The Future of Financial Advice

Smith & Williamson Industry Roundtable

For professional advisers only.

Introduction

Mickey Morrissey,
Head of Distribution
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Financial advice at a crossroads

Change has come to the advisory market. Today, advisers are responding to major shifts in technology, regulation and client behaviour. As Mifid II creates a more transparent industry, consolidation looks to build a more focused one. There are risks, but there are also rewards for those that truly understand the changes afoot.

Increasingly demanding and well-informed clients want to know where every pound comes from and where it goes. Their understanding of platforms and products has never been greater. They also expect advisers to adapt and make technology work for them. And it is technology — as well as outsourced investment solutions — that could bring smaller investors back into the fold, as robo-advice increasingly looks like a reality. Can the tech giants do for financial advice what the major supermarkets have done for banking and insurance?

The industry must also deal with the questions posed by the new Mifid II regulations, both national and international, including new reporting obligations, new codes of conduct, new standards, in addition to the ongoing justification of action to the regulators. Then there's the challenge of an industry facing a wave of acquisitions and consolidation. What does this mean for advisers and the clients they serve?

To discuss these and other pressing issues, we brought together voices from across the industry. We hope you find the following discussion useful as a guide to the key obstacles and opportunities in the ever-evolving advisory market.

Panel:

Mickey Morrissey, *Smith & Williamson (Chair)*

Angus Robb, *Defaqto*

Dave Field, *Novia Global*

Nick Britton, *Association of Investment Companies*

Alex Morris, *Financial Relationships*

Tony Wassell, *Partners Wealth Management*

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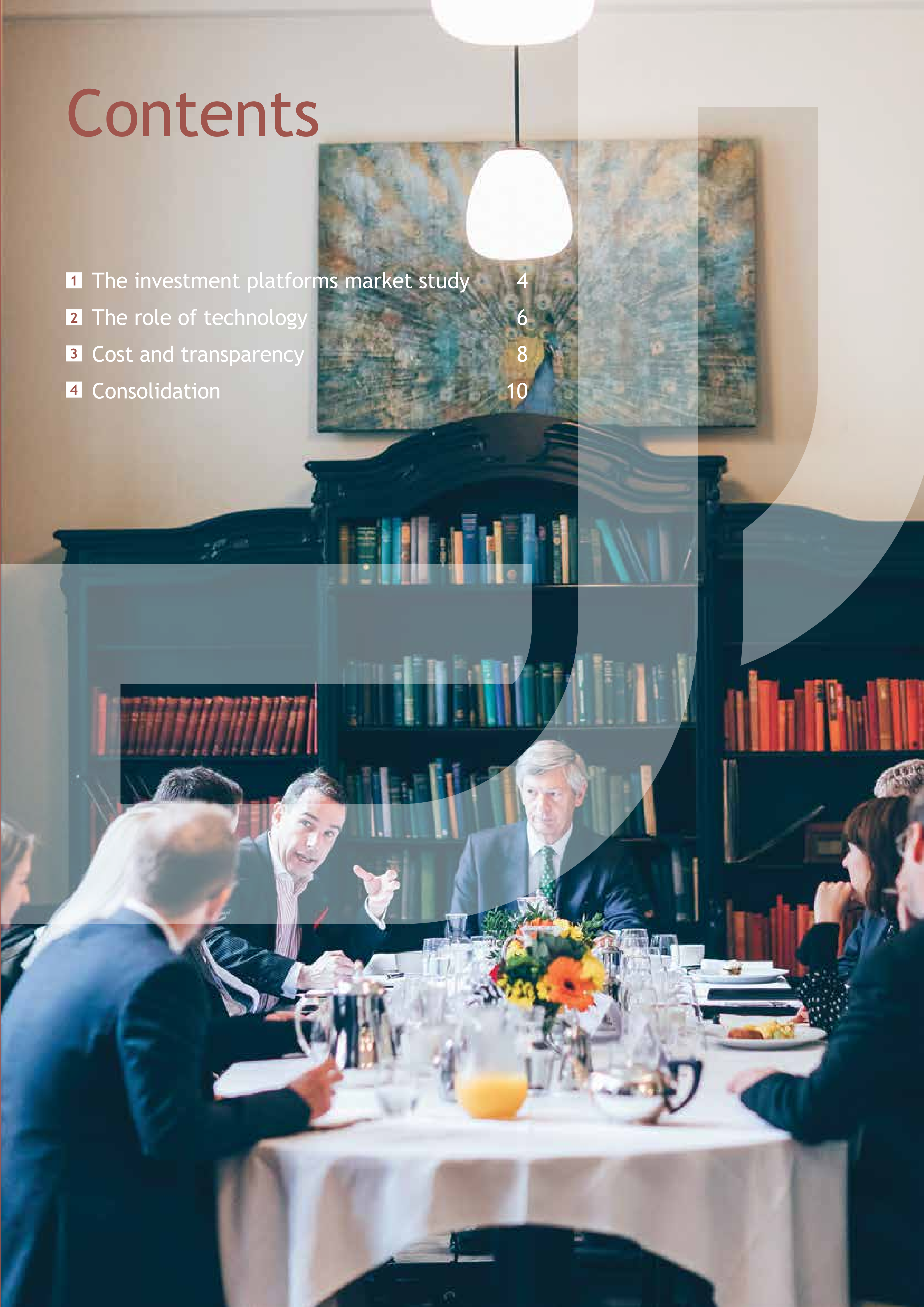

