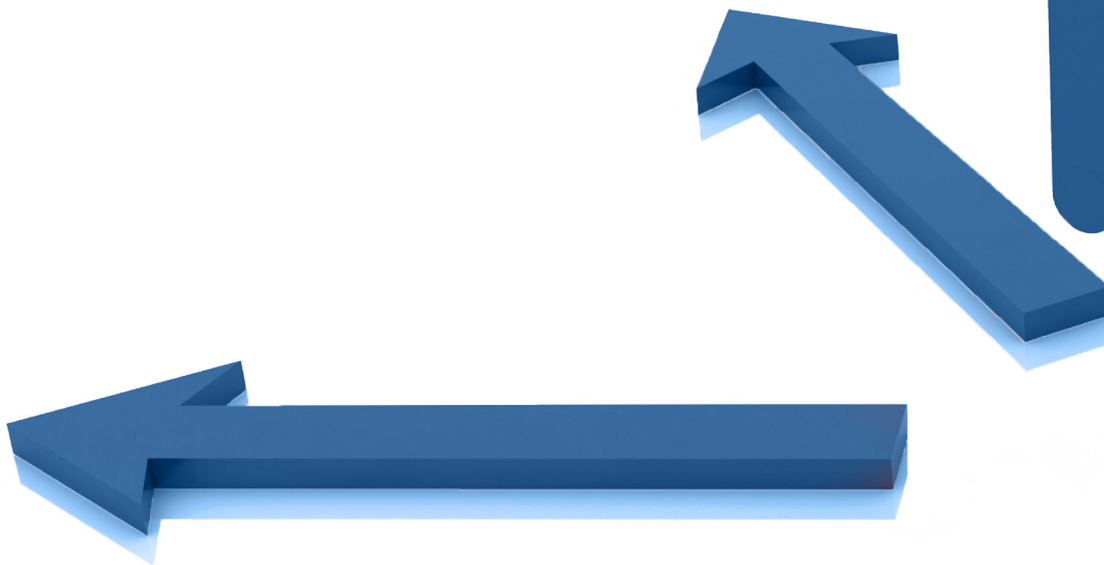


Outsourcing investment management

Investment management and your
business model - an overview



Kindly sponsored by:

Seven
Investment Management



01 | Introduction

To carry out investment management on a professional basis, a range of talent, tools and expertise is required – all of which have to be integrated to provide the necessary process, structure and discipline for effective investment.

Now of course every firm has the choice as to whether they should be doing this themselves, but in doing so they need to be confident that they have the depth of experience, personnel and facilities, as well as the necessary budget, to fully maintain such a capability.

Investment management is no longer just the occasional selection of a few stocks and funds to fulfil an asset allocation model. Good investment process requires discipline and design. This includes not just proper risk and performance measurement, but also evaluation of volatility and liquidity, and that is before even the first investment is ever made.

There is the question of structure of a longer term strategic core, with a tactical overlay to provide a certain amount of flexibility. There is the continuous selection and monitoring of the actual and potential investments themselves in terms of ownership, performance and operation. Add to this the use of more sophisticated but necessary techniques to manage the risk of portfolios and you can begin to see some of the complexities of managing investment services in-house.



02 | Investment management and your business model

With the forthcoming implementation of RDR the advice landscape is changing. Advisers are reviewing their business models to focus on those aspects of their role that their clients most value; they are reviewing how and where their time is spent, and how best their skill set is used to provide ongoing service and value to their clients.

