THE LANG CAT

SERENITY. **COURAGE.** WISDOM.

Disruption and innovation in retail investment pricing for the next five years

a white paper by the lang cat
October 2020

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MULTREES

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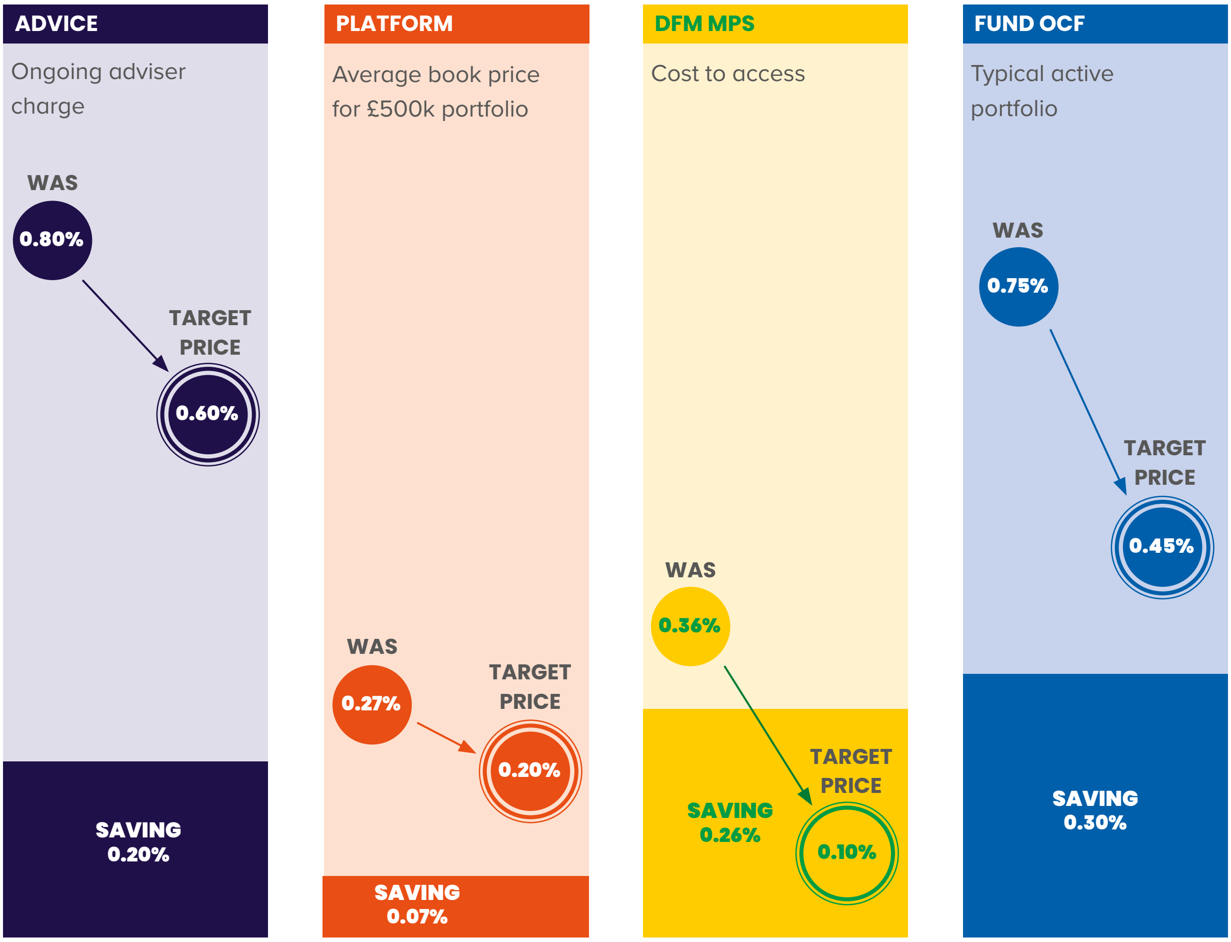
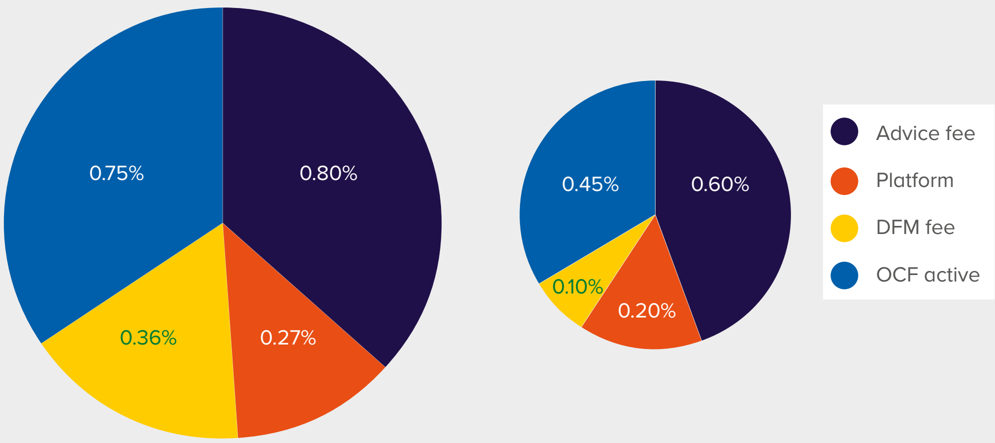
SPARROWS CAPITAL

Read on to find out why we think the target price for advice, platform, DFM model portfolio services (MPS) and fund management can drop by more than a third in five years...



PIE OF DESTINY 2020

PIE OF DESTINY TARGET PRICE 2025



TOTAL: 2.18% ACTIVE

TOTAL: 1.35% ACTIVE

CONTENTS

"*insert divinity here* grant me
the **serenity** to accept the things I cannot change;
the **courage** to change the things I can;
and the **wisdom** to know the difference."

INTRODUCTION

Hello and welcome to this white paper from the lang cat . Over the next thirty pages or so we've got a bit of an ambitious job to do: setting out what we believe is a blueprint to remake the accepted norms for how clients – those selfless souls who fund, directly or indirectly, all our lifestyles – pay for retail financial services.

The genesis of this paper came from work we started as part of our recent paper on centralised investment propositions – *Better. Faster. Stronger*. – kindly sponsored by Intelliflo[1]. In the later stages of that work, we looked at how pricing might shift over the coming years and identified some firms doing interesting things in the space.

Events, as they say, ensued, and we found ourselves having lots of interesting and sometimes quite spirited debates with various involved parties who variously felt we were:

- unnecessarily upsetting what is a very tolerable apple cart thank you very much
- in the pockets of Big Providers and possibly the Deep State
- wrong in the method but right in the amount
- right in the method but wrong in the amount
- the very worst snowflakey expression of the Woke Liberal Left, or something (we had stopped listening by then)

Clearly there was more to go at, so we put on our brave pants, started digging and what you're reading is the result.

Originally we intended this paper to simply set out in more detail what we think is reasonable to expect in terms of new models which may or may not drive down the total cost of ownership (TCO) of retail investment and to think about some of the economic effects of so doing. Along the way, though, we came to see that there are some aspects which either aren't broken or which are broken but shouldn't be fixed. And so we had our theme – changing what can change, accepting what can't, and understanding the difference.

We'll get into all of this as we go through. For now we must send gratitude to our contributors and also to our sponsors – Sparrows Capital, Multrees Investor Services, and Orbis Investments. We needed sponsors for this piece of work because of mortgages and stuff, and approached all three on the basis that each, in their own way and space, is doing something different. We've given each firm some room at the end to tell you in their own words what they get up to, and we interviewed each one to get their views on how the market is shaping up. Beyond that, though, none of them had any editorial influence on the paper, which represents the lang cat's views and not anyone else's. Well, maybe yours, shortly.

Enjoy the paper and remember: the Deep State is watching you at all times. Don't ask us how we know.

1. *Better. Stronger. Faster.* How do we rebuild centralised investment propositions from here? July 2020 https://www.langcatfinancial.co.uk/product/better-stronger-faster-how-do-we-rebuild-centralised-investment-propositions-from-here/

BEFORE WE BEGIN: DISRUPTING DISRUPTION

The prize for 'most overused piece of business-speak' in financial services has no shortage of contenders. 'Disruption' is one of the strongest.

We hear a lot about our industry disrupting itself or being disrupted. It's become something CxO's say at conferences to try and sound relevant and get young MBA grads to talk to them at the bar afterwards. Robo-advisers toss the term around with abandon, and we'll admit to having been lazy a few times ourselves[2].

We contend that there has been little real disruption in long-term savings and investment in the last decade or so. That may sound odd, in a time of Covid, and with pension freedoms and the RDR still recent memories. But when you dig beneath the headlines, little has changed. Clients meet an adviser, get some advice which normally carries an ongoing percentage charge, and invest in a range of funds charging a flat percentage inside a product which charges them a tiered percentage of their assets. That's the way it was and that's the way it is. Overall charges haven't come down; if anything RDR has made retail financial services more expensive.

So for an industry which has seen so much change in the last decade, everything remains remarkably similar. What gives?

DISRUPTION, DISRUPTED

Here it is: we haven't experienced disruption at all. We're not using the right words. To understand this we need to pay a posthumous visit to the mighty Clay Christensen, who originally coined the term 'disruptive innovation' back in 1995 with a treatise on disk drives amongst other things[3]. His fundamental assertion is that well-run large incumbent companies research the requirements of their existing customer base and design offerings and technologies to that, becoming blind in the process to emerging customer groups. Christensen writes:

"The technological changes that damage established companies are usually not radically new or difficult from a technological point of view. They do, however, have two important characteristics: First, they typically present a different package of performance attributes—ones that, at least at the outset, are not valued by existing customers. Second, the performance attributes that existing customers do value improve at such a rapid rate that the new technology can later invade those established markets. Only at this point will mainstream customers want the technology. Unfortunately for the established suppliers, by then it is often too late: the pioneers of the new technology dominate the market."

2. But we always felt bad when we were.
3. Bowers & Christensen, Disruptive Business Innovation: Catching The Wave, Harvard Business Review, January 1995, https://hbr.org/1995/01/disruptive-technologies-catching-the-wave

PART 1
PART 2
BEFORE WE BEGIN: DISRUPTING DISRUPTION
PART 3
PART 4
PART 5
PART 6
PART 7
PART 8

We all know the Polaroid/digital camera analogies. But what was the last genuinely disruptive innovation in our sector? It might be the arrival of platforms in the UK in the early 2000s. Or it might be passive management. (It almost certainly is passive management.)

In 2015, Christensen realised he'd created a monster[4]:

"In our experience, too many people who speak of "disruption" have not read a serious book or article on the subject. Too frequently, they use the term loosely to invoke the concept of innovation in support of whatever it is they wish to do."

That point about recruiting the words of innovation and disruption for just whatever it is you wish to do is at the heart of why what we think of as disruption in our own sector fails to achieve much of anything, including the crucial area of pricing. Your robo-adviser isn't disrupting anything if all it is trying to do is punt a basket of ETFs with a nice website on the front end and some adverts.

Christensen's term for making an industry better without smashing it apart is **'sustaining innovation'.** We think that's a much better description of what we do in retail financial services.

Most of what we think of as disruption in our sector is actually sustaining innovation. That is to say, it's a (cool, exciting, even transformative) way of making the existing landscape better while keeping the train on the tracks.

