Embracing a new financial planning landscape

By Albert Louw, Head of Business Development, STANLIB Multi-Manager

The financial advisory landscape has changed remarkably over the past decade.

Increased regulation

The financial advisory landscape has changed remarkably over the past decade. The start of this new "era" came in 2002 with the publication of the FAIS Act which set minimum standards of qualifications and professionalism for financial advisers.

The Retail Distribution Review (RDR) discussion paper released in South Africa in November 2014 and the planned change to a "Twin Peaks" model of financial sector regulation further aim to enhance professionalism and improve investor outcomes. The "Twin Peaks" model of financial sector regulation will see the creation of a prudential regulator – the Prudential Authority – housed in the South African Reserve Bank (SARB), while the Financial Services Board (FSB) will be transformed into a dedicated market conduct regulator known as the Financial Sector Conduct Authority.

The financial advisory landscape looks significantly different now than it did even five years ago. Financial advisers looking to build a successful business for the future should aim to find opportunities among this ever-changing regulatory landscape.

Too much regulation or not – Embrace the opportunity

The South African financial planning industry is one of the most established in the world. Highly skilled financial advisers have spent decades building successful businesses based on robust investment advice, processes, trust and reputation. For these advisers increasing regulation has required minimal changes to their business models.

Over the past 10 years, there has been a natural tightening of standards across the broader advice fraternity. This has resulted in more comprehensive financial planning and improved advice to investors. However, the final outcome of the RDR proposals is still expected to have a profound impact, specifically on financial advisers who have yet to make the paradigm shift in how they execute their advice models and reposition their businesses for this new era.

There is a lot to consider when RDR is finally implemented. Will there be a big drop in adviser numbers? Will clients be reluctant to embrace the concept of advice fees? How can clients be persuaded to pay for advice? How will financial advisers build a profitable business? Will there be an increasing gap between clients able to pay for advice, and those who aren not able to?

Despite the uncertainty and challenges, one thing is certain, financial advisers with strong relationships and the willingness to adapt and improve will remain relevant to clients.

Opportunities – The need for financial advice is greater than ever

There remain several primary challenges to clients' financial security in the context of today's economic and demographic environment. These reinforce the importance of the role of the financial adviser and the need for suitable financial planning.

The key challenges that clients are facing include but are not limited to:

Increasing longevity – Average life expectancy has increased significantly since most retirement systems were first established. Today, life expectancy in South Africa is close to 70, and more than one in three South Africans who are 65 today will live past 80 years old. Meanwhile, only 6%[1] of South Africans save enough for retirement, according to the World Bank.

High debt levels at retirement – In South Africa only 33%[2] of retirees are debt-free once they stop working. The country's national savings makes up just 15.5% of GDP. The fact that people are not saving enough is highlighted in the latest Momentum/Unisa Household Liabilities index[3] that shows the real value of household assets continue to fall because of lower contributions towards savings and a lack of investment growth on savings.

Lack of preservation – In addition to South Africans not saving for retirement at all, there are many who aren't saving enough or who don't preserve their retirement benefits between jobs. Many South Africans have been tempted to access their retirement savings when changing jobs so they go back to a zero base in terms of retirement savings and, significantly, wipe out the years of compound interest they had previously earned.

Lack of engagement and financial literacy – At a time when the need for financial advice is so great for so many, levels of engagement with financial advisers are disappointingly low. According to BlackRock's September 2016 Viewpoint[4], only 17% of individuals in the United Kingdom (UK) and Germany, and only 14% in the Netherlands, use the services of a financial adviser. The levels of adviser engagement in South Africa is expected to be even lower due to our high unemployment rate and lower levels of financial literacy.

If anything, the above highlights the significant opportunity for financial advisers, as many people need professional financial advice. However, some of the new challenges facing financial advisers include:

- The arrival of a **new competitor** - the digital wealth manager
- Clients questioning the **quality of advice** as they struggle to link the value of advice given with their needs and outcomes.

The arrival of the digital wealth manager

Financial advisers are competing against the newest player in the market, the robo-adviser. The term robo-adviser implies that an element of advice is included in the process. However, it is provided without the intervention of a traditional (human) financial adviser.

Two factors are likely to drive consumer use of robo-advisers. Regulatory changes will be too onerous for some financial advisers to continue in business, leading to a likely contraction in the number of financial advisers operating in the sector. Quality advice comes at a price, one that the South African investor is not used to paying for. A large portion of customers could be priced out of the market due to a reluctance to pay for advice.

