The value of discretionary fund management

Chapter 1: The impact on the adviser model
# Index

<table>
<thead>
<tr>
<th>Page</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>The value of DFM: Sample of key findings</td>
</tr>
<tr>
<td>5</td>
<td>Introduction</td>
</tr>
<tr>
<td>6</td>
<td>How do the characteristics and behaviours of DFM users and non DFM users vary?</td>
</tr>
<tr>
<td>7</td>
<td>The principal drivers of adviser businesses deciding to employ outsourced DFM</td>
</tr>
<tr>
<td>10</td>
<td>What are the most important factors when selecting a third-party?</td>
</tr>
<tr>
<td>11</td>
<td>Changes in client bank numbers, following adoption of a third-party investment partner</td>
</tr>
<tr>
<td>12</td>
<td>Time monetisation: the effect of adopting DFM on an adviser business</td>
</tr>
<tr>
<td>14</td>
<td>The key findings</td>
</tr>
<tr>
<td>15</td>
<td>The impact on advisers' salaries</td>
</tr>
<tr>
<td>16</td>
<td>‘I would change, ‘if’.” Non DFM users’ objections to adoption</td>
</tr>
<tr>
<td>18</td>
<td>Discretionary fund management at Rathbones</td>
</tr>
</tbody>
</table>
The value of DFM

Sample of key findings

Comparative make-up of client banks post-adoption
- Firms who have adopted DFM are, on average, double the size of non-adopters (10.5 advisers versus 4.7). Advisers within adopting firms also look after 14% more clients than non-adopters. (for full details, see page 6)

Client revenues by adviser
- Advisers who had adopted DFM received annual revenues of £220,716 per head, versus £186,606 for non-adopters - 18% more per adviser. (for full details, see page 6)

Variance in average hourly fees charged
- ‘DFM users’ charged clients fees averaging £206.40 per hour, while non DFM users in the study achieved £196.40 for the same time. (for full details, see page 6)

Principal drivers of adviser business transition
- The most common catalysts for adviser adoption of DFM included strategic review (40%), organisational change (18%) and wider ‘events’. (for full details, see page 7)

Most important factors in selecting a third-party DFM provider
- The study showed that the most important factors included the ability to personalise, performance, cost and more. (for full details, see page 10)

Client numbers on the rise following adoption
- 19% of adopting advisers had seen an increase of 20% or more. (for full details, see page 11)

Changes in adviser time monetisation following adoption
- The new research compares the time DFM users and non DFM users are able to devote to revenue-earning activities. (for full details, see page 12)

The impact of adoption on advisers’ salaries
- The Rathbones value of discretionary fund management report examines the increases in salaries for advisers following adoption of a third-party investment partner. (for full details, see page 15)
Introduction

Over the last 10-15 years, third-party discretionary fund management has become an investment model embraced by many advisers, with an estimated take-up of 40-50% of the industry - and many expecting this to reach 60-70% in the next few years.

Its adoption has been influenced by diverse industry factors: the quest for greater adviser profitability, the need to increasingly put client service at the centre of the adviser offering - and the need to react faster to market volatility.

But, having adopted DFM, what has been the impact on the UK’s adviser businesses?

- Have revenues changed as a result?
- How do client bases compare between adopters and non-adopters?

- And what of today’s non users of DFM? How have they evolved in comparison to adopters? And how have their businesses performed against their ‘adopter’ colleagues?

While the ‘discipline’ has existed for over a decade, surprisingly little, if any, robust data exists to understand these dimensions. As a significant player in the field, Rathbones felt this was essential to understand. So, in Q1 2018, we commissioned CoreData, the independent financial services research consultancy, to conduct a comprehensive research study to understand the changes that have taken place.

Following in-depth interviews with a small group of advisers, this informed a research programme with a further 100 advisers (DFM users and non DFM users). Permitting accurate comparison of behaviours - and the resulting business performance of the two adviser groups.

The findings are important as, despite columns of opinion and conjecture in the media, they demonstrate the facts, realities and successes of long-term DFM usage.

The report has been divided into two ‘chapters’. This, the first, examines the impact of outsourced discretionary fund management on the adviser model. The second, to be released later in 2018, explores its impact on relationships with clients - and the value it has brought. Actual responses from those surveyed are shown throughout.
How do the characteristics and behaviours of DFM users and non DFM users vary?

The research first benchmarked the key differences in size, structure and dynamics of DFM users following adoption of DFM, with those of non DFM users:

A  
**Size by adviser numbers.** Firms that have adopted DFM are, on average, double the size of non DFM user firms (10.5 advisers versus 4.7).

