WHITE PAPER

EUROPE'S IFA MARKETS POST-MIFID II

Having been reshaped significantly by various pieces of regulation over the past few years, Europe's independent financial advisor (IFA) markets now face the implementation of MiFID II in January 2018. Many industry players and commentators are branding the updated version of the directive counterproductive, warning that it will hurt IFAs. Cerulli, however, is more positive, in keeping with our optimistic view of the industry's long-term prospects.

Over the past few years, many European countries have imposed stricter regulations on their local financial advice markets. They have increased qualification and compliance requirements, ironed out definitions and boundaries of advice, and generally raised professional standards. In some markets, such as the UK and the Netherlands, regulatory intervention has been bold; in both countries retrocessions for all advisor types have been banned. Sweden originally favored that route, but later backtracked. The subject of a ban on commissions has been hotly debated in recent years. Ultimately the Swedish government stopped short of an outright ban in favor of promoting (what it perceives as) a more competitive market, much to the Financial Supervisory Authority's dismay. The new law does propose a ban on commissions, but only in line with the pending MiFID II rules.

MiFID II will ban retrocessions for advisors that call themselves "independent" and significantly increase reporting and red tape. Most advisors expect their compliance costs to soar, with some expecting them to even double. The markets in the UK and the Netherlands will be least affected as their governments introduced such changes years ago. How these two markets have been reshaped by the measures can help us predict the outcome of MiFID II in other Continental markets.

Third-party funds

The UK has the most vibrant and professional IFA community in Europe. Evidence of this can be found in Exhibit 1, which shows that 23.4% of third-party mutual funds sold in the country are distributed via local IFAs. This figure dwarves the relevant percentages of all other countries. There are more than 22,000 non-captive financial advisors in the UK. That number grows to about 27,000 if we include wealth managers, discretionary managers, and so on.

Exhibit 1: Percentage of Third-Party Funds Distributed via Independent Financial Advisors by Country, 2017

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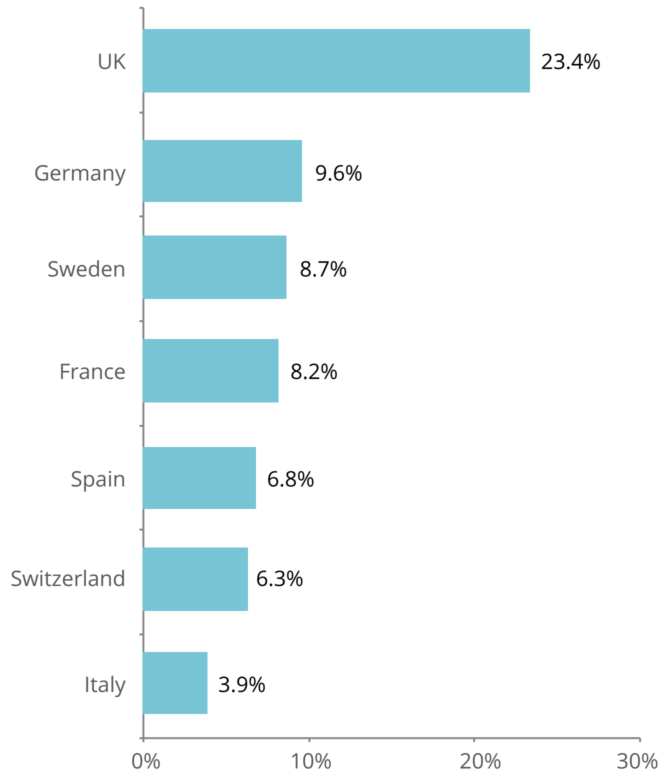


Source: Cerulli Associates, The Cerulli Report – European Distribution Dynamics 2017: Managing Complexity as Opportunities Evolve

However, the UK's Retail Distribution Review (RDR) resulted in rapid industry consolidation, with advisor numbers dropping by 25% since the review's introduction in 2011, and there is still room for further contraction. The players that have not engaged in M&A activity have resorted to outsourcing investment decisions to discretionary fund managers. According to Cerulli research conducted in the middle of 2016, more than 40% of non-captive financial advisor assets are invested via outsourcing allocation and fund-selection decisions. Many advisors have also changed their focus to servicing higher-end clients, which are more profitable.

At the same time, a new breed of independent advisors has been steadily stealing marketshare: so-called robo-advisors. Robo-advisors in the UK hold about 60% of total European robo-advisory assets and continue to grow dynamically. Various forms of remote, simplified, or digital advice are also being adopted by traditional advisors.

In Germany, the independent advice market has also evolved over the past five years. It has moved away from a situation in which anyone could call themselves an "independent advisor" and start pushing products. Lufthansa pilots, for example, were well known for being part-time independent financial advisors. The regulatory framework has improved, with qualification requirements and burdens increased, and thus many advisors have been forced to exit the market. However, it continues to be the largest market in Europe, with more than 37,000 advisors.