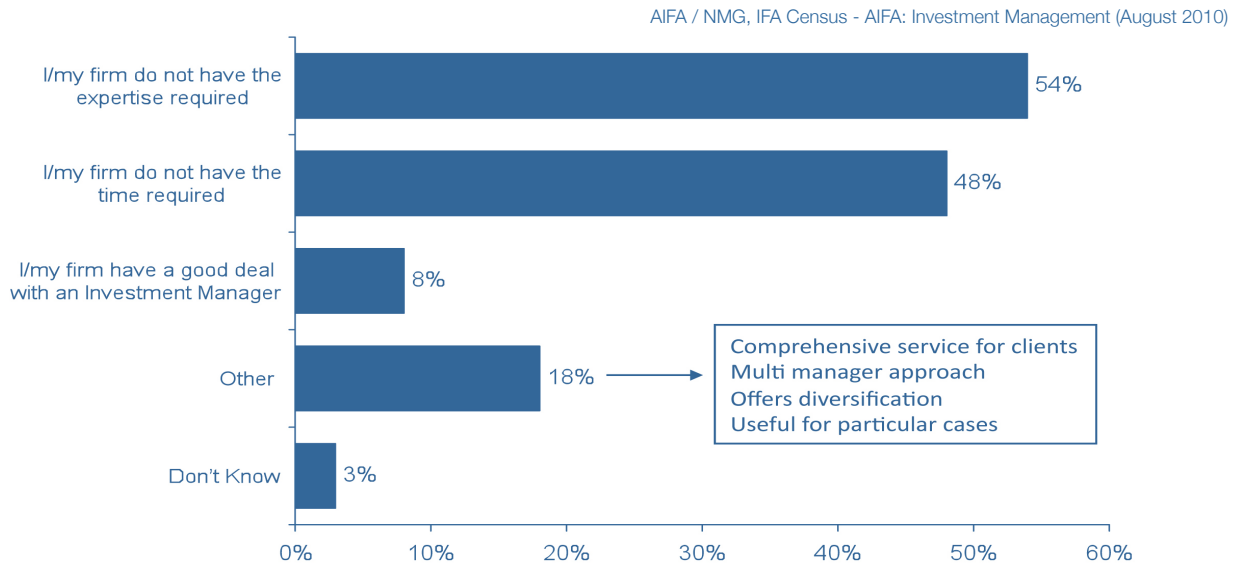
If the investment management function is outsourced, additional time is created allowing advisers and firms to dedicate more time to their core competencies, such as client relationship building and financial planning. The expertise and fund management talent of the selected investment managers, can then be put to good use monitoring the performance of hundreds of funds on your clients behalf.

Advisers can also benefit from the cost saving resulting from not needing to purchase investment tools, such as stochastic and asset allocation modelling to evidence and track investment suitability for the client.



03 | Reasons for deciding to outsource

From some recent research AIFA has undertaken with IFAs, it was identified that lack of expertise and time are the main reasons that advisers have taken the decision to outsource fund selection.



So whether you decide to keep investment management in-house or outsource there are a number of considerations to bear in mind, as part of that decision-making process.

“Financial Advisers are more able to spend time on holistic financial planning.”

04 | What to look for when deciding to outsource investment management?

Once you have decided to outsource investment management there are a number of things to look for when deciding who to partner with. As a minimum, external investment managers are expected to demonstrate:

- Strong financial background and credit record, with risk control aligned to regulatory requirements
- An appropriate level of experience and performance related to assets under management
- Investment staff that hold relevant professional qualifications
- Established corporate governance and internal controls to ensure regulated operation