SO WHAT DO WE DO?

The first thing we need to do is get our language right, and save the D word for things that really are different. That counts for this paper too. Sustaining innovations are good things and can improve outcomes markedly for end clients and the advisers who serve them. Most of the pricing challenges and innovations you'll read about in the following pages are sustaining innovations, not disrupting ones.

Next, we're going to have to accept that the changes we seek – especially if we are interested in 'disrupting' pricing (which is to say, more explicitly, lowering it) won't come from the incumbents. It will be businesses which don't have the constraint (and power/momentum) of legacy. It's no accident that the sponsors of this paper aren't mainstream names.

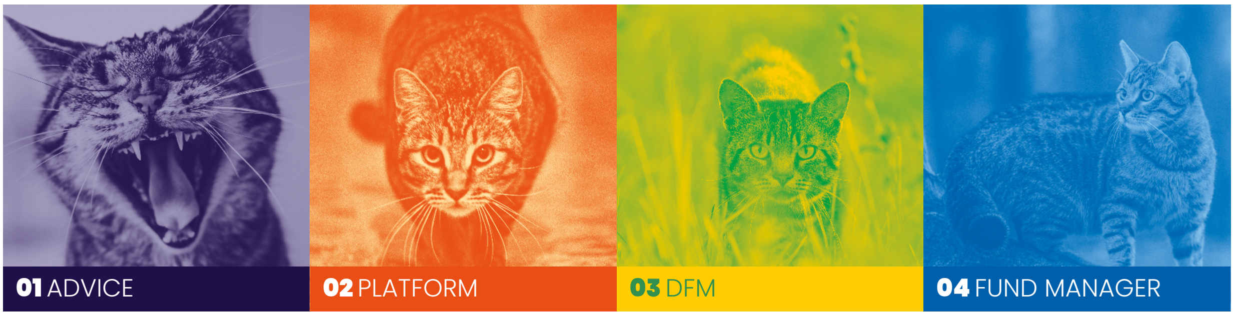
And finally we will have to accept that the practices of the past won't be the ones of the future.

Maybe we won't have a lot of disruption as Christensen envisages it. But, as we hope to show through the rest of this paper, there is plenty of scope for pricing to evolve.

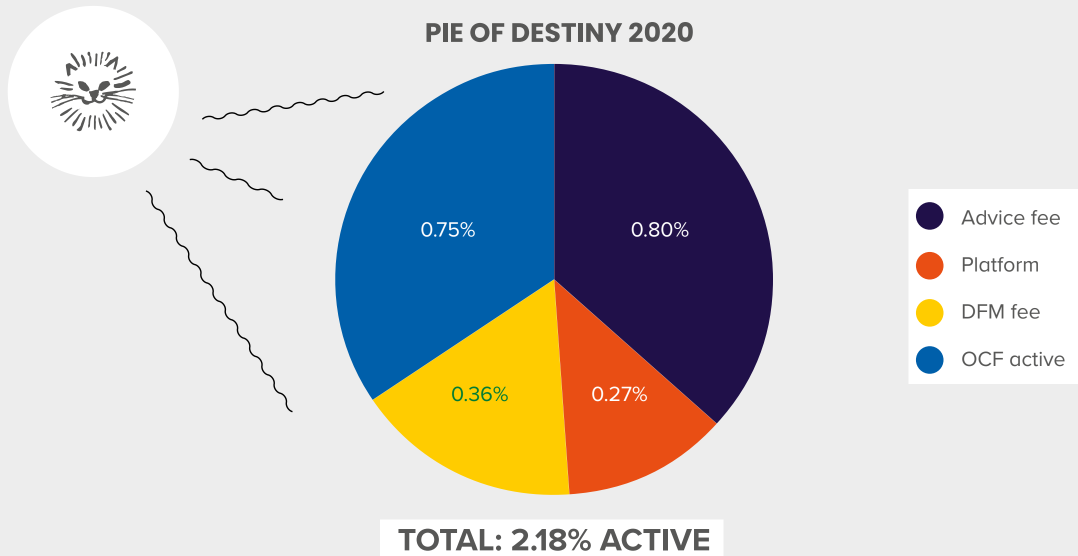
4 Christensen, Raynor & McDonald, What Is Disruptive Innovation?, Harvard Business Review, December 2015, https://hbr.org/2015/12/what-is-disruptive-innovation

WHERE WE ARE NOW: ADVICE, PLATFORM, DFM, FUND MANAGER[5]

From this point we'll divide each of our sections into the four major market participants.



Some years ago, we created the Pie of Destiny, which was a pie chart that showed the constituent elements of a typical RDR-compliant active portfolio. After a while we retired it, but we think there's value in bringing it back here. We've built it on active portfolios – some readers will be screaming right now, but it will all make sense as we move through the paper. We'll start over the next few pages by looking at how the Pie of Destiny breaks down.



5. John le Carré's less successful follow-up novel.

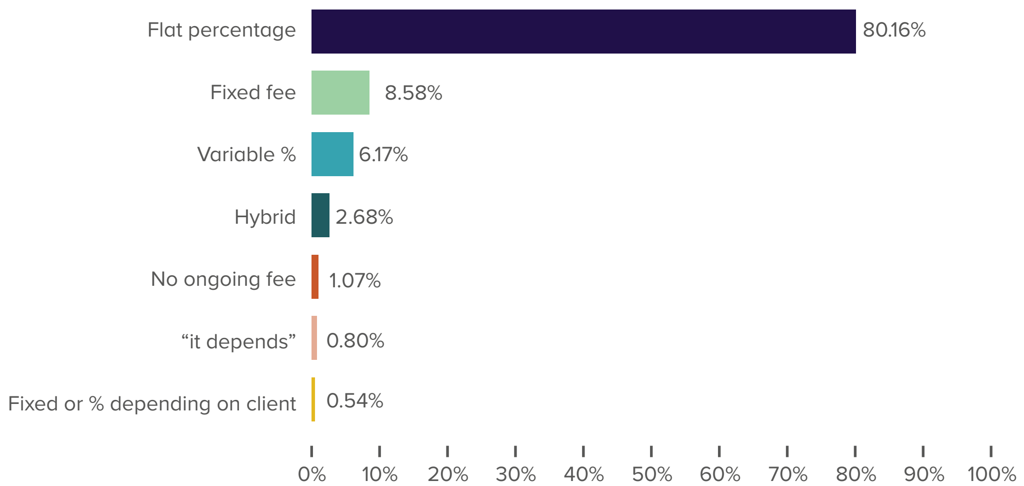
PART 1
PART 2
PART 3
WHERE WE ARE NOW: ADVICE, PLATFORM, DFM, FUND MANAGER
PART 4
PART 5
PART 6
PART 7
PART 8

01 ADVICE

First up is the pricing of the advice market. We'll turn here to our annual survey of the advice market, *State of the Adviser Nation* (SOTAN), which surveyed just over 400 firms and was published in Q1 2020.

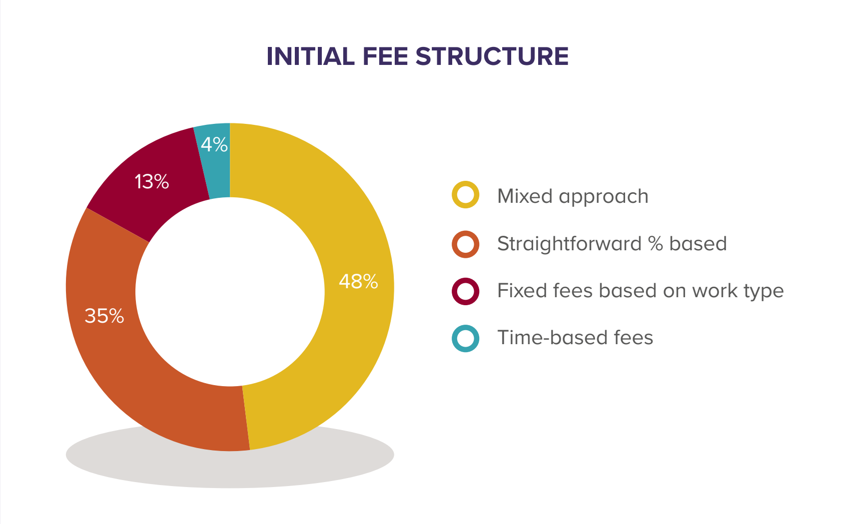
It's clear from the chart below that percentage-based charging still rules the roost for ongoing advice and service. In fact, 80% of respondents only use percentage-based charging. 9% say they use some kind of fixed fee and only 6% go for variable percentage charging shapes such as tiered.

ONGOING ADVISER CHARGING

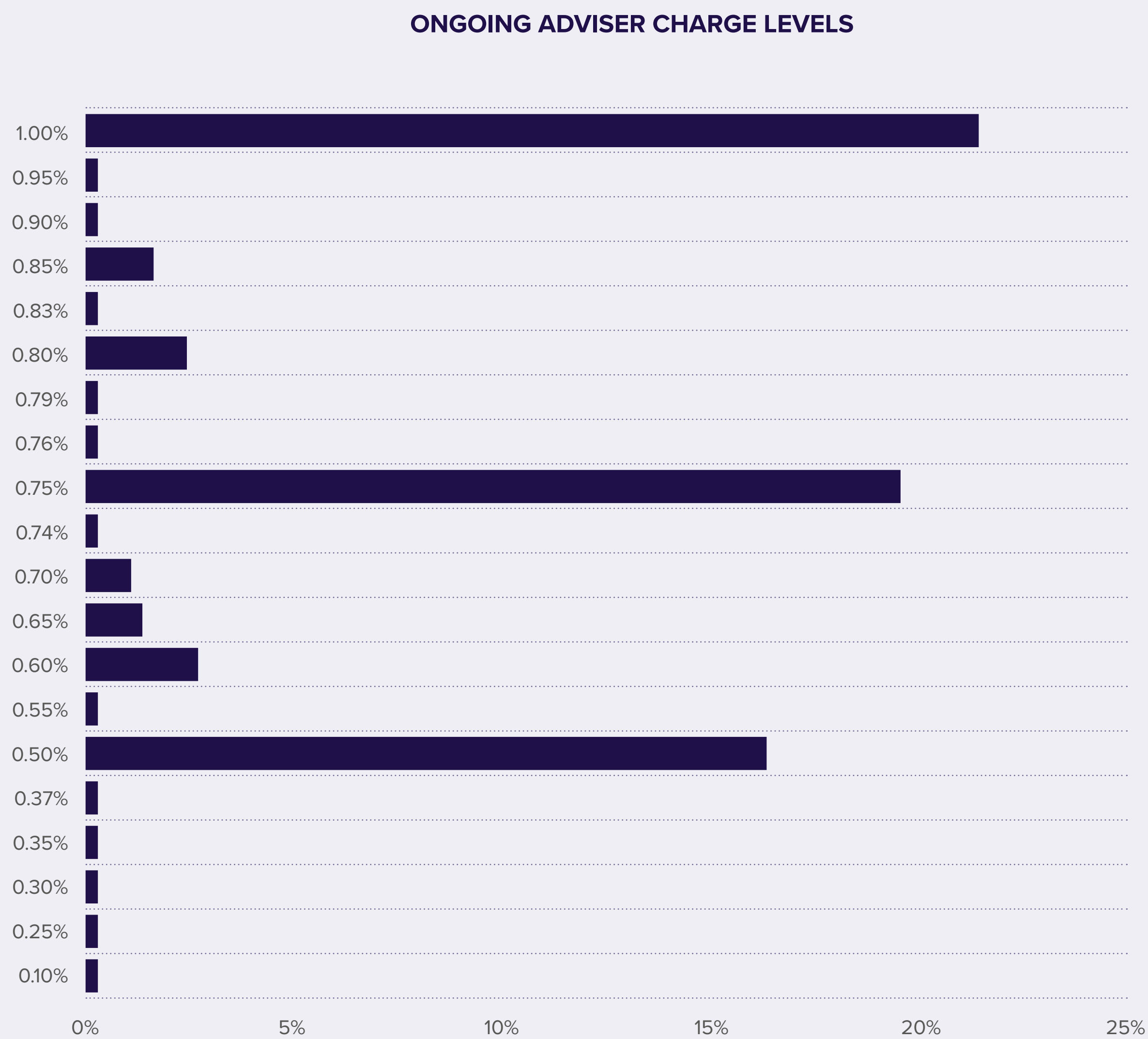


> “We use an algorithm that reduces the level of both initial and ongoing fees the more money we manage for clients.”
>
> **SOTAN IFA respondent**

Initial advice is a bit more varied, but even here more than 8 out of 10 adviser cats have either a straight percentage or a mix.



