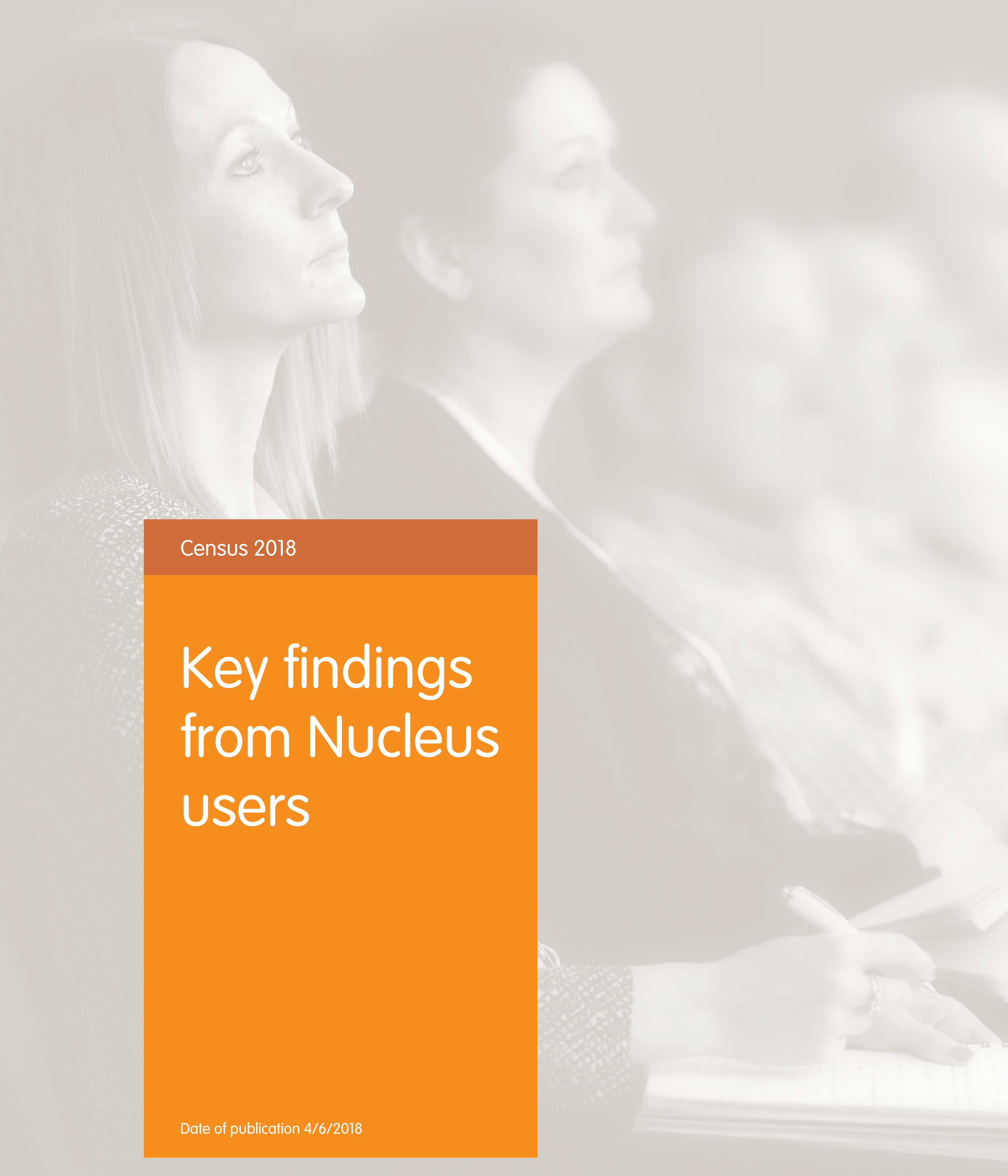
For adviser use only



Census 2018

Key findings from Nucleus users

Date of publication 4/6/2018

Contents

Introduction

First of all, thanks again to everyone who completed this year's census questionnaire. Without your participation, there would be no census, so I hope the output merits the effort you all put into completion. This is the deepest dive we've done into you and your businesses, and, as progress continues, there are some interesting changes, particularly with client numbers, charges and succession planning.

Despite pension freedoms fuelling the growth of many firms over the past few years, you've told us that the need for holistic financial planning is your biggest opportunity. This feels like a natural progression for many of our audience. All the signs point to a continually growing advice market, with times of uncertainty and increasing complexity meaning the demand for quality advice has never been higher. And many are placed to benefit from this, as you'll see from the findings this year.

As always, we'd love to hear what you think about the outputs, so please drop me or one of the team a message if there's anything you'd like to see covered in next year's census.

Thanks again for your participation.

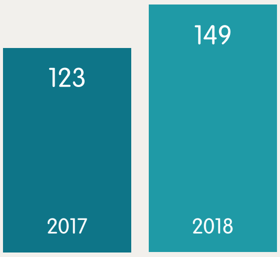
Dave

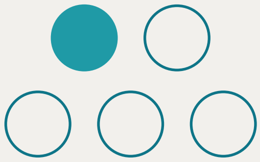
David Ferguson
Founder and CEO

Key highlights

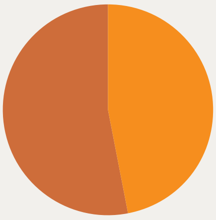
40% of firms generated gross turnover of over £1m in 2017

Average client numbers





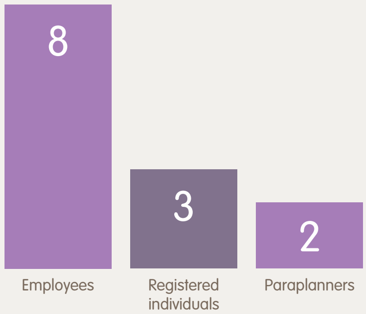
One in five expect client numbers to increase significantly

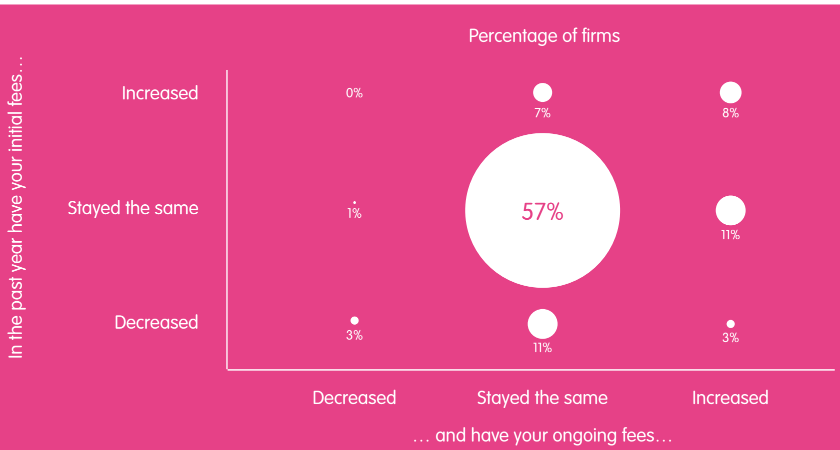


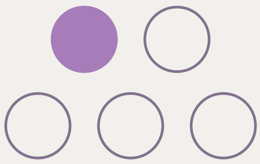
47% expect a moderate to severe level of impact from replatforming and platform mergers

Two-thirds expect the FCA's asset management market study to improve the transparency of investment management costs

Median number of employees within firms using Nucleus





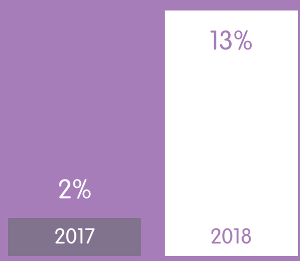


One in five firms employ five or more people aged under 30

Key highlights

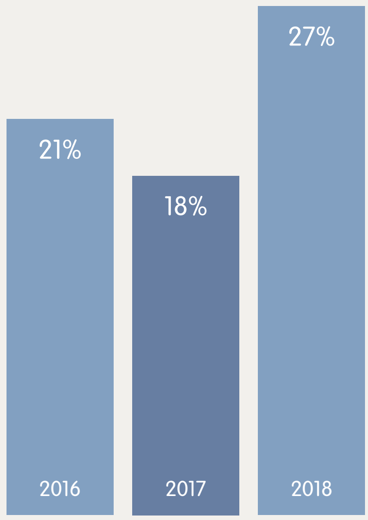
3% expect Brexit to have a fair degree or significant impact on their business

What do most clients value in you?

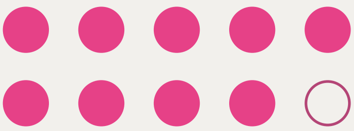


Trust

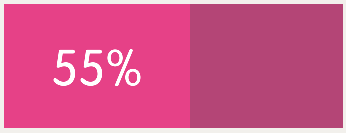
Asset management pricing



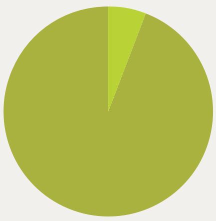
Almost 30% expect a significant decrease in asset management pricing



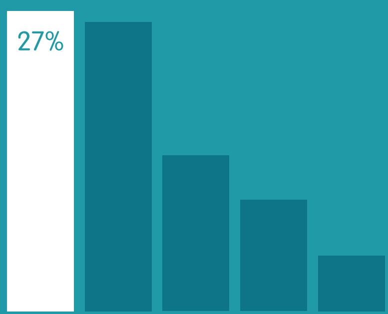
Nine in 10 firms saw an increase in the number of DB to DC pension transfer requests



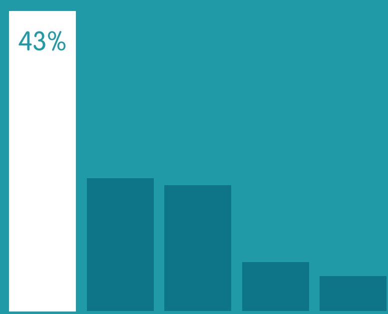
55% are 'concerned' about a potential DB mis-selling scandal



Only 6% are likely to sell their business to a large consolidator or product provider



Regulation is the biggest challenge



'Need for financial planning services' the biggest opportunity

Strength in numbers

2017 was a period of significant growth for Nucleus users. In business terms, this was a record year for many, reflected in the higher level of average assets managed on behalf of clients, boosted by an increase in the numbers of DB transfers. Strong levels of turnover were delivered, with four in 10 firms turning over more than £1m. Expectation is that the proportion of turnover retained as net profit will also increase, with the average expected to be 27%, well ahead of wider industry data from the Personal Investment Management and Financial Advice Association (PIMFA).

