

Stakes in the Ground'
With Profits
Executive Summary Report

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December 2006

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1. Introduction

- 1.1. AIFA, ABI and other stakeholders have developed a concept called 'Stakes in the Ground' (SITG) to provide evidence of current financial services practices.
- 1.2. The objective of SITG is to create a 'map' of current practice and process, providing regulators, Ombudsmen, the industry and consumers with a point of reference to draw upon in the future as evidence of how business was conducted at a given point.
- 1.3. Rather than attempt to address the entire investment advice process, work focused on developing the first stake, specifically around advising on With Profits business. All other products / areas were out of scope.
- 1.4. It is not the role of SITG to comment on the appropriateness or otherwise of the processes that have been evidenced. The fact that a process has been recorded and commented on within this report does not mean that it should be adopted as 'best practice'. It is for advisers to decide on the processes that they need to employ in the compliant running of their businesses.

2. Assumptions

- 2.1. The SITG stakeholders made several assumptions to define the context and constraints of scope of work.

With regard to With Profits, this covered:

- New monies
- Regular premiums / top ups, including indexation
- Existing policies, including PUP, those which are dormant, pre-LAPR removal, e.g. frequency and reasons for reviewing such holdings
- Policies within both open and closed funds
- Traditional With Profits funds, unitised and other recent variations on such funds

- 2.2. The focus of the work was on advisor firms operating as 'independents', i.e., not those operating as part of a bank or building society; banks and building societies have prescribed processes adopted by all their advisers. For this report the term IFA is used throughout and for the purposes of clarity it includes those operating as whole of market advisers.
- 2.3. Each of the sponsors involved their respective members specifically to generate interest, e.g. in the on-line quantitative research or as part of the qualitative research.

3. Approach

- 3.1. The project comprised a number of individual activities which collectively delivers the required map

3.1.1. Environment analysis.

This analysis provides a context to understand the background against which advisers behave, specifically in relation to 'With Profits' business.

3.1.2. Research amongst advisers:

- Small to medium sized firms (Quantitative Research).

544 advisers completed an on-line survey during the period 9th August 2006 – 5th September 2006. The average completion time was 14 minutes.

207 of the original 544 advisers completed a follow up survey focused on client numbers, during the period 26th September – 30th September 2006.

Appendix 1 details the complete question / no. of responses from the on-line survey for charts and tables used in this report.

- Large firms (Qualitative Research).

20 representatives of National, Network and Regional firms participated in a 45 – 60 minute interview, during the period 22nd August 2006 to 8th September 2006. All the interviews followed the same discussion guide to ensure consistency of the questions asked whilst allowing for in-depth focus on key areas.

3.1.3. Additional Analysis and Research

- Two specific groups of respondents to the on-line survey merited further investigation:

The 35% who agree or strongly agree that *'With Profits is an outdated concept and I would advise any client who held a With Profits policy to switch to another form of investment'* (called 'Sceptics')

The 54% who agree or strongly agree that *'I believe that in most cases the disadvantages of holding an investment in a closed fund are sufficient in isolation to justify recommending that a client reinvest elsewhere'* (called 'closed funds')

- To investigate the specific attitudes and behaviours of these groups two further activities were undertaken:

Detailed analysis of the on-line survey data, comparing their responses to key questions to those for 'all respondents', to identify if any significant differences.

Twenty follow-up depth telephone calls, focusing on understanding the processes used when reviewing existing clients' / new clients' holdings and the reasons behind their agreement with the statement(s).

The sample was:

- 10 from 'Sceptics' and
- 10 from the group that agreed to both statements.

Calls typically took 10 – 15 minutes.

The results of this additional analysis are included in the main body of this report.

3.1.4. Quantitative Sample

- Accurate segmentation of the IFA community is a complex process but the Insurance Pocket Book 2006 and Matrix Database indicate that:
 - 46% of the total number of IFA firms are single outlets and have annual turnovers of less than £1 million
 - 409 (or 3.6%) of the 11,516 active firms have a turn-over of >£1m per annum
 - 48% of firms are members of a network
- Of the 544 respondents to the on-line survey:
 - 41% of respondents work in 1RI firms and 60% work in 1 or 2 RI firms
 - 77% of respondent firms have a turnover of £1m or less and 13% a turnover of >£1m.

There were 10% of respondents who preferred not to respond to the question about turnover, or didn't know the actual figure
 - 40% of respondents were regulated via an IFA Network or National IFA Partnership
- Based on this analysis the response to the on-line survey appears representative of the broader IFA community

3.1.5. Library

A library sourced from many diverse sources provides evidence of the material that advisers typically use with regards to With Profits.

The Library includes material not in the public domain, e.g. that provided by the IFA firms and commercial organisations such as AKG, which is not available for distribution.

4. Executive Summary

4.1. Attitudes towards With Profits

There is a balance of views within the IFA arena regarding the underlying concept of 'With Profits'. Whilst some of those interviewed believe it to be a sound concept, there are others who believe that there are flaws, such as a lack of transparency, which cannot be over-come.

There is a block of advisers who are anti-With Profits. These are more likely to be amongst the 49% who disagree that 'With Profits has a part to play as part of an overall portfolio of investments' and the 35% who agree that 'With Profits is an outdated concept and I would advise any client who held a With Profits policy to switch to another form of investment' – the 'sceptics'.

Further quantitative and qualitative analysis and research into the 'sceptics' group indicates that there are no significant differences between their responses to the on-line survey and that of all respondents. Further, that although they may have a specific attitude towards With Profits, this does not translate into different behaviours; they still adhere to proper processes when reviewing existing or new client's holdings before reaching their recommendations.

Some advisers, however, believe that the 'With Profits' concept is still a valid one; 42% agreed that 'With Profits has a part to play in an overall portfolio of investments' and many are confident about their knowledge levels, 85% or more are confident about 'having sufficient knowledge on the way With Profit operates to advise clients on new / existing products'.

4.2. Use of Wraps, Platforms and Other Investments as Alternative Products

Advisers are using a range of products / funds as alternatives, e.g. cautious balanced funds, property funds, managed and balanced managed funds to replicate a With Profits holding. This approach is supported by an increase in the number of on-line or PC based tools to help:

- Determine the clients risk profile
- Create an asset allocation strategy
- Select funds

Some of the more specialist investment firms have launched their own in-house OEICs with model profiles to match the risk assessment in the fact finds.

For advisers without access to such sophisticated funds, there has been an increase in the use of Wrap and Fund Platforms, such as Cofunds, Fidelity and Transact.

4.3. Adviser Awareness

There is a high level of awareness of With Profits amongst advisers and the head offices of Networks, National and Regional firms with regard to:

- The level of exposure to existing With Profit holdings
- The need to review clients on a regular basis
- The key aspects that need to be considered when considering With Profit products, e.g. MVRs, closed or open funds

Adviser confidence is high, with 85% or more of the 544 respondents stating they were 'very confident' or 'confident' about 'having sufficient knowledge to advise on new / existing with profit products'. However, many would like to see more being done as 72% of respondents 'disagree' or 'strongly disagree' that 'Providers ensure that the IFA is equipped to advise on With Profits by providing suitable training and education'.

Despite such high levels of confidence, there is a general nervousness amongst advisers about handling a product that has been the subject of significant adverse comment in recent years.

4.4. Review Processes

In all firms there are either (i) specific processes in place or (ii) With Profits is considered part of the general Procedures Manual.

Where a firm is part of an Appointed Representative Network or a National / Regional firm monitoring and appropriateness is closely supervised. This supervision is typically carried out by a central team who review all cases. Those advisers who are directly regulated tend to have monitoring against their internal processes, unless they have purchased support services from an external supplier.

Nearly 50% of advisers to the on-line survey have reviewed With Profits Bonds / Pensions / Mortgage Endowment client holdings in the last 12 months. Where not all clients had been reviewed, a large number (nearly 50% of respondents for With Profit Bonds / Person and Stakeholder Pensions) state it is their intention to do so in the next 12 months.

Many advisers stated that they were still in the process of reviewing clients in light of A-day changes, hence the delay in specifically reviewing With Profit clients.

However, a significant number stated that they would not be conducting reviews on certain products, e.g. nearly 40% of respondents for Mortgage Endowments, because there was no on-going relationship with the client.

It would appear that one third of 'active' clients and two thirds of 'in-active' clients have not received a review in the last 12 months.

