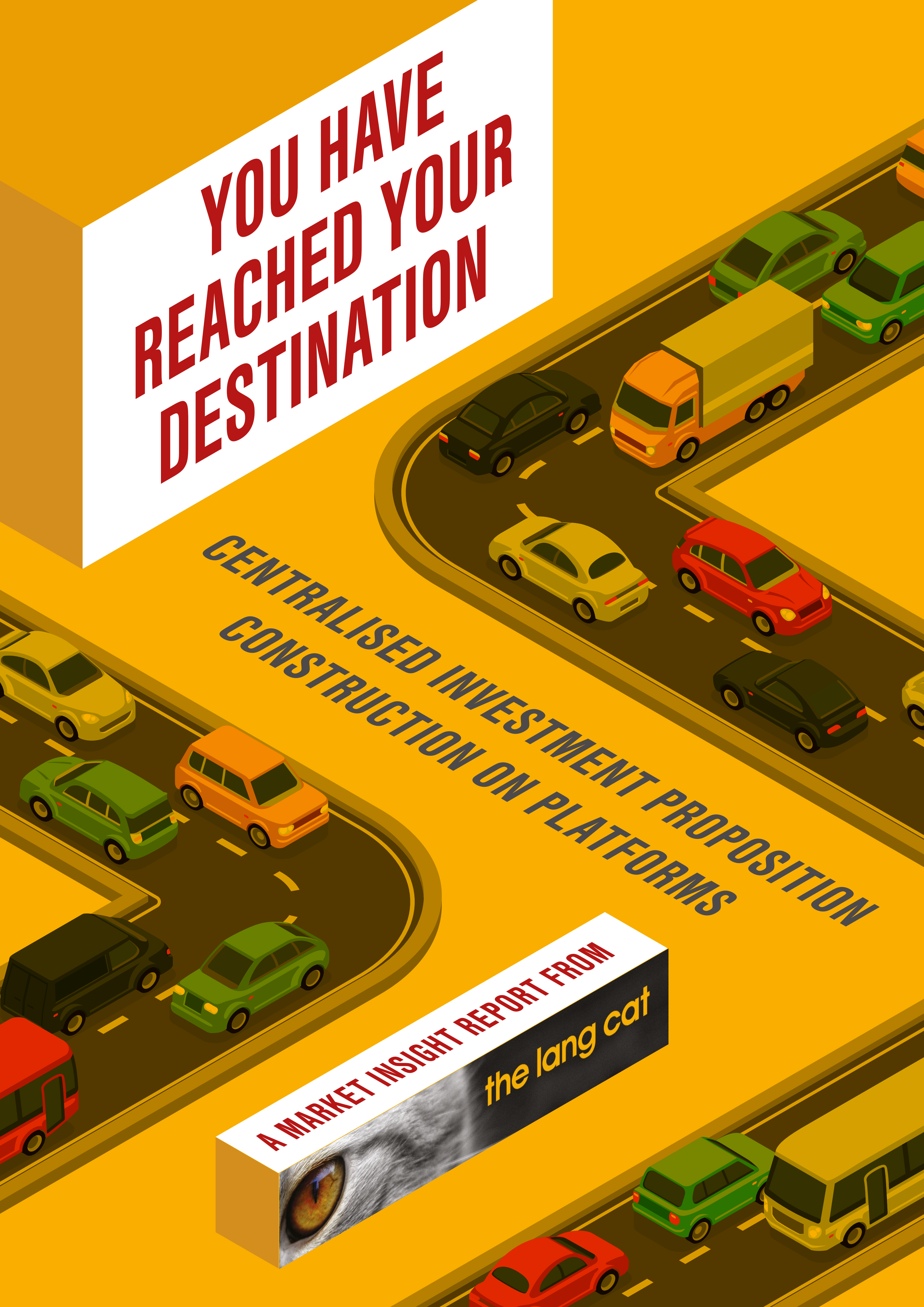

YOU HAVE
REACHED YOUR
DESTINATION
CENTRALISED INVESTMENT PROPOSITION
CONSTRUCTION ON PLATFORMS
A MARKET INSIGHT REPORT FROM
the lang cat

# BEFORE WE GET GOING

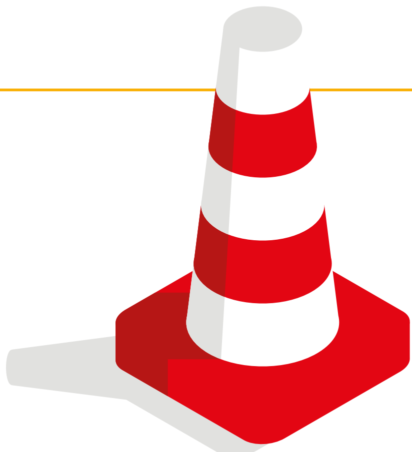
This paper was commissioned by Tatton Investment Management. Its primary focus is to take a look at how advisers construct centralised investment propositions for delivery on platform, and the advantages and drawbacks of the various routes.

There's no getting around the fact that this is a sponsored analysis; Tatton IM is paying the bill. Now, we're all grown-ups; Tatton isn't about to commission a piece of work which works directly against its own commercial interests. But it is (self-)interested in the issue of CIP construction and wants a balanced piece out there in the market; with no axe to grind in any direction. And that's where the lang cat comes in.

All this means we needed to set some ground rules. Firstly, we let Tatton check we got the facts right where we made reference to its own proposition. But we didn't let it check or challenge any other data or facts, especially on competing propositions.

Secondly, we believe that providers hire us for work such as this because of our independence and for the honest, direct and sometimes plain awkward opinions that come with it. The views we express here are our own and Tatton had **zero** editorial control or influence on the analysis. The paper is based on a combination of our experience in the market, our own research and views from advisers we speak to. The day we let ourselves be compromised is the day it all falls apart for us.

Trust that, or don't – but it is the truth.



# CONTENTS



# A NOTE ON RESEARCH

Throughout this report, you'll see references to 'our research' and various statistics. All these are taken from two lang cat publications:

- *The Great Mid-Life Crisis: State of the Platform Nation*, which is our 2017/18 guide to advised platforms. It was published in October 2017.
- *Never Mind The Quality, Feel The Width 3*, which is a joint annual study with CWC Research into the adviser outsourced investment market. NMTQFTW3 (as we call it to fool the unwary) was also released in October 2017. It surveyed hundreds of portfolios, and about 80 adviser firms. The fund and DFM data inside it was provided courtesy of FE and is used with thanks.

Both reports are available for purchase from www.langcatfinancial.co.uk

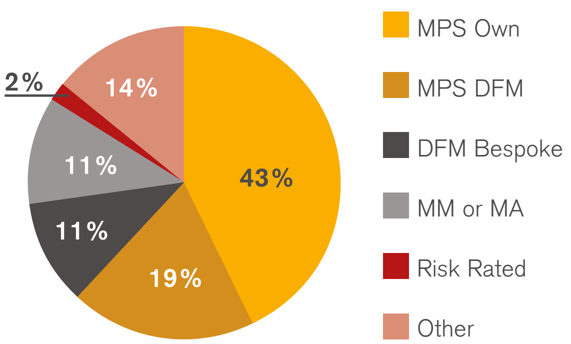


Hello, and welcome to this study from the lang cat on how advisers construct centralised investment propositions (CIPs) on platforms. If your travel plans today do not include CIPs, advisers, or platforms, now would be a perfect time to exit the vehicle.