1 The investment platforms market study

Mickey Morrissey: Let's say you filled a room with 50 advisers and asked how many of them use a platform. I imagine most of them would put their hands up. And then ask how many of them have had issues with the platforms they use, and you would probably get the same response. Which is why the investment platforms market study, the subject of our first topic, is so important. I've just been reading the interim report, and we'll be able to see the final report next March.

One big issue with platforms is switching from one to another. We've got an expert from a platform here, Dave Field from Novia Financial. So, Dave, do you have any observations on this?

Dave Field: Well, it used to take six to eight weeks and a lot of work to move a client from platform A to platform B. Today, we can move money in 24 hours. But for advisers, it's not just about how do I get from A to B, it's why am I going from A to B. It's about going through the whole suitability process, looking at all the costs. Because every platform does things differently. And all platforms charge for things in different ways. So, justifying to the client why it's right for them to move is a time-consuming process. We do try to help advisers work through this, but it does take time. And that's time the adviser is going to have to charge for.

Alex Morris: One of the biggest issues is that you recommend a switch for all the right reasons, but increasingly aware clients are looking on the internet. They're more aware of these products and they're more engaged. They know exactly what price they might come in and out of the funds at. But there's one thing I always drum into them — this is not just a piece of administration. If you come out of the market high and go back in low, fantastic. If you do it the other way around, you're in trouble. Our job is to choose an appropriate time for the client to leave the market and an equally appropriate time to put them back in. You've got to be very careful, because if they lose a penny, they will come to you for the difference.

Tony Wassell: As I see it, there are two potential hurdles when transferring assets. The first is whether the new platform will accept the assets that are being transferred. And the second concerns the products that can be held on some platforms and not on others. Take junior ISAs, for example. Some platforms can't hold junior ISAs, which may not sound like a big deal. But for a client with several million pounds who has bought their child a junior ISA, they want everything in the same place. It's an issue and platforms are starting to realise this.

Mickey Morrissey: As some of you may know, our service includes investment companies and ETFs. We are aware that a number of platforms are unable to administer these, not efficiently anyway. I was going to ask you about this Nick, because you represent the AIC (Association of Investment Companies). And you've done a lot of work looking into this.

Nick Britton: That's right. We've been trying to work with platforms to make investment companies available. And I think that battle has largely been won, in that most platforms, with one of two notable exceptions, allow you to hold investment companies. But being allowed to hold them, and being allowed to include them efficiently and cost effectively, are very different things.

Mickey Morrissey: Moving on slightly, I hadn't really appreciated how many orphan clients are on platforms. There's a lot of money attached to these clients and they are almost penalised for remaining on some platforms. One contact was telling me that they overcharge orphan clients as an incentive to leave the platform. I thought that was a rather unusual incentive.

Dave Field: It's a difficult one for us, because we are an advice platform. When a client isn't being advised, we have to increase costs to service them. So, on the one hand, we don't want to penalise clients. But equally, we can't just start giving them advice. What we try to do is go to them and say, 'Look, we can give you a list of advisers available on the platform, or you should seek an adviser, or you should look to transfer to a more appropriate solution (i.e., a D2C (direct to consumer) platform, if you want to manage your own investments). So, if we look at it from the other side, is it fair that the increased cost of servicing is borne by the platform when the client is no longer paying an advice fee?

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>
> **Alex Morris**

2 The role of technology

Mickey Morrissey: Let's move onto the role of technology. Angus, I think we'll start with you here, because Defaqto is very much a technology-driven company. What tools can you now make available to your investors?

Angus Robb: We have a system that is increasingly becoming a start-to-finish advice program, from fact finding to risk profiling to product selection. It doesn't have a transactional element yet, but I suspect that will come in time. Technology is a major selling point for us. And I think that will continue.