4.5. Sources of Information

There is a considerable range of information available and used (at the discretion of the adviser) for both existing and new business. No one source is considered more important than any other, with the emphasis being on using information which is 'fit for purpose'.

The main sources of information being used are:

- Published surveys
- Independent Technical Reports
- PC / Internet based analysis tools

- Magazine articles
- Key Feature Documents
- Network / Services company technical team reports

Principles and Practices of Financial Management are mentioned specifically as being used by 28% of advisers for existing business and 18% for new business.

Around 45% of respondents use technical reports (mainly those from AKG), which have summaries of such documents so the overall levels of use of PPFMs and their information is higher.

Many advisers feel the original documents from Providers are unwieldy and written in an inconsistent manner making comparisons difficult.

4.6. Closed Funds

There is a large amount of mis-trust in closed funds, with many firms stating that the current bonus levels and MVRs make holding onto such investments a poor alternative to switching into another investment (with the same risk profile, but with a greater likelihood of a better return over time)

Misgivings over the potential for closed funds comes through in the level of agreement (54% of respondents to the on-line survey) with the statement '*I believe that in most cases the disadvantages of holding an investment in a closed fund are sufficient in isolation to justify recommending that a client reinvest elsewhere*'

On further qualitative and quantitative analysis and investigation, however, the attitudes of the 54% do not affect their adherence to laid down processes when reviewing existing or new client's With Profits holdings. However, there is a small minority of advisers who would automatically switch.

5. Main Findings

5.1. The With Profits Concept

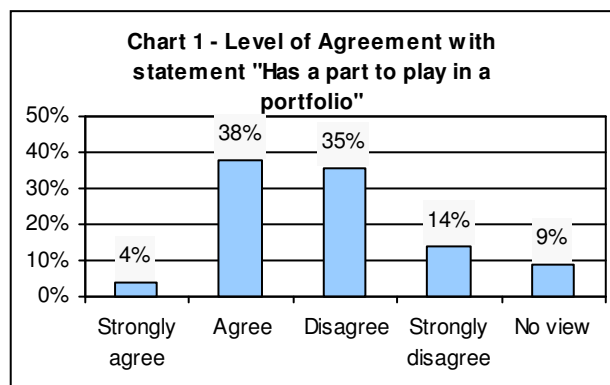
5.1.1. Many of those interviewed in the qualitative research state that the basic premise behind the With Profits concept is a sound one. That is, the ideas of:

- Pooled risk
- Smoothed returns
- Guaranteed nature of the bonuses

However, there are others who believe that there are flaws in the concept, such as a lack of transparency, which cannot be overcome.

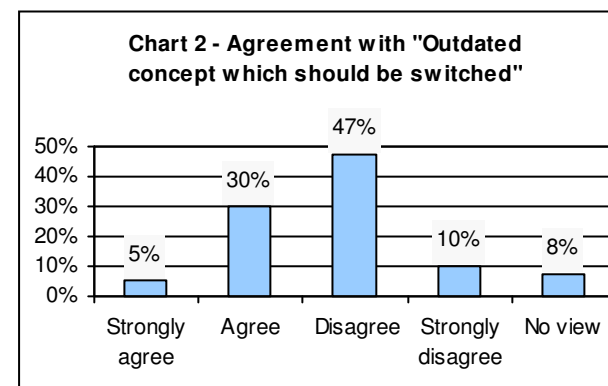
5.1.2. This balance in 'belief in the concept' is evidence by:

- 42% of respondents to the quantitative on-line survey either 'Strongly Agree' or 'Agree' with the statement that 'With Profits has a part to play as part of an overall portfolio of investments'. However, 49% 'disagree' or 'strongly disagree' with the statement – see Chart 1



- The level of disagreement to the statement 'With Profits is an outdated concept and I would advise any client who held a With Profits policy to switch to another form of investment'. Nearly half the 544 respondents disagree with the statement and a further 10% strongly disagree.

However, just over a third (35%) either 'agree' or 'strongly agree' – see Chart 2. This group has been named 'sceptics'.



5.1.3. A thorough quantitative analysis of the 'sceptics' group, as compared to the main on-line respondents, shows that there are no significant differences in behaviour between the two groups across a number of aspects, e.g.

- The amount of reviews
- Why reviews have not been conducted
- The amount of existing business in closed funds
- The advice given in last 12 months
- Sources of information used
- Important considerations.

Additionally, when discussed during the follow-up telephone interviews, it was clear that although 'sceptics' have issues with the With Profit concept; they still follow a process to ensure that the advice given to the client is robust and thoroughly considered.

5.1.4. One perceived factor in the demise in support of With Profits is the lack of transparency in the under-lying fund. However, this is also an issue with some of the more recent product innovations which are being marketed as alternatives, e.g. constant proportion portfolio insurance.

5.1.5. With Profits is still recommended, either in terms of retaining existing holdings or as new business. However, for new business, the level is dramatically lower than 10 years ago and there is usually a more stringent requirement placed upon the adviser, typically by their Network or compliance team, to ensure that it is the best advice for the client and their circumstances.

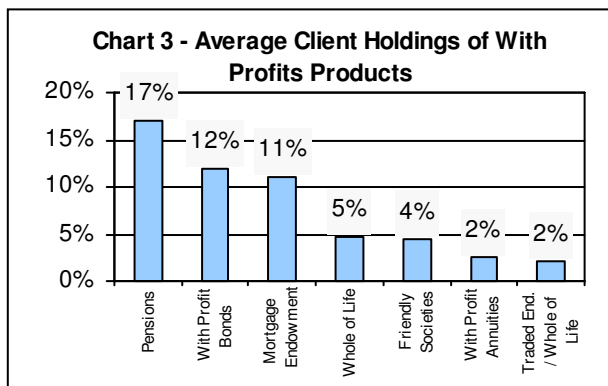
5.1.6. The larger firms with a focus on High Net Worth clients tend to be more likely to have a mandatory policy against using With Profits. Networks give guidance to their members and put in place monitoring processes, but they are unlikely to be prescriptive in stopping their members from recommending With Profits.

5.2. Amount of Business – Past and Present

EXISTING BUSINESS

5.2.1. The qualitative research indicates that the main existing holdings tend to be in With Profit Bonds and Pensions (both Group and Personal ones).

These findings are supported by the quantitative research – see Chart 3.



5.2.2. Typically, firms interviewed as part of the qualitative research did not spontaneously mention Mortgage Endowments or other types of products where 'with profit' funds are extensively used.

When pressed as to why Mortgage Endowments were not perceived to be as high as in the quantitative research, the typical response was that:

'Most mortgage endowments have been reviewed and with the current minimal levels of new sales, the general holding level is low'

5.2.3. It appears virtually impossible for many large firms and Networks to quantify the exact amount of With Profits being held due to:

- Member firms not having to report such details (typically for Networks with Directly Regulated advisers)

'Many of our member firms have been in existence longer than the Network and therefore, potentially have a large number of clients with With Profit holdings, which we can't measure'

- Not having comprehensive back office systems containing customer data (larger firms, such as Regional / Nationals)

In terms of trying to put a figure on the possible exposure, comments included:

'Even conservatively, our 'firms' are likely to have £bns in With Profits Bonds'

'At the peak in the 1990's, 40 – 50% of business written would be With Profits of some type'

'In the past, the default fund for Group Personal Pensions would have been With Profits'

Those firms best able to quantify the amounts of existing holdings were mainly the Regional ones, e.g.:

'c. £120m is held in With Profits Bonds and £80m in Pensions – individual and group – and annuities'

5.2.4. Firms operating in the HNW area or those who moved into Wraps and Platforms during the 1990s, believe that they addressed their client's With Profit products early and that the current levels of holding are negligible.

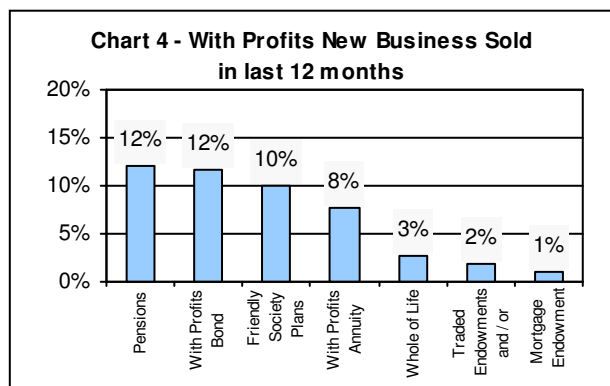
Some advisers who have started to use Wraps / Platforms in the more recent past, state relatively positive that their client holdings of With Profits are low. This is due to the fact that With Profits is not available on the wrap / platform and they have, where it has been appropriate, replicated the client's risk / investment profile through the use of model portfolios and / or asset allocation tools.