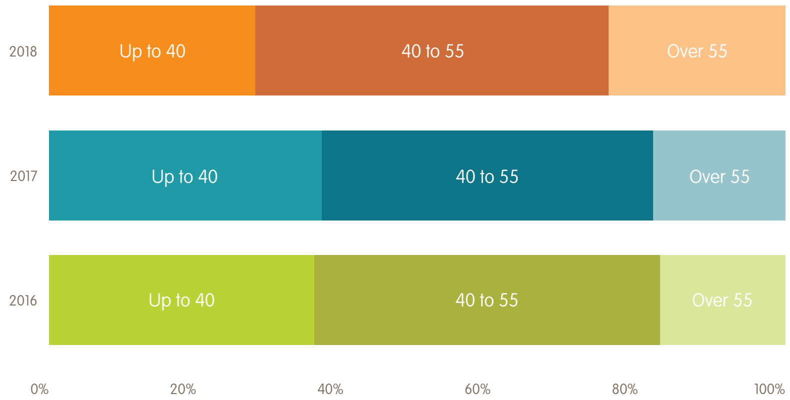
One upward trend our audience can't control is the increase in age, with more responders now creeping into the 'over 55' age bracket.

Other rises include the increased business expenses experienced by many. Some of these are longer term investments in areas such as cyber security or the costs of investment in technology which should pay dividends for firms in the future. But many have reported increases in their regulatory bill and additional costs associated with legislative requirements, particularly the Markets in Financial Instruments Directive (MiFID II) and General Data Protection Regulation (GDPR).

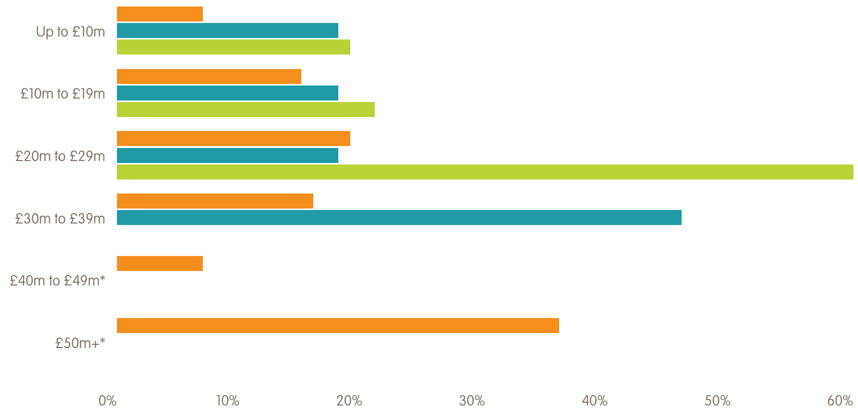
But what of the downside? Despite many responders making no change to their pricing, some have reported seeing pressure on fees. In fact, more responders have decreased their initial fees than have raised them, although the reverse is true for ongoing fees, significantly so.

All in all, these are all extremely positive signs of growth within the Nucleus audience.

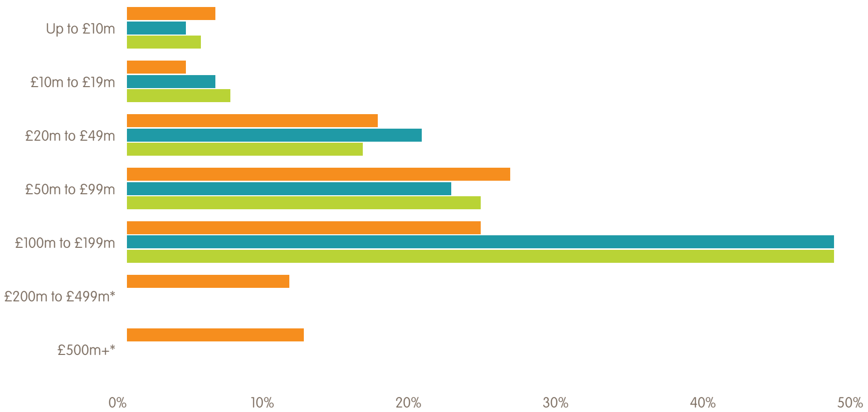
What is your age?



What amount of assets do you personally control or influence?

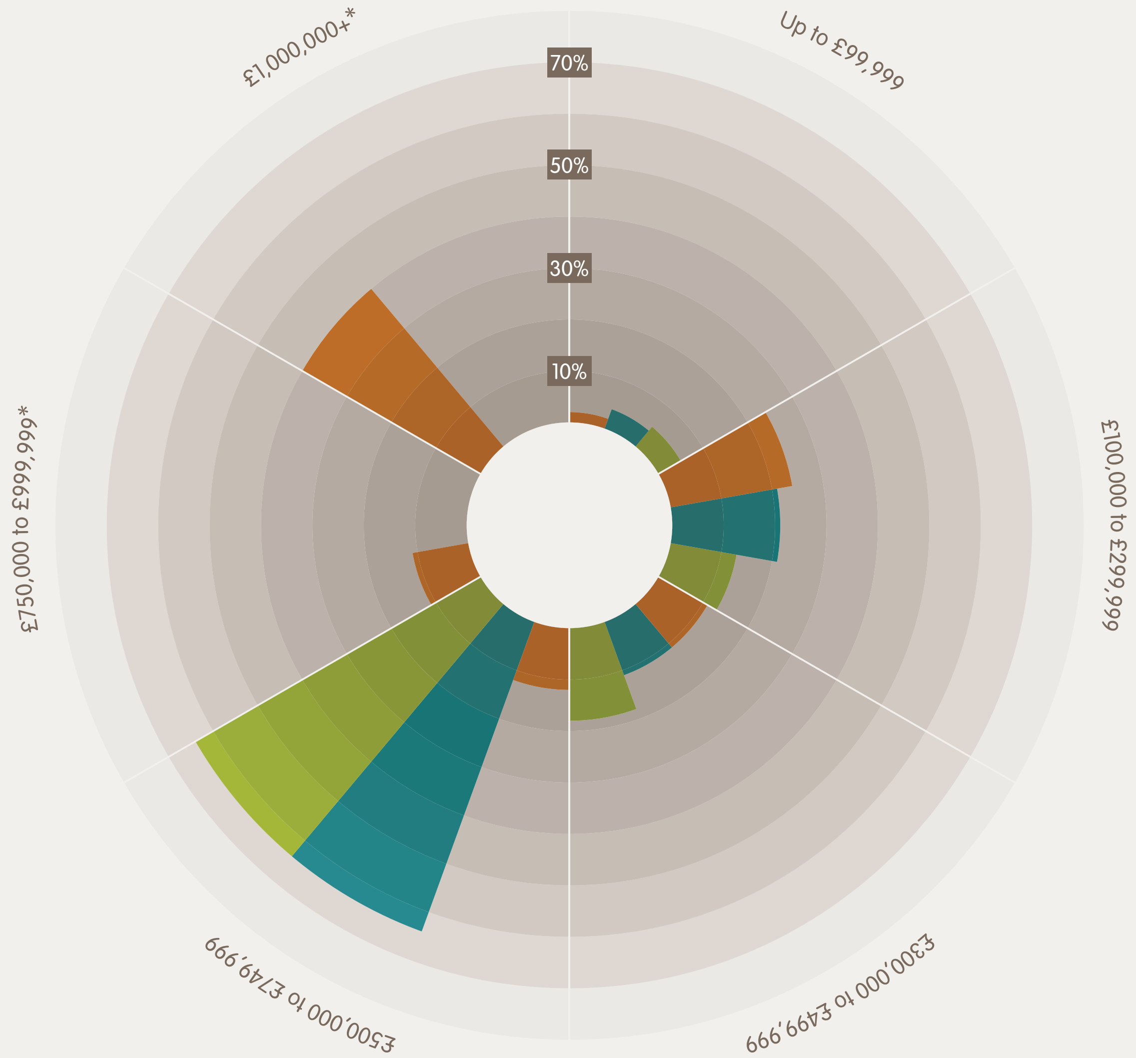


What amount of assets does your firm control or influence?

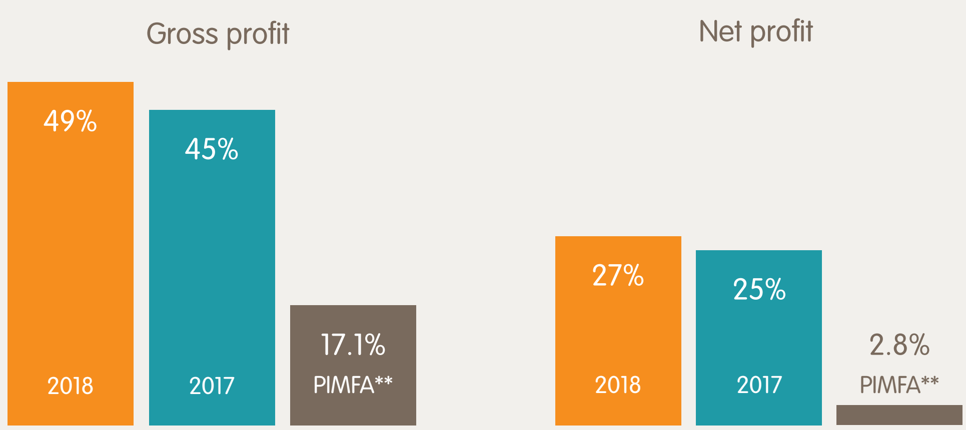


* New bands introduced in 2018

What is the likely gross turnover for your business in 2017?



What % of your 2017 turnover do you expect to retain as...



* New bands introduced in 2018 ** PIMFA, The Financial Adviser Market: In Numbers, edition 5.0, May 2017

Increased clients brings capacity concerns

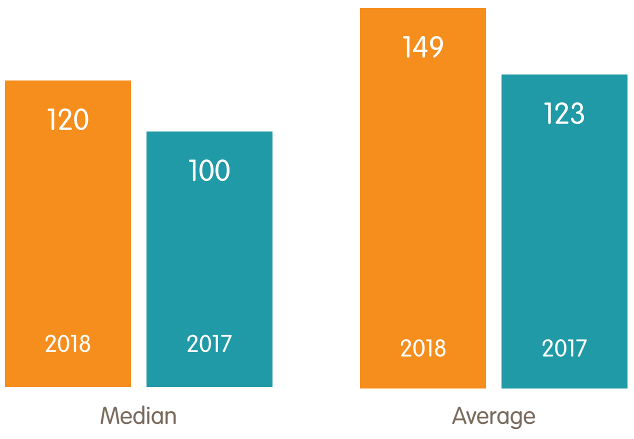
The growth seen in the average number of clients managed is great news for advisory firms, and expectations are that this growth will continue across 2018 with one in five expecting a significant increase in client numbers for 2018.

Not only are client numbers going up, but the average values available to invest is also rising. The proportion of clients with over £500,000 has more than doubled compared with 2017's census. However, more clients with increased requirements means capacity issues are hitting home for some.

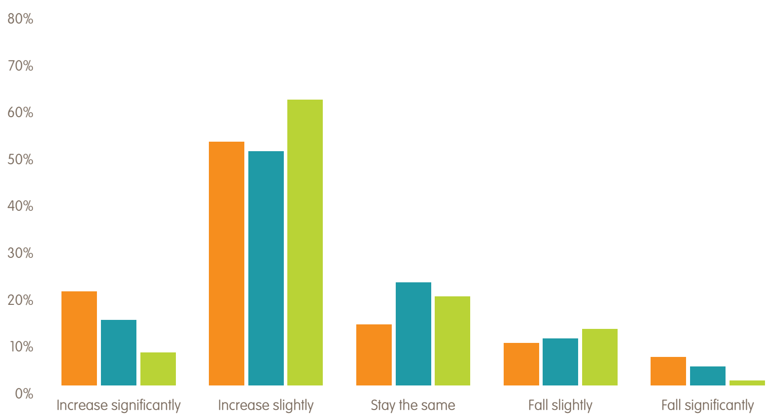
Clients welcome time with advisers, and openly value how you make sense of the complicated financial landscape for them. This leads to increased levels of trust between the client and adviser, which is a critical element of the advice process and a trait not always associated with the financial services industry. Therefore, it's encouraging to see one in five users spending more than 40% of their time with clients or prospective clients. However, one in four users say that business growth and efficiency is their main concern, so the challenge becomes how additional capacity can be created to ensure enough time is spent on this strategic challenge.

