



# **3Q Solutions**

## **Approach to**

### **Wraps**

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## Executive Summary

Although wrap accounts are still in their infancy in the UK market, the desire to deliver a wrap platform is becoming more and more prominent as evidenced by industry newspapers. A wrap account is a mechanism for deciding suitable asset levels and managing transactions based on a client's portfolio of assets, and then executing them. 3Q's definition of a wrap platform is a combination of a solid wealth management model, and a throughput processing model with a well defined administration process.

There are £1768 billion (€2752 billion) of wrappable assets in the UK with analysts suggesting that £150 billion will be under the control of wrap platforms by 2008. What financial adviser can ignore this potential to market this opportunity and improve selling efficiencies and advice as well?

There are two distinct strategies for developing wrap capability for a financial services distributor: one that concentrates on building infrastructure then loading on the client portfolios, and two that creates a service to the client, and an operational model to support it in parallel. In short to:-

- Develop the infrastructure, both technical and operational, market the service and gain the first client. This will plug into asset managers and lending agents who support the wrap model of open architecture product administration.

or

- Develop the client base by gaining a commitment to manage all assets, both wrappable and non wrappable, with superior advisory, communication and performance services. The financial organisation will gain a commercially viable level of business that will create a new recurring revenue stream.

Having analysed the marketplace for wrap platform investment and understood the business drivers behind it, 3Q believe that wrap accounts will become a reality and grow in stature over the coming years. However, in its analysis, 3Q found that there are very few financial distributors who are willing to invest in wrap now for a number of reasons;

- Support of wrappable assets by providers
- Investment in cashflow to move from commission to assets under management (AUM) remuneration
- State of current client base and its portfolios

As already mentioned, the wrap platform is a combination of wealth management, core administration and throughput processing, and 3Q have strategically aligned themselves with organisations that have a focus on improved client accumulation, enhancement and protection. 3Q's immediate future development will focus on achieving superior client portfolio management, and client profitability for its client organisations. Its long term development will eventually embrace throughput processing of the transactions that make this portfolio most cost effective.

*"To satisfy today's sophisticated clients; IFA firms in the UK market are demanding wrappable products and a wrap platform to manage them. The key elements of a wrap platform is the ability to aggregate, analyse and create advisory elements that lead to well constructed financial transactions, then execute these transactions electronically. We have understood the end point for years; how to get there and the path to take are the difficult questions. We see two distinct paths, and both have their strengths and weaknesses", Ray Young, CEO 3Q Solutions.*

## Introduction

Many articles have been written regarding the wrap. Some of note are; “The Aquera Wrap Platform”, Datamonitor’s “Wrap Accounts – Next Stop UK” and “The Taxonomy of Wrap” by Ian Orton of the Wealthnet. Most people examining this subject are painfully trying to ascertain what to do with a wrap. This paper is a little different as it tries to address the questions any financial distributor needs to answer in order to identify how **THEY** should approach the subject of wrap and what decisions they have to make in order to come to a definitive and comfortable conclusion on the subject.

## Background

### The Origins of a Wrap Account

Wrap services have been in place in the US and Australia for some time now.

- The US model was originally designed to allow access to institutional investment funds by pooling large investments in one place, but has since extended for the mass affluent by re-inventing itself as a mutual funds platform, similar to fund supermarket.
- Australia appears to be closer to what the UK currently understands a wrap offering to be. Australian wrap development was based on the need for an IFA channel to cut administration costs against a backdrop of a recognised need to move from upfront commission to recurring fee-based revenue.

*Please see Appendix 1 for more information on the US and Australian Wraps*

Research suggests the wrap account is an advice model and not just a transactional model which the UK market is beginning to put in place.

### The Drivers of a Wrap in the UK

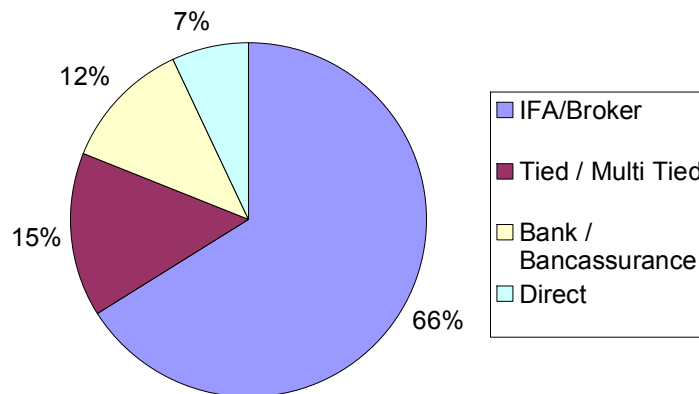
The UK financial services sector has seen a lot of change in the last number of months. Some include:

- The Sandler report
- The regulatory push for transparency
- The pressure for unbundling products and advice
- Depolarisation
- Pension simplification.

