol qualifying employees into a company scheme. However, advisers are perfectly placed to help smaller companies navigate the pensions landscape.

From October last year, the largest employers had to comply with the auto-enrolment legislation, with other businesses staged in.

But while finance directors and HR managers may be receiving the news with a sense of financial foreboding, for advisers the advent of auto-enrolment should prove a welcome boost to business.

Latest research from The Pensions Regulator published in March this year reveals 59 per cent of financial advisers and pension consultants believe auto-enrolment will increase business, while 89 per cent say they will charge over and above normal rates for auto-enrolment activities.

The same research also reveals a strong employer appetite for third-party advice. Three-quarters of employers with 250 or more employees either had, or planned to consult with, an external adviser. This compared with nearly four-fifths, 79 per cent, of medium employers with 50 to 249 employees; 78 per cent of companies with five to 49 employees; and 65 per cent of micro employers.

The spoils for the larger employee benefit consultants are clear when firms such as Asda, Pepsi, McDonald's and Marks & Spencer are auto-enrolling tens of thousands of employees.

M&S for example employed Hymans Robertson to put in place a master trust to be run by Legal & General, which replaced the retailer's existing defined contribution scheme.

Julie Parker-Welch, reward manager at Marks & Spencer, says: "When it comes to pensions, retail is a pretty complex sector with multiple sites and higher employee turnover rates.

"We conducted a thorough consultation with our employees and we're confident we've now created a scheme that will ensure a smooth transition for our existing members and provide eligible new members with the information they need to make the right pension choices for them."

Small fish, big rewards

But mega-employers such as M&S make up just a small proportion of the UK's total business population, and there are many thousands of smaller

> "There are thousands of smaller companies in need of financial support and advice on a more limited scale

companies in need of financial support and advice on a more limited scale.

Andy Cheseldine, principal at Lane Clark & Peacock, says auto-enrolment presents a "great opportunity" for financial advisers, particularly in a post-retail distribution review world where commission has been abolished.

"[Advisers] wouldn't have got commission on [auto-enrolment] work anyway, so why not charge a fee for it and spend the time with the pensions manager, working through the implications and act as a locum doing project planning, communications and maybe staff presentations in due course," Cheseldine says.

Analysis undertaken by Jelf Employee Benefits found small and medium employers' awareness of auto-enrolment had actually fallen in the past six months even though staging dates are fast approaching. Less than

> Getting to grips with auto-enrolment and the associated complexities is no mean feat

one in three employers, 29 per cent, are aware of their staging date and are ready for the exercise. This compares to 38 per cent in November 2012; 31 per cent in May 2012; and 29.5 per cent in May 2011.

This regression coincides with providers cherry-picking the companies with which they are willing to work.

Cheseldine says employers may find they are unable to extend arrangements with existing providers since the members being auto-enrolled are too low margin.

"Some employers have assumed their existing pension provider will take them on, but that is not happening. Providers say they don't want low-paid staff or they will only take them for an additional fee, or if employers can be ready ahead of their scheduled staging date," Cheseldine says.

In good time

Time constraints are a major issue, too. Pensions minister Steve Webb says employers need at least 12 to 18 months to prepare for auto-enrolment since the changes have implications across the whole business from IT to payroll to HR.

All this plays well to financial advisers who are able to help smaller employers ready their businesses early and to shop around for the best providers on the market.

Webb concedes smaller businesses will get fewer "good deals" than their larger counterparts, but has ruled out any kind of fee cap. Consequently, employing a savvy adviser could save employers and their workforces thousands of pounds in pension fees.

In many cases SMEs will opt for the government's default arrangement, the National Employment Savings Trust (NEST). The vehicle is obliged to take all employers irrespective of size and will be an important port of call for financial advisers targeting the smaller end of the market.

John Taylor, managing director of customer and proposition at NEST, says: "Running a pension scheme is not the primary focus [for most] businesses, so it is likely they'll want to minimise the time they spend on it. Many employers will also be looking for third parties to take over some or all of the work involved with setting up and administering their schemes."

Up to speed

Yet getting to grips with auto-enrolment and all the associated complexities is no mean feat, even for advisers with specialist pensions knowledge. Financial advisers that are ahead of the game and able to offer employers the requisite support will be the ones to profit from the new legislation.

To help advisers get up to speed, Taylor says NEST holds regular workshops covering what auto-enrolment means for clients and the role NEST plays as a provider.

The regulator is also supporting advisers via an online information and resources hub covering all aspects of auto-enrolment.

Charles Counsell, executive director employer compliance at The Pensions Regulator, says: "With increasing numbers of employers now looking to their advisers for help in fulfilling their duties, it is important financial advisers can access the right information to respond to them. Our new hub ensures the range of information and resources about the steps to compliance are easy to locate."

Lessons learnt from businesses that have been through auto-enrolment already show it takes time and considerable effort. Smaller companies might have less complexity than their larger counterparts, but their options and resources may also be limited.

Professional advisers can help take the pain out of auto-enrolment and ensure pensions reform achieves its goal of getting more people saving, but they need to act now if they are to make a genuine difference.

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When the bubble bursts

Interest rates have been lower for longer than anyone can remember and at some point the tide will turn. **Neal Underwood** talks to experts in the financial world about the likely outcome when this happens

Talk of a bond bubble has led to concerns that the UK could witness a return of the 1994 blow-up in the bond market. However, the chancellor's Budget indication that interest rates will remain low has taken some heat out of a worrying situation.

With interest rates remaining at 0.5 per cent for the past four years it was only a matter of time before commentators started drawing comparisons between today and the blow-up of the markets in 1994, where a sudden and unexpected rise in interest rates saw fixed income assets drop in value and investors rush for the exit.

However, the comparisons are slightly unfair. In 1994, changes in interest rates were announced without warning, leaving markets to react as news hit the stock exchanges. However, George Osborne has confirmed in the Budget that the UK will follow in the footsteps of the US Federal Reserve and give the Monetary Policy Committee (MPC) power to provide explicit guidance on where interest rates are going.

Osborne said: "That is what the US Federal Reserve has now done – making a commitment to keep interest rates low while employment is high, provided inflation is not expected to rise too much.

"This can help the economy because it gives families planning their futures, and businesses wondering whether to invest, more confidence that interest rates will stay lower for longer."

The tweaking of the MPC's remit and confirmation that interest rates will stay low means the likelihood of a sudden rate rise, as happened in 1994, is unlikely. Further to this, Osborne announced a continuation of the quantitative easing programme following poor growth forecasts, making a rate rise even less likely in the medium term.

> **"Confirmation that interest rates will stay low means the likelihood of a sudden rate rise, as happened in 1994, is unlikely**

Lessons learned

In the US, the lessons from 1994 were well-learned by the Fed, which has implemented 17 well-telegraphed rate increases since June 2004 without spooking the bond market, and now the UK will follow suit. Giving clear indications of where the UK's interest rates are heading will hopefully curtail a rush out of fixed income on these shores.

Ben Bennett, credit strategist at Legal & General Investment Management (LGIM), is not convinced a bond bubble is inevitable. He believes that any potential growth in the near term is likely to be stymied by the fact there is still a lot of debt around.

Bennett does not foresee a 1994-type episode, in part at least because there is not enough growth to justify a hike in interest rates. However, this lack of growth could be an issue in itself.

"If the policy makers try and slow things down and we see no growth, they will reverse it again; it's a big problem over the long term. We've still got to be cautious in terms of growth prospects. We're trying to lend money to companies which are expected to grow, for example because of emerging market exposure, or to governments which have fiscal stability."