In all areas of life, people are looking to make cost savings wherever possible, yet expect the quality of the service to increase. With some firms increasing ongoing fees, they will need to ensure that their service proposition is geared up to match the pace of growth of their business, possibly through technology or outsourced solutions. Nucleus users acknowledge this, with almost three quarters of responders saying that their clients have at least a moderate expectation of digital engagement with their investments. This bodes well for the future.

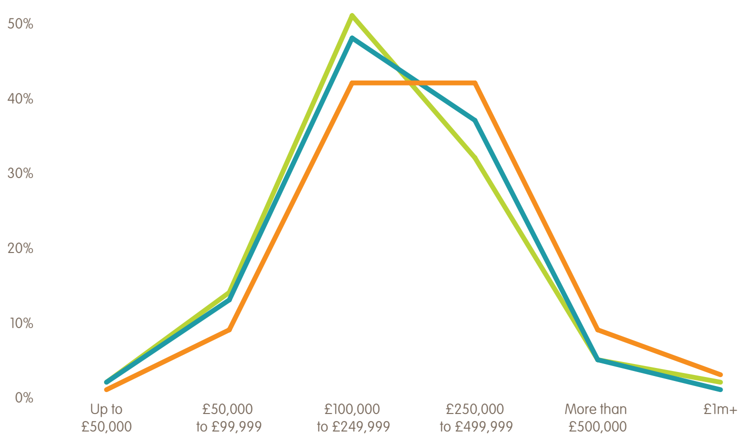
How many active clients are you personally responsible for?



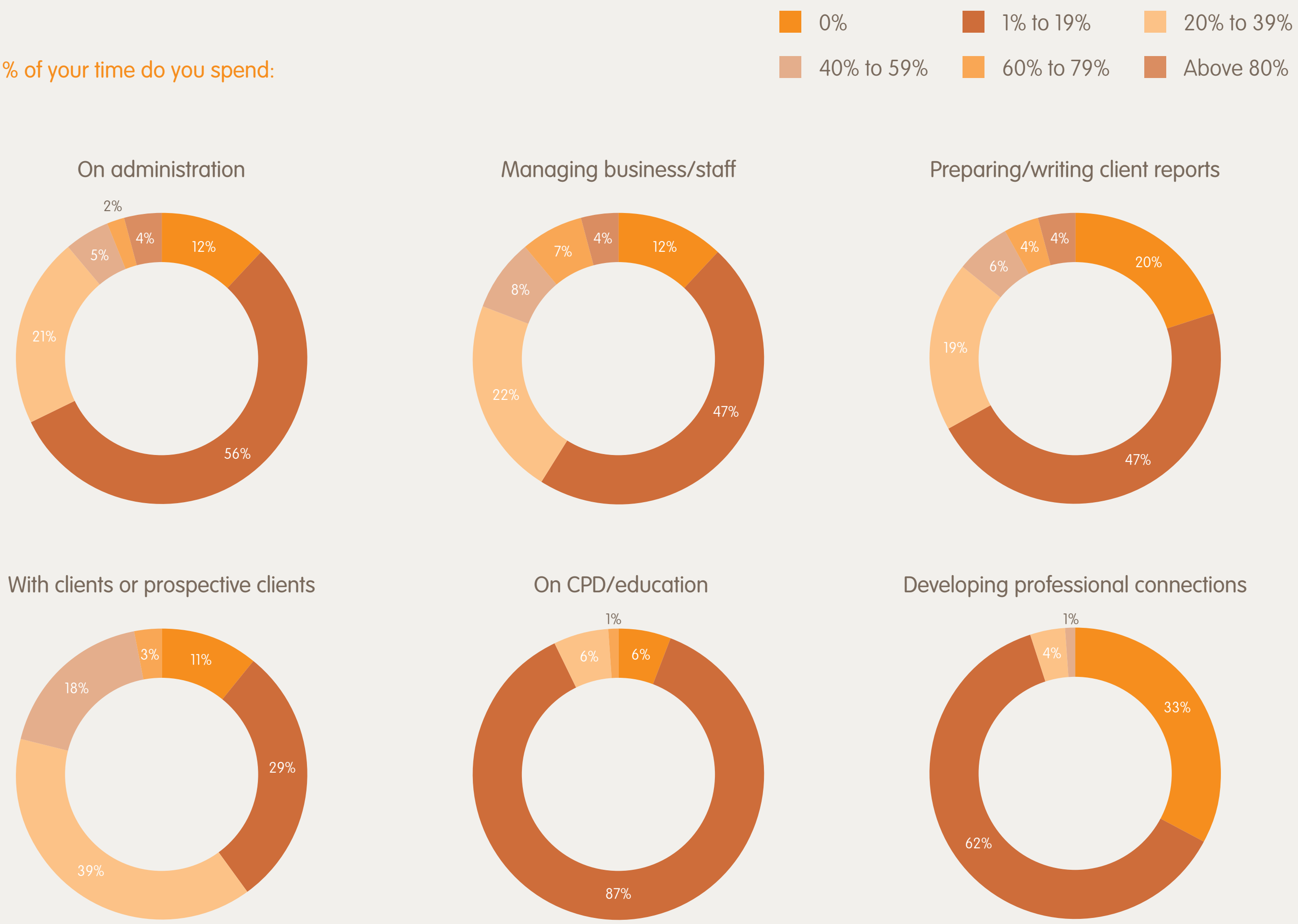
In the year ahead, do you expect the number of clients you actively deal with to...?



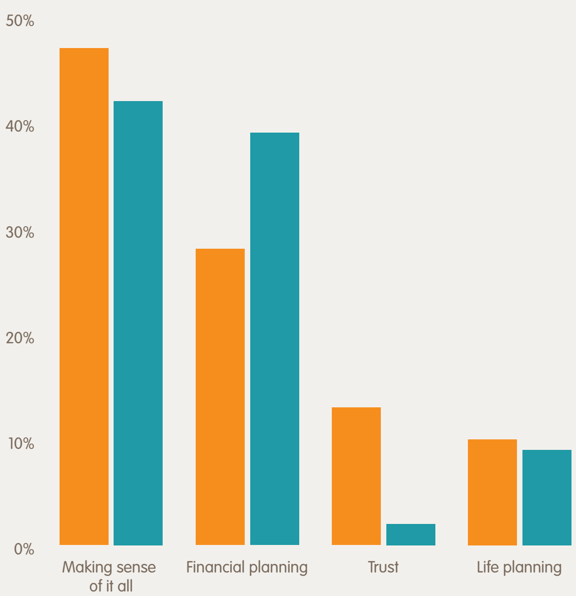
Looking at your client profiles – what would you estimate as their average investable assets?



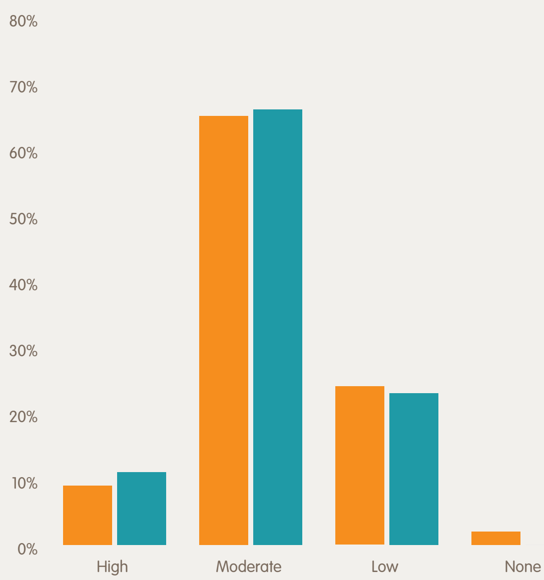
What % of your time do you spend:



What do your clients most value in you?



How would you rate the majority of your clients' expectations about engaging digitally with their investments?



Platform service remains key

Platform usage among advisory firms is now extensive. And with the advised platform market predicted to grow to over £900bn* by 2022 this shows no immediate signs of changing.

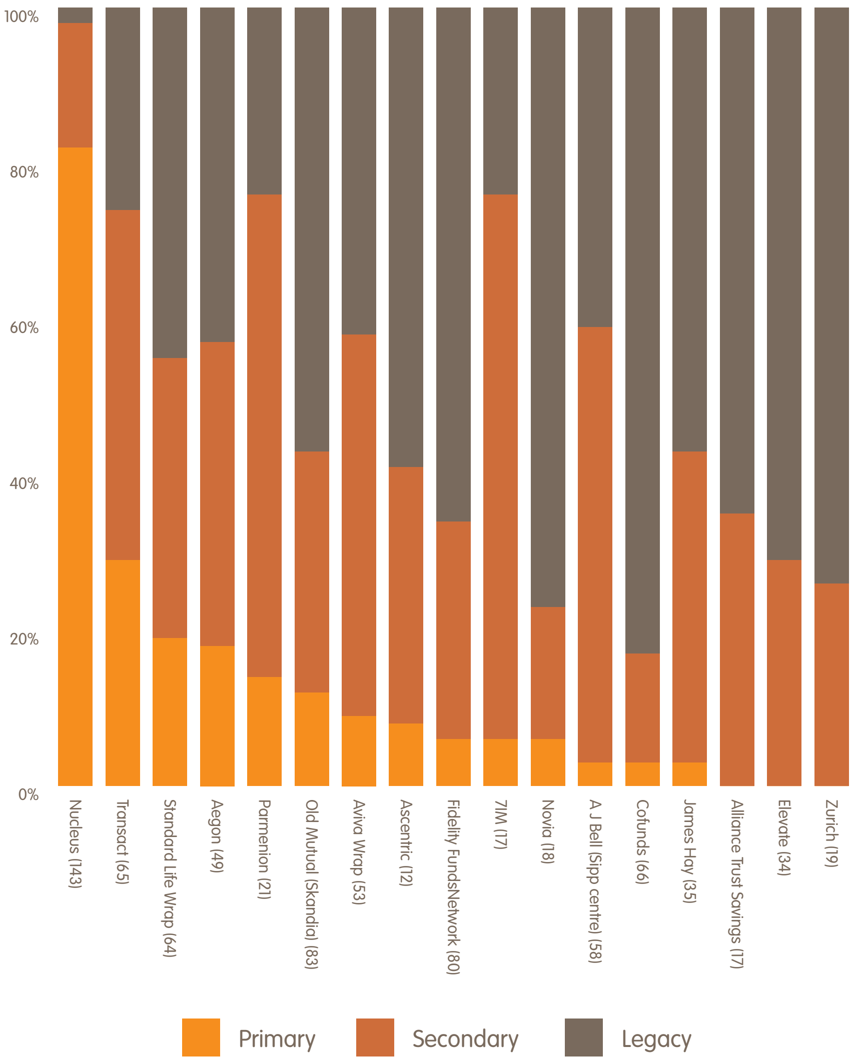
On average, Nucleus users have links with six platforms, of which one is their primary platform, two are secondary, and three are legacy. 82% of users consider Nucleus their primary platform, down marginally from 2017.