Tony Wassell: I think we're looking at a two-tier system, and technology may be the perfect solution for that setup. As a firm, we'll continue to focus on people with more than half a million who warrant the advice and have the money to pay for it. They're cash rich and time poor.

Technological advice, however, will be aimed at a very different audience. When Amazon and Google kick off the robo-advice market in the coming five-plus years, they'll sweep up. But it won't be clients with three or four million in assets, because they want to pay for face-to-face advice. What robo-advice will do is fill a gap that needs to be filled. People can say, 'I have this much money to invest and I want to take this much risk'. They do run the risk that as they make too much money they do need more in-depth advice. That's where we come in.

Dave Field: What technology can also do is drive down costs. Things like paperless application are changing the way people do business. Everything is online now, so that's where you need to deliver. We have absolutely no paper on our offshore platform — it's all delivered online. At one time, in the offshore space, it could take three to four weeks to send a piece of paper around the world getting all the relevant signatures to make a trade. When you decide to make a trade, you want it to happen there and then. With us, this now takes three to four seconds.

Robo-advice is unlikely to help with more complex issues. But it can be a very simple service for a certain type of client. And undoubtedly, it will have a role to play.

Angus Robb

Mickey Morrissey: We have to consider the next generation, which will be far more advanced. They'll be moving money while drinking their coffee in Costa. They're going to demand a lot more from technology.

Nick Britton: Look at what's happening in the banking industry with Monzo. There are a lot of 20-somethings walking around with these pink debit cards. It's about more than just not using cash anymore, it's about budgeting for food and clothes. It's far more sophisticated than anything your high-street bank offers. If that's happening in the banking industry, which is very conservative, then it's only a matter of time before it comes to our industry.

Dave Field: I think the point about robo-advice is — if it's done properly, there's a gap there that needs to be filled. Because the cost of face-to-face advice is just too great for most people. But no-one seems to know what robo-advice is. If it just does the same thing as face-to-face advice, it's going to have the same servicing costs. And people still won't be able to afford it. What you want is self-service advice that does a certain job for a certain segment of the market at a certain cost, and face-to-face advisers that do a different job for a different section of the market. But we aren't there yet; it still feels like there's an element of confusion around what robo-advice can be.

Angus Robb: Robo-advice is unlikely to help with more complex issues. But it can be a very simple service for a certain type of client. And undoubtedly, it will have a role to play.

Tony Wassell: It's a little like when Tesco, M&S and Sainsburys all decided to go into banking with mortgages and loans. It brought banking more into the mainstream, because they all have a huge customer base. Amazon, Google and their ilk could potentially do the same with robo-advice. Bring it to people in a format they're used to and use already. And then it will be in a shape that people recognise and it'll become more mainstream.

3 Cost and transparency

Mickey Morrissey: Transparency has always been an issue, but it's really come to the fore with Mifid II. And it's quite a challenge. We've seen the post-ante and ex-ante numbers coming through, and some of them look awful. Will clients look at the cost projections over the next five years and think, I'll just buy a new car instead?

Tony Wassell: Actually, I like Mifid II. Is that bizarre for an advisory firm? I like that we can sit down with the client and say, 'This is the Mifid II version of your fees, bearing in mind that the ongoing charges figure is already sold within the funds.' As long as you explain that this doesn't change anything, it's nothing to be feared.

Mickey Morrissey: My fear is that if it's not explained it will force people down a different route, notably passive investing.

Alex Morris: RDR (retail distribution review) was great, because it cleared everything up and made everything transparent. What I find interesting with clients is that when I came into the industry 20 years ago, commission was prevalent. You'd offer the client fees and they'd decline them, because they'd rather pay for the service where, typically on a pension or an ISA, you'd have a 1.5% annual management charge and a third of that would go to the adviser. Clients never questioned it, because that's the way it always was. After RDR, you're paying fees and they're broken down by advice given, platform charges etc. The cost is actually half what it used to be, but now the client questions everything.

Dave Field: The thing about RDR in the UK is that there was a transition. We might look at the legislation and think, those labels don't make sense, but that's the legislation and that's what you're going to have to run past the client. Once everyone understands what all this means, it makes sense and it's all relatively straightforward. In the UK, you'll probably have six months of people getting familiar with the new formats and information.

Mickey Morrissey: RDR made open-ended funds cheaper in the UK. Before that, investment companies were often the less expensive option, but all that now seems to have changed, with open-ended funds charging around 0.75% and investment companies still sitting at 1.5%. But, and Nick I'd like you to touch on this, investment companies have found a way to level the playing field with a system that doesn't exist in the open-ended space. Once an investment company reaches a certain level, say £500 million, the price drops, and when it gets even higher the price drops again – it works on a gradient.

