Surfing the Wave

How Financial Advisers thrived in 2019 despite rising costs and increasing regulation

FE fundinfo
Financial Adviser
Survey 2020

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About This Research

This FE fundinfo survey was conducted throughout November and December 2019. It consisted of 46 questions and was completed by 271 financial advisers over this period. Responses were taken from financial adviser users of FE fundinfo's FE Analytics tool.

It spanned a broad range of subjects including business drivers, revenues, new business and overheads for firms, the effects of MiFID II reporting and other regulatory changes, trends in investing, outsourcing, investment and retirement propositions and ESG investing.

The research was conducted prior to the outbreak of Covid-19/Coronavirus throughout the UK and abroad. The results of this survey and the collected responses are not reflective of the market turmoil surrounding the global pandemic, which at the time of publication (April 2020) continues to impact on every aspect of the global economy. Instead, this research seeks to build upon previous surveys and provides a snapshot of the UK financial advice industry at a set point in time.

This is the fifth annual survey conducted by FE fundinfo.

Executive Summary

In the space of just a few short weeks the world has watched with growing alarm as Covid-19/Coronavirus has spread from Wuhan in China's Hubei province to Europe, Asia, the Middle East and the Americas. The lockdowns that we saw the Chinese government enact in response to the pandemic have at the time of publication (April 2020) become commonplace across towns, cities and entire regions across Europe and North America.

The economic fallout will take years to be understood. As industries have ground to a halt, the markets have reacted accordingly, and central governments have responded with huge guarantees and fiscal stimuli.

Naturally then the task of financial advisers has become and will continue to be a lot more complex as the fallout becomes clearer. What, at the outset of 2020, appeared to be another year of comparative calm, has now been turned upside down by a once in a century event. The crises of 2019 – the fallout from the Woodford collapse, DB transfers and other issues – appear to be almost insignificant by comparison.

Nonetheless by the results from this year's survey reveal that despite everything, the financial advice industry is well equipped to deal with these crises.

2019 showed that strong demand for financial advice is being driven by ever more complex financial needs, low growth in DIY investing and a genuine lack of alternatives to spending time with a professional adviser. This has increased the perceived value of seeking out quality financial advice and this shows through in the findings of this research.

Not only does the demand for advice seem to be growing, but there are other drivers too. There is now a growing interest in investing sustainably and the fund management industry has launched a raft of environmental, social and governance (ESG) funds to attract consumer attention.

These silver linings all have clouds. Advisers are facing pressure as they attempt to keep ahead of the rising costs of doing business. Regulatory and reporting overheads seem to be biting hard as well as spiralling professional indemnity insurance costs.

In order to be able to capitalise on the opportunities presented, and remain profitable, advisers need to scale their businesses, which incurs further costs, notably technology investment and staff recruitment and retention.

Advisers battled through tough times and Brexit uncertainty in 2019 and prospered. How will they fair in this unchartered territory?

Key Points

- More than 54% of advisers are increasingly positive regarding their business outlook than they were a year ago. Only 5% are less positive.
- 79% of advisers surveyed reported an increase in new client numbers in 2019, with only 1.4% reporting a reduction.
- Nearly 52% of advisers reported increased turnover of at least 5%, with almost 30% reporting turnover increasing by over 10%.
- However, almost 85% of firms surveyed said that their operational costs had risen, with staffing, PI cover and reporting/regulation being cited as the most common drivers.
- The burden of regulation is the biggest cause of concern in the running of an adviser practice.
- MiFID II has had a mixed but relatively low impact to adviser practices one year on from implementation. The trend is towards an improvement in business processes as a result of MiFID II legislation bedding-in.
- The lack of clarity on DB transfers from the regulator and high PI cover costs have made many firms avoid advising on them.
- When it comes to future FCA initiatives, advisers are most interested to see the regulator focus on addressing the advice gap and improving the financial education of consumers.
- The new Senior Managers & Certification Regime (SCMR) regulations seem to have been taken in the industry's stride with only 5% reporting that they were unlikely to hit the December deadline.
- Centralised investment propositions are becoming ever more popular, but there was a bigger rise in the number of firms operating a centralised retirement proposition (up 13% year-on-year).
- Outsourcing of investment management continues to increase with more than 57% of advisers in the survey using 3rd party model and managed portfolios in some capacity.
- ESG investing has become more mainstream with larger percentages of advisers' clients driving demand for more socially and environmentally responsible strategies.
- 55% of advisers said the amount invested into ESG investments had increased last year and the biggest asset allocation changes were in favour of ESG funds.

Introduction

Welcome to the 2020 UK Financial Adviser Survey, now in its 5th year and the first under the FE fundinfo brand.

With five years of research to look back on, this report keeps an eye on longer term trends in the UK financial adviser market whilst exploring more topical areas in this ever-evolving market.

This year, we're looking in more depth at the business of being an adviser, the impacts of increasing regulation, changes in investment and retirement strategies, trends in outsourcing and finally ESG.

Nowhere in this research is there any suggestion that firms are struggling to generate new business. Implicitly, it looks like firms are actually limiting the amount of business they take on, almost certainly because they are resource constrained.

However, without scale in the business, a firm could be exposed to a number of risks: the cost of regulatory compliance and PI cover could easily exceed the revenues of a smaller revenue generating firm as well as the need to plan for new staff to replace an ageing practitioner-base. New technology and investment outsourcing can take some strain out for smaller practices, but time and investment is required.

Almost 85% of all advisers surveyed reported that their operational costs had increased over the last 12 months and over half cited cost and 'regulatory burden' as the main concerns for their businesses.

Over 160 comments relating to the increase in operational expenses encountered year on year by advisers centred around four key themes: staffing, the cost of PI cover, the rising regulatory and reporting cost burden and technology investment.

On the regulation front, there seems little evidence that the FCA are planning to ease the pressure on advisers going forward. The "Dear CEO letter" further compounds the additional costs and work expected of advisers after MiFID II, DB transfers/increased PI cover, SMCR and the FSCS levy.

There is additional pressure too on retirement advice and the way in which the decumulation journey differs from the accumulation phase.

The FCA are pushing for retirement investment pathways across the industry and specialist advice in this area looks to be increasing but this year's survey shows that advisers are still not offering specialised retirement propositions as matter of course. It seems to be on the rise though – in the previous survey, only 34% of firms surveyed said they offered a specific retirement proposition, whereas that number has risen to almost 48% in this survey.