Fans of round numbers are clearly drawn to the advice profession; just look at the clusters at 1%, 0.75% and 0.5% for ongoing. We aren't in three-plus-a-half world anymore, but if there was a two-plus-point-seven-five world then we'd pretty much be in that. For now, we'll use 0.8% as a reasonable mean average.



PART 1
PART 2
PART 3
WHERE WE ARE NOW: ADVICE, PLATFORM, DFM, FUND MANAGER
PART 4
PART 5
PART 6
PART 7
PART 8

02 PLATFORM

Conveniently, we recently published research on platform pricing movement over the last five years. The table below[6] shows a downward trend – but it's important to note that this is published pricing rather than back-room deals.

	£100k	£500k	£1m	£2m	£5m
2015 MEAN AVERAGE	0.43%	0.32%	0.28%	0.23%	0.19%
2020 MEAN AVERAGE	0.37%	0.27%	0.22%	0.17%	0.12%
REDUCTION	15.45%	14.67%	20.89%	27.21%	34.38%

The lang cat's own Platform Analyser system allows advisers to input special deals, and without breaking any confidences we see high incidences of reduced percentage charges on existing tiered structures. One or two platforms are happy to amend the tiering itself for the right account. Next to no deals are done based on fixed fees or other pricing structures.

On that subject, the last fixed fee horses rode out of town in the last year or so – Alliance Trust Savings is now part of Embark and no longer offers fixed fees, while Wealthtime has made it clear that fixed fees won't be part of its offer in future either. Only one platform – Aegon Retirement Choices – offers a cap as standard, though some other platforms' special deals do offer a 'zero tier' above a certain amount (typically £1m) which is the same thing. A couple offer modular pricing based not just on portfolio size, but on which elements of the platform service the firm wants to use – Multrees Investor Services being a prime example[7].

6. Source: the lang cat, 2020. From research available to our paid subscribers. Do feel free to ask … Based on a fund-only model portfolio, 50% SIPP, 25% ISA, 25% GIA. Quarterly rebalancing included to correct a 2% drift.
7. Sponsor plug alert #1.

03 DFM

If we're using a platform we must be holding something on it, and about half of firms outsource at least some of their client assets[8] to third-party discretionary MPS. The chart at the bottom of the page shows the investment approaches firms use, along with the average amount of business placed there for firms who use that approach, and the average for the market as a whole. So we can see that where firms are using a DFM, about a third of assets go that way; across the market just under 20% of flows are going to MPS.

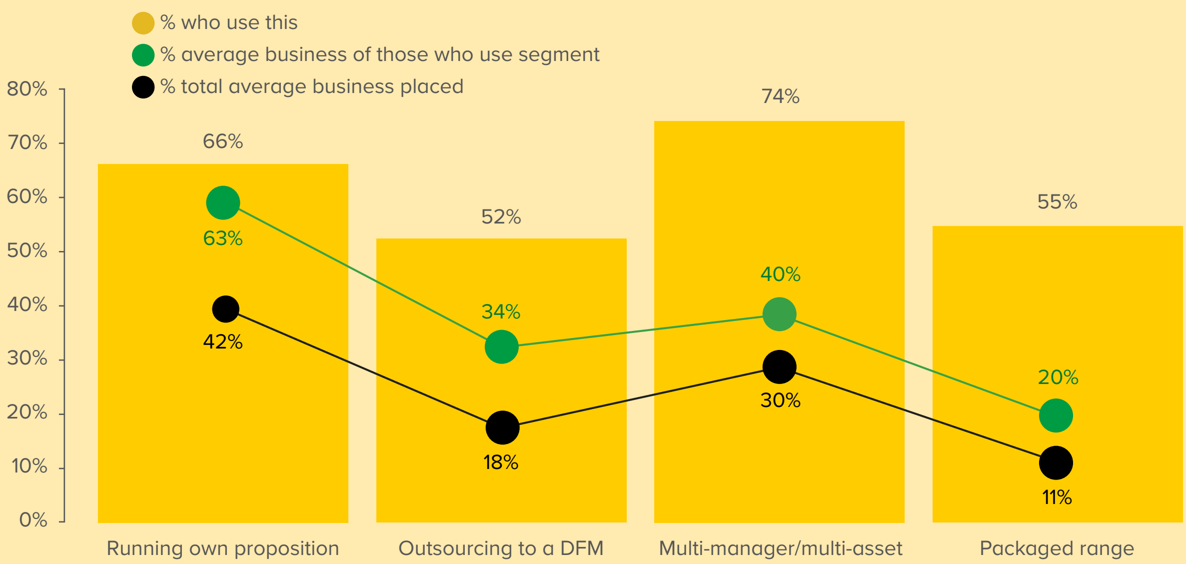
Average charges don't help us much here – but typical charges are either 0.25% or 0.3% plus VAT on the entire portfolio, with no tiering or capping. 0.36% including VAT is a decent market proxy.

Some firms are bringing the price down, such as Tatton with its 0.15% charge and no VAT. Some vertically integrated firms are also pressuring costs down, with AJ Bell's MPS also coming in at 0.15% but with VAT on top.

(The VAT issue is a thorny one and in flux at the moment; Brewin Dolphin's recent announcement that it is removing VAT may well be the inflection point and we expect VAT on these portfolios to be a thing of the past in the next year or so.)

And just one or two firms are doing something a little more interesting – particularly Sparrows Capital[9] both on a standalone basis and through Intelliflo's IMPS offering.

PART 1
PART 2
PART 3
WHERE WE ARE NOW: ADVICE, PLATFORM, DFM, FUND MANAGER
PART 4
PART 5
PART 6
PART 7
PART 8

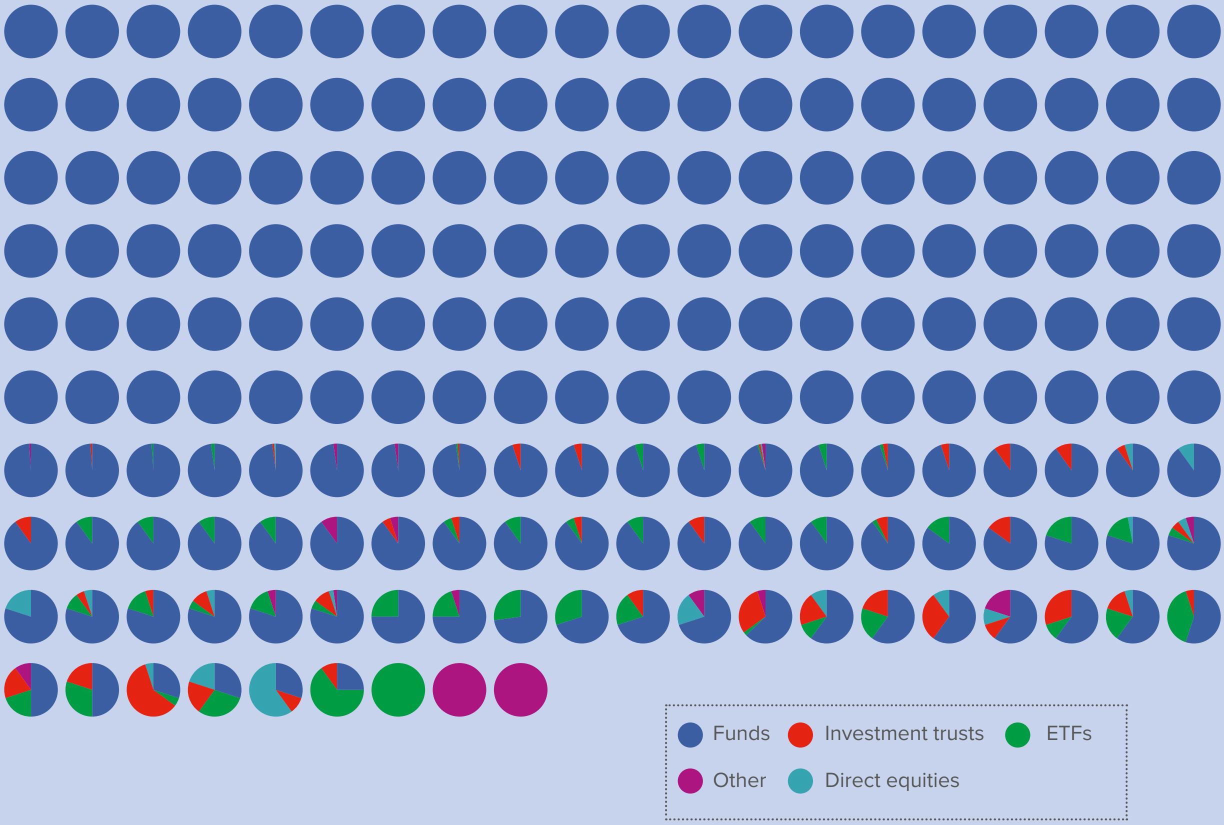


8. Source: *State Of The Adviser Nation*, the lang cat, 2019-20.
9. Sponsor plug alert #2.

04 FUND MANAGER

If we have a portfolio then we'll need to put something in it, and our SOTAN survey found that well over 90% of the assets advisers invest on behalf of their clients go into OEICs of one form or another (the rest is cash, investment trusts and the occasional ETF). So fund managers are a big part of our story.

ROUGHLY WHAT PROPORTION OF THE FOLLOWING INSTRUMENTS MAKE UP YOUR MODEL PORTFOLIOS?



There are clearly as many fund OCFs as there are funds, but all bar a few work on a straight percentage with no discounts for size or anything else, really. Those few working in a different way include Orbis[10] and others trying to make performance fees work. We'll return to this as a subject.

Our SOTAN survey also asked firms what their typical mid-risk portfolio OCF is, whether insourced or outsourced. To the right are the ranges we found.

Again, a straight mean average doesn't help much here, but we'd suggest a passive portfolio is priced on average at around 0.2%, a core/satellite portfolio at around 0.5% and a straight active portfolio at around 0.75%.

