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FUTURE OF FINANCIAL ADVICE

The Australian Renaissance

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SUMMARY

The Australian financial advice sector has undergone significant change, triggered by increased reform and regulatory scrutiny. While some observers have commented on the collapse of the industry, learnings from other markets and industries suggest that the current period represents an opportunity for rebuilding a sector that better meets customer and regulatory outcomes and is economically sustainable.

In this report, we provide insights with regard to this opportunity, by providing an overview of the financial advice sector in Australia, what the future may hold, and a blueprint for how advisers and advice firms can respond and realise this potential.

The report begins by sizing the potential demand for financial advice in Australia and characterising the advice supply-demand gap that has arisen from challenges currently experienced by the sector, including the decline in financial advisers and reduced revenues caused by margin pressure. It provides perspectives from the UK and US, and from other sectors such as general insurance broking, that have been able to build sustainable businesses. Finally, we draw on these insights to characterise how the industry structure is likely to evolve and provide a set of actions for market participants to regain trust and build a more resilient sector.

THE STATE OF THE FINANCIAL ADVICE SECTOR

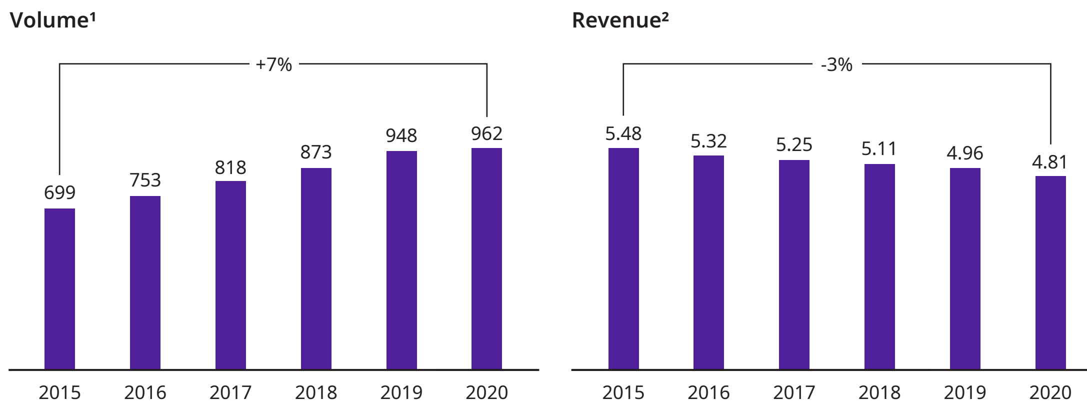
While the pool of investable assets in Australia continues to rise, the financial advice sector is retreating, with the number of advisers declining, industry profitability decreasing, and a growing financial advice gap for those that cannot afford the current offerings.

MARKET SIZE

According to the Australian Securities and Investments Commission (ASIC), as of October 2020, there were 21,670 individuals on the financial adviser register, authorised under an Australian financial services license (AFSL). Of these, approximately 15,600 were financial planners, with the remaining registered advisers being inactive, accountants, or stockbrokers. While sources vary, it is estimated that between two and 2.2 million Australians are currently using a financial adviser or have seen one in the last 12 months.[1] Existing advisers oversee approximately AU$962 billion in funds under advice (FUA), including deposits, equity portfolios, superannuation, and investment properties. The FUA have grown by seven percent annually since 2015, driven primarily by the increase in household wealth in Australia.[2]

Conversely, there has been a decrease in industry revenues. Interviews with key players across the industry suggest that declining revenues have been caused by rising compliance costs and increased fee sensitivity, as a result of growing regulatory scrutiny. However, the same respondents commented that there has been marginal improvement during the COVID-19 pandemic, a time when more people are seeking confidence due to uncertain economic circumstances.

Exhibit 1: Total addressable market (FY15-20, AU$ billions)



1 Market volume growth reflects conservative (lower bound) assumptions associated with percentage of assets (cash, equity, property, superannuation) that are subject to advice

2 Addressable revenue is based off research indicating that fee for advice in 2020 averaged 0.5 percent of assets per year, with historical trends based of revenue growth reported by IBISworld

Source: ABS, major bank financials, IBISworld, ASIC, APRA, Oliver Wyman analysis

1 Roy Morgan, Adviser Ratings, ASIC Investor Survey, Investment Trends.

2 ABS data.

MARKET DYNAMICS

External factors, including increased regulatory scrutiny and the economic uncertainty arising from the COVID-19 pandemic, have led to fundamental shifts in both the supply and demand drivers.