ESG investments are growing in investor consciousness and, as the 'Greta effect' strengthens, will soon move from being a specialist interest to the foundation of almost every investment decision taken.

We look more deeply into the subject of the fast-maturing ESG sector as we conclude our latest research into the adviser marketplace.

Chapter 1

The Business of Being an Adviser

When the private equity industry starts weighing into a particular sector, then something's likely to be going on and it is becoming more evident that there's a lot of money to be made in – and from – financial advice.

"the IFA market is 'a dynamic space' where consolidators were seeking scale 'in order to grow market share at speed' while IFAs needed 'both exit options and a solution to the increasing regulatory burden.'"

Claire Frangou, Director at KPMG, NMA, 6 January 2020

Even with networks and consolidators doing their best, financial advice is still predominantly an industry of small practices where scale can dramatically help profitability.

So, it's no surprise to see a constant barrage of news of private equity-backed consolidators buying up adviser practices in order to benefit from the relative economies of scale.

This year's research tells a very positive story as to why private equity is so interested in the business of financial advice.

Business Outlook

Over the last year, the sentiment of financial advisers has improved further as 53.3% are now more positive about their business outlook as opposed to only 41% some 12 months ago.

Are you more or less positive about your business outlook than you were 12 months ago?

Response	%
More positive	53.3%
Less positive	5.03%
Little/no change	41.62%

There's good reason for advisers to feel positive about their business outlook. In a year which would be hard to describe as vintage, advisers saw both a rise in new client numbers and a corresponding rise in turnover.

Demand, revenue and turnover:

This year's research shows that demand for advice is rising and, consequently, revenues are rising:

How has the number of clients you/your business advise changed over the past 12 months?

Response	Percentage
Increased	77.83%
Decreased	1.36%
Stayed the same/little change	20.81%

Over the past 12 months, has your turnover...?

Response	Percentage
Increased more than 10%	29.41%
Increased between 5% - 10%	22.17%
Increased between 1% - 4%	6.79%
Increased under 1%	1.36%
Stayed the same	14.48%
Decreased	1.81%
Prefer not to say	23.98%

Over one third of survey respondents showed their firm's turnover at under £1m and almost 65% having a turnover less than £5m.

Demand, it seems, appears to be underpinned by a couple of issues:

- Pension freedoms and the rise of DC pensions (and DB transfers)
- The surge in baby-boomers with a 'tidal-wave' of money and approaching retirement

What is the turnover of your business per annum?

Response	Percentage
Under £1m	33.48%
Between £1m - £2m	18.55%
Between £2m - £5m	12.22%
Between £5m - £10m	5.43%
More than £10m	4.52%
Prefer not to say	25.79%

Costs and regulation

However, when we look at some of the biggest concerns facing advisers, there are some significant issues which are impacting on their businesses.

What's the biggest concern currently facing your business?

Response	%
Uncertain economic conditions caused by Brexit	14.72%
Burden of regulation	43.15%
Increasing competition for new clients	4.06%
Clients turning away from regulated financial advice	4.06%
Recruitment/succession planning	11.17%
Cost pressures of running a business	16.24%
Increasing vertical integration within the industry	2.03%
Other	4.57%

Slightly more than 43% of advisers are concerned about the burden of regulation, coupled with and related to the costs of running a business. Growing the business also shows up as a significant cause for concern, with difficulties revolving around succession planning and recruitment.

There's no doubt that these business concerns revolve around rising costs and the rising burden of regulation.

Almost 85% of firms surveyed said that the costs of running their business had increased.

Have the operational costs of running your business increased this year?

Response	%
Yes	84.58%
No	15.42%

What has been the biggest driver behind your increased operational costs?

Clients Overhead Succession management
FSCS Levies FCA Costs MiFID II
REGULATION Compliance Investment
REPORTING
Administration
Software system Recruitment Staffing Employees
Technology FEES
DB Transfers PI COVER

Essentially, there were four main areas of concern when we asked the question "What has been the biggest driver behind your increased operational costs?"

- Staffing, recruitment and succession-related issues (33% mentioned this)
- PI Cover and cost concerns (27% mentioned this)
- Reporting and regulatory concerns (26% mentioned this)
- Technology costs (15% mentioned this)

There are a couple of interesting observations on the results of this question. Clearly there's a lot going on, with multiple drivers around these four main themes, but staffing, recruitment and succession planning comes out as the most widely cited concern, followed by the PI cover issue and both push reporting and regulatory issues into third place.

There seems to be intense competition for staff as more companies than ever attempt to scale their businesses. Plus, there are some new entrants to the market such as Nutmeg, who are introducing real advisers to their propositions, further straining the labour pool.

Therein lies a growing storm of an increasing demand for financial advice, but an aging workforce. Technology, while an increasing cost, does not seem to be an answer on its own. **FE fundinfo's David Scholes** says: *"The average age of an adviser is high; there is not much fresh blood coming in, yet the demand is clearly there. The generation after the 'baby-boomer' generation are likely to be the first to have a significant inheritance and are going to need advice. While we can expect some developments in robo-advice to meet this demand, past experience has shown that technology is often slow to respond and will be incremental, rather than revolutionary."*

The other notable observation is that almost nobody mentioned new business or client acquisition as an issue, further supporting the assumption that advisers are not short of business.

Segmentation

With such a demand for professional advice, we wanted to understand how advisers segment their growing client base and if they have a minimum threshold on which they'd accept a new client mandate.

Do you/does your firm have a minimum investment threshold for new clients?

Response	%
Yes - More than £25,000 but less than £50,000	2.71%
Yes - More than £50,000 but less than £100,000	7.69%
Yes - More than £100,000 but less than £250,000	9.50%
Yes - More than £250,000 but less than £500,000	7.69%
Yes - More than £500,000 but less than £1m	3.17%
Yes - More than £1m	0.90%
No	68.33%

Although there is some evidence of applying thresholds it would be hard on the basis of this evidence to accuse advisers of turning people away based on their net-worth.

Segmentation of clients other than by net-worth seems to be becoming more sophisticated within advisory firms.

We asked whether firms segment in other ways and found that they indeed segment by sophistication in understanding investments, life stage (e.g. accumulation or decumulation), attitude to risk and frequency of contact which were all used to some degree by almost two thirds of firms surveyed.