He notes that the MPC is talking about more quantitative easing (QE) and relaxing the conditionality behind inflation.

"That for me is my biggest concern nearer term. It's a funny concept; growth is pretty weak, and lots of countries will find it hard to create inflation," he says.

Avoiding a rout

The risk to the bond market does not just lie in monetary policy. Today's bond market is much bigger than it was in 1994 and is a somewhat different beast as there are more individual investors sitting alongside institutions.

Some see this as a risk in that even if fund managers hang on to their positions, individuals – who scare more easily – may spark a sell-off. Ultimately if there was something approaching a rout, there could be more losers this time round.

But incremental interest rate rises, when they do come, in addition to the lack of growth for the foreseeable future, seem to point to avoiding a collapse in bond markets. Investors have plenty of time to prepare for

> **Diversification is key... be sensible and think about the medium-term allocation game**

any rate increases and to position accordingly, attempting to counter any potential capital losses.

According to experts, this means a bond bubble, or a burst of what bubble there is, does not look that likely, certainly in the near term. Bennett believes some opportunities remain in the fixed income space.

"Government bonds, including bunds, treasuries and, barring an accident in currency markets, gilts, are still reasonably attractive. On the corporate bond side we look at those with exposure to growth areas such as emerging markets, Asia or infrastructure-type assets. We're also avoiding banks. But there are still certain corporate bonds that are attractive," he says.

Still opportunities

Tim Cockerill, head of collectives research at Rowan Dartington, says that for some time, people have been looking for the next bubble and lots of fingers have pointed at bonds.

"With gilts, you've got a built in capital loss. They've been sustained because of low interest rates and QE, plus the Bank of England owns around a third of them. It's not a market that has operated freely and you can't escape the fact there will be a pullback to par.

"With gilts being the rate off which other fixed income investments are priced, you see the same story all the way through. I do think it's a bubble, but not one driven by speculation. A slow deflation of the bubble is what you'll get. I don't imagine any event that suddenly changes things. I don't see a rout. If sterling gets weaker you may see some selling pressure, but not from the Bank."

Peter Toogood, investment director at Morningstar OBSR, believes bond bulls are becoming an increasingly rare breed, but also does not envisage a rout. "What we've seen so far this year is a cash to equities allocation. If you start with cash returning zero, equities look the best relative value, but I don't think there's a lot of net selling of bonds.

"You could say it looks like a bubble in relation to the normal economic cycle, but is it normal? It's a heroic assumption to assume normality. It becomes a bubble only if you think things get a lot better from here."

Toogood also believes demographics will act against the idea that bonds will explode.

"People are getting greyer and older. There's a constant bond buyer, and the yield will be compelling. Only if it's better times ahead could we see a bond bubble. There won't be a crash, but there could be some capital losses."

Bonds form a key part of Rowan Dartington's client portfolios, in particular income strategies.

"You're working to a risk budget, so income models still have fixed income, although we've been pulling duration in," says Cockerill.

"Diversification is key. Overall we're conscious of sterling and may consider more overseas allocation in due course. We have in the last six months made some changes, moving from fixed income to equities, but it's not a major switch. It's been quite gradual. I wouldn't be surprised to see a pullback [in equity markets] which would see fixed income holding up quite well."

Ultimately, says Toogood, bond markets are at the behest of the macro environment, but he does not think we are in bond bubble territory.

"It's getting uncomfortable, but it's a year or two away. £168 billion of gilts were issued this year. You just don't have a bond bubble against current circumstances.

"The key is to stay diversified, be sensible and think about the medium-term allocation game. At this point don't dump one thing and buy something else. It's not logical to behave so irrationally." ●

Should we say goodbye to property?

The retail sector is in disarray, poor economic growth is bad news for industrial property, and outside London there seems also to be an oversupply of office space. What advice should be given to a client who wants to invest in property? By **Neal Underwood**

The nation's love affair with bricks and mortar isn't waning, despite a property crash and pressure on residential and commercial property, and for advisers it is still an exciting asset class that can help diversify a client's portfolio.

All areas of the UK property market are struggling under some pressure, but despite this, Rob Martin, director of research at Legal & General Property (LGP), is forecasting improved UK commercial property returns in 2013, albeit with a continued polarisation between the best and worst performing assets.

"While 2013 economic growth is likely to remain sluggish, there are signs that property returns are set to improve," he says. "An easing in commercial real estate credit markets and the persuasive valuation case for UK commercial property should mean that prices for the market as a whole will be broadly stable in the next 12 months."

He expects total returns to be dominated by income return, which currently stands at 6 per cent.

Reasons for optimism

"Three key drivers underpin our more positive outlook for 2013," says Martin. "First, central banks look determined to boost growth and this has fed through to our economic growth forecasts, which have been marked higher. This gradual improvement should translate into greater occupier confidence in bearing the cost of moving into modern, well-located buildings."

Second, he says, there is evidence of an easing in commercial real estate credit markets. US and emerging market banks, insurance companies and debt funds are increasingly originating new debt capital to the sector and there has been a greater willingness among the UK banks to lend to commercial property in recent months. However, these positive signs must not be overplayed, in his view.

"Our third driver for optimism on future returns is the valuation case," says Martin. "The risk premium offered by investment in commercial real estate is comparatively attractive against historic averages."

Portfolio must-have

Robert Forbes, financial planner at Plutus Wealth Management, says the firm always advises clients to hold property as part of an overall portfolio.

"At one end of the spectrum you've got property funds and variants thereof, either international property or UK property. They should sit in everyone's portfolio. Then you've got direct ownership: individuals owning residential property and business owners with a small self-administered scheme owning their business property."

At present, buy-to-let is not as profitable as it has been in the past, says Forbes. "Rental yields have gone up, but mortgage rates are relatively high. Also it's all about location."

The key with a property fund, says Forbes, is to dig down into the underlying investments and he is currently investing clients in international property.

"It might have, for example, just one big shopping centre. In our portfolios at the moment we've just moved out of UK property and increased our weighting to the international property sector. That's our position for the time being but things will swing back. Commercial property is struggling a bit so the gains are to be made elsewhere in more nimble funds," he says.

Strange cycle

Peter Toogood, investment director at Morningstar OBSR, says the UK has had a very strange property cycle, with many property assets re-rated.

"This is reflective of the economy. When interest rates go up there is a clear out. However, this is unlikely to happen in the same way [as in the past]. If there is a slow recovery, property will be reflective of that."

Prime property assets are still relatively highly rated, points out Toogood.

"If institutions can take the duration, yields look attractive. Prime looks better than secondary or smaller lot sizes, where you have an issue with liquidity and constraints inside retail [commercial property fund] offerings. But those with a longer duration mindset should do OK. Commercial property funds are offering 6-6.5 per cent yields, which is good versus cash or bonds."

Property tax break

One positive development in commercial property funds has been the conversion of some vehicles to Property Authorised Investment Funds (PAIFs), which enables part of the fund's income to be paid to investors gross, without the deduction of tax.

One of the first companies to take advantage was M&G, which converted the M&G Property Portfolio.

"PAIF legislation was introduced in 2008, so it's nothing new," says Andrew Watson, director of advisory and partnership sales at M&G.

"It enables eligible investors who were previously unable to reclaim their full tax efficiency to be paid income gross. This means authorised UK property funds can be more tax efficient.

"We expect others will now follow our lead. If you roll the clock forward, I would easily expect in a year or two for all eligible funds to convert to PAIFs."

The conversion process has been complex, says Watson, and others have a way to go. "We've learnt a lot, and it was subject to a shareholder vote. But we did it because it benefits investors, and any costs were paid for by us."