B  
**Client numbers.** DFM users look after 172 clients per adviser, compared to 151 clients for non DFM users - 14% more per adviser.

C  
**Revenues per adviser.** Adopters confirmed revenues of £220,716 per adviser, against £186,606 per adviser in non DFM user firms (18% more).

D  
**High net worth investors.** DFM users posted a marginally higher percentage of high net worth clients than their non DFM user counterparts (13% versus 11%).

E  
**Satisfaction with structure of client base.** Advisers who had adopted DFM, expressed significantly greater satisfaction with the wealth make-up of their client bank (78% versus 64%).

F  
**Hourly fees.** DFM users were able to charge £10 more per hour for client reviews, achieving £206.40, while non DFM users achieved £196.40 for the same time.
The principal drivers of adviser businesses deciding to employ outsourced DFM

The past decade has seen adviser firms exposed to seismic regulatory events such as RDR, MiFID II and more, coupled with significant market volatility and the need to monetise client time effectively post-RDR. The research therefore set out to understand which of these were the primary catalysts behind the business decision to adopt a third-party investment management model.

By far, the most common catalyst that drove transition was a ‘strategic review’. Cited by 40% of adopting advisers, this reflects a recognition at business level to de-risk, to evolve the firm’s offering, for increased levels of compliance - and even the outsourcing of cost. Organisational change (18%) and regulation (15%) were significant drivers for other advisers - and a ‘market event’ cited by a smaller 5%.

The research then asked DFM users if their business found it ‘difficult to introduce third-party investment managers into the business’. A high 76% of the advisers questioned ‘strongly disagreed’ that introduction had proven difficult, suggesting a broadly warm welcome for the business transition.

Figure 1: 

<table>
<thead>
<tr>
<th>Catalyst</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>My clients were happy for me to use third-party investment specialists</td>
<td>97%</td>
</tr>
<tr>
<td>My organisation did not find it challenging to introduce third-party investment managers into the business</td>
<td>76%</td>
</tr>
<tr>
<td>I am happy for DFMs to contact my client directly</td>
<td>46%</td>
</tr>
</tbody>
</table>

Figure 2: Numerous catalysts for third-party adoption

- Strategic review: 40%
- Organisational change: 18%
- Regulatory event: 15%
- Market event: 5%
- Other: 21%
The value of discretionary fund management
DFM user:
The catalyst was the FCA. The smallest fund switch change now needs a full fact-find and a report which makes it completely non-viable from a cost perspective. This came in about 2012 (FSMA) and our regulatory team said you have to knuckle down and get to grips with these changes or not do it at all, which meant outsourcing. Outsourcing was designed to free us up and take away the regulatory burden. It was also there to improve performance. I think it has delivered on all of those aims.

The Rathbones view on cost:
It is right for advisers to be focused on cost, but not if this risks value. Equally, DFM needs to be viewed in the light of the full spectrum of client costs including platform, fund charges and management fees, rather than in isolation. This report shows that focus on cost alone means clients will not get the full benefit of the resource and expertise afforded by a DFM, while advisers may fail to achieve full value for their clients.
What are the most important factors when selecting a third-party?

The research then probed the more important factors for advisers when choosing an outsourced investment partner. Overall, advisers have to first make the choice of which of the two principal DFM models is more compatible with that of their own business: choosing between more traditional firms with a stockbroking heritage, and modern providers with a more centralised control of risk and asset allocation.

Performance was cited as the most important factor (81%); this encompassing investment houses’ bespoke and passive strategies for delivering against client goals. Cost figured second (75%), as advisers ensure the combined cost of DFM - and their fees - delivers value to clients. Investment process was the third most important factor, taking into account investment rigour and portfolio balancing. Ability to personalise (30%) also figured significantly, reflecting the increasing need to align bespoke approaches with increasingly complex client requirements.

Interestingly, advisers place relatively lower importance on ratings (8%) or intellectual capital (3%), placing greater store instead on past relationships with a manager (17%).

The Rathbones view on performance: We believe that when it comes to DFM performance, it should be seen as a plot point in a client’s investment strategy, rather than an absolute. Other factors also need to be recognised: the assets used to achieve any performance, the level of risk that can affect future volatility, and finally the level of personalisation involved. Bespoke portfolios are traditionally hard to compare, but a small number of providers (ourselves included) use ARC and GIPS to deliver a higher level of consistency and transparency in measurement.
Changes in client bank numbers, following adoption of a third-party investment partner

The study then progressed to examine how the take-up of DFM had affected the size and shape of advisers’ client banks. Since adoption, 19% of DFM users had seen an increase of 20% or more, 3% had seen growth of 15-19% - and 9% an increase of 11-14%. In total 52% of the sample had seen a marked increase, contrasting with 16% of the sample who noted a decrease.

