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Defining your investment strategy

A wake up call

Proposals in the Retail Distribution Review (RDR) seek to change adviser remuneration, introduce higher levels of professional qualifications and drive improvements in the clarity with which advisory firms describe their services.

Your firm's investment strategy will be a key part of your client service proposition and under the RDR will become a key differentiator. Yet many firms are struggling with allocating adequate time and resources to the critical area of investment strategy for their clients and equally important is dedicating time to monitoring and reviewing existing holdings and portfolios.

Whatever the shape of your service proposition the research, analysis and selection process that you adopt will help define the advice you provide; without applying a rigorous selection process, robust due diligence and ongoing monitoring your firm may face unnecessary regulatory risks and possible censure. You may also fail to meet some of the tenets of the FSA's Treating Customers Fairly (TCF) initiative.
Constructing and maintaining a robust investment advice process need not be time consuming and costly but you need to 'wake up and smell the coffee' and start the process to review the way you do things now

As investors have access to more fund information and data than ever before they are demanding higher levels of advice and challenging the status quo; so reviewing your current process will not only help reduce risk in the business but will respond to the demands of your clients. An increasing number of firms have found that outsourcing their investment research to a specialist firm rather than continue to do this in-house is delivering real benefits and by taking this approach you will:

- Free up valuable time to build and enhance client relationships;
- Allow you to be proactive by alerting clients in advance of issues and opportunities;
- Help meet your TCF requirements;
- Have a consistent approach to the provision of investment advice;
- Deliver efficiencies, reduce regulatory risk and add capital value.

Where do we start?

Within your firm you need to spend time to discuss and agree your investment philosophy or ethos and out of that will come your investment strategy to sit within your advice process.
Some key areas to consider would be:

- Are you exclusively an advisory business or does an option to offer discretionary fund management feature within your overall proposition;

- What's your view on passive v active? As charges are increasingly being seen as a drag on investment returns and combined with the failure of some fund managers to outperform benchmark indices, more and more advisers are turning to other investment vehicles such as passive funds and Exchange Traded Funds (ETFs) as a more cost effective way of gaining exposure to different asset classes and markets for their clients' portfolios.
- What's your approach to asset allocation? Do you have the necessary expertise to set the asset allocation for clients, define and create investment portfolios? How will you monitor and rebalance portfolios to the agreed asset allocation and how frequently will you do this?
- What client segmentation have you done? Fundamentally, the approach to client segmentation for any Advisory business must result in the adviser delivering the right service and the right advice to the right client at the right time BUT the proposition must be delivered in such a way that it is profitable to the Advisory firm. For client segmentation to work successfully, the methodology needs to be robust and as simple as possible or otherwise the business will tie itself up in knots and end up making the situation worse for both itself and its clients. It is also important to identify those clients who have the potential to buy more in the future which will help the business in being able to track where its future income/profit stream will come from.

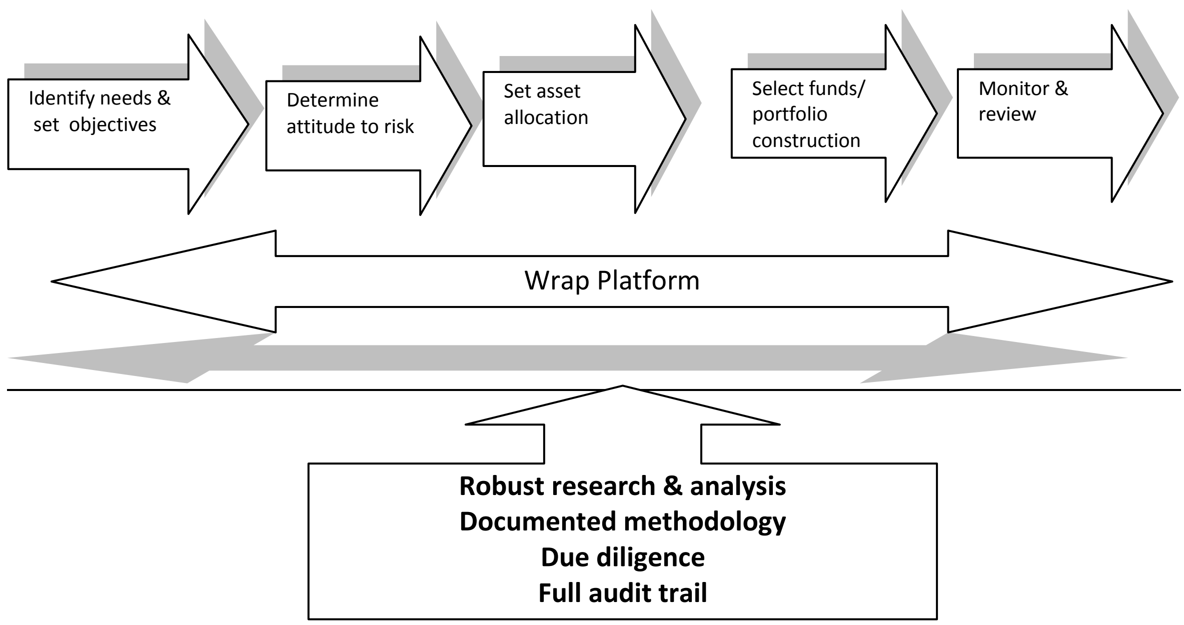
All this needs to be documented and this approach should form the basis of your overall client service proposition.