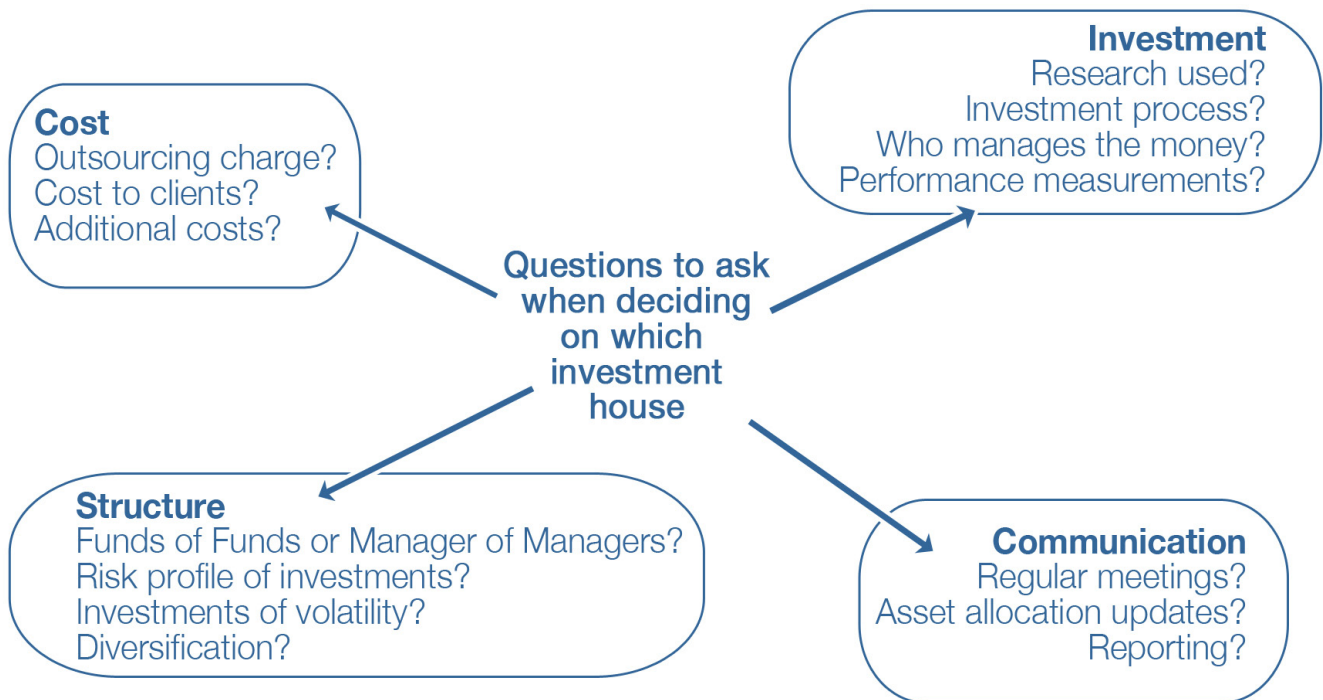
Additionally you may want to understand the following:

- How active the fund manager is going to be?
- What minimum asset allocation exposure do they have?
- What structure does the investment manager offer, Fund of Funds or Manager of Managers?
- What process does the investment manager follow?
- What sort of levels of diversification does the investment manager have?
- How independent is the manager selection?
- What level of volatility will your clients money be exposed to?
- What are the charges for outsourcing?
- How is performance measured and reported?
- How regularly will your investment manager meet with you?
- How regularly will your investment manager provide asset allocation updates?

“Investment portfolios are regularly reviewed and updated which would take time to do in-house.”

“Ease of administration
saves time”

Other considerations for selection may include the ability to align processes with the IFA firm and whether the entire investment management functions are to be outsourced or just components.



IFA firms may want to appoint an investment manager through a selection process which incorporates an application, a preliminary review, second review, fees negotiation and legal contracts being agreed. They may also want to establish an ongoing review process to ensure the due diligence of their selection going forwards.

“Access to some
institutional funds and
stockbroker services”

Outsourcing compliance rules

The Financial Services Authority has reminded firms that they cannot contract out of their regulatory responsibilities by outsourcing their functions. Reasonable steps need to be taken to avoid undue operational risk.

Firms should exercise due skill and care when outsourcing and take steps appropriate to the particular outsourcing contract to ensure a number of conditions are satisfied such as: making sure the provider has the ability to provide the service, supervising the outsourced functions, assessing performance and taking action if the provider falls short of the required standards. Please refer to FSA COBs rules 11.7.4 for guidance.

05 | Investment management due diligence

Due diligence and the terms of the contract are very important between the investment house and the IFA firm. Every effort must be made to ensure that the investment house performs as expected and in the worst case scenario, if the IFA firm wants to pull out of the investment outsourcing contract, that this will have no detrimental effect on the client.

