St James's Place

Simplifying Client Charges - Analyst Q&A Transcript

17 October 2023

Attendees:
SJP:

- Craig Gentle (*Chief Financial Officer*)
- Hugh Taylor (*Director Investor Relations*)
- Charles Woodd (*Director – Finance*)
- Andrew Cullen-Jones (*Director - Business Development and Advice*)
- Gareth Stokes (*Investor Relations*)
- Francesca Wellham (*Investor Relations Associate*)

Analysts:

- Andrew Crean - Autonomous
- Charles Bendit - Redburn
- David McCann - Numis
- Fahad Changazi - Mediobanca
- Freya Kong - Bank of America
- Gregory Simpson - Exane BNP Paribas
- Jude Neanor - RBC
- Julian Roberts - Jefferies
- Larissa van Deventer - Barclays Capital
- Nasib Ahmed - UBS
- Peter Richardson - Berenberg
- Rae Maile - Panmure Gordon
- Ross Luckman - Panmure Gordon

Craig Gentle:
Thank you everyone for getting here. The announcement we made this morning was the tail end of a very sizable project, geared towards future proofing, simplifying, and aiding comparability, and it built on the work that we completed as part of the preparation for Consumer Duty. It has been a very important and sizable piece of work. The purpose of this afternoon is to give you an opportunity to spend some time with us to see if there is anything we can do to help you with loose ends. You have got our commitment that we will help you as time goes on.

Charles Bendit:
Could we start by reconciling the pre-tax all-in fee rate that SJP earns from the product charge, the advice charge and the retained fund fee, with the 43 - 45 bps net income from FUM guidance?

Craig Gentle:
There are two material components that you will need to allow for:

- Firstly, the back-office administration and ongoing development costs, an activity that is principally outsourced to our partner SS&C. SS&C basically run the back office and they charge us for all of the administration of getting business onto the books, running business on the books and dealing with transactions on the books. Being a business with 900,000+ clients, this equates to a sizeable activity. We have had to project forward to reach a view on what that cost looks like under the new structure.

- The other material component will be tax. When I first released guidance on net income from FUM there was a desire to have more information around how the tax applies to different wrappers. Unfortunately, this is more complicated than it might seem, particularly when you get to bonds, and we have UK bonds and offshore bonds that are manufactured in our life company in Dublin. There is a lot of variability between wrappers, but also variability between the years that bonds have been written.

However, you need to be conscious that we are putting together a range that will become relevant in 2025, so in doing that we have made many assumptions around things that will change. The guidance we have provided is a good guide to what the income will deliver.

Nasib Ahmed:
The back office spend that you said we need to net off, you are adjusting that for inflation so that has gone up. When you do the reconciliation on your previous reporting of the 100 bps, take off tax, you get pretty close?

Craig Gentle:
You will not be a million miles away. There will be differences to accommodate in the future forecast. We have come up with a range that we believe will give you the most likely outcome based on whatever assumptions you choose to make. You will find it is close, but not that it reconciles fully. One of the many things we have had to do is assess what our back office looks like under the new structure. Whilst I do not believe there will be material differences, there will be some differences in the way the back office works in an unbundled environment. There will be different demands on Bluedoor, and we have had to make an assessment of what those demands are and the subsequent repercussions. We have given guidance that you should rely on and use in your existing modelling.

Larissa van Deventer:
Appreciating that it is going to be a while before we get the new format of reporting, this morning you mentioned a new target net income from mature FUM range of 43-45 bps which replaces the previous 54-56 bps. Do I understand correctly that 54-56 bps holds for the next two years and then drops to 43-45 bps?

Craig Gentle:
Yes.

Larissa van Deventer:
Then what happens after 2031 when all funds in gestation mature and how does that evolve?

Craig Gentle:
Fundamentally what you may find is that the margin will be relatively static during that period, with more higher income business going into mature FUM. There could be some positive development but

not so noticeable, given the size of FUM, that I would suggest you start changing that profile. It is a hopper of business with different levels of income. What we have got is a fairly steady rhythm of higher income bonds and pensions maturing through gestation, lower income ISAs and unit trusts going straight in, and they have a somewhat compensating effect given the size of the hopper that they are entering.

Larissa van Deventer:
Is the 4.5% initial fee staying for pensions?