Our job here is to stimulate debate about the relative merits of the three main routes for CIP construction. It'll come as no surprise to readers that our sponsor, Tatton Investment Management, quite likes the one that's about outsourcing to DFM model portfolio services (DFM MPS), but we'll spend an equal time on each.

As we write this, in late 2017, it's a quite remarkable time in this admittedly specialised subject. We took a check on the market over the summer, and you can see the results in the pie chart. There is a huge range of kit out there that you can use – but many of you do still choose to do it yourselves.

**HOW NEW BUSINESS IS INVESTED**




Before we dive in, when prepping and researching, we looked back over the evolution of what advisers could reasonably access through retail products, and we were struck by just how much has changed in the last fifteen years or so.

## THIS WAY AND THAT WAY

It helps to imagine a pendulum. Back in the late nineties or so, we all remember very limited unit-linked fund ranges, with varying levels of quality, which never got used because everyone was going straight into the unitised with-profits fund anyway.

Pendulums don't stay still for long, and in the early 2000s our imaginary one swung to the other extreme with the launch of open architecture offerings from Skandia MultiFunds, and Cofunds, and FundsNetwork (and Transact, but it didn't have 'funds' in its title and so didn't get invited to the cool kids' table). Suddenly advisers had thousands of funds to pick from. And they revelled in it; many firms relocated their entire offering into being investment experts.

And so we went on for a while. The platform market burgeoned. Fund offerings expanded still further as managers sprinted to capitalise on this new glorious open architectured dawn. But some firms were starting to feel a little pressured. With thousands of funds to choose from, and investment trusts, and more besides, how could they be sure of picking the right thing in all economic circumstances? Multi-asset funds and absolute return vehicles started cropping up more regularly in best-buy lists, and the pendulum inched slowly back down.

But then came the twin-headed beast of the global financial crisis and the Retail Distribution Review (RDR). This brought the pendulum slamming back to something like the centre. The RDR saw the unbundling of the advice process. Advice became the product, and the platform, tax wrapper and investment proposition all became parts of the supply chain. Many advisers took the opportunity (or needed to) refine, update and most importantly, evidence, their advice and investment propositions.

Add to that the increasing popularity of asset-allocated, Markowitz-powered modern portfolio theory and risk modelling, and science (or at least pseudo-science) started to muscle in too.

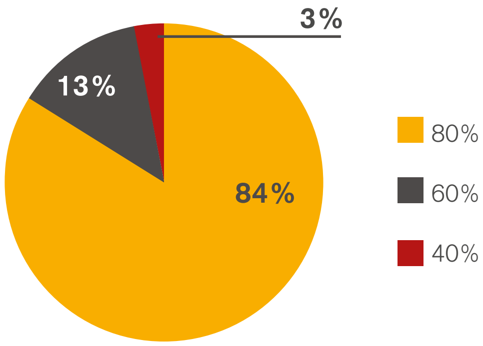
A good proportion of advisers took the view that investment management was either not a core expertise, or could be done better via the resources or experience available to a DFM.

It was only a matter of time until the regulator jumped on board, which it did in 2012 in its FG12/16 Finalised Guidance paper, *Assessing suitability: Replacement business and centralised investment propositions*. From that point on, CIPs were officially A Thing, and firms have spent much of the last four or five years stitching together investment offerings which give predictable outcomes (in terms of volatility control if not returns) and which will, frankly, keep the regulator off their backs.

And so it seemed the pendulum had come to rest somewhere sort of coherent – advisers could put together, either by themselves or with help, or outsourced – portfolios which would behave in a way that didn't shock anyone. Importantly, those who wanted to sit in the investment chair still could; those who had decided that planning was the key offer could get rid of the job to someone who actually wanted it.

In our most recent research, we found that 84% of firms flow 80% or more of their new business into their CIP; whatever form that might take.

% OF NEW BUSINESS GOING INTO A CIP




But that's too simple for the industry we know and love. In the last year or two, we've seen the pendulum start to head back to the more restricted side, with consolidators buying up firms and hugely increased flows into what we'll charitably call 'aligned' multi-asset funds. We can expect to see some regulatory interest in this soon as part of the investment platforms market study.

## MAPS NOT PENDULUMS

So we are where we are. That's been our journey for the last two decades. For the rest of this paper, then, we'll not worry about our journey as a sector, and we'll concentrate on something much more important – the client's destination and how advisers help them get there.

We'll tackle each of the three main ways that firms build CIPs and look at the advantages and drawbacks of each:

- **In-house CIP**: this is where the firm creates its own CIP, either in glorious isolation or by hiring in some (usually) consulting investment or discretionary management expertise. There is a huge range of approaches firms can take; one characteristic they all share is that the buck firmly stops with the firm for every decision about every fund in the CIP.
- **Multi-asset/multi-manager fund**: on the one hand this is fund-picking, but on the other it's a full outsource. These portfolio funds can be highly effective; but they can also be very, very expensive – and not every client will be happy being stuffed into a single line of stock.
- **Outsourced DFM MPS**: this is where the adviser hands over the investment privileges to a discretionary manager, who manages a series of models on the adviser's chosen platform. The DFM doesn't have a suitability relationship with the client; she's simply running a model portfolio to a set objective. Can firms square the suitability circle if the investment manager never meets the client and the adviser can't influence the model?

We don't think we're spoiling anything by telling you that there is no definitive answer. As you'll see from our sat-nav diagram overleaf, *all* these approaches can get you and your client where you need to go. The question is – what's the journey like? And how much do you want it?

That's what we're here to find out. We hope you enjoy this paper – as always, we'd love to hear what you think.

