2020 Australian Financial Advice Landscape

This is an abridged version of the full report published in April 2021

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Contents

We believe in the power of advice

This year's Financial Advice Landscape Report highlights the changes advice businesses are making in response to COVID-19, the ongoing fallout from the Royal Commission and evolving investment trends.

With the pandemic playing on the psyche of Australians and their money management, there was a noticeable increase in the demand for advice. The backdrop was the continued increase in operating costs, a reduction in the number of advisers and a tighter talent pool for front and back office expertise. All these factors contributed to a sharp increase in the cost of advice.

At Vanguard, we believe in the power of financial advice and the critical role it plays in driving successful outcomes for investors. That's why we continue to advocate for the industry and invest in areas that can help you realise increased efficiencies, support your product recommendations, and help make financial advice more accessible to Australians.

- During the past 12 months we established our new specialist Adviser Offer team to support advisers with practice development, portfolio analytics, research, and investment strategy.
- As more advisers embrace technology, we've added to the suite of digital tools available with the launch of the Vanguard Retirement Income Builder, a retirement income planning tool. It's designed for you to use with clients and present a visual story about their wealth sources, drawdown and expenses in retirement, and eligibility for the age pension.
- During 2021, Vanguard's Investment Philosophy workshops will increase their firepower with the addition of our Digital Investment Philosophy Toolkit. It will equip you to craft and produce your individual investment principles and beliefs, to share with clients and support your value proposition.
- Vanguard also continues to manufacture and distribute low cost index and active products in response to client needs such as increased demand for ESG strategies.
- Our focus on ETFs remains steadfast as many advisers uplift their use of listed products to increase the liquidity in client portfolios.
- We're also investing in developing our sales crew, such as uplifting the number of CIMA® qualified team members, to ensure they're well positioned to support both your business and your client needs.

While there are challenges ahead, we're working hard to put more tools and support services in your hands, when and where you need them.

Because advice matters.

Rebecca Pope

Head of Intermediary

Vanguard Australia

Vanguard®

Navigating uncertain times

Welcome to the 2021 abridged Landscape Report, where we look deep inside the evolution of the financial advice industry and identify emerging trends and changing attitudes that impact this space.

The biggest revelation this year, as the pandemic threw the world into chaos, is the amplification of the value of advice. Our research has shown that trust in advisers has doubled, emphasising the impact good advice can have on all Australians.

On the other side of the equation are the challenges that advisers continue to face as regulatory changes impact on every practice, large and small. This continues to drive advisers from the industry, but this will create opportunities for the businesses that can adapt.

There is great empathy and solidarity with the industry, and the challenges both businesses and individual advisers have been facing. Our data shows that positive sentiment exists within the landscape.

It is great to have Vanguard support the delivery of this report, and by doing so helping to get the key information relevant to the practice level into the hands of those who need it. I trust that you will find peerless insights within, on everything from technology providers to the future of work, and the challenges that remain to be navigated by this emerging profession.

The good news is that we are seeing plenty of examples of practices that are thriving, having redesigned their business and value proposition. This will serve to meet the needs of the new clients that will be looking for financial help – demand for advice is as strong as it's ever been and across every age group.

Adviser Ratings is a data business, and we aim to use that data to help the entire industry to 'see around corners'. By providing information such as that contained within this report, we are giving the tools to advisers, practice managers, product manufacturers and industry bodies to see what's happening right across their industry – now, and into the future.

Angus Woods
Founder
Adviser Ratings

AdviserRatings

Chapter 1

The Australian Consumer

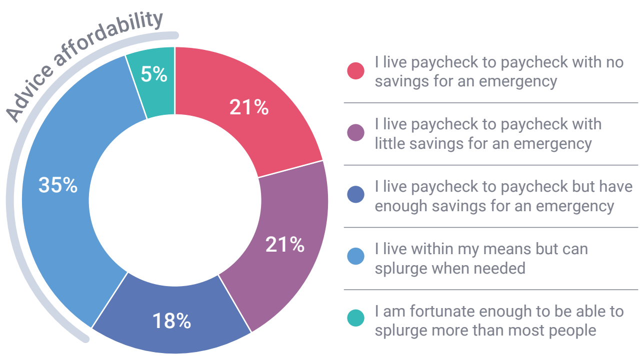
1

The impact the pandemic has had on the psyche of Australians and their money management bodes well for the wealth management and financial planning industry. It has led to a noticeable increase in demand for advice. Many Australians have realised that job security is not guaranteed, whilst others have had the opportunity to re-evaluate their financial positions.

Even so, the proportion of advised Australians aged 21 and over dropped from 12.2% to 11.2%. This was driven by: sharply increased costs of advice restricting access for a portion of consumers; a 26% drop in adviser numbers over the past two years; and the orphaning of sub-economic customers as part of the ongoing rationalisation of client bases.

On our estimates, at least 40% of Australians can afford a financial adviser. Technology can significantly increase affordability and access, and consumers are predisposed to using such technology to improve management, visibility or control of their finances. Promisingly, on average, 30% of unadvised Australians have indicated they "think they will require the services of one".

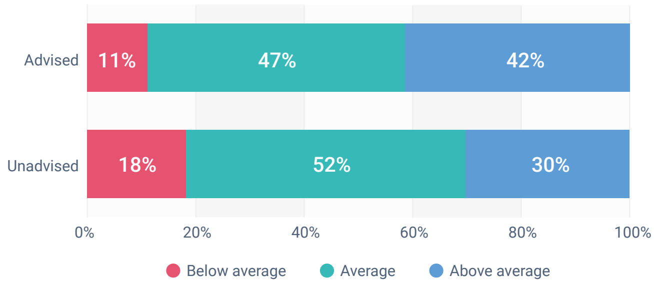
Chart 1.1 – Percentage of Australians that can afford advice



Source: AR Data

A January 2021 survey of more than 3,000 Australians by Adviser Ratings found that advised consumers rate themselves as comparatively far more financially literate than unadvised Australians, across all age groups and demographic types. This reflects the psychological value that advisers bring to their clients in the form of confidence and literacy. These results are constant reminders for both government and the public; the industry needs to reinforce them as policy setting around access to advice continues.

Chart 1.2 - Consumers' self-rating of financial literacy



Source: AR Data

The mass democratisation of advice is an essential step towards assuring the future of the traditional advice industry and the sustainability of comprehensive advice models. This will occur only once the industry finds ways to lower the cost to serve and engage consumers where they live – via better technology, delivered on a smart phone, on demand.

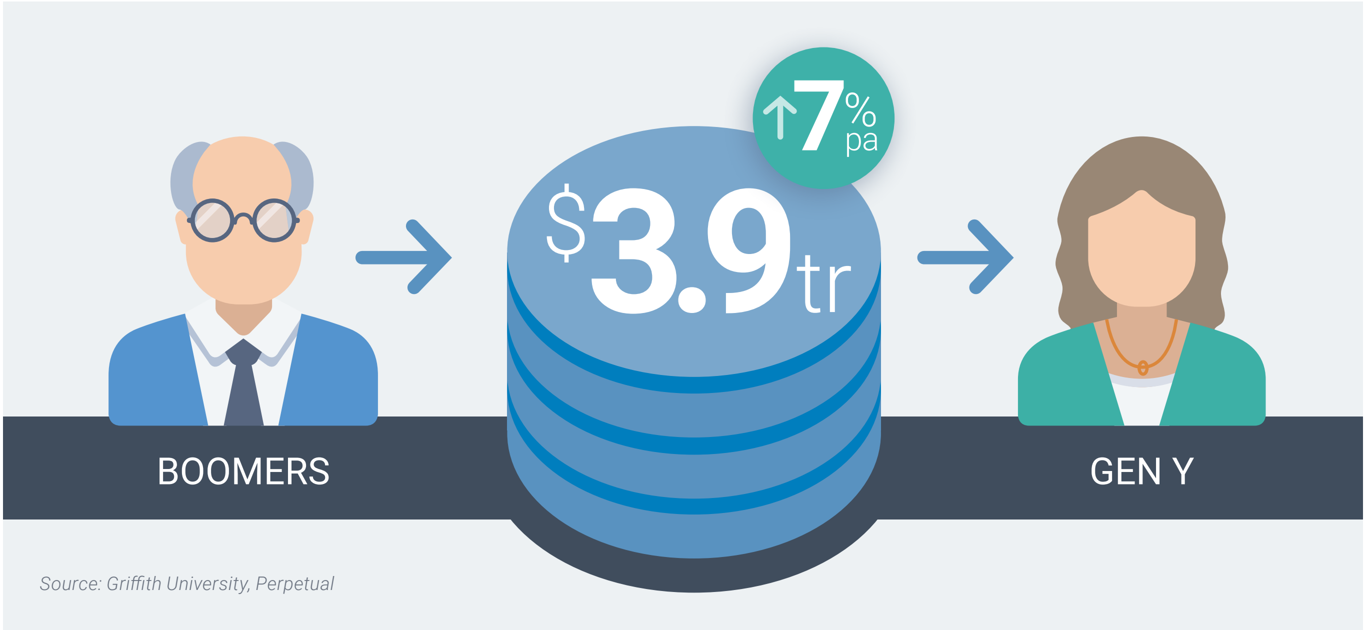
Generational transfer of wealth

The first baby boomers began retiring in 2006 and now there are 120,000 people retiring annually in Australia, and rising. Baby boomers represent approximately 25% of the Australian population, and 55% of total wealth. Today, there are more 65 year olds than 1-year olds!

We have entered the greatest transfer of wealth in the history of our country. According to Figure 1.1, over $3.9 trillion will be transferred over the next 20 years, primarily from baby boomers to Generation X & Y family members. That estimate is rising by 7% p.a.

> "We have entered the greatest transfer of wealth in the history of Australia."

Figure 1.1 - The great wealth transfer

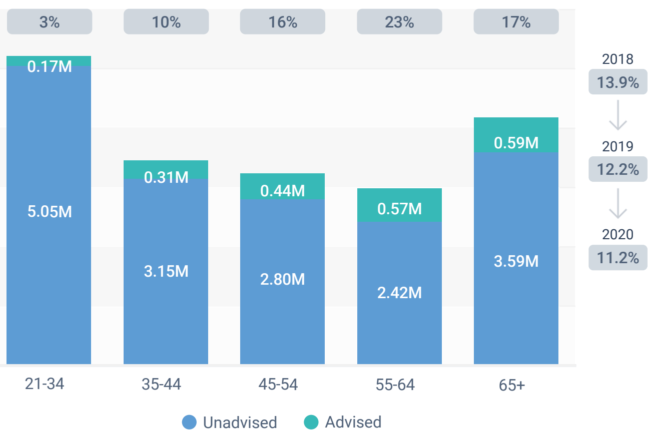


Source: Griffith University, Perpetual

More clients, fewer advisers

Whilst Adviser Ratings lead data indicates demand picked up in 2020, the supply of advisers to meet this demand is falling. The outcome is those with an adviser dropped from 12.2% to 11.2% of Australians aged 21 and over, or a 150,000 fall in those with an adviser from the prior year.

Chart 1.3 – Number of advised Australians by age group



Source: AR Data, Australian Bureau of Statistics

The three key reasons for this drop in advice delivered, despite an increase in demand, is three-fold:

1. **The cost to provide advice shutting out a portion of consumers:** advisers were more inclined to close their books to new clients in 2020 in order to service existing clients. The cost / benefit equation from an acquisition perspective was negative during the pandemic year, as "lower value" consumers sought advice, whilst advice practices were still reorganising their business models post years of regulatory impost. The average cost of advice has risen a significant 30% in two years.

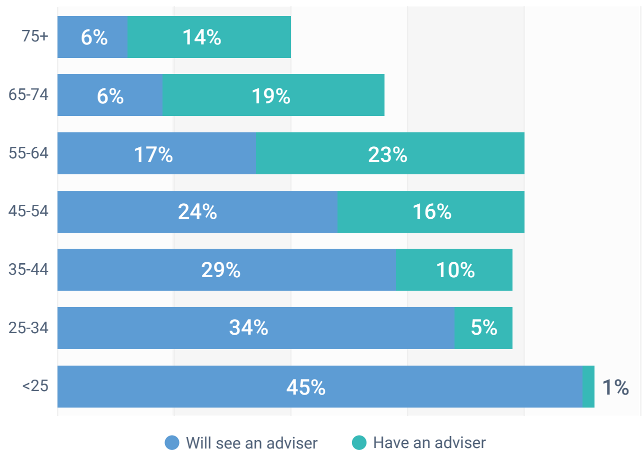
2. **The exodus of advisers:** the 26% drop in adviser numbers over the last 2 years has directly contributed to a lower advised consumer ratio. In addition, the type of adviser that exited the industry, was more likely to have lower value clients. The move by banks out of wealth, a departure of employed advisers and with AMP maintaining only profitable practices, has seen a void at the lower end of the advised consumer market.

3. **Rationalisation of client bases:** For advisers who have remained in the industry or inherited client books from existing advisers, the strategy of rationalising client bases continued in 2020. Advisers have started to evaluate what each client is worth to service in a heightened world of compliance, and have started divorcing clients from their practice.

Whilst there was an overall drop in consumers with an adviser, naturally the actions ascribed above meant the average funds under administration per advised client rose.

With greater exposure to the benefits of superannuation than previous generations, the younger demographic is displaying a willingness to seek financial advice, which is a good indicator for the longevity of the advice profession.

Chart 1.4 – Percentage of Australians who say they will see an adviser



Source: AR Data

Promisingly, this data is matched by consumer intent. On average, 30% of unadvised Australians have indicated they "think they will require the services of one". This aligns with other studies by both ASIC (41%, Aug 2019) and Investment Trends (44%, July 2020).

> "The role the pandemic has played on the psyche of Australians and money management bodes well for the wealth management and financial planning industry."

Impact of the Pandemic

Our consumer survey recently found the pandemic directly impacted the earning capacity of 30% of Australians. Whilst many of these Australians are back to full pay or have found a new job, there are still lingering effects on many.

The role the pandemic has played on the psyche of Australians and money management bodes well for the wealth management and financial planning industry. Many Australians have realised that job security is not guaranteed, whilst others had the opportunity to re-evaluate their financial positions.