Charles Woodd:
It stays for all business. A maximum 4.5% is what we charge for initial advice in the future.

Nasib Ahmed:
Are you taking a margin of the 4.5% initial advice charge?

Charles Woodd:
We have always taken a proportion of the initial charge. We collect the 4.5% charge, pay Partners and pay for Partner supporting overheads out of that, this is what goes into the new business margin. The guidance provided is that the new business margin is going to be basically nil. It will not be precisely nil, but it will be close to nil.

Nasib Ahmed:
Are you taking more of the 4.5% under the new structure?

Craig Gentle:
No, as a reminder, 4.5% is the maximum initial advice fee that will be paid. The retained split of the 4.5% charge will not change and the amount that we retain is kept for related expenses. These related expenses will continue to happen, but under the new structure the margin arising from new business will add up to somewhere close to nil.

David McCann:
Can you give us a sense of what those related expenses are and what is the gross amount that you are receiving in new business margin under the new structure?

Craig Gentle:
The sorts of costs include Partner events, Partner training and Partner conferences which are held throughout the year. The residual amount that we collect funds these expenses, which generally all relate to Partner activity.

Charles Woodd:
In addition, there are allowances which we pay to Partners. We provide business and premises allowances, which we pay in addition to providing conferences and various events. There are also other associated costs of managing and overseeing the Partnership in order to provide them with support and help grow their businesses, which we refer to as the Field Management Team. The income net of these marginal costs comes down to roughly nil.

David McCann:

I appreciate this is not a change from what you are already doing, but why are these costs not just within your controllable expense base?

Charles Woodd:

It is a historic presentational point, we have typically taken expenses which are related to particular drivers of the business and associated them with those drivers. The reason why they are not in the controllable expenses is because these expenses often move with the volume of business. Therefore, if we were very successful and grew new business by 50% you would see a corresponding increase in the expense, which would impact the ability to manage controllable expenses.

Craig Gentle:

We can also switch off these additional costs. If we were experiencing a significant headwind on new business, inevitably that pot would go down. We would not be doing the number of conferences because we have to try and cut our cloth within that line, hence the variability. There are some elements that are more fixed in nature for the short term, for example, where we pay a premises allowance if Partners are not using our property it is akin to an annual commitment. Over the years we have tried to remove some of the variability so you see less of a gearing effect, which is why we are confident with the guidance provided. It is going to be a small positive or a small negative, but in terms of the operating model that element will be designed to be somewhere close to a break-even figure.

Andrew Crean:

Under the new structure when you get rid of the new business margin, where do these costs which are currently in the margin arising from new business line go?

Charles Woodd:

We are still taking a 1.5% margin from the 4.5% and paying these costs from this, and this remains unchanged. Following the announcement this morning, we are reducing the income that is going through that line as there will no longer be an initial product charge, but we are not changing the expense. The quantum of the reduction is enough to just about eliminate that line.

Andrew Crean:

Within the 6% and 5% there is a 1.5% and 0.5% product charge, which produces the new business margin. Taking gross premiums and multiplying it by 1.5% and 0.5% you get to a figure more than you achieve on your margin arising on new business. Should we assume the negotiated element is part of the 4.5% initial advice charge?

Andrew Cullen-Jones:

When Partners present a charge to a client, the 4.5% initial advice charge can come down as well as the initial product charge.

Andrew Crean:

So, there is not a huge amount of additional cost above the 1.5%?

Charles Woodd:
In terms of the new structure, we are saying there is not going to be a huge amount of additional costs above the 1.5%.

David McCann:
What is a reasonable bound for the margin arising from new business? How negative / positive could that go?

Craig Gentle:
To clarify, this is a modelling exercise that picks up in 18-20 months' time and projects forwards, so it is not structurally zero because there will be things that push you forwards and things that push you backwards. However, I would anticipate the range being within a low single digit million positive to a single digit negative. Fundamentally nothing has changed other than the removal of the initial product fees.

We are talking about quite small amounts in the context of the Cash result, and these are the costs of running a 4500-5000 team of advisers. We have to make estimates and assumptions around what we want to do and what we might need to do to manage, motivate and protect the Partnership.

David McCann:
Can you give us an indication of what the product tiering will look like?