DFM users also said that their clients had grown in size, with almost a third (32%) of their client base now investing more than £500k, against 27% ‘pre-adoption’.

**Figure 4:** Changes in client numbers following adoption

- Increased by 20% or more: 19%
- Increased by 15% to 19%: 3%
- Increased by 11% to 14%: 9%
- Increased by 6% to 10%: 12%
- Increased by 1% to 5%: 9%
- No change: 33%
- Decreased by 1% to 5%: 8%
- Decreased by 6% to 10%: 6%
- Decreased by 11% to 14%: 0%
- Decreased by 15% to 19%: 2%
Time monetisation: The effect of adopting DFM on an adviser business

The adoption of outsourced DFM has changed advisers’ investment responsibilities - and the time required to deliver on these tasks. The Rathbones research therefore set out to understand the impact of this redistribution of time on adviser revenue generation - and what activities ‘replaced’ the time non DFM users still allocated to investment management.

To understand how this differed for DFM users and non DFM users, both groups were asked to define and rank those activities which most resulted in revenue generation for them. Perhaps not surprisingly, ‘Meet with existing clients’ was the highest figuring activity for both groups, at 76% and 73% respectively. The results are detailed in figure 5 overleaf.

A divergence in the differing roles can be seen more in responses to the next four most popular activities.

- For adopters ‘managing existing clients’ represents a more sizeable revenue opportunity, with 70% expressing this, compared with a far lower 64% of non-adopters.

- Conversely, non DFM users (58%) saw ‘managing existing client investments’ as a significant revenue generator, compared to 51% for DFM users who will have outsourced much of this to a DFM.

- Interestingly, non DFM users identified seeking new clients as a key revenue area (46%), while DFM users saw this as having a far lower importance at 31%.

- An extension of the same need above, ‘marketing’ had far greater import for non DFM users than DFM users (21% versus 12%).

The study then asked both groups which of these revenue-generating activities they actually spent their time delivering against each week.

- Non-adopters spent almost 50% more time managing client investments than adopters (20% versus 13%).

- Most significantly, DFM users revealed they spent considerably more time than their counterparts on meeting revenue-generating clients (25% over 19%).

- For ‘managing existing clients’ (the second highest revenue-generating activity), DFM users and non DFM users both focused a similar percentage of time (20% and 23%).
**Figure 5:** Biggest revenue generators and the time spent on them

<table>
<thead>
<tr>
<th>Primary activities which resulted in revenue generation in business</th>
<th>Percentage of a typical working week spent</th>
</tr>
</thead>
<tbody>
<tr>
<td>DFM users</td>
<td>Non DFM users</td>
</tr>
<tr>
<td>Meeting existing clients</td>
<td>76%</td>
</tr>
<tr>
<td>Managing existing clients</td>
<td>70%</td>
</tr>
<tr>
<td>Managing existing client investments</td>
<td>51%</td>
</tr>
<tr>
<td>Seeking new clients</td>
<td>31%</td>
</tr>
<tr>
<td>Training/continued professional development</td>
<td>13%</td>
</tr>
<tr>
<td>Marketing</td>
<td>12%</td>
</tr>
<tr>
<td>Regulation and compliance</td>
<td>8%</td>
</tr>
<tr>
<td>General administration</td>
<td>3%</td>
</tr>
<tr>
<td>Media/social media</td>
<td>0%</td>
</tr>
</tbody>
</table>
Firms who adopt DFM are, on average, double the size of non-adopters, with 20% more clients per adviser.

Advisers who use DFM received annual revenues of £220,716 per head versus £186,606 for non-adopters.

The average hourly client fee for advisers who use DFM, compared to £196.40 among those who don't.

Of adopting advisers had seen an increase in clients of 20% or more.

The average increase in salary for advisers who use DFM compared to those who don’t.

When it comes to allocating their time, non-adopters saw marketing as being more important than adopters 21% versus 12%.

Was given as the most important factor in choosing a DFM provider, as well as personalisation, cost and more.
The impact on advisers’ salaries

As can be seen, the research shows how outsourcing investment management allows DFM users to spend more time on activities that generate higher levels of revenue. The research therefore set out to determine whether the subsequent increase in client income and profitability had translated into personal remuneration.

It had. 12% of advisers revealed their salary had increased by 20% or more, 6% by 15-19% and 8% by 11-14%.