5.2.5. Firms more focused on pensions (both Group and Individual) believe that client's holdings have been reviewed as part of the Pension Reviews held during the 1990s and, more recently, as a result of the A-Day changes.

Holdings therefore have been reviewed more than once during their life time and any necessary changes already made, reducing the overall exposure to such holdings.

NEW BUSINESS

5.2.6. New sales of With Profits are low. 31% of the 544 on-line respondents have sold a product in the last 12 months, the main products being Pensions (personal / stakeholder), With Profit Bonds or Friendly Society Savings Plans – see Chart 4.



5.2.7. A number of the firms, mainly the National / Regional ones who participated in the qualitative research, could not recall the last time a With Profits product was sold. For some, it was such a remarkable event, that they could pin-point it immediately.

'Not written a With Profits product in the last 5 years'

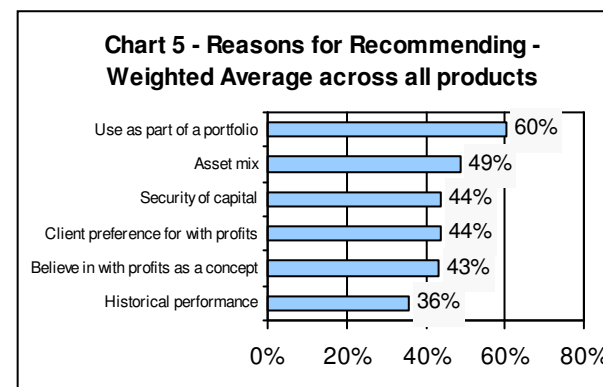
'Since 2002, c. 2% of business has been written in bonds, guaranteed funds and retirement annuities'

'Nowadays, it's mainly top ups and indexation'

5.2.8. NMG's IFA Census Investment Special Report (May 2006) supports these trends. This research indicates an increasing number of advisers who 'do not recommend With Profits under any circumstances' rising from 39% of respondents in May 2005 to 48% in May 2006.

Only 1% of respondents say that they 'would recommend on a regular basis'.

5.2.9. For those advisers who have sold a With Profits product in the last 12 months, the main reasons given for this recommendation is that 'it used as part of a portfolio' or that 'its asset mix is right' – see Chart 5 (top 6 reasons).



5.2.10. The quantitative findings are consistent with those from the qualitative research. In many cases sales in 'With Profits', where they exist, are due to it being considered 'the most suitable product for that specific client's requirements'.

MONITORING

5.2.11. A variety of methods are used to monitor reviews on existing business and new business levels:

- In some firms all With Profits business is monitored
 - Information such as type, amount and provider are logged and reviewed on a daily basis.
 - All suitability letters are reviewed and, depending upon the firm, this could be before it is issued to the client, once it has been issued to the client, once the business is submitted to the provider (and before the business is put on risk) or post sale.
 - This approach is more commonly found amongst Appointed Representative Networks and some Regional firms
- Other approaches to monitor activity include:
 - A technology enabled firm uses the hits to its web-site to monitor activity.
 - Typically for directly regulated firms the amount of monitoring depends on the services that they either outsource or provide internally, e.g.:
 - Audits
 - Business Reviews
 - Account Managers

5.2.12. Some firms spoke of the frustration of relying upon providers to supply information on new business levels. In some cases it is not possible to monitor With Profits usage through this source because the information is typically at product level, where as to accurately monitor With Profits, it would be needed at a fund level within the product.

5.3. Drivers for Change in New Business Levels

5.3.1. There have been a number of factors which advisers believe discredited the With Profit concept. No one driver was considered to have had more impact than another, and typically a number of aspects were mentioned by those interviewed.

Topics included:

- Clients
 - Clients feel cheated as they had an expectation for smoothed returns which has not been the case.
 - Bonus rates have remained subdued, despite an up turn in the markets and this has created a perception of unfairness.
 - The application of sometimes penal MVRs making it difficult to access funds.
- Providers
 - Poor management of the funds and inappropriate distribution of profits.
 - Quick to apply MVRs / reduce bonus levels whilst being slow to reverse the trend when the stock market improved.
 - Complacency by providers, who failed to react to market changes quickly enough.

- Performance
 - Funds being closed to new business impacting the ability to exploit improvements in equity performance.
 - Calculations of future performance, across both open and closed funds, compare unfavourably to alternative investments.
 - The performance of With Profit funds and products was forced to be more competitive (and some consider manipulated) when distribution funds were introduced.
- Product / Funds
 - Lack of transparency in operation of the fund and charging
 - The erosion and eventual eradication of tax advantages for life products over other forms of investment e.g. LAPR
 - Compared to an annual bonus statement for traditional 'With Profit' products / funds the introduction of unitised With Profits funds provided greater access to information, e.g.:
 - Fund pricing
 - The impact of MVRs
 This highlighted the opaqueness of the operation of the traditional products.
- Sales Process
 - In the past, With Profits was considered an 'easy sale' but it isn't clear whether some of the sales people fully understood what they were selling.
- External Parties:
 - The introduction of new solvency requirements for Life Companies at a low point in stock market performance, impacted upon the ability of some funds to recover
 - A lack of understanding of 'with profits' led to knee jerk reactions by some groups, e.g. press and consumers

5.4. Alternative Products

5.4.1. A number of products / funds are being used as alternatives to With Profits. The main ones mentioned during the interviews are:

- Cautious balanced funds
- Property funds
- Managed / Balanced Managed Funds
- Distribution Funds
- Protected Funds
- Fixed Interest
- Income Funds

5.4.2. For the more specialist Investment Firms, alternatives also include more sophisticated products, e.g.:

- Hedge Funds
- Fund of Funds
- Manager of Manager Funds
- Derivatives
- Absolute Return Funds

5.4.3. In a handful of instances, some firms have launched their own, in-house OEICs. These are typically supported by asset allocation tools and model portfolios.

5.4.4. The past decade has seen considerable innovation in the investment product marketplace. The introduction of Wrap and Fund Platforms and better asset allocation tools enabled advisers to feel more confident about investing client money in alternative investment vehicles. Many advisers are now more likely to construct a portfolio of investments selected from a range of fund managers aligned to an asset allocation strategy. For these advisers, the concept of With Profits no longer fits within their business model.

5.4.5. A number of sources were cited for Asset Allocation tools:

- Mixture of in-house developed ones (typically for the more investment oriented / HNW organisations).
- Purchased from an external supplier.
- Available via a provider's extranet.

5.4.6. In a small number of cases the introduction of Wraps and Fund Platforms had been a driver for them to review their clients' portfolios. Advisers who have adopted this route objectively consider the key aspects of the With Profit holding before recommending any switch or change.

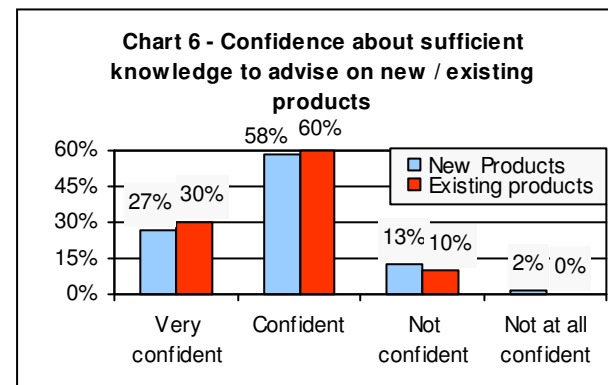
- Many firms who use asset allocation tools also use model portfolios, which were then matched to the client's risk profile to determine the asset mix.
- In some cases, the portfolio constructions are considered to be guides and not fixed, leaving the adviser with the room to adjust to better suit the client's circumstances and requirements.

5.5. Levels of Adviser Confidence

5.5.1. Advisers responding to the quantitative research appear confident about their knowledge of existing and new With Profit products. 85% or more of the 544 respondents stated that they were 'Very Confident' or 'Confident' about 'having sufficient knowledge on the way With Profits operates'. See Chart 6

Regulated status has no apparent impact upon the level of adviser confidence.