Like last year, Nucleus users are still primary users of Transact, Standard Life Wrap and Aegon. So firms generally appear comfortable with the primary platforms that they have chosen. However, this doesn't mean that continued support is guaranteed. Elevate, Alliance Trust Savings (ATS) and Zurich show no primary users within the responder base this year, and Parmenion and Novia both saw big drops in primary usage. Novia are now a legacy provider for almost 80% of users. Some users may have already felt the impacts of disruption in the market (changes in ownership / a decline in service standards etc) with other platforms.

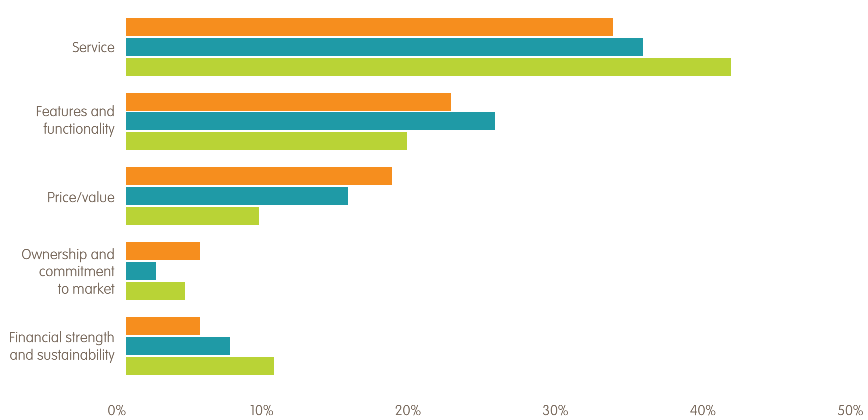
When considering a new platform, service, features and functionality, and price/value remain the top three features influencing this decision. At a time when the platform market feels a little unsteady in places, it's interesting to see the audience acknowledge this, with ownership and commitment jumping from seventh place last year to joint fourth, alongside financial strength and sustainability. With consolidation, separation strategies and disposals all on the immediate horizon, advisers seem keen to partner with those platforms with stable ownership and a clear direction.

* Fundscape Q3 17 platform market report, on a realistic growth projection basis

Which platforms or wraps does your firm use? (number of responses)

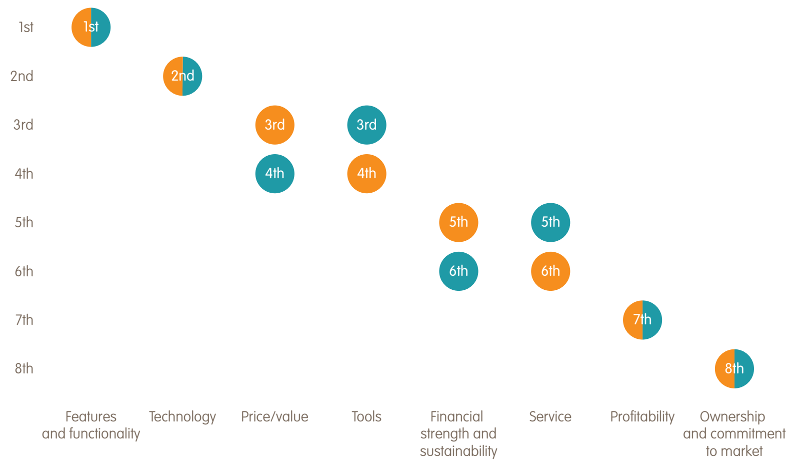


What do you feel is the most important factor when selecting a new platform?

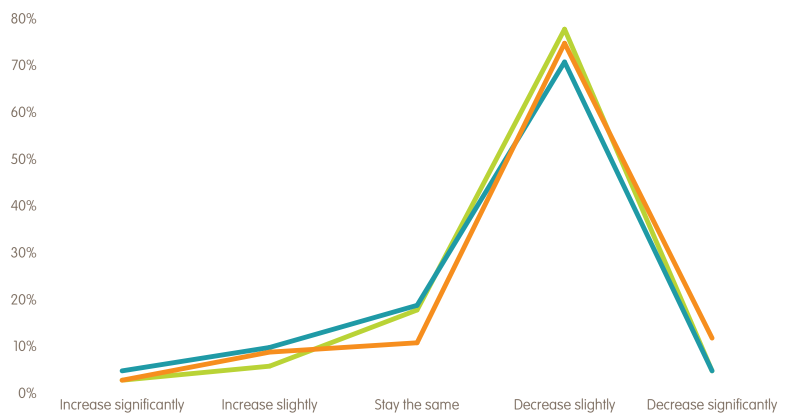


Key 2018 2017 2016

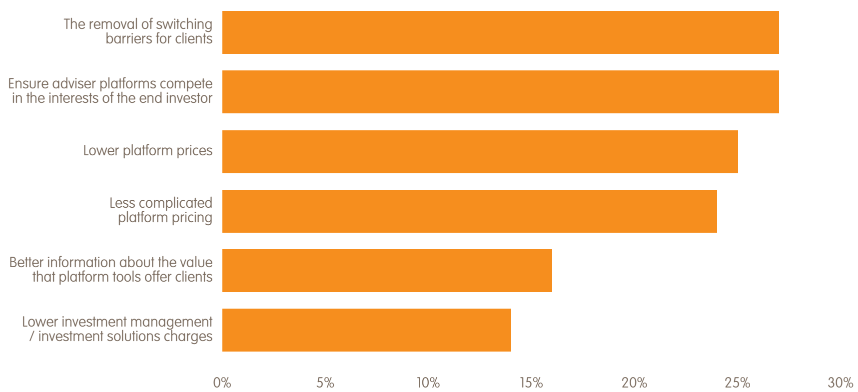
Rank of the increasing factors when selecting a new platform



Where do you think platform pricing will ultimately land in the market?



What changes or benefits do you expect from the FCA's platform market study?

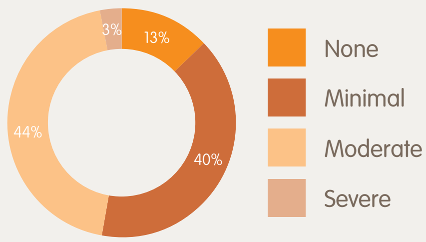


71% of responders say that price/value will play an increasingly important role in new platform selection and 83% of responders expect platform prices to decrease, with 10% expecting a significant decrease. This comes from two obvious fronts:

- Competition – from low cost new entrants, sustainable price cuts (from Nucleus and Transact), and market share grabbing deals.
- Regulation – following the FCA's platform market study.

Financial strength and sustainability also increased in importance in new platform selection. Knowing that their chosen platform has the financial strength to endure is important in ensuring clients receive a consistent experience.

What level of impact do you expect from ongoing platform mergers and replatforming projects?



Replatforming was a big theme with many platforms struggling to complete these projects on time and within budget. This has had a big impact on their bottom lines. In terms of impact, only 13% of Nucleus users believe they will have no impact from this or platform mergers this year. Nearly half think the impact will be moderate to severe. Recent well publicised negative adviser experiences following both Aegon and Aviva's replatforming demonstrate how difficult this process is, and show the consequences when things go wrong.

As well as changes in pricing, users expect the FCA's platform market study to help remove the barriers to switching for clients, and ensure that adviser platforms compete in the interests of clients. All platforms claim to be client-centric nowadays, but clearly the adviser and client experience doesn't reflect this mantra.

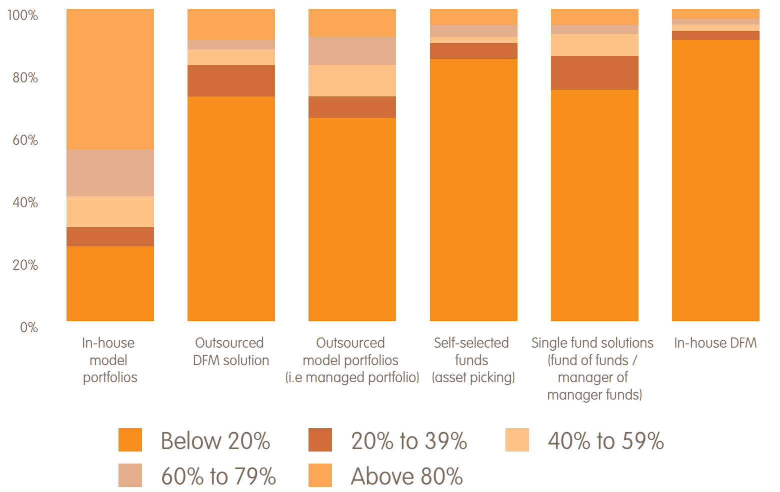
Investment fees – a turning point approaches?

The MiFID II regulations came into effect at the start of 2018, and this led to more negative headlines for investment managers, this time surrounding the disclosure of transactional and incidental costs.

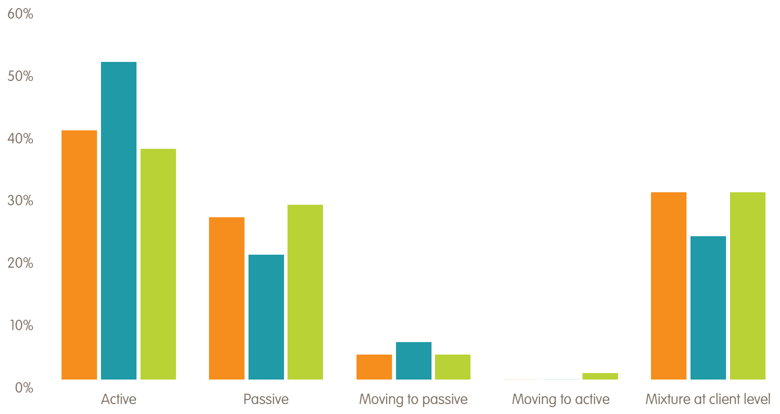
For Nucleus users, in-house model portfolios continue to gather the largest proportion of client investments. This year, 45% of all users with in-house model portfolios will allocate over 80% of client monies into this solution, up from 34% in 2017.

The active vs passive debate rumbles on, with the split returning towards 2016 levels. Active management remains the prominent solution, with a mixture at client level accounting for almost a third of client solutions. Interestingly, no one responded saying they were moving towards active solutions.

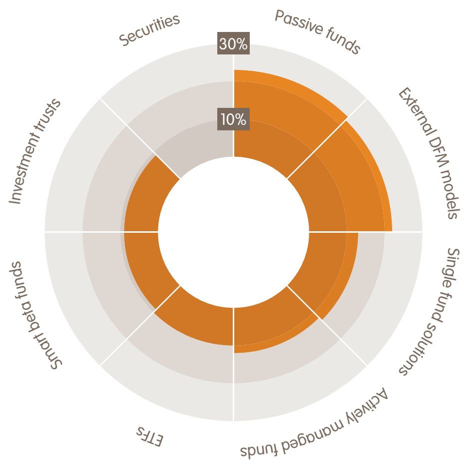
What proportion of your clients investments will go into the following investment solutions?



