Moving to fees
Convincing your clients of the benefits of RDR

This document is directed at investment professionals in the UK only and should not be distributed to, or relied upon by retail investors.
Moving your clients to fees is part of a bigger process of building a successful advice business. This document builds on previous guides and aims to help you manage the transition successfully. You can access this information on www.vanguard.co.uk/adviser
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Why fees are good news

This guide discusses ways to help your clients understand the benefits of the Retail Distribution Review (RDR). RDR may require you to review your entire business model, from your value proposition to the way you communicate with your clients. But, by explaining the changes clearly, you can turn RDR to your advantage.
Why fees are good news

Working for your clients

RDR aims to rebuild investor confidence in markets and financial regulation. By banning commissions and requiring you to move to fees, it may seem to undermine the advice business model. But RDR has the potential to improve the advice market in the long-term. It aligns your interests with those of your clients and enables you up to do what is right for them without regard for third party incentive schemes. This should allow you to focus on building long-term relationships with your clients.

Running the business your way

With RDR, you’ll determine your own fee structure. In the long term, this will give you greater control over your revenues and ultimately your business.

Some advisers fear for the stability of their revenue stream when moving to fees. Indeed, commissions from product providers may at first seem a more reliable source of revenue, and advisers who have moved to fees often report an initial drop in revenue. But, after overcoming the transitory difficulties and persuading their clients, most say that revenues recover and are more stable than before.

Creating business value

Despite some initial difficulties, advisers in the UK and abroad usually find that the transition to a fee-based model strengthens their firm. Many advisers used to build their value proposition on their ability to deliver market-beating returns for their clients. But rather than chasing returns, advisers can more aptly demonstrate their ability by acting as wealth managers, financial planners and behavioural coaches. They provide discipline to clients who often make impulsive and emotional decisions when left to their own devices. The value good advisers create for their clients goes far beyond investment management, to include life coaching, financial planning and reviewing progress against their mutually agreed-upon goals.

Advisers provide many services to their clients, not just investment management.
Getting ready for RDR

You have spent time getting your business model right and defining your value proposition. Now you need to think how you are going to bring your clients along with you.

You’ll need a solid communication plan in order to win your clients over. From our experience, advisers who manage this transition successfully spend as much time with their clients as they do working out their fee structure.
Getting ready for RDR

Putting your clients at the centre

Your clients need to feel that the change serves them rather than simply helping their adviser cope with regulatory developments. Your conversation should focus on the benefits to them and how their experience will improve as a result of paying fees.

You may have managed to align their advice needs with the commission structure in the past. But moving away from commissions will allow you to improve the quality of your advice. As a fee-based adviser you can put greater emphasis on services that are not covered by current commission schemes but which matter to your clients: strategic asset allocation, research and due diligence, monitoring and rebalancing with long-term objectives in mind.

Expressing your value proposition

Once you have defined your value proposition, you’ll need to communicate it to your clients. You may have a compelling service model, but that doesn’t guarantee your clients will understand it. They may still think your role is to provide them with better returns than anybody else, or to predict which way markets will go, when you want to focus on achieving long-term financial goals for them.

When providing fee-based advice, start from the client’s perspective. Why should a client use you? What’s in it for them?

Best practices focus on several metrics:

- Quality – What can you do better for the client? (Better than the clients themselves or than another adviser).
- Quantity – What can you deliver more of (e.g. relevant plan updates) or less of (e.g. market noise).
- Cost – What can you do more cost effectively for the client?
- Time – What can you do faster or more efficiently for the client?
Understanding your clients’ point of view

Your success as a fee-based adviser will ultimately depend on whether clients see value in the service you offer. Your clients willingly pay for a number of services, from insurance to pay-TV, because they understand the value exchange that takes place. If you keep this fact in mind, you will see that costs are only a problem in the absence of value. A fee-based model makes the value exchange that takes place more visible to your clients. That’s why focusing on the entire breadth of your services – from life coaching to financial planning to allocating assets and reviewing performance – is so important in bringing your clients on board.

