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Chairman's foreword

Welcome to our new edition of *Expert Adviser*. This next year will tell us a deal more but we're beginning to see the shape of change coming in the approach from the new regulator.

The FCA has set out an agenda that I hope will lead to better regulation and a better deal for advisers. Greater transparency; more emphasis on markets that work rather than rule making; measurable performance indicators; and, not least, better value for money. We will soon see whether the FCA can deliver on this.

As we look to the future, the impact of the RDR on adviser numbers and the rising cost of giving advice places greater focus on access to advice. In September, APFA launched its Regulatory Dividend campaign. The campaign is aimed at lowering the direct and indirect costs for an advisory business but not the standards of consumer protection. We believe the FCA could do much to help, such as in respect of reporting, fees and the introduction of a long stop. This will be a priority going into 2014.

Already we have seen an acknowledgement that financial advisers have been paying fees which are too high in proportion to the risk they pose and the FCA is consulting on revisions to the way it calculates fees to give a fairer settlement next year.

This is just the start. We will be pressing for further changes when the FCA looks at the whole system early next year. Changes to the MAS fees should see further rebalancing for advisers. The National Audit Office will be reviewing the FCA for value for money – finally providing some much needed scrutiny of regulatory costs.

The FCA is also looking at the data it collects. The project has the right aims – to minimise the burden on firms by seeking to ensure that only what is needed is asked for and seeking alternative sources for information. APFA will work with the FCA to ensure that a proportionate outcome is reached.

In addition to this, the FCA is deferring the implementation of its new capital requirements. APFA raised concerns about the proposed changes, asking for a simpler way of calculating capital. The review will give firms some breathing space and streamline the way capital requirements are calculated. So I have some hope for a better deal for advisers in the near future.

Prevention is better than cure. APFA has been active at a European level with three proposals that will affect advisers in the future. In the course of the legislative process, often odd proposals emerge that require vigilance to spot and co-ordinated effort to remove. APFA, working in partnership with associations from other member states, has managed to see off proposals to make advisers jointly responsible with insurance product providers for their Key Information Documents and an attempt to cap charges for advice. But we need to remain active to ensure the final rules do not include such measures.

This is a brief flavour of some of our recent efforts on your behalf. I hope you enjoy the magazine.

The Rt Hon Lord Deben

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Bridging the advice gap

What the regulator demands is not an economic proposition for the adviser, says **Anthony Hilton**

Back in 2010, the Financial Services Authority's then chief executive Hector Sants told a Parliamentary Select Committee looking into the possible impact of the retail distribution review (RDR) that the regulator expected only between 10 per cent and 20 per cent of independent advisers to drop out of the market, "...otherwise we would not be doing it".

In the event, the drop-out of advisers has been far higher and, in addition, the banks that provided a sort of half-way house have also drastically scaled back their role as advisers and intermediaries – starting with Barclays in 2011 through to Santander earlier this year.

To fill that gap, the regulator rather hoped that the Prudential and the other big insurance companies would come back into that space, obviously not as independents but with some ability to hold the client's hand. But the savings industry – with the exception of Legal & General – has shown little desire to do so.

The combined result is an advice gap. The vast majority of the population who would benefit from a bit of hand-holding and guidance don't get it because they cannot afford to pay for it. This matters because in many ways investment is like amateur tennis – it is the unforced errors that cost you the game.

However, today it is exactly those people who need help in avoiding those errors who can get no help at all unless they go in search of web-based advice, such as that provided by the Money Advice Service. Welcome to the world of unintended consequences.

In most business sectors the unforeseen consequences would be a sign to pause – a hint that perhaps too much was being attempted too quickly. But not so in this space. Instead, the regulator is now putting similar pressure on insurance brokers so that they too are having to raise their game. In principle this is a good thing – or at least hard to argue against – but in practice it threatens (as with financial advisers) to squeeze out a lot of players and thereby leave a lot of clients with no advice at all.

It is the usual problem that what the regulator thinks is desirable in terms of treating the customer fairly is not an economic proposition for the adviser.

The regulator thinks that putting together a proper financial advice package for a client, even with relatively simple needs, should involve at least five to six hours' work by the time meetings, travel and regulatory paperwork have been dealt with.

Most advisers need to value their time at a minimum of £150 an hour – to cover the costs of premises, staff and everything else. That means the adviser has to charge the client between £600 and £1,000 as a minimum. Unless the client has at least £50,000 (where £1,000 is a 2 per cent charge) or better still £100,000 (where it becomes 1 per cent) the cost of advice is prohibitive.

Personal responsibility

Regulation has created a crisis among advisers, which is no less real for being invisible. The fashion at the moment is to pretend that the problem does not exist. But if the country is serious about developing a sense of personal responsibility towards financial matters in the population at large, it has to understand that the system it has put in place is not fit for purpose.

The advisers who survive are well placed to support fee-paying clients. But the bulk of the population is left to fend for itself. That surely is not the way to rebuild a savings culture.

> **"Regulation has created a crisis among advisers, which is no less real for being invisible**

Best of a bad situation

The Financial Services Compensation Scheme (FSCS) gives customers the confidence to trust – and thereby supports the whole financial industry. However, the cost of failures has grown massively and the debate on who should pick up the bill continues. **Anthony Hilton** meets **Mark Neale**, the chief executive of the FSCS

There is a useful rule of thumb in the financial sector that the cost to the industry of regulation and compliance is roughly four times what is publicly spent by the official bodies.

Thus when the annual budget of the Financial Services Authority was £200 million, then the industry was reckoned to be spending an additional £800 million internally.

Now that the combined annual cost of the Prudential Regulation Authority, the Financial Conduct Authority (FCA) and various affiliates is running at close to £1 billion, then by the same rule of thumb the industry as a whole is spending £4 billion – enough every two years to stage the Olympics.

There is, however, one paradox. One would have thought all this spending would lead to a safer industry less prone to disaster.

But interestingly the cost of compensation to clients for various industry failings and failures has also risen steeply over the years. Massively more is spent on compensation to clients in this highly regulated world, than was spent in more carefree days.

> **"Interestingly, the cost of compensation to clients ... has risen steeply over the years. Massively more is spent on compensation in this highly regulated world than was spent in more carefree days**

Protecting the innocent

It is, however, a false comparison. Mark Neale, the chief executive of the Financial Services Compensation Scheme (FSCS), points out that it is not the job of the regulator to stop firms failing, and neither in a dynamic capitalist system is that desirable. Rather it is part of the role of the FSCS to make sure that there is no risk to the wider system when firms fail, and that no failure should be at the expense of the innocent bystanders and clients.

It is true too that while the FSCS has paid out the astonishing total of £26 billion (yes billion) to 4.3 million people since 2001, by far the largest slice of this arose from the banking failures of 2008.

The FSCS, for example, was instrumental in providing the funding for Santander to take over the retail deposit accounts of Bradford & Bingley. It cost the agency billions to do so because it had in effect to give Santander the cash to cover those deposits. It got that money in the form of a multi-billion loan from government, which still remains on the FSCS books and costs just under £400 million a year in interest charges – the idea being that it will ultimately be paid off with the proceeds of the disposal of the bank's assets.

This process, it was reasonably decided, was a better outcome for customers than simply compensating them directly for their lost deposits because it meant they still had access to banking services.

> **“The FSCS does its best with its budgets, but it is in the nature of financial failure that it is unpredictable, therefore the special levies are too**

Central purpose

This focus on getting the best possible outcome in what is inevitably a bad situation plays to what Neale sees as the central purpose of the FSCS. It is there to give customers confidence and to underpin their trust in the system. In this way it makes the public more willing to buy financial services and therefore supports and promotes the entire financial industry.

He is nevertheless conscious that sudden demands for money can be a problem for practitioners. The FSCS does its best with its budgets, but it is in the nature of financial failure that it is unpredictable, and therefore the special levies are too.

There is one obvious solution which would be to pre-pay – for the industry to build up a compensation fund big enough to deal with the problems as they arise, so that it does not have go back to its members each time there is a big failure.

Neale thinks such an idea has merit and ought to be more fully discussed by the industry than it has been. The downside of course is that firms would have to find the capital in advance; the plus is they are much less likely to be frustrated by demands for more. Consensus is important, however, so it is something the industry would have to ask for rather than something for him or the regulators to impose.

Instead, starting next year the FSCS is going to try smoothing. It will try to forecast costs over three years rather than one year ahead and collect one third of this 36-month total each year. It will not remove the possibility of special levies, but it will give firms three years of visibility about the size of their main contribution.

Scale of payments

Another idea to spread the load more fairly is to link the money firms pay into the compensation scheme to the riskiness of the business they do.

Thus a financial adviser whose clients generally opt for mainstream plain vanilla products might pay less than a similar sized firm where the clients were loaded with investments from the more exotic end of the spectrum.

The idea is that there would be a differential scale of payments to reflect the fact that different products carry different levels of risk. There are other possible risk differentiators too.

The problem is not in the theory. The problem Neale says is in operating such a system in a way that would

> Simply thinking that risk weighting would be nice to have or the right thing to do is not enough. Someone in the industry has to put in the effort to devise a workable system or it simply won't happen

be accepted as objective and fair to all involved. One senses a note of frustration here – a sense that he feels the industry could do more to help itself. He would like to see it get behind the concept and put in some serious work to see if indeed it might be made to work in practice.

Simply thinking that risk weighting would be nice to have or the right thing to do is not enough. Someone in the industry has to put in the effort to devise a workable system or it simply won't happen.

Insurance issues

Another approach might be to tackle the problem through professional indemnity (PI) insurance. In theory, firms doing riskier levels of business ought to pay a higher insurance premium and to some extent they do.

In theory too, when a firm fails in circumstances where it will provoke a claim on the fund, one might expect the adviser's PI policy to pick up the tab.

Again though it does not always work like this. In some cases the claims excesses on the policy are greater than the capital of the firm. Increasingly this will be combined with exclusion on the policy, which says that it does not respond to demands from the FSCS.

Thus the compensation fund cannot claim on the PI cover even when it is the failure of the adviser which has caused a claim on the fund.

The obvious solution to this, one would think, would be for the regulator to decree that such exclusions in PI policies are not acceptable.

The result might be to push the cost of PI insurance up for everyone, but the more dangerous firms would pay proportionately more. That in turn might pressure them to tone down their activities so that they live less close to the edge and thereby become less likely to fail.

Again, however, this is not a change which Neale or the FSCS could make – any initiative would have to come from the regulator and the industry. But it is something the regulator is engaged with and thinks is a big issue. So it is not beyond the bounds of possibility that something might happen.

Potential losses

There is therefore much to be positive about in the way in which the FSCS is going about its task and this is something the financial adviser community needs to bear in mind as we come finally to the bad news.