Supply-side landscape

Falling adviser numbers: Total adviser numbers are down, falling by about 13 percent per year since 2018. This has been driven by acceleration in retirement of older advisers, with only some replacement from new entrants (320 new advisers in 2019, compared to only 120 new advisers up to October 2020).[3]

Challenging practical economics: Interviews with key players indicate that this is due to the removal of commissions and grandfathering, and the rising cost of advice, including compliance and Financial Adviser Standards and Ethics Authority (FASEA) qualification requirements.

An up-market shift: For high-net-worth (HNW) and above segments, boutique wealth providers have rapidly expanded their staff. Private banks have continued to sharpen their focus on ultra-high-net-worth (UHNW) individuals, tightening their target client segments and sharpening their propositions.

Heightened mergers and acquisitions (M&A) activity: There have been several large transactions, most recently IOOF and MLC, but also greater M&A activity within the mid-market space. Approximately 15 percent of all M&A transactions in the Australian financial services sector have involved financial advice companies.[4]

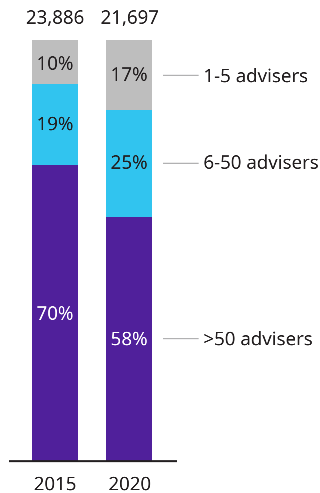
Industry fragmentation: The unwinding of vertically integrated business models, combined with a shift to independence, has seen a rise in the number of smaller licensees. Also underpinning this shift has been the move by various banks to exit all or part of their advice businesses.[5]

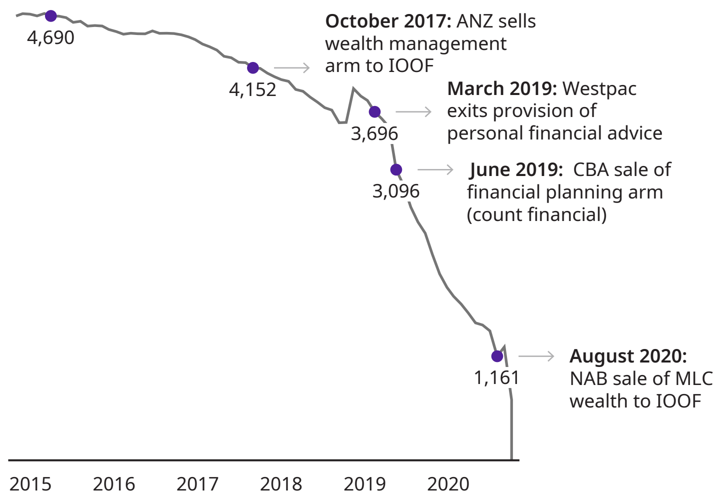
3 ASIC Register October 2020.

4 Dealogic October 2020.

5 ASIC Register October 2020.

Exhibit 2: Supply side dynamics show a strong decline in adviser numbers, banks exiting the advice sector en masse, and increased fragmentation





Note: Data shown for year end (December), except for 2020 that shows October

Source: ASIC, Oliver Wyman analysis

Demand-side landscape

Rising customer expectations: A 2019 ASIC survey highlighted a growing trust gap, with 19 percent of the individuals surveyed attributing a lack of trust as a barrier to receiving financial advice.[6] This trust gap has triggered increased fee sensitivity, and created greater demand for fee-based, one-off advice.

Changing demographics: Household wealth across Australia continues to grow.[7] We expect a changing client base for financial advisers, due to Australia's aging population, as well as the intergenerational wealth transfer occurring throughout the country.

THE ADVICE GAP

As a result of the mismatch that currently exists between supply and demand, we are seeing a growing advice gap. Specifically, Australians increasingly need advice to manage the conflicting demands on their money, but they are less able to access financial advice in an affordable manner.

Currently, few providers have a viable model for the mass market in Australia. Generally, financial advice business models have been focused around HNWIs and the UHNW segment, and to some extent, the affluent segment as well, leaving the mass market segment underserved.