Craig Gentle:
Not yet, but what we will be publishing in due course is taken into account in the guidance that we have offered.

Andrew Crean:
I did not get a sense that there was a huge change in the charges, is that broadly correct?

Craig Gentle:
For unit trusts and ISAs clients will be better off under the new structure.

The complexity with bonds and pensions is that the structure we currently have involves no product charge in the gestation period. Under the new structure, however, asking whether the overall fee is higher or lower depends on the duration of the product. The new structure does positively result in simplification, so it looks very much like a unit trust and ISA. We had to make a commercial value and price judgement as to where it needed to be to look similar to what you would see in the market, but also simple in as much as it was the same each year without any ups and downs. You end up with a form of complicated interpolation to work out what the annual ongoing charge needs to be to tick all of the boxes. The result is that if you take out a pension for 10 years, under the new structure it will look as if it has cost you more than it did under our current structure. However, the reality is we do not have much business that stays on the books for only 10 years. If you look at what we have announced this morning, the difference between what we do today and the structure from 2025 has a crossover point at about 30 years. If you then take into account the change we made at half-year and assume that it is part of this reassessment it is more like 18 years. I appreciate these were two different decisions for two different reasons, but it is quite a short intervening period in a business like ours.

David McCann:
To what extent can we really say that these changes announced today are the final state? i.e. this is what the charges are going to look like for the next 10 years, appreciating the regulatory environment and new Chief Executive starting. Is there any chance of drift between now, implementation and a period of time in the future?

Craig Gentle:
With Mark arriving as the new Chief Executive, if you ask me the question do I think Mark will have an appetite to revisit the conclusions that we have reached following a very lengthy project? I doubt it. Mark has been part of a Plc board that did all of its final assessments on this. You can see the impact it has on the profile of the Cash result over the next few years. We really do not take that lightly, but we have gone every step of the way to make sure that we have something that is sustainable. Will we find very small things that we can do to enhance along the way? I am sure that we will, but I do not think they will be subject to an RNS or another significant announcement. Will we be fine-tuning it? Absolutely. But again, I do not think that it is going to be subject to an RNS. This puts us in a great place to grow the business over the long-term and unbundling also brings us an opportunity for real agility within the business. As great as the bond and pension product structure was, it was nigh on impossible to make changes because you always had to have a reconciliation between two different types of view. Making small changes was very challenging.

The expectation of businesses across the financial services like SJP in the long term will be to have ongoing mechanisms to share economies of scale. If you think you can build a financial services business that just grows and grows with no change in outcome for clients, you are likely to be mistaken. Under this new structure we can be in a position to make small changes everywhere. This could just be a feature of the business that you would barely notice from year to year, rather than having to store it up and have a big change in charges structure. But to get back to your question, David, we are done. This is the change.

David McCann:
Are the FCA satisfied that this is going far enough?

Craig Gentle:
Have they signed off on it? You do not get that, that is not what regulators do. Can I sit here and say they have signed off on it? No. Have we been engaged with them every step of the way? Yes. We have taken them through this, we have engaged with them all the way through.

We think everything we have done is entirely consistent with the regulatory framework that they have been working on for the last few years.

Andrew Cullen-Jones:
The principles that we came up with in looking at our component costs involved 'value' as the first principle, asking 'where is value across the value chain?' and 'does our new charging structure and components equate to that and get the right balance?'. The second one is the cost to provide the service plus an appropriate profit margin. The third one is around comparable market rates and 'where do the price points sit in the market around that?'. There is a lot of regulation that is geared towards particular parts of the value chain, for example, the Assessment of Value / VAS which came out of the Asset Management Market Study. We had to look at those rules and consider how does an

asset manager that provides a fully bundled charge best address a piece of regulation that is designed for an asset manager that only plays in that part of the value chain? How does that manifest itself in how we meet that regulatory challenge? Part of the challenge here is that we have always felt that our total charges are competitive, we still firmly believe that and are well-placed in the market. The lenses that we have gone through to design the new structure were designed with that regulatory framework in mind around Assessment of Value and fair value, that are intrinsically part of Consumer Duty.

Nasib Ahmed:
Is the 17 bps that you are holding back from the fund management charges just a reallocation?