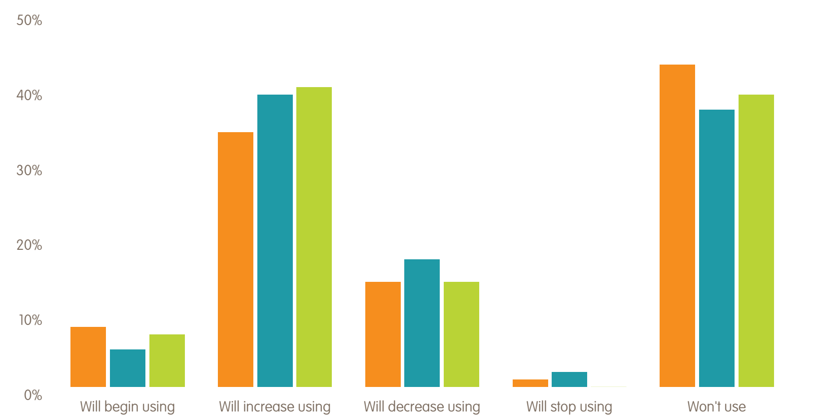
Are your clients investments predominantly...?



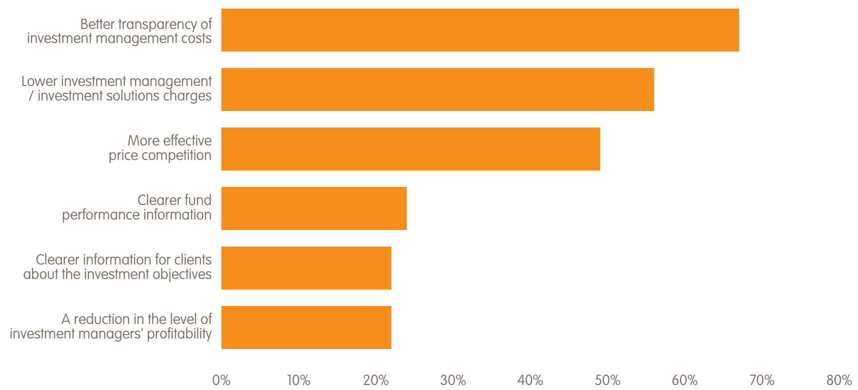
Over the next 12 months, how do you see your use of the following investment solutions changing? (Percentage who answered 'increasing')



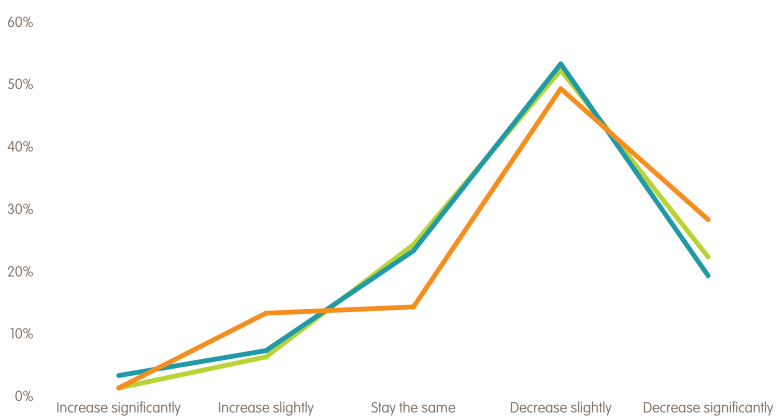
How will you work with third party discretionary fund managers (DFMs) in future?



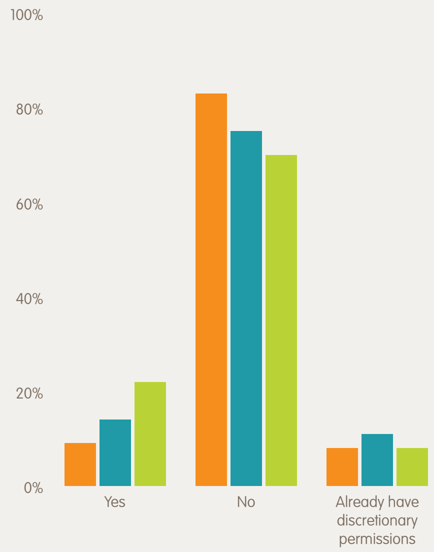
What changes or benefits do you expect following the FCA's asset management market study?



Where do you think asset management pricing will ultimately land in the market?



Are you planning to have discretionary permissions in the future?



DFMs continue to polarise opinion, with 22% of those that use them expecting to increase their usage in the next year, and only 6% decrease. Interestingly, over the longer term, 43% of users say they won't use a DFM, about the same as those who say they will begin or increase using. Only 14% said they would decrease or stop using.

The interest in obtaining discretionary permissions appears to be waning. In 2016, one in five responders planned to hold discretionary permissions, and this has dropped to under one in ten. The percentage that already hold has remained constant at 8%.

Expected outcomes from the FCA's asset management market study show that two thirds of Nucleus users expect to see better transparency of charges, along with lower charges, and more effective price competition. This, along with the MiFID II requirements for investments managers sees three-quarters of users expecting asset management charges to decrease, with almost 30% expecting a significant decrease. Disruption in this area will not be easy, but surely a turning point is approaching.

Confidence in your business

The median number of employees within firms drops slightly to eight, with over 80% having less than 20 employees. Progress continues with just under one in five firms employing five or more people aged under 30. Some of the comments around diversity in financial services highlight that attracting younger staff into the industry is tough. There is clearly a long way to go before this is resolved, but these figures suggest that the trend is in the right direction.

Ad valorem charging remains dominant with this approach taken by 73% of firms. A time-only charge is present in only 1% of firms with the remainder charging on a combination basis. Despite arguments that clients are 'confused' by ad valorem charging, Nucleus clients can log in to the platform and see this in pounds and pence whenever they like.

In the past year, most firms have made no changes to their initial and ongoing fees. However, 16% of firms have decreased their initial fees, slightly ahead of those that have increased theirs (15%). 21% have increased ongoing fees compared to 4% that have lowered them. 8% of firms have increased both initial and ongoing fees, compared to 3% who have reduced both. The slight difference between those that have dropped vs increased initial fees helps account for the overall reduction in adviser charges we've seen on the Nucleus platform over the past two years.

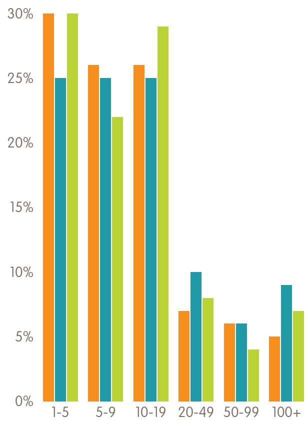
Your FCA regulatory bill continues to rise, with the average bill now over £25,000, compared to £20,000 in 2017. Over 80% expect this to rise again this year and the FCA recently announced a 4% increase on regulatory levies next year. Over 80% of you are unlikely to increase client fees to cover this.

Cyber security remains a key issue with over three quarters of users rating this as a high or very high concern.

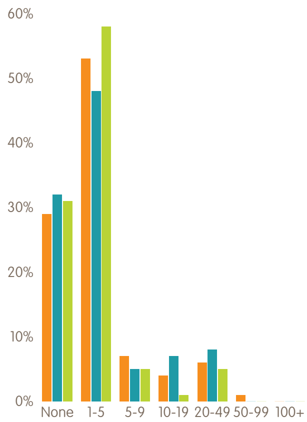
Overall, 99% of responders are confident about their future business for the next three years.

The median number of employees within firms using Nucleus

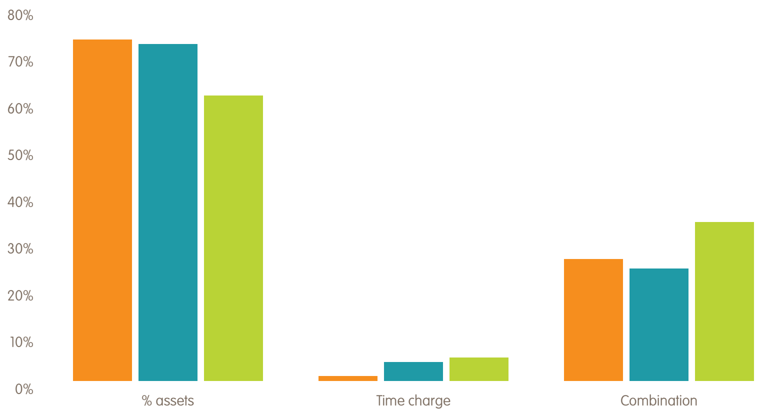
How many employees do you have in total?



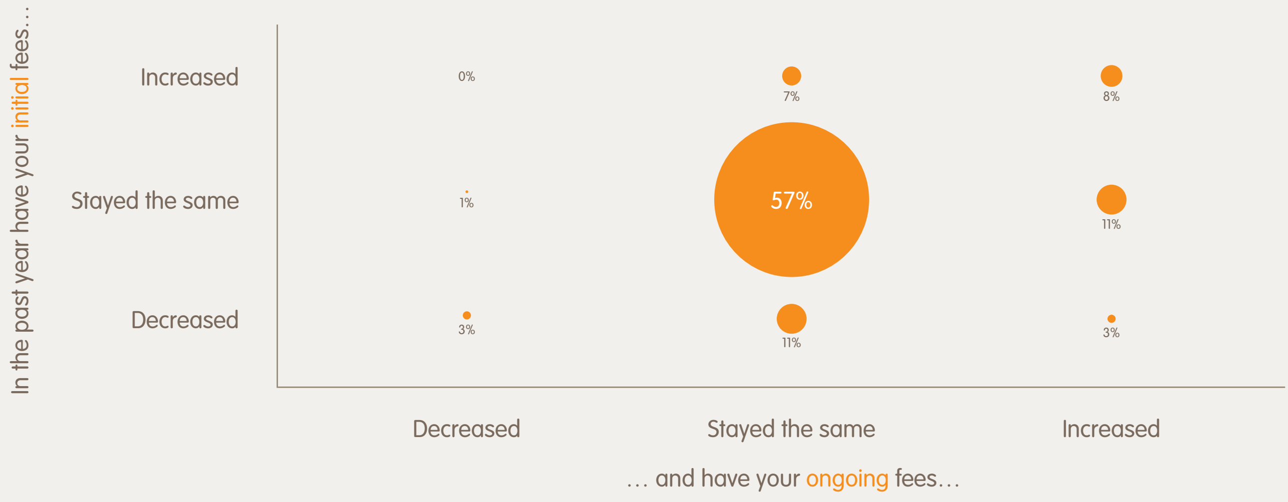
How many employees in your business are under 30 years of age?