Early in October, the FCA declared a financial advisory firm called Catalyst to be in default and at the same time liquidation proceedings began in London against ARM, a Luxembourg-based provider of the structured products that Catalyst distributed.

It all had uncomfortable echoes of Keydata, even to the extent that the structured products were based on second-hand American life assurance policies, but thankfully the likely claim on the fund will be very much less than Keydata's £330 million.

Nevertheless, Neale at this early stage thinks the loss will be in the tens of millions and that will most likely have to be funded by a special levy on the advisory community early next year.

Given that the sector is already scheduled to pay a normal levy of just under £80 million, it is quite easy to see circumstances where it will be paying at least 25 per cent more.

News digest

Michelle McGagh looks at the key issues of the quarter

When the Financial Conduct Authority (FCA) took over from the old regulator in April, it made it clear that it would be tougher and more proactive, and it is proving true to its word with a catalogue of enforcements and clamp-downs.

Much of the focus of the new-look regulator has been on the banking sector, which has been hit by scandal after scandal – from Libor rate-rigging to interest-rate hedging, and the near-collapse of the Co-operative Bank.

Unfortunately for advisers, the poor practices of banks often reflect on them in regulatory burden and cost, something which APFA is fighting hard to correct by campaigning for a regulatory dividend for advisers who have fully embraced the retail distribution review (RDR).

Product scrutiny

The spirit of the RDR is failing to filter through to bank staff and the FCA reported it still has concerns about the mis-selling of investment and protection products. Martin Wheatley, FCA chief, said moving away from rewarding staff for high sales would not stop mis-selling.

To try and counter this problem the regulator will start to look at product design and performance in its scrutiny of banks.

Next scandal

As if the banks hadn't been at the core of enough scandals, there is another looming on the horizon: forex trading.

An investigation into the potential bank rigging of the foreign exchange market is the new focus of the FCA, which is working with organisations in the UK and abroad. As the mess of the Libor rate-rigging continues to unfold, it looks as though UK banks could find themselves in more hot water.

> **"An investigation into the potential bank rigging of the foreign exchange market is the new focus of the FCA**

Naming and shaming

Those organisations under the FCA's watch have even more to fear. Under new parliamentary powers it now has the ability to name and shame firms, and even individuals, that it is investigating. It will publish warning notices against firms ahead of completing enforcement action and can make a decision to name individuals as well.

Pressure from APFA, however, has ensured the FCA will take into account the size of the firm in question before issuing warning notices and more prevalence will be given to discontinuance notices.

Chris Hannant, director general of APFA, said: "We're pleased that the FCA has listened to our concerns, particularly around how notices of discontinuance are publicised, and that they will be doing more to ensure they get the same prominence as the original warning notice."

Sipp complaints

The Financial Ombudsman Service (FOS) doesn't shy away from pointing the finger at below par companies either. It reported a 33 per cent rise in Sipp complaints in the three months to the end of September – it also saw increases in the number of personal pension and annuity-related complaints.

It received 176 complaints related to Sipps over the period, up from 132 in the previous three months. Personal pension complaints hit 381, up from 330 in the previous three months and annuity complaints rose from 172 to 202 over the same period.

Considering the figures, it is no surprise that a third thematic review of Sipp providers has been launched. The regulator has written to operators to warn them it will look into firms' financial resources, quality of business and operational procedures and controls.

Prince Charles wades in

If it wasn't bad enough for the pensions industry that the FOS and the FCA are breathing down its neck, Prince Charles has waded in too.

It is the first time the royal has spoken out about the pensions industry and he was not particularly complimentary, saying the focus on short-term gains was "unfit for purpose" and calling on the industry to design a pension system "for the 21st century, not the 19th century".

Not very liberating

One area of pensions that is certainly not fit for purpose is pensions liberation, upon which HM Revenue & Customs has announced a crack-down. It has toughened up its pension scheme authorisation procedure and moved away from its 'process now, check later' approach.

The taxman will halt transfers to schemes that it has concerns about and will now provide details of the status of a pension scheme to a transferring scheme without seeking consent from the receiving scheme.

Compensation awards

Turning back to the FOS, advisers have been looking with interest at a landmark legal battle, which will determine whether investors can sue firms for compensation after they have accepted an award from the Ombudsman.

The case centres on Focus Asset Management & Tax Solutions and clients Barry and Julie Clark. The court is debating whether the Clarks, who lost £500,000 after being mis-sold an endowment policy, can receive further compensation from the firm, despite being awarded the maximum pay-out of £100,000 from the FOS already.

In December 2012 the High Court ruled they could claim further damages, but the firm successfully applied for an appeal in April. The lawyer for Focus said allowing further claims would see clients use the FOS as a "stepping stone" to make future claims.

FSCS scope

The FCA is consulting on widening the scope of claimants eligible for FSCS compensation. It is looking to allow all unincorporated associations and certain large partnerships to become eligible for compensation if an investment firm fails. The FSCS estimates that the changes would apply to 5,000 associations and 24,000 partnerships.

Trained focus

The FSCS consultation isn't good news for advisers and makes APFA's plea to the regulator even more urgent. It has urged the FCA to look at the heart of the problem, rather than at advisers in order to prevent further investment failures like Arch Cru and Keydata.

In its response to a regulatory guidance paper, APFA urged the FCA to look less at distribution of investment and more at product design. In its response APFA said "the damage was too often done by the time [the regulator] intervened."

"We accept that financial advisers should only recommend properly researched and suitable products to a client, but it must be the case that a product description issued by a regulated firm can be relied on for its accuracy," it said.

Reasons to cheer

It's not all bad news for advisers; the FCA has further delayed the introduction of its capital adequacy rules for financial advisers until the end of 2017.

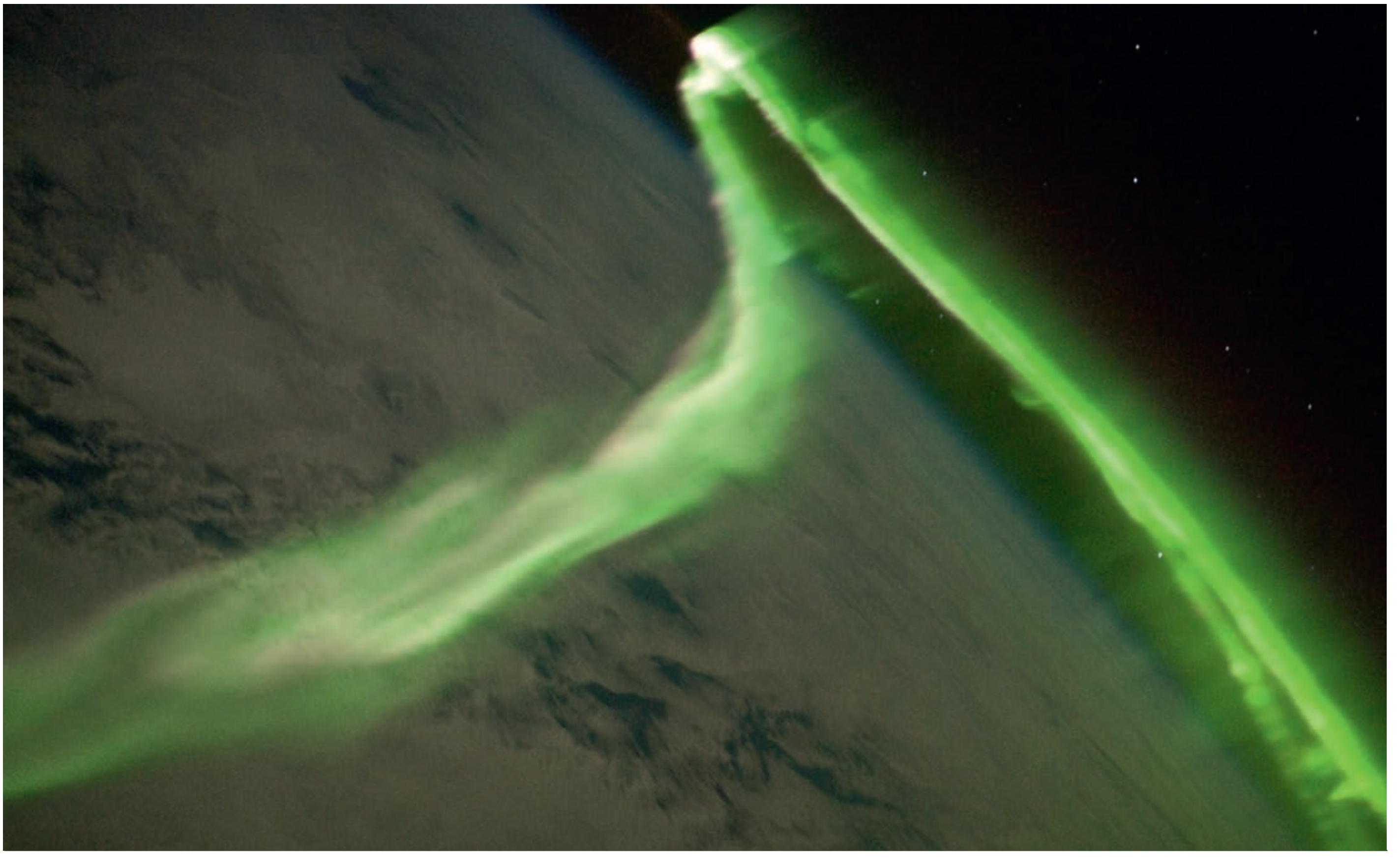
This is the second time the rules have been deferred – the date of implementation was originally 2013 and then pushed back to 2015 – as the regulator acknowledges that firms are still dealing with the cost and effort of implementing RDR, plus a European review currently underway may change the rules around capital adequacy.

The FCA is also reviewing its whole approach to capital adequacy and how its rules could affect competition.

APFA's Hannant said: "We had previously raised a number of concerns with the regulator about the complexity and potential impact of the proposed rules, and we are pleased these are being addressed."

The delay fits with APFA's call for a regulatory dividend for advisers that will make it easier for them to do business.

Hannant added: "Simplifying the capital adequacy requirements asked of advisers would reduce the regulatory burden firms face."



The regulatory dividend

The regulator has demanded much of financial advisers and massive efforts have been made to comply. What do advisers now need of the regulator to ensure a healthy future for financial advice? By **Michelle McGagh**

Advisers have worked hard to upgrade their businesses and the advice sector over the past few years, and now it's time for the regulator to acknowledge this transformation with the introduction of a regulatory dividend.

Under the Financial Services Authority (FSA) and now the Financial Conduct Authority (FCA), advisers have been subject to painstaking changes in their business models, increased qualifications and countless blank-chequebook moments repairing damage they didn't cause.