Nick Britton: Although the changes to commission following RDR levelled the playing field somewhat for investment companies, a less advantageous consequence was that open-ended funds became noticeably cheaper. So, as a result of RDR, in the past five years, about 40% of the industry has changed its fees. And those were typically reductions in the base fee and the tiered fees. Performance fees, however, are driven by the board, because the thing about investment companies is that you have an independent board that actually negotiates the fees on behalf of you the shareholder. That means they can react quickly to pressures in the market, which is why fees have been coming down.

The problem remains that we still don't really have a level playing field. Investment companies aren't as available on platforms. That's frustrating, because investment companies are part of the solution for bringing better value to the market.

> The problem remains that we still don't really have a level playing field. Investment companies aren't as available on platforms.

Nick Britton

Alex Morris: It feels like we're only talking about cost. When we look at a fund, we look at how long it's existed, how long the manager's been there, what was performance like at the time of Lehmans' collapse. Cost is the final consideration. And that's because very few clients put cost at the top of the list of criteria. And how they approach cost when they do consider it differs from client to client. So, when we go to the client with six to eight funds that our analysis has identified as suitable, we say, 'Do you have a cut-off point on cost — is anything above 1.85% or 2% TER (total expense ratio) too much?' We'll ask, 'Do you want to have less in the more expensive funds? Is diversity so important to you that you have an equal percentage in all of them?' It's interesting, I've never had the same answer to the same question.

4 Consolidation

Mickey Morrissey: Our last topic is consolidation. And never a day goes by without me seeing another headline about consolidators gobbling everybody up. Many go around the country presenting to intermediary firms about acquiring or consolidating. Their take is that a lot of firms overvalue themselves, so the hit rate of acquisitions is actually quite small, maybe 10-15%. And a lot of companies just get pushed to one side.

Alex Morris: Consolidation will increase, because there's an age issue. The average age in the industry hasn't changed much in recent years, it's about 58. And there are fewer youngsters coming through. If it becomes a requirement to be chartered to be a financial adviser, there will be even fewer, because that's five years of education, working in an office and passing the exams to get to that level. I think consolidation is going to happen more and more as people retire.

The consideration we have as advisers, and I'm now 43, is that anyone buying my business is going to want to tie me in for five years. I can't just get to 53 or 55 years old and think, 'OK, I'm selling the business.' That's because the value, or a large part of that value, is me. Consolidation is something I need to be thinking about sooner rather than later.

Dave Field: Actually, if you provide a consistent service for your clients, then the demand for the adviser to stay on should be reduced. Clients buy into the advice process and the service they get, not the individual. The adviser is important, but the more consistency you have, the more attractive your business is to a potential buyer. They know they can put someone in your place and the majority of clients will stay.

Nick Britton: We train thousands of advisers a year, across firms of all sizes. Quite often, we do meet advisers that are "lifestyle businesses". And you know, they're not looking particularly to grow their client base, but they love their jobs. They're very happy with their clients, their clients are very happy with them. And I don't see why that's a problem. Clearly succession will become an issue eventually, but it would be a shame if regulation or other pressures meant that these old school firms were driven out.

Tony Wassell: This is something that started with stakeholder pensions, where we moved away from commission to what is now a fee-based business. We're now focused on wealth — £500,000 plus — and many of those consolidating will be dealing with a shrinking pool of smaller clients. In the future, the industry will be more tech-driven, and smaller clients won't be using financial advisers at all. So, I think we have to consolidate into a more high-net-worth, highly qualified industry. And that's where we should be as a profession.

Mickey Morrissey: Before we conclude, I'd like to discuss the vertically integrated model. The most obvious recent example in our industry is Old Mutual's acquisition of a number of advice firms. Do you think the integrated model is going to grow, or will there just be a few outliers?

Tony Wassell: I've come across vertically integrated businesses, but I'm not necessarily sure it will grow as a model. As an adviser it does become more restrictive by definition, because you feel obliged to look after your parent company. It should be important to you that your clients see you as completely independent.

Alex Morris: When the banks started giving advice, it was seen as a real threat to our market. Someone being able to walk into HSBC on the high street and get proper independent financial advice – that looked like a direct challenge to us. But when the FCA started looking behind the scenes, the banks were clearly pushing their own services and products. So, customers are left thinking, 'Is this really independent?'

Dave Field: For me, it's about how you manage the conflict of interest. Because, rightly or wrongly, there's an investment company at the top trying to make a profit. They've got an adviser, a platform and an investment manager, and they want to make a profit out of all three. That's not a criticism. But can the adviser truly remain independent in those circumstances?

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