What does the new charging model really mean?

Your clients may find your fee model easier to accept if they understand the full implications. We all know that clients never received ‘free’ advice. In the past, the costs just weren’t transparent.

After RDR, you decide your own fee structure. You can charge your clients a flat fee, an hourly fee or a fee based on the assets under management. Depending on the amount you charge and the way you structure it, your move to fees may involve no change at all for your clients, except that the charges may become more transparent.
What do your clients really think?

Some advisers worry whether their clients will be willing to pay for a service they have previously perceived as being free of charge. In fact, a large majority of clients understand that under their current arrangements, they are already paying for the advice they receive.

A survey carried out by Adviser Impact*, also showed that about 45% of clients had at least some understanding of forthcoming regulatory changes.

Q. How does your financial adviser charge for his/her services?

* The data was gathered from 600 consumers across the country, via on-line survey, in September 2011. All respondents work with a financial adviser, make or contribute to the financial decisions in the household and meet specific asset criteria. They represent the clients and prospects of independent advisers.
Perhaps more importantly, a vast majority of the participants say that the value they receive reaches beyond investment performance. Clients particularly value their adviser’s support in articulating their goals and monitoring progress.

Q. When you think about the fees/commissions you pay your adviser, to what extent do you agree or disagree with the following statements?
Consumers also believe that advice plays a critical role in helping them reach their primary financial goals. Eighty-eight percent of consumers say that the advice they receive from their adviser makes a difference. These results should encourage advisers as they move to a fee-based model.

Q. Thinking about your most important financial goal, how important do you consider the advice you receive from your financial adviser in reaching that goal?
Winning your clients over

At some point you will have to sit down with your clients and explain how and why you are changing your charging structure. This conversation will be the most critical part of your transition. Carefully preparing for it, and keeping in mind some conversation techniques, can help you stay in the driver’s seat and get the result that you want.
Start early

The earlier you have a conversation the more time you give your clients to get used to your new charging structure. Putting the conversation off until you can’t avoid it any longer may undermine trust. You may give the impression that you are acting under pressure or that you don’t have a plan.

Your clients will find the conversation easier if they understand the subject beforehand. Sending them a letter outlining what you are doing and why will give them time to think about your new fee-based approach. Giving your clients time, rather than bringing the topic up unexpectedly, creates confidence. We include an example client letter at the end of this guide which contains some of the points you might want to cover.

Make it about them, not you

Putting yourself in your clients’ shoes will likely improve the tone of the conversation. Try to anticipate what they might think, the objections they could bring up and the questions they may ask.

Focus on how they benefit from the transition rather than on the constraints that led you to change your business model. Asking your clients questions along the way will make the conversation more interactive.

Sometimes, conversations can get difficult. Knowing how you react under pressure and avoiding getting defensive can prevent the conversation getting off track. Remember that your clients have the right to be heard and can offer valuable insights.

To help you prepare for this crucial conversation we include a checklist at the end of this chapter.
Be prepared to walk away

In rare cases, you may deal with clients who will not pay for advice, regardless of the advantages it brings. Other clients might be too small to serve appropriately and profitably under your new fee-based scheme. In either case, you should consider how you might help those clients find another, more suitable, advice source.

Your company is undergoing a complete transformation and your success depends on focussing your energy and attention on those clients who will build long-term sustainable profitability. Given the scale of the change, you can’t expect to win over every client.
Difficult conversation checklist