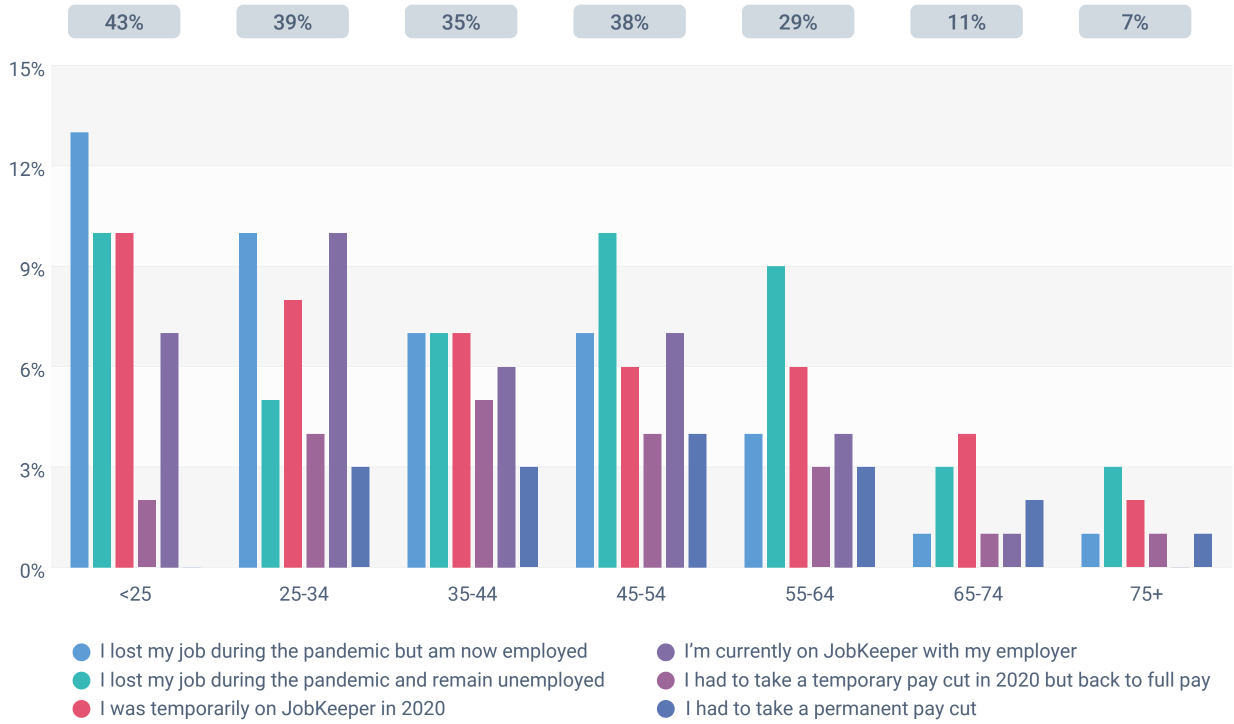
This re-evaluation was felt across the full spectrum of consumers:

- Those negatively impacted through job losses or lower salaries have had the opportunity to **reconsider risk** in the context of spending, investing and saving.

- Those positively impacted through increased stimulus measures have been exposed to the **value increased money provides** in both flexibility and spending behaviours. In the younger segment, it has increased awareness of investing and trading – as evidenced by more than $11Bn in retail funds coming into the market to June 2020, whilst institutional money stayed on the sidelines. And while there has been some reckless "investing / trading" activity, this creates an education for those consumers who wouldn't traditionally be exposed to money management and the importance of it.

- Those who have not been directly impacted have been exposed to a jittery market, peers and family members losing their jobs and a **changing dialogue around money** from both society, media and government.

Chart 1.5 – Percentage of Australians by age group financially impacted by the pandemic



Source: AR Data

April 2021 figures from the Australian Bureau of Statistics (ABS) shows the unemployment rate at 5.5% and underemployment at 7.8%. Commonwealth Bank economist Kristina Clifton said: "The jobs lost in the early months of the coronavirus pandemic have now been fully replaced." The latest figures from the ABS reference the period post JobKeeper. No clear aggregate impact can be seen in the period from March to April.

Notwithstanding, the recovery remains fragile, with stimulus measures still bolstering employment rates, banks still supporting consumers and a general weariness around efficacy of a vaccine longer term.

In January 2021, 13% of all Australians were still impacted financially by the pandemic. Whilst the younger cohort of consumers are recovering quickly when it comes to employment and wages, there remains a concerning number of consumers in the 45-64 age groups that are either underemployed, have had a permanent salary reduction or who were reliant on JobKeeper.

At the time this survey was conducted, consumer and business confidence started to rebound, creating an ideal mix in the demand for financial advice. All in all, the value of advice has only been strengthened during the pandemic as Australians take more notice of their money and their financial safety nets. Conversely, supply is drying up and an advice gap is widening as the demand expectation, particularly with the cost to provide advice, unable to be met.

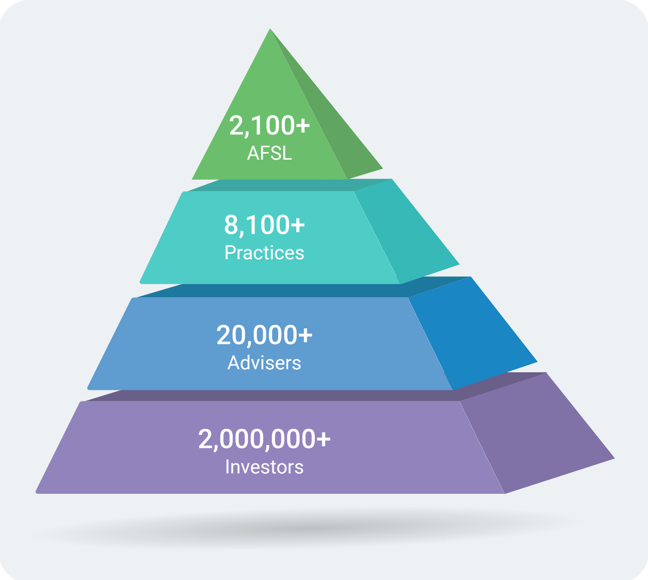
Chapter 2

The Australian Adviser

2

In the ongoing push to become a profession, the adviser exodus continued in 2020. Anxiety abounds within the industry given the acceleration of change in moving towards a profession, whilst regulatory costs increase the cost to deliver advice. However, the volume of advisers leaving represented a substantial slowdown from the previous year as a range of factors including COVID-19, extended FASEA deadlines, other potential regulatory concessions to reduce advice red tape, and growing consumer demand, gave more reason to pause instead of hitting the exit button.

Figure 2.1 – The advice market ecosystem



Source: AR Data

Of the 20,674 currently registered advisers, the majority are still active financial advisers, although many that are registered are no longer active in client-facing or advice-dispensing roles.

Adviser movement

The adviser population shrank by a further 12% – 2,837 advisers – in 2020, to 20,674, as the inexorable decline in numbers from the December 2018 peak continued. This represented a substantial slowdown from 2019, as a range of factors, including COVID-19, extended Financial Adviser Standards and Ethics Authority (FASEA) deadlines, other potential regulatory concessions to reduce advice red tape, and growing consumer demand gave advisers reason to reconsider leaving.

There were 5,697 total adviser movements in 2020, a 37% reduction from the 8,469 moves in 2019, as both exits and switches slowed considerably. This was comfortably the lowest total adviser movement since 2014. However, the industry is suffering from lack of new supply, which is dampening total movement statistics.

This constant adviser rotation has impacts in a variety of areas. It destabilises advice businesses, disrupts adviser-client relationships, and creates interesting B2B challenges for the vendors that service the advice industry. These add to inefficiencies in the system at a time when the industry can least afford them.

Adviser Ratings predicts the fall in the adviser population will be even more severe than we originally predicted, before staging a recovery akin to that experienced in the UK following the RDR reforms there. Our latest analysis suggests the industry nadir will be reached within the next 24-36 months.

In our inaugural 2018 report, we boldly predicted that thousands more advisers would exit the financial advice industry over the next five years, leaving 15,000 advisers and more than $900 billion of net client wealth in transition.

This is happening at a faster rate than even we anticipated.

Much of this wealth is moving between advisers, albeit at the expense of lower-value clients. We conservatively estimate adviser numbers will drop to 16,986 by the end of 2021. This is due to:

- Ongoing angst around qualifications required for FASEA, well before the required deadline
- The imposition advisers are feeling from the mandatory ethics exam before 1st January 2022. Approximately 8.5K advisers, or 41%, are still to sit the exam this financial year, with more than 2K advisers deciding they won't, implied by our survey responses.

- The announcements made by every major bank on exiting the industry, and the ongoing cull of advisers deemed unprofitable at AMP and IOOF.

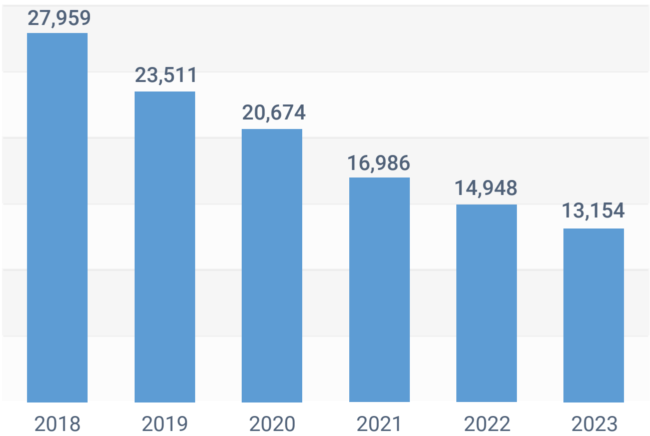
- A non-existent supply of new advisers from universities or as part of the Professional Year.

> "We conservatively estimate adviser numbers will drop to 16,986 by the end of 2021."

Our latest forecast

This year's survey asked advisers whether they would stay in the industry. Based on this data and overlaying it with current FASEA exam pass rates and statistical FASEA failure rates alongside current education requirements to be FASEA compliant,we expect the retail advice industry to lose a further 2,000 advisers from our original forecast, settling at approximately 13,000 advisers.

Chart 2.1 – Adviser numbers forecast to drop to 13,154 by 2023



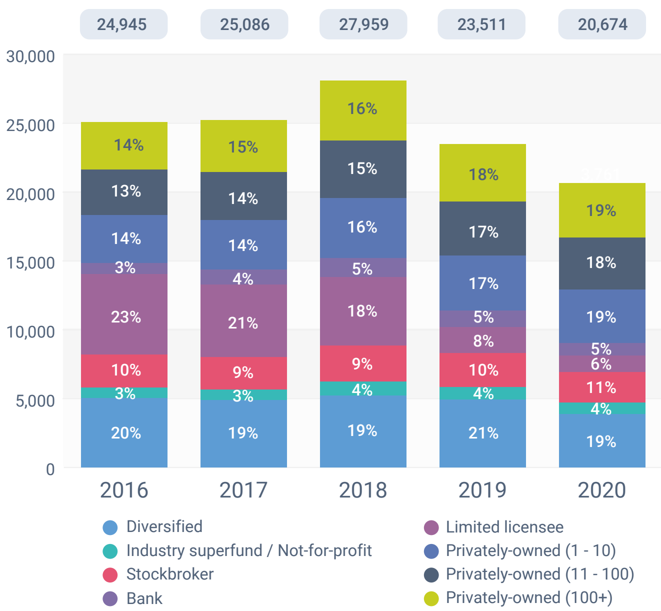
Source: AR Data

This number is caveated by any potential legislative change, particularly around scaled advice. In November 2020, ASIC released Consultation Paper 332: Promoting access to affordable advice for consumers, represented both an acknowledgement from the regulator that the current framework doesn't support the commercial provision of scaled advice and a willingness to rethink the compliance regime around it. Clarity on scaled advice may help stem the outflow of financial advisers as practices and their advisers may be able to reengineer their businesses to offer a low-cost affordable offering.

This decline in advisers needs to be addressed, given the impacts it has across the entire advice landscape. All stakeholders, with particular emphasis on consumers, will be adversely affected. Whilst many retail advisers have moved upstream into wholesale advice, most of this decline is attributed to exits.

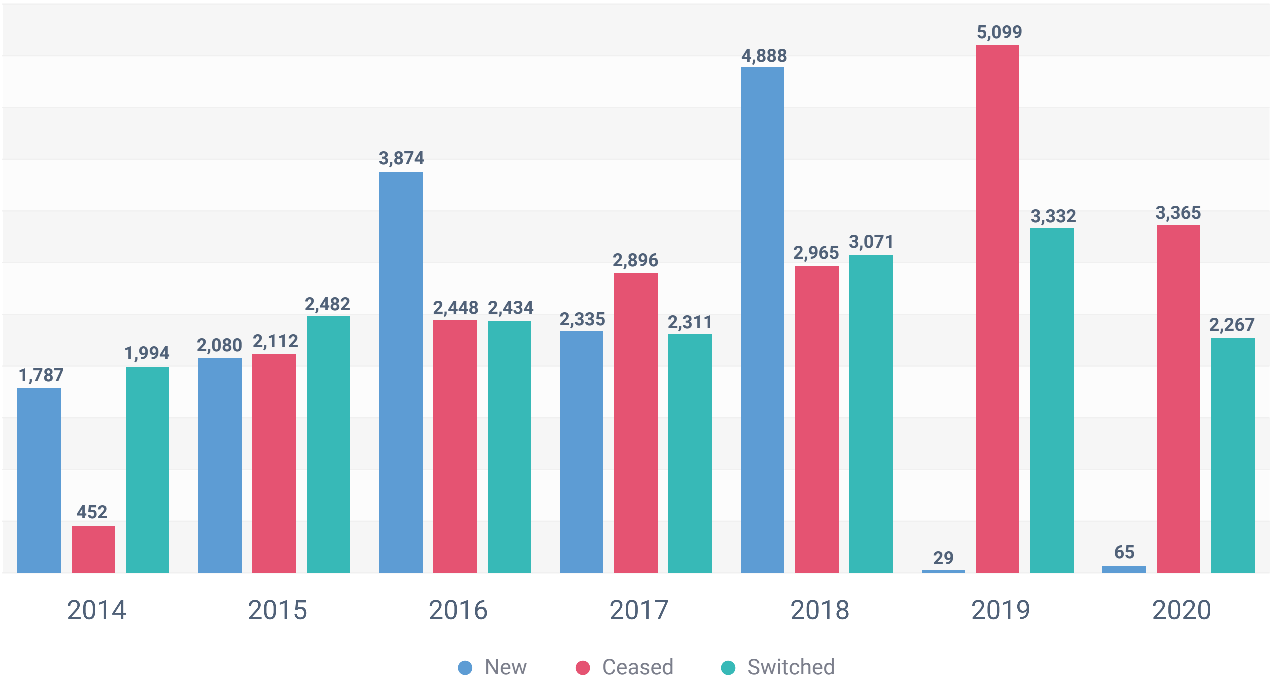
Part of this decline is due to exits by the banks and rationalisation at AMP and IOOF. Accordingly, the growth in the privately owned/limited licensee space is accelerating, with this market now representing 61% (up from 44% five years ago) of all advisers in Australia, primarily comprising practices with one to five advisers.

Chart 2.2 – Adviser population by licensee ownership/affiliation (2017-21)



Source: AR Data, ASIC Financial Advice Register

Chart 2.3 – Adviser movement history



Source: AR Data, ASIC Financial Advice Register

Despite adviser entries doubling when compared with 2019, the total of 65 new advisers still represented a rounding error for what is truly required to return the industry to growth. The lack of supply from universities combined with the onerous apprenticeship and exam hurdle pre-requisites are stifling new starter volumes.

> "The total of 65 new advisers still represented a rounding error for what is truly required to return the industry to growth."

Declining Adviser Numbers

With 26% of advisers exiting in the last two years, we can expect more of the same for 2021, with the FASEA exam proving to be the biggest barrier to advisers staying in the industry beyond the end of this year.

The latest FASEA exam had the lowest pass rate yet. A total of 1,079 advisers sat the exam, compared with an average of 1,323 across all sittings. Only 73% of those that sat the January exam passed. The overall pass rate across all sittings of the exam is 89%, with 12,320 advisers (or 59% of all advisers) now having completed the exam.

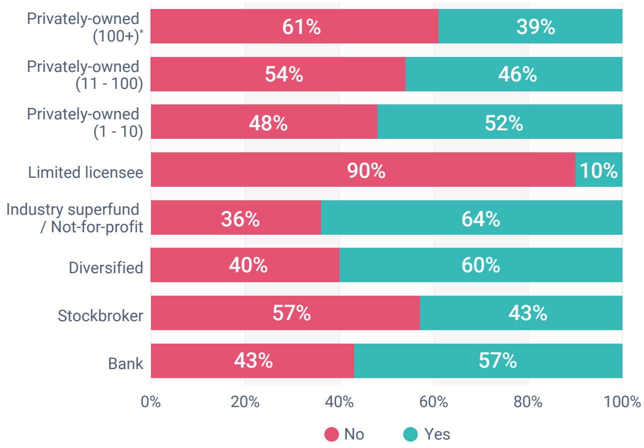
There are particular types of advisers more at risk of exiting relating to FASEA exam anxiety:

1. Accountants: many accountants are deciding to give up their authorisation status, focusing on typical accounting client relationships. The market is shifting towards a partnership model between accountants and advisers.

