

TISA

September 16th 2009

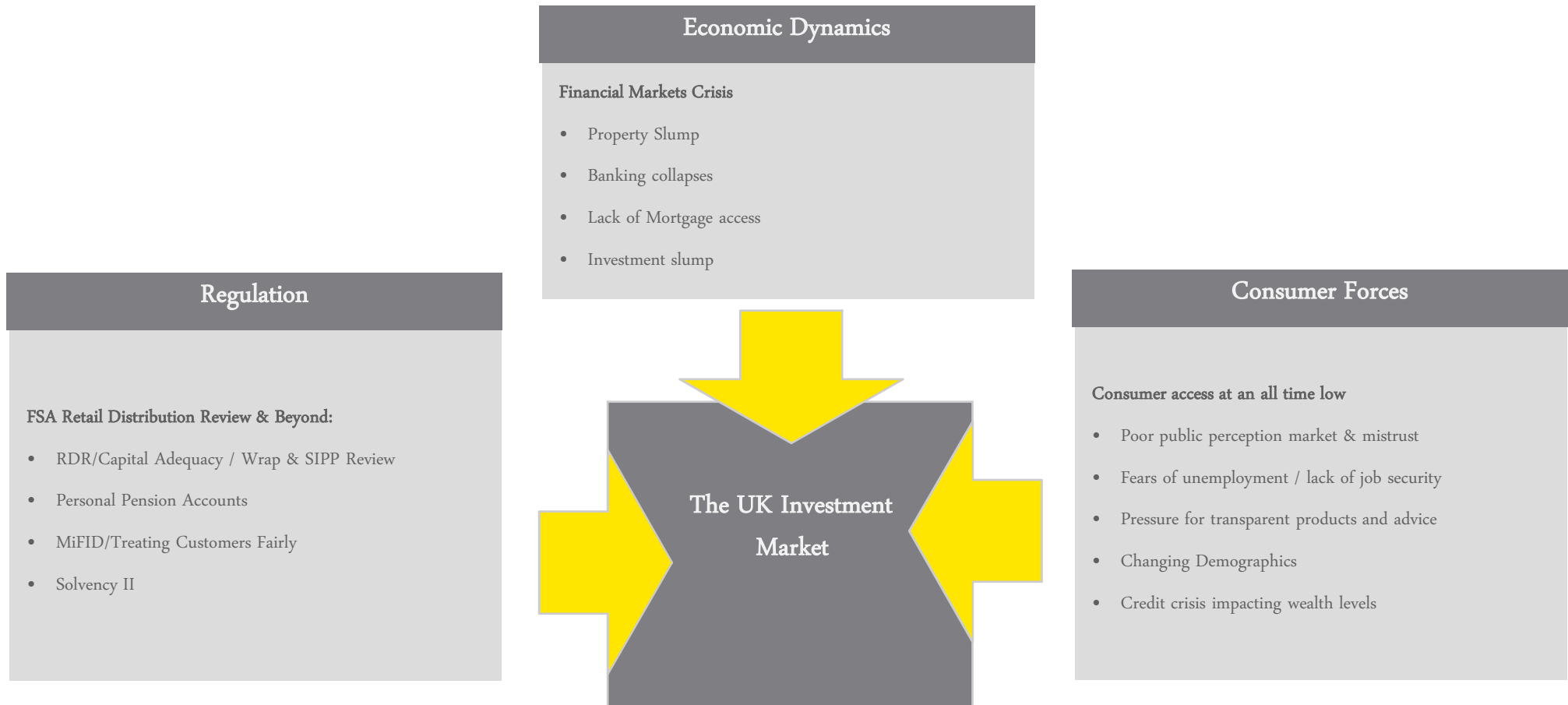
“Distribution Trends in Life & Pensions”

14 September, 2009

2012

- 2012 is the year of the Olympics. Frenetic activity is already taking place to meet challenging development deadlines for the venues. Athletes are already on training schedules designed to maximise their chances of winning gold medals.
- 2012 is also be the year of Solvency II implementation. IFAs will need to understand the implications for the companies they recommend
- 2012 will see millions of employees auto-enrolled into private pensions and Personal Accounts
- 2012 will be the year in which thousands of intermediaries have to meet the deadline of moving from commission based salespeople to fee based professional advisors as required by the Retail Distribution Review
- **It's two and a half years away.** But it's probably time to start thinking about some of the issues

Today, there are a number of other forces impacting the UK market



All of these issues will bring substantial challenges to providers and distributors