In the new environment, a small number of IFA’s are likely to move from a transaction based model where commission dominates turnover, to an advice led fee based model with the focus on holistic financial planning, which can better be facilitated through the usage of wrap platforms.

IFA’s is the biggest channel for selling life and pensions generating 66% of sales in 2002.

### UK Distribution Channels



**Source:** Datamonitor, 2004. Wrap Accounts: IFAs Perspective

#### Some Stats from IFA's

- 34% of distributors claim to offer some form of a wrap – normally information consolidation services
- 11% of IFA's said they offered single technological platforms for the full range of products
- Only 27% of IFA's are considering offering wraps in the future
- Only 7% have immediate plans to introduce one now
- Larger IFA's are more positive about wrap accounts
- 71% of IFA's working in regional branches of a large IFA felt that wraps would widely be adopted by financial advisers<sup>1</sup>

Datamonitor's survey indicates that a wrap service is inevitable, but which strategy are people taking. As we can see, only 7% have immediate plans to introduce a wrap now. There are a number of key considerations that must be taken into account and answering these questions may lead to a conclusion:

- How long will it take my company to change from a primarily up front commission based firm to a fee based and assets under management based firm?
- Do I have sufficient wealth management services and expertise and processing to warrant a wrap platform?
- Am I prepared to relinquish control to a wrap platform provider?
- Is the current provider market open "enough" to warrant investing in wrap services?

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<sup>1</sup> **Source:** Datamonitor, 2004. Wrap Accounts: IFA's perspective

## Why do we need a Wrap Offering?

There are two reasons for wrap being such a key development in the financial services industry in the UK. Firstly, the client is demanding services such as consolidated statements of finance, appropriate tax positioning and sophisticated diversification. However, the most forceful argument seems to come from the adviser community that is looking to drive client loyalty through service and account aggregation while reducing administration costs and moving from commission based fee to a single fee. More importantly, there is £1768 billion (€2752 billion) of wrappable assets in the UK with analysts suggesting that £150 billion will be under the control of wrap platforms by 2008.

### “Should we provide a Wrap Account to our Clients”

The answer to this question is that many financial organisations are already providing this type of account at a very basic and unsophisticated level. The overall concept of a wrap account from a client's point of view is the management of their assets as a whole rather than as a disparate group. Most good financial advisers do this, albeit on paper. The underlying management of these assets encased in life assurance, banking and real estate contracts is where the difficulty in terms of cost and control lie.

One wonders what marketing message will be used to “entice the client to buy into a wrap account” as it is currently being described in the UK. In time to come, will clients know that they actually have a wrap account and will they value it? Many industry commentators believe the introduction of wrap into the UK is as a result of a concerted effort by distributors to “bypass” the life assurance industry. Moreover these commentators are suggesting distributors are hoping to grab the revenue for administering investment for them. Not surprisingly the life assurance industry is keen to stop this happening.

3Q Solutions believe that financial service organisations must ask themselves, what level of sophistication do they want to take a wrap platform to, and can they increase client profitability from the platform, thereby increasing shareholder value?

Increased sophistication leads to increased costs. Experience tell us this increase must be matched with new business models and supporting technology.

## Industry Definition of a Wrap

Before we improve the wrap offering, we must define it and identify where it can be improved and where these improvements can make money.