Looking at property as an asset class, Watson says the vast majority of the total return is generated from rental income, which benefits clients in this income-hungry climate.

"This makes the asset class a bit more attractive. It's a cyclical asset class, but at the same time clients are desperate for income. Property is a great source of income – all the evidence points to that," he says.

For him, the message is that diversified portfolios and active management are key.

"It's a question of the client's attitude to risk, but it's a good, non-correlated asset class. We've been very fortunate that our fund has managed very well. It tends to be at the prime end, but has a very diversified geographical and sector base."

Watson says M&G has managed to avoid big blow-ups in commercial property, such as tenants going bust, and expects the good fortunes of the commercial property market to continue to the end of the year and into 2014. ●

Hedge funds: the potential and pitfalls

Man is the second largest hedge fund group in the world. So who better to ask about the changes sweeping the hedge fund industry, and their impact on investors, than its recently appointed chief executive **Manny Roman** – a Goldman Sachs alumnus and former CEO of GLG, which was acquired by Man in 2010 and now forms one of the three core pillars of its alternative investment offering, alongside AHL and FRM?

Is being so big an advantage? The US fund administrator SEI does an annual survey of hedge funds and asserted in its latest report that small funds tend to outperform the multibillion dollar operations. According to SEI, most funds that boasted returns in excess of 20 per cent in 2012 had less than $1 billion under management.

Roman does not buy the argument that small firms do better. He takes the opposite view and is convinced – with academic evidence to support him – that the big funds outperform over time. He believes there is insufficient attention paid to the casualty rate in the sector – the fact that almost 10 per cent of the industry, or 800 funds out of 8,000, close down every year and there is also a roughly similar number of launches.

This means that in five years' time, half of today's funds will have disappeared and been replaced by funds which do not even exist yet.

Of those that will disappear, most will be small and go out of business because they cannot attract enough money to be viable in the long term. Thus it is a mistake to take a view of performance without taking into account the longevity of the fund in question. Judging over one year does not take account of the risk that the fund may fold soon after.

The reality is that the glory days when individuals would leave an investment bank on a Friday and launch a fund with £100 million on a Monday have now gone and are unlikely to return.

The investor base of hedge funds has changed a lot in recent years, with a heavy shift towards pension funds. They want much higher levels of service, more research and risk analysis, and investors in general are much less willing than they once were to give unconditional backing to new groups. They are far more likely to wait a couple of years to see how it performs. So it's chicken and egg. Without money there can be no performance; without performance there is no money.

Luck or skill?

The other thing you can tell in the short term is whether performance is skill or luck. Roman is highly sceptical about star fund managers. Instead his firm is pleased to have people who are right a little more than half the time, their average success ratio being about 55.5 per cent.

Stars are rarely what they seem. To be 95 per cent certain that a fund manager who beat the S&P 500 by 3 per cent a year achieved that result by skill or by luck would require a performance record of 300 years, says Roman. That kind of data simply does not exist, but that is what the maths says.

Rather than putting faith in someone who appears to have a Midas touch, he reckons it is easier – though by no means easy – to try to find people who are simply right more than half the time. Having a win/lose ratio of 52 to 48 is the foundation for a successful firm.

Roman is utterly realistic about where a hedge fund group's performance comes from, and it is not glamorous.

First, he says, they select bright people, invest a lot of time and money in training and then work them hard.

Second, passive investment creates opportunities for those who are active. The sheer weight of indexed money in the markets today throws up anomalies, which can be exploited by the nimble and alert.

Third, hedge fund groups normally cover a range of asset classes and having experts in credit sitting alongside experts in equities means they are better placed than traditionally structured asset managers to see anomalies and opportunities across asset classes.

Fourth, though markets have a lot of institutional money they have a retail mentality and are prone to mood swings and irrational judgements. This also gives hedge funds the opportunity to outperform.

Two things flow from this. The typical investor is unwise to try to manage their own portfolio because the odds are stacked against them. They would be far more sensible to invest through funds – not necessarily hedge funds, but with professional management and a spread. Second, if investing in hedge funds they should expect an annual average return after charges of between 6 and 8 per cent.

One of the main planks of the Man business is FRM, its fund of hedge funds business and the largest outside the US. Here again the conventional wisdom is that funds of funds do not deliver value to compensate for the extra layer of fees that they carry. Roman's view is more nuanced. Performance is only part of the fund of fund offer, he says. Clients also expect risk analytics, portfolio optimisation and sometimes managed accounts, and a high level of service may well be more welcome than a few extra basis points of performance.

Looking to the future

It is important to be realistic about the alternative. First, a fund of funds can gain access to individual funds, which clients could not get into on their own.

Second, it will probably be able to negotiate lower charges than the individual could.

Third, it is not feasible for most investors to do their own assessment of the hedge fund universe – they simply do not have the skills, let alone the time.

Fourth, the infrastructure that a fund of funds can add in terms of risk management and transparency of a hedge fund portfolio would be difficult to get by going directly to small managers.

So what does the future hold for their industry?

Setting to one side the possibility of more regulation – something which is impossible to predict – Roman is an optimist.

The business may be less profitable going forward because it has to carry more regulatory and reporting costs and deliver higher levels of customer service than hitherto, but beyond that, the message is simple.

The golden rule is to remember that clients will not pay for beta – simply delivering market average returns. The customers want performance. Provided the hedge fund manager can deliver that, then it should be able to keep its customers satisfied. ■

"The golden rule is to remember that clients will not pay for beta – simply delivering market average returns"

Putting a price on risk

The new regulatory framework for insurance companies proposes to give a risk weighting to the assets on the investment side of the balance sheet and will require that capital is held in accordance with the risk weighting of the portfolio. **Jennifer Hill** looks at how Solvency II will affect investment allocation

Stringent capital adequacy rules will make it more expensive for insurance companies to hold riskier assets, which could prompt a shift in investment strategy at an ultimate cost to the client.

The new Solvency II rules for insurance companies propose giving a risk weighting to the assets held on the investment side of company balance sheets and will require them to hold sufficient capital to meet liabilities.

This has led to speculation that the holding of equities and illiquid long-term assets will become unattractive, as it will be much more costly in capital terms than an investment in less-risky assets, such as government bonds.

"A more risk-reflective balance sheet and capital requirements could lead some insurers to reduce their investment risk," says David Hare, an insurance partner at Deloitte.

Bad news for pensioners

Hare said a shift in investment strategy would impact insurers' annuity rates.

"Life companies typically back annuities with corporate bonds, property investments and other assets to give a fixed income stream," he says.

"They take investment risk because they have to price the annuity in a way that gives away some of that investment upside risk to the customer, otherwise they wouldn't be able to price the annuity as keenly: it's a very competitive market.

"If insurers have to take less investment risk, the price of annuities is likely to go up. Is that really in policyholders' interests?"

Another big change brought about by Solvency II is that an insurer's liabilities will be valued with reference to swap rates, instead of the gilt yields that are used in many cases, which could spell a mass exodus from one to the other.

"Those offices that currently use gilts to match annuities may well choose to use swap-based strategies going forward," says Hare.

Valuing assets

The details of the directive, which will introduce economic risk-based solvency

> **Insurers are taking a wait-and-see approach and not jumping to any conclusion on the impact on investment strategies or annuities**

requirements across all 27 EU member states, are yet to be finalised.

The directive's main provision comprises two components: solvency capital requirements (SCR) calculated as an estimate of the capital that must be held to meet future liabilities with 99.5 per cent confidence over the next 12 months; and a minimum capital requirement (MCR), a calculation to meet the threshold below which regulatory action would be taken.