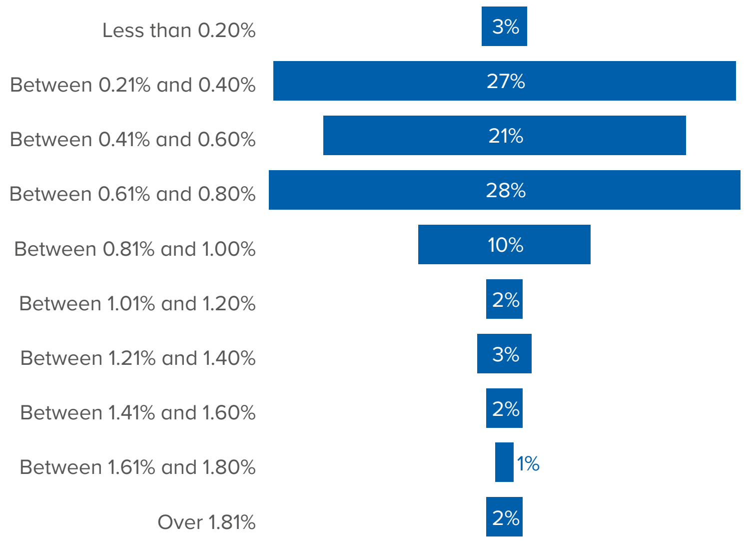
One thing that's undeniable is that virtually every fund advisers use is charged on a flat percentage basis. This is so self-evident that we don't even test it, but we're confident usage of funds which have either symmetric or asymmetric fee elements is minimal in this context.[11]

We looked at price stability in platforms a moment ago; it's only right we should do the same for asset management. Happily, the FCA's Asset Management Study[12] was vocal on this issue when it was published in June 2017. Have a look at the marked difference between active and passive OCFs over the reference period[13]:

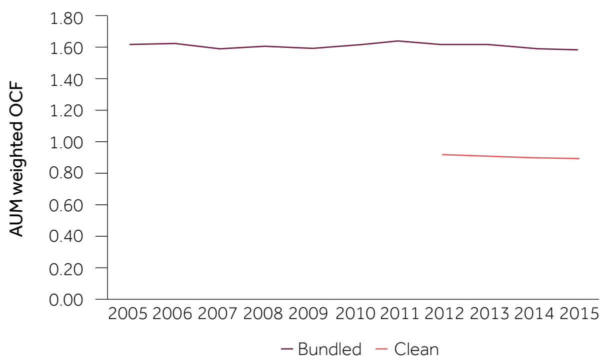
The reason we highlight this is that when we move on to talking about price innovation, we don't need to talk about passive very much. The market here has correctly identified that lower is better in forms of price, and is taking care of it nicely. It will be – you'll see – much more important for us to think about where active management goes from here.

And yes, in our book passive management is disruptive innovation.

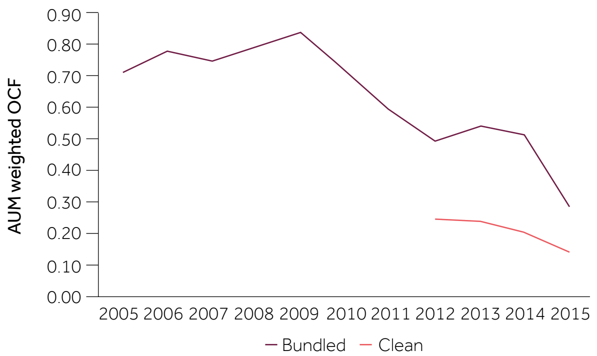
WHAT'S THE OCF OF YOUR MOST COMMONLY USED MID-RISK MODEL PORTFOLIO?



TRENDS IN THE AUM WEIGHTED OCF FOR ACTIVE SHARE CLASSES OVER TIME



TRENDS IN THE ASSET-WEIGHTED OCF FOR INDEX-TRACKING SHARE CLASSES OVER TIME



Source: OCF data and information about the fees structure of share classes from a sample of asset managers enriched with information from Morningstar direct. AUM data from Morning star Direct.

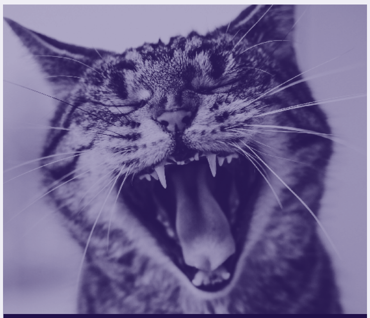
10. You worked it out. Sponsor plug #3.
11. For an interesting definition of these structures see Clare et al, Heads we win, tails you lose: why don't more fund managers offer symmetric performance fees?, Cass Business School, October 2014.
12. FCA, MS 15/2.3: The Asset Management Market Study, Final Report, June 2017, https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf
13. Graphs reproduced by us from MS 15/2.3, pp. 35-36.

THE SERENITY TO ACCEPT THE THINGS WE CAN'T CHANGE

We'll be honest – if we had our way we'd do courage and identify what should change first, because we're tigers. Rarrr![14] And so on.

Actually, though, it works out fine. Because although it's fun to throw rocks to see what happens, the truth is that not everything is awful all the time, and somewhere out there are a bunch of advised clients getting good outcomes, achieving their goals and being happy along the way. We just don't read about them all that often.

There are some things that aren't going to change in our sector, and we need to understand that. We'll make this section short, and run through what we think is immovable, one way or the other, for each of our four main market participants. Our rule of thumb is that if it would require a massive structural shift in the industry to change it, then it's beyond the ability of adviser firms to influence it and so it's out of scope.



01 ADVICE

Advisers don't have it easy, and – as we saw in the last section – they are often the single most expensive element of the chain. There are a few key reasons for that, and they will help us understand the things that can't change for this most important group.

Economies of scale – it's hard to argue that advice scales in the way that fund management obviously does. The personal nature of advice (forget robo-advice for now) simply means the more clients the more bodies, layers of management and additional cost, all of which needs to be paid for. Advice at scale remains a highly challenging endeavour and it's no surprise that large advice firms aren't any cheaper than small ones. So we can't just assume that the consolidation trend, or trying to inject scale into the sector, will lead to pricing change.

The shape of advice – initial advice is usually more intensive than ongoing (with the exception of spikes of work around major life events). Serenity dictates that we can't wish that away and in most cases firms will have to match effort to charging in at least some fashion.

Regulation – successive waves of regulation including FAMR have made it clear that advice must be charged as advice. It isn't possible to have 'free' advice paid for by retrocessions from funds, or platforms, or anything else. It is possible to bundle some charges, but they have to be broken out in disclosure. So we need to be comfortable with the fact that we can't drop the price of advice by hiding it away somewhere else.

14 We're sorry about that bit.

02 PLATFORM

"Ad valorem pricing is effectively an insurance premium. Larger retail client portfolios carry more, not less risk."

Chris Fisher,
Chief Executive, Multrees Investor Services

The direct consumer market shows us that pricing model variability is possible; there is nothing stopping advised platforms doing the same. That said, here are a few home truths...

Costs scale with portfolio size (at least a bit) – regulatory requirements mean platforms have to reserve more capital the bigger they get. Operational costs increase, as does the risk of mistakes in execution, so although it seems perverse that a wealthy client needs to pay more in case their platform screws up, that's the reality.

Cross subsidy is a fact of life – if a platform wants an adviser to place a chunk of their book on it, it'll have to create a charging structure that works at multiple portfolio points. Some degree of redistribution of charge load from small portfolios to larger ones is a natural part of that and isn't going away any time soon[15].

Fixed fees went away and have no plans to return. We need to be serene about that. However, that's the only thing we need to be serene about.

03 DFM

"There's a category difference between active and passive DFM MPS. The active side is akin to hiring an investment consultancy to pick funds for you, but an investment consultancy has no liability and so tends to charge fixed fees rather than a percentage of your clients' assets."

Mark Northway
Sparrows Capital

DFMs are an interesting constituency in all this. The assets – in the models we're talking about in this paper – aren't in their own custody. They hold minimal operational risk; they need to key the right rebalances in, but that's it. What the client is paying for, then, is intellectual capital and a bit of administration, and some form of responsibility that the portfolio is following its given mandate.

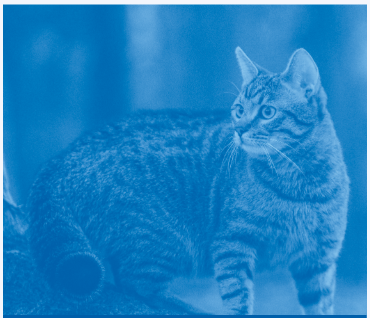
It's worth saying that, just as we did for asset management in the last section, we need to draw a distinction between passive and active MPS. The former is simply trying to fulfil a particular risk level at the lowest available profitable price. The latter is trying to bring a lot more to the table, and is charging for it.

On that basis, we don't think there's a lot of serenity required here. This is a market participant who can do all sorts of stuff.

We'll mention one constraint – as we know from working with Sparrows in the past on its fixed fee DFM proposition, most platforms can't deal with calculating, deducting and remitting fixed DFM fees, though they can do for advisers. If we're honest, we don't feel too serene about that, so you may well find the issue popping up in the next section.

15. Who knew platforms were so socialist?

PART 1
PART 2
PART 3
PART 4
THE SERENITY TO ACCEPT THE THINGS WE CAN'T CHANGE
PART 5
PART 6
PART 7
PART 8



04 FUND MANAGER

Ah, fund managers. It may not be a surprise that we don't feel serene about very much to do with fund management. While it's certainly true that some costs of fund management scale as fund size grows, it's certainly not the case that they do so in a perfect union, up and to the right, forever and ever.

We are thinking about fund management – and everything else – in the context of retail intermediated business, so we will be serene about the fact that the OEIC structure is here to stay and keep ourselves pretty much to the mainstream.

As we mentioned in the last section we need to distinguish between active and passive here, in terms of serenity and the scope of this paper. When you can readily buy a mainstream index fund from a major provider for 0.08%, there isn't that much left to go at. So we'll stick a pin in passive management for now, and concentrate on the active sector.

“If we want to drive overall costs down including fund manager fees then we need to talk about the cost of advice and model portfolio services in the same way. We should never compare the costs of funds and MPS as the operational costs are completely different. An optical cost is not necessarily the actual total cost. Distributors and platforms are playing both pusher and junkie here. Pusher because they have facilitated opaque fee structures and services with minimal oversight; for advisers and DFMs, junkie because they have started to use their own product and launching their own DFM and MPS offerings.

An example. I read reports that Woodford Equity Income Fund investors “footed the bill for £16m worth of wind-up costs so far, including £11.0m paid out to Blackrock for getting rid of the liquid stocks, £3.2m for PJT for disposing of the illiquid stuff and £2.5m to law firm Debevoise & Plimpton for assisting with the illiquid transaction as well.”

My call to action is more focus on DFMs and MPS through the same value lens as for funds. A better discussion of the total costs of fund management to allow fairer comparison. Should we pay for safe custody and governance? I think so. You probably do too. However has anyone asked Ms Miggins? Unlikely. What then is the cost of weaker governance? Nothing obvious until it all goes wrong as it so frequently can. Then you want to pay for the controls but not all propositions offer the same quality of regulatory protection or governance. Time for transparency to level the playing field rather than allowing firms to play disingenuous and opaque regulatory and cost arbitrage. Caveat emptor.”

