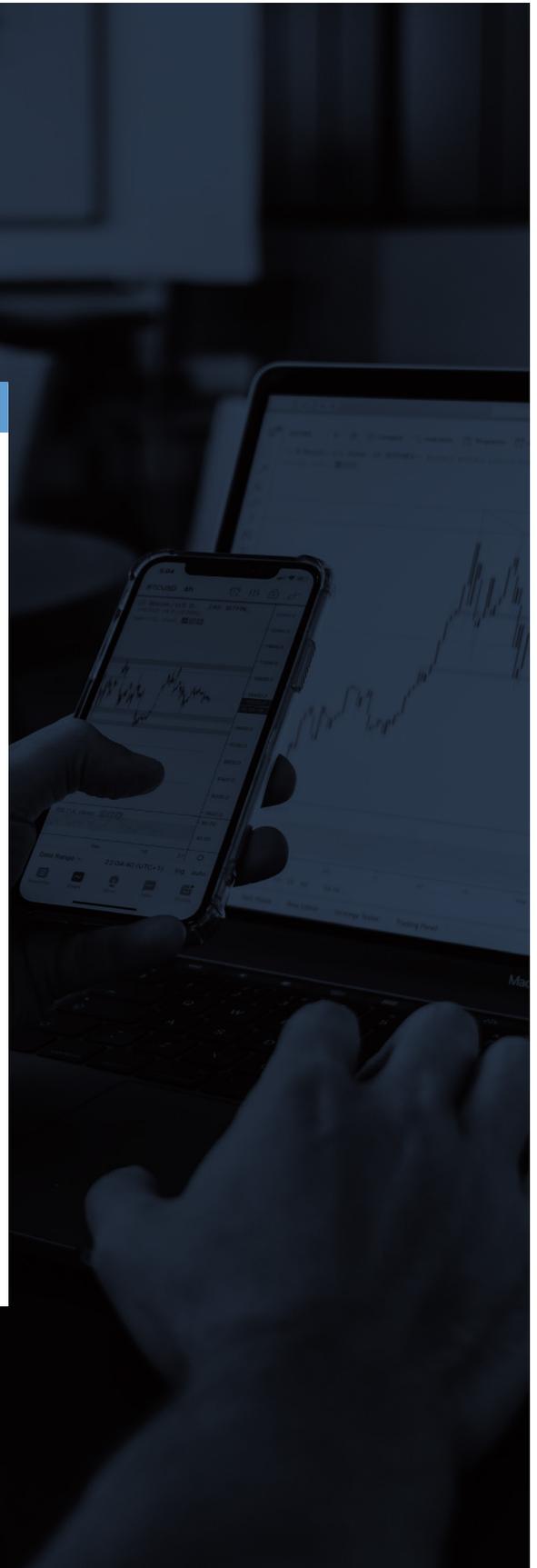


# AUSTRALIAN FINANCIAL ADVICE LANDSCAPE

This is an abridged  
version of the full  
report published in  
December 2019

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## WE BELIEVE IN THE POWER OF ADVICE

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### From Vanguard's Head of Distribution, Matthew Lumsden

AT VANGUARD, WE believe in the power of advice to help Australians shape their financial future.

We know you make a difference to your clients' lives. But how do you measure it? And, how could you unleash significantly more client value to maximise your business opportunities and increase retention?

At last month's Vanguard Adviser Roadshow, Advice Matters, we shared research into quantifying the value of advice when looking through the client's lens. This research is available now and is summarised in the article within. Some of the results may surprise you.

Once you've read through our research you may wish to explore your specific client segment to understand the dimensions of service that are most valued by your clients. It's easy to do with our Value of Advice Toolkit.

Use this toolkit in your own business to gain insights into client perceptions and preferences. These insights could become your most powerful tool in attracting and retaining clients. I'd encourage you to read the research and download our toolkit today.

Amidst the uncertain world around us, we are confident that these tough times will pass and we will emerge stronger than before. Helping clients stay the course and stick with the plan you've laid out becomes more important than ever. We look forward to partnering with you no matter the market conditions and helping you and your clients reach your investment goals.

Because advice matters.

## NAVIGATING UNCERTAIN TIMES

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### From Adviser Ratings CEO, Mark Hoven

THE AUSTRALIAN FINANCIAL advice industry is facing a generational change. In 2019, it was shaken by the Royal Commission, resulting regulatory reform, and strategic exits by the major banks that had materially defined the industry's evolution over the past two decades.

In 2020, the industry is rapidly shape-changing into a privately-owned world of small businesses confronted by existential challenges on all fronts. Reversing low public trust, embracing professionalism, and re-engineering the economics of running an advice business are some of the critical matters that require attention before the retail wealth management industry can be confident about its future.

For financial advisers, these are both the best and worst of times. While many advisers are choosing to leave the industry, others see wonderful growth opportunities amidst the tumult of change. For those who stay, there are nevertheless many adjustments that they must make to remain compliant, profitable, and effective in changing people's lives through the power of financial advice. For everyone – those staying and those retiring – their resilience will be severely tested as fundamental change on this scale is unprecedented.

Adviser Ratings' mission is to make financial advice affordable and accessible for everyone; however, many may observe that recent changes are taking the industry in the opposite direction. While this may be true in the short term, we believe that innovation, application of technology, and a reinvigorated industry leaning into growing consumer demand will ultimately find a successful path.

This 2019 Financial Advice Landscape report is a unique, data-driven snapshot of the industry from all angles. It also incorporates contributions from more than 1200 financial advisers that have generously provided their feedback through surveys and anecdotes. With the tremendous support of Vanguard, we are delighted to bring you this institutional quality report. We trust that it will help you in navigating these uncertain times.



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TRASH

## CHAPTER



## THE AUSTRALIAN ADVISER

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As the disruption in the advice industry continues, our research has shown what the average financial adviser in Australia looks like. As the flux continues, we expect this data to change rapidly.

This will be driven by older advisers leaving the industry, and a shrinking of advisers' client books.

THE 'AVERAGE' AUSTRALIAN adviser may still be most likely a male, but the rest of the data points are shifting rapidly each and every year, and we expect this to continue to be the case as the industry undergoes the largest shift in its history. As the major players exit the industry and others step up to become dominant forces, what will the future look like? Average FUA and number of clients has decreased in 2019 and the shift of advisers into smaller boutique licensees has been a significant change from two years ago.

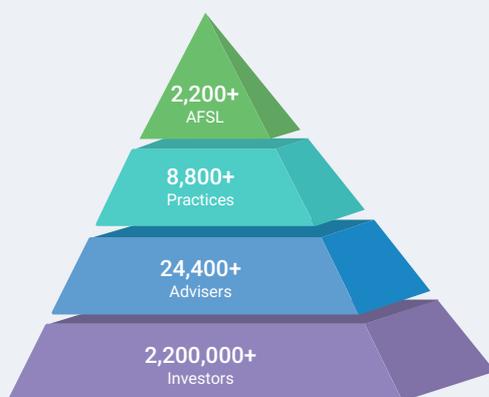
### Value of an Adviser

Numerous studies have been conducted in the last few years that directly measure the value added by financial advisers.

We examine four key reports published by prominent fund managers and research houses:

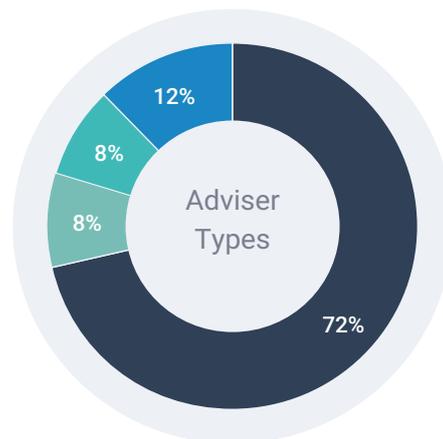
- Morningstar's Alpha, Beta, and now...Gamma (Blanchett & Kaplan, 2013)
- Vanguard's Advisor's Alpha (Kinniry Jr., Jaconetti, DiJoseph, Zilbering, & Bennyhof, 2016)
- Envestnet's Capital Sigma (2016)
- Russell Investment's Value of an Adviser (2019)

Chart 1.1  
THE ADVICE MARKET ECOSYSTEM



Source: AR Data, ASIC Financial Adviser Register

Chart 1.2  
ADVISER TYPES



Financial Advisers	17,463
Accountants	2,059
Stockbrokers	1,953
Inactive	2,928

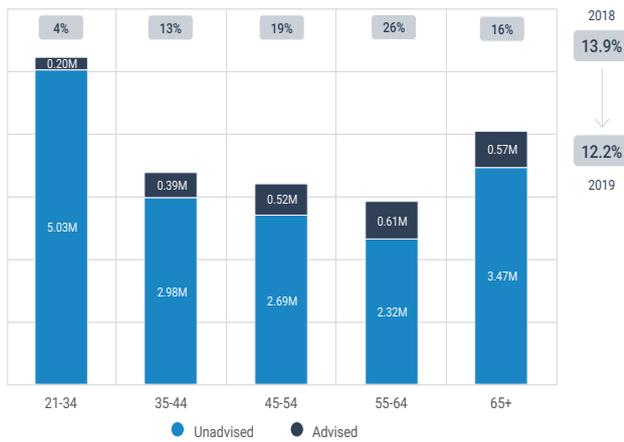
Source: AR Data  
Note – ASIC Financial Adviser Register at November 2019 = 24,403 advisers

Key areas that advisers directly influence include:

- 1 The financial planning and the additional wealth management services an adviser provides.
- 2 Asset selection and allocation, which for an unadvised investor is the “cost of getting it wrong”.
- 3 Investment selection, including as Russell Investments terms it, the “behavioural mistakes individual investors typically make”.
- 4 The systematic rebalancing of portfolios.
- 5 Tax smart planning and investing.

In summary, the direct value added to a consumer's wealth ranges from 3.0% to 4.4% by using a financial adviser – a direct counter that advisers should articulate in the face of regulatory headwinds and a loss of trust in the wider community.

**Chart 1.3**  
NUMBER OF ADVISED AUSTRALIANS BY AGE GROUP



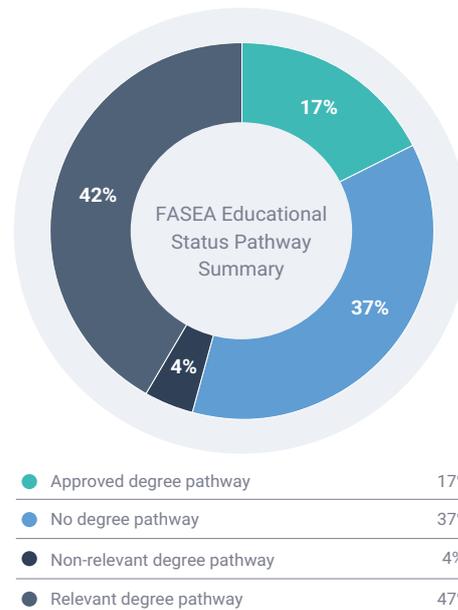
Source: Adviser Ratings Q3 Survey, Australian Bureau of Statistics

### Market size

In our 2018 report, we predicted a significant exit of financial advisers from the industry following the effects of The Financial Adviser Standards and Ethics Authority (FASEA), the implementation of recommendations from the Royal Commission and changes in remuneration from the Life Insurance Framework. In 2019, we forecast that the market of active advisers will reduce from approximately 21,500 to around 15,000 in the next five years and \$900 billion of funds under advice (FUA) will potentially be orphaned or be transferred to a new adviser. This is happening at a faster rate than even we anticipated, based on:

- Angst around qualifications required for FASEA happening well before the required deadline. The government has gone some way to alleviate this anxiety by extending this deadline to 2026 although finalisation of this legislation has been pushed into 2020.
- The dread that advisers are feeling about the mandatory Ethics exam before 1st January 2021. An imposing 3.5 hour exam is causing many to re-evaluate their retirement plans or leave for another profession.
- The announcements made by every major bank,

**Chart 1.4**  
FASEA EDUCATIONAL STATUS PATHWAY SUMMARY



Source: AR Data

**Chart 1.5**  
BIG SIX REMEDIATION FOCUS (INTERNAL TEAMS)



Source: AR Data and public record  
\*Planned resource level in March 2020

particularly that of Westpac in 2019, that they are exiting advice in some form (for Westpac, it is a complete departure).

- The remediation work being undertaken by banks and the Big Four accounting firms is giving some advisers and associate advisers a smooth exit strategy (and fairly well remunerated).

So where will the industry end up in the wash?

This year's survey, despite an obliteration in practice values (with AMP putting a stake in the ground at 2.4 times revenue), indicated an estimated 17% of practice owners would still entertain selling their practices in the next 12 months. With an average funds under advice of \$124M per practice, in the short term this represents a potential \$190 billion shift.

The exits in 2019 were higher than we originally forecast – 14% of advisers left the industry across all age groups. With the decline in advisers from 28,365 in December 2018 to 24,403 by end October 2019, and the continued stress on adviser business models, we feel stronger in our conviction of an advice market heading towards net 15,000 advisers with >\$900 billion of FUA to find a new home in the next five years.

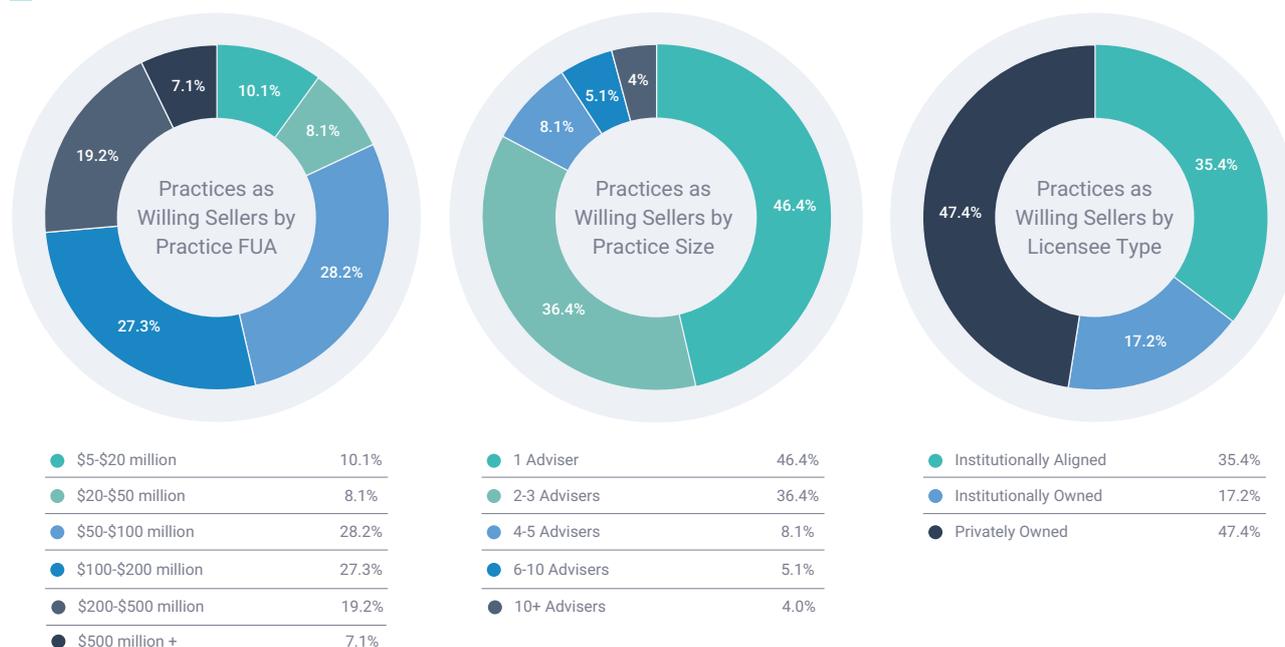
The growth in the privately-owned space is accelerating, with this market now representing 58% (up from 38% five years ago) of all advisers in Australia, comprised primarily of practices of one to five advisers.

