March 2021

The DFM landscape

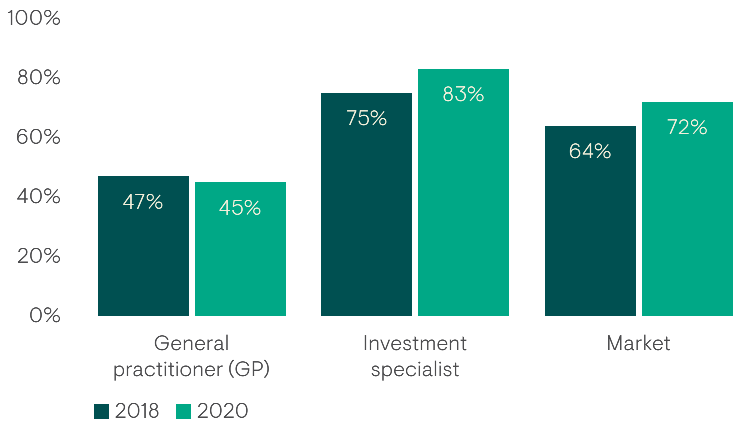
In our February 2021 "What are advisors thinking?" piece, we touched on advisor trends relating to investment strategy. One noteworthy investment trend identified is with respect to the relationship between advisors and discretionary fund managers (DFMs). Below, in our first of two articles on DFMs, we summarise some of the key take-aways from the survey as they relate to the DFM landscape.

1. Usage of DFMs by advisor segment

With the exception of general practitioners ("GPs") all advisor segments have seen an increase in the usage of DFMs, either through the use of an independent DFM or by practices themselves acquiring a Category 2 license and incorporating DFM services into their business.

Understandably the GP segment saw the lowest penetration and growth as DFMs have typically targeted the larger investment-focused advisor practices to ramp up the asset base in the shortest possible time.

Figure 1: Usage of DFMs per segment

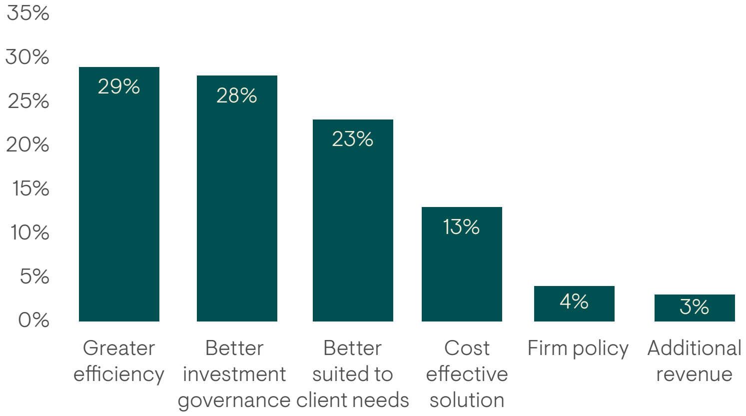


Overall, 72% of those surveyed reporting using a DFM in some shape or form, clear evidence that advisors perceive value in having discretion over client assets.

2. Reason for DFM usage

As an advisor's business grows, the complexities associated with running a larger business with more clients and more product options also increases. This could also explain why DFM usage is more prevalent in the investment specialist segment, since the requirement to seek out operational efficiencies in this segment is more pressing. This together with investment governance (on the back of increased regulatory oversight) account for more than 50% of the motivation to use a DFM.

Figure 2: Reason for DFM usage



Perhaps more interesting is that while DFMs themselves often claim improved cost to client as a reason for their usage, only 13% of advisors believe this to be a driving factor in choosing a DFM. Unsurprisingly then, the main reason for not choosing to use a DFM is the perception that they are too expensive. Even more concerning is that for those advisors who expressed a concern with the use of DFM, 68% of the concern related to uncertain value for money.

Figure 3: Reason for not using DFM

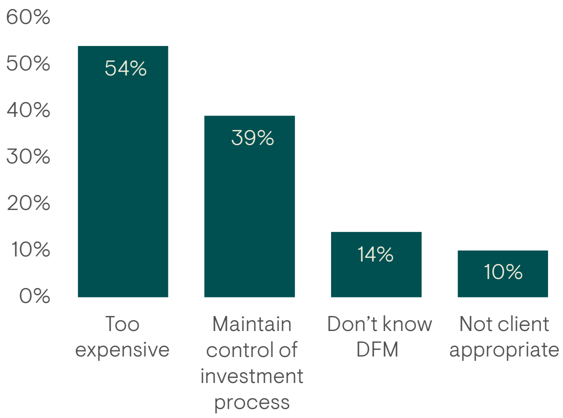
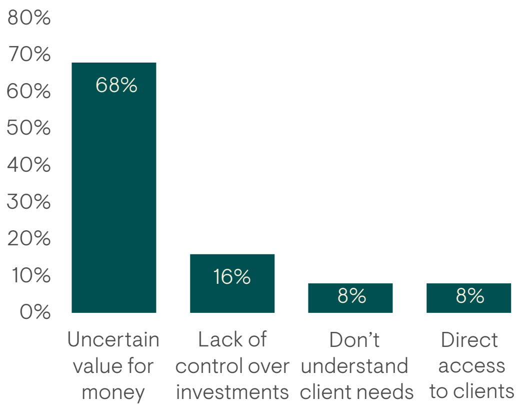