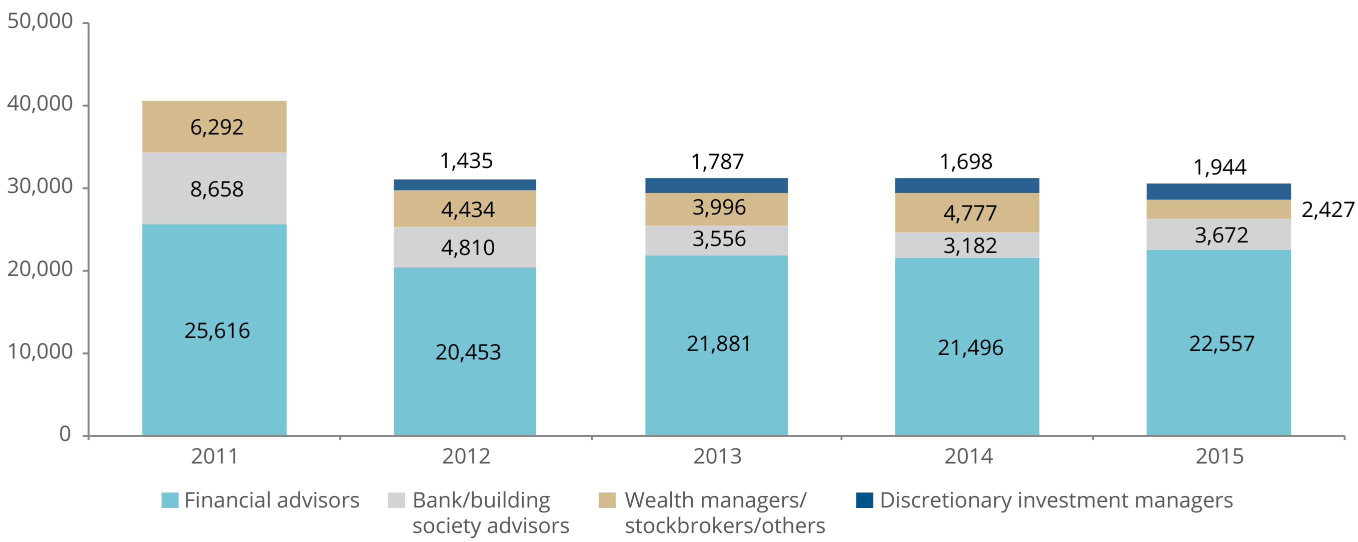
Level playing field

The German regulator also established "fee-based" advice as an alternative to "commission-based" advice to create a level playing field and to encourage investor choice. It forced companies to operate under one of the two remits—or both but with two separate business lines. So far, fee-based advice has not gained significant traction overall. Demand is mainly limited to the self-employed, professionals, and companies—groupings that are used to dealing with invoices and hourly rates of fees.

At the same time, German IFAs have been forced to declare all commissions. However, this measure has had little impact because advisors typically declare commissions in percentage terms and hide them in paperwork, so their clients still do not know what the advice is costing them in euros and cents.

Exhibit 2: Number of Financial Advisors in the UK, 2011–2015

The UK's Retail Distribution Review resulted in rapid industry consolidation with advisor numbers dropping by one-quarter since the review's introduction in 2011.



Sources: APPFA, FCA, Cerulli Associates, The Cerulli Report – European Distribution Dynamics 2017: Managing Complexity as Opportunities Evolve

For regulatory and tax reasons, many IFAs have resorted to outsourcing investment allocation to discretionary wealth managers and to asset managers via mandates, funds of funds, or multi-asset funds.

Robo-advice is showing significant growth potential in Germany. It is the second-largest and most dynamic robo-advice market in Europe, even though it significantly lags the UK's. The *maklerpools*, the IFA networks that have been helping their members deal with operational and compliance issues, have begun encouraging IFAs to incorporate robo-advice into their businesses, mainly targeting clients at the lower end of the wealth spectrum.

Stand-alone robo-advice brands in Germany accounted for about €560 million (US$626 million) at the beginning of 2017. This compares with assets under management (AUM) of €1.78 billion in the UK. The main stand-alone robo-advice players in the German market are Scalable Capital (which has also successfully entered the UK market), Vaamo, Ginmon, and Liqid.