### The individual adviser

Financial advisers have possibly the broadest and most challenging remit of any profession – they are the individual charged with understanding their client's goals,

Chart 1.6

#### PRACTICES AS WILLING SELLERS



Source: AR Data

aspirations, successes, tribulations, medical history, family circumstances, personal relationship ups and downs, and financial standing (well, at least they should). With \$1.5 trillion being managed by 24,000 of these individuals, it is important to understand the demographics and economics of how they operate and the value they serve.

### Fee Structures

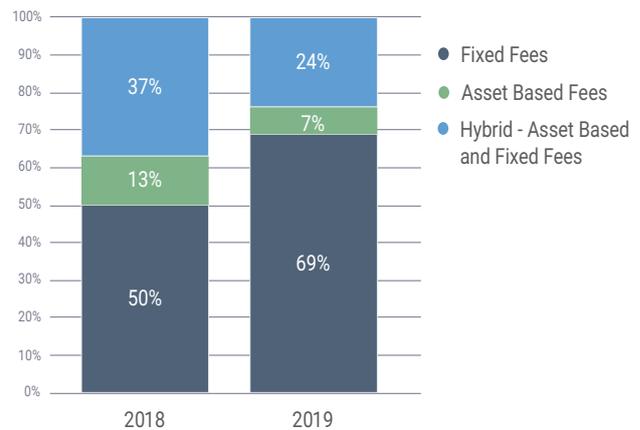
2.2 million Australians (or 12% of the population over 18) share their lives and wealth with a financial adviser. The major barrier to more people seeing such a confidante is trust and perceived value. Charts 1.7 and 1.8 describe adviser fee structures and levels are what the industry has been grappling with when it comes to value and trust, or conflicts.

Chart 1.7 highlights the rapidly changing fee structures of financial advisers. With investment commissions extinguished on the back of Future of Financial Advice (FOFA), due to perceived or known conflicts, asset-based fees have been in the cross hairs in 2019. This has been reinforced by what some are saying is a key driver behind Standard 3 of the new Code of Ethics – “You must not advise, refer or act in any other manner where you have a conflict of interest or duty.” In short, the change to fee mix over the last 12 months has been stark, and we will see the asset-based and hybrid fee structure continue to evaporate in 2020.

Fees have crept up slightly in 2019, with the median ongoing fee increasing from \$2,510 to \$2,800. Average FUA, per Chart 1.8, have increased by 2% per client, yet fees have had a corresponding 11.5% increase. The FUA increase is not statistically significant, but does reflect a stable equities market over the last 12-18 months. The data supplied by the same cohort of advisers from 2018 has not shown a significant movement in client wealth.

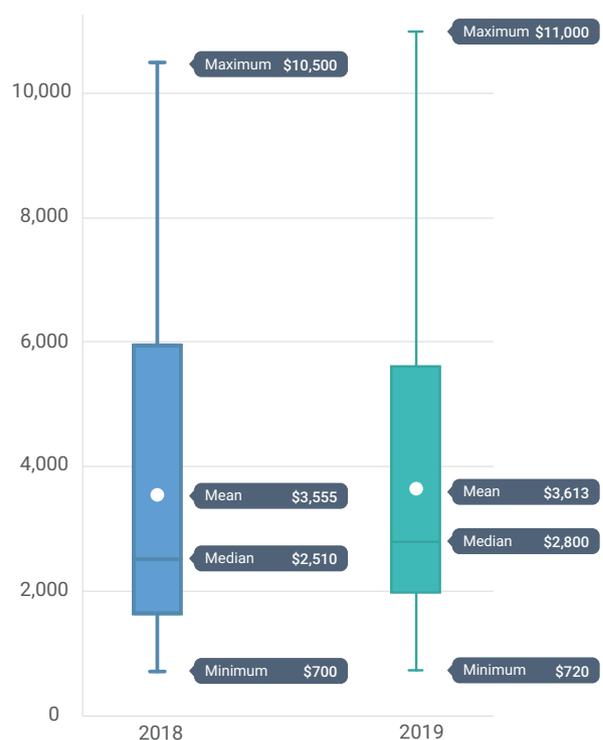
Chart 1.7 is interesting in the dynamic of compressed competition as identified by the smaller box in 2019 – the market moved to fees that are generally more consistent as advisers and practices find their feet with respect to setting appropriate price levels. We expect, as specialisation plays out and practice economics tighten, average client pricing will start to diverge as value becomes more important.

Chart 1.7  
ADVISER FEE STRUCTURES 2018-2019



Source: AR Data

Chart 1.8  
AVERAGE FEE PAID BY CLIENT 2018-2019



Source: AR Data

## Client Numbers and Funds Under Advice

Chart 1.9 and Chart 1.10 shows a 7% decrease in advised customers and FUA, with the average adviser servicing 94 clients in 2019 against 102 in 2018. This reflects changing dynamics in the market:

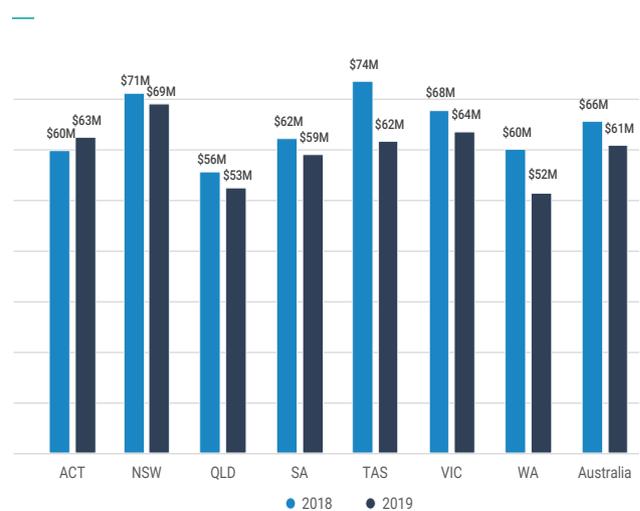
- A voluntary rationalisation of client bases by advisers, as they adjust business models.
- Removing the “fees for no service” clients from adviser’s books.
- Lower value or “under serviced” client’s leaving advisers (with industry funds being the benefactors of this change).

State dynamics reflect the type of licensees and adviser groups currently rationalising within each region. We anticipate the landscape will look vastly different at the end of 2020, and a divergence of advised customers and FUA becoming apparent, with “higher value” clients remaining with advisers (as is MLC’s new strategy) and “lower value” clients being pushed into industry funds or technology solutions.

The FUA per adviser within each licensee group described in Chart 1.11 reflects several factors:

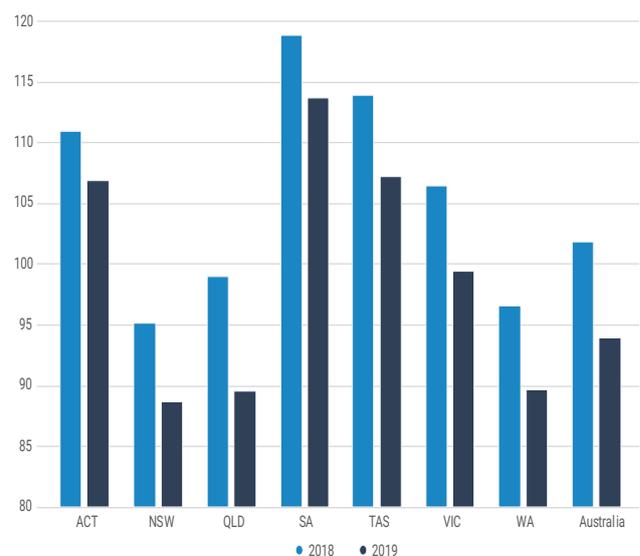
- Portion of Risk Advisers – Licensees such as Synchron, Lifespan, Affinia and Millennium3 rank lower because they have a high proportion of risk advisers within their license. It is important for product manufacturers to distinguish between investment and risk-focused licensees, particularly in the small privately-owned space.
- Demographic of Adviser Base – There is correlation between the years an adviser has been practicing and their quantum of FUA. The top five licensee groups below where their advisers participated have an average 15 years of experience versus 12 years for the industry.
- Portion of Accountants and Stockbrokers – Stockbroking businesses (which didn’t factor in the top 20 survey respondents this year) tend to have higher balance clients given their heritage focus on HNWI. Accounting focused licensees such as Count and GPS Wealth have a very mixed adviser and client base.

Chart 1.9  
STATE BREAKDOWN OF FUA BY ADVISER 2018-2019



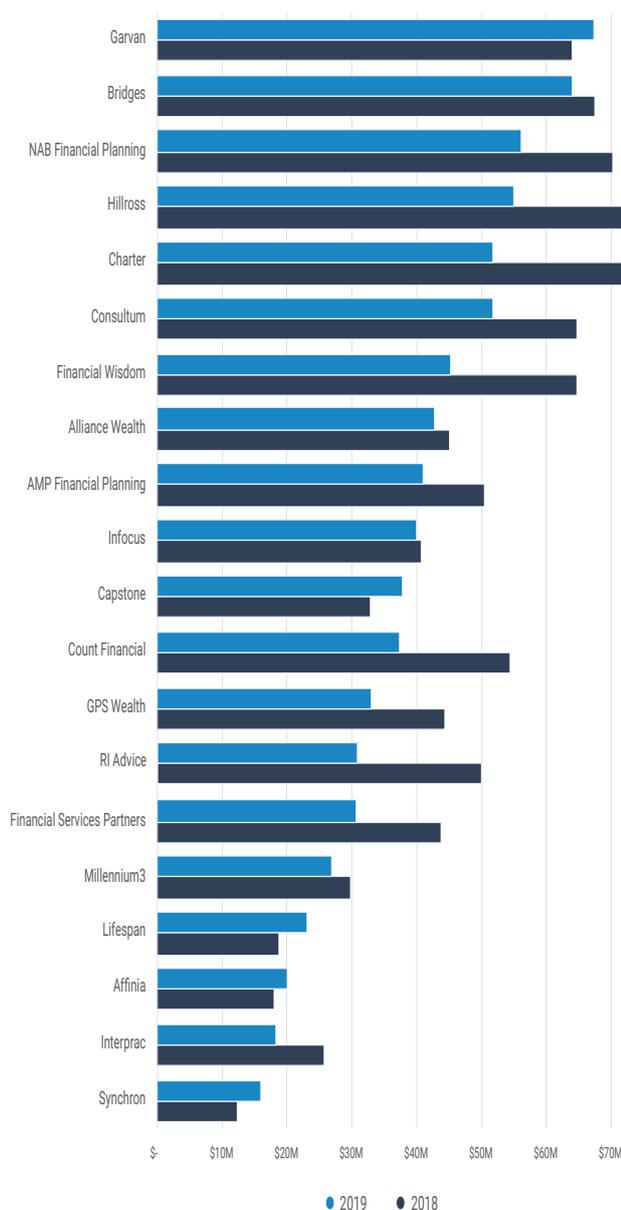
Source: AR Data

Chart 1.10  
STATE BREAKDOWN OF AVERAGE NUMBER OF CLIENTS PER ADVISER 2018-2019



Source: AR Data, ASIC Financial Adviser Register

Chart 1.11  
**TOP 20 LICENSEES AVERAGE FUA PER ADVISER  
 (BY RESPONDENTS)**



Source: AR Data, ASIC Financial Adviser Register

- Type of Clients – Advisers within licensees that have a higher portion of SMSF clients will invariably have higher than average FUA.

### In-Force Premiums

The Australian consumer has comparatively low life insurance penetration rates compared to other countries in the world. As highlighted in the 2018 Landscape Report and supported by ongoing net premium statistics by APRA, a 2016 survey conducted by Zurich and the University of Oxford indicates the rate for income protection in Australia is 27% (global = 33%) and 25% for life insurance (global = 32%).

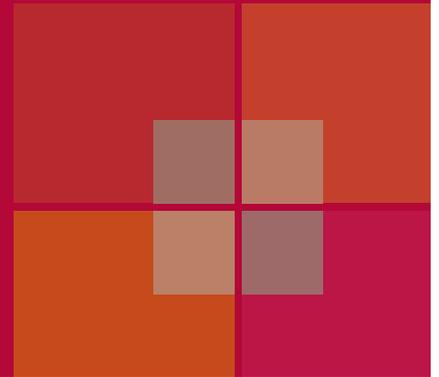
The challenge for insurers and advisers are numerous, but key issues include:

- With life insurance being a product that is sold not bought, the low penetration of consumers seeking advice makes it difficult to promote the benefits of life insurance to a wider audience.
- Insurers' inability to cut-through with their message.
- A decreasing distribution model, with risk specialists leaving the industry 2.4 times more than other advisers.
- The ongoing noise arising from the Royal Commission.

In our analysis into retail life insurance, we found average retail premiums of clients were higher in states where a higher proportion of risk specialist advisers were concentrated (by licensee). Western Australia and Queensland have considerably higher in-force premiums by adviser than other states. This is indicative of both concentration of risk specialist advisers within certain licensees and potentially the type of higher risk occupations common in those states (for example, within the resources industry which has a greater awareness of and demand for income protection, life and trauma insurance).

Whilst 2019 respondents were more varied in terms of risk expertise, there has been a general trend of decreased in-force premiums per adviser year on year, which reflects the general sentiment around life insurance and supported by the latest APRA statistics.

# Financial advice: What is value for money?



As household financial choices have become more complex, the demand for low-cost, quality financial advice has increased across the globe. Traditional financial adviser services are therefore coming under increased scrutiny regarding what constitutes value for money.

