Scorpio Partnership

Immediate release

PRESS RELEASE

UK WEALTH INDUSTRY TURNS TO RISK MANAGEMENT IN CREDIT CRISIS

LONDON - "Transparency, simplicity and liquidity" in asset allocation and portfolio construction are the emerging themes of a strategic assessment of sentiment within the UK wealth management industry conducted by **Scorpio Partnership**, the leading business strategy advisor to the wealth management industry, on behalf of **Royal London Asset Management** (RLAM).

In today's economic environment, where wealth levels have been significantly hit and client trust in wealth managers eroded, the Scorpio Partnership team pooled the collective knowledge of 32 decision makers at 14 of the UK's leading wealth management firms governing over GBP200 billion in AuM during Q1 2009 to measure where portfolio construction was heading.

Stan Bland, head of sales at RLAM, said **"***We were keen to find out exactly how the investment proposition for high net worth individuals would re-develop in the current business environment. Will it be more of the same, just better, or entirely different? This analysis points to some critical change themes emerging."*

Six key themes emerged from the analysis

- There is an ongoing bias towards cash and bonds dominating portfolio models;
- A reassessment of core/satellite portfolio models is underway;
- A preference for stable performance has come to the fore;
- Single strategy fund over multi manager vehicles;
- A trend towards greater collaboration in product innovation is taking place as wealth managers refine their role in the value chain;
- A growing demand for communication by wealth managers direct from the investment coalface.

Sebastian Dovey, managing partner at Scorpio Partnership, said "*Wealth managers across business models in the UK are redefining the role of investment management at the heart of the value chain."*

Perfect storm conditions have created an unprecedented environment for change in the way UK portfolios are managed

Cash and bonds are dominating the portfolio construction landscape. This is the outcome of unique events in the wider financial landscape. Hedge funds and complex instruments have been strongly criticised in the press and by the industry in general. Clients, burned by exposure to equities, have retreated to cash and the property market downturn has impacted on a core UK asset class.

Cash and investment grade bonds dominate the current investment landscape for HNW clients. Cash is, however, a temporary holding position as clients take stock of their wealth destruction and scandals in the money markets cause clients to second-guess the safety of these "safe" instruments.

In this context, investment grade corporate and sovereign bonds are also seen as safe assets. Indeed, nationalisation is turning some corporate bonds into government securities. Clients are considering playing these risks but are not yet ready to go beyond the high-grade environment to other debt instruments. Again, simplicity is key.

Equities and alternatives do, however, remain on the horizon for future investment. The challenge is calling the bottom of the market and convincing clients to act.

The use of ETFs and passive funds is also on the increase, largely due to cost and liquidity. These instruments are being used in some more creative ways to access specific investment strategies on a short term basis, like commodities. However, the counterparty risks of passive vehicles and ETFs are high on the radar and many are still wrestling with the lack of commission on these instruments. This is driving wealth managers toward active management.

Core satellite models are being reinterpreted in traditional asset classes

Traditional satellite elements (alternative assets) have been largely pulled out of portfolios. In the current environment cash is now the core component – where safety and liquidity are key. Actively managed investment grade corporate bonds are being used as an alpha producing element – particularly while interest rates and inflation are low.

This reflects the wealth managers need to create value for clients. Wealth managers' are looking to traditional instruments to achieve growth in client portfolios. Bonds are now being used as a core alpha-generating element of the portfolio mix. This is causing an increased interest in active bond managers across all wealth levels.

"*The shift in construction of asset management models indicates a major change in investment philosophy," said* **Graham *Harvey***, *senior associate at Scorpio Partnership. "Wealth managers are increasingly keen to demonstrate their role in wealth re-creation for HNW clients. Also, the compression in margins from equities and alternatives to cash and bonds is changing the commerciality of the asset management model.*"

Transparency, simplicity and liquidity are paramount in selecting asset classes and in dealing with fund managers

Transparency, simplicity and liquidity look set to dominate the agenda across all asset classes during 2009.

Due diligence has become more critical than ever as the industry responds to the destruction of client wealth through the collapse of funds, vehicles and institutions. Performance remains an important quantitative metric of fund selection but is now seen as part of a wider need for stability and consistent performance. There is a preference for consistent upper mid-quartile performance over the helter-skelter of top-tier to bottom-tier returns of more volatile managers.

Qualitative and operational issues have become more important in the last year. Tenure of managers, team structures, stop-loss systems and direct meetings with fund managers or portfolio specialists have become critical to potential investors. Interestingly however, an assessment of fund managers' parent company remains relatively low on the radar. This is despite concerns about counterparty risks and defaults in asset classes and structured products.

Wealth managers are increasingly favouring team-based approaches to asset management over star managers in traditional asset classes. This is because of a belief that the true stars either do not exist or have emigrated to the alternative investment industry.

Stan Bland said, "*From our perspective at RLAM the results suggest that, unsurprisingly, the wealth management industry is responding to market challenges with far more detailed analysis of risk*."

Fund structures are becoming increasingly important. Clients are looking to claw back returns through tax efficiency, which is increasingly important since the new Budget and 50% income tax band were announced by the Chancellor of the Exchequer. Some clients are also concerned about fund structures domiciled in unfamiliar or less well regulated offshore jurisdictions.