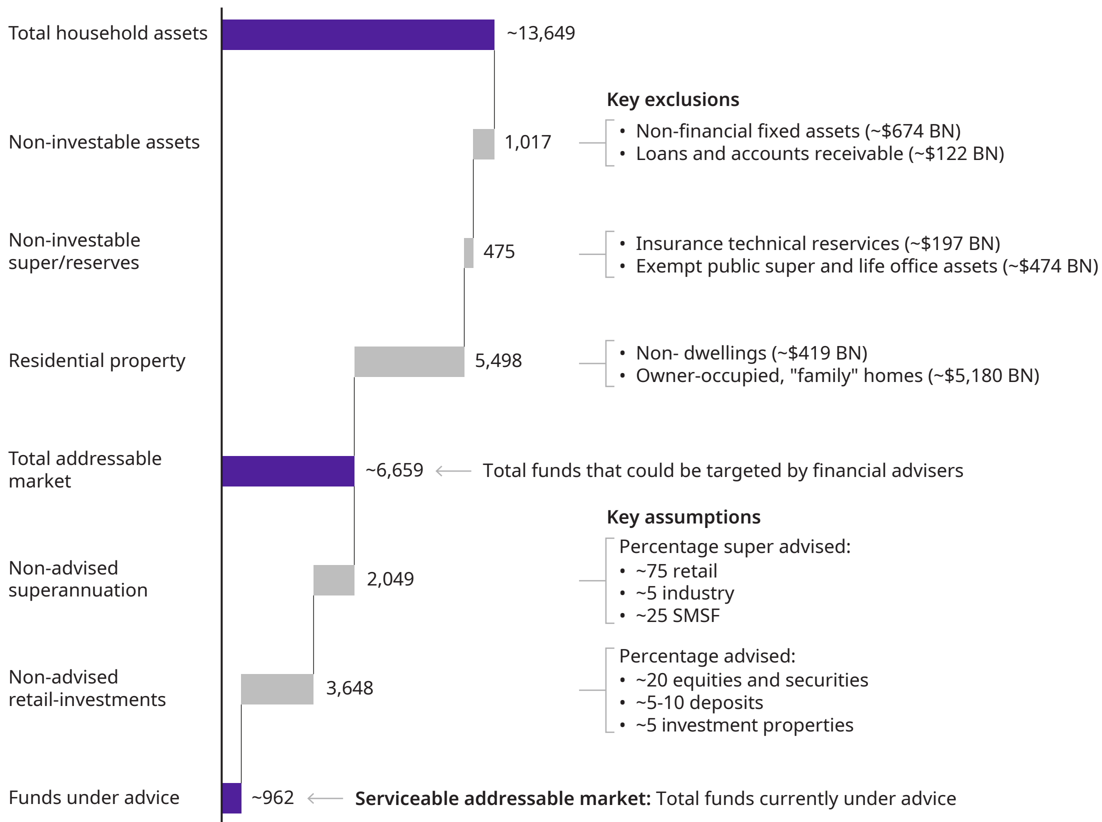
6 ASIC 2019 Report, *Financial advice: what consumers really think.*

7 *Australian national accounts: finance and wealth.*

We estimate that advisers currently manage about AU$962 billion in investable assets for less than 10 percent of the population of Australia.

Exhibit 3: Our top-down estimates size the advice market at ~$1 trillion

Addressable financial advice market (funds under advice)
2020, AU$ billions



Source: ABS, Rainmaker, ASIC, APRA, Strategic Insight, Oliver Wyman analysis

The significant step down from the total addressable market to funds under advice highlights the large advice gap in Australia.[8] Significant value can be achieved by addressing this gap, with recent research suggesting that providing financial advice can add as much as 5.2 percent to an investor's bottom line. The majority of this would come from the advice helping the investor to avoid behavioural mistakes, including selling during a falling market, and benefit from tax advantages.[9]

8 Advice gap to leave millions stranded.

9 Russell Investments, Value of an adviser 2020.

Currently, the biggest barriers to accessing financial advice are cost (35 percent), financial situations not requiring advice (29 percent), the desire to manage an individual's own finances (26 percent), a lack of trust (19 percent), or a lack of perceived value in paying for financial advice (18 percent).[10]

We believe a significant proportion of the advice gap is addressable through increasing customer awareness and redefining the advice service and value proposition such that it is more targeted towards customers' needs and helps increase their confidence of achieving their life goals.

LESSONS FROM OTHER MARKETS AND INDUSTRIES

We have taken inspiration from three relevant areas to help inform what the financial advice landscape in Australia could look like in the future:

- UK financial advice market: This market has undergone regulatory reform, which is similar to what the Australian market is currently experiencing.
- US financial advice market: The independent sector has been thriving and there has been a high degree of innovation.
- The general insurance brokerage industry: While the sector is very different, it acts as an example of one where intermediary businesses have thrived.