Jon 'JB' Beckett
Author, New Fund Order, NED, fund selector and (steam)punk[16]

16. JB would like us to point out that you can buy his book, New Fund Order, here.

THE COURAGE TO CHANGE THE THINGS WE CAN

And so we come to the most important part of this paper – what can we change? Back in our *Better. Stronger. Faster.* **paper we suggested that the total cost chain for advised retail investment could easily come down by 0.5% or more; a significant and welcome slice out of that pie we saw on page 7. As you'll see, as we've gone deeper in this paper, we think we might have lowballed that figure.**

We talked about apple carts a little bit in the opening of this paper, and this is where we start to upset them. Remember, this is about innovation in pricing, not just doing the same thing for slightly fewer basis points.

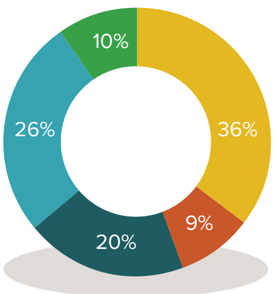
For each of our four constituent elements, we'll look at forms of pricing innovation[17] which we think should be doable with enough vim, vigour and commitment. There are bound to be some we haven't thought of yet; we feel sure you'll let us know if so. We'll rate each suggestion for impact, doability and likelihood. And in the next section, we'll add a 'wisdom' overlay to work out whether we really should be pushing at that door.

01 ADVICE

The current basis of charging for advice may not be broken, but it's certainly flawed. It simply doesn't cost twice as much to look after a £250,000 SIPP as a £125,000 one. Portfolio size is a pretty poor indicator (except at the far margins) of service requirement, and there is too much of something we call 'lazy upside'. This is where advisers are remunerated for something they haven't had anything to do with – markets go up; a client puts a bit of their bonus into their ISA – and is inevitably open to challenge.

It's tough for advisers in a time of rising regulatory costs and professional indemnity premiums – but equally, as we found in SOTAN, few advisers have 'given blood' so far. Only 9% of firms have proactively reduced client total cost of ownership (TCO) by cutting fees, compared to over a third who have done so by changing their investment approach.

"Have you changed clients' total cost of ownership in recent years?"



- Proactively reduced customer total cost of ownership (TCO) by way of the investment component
- Proactively reduced customer TCO with your adviser charging
- Proactively reduced customer TCO due to product or platform charges
- Charges have organically come down a bit due to marginal price reductions out of my control
- If anything it's increased slightly

17. Nearly said disruption there, but got away with it.

PART 1
PART 2
PART 3
PART 4
PART 5
THE COURAGE TO CHANGE THE THINGS WE CAN
PART 6
PART 7
PART 8

That's not a surprise; those who are closest to the client tend to be able to defend their pricing the longest. But in a world where everything's under pressure, it feels like some of that pressure will inevitably come to bear on advisers.

Of the near-endless potential pricing options, these are some we think could be workable.

01 ADVICE

1. FIXED MONETARY FEE FOR ONGOING ADVICE

As we saw earlier, fixed fees for upfront work are already relatively common. The arguments against them for ongoing advice are well-worn but are generally veiled versions of "clients won't pay the fees if we surface them in this way". One firm that has found this isn't the case is Capital Asset Management, whose CEO, Alan Smith, says, *"there are lots of reasons to charge basis points, but it's a conflict of interest. If you believe as we do that the greatest value you provide is in strategic planning for clients, then it makes sense to align your pricing with that. Concentrating your charging on the assets inside a pension or an ISA misses out the value you deliver on all other areas of the client's life."*

Capital targets wealthy individuals, but that's not true for every fixed fee firm. Niche IFA in South Wales also offers a fixed fee option at a much lower price point and Ray Adams, its chairman, says *"The key for us is efficiency. The days of sitting with a client for 2-3 hours writing down their fact find, then spending a few hours typing it into a back office software and then rekeying into other software tools has to end too…How can it be fair to pass these multiple hours of expensive adviser time onto the client?"*

Although two clients with similar needs where one has, say, £1m and another has £5m might pay the same under this model, there is clearly some requirement for the wealthier client to shoulder some more of the burden – even if it's just a greater share of the PII costs. So fixed fee doesn't have to mean every client pays the same – that cross-subsidy that makes advice affordable for slightly less affluent clients can stay in.

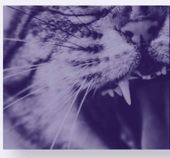
Another dimension to this is to consider risk pricing. IFA firms may charge, say, 0.75% ongoing. They accept that this ongoing fee revenue may fluctuate by up to 10% or even more in a volatile year, but hope fees will rise over time with markets, and that the risk will pay off. With recency biases fully intact, the last decade since the Global Financial Crisis does suggest this will happen,

> "We attract a lot of clients by actively publishing our fees on our website. We routinely charge our clients from various backgrounds directly and we are continuing to service clients from most socio-economic backgrounds with ease. The key to maintaining efficiency and profitability for us is that combination of using best of breed technology as well as having the right staff for each part of the job!"
>
> **Matthew Wiltshire**
> **Managing Director, Niche IFA**

and lots of IFA pricing models were born in the last decade. But fixed pricing takes an element of that risk off the table. Over time, that should mean fees across an adviser's book take up less of the clients' portfolios: it would help with transparency too.

Fixed fees act as a 'gating' mechanism – those who can't make their peace with them simply don't darken the adviser's door. Despite that, firms wanting to put fixed fees in place should consider some kind of health warning for clients with smaller portfolios rather than leaving them to do the maths. And of course, that health warning becomes less and less of an issue depending on where the firm sets its minimum fees.

Finally, a fixed fee doesn't have to be an overall one. It could be an hourly fee with an estimate next to it. This has been a successful model[18] for some planners in the USA but hasn't yet found its feet in the UK.



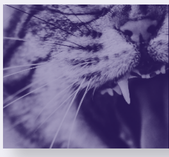
IMPACT ON FEES .... LOW
DOABILITY ....HIGH
LIKELIHOOD ....MEDIUM

18. For a great exposition on this, read founder of the XY Planning Network Alan Moore's piece on his experience as an hourly planner: https://www.wealthmanagement.com/2015-compensation-survey/compensation-survey-2015-can-hourly-fa-survive

2. SUBSCRIPTION MODEL

A form of fixed fee where a monthly commitment (usually) entitles clients to a given amount of service, it's often talked of as a route to encourage younger clients, who are used to mobile phone contracts and Netflix, to get onto the advice bus. It neatly removes the link between portfolio size and service, but firms would have to be pretty clear on what £100pm (say) would buy – an annual phone call and the ability to sue if the advice isn't good doesn't feel like something that would keep a client motivated in month seven. There may well be a place for this, and it's good to break that link to investment management, but it feels further off than committing to fees in advance based on an assessment of the likely work for that client. There's absolutely no guarantee that this will lead to a reduction of the overall fee burden either – a modest subscription of £100pm is a zesty 2.4% a year of a £50k SIPP and that doesn't feel great. It might be possible to detach the subscription fee from the product (see below), but that will likely lead to VAT issues and push the total cost back up again.

Nonetheless some commentators, such as EY, believe that subscription models have the ability to remake the industry; its NextWave Consumer Financial Services report from 2019 asserts that *"the industry will become the new subscription-based model, and in doing so, we will witness the disintermediation of the financial service from the financial product. The catalyst will be the concept of "the consumer's personal financial operating system," a dynamic, trusted and embedded digital experience that helps consumers improve their financial lives through constant, relevant, daily interaction and engagement."*



IMPACT ON FEES.... LOW ●
DOABILITY ....MEDIUM ● ●
LIKELIHOOD .... LOW ●

"Our clients have taken quickly to a fixed subscription model. It does need some positioning and it forces you to have clear discussions on value, but that's healthy. One aspect that's been particularly positive with our clients is the sense of 'fair play' – that they're neither subsidising other clients nor being subsidised by them. We wouldn't work any other way now."

Matt Pitcher
Managing Partner, Altor Wealth

3. SPLIT PLANNING AND ADVICE

Planning, as you no doubt know, is unregulated. Advice on investments, pensions and so on is *highly* regulated, and we all know that TCO inside regulated products is a) easy to measure and b) an area of keen regulatory focus. The idea here is to have two separate fee schedules – one is (probably) percentage-based, linked to and recovered through the investment product . The other is a fee-for-service model which covers financial planning, cashflow modelling, behavioural coaching and general financial wellness.

This is seductive on a number of levels[19]. Firstly, it retains some of the percentage-based upside (lazy or otherwise) that has been the engine room of so many advice firms' growth over the years. But by aligning regulated advice with that form of charging, it makes it clear that there's a difference between tax optimisation, picking portfolios, or managing drawdown and creating meaningful financial plans, creating positive financial behaviours and working on goals. That latter part (arguably) sits uncomfortably with the regulated part anyway; many financial planners feel that the boring investment-y bit muddies the water.

The benefit of this is that the client understands what she's paying for. The charge 'load' on the portfolio is reduced, and while there may be VAT payable on the fees for the coaching element, that may not be such a stark issue as in the pure subscription model above. It's not unthinkable that an ongoing adviser charge of, say, 0.8% could be halved, with the rest of the revenue coming from coaching fees.

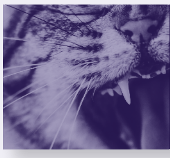
19. Like love in a multi-storey car park. Or a lift. That's enough of that now.

01 ADVICE

Presentation is key here and not everyone's a fan. Alan Smith again: *"I think it can be a bit of a fudge. For us, we are happy to reference each element that we take care of, but we present that as one total fee and that works for us and our clients."*

A further downside is that it isn't necessarily cheaper for the client. It also requires confidence on the part of the financial planner, that she provides enough valuable service in coaching and planning to stand alone apart from the regulated services.

Nonetheless, we think this is in keeping with the direction of travel on regulation and, while it will take some time to calibrate properly and get used to, could be a persuasive model in future.



IMPACT ON FEES .MEDIUM ● ●
DOABILITY ....HIGH ● ● ●
LIKELIHOOD ....MEDIUM ● ●

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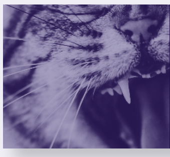
4. TIERING, CAPPING & COLLARING

All other things being equal, this is the simplest 'innovation' to achieve. Many firms already offer a form of tiering, where advice fees are stepped. So if you come in with a £1m portfolio, you might pay 0.7%, whereas it's 0.8% up to that amount. The problem, of course, is that a £900k portfolio costs the client £7,200, and the £1m portfolio costs £7,000. So the differentials get squeezed, or the firm does a special deal for clients close to the 'step' and the de facto step point gets lower and lower.

The answer is to have smarter tiering. But the problem here is that too many platforms – more than half the market – don't offer tiered advice charge functionality[20]. So firms that can't get their platform to (for example) charge 0.8% on the first £500k, 0.6% on the second £500k and 0.2% thereafter, end up having to do a sort of fudge where they work out what the composite charge would be and put that in as a flat percentage, which theoretically gets reset every year, except obviously it doesn't.

This is both dumb and easy to fix.

The same goes for caps (maximum fees) and collars (minimum fees). All can be achieved and justified quite simply, as long as the functionality is there. We think this is the most likely way in which fees will trend down for advice; it allows firms to put their competitive foot forward for the client segment sizes that they most want, and it's not too innovative. A sustaining innovation indeed. Now all we need is for the provider/platform sector to build the fee module functionality.