Around a third (32%) said they did not segment their clients. This is a pretty significant number of advisers that are not using segmentation techniques and suggests that there is the likelihood that they might not be compliant with the new Prod rules and the wider MiFID II rules in general.

Prod tightened the rules around the design and sale of products to ensure they clearly met the needs of their identifiable target markets, were only sold to those target markets and delivered appropriate outcomes.

Advisers were recently urged to “fix the roof while the sun is shining” as experts predicted the FCA would begin a crackdown on Prod rules, which requires that advisers segment their client bases accordingly.

Do you/does your firm segment your clients by any of the following?

Option	Percentage
Sophistication in understanding of investments	18.69%
Net worth of the individual	35.98%
Investment goals e.g. Accumulation/decumulation	25.70%
By client need/outlook	0%
By frequency of contact	21.03%
By life stage	26.1%
By attitude to risk	23.36%
We don’t segment our clients	31.78%

Adviser Networks and consolidation

Are you part of an adviser network?

Option	Percentage
Yes	23.08%
No	76.92%

The most common networks from those surveyed were St James’ Place, Quilter and Sense Network.

Interestingly, network membership continues to fall, with only 22% of firms now members, against 25% the previous year.

Advances in technology, reporting, platforms and outsourcing – some of the attractions of centralised resources within a network – are now easily available to adviser firms directly.

Direct authorisation seems to be more popular than ever with advisers due to the rising costs of network membership and increasingly the desire to control their business overall.

There has been much news about consolidation in the adviser market throughout last year driven by private equity and also product manufacturers creating their own distribution networks. However most of the firms we surveyed were largely unaffected by the consolidators and vertical integrators, with only 15% of advisers having been affected.

Has the trend towards adviser firm consolidation and vertical integration within the financial advice industry affected your business?

Yes	14.72%
No	85.28%

Comments made by respondents that were affected fall into two camps – they either worked in a firm that was being consolidated, often because the owners were retiring, or that they were scaling their own businesses by acquiring complimentary practices. These practices bring more staff and allow the consolidation of central overhead, aiding profitability.

FE fundinfo's David Scholes says that consolidation may increase further in the future: *"Integration has been slow, but with rising costs, we would expect this to change. The cost of running an advice firm is rising which in the long run could force many to consolidate or leave the industry altogether. We may see advice firms joining networks and becoming umbrella-type organisations, offering all sorts of services.*

"Added to this, we have pull factors too. For some of the larger networks, it is part of their long-term business strategies to acquire smaller IFAs, which may become increasingly attractive to those looking to exit the industry."

Chapter 2
Increasing Demands from the Regulator

Advisers have been most vocal about the drag on their business from further regulation and are sceptical about the real benefits for their clients. The prevailing sentiment seems to be that too much time is taken up ensuring compliance with ever changing regulation rather than spending time face to face with clients.

MiFID II

Let's start with MiFID II as last year was the first full year of implementation and allows us a more realistic look at the benefits and drawbacks of the regulation from an adviser's viewpoint.

We asked how has MiFID II affected your business processes and then compared it to the previous year (the very start of MiFID II) to spot any trends.

	2019 survey	2020 survey	Change
Improved business processes	25%	29.65%	4.65%
Worsened business processes	32%	21.51%	-10.49%
Made little or no difference	43%	48.84%	5.84%

The good news, as expected, is that some of the benefits of MiFID II are beginning to shine through now that firms are used to the new regime. It's good to see that the downside of the additional reporting and other burdens are only weighing on around 20% of respondents in this year's survey as opposed to one third a year before.

FE fundinfo's Regulation Manager, Mikkel Bates, says: *"As with any new reporting or record-keeping requirement, the greatest impact will be felt in the first year. Thereafter, however disruptive it was to implement, it gradually becomes regarded as 'business as usual' and much of the pain is forgotten."*

Client reporting

Client reporting of costs and charges – both pre-sale and annually – have polarised opinion, some seeing it as positive but many more noting it has a negative impact on their business processes.

As with all things regulatory, it takes a long time for the benefits to filter through to the end client but advisers do note that 26% think their clients understanding of costs and charges had improved. There's still 74% of clients saying that there understanding of cost and charges has not, so more work to do here.

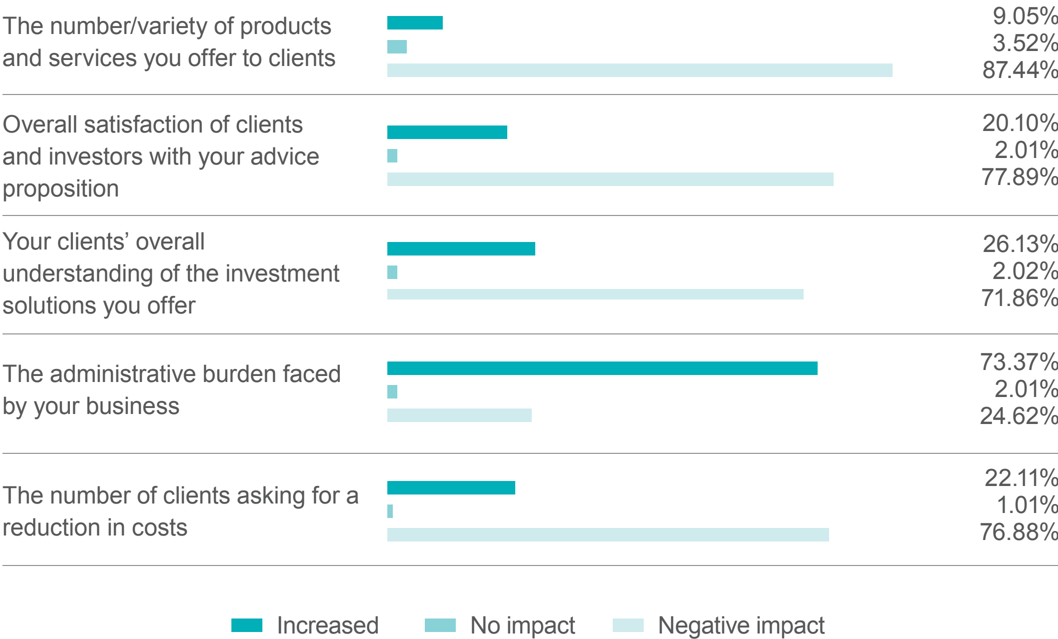
What is apparent is that the increased cost disclosure requirements haven't, on the whole, made advisers change their product offering. This suggests that they may not have experienced much client pressure on costs, despite increased visibility.