2. Risk Advisers: Risk advisers have been dealing with the impact of LIF alongside FASEA, resulting in a far greater exodus from the market than amongst holistic advisers.

3. Stockbrokers: We are seeing a shift in senior stockbrokers carving out their retail clients to junior stockbrokers and moving to wholesale advice. There is still an element looking to leave the industry. The major stockbroking groups are going through business reorganisations and client distribution strategies to help counter a loss in stockbrokers.

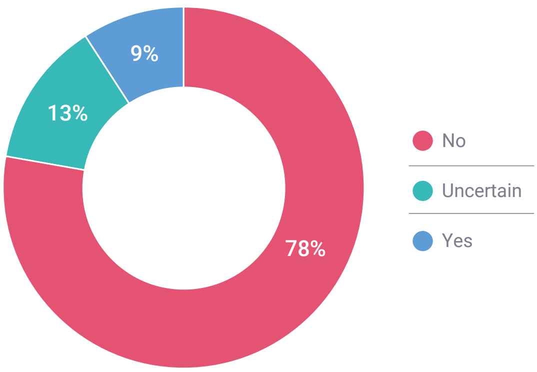
Chart 2.4 – Proportion of advisers who have completed exam by licensee type (December 2020)



Privately Owned (100+) – slightly skewed towards "No" by accountants sitting the SMSF Adviser Network licensee (>800 accountants).

Source: fasea.gov.au, AR Data

Chart 2.5 – Advisers intention to leave the industry



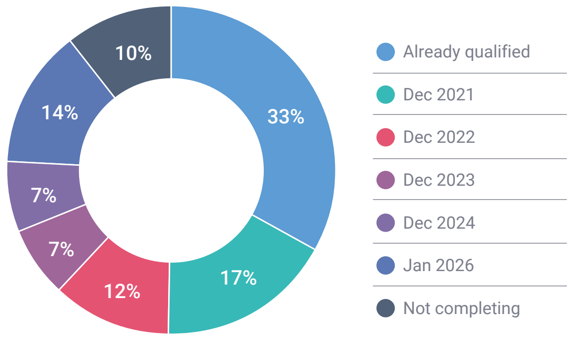
Source: AR Data

These exits, and the ongoing regulatory change and its impact on the financial advice profession, are highly significant to existing advice providers. When they are required to attain bridging qualifications and complete an exam that will determine their ability to do what they have always done – that is provide advice – the personal stress to those directly affected cannot be overstated. The stress is even greater for those who wear more than one hat, perhaps as a licensee, business owner and financial adviser. It's also been reported in the profession's media that the changes have led to significant mental health issues and even suicide.

Approximately 41% of advisers still need to complete the exam by December 2021 and 67% of advisers have not yet completed a FASEA-approved bachelor degree (AQF7) or above, nor do they hold an equivalent qualification. A quarter of advisers have decided either to wait until the final year of the requirement or have decided that is when they will retire from the industry.

The effect on stockbroking outfits or diversified licensees, such as IOOF, will mostly be determined by the responses of the existing advisers within these licensee groups.

Chart 2.6 – When advisers expect to meet FASEA education standard

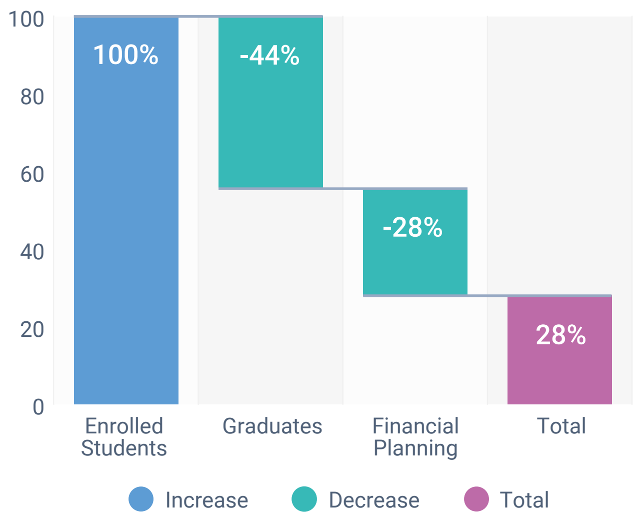


Source: Adviser Ratings 2020 Financial Advice Landscape Survey, Adviser Ratings Nightingale Database

Education, new talent & professional development

The industry has a major new talent supply problem, with only 900 students enrolled in tertiary financial planning courses nationally. An Adviser Ratings survey of academics from nine universities identified a concerningly high drop-off rate of students making it into their chosen profession, with only 28% of enrolled students eventually working for a financial planning firm. The major deterrents cited were the "starting challenges" faced within the FASEA professional year, and the negative perception by the public, particularly following the Royal Commission.

Chart 2.7 – Attrition rates along the journey from studying to working in advice



Source: AR Data

Financial planning courses cost more than accounting and there are far fewer students to provide economic scale for providers. Unless higher education providers can attract more students, they will be forced to shut down financial planning degrees, further stunting supply.

FASEA's accreditation of programs and courses has improved consistency of content taught to new entrants to the advice profession, and lifted competencies of existing advisers. Ethics and professionalism, for the first time, are a core component of education requirements. However, more focus is required on the development of trust and relationship skills and there are doubts whether higher education providers are equipped to practically develop students' skills in these areas.

The announcement to wind up FASEA has created further uncertainty and anxiety amongst advisers about more potential changes to education regulatory settings. Many advisers still haven't completed the exam and there are considerable challenges to standards within the Code of Ethics. The emergence of the financial coach is a new phenomenon, partly reflecting the growing consumer demand for financial help with savings and expense management, and partly to avoid the new standards and education requirements.

Changing fee structures

Financial advisers have possibly the broadest and most challenging remit of any profession – they are the individuals charged with understanding their clients' goals, aspirations, successes, tribulations, medical history, family circumstances, personal relationship ups and downs, and financial standing. With $1.5 trillion being managed by 20,674 of these individuals, it is important to understand the economics of how they operate and the value they serve.

> "The announcement to wind up FASEA has created further uncertainty and anxiety amongst advisers about more potential changes to education regulatory settings"

Among Australians, 2.1 million people (or 11.2% of the population over 21), share their lives and wealth with a financial adviser. This is down more than 150,000 Australians from a year ago, despite trust increasing during the pandemic, per latest results from CoreData.

CoreData's measurement of trust in financial advice plummeted after the Royal Commission, diving 25 percentage points, from almost 60 per cent to just more than 35 per cent. For the next year and a half, trust bounced around between about 36 per cent and 42 per cent.

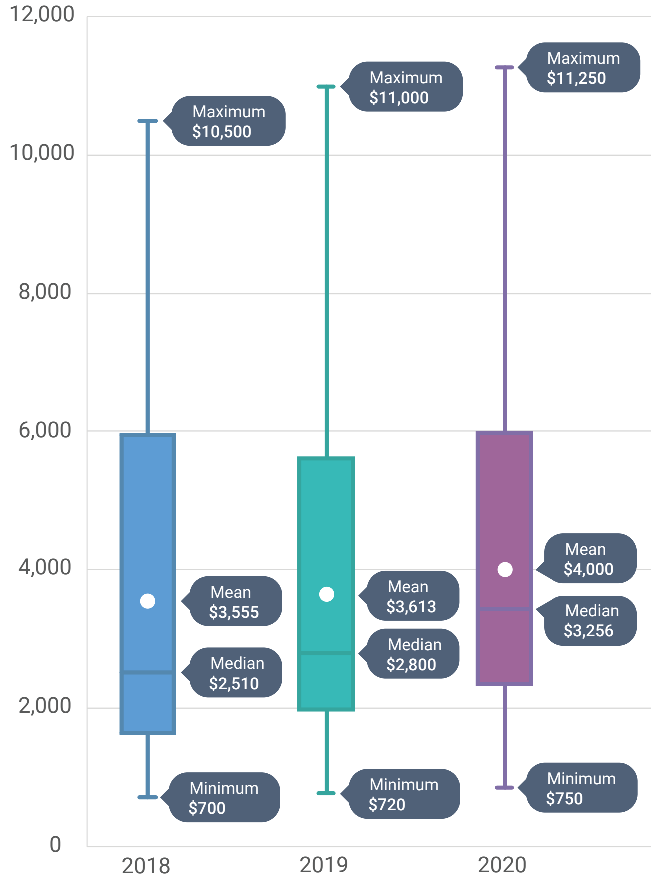
But the public's trust in advice remained stubbornly unresponsive to many of the positive developments taking place in the industry – developments that were not solely a result of actions taken to address issues the Royal Commission identified. There were also real steps towards improving educational standards and qualifications within the industry, to put it on a footing more recognisable as a profession.

These changes seemed to have had a positive effect. For the past three quarterly surveys – since the second quarter of 2020 – trust in finance advice appears to have taken a step up and to have found a new baseline at 48-50 per cent.

Whilst trust in financial planners was somewhat reversed in 2020 due to the pandemic, the reason for the decline was primarily advice affordability. Client fees increased considerably in 2020 to help offset escalating practice costs. This was achieved by offboarding lower-value clients and increasing fees to higher-value clients.

The median ongoing fee increased by 16% from $2,800 to $3,256 (Chart 2.8). This change in client demographic, coupled with stock market growth, helped increase the average funds under advice (FUA) per client 13% in the last 12 months (Chart 2.9).

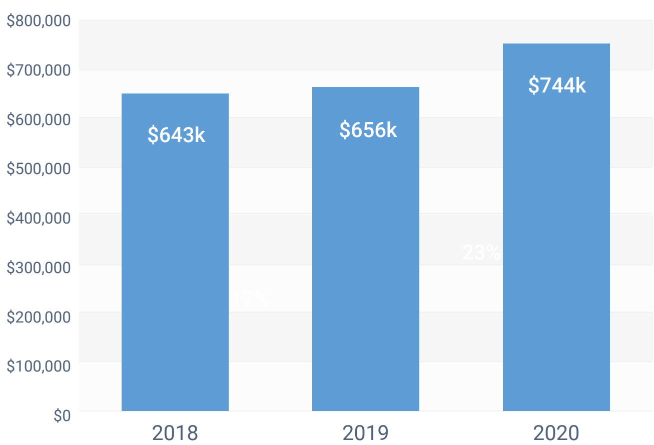
Chart 2.8 – Average and median client fees 2018-2020



Source: AR Data

Whilst, the average FUA has increased 15% in two years, it is against a backdrop of a 30% increase in client fees over the same period; laying bare the stresses to running a profitable practice and the impact they have on Australians being able to access affordable advice.

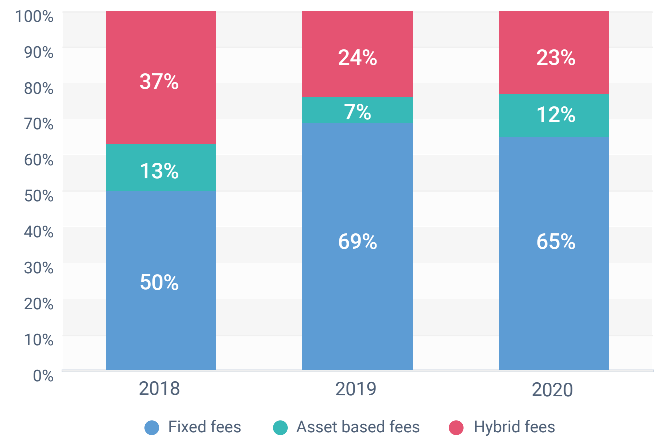
Chart 2.9 – Average FUA by client 2018-2020



Source: AR Data

Chart 2.10 highlights the rapidly changing fee structures of financial advisers. With investment commissions extinguished on the back of FoFA and, most recently, with the ending of grandfathering in December 2020, asset-based fees have been in ASIC's crosshairs for the past couple of years. Whilst the move to fixed fees remains, the increase in asset-based fees in 2020 reflects the change in adviser types. Accountant-advisers (fixed-fee advisers) have been exiting in greater numbers than holistic advisers, and risk-based advisers moving into holistic advice are more inclined to price on an asset-based arrangement.

Chart 2.10 – Adviser fee structures 2018-2020



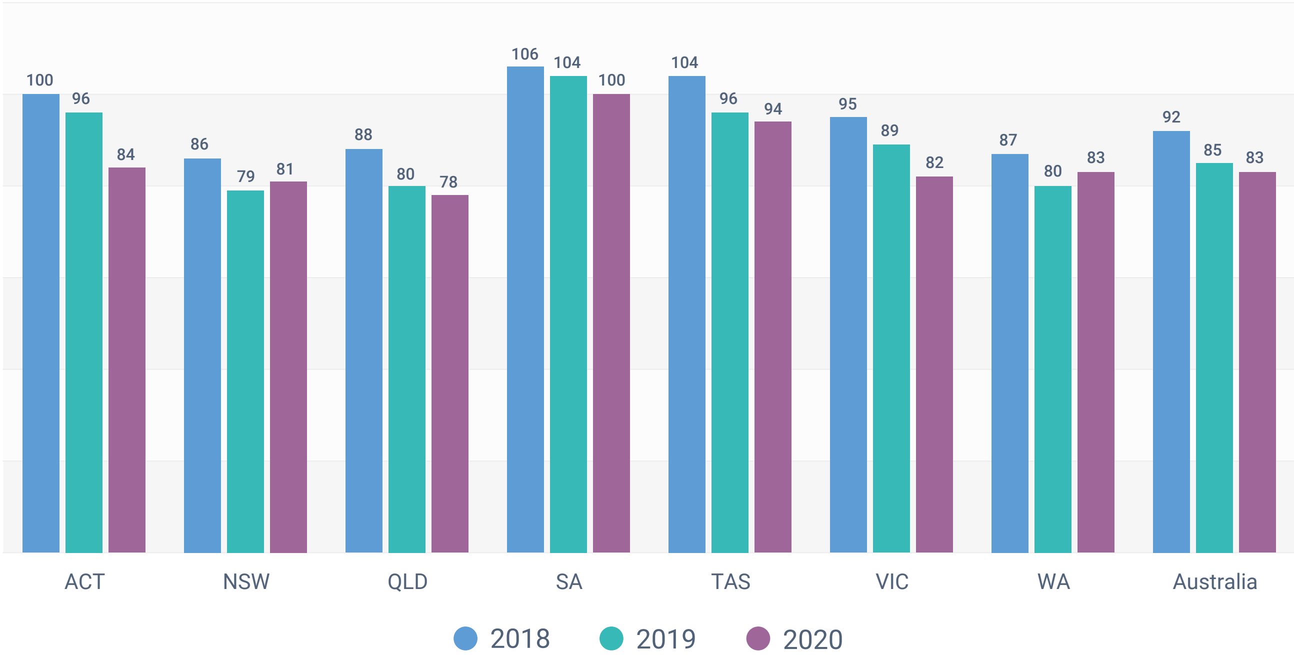
Source: AR Data

> "Comparatively, the average FUA has increased 15% in two years against a backdrop of a 30% increase in client fees over the same period."