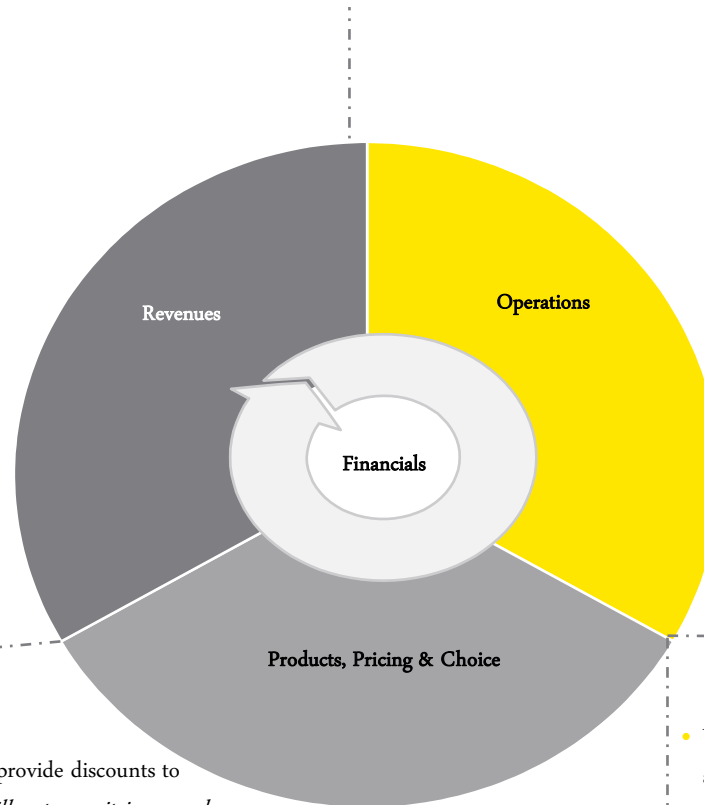
Distribution

The Retail Distribution review

- CP 09/18 “Delivering the RDR” describes a future retail investment landscape that will present serious challenges to most intermediary, network and service provider models
- New advice models will require higher professional standards. Commission on new business will be abolished (except where only Basic Advice is provided) and the FSA “... intend to increase significantly our focus on existing inducements rules”
- Fee rates must be disclosed at the start of the advice process and fees can be paid by invoice, authorised deduction from a platform or authorised deduction from the investment by the provider
- We believe it is likely that the RDR will come into force on January 1st 2013 or sooner and that the regulation will be very closely aligned to that described in CP 09/18
- Quality v Quantity

The RDR – some common questions...

- How will the RDR impact existing business? *Existing trail and renewal commissions can continue – post 2012 payments must be agreed with and paid by the client*
- Commission on GPP increments can continue but not on new members
- Can fees be % based? *Yes, but the FSA would not expect the % to differ by product type*
- Will advisors generate fees that are equivalent to current commission income? *It depends on the value proposition and the fee scale but some reduction seems likely for many advisors – at least in 2013*



- Advisor charging can be facilitated by product providers making payment on behalf of clients. How will this work with OEICS? *It may be necessary for fund managers to introduce new share classes to facilitate payments but most platforms should be able to facilitate*
- Will all advisors need a platform post RDR? *Platform cash accounts are the most elegant solution to fee payment and they can also reduce costs and improve the customer experience. However, the FSA will require evidence that migrating clients provides them with improved overall outcomes*

- Will fund managers and insurance companies be under pressure to provide discounts to the clients of large distributors? *We think they will. But the FSA will not permit improved terms to be expressed as more than 100% invested*
- Will passive funds and ETFs become more popular? *We think this is likely – the absence of commission on these investments has inhibited sales*

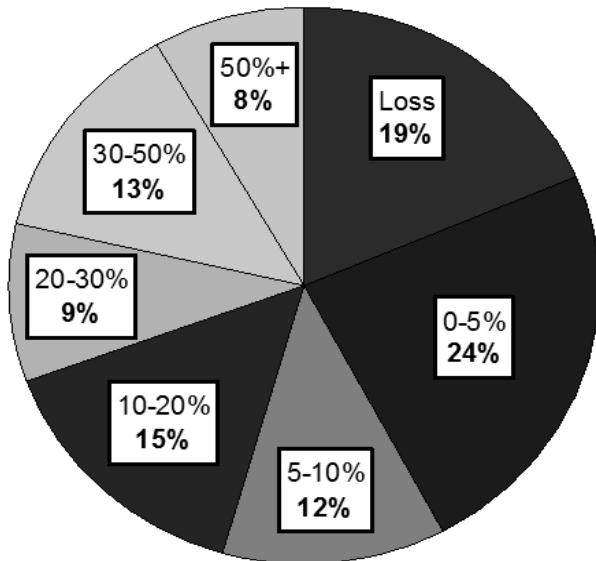
- Will RDR have a negative financial impact on advice firms, service providers and networks? *Action will need to be taken to create a new and compelling value proposition – this could be quite challenging*
- Is it possible that the advisors' share of the cake will reduce? *Yes – this is the only part of the value chain that has so far avoided margin pressure*