UK FINANCIAL ADVICE MARKET

Market context

The UK's retail distribution review (RDR) took effect at the end of 2012. Similar to what has happened in Australia, the reforms included a commission ban on investment products, changes to adviser classifications, and higher minimum qualification standards for advisers. As evidenced by Exhibit 4, after a steep decline from 2007 to 2013, adviser numbers have rebounded.

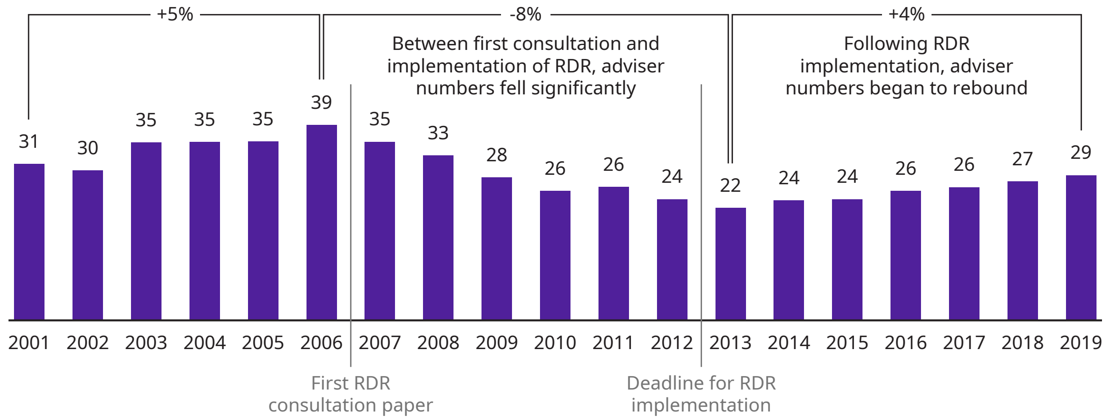
Again, similar to what has happened in Australia, major UK banks exited the UK market as a result of the RDR (and in response to the preceding Global Financial Crisis), and after receiving a series of fines for mis-selling investment products.[11] However, these banks have begun to re-enter the market in recent years, albeit in segmented ways, by targeting a broader customer-base, including lower-end segments via digital offerings.

10 ASIC, 627 Financial advice: What consumers really think, August 2019.

11 Source: *Timeline of UK banks investment mis-selling.*

Exhibit 4: UK adviser numbers fell by ~44 percent prior to RDR implementation, but have since rebounded with an annual growth rate of four percent

Number of advising staff working in UK financial advice firms[1]
In thousands, 2001-2019[2]



1 Defined as CF30 staff within firms that have an FCA primary "Financial Adviser" category (does not include any CF30 staff in firms whose primary category is not Financial Adviser)

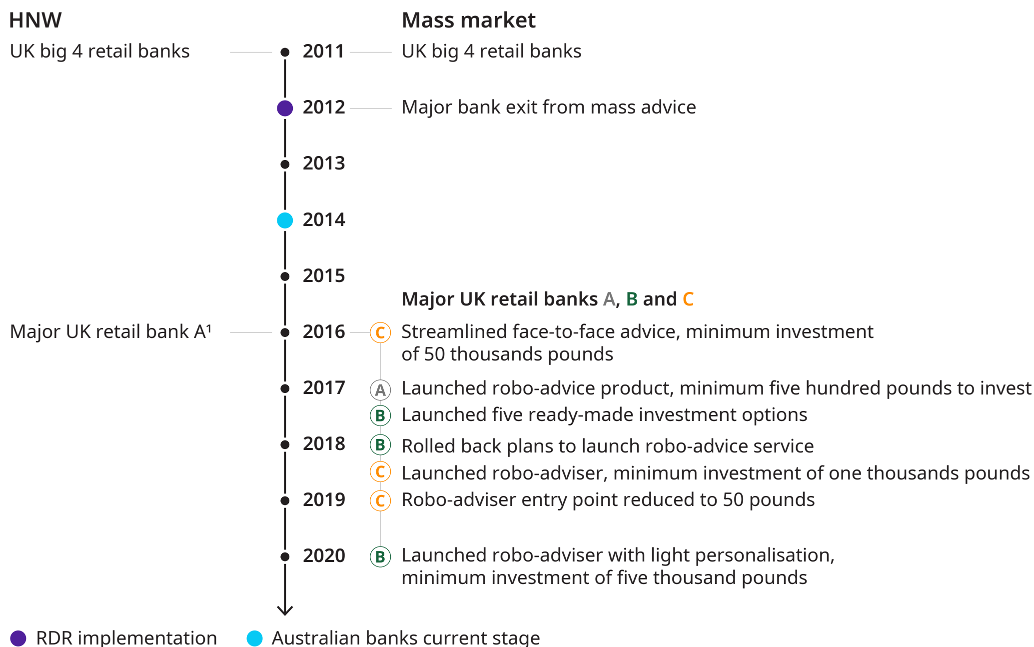
2 The FCA made changes to the categorisation of "financial advice firms" in its database in 2016, and only provides revised data from 2013. Though not strictly like-for-like, changes are sufficiently small to warrant the inclusion of the data from earlier years