Vanguard's Investment Strategy Group has developed a three-part framework for measuring the value of financial advice incorporating portfolio and financial outcomes as well as emotional outcomes.

Although there is a good body of research determining the importance of portfolio and financial outcomes when assessing the value of advice, very little research has been done on other aspects of value. In Vanguard's newly-released research, there is strong evidence stating the importance of an investor's sense of well-being when considering satisfaction with their financial adviser.

## Assessing the value of advice

A large number of industry and academic studies have sought to develop better ways to measure the value of advice to investors. Many, such as Vanguard's Advisor's Alpha® and the Morningstar gamma methodology<sup>1</sup> take a normative or simulation-based modelling approach. Several robo-advisers have attempted to model the potential benefits of their methods using hypothetical or stylised investors<sup>2</sup>. Academic and policy researchers have contributed competing narratives as to whether or not professional advice contributes to investor value<sup>3</sup>.

Vanguard's September 2019 Research Paper, *Assessing the value of advice*, adds to this debate by introducing a three-part value framework for advice incorporating portfolio, financial and emotional value (Figure 1).

Figure 1. Value of advice framework

Component	Description
 <p><b>Portfolio value</b></p>	<p>Optimal portfolio construction and client risk-taking</p> <ul style="list-style-type: none"> <li>• Portfolio risk/return characteristics</li> <li>• Tax efficiency</li> <li>• Fees</li> <li>• Rebalancing and trading activity</li> </ul>
 <p><b>Financial value</b></p>	<p>Attainment of financial goals</p> <ul style="list-style-type: none"> <li>• Saving and spending behavior</li> <li>• Debt levels</li> <li>• Retirement planning: cash flow, income, and health costs</li> <li>• Insurance and risk management</li> <li>• Legacy/bequest/estate planning</li> </ul>
 <p><b>Emotional value</b></p>	<p>Financial peace of mind</p> <ul style="list-style-type: none"> <li>• Trust—in adviser and markets</li> <li>• Success and sense of accomplishment</li> <li>• Behavioural coaching</li> <li>• Confidence</li> </ul>

Source: Vanguard, 2019.

- **Portfolio value.** The first dimension concerns the portfolio designed for the investor. Value comes from building a well-diversified portfolio that generates better after-tax risk-adjusted returns net of all fees, suitably matched to the client's risk tolerance.

Our study explored how financial advice improved portfolio diversification patterns in self-directed investors switching to advice. Advice appears to remedy common portfolio

1. See Bennyhoff and Kinniry (2018) and Blanchett and Kaplan (2018).

2. See Betterment (2019).

3. As examples, see Foerster, Linnainmaa, Melzer, and Previtero (2014), Brancati, Franklin, and Beach (2017), and Kim, Mauer, and Mitchell (2016).

errors attributable to cognitive or behavioural biases or lack of financial literacy.

We found that the benefits of advice include: a disciplined approach to equity risk-taking; the elimination of large cash holdings; the elimination of home bias; a disciplined approach to active/passive share; and the reduction or elimination of individual stock risk (at least for the managed portion of the investor's assets). In these ways, financial advice can help improve portfolio outcomes for investors.

**Read more:** [The value of advice: Improving portfolio diversification](#)

- **Financial value.** The second dimension assesses an investor's ability to achieve a desired goal. A portfolio does not stand on its own. It is in service to one or more financial goals, such as retirement, growth of wealth, bequests, education funding, and liquidity reserves.

One way to evaluate success is to estimate the probability of achieving a financial goal or wealth target at the end of a specified period. Ultimately, an adviser should seek to improve an investor's chance of achieving his or her desired future spending goal. To do this, the adviser must consider a myriad of planning-related metrics that extend beyond portfolio outcomes. These include financial behaviors such as optimal savings and spending; the assumption of debt; budgeting; insurance and risk management; various elements of tax-efficient retirement planning; and legacy, bequest, and estate planning.

- **Emotional value.** The third dimension is an emotional one: financial well-being or peace of mind.

The value of advice cannot be assessed by purely quantitative measures. It also has a subjective or qualitative aspect based on the client's emotional relationship with the adviser (or, in the case of robo-advisers, with the institution and its brand). Underlying elements include trust (in the institution or adviser), the investor's own sense of confidence, the investor's perception of success or accomplishment in financial affairs, and the nature of behavioral coaching such as hand-holding in periods of market volatility.

There is a distinct difference in how the various attributes are perceived between traditionally advised and robo-advised investors.

Most of the perceived value among traditionally advised investors is assessed through the direct relationship and interaction with the adviser. On the other hand, robo-advised investors are influenced by attributes that connote transparency and empowerment.

**Our research demonstrates the important role emotions play in the financial advisory relationship. In a survey of advised investors, we established that emotions account for around 40% of the perceived value of financial advice.**

There are, however, important emotional attributes that are common for both groups of investors—such as trust, having a personal connection, regular plan monitoring, and saving time through task delegation.

**Read more:** [The value of advice: Assessing the role of emotions](#)

## Summary

Prior studies of the value of advice have tended to focus on individual elements of the above framework. Some have assessed portfolio outcomes, such as risk-adjusted returns and the value of portfolio tax efficiency, while others have estimated the impact of financial planning strategies on forecast wealth.

We believe that the value of advice arises along all three dimensions and that the relative importance of each will vary by investor and the advice delivery method.

Portfolio outcomes are of course foundational to most advisory relationships. However, value should be defined more broadly. Our research illustrates the importance of the second dimension of value, financial outcomes which includes advice on areas such as spending and saving, debt management, risk management and insurance, and so on. These metrics are just as important as (if not more so than) portfolio decisions in attaining financial success.

The importance of our third dimension, emotional outcomes, uses survey data to estimate the emotional component of advice. We found that it accounts for half of the value assigned to the adviser-client relationship.

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## CHAPTER

# [ 2 ]

## ADVISER MOVEMENTS

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With 25% of the advisers in Australia either leaving the industry or changing licensees each year, these statistics are key to understanding the present and future of the advice industry. It illustrates the decline of the banking sector, and the emergence of the new wave of heavyweights in the advice industry.

ANALYSIS OF RECENT adviser movements reveals two characteristics starting with “F” that could be said to dominate the subject this year: flux and fragmentation. Adviser movements both entering and leaving the industry and also moving between licensees within the industry have increased dramatically in the last 12 months. The formerly dominant “Big Six” wealth institutions (AMP, CBA, NAB, ANZ, Westpac and IOOF) no longer license the majority of Australia’s advisers, with most advisers migrating to the abundant and growing privately-owned licensee sector.

### Industry Flux – Movement Aplenty

The end of 2018 saw a massive influx of advisers becoming authorised in order to beat the new FASEA professional standard deadline (including relevant bachelor’s degree for new authorisations) of Jan 1st, 2019. Over 2,000 advisers were added to the industry in December 2018 alone.

However, that initial gain in numbers has been all but wiped out this year, which has seen total authorised adviser numbers decrease from 28,365 to 24,103 by November 2019. This is a net loss of 4,262 advisers, reducing the total number of advisers by 15% YTD. Advisers are also moving between licensees at a greater rate than has been the case historically.

### Industry Fragmentation – By The Numbers

Westpac exited from advice in 2019 and most other Big Six members have announced their intentions for further rationalisations and/or closures within their respective wealth arms. The latest figures from the beginning of December show that Big Six authorisations of all advisers now account for just 24.5% of the market. This figure is expected to continue to contract.

In parallel to their decline, privately-owned licensees are continuing to see growth in both their overall number, and in the number of advisers they authorise. Since October 2015, the number of licensees authorising advisers in Australia has grown by 55%, from 1,374

to 2,137, with licensees of 20 or less advisers contributing to this growth – from 1,340 to 2,057. As it currently stands, nearly 93% of the total number of licensees in the country authorise 20 or less advisers.

### New Advisers Flatline

The new qualifications regime which came into effect on January 1, 2019 has resulted in very few new advisers being authorised this year.

Chart 2.1 demonstrates the flatline in new adviser numbers in 2019, in comparison to previous years. Historical spikes in new adviser numbers were predominantly the result of regulatory changes – in 2016 the accountant’s exemption regarding SMSF advice was repealed (meaning AFSL authorisation would be required for accountants to continue to advise on certain aspects of SMSFs) and in 2018 when advisers rushed to be authorised prior to regulations that applied to new advisers as previously mentioned.

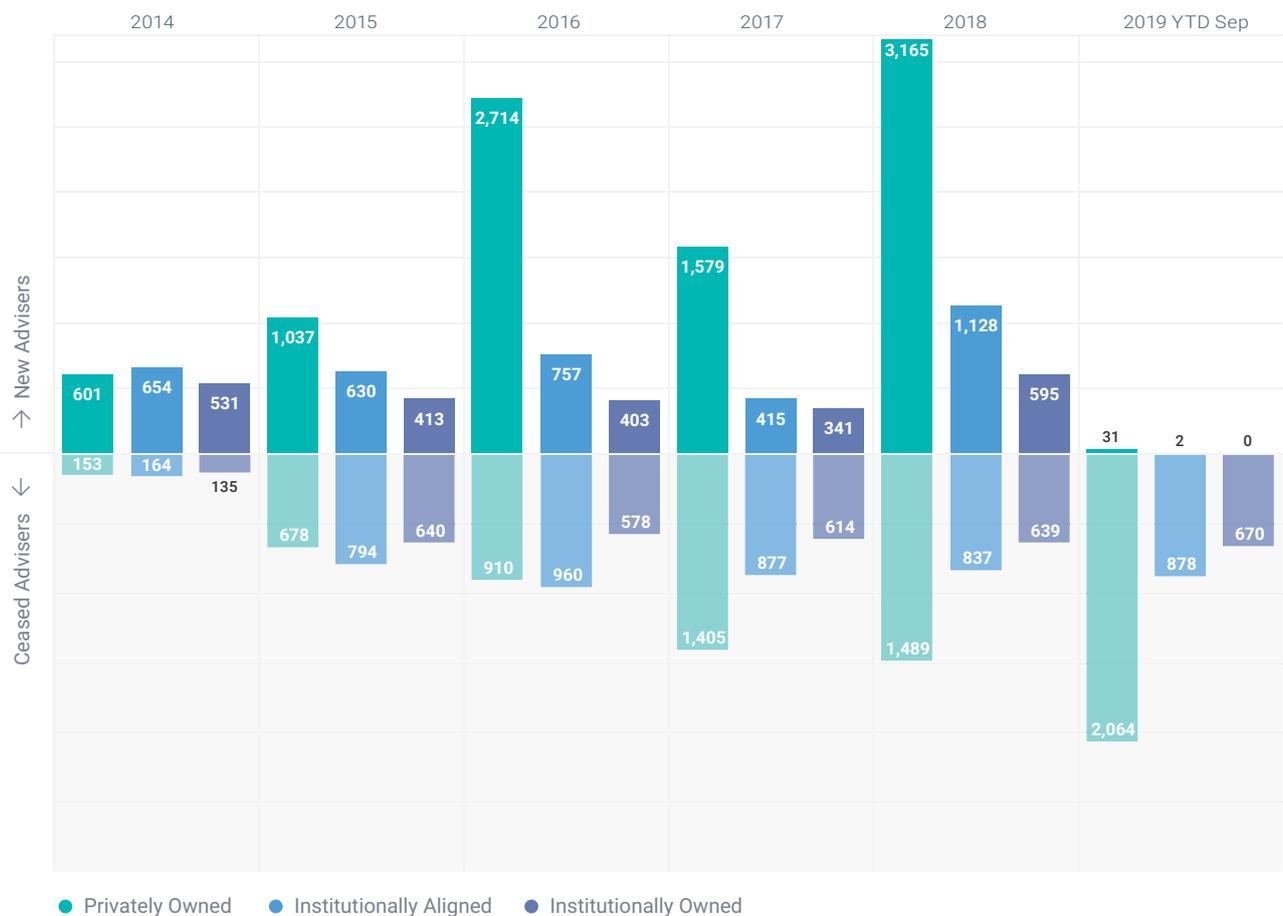
The trend of increasing cessation (which indicates leaving the industry or transitioning to a new licensee) of advisers has accelerated across all types of licensees (institutional, aligned and privately owned) since 2015.

### Adviser Switching Accelerates

The increasing flux of adviser movements within the industry is illustrated in Chart 2.2, which shows gross adviser movements of existing advisers switching between licensee types since 2014. We note that in every year since 2014 more advisers are switching out of the institutional and aligned licensees than are switching in. The strong growth in advisers moving towards privately-owned licensees has continued for the last half decade and we would expect that by the end of 2019, more advisers would have switched into privately owned licensees than in 2018.

Chart 2.3 further illustrates the dramatic transition away from institutionally owned and aligned licensees towards privately owned licensees, and the gross increase in movements. This chart deals solely with

Chart 2.1  
NEW ADVISERS VS EXITING ADVISERS



Source: ASIC Financial Adviser Register, AR Data.  
Note: Data up to September 2019

advisers switching from one licensee to another in the given year, meaning the total numbers above the x-axis are equal to the total numbers below for any given year. Migration towards privately owned licensees has been positive and generally increasing year on year since 2014. We note the acceleration in 2019, which shows that by Q3, already more advisers have switched out of institutionally owned and aligned, and into privately owned licensees, than in any of the previous five years.

### Adviser Exodus Begins

2015 marked the beginning of the current trend of adviser movements away from the institutionally owned and aligned licensees. The FOFA legislation came into effect for most advisers in mid-2013. Following a change in federal government and lobbying from the big wealth institutions, amendments designed to decrease their regulatory burden were announced; however, the amendments were disallowed by the sen-

Chart 2.2  
NET ADVISERS IN INDUSTRY SWITCHING INTO LICENSEES



Source: ASIC Financial Adviser Register, AR Data.  
Note: Data up to September 2019

**“THE OLD BIG SIX OF THE MAJOR BANKS AND AMP/IOOF ARE BEING REPLACED BY THE NEW HEAVYWEIGHTS OF THE ADVICE SECTOR”**

ate in late 2014. It may be that this signalled to advisers that reforms starting with FOFA were to continue, and from 2015 we can see an increasing loss of adviser numbers in both the institutionally owned and aligned space, as advisers moved to privately owned licensees that potentially had licensee conditions and business models that were more attractive. Since 2015, there has been no overall growth outside of privately-owned licensees. The smaller decline for institutional and aligned licensees in 2018 is again attributable to the

influx of advisers at the end of that year. Institutionally owned and aligned licensees have lost more than 2,400 advisers already in 2019 alone.