### MiFID II

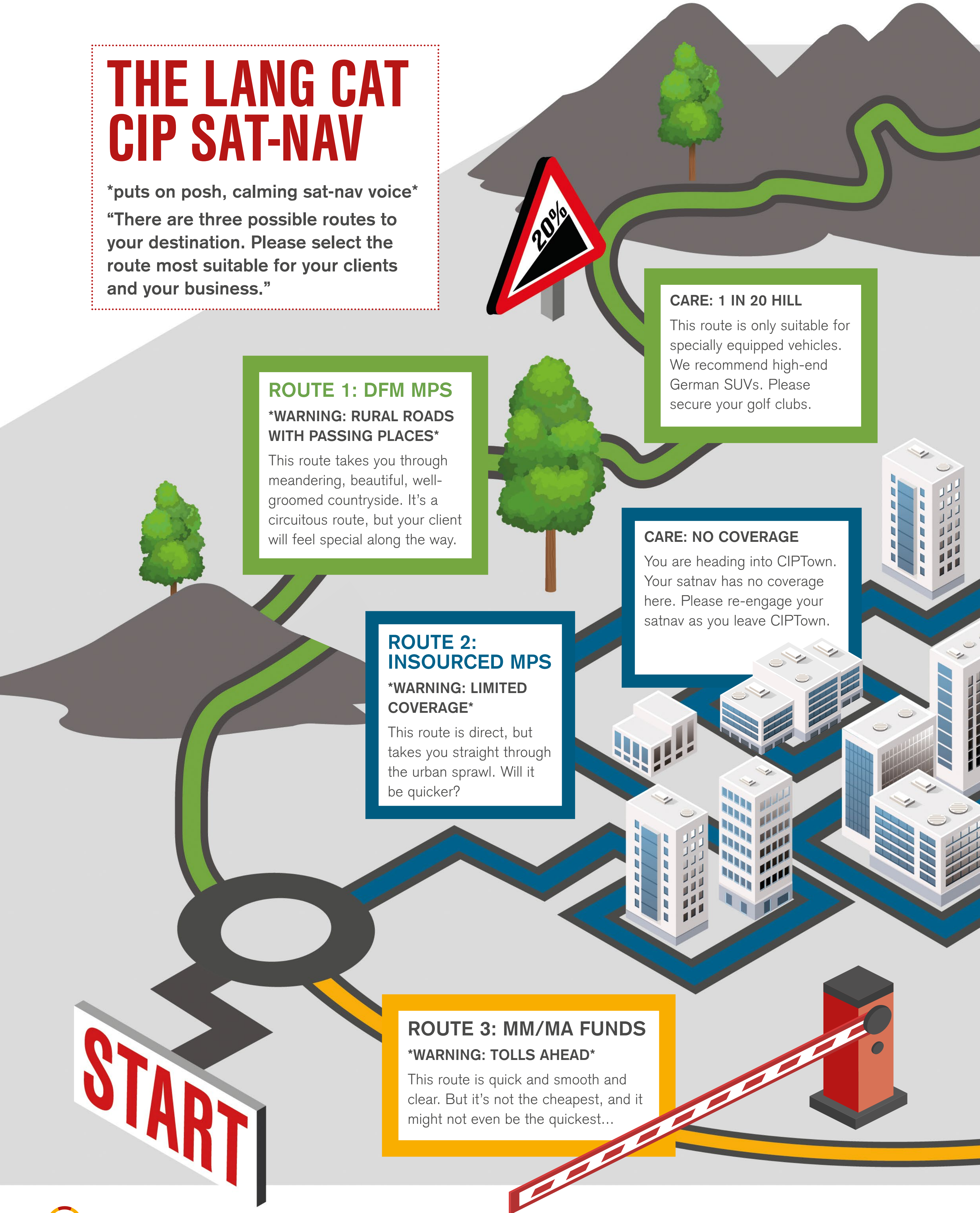
MiFID II is going to be a crucial subject in 2018 and beyond for any adviser recommending any form of investment, which is to say all of you. It's a complex subject and beyond the scope of this paper – but as we go through the various CIP options we do highlight some key issues you'll need to keep in mind. In a similar spirit, here are a few things you'll need to factor into your MiFID II readiness work irrespective of what route you choose for CIP construction:

- Advisers need to regularly research the market to ensure recommendations meet their clients' needs. MiFID II means that fund groups and platforms will provide additional detail around target markets for their products. These target market definitions should be used by advisers when constructing their own centralised investment propositions.
- If your investment proposition uses, or could use, exchange traded products (ETPs), you'll need to ensure you have a Legal Entity Identifier. These can be obtained from the London Stock Exchange. https://www.lseg.com/LEI.
- The reporting frequency for any assets held on a platform and/or with a DFM moves from six monthly to quarterly on 3 January 2018.

# THE LANG CAT CIP SAT-NAV

***puts on posh, calming sat-nav voice***

**"There are three possible routes to your destination. Please select the route most suitable for your clients and your business."**




**CARE: 1 IN 20 HILL**

This route is only suitable for specially equipped vehicles. We recommend high-end German SUVs. Please secure your golf clubs.

## ROUTE 1: DFM MPS

***WARNING: RURAL ROADS WITH PASSING PLACES***

This route takes you through meandering, beautiful, well-groomed countryside. It's a circuitous route, but your client will feel special along the way.

**CARE: NO COVERAGE**

You are heading into CIPTown. Your satnav has no coverage here. Please re-engage your satnav as you leave CIPTown.

## ROUTE 2: INSOURCED MPS

***WARNING: LIMITED COVERAGE***

This route is direct, but takes you straight through the urban sprawl. Will it be quicker?

## ROUTE 3: MM/MA FUNDS

***WARNING: TOLLS AHEAD***

This route is quick and smooth and clear. But it's not the cheapest, and it might not even be the quickest...


## WHAT DOES IT ALL MEAN?

So our map is a bit of fun, but it has a serious point. Each of the three routes we've identified has its advantages and drawbacks. But they all get you and your client where you need to be – if they're well run, of course.

**Route 1 – outsourced DFM MPS** – takes you through upmarket areas, where you will feel most welcome if you're in a posh SUV with some golf clubs in the boot.

**Route 2 – insourced CIP** – is arguably the most direct because you don't have anyone else involved. But it takes you through a dense urban environment, where your sat-nav stops working and you'll have to make your own way. Lock your doors as you go through.

**Route 3 – multi-asset or multimanager funds** – is lovely and smooth and simple. But it carries a cost, and isn't necessarily any quicker.

What route you choose for your clients is up to you…but the next few pages might help you decide.

# IN-HOUSE CENTRALISED INVESTMENT PROPOSITIONS

## WHY?

- Because you want to control costs and the supply chain and have as few firms involved as possible.
- Because you reckon you can achieve the same or better results for the same risk budget as the multi-asset or DFM guys, and provide a more personalised, but less costly, service.
- Because asset allocation and investment selection is a core specialism of your business and supports your charging model to your clients.

## WHY NOT?

- It's by far and away the most time-intensive option for CIP creation, and it's not certain you can recoup all your additional time cost with additional fees.
- You're on the regulatory hook for suitability not just for the overall portfolio, but for each constituent part of it; every decision has to be evidenced.
- If you run your own CIP without discretionary permissions, you'll need permission from every client for trades in the portfolio. Good luck…

## OUR RESEARCH SAID...

A tough one, this. There is no central register of in-house CIPs, so we can't compare how they perform, what they cost or indeed whether they're any good. We do know from our own experience that there are some absolutely excellent portfolios out there, from firms both large and small. We know that many firms are supplementing their own skills with professional investment consultants, and we know that more and more firms are going for discretionary permissions to avoid the 'trail of dead' problem with individual client authorisation. But beyond that, we don't have any numbers to analyse.

