Fewer Advisers & Less Advice

Forecast 2013: The new year will usher in new rules for advisers and a new reality for those seeking financial advice

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This article was written by Jonathan Davis from Jonathan Davis Wealth Management for Morningstar's special series about the Retail Distribution Review (RDR) in the UK. It is part of Morningstar's "Perspectives" series, which is a series of articles written by third-party contributors.

Over the next few years we should expect a 20% fall in the number of individually registered independent financial advisers (IFAs) who advise on investments, with the overall number of investment advisers falling by perhaps 40%.

Recent data shows there are roughly 50,000 financial advisers in the UK, but in the next few years it wouldn't be surprising for that number to fall to 40,000.

In my view, there are three reasons why we can expect fewer independent and restricted investment advisers in the future.

Reason #1
While many IFAs call themselves "independent", they have very similar business models to restricted advisers who work for institutions like St. James' Place or Standard Life. While IFAs do not act as direct salespeople that offer investment products from one particular firm, their commissions and livelihoods are tied to various firms. Ultimately, the business model is almost identical to restricted adviser. With RDR, some independents will see it as impractical to continue as independent due to changes in regulatory requirements. Thus, they may move to the 'direct sales' model.

I estimate this could reduce the number of independents by some 20%.

Reason #2
The new RDR rules scrap up-front commissions on investments and pensions to financial advisers. Some current advisers – independent or restricted – will not be able to continue in business as their product-selling model will not withstand the change. They will not be able to keep cash flows high enough to continue in practice.

In a similar vein, even those who manage to hang around after the RDR changes will either a) not charge enough annually to survive or b) be structured in a way that hinders long-run business survival.

With the new rules being put in place, businesses will need to rejig their team and cost structures, which may involve beefing-up their back office and offering a higher quality consultative service to clients. I expect that many businesses won't be ready for this type of dramatic change, thus, they too will fall by the wayside over time.

I suspect this change could reduce adviser numbers – independent and restricted – by 20% over the next few years.

Reason #3

Then you have the economy, markets and shifting population dynamics.

Morningstar research has shown that even though the stock markets are at multi-year highs, outflows from equity funds are also extremely high. This is contrary to decades of experience where rising markets attracted big inflows. Is it because investors are savvier now? Do they expect the market to tumble so they hold off from buying? The short answer is, probably not. I believe people are withdrawing from equity funds simply because they need the money to spend on living expenses. Also, there are more retirees now compared to previous decades, which means that in the overall population, there are fewer investors putting money into the markets and more retirees taking money out of the markets or shifting their money to safer bond funds. The overall decumulation of pensions exacerbates net outflows.

Furthermore, the economy will likely struggle to grow (to put it mildly) for years. This, and the fact that we have remained in a secular equity bear market since 2000, results in less overall investing and, therefore, a general withdrawal from investment advice.

A decline in the number of investors and generally lower churning of existing holdings (which traditionally was a significant source of adviser revenue) will knock out a large swathe of current advisers.

Fund Management Groups to Consolidate

We can also expect that there will be fewer fund management groups in the future. The reason is this: if there is going to be reduced net investments made (or even net outflows) we may witness a falling market. Thus, some fund companies will be forced out of business in the future. Expect to see more consolidation of fund groups vying for a bigger market share within a declining market.

During this period of transition, expect fund management firms to start spending more on marketing to get closer to end investors. Thus, although a small number of firms may take a bigger market share of a shrinking market, their costs will soar for marketing since they can no longer rely on low-cost IFA distributors to sell their wares.