The Financial Adviser Opportunities for DFMs

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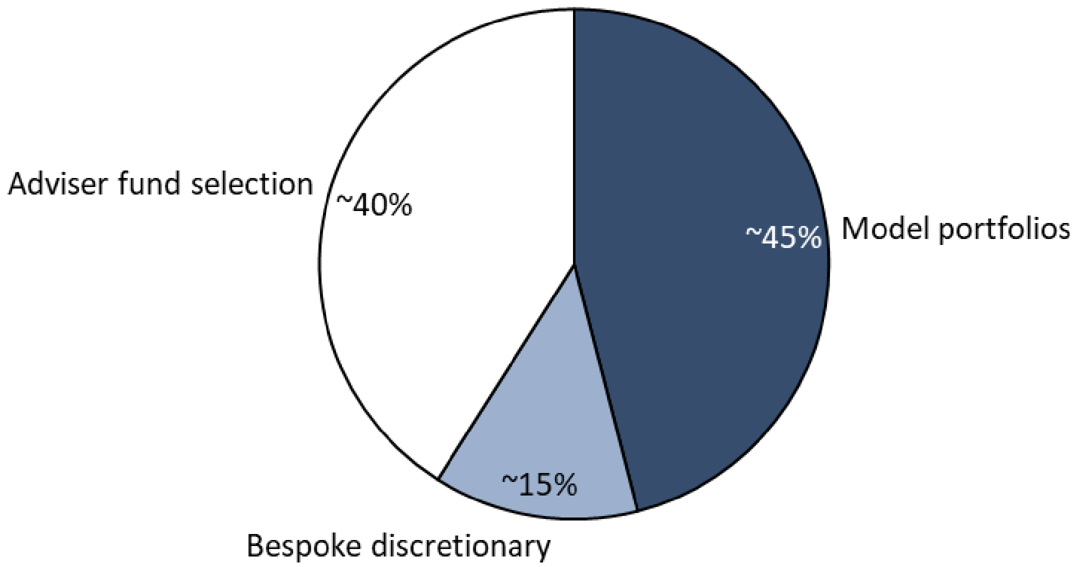
With growing competition between model portfolio providers, what can discretionary fund managers do to position themselves more competitively among financial advisers

The Growth of Model Portfolios

Model portfolios are an important part of the UK independent financial adviser channel, accounting for around 45% of advised client assets, with a further 15% of assets sitting within bespoke discretionary portfolios (figure 1).

Figure 1: Split of UK independent financial adviser channel AUM by investment solution



Source: NMG Consulting Distribution Insights Studies

The growth of model portfolio usage has been driven by regulatory forces and changes in provider propositions:

- The FCA's guidance on client suitability assessment within Centralised Investment Propositions (following the RDR) grew demand for outsourced investment solutions linked to customer risk profile
- Increases in the use of platforms grew demand for centralised investment propositions to be hosted on-platform
- MiFID II fee disclosure requirements grew demand for outsourced client investment reporting

DFMs as Model Portfolio Providers

Independent discretionary fund managers (DFMs) have evolved from private client stockbrokers to become model portfolio providers, managing ~50% of model portfolios assets in the UK (the remaining 50% being managed within models run by the advice firm, a platform or a back office technology provider). And there are plenty of strategies that independent DFMs can employ to protect and grow share-of-wallet within existing advice firm clients, including integration with financial planning software and support with business continuity.

However, as the economic shock caused by COVID-19 increases demand for model portfolios, in this Citylogue we will explore what DFMs can do to capture the new business opportunities within the financial adviser channel.

Different New Business Opportunities by Advice Model

So, what do these new business opportunities look like?

The answer depends on the scale, internal capability and operating model of the advice firm:

- **Networks and national advice firms** are setting up their own model portfolios as the centralised investment proposition with an internal investment committee, requiring DFMs only for the initial setup of the investment team and ad-hoc consulting support
- **Investment specialist advice firms** are looking to white-label model portfolios from third-party DFMs, with some input into the investment selection process in exchange for a share of multi-manager fees
- **General practitioner advice firms** are considering outsourcing a large proportion of their assets to DFMs to manage the centralised investment proposition and to generate client reports

While DFMs had success in supporting networks and national advice firms in launching their own model portfolios, only a handful of these opportunities remain. And most DFMs are willing to white-label investment solutions for only a small number of preferred investment specialist adviser clients, due to the increased costs and the risks associated with jointly-run model portfolios.

Instead, it is the general practitioners that hold the greatest opportunity for DFMs.