IMPACT ON FEES .MEDIUM ● ●
DOABILITY ....HIGH ● ● ●
LIKELIHOOD ....HIGH ● ● ●

20. Ten do: The Aegon Platform, Ascentric, James Hay, Multrees, Novia, P1, Parmenion, Raymond James, Seven IM and Wealthtime.

02 PLATFORM

We've already given platforms something to do in terms of new developments with tiered adviser charging, but we see no reason to stop there as we don't want them getting bored.

As we saw on page 10, platforms have given blood already in terms of reductions on book price, and we all know special deals are rife. So in terms of straight-up basis points pricing, the job of getting client fees down is already happening thanks to strong buying pressure from adviser firms. We will set our thoughts, then, to more innovative ideas which may or may not sit comfortably alongside established practice.

1. CAPPED FEES

No surprises here – platforms should, in our opinion, offer fee caps. There comes a point at which you've just made enough money from a client. This is functionally very easy; most platforms have the ability to create new pricing tiers before breakfast. Aegon currently leads the market with its cap, and it's worth noting that Vanguard does the same thing over on the direct side. More of this sort of thing would still allow some level of risk pricing for larger investors but be a bit more realistic. We know of a few platforms that get down to 0.01% above a certain amount; we'll grudgingly allow that, but the main thing is to get pricing tiering down quite sharply once the threshold has been reached.

It's not all completely straightforward, though. Chris Fisher, Chief Executive of Multrees Investor Services, highlights that *"capped pricing fails to acknowledge the custody risk associated with retail clients, though many of the platform admin services e.g. reporting, could carry a fixed fee. Ad valorem pricing is effectively an insurance premium. Larger retail client portfolios carry more, not less risk."*

IMPACT ON FEES .MEDIUM ●●
DOABILITY ....HIGH ●●●
LIKELIHOOD ....HIGH ●●●

2. MODULAR PRICING

Now we get into something a bit different. The concept here is that it's rare for an adviser firm to use everything a platform provider makes available. You may use the client portal but not the portfolio management engine because you prefer multi-asset funds. You may never use the CGT tool but rate the investment research facilities. And so on.

It's not something that pains most advisers; that's because the client pays. In many cases, it isn't a hard argument to make that clients are paying for functionality they don't need.

One potential way to reduce the cost of platforms is to make a business decision about what you want to use and what you don't. You will obviously need central client registry, custody and execution, client money, and some kind of service layer, along with an online portal where your own administrators can work. But beyond that, platforms can be broken down into a host of services, all of which can be priced separately. Providers can decide what gets sold standalone, what's bundled (so maybe portfolio management and premium reporting go hand in hand) and even whether a basis points charge to the client is appropriate (see the next bit).

One provider that works this way already is Multrees[21], where firms make a decision at the start of the relationship which modules of the MIS proposition they want to use, and the price shifts as a result. We also see optionality of this kind from 'white label' platform providers like IFDL, but relatively few have brought it into the mainstream.

> "For some of our more institutional clients we operate a dual ad valorem custody fee, and a fixed per account maintenance fee to cover non-custody services. Most client firms however prefer the variable cost model of ad valorem pricing all round."
>
> **Chris Fisher**
> **Chief Executive, Multrees Investor Services**

02 PLATFORM

To be clear, this isn't a way for platforms to ship their current bundled offering at its existing price and then add some bits on the side for ancillary revenue. This is about going back to the fundamentals of what platforms are and can do for both client and firm, thinking fresh about how to offer them.

A key element here is client contact. The lowest pricing deals in the market – from Multrees, Hubwise, Seccl and other similar 'white label' platforms – are reserved for situations where the adviser firm deals with all client contact, and limits contact between the firm itself and the platform provider to a number of key individuals who can be well trained in how to navigate the platform's quirks and procedures.

This approach can significantly suppress platform charges to perhaps 0.12% a year or much lower. It does throw more responsibility back onto the adviser firm itself (not necessarily becoming a platform operator in its own right, though that model is available through entrants such as Hubwise and Seccl), but even the level of support can be flexible. Importantly, businesses such as these and other newer entrants such as Fundment are built to work at these lower costs; this isn't a special deal which is subject to buyer's regret from the provider that really wanted to be doing the business at 0.35% before the Head of Sales got involved. We think there's huge potential here for professional, well put together firms.

IMPACT ON FEES....HIGH ●●●
DOABILITY ....MEDIUM ●●
LIKELIHOOD ....HIGH ●●●

3. ADVISER PAYS

In this model, we acknowledge that an as-yet-undefined percentage of the benefits of platforms accrue to the adviser firm rather than the client. Efficiencies, bulk client management, portfolio tools and so on are all very nice, but the client doesn't get much from them. The way we know that, of course, is that advice is no cheaper post-RDR and the advent of platforms than it was before; in fact the old 0.5% baked-in trail has headed north, as we saw earlier.

In this model, then, offered by just a few platforms, the adviser firm accepts an invoice for the platform's charges, marks it up and passes it on as part of its overall advice fee. The defence here is that it's just software, and no client gets asked for basis points to pay for Intelligent Office.

There have been examples of certain platforms agreeing to levy 'service charges' in addition to their own normal charges and then remitting these back to the adviser firm. This aims to do the same thing – to let the adviser firm take a revenue share. But whereas the 'adviser pays' model involves an element of risk transference onto the firm, this leaves things as they are and – we think – requires a quite remarkable amount of crowbar work to fit it into the regulations.

In practice, most adviser pays models so far have involved the adviser firm becoming the platform operator themselves; we see this in arrangements like the one between Clifton Wealth and Hubwise. The firm is doing more and taking over functions from the platform so it gets to take some of the revenue, and the best way to do that is for the firm to charge clients what it believes is appropriate, and the platform to do the same to the firm.

This model won't be for everyone, but for scale firms who are ready and willing to invest in technology, middle office operations and take the SM&CR responsibilities seriously there is the potential to not only generate some margin, but also reduce the total cost of investing.

IMPACT ON FEES.MEDIUM ●●
DOABILITY .... LOW ●
LIKELIHOOD ....MEDIUM ●●

21. Sponsor...oh, you get the idea.

While platforms have already given blood, the DFM MPS sector is, as yet, only in the very early stages of the same prospect and certainly hasn't earned a cup of sugary tea and a biscuit, let alone a badge. That said, as we sent this report to press we saw a new MPS service from Investec being launched at 0.24% instead of the more typical 0.3% before VAT, so there's always hope[22].

Before we dig in, this sector bears a little more discussion. As we mentioned earlier, we're really concentrating on active MPS in terms of potential disruption and innovation; there's a category difference between passive or indexed portfolio managers who are simply monetising their intellectual property – see below for more on that – and active managers.

There's an abiding question with this part of the value chain – why doesn't the manager simply create a series of multi-manager OEICs and be done with it? The answer, explains Mark Northway of Sparrows Capital is that *"the costs of wrapping a portfolio in an OEIC are substantial, as is the operational cost. One of the huge benefits of platforms is that they allow managers to 'unwrap' multi-asset funds."*

Research by the lang cat and CWC Research a few years ago[23], showed that the mean average OCF for an 'active' DFM MPS was around 0.6%, which makes 0.96% with a typical 0.36% access charge. By contrast, the like-for-like average OCF of a multi-manager fund was 1.06%. We expect these have trended down a bit since 2017, but not by much, and probably in lockstep.

It's important because if we're to think about how pricing is to shift for DFM MPS, we need to get past the 'lower is better' axiom. If that were true, vertically integrated propositions which don't charge an access fee but which limit the investment universe to proprietary funds would rule the roost. If active DFMs aren't just interested in monetising the IP they've put into creating core portfolios for their own wealth clients further in the IFA space, then their motivations can only be to sell their own funds, or to capture big market share with aggressively low pricing.

So let's have a think about how pricing could shift beyond a simple race to the bottom in a hope to capture market share.

1. FIXED FEE

As we mentioned on page 15, an on-platform DFM MPS (which is what we're covering in this paper) is effectively intellectual property (IP) with a bit of execution and administration. That's something which sits strangely with an uncapped ad valorem charge which is often as much as or more than the platform charge itself.

Enter fixed fee DFM propositions, which allow firms to 'rent' the IP for a set amount per client per month, and which take the execution risk on the chin.

So far, there are only two flat fee DFMs in the UK we're aware of; Sparrows Capital and Betafolio[24], but that surely won't be the case forever. There are also issues with platform functionality – again this is not beyond the wit of humanity or head of proposition to fix.

> "We use the Sparrows DFM service and love the fixed fee approach as it chimes with how we charge our clients. We're all used to subscription models now and why should investment management be different? Our one frustration is that the platforms can't deal with capped or fixed fee DFM charging, so we end up having to do more behind the scenes as a result. We really need them to get their act in gear; we think this is the way the industry will go."
>
> **Matt Pitcher**
> **Managing Partner, Altor Wealth**

22. This is satire and written with love. Hello Investec.
23. the lang cat and CWC Research, Never Mind The Quality, Feel The Width 3, 2017.
24. Updated 9 November to include Betafolio.

PART 1
PART 2
PART 3
PART 4
PART 5
THE COURAGE TO CHANGE THE THINGS WE CAN
PART 6
PART 7
PART 8

03 DFM

As with any fixed fee vs ad valorem proposition, there is a cross-over or arbitrage in terms of fees. But would a ‘typical’ IFA client balk at, say, £20pm for her portfolio management? We suspect not. For the record, that £240 (and it’s not a given that VAT needs charged) would equal 0.24% on a £100k portfolio, or just under 0.1% on a more typical £250k portfolio.

If we’re interested in suppressing the total cost of ownership, then fixed fee DFM MPS seems a logical way to take basis points out of the value chain.

IMPACT ON FEES ....HIGH
DOABILITY ....HIGH
LIKELIHOOD ....MEDIUM

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2. TIERED WITH CAP

It’s entirely inside the gift of DFMs to tier their charges; the platforms will need to build the functionality but please see earlier comments about not getting bored. If what we are doing is renting IP, then there is little room for ‘lazy upside’.

Within this shape, we have the capability to say that there is a point where enough is enough, and to introduce a zero tier. Must a £1m client pay 0.36% in the same way as a £100k client for their risk-banded global multi-asset portfolio, 100% invested in mainstream long-only mutual funds? Does the £1m client get 10x the value? Or does the £100k client get only 10% of the value?

IP is valuable, though. And so it might be reasonable for a DFM to say that it has a minimum ‘collar’ at the bottom end – this behaves a bit like a fixed fee. Would it be credible for an adviser to say “look, I’d like to get Lang Cat Wealth Management to run your money; they charge 0.15% of your assets for the first £500k and nothing above that, but their minimum annual charge is £500, so if you dip below £333k or so, their fee will start to rise as a percentage of your assets.”

We think it might.

IMPACT ON FEES ....HIGH
DOABILITY ....HIGH
LIKELIHOOD ....MEDIUM

---

3. ADVISER PAYS

This is simple and needn’t detain us. The firm simply buys in the IP and carries the cost inside their own adviser charge to the client. This is effectively the base model of Dimensional, but in our version the DFM would still execute rebalances and so on, if only to reduce the MiFID II burden.

As with the platform ‘adviser pays’ model, the issue here is that inviting a third party into an area of service doesn’t necessarily mean the cost goes down, so some care is required. But most firms are acutely aware of competitive pressure, and so we can probably trust the market to do its thing. Nonetheless, this feels like something for larger firms, and at some point you have to ask whether firms aren’t better just insourcing and building their own capabilities.