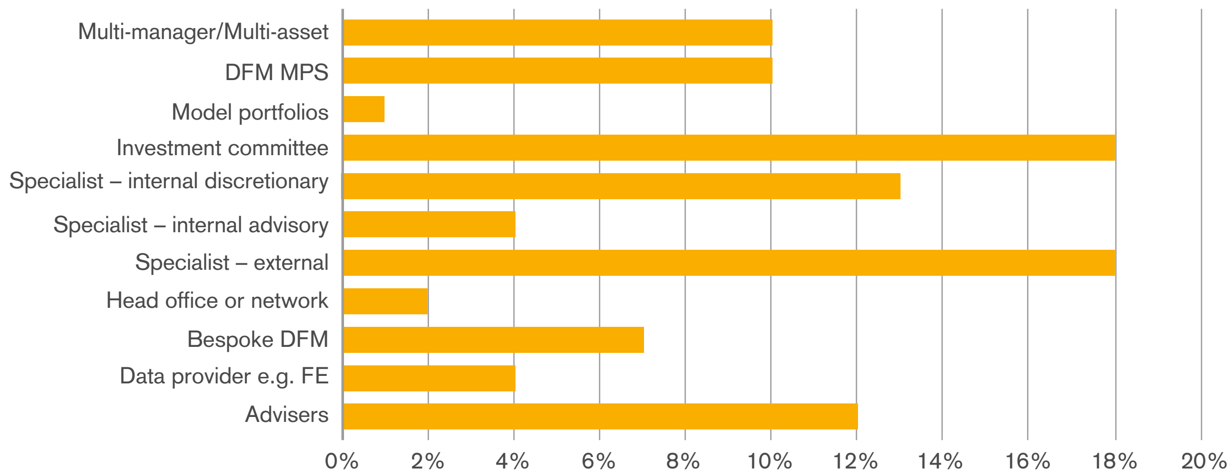
Other than that…

**43%** OF FIRMS WE SURVEYED USE THEIR OWN MPS.

**73%** OF FIRMS USE FE FOR FUND RESEARCH; **20%** USE MORNINGSTAR.

ONLY **21%** OF FIRMS MAKE ASSET ALLOCATION DECISIONS; **39%** MAKE FUND DECISIONS.

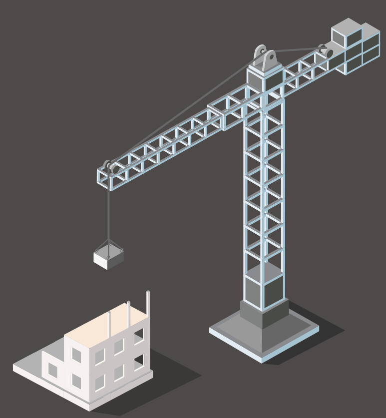
**WHO PROVIDES THE ADVICE AND EXPERTISE?**




# PRACTICALLY SPEAKING

This is always going to be a trade-off. The practical implications of creating and maintaining your own CIP – which will normally include at least seven portfolios – are inevitably considerable. If they weren't, the outsourcing market wouldn't exist. So as we write this we will be as positive as we can.

- Creating and maintaining models on a platform is hard work. Some are excellent; some less so. Your administrative experience in terms of maintaining them is not evidence of suitability of that platform for your clients, however. If platform A is twice the price of platform B, but much harder to use for you, you'll still be expected to have a very good reason as to why your client isn't on B.
- Running investment committees (or really any committee) is not as much fun as you'd think.
- Unless you are a large firm, you will probably need to pay for external expertise and representation on your committee.
- Every decision you take will need to be fully evidenced (if only to cover you in the event of potential future litigation). You should consider having a formal secretary and process to approve or challenge minutes as part of your committee structure. It should also report into your main Board. If you haven't got a main Board, you'll need one of those too.
- Most firms who run in-house model portfolios on an advisory basis end up with multiple versions (pro tip: name your portfolios using month and year) as a result of clients not returning authorisations to trade. Think about creating an online journey (maybe using your back office client portal) to get permission.
- Don't exceed your permissions; never trade without authorisation.
- Gaining discretionary permission is much harder than popularly believed – absolutely doable, but requires major effort. It also increases your capital requirements and level of supervision, not to mention your professional indemnity costs.



# THE REGULATORY PERSPECTIVE

As far as the regulator is concerned, you're nice and easy. It only has to come and see you once to find out all about how you disclose, how you run your CIP, how you justify your fund selection and asset allocation decisions, how you avoid bias, how you communicate with your clients and how you avoid exceeding your advisory permissions if that's all you have. However, there is another side to that coin…

- You are responsible for every micro-decision as part of every portfolio – as opposed to outsourcing, where you are responsible for one major decision.
- Even with discretionary permissions, you are facing a retooling of your process in terms of disclosure and communication as a result of MiFID II – and if you insource, it's completely up to you.
- In its recent publications, the regulator has expressed concern about existing methods of filtering funds, particularly via ratings which may have a commercial element to them.
- If you are or hold yourself out to be whole-of-market, the regulator will expect you to consider instruments other than mutual funds in terms of suitability. The interplay of suitability across investment and platform choice is complex here and will need careful documenting.

## HOW MiFID II AFFECTS YOU

There is no shortage of MiFID II impacts for those of you who choose to run your own CIPs. In addition to the basics, you'll need to consider:

- Conflicts of interest – if you are running an in-house discretionary CIP and charging for it, you will need to address and manage the in-built conflict of interest. Just disclosing isn't enough.
- If you're advisory, you'll need to disclose cost impacts for each switch to every client affected in each portfolio. Add this to getting client permission for each trade, and we think this makes running advisory models almost untenable.
- If discretionary, you'll need to put proper quarterly reporting in place and observe the 10% drop rule.

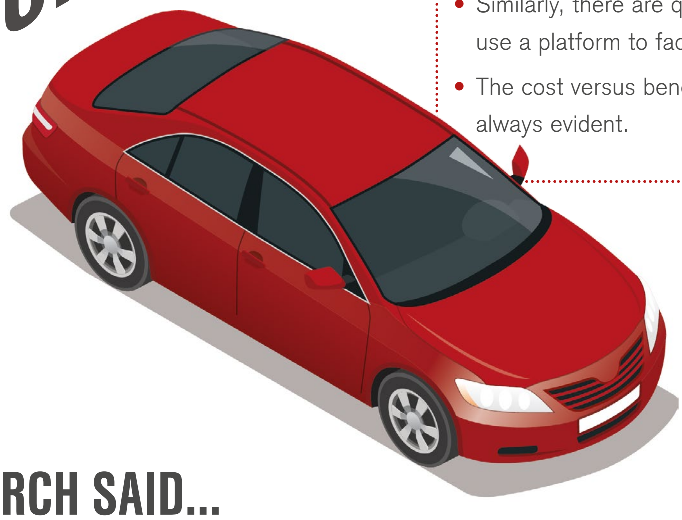
# MULTI-ASSET/ MULTI-MANAGER FUNDS

## WHY?

- You don't consider yourself an investment expert and want to outsource in full to a third party.
- It fits nicely into a step-by-step process.
- It's by far the easiest of the options to research.

## WHY NOT?

- It may leave you vulnerable to scrutiny around adviser charging levels.
- Similarly, there are question marks around why you'd use a platform to facilitate single fund solutions.
- The cost versus benefit of some of these ranges is not always evident.