The intermediary population - 2008

Size and segments

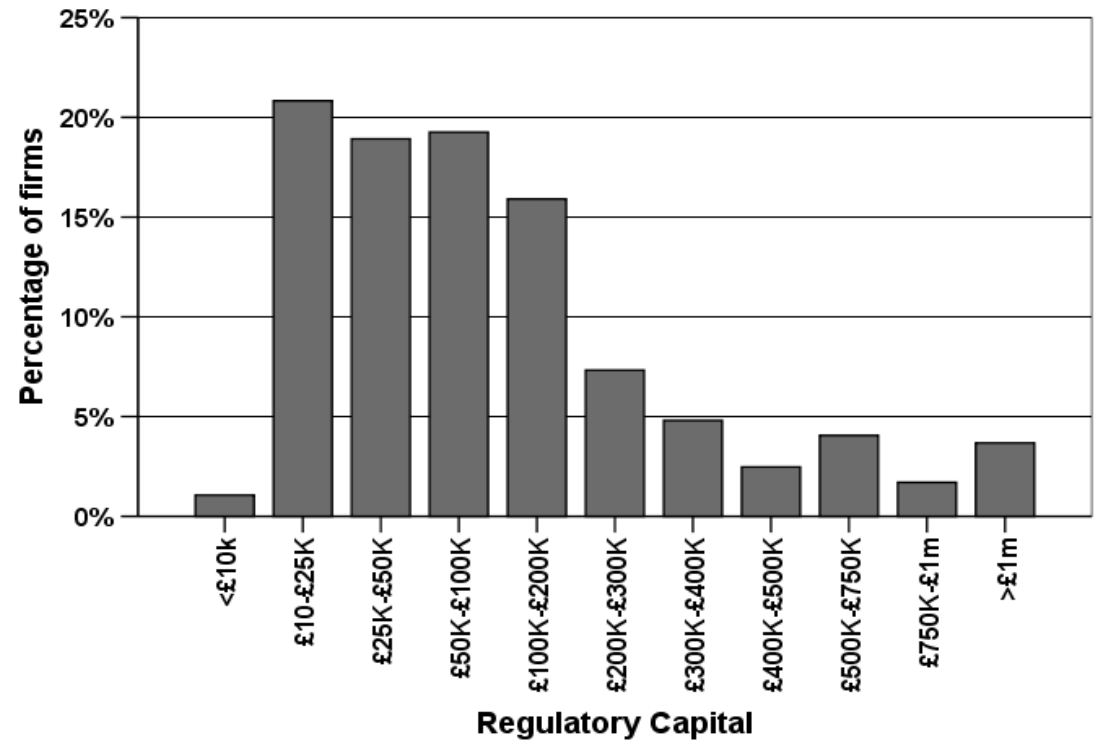
In 2008 there were an estimated 25,000 “Independent Financial Advisers” in the UK . A further c.15,000 tied or multi-tied advisers (including basic customer advisers) were estimated to sit within banks

Profit margins



Almost a fifth of financial adviser firms were loss-making in 2008 – that figure will increase significantly this year with high profile casualties