### Transition At The Top – The New Big Six

So now we may ask – who are the new big players in advice? Is there a new Big Six? At present the top three licensees by number of advisers are still legacy members of the old Big Six. Adviser numbers are still very fluid and are changing daily. As of mid-December 2019, AMP remains the largest network with 2,182 advisers followed by IOOF with 1,465. NAB's network is the third largest at present with just over 1,200 advisers but is decreasing daily, and with their stated intention to further divest and also to merge its Garvan, Apogee and Meritum licensees next year, NAB's adviser footprint could be dramatically reduced in the next 12 months.

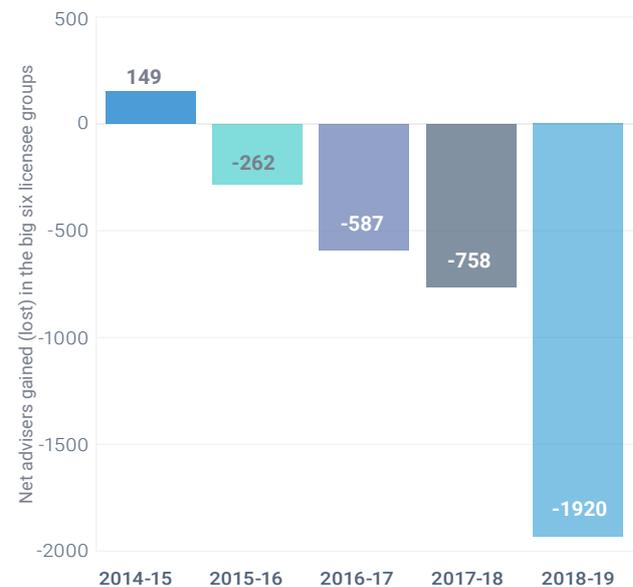
This brings us to the new heavyweights of the advice sector. Though not as dominant (yet) as the traditional Big Six have been, these four groups are the next biggest market players. The National Tax and Accountants Association houses the SMSF Advisers Network (SAN). This licensee has seen rapid recent growth in the last couple of years. The significant increase in adviser numbers in a relatively short period of time saw ASIC impose additional conditions by consent on the licensee in Q2 this year. It started the year with 1,091 advisers but since has thinned down to 934, making it the fourth largest licensee according to numbers.

Easton Investments Limited is the next largest network, currently with 721 advisers licensed through its three major brands, Merit Wealth, GPS Wealth and The SMSF Expert. Easton announced the major acquisition of GPS Wealth (currently almost 300 advisers) in June 2017 and continues its desire to grow through investing in direct to market providers and also through the provision of advisory services through the accounting channel.

Synchronised Business Services (Synchron) is one of the largest privately-owned licensees, and the only one

Chart 2.3

### ACCELERATION OF ADVISER EXITS FROM THE BIG SIX



Source: FAR

continuing to grow through 2019. It offers risk management, superannuation and investment advisory services through its current network of 521 advisers spread across Australia. Finally, we have Morgans Financial with 504 advisers in its full-service stockbroking and wealth management network. Morgans entered a strategic relationship with CIMB Securities International (Australia) Pty Ltd (CIMB Australia) in 2013.

The above four networks all have more than 500 advisers in their licensees. They are followed by a further 10 groups, each with over 200 advisers which make up the bulk of the larger adviser networks. The decline of the Big Six has seen the firms mentioned here come to be the new dominant players in the advice market. However, it is unlikely a half-dozen companies will come to dominate the market as the Big Six once did. It should be remembered that in today's market, fragmentation is the new norm.

# Business

## \$3 billion of 'over-borrowing' risks new global crisis, warns IMF

IMF report says 'over-borrowing' risks new global crisis, warns IMF

Commodity	Rate	Change
Gold	\$146.06	▲
Oil	\$52.14	▲
Platinum	1,352	▲
Silver	1,378	▲
Copper	1,352	▲
Nickel	1,352	▲

Index	Rate	Change
FTSE 250	3,471.25	▲
FTSE All Share	3,471.25	▲
FTSE Euro Stoxx 50	3,471.25	▲
DAX	3,471.25	▲
Nikkei 225	3,471.25	▲
Hang Seng	3,471.25	▲
ASX	3,471.25	▲



Long haul for Tesco  
Andrew Critchlow  
Company sends US  
share sales into  
spiral but profits fall

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CHAPTER

[ 3 ]

ADVICE BUSINESS LANDSCAPE



Adviser movements may be the most visible indicator of change, but beneath the surface, the whole industry is fundamentally changing. Understanding how these changes are coming to the fore will be key for the advice businesses of the future to flourish.

THE PAST TWO years has seen the most seismic shifts ever to occur in the financial advice landscape in Australia, and the flux hasn't ended yet. For the purpose of this report, we will move beyond what has happened at the institutional end of the market, and the super funds, and focus more on what is relevant and needs to be considered at the SME and individual practice level. While we will look at areas like remediation as part of the broader landscape, the majority of this section will refer to SME matters.

## Licensee Structural Matters

### Licence Pricing

The major institutions staying in the market have increased licensee pricing significantly for the single authorised representative (AR) business with less than \$500k revenue. Pricing has moved from the \$20-30k for the first AR in a business to circa \$45-50k. There are reports this could go as high as \$80k in the near future. This means the rapid reduction in adviser numbers in this segment will continue over the next 12 months.

When it comes to medium-sized practices with circa \$500k-\$2m turnover, many in the market have moved to a hybrid model between flat fees and a percentage of turnover while many others are flat fee only. There is no single model but different varieties and mixtures of these pricing elements. No matter what model is selected, the market is rapidly moving to an average cost of \$40-50k per AR, with scaling for subsequent ARs at circa \$20-30k. Licensees are conscious of the practices nudging turnover of \$2m and above being tempted towards self-licensing as an alternative. The opportunity cost for self-licensing is circa \$150k total cost. Variable costs of

technology and professional indemnity (PI) insurance take it higher for larger practices.

Of that \$150k, we increasingly see an unbundling of technology and PI costs. For example, a good dealer to dealer offer or licensee deal could secure 30% off the full Xplan rate if the practice uses every module. A self-licensed firm with no access to discounts will find this is a major cost consideration. The other big area is PI, with premiums and excess constantly climbing. It is not unusual to see excesses over \$25k and premiums above 2% of revenue. The days of subsidisation of these costs is rapidly coming to an end.

To attract larger practices, licensees will usually offer fee caps in the \$120-150k range to make their offer comparable to self-licensing. They are also competing against dealer to dealer offers such as Centrepoint which offer access to discounts and services as required. For licensees, while fees are an issue, the bigger issue is risk. The days of "luring" practices on the basis of growth alone are gone, the risk simply isn't worth it. Licensees have been boxed into a corner of cost-plus, component pricing; it will be interesting to see how they can introduce more upside into their model, whilst being acutely aware of the self-licensing alternative.

### PI Coverage

Institutional and privately-owned licensees with many advisers have experienced considerable PI insurance pressure. Some have been declined cover and it is not unusual to see 50-60% premium increases and excess above \$25k. As a general rule, premiums are now quoted at circa 2.5% of turnover. This area is a major concern for licensees.

PI insurers are generally more comfortable with the individual practice with its own licence, provided it is run well. In the midst of the Hayne Royal Commission numbers grew substantially in this segment, however, they have moderated to a normalised level of circa 40-50 per month. During June 2019 a large number of licensees handed back their licences mainly due to sharp rises in

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**“THE OPPORTUNITY COST FOR SELF-LICENSING IS \$150,000, OR HIGHER FOR LARGER PRACTICES”**

costs – technology, compliance and professional indemnity insurance. Some have also weighed up the risk profile should ASIC increase activity in this segment.

### Compliance Shortcomings – Fee Disclosure Statements (FDS)

ASIC Report 636 was released in late November 2019. It covered 30 licensees randomly drawn from small, medium and large licensees. The review looked at 1,496 Fee Disclosure Statements (FDS) and 373 renewal notices (RNs). ASIC also commissioned a compliance consultant to review 176 FDSs in detail to determine whether the contents complied with legal requirements.

The review found that 7% of the FDSs required to be given to clients by law, were not given. In 35% of the instances when a RN was required, it was not given.

When reviewing policies and procedures, ASIC found that more than half of licensees did not have effective processes to remind them when RNs are due or to turn off ongoing fees. Given the size and standing of many of the selected licensees, this is a concerning outcome and as a result, expect this to be a significant compliance and remediation theme in the period. It will go beyond the institutions and could be a balance sheet test in the privately-owned market.

### Notice of Non-Independence

In recent years ASIC has banned the use of the term independent unless the entity meets S.923A of the Corporations Law. The Royal Commission took it further, with a recommendation to place a warning to clients that the practice is not independent and why. The exact wording and nature is yet to be revealed, however, the anticipation of the recommendation was one of many factors moving the market more strongly into the privately-owned space.

### Remediation

The institutions are all at various stages of implementing this instruction, and the total estimated liabilities keep rising as more work is done. According to Shaw &

Partners, the total cost of remediation provisioned by the four banks and AMP/IOOF is approaching \$10.6b. This includes the cost of determining the extent of the problem as well as customer compensation. The total bill for the industry may be substantially greater as original estimates have been easily surpassed, and when ASIC turns its attention to other institutions and the larger privately-owned licensees.

### Business Risk

In today's climate, advice businesses are facing severe headwinds as the overall industry and individual businesses go through a very difficult transformation. At the risk of stating the obvious, it follows that the level of business risk is elevated and the degree of scrutiny from a range of counterparties is rising:

- Regulators have raised their game following a public shaming from the Royal Commission;
- Lenders are increasing their quality of surveillance, monitoring covenant compliance and tightening lending standards;
- PI insurers are contemplating overall system risk and asking themselves the question should they continue to cover this sector;
- Financial product manufacturers, now captured under the Design and Distribution Obligations and Product Intervention Powers Act 2019, are contemplating the need for proper risk assessments on their distribution partners;
- Investors in and acquirers of advice businesses / books are going deeper than ever before on due diligence;
- And financial advisers staying home or contemplating switching are asking as many questions as they are being asked about the suitability and stability of their licensee.

Each of these stakeholders will assess risk in different ways based on a range of information sources, both quantitative and qualitative. As the advice world slowly transitions to cloud-based, connected technology systems with the ability to digitally capture almost

everything, the availability of new data sources and data relationships will improve effectiveness of risk management.

## Practice Developments

The practice experience has to some extent depended on the segment in which they reside. Larger practices in the large institutions have left in large numbers and many have obtained their own licence. Overall, it's a feeling of gaining greater control of their destiny having experienced uncertainty in their previous environment.

Practices of small to medium size have been less likely to obtain their own licence and have often joined larger, privately owned licensees. As a general comment, practices coming from the institutions have been through considerable transition stress. In addition, they have often seen their costs rise substantially as they move from a subsidised model to a more user-pays model, particularly regarding technology and compliance. On the other side, where they came from have re-priced in this direction as well. This means advisers departing and staying in the large institutions have felt substantial cost pressures.

On average, practices have experienced flat revenue growth due to lower consumer confidence in advice with a sharp rise in costs. This has led to declining profitability, often in the 10-20% range for normalised EBIT to revenue. This has made practices seriously scrutinise costs and incumbent solutions in areas such as technology.

## The Business Revenue Challenge

### Commissions and Grandfathering

When rebating commission or moving to a commission-free product this involves informed client consent in some manner. The minute this occurs it triggers a conversation the practice has to hold with the client to position their value for the fee.

Many legacy product providers have begun and will continue to accelerate systems and product rationalisation programs. In addition, Best Interest Duty

(BID) is triggered when an adviser sees a client. For many advisers the average cost of this advice piece is \$3,000-4,000. If that's the case, it's either unprofitable or completely changes thinking on the advice offer and experience.

In many cases the pending removal of grandfathering and the anticipated movement to annual opt-in has moved this work into the urgent category over the past 12 months. Unfortunately, many practices in the institutional market have often experienced months to move the client through a cumbersome pre-vet and paraplanning process.

As a general rule, practices either upgrading grandfathered clients or discontinuing the relationship would expect to have a 10-15% revenue loss; however, practices that take a serious look at their value proposition and pricing discover that they are undercharging the bulk of their client bases. The practices that go through this change management exercise often report increases in their revenue of 10-15% and a reduction in costs. Profitability often moves from 15-20% normalised EBIT to 30-40%. This revenue and profit uplift needs to be sustained into the second year.

In very recent times the FASEA Code around Standard 3 has cast doubt on charging models incorporating percentage-based fees, insurance commissions and other areas of conflict. As a result there has been a greater shift towards flat fees. Once again, the businesses that invest in their value proposition and client experience often thrive through the change versus standing still.

### Managed Account Margins

Three to five years ago there was a high prevalence in the privately-owned sector of licensees utilising various entity structures to receive margin from Managed Discretionary Accounts (MDAs) and managed accounts platforms. It's not unusual to see licensees have 20% or more exposure in their revenue line to these sources.

In the post-Hayne era and the emerging FASEA Code many managed accounts platforms stopped offering these payment sources in the past two years. More progressive licensees have moved ahead of the regulation and already reduced their exposure. Should this revenue source come to a more abrupt end, combined with higher compliance and technology costs, the impact could lead to many privately-owned licensees experiencing financial difficulties. Many larger practices exiting the institutions have expressed concerns about sustainability of these licensees and taken control of their own destiny through self-licensing. This hit fever pitch in the Hayne Royal Commission period but has moderated since.

### Life Insurance Framework

Prior to establishment of the Life Insurance Framework (LIF) in January 2018, upfront commissions were 110-120% of the first-year premium. Under the LIF reforms this commission rate has now reduced to 70%. Practices report many of the same technology and service problems with life insurers, therefore, many are experiencing rising costs with lower revenue due to commission rates falling. Overall the life insurance sector is under major pressures.

On January 1, 2020 we will see risk commissions move again to 60% upfront and 20% ongoing. It is fair to say the movement in commissions from 110-120% to current levels plus the pending education requirements has led to a number of risk specialist advisers exiting or planning to exit the market. Many practices have concluded that they need to charge a fee to top-up commissions to remain viable. Industry analysis shows the cost base for a “cleanskin” in insurance is north of \$3k. Unless we see a technology revolution in insurance to reduce the end-to-end cost of advice the challenges for risk specialist firms will remain. For firms with a more holistic offer they have the ability to offset and cross-subsidise within a flat fee. The addition of structural and estate planning facilitation is a growing addition to the value proposition.

For risk practices targeting the mass affluent a commission-only model has become very difficult and exits continue. Valuations for risk-related revenue depends

Chart 3.1  
VALUATION MULTIPLES FOR TUCK-IN PRACTICES



Source: FAR

on the business model. Higher quality revenue attracts a high-two multiple at present.

The Hayne Royal Commission placed a significant bias towards eventually moving commissions to zero, pending a review about to commence from ASIC. The entire viability of rump of the life insurance advice industry will sweat on these developments. Should it occur radical change would follow.