Respondents who 'follow recommendation set out by their Network' are more likely to state that they are 'confident' in having sufficient knowledge to advise, as are respondents who write 75% – 100% of their business in Collectives / OEICs.



5.5.2. Networks and National / Regional firms offer a range of services and support to either directly address the issue of knowledge levels of With Profits or to act as a specialist source of information for an adviser, e.g.:

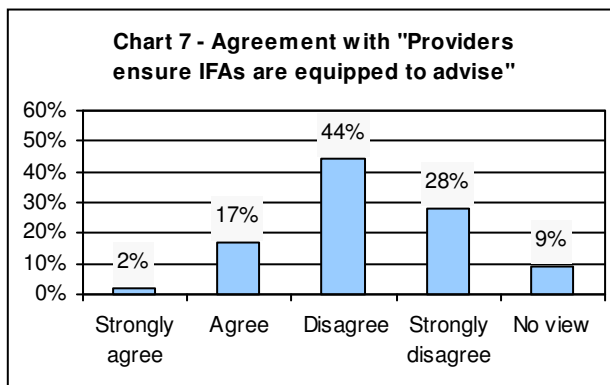
- Access to specialist reports such as that available from AKG.
- Use of newsletters to provide up to date information.
- Meetings, workshops and seminars.
- Training sessions.
- Centralised specialist units, helpdesks and technical teams.

5.5.3. Some external providers, such as DecisionsDecisions, prefer that their tools are used by a centralised team who can be trained specifically to use and interpret the output whilst others [O&M Profiler, Synaptics and Defaqto] are used by the individual advisers.

In the latter instance, the firms support the use of such tools by providing suitable training, education and monitor use through the review process

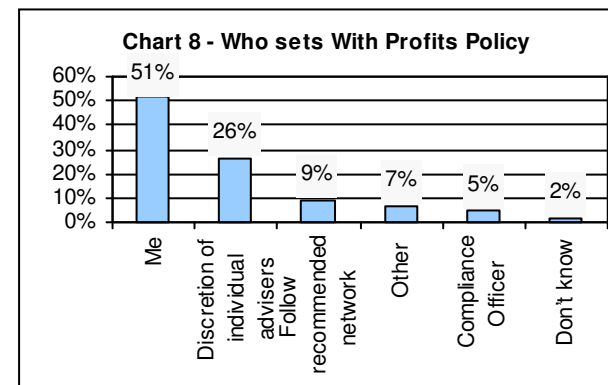
5.5.4. A number of larger firms make use of highly qualified (typically to the same level as an adviser) para-planners and / or administrators, enabling the actual advisers to spend more customer facing time. In these instances, it is typically the para-planner and / or administrator who use such tools. However, no measure was made of this specific group's confidence levels. In smaller firms it is the individual adviser who is likely to be using these tools.

5.5.5. The onus is on the adviser to ensure that they are informed. Advisers perceive that Providers are doing little – a view supported by 72% of respondents who 'Disagree' or 'Strongly Disagree' that 'Providers ensure that IFA are equipped to advise on With Profits by providing suitable training / education' – see Chart 7



5.6. Policy Setting

5.6.1. In the quantitative research, half the advisers said that they were personally responsible for setting With Profits policy. See Chart 8



5.6.2. Amongst the larger firms, Networks and National / Regional firms there is typically a standardised view within a firm. In some Regional Firms there was the view that most advisers would work to the same principles, but this would be based on discussion and there would not necessarily be a 'house view'.

5.6.3. Different approaches in setting policy tend to reflect the nature of the firm, e.g.:

- Formal, using committees, for the larger firms. One firm used two committees (an investment and a product one) to avoid conflicts of interest.
- Informal for Regional firms, typically group discussions and debate including all, or at least a quorum of advisers.

5.6.4. In only one instance in the qualitative research did two different views exist within a single firm. This split was based on business line, i.e. one approach was adopted by the Corporate team whilst another is used by the Individual team. There was not a significant difference in view, more one of emphasis.

5.6.5. Attitudinally, there were three main views held about With Profits:

- The negative:

‘Unless you are forced to by a client, don’t [recommend With Profits]’

‘Where possible for existing, active clients look to review the policy to replace it with a non-with profit type alternative*’

[* subject to ensuring that aspects such as MVRs, length of time to maturity, whether the fund is open / closed and other key aspects were taken into account]

- The neutral

‘There are other options that can be considered as replacements, although these have to be fully justified before being recommended’

- The Positive:

‘With Profits has a place in a portfolio and its inclusion is dependent upon the circumstances of the client and their overall approach to risk’

‘Happy with With Profits as a concept and therefore advisers use it as part of the portfolio’

5.6.6. Frequently the policy has been in place many years. Reviews of such policy are driven by external factors, such as changes in FSA regulation and guidance. Only a couple of firms interviewed reviewed their policy on a regular basis as a matter of course.

5.6.7. A written statement of policy is the exception. The more common approach to policy communication is for it to be communicated verbally, through:

- Adviser team meetings
- Workshops
- Regional meetings (depending upon the size of the firm).

And in some cases, other forms of communication used include:

- Training sessions / workshops
- Materials such as procedure manuals and company intranets
- Company wide emails.

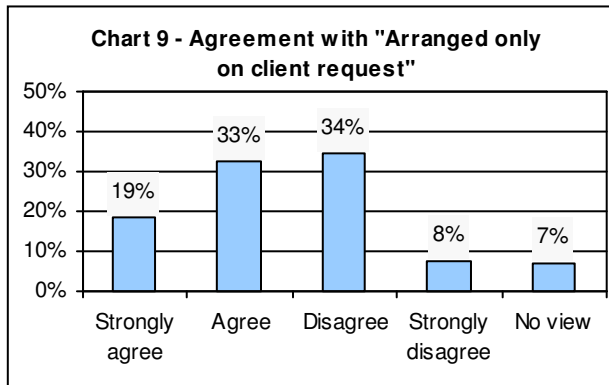
5.6.8. Despite respondent confidence about their own knowledge levels to advise on With Profits being high (Section 5.5 and specifically Chart 6) this does not directly translate into confidence about the product.

There is a general nervousness amongst advisers about handling a product that has been the subject of significant adverse comment in recent years.

5.6.9. There is a level of concern amongst advisers providing advice on With Profits and the need to be particularly cautious when doing so, due to the perceived ‘toxicity’ of the product and poor press.

One firm involved in the qualitative research stated that if a client were to come to them requesting a With Profits product, they would work through, in detail, the advantages and disadvantages of With Profits and the alternatives. Should the client wish to proceed with With Profits, the IFA would recommend that they seek advice from another firm.

5.6.10. This nervousness is supported by the qualitative research as when asked about the level of agreement with the statement ‘I will only arrange a With Profits product at the express request of the client’, see Chart 9 which shows 19% of respondents strongly agreed with the statement and a further 33% agreeing.



5.7. Guidance from Networks, Nationals or Central Teams of Regional / Larger Firms

5.7.1. Guidance is provided to advisers in a number of ways:

- Compliance / Procedure Manuals
- Fact finds (to assess risk levels)
- Treating customers fairly procedures
- Specific 'With Profits Review Material'
- Provider supplied With Profits review material
- Adviser bulletins
- News letters
- With Profit 'Check Lists'

5.7.2. Examples of material are included in the 'Stakes in the Ground' - With Profits Library. Due to the confidential, commercial nature of some of the material, it is not for circulation.

5.7.3. The guidance ranges from the detailed (using specific detailed With Profits review notes and information packs) through to relying upon existing processes and communications around these.

The latter approach relies upon the adviser using their experience and knowledge of a client alongside existing processes and procedures to provide objective advice to meet the customer's objectives.

For those firms where With Profits is inculcated in the overall Procedures Manual, the process is generic, typically covering:

- Review / conduct fact find with client
- Information gathering
- Option generation and assessment
- Development of fully supported recommendations

5.7.4. Networks with Appointed Representatives typically have more specific guidance for With Profits, which the Network then closely monitors.

5.7.5. Those Networks and firms with Directly Regulated advisers appreciate that they can provide guidance and information but that the adviser is at liberty to choose their own policy and approach.