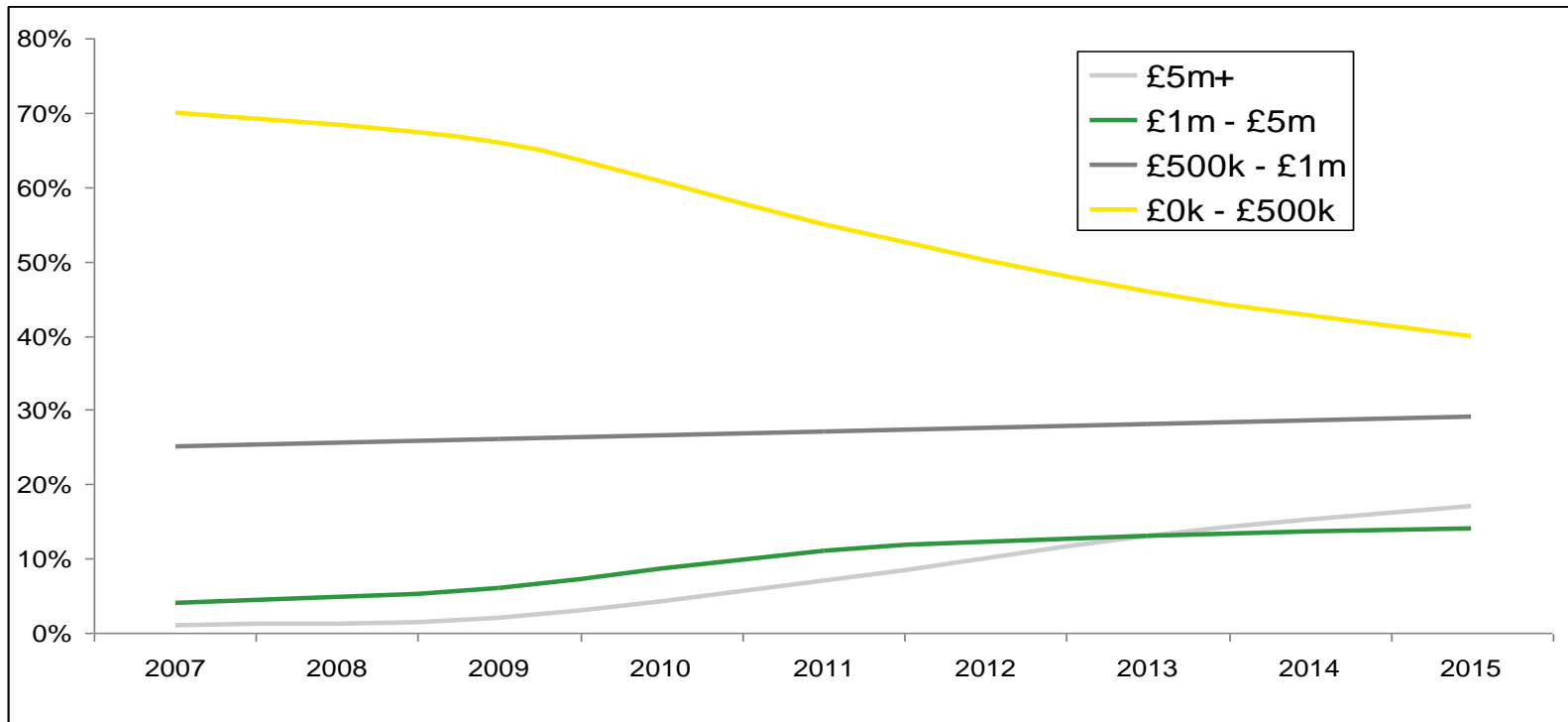
Capital resources



A significant number of financial adviser firms are poorly capitalised, with about 40% of firms having regulatory capital of less than £50,000.

The IFA channel is consolidating

Market share of IFA firms based on turnover



Source: Cydonia 2008 (Data sources: FSA, Matrix Data)

