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## Commentary on Emerging Trends in the Delivery of Financial Advice in the UK Created by New Regulation

FinaMetrica cofounder, Paul Resnik, is just back from a seven week trip to the United Kingdom. Paul spoke with several hundred industry participants in 12 cities. These included advisers, banks, life companies, compliance managers, regulators, investment managers, researchers, consultants and others. He found almost all product and service suppliers engaged in reframing their business proposition to take account of impending regulatory changes or building to take advantage of the opportunities created by the failure of competitors.

High-end IFAs in particular are significantly more optimistic about the future than most others. Many are further advanced on the journey to acceptable practice and some moving towards best practice. Most IFAs felt that the banks and life companies were at a disadvantage in terms of both momentum to the new standard and had lost the community's confidence and trust.

Paul had travelled to the UK to explore the reasons for and likely consequences of a recent guidance paper ([http://www.fsa.gov.uk/pubs/guidance/fg11\\_05.pdf](http://www.fsa.gov.uk/pubs/guidance/fg11_05.pdf)) produced by the FSA. The paper outlines the process that advisers must undertake to prove the suitability of their investment recommendation with regard to the investor's willingness and ability to take risk. This is seen as requiring a fundamental shift from a 'Product First' to a 'Client First' engagement by product and service suppliers with UK investors.

We thought readers might find something of value in what he learned on his trip. Here are the other major themes:

1. The financial services industry's enjoyment of 'super' profits is at an end:
  - Suppliers with inefficient business processes, poor services and expensive products are struggling to remain relevant.
  - Many players in the supply chain are striving to become significantly more efficient, add greater relevance or deliver further value.
  - While there is a high expectation of significant rationalisation across the board this has yet to happen.
  - The number of advisers is expected to reduce from around 30,000 by as much as 25% over the next three years.
2. There looks to be an oversupply of wrap platforms. Currently there are 29 in the market and several more in the wings. It's difficult to see how they can all be adequately resourced, built and distributed.
3. There is a widespread acceptance that there will be an ever increasing engagement by Government in industry practices. The highly interventionist FSA will continue to promote its combination of process-oriented and principles-driven regulation. This is in recognition of the belief that financial services are now too important to the community to be left to self regulation. The FSA's approach is to promote the personalisation of advice consistent with the practices adopted by high-end financial advisers.
  - This generally entails a solid emphasis on cash flow analysis and planning.
  - It sees the demise of simplistic 'Portfolio Picker' risk questionnaires as impersonal shortcuts.
  - It recognises the separate roles of risk tolerance and risk capacity in the advising process and the requirement for the adviser to show reconciliation of any differences between them.
  - One issue that is not resolved is how advisers who have used inappropriate tools for risk profiling in the past, 9 of the 11 tools reviewed by the FSA did not pass muster, should deal with clients potentially misadvised.
4. There is an ever increasing recognition that the investment decision is the last component of the planning process. The amount of investment risk taken on is decided after all the other lifestyle options available to the client have been explored.
5. Growing recognition that, on average, portfolios have not adequately rewarded clients for taking equity risk over the last 40 years.

6. An understanding that a more sustainable investment proposition for clients is about wealth preservation as much if not more than wealth creation.
7. There is a very visible move to model portfolios away from customised portfolios. This is accompanied by a continuing shift from active to passive asset management. Both are widely recognised as necessary to increase business efficiency and to improve the consistency and add quality to returns.
8. Growing recognition of the cost to consumer confidence caused by the failure to appropriately and consistently label funds, explain risk and to frame investors' expectations. There is an acceptance that this needs to radically improve in the future but no shared view of how this might best be done.
9. Business processes moving from adviser knows best to informed client consent.
10. A growing acceptance of the need to add to the advisory business's client proposition non-investment related services and benefits.

A copy of the slides that Paul used in his UK presentations can be downloaded from [http://www.riskprofiling.com/Downloads/Edinburgh\\_Exposition\\_June\\_2011.pdf](http://www.riskprofiling.com/Downloads/Edinburgh_Exposition_June_2011.pdf). The essential arguments are that:

- ❖ There are many good reasons why regulation has been imposed in the UK. Not the least being the lack of consistency and relevance in the framing of investment risk and return expectations for both investors and advisors.
- ❖ There is a straightforward and rational methodology available to all participants in the value chain which will bring consistency and integrity to the advising process.

This methodology is the integration of five fundamental building blocks of the good advice value chain that enables a client to make a properly informed commitment to his or her plan. They are:

- ❖ A reliable, psychometric personal risk tolerance assessment tool.
- ❖ A consistent, realistic and understandable method for both financial advisers and fund managers to explain risk and return.
- ❖ A cash flow planning tool to illustrate the client's spending against available assets taking into account the asset mix consistent with risk tolerance, risk required and testable for the client's risk capacity.
- ❖ A proven methodology to make future capital market assumptions to be used in the cash flow planning process.
- ❖ A proven capability to deliver portfolio outcomes consistent with pre-agreed benchmarks with the client.

FinaMetrica is working to integrate its learning with service suppliers in the UK value chain. So far we have agreements in place and developments underway with Prestwood, Voyant, Plan Plus who provide client facing cash flow planning tools, Morningstar who provide optimised portfolios and fund ratings and Margetts who are a multimanager portfolio manager. We continue to look for partners who will work with us to make advisers' business processes more efficient and investor outcomes more predictable.

We are very optimistic for the quality of advice in the UK. We believe that investors will be better off as a consequence.