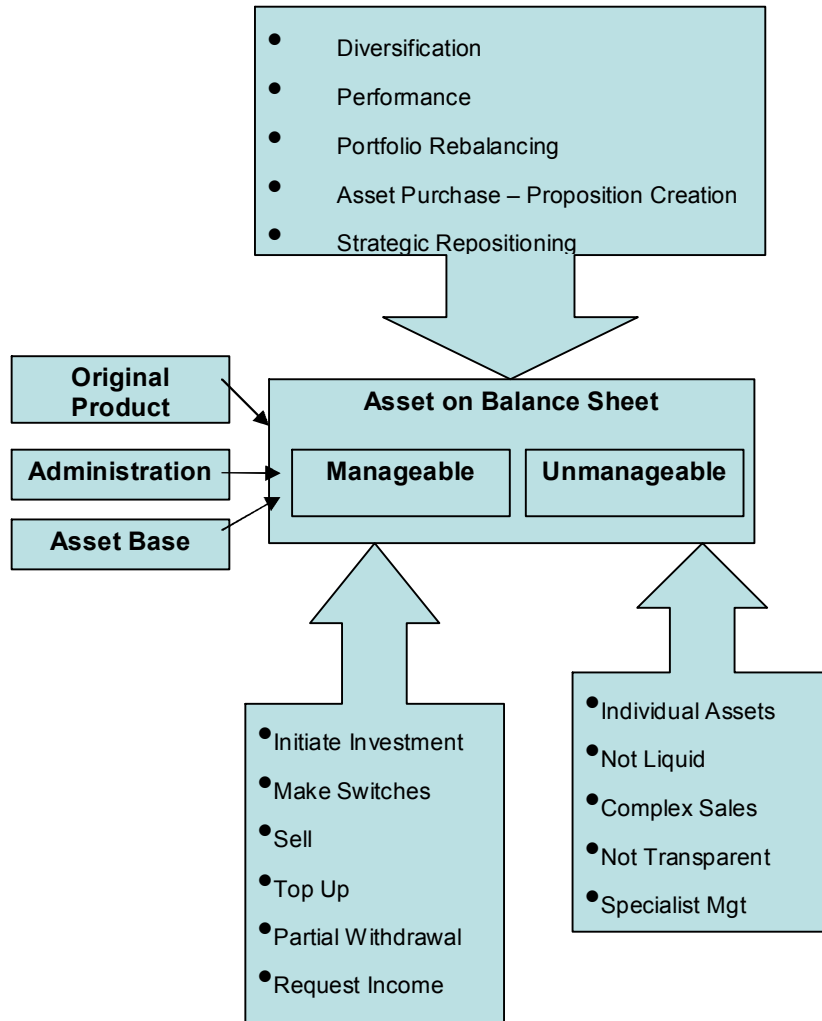
By aggregating an individual's financial requirements, assets and liabilities advisers can take a holistic approach to financial planning and advice. Financial products are not sold in isolation, but as part of a portfolio that meets the overall needs of the customer taking account of their individual circumstances preferences and attitude to risk. Traditional product wrappers (pensions, ISAs, etc.) are utilised within a wrap to provide tax-efficiency, and investment advice can be separated from product advice. Wrap facilitates the ability to develop improved advice, based on access to complete information and planning tools.

## **3Q's Definition of a Wrap**

3Q Solutions take a step further when evaluating a wrap offering. We believe the following features best describe a wrap proposition:

- Retail private client portfolio management service
  - Client investments as a single portfolio
  - All savings and investments, irrespective of tax vehicles
- Flexible investment choice
  - Selection from a range of providers/fund managers
  - Discretionary and non discretionary
- Financial planning with advice
  - Typically fee based (normally related to value of assets)
  - Single charge across multiple products
- High service levels
  - Consolidated tax and performance reporting on whole portfolio
  - Investment performance, what-if projections, asset allocation analysis risk profiling support
- Straight Through Processing
  - Integrated Back Office Administration
  - Exception Management

## 3Q Wrap Model



An aggregated view of a client's investments within the wrap is essential. Front-end tools to assist with client servicing, risk profiling and asset allocation should support that aggregated view. The ability to transact business on-line, using straight through processing is also required. Key features of wrap are the ability to charge clients across all holdings within a wrap not just at product level and the facility to move investment holdings between tax wrappers. As well as holding and managing as many assets as possible on the platform, it is essential to allow integration with third-party provider systems where existing assets may reside, and also to support data entry, storage and reporting of other valuable assets such as property.

To summarise, wrap is a combination of a solid wealth management model and a throughput processing model with a well defined administration process.

**The Attributes of a Full Wrap Account are:**

<b>Capability</b>	<b>Change needed to deliver these capabilities</b>
Hold any investment asset	Holistic advice not financial services advice
Facilitate any tax regime	Tax efficiency
Tools for holistic analysis and management	Standard and deep analysis
Access on line for management	Lower costs of administration gives higher net returns
Has a single transparent price	Open architecture gives open choice

## Wrap Strategy

### Two Strategies for Developing Wrap Services

There are two distinct strategies for developing wrap capability for a financial services distributor:

Firstly

- Develop the infrastructure, both technical and operational
- Market the service and gain the first client's (including asset transfer)
- Plug into asset managers, lending agents etc who support the wrap model of open architecture product administration.