The retail distribution review (RDR) was a major upheaval for the advice sector but advisers – whether independent or restricted – have risen to the challenge of delivering a service to clients that is truly 21st century.

But what has been lacking is recognition for the work that advisers have put in to their businesses to comply with the ever-shifting rules. The Association of Professional Financial Advisers (APFA) is campaigning hard for the FCA to give something back to more than 20,000 advisers who have survived the implementation of RDR and started 2013 with more robust, client-centric businesses.

> **"What has been lacking is recognition for the work that advisers have put in to comply with the ever-shifting rules**

APFA has called on the FCA to look at a number of options for regulatory dividends:

- streamlining of data collection and an increase in the time for reporting from six weeks to three months;
- for the FCA to abandon a one-size-fits-all policy and regulate in proportion to the size of a firm and the risk it poses;
- to look at the long-stop in 2014/15;
- to review the increase in the Financial Services Compensation Scheme (FSCS) threshold from £100 million to £150 million for advisers;
- to reduce its fees to advisers on the basis that RDR-compliant firms pose less risk and need less regulatory resource and scrutiny.

Time consuming

Top of both APFA's list and that of Neil Liversidge, managing director of West Riding Personal Financial Solutions, is a review of data collection.

Liversidge is incredulous at the amount of form-filling and paper-pushing the regulator makes advisers undertake.

"I would like to see a reform of Gabriel reports," he says. "There is too much focus on collecting data from those advisers who are just trying to make a living and do a good job for their clients.

"They need to abolish Gabriel or simplify it. The amount of data [we have to provide] is scandalous. I have a PA and she spends four to five hours a week just recording data for Gabriel; that time could be spent much better on clients, which is what we want to do."

David Winter, principal of David Winter Independent Financial Advisers, believes the amount of paperwork that advisers have to undertake and give to clients is "absolutely over the top".

"I have just completed a straightforward investment into two ISAs and an investment bond for a couple – I had to give them 104 pages [of documents]," he says.

Increasing costs

The level of paperwork is matched only by the increasing cost of running an advice business, which is subject to a number of fees, of which the most notable are levied by the FCA and the FSCS.

Winter says the regulator and compensation scheme needs to realise that the cost of the levies is ultimately borne by the clients.

"I charge my time at £200 an hour and I'm embarrassed to say that, but

that's what it costs to keep me going because of the fees, and there is only one place we will get [the money] from: clients."

Winter would like to see the regulator separate the advisers from banks when judging risk to prevent "reputation and financial ruin" and realise that advisers are "talking about real people not just numbers".

The cost of funding the FSCS is set to increase for advisers to £150 million, which analysis by the regulator says could eat away at up to 30 per cent of an advice firm's revenue. This is an area Liversidge would like to see reformed.

"I cannot understand why I am sending top-up cheques to the FSCS for people who were mis-sold

> **"Advisers can be forgiven for feeling that they are unfairly scrutinised by the regulator**

derivatives by a London stockbroker, when I'm dealing with people's £50,000 pension pots in Castleford," he says.

Liversidge says his firm is "boringly profitable" and should not be lumbered with the cost of bailing out those who deal "in the Wild West".

"I would like them to come up with a defined range of products, including funds, that are covered by the FSCS and anything off that list… would have to have a lawyer involved to sign it off and say the person understands the risks," he says.

"If you want to play in the Wild West you have to do it without the FSCS."

Cap liabilities

There is a fear that costs could continue to rise if the regulator does not impose a long-stop, something APFA has been campaigning for many years to be introduced.

Winter says that a client who was sold a mortgage endowment policy 19 years ago had recently accused him of mis-selling and "because I could not prove I had not said something 19 years ago" he had to pay out £3,500.

"I understand the arguments against a long-stop, but you cannot retire and take your liabilities to the grave," he says.

Constructive relationship

Advisers can be forgiven for feeling that they are unfairly scrutinised by the regulator considering the threat they pose when compared with larger institutions.

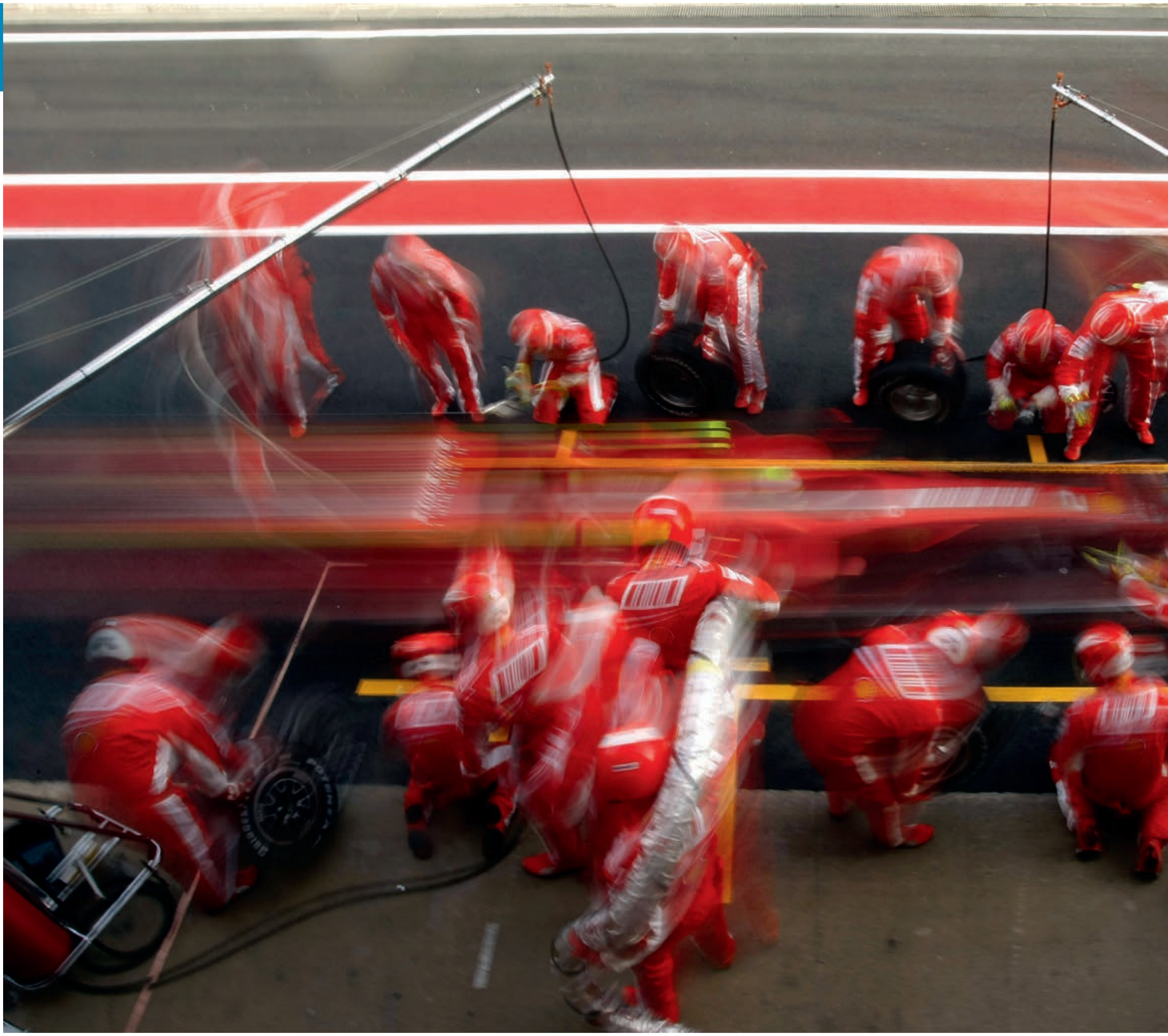
Winter thinks increased "eyeball-to-eyeball" communication would solve a number of problems.

Although he does concede that a recent over-the-phone inspection was "first class" and that the inspector was "working to help us rather than against us".

He said that he was hopeful that the good experience he had recently is a reflection of the future direction of the regulator dealing with advisers proportionately.

"Come in and talk to some of my clients, come out of those ivory towers," is the message he relays to the FCA.

"These are real people [that we're dealing with] with real problems. We are not trying to rip them off and sell them products they do not need, that is all behind us."



Performance tuning

Jennifer Hill talks to advisers to canvass their views on life post-RDR, how it has bedded down and the benefits it has brought

The birth of the retail distribution review (RDR) may have been fraught and the implementation at the start of the year no better, but almost a year on advisers are reaping the benefits of the landmark change in financial advice.

The fallout from the implementation of the RDR has not been as severe as predicted last year, although the Financial Conduct Authority (FCA) has reported a not insignificant drop in adviser numbers of 20 per cent.

However, advisers are shaking off the reduction in numbers and those that have moved to a post-RDR business model are reveling in the changes the new rules have brought.

Philip Martin, Openwork proposition and marketing director, credited the RDR for making the national firm rethink its future.

"It has been a catalyst for us to look at how the business model is set up, its sustainability and whether it will work in the future," he says. "Without the RDR there would have been a chance that we would have just carried on as we were."

Professional upgrade

For Tim Langman, managing director of Perspective Wealth Management, the RDR was a watershed moment for financial services that has put financial advisers on a par with solicitors and accountants.

> **"With a focus on delivering good customer outcomes, greater compliance and more stringent reporting requirements, more advisers are outsourcing**

"Although there were unforeseen consequences of the legislation, the need for increased professionalism and a minimum standard for advisers was long overdue and can only be good for consumers who seek financial advice," he says.

"There was also a requirement for greater transparency of fees across our profession, which the RDR has addressed; this alone brings our industry in line with what many describe as more 'traditional' professions, such as law and accounting."

While other professions may have greater respect for advisers post-RDR, Langman said his clients have not noticed any difference and the implementation of the rules was confirmation of the business model he has been operating for a number of years.

"Clients have seen little difference, as the way we work has evolved over the years to be RDR-ready rather than us requiring a revolution at the beginning of the year."

Dennis Hall, managing director of Yellowtail Financial Planning, said his firm was also ahead of the curve.

"For a firm like mine, that was largely working in an RDR-compliant way for the previous seven years, the actual experience of life post-RDR isn't that different to life pre-RDR," he says.

"Our biggest problem has been in consciously trying to look at the next big differentiator between ourselves and the rest of the firms where we no longer enjoy first-mover advantage now everyone says they are fee-based."

Payment pain

The biggest benefit for Perspective has been cutting the ties with product providers and gaining greater control over its business model.

"We are no longer paid at the discretion of providers, but have agreements for payment directly with our clients; advisers now have control of the adviser/provider relationship," says Langman.