IMPACT ON FEES.... LOW
DOABILITY ....MEDIUM
LIKELIHOOD .... LOW

PART 1
PART 2
PART 3
PART 4
PART 5
THE COURAGE TO CHANGE THE THINGS WE CAN
PART 6
PART 7
PART 8

04 FUND MANAGER

Here we go. Crack your knuckles. As Dave Ferguson of Nucleus says, *"active fund management is over priced, over supplied and under delivers, and the cost should fall 33% in the next five years"*[25]. We think it can do at least that, and here are some ways we think it could happen. Most of these echo the FCA's Asset Management Market Study (AMMS), which noted the #thirtysixpercent profit margin of the fund management industry but preferred to leave it to those particular foxes to sort that henhouse out.

Just like with DFMs, let's pause here to think a little bit more about the nature of this bit of the value chain. There is an inherent danger in papers like this – though we're fighting it as much as we can – to simply say that lower is better, and that managers should cut their fees and be done with it.

The problem is that the entire enterprise of fund management, especially active management based on fixed percentages, is an asset-gathering game. If you cut your price, you simply need to gather more assets for the same shareholder return, and eventually – as we've seen with some very high profile funds – size becomes an enemy of outperformance. As steampunk, independent NED and author Jon 'JB' Beckett[26], says, "*cottage industries [are] turning into soaring oligopolies.*"

So where does this take us? Marcel Bradshaw of our sponsors Orbis says, "*we need to look at the incentive for the manager – is it the growth of the firm, or the performance of the asset?*" If we believe it's the latter, then judging funds on their OCF isn't much help, especially as it encourages us to compare the apples of active to the oranges of indexed management.

Instead, we might be better served looking at **net of fee returns and alpha generated**. And when it comes to costs, for active managers the yardstick must surely be "how much of the alpha the manager has generated do I give up in fees?" To put it another way that advisers would recognise, "no-one cares about costs when you're getting double-digit returns."

> "...many costs are unseen by investors. Third parties have been strangling the fund industry and inflating costs for years. Today this is legal, accepted and morally permissible. The industry has tolerated what were cottage industries turning into soaring monolithic towers, because everyone was focused on size, growing assets and thus reducing costs per £1. These services often favour large size business models (ad valorem). When we talk about economies of scale then there are a lot of oligopolies in the supplier space and so price competition for smaller and mid-sized fund managers is weak. When large fund managers become larger then their profits are supernormal since they rarely discount fees back to investors and the regulatory capital cost and small tweaks to operations are easily exceeded by significant multiples. If the reverse was true then firms would not pay millions to acquire asset books."
>
> **'JB' Beckett**
> **Author, iNED and investment (steam) punk**

Done right, and platforms certainly already have the data to be able to publish this 'share of alpha' metric, it opens out the market to new approaches, and feeds things like Assessment of Value reports. It's a relatively subtle change in outlook, but could have a profound effect in enabling the sort of innovations we'll look at now.

25. https://www.ftadviser.com/investments/2020/09/24/nucleus-boss-expects-fees-to-fall-by-33-in-five-years/
26. JB would like to point out again that you can still buy his book New Fund Order here.

04 FUND MANAGER

1. TIERED/STEPPED

We've made our views on rewarding individual holdings per client clear, but other tiering mechanisms are absolutely possible: by fund size overall, or by share class size where unique share classes exist for a particular platform.

This is a formal mechanism for baking in fund charge reductions. There are clearly subtleties in the space which might militate against a mechanistic approach such as this, and managers such as Vanguard and, latterly, Baillie Gifford have reduced charges.

Nonetheless, might professional advisers favour a well-run fund which sets out in stone how it will reduce charges as it grows? This would be in the spirit of the AMMS and, we suspect, might make a number of firms very happy. Shareholders, not so much.

IMPACT ON FEES .MEDIUM ● ●
DOABILITY ....HIGH ● ● ●
LIKELIHOOD ....MEDIUM ● ●

2. PERFORMANCE FEES

> “Fixed percentage charged funds can't ensure value for money. They have to chase scale, especially during periods of fee compression. And all the risk of that sits with the client, not the manager, because he gets paid whatever happens. The nature of an investment product is that you can't predict VFM. So in our view the only way to ensure a client gets a fair shake is to align the incentives. In our model, the only way we get paid is if we deliver. We don't make anything if we don't add alpha to the client. But if we add significant alpha then we get paid well. The alignment of incentives means that we are absolutely focused on alpha generation, not on being a benchmark-hugger or worrying about being a basis point or two more or less for a particular strategy.”
>
> **Marcel Bradshaw**
> **UK Retail Director, Orbis Investments**

This isn't a new argument, but it is one which deserves to resurface as we start to think more deeply about what alpha generation, active share and the avoidance of closet trackers really means. It's also, for the record, probably the only genuinely disruptive innovation in this whole paper.

One way to think about performance fees is as an intensification of the alignment of interests, as we see from Orbis. When the manager doesn't deliver performance above a certain level of alpha generation, she doesn't get all her charges. Within this concept is a wealth of nuance. We don't want a fund manager chasing raw performance at any price, or going all-out at the end of a reference period because the numbers are a bit shy and he promised his kids a PlayStation 5. But this is manageable with appropriate incentive structures, and performance payments too.

We won't rehash all the performance fee arguments here – our sponsor Orbis sums it up better than we can. But we will observe that if we're looking for innovation in pricing of asset management, we can't just rely on managers voting for Christmas[27], and adviser firms will need to evidence some kind of appetite for this kind of risk-sharing.

We also can't rely on the venerable 2+20 private equity fund model. That doesn't align interests in the way we're talking about here – the fund manager still makes her 2% irrespective of what happens.

27. Yes, we just called them turkeys.

04 FUND MANAGER

Much like the modular platform approach, this doesn't work if the upside for fund managers in years of plenty is so high that over a reasonable lifetime the total charges are more than a typical flat percentage fund. The fund manager might wish that were the case, but that's not the game here. The point is to align interests to be sure, but to accept that in a typical standard distribution of investment returns, the fund will probably generate less in fees than the 'soaring oligopolies' mentioned above; if it shoots the lights out every year then no-one will argue with those charges being higher than your average.

IMPACT ON FEES.MEDIUM ● ●
DOABILITY ....MEDIUM ● ●
LIKELIHOOD .... LOW ●

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3. INSTITUTIONAL V RETAIL

We'll finish with what we think might be the single most impactful pricing innovation out of the 13 we've suggested so far. It's not disruptive in a Clay Christensen sense, but it is one which is entirely in the gift of fund managers, requires no new development or coding, but does require managers to accept less revenue. This is our Jerry Maguire moment, and we look to the stars.

The great lie about platforms is that they've made institutional style investment available to retail investors. This was never true but is even less true now.

The argument against allowing retail investors access to 'insto' share classes is obvious: deal sizes aren't big enough. But in our market we do have aggregation of deals, so it's not (always) the case that every deal coming through is a £2.50 repurchase as a result of a single rebalance. Electronic messaging systems reduce transaction costs still further irrespective of deal size.

No-one is arguing that retail should get the same deal as pension funds or local authorities buying a million units at a time. But the differential is just too big right now. Affluent clients, with their asset deals aggregated, are paying schmucks' rates. This is just wrong.

We'd argue for a share class for mainstream funds that is priced between a pure insto price and the retail price. To sweeten the deal, we wonder if more can be done to aggregate deals in new ways. Can platform operators who share custodians but have (understandably) completely segregated custody pool their resources when it comes to trading? If not, why not?

And within this is our most unpalatable truth. Fund management, of all our constituent elements, is the most resistant to pricing innovation; its fortunes must and should be inextricably linked to investment performance.

The thing that needs to change; the sustaining innovation; is that it just needs to cost less. Platforms have given blood. DFMs are about to spring a leak. Advisers will drift down, but they carry the can for almost everything that goes wrong and need to be paid for that. Beyond that we have a shortage of Type AB, and fund managers are best placed to provide it. Those that can see this can take, we believe, major market share very fast.

We think it should be possible for everyone to keep their respect, and for a typical diversified active mid-risk portfolio to drop by at least 20 basis points, purely by asset managers recognising that not all the retail market is icky, and rewarding that with a new in-between class.

IMPACT ON FEES....HIGH ● ● ●
DOABILITY ....HIGH ● ● ●
LIKELIHOOD ....MEDIUM ● ●

PART 1
PART 2
PART 3
PART 4
PART 5
THE COURAGE TO CHANGE THE THINGS WE CAN
PART 6
PART 7
PART 8

“THIS TIME IN FIVE YEARS… WE’LL HAVE SLIGHTLY LOWER RETAIL INVESTMENT PRICING.”

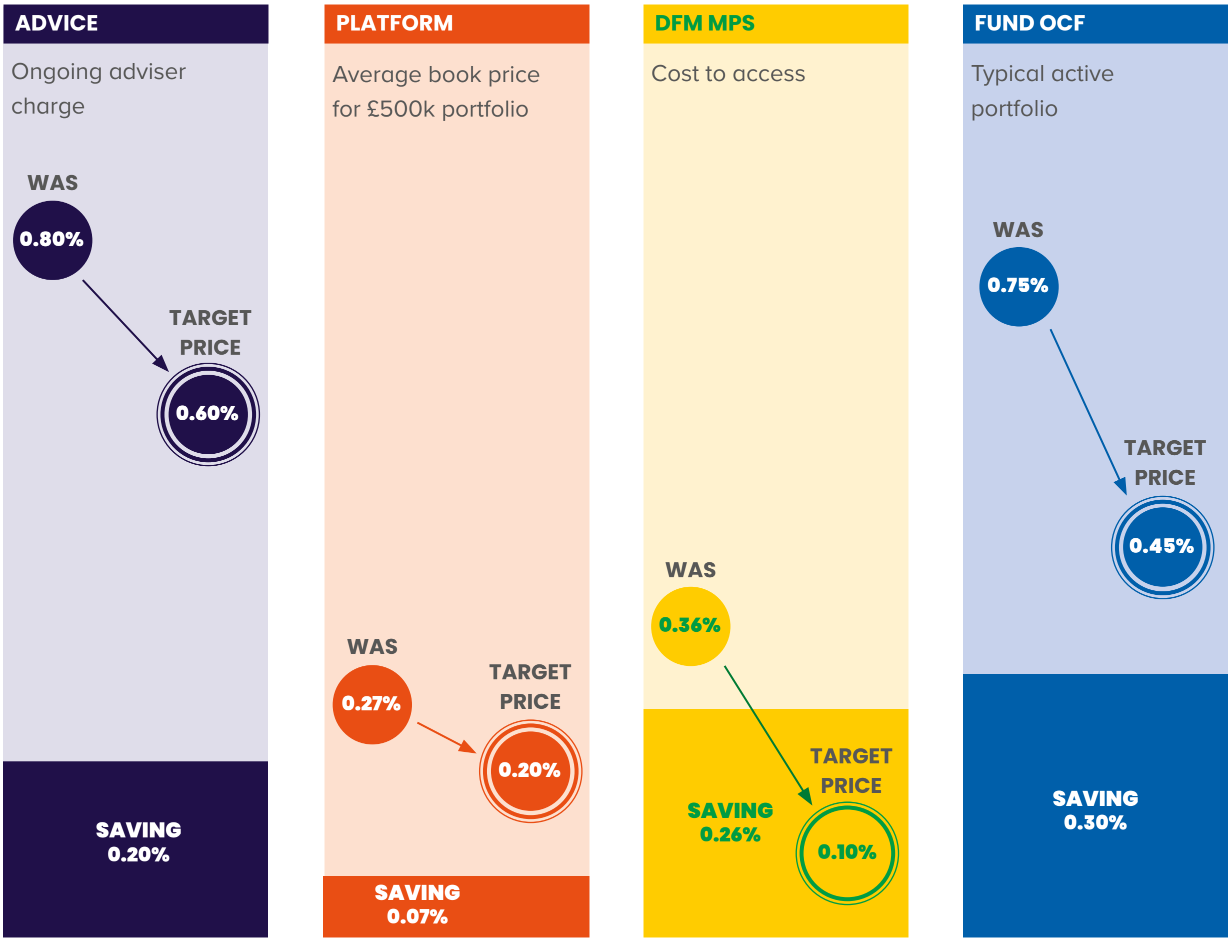
Let’s give our future selves something to be embarrassed about and estimate what our suggested measures could do to TCO within the next five years.