Secondly

- Develop the client base by gaining a commitment to manage all assets, both wrappable and non wrappable.
- With superior advisory, communication and performance services the financial distribution organisation will gain a commercially viable level of business that will create a new recurring revenue stream. Then they can start to plug into the new open architecture of product providers, thereby forcing service selection based on market forces.

### Potential Wrap Platform Provider Model

Having defined wrap earlier (see page 7), the question we need to ask is who will provide these services now. If there are two distinct strategies for providing wrap services, there are two distinct developing models, each supporting its underlying business strategy but with each having the same ultimate vision in the future.

Ultimately, the financial services distributor will deliver the wrap account to the client. However who will deliver the wrap "machine" i.e., the tools to:

- Select the correct investment and asset class,
- Administrate the purchase of the asset to take advantage of tax benefits.
- Define the process for changing this while minimising organisational and operational costs.

A wrap platform provider is a new category of organisation in the financial services industry. It could well be an organisation already operating as a distributor or product provider. Multiple variants of the wrap proposition are likely to evolve, and their characteristics will depend on the wrap providers business models. A key feature of wrap is the separation of investments from products. Investment selection and product selection are two separate, but inter-dependent activities, the product being the tax-wrapper that encompasses the investments.

So what options are open to players in the UK market for introducing wrap services to its clients? Broadly speaking, there are two.

1. The current player's scenario is based on the continued involvement of today's distributors and product providers. In this scenario the wrap service is a hub that sits between the two categories of organisations, providing customer-centric aggregation, transactions and on-line tools. Significant process efficiencies are introduced as a result of the automated interaction between distributors and providers.
2. The new model is based on the dis-aggregation of today's product providers, with a significant shift of power to distributors and/or fund managers. The wrap service is not just a hub, it also allows for the building and administration of products. By involving fund managers, distributors can design their own white-labelled products.

## Leaders and Followers

As we can see from the strategies outlined above, delivering wraps services to clients will mean one of the following, depending on your strategic position:

1. Develop a client base, based on wealth management services, using existing providers and asset managers to maintain your independence by controlling your own technology and processing. Over time “plugging into” open architecture providers who support your wrap technology and processes.
2. Register with a wrap platform provider supported by a single life company, using their technology and process, therefore tying yourself to this company for your processing. You hope this platform provider becomes the “standard” so that you can use products and asset management from tomorrow’s providers.
3. Develop your own wrap platform and when a critical mass of open architecture providers emerges, offer the full service to your clients.

## What is the Difficulty in Delivering a Wrap Account?

The main constraints to implementing a wrap strategy are:

1. The level of wrappable assets held by clients. Three of the largest categories of assets held by clients are benefits from Occupational Pension Schemes, investment property and business assets. These have not been managed heretofore by the IFA, banking or insurance industry except for the assets managed under SIPPS.
2. Question regarding fee changes: Will a client “suffer” two sets of fees – the original fee (most of which was given in upfront commission) and a new asset management fee?
3. Where assets held by institutions are not wrappable, attempts to transfer the assets into more wrappable products may incur exit penalties or loss of benefits.
4. Of the wrappable assets (those currently being administered on a unit accounting basis), what current administrators (asset managers, life companies) will facilitate the integration effort to provide asset valuations and provide through put processing online.
5. For any distributor wishing to provide wrap services, the remuneration model would suggest that they would have to invest heavily in their organisation to sustain the cashflow impact of changing from an up front commission based service to a fee based and fee for funds under management based remuneration model.
6. The cost to the client to move current assets to wrap account service.

Highlights for answering the question are:-

<b>For a wrap account</b>	<b>Against a wrap account</b>
Admin down 70/30	Set up cost
On-going revenue	Technology spend and fear
Sell on value	Co-operation from industry
New money from legacy business	Revenue flow

## Critical Success Factors for a Wrap

3Q Solutions believe there are a number of critical success factors for wrap over the coming months and years. The most important not being technology but being discussed in 1-3 below.