A breach of MCR would be expected to lead to quite significant intervention, such as closure to new business if the firm was unable come up with a credible plan to resolve the issue within a few months, according to Hare.

A key consideration for insurance companies will be the calculation used to determine the risk-adjusted valuation of assets or 'relevant risk-free rate'.

"The choice of 'relevant risk-free rate' for discounting technical provisions will influence the matching strategies that insurers choose to follow," says Hare. "Illiquidity is seen as a risk: it's much harder to sell corporate bonds than it is gilts, particularly at times of market stress."

Testing, testing

When it comes to Solvency II, all eyes are on the long-term guarantees impact assessment, which will look at what impact Solvency II rules will have on long-term products and protection. A number of insurers across the UK and the other member states are participating in the assessment.

Standard Life hopes the test period will lead to a system that does not punish insurers for investing in illiquid long-term assets.

Bruce Porteous, head of Solvency II at Standard Life, says: "The Solvency II treatment of equities is very similar to the Financial Conduct Authority's existing ICAS [individual capital adequacy standards] regime and also to firms' own internal economic capital assessments, so we do not see a huge change here."

However, he hopes that the 'matching adjustment', a mechanism used to remove artificial volatility from the assets and liabilities of insurer's investments, will not penalise riskier investments.

"On illiquid long-term assets, we are hopeful that the Solvency II matching adjustment proposal, being tested in the long-term guarantees impact assessment, will result in an appropriate matching adjustment being retained in the Solvency II rules which, therefore, does not penalise investment in illiquid long term assets," he says. "Insurers are natural investors in the type of illiquid long-term assets – like infrastructure project bonds – that are needed to get European economies growing again and we believe that a well-designed and appropriate matching adjustment will allow insurers to invest in these types of assets."

Case-by-case basis

Under Solvency II, insurers will have the choice between using a standard formula or an internal model for calculating their SCR. Internal models have the advantage that they are more risk-sensitive, capture individual risk profiles more adequately and, consequently, reduce capital requirements.

However, one fundamental requirement to qualify for the internal model approach is that the model is "widely used and plays an important role" in the course of conducting an insurer's regular business.

"If it flows though the company and how it makes its decision, then the company should be well placed to get regulatory approval to use this as the basis for SCR," says Hare.

"Insurance companies are full of clever people. If the standard formula for the SCR is less onerous on some asset classes or asset durations, then there could be opportunities for insurers to maximise their return on risk capital by taking advantage of these arbitrage opportunities."

Wait and see

The European Insurance and Occupational Pensions Authority will publish its report on the results of its Solvency II assessment in the autumn.

The directive is unlikely to come into force until the start of 2016 at the earliest, and even then, transitional measures will apply to give insurers time to comply.

"The hope is that before the end of this year, insurers will know the lie of the land," says Hare.

"This has been a very difficult political issue for a number of years and it is not impossible that the final outcome could get postponed again, but the industry really wants clarity over the future treatment of capital structures and investment strategies."

Until then, insurers are taking a wait-and-see approach and not jumping to any conclusion on the impact on investment strategies or annuities.

Porteous says: "Until the Solvency II rules are finalised, it is difficult to predict how insurers' asset allocations might change.

"However, we remain very optimistic that equities and illiquid long-term assets will be treated fairly and appropriately and that they will remain attractive to insurers.

"This will allow insurers to continue investing in long-term investment projects to help European economies start growing again." ●

Investment managers pick up the baton from banks

Banks continue to find it difficult to meet the loan needs of their business customers, but fund managers are beginning to fill the gap. **Anthony Hilton** looks at the growth of loan funds, corporate bonds and private placements

At the Conservative Party Conference back in autumn 2011, Chancellor George Osborne told the party faithful that government was working on a plan to help small to medium-sized businesses access the bond markets.

However, the task proved to be a lot tougher than he suggested at the time. There are reasons why small companies don't issue bonds; investors don't want to buy them and small companies do not want to sell them as the costs involved with an issue can make it a very expensive form of financing for the small amounts of capital they normally need.

It is one of those cases where size does not just matter – size is everything. Big companies can issue bonds because insurance companies and pension funds will buy the debt and hold it, but it has always been the case in this country that the moment you drop below the FTSE 100 the mood changes.

As a result there are virtually no more smaller-company bond issues today than there were back in 2011. It is also the case that the investment banks, which dominate the bond raising business, are only interested in big companies and big investors.

It is quite different in America. Investing institutions in the United States have always been more willing than their UK counterparts to hold corporate debt – so much so that the private placement market is the major source of funds for mid-sized companies there.

But they do not bother having the debt listed, they simply buy the whole bond issue and hold it to maturity or sell it on privately to like-minded institutions.

As a result, bank finance, which is the backbone of European corporate financing, accounts for only about one-third of the money raised in America. That is one reason why they have found it easier to recover from the financial crash.

Change in financing

There is also a long tradition of British companies tapping into this American market because they get no joy at home.

Dairy Crest, a well-known company but nobody's idea of a giant, raised $85 million at a coupon of under 4 per cent. They were one of a crowd that has included Logica, Serco, Capita, Whitbread, Northumbrian Water, Great Portland Estates and British Land.

> **"The investment banks, which dominate the bond raising business, are only interested in big companies and investors**

On a rough measure, around a third of the top 350 have issued bonds privately at some point or another in the US. But again, this is not a market for the really small.

City institutions have been stung by the criticism that British companies can find American insurers to buy and hold their debt, but they can't get British insurers or pension funds to do likewise.

As a result, leading firms like M&G (which is owned by the Prudential) and Aviva Investors have seriously raised their game, and others are also putting toes in the water.

It takes time to build up expertise in non-traditional areas but the aforementioned groups have made huge strides in recent times, first in raising money from pension funds to finance dedicated vehicles geared to providing loans to corporates, and then in deploying these monies. The money is now flowing into business, with the haulage group Eddie Stobart as one famous beneficiary.

An even bigger change in recent times, however, is that mid cap companies have decided to try to raise money direct from retail investors rather than the institutions.

Three years ago, the Stock Exchange launched the retail bond platform to provide a venue where these issues could be floated, bought and sold and it did so because it saw that in Italy such issues were far more popular with mainstream investors than were conventional equities.

It appreciated that the banks were likely to be constrained for some years, so there would be an appetite among companies to try something new and it guessed there would be a willingness among investors to look for innovative ways to get a decent return on their savings.

The demographics are just right too. In an age when more and more retired people are desperate for a secure income, and younger savers are trying to build a solid pension through a SIPP, a portfolio of retail bonds has a lot going for it.

That said, it is always hard to create a new market because no client wants to be first. Lawyers don't want to advise because there are no precedents. Regulators don't want to give approval in case it returns to bite them. Buyers don't want to buy because no-one else has. Sellers don't want to commit in case buyers go on strike and they get tainted by failure.

Corporate bond boost

However, retail investors had already shown their appetite for income and security through the huge surge in the popularity of corporate bond funds.

But there were signs that this was going off the boil as talk of a bond bubble took hold and investors began to show concern about what was under the bonnet, worry about opaque fees and worst of all have no certainty as to the level of income.

A single bond provides that certainty, albeit with a greater risk as it is one stock, not part of a pool. So, after a slow start while people got used to the new idea, it has really taken off. In excess of £2 billion of capital has now been raised in this forum.

Where we are now is that a growing cadre of mid-ranking stockbrokers – firms like Numis, Investec, Oriel and Canaccord – are bringing mid-cap companies to market. They cover all sectors – finance in the form of Tesco Bank, mainstream industrial companies and a lot of issues related to housing associations for residential property development.