Client numbers continue to decline whilst average FUA grows

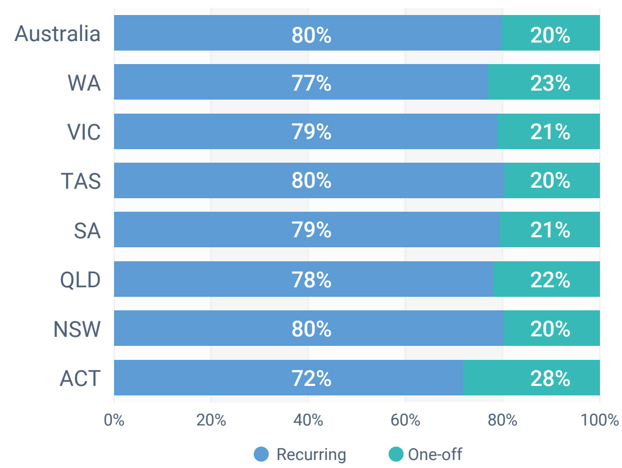
Client numbers have declined whilst FUA grew. Charts 2.11 and Chart 2.12 reflect this changing dynamic in the market at an aggregate adviser level. The voluntary rationalisation of client bases by advisers, as they adjust business models, shows an industry quickly adjusting to the realities of supporting a higher cost base to survive.

Chart 2.11 – State breakdown of average number of clients per adviser 2018-20



Source: AR Data

Chart 2.12 – Recurring v one off clients



Source: AR Data

2020 witnessed an increase in “one-off” clients. In previous years, the ratio of one-off to recurring clients was about 15% to 85%. Advisers are constantly attempting to shift one-off clients into the recurring bucket. In a potential sign of the need for scaled or limited advice, one-off clients made up 21% of an adviser’s client base in 2020. We anticipate some of this related to the Record of Advice requests coming through as part of the Early Access to Super legislation, combined with a general increase in other one-off financial requests associated with the pandemic.

In addition, the higher proportion of one-off advice is due to the jettisoning of lower-value recurring clients. Further, our latest survey indicates sophisticated clients (as defined by the Corporations Act) make up 25% of an average retail adviser’s client base. This pressure to go “upmarket” to high-net-worth clients is against the aforementioned backdrop of pressure from government for advisers to open up to scaled advice (and arguably lower-value clients).

Chapter 3

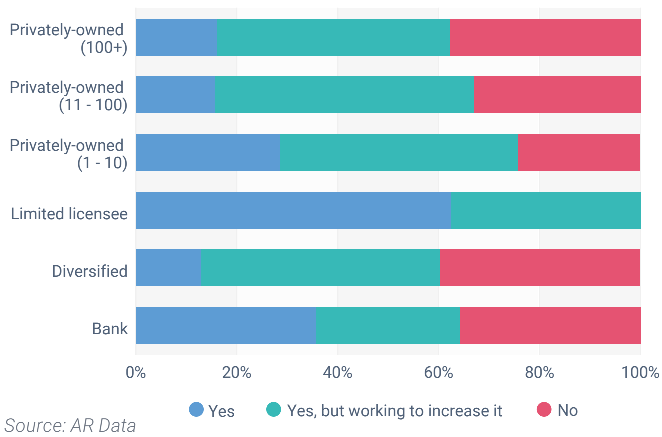
Advice Business Landscape

3

In 2020, the advice business value-chain was defined by cleaner structures and rising costs throughout, as licensees and practices repositioned their value propositions with each other and with their clients. The ongoing mass fragmentation and mass miniaturisation of the licensee market also led to more single-practice licensees opening and closing, and further adviser dispersion from the big end of town into small businesses.

Combined with the residual economic impacts of COVID-19, the shake-out in the sector will continue as the gap between strong and weak expands. The strong are building scale and becoming genuine financial services businesses. Valuations are holding together for quality businesses and demand is strong. Many practices remain challenged by rising costs, complexity and process inefficiencies. Technology continues to offer great opportunities for client experience and process improvement; however, many practices feel overwhelmed by the choices.

Chart 3.1 - Practice owner satisfaction with profitability



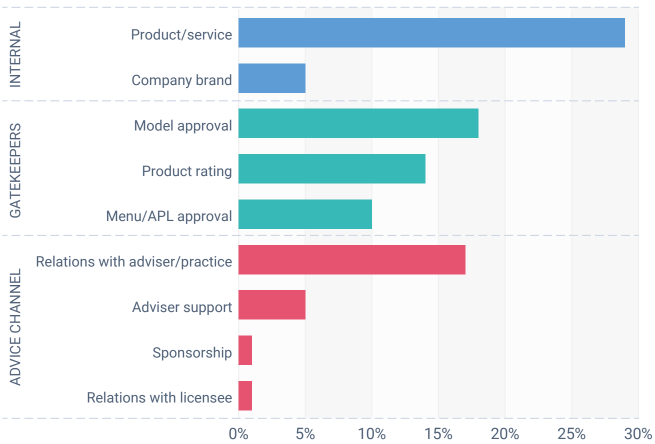
Source: AR Data

Regulatory pressures of recent years continued into 2020 although, driven by COVID-19, ASIC shifted away from "improving quality of advice" to being more focused on pandemic relief measures around economic stimulus and consumer protections. Nevertheless, it remained a busy year of change, including the announced closure of FASEA, scaled advice consultation, Design & Distribution Obligations (DDO), internal dispute resolution and new breach reporting guidelines. Collectively, these regulatory reforms change the economics and risks of providing advice for many firms.

The industry remains confronted by other disturbing trends as well. The well-documented shrinkage in the adviser population, lack of supply of new talent, and more onerous on-boarding obligations are constraining growth for many firms. Adviser exits and more disciplined commercial approaches by practices are driving growth in orphaned client volumes. And stricter adherence to Best Interests Duty is placing pressure on approved product lists and governance processes for researching and comparing choices.

> "Adviser exits and more disciplined commercial approaches by practices are driving growth in orphaned client volumes."

Chart 3.2 Distribution success factors



Source: AR Data

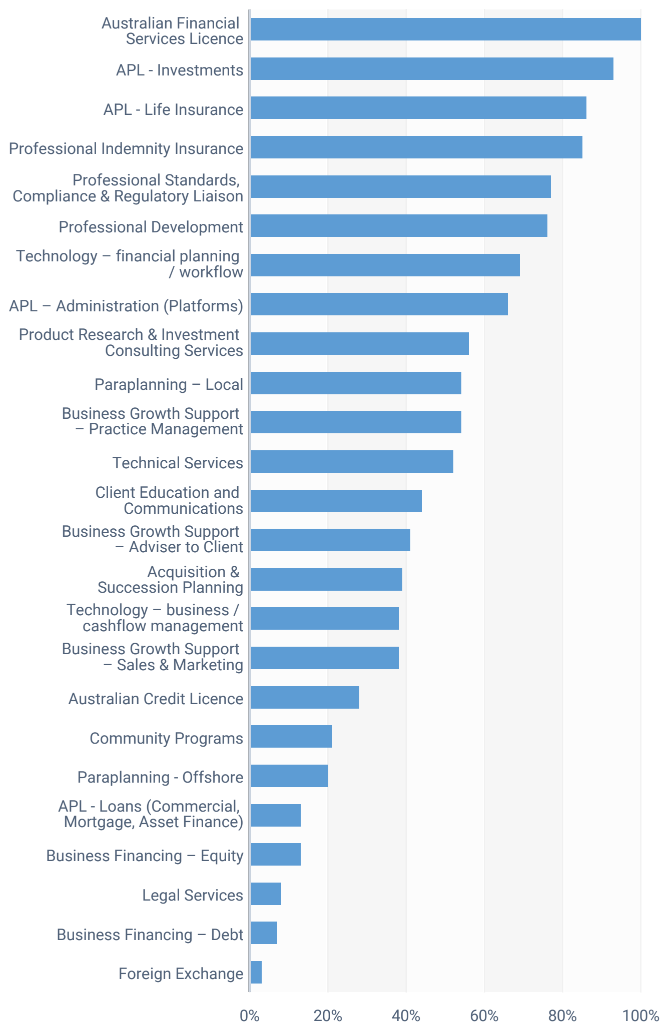
The Design and Distribution Obligations (DDO) legislation will make choosing the right advice partners as much about assessing counterparty risk as sales opportunities, and vendor firms do not appear to be well prepared for these new rules of engagement. The fragmenting, dispersing and remote-working adviser marketplace is also putting pressure on distribution teams to be well organised and religiously disciplined in managing quality of activity and corresponding outcomes. Vendor firms are beginning to treat CRM investment seriously to manage an increasingly challenging distribution environment, applying more advanced methods of profiling and segmentation to reach the right adviser audiences.

Licensee services

As the regulatory environment has shifted around the licensee, we have seen the progressive removal of product subsidisation. With licensees now seeking to at least break even, we have seen models with far lower levels of fixed costs than the past. Licensees often insource only critical areas of operation and value, complementing those resources with external specialists.

As an example, Chart 3.3 demonstrates a shift in resources allocated to business growth. In the past, licensees used to insource these resources and compete in this area. In today's world, the major focus goes to the core of professional practice, and business growth is connected into external specialists.

Chart 3.3 - Licensee service offerings



Source: AR Data

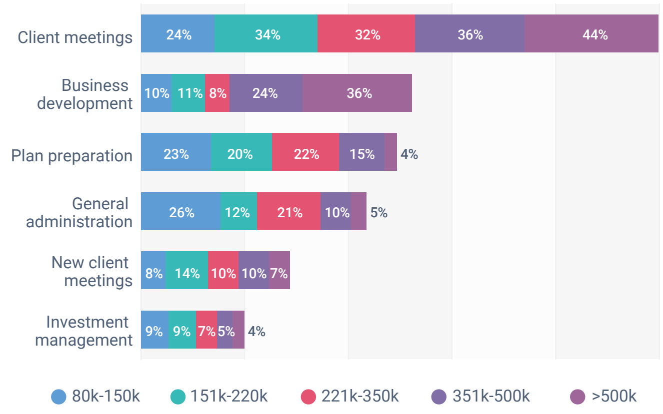
With the withdrawal of the banks from the market and ongoing practice consolidation within AMP and IOOF, two important forces have come together, driving funding and succession. Consolidation is increasingly leading to larger, multi-partner business models.

With institutional capital on the sidelines, private sources have become key in the ideal mix between cheap debt funding and equity capital. Solutions such as AZ NGA and Focus Financial offer solutions separate from the licensee. By contrast, solutions groups such as Countplus and Fitzpatricks have both. The fact that 18% of licensees offer practice funding solutions and 15% are considering it makes this a theme to watch. Shrewd practices will assess their ideal funding mix and the long-term quality and sustainability of partners in this area.

How an adviser spends time is a critical insight for determining their productivity and ultimately their revenue. Research by Virtual Business Partners confirms that advisers who spend more time on new client meetings and business development are more likely to be in the higher income bracket. Sadly, advisers are still spending too much of their time on general administration and plan preparation (39%), compared with only 10% on new client meetings and 13% on business development.

Solving this problem with the help of outsourcing administration and plan preparation to others can free an adviser's time for revenue-generating activities, leading to uplift in revenue and client experience.

Chart 3.4 – Time spent by take home pay



Source: VBP Practice Efficiency Survey (2021)

Advisers with the highest take-home pay strategically spend most of their time (44%) on client meetings and a further 36% on business development, with the least amount spent on administration tasks. If advisers are looking to move into the higher income range, it's imperative they have the support of a team to free themselves of administrative burden and allow them to spend more time in front of clients.

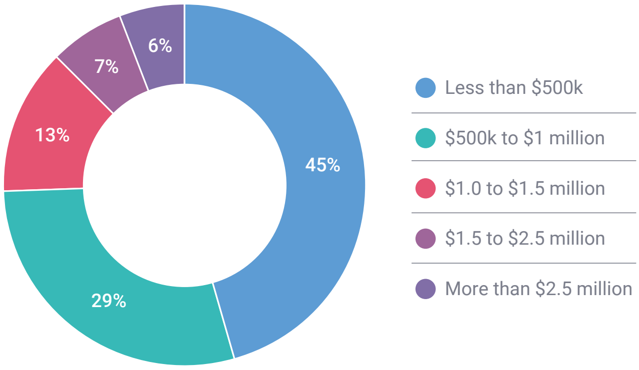
Practice profitability

Prior to COVID-19, practices were already experiencing top-line revenue growth pressures off the back of reputational issues. COVID-19 amplified this, although the strongest practices still experienced high single-digit growth due to their client experience and advocacy.

For businesses reliant on referrals and growth outside this factor, it's been virtually non-existent. This has further increased the divide in 2020 between the strong and the rest. Weaker businesses have felt the impact of grandfathering ending on Jan 1, 2021 and increasing pressures around opt-in and, in some cases, the introduction of annual agreements.

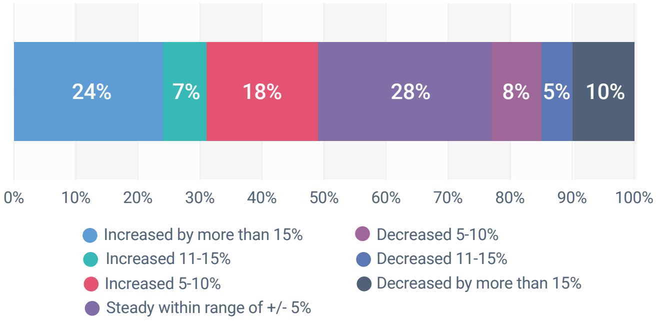
Chart 3.5 shows that, despite major consolidation, the dominant model is still the business with one or two advisers and revenue under $1m, and particularly under $500K. The majority of practices in the $500K revenue area have struggled with growth and profitability due to rising costs, compliance and change management. The businesses in this segment that have 30-40% EBIT/revenue margins control their fixed costs and leverage business partners well. They usually have tight discipline on their ideal client and capacity limits.

Chart 3.5 – Annual revenue



Source: AR Data

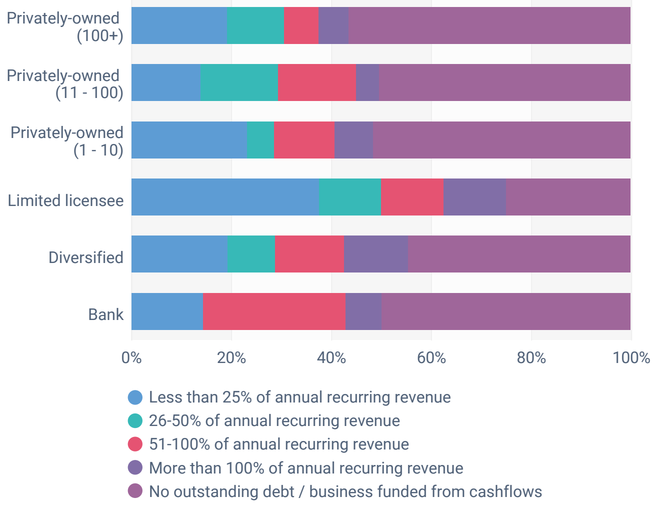
Chart 3.6 – Change in revenue (past 12 months)



Source: AR Data

Balance sheets are also a key area to watch with the cost of funding low. Chart 3.7 shows that debt levels in practices are low, indicating many practices have headroom to expand through debt-funded bolt-ons. This picture turns the other way as the banks heavily scrutinise the business model and projected growth and profitability of the practice. This is where the divide increases even further between the strong, who can access this debt funding, and the rest.