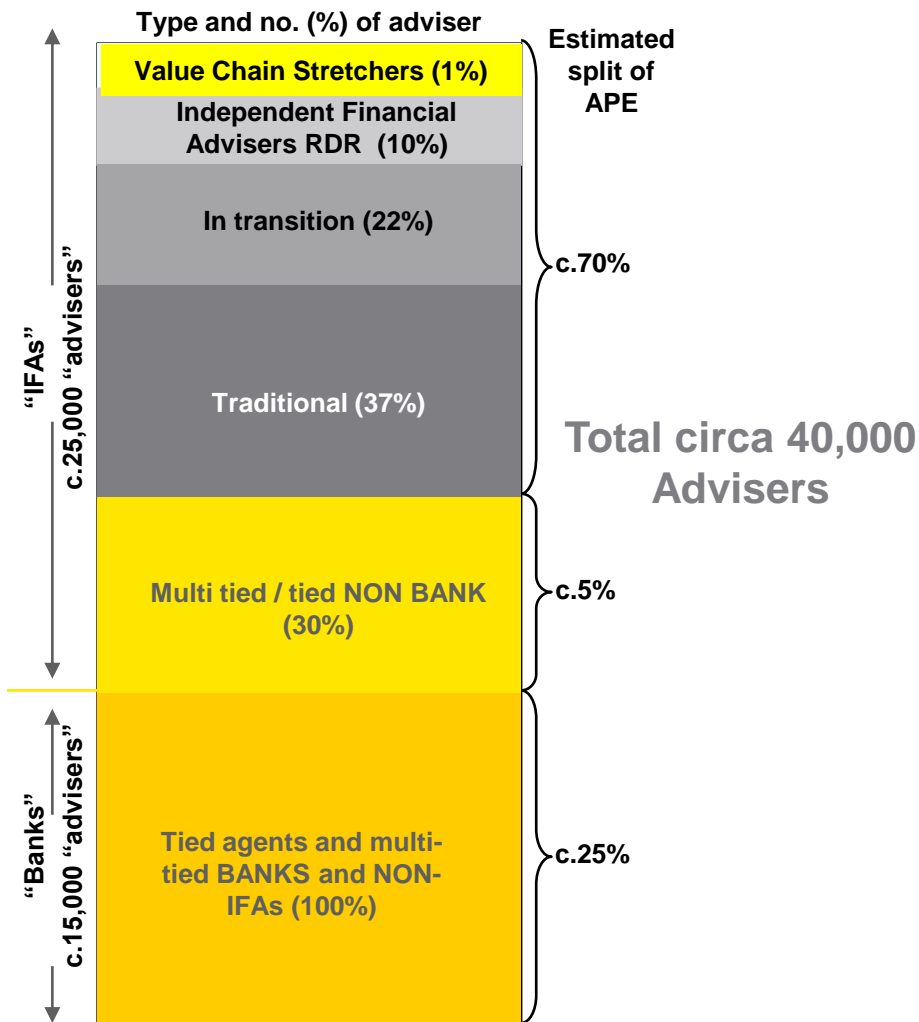
- Convergence – IFAs, wealth managers, private banks, private client and stockbrokers
- Firms will either develop own fund range or outsource investment management
- Firms will specialise – investment, pensions, corporate, etc
- Focus on cost reduction – platform consolidation

Consolidation trends

- ▶ Percentage share of firms turning over less than £500k will fall due to key shareholder exit, RDR outcomes and tightening economic conditions
- ▶ Firms turning over more than £5m will have a greater market share than those with t/o £1m-£5m in 2013. But will they be profitable?
- ▶ Value of firms has fallen dramatically due to reduced revenues and regulatory challenges. It will be some time before we see a recovery

The current distribution landscape is quite complex
 Our post RDR hypothesis is quite simple at this stage

2009 Distribution Landscape – An EY hypothesis



- This hypothesis is driven by a set of assumptions based upon EY's market insight, research and experience within the distribution space
- Bancassurance includes advisers that are focused on selling mortgage, protection and simple products. IFAs within banks are captured within the IFA business models
- Our estimate below sees a market with just 20,000 advisers
- We believe that the number of IFAs will be dependant on the premium placed on the value of the brand
- "Restricted" advisers are actually less restricted than independent advisers
- We believe that future advisor value propositions will be more innovative and more compelling. Providers will need to recognise this

We estimate that post-RDR there will be around 10,000 independent advisers and around 10,000 "restricted" advisers - plus bank staff selling commission based basic products and protection

Profitability could be challenging for some business models

2009 pre-RDR scenario

Turnover	Basic commission	£40m
	Uplifts	£8m
	Fees from advisors	n/a
	Provider payments	£2m
	TOTAL TURNOVER	£50m
Management expenses		£45m*
Gross profit / loss		£5m

Number of advisors	700
Average productivity	£70,000 (£49k "net")
Average case size	£1500 (net commission)
Number of cases pa	46

* Management expenses of £45m include £35m to advisors – based on 70/30 commission split

2013 post-RDR scenario

Turnover	Basic commission	n/a
	Uplifts	n/a
	Fees from advisors	£4.2m**
	Provider payments	£2m
	TOTAL TURNOVER	£6.2m
Management expenses		£10m***
Gross profit / loss		(£3.8m)

Number of advisors	700
Average fee income	£56,000 (£50k "net")
Average fee	£1,250 plus VAT
Number of cases pa	45

** Fees from advisors of £4.2m assumes average £6k per advisor for menu of services)

*** Management expenses of £10m assume no payment to advisors)

Options for large advisory firm and or network or service provider

What are the options? Will the model survive?

