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“Selecting an investment partner”

This article has been prepared by Frontier Capital Management for information to UK based intermediaries and wealth managers only.

The UK Financial Planning industry is undergoing a fundamental change in the way businesses are operating. The largest change is the movement away from “transaction/product based” advice and towards true financial planning as the core “value proposition” for the end client. This transformation is normally accompanied by other key business decisions aimed at streamlining and increasing both value for the client and profitability for the business and can include:

- Segmentation of clients and clearly defined service offerings
- Adoption of a financial planning software platform
- Adoption of a standard risk profiling tool
- Systemising the investment management proposition

The final item above often is directly linked to the other points since a business with a standard risk profiling tool will normally want to have a consistent “investment solution” for each client with the same profile.

An outsourced investment approach to a specialist manager makes more sense than ever in our increasingly competitive environment. Why tie up valuable staff and resources in building your own investment proposition if a world class, low cost, rigorous solution is already available?

If your business is considering a decision to outsource all or a portion of your investment management then this document can offer some objective help in selecting the right investment management firm as a partner.

Many industry leading advisers who have successfully created their own in-house approach to investment management have later abandoned this strategy as it did not allow them to create maximum client and shareholder value within their business. This is not to say it didn't work, but they believed their scarce time and human resources were better employed elsewhere to add value to their clients.

A partnership approach with a single investment manager is not without its risks. However, many negative experiences that we have witnessed have occurred due to a lack of proper due diligence before establishing a relationship. By following the methodology outlined below you can minimize the risks and achieve a successful outcome for your clients and your business.

1. Start by evaluating your business objectives

How would my business look if I was designing it from scratch today? Which clients are best suited to my value proposition? What do these clients really want/expect from me? What might they expect from me in 3 years time? Would I be best to focus on core services (such as relationship management, strategic advice, lifestyle planning, cashflow analysis, technical advice on tax and pensions) and outsource the rest, or should I retain internal control of the investment process? What value would I like to receive for the goodwill I am creating in my practice?

Outsourcing investment management provides a way to:

- Deliver a consistent investment approach through all market conditions which is critical for long-term investment success
- Ensure compliance with Treating Customers Fairly (TCF)
- Significantly lower the clients overall cost of investing (reducing their costs while allowing you to increase your margins)
- Free up your limited internal resources, allowing you to spend time on the high value added tasks for your clients
- Build a business partnership with a key supplier (or suppliers) that can support your business growth in ways over and above mere investment management (e.g. Introduction to other successful advisers, sharing of best practice information between users, and strong educational support)
- Meet your client's expectations of a genuinely holistic service
- Strengthen and protect existing client relationships through adherence to their financial plan
- Increase average fees per client
- Increase referrals from your existing clients, and
- Create a larger capital value in your business.

The financial services industry has made many promises to clients regarding the delivery of genuine high quality advice. While we believe many of these promises cannot be met using existing business models, a "new model" approach and a sound business plan can create real sustainable value for all stakeholders (clients, advisers, product manufacturers).

2. Due Diligence – research your options

The lead-time to carry out effective due diligence on any prospective partner is around 90 days. There is then a 'getting to know you' period that may take 12 months to truly establish a successful relationship. Several hours spent over a 90 day period in this initial engagement phase can save you from months of work trying to fix the damage that a poor investment management firm can do to your clients and your business.

During the due diligence phase there are several areas you should consider:

- ***Do the philosophies match?***

If you are a firm that provides independent fee based advice to your clients then there is little point researching an investment management firm that is owned by a giant institution that still moves product through the use of large up-front commissions.

- ***What are their key points of difference?***

How does the firm differ from others in the crowded investment management marketplace? If you are not sure, ask them. They should be able to articulate their difference to you and to your clients.

- ***Where is the firm's specialist expertise?***

Every business today must specialise to survive. The days of being all things to all people are long gone, and promises of such can only lead to disappointment. Find out where the potential firm has specialist knowledge and see if it matches well with your client's needs. It may be that you will need more than one investment management partner to deliver a solution that is appropriate for your clients, so choose two or three specialists rather than one generalist.

- ***What are their technical skills like?***

Ask to attend an educational session to really understand the investment philosophy before you commit hours and hours to more detailed investigation. Look for evidence of real value-added strategies that may apply to your clients, and support in communication of these strategies to your clients in a way that they will be able to understand. What educational and professional qualifications does the staff of the manager have?

- ***Does the firm have a strong "evidence based" approach?***

As you may have already discovered, a healthy mix of scepticism is required to provide successful investment outcomes to clients. Firstly, most investment managers do not achieve even market index performance after fees. Secondly, from the ones that do, it is impossible to separate how much of that was luck and how much is skill, as academic research has shown that good performance is unlikely to persist over the long-term. Thirdly, while there are a handful of fund managers who do seem to outperform, there is no systematic way of identifying who these fund managers are ahead of time.

Ask to see the evidence supporting any investment approach that you are investigating. Any manager that has built their business on this strong foundation will be happy to spend the time to show you.

- ***What are the real costs of investing using their approach?***

The annual management charges disclosed in any product disclosure statements often account for less than one-third of the real costs of investment management. Every time any underlying assets are bought or sold within a fund, additional costs are incurred. For example in a multi-manager portfolio these transaction costs alone can be above 2.5% and are not included in TER calculations. It is very important to distinguish between published TERs and these additional 'hidden costs' of investing, and you should ask the fund manager directly as to what his estimates are of these hidden costs. For further information on hidden costs and the impact on future returns, please refer to Frontier's research article: 'When is a Total Expense Ratio not a Total Expense Ratio?'

- ***What other services can the firm offer?***

It is important to evaluate an investment firm on the sum of their value-added services. For example, can the firm help you to formulate your investment policy? An investment firm that can help you grow your business, help with your marketing strategy and help you communicate with your clients effectively, as well as provide a superior investment solution is worth their weight in gold.

- ***What are the office systems like?***

Arrange a walk through (on their premises) of the business systems employed. Look for evidence of a highly systemised process, not just the naming of various pieces of computer software. People and process deliver consistent outcomes, not pieces of software. Lack of systems and processes could mean problems in the future.

- ***Conduct a detailed due diligence on the behind-the-scenes detail***

Many of the best investment management propositions are not delivered by the mainstream big brands or insurers. While small is often "innovative", it is far less so when it comes to security of clients' funds. Therefore, you need to confirm who the independent fund administrator is, the fund auditor (preferably a big firm) and who has custody of the fund assets. Therefore a detailed due diligence needs to be conducted to feel certain that the i's are dotted and t's are crossed. Any potential partner should be able to provide a detailed due diligence process for you to walk through.

- ***Obtain testimonials from other advisers***

Ask for the names and telephone numbers of other firms they are working with, and arrange to give those firms a call. Obviously the feedback should be positive.

- ***Test drive a case or two***

Once these other areas have been satisfied the true test is to put a case through. Upon completion evaluate how you were dealt with, kept informed, and most importantly the responsiveness of the administration team.

▪ ***Establish the relationship***

If you are still satisfied at this point, agree on a period of 6-12 months to establish a genuine joint venture partnership. These types of relationships take time to build and to bed down. Expect the total process to take around 12 to 18 months, and to require genuine input and feedback from you along the way. Delegate, but don't abdicate responsibility for its success.

3. *Taking the next step*

If you think that an investment outsourcing arrangement makes sense for your business, please contact your Frontier Business Development Manager and ask us to start you off on your journey.

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