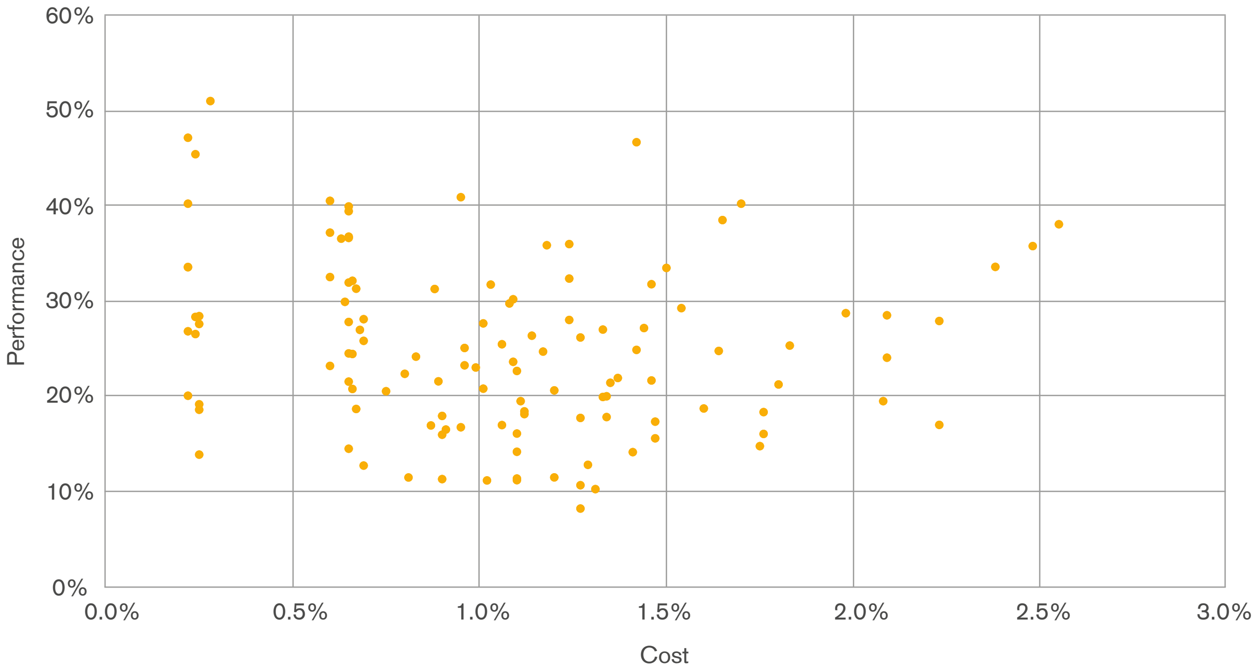


## OUR RESEARCH SAID...

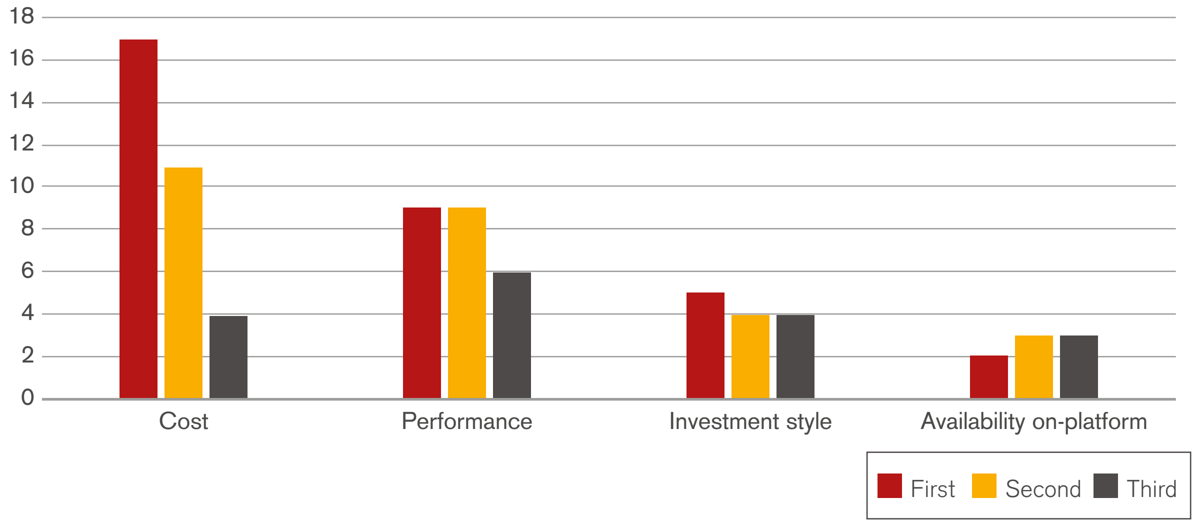
**AVERAGE OCF OF MM/MA RANGE:**
**1.06%**

| Provider | Range | Mid-risk active OCF | Mid-risk passive OCF |
|---|---|---|---|
| 7IM | A range of 4 actively managed multi-manager funds and 6 passively managed (the AAP range). | 1.32% | 0.65% |
| Architas | A range of active, passive and blended risk-rated funds. | 1.33% | 0.65% |
| Aviva Investors | Five risk-rated multi-asset funds. | 0.57% | |
| Fidelity | The Pathfinder range of funds. Allocator (passive), Multi-Asset (active, in-house) and Multi-Asset Open (active, Fidelity + others). | 0.80% | 0.25% |
| Standard Life Investments | A range of 25 funds – five risk ranges and five different management styles. We illustrate MyFolio Managed and MyFolio Market here. | 0.85% | 0.37% |
| Old Mutual Global Investors | The Cirilium range of active and passive risk-rated funds. | 1.24% | 0.60% |
| Vanguard | The LifeStrategy range of 5 passive funds. | | 0.22% |

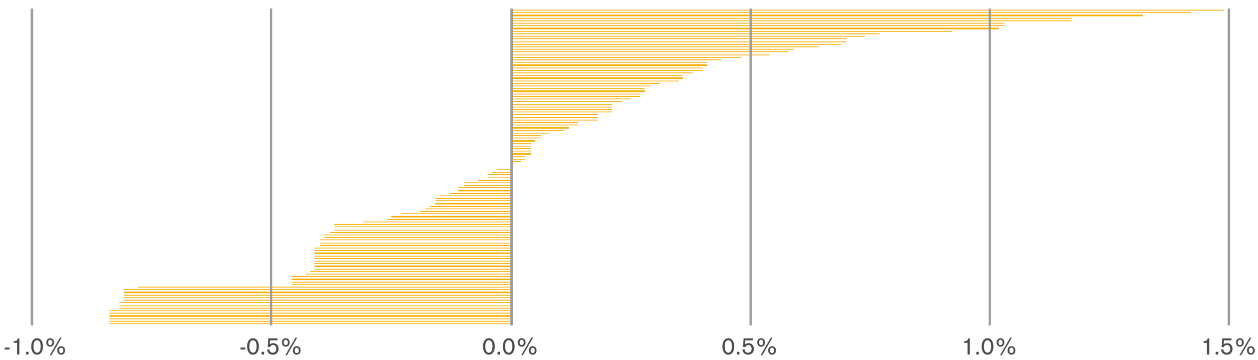
## MM/MA 3YR PERFORMANCE TO JUNE 2017




## TOP THREE CRITERIA FOR OUTSOURCING TO MM/MA




## DEVIATION FROM MEAN OCF: MM/MA PORTFOLIOS



# PRACTICALLY SPEAKING

Going down the multi-manager/multi-asset route (from now on referred to as MM/MA for our collective sanity) offers very few practical barriers. In fact, you could make a strong case that platforms have enabled this end-to-end process more than any others. Pick a range, map to your risk profiler. Rinse and repeat.