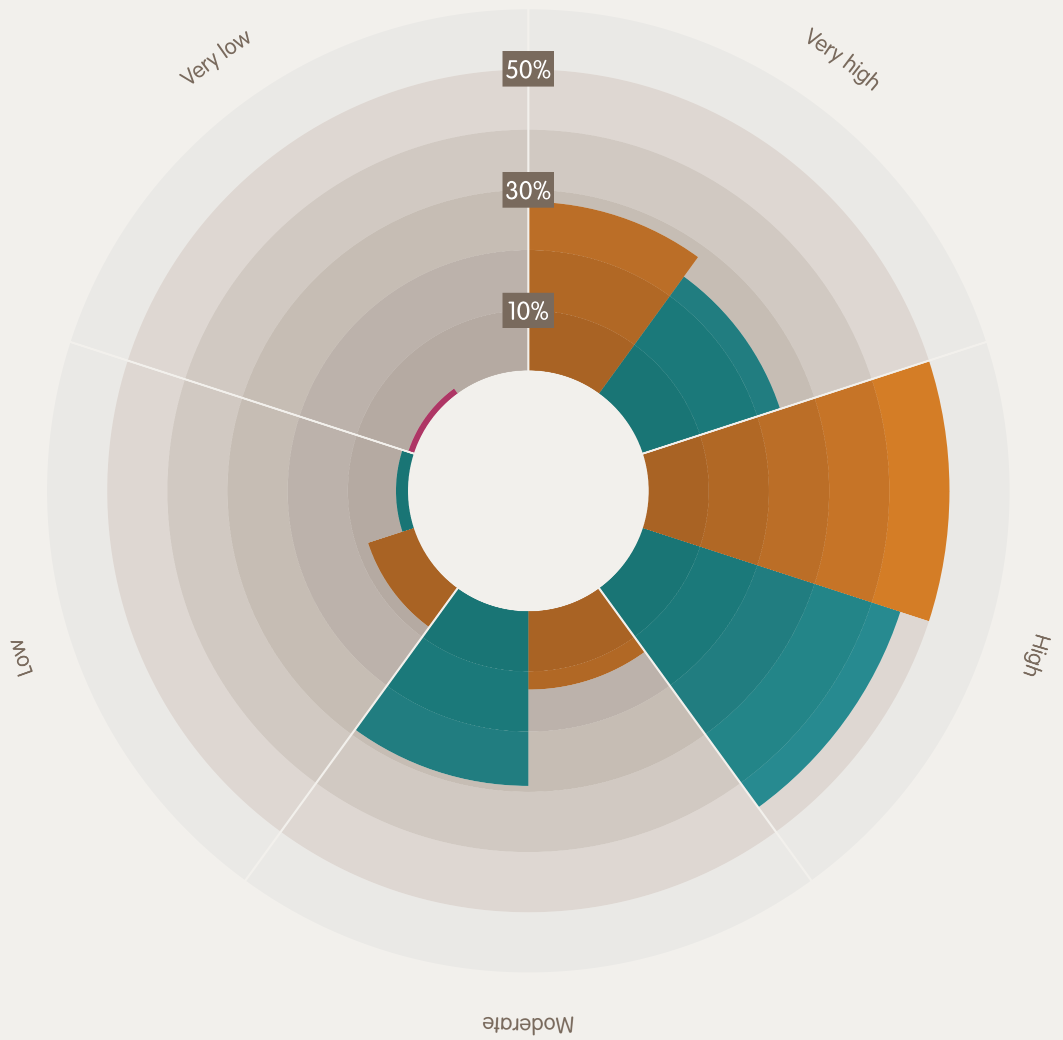
For fee business do you operate a % of assets basis or a time charge?



What percentage of firms have changed their initial and ongoing fees over the past year?



How much of a worry is cyber security for your business?



Minimal change in third party providers

Fund research and analysis

Typically, the Nucleus audience use two or three third parties for fund research. Financial Express (FE) lead the way, with double the users of the next provider (Morningstar). FE has been the most used in this area for the past three years and was one of only two providers to have increased usage among the Nucleus audience over the year.

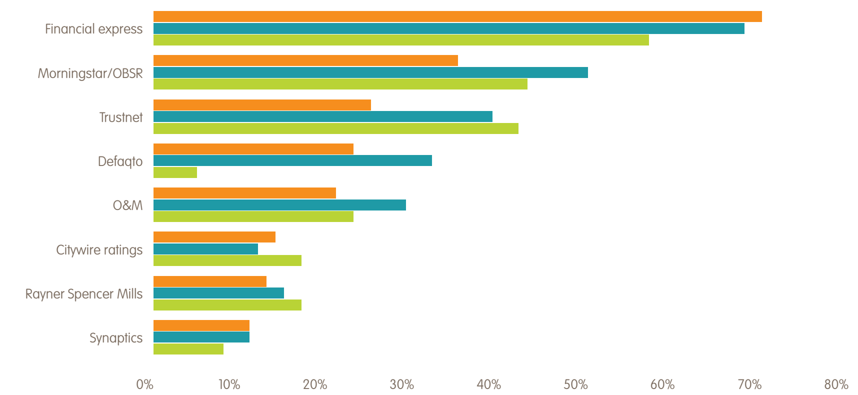
Risk profiling

Nucleus users work with one risk profiling tool. Distribution Technology's Dynamic Planner tool leapfrogs from fourth place last year in to the top spot this year, with nearly a quarter of users. Last year, an in-house solution was the second most frequently used. This has dropped slightly, with more choosing to use an outsourced option. Regulatory pressure to use outsourced tools combined with their own common-sense approach and knowledge of the client could explain this.

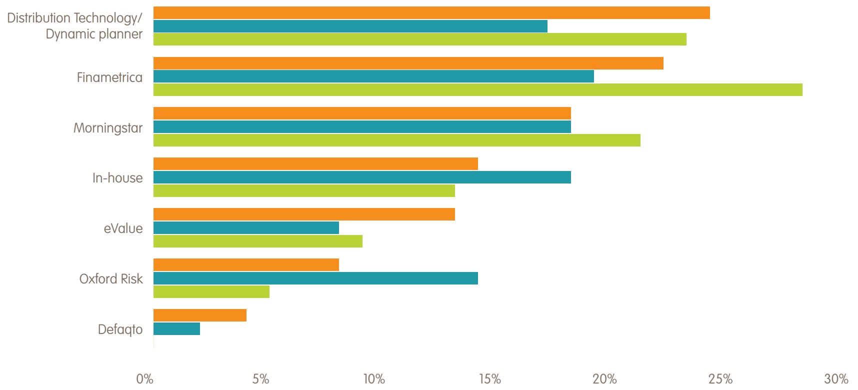
Back office

Intelliflo continues to lead the way, maintaining a big gap between Iress in second place. Unlike risk profiling, the in-house solution has increased in popularity this year, and moves up to third place with 10% of users. Many firms still like to maintain full control over their own systems, or are still small enough to manage this without a need to outsource.

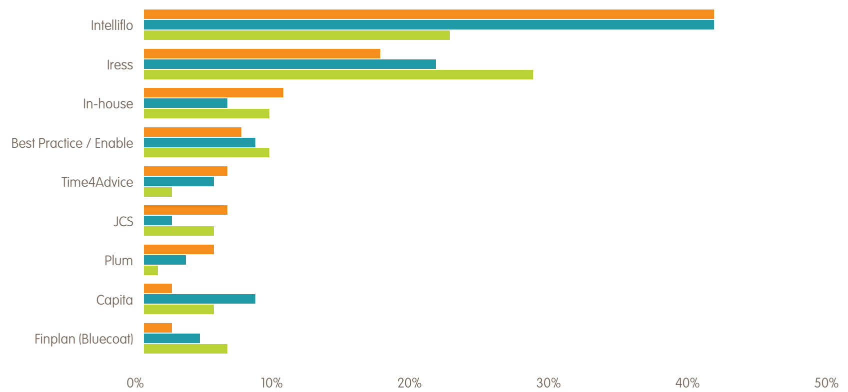
What are the main data sources you use for fund research and analysis?



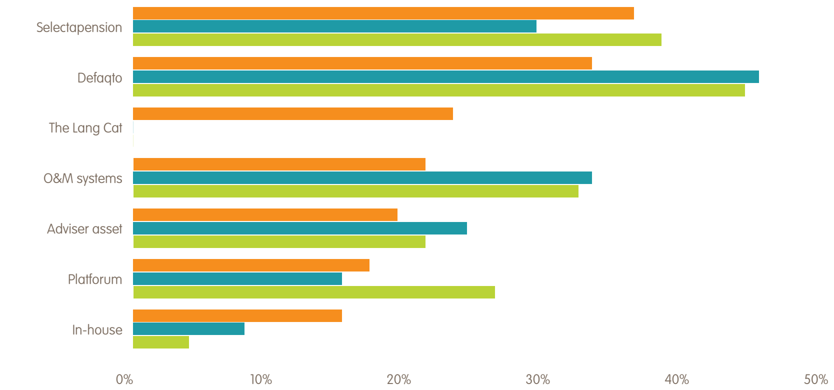
What risk profiling tools do you use?



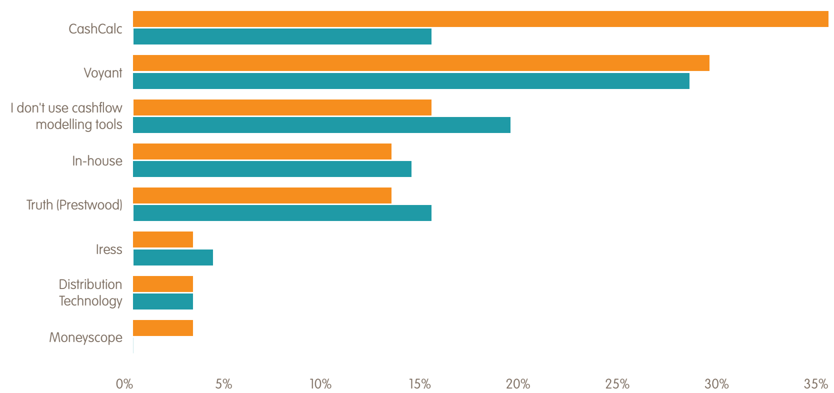
Which data management/back office system(s) are used in your firm?



What platform comparison tools or websites do you use?



Which cashflow modelling tools do you use?



Platform comparison

Two platform comparison resources are drawn upon by Nucleus users. Defaqto drops from a dominant position last year, to second place behind Selectapension who jump up from third last year. The Lang Cat's 'Platform directory' looks to have been well received by firms, with nearly one in four responders using this free resource for platform research. O&M's usage has fallen from a third of users in 2017, to a fifth in 2018.

Cashflow modelling

Despite Voyant slightly increasing the percentage of users, CashCalc has shown a massive increase and knock Voyant off top spot. Advisers appear to prefer CashCalc's lower charging model. Last year, a third of users said they didn't use cashflow modelling tools, or use an in-house solution. This momentum is maintained with 30% of users this year.