Note: Advising staff numbers from 2001 to 2009 are based on Datamonitor, which reports firm numbers by size buckets. The number of IFAs are based on Oliver Wyman's estimates of the average size by each bucket

Source: PIMFA (using FCA register), Datamonitor, Oliver Wyman analysis

Exhibit 5: UK banks mostly exited financial advice post-RDR, but many are re-entering the market with various new propositions

Timeline of UK banks exiting/re-entering the financial advice market



1 One of the major UK retail bank's increased the minimum requirement for investable assets to £250,000 in 2016

Source: Financial Times, FT Adviser

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Who’s winning and why

The large advice gap in the UK has been bridged by two different types of advisers: direct-to-consumer (D2C) platforms and focused traditional players.

D2C platforms have grown assets under administration (AUA) rapidly post-RDR by implementing segmented advice models whereby they can economically service both the lower end, via low-cost, telephone-based channels, and higher end, via face-to-face advisers. Equally, they have excelled in key capabilities, such as human-centred design to create modern customer-centric experiences.

The traditional advice model has also flourished due to the fundamental need for advice remaining intact. However, upheaval in the sector has created fewer, stronger players that have more focused offerings, such as retirement planning.

While retail banks have also re-entered this market in a more segmented way, it is too early to gauge the success of these efforts.

US FINANCIAL ADVICE MARKET

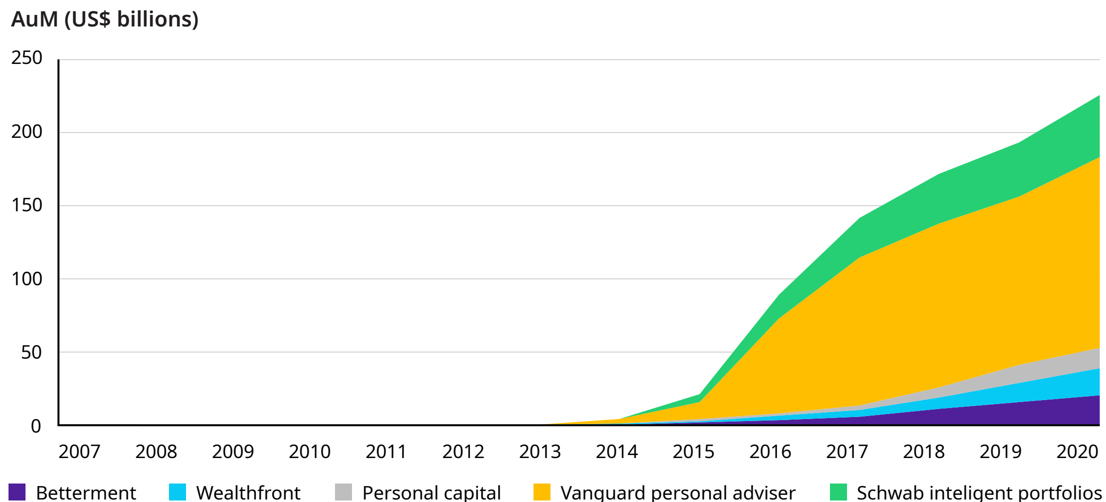
Market context

While the regulatory intervention in the US has contrasted the steps that have been taken in Australia and the UK, the analogous trend is the growth in registered investment advisers (RIAs). In the US, RIAs with fee-based assets under management almost doubled their proportional share of assets under administration over the last 10 years. Growth in the RIA channel has been largely driven by an increase in client demand for impartial and independent advice, as well as a regulatory climate changing in favour of fiduciary advisers. In particular, clients are increasingly aware of the conflict of interest faced by intermediaries that are incentivised by commission-based remuneration structures to sell proprietary products. This highlights the differentiating value proposition of RIAs that market their commitment to putting investor interests first in line with the “fiduciary” standard.