However, Hall notes that many advisers are still operating on a fee system that looks "remarkably similar" to the old commission model.

"That's the problem we've experienced in previous years: a true fee-based model that requires clients to write out cheques or pay by standing order is so 'in the client's face' that there are too few of them willing to pay this way," says Hall.

"You need to adopt a fee-charging regime that's easier for clients to engage with, otherwise the pace of business growth is painfully slow. We've eased back on the perceived pain we were making our clients endure on our earliest fee models; we still offer the option of paying by cheque, but most clients prefer the percentage of assets under management model."

Compliance burden

The introduction of RDR and the move from commission to fees has seen advisers analyse and overhaul their business proposition and level of service. With a focus on delivering good customer outcomes, greater compliance and more stringent reporting requirements, more advisers are outsourcing.

Matt Timmins, joint managing director of SimplyBiz, says: "Outsourcing compliance and access to end-to-end advice process support has now become almost a necessity for many directly-authorised firms who want their business not only to survive, but thrive in the post-RDR world," he says.

“Advisers have got to become commercially minded. They cannot promise to deliver something and not make a profit on it

He notes a recent study by Stoke Bishop Associates, which found that small advice firms trying to do everything themselves will “face higher costs and will fail under the weight of administration and compliance,” says Timmins.

Many advisers have also introduced more robust IT systems, from back-office customer relationship management to risk-profiling tools, which have made it easier for advisers to fulfil requirements around knowing their customers.

“[The introduction of better IT systems] will also mean better audit trails and, therefore, better safeguarding against any future complaints,” adds Timmins.

While a stricter reporting regime is supposed to safeguard consumer interests, Hall questions whether it will create any real benefit.

“The big concern I have is ensuring that the additional reporting is done and that the information is accurately gathered,” he says.

“The RMAR and Gabriel reporting was always onerous enough – and to seemingly little benefit from where I stand. We’re still facing large Financial Services Compensation Scheme costs for failed firms and I wonder what this additional reporting will actually bring to the table in terms of consumer protection.”

Further changes

Martin thinks there is still “a long way to go” and while advisers have a handle on how their businesses should look, there is a “lack of confidence” when it comes to explaining their value to clients. Advisers will also have to face up to the fact that some clients may no longer be profitable.

“It’s about segmentation and understanding profitability; what you are promising and what is the cost of delivering it,” he says. “We are looking now at adviser as manufacturer... and advisers have got to become commercially minded. They cannot promise to deliver something and not make a profit on it. Every customer will have to stand on their own two feet.”

While there are still tweaks to be made to the rules, the benefits of RDR to adviser business are beginning to show and hopefully in time the RDR will have achieved the regulator’s original objective: to improve consumer confidence in financial services.

One year after RDR, let's keep moving forward

Ken Davy, Chairman of the SimplyBiz Group, considers the impact of RDR and how the advice sector has responded

Financial Services looks like a very different beast today in comparison to when I joined the profession in 1970.

Nonetheless, despite the changes in regulation, developments in technology and the ever-growing TCF rule-book, the fundamental needs of consumers have remained the same, which is to protect themselves and their families from death and disability whilst also saving for the future.

The RDR had laudable aims and was implemented for all the right reasons, yet the recent so-called 'improvements', such as removing trail, are making ongoing income harder to sustain.

The FSA encouraged the building up of trail and similar income to help financial advisers build sustainable businesses. This contracted income has helped many firms continue to develop in the new RDR world. Removal of this income source, which has been built up in good faith based on the regulator's expectations, is not only bad news for adviser firms, but could also have huge implications for their clients. Indeed, I would not be at all surprised if this constant 'tweaking' of the rules ends up delivering the opposite result to that which the FSA would have hoped to see.

The definitions of independent and restricted advice are also evolving. However, what is even more disconcerting is that the resulting definitions seems to differ from player to player within the market on an almost daily basis, which can only result in even further consumer confusion and detriment.

Need for clarity

The FCA defines independent advice as, "a personal recommendation of a retail investment product on a comprehensive and fair analysis of the relevant market that is unbiased and unrestricted", and will be checking to see if the advice sector is complying.

In reality, there is no 'grey area' here and no space for fancy newly coined phrases which purport to be a half-way house between independent and restricted.

It is up to each member of the profession to support and adapt to the new environment that suits their clients and their business model most effectively. This clarity will undoubtedly prove beneficial to them, their clients and the entire profession.

I wholeheartedly believe that, handled correctly, the future of our sector is set for bigger and better things. We still have too many politicians, regulators and commentators who continue to focus not on the benefits being delivered to consumers by financial advice, but rather become obsessed with methods of remuneration.

At the end of the day, providing accurate financial advice for each individual consumer's situation is what our profession delivers on a day to day basis.

The adviser and the consumer need to have the freedom to be able to determine not just the remuneration but how it is paid, in a way that is suitable to both parties.

Advisers have demonstrated remarkable resilience through the many upheavals which have plagued the financial services sector. The very fact that adviser numbers now appear to be recovering since the post-RDR fall shows just how resourceful our profession is.

Now is the time for the sector to pull together to ensure that all advisers have access to the strong support they need, regardless of which business model they choose to adopt.

This will ensure the continuation of a robust and successful sector into the future for the ultimate benefit of our clients. ■

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"Advisers have demonstrated remarkable resilience through the many upheavals which have plagued the financial services sector"

Future proofing

Commonly perceived as a cure-all to care costs, the long-term Care Bill will actually only cap fees for 'care', not 'hotel' costs like food and accommodation. Advisers need to educate their clients and help them plan for the additional charges. By **Jennifer Hill**

Clients who are expecting the new long-term care rules to cover the cost of a loved one's care will be sorely disappointed, and advisers will be key in filling the financial gaps that are left. The backbone of the government's strategy for reforming long-term care is a £72,000 cap on the cost of care, coming into effect in April 2016.

Although the figure is considerably higher than that proposed by the architect of the new Care Bill, Andrew Dilnot, who proposed a £35,000 cap, it is still the biggest shake-up of care in 100 years. The Bill will also take on board a number of other recommendations from Dilnot, including consolidating national and local care provisions on to a single system and ensuring that consumers have access to financial advice on care costs.

Currently at the second reading stage in the House of Commons, although a date has not yet been set, the Bill will become law by the beginning of 2014 – although it is already causing headlines.

No cure-all

The most recent headlines are about the exact costs that the cap will cover and what levels of help individuals will receive. Currently, individuals in England pay for their own residential care costs if they have assets of £23,500 or more, often including the house – the figure is £23,250 in Scotland and £22,500 in Wales.

Under the new rules the asset threshold will be increased to £123,000 – but don't be fooled by the generous increase, it does not mean that everyone with assets less than this will receive free care. Only individuals with £17,500 or less in assets receive free care and those with assets up to £123,000 will receive state help towards the £72,000 cap on a sliding scale.

The £72,000 cap is another misnomer, as it does not cover the 'hotel' costs of accommodation and food, which average £12,000 a year for a person in full-time care and have to be paid separately to the 'care' costs, which are covered under the cap.

Martin Bamford, managing director of Informed Choice, says: "In practice, only around one in eight elderly people will ever qualify for the fees cap, with some estimates suggesting this could fall to as low as one in 200 in ten years' time. As with most state benefits, it is primarily designed to help those in crisis, rather than the general population, particularly those with property and other wealth, which can be used to fund care costs."

Misinterpretation

One key problem with the care reforms is that the cap prices care in relation to the rate local authorities pay for it, not the actual care costs of the home an individual may be living in. This means that while an individual may reach the £72,000 cap fairly quickly in an expensive home, the local authority will assume the costs are the same that it would pay over the same time-frame.

Carl Lamb, managing director of Almary Green, says: "Most self-funders will pay significantly more than [the local authority rate] for personal care in their chosen care homes, so clients will have spent more than the cap before they are deemed to have reached the ceiling."

Explaining the nuances of the Care Bill to clients who believe they will not face care bills will be a task for advisers. They will also have to equip themselves with knowledge of the widely misinterpreted notion that nobody will be forced to sell their home to pay for care.

The 'deferred payment scheme' (DPS), which will be available from 2015, will see local authorities offer loans to those going into care, using their property as collateral. The loan is then paid back on the death of the homeowner.

Diane Weitz, a director of Ashlea Financial Planning, says there is a "widespread view" that if an individual uses the DPS, their home will be removed from the threshold calculation, which is not the case.

"Fees will be offset against the value of the house and an interest rate will be charged on the loan, thus the loan represents an ever-growing cost," she says.

"Surely if someone is in a care home and are the last survivor they won't need to live in their home; it's far better to take proper financial advice, sell the home and invest the proceeds."

Growing problem

In 15 years' time, more than half the population will be over 50 and the number of 85-year-olds will have increased five-fold. Care homes are taking in around 125,000 every year – 50,000 of which have to fund their own care.

Despite this, there are only 600 advisers who are qualified to give long-term care advice and are accredited by the Society of Later Life Advisers (Solla).

"As advisers, we face the challenge of enlightening our clients and ensuring that they're not pinning their hopes on government support in vain," says Lamb. He anticipates growing demand for lifetime financial planning solutions that produce cashflow projections for a range of scenarios.

Drawdown – time to take another look?

Ray Chinn looks at the different ways in which advisers and their clients may choose to use income drawdown

For the past couple of years, sales of drawdown plans could be at best described as 'flat'. Legislative change, which reduced the level of income available (to 100 per cent of the Government Actuary's Department (GAD) rate) plus low gilt yields made it difficult for advisers and clients to warm to drawdown.

In the first half of 2013 we've seen the regulation reversed, so the clients can once again take 120 per cent GAD, and also gilt yields slowly rising. In September the gilt yield rose from 2.75 per cent to 3.00 per cent, which means a drawdown client aged 60 with a £100,000 fund will be able to take an annual income of £6,360 compared to just £4,900 prior to the GAD changes and gilt yield rise.

Of course it is not all about maximum income levels – although the greater flexibility always helps. There are a number of different ways advisers and their clients may look at using income drawdown.

Tax Free Cash (TFC) only, nil income – an obvious route for those who have reached age 55 and would like to unlock tax free cash – perhaps to pay off mortgage debt – but who have no current need for any income.

Income generators – clients who have retired and therefore need an income from their plan. Some clients may need to take maximum income (so the increases referred to above will be of benefit), others may be happier with a lower level of income, or a flexible income, both of which might be more appropriate for clients who are working part time or on a consultancy basis.

Tax and death benefit planning – here clients may be looking at more complex issues such as tax planning and/or death benefit planning, potentially keeping as much of the fund uncrystallised as possible.