### 1 Variations

Wrap platforms will be provided by 3<sup>rd</sup> party solution providers e.g. Transact, life companies e.g. Skandia and the variations on these will be dictated by the level of control they exert on the client base, the level of openness to the product, asset market and the level of services provided. In order to maintain complete independence, a distributor must not relinquish control of their client base and must have access to the entire market. Therefore the level of wrappable assets held by the client and the services performed on these, is a key decision making factor for the IFA, as it will dictate his/her level of independence.

### 2 Drivers

Wrap as appeared due to the growing cost of product administration and the inefficiencies of the life market. These may change as life companies open their product services (remember when you could not get all term quotes from one system) and the wrap service of the future may just be an add-on to a powerful client portfolio management system e.g. 1<sup>st</sup> Software, plugged into the open architecture of product and asset managers.

### 3. Constraints

It will be important to understand the impact to an organisations business from the immediate and future point of view. The immediate impact will be an analysis of the existing client base to ascertain if wrap services is suitable, can the firm sustain a change in remuneration policy and is the investment available for technology, training and possibly recruitment. For the future, has the firm a bridge to retreat over if the wrong strategy is taken, will the future revenue stream sustain the business and will the investment gain the desired return in both financial and business expansion terms.

## 3Q Conclusion

3Q Solutions services the sales and marketing effort of financial distribution firms, with a proven business model that creates a compelling service for selling financial service products, providing financial planning services and ultimately wealth management services. A key element of any wrap platform is the ability to aggregate, analyse and create advisory elements that lead to well constructed financial transactions. As a result 3Q have examined their role in the wrap market.

### Client First Priority

3Q believe that the success of wrap services will be determined by the level of benefit to the end client as opposed to the benefit to the adviser. Moreover, 3Q believe that the advisory and asset management services provided must come first. Charging structures and efficiency of service are key to providing the client with the service level being sought.

### Level of Wrappable Assets

Because of the history of product development in the UK has created a large and sophisticated number of legacy systems. Unravelling data and processing into a wrap platform model will require considerable levels of investment from existing product providers and asset managers. Obviously new comers to the market such as fund supermarkets are ideally positioned to distribute their product based on an open architecture but from the overall service viewpoint, the client has assets both wrappable and unwrappable and both must be catered for. The model for servicing wrappable assets has been well documented and implemented in some cases as mentioned above, however, when examining a client's overall portfolio, a large majority will have more unwrappable assets. Once the level of wrappable assets increase – then it's time to invest. To do this, a compelling proposition must be given to the client to transfer existing assets to wrappable assets or understand the nature of the limited service available with unwrappable assets.

### What Strategy?

3Q believe that a strategy of building wealth management services is key to the success of a full wrap service. 3Q will concentrate on this area of development.

Wealth management is a service that is sold once and is underpinned by a number of product propositions e.g. income protection, managed funds and pensions, and the client's financial plan. 3Q's wealth management solution incorporates a rules engine that takes the information from the client's financial objectives, balance sheet and any underlying products and develops a sophisticated financial plan which drives the wealth management service.

The overall aim of this wealth management model is to:

- Accumulate assets
- Protect assets
- Transfer assets

The wrap platform market will remain unstable for some time yet with the life company model being too restrictive and the independent platform model failing to achieve a critical mass of open architecture products and assets. 3Q have concluded that these business models will have a slow market take up. 3Q do believe however, that the wrap market will develop and its solutions will over time "plug into" open architecture product providers and asset managers.

## Appendix I – The Origins of a Wrap Account

Most articles written about wraps in the UK compares it to experiences in the US and Australia. This can be misleading as the drivers in the UK are different from those in the US and Australia. What works in different parts of the world may well not work here. The current economic climate is also significantly different to that in the US and Australia when their wrap markets emerged. One of the original implementations of the wrap account was the Hutton Investment managed account. However, the US model is broadly based on equity and bond holdings outside of life and pensions industry and therefore cannot easily be compared with the initial introduction to the UK which is firmly aimed at changes in the life, pensions and managed fund industries.

A number of different variations on the wrap theme has emerged over the past 12 to 18 months, with various levels of sophistication and integration. When putting the US experience beside that of the UK, one must remember that the US market is much larger, diversified and regulated in a very different way – most importantly, the profile and attitude of the end consumer is very different in that US consumers tend to have short term objectives but will actively manage their own underlying portfolio.

The Australian wrap incorporates banking deposits, property funds, pension assets, bonds and equities. Success of this wrap was driven by the level of investor sophistication and partly due to the importance of the IFA distribution channel in Australia. The fact that the same pension movement is occurring in the UK at the moment emphasises the fact that it will be a success.