Craig Gentle:
The problem we had from an unbundling perspective was everything was in one charge. The work we have been doing has not been about reallocating, it has been about ignoring our current charges and saying if we are starting from fresh what would our charges be for each of the services we provide? and can we justify those charges in the context of value that activity delivers for clients?

Nasib Ahmed:
What happens when clients switch off advice? Under the new structure you are charging 25 bps, so you lose that?

Craig Gentle:
If a client approaches us and says I would like to switch off my advice charge, clearly we would have an interest in why because it could indicate there is a problem that we can resolve. So, for example, if they have fallen out with their adviser we could probably rectify that because we are an advice business. We believe in the value of advice and if somebody switches it off that value will not emerge for them. If they say no they just do not want the advice they have changed their mind, we would switch off charges for ongoing advice but they would no longer have access to an adviser. The level of service that a client would receive would be much more similar to the level of service you would receive if you invested in say a pension fund on an unadvised basis with a third party. We would absolutely continue to provide any administration support they require. Now the reality is very few people seek to switch off their advice fees, but it does sometimes happen.

Nasib Ahmed:
But you lose the 25 basis points?

Craig Gentle:
Yes, absolutely, because there is no service being provided.

Nasib Ahmed:
What proportion of clients switch-off advice?

Charles Woodd:
A very small proportion. We have an advice-led model, our target market is people who want advice.

David McCann:
Are you happy with the signalling in July? And what actually happened post-July?

Craig Gentle:
The programme of work we have had extends before July. The position in July was that we had to be ready for Consumer Duty compliance at the beginning of August. We had to make judgments in July as to what was needed in order for us to be able to conclude that we were comfortable. The one area from a Consumer Duty compliance perspective that we had a discomfort with was on long duration bonds and pensions, simply because of the price that was being charged over a long duration. We could have wrapped it into the overall assessment that we have just completed but we took the view it was something we needed to do to conclude that we were compliant with Consumer Duty. It therefore follows that what we have announced this morning is not driven by Consumer Duty. It is entirely consistent with Consumer Duty, but it has not driven us to make the decision that we made last night and reported this morning. It is a really important differentiation, because saying something is consistent with Consumer Duty is different from saying you have got to do it because of Consumer Duty.

Nasib Ahmed:
Has there been much feedback from clients?

Craig Gentle:
It is too early to say at the moment, we will do a round up at the end of the week to see what the Partner experience has been with clients, although I expect it to be positive. We had some good feedback via the Partnership from clients related to the decision we made at half-year.

Nasib Ahmed:
What happens to clients that are still in gestation by H2 2025, do they go up to the 80 bps ongoing advice charge?

Andrew Cullen-Jones:
No, they stay on the charge as is and then at the end of gestation they will be on the new charging structure.

Craig Gentle:
It is almost as if the day they mature they are a new piece of business. This is what drives the acceleration because there is a period of time where the hopper of mature funds under management has got two feeders into it, one is new business and one is maturing gestation.

Larissa van Deventer:
Within the presentation slides it shows the EEV NAV impact per share and you say that it is down 17% due to 3 components. The first one is the dividend, the second one is profit for the period and the third is the impact of simplifying the charge structure. Can you isolate that third point and is that your estimate of the impact on your embedded value long-term?

Craig Gentle:
The big adjustment is where you are changing the quantum of future charges for business that has already been written. The amount of cash that emerges will be different and it is really important to remember that EEV only reports income on stuff that has already been written. Although there is a benefit in the future with the pattern of cash emergence, that is not something you will see in the EEV.

Larissa van Deventer:
Does it reflect your assessment of the impact on the current book?

Charles Woodd:
We have done some modelling and yes that includes our assessment of what that is. We are projecting into the future, a number of years in terms of all the assumptions that one has to make about what behaviour is going to be. Using these assumptions, we have provided an initial assessment.

Charles Bendit:
Are the changes to the fees going to be done behind the scenes or is there going to be a repapering exercise that involves waking up clients who are dormant in their relationship with SJP?

Craig Gentle:
There is a whole change programme ahead of us, but I think we will try and do this with minimum interruption to clients. We have an advantage of being a relationship business, so we have the power of the Partnership with us to make sure all of this is communicated and explained, but the general approach is that we will try to minimise interruption.