### Impact of FASEA on referral and related businesses and remuneration structures

When taken literally, the FASEA guidance released on Standard 3 would make one think all referral models are unworkable. In recent weeks more context has been released and ASIC have agreed to take a facilitative approach to licensees monitoring adherence to the code on January 1, 2020. As a result, businesses and referral arrangements are currently experiencing substantial uncertainty.

### Trading Practices

The marketplace has shifted significantly with advice business valuations. Three to five years ago a client base was seen as a whole and generally speaking the various

revenue segments carried similar valuations. This was also underpinned by institutional buyer of last resort (BOLR) schemes that valued all revenue equally between three-four times.

With the collapse of the institutional market, an arbitrary 2.5 times revenue outcome imposed by AMP, and the pending abolition of grandfathering there is now a stark difference in the valuation of different revenue segments.

It's important to note that businesses valued on revenue are often "tuck-ins" and the buyer is not purchasing them as a going concern. The institutions are rapidly extracting themselves from single adviser practices with \$200-500k of revenue. In addition, older advisers have weighed up the FASEA requirements and decided to exit now to give themselves certainty.

The supply of businesses is very high and that is placing downward pressure on valuations in this business model, even if the revenue is of high quality. In addition, we often see new conditions and warranties to protect the buyer against an increasing risk environment. These clauses and the potential revenue clawback associated often stretches out for two years. Previous upfront payments of 80-90% look more like 50-70%. The buyers are typically above the \$2m turnover mark with strong balance sheets.

Due diligence in the current environment is literally line-by-line on every client looking at date compliance on FDS, opt-in, last statement/record of advice (SOA/ROA) and evidence of fulfillment of ongoing service agreements

A transaction involving a going concern is usually based on a normalised EBIT basis. Valuations of well run, compliant businesses still attract multiples of 5-6 times. In this type of transaction, valuation tends to follow the strategic intent of the buyer. This strategic intent could involve expanding into various markets or talent and succession depth that comes with the deal. Once again,

payment terms have also shifted markedly to protect the risks of the buyer.

When it comes to funding, many practices are still using debt funding due to low cost of debt capital. There is limited supply of lenders and terms and due diligence has definitely tightened in the market. Privately owned equity funding is still in its early stages.

## Client Impacts

Over the past 12 months the number of dislocated clients has risen rapidly. With many advisers triggering BOLR at AMP and the banks withdrawing or shrinking their salaried channels, this has led to many clients exiting their advice relationship without necessarily knowing. Some have found a new home, but many have not, representing a client acquisition strategy for practices with strong marketing acumen and branding presence. This situation is particularly acute in regional areas, with some savvy practices advertising themselves as a home for clients previously attached to banks. More organised transactions such as the Westpac transaction to Viridian have been the exception not the rule.

This whole process has brought to a head the issue of business agreements and ownership of the client. In the bank channels, the bank owns the client. Previously, the bank used to protect its position when an adviser left or organised themselves an orderly transition into the self-employed, aligned channels. With the banks exiting or shrinking their advice models, many advisers appear to be picking up previous clients without issue, however, one should be very careful assuming that will apply to them with certainty.

There is the very serious problem of clients becoming orphaned through unaffordability under an adviser's higher pricing model, or by an adviser unilaterally choosing to concentrate on higher net worth clients.

## The Changing Shape of Advice Businesses Advice Support Model

In years past many of the institutional and larger licensees offered practice development manager (PDM) ser-

## “MANY MORE PRACTICES ARE EXPLORING LOWER FIXED COSTS THROUGH PARAPLANNING SOLUTIONS OFFSHORE”

As the institutions exit or substantially rationalise, this role has gone with the associated cost reduction. Yet the challenges, opportunities and problems haven't changed, and many more substantial practices have sought private sources for business solutions. With many advisers exiting but wanting to stay involved this privatisation will become a more dominant trend. We can expect to see more experienced advisers remaining involved in the industry but contributing in non-advice business functions, either directly employed by the practice or working from within consulting firms.

Practices are structured in different ways however, many have moved towards an advice team, or pod model, with a principal adviser, paraplanner/technical resource and a client service officer shared with another pod. The weight of compliance requirements, practice transition and associated technological change has tested the cohesiveness of the typical pod.

More and more practices are exploring revenue growth with lower fixed costs through paraplanning solutions offshore. The more successful cases treat the offshore staff like a member of the team and establish a daily operating rhythm through the pod structure. The successful practices also place a premium on the skilling and development of the resource.

### Onboarding New Advisers

Recommendations from ASIC report 515 and the Royal Commission around performing more thorough due diligence before onboarding new advisers have been picked up already and major change has occurred.

This includes increased vetting of adviser background through use of professional background screening companies, and an increasingly forensic approach to reviewing past advice files. The costs for this additional due diligence is substantial, both in terms of time and the fees paid away to third party service providers.

Well known privately-owned licensees are getting flooded with enquiries but are also terrified of getting it wrong. This has driven a material improvement to the level of background screening of new personnel. This greater attention to the threat of importing risk through recruitment and authorisation commenced earlier in 2017 when the government introduced the Banking Executive Accountability Regime (BEAR) and concurrently the Australian Banking Association (ABA) launched its Conduct Background Check Protocol. While the BEAR and the ABA response were intended for banks, it has spread the standard into the advice industry and now thorough vetting of authorised representatives is a more common practice.

### Trainee Advisers

When the Professional Year was brought into the FASEA adviser entry framework there was clearly a vision it could work in a similar manner to the accounting profession. In accounting they have a long established, well-resourced approach, however, this is completely new to financial planning. The institutions would generally have been expected to have the financial capacity and organisational precedent to bring decent volumes of trainee advisers into the industry in this manner. However, with their rapid departure, it falls onto the shoulders of the privately-owned licensees that are concurrently dealing with a myriad of other (expensive) issues, draining their ability to step-up in this important area.

### Risk / Compliance Teams

The suite of legal and regulatory obligations that licensees must now meet are extensive and growing as new requirements follow from the Royal Commission. At the same time, consistent with its new “Why Not Litigate?” mantra and in pursuit of earlier findings emerging from

prior industry reviews, ASIC has ramped up surveillance and inspections across the board.

When a licensee receives a request for information and may have compliance concerns about a particular practice, the licensee seeks to stay heavily involved via a three-way interaction between the licensee, the external expert and the regulator. The implications are too significant for the licensee not to take an active role. It's increasingly becoming the case that licensees in all segments will spend what's required to rectify the issue, however, depending on the circumstances seek recovery. For example, for the FFNS investigation, practices can expect requests for reimbursements where the fee is over certain thresholds (\$2,000-\$3,000) and the evidence shows absolutely no activity can be demonstrated.

For smaller licensees there is genuine risk if the expenses escalate. Weak balance sheets and cash backing represent genuine risk under these compliance themes.

### Technical Services

With the reduction in institutional investment in the industry have come reductions in technical teams. With ever-increasing complexity in advice and pressure on more sophisticated value propositions, the demand for these services has risen. The value of a strong technical team within a licensee will become an even more compelling proposition for advisers in transition, however this is likely to be a rare commodity. Instead, the solution will shift to accessing teams held through platforms, product providers, and the fast-growing dealer to dealer sector.

### Due Diligence Teams

Three to five years ago many of the large institutions had their own internal transactions teams to enable succession planning and part book sales within the system. These teams have reduced to very low numbers, and are more dealing reactively to exits. The transaction market has moved private in big volumes. Groups such as Forte, Radar Results, Centurion Market Makers and

Seaview Consulting report big spikes in transaction volume. This shows no sign of abating.

### Data and Automation

Leading practices are increasingly seeing data as a major asset in their business. In addition they are seeking best of breed technology solutions that have open API interfaces with other software solutions. Data silos and disparate systems continue to have a major impact on efficiency, cost and the client experience. Automation is only possible through an open source technology stack. Solutions such as XEPP0 are increasingly supporting this type of environment and in fact seek to connect data from accounting, mortgage broking, general insurance and other open API solutions to form one view of the client across an integrated financial services approach.

Notwithstanding the benefits of leveraging data more holistically, there are also risks to control. In July 2019 we saw the continuation of substantial changes and penalty increases for privacy breaches. Reporting is now mandatory and the penalties could easily put a practice out of business. Within the institutions, practices have been able to leverage off the broader focus on data management, privacy and cyber security within the broader organisation. For practices operating off their own steam in this area, having a top quality technology partner focused on this area is now an essential versus a "consideration".

### Approved Product Lists

We have seen an increased prevalence of ASIC prosecuting Best Interests law. As a general rule, licensees have chosen to broaden their approved product lists (APL) in response. On top of this trend, as practices experience higher costs they tend to look very hard at costs throughout the value chain. As a result index investing, ETF's and LIC's continue to grow. Older, expensive managed funds have attracted increased scrutiny and turnover as the adviser reviews a client under best interests. This has placed high pressure on incumbent investment managers with soft performance and potentially higher margin on their back versus front book.

## CHAPTER

## [ 4 ]

## INFOGRAPHIC SECTION

The full Landscape Reports contains hundreds of graphs illustrating how the financial advice landscape is changing. For this version, we have developed new insights that are specifically relevant to the adviser market.

Chart 01

**DISTRIBUTION OF PRACTICE SIZE BY TYPE AND NUMBER OF PRACTICES**

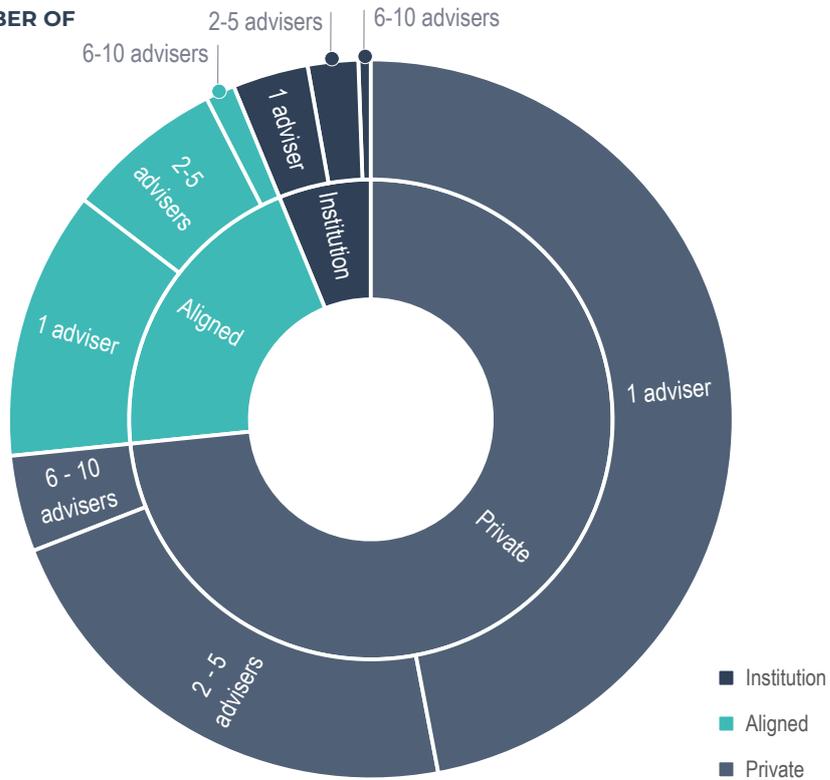
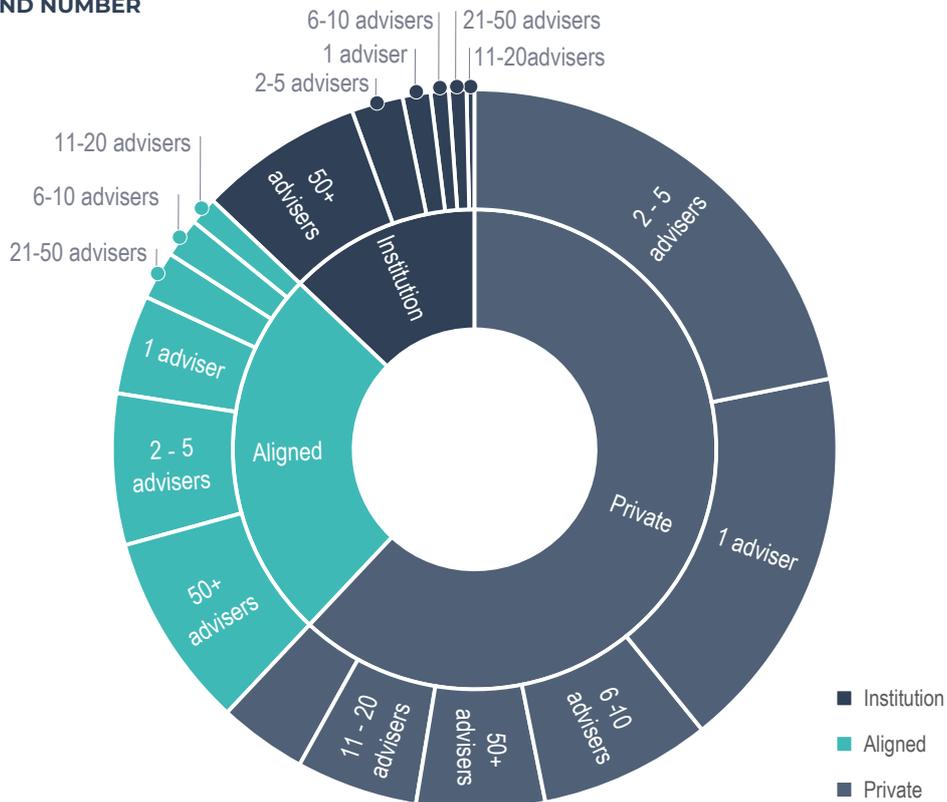
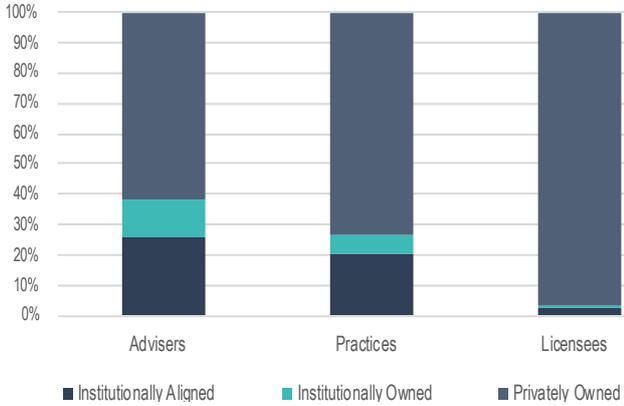


