

INVESTMENT OUTSOURCING: LESSONS FROM THE UK

ABBIE KNIGHT, DIRECTOR DISCUS

Abbie Knight from DISCUS, explains some of the changes underway in the UK financial services industry. Specifically, she looks at the complexities associated with the rise of discretionary fund management services and how her company DISCUS aims to address these by creating a single port of call for advisers to evaluate the outsourced investment market.

In 2003 I migrated to the UK from Australia, with a view to broadening my experience in financial services. It was quite a surreal experience. I felt like I had a crystal ball; as though I could see exactly what was coming down the line for financial advisers and investment houses alike.

ABBIE KNIGHT

Abbie has more than 18 years' financial services experience. She is a marketing and business consultant to financial advisers, boutique wealth managers and asset management firms. She is the co-founder of DISCUS (Discretionary Investment Services Coming Under Scrutiny), an innovative financial services business designed to deliver quality insight, discussion and information on the outsourced investment market, particularly discretionary propositions.



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Why? Back then Australia appeared to be leaps and bounds ahead from a regulatory and technology perspective. Fast forward to today and one could argue that the UK has not only caught up with but also surpassed the Australian market. The Retail Distribution Review (RDR) has led to a rise in professional standards, transparency of pricing and clearly defined value propositions from advisory firms, not to mention the evolving pension backdrop with auto-enrolment and pension freedoms.

Across the world, the UK is looked upon as a shining example of “best practice” for those in similar markets. I can say this with a high degree of conviction given I run an annual UK/Australian financial adviser knowledge exchange. This forum serves as an excellent “looking glass” through to the challenges and opportunities advisers face in both markets.

+ TRENDS IN THE UK MARKET

Today most investment business in the UK is conducted through wrap platforms (“wraps”). Since wraps first emerged in 2002 the market has grown to represent more than £300 billion in advised assets. In the post-RDR world advisers are also required to have a centralised investment proposition (CIP) to reduce risk and ensure consistency of client outcomes. This has led to an explosion in the use of managed solutions. Currently 88% of all advised assets are held within managed solutions, such as model portfolios, multi-asset funds and bespoke discretionary portfolios. Of this, 49% of assets are managed on an outsourced basis - up from 40% just a few years ago.

+ INCREASED APPETITE FOR DISCRETIONARY INVESTMENT SERVICES

Firms are beginning to realise the limitations of running in-house advisory models, which can be highly inefficient and unwieldy as permission is required before each trade or rebalance. To overcome these challenges a firm can obtain their own discretionary permissions. While this is arguably more efficient, it also comes with additional, complex and costly regulatory requirements. Appetite for this approach is growing, particularly for larger businesses, but it still represents just 3% of the market (although some say there is scope to grow to 10 to 15%).

Today's preferred model - and a trend we have been watching closely at DISCUS - is to use third party discretionary fund management (DFM) services. Choosing a DFM service is not without its own complexities though as can be seen below. This is why we set up DISCUS (pronounced "discuss" and short for Discretionary Investment Services Coming Under Scrutiny). Our aim is to help advisers navigate their way through the plethora of discretionary propositions available in the outsourced investment market today.

+ THREE PATHS TO DISCRETIONARY

Currently there are three paths an adviser can take to access DFM:

1. Bespoke portfolios (full-fat DFM). Investment portfolios designed to meet specific requirements, with considerable interaction between the client, adviser and investment manager. Portfolios might include direct investments, collectives, alternatives and more sophisticated financial instruments. This service is most suited to clients with specific requirements such as capital gains tax (CGT) limitations, income or the need to exclude or include certain stocks. A highly personalised service, minimum investments often start at £200,000 or £500,000.

2. Managed portfolio services (MPS). Pre-defined portfolios aligned to specific risk or return objectives where the adviser decides on the portfolio that is most suitable. Collectives or a combination of collectives and direct investments, and in some instances alternatives, are used. MPS can be on platform or directly held in the discretionary manager's nominee account. Minimum investments are lower than for bespoke portfolios.
3. Unitised discretionary (DFM). Essentially MPS wrapped in a collective structure (unit trust or open-ended investment company - OEIC). Funds are unitised multi-manager or multi-asset, and mirror the methodology, philosophy and approach of a discretionary manager's MPS. Operating as a fund, typically on platform, they do not offer the personalised service of a full-fat discretionary service. Look-through reporting is more akin to that of a bespoke offering. This differentiates unitised DFM from a traditional manager-of-manager or fund-of-fund approach. A further benefit of the unitisation is that trading within the fund is not subject to CGT or value added tax.

+ THE WINNERS

The biggest beneficiaries of the changing market dynamics are discretionary investment houses and platforms. Prior to RDR and in the years that have followed, both parties have acknowledged the central place of a platform within an advisory business. This, coupled with the inefficiency of advisory models and the requirement for centralised investment propositions, has led to massive growth in MPS and unitised DFM. To put this in context, in 2016 more than 180 discretionary propositions were available through platforms.

Prior to RDR, DFM services were used by a privileged few advisory firms - those with high net worth clients who deal with complexity and have large enough portfolio values to meet the minimum investment thresholds. Discretionary managers were also precious about retaining custody in-house, which resulted in introducer style arrangements.

Unfortunately, the nature of this form of arrangement led to adviser concerns that the discretionary manager, in building a direct relationship with the client, would ultimately lure them away and cut the adviser out. Now, by using a platform, advisers retain complete control over investor servicing. Often the client will have no need to meet the discretionary manager at all.

+ ADVISER IMPACT: INCREASED COMPLEXITY AND REGULATORY PRESSURES

While the above changes are largely positive for the UK financial services market in general, two forces have had a direct impact on financial advisers specifically. With a 54% increase in discretionary providers offering solutions to intermediaries, advisers are dealing with increased complexity. What is the difference between each solution: MPS on platform or off platform and a uni-tised DFM? What are the benefits of each? How do advisers go about finding the “right” discretionary services for different client segments?

At the same time the regulator has introduced a requirement for auditable due diligence, which must be undertaken prior to adopting outsourced investment solutions. Due diligence must be implemented without bias and regularly reviewed.

+ OUR SOLUTION: DISCUS

It was in order to address these complexities that we launched DISCUS in the UK (not yet available in South Africa). Through our website we share insight on the outsourced investment market, due diligence guidance, and a “compare” tool to help advisers research discretionary propositions based on their own criteria. The market is only going to get more complicated as more discretionary offerings enter the fray and regulations change. We hope that the use of a centralised portal of insights and engagement like DISCUS makes it easier for advisers to adapt to these on going developments.