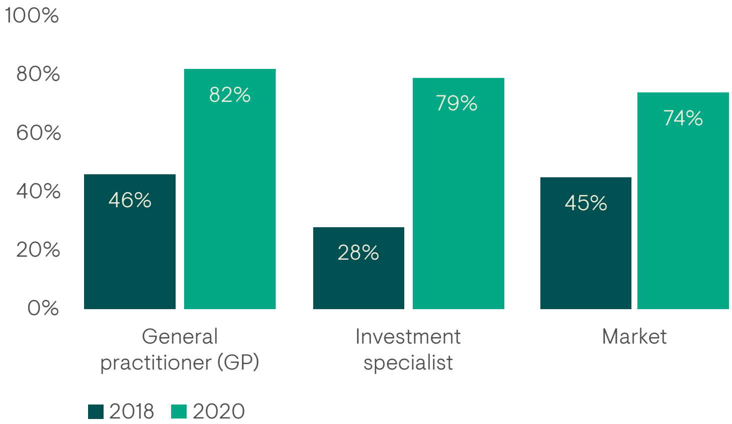
Figure 4: Among those using DFMs, main concern relating to their use



3. Potential for growth in DFM assets

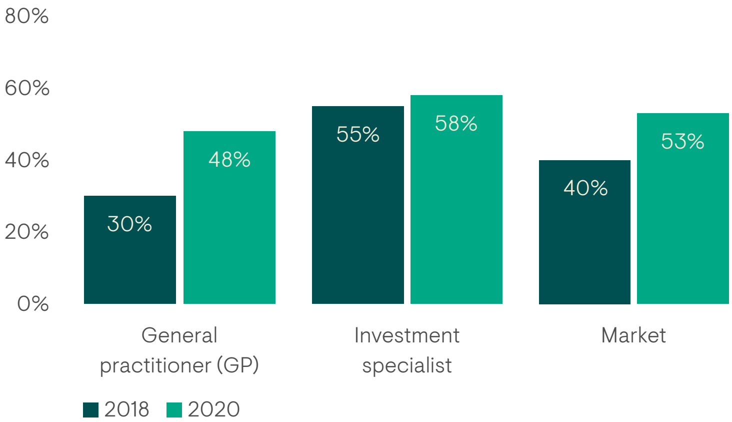
All advisor segments expect to increase their usage of DFM solutions. There are 2 ways in which this could happen. Firstly, by more advisors choosing to use DFMs (in the GP segment). We think that technology will need to be employed to unlock this opportunity since DFMs lack the reach and capacity to effectively target and service this segment of the market. Most likely this could be achieved using generic models.

Figure 5: Percentage expecting increase in DFM usage



Secondly, by increasing client take-up of existing DFM solutions (in the Investment Specialist and Holistic sectors). While DFMs are used in these segments, the actual take-up of DFM solutions is typically only about 50% of some advisors' books. Reasons cited for the slow take-up are potential CGT implications, client pushback and advisor inertia. The key to converting the remaining clients lies in building a compelling argument (performance comparisons) around the benefits of moving to the proposed solution.

Figure 6: Proportion of client base using DFM



4. Evolution of DFM investment structures

While investment propositions vary greatly by DFM, they generally tend to follow a similar lifecycle. Most start out with model portfolios using a combination of multi-asset funds since this is the path of least resistance to getting an advisor over the line. Over time, these migrate to using a combination of multi-asset and building block funds as the DFM looks to prove value-add through manager selection and taking more control of the asset allocation process. This often leads to the inclusion of passives to reduce costs thereby offsetting the additional cost of the DFM. Ultimately (and providing enough scale has been built) the DFM may launch their own CIS vehicles to gain additional control over the investment proposition.

We'll delve further into this important aspect in a future article and have a close look at how assets on the Ninety One platform are being managed by DFMs and how these compare to advisor-managed investment propositions.

Take-aways for Ninety One

While a lot what the NMG survey revealed about DFMs may seem obvious to many advisors, there are some take-aways that will play a significant role in our business planning. DFMs have an important role to play in the advisor/platform landscape and ultimately we should all be aligned, so as to deliver better investment outcomes for clients. Like any industry, not all players are equal and it is encouraging to see from the survey that advisors are placing a high emphasis on measuring the value-add that a DFM brings to the party. Platforms also have a role to play here, through enhanced reporting and functionality that will allow the advisor to measure the performance of the DFM and apply the same scrutiny as they have become accustomed to when measuring funds.

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