Chart 3.7 – Outstanding debt for practices



Source: AR Data

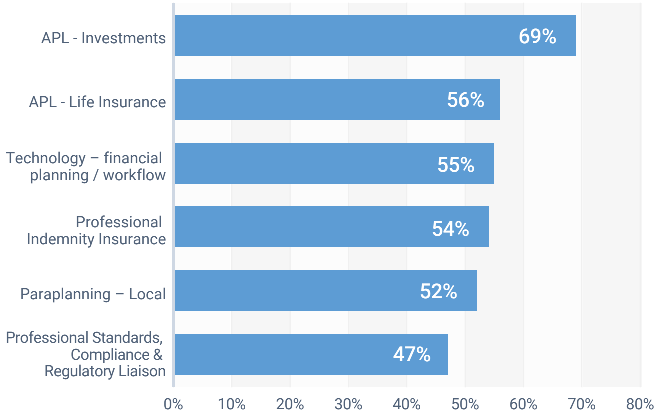
On the other side of the equation, costs have increased about 10%. This is mainly due to regulatory uncertainty and pressure, but also higher costs in all parts of an advice business. Businesses are increasingly experiencing roadblocks in their initial and ongoing advice process. These include different forms of paraplanning solutions plugged into the advice process.

> "Costs have increased about 10%, mainly due to regulatory uncertainty and pressure, and also higher costs in all parts of an advice business."

Practice developments

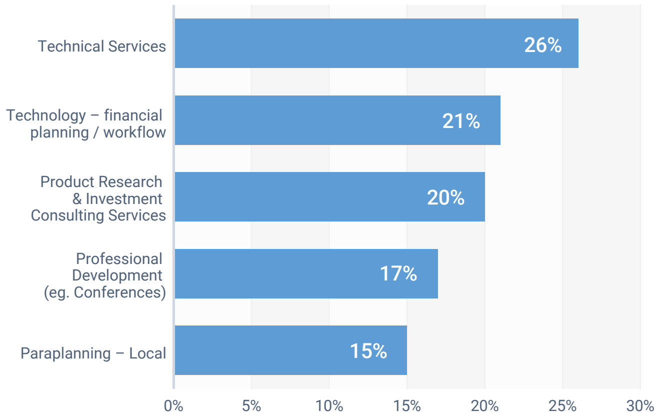
The practice experience has to some extent depended on the segment in which they reside. Larger practices in the large institutions have left in large numbers and many have obtained their own licence. Overall, it's a feeling of gaining greater control of their destiny having experienced uncertainty in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

Chart 3.8 – Services sourced directly by self-licenced practices



Source: AR Data

Chart 3.9 – Services sourced by self-licenced practices from other licensees / D2D groups



Source: AR Data

Practices of small to medium size have been less likely to obtain their own license 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. Conversely, the IOOF/MLC transaction started a new discounting trend to compete. Given stated goals to break even over the next 2-3 years, this could be short lived.

Vanguard®

Future-ready your business

The Adviser Ratings report provides insights into current and emerging trends within the financial advice industry.

To help you prepare your business for the future, we've prepared this short guide to give you an overview of what other practices are doing well and how you can further harness the power of your people and improve efficiencies.

What are successful financial planning businesses doing?

- They invest time and money on moving their business forward each year.
- They have a client-centric culture and a focus on continuous improvement.
- They use technology to support their business, processes, and clients.

What are they doing well?

They have a clearly defined business model that includes:

- A well-articulated client value proposition and investment philosophy.
- An identified 'ideal' client and target market.
- A clear, profitable pricing and service model suited to their ideal client.
- Robust systems and processes to support their operations.
- A purpose-built client experience delivered consistently by staff and through the use of technology.

Ideas to help you future-ready your business

Look at your business from a client's perspective

- Review your end-to-end offer from a client's perspective.
- Use digital engagement software and client portals to help educate and keep clients informed.
- Leveraging your data to create a personalised experience i.e. capture information in your CRM regarding your clients' personal preferences, coffee order, hobbies, and interests.

Focus on business efficiency to help drive long-term profitability by:

- Regularly mapping and reviewing your processes for ongoing improvement.
- Using technology to reduce time spent on the "back office" such as compliance and workflow processes and spending more time adding to your client relationship "front office".
- Outsourcing functions where it supports your business in a cost-effective manner. e.g. paraplanning, client services, marketing.

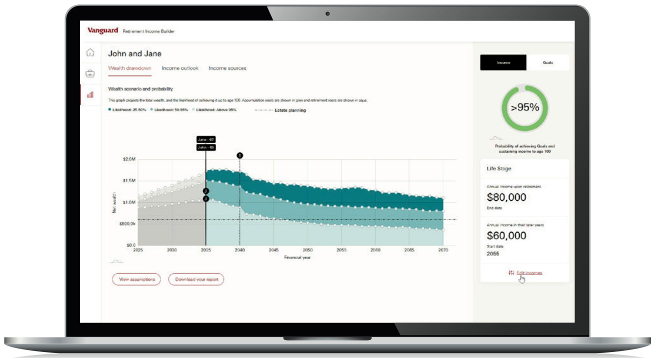
Gain buy in from staff and:

- Continuously communicate your plans and priorities with staff.
- Look at options to fix pain points, one or two issues at a time.
- Take on board staff feedback regarding the speed of change and adapt as needed.
- Create a culture which encourages everyone to "seek a better way."
- Celebrate wins along the way. Engaged staff = more engaged clients.

Improve client engagement via technology by:

- Utilising online fact finding and risk profiling for clients to complete prior to meetings.
- Sharing documents securely via a client portal and gaining e-signatures for approval.
- Storing documentation via a client portal for client accessibility.
- Presenting advice to clients via interactive mediums such as videos and presentations.
- Educating and informing clients via portals, social media, and regular direct relevant communications.
- Seeking to create more touch points and gain deeper relationships with clients; technology should help achieve this (but not replace it).

Introducing the Vanguard Retirement Income Builder



The Retirement Income Builder tool makes it easy to project the likelihood that your client will achieve their retirement income goals by:

- Planning their retirement income taking a total returns approach
- Forecasting their total wealth using the Vanguard Capital Markets Model®
- Identifying the sources of drawdown including accessibility to the age pension
- Generating 'what if' scenarios to inform adviser & client decision-making

Access now

At Vanguard we're investing in technology to support your client interactions and engagement. The Vanguard Retirement Income Builder is designed as a storytelling tool for you to use with your clients at planning and review meetings.

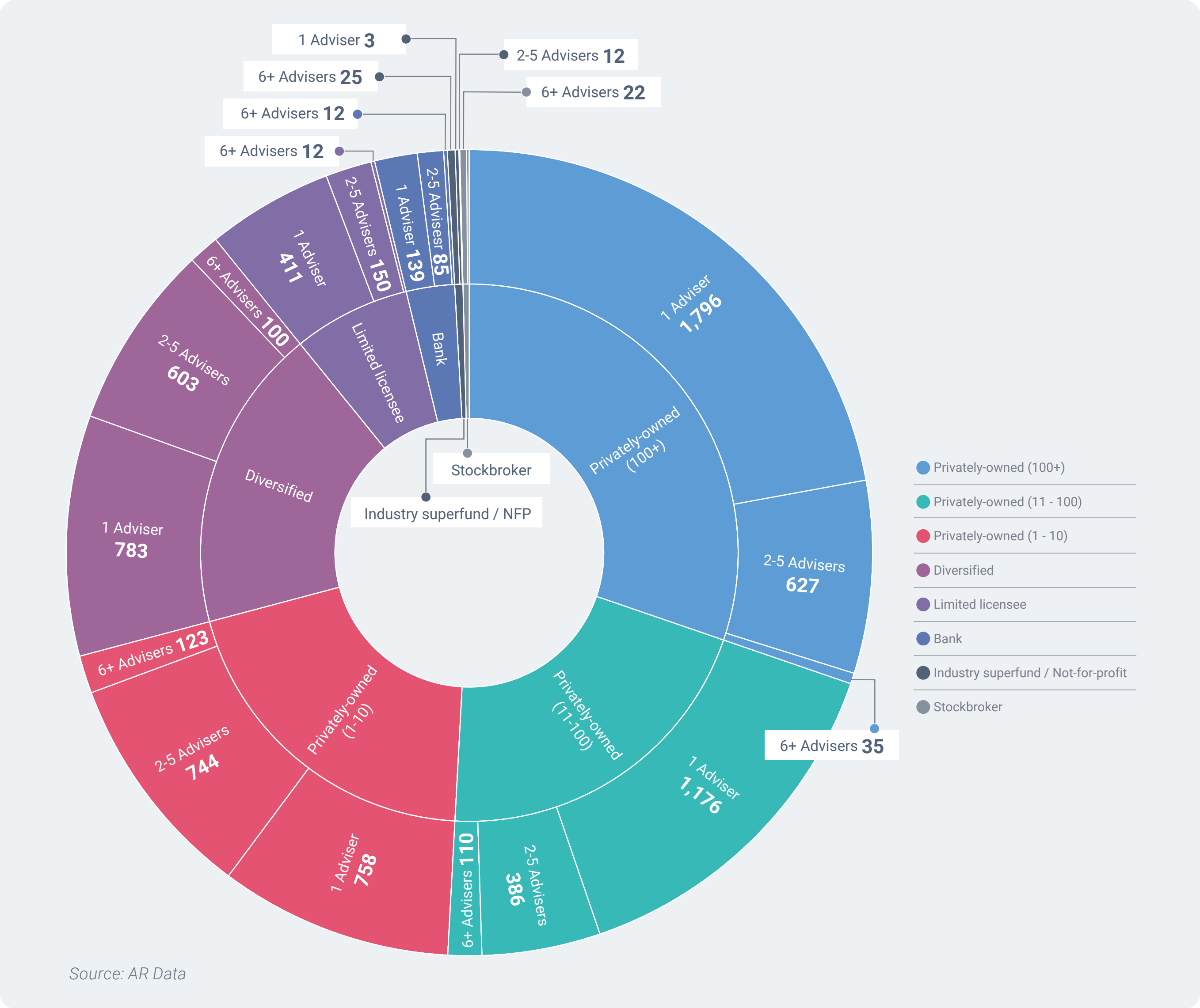
To find our more, contact your Vanguard Sales Executive or call 1300 655 205.

Chapter 4

Infographics

4

Chart 4.1 – Practice distribution per licensee segment

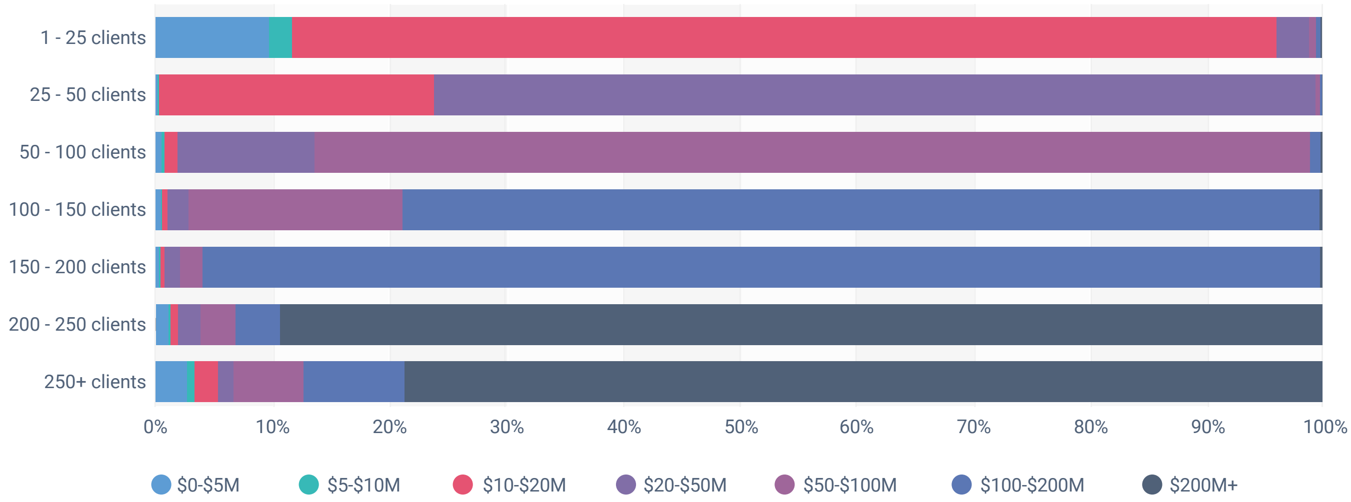


Source: AR Data

Chart 4.2 – Adviser distribution by FUA

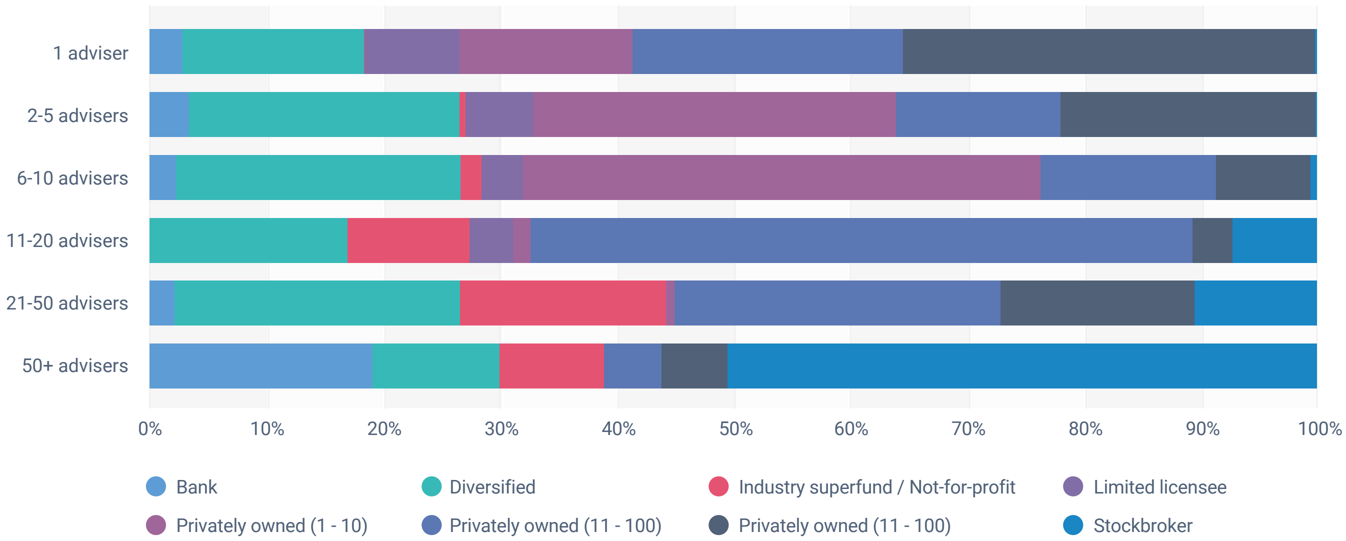
Source: AR Data

Chart 4.3 - Adviser distribution by FUA and number of clients



Source: AR Data

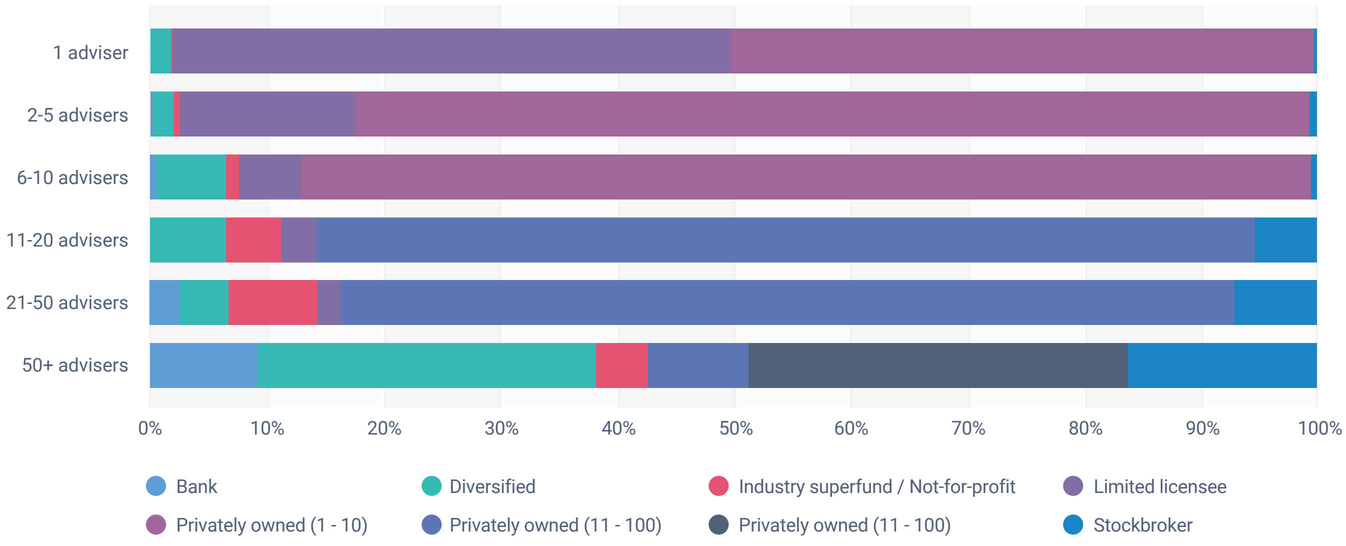
Chart 4.4 - Adviser distribution by practice size and type