5.7.6. Types of guidance provided by firms involved in the qualitative research include:

- Bonus levels
- Chargeable events and taxation issues
- Fund make up and prospects
- Financial strength
- Early surrender penalties / MVRs / MVR free dates
- Open / closed With Profits funds, Pensions – age of client and time to NRA
- PPFMs
- With Profits vs. Unit linked
- What to include in suitability letters

5.7.7. Irrespective of whether it is a specific or generic part of the procedures manual a majority of firms have a robust evaluation process for clients with existing With Profit holdings, which they can demonstrate its existence and monitoring processes.

5.7.8. There is typically a centralised team / person with specific responsibility for ensuring that advisers are kept up to date with current information about With Profits.

5.7.9. Most Head Office teams within the Networks, Nationals / Regional firms have been providing guidelines to their advisers for years.

5.7.10. The content and regularity of issue are typically dependent upon external events or drivers:

- FSA changes
- Introduction of new products
- Comments in financial press

Firms with more specific processes review them as required, to ensure that the content remains appropriate and accurate.

5.7.11. Communication of guidance is via many different channels:

- Email / Internal Newsletters
- Support services people, e.g. technical teams
- Training and Development seminars
- Company Intranets / Knowledge Banks
- Adviser meetings / Roadshows

5.8. Reviews of Existing With Profits Business

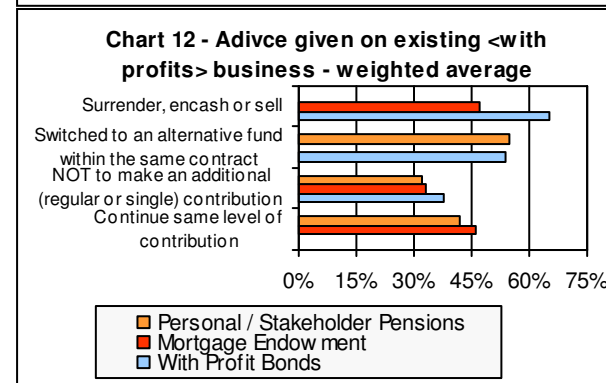
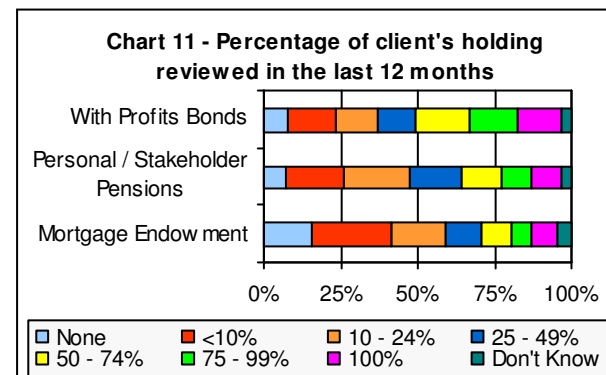
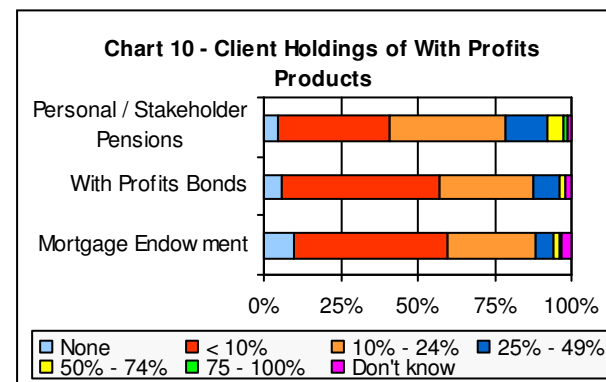
5.8.1. As previously stated, the three main existing With Profit product holdings are (see Chart 10):

- With Profits Bonds
- Pensions
- Mortgage Endowments

5.8.2. Those products which advisers have reviewed the most in the past 12 months are shown in Chart 11.

5.8.3. There was a high level of agreement to the statement 'I always review a new client's With Profit holding as part of the initial fact finding process', with 24% strongly agreeing and 62% agreeing. Only 8% disagreed, and the remaining 6% held no view.

5.8.4. The actions taken within the last 12 months, as a result of reviewing a clients holding, vary depending upon the product held. See Chart 12 (weighted average across all products).

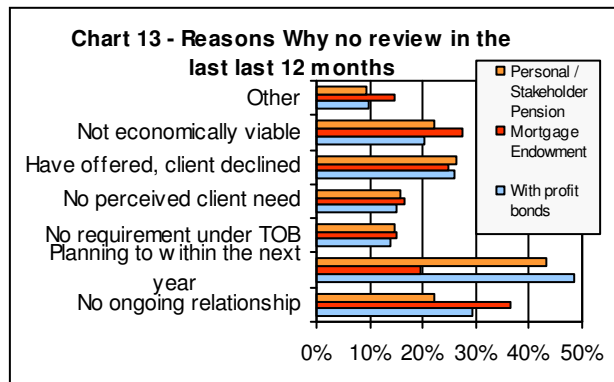


5.8.5. For With Profit Bonds and Mortgage Endowments, the most quoted actions taken were to 'advise a client to surrender, encash or sell the policy', whilst for Personal Pensions / Stakeholder Pensions, the most quoted advice was 'to switch from With Profits to an alternative fund within the same contract'.

5.8.6. Nearly half of advisers have reviewed their With Profits Bonds / pensions / endowment client holdings in the last 12 months.

The main reasons given for not reviewing the specific holding are shown in Chart 13, restricted to the top three product groups.

- For With Profit Bonds and Personal / Stakeholder Pensions, nearly 50% of respondents are planning to review their client's holdings in the next 12 months.
- For Mortgage Endowments, the most likely response is that there is no on-going relationship with the client.



5.8.7. For other product holdings, there are variations in why reviews have not taken place:

- Friendly Society Savings Plans – the most likely response is 'not economically viable to do so' (33%) or 'no perceived client need' (31%).
- With Profit Annuities and Traded Endowments are most likely to say 'no on-going relationship' (24% and 30% respectively).

5.8.8. The least rated reason for not conducting reviews is 'no requirement under Terms of Business' – only 14% of respondents gave this answer (weighted average across all products).

5.8.9. Amongst the Nationals / Networks / Regional firms, only one is currently actively encouraging their advisers to identify and review clients with With Profit holdings. The process is clearly articulated within a detailed pack, available to both Appointed Representative and Directly Regulated advisers covering:

- The Current Situation with With Profits
- Risk management – hints and tips
- Alternatives to With Profit Investments
- The Review Process Map along with a description of the 6 point process
- Approach letters (pre-approved) for use with clients
- Access to AKG and OBSR reports
- Client facing leaflet

5.8.10. Three further firms are in the process of developing and implementing specific review material, along similar lines to the one described above. This material is being developed to support the current treatment of With Profits within existing processes.

5.8.11. In the qualitative research, a number of firms mentioned that they used Standard Life's 'With Profit Review Programme'. A couple mentioned that they were using this as a framework, but that they have personalised the material / process to their specific firm so as to ensure it is seen as being objective and unbiased towards any one provider.

The Standard Life process:

- Reviews With Profit bonds only
- Incorporates data from AKG, bringing together multiple sources of information
- Is based on sophisticated technology using stochastic modelling techniques (provided by Tillinghast Towers-Perrin)
- Can be used alongside the Standard Life Risk Assessment Questionnaire
- Compares results with existing plans, as input into client reviews
- Acts as input for customised client reports
- Provides written evidence for future reference and audits.

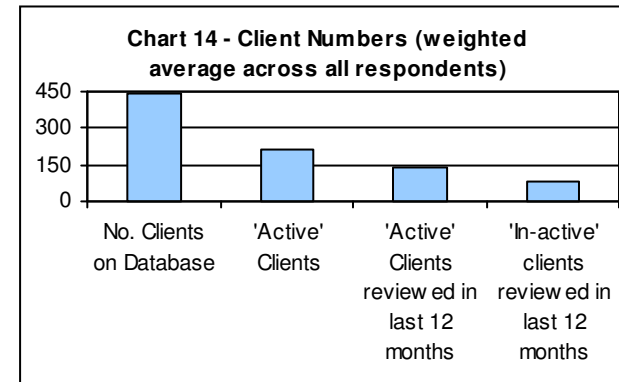
It therefore covers a significant amount of the review process but only for With Profit Bonds.