Chart 02

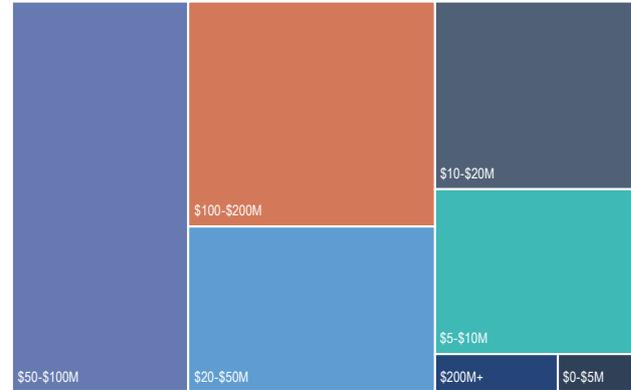
**DISTRIBUTION OF PRACTICE SIZE BY TYPE AND NUMBER OF ADVISERS**



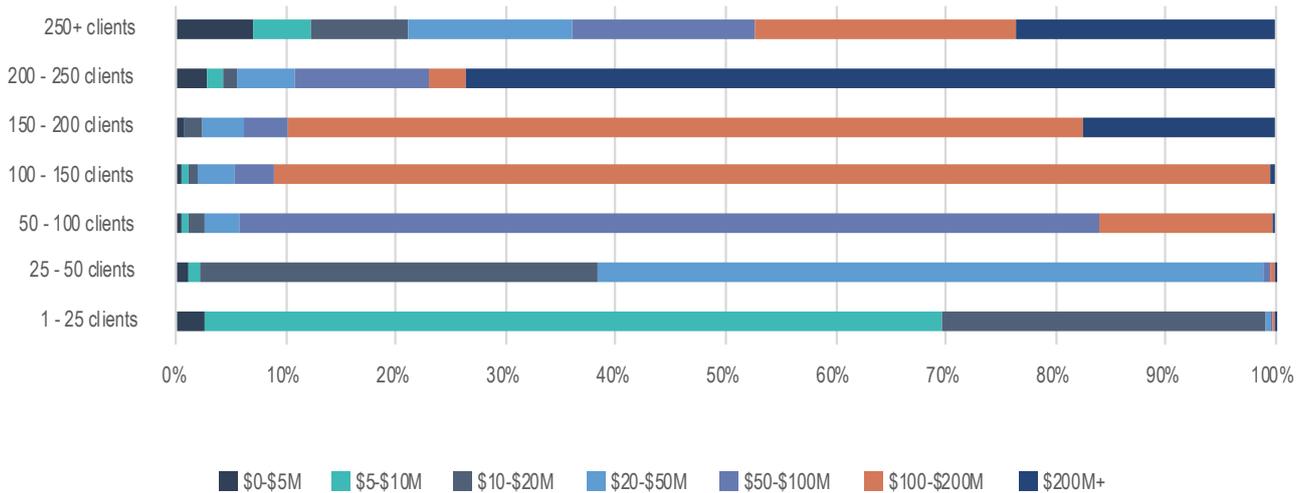
**Chart 03**  
**ADVISER DISTRIBUTION BY LICENSEE TYPE**



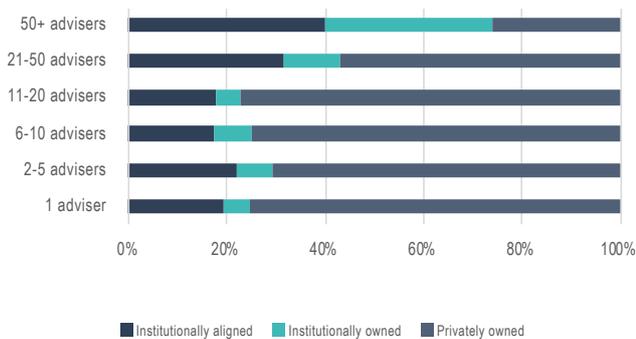
**Chart 04**  
**ADVISER DISTRIBUTION BY FUA**



**Chart 05**  
**ADVISER DISTRIBUTION BY FUA AND NUMBER OF CLIENTS**



**Chart 06**  
**ADVISER DISTRIBUTION BY PRACTICE SIZE AND TYPE**



**Chart 07**  
**ADVISER DISTRIBUTION BY LICENSEE SIZE AND TYPE**

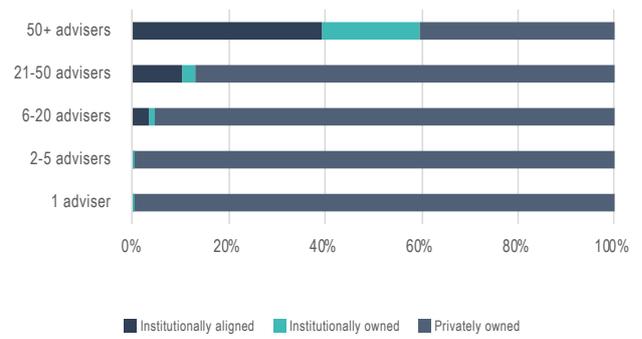


Chart 08

ADVISER DISTRIBUTION BY LICENSEE TYPE AND NUMBER OF CLIENTS

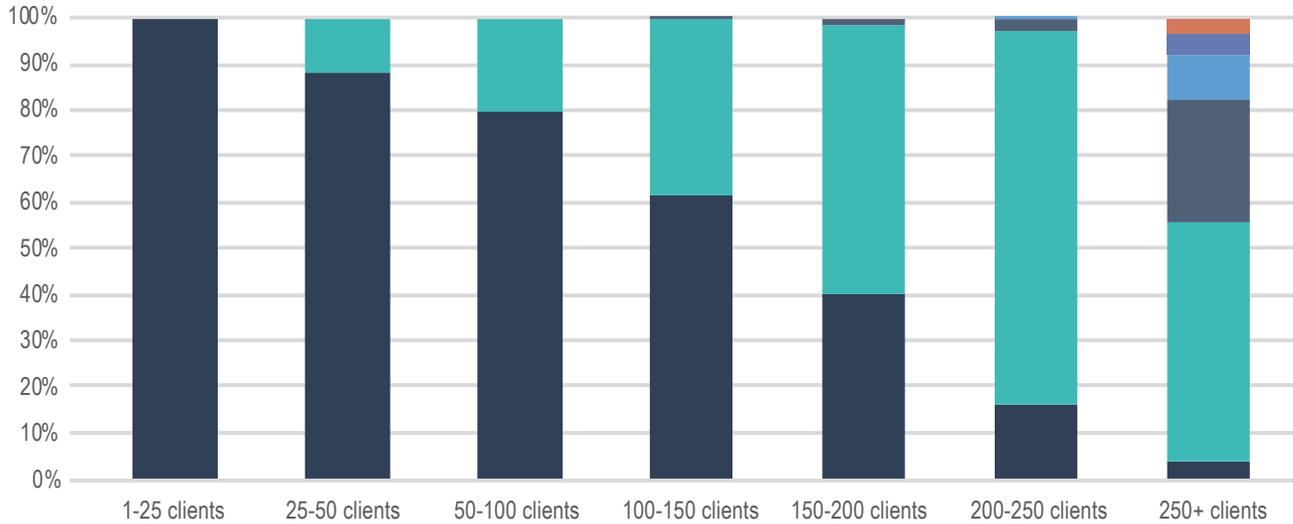


Chart 09

GENDER DISTRIBUTION BY YEARS OF EXPERIENCE

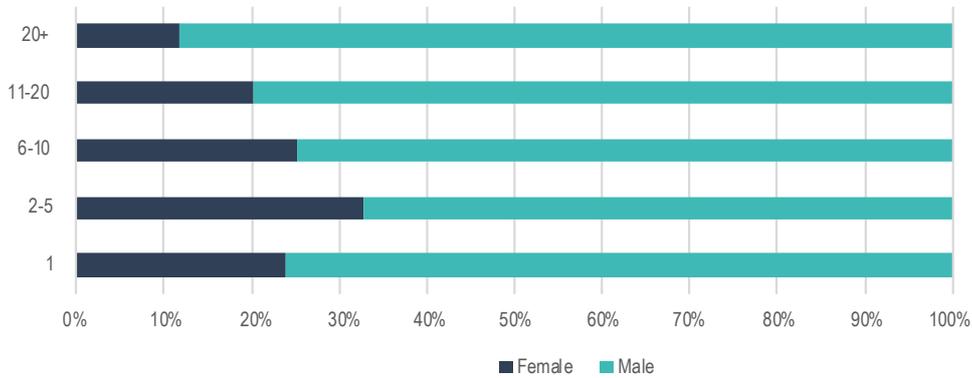
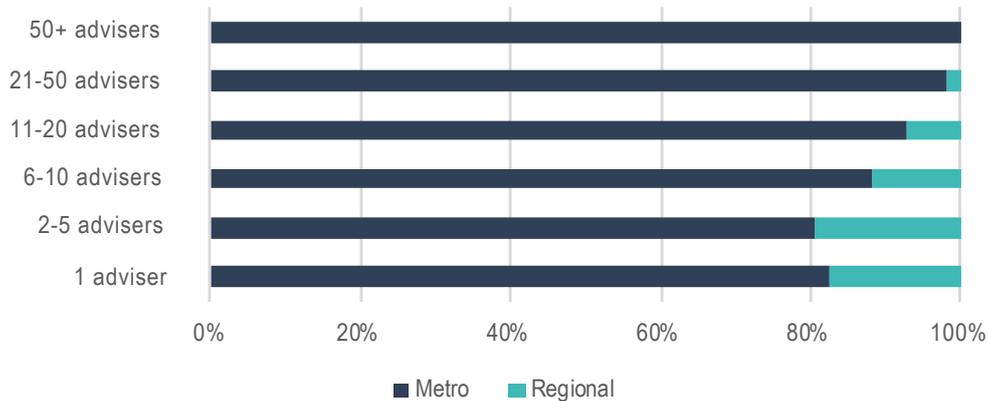
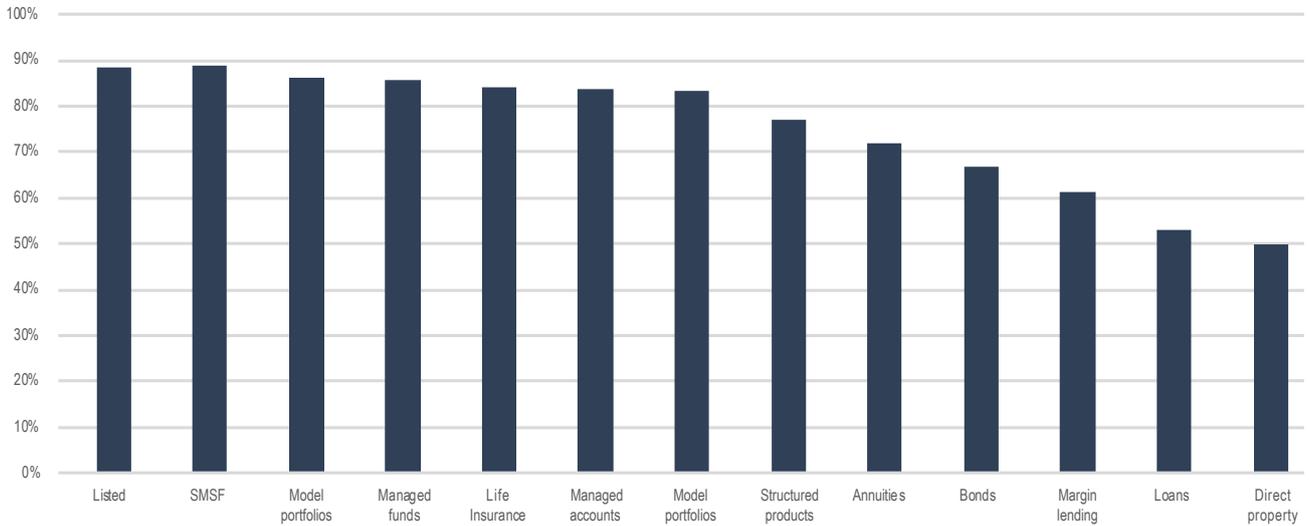


Chart 10

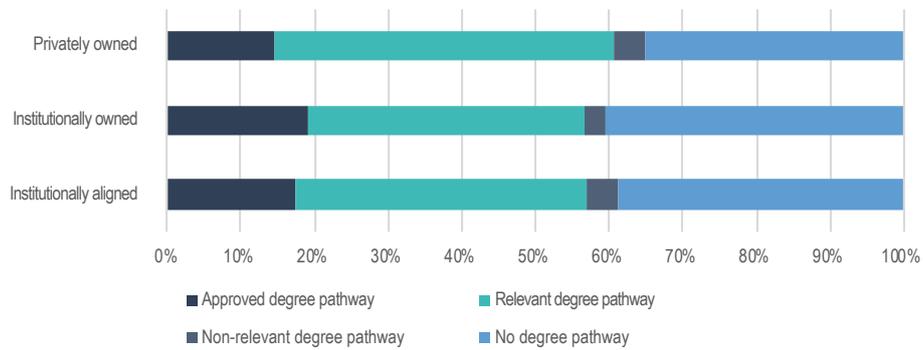
REGION DISTRIBUTION BY NUMBER OF ADVISERS PER PRACTICE



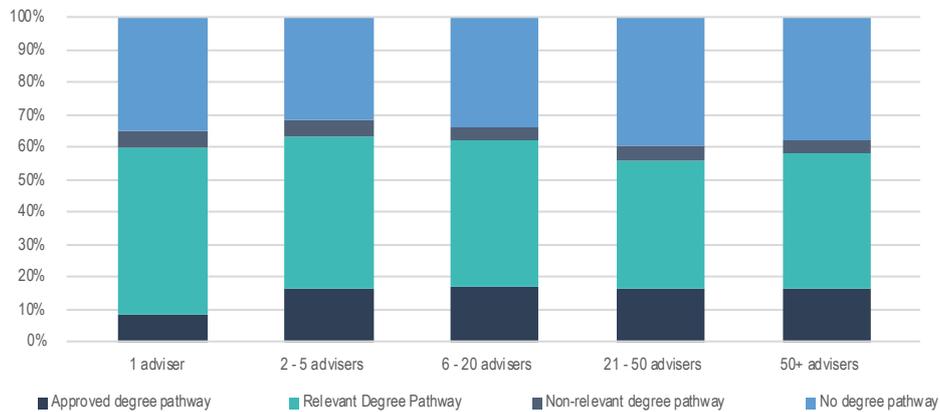
**Chart 11**  
**PREFERRED PRODUCTS BY PRACTICE**



**Chart 12**  
**FASEA REQUIREMENTS BY LICENSEE TYPE**



**Chart 13**  
**FASEA REQUIREMENTS BY LICENSEE SIZE**





CHAPTER

[ 5 ]

DIGITAL ADVICE TECHNOLOGY



The current providers of technology solutions have improved their service, but the new age of advice means that they need to evolve solutions to not only meet the needs of advisers, but to help those advisers service their clients.