FE fundinfo's Mikkel Bates says: *"There is a difference between cost disclosure and cost justification. With the arrival of Assessment of Value (AoV) reports for fund groups at the start of 2020, the shift has gone from the former to the latter and we have seen cases of groups making changes to fund charges or moving investors to cheaper share classes.*

"In the adviser space, they have had to justify their charges to their clients since 2012 (RDR) at the latest, so this is something they are used to doing; consolidating their charges with fund charges in MiFID II disclosures was never likely to have much effect on adviser costs.

"Although much of the regulatory world is now on hiatus during the Covid-19 pandemic, once things settle, it is likely the FCA will turn its attention to AoV for advisers once it has fully bedded in for fund groups, so it will be interesting to see if that changes things. Already, there has been much criticism of the 'advice gap' with many consumers unable or unwilling to pay for advice, so that may increase if advisers have to justify their charges even more."

How have the cost disclosure requirements introduced under MiFID II impacted on the following?



Advisers are pretty sanguine as to the impact the new reporting regime is having on their clients. Although there has been a small improvement in the perceived benefits in transparency and protection for clients, only 54% of advisers saying the changes are positive aren't exactly a ringing endorsement, given the huge amount of additional regulatory burden.

FE fundinfo's Mikkel Bates says: *"This perhaps is not that surprising, as advisers have direct contact with their clients and will already believe that their clients were protected and they delivered the necessary transparency. In most cases, outlining at the point of sale and annually thereafter what the effect of costs would be and adding transaction costs will have had little effect on this."*

Since January 2018, has MiFID II provided greater transparency and protection for your clients?

Response	Percentage
Yes	54.65%
No	45.35%

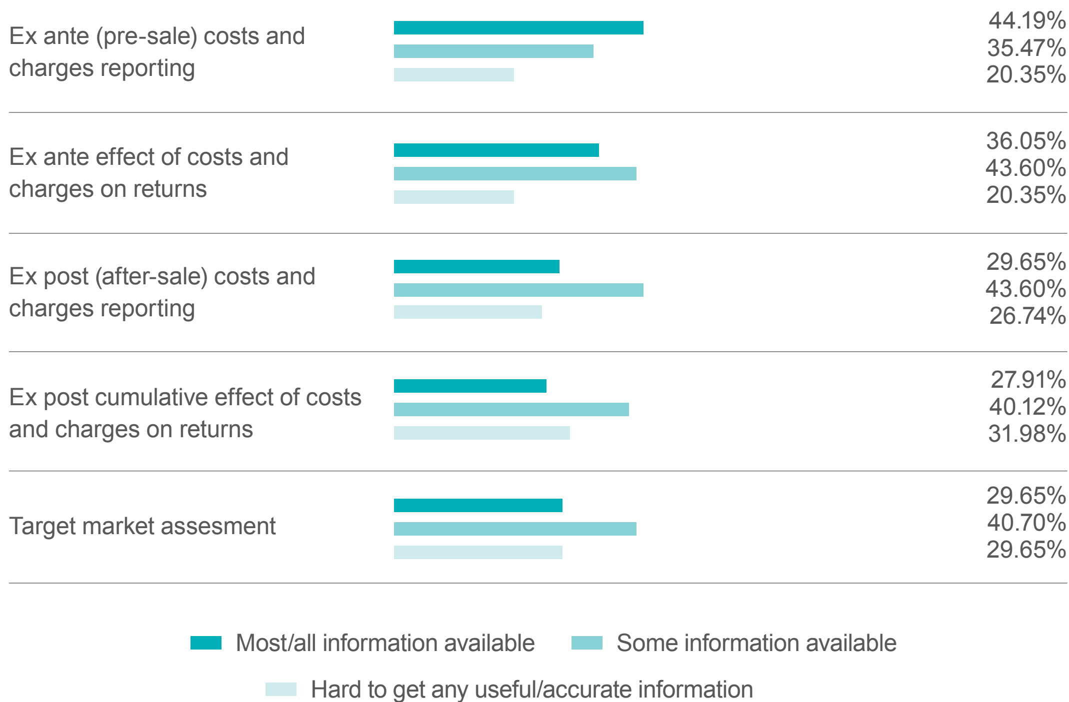
Reporting

On the subject of reporting, the new information supposedly available from fund groups such as ex post costs and target market assessments available to advisers has been more difficult to access.

On average only 30% of advisers felt this information was easily accessible and complete and another 30% thought it was hard to get accurate and useful information.

FE fundinfo's Mikel Bates says: *"On the target market data, the high number of partial/hard to collect may be down to either an expectation of more detail to be provided by fund groups or some problems with fund groups' misunderstanding the definitions on version 1 of EMT, which hopefully will be resolved in 2020 by version 3."*

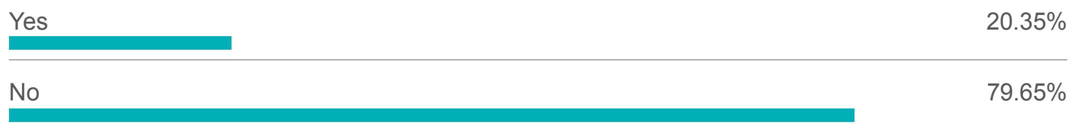
Since January 2018, how easy has it been to obtain the information you need from fund groups for:?



PRIIPS, KIIDs & SMCR

As far as PRIIPs and KIIDs go, it's an even less satisfactory position with even fewer advisers recognising the benefits for their clients this year than last.

Do you believe the PRIIPS regulation and the need to provide a KIID to your clients has increased their understanding of a fund's risk/reward and costs?



This regulation really doesn't seem to be working at all for advisers or their clients and you'd expect that a gradual acceptance of PRIIPs and KIIDs and any benefits would be forthcoming. Instead, opinion seems to have hardened as to their ineffectiveness.