- From a research perspective, the tools (and buckets of data contained within) on offer from the likes of FE and Morningstar are an analyst's wet dream. Compare this to the difficulties faced by advisers when trying to analyse the DFM market.
- Similarly, there's a multitude of risk profiling software to choose from. If you can get risk profiling and fund analysis talking to your platform then you're virtually up and running.
- From a cost perspective, there are no explicit trading or rebalancing costs so platform charges, and by extension customer total cost of ownership (TCO), is easier to control.
- On that note, you're also avoiding the sheer practicalities of managing an MPS on a platform, whether you're running with discretionary permissions or not.
- This lack of trading/rebalancing also has an associated CGT benefit for those clients holding GIA assets. Paradoxically, we hear that many advisers use MM/MA solutions in order to service lower value clients; they might actually be better in this regard for more well-padded felines.

## HOW MiFID II AFFECTS YOU

A simple proposition doesn't equal a simple MiFID II treatment. Much of what you'll experience is a basic firming up of existing suitability requirements, but…

- Periodic suitability assessments are required for investment advisers and discretionary fund managers. This is described as at least annually, which may be a concern for some niche, light touch advice propositions.
- In addition to any buy/sell recommendations there is also a need to provide a recommendation with the suitability report for a 'hold' decision for a fund, that is, when there is no action required at all. You will no doubt make a conscious decision on this as part of your investment committee, but it needs to be documented and explained to clients.
- Total cost disclosure may come as a shock to some clients in more fully priced offerings.

- Still on the trading (or lack thereof) theme, reporting may be more palatable for some clients. It's easy(-ier) to report on single line investments. We've seen client reports bulge into dozens of pages with all the lines of buys and sells disclosed. You need never have to answer "what is an MPS rebalance?" again. Conversely, some clients may feel there is not enough going on for their money.
- Given that the vast majority of MM/MA ranges are available on the vast majority of platforms then you're protecting yourself from further admin headaches should you choose to either (1) move to another platform for whatever reason in the future or (2) run a multi-platform proposition for your client segments. The only thing to bear in mind is that some MM/MA ranges run with discounted share classes on certain platforms, causing a headache if you move to one with only the standard class.
- Clearly, you do need to be happy with what's inside the fund. With an MM/MA range you're buying into everything within the proposition. Geography, asset allocation, ethics. The job lot. These are all degrees of control that you're giving up. Were you running your own MPS range and unhappy with a holding, you could sub it out.

# THE REGULATORY PERSPECTIVE

- Is it all a bit too easy? If one of the original visions of the platform market was to open up a world of investment choice, why are you now wrapping everything up into a single fund?
- And specifically, why are you using a platform for it? Is this what's best for your clients or is it what's easiest for you as a business? Fine if the answer to both is "yes", but it's best understanding that before the awkward questions are asked. Potentially the most awkward one being…
- …why are you charging, say, 1% per annum if the investment specialism is all happening outside your firm? How is that charge broken down by what you do for your clients? How is it that firms that in-source can charge the same or less than you? By the same logic, this point also applies to on-platform DFM services.
- With the ongoing eye of the regulator firmly focused on customer value for money in the guise of the ongoing investment platforms market study and asset management market study, there are potentially further awkward conversations to be had around some of the costlier MM/MA ranges, particularly those embedded within a vertically integrated proposition. In our work in this sector to date, we've found no direct link between cost and net-performance of these ranges. Maybe someone else will.

# OUTSOURCED DISCRETIONARY MODEL PORTFOLIO SERVICES

## WHY?

- Because you don't want to make investment decisions any more, and want a professional discretionary manager to do it for you.
- Because you prefer portfolios to single-instrument multi-asset funds.
- Because you're looking for something with the flavour of discretionary or wealth management without the need to go off-platform and into a DFM's own custody.

## WHY NOT?

- Neither fish nor fowl – more complex than multi-asset, but not bespoke like a full DFM service.
- Can be expensive when trading costs, DFM fees and the OCF (ongoing charges figure) are taken into account as well as adviser charges and platform fees.
- Suitability responsibility remains with you; the DFM has a limited relationship at best with the individual client.

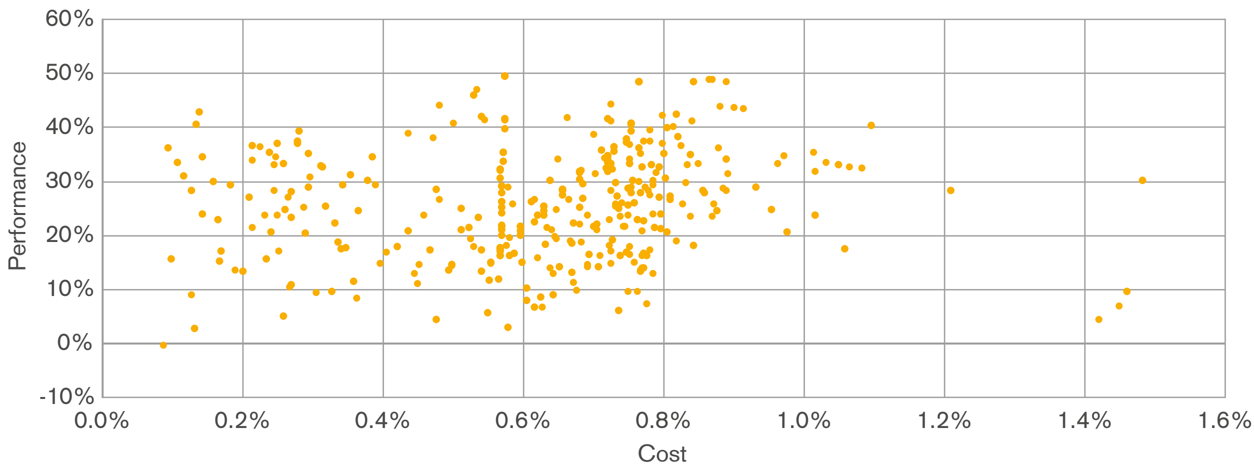
## OUR RESEARCH SAID...

First things first, the lang cat's view is that far too many DFMs have a long way to go on transparency. We have no problem finding out what's going on in multi-asset funds, but successive studies into this market have led to considerable frustration.

Some DFMs are leading the way but not enough of their peers are following that lead. So one thing our research says is: if you can't find out freely what a DFM is up to in its MPS, then steer well clear.