The US wrap mainly focused on the equity investment, indirect and direct bonds and on the HNW market. Very few US wraps have allowed for the inclusion of life and pensions products. This is a different scenario for the UK.

The primary advantage of the US wrap is the ability to offer institutional style investments because investment managers can bulk up orders and manage assets as they would an institutional client. Investors see the advantages of institutional investments such as no bid/offer spreads and no upfront charges.

The US market has grown by 40% per annum since 1996. The largest players here are Merrill Lynch, Salomon Smith Barney, UBS, Morgan Stanley, Prudential Securities and American Express

<b>Consultancy Wrap</b>	<b>40%</b>
<b>Mutual Fund Wrap</b>	<b>17.5%</b>
<b>Proprietary Wrap</b>	<b>11.5%</b>
<b>Portfolio Manager Wrap</b>	<b>10%</b>
<b>Fee Based Brokerage Wrap</b>	<b>21%</b>

**Source:** Aquera Report 2004

## **Appendix II – Some Current Players**

### **3<sup>rd</sup> Party Providers**

#### **1 Investment Management (7IM)**

This is a division of Killik and Co, the private advisory stock broking service that has over 36,000 clients with GBP2bn in assets under management. Their platform offers a range of investments as part of their offering. The service currently offers pooled accounts, investments from individual fund managers and individual stocks or a mixture of all three. Other products include ISAs PEPs, SIPPs and family trusts.

They offer a single fee service related to the value of the clients portfolio. 7IM links with 1<sup>st</sup> Software which provides the aggregated data for valuations. 7IM launched in 2002 and currently has GBP150m under administration.

#### **2 Hargreaves Lansdown**

This is one of the UK's largest brokerages. HL's Vantage service offers clients the opportunity to invest in ISAs, PEPs, unit trusts, OEICs, securities, investment trusts and SIPPs. Life assurance and investment bonds are not offered.

#### **3 Transact**

Independent wrap service offering from Integrated Financial Arrangement plc. Modified version of an Australian master trust model. Offers a range of investment and tax wrappers and will trade with anything that has an electronic price feed and is tradable.

### **Product Providers**

#### **1 Skandia**

One of the largest life companies in the UK and distributes solely through the IFA network. Their offering is described as a custodial wrap in that it is not purely an information service but does all the administration required. It does not have an open architecture in that it does not provide an investor with access to all investment managers available in the market. Skandia offers a range of multi-manager style products.

#### **2 Barclays**

This is one of the UK's largest retail bank and offers wraps through their stock broking arm called Barclays Managed Account Program. Their service offers clients the options of 6 investment managers and the choice of 12 portfolios. The six investment managers include Lazard, Brandes Investment Partners, Nicholas, Applegate, Capital Asset Management, Alliance, Investco and Goldman Sachs.

#### **3 Abbey**

They spent GBP20m on the development of a wrap proposition. They were the first company to be approved by the FSA for providing wrap services. Abbey's vision is that it wants to be as close as possible to the "full wrap" idea as mentioned earlier. It currently offers the majority of tax wrappers except for onshore and offshore life bonds and no trusts.

#### **4 Funds Direct**

Set up in 1999 as the UK's first fund supermarket. Egg owns 85% while Prudential owns 15%. Currently offers 1500 funds in the UK and 7000 throughout Europe. It is currently repositioning itself as a wrap platform that will offer funds both inside and outside of ISAs, PEPs, stocks, income drawdown and pensions all online.

## **Appendix III – Bio of Author**

Having spent his initial part of his career as part of the IT management team at a large financial services company in Ireland where he introduced technology solutions for selling and marketing financial products, Ray established Foresight Computer Solutions in 1995. This company has successfully become the leading provider of software to Independent Brokers in Ireland. Ray has a passion for financial services and lectures in a prominent third level college in his spare time. As CEO of 3Q Solutions, Ray uses his 20 years experience in developing successful and innovative financial services technology solutions to bring 3Q products and services to their target markets.



**Ray Young, CEO  
3Q Solutions**

## **Appendix IV - Information Sources**

- Aquera 2004
- Datamonitor, 2004. Wrap Accounts: The IFA's Perspective, April
- Datamonitor, 2004. UK Life and Pensions under Wraps, June
- Datamonitor. 2003. Wrap Accounts – Next Stop UK, December