FE fundinfo's Mikkel Bates says: *"There is no obvious reason why opinion has hardened even more against PRIIPs KIDs, but they have been unpopular since the beginning. During 2018 and 2019, many KIDs will still have shown positive returns for equity funds in unfavourable scenarios, because – despite the mantra about past performance being no guide to the future – the future performance scenarios are derived from past performance over a period of good returns.*

"The regulators have been consulting about changing the method of calculating and showing future performance scenarios and also adding past performance, with any changes likely to take effect from some time in 2021 (notwithstanding any delays caused by Covid-19), but it will take a long time for advisers to have any trust in KIDs."

Another piece of new regulation that advisers have been asked to grapple with is the Senior Managers & Certification Regime (SMCR) rolled out in the middle of conducting this survey on 9 December 2019.

It's very early days to assess its efficacy but almost all advisers seemed to be confident that they were ready for it.

Are you confident that your firm will be ready for their Senior Managers and Certification Regime (SMCR) when it applies to all FCA solo-regulated firms on 9 December 2019?

Response	%
Yes, we're already sorted	69.19%
Expect to meet the deadline	23.84%
Struggling, but should be ready on time	1.74%
Struggling and unlikely to be ready on time	0%
No	5.23%

FE fundinfo's Mikkel Bates says: *"For small firms, it will be clear who is responsible for what, so it has been primarily a case of documenting this. Larger firms will have been able to allocate the necessary resources to it. It will have been impossible not to have been aware of the impending obligations during the second half of 2019, as there has been much press coverage and numerous conferences and events covering it."*

Future regulation

Looking to the future, the FCA are reviewing the RDR regulation introduced in 2012 and FAMR, to see how successful they have been in achieving their objectives.

We asked advisers what themes or aspects of the industry that they felt the FCA should be looking at in their review. The results were particularly interesting and refreshing to hear.

The two main areas that advisers thought the FCA should be reviewing were addressing the advice gap (56% of advisers mentioned this) and improving financial education among consumers (45%). This points to an industry that is keen to increase overall investor understanding of investments and financial planning.

Explicit in the free form answers to this question however was that any further review by the FCA shouldn't result in more regulatory requirements for advisers. Common themes from the survey on this subject include:

"Is all the new regulation actually helping the end consumer – increased burden and cost of regulation makes it less affordable for people to get financial advice?"

"The FCA should be promoting the positive impact financial advice has on clients rather than introducing further regulatory burdens."

"Reducing the regulatory burden on advice firms."

It's notable how many times advisers have put the words regulatory and burden together in their responses to this survey.

In 2020 the FCA will be reviewing how successful the Retail Distribution Review (RDR) and the Financial Advice Market Review (FAMR) have been in achieving their objectives. What themes/ aspects of the industry would you like to see the FCA looking at?

Theme	%
How AI/robo advice can be integrated into an investment proposition	23.26%
Tackling the increase in vertical integration and consolidation of the market	22.67%
Addressing the advice gap	55.81%
Increasing competition within the industry	6.40%
Improving the provision of financial education among consumers	44.77%
Developing a regulatory framework for a post-Brexit market	27.33%
Developing a common framework for ESG investing	28.49%
Reviewing the levels of professional qualifications for advisers	21.51%
Further increasing transparency in relation to the cost of advice	22.67%
Further investigation into contingent charging in the pensions transfer era	13.95%
Was unaware that RDR and FAMR are to be reviewed	9.30%
Other	4.07%

Advisers also showed a good deal of support for post-Brexit regulatory framework, a common framework for ESG investing and how AI/robo can be applied to the advice market more effectively.

ESG (Environmental, Social, Governance) investing is an area we will cover later in this report, but developing a common framework is a key priority for many, particularly when the term means different things to different investors.

FE fundinfo's Mikkel Bates explains: *"'ESG' as a starting point is not particularly helpful, given 'environmental', 'social' and 'governance' are different and sometimes conflicting terms. Already there have been instances of companies who have been lauded for their good governance and sustainability, yet operate in the tobacco or arms industries. Similarly, one ratings agency's idea of an environmentally friendly firm may differ wildly from another's. We have the case of electronic car manufacturer Tesla for instance, where a ratings agency praised their green credentials for lowering emissions, while another scored them lowly for the use of Lithium in their batteries. A common framework is a good starting point, but we may find that other terms, such as 'responsible' or 'sustainable' investing prove to be more useful in the long term."*

Chapter 3
Investment vs. Retirement Strategies

Every year, this survey takes the opportunity to quiz advisers on their investment strategies for both accumulating and decumulating clients. In the following two chapters we look at how advisers are choosing to manage clients' money – in-house or outsourced – and analyse any emerging investment trends.

Centralised Investment Propositions

It is only to be expected that, as advisers seek to maximise efficiencies, more and more are introducing a centralised investment proposition (CIP), either in-house or outsourced to a 3rd party.

This year's results shows further progress here with almost 85% of advisers having a centralised investment proposition, up 10% on the previous year.

Do you have a centralised investment proposition?

Answer	%
Yes	84.88%
No	15.12%

However, when it comes to the subject of centralised retirement propositions, less overall adoption is happening here, although there is a steady trend in building retirement solutions, partly as the FCA are keen to see retirement pathways adopted over the course of 2020 for non-advised clients.

Do you have a centralised retirement proposition?

Answer	%
Yes	48.84%
No	51.16%

Slightly more than 48% of advisers now have a centralised retirement proposition, as against 34% in the previous year, an increase of 14%.

In fact, in the previous year's survey, over two thirds of advisers said they still used their "preferred investment solutions" as opposed to a decumulation-focused process.

Whether this increased adoption is an acknowledgement from advisers that the decumulation journey warrants an entirely separate process, or that retirement advisory is where new client demand is centred and needs to be more efficient is unclear.

This is pertinent when the survey asked advisers what 'were the most important aspects to clients in a retirement proposition'.

Which of the following is the most important to clients in your retirement proposition?

Option	Percentage
Sustainability of income	71.43%
Preservation of capital	21.43%
Limits on charges associated to investments	2.38%
Others	4,76%

Defined Benefit Pension Transfers

With the FCA looking into the advice surrounding Defined Benefit (DB) Pensions transfers, has your business done any of the following in relation to this?