Since 2008, nearly 140 digital advisory firms have been founded in the US, with over 80 of those started in the past two years alone[5] . A robo-adviser, in its uncontaminated form, provides a certain degree of advice, although on a more limited basis. Younger generation Y and millennial customers are likely to be attracted to the new digital wealth manager because of the anytime, anywhere opportunity to transact. This poses a further challenge to financial advisers who are trying to diversify their client base beyond its current predominantly aging customer profile.

According to the Investor Pulse Survey[6] clients are contemplating robo-advice for convenience (42%), the appearance of simplicity (33%) and because there is no deliberate product push (31%).

Although the model may simplify the investing process, clients overestimate the effectiveness of robo-advisers in replacing the holistic advice given by traditional financial advisers. Non-comprehensive financial needs analyses and single-needs selling can result in detrimental financial planning shortfalls, which a client may only discover many years later.

Many clients in the 2015 Accenture[7] report indicated their preference for continued access to traditional advisers. Despite this, financial advisers need to consider new ways of reaching, engaging, and connecting with clients through digital technology.

A hybrid business model that combines digital-user interfaces and client-relevant digital content (i.e. knowledge sharing), with face-to-face financial adviser interactions provides a far more compelling offering and a way to remain relevant to clients' needs.

Quality of advice centred on holistic financial planning

Many financial advisers have adopted a "wait-and-see" approach to the new RDR legislation. Based on changes in the post-RDR UK market, there is likely to be a move away from investment planning (i.e. product pushing) to a more clearly defined focus on financial planning.

In the post-RDR era of increased scrutiny and higher professional requirements, financial advisers cannot afford to provide investment advice without rigorous and up-to-date investment research and analysis. The costs of setting up and maintaining a quality in-house research team are simply too high for many advisory businesses. In addition, advisers will want to mitigate the risks involved in defending, explaining and taking responsibility for all investment decisions. As a result, outsourcing investment research and portfolio construction to an independent provider has become an increasingly attractive solution for adviser businesses that want to focus on providing high-level financial planning and demonstrate value-add through quality advice.

Robust financial advice (i.e. a well-designed strategy) is based on an individual or family's clearly defined financial and life goals. These could include education funding, buying a larger home, starting a business, providing for retirement or creating a legacy. The power of a goal-based approach to financial planning lies in its ability to highlight how realistic a goal is relative to a client's risk preferences and the investment opportunities available.

As the ethos of goal-based investing gains traction with financial advisers and clients, it makes the principle of investing more tangible and relatable. It also helps to prevent rash investment decisions by providing a clear process for identifying goals and choosing investment strategies to match those goals.

Financial advisers looking to enhance and differentiate their value proposition as well as better equip themselves to deal with sometimes irrational and counter-productive investor behaviour will do well to adopt a goal-based approach. Key to the approach is shifting the focus from generating the highest possible portfolio return or beating the market, to investing with the objective of attaining specific life goals. Measuring investment performance is important, but measuring up to the goals set by a client as part of their financial plan is a more effective measure of financial success.

Conclusion

More stringent regulation, together with the outcome of RDR, will change the face of the financial adviser in what is seen as "a new era". Financial advisers have an opportunity to embrace the changes despite current uncertainty. The need for financial advice is greater than ever but increased competition from robo–advisers along with increased scrutiny of the quality of advice, presents many challenges for financial advisers.

To succeed will require a focus on the real needs of clients to help them achieve their life goals. Helping clients invest according to their unique needs, objectives and time horizons encourages them not to view risk as something to fear and avoid, but rather as a barrier not to fully achieve their goals. By remaining highly relevant to clients' investment and financial planning needs, financial advisers can truly differentiate themselves and strengthen client trust at the same time - There is no substitute for the trusted financial adviser.

Footnotes: [1] www.enca.com [2] www.enca.com [3] www.businesslive.co.za – South Africans do not have enough saved to see them through an emergency (23 January 2017) [4] BlackRock – Viewpoint (September 2016) [5] Tracxn Report – RoboAdvisers (Feb 2016)
[6] BlackRock – Viewpoint (September 2016) [7] Accenture – The Rise of Robo-Advice: Changing the Concept of Wealth Management (2015)