Flexible Drawdown – this option is only available for customers who can meet the Minimum Income Requirement of £20,000 p.a. through a lifetime annuity or similar. Once this threshold has been met, Flexible Drawdown offers the most flexible (as the name suggests) method of taking income from the pension pot.

The range of product solutions aimed at the drawdown market is also wider than ever before, with Fixed Term Annuities also taking their place alongside traditional drawdown plans – with both being governed by the drawdown regulations.

All in all, it's the perfect time to take another look at drawdown. At LV= we offer a full range of drawdown solutions: capped, flexible and fixed term annuities. For more information, visit www.LV.com/adviser

Ray Chinn is head of pensions & investments, LV=.

"In the main, we continue to advise clients along the same lines as before: in order to maintain choice, and provided it is affordable, the best solution is usually to plan to self-fund care."

Point of entry

The absence of pre-funded long-term care insurance products in the UK means most planning tends to take place at the point of entry to a care home, rather than in advance, according to Bamford.

"At this stage it becomes a case of prioritising objectives, understanding state benefit and funding entitlements, and then understanding options for managing existing assets," he says.

"Advisers who specialise in this important and growing area will have an in-depth understanding of the various options, which should not be limited to immediate care annuities, but should also include managing cash assets and repositioning existing investment portfolios to fund income shortfalls."

Norman Stevenson, a director of Cathedral Independent Financial Planning, believes taking a holistic approach to financial planning will ensure long-term care is factored into a client's financial plan.

"Such an approach can ensure that all bases are covered – considering, for example, boosting income from investments, state benefits, charity support, use of annuities, rental income, equity release, support from family and NHS continuing care, to name but a few," he says.

Raising awareness

Jeremy Over, long-term care specialist at Spectrum Financial Services, says advisers have a duty to address long-term care planning with clients when looking at pension income options, creating wills and power of attorney, and then mention it at every review.

"The quicker people see the whole picture, the quicker they can acknowledge and plan for it. The optimist in me believes that more will be done in raising awareness of the short-comings of the Care Bill... However, until that time, it falls on the shoulders of advisers to make as many clients as possible aware of this future pitfall and ensure that it is something that is on their planning horizon before they are faced with it."

Markets and fund positioning in 2014

Jim Leaviss and **Mike Riddell**, manager and deputy manager of the M&G Global Macro Bond Fund, discuss their expectations for US monetary policy, the fund's continued overweight allocation to the US dollar, and their caution towards high-yield and emerging market bonds at present

"Getting a sustained upturn in the housing market is crucially important for the wider US economic recovery"

Q: In your opinion, when will the US start to taper its quantitative easing (QE)?

We believe QE 'tapering' has become a story for 2014 on three main counts, namely the drag on current gross domestic product (GDP) growth from the recent government shutdown, the sensitivity of mortgage rates to rises in bond yields and the very low core inflation rate in the US.

Estimates for the drag on fourth-quarter GDP resulting from the shutdown range from 0.25 per cent by the US government up to market forecasts of around 0.6 per cent.

While it is difficult to quantify the impact at this stage, there will be lower growth than previously expected. Given that no longer-term solution was found, the US will face it all again in the new year.

In terms of inflation, the core Personal Consumption Expenditure measure of prices, also known as the Core PCE Deflator and the preferred indicator of the Federal Reserve (Fed), has trended downwards to around 1 per cent during recent months. Weaker commodity prices and low wage growth have been partly behind this. Compared with the Fed's target rate of 2 per cent, tighter monetary policy is not warranted against this backdrop for now.

Furthermore, getting a sustained upturn in the housing market is crucially important for the wider US economic recovery. Housing activity has powerful multiplier effects in consumption and employment. Tightening monetary conditions too early would risk higher mortgage rates dampening down this engine.

The sensitivity of mortgage rates to reduced QE can be seen from the experience of the summer. When talk of possible tapering by the monetary authority sent US Treasury yields 100 basis points higher in June, this fed directly through into the 30-year mortgage rate.

There is a lot of uncertainty about the start of the reduction of asset purchases, but tapering may begin around next year's first quarter depending on the growth data. If that happens, it should be remembered that tapering would be reduced stimulus while continuing with stimulus. Interest rate rises are likely to be much further off.

Q: What is your outlook for government bond yields in this environment?

The fund had a very short duration last year and at the beginning of this year as we thought core government bond yields suggested the market was much too relaxed about the steady improvement in US economic data.

The fund's duration was around 2.3 years just prior to the global bond market sell-off in May, substantially shorter than an average global bond fund. This provided significant support to the portfolio in the downturn. We increased duration to 3.6 years at the end of June and further to 4.7 years at the end of July after valuations had corrected to more attractive levels.

"When talk of possible tapering by the monetary authority sent US Treasury yields 100 basis points higher in June, this fed directly through into the 30-year mortgage rate"

The size of the sell-off seemed an overreaction and we generally moved into the five- and 10-year parts of the curve where we saw the best relative value. This positioning was retained until recently, but we have just started to reduce duration again. Government bonds are beginning to look slightly more vulnerable following the strong rally since September's 'no-taper' decision by the Fed.

Q: If inflation is trending lower, why do you hold inflation-linked assets?

The fund's allocation to inflation-linked assets is mainly held through bonds linked to UK inflation. We particularly like these bonds because the UK is one of the only developed countries that has a 'sticky' inflation problem.

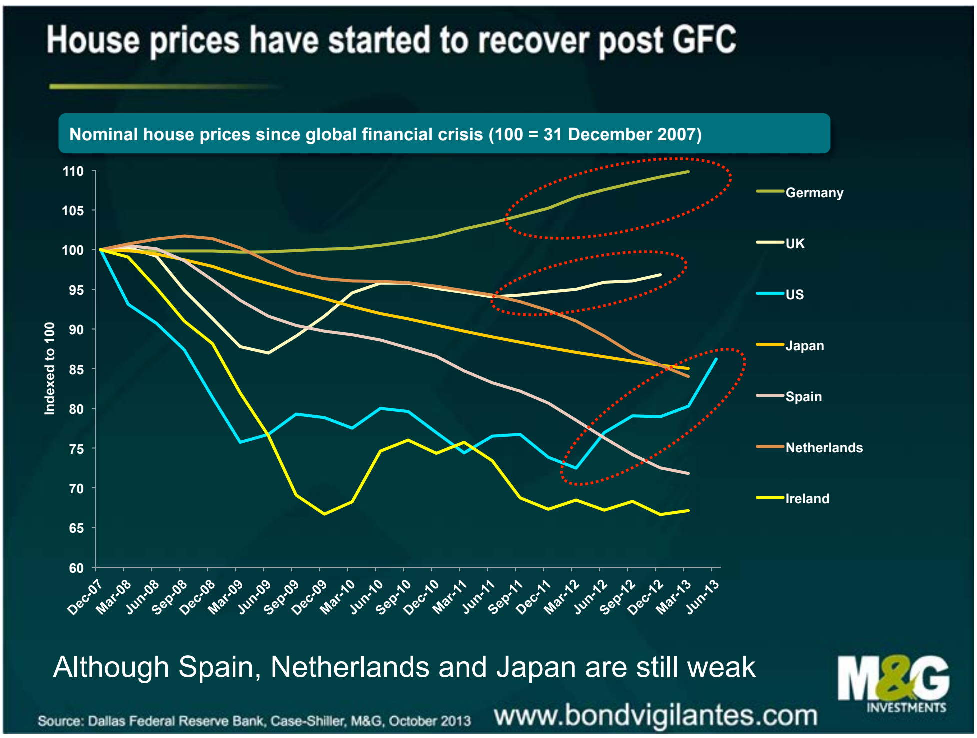
Inflation has been consistently above the Bank of England's 2 per cent target rate and it remains so. However, the UK inflation-linked bond market is essentially pricing in that UK inflation will remain at the target rate for the next five to 10 years.

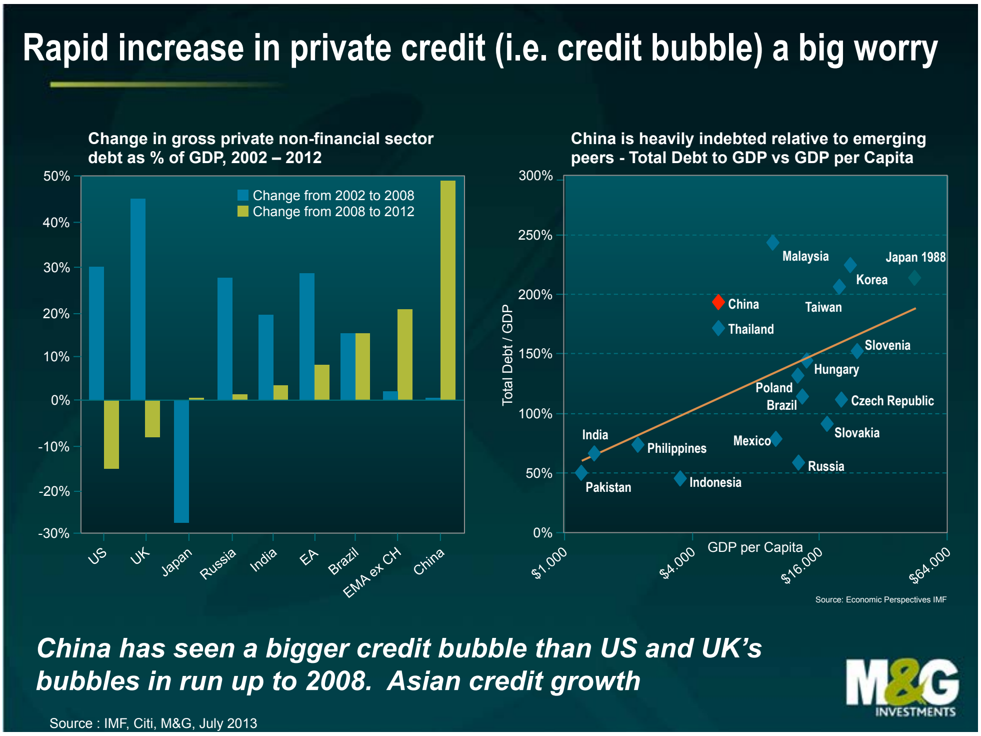
The fund also holds some exposure to German inflation-linked bonds. QE on the scale we have seen in recent years is a huge monetary experiment. So far, there has not been any sign that central bank asset purchases are resulting in higher inflation, most likely because the banking sector is deleveraging.

In Europe, private credit growth is negative and it is therefore difficult to see how inflation might occur. However, bond markets are not pricing in any inflation at present – the European inflation-linked bond market is pricing in a eurozone inflation rate of only 1.0 per cent per year for the next five years.

Q: Where does the UK's inflation 'stickiness' come from?