## The Case For Digital Advice

Fallout from the Royal Commission has led to a loss of trust in financial services and institutions are abandoning their advice businesses. Advisers are leaving the industry in droves and customers are being orphaned.

It seems like the perfect role call for the digital advice sector. Save the orphaned clients, attract new consumers with funky services, help rebuild trust in the sector. What a heavy load to carry for such a young upstart community, but it is worth dreaming.

Most Australians don't receive any advice because it's either too expensive, they don't think they need it, they can do it themselves, they don't trust advice or don't see any value. Digital advice is seen as a solution to these problems.

Digital advice will give the large portion of Australians free or low-cost access to services that will scale with their needs. Some of these consumers will ultimately find the technology lacking and look to outsource their financial management to an expert adviser. This same person may have never thought to seek an adviser if they had not had a digital service that highlighted to them just how many factors need to be considered. Ultimately, this will mean the right types of consumers are seeking expert advisers – those that will benefit the most from more sophisticated services.

## Growing the Customer Pool

As an industry, superannuation is often seen as a gateway to advice, where those consumers engaged in their finances because of superannuation are often thinking about retirement, have mature balances, and make commercial sense for financial advisers. But how do these people get help between the ages of 20 and 50? Digital advice allows the industry to shift down the curve, serve the masses, and grow the size of the market.

The arithmetic element of advice is better done by computers. They can crunch numbers faster and more accurately. Where advisers excel is helping clients define

their goals, understand what's important to them so that they feel heard, counsel them through difficult situations, and offer them unique opportunities to better their financial position.

## The Emerging Digital Smart Tool Providers in Australia

In September 2018, Adviser Ratings launched its Smart Tools register to promote the emerging Australian community of personal digital finance tools selling directly to consumers, or put another way, business to consumer (B2C). This register currently features over 45 different providers spanning a range of capabilities, with several new ones added during 2019.

With the trust and reputational issues currently faced by the traditional face-to-face advice industry potentially also impacting this start-up community, together with the mass migration of consumers online, it seems a time of both great challenge and opportunity for these providers.

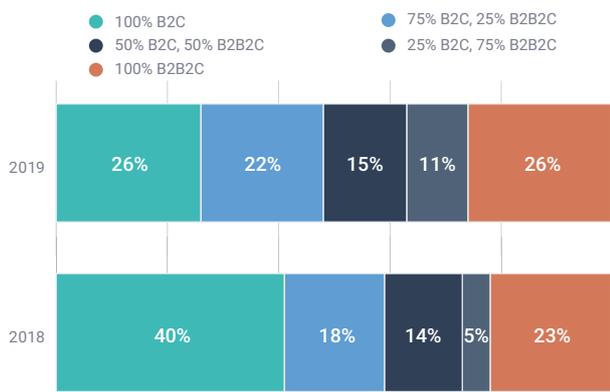
In November 2019, Adviser Ratings conducted a survey of smart tool providers and major institutions to determine the state of play in this local industry, whether there were opportunities for these two groups to work more closely together (the "hybrid" approach) and where the technical and functional development of these capabilities is heading.

## Smart Tool Business Focus

There is a definite shift from B2C towards B2B2C in the past 12 months, which is understandable given the challenge for any start-up firm running a pure consumer-focused business to quickly build brand, reputation and a commercially viable customer base. Prudently, these businesses are switching their focus towards partnering with larger businesses to capture more secure revenue streams and, in some cases, investment partners to help fund further product development.

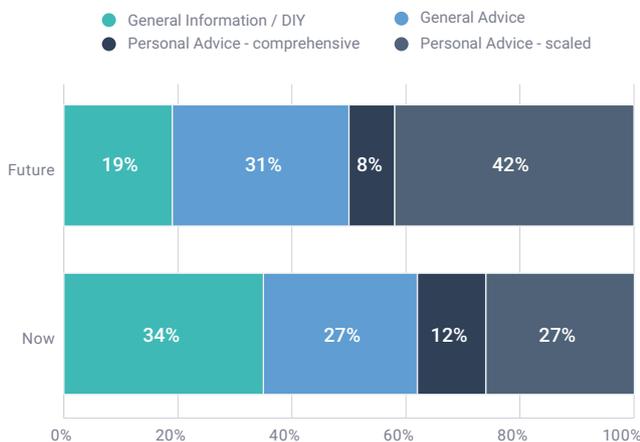
Despite the growing influence of the aspirational millennial, the customer base of the current crop of digital finance tools is relatively balanced across the age demo-

**Chart 5.1**  
**SMART TOOL BUSINESS MIX**



Source: AR Data Q4 2019 Survey

**Chart 5.2**  
**SMART TOOL SERVICE OFFERINGS**



Source: AR Data Q4 2019 Survey

graphic. This may be skewed by the heavy concentration of investment solution tools that are primarily targeting the older DIY investors with established wealth.

It is natural as this sector evolves and matures that the sophistication of the offerings will increase. Partly this is consumer-led or partner-led, because technology allows it, and also because it makes commercial sense to own a greater share of a customer's wallet through higher margin, more ongoing services.

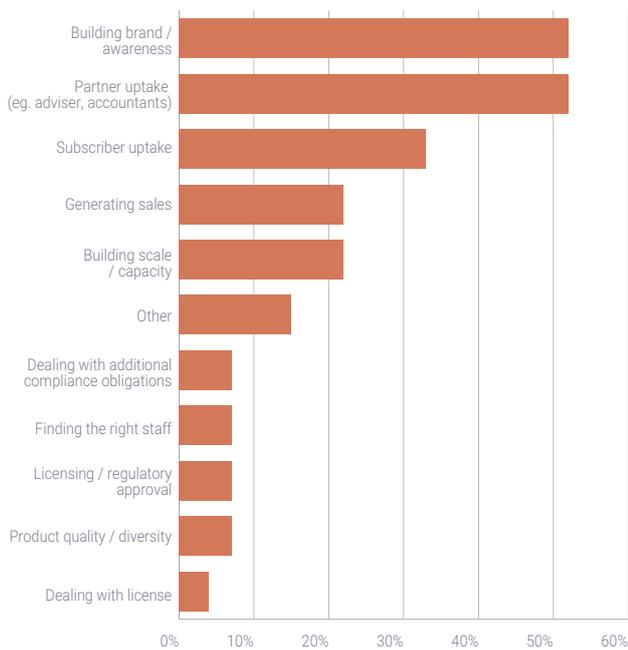
Every business measures their performance differently, particularly fintech start-ups compared with institutions. For the majority of these smart tool providers, it is all about gaining a foothold in a new world with extremely scarce capital and resources. The businesses surveyed were generally equally split in relation to considering themselves ahead, behind or in-line with their expectations of business performance. Of more interest was the focus on growing subscribers and B2B partners as the most important business KPIs, with the underperformers simply not as quite advanced with both as the more successful firms.

### Operational Changes

As smart tool providers expand into the scaled and comprehensive advice space, they will come under harsher and more prescriptive regulatory obligations consistent with all licensed advice businesses – 58% of the survey respondents are increasing the risk and compliance resources within their business, either through new hires or repurposing existing staff. This increased investment is also necessary if these businesses hope to successfully partner with established institutions, many of whom are either doubling down on investment into compliance as well as suffering from the fallout of the Royal Commission and various ASIC investigations.

By their very nature, digital businesses generally rely heavily on algorithms to increasingly automate decision-making and investments without the intervention of any human. These algorithms can be simple, and with the advent of machine learning, increasingly complex. They may be operating at any stage of the customer engagement cycle: as part of a dynamic fact-finding

Chart 5.3

**CHALLENGES TO PROGRESS FOR SMART TOOLS**

Source: AR Data Q4 2019 Survey

process; converting the fact-find and risk profiling exercise into a risk-based investment portfolio; to the way customer queries are handled.

And while automation invites risk, it also improves efficiency and aligns with the expectations of customers who want to be delighted with their online experience.

### Advice Technology

Advice is costly to provide. Meeting know-your-client (KYC) requirements takes time, generating advice documents is mostly inefficient, data feeds are inconsistent or error-prone, implementation is still far from straight-through-processing (STP) ubiquity, and the provision of ongoing services is largely a manual process with some technology to provide reminders and check-lists.

There are new and innovative technologies surfacing more frequently than ever. They offer automated text generation for advice documents, virtual client meetings, automated compliance, and more. Unless you are one of the lucky firms who have simplified their core processes, these add-ons will only add complexity on top of, and magnify the issues with their primary systems and processes.

### Making Technology Work For Advice Businesses

Dealer groups have typically chosen to be the provider of technology to their advisers, negotiating scaled contracts, and administering custom services. Some groups have gone down the path of offering their advisers choice, a panel of approved vendors from which advisers can implement their own solution. Trying to implement more than one system, each playing significant roles, introduces risk to data integrity. This risk can be managed, but an adviser will need to ensure there is always a single source of truth and that the source is always the most up to date set of data. This can be particularly difficult when multiple systems are each used as points of data entry.

Advisers displaced by the closing of AFSLs as a direct or indirect result of the Royal Commissions are now joining smaller groups or starting their own AFSL. This market dynamic creates an opportunity for technology vendors to pitch their wares. But as smaller clients, the commercial terms are less favourable compared with those offered to larger dealer groups. And the cost of ongoing administration and expertise required to manage a system like Xplan is often underestimated, resulting in significant frustration.

The SOA has been a challenge for the industry for many years. It can be difficult, timely and expensive to produce, and it can mean very little to the client once it's been padded out with a series of disclosures that provide neither clarity nor context for the client. A digital SOA will result in a much more client-friendly means of communicating strategic recommendations, the reasoning, the consequences and the fees.

But this is downstream. Upstream problems need to be addressed first – information about the client, their financial products, their goals, potential products of benefit to the client, and strategic recommendations. The combination of Open Banking and digital design principles that have made it easy enough for three-year old children to use apps on their parents' tablet will lead to a much better view of a consumer's financial world. Big data will help advisers understand their clients, allowing them to anticipate their needs.

This era of automation will not make advisers redundant. Just as mutual funds disrupted the stockbroker, diversified funds and platforms reduced the need for an adviser to manage asset allocation or manually rebalance portfolios, and low-cost index funds disrupted the 'fund picker', continued technological advancement will force the adviser to get even closer to the client, to better understand their needs. The computers may do more of the arithmetic work. This will be a good thing for advisers and consumers.

## Financial Planning Software Competitive Landscape

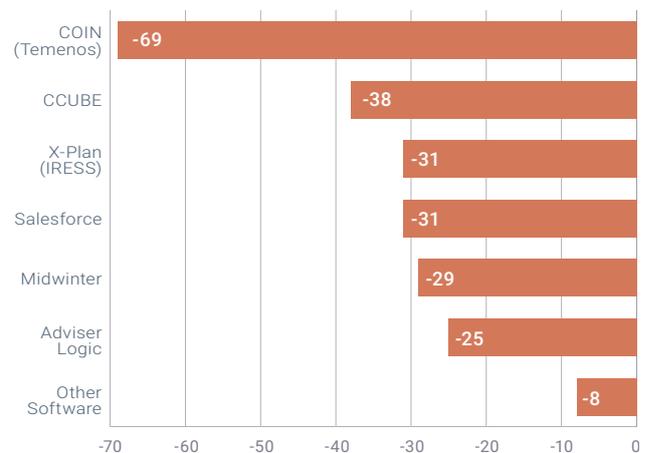
The most essential system for advisers is the financial planning software that dominates their desktop, is integral to professional service delivery to clients, and is relied upon by both front-line advisers and their support teams. The available offerings fall into two categories:

1. Mature, established and institutionally owned;
2. Independent challengers.

The first category is represented by Xplan (IRESS), Coin (acquired by Temenos), Midwinter (acquired by Bravura), and AdviserLogic (acquired by Morningstar). Another new entrant is global CRM giant Salesforce, which is putting pressure on the incumbent software players where the need for a better CRM has high priority.

The second category is represented by CCUBE, Advice Intelligence, and FinPal (built on MSFT Dynamics). Another player that arguably fits in this group is Fidu-cian, an ASX-listed diversified wealth business seeking to

Chart 5.4  
ADVISER SOFTWARE NPS



Source: AR Data Q4 2019 Survey

launch its financial planning software (and its investment platform) out to external financial advice groups.

Clearly there has been some notable corporate action in this category over the past 12 months, with the recent moves by Bravura and Morningstar bringing their significant balance sheets into a sector, until now, generally lacking the institutional investment to challenge Xplan's dominant position.

Until recently, newcomers have tried to challenge Xplan by doing well what it does poorly, aiming to create an improved user experience and modern user interface. These attempts have often failed to replace what Xplan does so very well – manage the end-to-end advice process including fact find, product research/comparison, financial modelling, SOA production, compliance and data feeds. While each individual element may not be best of breed, it's a difficult set of assets to include in a single system from day one.

However, with technological advancements reducing the cost to develop better digital capabilities, along with

greater access to data via APIs and the imminent Open Banking regulations, the barriers to creating a truly competitive and comprehensive product are lowering.

Further, the leading UK software Intelliflo will soon be entering the Australian market. In 2012, Xplan launched in the UK and has since taken 10-15% of the market, in part due to local acquisitions. Intelliflo is the leading provider there with approximately 40% market share. With the UK being Australia's closest peer in terms of regulatory frameworks for advice, and with a unique value proposition built around helping advice firms to integrate multiple technology solutions, the Intelliflo arrival presents at face value as a legitimate challenger to Xplan.

Acquired by Bravura, it is fair to ask whether the future of Midwinter is intended to serve the independent adviser as a direct client, or perhaps the focus will be on integration with their wealth administration platform. Midwinter also has one of the strongest reputations for providing intra-fund advice solutions to super funds, which would suggest a strong alignment with Bravura's super clients.

Morningstar is often thought of mostly as a research business, but they have significant data and technology assets. They also have a direct-to-consumer service for self-directed investors. The acquisition of Cuffelinks and more recently of AdviserLogic suggests an intended strategy to be more things to more customers. Embedding content, research and data generated by Morningstar, along with other investment solutions, into the AdviserLogic platform does add value to the adviser CRM experience and may be a compelling proposition in the market. Add to this recent work done by AdviserLogic in collaboration with Basiq (data solutions company co-funded by NAB Ventures and Westpac's Reinventure) to create automated fact finding, and again more recently announcing digital SOA capabilities, it looks to be an exciting time for this relatively young provider amongst the established CRM providers. Bringing some of this technology through to the self-directed channel could help create a marketplace where consumers can find advisers using AdviserLogic as a conduit between the two.