Client segmentation is evolving and being tied to wealth managers' proposition and product

Wealth destruction has forced the industry to focus on its value-added core of service, client profiling and ensuring wealth re-creation is as effective as possible. Along with destruction of portfolio value wealth managers have suffered damage to trust and to their brands. The industry is trying to rebuild client trust and using client segmentation and profiling techniques.

Longer term, it is likely the wealth management industry will become even less focused on the manufacturing element of the value chain. Wealth managers will increasingly focus on distribution and take selective involvement in product research and development. In this context, partnerships between wealth managers and fund managers are being redefined as more collaborative.

Stan Bland said, "*To regain the trust of clients, wealth managers will work harder at communicating investment risks to clients and will require the underlying manufacturer of funds to provide greater clarity on their products. Our combined ability to communicate frankly and effectively with clients during this period of market stress will be a key factor in the progress we all make.*"

Sample size and methodology

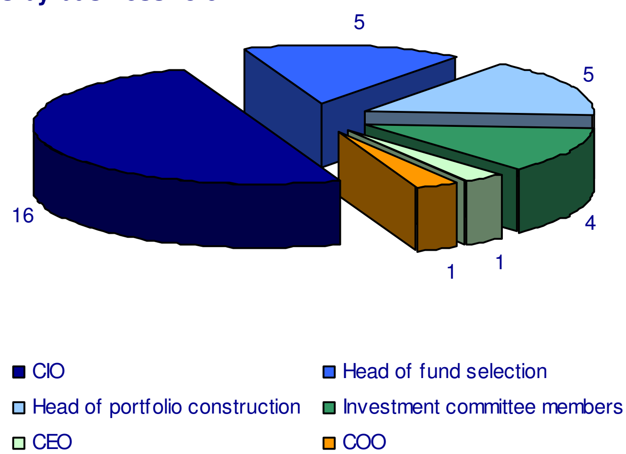
In 2009, **Scorpio Partnership** was engaged by **Royal London Asset Management** (RLAM) to undertake a strategic assessment of the drivers and challenges facing the UK wealth management industry. This assessment focused on both the current credit crunch environment and the long term trends and expectations of the UK wealth industry.

To fulfil this Scorpio Partnership took expert insights from decision-making personnel at 32 of the UK's leading wealth management firms.

These interviewees represent 14 of the top 25 UK wealth management institutions by size, controlling an estimated GBP200 billion in assets under management (AuM) for individuals ranging from affluent individuals to billionaire families.

Interviewees were CEOs, COOs, CIOs, heads of fund selection, heads of portfolio allocation, and other decision makers on investment committees. The full division of the interviewees by business title and role is shown in Figure 1.

Figure 1: Interviewees by business role



Source: Scorpio Partnership

The engagement focused on firms that use funds in high-net-worth (HNW) and ultra-high-net-worth (UHNW) portfolio construction. The sample firms were selected in collaboration with RLAM.

The interviewees were segmented into five groups (Figure 2) in order to assess the breadth of potential opinions in the UK wealth industry. The five business models were:

- UK-based private banks
- Internationally-based private banks with operations in the UK
- UK investment management firms
- Multi family offices (MFOs)
- Independent financial advisory firms (IFAs) with a focus on HNWs

Scorpio Partnership

About Scorpio Partnership

Scorpio Partnership is a strategy consultancy to the wealth management industry, based in London.

The firm has conducted more than 300 global assignments across the wealth spectrum for over 120 institutions in private banking, fund management, family offices, technology and resource management, as well as for related service providers to the wealth management industry.

Scorpio Partnership specialises in interview-based insight gathered from financial industries connected to global wealth. The firm does this with HNW individuals directly and wealth management industry professionals to support strategic assessments and future initiatives for clients. This long term pulse testing, refined over 10 years' expertise, forms the foundation for strategic recommendations to clients.

Scorpio Partnership has interviewed over 6,000 HNW and UHNW global consumers of wealth management services and more than 10,000 wealth management staff and intermediaries.

In April 2008*, Scorpio Partnership was voted the best global consultancy to the wealth management industry for the third consecutive year, ahead of the top three global management consulting firms. The firm is independent and owned by management.

**WealthBriefing, 2006 - 2008*

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About Royal London Asset Management

Royal London Asset Management (RLAM) was established in 1988 and specialises in providing investment management solutions for both the **Royal London Group** and a range of external clients. These include FTSE 250 companies, local authorities, universities, charities, wealth managers, financial advisors and private clients.

RLAM manages over GBP30 billion of assets, employing more than 50 experienced investment professionals in its London-based office.

Across areas of investment expertise, RLAM believes wholeheartedly in the long term added value of active fund management supported by a highly personalised level of service.

RLAM's range of portfolio management services includes:

- Bespoke segregated mandates tailored to clients' objectives
- Fixed income and cash pooled pension funds for institutional clients
- Full range of UCITS III compliant retail funds comprising unit trusts and a Dublin-based ICVC
- A property unit trust for tax exempt investors

Royal London is the largest mutual life and pensions company in the UK. Group businesses serve around 3.6 million customers and employ 2,870 people.

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