Option	Percentage
Stopped contingent charging for this service	9.88%
Upping the minimum investment required by DB clients	6.98%
Increased the range of products/services you offer to DB clients	1.74%
Developed a specialist investment proposition for DB clients	8.72%
Increased your charges for DB pensions transfer services	11.05%
Stopped advising on DB pension transfers	23.26%
None of the above/made no charges	45.35%
Other	8.72%

The thorny subject of DB pension transfers showed a very diverse approach to the market. The majority of respondents (c.46%) report that they still handle DB transfers as they always have, but the remainder have either stopped advising on them (c.23%) or changed their processes.

These include raising charges for DB transfers (c.11%), stopping contingent charging (c.10%) and developing a specialist investment proposition for DB clients (9%).

Comments on the question singled out the cost of PI insurance, lack of clarity form the FCA on acceptable practice and outsourcing DB transfer clients to third parties.

FE fundinfo's David Scholes says: *"the cost of running an advice firm is increasing year by year. In many cases this is largely down to PI insurance, where it's not uncommon for PI fees to have increased significantly over the years, particularly for those firms providing DB advice. The whole area is riddled with potential lawsuits, and PI providers are exiting the market, leaving fewer to offer the cover and that itself pushes the prices even higher."*

As we move from a DB to a DC world, the demand for advice on how to plan out a finite retirement pot has risen dramatically.

And advisers are overwhelmingly dealing with the sustainability of income for their clients, i.e. trying to eek out a finite sum of money over an ever-growing life expectancy in retirement.

FE Investments' Rob Gleeson says: *"The most important question the industry should be asking is 'what is sustainability of income?' We are finding that even for those with large pension pots, they are not generating levels of income which might have been expected. Traditionally, retirement propositions have been defensive, but we need to change the focus and reframe attitudes to risk in order to ensure a suitable level of income. For many advisers, a starting point is reframing the language – many will have not had conversations about risk in retirement with their clients. In five years' time we hope that this will have changed and IFAs will have much more experience in adjusting their clients' retirement thinking."*

It does seem to highlight that there is a certain "freestyle element" to retirement planning, rather than a defined 'best practice' approach. The FCA are keen to see more shape in how clients entering into retirement use their pots, particularly non-advised and it will be interesting to see if the regulator demands more from advisers going forward around their retirement propositions.

Undoubtedly the whole landscape has changed. As the first tranche of retirees to enjoy pensions freedoms retires, **Rob Gleeson, Head of Investments at FE Investments** says that a change in focus is needed. *"Prior to the introduction of pensions freedoms, planning for retirement was fairly simple. Investors would invest to accumulate and then pay into an annuity. But now, even for those investing in vehicles like Self-invested Pension Plans (SIPPs), there is no guarantee of long-term income. We need to reframe attitudes to risk in retirement in order to provide a long-term sustainability of income."*

Investment Trends

In terms of general trends in investment over the last year, there are a few notable but unsurprising trends.

When choosing funds, how has your exposure to the following sectors changed over the past 6 months?

	Increased	Decreased	Stayed the same/little change	N/A
US Equities	13.74%	11.54%	59.89%	14.48%
UK Equities	23.08%	19.23%	43.41%	14.29%
European Equities	10.44%	14.29%	59.34%	15.93%
Emerging Market Equities	18.13%	4.40%	60.99%	16.48%
Absolute Return	7.69%	20.08%	41.76%	29.67%
Corporate Bonds	7.69%	14.29%	59.89%	18.13%
Gilts	6.59%	16.48%	55.49%	21.43%
Mixed Investment (0-35%) shares	4.95%	4.95%	56.59%	33.52%
Mixed Investment (20-60%) shares	11.54%	2.75%	53.85%	31.87%
Mixed Investment (40-85%) shares	9.89%	1.65%	56.04%	32.42%
Property	6.59%	23.08%	51.65%	18.68%
Ethical	35.71%	1.10%	46.15%	17.03%
Alternatives	18.13%	3.30%	49.45%	29.21%

Given that last year was blighted by worries over Brexit, there was a considerable amount going on in UK equities with significant portfolio reallocations both increasing and decreasing exposure.

Absolute return funds took a bashing in 2018 and again last year (led in part by the GARS exodus, amongst others) and property followed suit, with M&G leading the charge for withdrawals until they suspended the fund. But by then, the property fund dominoes were tumbling.

The grateful recipients of all this free cash seems to have been the ESG market, with advisers reporting over 35% of increased exposure in this sector.

Otherwise, like all good long-term investment strategies, there was evidence of little or no change in most sectors, barring some tweaking.

A Note on Woodford

The collapse of the Woodford fund dominated much of the investment and personal finance pages throughout 2019. Our survey asked financial advisers what, if any, impact it had had on their outlook:

In the light of the failure of the Woodford Equity Income fund, have you/has your business done any of the following?

Response	%
Changed your clients' asset allocation	7.45%
Placed increased focus on the liquidity of underlying investments in funds	21.28%
Changed your investment style/look	3.72%
Advised clients to adopt a different investment approach	2.66%
Reduced your clients' exposure to risk	3.72%
Increased your clients' diversification	7.45%
Moved investments from open-ended to closed funds	0.53%
Asked your managed portfolio provider/discretionary fund manager (if applicable) for an assessment of the funds they include in their lists of portfolios	7.98%
Increased use of external research	9.04%
Made changes to the investment committee	7.98%
None of the above/made no chages	55.32%
Other	5.58%

2019 will be known as the year that the UK's best-known fund manager failed, long after the other big news of the year fades from the memory.

In his heyday, Woodford's own funds would have been held in client portfolios by many advisers in the UK (at its peak it had more than £10bn AUM), but when probed, a reassuring picture emerges.

Most professional advisers' processes seemed to have spotted that trouble was brewing at Woodford and moved client funds away as part of their ongoing monitoring systems.

“The Woodford Funds failed our due diligence.”

If there was one significant improvement that advisers have made since Woodford, it has been to place increased focus on the liquidity of underlying investments in funds (over 21% of advisers said they had implemented this).

Over 55% of advisers were fully content with their processes and made no changes and other advisers have made smaller changes such as increasing the use of 3rd party research, increased diversification and other asset allocation changes.

Chapter 4
Trends in Investment Outsourcing

Using third parties to manage and maintain investment mandates seems to be one of the more obvious ways to squeeze more efficiencies from a practice looking to handle more clients, but does the theory play out in practice and is the recent trend towards this approach slowing?

Third Party Managed Solutions

How advanced is the 3rd party selection and management process becoming? We analyse this year's findings in light of past years results and trends.