Typically, issues are between £25 million and £125 million, normally for five to seven year money, but the sums raised are gradually getting higher and yields are getting progressively lower as the market becomes more established. Two years ago, the pioneers were paying over 7 per cent – today most issues are below 5 per cent.

The clients include wealthy individuals and family offices, but also a lot of mainstream investors who have been unnerved by the volatility of the stock market.

It is therefore very much a throwback to how things used to be a generation ago when private investors would typically have equities, preference shares, conventional bonds and those with conversion rights into equities.

In an age where pension provision has become an individual's responsibility, secure investments with a good yield are likely to form the bedrock of many portfolios.

UCIS – the way forward?

Unregulated collective investment schemes have come in for a lot of criticism, with the regulator clamping down. But is there a way to use them sensibly? By **Jennifer Hill**

Unregulated collective investment schemes (UCIS) have come under scrutiny from the Financial Conduct Authority (FCA) after being mis-sold to retail investors and it is only now that the investments may find their correct place in the market, with sophisticated investors.

After a review of UCIS, the FCA concluded that they are high-risk, speculative investments that are unlikely to be suitable for the vast majority of retail investors. UCIS cover a diverse range of investments, from fine wine to forestry, but despite their esoteric nature the FCA said it has witnessed a "significant" increase in UCIS sales to retail customers and warned it is aware of a "number of risks" in the market.

It is for this reason that the FCA has proposed a ban on the promotion of UCIS to retail investors. It wants the promotion of UCIS to be generally restricted to 'sophisticated' investors who understand the nature of the funds and high-net-worth (HNW) individuals who can afford to take a risky bet on an unregulated fund.

At present, UCIS can be promoted to ordinary retail investors if an adviser first assesses the product's

> **Arguably, few adviser firms have the necessary resources to audit UCIS to truly make sure they understand the risks to their clients and their firm**

suitability. However, the FCA says its review suggests that only one in every four advised sales of UCIS to retail customers was suitable.

Stay clear

Due to the complex nature of UCIS, the fact they are unregulated and the lack of transparency in the funds, advisers are wary of using them and maintain that they are only for experienced investors who fully appreciate the risks involved.

Patrick Connolly of AWD Chase de Vere, says there is "very little need to take the risk, both for ourselves and our clients, of using unregulated products when there are more than sufficient options available in the regulated arena".

The fact that UCIS are not covered by the Financial Services Compensation Scheme (FSCS) is just one of the reasons Adrian Lowcock, senior investment manager at Hargreaves Lansdown, doesn't recommend the funds.

"I don't get involved in these because they are unregulated, don't have the same levels of investor protection and are not subject to the same sort of restrictions in terms of how they are managed. They are not suitable for the retail investor."

Austyn Smith, wealth management director at Austyn James Consulting, also has reservations about UCIS.

"I am not keen on UCIS due to their high level of specialisation and lack of clarity on those in control of the holding companies,' he says.

"I am not an expert on wine, so how can I assess if a wine investment is appropriate, or that those purporting to be experts really are?

"While these facilities may have HNW, sophisticated investors in mind, using wine as an example, wealthy individuals would most likely do best to go to a well-known wine merchant and invest directly with the experts."

He believes there should be a high minimum investment level to "dissuade investors who might otherwise be led astray by the marketing of easy gains, which in reality may be harder to come by".

Costly compliance

Arguably, few adviser firms have the necessary resources to audit UCIS to truly make sure they understand the risks to their clients and their firm.

Jamie Donald, managing director of Donald Asset Management, says: "We have what we call our 'due diligence budget', which put simply is the amount of resources we have available to conduct sufficient due diligence on any fund or product.

"We see ourselves as risk managers, not performance chasers, so understanding all of the risks involved with any product is absolutely crucial.

"Where a product is non-mainstream with limited independent past performance data available or unusual characteristics, this quite obviously requires a far greater understanding of the product and a higher level of due diligence."

He says that the complexity and esoteric nature of UCIS makes them difficult for advisers to assess fully.

"In many cases, an exotic non-mainstream investment would effectively be beyond the capability of a financial adviser firm to conduct appropriate due diligence and, therefore, advisers need to be incredibly wary before recommending such products to their clients," he says.

Austyn believes advisers need to look at the risk UCIS pose to their business, as well as the risk for clients, as professional indemnity insurers charge higher premiums if an adviser wants to write such business.

"While unregulated [investments] are not covered by the FSCS, recent cases have confirmed that a regulated adviser is responsible for the promotion and sale of UCIS if something goes wrong," he says.

Mis-selling scandal

Carl Melvin, managing director of Affluent Financial Planning, is even more critical of UCIS, believing they could be the source of the next big investment mis-selling scandal.

"Although the FCA says a financial adviser must consider all options to be able to demonstrate independence [under the retail distribution review – RDR], I have strong reservations about the use of UCIS," he says.

"UCIS have been used inappropriately, leading to consumer detriment. I cannot think why an adviser would use UCIS other than the desire for substantial gain."

He gives the example of a client who transferred pension assets into a SIPP and invested the pension into UCIS, which in the pre-RDR world led to a big commission payment to the adviser.

"There's more to come, I suspect: watch this space for the next scandal," says Melvin.

Testing the water

Others, however, have dipped their toes into the UCIS water. In 2011, Nigel McTear, owner of Independent Financial Planning Services, recommended a UCIS to an entrepreneurial, ultra-HNW client who was looking for a suitable investment to meet a specific need.

"He invested, the investment performed exactly as expected, he exited the investment as planned and was delighted with the outcome," says McTear.

Despite this success, McTear wouldn't use UCIS again. "They've become too toxic, too many have run into problems and they compete for space against some excellent regulated, recognised and non-UCIS specialist investments that frankly make UCIS a step too far," he says.

"Post-RDR, the commission bias might have disappeared but the other issues remain. Is there a way to use UCIS sensibly? The short answer is no."

However, he urged the FCA to avoid throwing the baby out with the bathwater as there is a "real risk" that venture capital trusts and enterprise investment schemes will get swept up in the regulator's review and that non-sophisticated investors will be deprived of accessing these tax-efficient investments.

"The ultimate loser will be new businesses," added McTear. "Having lost the support of their banks they now risk losing access to a vital source of venture capital."

Monitoring multi-asset funds

On the face of it, multi-asset funds offer similar advantages to multi-manager funds, at a lower cost. However, advisers need to act with caution and monitor what the manager is doing to make sure it tallies with their client's risk profile. By **Stephen Spurdon**

Where the US leads, the UK follows and the growth in multi-asset funds has predictably started across the water. But before they jump in, advisers must ensure the funds are living up to the risk profiles they promise.

Any fund using more than a single asset class could be called 'multi-asset' but the original format was based on 'balanced managed' institutional funds, which typically invested in equities, fixed interest, cash and property.

As the sector has grown, other asset classes have been added, such as commodities and debt instruments. In some cases the investment will be direct, but in others managers will gain exposure through buying funds, much like multi-manager, and many offer a mix of the two. Aside from that, funds vary in the strategies employed and how the fund's performance target is defined.

Born in the USA

The vogue for multi-asset arose because of the performance of large US university endowment funds whose spread of assets held were seen to have enabled them to ride out market turmoil.

Simon Armstrong, founding partner of Saltus, explains that while the endowment funds can manage a true multi-asset style, as they have long investment horizons, it cannot be truly replicated in the UK. This is because "in the UK the demand on open ended multi-asset funds is for daily liquidity, the managers usually have much smaller amounts of money at their disposal and they are of course judged on a much shorter-term basis".