	INNOVATION	SUMMARY	PRICING IMPACT BY 2025
01 ADVICE 	**Fixed fee for ongoing advice**	Probably brings down advice cost for wealthiest clients only.	c. 0.1% for portfolios over £500k only
	Subscription model	May be more expensive for early stage clients, but will balance out.	c. 0.1% for portfolios over £100k or so
	Split planning and advice	Unknowable overall – but would seriously drop the regulated/ disclosed amount.	0.3% – 0.4% but only on the regulated element
	Tier/cap/collar	Happening informally now, but should still reduce charges over time.	0.1% – 0.2%
02 PLATFORM 	**Capped fees**	Should make a big difference for larger portfolios; modest across the market.	0.05%
	Modular pricing	Could unlock the big move from 0.3% or so down to 0.2% or lower for larger firms.	0.1%
	Adviser pays	Not a given that it will reduce cost to client, but would anticipate at least a small benefit longer term.	0.05%
03 DFM 	**Fixed fee**	Could be a major shift; all but lowest portfolio sizes benefit.	0.2%
	Tiered with cap	Depends where the cap is set, but could be just as impactful as fixed fee.	0.2%
	Adviser pays	Like platform – not a given that cost to client reduces, but would expect some sharing of benefit to justify approach.	0.1%
04 FUND MANAGER 	**Tiered / stepped**	No reason why this shouldn’t have a modest but positive impact in the context of diversified portfolios.	0.1%
	Performance fees	Hard to judge, but for a normal distribution of returns we’d expect to see a benefit overall.	0.1%
	Institutional v retail	The big one – simply sees fund managers offering lower cost share classes than ‘normal’ retail via platforms. Could make a very big (and overdue) difference.	0.3%

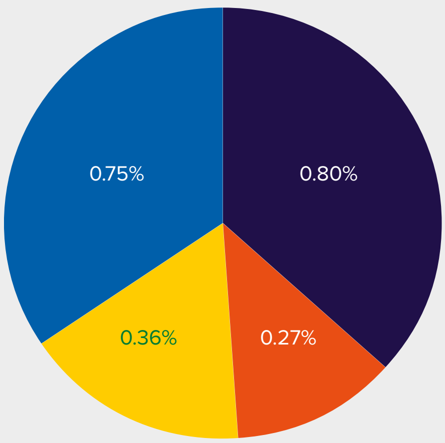
TARGET PRICE

None of this is a science. In practice prices will drift down anyway; the innovations we detail here are about step changes and won't happen in isolation. It's a big market with space for lots of different practices.

Nonetheless, we think we have enough to set a price target for our four main market participants for the next five years. Here we go...

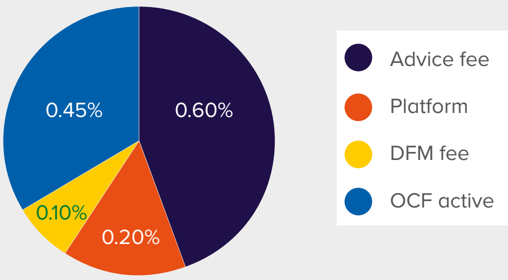


PIE OF DESTINY 2020



TOTAL: 2.18% ACTIVE

PIE OF DESTINY TARGET PRICE 2025



TOTAL: 1.35% ACTIVE

THE WISDOM TO TELL THE DIFFERENCE

We've seen 13 different approaches to getting costs under control in the retail intermediated investment market. There is room for movement in all parts of the chain, with the majority of the pain being felt by MPS providers and fund managers. Advisers are the most expensive part of the chain but get to defend their position robustly by being the bridge to the client and closest to them. Platforms have already taken some pain, but of course can always contribute a little more.

The question is: when is enough enough? At what point do we move beyond beneficial reductions in charges for clients and into the realm of unintended consequences?

CROSS-SUBSIDY CAN BE A GOOD THING

There's a reason percentage-based charging is so popular – it allows the industry to serve lower-value clients without charging them a disproportionate amount. The truth is that a client with £20,000 – and there are lots of them on adviser books, whatever people say – can't reasonably pay their fair share of fixed costs. It's desirable, then, that those with broader shoulders financially speaking pay a little more to ensure access for most, if not all. To move much of the sector to fixed fees and remove that element of cross subsidy risks freezing out potentially long-term valuable clients and restricting the size of the addressable market, not to mention widening the advice gap.

BARRIERS TO ENTRY

Innovation and even disruption are good things. But for a market to evolve and serve its customers better, there needs to be a profit pool to attack. It's notable that the big tech giants that are happy to carry losses for some years in order to generate huge profits later are generally participating in lightly regulated markets – taxis, advertising, shopping – and not in the brutally regulated world of intermediated investment. If we strong-arm fees too low, eventually we drive innovation out of the market and reduce the supply side of the sector to just a few very big, very rich scale providers. Maybe we get one or two well-funded kamikaze smaller new entrants, but maybe not. So if we want a vibrant sector, it has to be one which balances client good with incentives to enter and remain in the market.

REGULATORY TIGHT SQUEEZES

A couple of the routes we've suggested above involve adviser firms in particular taking on new roles and getting paid for new things. When done properly and well planned and resourced, this can work fine. But the temptation will be there – perhaps in ways we haven't thought of yet – for arbitrage and for some to walk the line of regulatory acceptability in order to reduce charges and/or to gain some additional revenue. That's a dangerous game; the FCA is not daft (despite what many advisers think) and is fully capable of shutting down areas of practice with which they aren't comfortable. Regulation is necessarily a blunt instrument – which is why principles-based regulation makes sense – and no-one wants to see the innovation baby being thrown out with the regulatory bathwater.

CONCLUSIONS: A CHANGE IS OR ISN'T COMING

So to sum up...

We know there are things we can't change, or which are so difficult to move with uncertain benefit that it's not worth the candle. We need to be serene about that.

But we know there are things we can do to get a grip on the cost of intermediated retail investment. We've identified 13 of those things, and our (admittedly optimistic) view of the future is that in the next five years, they and natural price compression could take something like a third out of the cost.

To put it another way, we think it will be relatively common to see ongoing charges including advice, custody, and a core/satellite portfolio at 1% in five years' time.

And we know that we can't just drive a coach and horses through the sector, as tempting as that might be. There is too much potential for detriment, and unintended consequence.

But if we accept our limitations, put our energies into where they can make a difference, and think things through, we can, should and must make this sector work better for clients; which will make it better for advisers and in fact better for anyone who hasn't got used to living off fat, unsustainable margins.

Let the next five years be a story of well executed, sustaining innovations.

We hope you enjoyed the paper. Thanks for reading.

THE LANG CAT
OCTOBER 2020

PART 1
PART 2
PART 3
PART 4
PART 5
PART 6
PART 7
CONCLUSIONS: A CHANGE IS OR ISN'T COMING
PART 8

MULTREES

Platform services that put the adviser in the driver's seat

At Multrees, we often find ourselves comparing traditional platform models to TV subscription packages. As anyone who has one of these subscriptions will know, they often provide access to many, many TV channels, which can drive up costs. But in reality, just how many of these channels does anyone actually use?

The same thing goes with many traditional platform providers, which expect the adviser's client to pay for access to a 'one size fits all' proposition that inevitably includes many services and functionality they simply don't need or want.

A 'one size fits all' platform also constrains the adviser to the restrictions of the platform proposition and limitations of a single system. This not only ignores the fact that adviser firms are different, meaning there will always be services that aren't relevant for their business, it also treats platforms as a single component. Quite the opposite: platforms are comprised of multiple parts, from custody through to trading, investment administration, client interaction portals, and more.

This is where a modular platform approach – with modular pricing – comes in, ensuring advisers and clients only pay for what they actually use. So, if only custody services are required, that's all the client pays for. And, importantly, there is still an option to access a full-service proposition if required.

The adviser takes the wheel

Our modular approach builds platform services entirely around the individual needs of each wealth management and adviser firm. Close collaboration from the outset ensures the adviser can shape the platform to their business model instead of having to accept that aspects of their business will be driven by whatever their platform is doing. And our flexible open architecture also individually configures platform services – from access to best-in-class services and tools through to seamless integration with third party technology.

For advisers this level of control also means that the platform sits much more in the background and will have little to no contact with the end customer for things like signatures and client paperwork. With greater controls comes the need for greater trust. In particular, the platform provider's compliance and risk team must be able to work closely enough with the adviser firm to know that rigorous controls are always followed. This trust ultimately allows processes such as account opening and transfers to be carried out far quicker. And, crucially, it gives advisers more control over the client user journey and greater ownership of their client relationships.

'One size fits all' may still be the dominant platform approach but we're here to change that for the better.

Multrees provides a fully white labelled service helping adviser firms to own the whole client journey, including enabling long term goal based centralised investment propositions. It is an award-winning provider of outsourced investment and platform services covering global custody, investment administration and technology, with £11 billion assets under management.

Contact andrew.back@multrees.com to find out more or visit www.multrees.com

Orbis
Invest Differently

TRUE PARTNERS SHARE IN BOTH PAIN AND PROFIT

At Orbis we believe that true wealth creation takes time. That is why we think of our investors as partners rather than clients. We look for investors who, like us, are obsessed with value for money and understand that the essence of a true partnership is that when things go well, both parties do well and when they go badly, the pain should be shared.

That is why our fees are linked directly to the outperformance we have, or have not generated on our clients' behalf. In other words, fees charged in good times are also subject to a refund mechanism during bad times.

We will not be the lowest cost asset manager in all situations but, when our fees are above average, it will be because we have delivered outstanding performance. Conversely, during periods when our performance is below average, our fees adjust to reflect this.

Currently, our approach is different to what the rest of the industry does. We believe our fees improve the value for money proposition for clients and our hope is that, over time, others will begin to take a similar approach. However, if they don't, we have never been afraid of being different.

Only pay for performance

Most funds charge a flat fee, regardless of how they perform. We don't. Our fee is based purely on performance.

No surprise fees

No entry, exit or ongoing charges. No administration or custody fees. No commission. That's our style.

In it together

Our fair fee structure means you pay when we outperform, and we refund during periods of underperformance.

Find out more about what we offer and how our fees work at www.orbis.com

PART 1
PART 2
PART 3
PART 4
PART 5
PART 6
PART 7
PART 8
ABOUT MULTREES, ORBIS AND SPARROWS CAPITAL

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