There are several reasons, but administered prices in areas such as utility, transport and telecom bills continue to be a main factor. Inflation rates of non-discretionary items like energy have consistently exceeded those of discretionary consumer goods.





Currently, the rise in house prices is accelerating, which is an additional factor for UK inflation. Higher house prices will further widen the wedge between the UK's Consumer Prices Index (CPI) and Retail Prices Index (RPI).

Housing has a much higher weighting in the RPI (17.3 per cent), and house prices feed through directly into the index, while the CPI accounts more indirectly for housing costs through a rental-cost weighting of 6.2 per cent. This is actually good news for index-linked bond investors because while CPI inflation is the measure that the Bank of England targets, RPI inflation is referenced by the UK's index-linked bond markets.

For monetary policymakers, the UK's inflation problem can only really be tackled by forcing discretionary spending into deflation. This would not be on the agenda given the importance of consumer spending in helping to sustain the UK's economic recovery.

For a recent analysis of the impact of house prices on inflation, see: *How do house prices feed into inflation rates around the world? It's important for central banks, and for bond investors* by Jim Leaviss, 3 October 2013, on www.bondvigilantes.com

Q: Where else do you currently see value in fixed interest markets?

We continue to prefer investment grade corporate bonds over government bonds, while we are a little uncomfortable with high-yield bond valuations.

The extra yield on investment grade credit over government bonds remains reasonably attractive and we still think investors are getting over-compensated for default risk across a number of sectors. We prefer European industrials and have exposure to US financials, which appear in better health than in Europe.

Within investment grade corporate bonds, we think the BBB area of the corporate bond market offers the most attractive valuations. BBB is still investment grade, and companies with these ratings are generally still very good quality.

The historical default risk differential between an A-rated company and a BBB-rated company is very small, and we think a yield pick-up of 0.8 per cent for investing in BBBs versus single As is worth taking for the extra risk.

Q: Why are you cautious on the sub-investment grade segment?

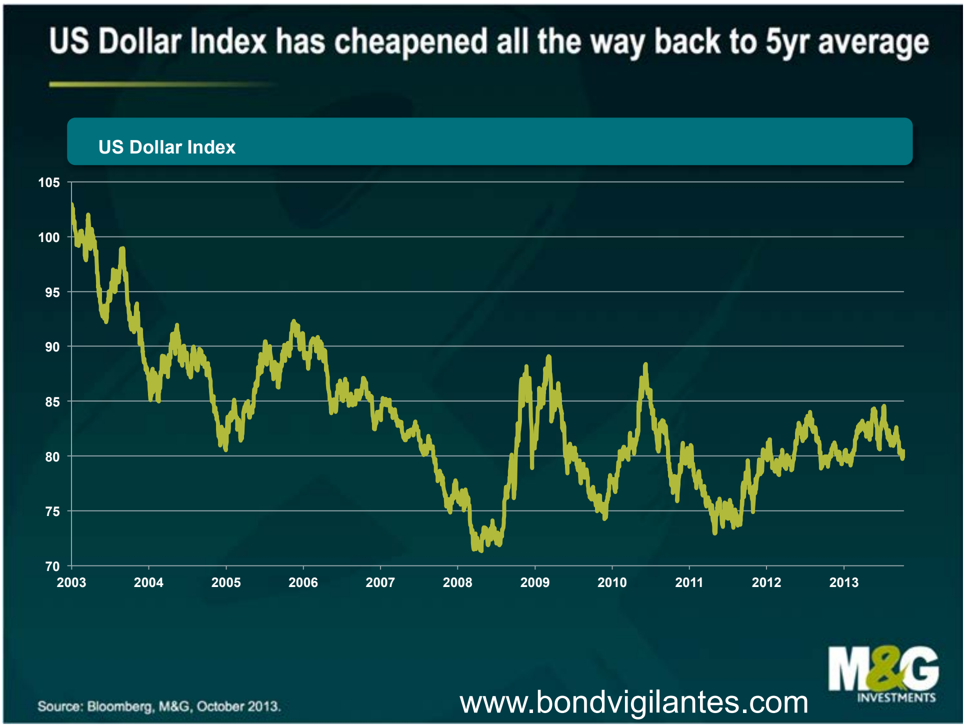
Our caution is particularly towards the US high-yield market where we have been reducing the fund's allocation. It is now close to zero.

This stance is mainly based on stretched valuations as spreads relative to investment grade credit have been narrowing across high-yield markets and are now particularly tight in the US. In Europe they look better, but not outright cheap.

A lot of hot money has been flowing into US high-yield bonds against the backdrop of the growing economy, but we need to see if it is going to stay there. There has also been some unattractively priced issuance by CCC-rated companies which took advantage of the market's search for yield.

In addition, trends of increased leverage and merger & acquisition activity pose potential risks to the

"We have consistently argued that the biggest bubble in fixed income is in emerging market debt"



credit metrics of US high-yield companies.

Therefore, we retain only around a 9 per cent weighting to high-yield bonds mainly through core European companies.

Q: What is your current view on emerging market debt?

We remain very worried about emerging markets and have consistently argued that the biggest bubble in fixed income is in emerging market debt.

For some time now, we have been concerned because of surging portfolio flows into emerging markets, better prospects for the US dollar and historically tight valuations.

More recently, we have become increasingly nervous because of deteriorating emerging market fundamentals. A number of emerging market countries have current account deficits at levels that we have seen immediately prior to emerging market crises. That is to say, emerging markets' external vulnerabilities are very large.

If the portfolio inflows stop or reverse, then there is a real risk that some countries could experience currency or banking crises. Contagion would probably spread quickly with, for example, fund managers being forced sellers to meet redemptions.

Emerging market debt valuations began to look slightly more attractive in July this year, and we did add some bond and currency exposure. But the asset class has recouped about half of the losses seen from May to July and valuations are once again looking stretched.

Our views have again led us to currently have minimal exposure in the fund to emerging bond markets.

For the latest views on emerging market debt, see: *Will the Fed push EM over the edge?* by Mike Riddell, 29 October 2013, on www.bondvigilantes.com

Q: Why do you favour high exposure to the US dollar?

The reasons that led us to be excited about the US dollar over the past 18 months included compelling valuations following a decade-long slump, an improving US current account balance, and the rapid move towards energy independence.

In addition, a strengthening US economic recovery was under way where a rebounding housing market and a steadily falling unemployment rate made it likely that America would lead most of the world in the monetary policy tightening cycle.

These factors remain behind our bullish dollar outlook. We previously favoured the US dollar against emerging market currencies and commodity currencies, but following its weakness in the third quarter, we now like the greenback against all other major currencies.

For further analysis on the outlook for the US dollar, see *Why the US dollar now looks cheap against, well, basically everything* by Mike Riddell, 11 October 2013, on www.bondvigilantes.com

A diversity of choice

Many believe investment trusts are the best savings vehicle for retail clients, but they have generally not been sold through advisers. Post-RDR this is no longer the case. What do advisers need to know about investment trusts? By **Neal Underwood**

Traditionally, investment trusts have not been sold in great numbers through advisers, but following the retail distribution review (RDR), which requires independent advisers to look at the whole investment universe when choosing investments for clients, that is changing.

An Association of Investment Companies (AIC) report shows a 53 per cent increase in investment trust purchases on platforms by advisers and wealth managers in the first six months of 2013, compared with the same period last year.

Total investment trust purchases reached £147 million in the first half of the year, against £96 million in the first half of 2012. The AIC said it was encouraging to see an increase despite the start from a low base.

James de Sausmarez, head of investment trusts at Henderson Global Investors, thinks adviser views about investment trusts are beginning to change, with smaller firms leading the pack.

"The position is that smaller financial adviser groups are switching on to investment trusts a little quicker. They're more nimble in their thinking, and they've started looking at where the value is," he says.

According to de Sausmarez, advisers are typically focusing on the larger, more liquid investment trusts, in combination with some of the more esoteric vehicles, investing in areas like infrastructure, to which they cannot gain access via open-ended investments.

"While an ability to invest in more illiquid assets may be a good long-term strategy, it causes a short-term conundrum for larger advice firms

Liquidity issue

The closed-end nature of investment trusts, which have a fixed number of shares, allow the fund manager to take a longer-term view. They provide the ability to invest in less liquid assets, such as private equity, venture capital and commercial property, which can potentially offer better returns or higher levels of income over time.

However, while an ability to invest in more illiquid assets may be a good long-term strategy, it causes a short-term conundrum for larger advice firms or those dealing with large amounts of money.

De Sausmarez says: "Can you put £20 million in and then take £20 million out? Not really. With the liquidity of investment trusts as they are, it's fine if you're dealing in small amounts on a regular basis... but they are never going to be [fine] for the big wealth managers."

He adds that large investment is not what investment trusts look for: "Investment trusts invest on a medium to long-term basis and [having large amounts of assets traded in and out] would be extraordinarily disruptive."

Adviser toolbox

Investment trusts are, however, ideal for those advisers who want a specialist manager and are looking to add value to client portfolios, says de Sausmarez.

Henderson has a diverse a range of investment trusts, some of which have been in existence for many years, with new trusts added from time to time.

"We launched Henderson International Income a couple of years ago, but Bankers Investment Trust, which is a global growth trust, has been around since 1887," he says.

"We have global, Asian and three European trusts. There's a good selection of different types of trusts."

However, Henderson, along with the other major investment trust players, does not have much in the way of alternatives in its investment trust range.

Andrew Merricks, head of investments at Skerrit Consultants, says he has used investment trusts in

> **With investment trusts you have to face the reality that they're more complex, less liquid and higher up the risk curve than open-ended funds**

client portfolios for many years. "I'm pleased if the numbers [of advisers using them] have gone up. Our biggest problem with using investment trusts in models is liquidity. But I've always been a fan of them at the right time in the cycle; you can buy assets cheaper and they have the potential for higher returns."

One of the advantages of investment trusts, says Merricks, is that investments can be more focused and specific.

"The other plus is that if there's a run on the assets they hold, they don't have to be forced sellers. Another big plus when markets are rising is the gearing factor, you can get a bit of oomph."

Merricks says he is not evangelical about investment trusts and there are definite pros and cons, but they are a necessary tool in a serious adviser's toolbox.

Clean costs

One of the advantages that investment trusts have over their open-ended counterparts in a post-RDR world is the fact there is no commission, and fees are clean.

De Sausmarez does point out, though, that some specialist investment trusts can have performance fees. "Investment trust fees are not in every case clean. But they're not open-ended funds. They've been extremely successful for longer than open-ended funds. Some have flat base fees, but a lot of our specialist trusts are on a base with a performance fee," he says.