Xplan has long had an integration with MoneySoft so that advisers can better offer cash flow management advice to clients, and to help with collecting fact find data. It has also been working with SalesPreso for over 12 months on a digital SOA. The biggest challenge with a digital SOA is not technical, but rather the quality of the data inputs. Each granular detail of the client's current financial position must be recorded as a unique piece of data, and accurately. Each piece of advice must be held to the same data standards. Manual data entry will likely be quite onerous, while automation of the advice will be particularly helpful, since it will be by default stored as structured data. A strategy worth watching as the more innovative, advice focused, tech-enabled businesses push into this space.

## Adviser Sentiment Towards Software Providers

The strikingly negative sentiment expressed by advisers towards the adviser software providers in Chart 5.4 suggests something desperately needs to change, and the corporate activity in the sector described earlier is warranted as a supply-side response. And on the demand side, advisers are making their feelings felt. However, the ultimate power to change the status quo rests mostly with the licensee for as long as the dealer group construct remains.

While these are disappointing results, they are not materially different in trend to our 2018 survey.

Most software deals, pricing and configurations are struck at the licensee level. By definition, those arrangements are negotiated to favour the licensee in providing support of its entire universe of authorised representatives. This may cause problems for larger licensee groups with a greater diversity of practices, as the central arrangement may not suit everyone. The emerging trend of licensees to unbundle modules, create panels of suppliers, and allow advisers to acquire best-of-breed combinations could be a cure albeit at higher cost.

Adviser software is possibly the most sensitive area for an adviser in terms of impact on work productivity and effectiveness. If the software is not performing this has a

material impact on their personal business and likely to generate a more emotional survey response.

The mass migration of advisers around the industry ensures that they are placing greater expectations on their existing software providers to help them in their hour of need.

Conversely, advisers arriving at new licensees are being compelled to switch software providers (among other enforced changes) and may not be getting the best onboarding experience as software BDM teams are unable to stay abreast of the adviser movements and can be overwhelmed by the pace and volume of change amongst their client base.

Best interest duty is stress-testing adviser software to have the best data, research, and product and scenario comparison capabilities to enable advisers to meet their obligations to clients. Failure or inaccuracies in any of those components could expose an adviser in the event of audit or ASIC investigation, and these concerns were acknowledged in some of the comments provided by advisers in the survey.

The hope that full-service challengers to Xplan would emerge has not materialised, and the simpler start-ups like Advice Intelligence and CCUBE have promised much but taken too long to get out of the starting blocks. When combined with Temenos withdrawing Coin from the local market, advisers could not be blamed for feeling let down by this sector.

Drilling deeper into how advisers have assessed the individual software offerings, the dissatisfaction largely extends across all areas investigated. Not a single named adviser software provider scored above 75% (3.7/5) for any component with most averaging around 65%. That's a solid C report card at best.

The patterns are clear too that Xplan is recognised for the comprehensiveness of its offering but equally criticised for complexity and cost of implementation, while the other challengers are a mixed bag largely due to incompleteness

of offering. Across the board though, advisers recognised and rewarded the software providers for strong adviser support. We think this is particularly important at the moment with high stress levels reported amongst advisers.

For adviser support, the ratings were generally influenced by the speed of response and the willingness to listen as much as the quality of the technical support. Innovations like chat were appreciated by some, however this was underwhelming for others if that service was not supported by a team that was immediately accessible in the event of more serious issues arising. Maintenance conducted on weekends should take into account the fact that many advisers are working through on behalf of their clients and need system access.

Support involving training and on-the-ground assistance while onboarding advisers into new systems was important and even more so where multiple modules were purchased and the software is designed to support a more end-to-end workflow.

There was very little commentary about client experience and no news in this case is generally bad news, given the acknowledged lack of investment in the front-end for most providers. Advisers who questioned the underlying data in the system or the accuracy of the generated forecasts from modelling modules did not have the confidence to show clients the output.

Naturally there were plenty of comments around functionality. The best CRMs were Salesforce and Adviser Logic. The strongest modelling capability went to Xplan and Midwinter. Workflow management was CCUBE. SOA generation was a big disappointment, with advisers complaining that the templating systems were compromised by difficulties in achieving compliant reports, in many cases requiring them to use their own templates outside the system. And finally with comparison tools, becoming a more important feature with greater focus on best interests duty, the quality of the data was paramount and the ability to compare more than two products at the same time raised as a desired improvement.



2:22

Search



# Amazon

\$1,672.60

UP \$1,327.41 (384.54%) Past 5 Years



1D 1W 1M 3M 1Y 5Y

## Stats

TODAY'S VOLUME  
1,361,860

Trade



CHAPTER

[ 6 ]

INVESTMENTS

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Although the investment landscape has been shifting for many years, the current stripping of advisers from the marketplace will allow fund managers to focus their energy on doing what advisers need most – help in providing advice for their clients.

## Investment insights

### Industry Snapshot – Net Fund Flows

Last year was an extremely tough year for most. Market growth may have nudged up year-on-year funds under management (FUM), but in many cases this only hid sub-economic inflows or worse, net outflows. Industry wide FUM growth attributable to net inflows (“organic growth”) for pooled investment products was a mere \$3.8bn. This represented an organic growth rate of 0.6%. Unless your product suite was long fixed interest (\$10.1b, 7.9%) or global equities (\$2.3bn, 1.2%) the chances are that, excluding market movements, you shrank in 2019.

Drilling down a level, which strategies did better or worse than their overall asset class average? Was it only the smaller “niche” strategies that grew strongly? Did any of the larger “core” strategies perform well?

The strongest organic growth amongst larger “core” style strategies came from Global Bonds, Global Infrastructure and Hedged Global Equities. Small “niche” fixed interest strategies generated the highest organic growth rates over the year. Negative organic growth occurred within a mix of core and niche strategies.

The numbers tell us what is happening but not why. That tends to be where the “art” (experience, market knowledge) takes over from the “science” (hard data). The key question is: which of these growth signals should be considered short term (and discarded) and which can be relied upon as being indicative of a medium or long-term trend?

The first knockout filter should be adviser / investor heuristics – to what degree might performance chasing / loss aversion based on recent returns be driving flows? The next filter is related to the first – to what degree might changes in cash rates be altering the relative attractiveness of being, or not being, in other asset classes and strategies?

From here it gets much harder to attribute change. But the following factors, if identified with high conviction,

can at least be considered to be longer duration drivers than the previous two:

- Asset allocation trends (e.g downweighting of Australian equities in preference for global equities)
- Portfolio construction trends (e.g less constrained, higher conviction investment management, or shifts between blended and core-satellite approaches)
- Shifting risk profiles / investor lifecycle stages (e.g superannuation assets shifting further towards pension phase driving more income oriented and defensive strategies)
- Insource / outsource trends (e.g the degree to which advisers and investors choose to invest directly vs outsource to professional investment management).

Because of the inherent subjectivity of this process it is important to test opinions created here with investment strategy “tailwind” analysis. That is, which investment strategies are supported by the “mega” trends and change drivers sweeping through the industry.

### Double, Double Toil and Trouble

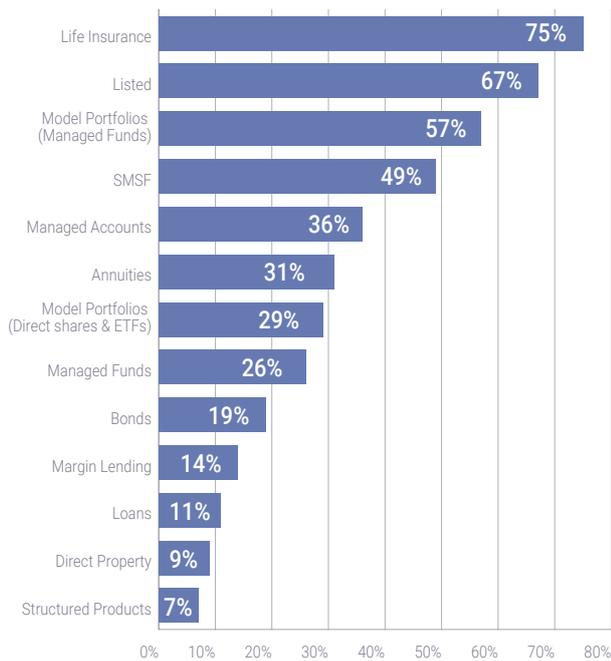
In 2019 intermediary focused investment managers experienced a Macbethian brew of coalescing and intensifying technological, demographic, market, and environmental ingredients. The bottom line is this: the marketplace is becoming more demand and less supply driven. The rules of the industry (which we constructed on our terms to suit us) are being busted apart and rewritten by (and therefore moving in favour of) our clients, the customers. In marketing terms product “push” is giving way to product “pull”. Force feeding (pushing) product through investment advisers to produce foie gras sales magic no longer works. Attracting (pulling) customers to you by offering differentiated, higher conviction product backed by brand and service is the new black. A willingness to accept a number 1 trim on SMA pricing helps too.

### Relevance Deprivation Syndrome

It is not hyperbole to say that the bulk of active management within Australian intermediated retail focused



Chart 6.2

**PREFERRED PRODUCTS NON-SUPER**

Source: Adviser Ratings Q3 2019 Survey

- Only 22 (8%) of all active strategies generated an economic inflow – meaning 92% of active strategies were either in outflow or generating “uneconomic” levels of inflow.

Our conclusion is that buyer behaviour within this sector has again shifted.

**Adviser Preferred Products**

In this year’s survey about approved product lists, we specifically asked advisers to focus on the product types / structures that they favoured or preferentially recommended to their clients. Putting aside life insurance for the purposes of this chapter, the most notable feature is the domination of listed in an absolute sense (66% of all respondents) and the combination of model portfolios of listed, managed funds and managed accounts (representing 57%, 35%, 29% respectively).

The former confirms the rising tide of interest for building portfolios with a fast-growing range of listed investment vehicles, but it also represents leakage from the traditional investment platforms as advisers can construct these portfolios directly or through the various trading platforms that are welcoming this intermediated attention.

The strong response to model portfolios and managed accounts confirms the growing appeal of outsourcing investment management to professionals in line with advisers re-thinking how they run their businesses more efficiently and where they can add most value to their clients. Taking up the rear is the traditional managed fund (only 26%), which doesn’t spell the end of collective investment vehicles merely the way they are packaged.

Drilling into the listed category provides few surprises, where we see a continued love affair for direct shares together with the explosion of interest in ETFs with BetaShares, ETF Securities and van Eck joining industry giants Blackrock and SSGA in the local market.

Meanwhile, we are about to see a change in demand for LICs from the adviser community. Under new FASEA

code of ethics obligations, January 1, 2020 signals an end to a carve-out from FOFA that was granted in 2014 by the Coalition that exempted LICs and LITs. As such, fund managers launching these products have been able to offer attractive incentives to advisers to promote to their clients. This ending of commissions will apply to both retail and wholesale investors, and to advisers and stockbrokers alike. It captures the extra stockbroking fees an adviser may earn for a traded LIC/LIT or the stamping fees from an IPO, unless these extra payments are rebated in full to the client.

mFunds are growing in presence on ASX if not materially in terms of invested capital. Nevertheless, fund managers continue to launch new offerings and build their presence in this market.

### Convergence of Value Chain Functions

Value chain hopping is now almost de rigueur as rapidly contracting margins demand attention and rapidly lowering barriers to entry create opportunities in other parts of the chain. The side effects of this behaviour, taking on new conflicts of interests and alienating existing customers with competing business models, are now seen as necessary evils for staying in business. They have moved from risks to be avoided to risks to be managed.

Unsurprisingly, “convergence” behavior is most prevalent in those components of the value chain with the largest margin – investment management and investment advice.

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## “FRAGMENTATION AND PROLIFERATION NOW MEAN CRAFTING THE PRODUCT DESIGN AND DISTRIBUTION STRATEGY REQUIRES MUCH MORE NUANCE”

### Fragmentation & Proliferation (of structures, gatekeepers and marketplaces)

Recent fragmentation has completely changed the game. There are more planning groups that matter, more adviser types that matter, more researchers / investment consultants that matter, more investment platforms that matter and more investment structures that matter.

Fragmentation and proliferation now mean crafting the product design and distribution strategy requires much more nuance. Yes, in some respects the over-quoted “Retail is becoming more like institutional” view is correct. Getting your fund through an investment committee and / or an investment consultant and into a multi-asset SMA is certainly looking a little more like institutional deal making than old style retail. But a pathway to achieving success in the listed market looks nothing like that. And nor does the increasing importance of bottom up brand building.

### Research Houses

Our focus is primarily on investment research houses and super fund researchers. Arguably these are not comparable, however the push by industry super funds into the third-party adviser channel means that they are now crossing over. Nothing has changed in this category in terms of new players, although little-known Australia Ratings is making some noise about growing beyond credit ratings on retail bonds and qualitative ratings on cash and bond trusts.

The recurring flaw is of course business models. User-pay revenue alone has never been enough for research houses to make an adequate return on investment; advisers will simply not bear the full cost of broad coverage qualitative investment research. It’s not surprising then that the most obviously (but perhaps not most insidiously) flawed business model – pay-for-ratings – remains as entrenched as ever, although Morningstar stands alone with a “pay-to-license-ratings” model. And, it’s arguably

Chart 6.3  
RESEARCH HOUSE NPS



Source: Adviser Ratings Q3 2019 Survey

going nowhere in a hurry, with ASIC itself moving to a partial pay-for-surveillance model. Nor is it surprising that this model continues to be a sore point amongst a meaningful proportion of the advisers.

What is surprising is how assertively a number of research houses are pursuing a relatively new form of potentially conflicted revenue – basis point linked investment management revenue – via in-house constructed SMA product and / or investment consulting. This move is yet to raise the ire of fund managers (as it did when van Eyk launched Blueprint back in 2003) but it hasn't gone unnoticed by advisers and may yet prove an issue in this channel. The point with advisers appears to be this: we may grumble about you being conflicted, but we will accept the situation if focus is not lost. This is the concern embedded in the following comment, which is representative of a number of survey participant's views:

“I have the feeling they [research houses] are becoming more dependent on selling product these days than research. They need to concentrate on what they are good at and have a dominant position in the market for and keep it as research”.

Business models aside, research house processes and focus remain much the same although the following recent changes are evident:

- A greater focus on investment consulting relative to research.
- A greater focus on portfolio construction and reporting tool development relative to research and ratings development.
- A greater focus on listed product and managed account product research.
- A greater focus on investment product fees and expenses, both absolute and relative to peers.
- A greater focus on a fund manager's ability to sell and support their investment products (which reduces business risk and minimises the risk of low FUM products being pulled out of rating's processes).





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