The current multi-asset offering spans two basic approaches: the first is balanced managed in style and performance targeted, the second emphasises tactical asset allocation and has risk or volatility targets.

Fund evolution

The evolution of multi-asset is well illustrated by BlackRock's range of funds, which go back to the Mercury Asset Management days of the organisation. Four actively managed Portfolio funds were launched between 1989 and 2006 and its five Consensus funds are more recent.

The Portfolio range is balanced managed style, while the Consensus range is the risk-rated type of instrument. Tony Stenning, head of UK retail at BlackRock, says the Consensus 85 fund, which has a maximum equity exposure of 85 per cent, was originally launched as a life fund around a decade ago, being moved into the company's unit trust side in August 2005.

Despite snide remarks about the higgledy-piggledy assembly of such a range, it reflects the development of the multi-asset concept over time. It could also be said that it matters less what strategy the fund works to, but what return that strategy produces at the end.

Risk fits

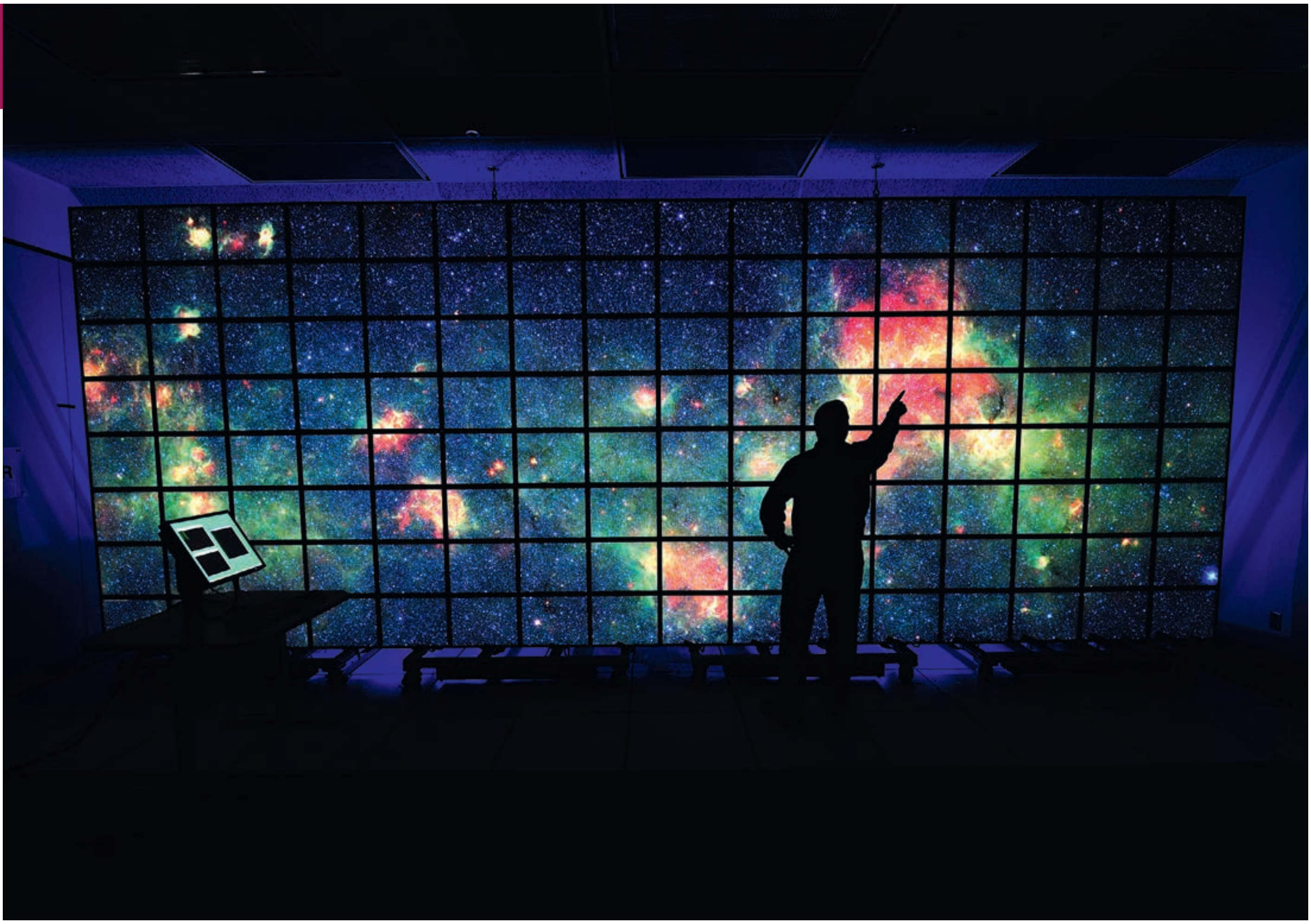
Due to the interchangeable nature of multi-asset strategies, advisers must ensure that the risk profile the fund is working to fits with their client's appetite for risk.

BlackRock's multi-asset funds are risk-rated by Distribution Technology, as is the case with Allianz, Fidelity and Rathbone, but most asset management companies typically use their own internal asset allocation models.

Octopus Investments has gone one step further when it comes to specifying risk. Not only has it designed its own risk profiling tool with Barrie & Hibbert, its determination to stick to risk bands is more than just an aim or stated target; managers are mandated to target a certain level of risk in their funds.

Similarly, Mike Webb, chief executive officer of Rathbone Unit Trust Management, says its multi-asset funds operate with a risk benchmark. "The aim is to achieve the return over a cycle but in fact we are more determined to stay within the risk parameter set by the fund's mandate," he says.

As a further inducement to maintain the risk profile, Allianz Global Investors



imposes a penalty. Fraser Blain, head of UK advisory and strategic distribution, says this means that if the fund risk profile changes, the 0.75 per cent investment management fee is waived for the following three months.

Targeting risk

Oliver Wallin, investment director in the multi-manager team at Octopus, says mandating risk targeting ensures a higher level of commitment to remain in a volatility band and ensure a closer alignment of interest with the objectives of advisers and clients.

"With the retro-risk rating of existing multi-asset funds, the challenge for advisers is that this alignment is not there. The fund manager is not mandated to manage the money to a certain level of risk. Risk rating just provides a snapshot of the fund at a given moment in time and risk rates it accordingly," he says.

Ratings produced by the ratings agencies may include some measure of volatility in their calculation, but as with all such measurements, this is a backward glance and a poor measure of just how risky multi-asset funds are.

Steven Edgley, head of institutional product and investment directors at Fidelity, says: "Of course, it is anomalous that the industry makes such a play of 'past performance is not a guide to future performance', but past performance is what the aggregators are using to describe the 'risk' of funds. Is past performance data indicative of future risk levels?"

James Klempster, manager of multi-asset portfolios at Momentum Global Investment Management, agrees that ratings agencies may not be the best gauge of risk.

He adds that "the quantitative approach tells you very little about where the fund is going to go in the future. For instance, we tell clients they can't buy past performance but that you can buy the process that delivered it."

However, there may be some movement from the data aggregators to properly assess multi-asset funds, according to Blain. "We are in conversation with them. They appear to be reacting to the need to provide advisers with an enhanced service with regard to multi-asset."