<table>
<thead>
<tr>
<th>Prepare</th>
<th>Know the outcome you want from the conversation, be it to convince the client of the benefits of fees, or that you can no longer serve them.</th>
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<tbody>
<tr>
<td>Believe</td>
<td>Be open and honest. Simple honesty is the best way to appear confident and secure when you speak.</td>
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<tr>
<td>Listen</td>
<td>Don’t just ‘hear’, but really listen. Consider your client’s point of view, concerns and desires so you can then address each concern, not just brush over it.</td>
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<tr>
<td>Ask open ended questions (then listen some more)</td>
<td>If you sense there’s more to what they’re saying, ask open-ended questions and keep the conversation flowing. Then listen some more.</td>
</tr>
<tr>
<td>Maintain eye contact</td>
<td>This helps to build trust and show that you are listening.</td>
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<tr>
<td>Be aware of body language</td>
<td>Posture, stance, facial expression and tone of voice can be more important than the words you choose. Use your personal skills to be just as open and friendly in this crucial and difficult conversation as you are when extolling the virtues of your service offering.</td>
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<tr>
<td>Know what you’re talking about</td>
<td>Have all the facts and details to hand, especially the benefit to clients of moving to fees and how it can help ensure transparency and aligned interests.</td>
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<tr>
<td>Relax</td>
<td>If you go into a conversation thinking that it might be difficult, you may tense up. Don’t force it, just let it come naturally.</td>
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<td>Don’t debate</td>
<td>Try to have a conversation with your client, don’t let it get into the realm of debate. This is not a conversation that you need to ‘win’, you need to help your client win. Remember, it’s all about them.</td>
</tr>
<tr>
<td>Know when to quit</td>
<td>You won’t be able to convince everyone so know when to give up. Don’t waste your effort on a client who will never see the benefits of fees.</td>
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Avoiding common pitfalls

You will face challenges as you move to a fee-based model, from determining your fee structure to bringing your systems up to scratch and getting your people behind you. You can work through these problems if you have a plan and give yourself some time to implement it.
How much should you charge?

Whichever way you collect your fees, you will also have to decide how much to charge. Your fee level will have to strike a balance between what your clients are willing to pay and what you need to cover your costs. Your fees should reflect the quality of the service you provide; charging realistic fees will lead to a sustainable business model.

You could start with the end in mind by deciding what turnover you would like and divide that number by your advice capacity (clients/advice hours/AUMs). This calculation will show you how much you have to charge to reach your target volume. You could also try setting a fee and estimate the total revenue you can generate from it. From there, you can see if this figure allows you to cover your costs or if you will have to change your business model to align revenues and expenses. Either way, you will always have to ask yourself whether your clients will find your fee level realistic.
Administration does not add value

Justifying a move to fees by citing administration costs might seem tempting, but administration does not add value for clients. Instead, the value has to come from your clients meeting their goals and an ongoing high level of excellent service.

Reviewing your current systems and back office operations might help control costs and make the transition easier. An efficient and well-functioning back office will also help you build the flawless processes you need to deliver on your value proposition and keep your promises.
Moving your people to fees

Advice firms can only succeed in the transition if they align their staff to the new business model. Many individual advisers have traditionally retained a high percentage of the revenue they generate, leaving the firm with a small margin to cover their operating costs. With RDR, advisers must focus on generating a future flow of ongoing client fees rather than a single inflow of instant revenue. You may need to review your firm’s compensation structure to align your advisers’ pay with the new fee model.

If your company focuses on building assets, adviser compensation could help to encourage long-term asset-building and retention. Firms could also swap short-term revenue for a long-term stake in the business to encourage a long-term focus among their staff. Either way, your success depends on ensuring that your people understand why the business is changing and support the transition. We have included a sample staff memo at the end of this guide to help you communicate with your staff.
Dear Client,

Introducing our new client-focused service model
We are writing to you to inform you about some important changes to our business model which we will implement in an effort to improve our service to you. As of next year, we will move away from the current commission-based charging scheme and establish our advice fees directly with you, our client.

Increasing transparency
You may have read about changes in the way Financial Advisers will operate in future. Much of the discussion revolves around an important change in regulation coming into effect on 1 January 2013, called the Retail Distribution Review (RDR).

RDR aims to raise the quality of the financial advice service you receive and improve the transparency of the fees you pay in return. At Smith & Co, we place primary importance on our duty of care to you as our client. We have always operated to the highest professional and fiduciary standards and already live up to the spirit of the changes introduced by RDR in many ways.