5.8.12. The remaining firms involved in the qualitative research believe:

- They have addressed existing holdings over the last decade through regular review of clients by seeking suitable alternatives.
- They do not move clients simply because they are in With Profits but because it is appropriate to meet the required objectives (this is more so for firms who express a negative view of With Profits).
- For firms who are more investment focused, clients are reviewed on a quarterly or half yearly basis, to ensure that the asset allocation is still appropriate. These firms tend to be those who have reviewed a client's portfolio in the past.
- Only a couple of firms mentioned that their Terms of Business dictates the frequency of the reviews that a customer could expect. This was a more typical response of a regional firm.
- Many firms feel that their procedures and processes (as covered in their manuals) would ensure that their advisers review the overall client situation in association with their attitude to risk and financial aspirations, in a fair and objective manner.
- A couple of firms mentioned that their lack of specific With Profits activity is a result of the amount of resources required to handle

A-Day and the impact it has had on their pensions portfolio.

5.8.13. Specific questions were asked of the quantitative respondents about their client data base, and the split between 'active' and 'in-active' – see Chart 14.



- The weighted average number of clients on an adviser's database is just under 450. Of the 207 respondents, 23% of them stated that they currently had >1,000 clients. This number covers ALL clients, including:
 - Clients that are currently being serviced
 - Those who are not currently being provided with an ongoing service, but for whom the respondent is 'the nominated adviser'. For the survey, 'nominated adviser' was defined as where the adviser's agency details are associated with that client on the records of the life company or fund manager.

It is not dependent upon the adviser continuing to receive commission.
- 'Active' clients account for 48% of the data base. Consequently, 52%, or a weighted average of around 230 clients are considered to be 'in-active'

- Out of the average holding of around 210 'active' clients, c. 135 are reviewed at least annually, equating to about two thirds of such clients.
- Out of the c. 230 'in-active' clients, c 80 are reviewed at least annually, equating to about a third of such clients.
- The implication of this is that:
 - Roughly a third of active clients, on average c. 75 per adviser, are not reviewed on an annual (or more frequent) basis
 - Two thirds of in-active clients, on average c.150 per adviser, are not reviewed on an annual (or more frequent) basis

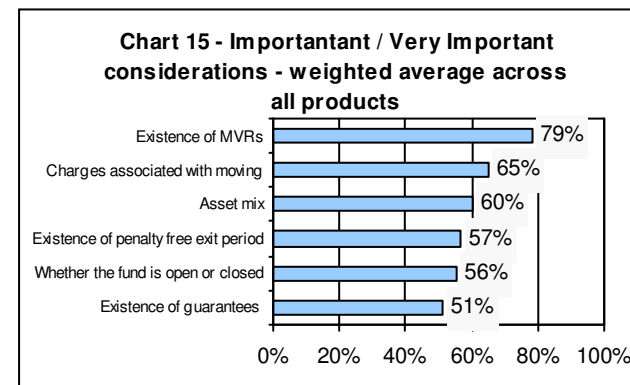
It is likely that amongst this group some may have been reviewed >12 months ago and / or were part of an endowment or pensions review, so may not need to be reviewed again

5.9. Key Considerations included in Reviews

5.9.1. When an adviser reviews existing With Profits business, the top 6 key considerations, across all products, are shown in Chart 15

5.9.2. There are variations in the top considerations depending upon the product, for example:

- Mortgage Endowments; 'life cover' replaces 'whether the fund is open or closed'
- With Profit Bonds; 'withdrawal of capital without penalty' replaced 'existence of guarantees'



5.9.3. The least important aspects are considered to be:

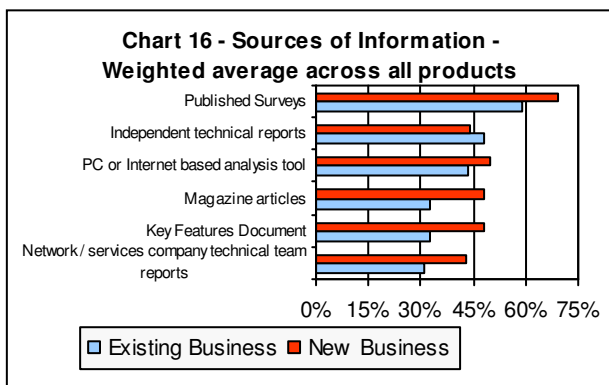
- 'Existence of LAPR'; 29% on average across all products though it increases to 51% for Mortgage Endowments and 47% for Whole of Life products.
- 'Belief in With Profits concept'; 33% on average across all products but 40% for Friendly Society Savings Plans.
- 'Life Cover'; 36% on average across all products but 74% for Mortgage Endowments and 80% for Whole of Life.

5.9.4. Despite the existence of LAPR not being an 'important' or 'very important' consideration, apart from those indicated in 5.9.3, 55% of respondents to the on-line survey stated that they agreed / strongly agreed that it was a 'decisive factor in advising clients to keep a policy'.

5.10. Sources of Information

5.10.1. General Sources of Information

- A considerable amount of information is available and used at the discretion of the adviser for both existing and new business. There is no one source that is considered more important than another (qualitative research) and they all have a role and should be called upon as required.
- The top six sources of information are consistent for both existing and new business (in the quantitative survey) and are shown in Chart 16
- Examples of all 6 sources are included in the 'Stakes in the Ground' – With Profits Library



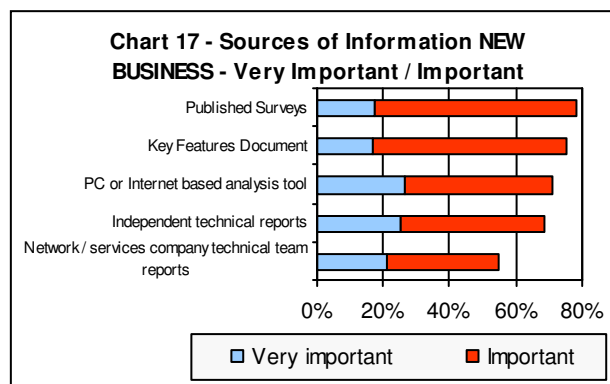
- There is a marginal increase in the percentage of respondents using sources for new business compared to existing business, reflecting the perceived need to be able to substantiate the advice given in an environment which is generally nervous about With Profits.
- There is some minor variation between the top three sources of information for Existing Business and for New Business – see Table 1:

Table 1: Comparison of Top 3 Sources of Information for New and Existing Business

Existing Business Sources of Information – Top 3	New Business Sources of Information – Top 3
1. Published Surveys	1. Published Surveys
2. Independent Technical Reports	2. PC or Internet Based Analysis Tools
3. PC or Internet Based Analysis Tools	3. Key Features Documents

- For existing business the top three sources; published surveys, independent technical reports and PC are consistent across the three main product holdings of With Profit Bonds, Mortgage Endowment and Personal Pensions / Stakeholder Pensions
- From the qualitative research, the spontaneous mentions of sources included many of those mentioned in the quantitative research top 6
- The key sources of information address different needs:
 - Published surveys provide an external assessment of a topic / fund or aspect of With Profits, e.g. Money Management's three recent surveys are:
 - Taking a Cautious Approach; April 2006
 - Results Laid Bare; Aug 2006
 - Financial Strength of With Profit Offices; Aug 2006
 - Technical Reports, specifically those from AKG, cover significant detail on the companies (financial strength) and funds (both open and closed)
 - Analysis tools help support the adviser in looking at aspects such as asset allocation / asset mix.

- Key feature documents are a required element for New Business recommendations.
- In many instances, the Network, National or Regional firms provide access to the information either free or at a substantially reduced cost.
- In some instances, the Network, National or Regional firm provides a summary of a larger or technical report which is then disseminated to their advisers. Guidance provided in this manner is typically accompanied with information on what needs to be considered, i.e. what are the key aspects to take into account but this is not directional
- Specifically for New Business, the various sources of information were assessed for their levels of importance. There was a clear 'premier league' of sources, which all received >70% rating of 'very important', as shown in Chart 17



- There is no one overall 'most important' source – advisers are expected by their firms, Networks or support services companies to use the relevant sources to support a particular recommendation. The choice of what to use, therefore is up to the adviser

5.10.2. AKG

- AKG is a major supplier of information, to the market as a whole as well as to advisers.
 - AKG produces three key reports that are relied upon (either in entirety or in summary), namely:
 - Company Profile and Financial Strength Report
 - UK Life Office OPEN With Profits Report
 - UK Life Office CLOSED With Profits Report
 - In addition, AKG also provides:
 - Commentary to the market, e.g. With Profits in a Changing World (November 2004)
 - Information to support other suppliers, e.g.:
 - Defaqto
 - Synaptics
 - O&M Profiler
- These were often mentioned during the qualitative interviews with Networks and National / Regional Firms as being analysis tools offered to their advisers.
- Information to the two main IFA portals (The Exchange and Assureweb).