IFA firms need to be aware of any additional costs and ensure that sufficient levels of data access and security are maintained. Ensuring the right governance processes are operative for the length of the contract is critical for successful outsourcing, with documented evidence for audit purposes. Regular reviews (at least annual) should take place to review the investment house in terms of quality and efficiency.

The due diligence document should include the information below and should be updated regularly.

- Research approach
- Performance track record
- Experience
- Asset selection criteria
- Details of registrar, trustee, custodian, investment managers and auditor
- Structure
- Investment objective
- Minimum investment
- Charges/fees
- Flexibility
- Risk factors

“Professional investment management.”

06 | Conclusion

Outsourcing investment management may support a firm’s strategic plan but it is not the only option. With the Treating Customers Fairly initiative and the required transition to the Retail Distribution Review rules, outsourcing needs to have demonstrable additional benefits to the client which are clear and transparent. Outsourcing an IFA firm’s investment process should enhance the client proposition whilst saving time and cost for the firm.

IFA firms that have experience and have seen success through offering clients discretionary fund management and/or advising upon clients’ investment portfolios may well choose to keep the investment management in-house. This may well prove to be in the best interests for the firm and its clients.

The key point is that investment is a continuous process. It requires a fully committed approach to managing money or the ability to access others whose specialisation is only professional institutional investment.

“The investment house has the resources available to do all the investment research.”

“Peace of mind that clients’ portfolios will react to changing market conditions in a measured and logical way.”

Seven Investment Management (7IM) combines a discretionary asset management service, multiple asset class funds, and an independent investment platform. We aim to form a partnership with financial advisers to help drive costs down and service levels up for the end client.

We focus on producing broadly diversified portfolios that have a keen eye on cost and pay close attention to managing and reducing risk. The risk weighted 7IM portfolios include both a long term (strategic) asset allocation and a short term (tactical) 'tilt'. We do not just automatically re-balance to a pre-determined neutral position at a given date in time. Those strategic and tactical asset allocations can then be implemented with either actively managed or passive instruments.

Launched in March 2002, the company now has around £2.5 billion in assets under management and administration (June 2010).

To find out more, please call 020 7760 8777, e-mail information@7im.co.uk or visit www.7im.co.uk



The Association of Independent Financial Advisers (AIFA) is the voice of the IFA profession. We are here to present the collective view of our membership to the regulator and those policy makers who have an impact on the IFA market place and the business operation of IFAs.

There is a clear need for IFAs to speak with one strong voice. Our role is to bring about this united front. We influence the opinions of decision makers to direct policy towards a light-touch regulatory structure, and are sought out to provide our knowledge and expertise to better understand and define practical policy.

We are funded by our members and industry supporters, and are a not-for-profit organisation.

Important Note:

The assumptions in the document are based upon questions AIFA placed on IFA census in August 2010 which focused on IFAs' behaviour with regards to outsourced and in house investment management. 358 IFAs responded to the survey, 296 were investment specialists and formed the base for these questions (defined as those generating more than 25% of their income from pensions, drawdown, OEICs, ISAs, onshore or offshore bonds). Fieldwork was undertaken between 3rd and 23rd August 2010.

This is not a definitive advising and selling guide. Advisers and their organisations must have their own practices and procedures in place. The guide must be read in conjunction with the relevant sections of the Financial Services Authority's (FSA) COB rules and is not intended as a replacement for them. AIFA has produced this guide in the spirit of helpfulness to assist members by helping them decide which is best for their firm and their investment clients and may result in firms reviewing their existing investment management decisions.

Association of Independent Financial Advisers
Austin Friars House
2 - 6 Austin Friars
London
EC2N 2HD

Tel: 020 7628 1287
Email: info@aifa.net
Web: www.aifa.net

Ref: AIFA-OIM-10/10
Registered in England No: 37799289
Registered office: 100 Fetter Lane, London, EC4A 1BN