Adviser risks

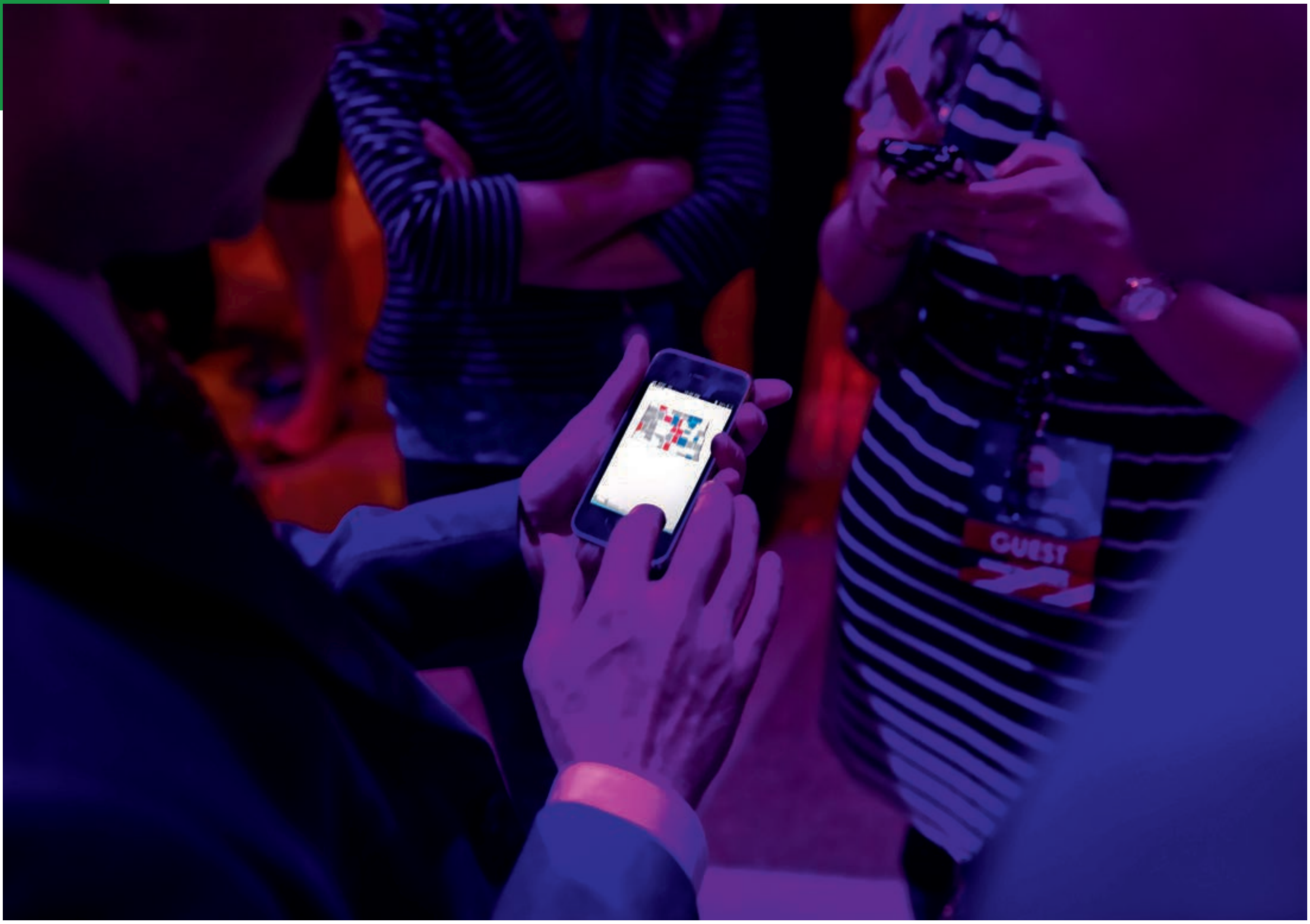
Even where funds have a risk objective, the method of asset allocation can have pitfalls. Webb warned advisers to be wary of mixed-asset funds where the portfolio is populated on the basis of the long-term stochastic model, which is backward-looking and allocates assets on the basis of their historic risk/return profile.

If risk or volatility bands are not stipulated in the fund's mandate, anything written elsewhere, such as in factsheets, is irrelevant. Advisers must also note that in performance tables, all that is being measured is relative value.

Unfortunately for advisers there is not one way to determine whether a multi-asset fund is sticking to its risk profile.

They must keep a robust watch to not only determine whether the funds are hitting adequate risk levels, but more importantly that the funds still remain suitable for their clients.

> **Risk rating just provides a snapshot of the fund at a given moment in time and risk rates it accordingly**



Is there anybody out there?

Many pundits have said that the firm of the future will use social media to maintain regular contact with its clients. But is anyone actually doing this and, if so, how does it work in practice? By **Gill Wadsworth**

Whether an adviser is trying to attract new clients, rebrand their business or build a media presence, one thing is certain – they can no longer ignore the importance of social media and the benefits it can bring to their company if used correctly.

Almost 90 per cent of households in Britain have at least one mobile phone, an increase from just over half at the turn of the century, according to 2011's General Household Survey. This huge growth in telecommunications alongside our almost universal computer ownership represents the importance of the digital age to today's homes and businesses.

Whether using smartphones, tablet computers, laptops or PCs, consumers expect to be able to interact with suppliers online and the use of social media sites – such as Twitter, Facebook and LinkedIn – has come to represent a critical part of companies' communications and marketing strategies.

A survey of financial services companies conducted by Corporate Insight last year found 92 per cent of firms actively engage with clients through Twitter, while 88 per cent had a presence on Facebook.

Martin Dodd, an independent financial adviser based at the Midlands Investment Agency, uses a range of social media to reach both journalists and potential clients, and he believes advisers disregarding these channels do so at their peril.

He says: "Social media is here to stay and if financial advisers ignore it then they are missing a potential avenue for business, or at least getting word out to potential and existing clients."

Learning curve

Advisers can learn some lessons on how to use social media from larger business which have, as might be expected, a notable presence on most of the major social networking sites.

Mercer uses Twitter, Facebook and LinkedIn, targeting each site

"At a breakfast networking event there might be 30 people attending of whom I will probably talk to about 10. On Twitter I have 1,400 people following me and I can communicate with all of them in one tweet

for a specific purpose. Facebook, for example, provides access to graduates and acts as a means of connecting with future personnel. The company also uses LinkedIn to instigate debate and share ideas and Twitter to promote thought leadership.

Similarly, Aon Hewitt uses Twitter and LinkedIn but it does not have a presence on Facebook since it sees the site as personal rather than professional.

Sarah Lane, digital marketing manager at Aon Hewitt, says: "LinkedIn and Twitter are a lot more business orientated [than Facebook]. People expect to see things related to their business and work issues on those sites, whereas Facebook is more focused on friends and social life."

An obvious benefit to using social media is the global reach networking sites can offer. Social media opens up an audience that is otherwise beyond the scope of most smaller businesses and maximises client potential.

Dodd says: "Using social media means you can speak to so many more people. At a breakfast networking event there might be 30 people attending of whom I will probably talk to about 10. On Twitter I have 1,400 people following me and I can communicate with all of them in one tweet."

Social media rules

What you say and how you say it matters just as much online as it does when speaking to contacts in person or though other media.

Pete Matthews, director at Jacksons Wealth Management and founder of meaningfulmoney.tv, which uses online video to share ideas and connect with clients, says social media should be treated as a good conversation and not be seen as an opportunity for pure self-promotion.

"Treat Twitter as you would any ordinary conversation. If you were at a dinner party and you just shouted about how great you were no one would want to sit next to you. Social media is the same, you want to make a good impression," he says.

Matthews' dedication to social media started in 2010 when he first starting posting videos and blogs on his own site. In the space of three years the site has become the second biggest introducer of new clients to his regulated financial adviser company.