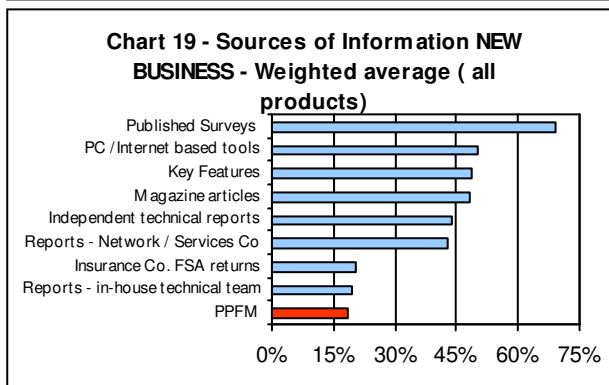
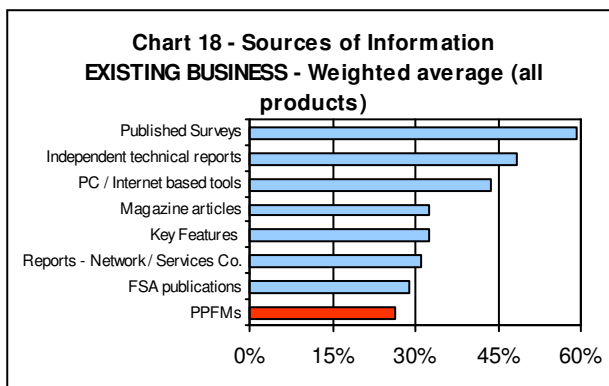
- AKG emerges from the research as one of the main sources of information, more so for existing business where their specialist reports on closed funds probably comes to the fore.

5.11. Principles and Practices of Financial Management (PPFM)

- 5.11.1. Many Networks and National / Regional firms have communicated with their advisers, both appointed representatives and directly regulated, about the FSA requirements on (PPFM) [qualitative research].

5.11.2. From the quantitative research, there appears to be a low take up of the use of these documents – see Chart 18 (Existing Business) and Chart19 (New Business).

28% of respondents make use of PPFMs as a source of information for existing business and 18% use them for New Business recommendations.



5.11.3. No firm made it compulsory for their advisers to use PPFMs as they:

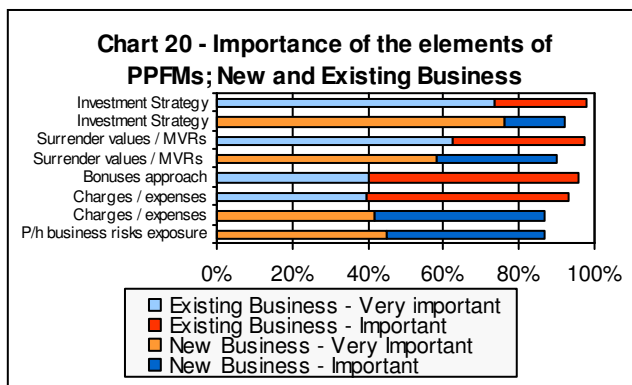
- Are sometimes considered to be too technical, which is consistent with some of the larger firms expressing concern about their members being able to really understand the specifics of With Profits
- Firms such as AKG provide summaries of the PPFMs, as do a small number of the Networks / Nationals / Regional firms. Advisers with access to these sources therefore may not see the need to use PPFMs as a separate source of information.
- As each Provider produces a PPFM for each With Profit fund, there are a multitude of them available. Although they follow a consistent format, there is much variation in the amount of information each provider communicates within in section. This makes is difficult for advisers to make direct comparisons.

5.11.4. In terms of the rating of 'importance' of the various elements of the PPFM, Existing and New Business share three of the top four elements (see Chart 20 - overleaf);

- Investment Strategy
- Surrender Values / MVRs
- Charges and expenses.

They differ on the one of the top four 'important elements', reflecting the greater importance given to the bonus levels for existing business:

- New business – Policyholder business risks exposure
- Existing business – Payment of bonuses approach



5.12. Analysis Tools

5.12.1. There are many tools available within the IFA market. It appears that many advisers have access to at least some of these, typically provided by their Network, National or Regional head office either free or at a substantially reduced cost.

The most frequently mentioned analysis tools are:

- Defaqto
- O&M Pension Profiler
- In-house asset allocation tools
- Synaptics

5.12.2. The use of such tools is increasing, e.g. the introduction of further tools such as the Standard Life With Profits Review Process. At least 5 of the firms involved in the qualitative research now use or recommend the use of this material.

5.12.3. Although many firms provide access to a number of tools, it is frequently at the discretion of the adviser as to what to use and under what circumstances.

5.12.4. Monitoring the use of the Analysis Tools varies depending upon the type of firm that the adviser belongs to, as does the relevant use of such tools. The three main levels of monitoring the use and relevance of analysis tools are;

- If they are a member of an appointed representative Network, then the business monitoring unit will review cases and ensure that the suitability / recommendations utilise the correct research to validate the outcome
- If the adviser purchases services from a support services company, then there is little central monitoring of use or relevance, unless compliance checks are part of the services acquired. In these instances, the responsibility is on the individual firm and their internal compliance processes
- In the case of a National / Regional firm, some of these have rigid internal processes and ensure that 100% of all cases are reviewed, sometimes before the recommendation has been issued to a client.

5.12.5. A variety of views are expressed over the importance of analysis tools, e.g.:

‘Asset allocation tool – absolutely necessary. Others, as required’

‘Would like to insist but recognise that we can only offer guidance as to what is practical, relevant and appropriate to use in certain circumstances and leave the choice up to the individual adviser, who has a more thorough understanding of their client’

‘Tools are an element of the overall review / research process and needs to reflect the requirements of the customer and the final recommendation – not importance, more a ‘fit for purpose’

5.12.6. Concern was expressed by some firms about the level of training and support that was provided to the advisers to ensure that they fully understood how to use the specific tool and to ensure results were interpreted correctly.

5.12.7. In some firms, Para-planners / administrators prepare the necessary reports and recommendations, it is important to ensure that these people are included in any training and education.

5.13. Approved Lists

5.13.1. Around a quarter of the firms interviewed in the qualitative research used approved lists of providers. They typically saw the benefits as being a consistently applied set of criteria to generate a common list of providers, which eased the monitoring requirements as in many cases, 'on panel' recommendations did not have to be reviewed.

5.13.2. Some firms did not use 'approved lists' but took the opposite approach and used 'blacklists' either of providers and / or products / funds. This approach identified aspects or issues with products / providers where the firm was not satisfied and that they expected advisers either to directly avoid or to approach with caution, having identified the key aspects to be considered.

5.13.3. Firms that did not use an approved list provided their advisers with information (analysis tools, reports, surveys, PPFMs, etc) on which to make an objective decision.

5.13.4. All firms that used approved lists of providers go through a thorough process to determine them – this is for any product / provider and not specific to With Profits. Typically, the process would entail:

- Setting criteria. Most firms use 5 – 8 criteria covering aspects such as:
 - Financial strength
 - Credibility / reputation
 - Suitability of company to write such business
 - Service levels
 - Fund Performance
- Thorough review of all firms / products against the list, sifting out those that did not meet the criteria to produce a short list.

- Depending upon the size of the shortlist, the criteria would be made more specific, e.g. if most of the providers in a specific market met the criteria then it is possible that the criteria would be strengthened.

- The resulting list and process (indicating if there was a 2nd tier of providers / products) would be communicated to the advisers.