"My view is if it's a specialist investment trust offering a base fee lower than 0.75 per cent and it has a performance feel that is reasonable, with a hurdle that is reasonable, I don't see the problem."

On two of its larger investment trusts, the City of London and Bankers Investment Trusts, Henderson took away the performance fee in order to have broader retail appeal.

Direct investment

One thing de Sausmarez has noticed since the advent of the RDR is a large increase in the number of direct investors.

"All the online share dealers are growing [numbers of retail investors]. The man in the street has come back to using investment trusts. As you can see from the AIC data... financial adviser holdings have gone up."

Nevertheless, despite the increasing appeal of investment trusts to advisers and the retail market, de Sausmarez says this is no time to be complacent.

"With investment trusts you have to face the reality that they're more complex, less liquid and higher up the risk curve than open-ended funds. But I think we're looking for financial advisers to spend a bit more time on them, really looking at the whole of the market – investment trusts included."

Leading the field

Which are the biggest and most sought-after investment trusts in recent years and why? By **Neal Underwood**

The 10 largest investment trusts, according to statistics from the Association of Investment Companies (AIC) all have assets well in excess of £1 billion and almost all have delivered decent share price growth over one, five and 10 years.

On top of that, all bar one of the 10 have grown their dividends over the last five years between 1.6 per cent a year and, in the case of RIT Capital Partners, a staggering 47.6 per cent a year.

Many of these trusts have long histories. Some have been running for more than a century, and could not survive without rewarding investors – and all these trusts remain not only the largest, but also among the most sought-after in the sector.

> Many of these trusts have long histories. Some have been running for more than a century, and could not survive without rewarding investors

Top of the trusts
The largest investment trust in the UK is run by private equity company 3i, which is a mammoth £4.749 billion in size.

It's not hard to see why it has attracted that much cash, looking at the year to 24 October shows its share price was up 75.4 per cent, although its five- and 10-year returns are rather more modest.

3i invests in mid-market private equity, infrastructure and debt management, and has been listed on the London Stock Exchange since 1994.

Second place
Coming second to 3i in terms of size is Alliance Trust, with assets of £3.215 billion. The trust has been investing for 125 years and is a generalist, globally diversified vehicle that invests in both quoted and unquoted equities as well as fixed income. It has rewarded investors over one and five years, delivering share price increases of 22.8 per cent and 126.9 per cent respectively.

Bronze position
Scottish Mortgage, which is managed by Baillie Gifford, is another trust with a long track record, having launched in 1909. The trust has assets of £2.973 billion – and a share price rise of 278.5 per cent over five years demonstrates that investors have been wise to hold it.

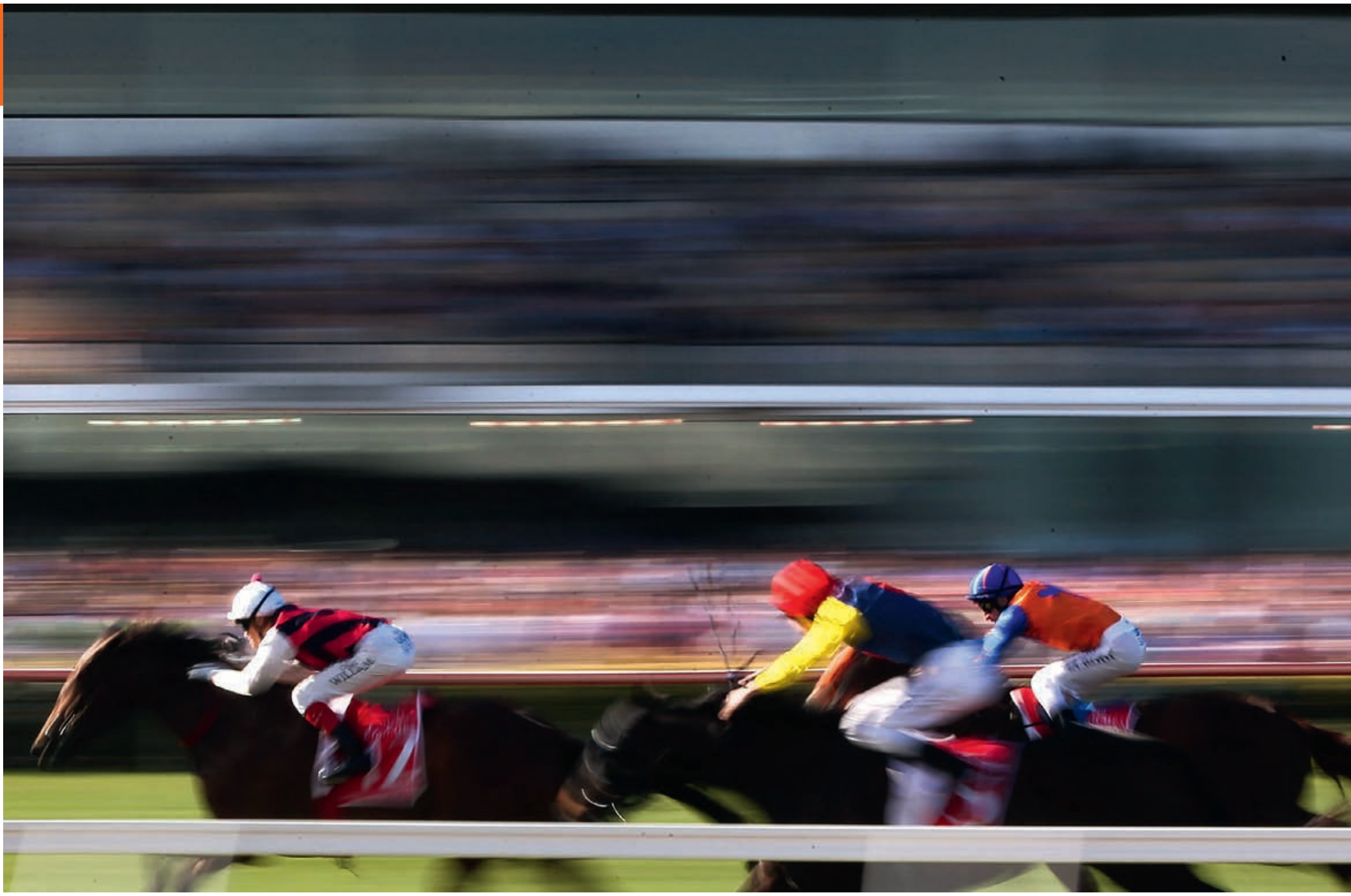
As with Alliance Trust, it has a global remit, and is benchmarked against the FTSE All World index. As at the end of September, one third of the portfolio was invested in North America, with continental Europe accounting for 25 per cent, Asia Pacific 20 per cent and the UK just over 12 per cent. James Anderson has managed the trust since April 2000, and his view is that a trust that for 100 years has had a global focus should continue to do so.

Anderson likes to identify themes, and over the last 10 years the three major ones have been the renewed rise of previously great powers, such as China; technology; and the collapse of the Western financial system.

In at four
Foreign & Colonial has assets of £2.675 billion and can trace its history all the way back to 1868, when it was the first-ever investment trust launched. The trust, managed by Jeremy Tigue of F&C, invests globally in listed and private equity companies, both in developed and emerging markets. It has increased its dividend every year for the past 42 years – quite an achievement.

Peter Walls, who manages the Unicorn Mastertrust, a fund of investment trusts, keeps a close eye on these mammoth funds and has stakes in Foreign & Colonial and Witan (in at number 10 on this list).

Due to the fact that his fund tends to underperform in a rising market, owing to the discounts on



the underlying investment trusts, he is a big fan of the large, liquid trusts. “These [trusts] have probably been more forthright and regular in buying back their shares for consideration. F&C, for example, is giving me upside exposure to markets,” he says.

Walls also holds Electra Private Equity, which didn’t make the top 10 but has assets of £1.297 billion, due to its ability, as the name suggests, to tap into private equity opportunities.

Halfway mark

RIT Capital Partners is a relative new kid on the block, having launched in 1988. The trust, which is chaired by Lord Rothschild, is £2.309 billion in size and can trace its origins back to the earlier Rothschild Investment Trust.

The trust invests in three main areas: equity funds, private investments and public equities, which combine into a widely diversified, international portfolio. Its one- and five-year share price performance hasn’t exactly shot the lights out, although over 10 years it has risen by a very credible 185.7 per cent.

What makes this trust stand out is the 47.6 per cent per annum dividend growth delivered over the last five years.

Sixth place

When comparing 10-year share price performance, the £2 billion Templeton Emerging Markets is the best of the biggest investment trusts. Over that period its share price has increased by 377.8 per cent. In addition, it has grown its dividend by more than 10 per cent per annum for the last five years.

The trust, run by veteran emerging markets manager Mark Mobius, was one of the first dedicated emerging markets funds in the UK when it launched in 1989. It is managed according to Templeton’s investment philosophy; searching globally for value stocks using fundamental, bottom-up research, and adopting a long-term investment horizon.

Others to watch out for

Rounding out the top 10 investment trusts in terms of size are Mercantile (£1.85 billion), SVG Capital (£1.55 billion), Murray International (£1.52 billion) and Witan (£1.49 billion).

“All these trusts remain not only the largest, but also among the most sought-after in the sector

Of these, only SVG Capital, a private equity vehicle that invests in a portfolio of private equity funds, has been disappointing in terms of its share price return, with a modest 32.3 per cent rise over five years and a fall over 10 years.

Mercantile, managed by JP Morgan Asset Management; Murray International, run by Aberdeen Asset Management; and Witan all again have long track records, having launched in 1952, 1907 and 1909 respectively.

Murray International’s 174.4 per cent and 344.8 per cent share price rise over five and 10 years is very strong, particularly combined with the fact it has grown its dividend by 12.6 per cent per annum over the last five years.

Prospects for recruitment

There is a shortage of able people in the advice sector and great competition for them. Where can advisers recruit to find the talent and skills they need? What training is available to help them improve the skills of the people they already have? By **Gill Wadsworth**

Recruitment is never an easy task, but it is being made more difficult for advice firms by dwindling numbers of fully qualified advisers. Figures from the regulator earlier this year show there are now just 20,453 qualified individuals to service a working population of 35 million, and as advisers face up to continuing pressures on their business, it seems that the adviser pool could decline further.

Much of the decline is attributed to the retail distribution review (RDR) which, among other things, demands all advisers hold a minimum qualification of a Level 4 Diploma rather than the Certificate in Financial Planning, which was acceptable pre-RDR.

> **Our biggest recruitment challenge tends to be finding individuals with the right attitude. We have made plenty of recruitment mistakes in the past, but it gets easier to recruit well with experience**

One consequence of the new regulation, according to recruitment consultants, is a dearth in available talent. "There are definitely fewer advisers in the post-RDR world," says Rob Pybus, partner and executive search consultant at FS Recruitment. "It has been more of a challenge to find the right people for clients."