Figure 6: Salary boosted as a result

- Increased by 20% or more: 12%
- Increased by 15% to 19%: 6%
- Increased by 11% to 14%: 8%
- Increased by 6% to 10%: 10%
- Increased by 1% to 5%: 12%
- No change: 40%
- Decreased by 1% to 5%: 6%
- Decreased by 6% to 10%: 6%

n=67
"I would change, ‘if’.”
Non DFM users’ objections to adoption

The research then sought to understand:
- The principal reasons for non-adoption
- How rigid non DFM users’ barriers to adoption are: what (if anything) would encourage them to become a DFM user

Reasons for non-use fell predominantly into two clear groups. Firstly, cost. 36% expressed that ‘the cost of using a DFM is too great’ (see figure 8 overleaf). A further 35% felt that they would ‘struggle to justify the cost of their own advice if they employed a third-party investment manager’.

Secondly, and to a lesser extent, concerns focused on ‘ownership and relationship’ with their end-client. This was expressed in three different ways: 8% of advisers felt their clients could ‘end up with all their assets entrenched with one provider’, a slightly smaller number (5%) were concerned ‘that DFMs would steal their clients’ and 4% felt they would ‘lose control of the investment value chain’.

The research then examined what provider - or wider activity - would encourage them to move to outsourcing.

Given the audience consists solely of non DFM users, responses are clearly perceptual, but are important beacons nonetheless. Encouragingly for the DFM sector, only 18% of the sample expressed that nothing would sway their current position (see figure 7 below).

The vast majority (70%) said that lower costs would force a change, overcoming concerns about their impact per se, on performance and in the justification of their fees. Beyond this, there was a far broader spread of factors. Second highest was the perception of a need for ‘improved performance’ (46%), while for 33% regulatory concerns were the barrier that needed lifting. 30% cited they wanted increased transparency in the investment and charging process, and 27% a broader availability of products.

Figure 7: Strong hope for future uptake of third-party investment managers

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower costs</td>
<td>70%</td>
</tr>
<tr>
<td>Improved performance</td>
<td>46%</td>
</tr>
<tr>
<td>Regulatory concerns</td>
<td>33%</td>
</tr>
<tr>
<td>A more transparent investment and charging process</td>
<td>30%</td>
</tr>
<tr>
<td>Wider availability of products</td>
<td>27%</td>
</tr>
<tr>
<td>Growth in my business (people and assets)</td>
<td>9%</td>
</tr>
<tr>
<td>None of the above</td>
<td>18%</td>
</tr>
</tbody>
</table>
DFM user:
We have taken the step to reduce our ongoing advice fee to reflect the fact that we no longer manage the money. We take the long-term view that it frees us up to concentrate on other areas.

Non DFM user:
We wish to keep the revenue in-house.
Discretionary fund management at Rathbones

While data on the ‘big picture’ adoption of DFM has been available for some time, we commissioned CoreData to understand a different dimension. Our goal was to understand what measurable effects adopting DFM had achieved for adviser businesses over time - and what value had been created for them. To achieve this, CoreData advocated a research framework that compared adopters of DFM with non-adopters. The research was anonymous, involving thousands of hours of adviser interviews to ensure robustness of findings.

The result is a highly significant piece of independent research into the changes that DFM has created in the UK: The value of discretionary fund management report.

This, the first chapter, examines the effect on the adviser model of adoption; the second chapter (to be published later this year) will examine its impact on the end-client relationship.

The report has also been invaluable in allowing us to examine how the findings can further improve our DFM offering to advisers. Areas such as performance, value for money, the tailoring of investment solutions to specific client needs and transparency of charges are the foundation on which we have built our DFM solutions. The study has given us the catalyst to further improve our client offering.

Despite huge growth in the use of DFM over recent years the question has remained: just how much value can the adoption of third-party DFM services add to an advice business? Rathbones has boldly answered this question, in pounds and pence, through this important body of research. Advice firms using DFM are, on average, double the size and look after 20% more clients. They also benefit from higher annual revenues. Advocates have espoused the benefits of adopting an outsourced investment approach for many years - it’s great to finally have hard evidence to support these claims.

Abbie Knight, Director, DISCUS

The value of discretionary fund management – chapter 2

Chapter 1 examines the value DFM had brought to the adviser/client relationship, the second chapter covers:

- What impact has adoption had on the client relationship?
- Performance. Have advisers seen changes to their clients’ portfolios?
- The impact of DFM on time spent with client
- The strategic impact over time of adoption
- Adviser profitability post-adoption

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