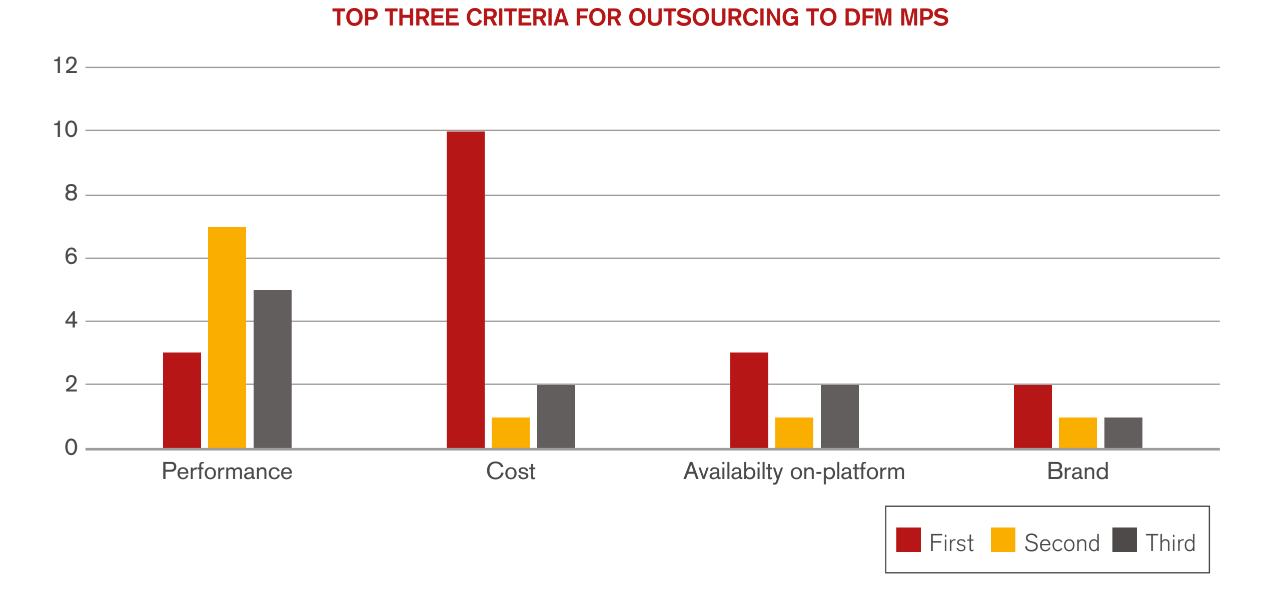
| AVERAGE OCF OF UNDERLYING ASSETS IN DFM MPS: | AVERAGE DFM CHARGE FOR ON-PLATFORM MPS: | AVERAGE PASSIVE EXPOSURE: |
|---|---|---|
| 0.60% | 0.36% | 19.74% |

DFM 3YR PERFORMANCE TO JUNE 2017



| | | | Active mid-risk portfolio | | Passive mid-risk portfolio | |
|---|---|---|---|---|---|---|
| **Provider** | **Range** | **DFM charge (inc VAT)** | **Portfolio OCF** | **TCO** | **Portfolio OCF** | **TCO** |
| **Brewin Dolphin** | A range of 5 risk models, each with active and passive portfolios. | 0.36% for active, 0.24% for passive | 0.65% | 1.01% | 0.20% | 0.44% |
| **Brooks Macdonald** | A range of 10 portfolios, each with their own risk profile and objective. Some are passive. | 0.36% | 0.70% | 1.06% | 0.30% | 0.66% |
| **Charles Stanley** | Three ranges (Dynamic Passive, Multi-Manager Income and Multi-Manager Total Return) each with 5 risk-rated portfolios. | 0.36% for active, 0.25% for passive | 0.77% | 1.13% | 0.18% | 0.43% |
| **Momentum** | Seven risk-graded managed portfolios and 3 income portfolios. | 0.30% | 0.79% | 1.09% | | |
| **Standard Life Wealth** | Two ranges (Conventional and Target Return) each with 5 risk-rated portfolios. | 0.30%* | 0.62% | 0.98% | | |
| **Tatton Investment Management** | A range of 7 distinct management styles, each range contains up to 6 risk-rated portfolios. | 0.15% | 0.56% | 0.71% | 0.16% | 0.31% |

* Standard Life Wealth does not charge VAT.




# PRACTICALLY SPEAKING

The first thing to say is that it's not as simple as picking a DFM portfolio from a drop-down list on your platform and allocating it to a client. You'll need to sign terms of business with the DFM, at which point you'll find that its portfolios become available magically on your platform (or that's the theory, anyway). Those terms are crucial, because they'll govern the relationship in terms of what the DFM can do without asking you or your client, who owns the client (and carries regulatory responsibility), and disengagement terms. You shouldn't sign anything without taking an external opinion if you're not confident in parsing terms and conditions documents.

When selecting a DFM to use, you've got a tough job ahead of you. There is no objective, whole-of-market comparison available (including from the lang cat). There are a couple of comparison services – from Asset Risk Consultants and FE Transmission – which do a creditable job, but they are both pay-to-play and some DFMs simply don't go there. Getting data from individual DFMs is a highly variable experience – trust us on this – and you will often be asked to sign a non-disclosure agreement before they'll tell you anything. This does not fill us with joy and love. We'd suggest you mistrust anyone who looks like they have something to hide (thankfully, our sponsors are among the angels in this regard).

Some other things to be aware of:

- Be careful if you use multiple platforms and want the same DFM portfolio across them all. Asset restrictions and functionality gaps can mean that not everything is available everywhere, and even when it is, ostensibly the same portfolio can hold different assets and have different performance.
- You're inviting a fourth party to the table; inevitably that's another layer of costs (though as we've seen, an average DFM MPS is very slightly cheaper than an average multi-asset fund).
- The DFM will rebalance and trade as he sees fit inside the portfolios. If your client is in a GIA, this may cause unplanned CGT issues.
- Portfolios tend to be broadly static, bar rebalancing. The practicalities of running, say, 10 portfolios across a dozen or more adviser platforms, all with different ways of working, is brutal for DFMs. Don't expect a similar experience to a full DFM offering.
- In theory DFMs can access alternative assets and ETPs freely; in practice most don't as (to quote one DFM we talked to) "it's too much of a pain on all but a few platforms". Expect mutual funds and maybe a few exchange traded funds (ETFs).
- Some platforms have additional charges for accessing DFM 'hubs', and there are often trading charges to think about too. The DFM won't be paying these and won't feel constrained by them; your clients will pick up the bill – so be aware of the variable nature of this as you go into the arrangement.

## THE REGULATORY PERSPECTIVE

In terms of how the regulator sees DFM MPS propositions, we don't think there is a huge amount of difference in their approach compared to multi-asset funds, or even fully outsourced off-platform DFM offerings. The basic principles of suitability and value persist no matter which route you choose.

### HOW MiFID II AFFECTS YOU

- Some MiFID II rules fall onto the DFM, so at least the pain is shared. And responsible DFMs as well as platforms will want to help you with the burden – but the bulk of it does fall on you.
- By using a DFM solution, whether MPS or bespoke you are exposed to the '10% rule'. This means that if portfolio falls by 10% or more (outside pensions) during a quarterly reporting period, the client must be notified of the loss no later than the end of the business day it happens.
- Exactly how this will work in practice will inevitably vary depending on what combination of platform and DFM you are using. Irrespective of the detail though the responsibility will fall on the adviser to notify the client.
- Advisers using these solutions need to ensure they have a robust process in place, ideally with as much automation as possible to administer these notifications if/when they are required.