From MiFID II straight into GDPR

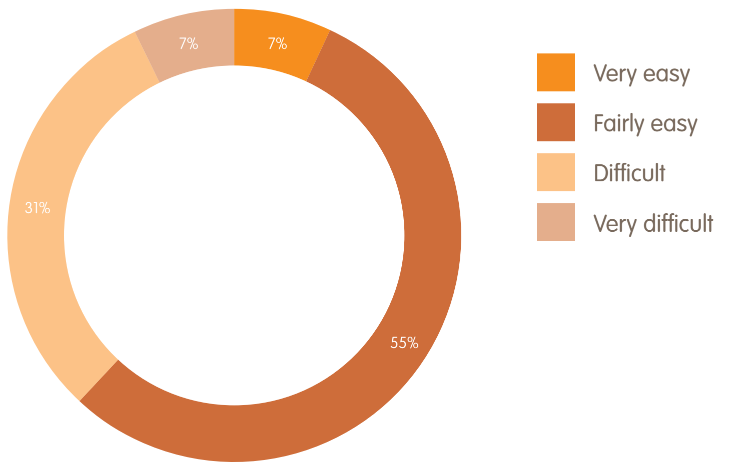
2017 saw a mass of regulatory work required prior to the introduction of the MiFID II requirements. This year sees no let up, with the GDPR rules now introduced. The FCA has announced an increased focus on the quality of advice for DB transfers, and of course, the Brexit discussions dominate the wider news headlines.

MiFID II requirements came into force on 3 January 2018. In last year's census, almost half of firms rated their confidence about being ready for MiFID II as 'neutral'. This resonates with results this year, which suggests that despite 62% finding the implementation of MiFID II requirements very or fairly easy, 38% found it difficult or very difficult. Nucleus' MiFID II whitepaper and webinars in conjunction with Phil Young (ex MD of support service provider threesixty) have proven to be some of our most popular.

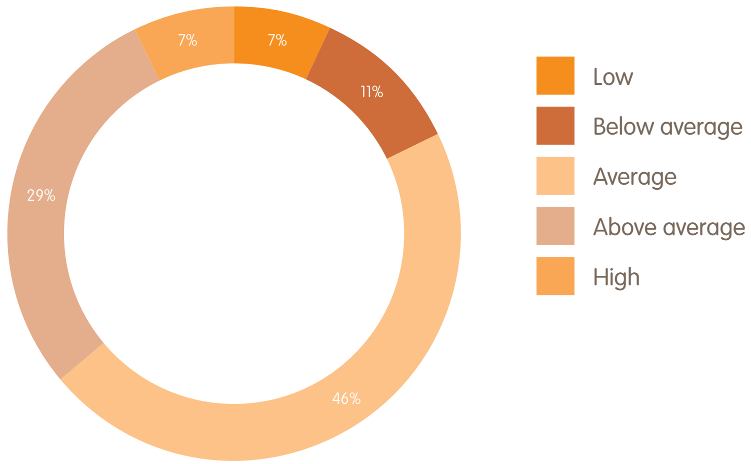
GDPR arrived in May, and the results resonate with how you rated your MiFID II readiness last year. Most responders showed an 'average' understanding of what they needed to do to be GDPR ready, suggesting they hadn't all quite figured out what the implications were of these changes. Nucleus has released a GDPR whitepaper to help improve awareness of adviser's requirements.

And of course, no report would be complete without a Brexit reference. Overall Nucleus users seem very unconcerned about Brexit, regardless of their political stance. Only 3% expect a fair degree or significant impact on their business. Many take the view that uncertainty has become the norm, and that clients will still need financial advice whatever the position.

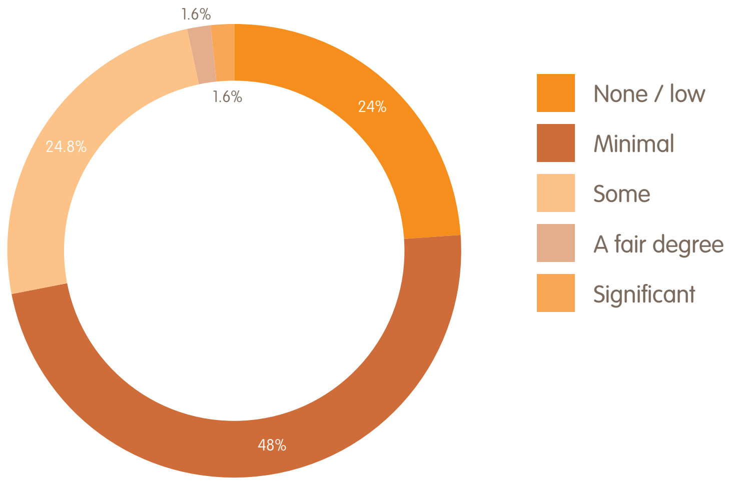
How difficult have you found it to implement all of your MiFID II requirements?



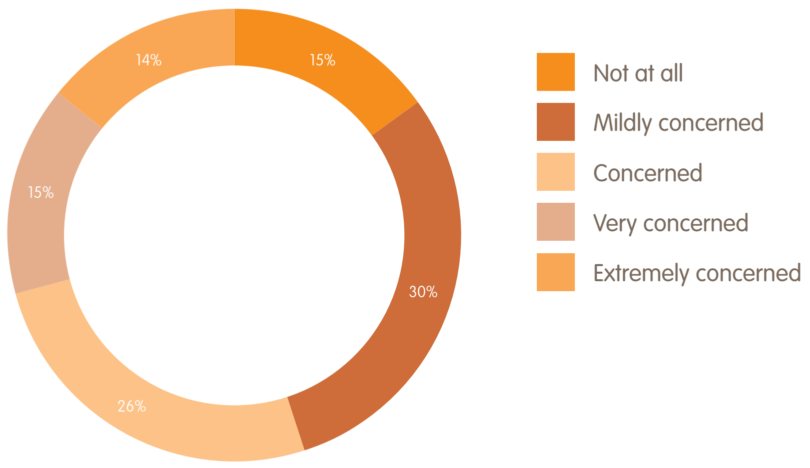
How would you rate your understanding about what you need to do to be GDPR-ready?



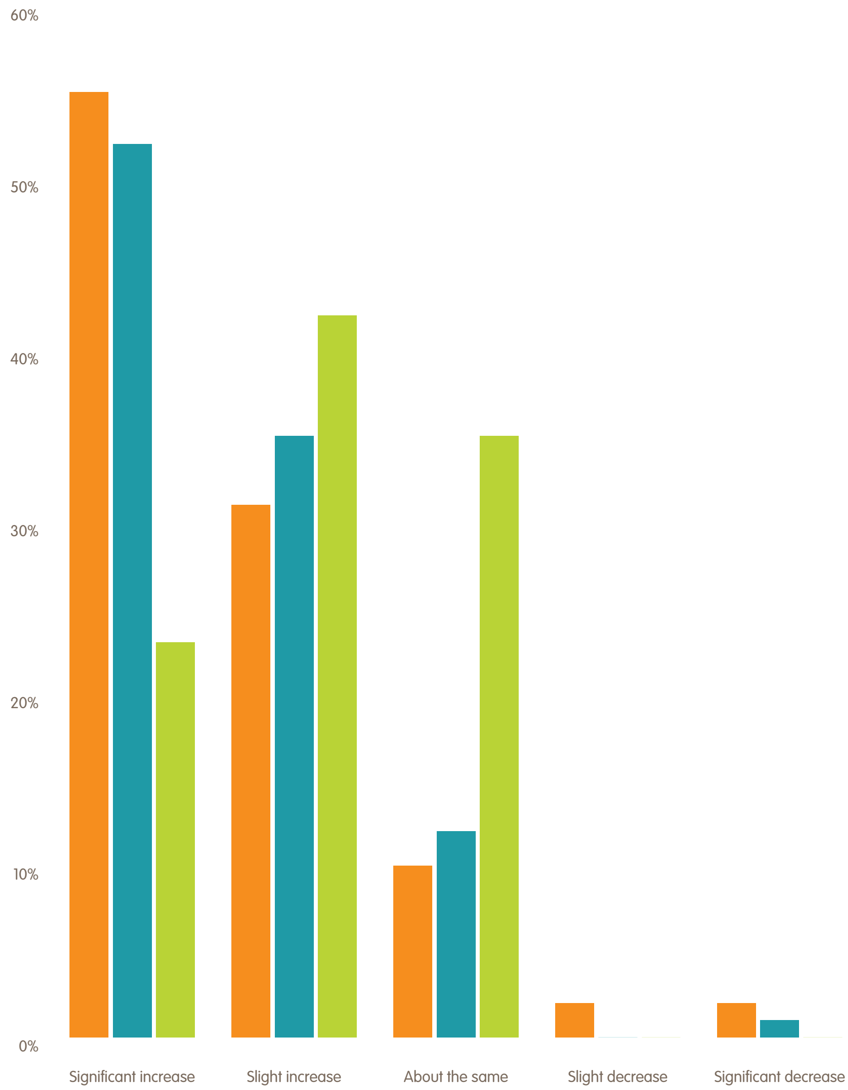
What impact do you believe Brexit will have on your business?



Are you concerned about a potential DB transfer mis-selling scandal?



Have you seen a change in the number of requests for DB to DC pension transfers?



Defined benefits: a source of growth … and concern

Some of the growth seen in firms across 2017 has been a result of increased levels of DB transfer requests. Almost nine in 10 firms have seen a year-on-year increase in the number of requests, and eight out of 10 firms employ someone qualified to advise on these transfers.

But again, there's a downside to this. More than half of responders are concerned about a potential DB mis-selling scandal. The poor PR that any such scandal would generate could tarnish the reputations of all advisory firms that participate, even those that use robust processes and exercise care when recommending a transfer. And of course, compensation claims would have further impacts on your regulatory bills.

DB transfers have been a major driver of growth for platforms and some advisory firms over the past few years, and the regulator keeps an increasingly watchful eye on this process.

In 2017, the FCA published several documents relating to pension transfers. These included:

- an alert highlighting their expectations on requirements when providing pension transfer advice
- CP17/16, a consultancy paper on how advice should be provided for DB and other safeguarded benefits, and
- a summary of their assessment of the advice given to consumers about DB transfers.

And so far in 2018, policy statement PS18/6: Advising on pension transfers, and consultancy paper CP18/7: Improving the quality of pension transfer advice have already been released.

Clearly the FCA's concerns around the DB transfer process mirror those of many Nucleus users.

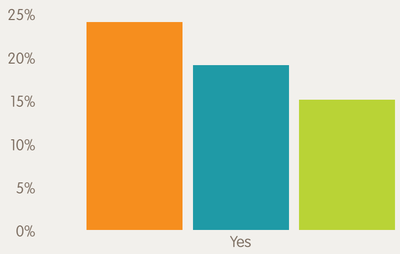
A natural progression

The future of the advice market continues to look rosy, as the increasingly complex financial landscape combined with times of uncertainty means the demand for advice has never been higher.