- In the main, a central team or individual would be responsible for:
 - Operating the process
 - Helping set the criteria (typically a committee or senior group would be involved in this aspect)
 - Communicating the lists
 - Maintaining and reviewing the lists

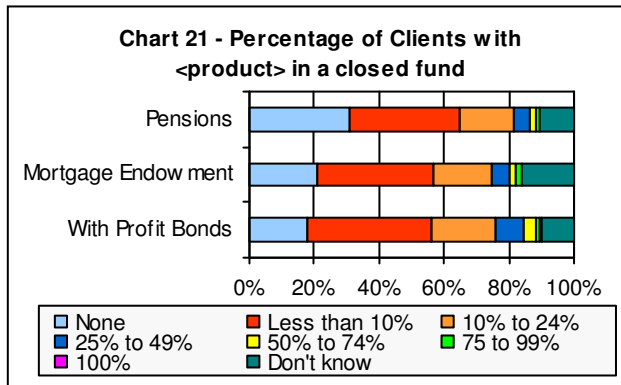
5.13.5. One firm followed up its quantitative process with a qualitative one, by holding site visits of the short-listed providers.

5.13.6. Approved lists are reviewed on a regular basis – varying between every 6 months to annually. Most firms stated that they would review on a more frequent basis should there be a significant market development, such as a fund being closed.

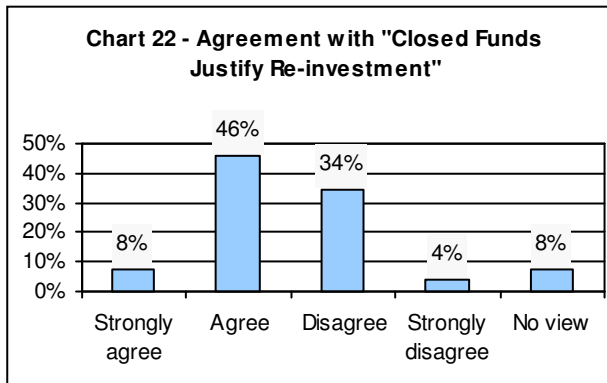
5.14. Closed Funds

5.14.1. For the three main existing With Profit holdings, the level of investment in a closed fund ranges from 25% (Pensions) - 31% (With Profit Bonds) - see Chart 21 - overleaf.

5.14.2. There is a lot of mis-trust about closed funds, with many of the firms interviewed stated that the current bonus levels and MVRs make holding onto investments a poor alternative to switching into another investment with the same risk profile, but with a greater likelihood of a better return over time.



5.14.3. Misgivings over the potential for closed funds comes through in the level of agreement (54% of respondents) with the statement 'I believe that in most cases the disadvantages of holding an investment in a closed fund are sufficient in isolation to justify recommending that a client reinvest elsewhere'. See Chart 22. This group has been named 'closed fund' and have been investigated further.



5.14.4. A thorough analysis of the 'closed fund' group, as compared to the main on-line respondents shows that there are no significant differences in behaviour between the two groups across a number of aspects, e.g. amount of reviews, why reviews have not been conducted, amount of existing business in closed funds, advice given in last 12 months, sources of information used and considerations.

Additionally, when discussed during the follow-up telephone interviews, it was clear that although the 'closed fund' group have issues with keeping clients' invested in such funds, they still typically follow a process to ensure that the advice given to the client is robust and thoroughly considered.

Only a few 'closed fund' respondents to the follow-up telephone interviews maintained their attitude that it was justification to re-invest in isolation; even then, in each case the individual also went on to say that they followed a process to reach that conclusion.

Appendix 1 – Question Details

Chart 1	Question; With Profits has a part to play as part of an overall portfolio of investments. No. of respondents: 544
Chart 2	Question: With profits is an outdated concept and I would advise any client who held a with profits policy to switch to another form of investment. No. of respondents: 544
Chart 3	Question; What percentage of your clients hold the following With Profits contracts? Please include all clients who hold with profit contracts irrespective of whether they were advised to purchase these by you or another adviser. No. of respondents: 544. Weighted average calculated by using the mid-point of the range in question, excluding 'don't knows'
Chart 4	Question; Which of the following types of With Profits business have you sold in the past 12 months? Tick all that apply. Include both where the entire investment of part only was made into With Profits). No. of respondents: 507
Chart 5	Question; What are the main reasons that you recommend <product>? Tick all that apply. No. of respondents: Varies from 5 – 61 depending on the product line. Weighted average calculated across each of the seven individual product responses
Chart 6	Question; How confident are you that you have sufficient knowledge about the way that With Profits operates to advise clients on New / Existing products? No. of respondents: 544
Chart 7	Question; Providers ensure that IFAs are equipped to advise on With Profits by providing suitable training / education. No. of respondents: 544
Chart 8	Question; Who in your firm is responsible for setting policy on the approach to be adopted when recommending a new With Profits investment or advising on existing With Profits business? No. of respondents: 544

Chart 9	Question: I will only arrange a With Profits product at the express request of the client No. of respondents: 544
Chart 10	Question; What percentage of your clients hold the following With Profits contracts? Please include all clients who hold with profit contracts irrespective of whether they were advised to purchase these by you or another adviser. No. of respondents: 544.
Chart 11	Question; What percentage of your clients who hold <product> have you conducted a review for within the past 12 months? No. of Respondents: With Profit Bonds - 512; Personal / Stakeholder Pensions - 518; Mortgage Endowments – 491.
Chart 12	Question: When answering this question please include all clients who hold With Profits contracts, irrespective of whether they were advised to purchase these by you or another adviser. For each product, please indicate whether in the last 12 months you have...? No. of responses: 213 – 492 Weighted average calculated across each of the seven individual product responses
Chart 13	Question; What are the main reasons that you have not conducted reviews for all of your <policy type>? Please tick all that apply. Base: 200 – 466
Chart 14	i) Question: How many clients do you currently have on your own data-base? For the purposes of this survey, this includes clients you are currently servicing and those where you are not providing an on-going service, but for whom you are the nominated adviser. A 'nominated adviser' is where your agency details are associated with that client on the records of the life company or fund manager. It is not dependent upon your continuing to receive commission. No. of respondents: 207 Weighted average calculated by using the mid-point of the range in question, and assuming that for the >1,000 category, the number of clients is 1,000. ii) Question: How many of these clients do you consider to be 'active' ones? No. of respondents: 207

Weighted average calculated by using the mid-point of the range in question, and assuming that for the >1,000 category, the number of clients is 1,000.

iii) Question: How many of your ACTIVE clients would you typically review their circumstances on an annual or more frequent basis? No. of respondents: 207

Weighted average calculated by using the mid-point of the range in question, and assuming that for the >1,000 category, the number of clients is 1,000.

iv) Question: How many of your IN-ACTIVE clients would you typically review their circumstances on an annual or more frequent basis? No. of respondents: 207

Weighted average calculated by using the mid-point of the range in question, and assuming that for the >1,000 category, the number of clients is 1,000.

Chart 15 Question; When advising a client who holds an existing <product> which of the following would be important or very important considerations in arriving at your recommendations? Tick all that apply. No. of Respondents: 27 – 402

Weighted average calculated across each of the seven individual product responses

Chart 16 Question; Existing business - For <product> which of the following information sources did you make use of to arrive at your recommendations? No. of respondents: 27 – 402

Weighted average calculated across each of the seven individual product responses

Question: New business - For <product> which of the following information sources did you make use of to arrive at your recommendations? No. of respondents: 5 – 61

Weighted average calculated across each of the seven individual product responses

Chart 17 Looking at the range of sources of information that are available to you in respect of With Profits business, how much importance do you place on the information provided by each of them when advising a client in respect of NEW business? No. of Respondents: 155

Chart 18 Question; For <product> which of the following information sources did you make use of to arrive at your recommendations? No. of respondents: 27 – 402

Chart 19 Question; For <product> which of the following information sources did you make use of to arrive at your recommendations? No. of respondents: 5 – 61

Chart 20 Question: Existing business - How important do you consider each of these when recommending a client in respect of an existing With Profits investment? No. of Respondents: 147

Question: New business - The following information is a list of information typically contained within a PPFM. How important do you consider each of these when recommending a client in respect of a NEW With Profits investment? No. of respondents: 38

Chart 21 Question; What percentage of your clients who hold a <product> are invested in a closed fund? No. of respondents: 213 – 492

Chart 22 Question; I believe that in most cases the disadvantages of holding an investment in a closed With Profits fund are sufficient in isolation to justify recommending that a client re-invest elsewhere No. of respondents: 544