Do you use 3rd party model/managed portfolio providers and if so, how many?

Answer	%
Yes - 5 or more	10.47%
Yes - between 3-4	18.60%
Yes - between 1-2	28.49%
No	42.44%

The trend towards outsourcing to 3rd party model portfolios and DFMs is still increasing and now over 57% of advisers in this survey use an external supplier up from 50% last year.

There is some evidence that advisers are focusing on slightly fewer suppliers than in previous years.

Over the past 12 months have you...?

Answer	%
Increased the amount you invest on behalf of your clients with third party investment solutions	56.98%
Mantained the amount you invest on behalf of your clients with third party investment solutions	39.53%
Decreased the amount your investment on behalf of your clients with third party investment solutions	3.49%

The direction of travel is pretty much one way here, only a tiny percentage of advisers are decreasing reliance on the use of 3rd party providers and 57% are increasing the amount they invest on behalf of their clients.

FE fundinfo's David Scholes says: *"Ten to fifteen years ago, a firm's investment proposition would have generally sat in-house. In today's world, technology can automate these processes significantly and depending on how it is managed, doesn't necessarily increase the cost to the end investor. Many advisers therefore have been attracted to these outsourced propositions that generally drive much more efficiency. This frees up time for the advisers to look after more clients, which makes their business more sustainable."*

FE Investments' Rob Gleeson adds: *"Most IFAs are not investment professionals, but rather lifetime financial planners. Many recognise that they are not experts in fund selection, so prefer to concentrate their time on providing due diligence around those that are. We are fortunate at FE Investments that we do not come from a traditional investment background, but are problem-solvers instead. We recognise the position that many IFAs have found themselves in and have developed an investment proposition accordingly."*

This is a trend borne out by the increase in adviser firms turning to our own FE Investments Model Portfolio Service. With growth of 49% in AUM over the last 12 months up until the end of January, we're seeing advisers address concerns around the risk management of running investments in house by turning to experts to conduct the ongoing due diligence.

What is the main criterion on which you select model portfolio providers?

Criterion	%
Cost	4.65%
Performance	25.58%
Platform availability	10.47%
Investment methodolgy	45.35%
Relationship with model portfolio service provider	10.47%
Other	3.49%

Where there have been some significant year-on-year trends is in the way that advisers have been selecting 3rd party providers.

In the previous year's survey, cost, performance and investment methodology all had broadly similar priorities for advisers, but this year there is a major switch to investment methodology as the main driver.

How does the use of 3rd party model portfolio services affect your business processes? (tick all those that apply)

Answer	Percentage
Reduces administration	60,47%
Reduces risk	60.47%
Improves client outcomes	61.63%
None of the above	4.65%
Other	1.16%

There are no surprises here. The three benefits of reduced administration, reduced risk and improvement in client outcomes are still considered as important this year and last. **FE Investments' Rob Gleeson** adds: *"In many cases DFM performance details are not easy to come by. Methodology then becomes more important for advisers who need to explain their investment propositions to clients."*

Have you changed providers in the last 12 months?

Answer	Percentage
Yes	33.72%
No	66.28%

The regulator is keen that advisers keep their suppliers under annual review to ensure that they continue to provide value to the end client.

It makes sense that 3rd party providers are rotated, and there was almost no change from the previous year, where again around a third of advisers changed their provider.

Chapter 5

ESG Now Taking Root

Last year it seemed that ESG (Environmental, Social and Governance) investment strategies were, while growing in importance, still at the edges of investor thinking. Throughout 2019 ESG has grown in importance, both for investors and IFAs, as well as for fund providers and asset managers.

FE fundinfo's Regulation Manager, Mikkel Bates, explains: *"In the future we will reach the stage where 'ESG' as a term will cease to be. It will be expected as 'the norm' by investors and will be provided by fund managers as part of the status quo. Most funds will factor it into their propositions so that it will no longer be considered a 'specialist' factor."*

So how are IFAs dealing with it and are they changing their approach? Or, are clients of IFAs not as bothered about ESG investing as people think they might be? And what in particular are the elements inside an ESG proposition that are important to clients?

FE fundinfo's Mikkel Bates says: *"Each client will be different and have different values when it comes to fund selection. For many, 'environmental' will trump 'social' or 'governance', but that will not always be the case. Transparency would seem to be the best way of helping clients navigate this complex area and there is certainly a role for ratings agencies and fund providers to play in disclosing how they are evaluating funds and investments."*

Do you incorporate ESG factors into your investment proposition?

Response	%
Yes	50.32%
No, but considering to do so	36.77%
No and do not plan to	12.90%

This year, only 50% said that they incorporate ESG factors into their investment proposition, a fall from the previous year.

Although there are a further 37% considering ESG provision, year-on-year, it looks like fewer advisers are offering an ESG investment proposition than the previous year, despite the fact that the sector has matured, product ranges have expanded and more money seems to be flowing into ESG funds than ever before.

FE fundinfo's David Scholes says: *"It is surprising that as many as 12% of advisers are not, and do not plan to factor ESG investments into their propositions. Even if we are to disregard movements by the regulator, ethically-minded retail investors are a growing force and you'd imagine many will want some level of assurance that what they invest in doesn't negatively impact society and the planet."*

What percentage of your clients do you think would be interested in incorporating socially responsible and ethical investing into their investment process?

Response	Percentage
0 - 25%	70.97%
26 - 50%	21.29%
51 - 75%	7.74%
76 - 100%	0%

Advisers also have a modest view as to how many of their clients would be interested in ESG investing.

The survey tends to suggest that it is still of niche interest to clients and this is possibly because advisers tend to deal with more mature clients less attracted by the benefits of ESG investing.

Do you think your clients understand what ESG investment involves?

Response	Percentage
Yes	38.71%
No	61.29%

There may also be a lack of understanding of the ESG sector at a client level and concerns around what funds invest in, fear of lower returns and the general immaturity of funds may have an effect on take-up. **FE fundinfo's Mikkel Bates** says: *"I think it may be an overstatement that 38% believe their clients have an understanding of what ESG involves. They may do in a very broad sense, but I doubt that many have considered the practicalities of how, for example, an environmentally-friendly investment may not be sustainable, or vice versa. There is a huge difference between how 'responsible', 'ethical' and 'sustainable' investing is perceived and as an industry we must do more to provide clarity and transparency."*

How has the amount of client money you have invested in ESG investments changed over the past year?