In parallel, the robo-advice market, originally led by US fintech start-ups, has experienced significant growth from 2014 onwards as traditional asset managers began rolling out hybrid-robo services. By offering services at much lower fees than traditional managers (30-45 bps versus 150 bps+), these players quickly acquired customers and grew AuM (194 percent CAGR between 2014-2020) as shown in Exhibit 6. While the robo-advice market is still small, accounting for less than one percent of the total pool of managed assets, it is growing, and the respective players in this space are improving their profitability. A big reason for this is the scale of the players offering robo-advice. The largest players on average manage about US$35 billion in assets, and they have managed to convert many of their customers from receiving traditional advice to receiving robo-advice quickly and at low cost.

Exhibit 6: Robo-adviser assets under management (AuM) growth, 2007-2020 (US$ billions)

From 2014 to 2020, AuM grew by 194 percent CAGR driven by hybrid-robo offerings by traditional asset managers



Source: CB Insights (2017), Company press releases

The robo-adviser market is highly concentrated, with the top 5 players having ~90 percent market share. Specifically, large incumbent platforms have succeeded in achieving scale faster than pure-play advisers thanks to their captive network of existing customers as well as brand strength. These incumbents have achieved success with a direct-to-consumer approach having recently expanded to offer hybrid advisory solutions to segments that value some interaction with an adviser but are not after the dominant comprehensive models of the past.

Implications for Australia

The key takeaways for the Australian financial advice market include the following:

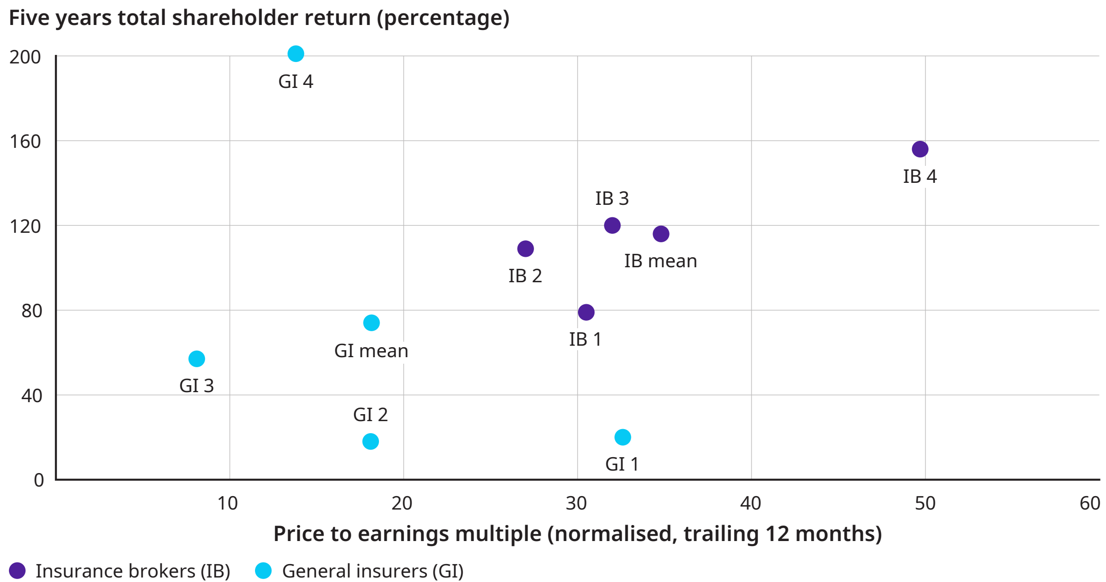
- Regulatory changes and consumer demand for impartial advice will further catalyse the growth of Australia's IFA sector.
- Similar to what has happened in the UK, scalable financial advice models will likely leverage digital technologies to improve the experience offered to customers, while also reducing service costs and compliance burdens.

AUSTRALIAN GENERAL INSURANCE BROKERAGE INDUSTRY

The IFA equivalent in the general insurance sector, brokers, have experienced significant success as a distribution channel and, while there are regulatory differences across the sectors, can provide some helpful insights for the financial advice sector to consider.

The top five insurance brokers trade at a higher valuation premium and have delivered superior total shareholder returns compared to the main general insurers, signifying the value that can exist in the distribution segment of the value chain.