Giving you full flexibility
As you know, we have until now received a commission from the provider of the investments and insurances that we have arranged on your behalf. RDR will withdraw these commissions in favour of a fee directly negotiated between financial advisers and their customers. We believe this change is in the interest of our clients as it will allow us to work for you without regard to any third party commission scheme and help cement our alignment of interests.

We would like to offer our clients the greatest possible flexibility in their payment method. Once we have agreed on an appropriate fee, you can pay us:

- Through an up-front payment from you to us
- Through a regular deduction from the value of your investment
- Through specific project-based or hourly rates

Whichever way you decide to pay, the level of our charges will not materially change but you will find them easier to understand. I would welcome the opportunity for a meeting to discuss our new fee structure with you in detail, to explain to you how our service is going to evolve and to answer any questions that you may have. In the short term, all of our previous arrangements stay in place. I will get in touch with you shortly to schedule an appointment at your earliest convenience.

I look forward to speaking to you soon.

Kind regards,

Your financial adviser

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Sample client letter

Client name
Client address line 1
address line 2
address line 3
Date

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I look forward to speaking to you soon.

Kind regards,

Your financial adviser

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For an electronic version please go to vanguard.co.uk/advisers or call our adviser support line on 0800 917 5508
Dear Team Members,

Securing our future
As you know, we have been progressing toward the implementation of the RDR. The most important part of our transition will be to win our clients over and help them understand the benefits of Consumer Agreed Remuneration.

The future success of our company depends on our clients understanding the value we deliver and supporting our fee structure. Moving our clients to fees may seem difficult at first, but I believe it will allow us to cement our relationships with clients and move our business in a better direction.

Putting an end to commission dependency
Under the current system, we receive commission from product providers for business we write for our clients. However, the commissions can bring certain problems:

• Market research indicates a growing perception among clients that our offers might depend on the commissions provided by certain companies. In other words, clients might wonder if we really always have their best interest at heart.

• In times of economic hardship commissions can lead to a significant revenue drag, as we have experienced in the past.

I know that many of you worry about our clients’ willingness to pay for our services. But clients most likely pay for a number of services already, from insurance to pay-TV, because they understand the underlying value transaction. Cost is only a problem in the absence of value and the services that we provide help our clients achieve financial independence. I have no doubt that they represent significant value for our clients and a competitive advantage for us. We just need to get better at describing them in a compelling and engaging way.

Growing stronger as a firm
At Smith & Co, we have always been proud of the quality of our service and the support we lend to our clients in achieving long-term goals. I have come to believe that the financial independence we are trying to achieve for our clients is at odds with our dependence on third party commissions. I also believe that moving away from commissions will make us stronger as a firm in the long term:

• Client fees will allow us to move away from ‘feast and famine’ commissions and towards more stable revenue inflows.

• The independence from third party fee structures gives us more control over the payment we receive. It also establishes a link between the fees we charge and the quality of the service we provide.

• Moving to client-agreed fees will solve the agency problem. Clients will no longer question our motivation and understand that we are their agent and not anyone else’s.

We are already working on a fee schedule that will give our clients a number of payment options and, in many ways, little may change for them. Many of our clients already pay an “assets under advice fee” and I expect this to continue.

Going forward, our business success will depend on the quality of the advice that we provide. This outlook doesn’t worry me because I know the quality we are already delivering. If we succeed in demonstrating the value of our service, moving to fees will be a blessing, not a problem.
What next

In this guide we’ve set out the common elements that have already helped advice practices in the UK and other markets move to fees. Winning your clients over represents one of the most important steps on your way to managing the transition. But the change RDR will ultimately bring about will emerge in the long-term and may require advisers to rethink how they serve their clients.

To lock in future profits you will need to provide an ongoing service that your clients value and enjoy and are willing to pay for again and again.

We are here to help

This guide is part of a range of materials and workshops that we provide for financial advisers to cope with these changes. If you found this information useful, you may want to visit the Adviser Support section of our website.

Better yet, why not give us a ring? We’d like to hear about what sort of information or resources would be most helpful to you as you work to build a valuable advice practice. Contact Vanguard Adviser Support on 0800 917 5508, or visit vanguard.co.uk
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