Source: AR Data

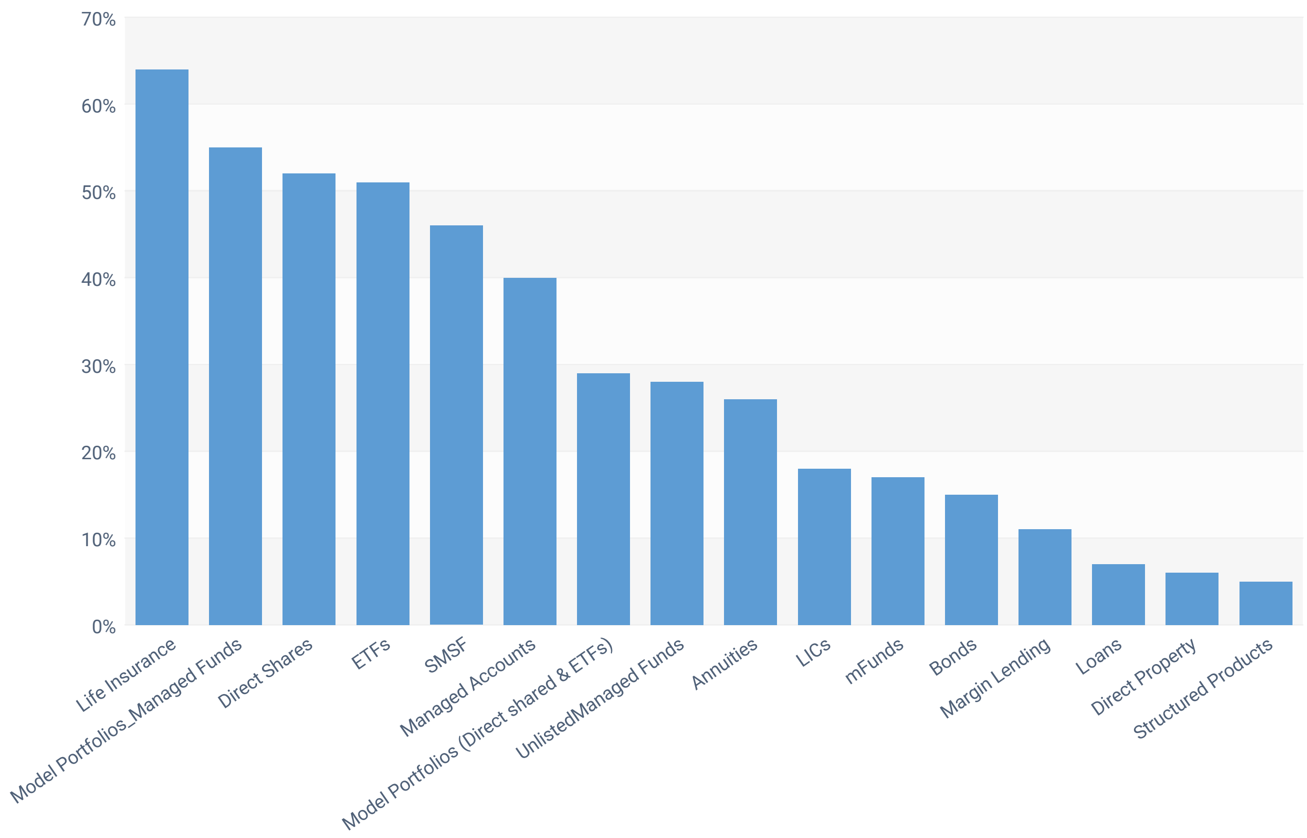
> "Cleaner structures and rising costs throughout the advice value-chain defined 2020 as licensees and practices alike re-positioned their value propositions with each other and their clients. "

Chart 4.5 - Adviser distribution by licensee size and type



Source: AR Data

Chart 4.6 - Preferred products by practice



Source: AR Data

4.7 – The average Australian adviser

Demographics

48 YEAR-OLD MALE FROM INNER MELBOURNE

$130,000 ANNUAL SALARY

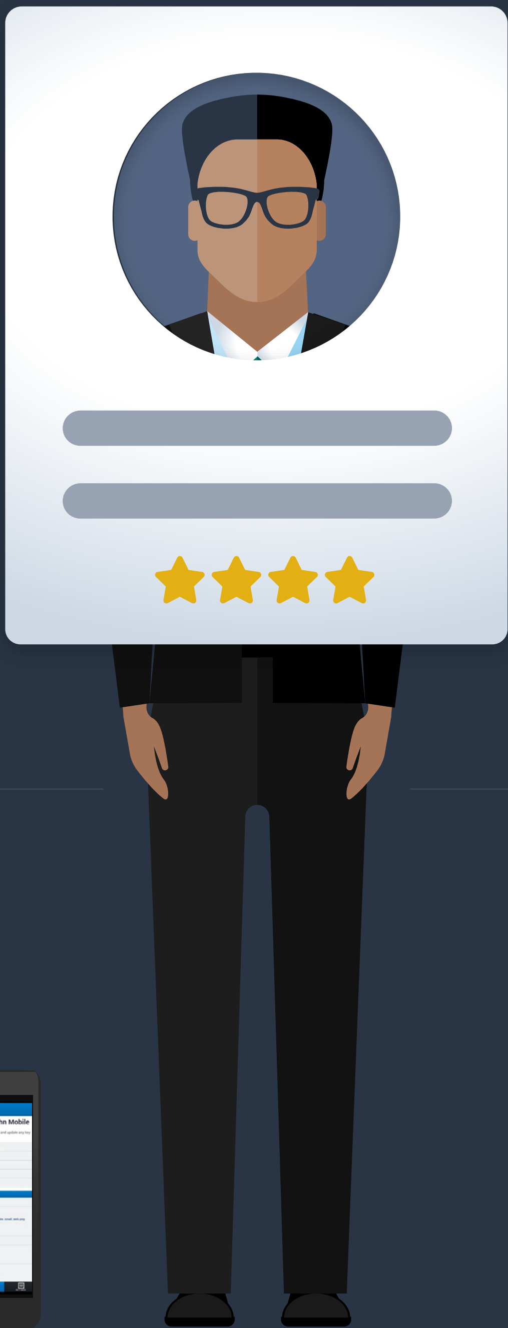
DEGREE QUALIFIED

Client Type

COUPLE

58 AVERAGE AGE

$4,000 ANNUAL FEE



Client Base

$74M FUA

20 ONCE-OFF CLIENTS

83 RECURRING CLIENTS

INSURED BY TAL

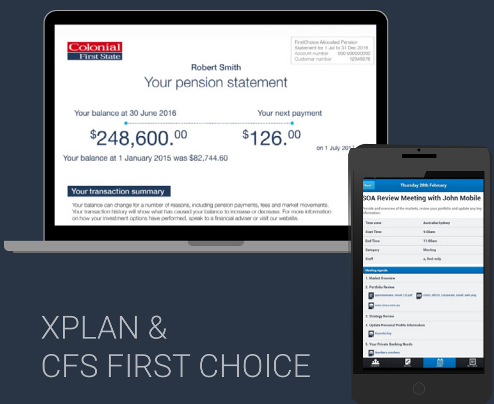
My Practice

<10 ADVISERS

PRIVATELY OWNED LICENSEE

$153M FUA PRACTICE SIZE

Software & Platforms



XPLAN & CFS FIRST CHOICE

Source: AR Data

Research & Investment

I MOSTLY USE MODEL PORTFOLIOS AND LISTED INVESTMENTS

MORNINGSTAR®

RESEARCH HOUSE & INVESTMENT CONSULTANT

Chapter 5

Investment Landscape

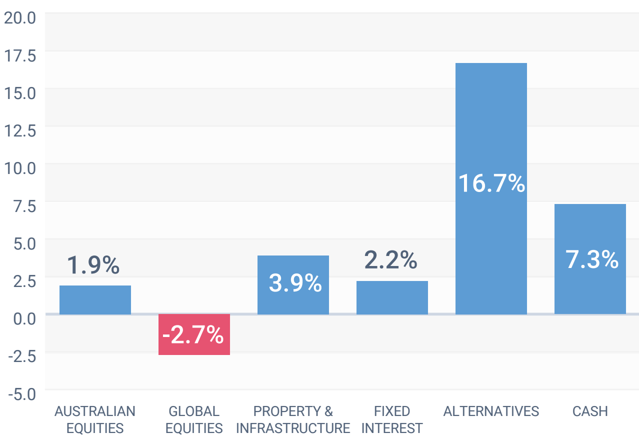
5

In mid-March 2020, with markets still plummeting the media consumed by end-of-days pestilence, the outlook was gloomy. Yet that forecast couldn't have been more wrong. For the year to December 2020, market growth (+$8.7 billion, 1.2%) and net flows growth (+$11.5 billion, 1.6%) ended well into the black. The industry's addressable pie therefore grew by nearly 3% to circa $722 billion. Market growth can be attributed to the impact of global stimulus but the flows? A part explanation will be ongoing contributions to adviser-built super, but where was the offsetting GFC style panic, the fear-based withdrawal of other investments? It seems that this time, like canny politicians, investment advisers and their clients did not let a good crisis go to waste.

Where the money went

Through calendar 2020, all asset classes, bar global equities, experienced positive net flows and achieved positive organic growth. Perhaps unsurprisingly in such an uncertain year, cash dominated absolute net flows (+$4.5bn). Somewhat surprisingly, Australian Equities bounced back from strong net outflows in the previous year to record net inflows of +$3.4bn. Most surprising were Alternatives, which received a net additional +$4.0bn from investors. Recalibrating organic growth ($) to organic growth rates (% change on base) tells a similar story, with an even more pronounced tilt to Alternatives, as per Chart 5.1.

Chart 5.1 - One year organic growth rate (%)



Source: Morningstar Direct, Milestream analysis

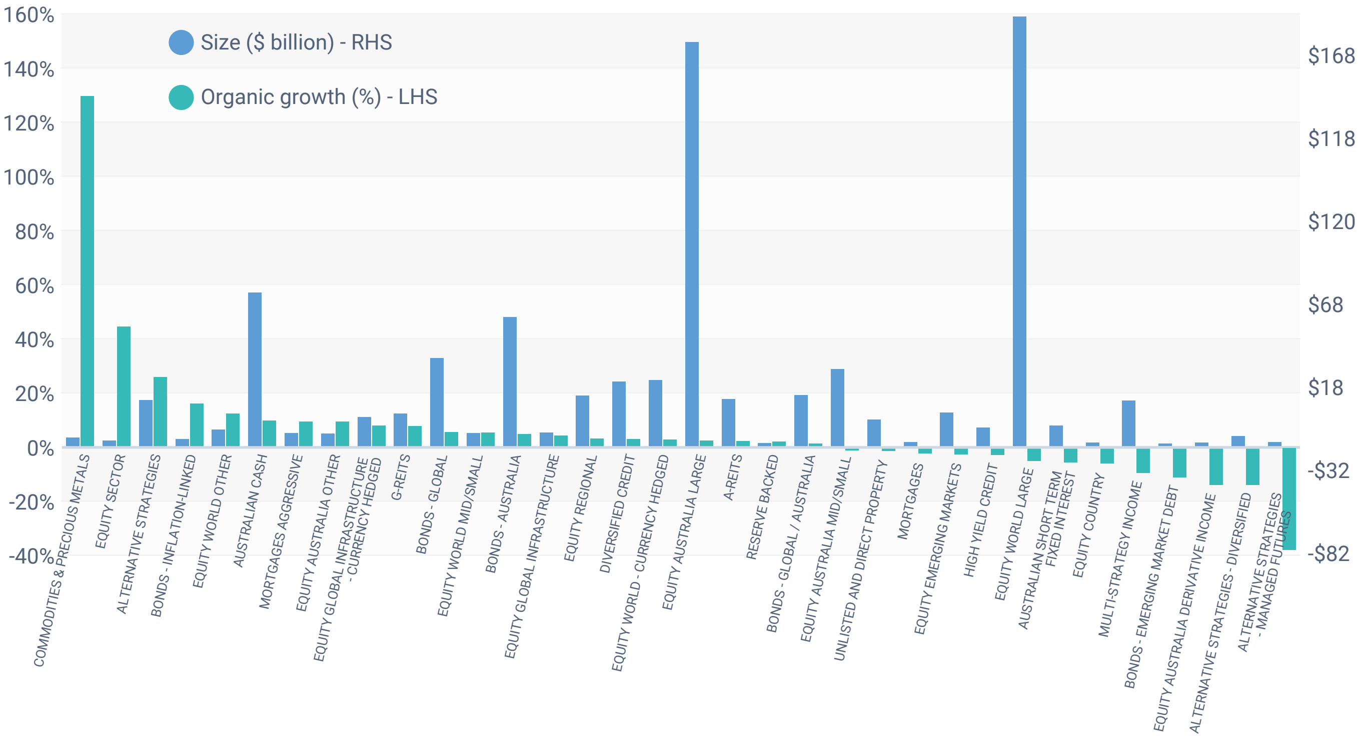
Sub-sectors and funds

The percentage charts show change – but alternatives is such a small category that the tactical tilt to gold dwarfed the outflows in nearly all other sub categories. Meanwhile, global equities is the largest category, which saw some rotation into sector global strategies like healthcare – and even Vanguard ex US.

Chart 5.2 displays asset class sub-sectors with organic growth rates (%) in green (on the left-hand axis) and sub-sector sizes ($bn) in blue (on the right-hand axis). The best informational value is derived through looking at both metrics together. If, for example, predominantly small sub-sectors have experienced the largest positive and negative growth rates, this can be indicative of shorter-term opportunistic/tactical allocations. Smaller and newer sub-sectors with large positive or negative growth rates could also be indicative of emerging trends taking off or being rejected as fads. Either way, they are small pots of money, so are typically meaningful only to smaller and early-stage investment managers.