Exhibit 7: Valuations of the top four global general insurers and insurance brokers (by market capitalisation)



Source: S&P Capital IQ, Oliver Wyman analysis

Keys to success

While the regulatory and contextual differences between the industries should not be underestimated, we believe there are four key considerations for the financial advice sector to keep in mind when charting the future.

Scale is critical

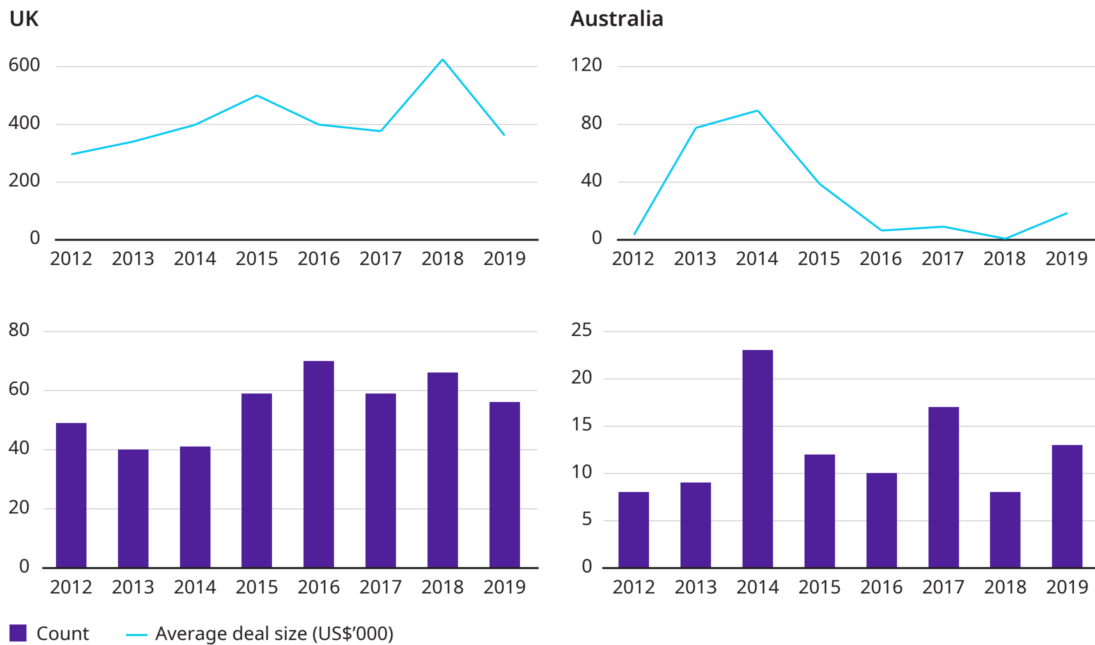
Consolidation has been a key driver of success, with large broker networks seeking to scale their large technology investments, and smaller brokerage firms unable to keep pace with technological advancements and the increased compliance burdens. This trend of scaling through consolidation has been observed across many markets for brokers.

Clarity on target segments

Brokers have made deliberate strategic choices on the segments they serve, such as small and medium-sized enterprises (and some HNWIs), while deprioritising other segments, such as the mass market. Equally important, brokers have continually invested in their value proposition to create stickiness in their segments, which has reduced incentive for end customers to go direct to insurers.

Exhibit 8: Insurance broking[1] M&A activity

2012-2019



1 Where target is classified as an insurance broking business

Source: Deallogic

Investing in technology to support smaller players and generate economies of scale

A core part of many large brokers' strategy has been their investments in technology-based insurance services. This typically includes the ability to provide transparent policies and pricing, along with facilitating the interactions that need to take place with insurers, making it both easier and cheaper for smaller brokers to conduct their business. For smaller brokers, this has provided them with access to scale benefits whilst retaining their independence and focus on serving clients. For larger brokers, this has increased and diversified their revenue base.

Extending across the value chain to provide additional services

As players have gained scale, they have experimented with providing additional services that deliver customer value. These have included increasing their types of advisory offers that focus on risk management, claims management, and risk prevention. The motivation here has been to not only provide additional services that customers value, but also achieve additional commercial returns over time. Whilst there has been mixed success here to date, the takeaway for the financial advice sector is the continued focus on serving end customer needs and willingness to go beyond core offerings in doing so.