However, there are a few additional considerations:

- You should expect to be asked to evidence your research and due diligence in selecting a DFM MPS. If you hold yourself out to be independent, you'll need to show you started with the whole of the market and worked back. You should create a top-down file: why you're outsourcing, why you're going down the DFM MPS route, how you narrowed the field and why you feel the solution you picked was suitable.
- That suitability needs to extend to each client; it isn't at a firm or book level. However, you don't need to repeat the full due diligence in suitability letters!
- Generally speaking, the regulator has listened to adviser moans that it treats platforms like products, when they are anything but. The impact of that is that the FCA will assume you are recommending your CIP first and then platform second, as an execution venue. As a result, just picking a DFM from the list that's available on your favourite platform isn't a good idea.
- As above, you will be expected to understand and have control of your supply chain, including a clear line of sight on who is contracting with whom, where suitability lies and so on.

# YOU HAVE REACHED YOUR DESTINATION

Time to park up, put the handbrake on, admire the scenery and do some other things that will stretch our metaphor to breaking point. We hope you've enjoyed our journey (arrrgh) through the terrain (double arrrgh) of CIP construction on platforms.

## IF THE LANG CAT WERE AN ADVISER

A terrifying prospect. Throughout our exploration of the options and putting ourselves in the shoes of the financial planning profession, we returned time and time again to some consistent themes.

- How much do you want it? It strikes us that if you want to create your investment proposition in-house then you've got to *really* want it. We understand the allure of owning the intellectual property of investment construction but each way you look, we see an administrative burden. Whether that's version control of models, client disclosure whenever you change anything or the act of obtaining discretionary permissions if that's the route you go down, it all adds up to an extraordinary amount of work and we admire those who are up for that.
- That's not to say outsourcing doesn't have its challenges; initial research being the most obvious one. Transparency is – rightly – the default expectation of all corners of the industry now. Developments in technology have created an assumption that information (for everyone) is freely available online. Information asymmetry (which we call 'DFM secret sauce' at the lang cat) no longer works and it remains the case that it is significantly easier to research the MM/MA space than it is DFM MPS offerings. That needs to change.

## OUR SHORT-TERM PREDICTIONS

- The market itself is buoyant. Advice firms are flourishing – demand for advice has never been greater and pension freedom money is flooding the market. The advised platform market grew by 25% year-on-year in 2017 and our ongoing prediction is continued growth of 14% over the next 5 years.
- MiFID II throws a grenade at everything and anything in its path but we reckon it makes life particularly difficult for advisers running models without discretionary powers[1]. We expect to see a shift in market share from this segment towards MM/MA and DFM MPS outsourcing in the near future as the admin burden becomes (understandably) too onerous for some firms. We've already seen a drop in the number of firms who say they regularly make asset allocation or fund selection decisions.
- Passive management is riding the zeitgeist but a change in market conditions – a crash/correction is surely inevitable at some stage – will create an opportunity for active outsourced CIPs to demonstrate their worth. It feels easy to pick funds when you are in a rising market – but less so when waters get choppier. Falling markets will create the opportunity for active management to demonstrate alpha, if indeed it exists.
- The current regulatory focus on value for money is unprecedented. Each link in the chain will have to better articulate and evidence its respective impact on customer outcomes. Some are well ahead of the game in this respect, but many have work to do. We think vertical integration in particular will spend time under the spotlight.

## FURTHER AFIELD

- Technology will change things because obvious things are obvious. The advised market will continue to develop kit that makes DFMs more accessible. Better software will also reduce the cost of delivery and reporting for these services. However…
- …as feeble humans we tend to overestimate how technology will change in a year but underestimate how things will develop in the longer term. Bill Gates had a point. Something will come along that changes everything, but not right away.
- At the very least, we should start to see more direct equities, investment trusts or ETFs in portfolios as platforms get better at handling them. One of the original visions of the platform market as being an open-source



1. Worst superhero powers ever.

universe of investments where all asset classes got along in harmony simply hasn't come to fruition. Around 94% of assets on platforms are held in collectives and cash. Fractional ETF trading is very much in its infancy on platforms and that's one way that things could improve.

- Smarter technology could also facilitate a greater degree of investment personalisation. We imagine a future where it is easy to overlay individual customer ethics, beliefs and preferences on top of default models.
- Just now portfolios tend to be created down party lines – left-wing passive hounds and right-wing active bulls. Or something. As we see the passive market – and the multi-asset version of it in particular – ride out a full economic cycle, we are likely to see more interesting smart beta or core/satellite portfolio constructions. We also expect to see greater use of alternatives. All these are effectively elements of a 'full' DFM service being democratised and commoditised and offered to the broader retail market via platforms.

## WHAT DOES THIS MEAN FOR YOU?

We'd love to end this paper with an eye-catching definitive statement that proves that one segment above all else is better than the rest. Unfortunately for you (and our sponsor) that isn't going to happen here.

We come back to the questions we posed at the start of the paper – what's the journey like, and how much do you want it?

For clients, all the routes we've looked at can offer a genuinely excellent journey. Note that we're not talking about returns here; what we mean is the predictability of portfolios or funds behaving in the way they're supposed to. Our industry has got very good at managing portfolios to a risk budget, and we think this in itself is a great step forward. Add that to an explosion in the use of cashflow planning and risk modelling tools with clients, and we are starting to get somewhere.

The big difference is in the adviser journey. There is no doubt, especially in a post-MiFID II environment, that running your own CIP is about as tough an ask as you could have. Yes, discretionary powers make that easier, but still far from easy – and getting new permissions isn't a cakewalk either.

How much do you want it? What is the ownership of investment intellectual property worth to you and your firm, either emotionally or in terms of increased adviser charges? If the answer to the first is "everything" and the second is "more than enough", then you have your answer, and the world is your crustacean.

For others – the move to outsourcing is entirely understandable, and fits very neatly with the focus of many firms on 'pure' financial planning. Certainly planning and investment management are different disciplines – whatever your approach – and it's good to see the sector doesn't conflate the two as often as it used to.

So we come to the issue of how to outsource if indeed that's what you want to do. We've covered the two main routes in this paper – both have advantages and drawbacks.

For us, a really crucial part is the issue about a single line of stock for your client, versus a portfolio approach. Whatever the technical rights and wrongs, we know that clients, particularly with larger portfolios, may have trouble believing a single fund can do everything they need.

Equally, DFM MPS propositions have a lot to learn in terms of transparency and visibility from the multi-asset sector.

Cost as a way to decide between the two isn't really much of a help – both have a huge range. It's right to be cautious of high charges – but equally, something cheap and unsuitable is still unsuitable.

All in all, creating the right CIP for you and your clients comes down to your beliefs, and the practical consequences of those. If you can work out that what you believe is the right thing for your clients, and deliver that in a profitable and sustainable way, you'll be able to describe what you do with pride. And there isn't a client alive who won't buy into that.

do what you love

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