In contrast, if larger and older sub-sectors (typically core portfolio allocations) are experiencing outsized growth rates (either positive or negative) then something big may be under way that is of relevance to all managers, regardless of size and stage of development. These sub-sectors are not immune to investor short-termism and flightiness, particularly if recent performance has been very poor or very strong, but their size and longevity is synonymous with maturity in a lifecycle sense. So big moves can mean big things, such as structural shifts in asset allocation or portfolio construction or shifts in investment management internalisation/DIYing behaviour.

Chart 5.2 - Sub-sector one year organic growth rates vs net assets

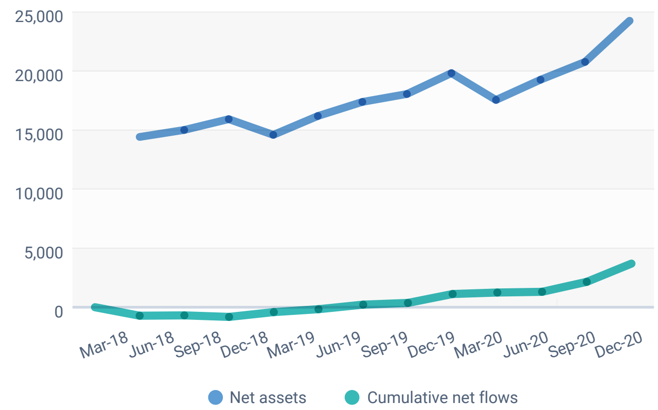


Source: Morningstar Direct, Milestream analysis

ESG (Everyone Shout 'GO!')

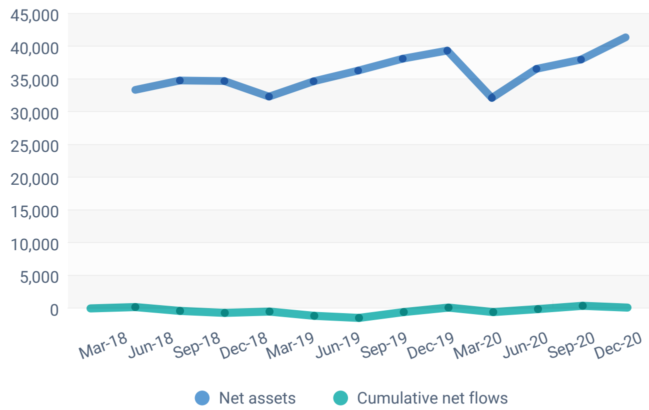
The Australian ESG sector (unitised products)

Chart 5.3 - "Overt" ESG funds - Net assets and cumulative net flows



Source: Morningstar Direct, Milestream analysis

Chart 5.4 - "Covert" ESG funds - net assets and cumulative net flows



Source: Morningstar Direct, Milestream analysis

> "As the value chain compresses, and with regulation clarifying and intensifying obligations on advisers, there is a stronger rationale for their use of listed products."

There are two distinct sub-segments of the ESG market based on investment manager marketing intent – overt and covert ESG funds (see definitions below). The covert ESG market is roughly twice the size of the overt ESG market. Flows within the covert ESG market have been flat over the past three years. Flows in the overt ESG market have been flat over the past 2-2.5 years with a modest uptick in the past 6-12 months.

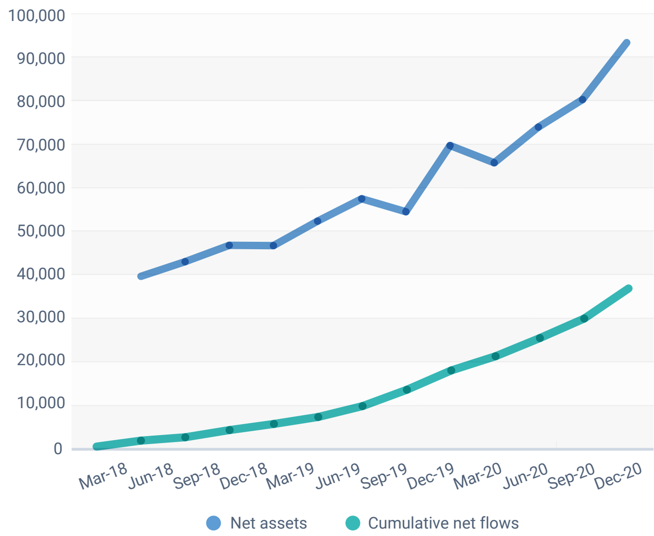
Overt ESG Funds: Are out and proud with their ESG credentials. Fund names and/or manager marketing collateral contain ESG phrases and acronyms. They are named and marketed to appeal to the cohort of ESG investors seeking to make values-first ESG decisions.

Covert ESG Funds: Are deliberately quiet achievers. Fund names and/or manager marketing collateral do not contain ESG phrases and acronyms. These funds do come with very strong ESG credentials. Or put another way, they look (and are marketed) as traditional products but under the bonnet house strong ESG engines. They are named and marketed to appeal to the cohort of ESG investors seeking to make investment-first based ESG decisions (or are not seeking strong ESG credentials and are comfortable that having them integrated into the process won't detract from performance).

The ESG performance trade-off question is not settled in the retail sector and more education is required to convince advisers. Whereas traditional funds with strong ESG credentials (covert ESG funds) are winning the bulk of the institutional mandates, in retail the modest uptick in ESG flows is thus far only going to overt ESG funds. This reflects that the only ESG motivator in retail at present is bottom up client demand. It could well take a number of years before covert ESG funds are "respected" for their credentials and rewarded with flows. In this scenario, the bulk of growth in ESG flows would continue to flow to those who market themselves overtly on their ESG credentials.

Open-ended listed products (ETFs/ETMFs) have grown strongly in the past three years. This sort of statement used to come attached with a tempering "but off a low base". With the segment rapidly closing in on $100bn (refer to Chart 5.5), having almost 15% market share (coming from shy of 8% just 2 years ago) and trouncing unlisted products in net flows, it is time that this caveat be dropped.

Chart 5.5 - ETFs / ETMFs net assets and cumulative net flows



Source: Morningstar Direct, Milestream analysis

Compositionally, there is a misconception that the open-ended listed market is almost exclusively the domain of passively managed products. It may well have started out that way (and is still undeniably rich in index-replicating strategies) but it has clearly evolved into a home for all investment philosophies.

Two tailwinds exist behind adviser-driven listed products uptake. One is commercial and the other is regulatory. As the value chain compresses, and with regulation clarifying and intensifying obligations on advisers, there is a stronger rationale for their use of listed products.

Research houses

2020 was undoubtedly the year when research houses got serious on ESG. There had been prior commitment from most, but this year saw a renewed burst of activity and an accelerating push to differentiate research services on the basis of ESG credentials.

Morningstar formally integrated ESG into its analysis of stocks, funds, and investment managers. Leveraging its purchase of ESG ratings and research firm Sustainalytics, Morningstar also launched a new ESG rating for managers – ESG Commitment Level. The ESG Commitment Level rating now sits alongside Morningstar's existing ESG classifications including its Sustainability rating and its Low Carbon designation.

Lonsec formally integrated its ESG Biometric scores into its main fund ratings model. Further, it entered into a partnership with ESG research provider Sustainable Platform and launched a new stand-alone ESG rating – the Sustainability "Bee" rating.

> "There is an accelerating push to differentiate research services on the basis of ESG credentials."

Zenith formed a Responsible Investment Committee and launched a Responsible Investment Classification (rating) to sit alongside its traditional fund ratings.

Despite this recent proliferation of ESG IP from research houses, ESG confusion continues to reign in adviser land, and the process of matching a client's ESG preferences with the right funds doesn't seem to be getting any easier. The culprit (as usual) is the lack of consensus industry definitions and the associated plethora of proprietary approaches all put forward with different takes and angles on the right way to tackle the ESG challenge and opportunity.

This fog of ESG will eventually clear but for now the simplest and most intuitive (rather than the most comprehensive or most accurate) ESG research and ratings framework will probably be the most popular one with advisers (at least initially). In the longer term, a technology-led solution (for matching clients to funds based on ESG preferences) fed by granular ESG datasets and built around regulatory compliance (Best Interest) will surely be of most use (and comfort) for advisers. In this regard, Lonsec's positioning on how to use its ESG Biometrics rating (for those seeking ESG from an investment-first, manager process perspective) and its Sustainability ratings (for those seeking ESG from a values-first, portfolio impact perspective) is relatively clear, and ticks the "simple" and "intuitive" boxes. We therefore believe Lonsec's ESG "solution" will gain the most immediate traction with advisers. However, longer term, Morningstar looks best placed to leverage its technology strengths and its deep and granular ESG datasets to provide the most appealing overall solution.

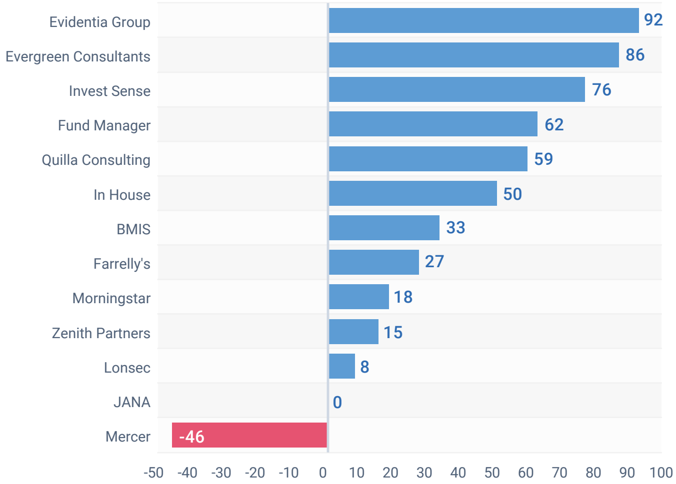
Investment consultants

68% of advisers indicated that they do not use a consultant, which seems abnormally high. We suspect that a material proportion of this response can be explained by a lack of awareness on the adviser's part of who their licensee or in-house research team is using as an investment consultant (and an understandable lack of contact with them). This dynamic would be most pronounced within the larger licensees (who were well represented in the survey).

More advisers reported that their investment consultant was a fund manager than reported they used Zenith, and a similar number reported using a fund manager as those who reported using Lonsec. Again, this result was somewhat counterintuitive and likely reflected the aforementioned adviser/licensee awareness dynamic.

The main observations from the NPS results in Chart 5.6 are that the boutique consultants scored best, reflecting that their high(er) touch service was resonating. Advisers are placing their trust in the apparatus either within their practice or their licensee to choose the right investment consultant and to work closely with them to provide the appropriate direction. Since this is not the adviser/practice head's skill set or core interest, it makes sense that the boutique consultants are proving so popular with the boutique advice firms, because they completely understand their businesses and have adjusted accordingly, unlike the major research and consulting firms, which present a more 'take or leave it' offering.

Chart 5.6 - Investment consultant net promoter score (NPS)



Source: AR Data

The largest of the boutiques, Evergreen, scored very well, considering its relative size. The firm has been able to scale thus far without lowering the 'touch' level (and thus satisfaction) with clients.

Zenith did well to keep a big group like AMP content but overall was only modestly positive on NPS. This may reflect Zenith transitioning clients to basis points fee structures for investment consulting services (i.e., some clients may be unimpressed with this fee approach when they, themselves, are being told to eliminate asset-based fees).

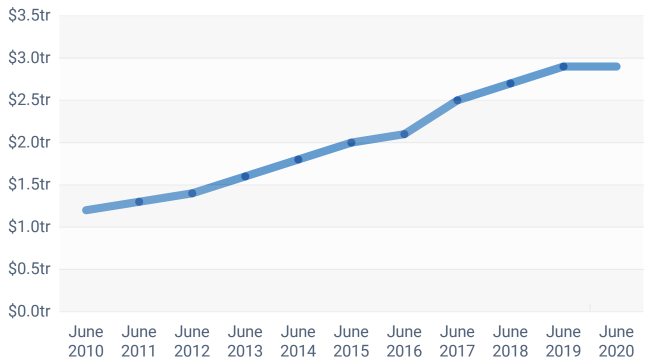
Mercer scored poorly. This serves as a warning to the new institutional entrant JANA to focus on tailoring an offering to the quirks and specific requirements of the intermediated retail channel.

> "The total funds under management in superannuation grew by more than 140% in the past decade."

Superannuation: funds under management

Total funds under management in Australia's superannuation industry is approaching $3 trillion; it is about 150% of GDP as of 30 June 2020. After several years of growth, the level of assets has levelled out for a time (Chart 5.7). Factors here were the superannuation early release scheme and the modest investment returns during this period.

Chart 5.7 - Superannuation funds under management



Source: APRA Annual Superannuation Bulletin, June 2020

The size of the industry and several individual funds has implications for how the assets are invested and their impact on both the Australian economy and individual companies.

A key trend is the internalising of investment management processes and functions, rather than the use of third-party investment managers. Superannuation funds have traditionally insourced only a small proportion of their investment management activities. However, the trend at funds is to insource as they gain expertise and the costs of managing portfolios falls.

Most of the larger funds are looking beyond the Australian sharemarket for investment opportunities, both onshore and offshore. Funds are also exercising their investments in listed companies, taking significant stakes in unlisted companies and starting to influence corporate remuneration and other strategic decisions.

ESG investment options of various flavours have been around for many years. More recently, superannuation funds have been integrating ESG factors into their standard investment processes and becoming more outspoken on ESG issues, either directly or via the Australian Council of Superannuation Investors; for example, Australian superannuation funds have been world leaders in divestment from tobacco companies.

Many large funds have either announced targets or aspirations for their investment portfolios to achieve net-zero emissions by 2050 or significantly reduce their emissions intensity. Not everyone is happy with these developments. In 2020, Senator Jane Hume, Assistant Minister for Superannuation, Financial Services and

Financial Technology, reminded superannuation funds that whilst ESG provided a useful framework through which to assess the risks and returns of investments on a long-term basis, “their job isn’t to rebuild the economy or create jobs or reframe the climate debate”.

The pressure on superannuation funds to demonstrate ESG credentials is not just coming from their members and special interest groups. In early 2020, APRA wrote to all entities it regulates, stating that entities should be proactive in assessing and mitigating climate-change financial risks and that it intends to update Superannuation Prudential Practice Guide SPG 530 on Investment Governance to explicitly include ESG considerations.

Chart 5.8 compares the market share by segment in June 2010 with 10 years later, showing a significant increase for profit-for-member funds (also known as not-for-profit funds). The total funds under management in superannuation grew by more than 140% over that decade, but the funds under management for Industry Funds and Public Sector Funds grew by 242% and 276%, respectively.