Revenue

- Increase payments from providers?
 - *FSA principles will make this challenging for all parties*
- Take a % of advisor fee as well as fixed fee?
 - *Market economics challenge. Likely to be even more competitive environment post-RDR*
- Different model for non-investment business?
 - *Mortgage and protection propositions may still offer the opportunity to gain commission uplifts*
- Revenues from platforms?
 - *Need to ensure visible positive outcomes for clients*
 - *Need to encourage advisors to use one platform*

Expenses

- Acquire/build advisor base to achieve scale cost benefits
- Reduce operating costs via a single platform with back office benefits
 - *Need to ensure visible positive outcomes for clients*

RDR winners and losers - summary

Providers

Winners

- Increased emphasis on risk mitigation – therefore will have access to capital or partners who do
- Complete consumers proposition based on a carefully selected market segment – either internet based or through a direct sales force, focusing on carefully selected consumer segments
- Compelling proposition to the market (ie administrator / insurer / distributor). What is the value add?
- Low cost base and technology embedded within the business
- Close to the market
- Intimate relationships with key distributors and,
- Propositions which meet the needs of those firms

Losers

- Focus purely on administration
- Don't recognise the importance of strong relationships with the "new model" post-RDR advisor
- Without the ability to listen to the market and launch appropriate products quickly

Distributors

Winners

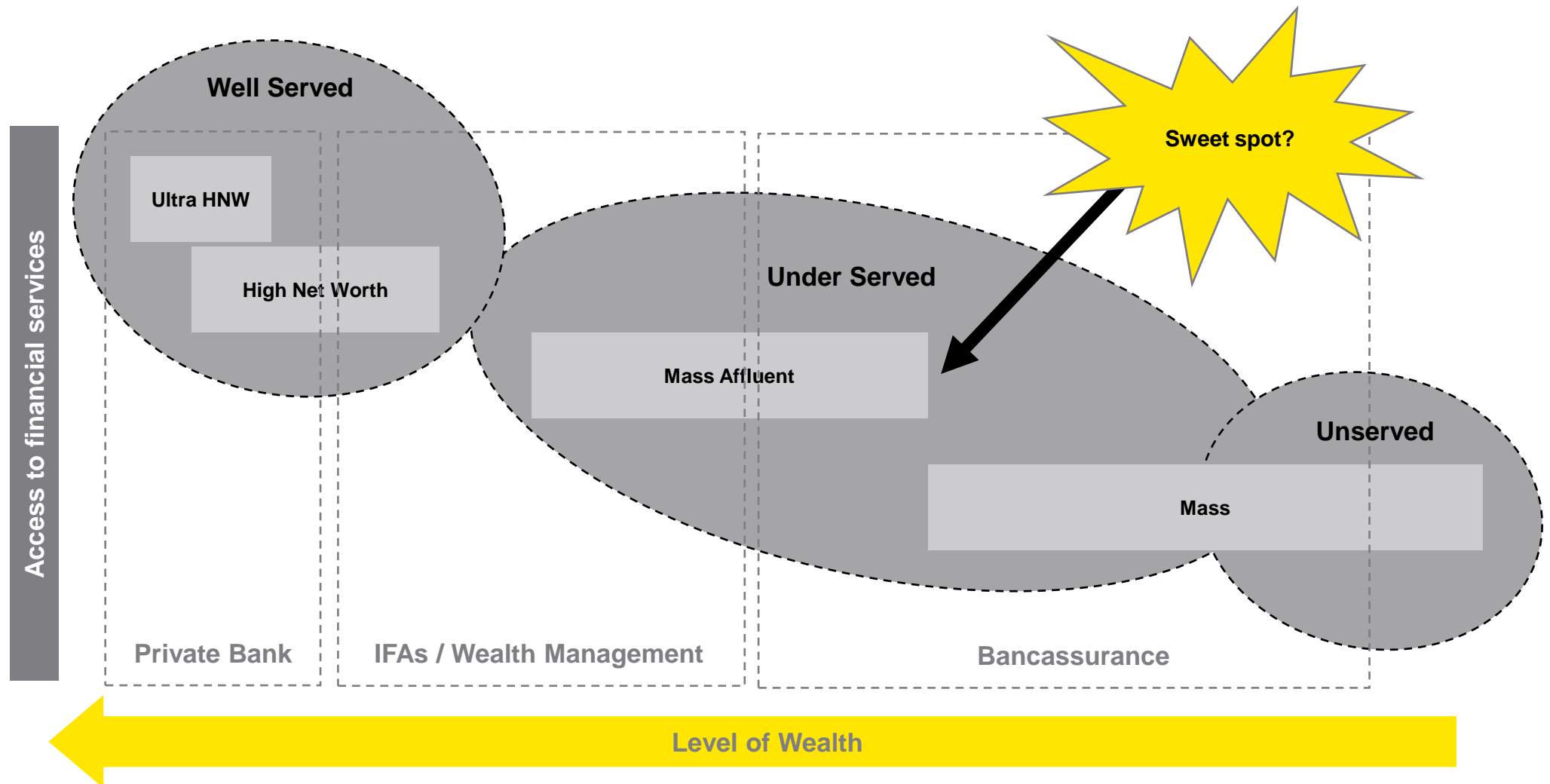
- Fee-based advisers who actively seek chartered qualifications, have solid capital provisions, and invest in developing themselves
- Firms that build a strong and consistent client proposition and customer experience
- Advisers that believe in the value of their proposition and are prepared to price accordingly
- Firms that recognise that their core competency is advice and look to outsource non core processes
- Firms that have strong leadership and the courage to make major changes to their business