Response	Percentage
Increased	55.48%
Decreased	0%
Stayed the same/little change	44.52%

Despite this perceived lack of understanding, around 55% of advisers are seeing an increase in inflows into ESG investments with no decreases, as the 'Greta effect' takes hold.

In terms of the asset allocation changes reported earlier in the research, the largest change across all sectors was a 35.71% increase in ESG (see chapter on Investment Trends, page 33).

There are a number of possible explanations: there have been a host of new ESG fund launches, there is a generally higher level of awareness of climate and social issues presented via the media (and the weather) and new technology to stem climate change is seen as a lucrative growth area.

What percentage of your clients do you think would be prepared to forego larger returns to incorporate ESG factors in their investments?

Response	Percentage
0 - 25%	83.23%
26 - 50%	15.48%
51 - 75%	1.29%
76 - 100%	0%

Although one of the basic principles of ESG is that you can invest for good without necessarily sacrificing returns, it seems as though there remains some caution. The vast majority of advisers (83%) say that only a few of their clients would be prepared to forego larger returns to incorporate ESG factors into their portfolios.

When asked which particular elements of ESG investing really matter for clients, climate change, ethical investing and environmental issues feature prominently.

This would make sense given the hugely increased media coverage on climate change as well as the high growth climate technology sector (wind, wave, solar, etc.) attracting investor attention.

Please list the following non-financial factors in order of importance to you or your clients when making investment decisions (1 = most important, 7 = less important) or indicate if you/they don't consider non-financial factors

Factor	Result
Environment	25.16% listed as most important factor
Climate change mitigation	5.48% listed as most important factor
Social factors	3.23% listed as most important factor
Corporate governance	7.74% listed as most important factor
Ethical (avoiding certain sectors, companies or industries)	23.23% listed as most important factor
Positive impact	13.55% listed as most important factor
Islamic finance	2.58% listed as most important factor

What is interesting is that the majority of the demand for ESG investments seems to be coming from investors themselves, as opposed to a proactive adviser or industry marketing initiative.

Having said that, last year saw a record number of ESG fund launches (with their associated marketing), and both trade and consumer financial journalists are talking more about ESG investment.

Advisers comment that the media are stoking client's consciences and one of the ways in which someone can do something to help is through the investments they make.

"Social Media is driving ESG, and people want their investments to be ESG compliant."

FE fundinfo's Mikkel Bates says: *"It's possible many new funds have been launched to avoid missing out on demand and/or to be used to showcase a firm's ESG credentials. The thinking being that if you don't have an ESG fund, ESG clearly doesn't feature highly in your investment process and therefore you become less attractive to potential clients."*

FE fundinfo's David Scholes adds: *"In the future ESG might actually be led by asset managers themselves. Many are already advocating the idea of an integrated ESG fund industry, where every fund will be responsibly managed as a starting point."*

Finally, we asked whether advisers expected demand for ESG products to change in the future.

Do you think the growth in demand for ESG propositions is mostly being driven by...?

Response	Percentage
Investor demand	35.48%
Institutional pressure	6.45%
Regulation	0.65%
A combination	37.42%
I do not think there is a growth in demand for ESG propositions	14.19%
Other	5.81%

Over 81% of advisers believed demand will continue to rise with barely anyone forecasting that demand will actually fall.

This is an excellent business development opportunity, particularly in attracting clients with a more developed social conscience. Performance from ESG funds has been positive in many cases and further fund launches are highly likely as asset managers look to broaden their ranges into this lucrative sector.

Do you expect the demand for ESG propositions will?

Response	Percentage
Increase over the next 12 months	81.94%
Decrease over the 12 months	0.65%
Will stay the same/see little change	17.42%

With over 80% of advisers predicting that demand for ESG propositions will increase in 2020, it seems highly likely that the ESG market will grow beyond the niche sector many forecast and become dominant as climate and social concerns continue to increase.

There is more work to do on how funds screen out non-ESG compliant firms and there are still issues about how you categorise some energy companies who have a foot in both traditional and green energy generation. The sector will mature further and with this, continue to grow strongly.

Analysts at Bank of America Merrill Lynch estimate that there could be over $20 trillion of asset growth in ESG funds over the next two decades, almost as much as the current size of the S&P500. It makes the decision of the 12% of advisers not engaging with ESG all the more perplexing.

Final Thoughts

It has seemed that throughout Coronavirus/Covid-19 pandemic each day has seen both society and the economy enter unchartered territory. Markets have collapsed then bounced, entire industries have shutdown and governments across the world have injected never-before-seen fiscal packages to businesses and their employees. Even the most seasoned of investor, or the most adept of financial adviser will have had their convictions tested.

While the UK government's focus has rightly been on ensuring the safety and health of its citizens, there will come a time when its attention shifts towards kickstarting the economy. Past crises have taught us that while there will be a great deal of short-term economic pain markets will inevitably rise again. When this will be no one can say, but ironically as this report shows, advisers are in a stronger position now than ever before to navigate these stormy waters and improve outcomes for their clients.

There's good news for advisers in terms of a ready supply of new business from clients desperately in need of good advice. It is worth highlighting the demand for ESG investing seems to be a very positive driver for the industry and needs to more widely integrated into the general service offering.

The UK clearly needs more financial advisers, but it does look like the industry is struggling to find the new blood fast enough whilst experienced practitioners are retiring or selling their businesses.

But with this positive backdrop comes ongoing difficulties. Every silver lining has a cloud and in this case it is the huge burden of regulation eating into the time and profit margins of advisers who would rather be spending that time and money on making their businesses more efficient, hiring or training new recruits and advising more clients. Particularly the clients that simply cannot find an adviser to assist them.

The ever-increasing levels of outsourcing demonstrate that advisers are trying to focus their resources on managing client demand, but free time to invest in new processes – particularly dedicated retirement advice – just isn't there.

The regulator needs to promote a market that can expand professionally and more rapidly, rather than getting bogged-down in minor details and weighing down firms with requirements that the end consumer neither understands nor needs.

The problem of the advice gap is no longer about the people who cannot afford a financial adviser. It seems like there just aren't enough to go around, regardless of the cost.

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Registered in England and Wales no. 03672592.

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