Better candidates

Couching the changes in stronger terms, Chris Newton, managing director of Financial Services Recruitment, says the "over-regulation" of the industry has created a "dire situation", compounded by a lack of young blood coming into the advice sector – the average age of an adviser is now 49.

However, advisory firms are more upbeat than their recruitment consultant counterparts when it comes to assessing the market for talent and many are looking to recruit. According to research by NMG Consulting for the Association of Professional Financial Advisers (APFA), one in five business owners and self-employed advisers currently have plans to recruit new advisers and/or paraplanners in the next two years.

Jason Walker, regional manager of Chase de Vere Independent Financial Advisers, said the imposition of higher qualifications has improved the standard of candidate and actually made the recruitment process more efficient.

"The RDR has created better quality in the market. Pre-RDR, we were seeing a lot more potential recruits, but the quality was poor. Post-RDR, the candidates we see are of a higher quality so it is positive in terms of the time recruitment takes," he says.

This experience is repeated at Informed Choice, where managing director Martin Bamford says the RDR has made it easier to find suitable recruits. "Candidates now need to differentiate themselves with qualifications that are greater than the minimum level, so Chartered Financial Planner or Certified Financial Planner is going to stand out from the crowd of Diploma-level qualifications."

Kissing frogs

Despite the advantage of better qualifications, advisers admit the recruitment process is not without its challenges or, as Bamford puts it "you have to kiss a lot of frogs before you find the perfect candidate".

A survey in September 2013 by wrap provider Nucleus showed 73 per cent of its members found the recruitment process difficult.

Challenges include finding candidates with the right specialisms or those with an existing client bank; and ensuring individuals have the right attitude to match the business culture.

Bamford says: "Our biggest recruitment challenge tends to be finding individuals with the right attitude. We have made plenty of recruitment mistakes in the past, but it gets easier to recruit well with experience."

In an effort to fill the talent pool, recruitment consultants are targeting former banking advisers, many of whom were made redundant as a result of the RDR. Santander, HSBC and Yorkshire and Clydesdale are among the banks that laid-off advisers following the onset of the new regulations.

Newton welcomes this potential source of new recruits, although he admits that some of the candidates "are not very good".

Pybus adds: "The skill gaps I've observed this year come out of financial advisers from the bank assurance arena. They have advised on investments and protection, meaning there is a practical skills gap on the pension front. They are qualified to do pensions but latterly they have not been working in that area."

Training pays

A lack of knowledge in a certain area is not always an automatic red mark against a candidate. Some firms provide in-house resources to plug knowledge gaps and train potential recruits, so long as they demonstrate a cultural fit with the firm. Walker says: "We always conduct a gap analysis as part of the recruitment strategy and we have a training department that can up-skill people across the whole advisory proposition."

> **Those advisers who are thinking of taking the leap and recruiting should take advantage of the schemes on offer**

In addition, Chase de Vere is able to take on graduate trainees and, over a two-year period, transform them into fully-fledged financial advisers. Similarly, Wayne Austin, managing director of the advisory firm of the same name, says he has recently taken on a graduate trainee.

Yet Newton says these are the exception rather than the norm, claiming financial adviser firms prefer to hire experienced advisers with an existing book of business.

"There are only a few firms that take on trainees," he says. "Financial adviser firms are looking for well-qualified individuals to bring funds under management and investment clients worth £5 million to £10 million," Newton says.

Recruiting suitable investment professionals is clearly a challenge for companies in the UK, but this is not insurmountable and there are lots of initiatives out there to help advisers take on new, younger employees.

A willingness to support individuals to develop specialisms and fill knowledge gaps will allow firms to cast the net wider when recruiting.

Additionally, a greater recognition of the value of implementing graduate trainee programmes will refresh the dwindling pool of talent and bring much needed new blood to the industry.

New talent

The APFA research showed one in 10 advisers would look to recruit new staff if industry schemes were available to help source partially trained graduates.

There are a number of initiatives currently in place for advisers hoping to tap new talent. Babington Business College offers an apprenticeship in 'Providing Financial Services', sourcing A-level standard candidates for employers.

Over 12 months the apprentice can obtain a number of qualifications to help them on their way to a career in advice.

The Financial Skills Partnership Graduate Foundation College is an industry-led initiative, which runs 10-week courses to help induct young people into the world of advice. Established firms can register an interest in taking on graduates of the college as new employees.

The Financial & Business Services Talent Partnership, which was set up by financial services companies, is also aiming to attract more young people through providing apprenticeships. The government has already backed the scheme and is keen for more small businesses to get involved.

There is a vast amount being done by the financial advice sector to ensure there are enough advisers to service the needs of the UK's ever-growing population, and those advisers who are thinking of taking the leap and recruiting should take advantage of the schemes on offer.

Above all, the key to successful recruitment is, Bamford says, to be instinctive and listen to any alarm bells.

He concludes: "Always trust your gut instinct when it comes to hiring people, never risk recruiting a candidate who gives you any cause for concern."

Coming clean

Clean share classes were introduced to create more transparency, stripping out fees paid to advisers and platforms from the annual management class. Why has the industry been so slow to push these forward? Will this change? By **Tim Cooper**

Advisers and platforms have welcomed the Financial Conduct Authority's (FCA's) latest guidance consultation stating that conversion to clean share classes should not disadvantage the client.

However, it adds another twist to the ongoing debate about whether platforms should transfer shares in bulk or not.

In April this year, the regulator extended its ban on cash rebates to legacy products. The main ban will come into force in April next year, meaning all new shares will have to be clean of cash rebates by then. For legacy business, the deadline will be 2016.

Some fund groups have been criticised for delaying or failing to bring out clean share classes since

> **"The regulator said it expected, in most cases, that clean share classes would be exactly the same as the old ones**

these rules were announced. Others have caused confusion by issuing clean share classes that are more expensive than the old share classes, when taking the rebate into account, potentially leaving clients worse off.

The FCA has now attempted to dispel this confusion with its guidance consultation, issued in October 2013. In this, the regulator said it expected, in most cases, that clean share classes would be exactly the same as the old ones; the only difference would be the reduced annual management charge (AMC). But it said the effect of a conversion on a client's circumstances should be considered and should only take place if it is fair and in their best interests.

Cost effectiveness

Following the April statement, some platforms have claimed that the cost of individual, compared to bulk, transfers would become prohibitive.

A clear split emerged between platforms such Novia, Standard Life, Ascentric and Alliance Trust, which have said they will make bulk transfers to clean share classes; and platforms such as Skandia, FundsNetwork, AXA Wealth Elevate and Cofunds, which have said they will leave it up to advisers and not force a transfer.

David Thompson, managing director, AXA Wealth Elevate, claims that the FCA's latest clarification supports his platform's stance.

"We believe that platform-wide conversions to clean share classes would not always be in the best interest of all customers," he says.

"There are still cost differences between retail and clean share classes,

which could result in an increased cost for clients. Some fund groups are also yet to launch a clean share class for certain funds.

"Our approach... provides advisers with the flexibility to choose the most appropriate share class for clients. For individual savings account and pension tax wrappers, remaining in retail funds could well be the most cost-effective solution for existing investments."

Switching clients

Emma Wilkinson, investment management director at Richmond House Financial Services, says her firm is currently working on a case-by-case basis when deciding to switch clients to a clean share class, and looking closely at price.

"We have had access to clean share classes for three to six months – for all of the funds we want to hold, pretty much.

"The only issue is that some fund management groups seem to have launched share classes that are more expensive than the previous retail versions, taking the rebate into account."

One of the wraps Richmond House Financial Services uses has said it will do a bulk conversion, another has said it will not.

"On the latter, when purchasing a new fund, we are typically making a decision based on the cost of the two funds – retail and clean," says Wilkinson. "We are looking to switch existing holdings to clean as a separate exercise later this year, but only where the share is not more expensive.

"The FCA has said the conversion shouldn't disadvantage the client. If the platform successfully negotiates super-clean [that is, cheaper versions of clean] shares to the extent that the more expensive clean classes are no longer more expensive on that platform, then bulk conversion becomes less of a problem. If it fails in negotiating super-clean, certain advisers may have an issue that the decision was taken out of their hands and so might the FCA."

Moving forward

Graham Dow, head of investment group relationships at Standard Life, says the platform is "absolutely comfortable" that it is compliant and that the guidance would not present a challenge to its approach.

"We have already stated that our platform will stop accepting fund rebates of any type, so we have to convert people into clean shares," says Dow. "The world of opaque pricing is behind us and we are moving to a transparent environment."

Dow accepts that some clean share classes were more expensive when first launched, but says this issue is disappearing as they accumulate more assets.

"We have spoken to the fund groups. They have given us comfort that, once the conversion is complete, that itself gives the fund enough scale to keep expenses down to pretty much [the same level] as the retail share class."

Standard Life missed its initial target of gaining commitment from 15

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> **The fund management industry has largely embraced clean share classes – preferential terms have taken longer**

fund management groups to provide super clean shares on its platform. But it does now have deals with 11 groups and more in the pipeline, says Dow.

"The fund management industry has largely embraced clean share classes – preferential terms have taken them longer," says Dow. "In the old world, we would negotiate a higher rebate. Now we are saying to the fund groups, 'it is not right that the customer should be adversely impacted, so can you create a share class that matches the existing commercial terms our customers receive?'"

He says that has taken longer because the increased level of transparency means they have to work out the "contagion risk" and what it means for their wider business.

"While the old commercial terms were transparent on our platform, it wasn't on the fund groups' literature, particularly the prospectuses," he says. "Some have come to the table very quickly; others may have to go through a sign-off process with various country heads."

New normal

Tony Clements, director of Lothbury, says he is discussing clean share classes with clients at review stage and this is becoming a standard part of how his firm works.

"The FCA guidance reaffirms our default position – that we will use the institutional or clean share classes where available, but consider each client's circumstances before acting," he says.

"Where a provider [plans to] bulk switch, then we have been sure to keep up-to-date with the process and methodology it follows for our clients. We have been using our regular review meetings to communicate with clients about these changes. We would expect to be... in a position to give them an analysis of the benefits."

Tim Piper, investment director at Easby Gale & Phillipson, adds: "We now have clean and super clean, as the wraps and platforms jostle for position. However, costs remain only one part of the overall advice and service process. Clean share classes will become the new norm and we will use them where possible.

"The bundled version may occasionally be slightly cheaper. But the difference is minimal. Being able to select a clean share class with a provider with good administration and being able to demonstrate transparency is the best way forward." ●

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