Losers

- Firms that lack best practice standards and controls
- Advisors that don't recognise the post RDR opportunity and don't put clients first

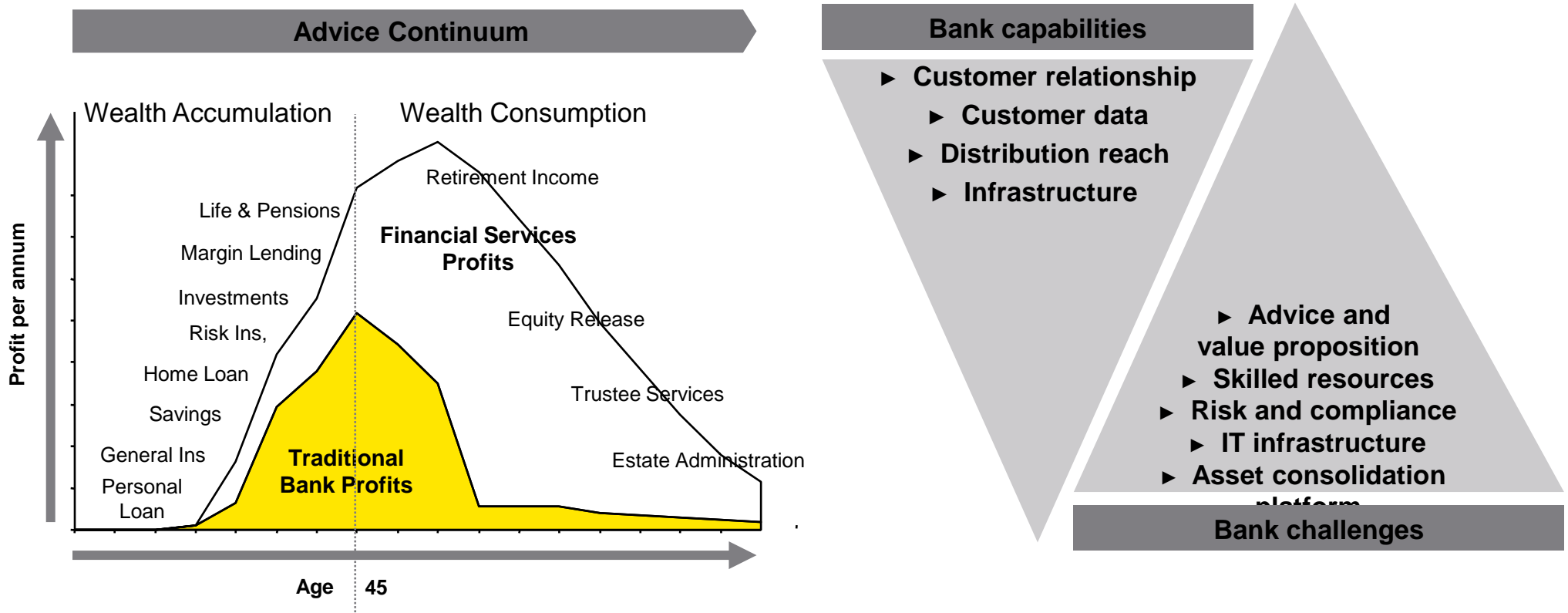
What about the banks?

The advice market continues to polarise as IFAs increasingly move upmarket to serve the high net worth consumer. This effectively leaves an advice 'vacuum' for the mass affluent and mass market consumers



Can banks succeed in the mass affluent retirement opportunity

Driven by their banking product set and underlying capabilities, banks have traditionally made the bulk of their profits from those customers **aged between 25 and 50**. RDR may bring **opportunities to penetrate less affluent segments** within this age range. However, bancassurers have **failed to extend** their proposition to meet the changed needs of those planning for or living in retirement – the **‘white space’**.