"It has taken three years of busting a gut to get any sort of payback but I have a sponsor now and more importantly [the online videos] drive new business," he says.

Dodd also says he has amassed new clients from connections made on social media, while Mercer has driven pension fund trustees to its seminars and events using Twitter.

Matthews says posting video online allows potential clients to connect with you in a way that isn't possible via traditional advertisements on radio or in the press, and it also costs less than a national marketing campaign.

"My first client in 2011 sent me an email out of the blue to say they'd found me via Google. They said 'having watched several of your videos we feel like we know you and can trust you', and that is exactly what it's about," says Matthews.

Digital regulation

While the spoils of an effective internet presence are clear, financial advisers should still tread carefully.

The Financial Conduct Authority (FCA) subjects social media to the same rules and regulations as all other financial material. However, Matthews does not see that this should present any genuine stumbling blocks.

"If any competent adviser fell foul of the financial promotions rule on Twitter they would have to be so monumentally stupid that they deserved it. It isn't difficult; keep the information generic and use disclaimers," he says.

Current FCA guidance may not go any further than the usual promotions regulation but as advisers' use of social media advances, the watchdog is likely to revisit its oversight of how online networking is employed by the industry.

Dodd says: "Definitely the FCA is looking at what people are saying, but it has some catching up to do in terms of what social media can be used for."

Where once the telephone was seen as an innovative and potentially intimidating piece of equipment, it is now ubiquitous, and the same is set to be true of the internet.

New wave

Those advisers that embrace the digital age and learn to use the plethora of tools out there will be the best equipped to meet the new wave of clients looking for financial support and advice.

Matthews concludes: "Other advisers are starting to follow suit and using more digital communication. The internet is a big place and the more people that fill it with useful information, the better it is for everyone."

Adopting the family office model

Financial advisers are following in the footsteps of wealth management firms and adopting family office models. This not only allows them to advise multiple generations of one family but also to link up with private banks to offer specialist lending facilities and fund management, as well as philanthropic services. By **Tim Cooper**

The number of advisers chasing high-net-worth clients continues to grow, but for the select band that has been serving wealthy clients for some time, one way to differentiate further is a family office proposition.

While many planners advise families without calling themselves a family office, an increasing number are building a dedicated brand and a proposition around the concept to attract more wealthy family clients and compete with private banks.

Their first step is usually to partner with other professionals to create an overall package that can include bespoke legal, accountancy, wealth management, philanthropic and private banking services.

"Planners now have access to the necessary tools, technology and resources to compete directly with the private banks in the family office arena

Advisers with financial planning skills are well positioned to have deep conversations with clients about their life goals. This enables them to take on the role of 'trusted adviser' by co-ordinating their team of experts to deliver integrated advice across all of the family's affairs.

In order to position their services in this market, advisers are also investing in their brand to create a luxury feel. Though it makes sense to invest in a smart office, experts say you don't necessarily need to match the plush premises of the private banks as long as your client experience and supporting materials genuinely set you apart.

Advisers expanding into the family office area are likely to already have a few wealthy family clients. In addition to client referrals, a good way to find more is via referrals from professional connections that already operate in this area.

Top advisers are adopting a targeted approach to this by using a structured engagement process; seminars and continuing professional development (CPD) related events are also a good way to add value and deepen these relationships.

Testing the water

Abbie Tanner, director of A Business Innovation, says that planners now have access to the necessary tools, technology and resources to compete directly with the private banks in the family office arena. However, she warns that a multi-family office proposition takes time to build.

"Before jumping in they need to set their strategy, then test and refine the proposition," she says. "Often these businesses only have a small number of clients who fit the target profile and who need a family office service. By completely shifting focus, advisers risk alienating or cutting off profitable client segments."

Tanner's advice is to host a panel with a small selection of top clients to gather feedback on the new services they are considering.

"See if they would value this offering and find out how best to price and market it," she says. "If the panel would not value a family office service, then you could avoid a costly mistake.

"One adviser we work with is building a family office around his own need for such a service, as a successful business owner. He understands the positioning and the audience [because it is] people just like himself and his wife. Unlike many advisory firms jumping on the family office bandwagon, he is taking time to test and refine the model prior to launch."

Taking on the banks

Managing director of Yellowtail Financial Planning Dennis Hall says operating as a family office is a good opportunity for advisers.

"Private banks don't offer a decent service below £5 million [investable assets]," he says. "We can access technology that allows us to replicate what they do easily. They just use funds, which we can get at similar prices on good platforms, so they don't offer much other than a name, which they charge a chunk for. We can deliver a better service and relationship because we stay, whereas in large organisations people shunt around."

He says the family office is a natural extension of the wealth manager's role: "While our job is primarily to help [clients] preserve and enhance wealth, from a long-term business planning view, we also want to ensure that it is transferred properly and efficiently and to look after the next generation. Some clients ask us to get involved with educating the children to avoid the risk of that wealth disappearing.

"I am not sure the children necessarily relate to me or I to them," says Hall. "But having younger

> **There is no escape from investing in premium marketing if you want to operate a family office**

advisers in the business helps build relationships with the generations."

This can mean taking on work that is unprofitable in the short term, but those with a family office approach take a longer-term view.

There is no escape from investing in premium marketing if you want to operate a family office, says Hall. But he adds: "We are nimbler than a larger organisation and you need cleverer marketing.

"For example, I know people who have put together high-profile events such as drive days for their clients and invited them to bring a friend. They picked up work by appealing to people in that way. We are working on an event for this October."

Brett Davidson, chief executive officer of FP Advance, agrees with Hall that there is a good opportunity in the £1 million to £5 million asset space. He says: "Many advisers have already evolved this service unconsciously, but they could package it and market it much harder. It is a great opportunity to partner with your professional connections by including them in the service rather than just begging for business."

Succession clients

David Crozier, director at Navigator Financial Planning, has joined other top advisers on a family office fact-finding mission to Switzerland. He agrees that a good financial planner can do the job better for less cost than some dedicated single-family offices.

"Our family office offering has evolved organically but, post-retail distribution review, we put it down on paper and turned out a high-quality brochure," says Crozier. "We will actively look for this business now. We have partnered with a private bank and will partner with a few solicitors."

Crozier adds that family clients "are brilliant compared to entrepreneurs. They think long term – 20 or even 50 years. Entrepreneurs think in terms of five years".

Louise Oliver, partner at Taylor Oliver, also focuses on this market as part of her top-level service offering: "At the initial meeting, we ask clients to draw up their immediate family tree," she says.

"This often leads to us having three generations in the boardroom and into advising on family trusts and gifts. It is very powerful.

"If a client pays you £15,000 to £20,000 a year, you can afford to embrace the family scenario. Thinking forward, you want [the children] on board. It is great for our succession."

Association of APFA Professional Financial Advisers

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APFA is the voice of the financial adviser profession. We lobby the Treasury, FCA, government, the EU and other opinion formers and policymakers to ensure the regulatory and business environment is positive towards members. APFA's objective is to play a critical but constructive role within the regulation process – offering insights from the 'front line' of the market. As a non-commercial, not-for-profit trade body we exist solely to bring about a better business environment for members.

We're recognised in the financial advice profession as having a positive impact on the marketplace and the commercial operations of our members. There is a clear need for intermediaries to speak and our role is to co-ordinate a united front by influencing the decision makers to direct policy towards an appropriate and proportional regulatory structure and better define practical policy.

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It's a great time to be joining an association that's recognised as a leading voice for the financial adviser community. Together we can influence the delivery of better trading environments and fairer policy decisions, too.

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