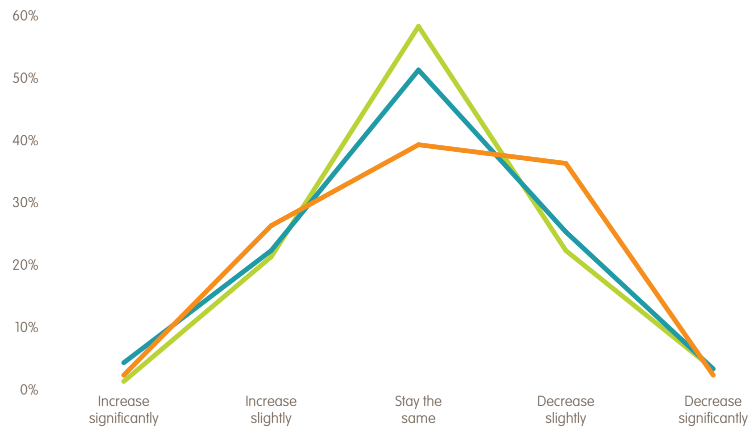
Despite what we've seen within data on the platform, a quarter of all users expect the cost of advice to increase, compared to 36% who expect it to drop. For those that expect costs to drop, they cite the future threat of robo advisers in some parts of the market as a concern, as well as the increased level of disclosure as part of the MiFID II requirements. There is more pressure on initial fees, with many seeing '3% initial' as becoming uncompetitive. MiFID II also fuels the idea that costs will increase, as advisers cannot absorb all the costs of meeting regulation. Increasing demands of moving to a more holistic financial planning approach also mean costs may need to rise in the short term as firms transition.

So, if more expect the cost of advice to fall, advisory firms must find ways to cut costs and/or evolve their way of working. We've seen a steady increase in the proportion of firms exploring alternatives to traditional face-to-face advice to meet the needs of different clients, with a quarter of firms now exploring these opportunities. Tools such as an online client portal, or screen to screen ability are high on many agenda lists. And client expectation is also high in this area, with nearly three-quarters of advisers reporting at least a moderate expectation from clients around online engagement.

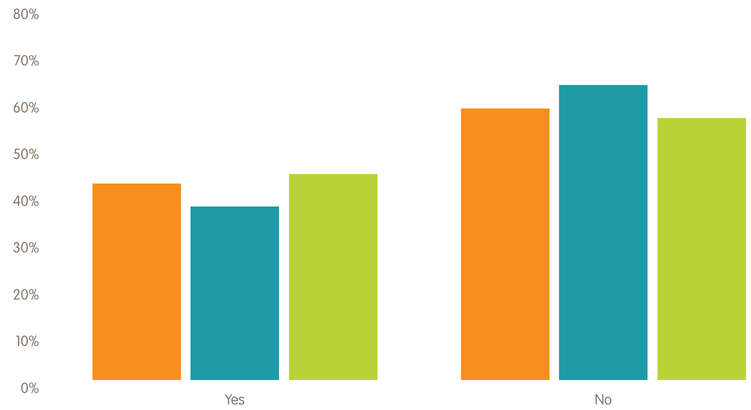
Are you actively looking at alternatives to traditional face-to-face advice to reach a different target client?



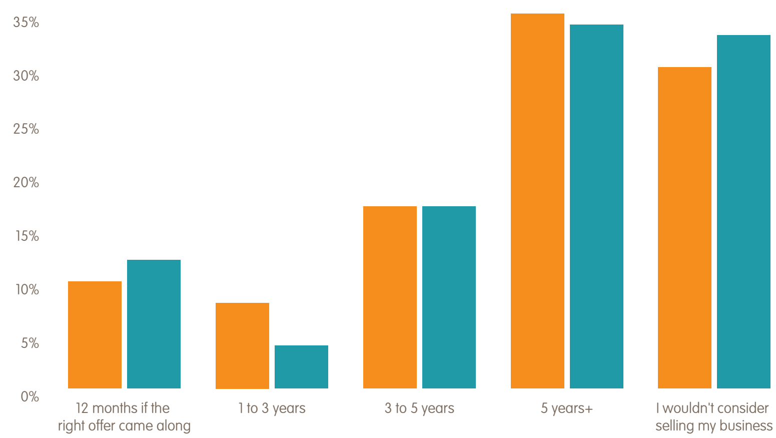
Where do you think the cost of advice will ultimately land in the market?



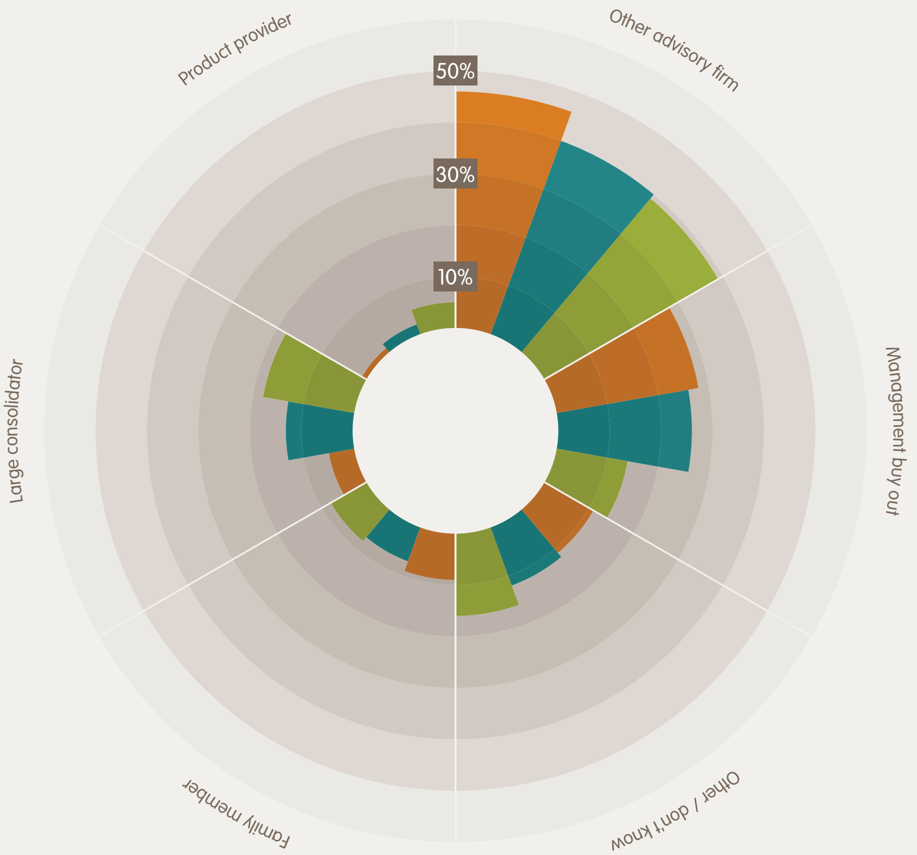
Are you interested in acquiring other businesses?



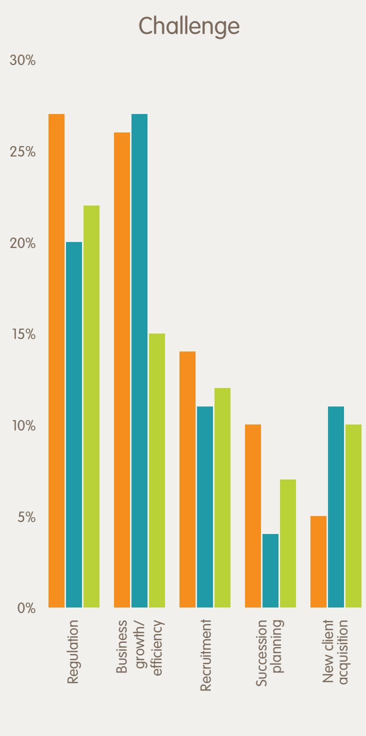
Would you consider selling your business in the next...

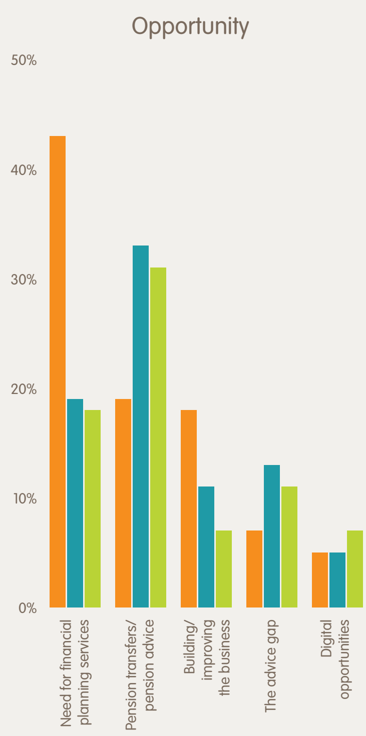


Who are you likely to sell your business to?



In business terms what is your biggest challenge and what do you see as the main opportunity over the next year?





There is still a strong appetite for business owners to acquire other businesses, with 42% saying they are interested. Fewer are interested in selling, with 35% considering selling their business within the next five years, and 30% of owners saying they wouldn't consider selling their business. Of those looking to sell, another advisory firm is the preferred route for nearly half of responders. A sale to a like-minded firm is the most likely way to ensure a consistent experience for clients. The lure of the large consolidator looks less appealing, dropping to only 4% from 13% last year, with acquisition by a product provider looking similarly unattractive, with only 1% considering this route. Again, this could suggest a willingness to ensure the least disruption possible for clients if the business owner(s) decide to exit. Some advisers may fear that the years of trust and loyalty built with these clients could be eroded quickly by a sale to a large consolidator.

There has been a significant increase in those business owners with a succession plan in place, up to 42% from only 25% last year. However, still over half of owners don't have a plan. Retirement still feels a long time away for many business owners, and less than 10% see this as an immediate concern or challenge.

The two biggest challenges facing the Nucleus audience this year are regulation and business growth, which account for more than half of responders. Advisers can do little about regulatory requirements, but with 2017 proving to be a massive year for many advisory firms it's no surprise to see thought around how firms can operate more efficiently.

The opportunities for the audience have moved from being 'pension freedoms' based towards the holistic need for financial planning services, and this feels like a natural progression for many Nucleus users.

Summary

2017 was a great year for many firms, but the levels of growth seen can bring as many challenges as it does benefits. The future of advice looks rosy, but there are headwinds in place.

Increased client numbers seeking time with advisers to help make sense of the increasingly complex financial landscape can create capacity issues with firms. And with many firms operating with a handful of staff, delivering this, as well as essentials such as compliance with MiFID II or GDPR legislation can bring both financial and opportunity costs.

Outsourcing is an important part of the advice process for many, which also requires time and effort to understand the benefits, and perform proper due diligence. And what about the future of the business in terms of using technology to reach a different audience, or create a succession plan? This all takes time away from doing what you do best – demonstrating value to clients through engaging in a lifestyle approach to planning.

Our census aims to track the progress that you and your businesses make each year, and I hope many of the outcomes from this year's report resemble your experiences and feelings. There's no doubt that 2018 is comprising of lots of hard work, disruption, uncertainty, opportunity, and growth. And if it's anything like 2017, we'll see your firms continue to go from strength to strength.

Finding out more

Nucleus

Nucleus is an award-winning, adviser built wrap platform. Since launch we've established ourselves as a major force for change in the market. We're a thriving community of over 400 adviser businesses who currently manage over £13.8bn of client assets (as at 31 March 2018). For further details please go to www.nucleusfinancial.com or contact one of our regional business development directors.

We hope you've found this census of value. If you have any comments about the census please contact our market insight manager Geoff Taylor (geoff.taylor@nucleusfinancial.com).

For more Nucleus publications, please visit www.nucleusfinancial.com/support/publications.

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