Providers

The future does not look bright for vanilla L&P

- Investment bonds are challenged:
 - Tax efficiency compared with mutual funds
 - Impact of RDR on commission differential
- Packaged pensions look challenged:
 - SIPP's at the top end
 - Personal accounts at the lower end
- Insured savings products are already history
- Future business models will need to demonstrate more obvious value:
 - To consumers
 - To shareholders
 - To advisors

So what options are providers considering?

- Risk mitigation
 - Standard and underwritten annuities
 - Equity release
 - Long term care
 - Protection
 - Investment risk mitigation – “Third Way products” – probably coupled with low cost passive funds
- Administration and aggregation - platforms
 - Product centric v client centric
 - Individual v corporate
- Distribution
 - Create direct to consumer propositions wealth and/or mass market
 - Worksite sales into the mass market alongside group pensions and employer portals/wraps
 - Acquire or build intermediary business
- Consolidation

Platforms

Wrap, technology, enablers and trends

The adoption of wraps by intermediaries has been slow to date with almost every player spending more and delivering less than plan. Serious challenges remain around the execution and economics in this market. There are now about a dozen platforms in the market. Only one – maybe two appear to be making money

The RDR will have an impact on the future platform landscape

- The RDR will encourage most independent and non independent advice firms to use a platform for a number of reasons:
 - Ability to take adviser charges out of the client cash account – particularly important when there is no new product sale or the product cannot make a matched payment to the adviser.
 - Enhanced customer proposition and more professional image for adviser
 - Efficiency
 - Strengthens relationship between the firm and the adviser's client
- The FSA are likely to be relaxed about independent advisers using one platform and one set of tax wrappers if this is in the client's interests

The outcomes are uncertain, and there are no clear winners at this time

- Capita and others are looking to build integrated front to back platforms and could completely disintermediate life companies in the post RDR commission free world.
- Many opportunities remain for providers to win users for their platforms but a price battle will challenge already thin margins and create casualties
- Winning providers in the space will need capital, courage and a feature rich, reliable, transparent platform with a compelling proposition which will attract users within the next couple of years. They will also need to demonstrate excellent intermediary support while keeping costs to the minimum. There are no obvious long term winners at this time
- Life companies may take the view that RDR will curtail the use of packaged products and invest into a wrap platform rather than developing adviser charging capabilities. Others will attempt to cover both bases for as long as this makes sense

The market is still immature. RDR will galvanise activity. Non-independence may require a different type of platform

Despite the lack of certainty we are seeing a number of trends in the wrap space

Fund Supermarkets

- ▶ Funds supermarkets such as Cofunds, Skandia and Fidelity are evolving their models towards a more transparent wrap platform with a range of tax wrappers and a cash fund. They often involve strategic partners

Life Companies

- ▶ The major institutional players such as Aviva, Axa and Standard Life seem to have all experienced implementation and economic challenges
- ▶ Life companies are extending their e-commerce capabilities to integrate with and provide aggregated client views to advisors
- ▶ Some life companies have invested cash and other resources to develop relationships with platforms

Independents

- ▶ The “independent” platform providers are attracting IFA investors but their propositions are quite basic at this time.
- ▶ The independent providers are also attracting institutional interest in terms of potential acquisitions

Intermediaries

- ▶ Intermediary interest in wraps continues to grow but many firms have yet to fully understand the concept let alone commit. The Bankhall Portavista platform was the first serious intermediary development but seems to have encountered some challenges
- ▶ Some benefit consultants have expressed interest in corporate wraps which are linked to employee flexible benefit systems

The attitude of the FSA to wrap platforms continues to confuse advisors, however there is a trend towards more transparent charging in anticipation of FSA intervention

And finally...

Summary – The potential post-RDR savings and investment landscape. .

- New advice and product propositions will emerge to meet the demand of new regulations, new demographics, new economics and new technologies.
- Margins will be scarce in aggregation and administration – driven by increased transparency, competition from new high tech/low cost entrants and increased commoditisation of asset management – (passive funds)
- Insurance companies will need to increasingly leverage their USPs – mortality, morbidity and investment risk management. This will require scale and capital
- Radical change in distribution. Increased use of internet and other non face-to-face channels to create multi-access propositions for investors
 - 70% to 75% of UK upper mass affluent and high net worth wealth managed by around 10,000 fee based Independent Financial Advisors and 10,000 “restricted” advisors - operating within banks, large scale intermediary organisations and owner managed businesses
 - Sales people promoting simple products via life company, bancassurance and brandassurance models with innovative approaches to engaging with the mass market
 - Increased emphasis on non-advised business for investors unconvinced by fee based advice propositions
- Very limited advised or execution only transactions “off platform”