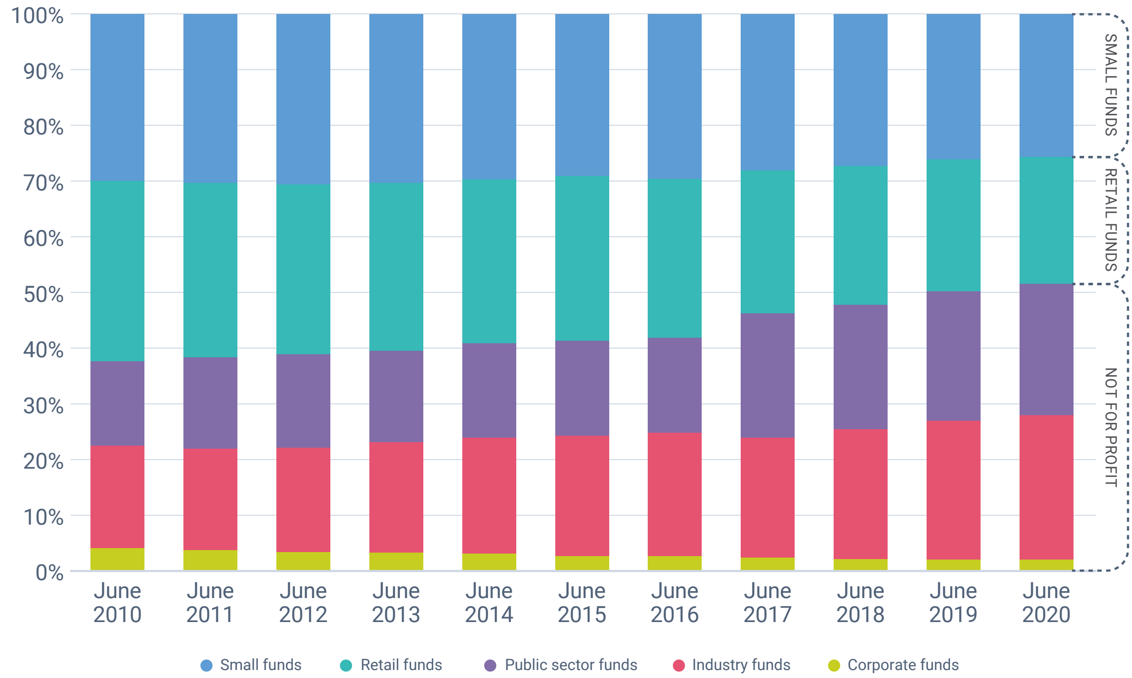
The reputational damage some retail funds experienced from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was one of the critical factors in the shift from this sector, with the industry funds sector being the primary beneficiary.

Early release, fighting over the Super Guarantee (SG) rate and superannuation’s very purpose, the regulatory focus on member outcomes, Your Future Your Super, Royal Commission class actions, mergers and acquisitions were all features of 2020.

Australia has the fourth-largest pool of pension fund assets globally and our retirement income system is often rated as one of the best. However, the superannuation system was designed for a different time and needs to keep up with evolving work patterns, an ageing population and increases in life expectancy. New challenges are continually emerging from efficiently investing such large amounts of money to dealing with the cohort of baby boomers in or approaching retirement.

The accumulation phase, with its compulsory contributions that many other countries envy, rates pretty well. Yes, there are problems to be addressed, such as efficiency, sustainability and equity. However, to be a super superannuation system, it is time for all stakeholders to devote serious effort and resources to make the transition from full-time work and beyond better for all Australians. After all, isn’t retirement outcomes what it is all about?

Chart 5.8 - Funds under management by fund type



Source: APRA Annual Superannuation Bulletin, June 2020

Chapter 6

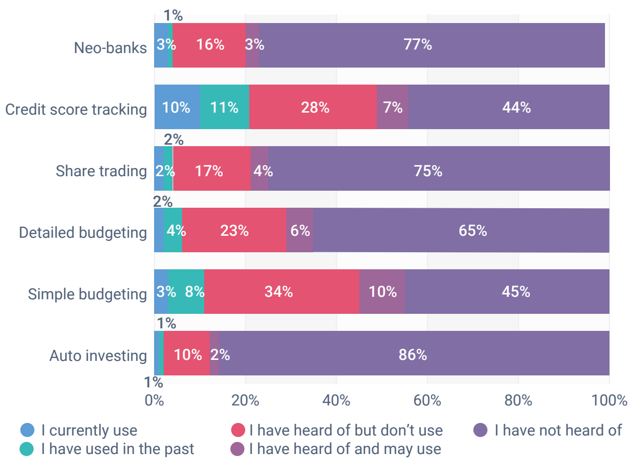
Digital and Technology

6

In November 2020, ASIC released Consultation Paper 332, promoting access to affordable advice for consumers. Whilst demand for advice remains high, the number of people accessing advice remains anaemic. The raft of new and existing technology solutions may in some part solve this dilemma, and potentially address affordability across a number of cohorts. Temporary measures such as the $300 maximum limit on a Record of Advice when seeking professional financial advice on early access to super suggest a changing mentality within government. The Government's willingness to rapidly introduce new measures should give technology providers and advisers more confidence to invest in technology solutions that address affordability.

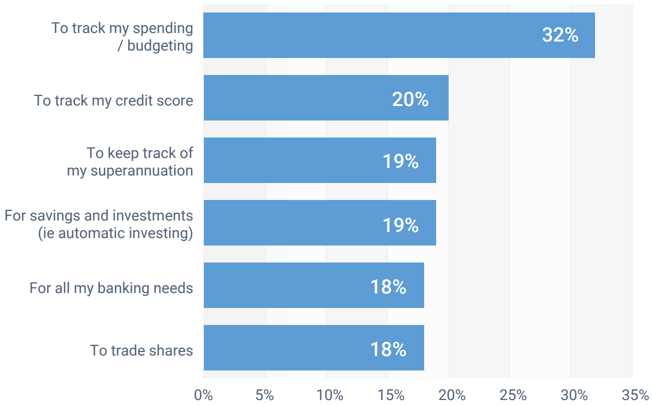
However, many consumers remain unaware that such technologies exist. Most solutions on offer are nascent offerings, with limited capital to drive awareness.

Chart 6.1 – Consumer's use of financial technology solutions



Source: AR Data

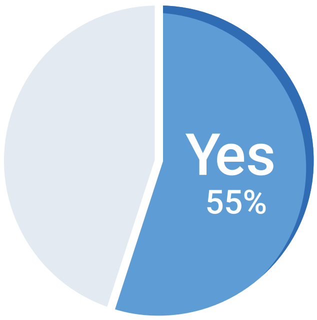
Chart 6.2 - Financial solution tools consumers are willing to use



Source: AR Data

Consumers are predisposed to use technology to improve management, visibility and control of their finances. There is significant opportunity for advice professionals to build or partner with technology solutions to solve the gap between advice supply and demand.

Chart 6.3 – Consumer's willingness to use technology solutions



Source: AR Data

> "There is significant opportunity for advice professionals to build or partner with technology solutions to solve the gap between advice supply and demand."

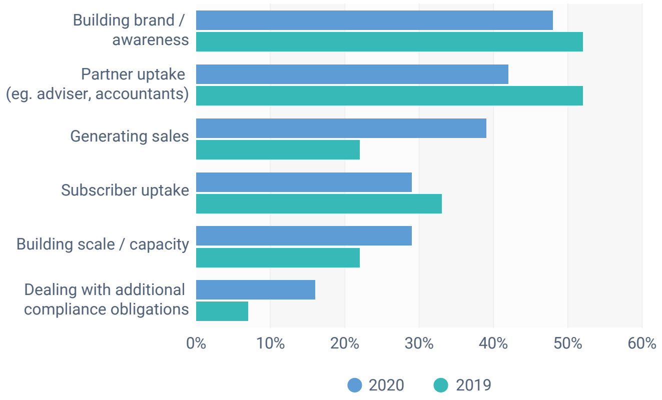
The industry and technology providers require ongoing certainty from the regulator and government on the parameters within which they can operate to solve the affordability issue. Whilst the balance sheets of advisers, licensees, product manufacturers and service providers are under strain and chasing known ROI, limited investment will be made into the unknowns, to the ultimate detriment of consumers.

The regulator, government and industry can change the advice landscape drastically for the better – the demand is there.

Digital advice and technology

Whilst the first unicorns are emerging in the wealth-tech space offshore, supported by institutional capital, Australia's domestic sector is still at an embryonic stage. It has not evolved considerably in the past 12 months and is largely unsupported by the traditional advice industry and larger institutional organisations that have the balance sheet and customer demand to do more.

Chart 6.4 Advice firms & use of digital tool solutions



Source: AR Data

The most common application for digital tools is to improve transparency on financial performance of a client's portfolio, an area where the traditional financial planning software providers have failed to deliver. However, digital tools offer plenty of benefits at the front and back ends of a traditional advice business:

- Lead generation. Digital tools can act as a valuable funnel to attract future clients who for a variety of reasons are not ready for a face-to-face advice experience. However, as these clients become more comfortable with the digital service and their financial lives evolve, they become low-hanging opportunities for conversion to a comprehensive advice relationship.
- Sub-economic clients. Rather than jettisoning low-value clients entirely, digital tools allow the relationship to be retained at arms-length but in a way that suits both parties, allows the adviser to maintain surveillance on the client's situation so they are well positioned to dial-up the relationship again at the right time.

Increasingly, advice firms are recognising the multiple benefits of partnering with a digital provider. The variety of digital solution choices available are growing, and span budgeting / cashflow management, investing, scaled advice, and post-retirement for pension applications. Each of these are plausible options, however they will represent different value and priority to the adviser, depending on the nature of their business and demographics of their client base.

Nevertheless, the cottage industry of Smart Tool providers is beginning to grow up. Several acquisitions and consolidations occurred in 2020. The evolution of Smart Tools towards more B2B2C and personal advice has slowed. Mixed regulatory signals about implementation of scaled advice, combined with struggling financial performance, generate headwinds to further progress. Equally, the Consumer Data Right is providing greater access to personal information, generating rich new raw material for the next wave of Smart Tools, largely focused on personal financial management, including debt, bleeding into the buy-now-pay-later sector.

The 2020 Netwealth AdviceTech Report identifies that star firms representing 12% of the advice industry are leading the way in adopting technology to improve their businesses, improve client engagement, and deliver better advice. However, more than two-thirds of advice firms are classified as "underperformers'' or worse, demonstrating that the advice industry is still in the early stages of technology adoption.

Adviser sentiment towards financial planning software providers and platforms is consistently rewarding the new and emerging players and castigating the incumbents, despite incumbents such as Xplan and the major bank-owned platforms continuing to hold dominant market share based on adviser desktops and FUA, respectively.

Adviser sentiment towards financial planning software providers

The term 'financial planning software' is fast becoming a misnomer, as a range of providers from 23 different technology segments could arguably claim to be integral to a successful financial advice business. For that reason, we added several more software providers to the 2019 cohort in the Financial Planning Software section of our Financial Advice Landscape benchmarking study. These include players like Fin365, Astute Wheel and Roar Software, which are doing different and promising things, and plugging gaps in existing technology stacks. We also wanted to test attitudes towards the SMSF software providers BGL and Class, although we recognise adviser exposure to these solutions is primarily through partnerships with accounting firms.

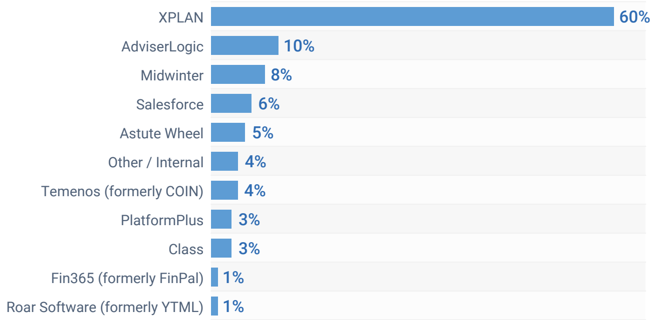
Our choices unsurprisingly created a mixed bag of providers, not always directly comparable. However, our objective was to test adviser sentiment towards a blend of players that, despite being competitors or adjacent solutions, often appear together in the one technology stack. It certainly generated some interesting commentary from the advisers!

Before we dive into the survey results, it is worthwhile to do a quick review of all the corporate activity with the traditional planning software providers over the past 12 months. While 2018-19 was dominated by the Bravura-Midwinter, Morningstar-AdviserLogic and Temenos-COIN hook-ups, 2020 underwhelmed. Apart from the unfortunate collapse of CCUBE and its fire sale to OpenMarkets, Advice Intelligence received some good press but suffered too much from the 'too early' tag to make much headway, while Intelliflo continues to tantalise as it builds towards a launch later this year. Meanwhile, licensee-owned solutions Platformplus by Infocus and FORCe by Fiducian seek to distribute their software into the open market but based on adviser feedback from our survey, only one has a decent chance of making progress.

> "In an industry long dominated by Xplan, there is a desire to support challengers and help them grow to provide decent competition and choice. "

We received 1,386 ratings from advisers on software providers. Once again, Xplan dominated, with an almost identical penetration score (60%) as last year (58%). Second and third place, AdviserLogic and Midwinter, respectively, swapped positions from last year, with Midwinter usage dropping from 11% to 8% of respondents.

Chart 6.5 - Software providers penetration



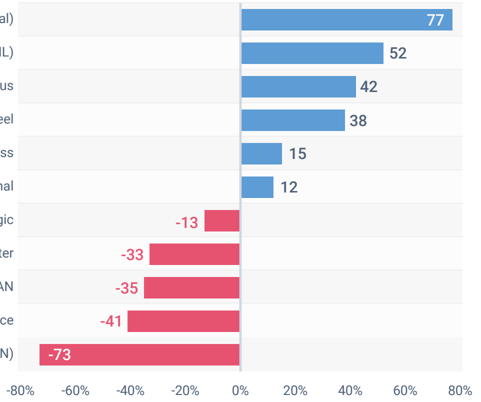
Source: AR Data

The more important graph is Chart 6.6, which presents the Net Promoter Scores (NPS). It is quite an extraordinary set of results, with the players that were relatively new or new to our survey (Class and Platformplus) all receiving strong support, whilst incumbents were harshly penalised. Even AdviserLogic wasn't spared, despite receiving the best score last year and following its acquisition by Morningstar, which was expected to increase its standing within the adviser community.

So how do we interpret these results? Can they be taken at face value? Firstly, in an industry long dominated by Xplan, there is an undercurrent of desire to support challengers and help them grow to provide decent competition and choice. We think this is partially reflected in these sentiment ratings, all else being equal. The verbatim comments anecdotally support the scores, too, with advisers more willing to forgive shortcomings in new players as part of "building" or "evolving" their offerings.

Most of the top scorers were admittedly lightly supported in terms of total votes, although we are comfortable there is sufficient volume and diversity to be representative. Equally, the poorest scorers received the highest volume of votes, to make those outcomes undeniable.

Chart 6.6 - Software providers net promoter score (NPS)



Source: AR Data

Some of the themes coming through in the adviser comments include:

- Licensees that support panels of software providers rather than mandating a single vendor generally had happier authorised representatives. This allows the adviser to create best-of-breed module combinations or switch if their choices prove unsatisfactory.

- Conversely, the benefits of combinations such as the Astute Wheel client portal, Fin365 CRM, Xplan research, Midwinter's modelling tool, Class Super, and PlatformPlus SOA generator, may be completely offset by the failure to ensure seamless data connectivity and transference of information through the technology stack – great on paper and terrible in execution. This was accentuated where licensees did not provide the necessary technology support to practices to enable them to take full advantage of the choice.

- Mandating a single software provider was described as the "achilles heel" for a licensee. Understandably, the licensee can promise volume to the vendor and predictably negotiate an excellent discount. While many advisers may not be delighted by the selection, the licensee can still save the day by passing those savings on to advisers and supporting them through flexible implementation.

- The modules/options chosen, and the configuration of the software, can make a material difference to the adviser experience.

- The elephant in the room – Xplan – cannot be ignored. Despite receiving a terrible report card, it is undeniably difficult to dislodge.

Despite so many misgivings about Xplan, the community that has grown up supporting this software due to its complexity has invariably created a defensive moat. So many people and service providers have built their careers around implementing, modifying, training and using this system that they have a vested interest in maintaining the status quo. Unfortunately, this is unwittingly adding to the cost of advice delivery and is one of many areas that must be addressed if advice businesses are to truly streamline and lower cost to serve.

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