MARKET OUTLOOK

The broader wealth management market remains in a state of flux with ongoing regulatory reform, changing consumer expectations and the evolving competitive dynamics in the sector. The exact outlook and timing is uncertain but we expect the market and its participants to evolve in multiple ways:

Advisers	• Further consolidation resulting in a small number of larger players dominating the market, with favourable profitability and valuations, and greater opportunities to invest in new technology, attract talent, diversify revenue, and access capital • Decline in adviser numbers by a further 10 to 15 percent as more tenured advisers exit the industry in the short term • Rise of the smaller independent financial adviser firms offering specific value propositions as non-conflicted advice becomes more sought after
Advice models	• Greater availability of tiered advice offerings, giving customers greater choice • Rise of digital direct to consumer and hybrid models to meet the needs of both the affluent and mass segments
Competition	• Injection of private equity capital into the sector to help professionalise and uplift efficiency • Industry funds reassessing how they meet their members' needs particularly as a large proportion of those age and have more complex needs • The ability of banks in the long term to identify how best to help their large customer bases with broader financial wellness needs that could benefit from "guidance" and "advice" offerings conducted in a low-risk manner • Accelerated growth in smaller technology enabled start-ups targeting niche, but highly valued advice offerings that will disrupt the market

We expect the future advice ecosystem to be more targeted for different customer segments, more diverse in terms of industry participants as well as usage of different advice models. Exhibit 9 illustratively outlines the evolution of the advice sector that we expect between now and 2025.

Exhibit 9: Future industry dynamics

Customers		Mass	Affluent	High-net-worth	Ultra-high-net-worth
Delivery of advice	Digital	purple	cyan	grey	
	Hybrid (digital/F2F)	cyan	purple	purple	grey
	Face-to-face (F2F)		grey	cyan	purple
Type of advice	Episodic, general advice	cyan	purple	grey	
	Ongoing/holistic advice		cyan	purple	purple
Providers	D2C platforms	purple	purple	grey	
	Super funds	purple	grey		
	Independent advisers	grey	cyan	purple	grey
	Retail banks		grey		
	Integrated wealth manager	grey	purple	cyan	
	Private banks			cyan	purple

Greater focus (purple – cyan – grey) Lesser focus

Source: Oliver Wyman analysis

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ACTIONS FOR FINANCIAL ADVICE PARTICIPANTS

Rather than a threat, the evolving market structure should be seen as a significant opportunity for the financial advice sector to reposition itself as necessary and reliable for consumers financial wellbeing.

The priority focus of advisers should be to develop ways to restore the trust gap in the short term in order to secure and build from existing client bases, as well as comply with changing regulatory expectations. In parallel, there are five actions to pursue to position successfully in the future sector structure:

- **Prioritised segment focus:** Establish a clear value proposition underpinned by a customer-first mindset; invest in understanding customer needs and re-start the process of transforming their service offerings. Advisers here need to go well beyond the traditional and static "fact-find" process to more holistically understanding their motivations and behaviours and doing so in a dynamic manner over time. These customer-first capabilities are relatively new to the financial advice sector and will take time and different skillsets to embed.
- **Stratify service offerings:** Align service propositions to specific customer segments, selecting priority segments to double down on and being the adviser of choice for those segments. Examples of these could include providing holistic advisory services to specific segments (retirees, young professionals in select industries/sectors, early-stage entrepreneurs etc.). For others, this will involve trying to provide a narrower range of services to a broader customer set. This can only be effectively done by first better understanding your customer set and subsequently critically assessing where your competitive advantage lies.
- **Code data within DNA:** Develop a detailed data footprint about customers at every point of interaction, taking advantage of open-data to enable a better understanding of their ever-evolving needs and so a better alignment of service offerings. Similar to customer-first, this is another capability that is in its infancy in the financial advice sector but critical for its future success.
- **Uplift technological capabilities:** Embrace developments in Regtech across Australia by utilising technology to reduce costs, while simultaneously improving compliance. Similarly, using technology to increase connectivity and engagement with clients, especially in a post-COVID environment.[12]
- **Partner orchestration:** Take advantage of technology to orchestrate partnerships across the advice value chain, including integration into digital ecosystems via APIs to enable a seamless customer experience. This will become critical especially for firms that aim to meet a broader set of customer needs and/or realise there are others that can provide select services at lower cost and better quality.

Ultimately, the approach taken will vary depending on the ambitions and size of each participant. Players will need to strike the right balance between pursuing growth and profitability, and continuing to maintain their client focus and internal culture, all while not adding to their technology debt.

Whilst we expect Australia's financial advice sector to experience more change in the short-to-medium term, we ultimately believe that the industry is currently in a unique position to transform and rebuild itself as a reliable and integral aspect of the future of financial services in Australia.

12 *Information paper: Regulatory technology*, October 2020

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