The Competition for General Practitioner Models

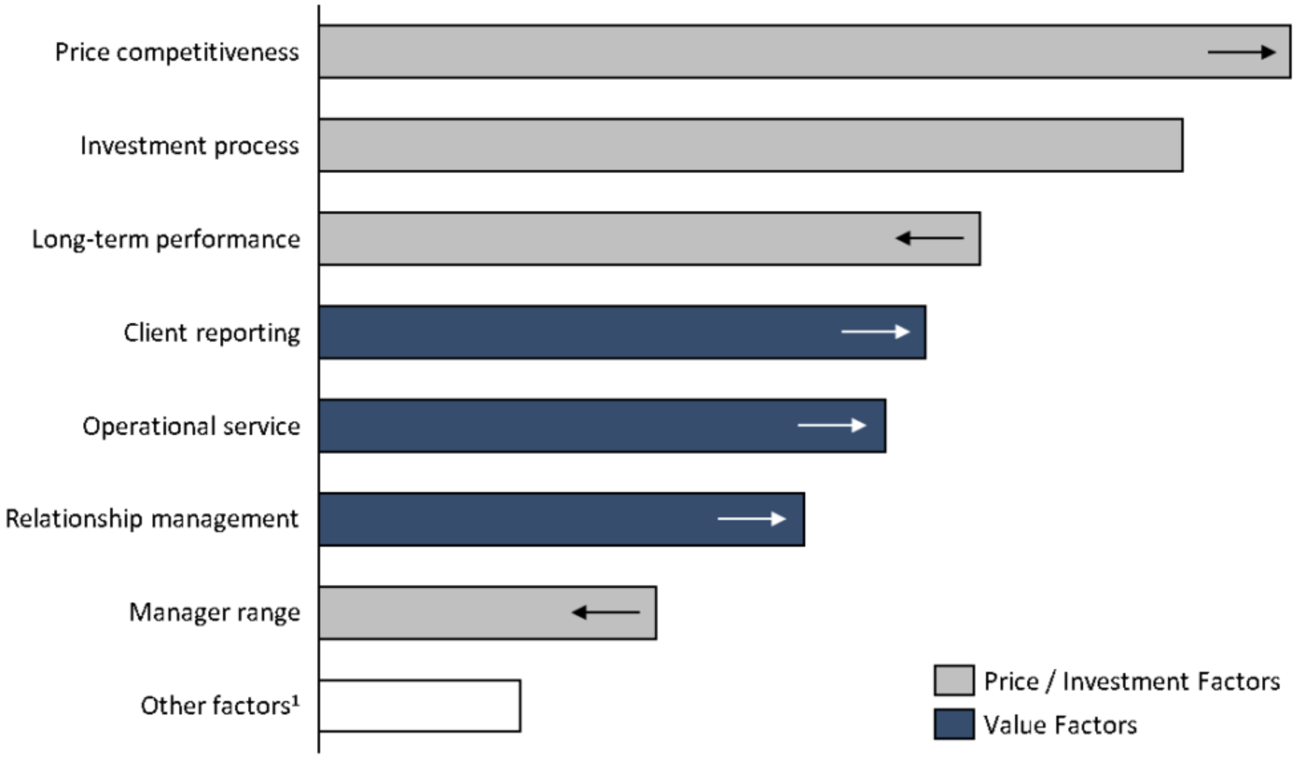
However, DFMs are not alone in competing to be the model portfolio provider for general practitioner advisers.

- Platforms and back office tech providers, attracted by fees of 15-50 bps for model portfolios, are looking to capture downstream investment economics
- Fund researchers are looking to model portfolios to generate basis point revenue (on top of subscription fees for research)
- Single strategy asset managers are looking to launch model portfolios to generate steady flows into their own single asset solutions

In order to successfully differentiate from a broad range of competitors, model portfolio providers must understand how they are selected by advisers.

Feedback from NMG’s distribution insights studies shows that, at a high level, price is becoming more important and performance less so, but deeper analysis indicates that the solution is more complex. In fact, advisers select DFMs on how they align to their advice proposition, based on a range of value factors, including client reporting, operational service and relationship management (figure 2).

Figure 2: Top-3 factors for selecting DFMs (by general practitioner advisers)



Source: NMG Consulting Distribution Insights Studies
[1]Other factors includes short-term performance, access to illiquid asset classes and access to portfolio managers

How Discretionary Fund Managers Can Succeed

If this sounds familiar, it should – as DFMs play an increasingly important role in both the back and front office functions of advice businesses, they will take on product wrapper provider-like responsibilities and, in turn, will be selected by advisers on this basis. Successful DFMs will position themselves more competitively by understanding the changes to the process by which they are selected and shaping distribution and M&A strategy accordingly.

So, it is clear that there is no singular winning solution for DFMs. Instead, successful strategies will be targeted at specific financial adviser subsegments and their relevant model portfolio provider selection factors, including:

- Price-led strategies using ETFs and scale for segregated mandates
- Service-focused strategies, investing in relationship management and service teams to grow penetration and share-of-wallet, leading to lower unit distribution costs
- Vertically-integrated platform strategies, pricing competitively and integrating with platform tools and reporting to gain captive assets

At NMG, we are working with DFMs to optimise their existing client base, define their distribution strategy and identify M&A opportunities to build competitiveness. For more information, contact:

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