Andrew Cullen-Jones:
In terms of 2025, at that transition point, no client charges will be going up.

Craig Gentle:
Yes, that is important. Although there is a new crossover point after 30 years, this applies for new business. Clients that are currently invested with SJP will pay less than they do currently. The clients that invest in a bond of pension on day one will have a different profile of charges than a client that invested on the day before.

Andrew Cullen-Jones:
It is very helpful in terms of managing existing clients and ensuring no clients are left behind.

Charles Bendit:
Between now and H2 2025 when the new charging structure is introduced, is there going to be a different incentive for either a client or an adviser to write business or potentially defer it until after the point which the new fee structure kicks in?

Craig Gentle:
Is there an incentive for the Partner to time it in a certain way? The answer is no because their initial advice is not changing, so their only incentive is to give the right advice. Is there an incentive for clients to hold back? Generally, the amount concerned compared to for example, the tax opportunity lost in the case of an ISA, are the overriding factors. We are expecting advisers and clients to think about that carefully, but it is not something we consider to be a particular roadblock. It has all got to be geared towards the best advice.

Greg Simpson:
Do you worry how much the explicit initial charge becomes a headwind for new business? Under the current structure an adviser could offer a pension with no upfront fee if they stay for 6 years, whereas now there is an up to 4.5% fee.

Craig Gentle:
I think the answer is no. Nowadays the relationship between a financial adviser and a client is so much more sophisticated, and we already have very clear documentation that refers to all of the initial charges and breaks those initial charges down.

Andrew Cullen-Jones:
In breaking out the component costs and improving transparency, we are hopeful that the market environment that Partners are working in becomes an easier one. I think there will be a market environment upside.

Craig Gentle:
The fact that advisers will be able to walk into new opportunities with something that looks the same as it does everywhere else. Our advisers have fed back that they see these changes having been made with them in mind.

Greg Simpson:
In terms of implementation, in hindsight the experience with Bluedoor some years ago was overspending, are you reliant on third parties to get this ready for 2025?

Craig Gentle:
Most businesses have strategic alliances with technology companies, and we have been no exception. Bluedoor was an enormous programme, but to put it in context, we were transferring 24 years of history whilst we were growing from paper files and green dot screens onto a totally different operating model. Where Bluedoor is of benefit to us is that because it is a 21st century system, this is doable. It does involve changing Bluedoor itself, but Bluedoor is a system that is capable of being changed. The other thing that gives me confidence is that we have still got access to the same people that did the migration working at SS&C. SS&C ultimately own Bluedoor, it is their system, so they are intimately familiar with it. If we were doing this from where we were before Bluedoor, there would be a proper challenge.

David McCann:
Is the intention to defend the dividend if you can?

Craig Gentle:
Our starting point is that we understand the importance of dividends and if we have the ability to support it with a higher pay-out ratio, then that is a decision that we would be happy to take. 70% is a safe approach, it's the right approach, it’s a sustainable approach, but if things look as if we can go further than that, we are not held by the 70%.

David McCann:
Would you defend a number lower than just holding the dividend? If it looked like you were way under covered, would you just go straight to 70% or would you go to some measure between?

Charles Woodd:
If there is a number in between, it would be a judgement as to what that number was going to be and the guidance is 70%.

David McCann:
If you were in our shoes on this side trying to model this, would you just model 70% of the Underlying cash?

Craig Gentle:
Yes, but as things progress we may be in a position to give you more on that.

Charles Bendit:
How do you envisage the business supporting passive products and the 17 bps within them?

Andrew Cullen-Jones:
We have not got any firm plans in place around this. There are lenses of this that we have looked at. For example, if you consider our Polaris range which is our unitised flagship active range of investment solutions, it has got active and elements of passive within it. If you think about the fund range based on the 17 bps margin that we retain, we are looking at active solutions in the 50 bps range. It would be fair to say you could get to a passive solution in that kind of unitised range of 20 - 30 bps and retain 17 bps. There is some work to do around this, but this provides us with a real opportunity to consider passive solutions, either as part of our broader IMA or as part of a portfolio solution.

Craig Gentle:
Thanks very much for coming in. Hopefully this has helped, but if you do need any more information, you know where we are and we're committed to give you all the help we possibly can. So thank you again for coming in.