Building your Advice Process

Having a structured advice process, containing several stages each underpinned by robust methodologies will set your firm apart from the competition and will enable you to justify the charge for your professional advice.

Building a differentiated business requires you to sell your proposition to the right target audience in a cost effective way, but another is to focus on where genuine expertise exists and to buy in or outsource other key aspects of the whole process. So let's look at a typical investment advice process:

The investment advice process



Identifying needs & setting objectives
Most advisers now approach this 'know your customer' with complete ease and confidence. Increasingly, some advisers are introducing lifestyle and life planning questionnaires into the process along with cash-flow modelling software tools seeking to respond to the increasing sophisticated client needs and to differentiate their service from the competition.

Attitude to risk
Advisers use a variety of tools to determine a clients attitude to risk and increasingly these involve more scientific approaches such as psychometric testing and questioning techniques, but there is no substitute for a good old fashioned discussion with your client where you can probe and challenge their attitude to risk and their understanding of the impact of market volatility in the market on their investments. This area is fundamental to establish client understanding, another part of TCF and needless to say this must all be recorded on the client file.

Asset allocation
Many books have been written on the subject of asset allocation and the impact – both positive and negative – on long term investment performance. Again, software can play a part in helping set the appropriate asset allocation, but you should ensure this is independent of any product provider to avoid any bias.

In setting asset allocation it is necessary to do this at a strategic level, based on the client's appetite for risk over the longer term meeting the client's expectations as determined by the risk profiling exercise. Some form of tactical overlay may then be considered to respond to shorter term shifts and trends in the market, but the strategic position should remain the starting point.

Fund selection/portfolio construction
This is an equally important stage of your investment advice process and you should ensure you choose funds based on a combination of quantitative and qualitative factors. The quantitative measures centre on performance and risk with a number of measures used in each area to provide a comprehensive picture.

The qualitative assessment of any fund is to assess how the fund will perform in the future. The purpose of this part of the analysis is to ensure that the fund has robust fund management processes in place, and a strong fund management team and the qualitative screen allows a more detailed look at the how the fund actually operates.

By combining both quantitative and a qualitative research you build up a thorough understanding of the fund, and how it works in different investment conditions and this can then be fed through into any selection for portfolio building. Use our ***FREE Rated Fund Service*** to make your fund selection and also refer to our Sector factsheet which will provide further guidance on the combination of funds.

Monitor and review
Not least to ensure you can justify the payment of ongoing remuneration you need to have a formal process for monitoring the underlying funds which form part of your recommendations made to clients and for reviewing performance and any required rebalancing.

Wrap Platforms

Once your investment strategy and process has been agreed selecting a wrap platform will be easier and some solutions will probably be capable of being eliminated because of the approach you want to take.

A wrap platform can play a part in helping firms to re-position their business model by improving their service proposition, streamlining the provision of data across a number of differing products and developing more efficient administrative processes; this should facilitate a very desirable client proposition that is certainly worth paying for. By adopting a structured and robust approach to the selection of a wrap platform we believe advisers can meet their regulatory requirements with a fully documented process.

With the administrative benefits of having a comprehensive view of their portfolio, the ability to switch investments in a timely and cost effective manner, together with tools to rebalance portfolios it is easy to see why the use of wrap platforms has become such a compelling option for the forward thinking advisory firm.

The regulator is continuing to review the use of wrap platforms in the context of delivering the desired outcomes from the RDR and the continued developments of wraps appear to us to be inextricably linked. For more help and guidance see our ***Wrap Platform Adviser Toolkit*** which is available as a free download from our website.

Legacy Assets

Many investors seeking your advice will probably have numerous and differing investment products possibly bought over a long period to meet varying needs – some of which may no longer exist!
The need to consider such legacy assets is one that requires careful consideration and whilst there is no doubt reviewing such investments can bring significant benefits to both the client and the firm, the process that must be undertaken can be both time consuming and will be subject to greater regulatory scrutiny.

The regulator has acknowledged that a large proportion of legacy assets *could* be more appropriately held on wrap platforms but has also issued clear guidance of the issues that must be taken into consideration to ensure that the clients' best interests are protected. In particular they highlight three areas of concern that they would like to see addressed:

- Is any increase in costs offset by a commensurate increase in benefits?
- Does the transition involve complexity that affects the client's ability to make an informed decision?
- Does the adviser have the competency to deliver the new investment proposition being offered?

As previously stated, the regulator acknowledges that the transformation could bring significant benefits to both the client and the advisory firm but they do want to see firms evidence due process to ensure the client's best interests are being protected.

Conclusion

By spending time reviewing your investment strategy you will provide focus in delivering a world class client service that will allow you to continue the journey towards making your business fully RDR compliant, delivering improved levels of advice and building trust with your clients. Firms adopting a clear investment strategy underpinned by a robust advice process will see a more sustainable business model going forward and if you want to discuss the opportunities for your firm and how we can help you with our outsourced investment solutions then just contact us.

Rayner Spencer Mills
Yorkshire House
41 Keighley Road
Silsden
BD20 0EH
www.rsmgroup.co.uk
01535 656 555