Profit significantly

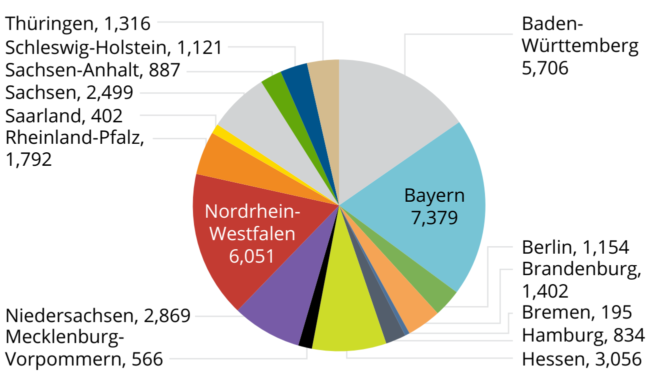
Outside Germany and the UK, the size of the independent advice industry lies somewhere between small and marginal. In France, it is small but not negligible. Managers such as M&G and Fidelity have managed to profit significantly from it, partly because they persevered and invested heavily in marketing and sales resources when other players thought it was not worth chasing individual IFAs in various regions. It is a slowly growing market and one that has changed very little compared to the aforementioned ones, as the regulator has not imposed radical changes.

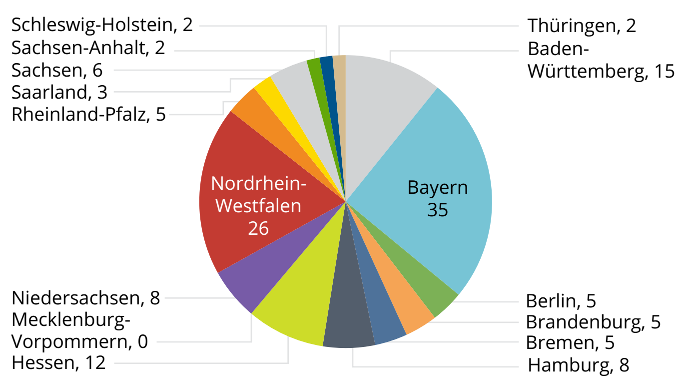
The 5,000 so-called CGPIs (*Conseiller en gestion de patrimoine investissements*) have in the main opted not to change their business models until they are forced to. Where there has been change, it has largely involved M&A activity and companies launching in-house asset management units. The latter are launching their own funds of funds (investing in third-party products), for which they are charging a management fee, thus creating an alternative source of income in anticipation of the banning of retrocessions.

In Spain and Italy, independent advice is in its infancy. In Italy, IFAs, which are now called "autonomous" financial advisors, have finally—after many years—won their campaign for an official register, allowing them to recruit new professionals and attract more clients, at least in theory. In Spain, there are only 159 independent advice companies. Their numbers and assets are, however, growing steadily. That said, a lot of advisors have been discouraged from following this route by increasing

Exhibit 3: Financial Advisors in Germany by Region, 2016

Fee-based advice has not gained significant traction overall, with demand largely limited to the self-employed, professionals, and companies.



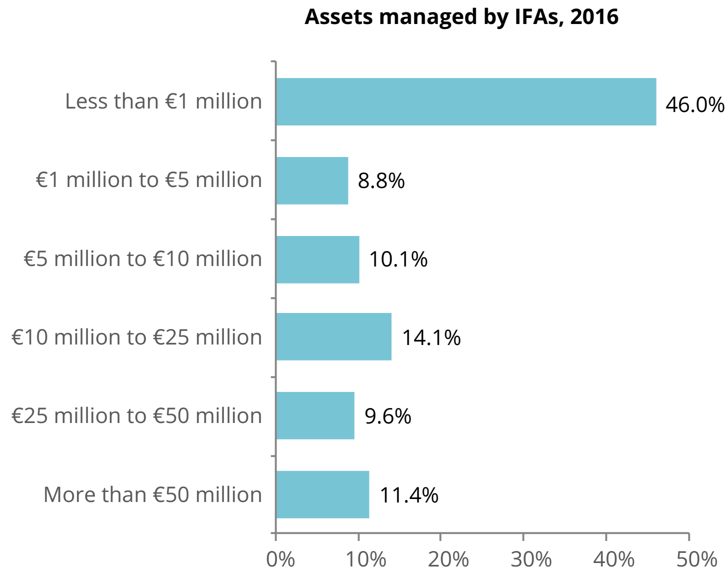


Sources: DIHK, Cerulli Associates, The Cerulli Report – European Distribution Dynamics 2017: Managing Complexity as Opportunities Evolve

Exhibit 4: Financial Advisors in France, 2014–2015

In France, the independent advice market is small but not negligible. Managers such as M&G and Fidelity have profited significantly from it.

Region	2014	2015	Change
Ile-de-France	1,818	1,851	2%
Rhône-Alpes	664	667	0%
Provence-Alpes-Côte d'Azur	485	496	2%
Languedoc-Roussillon	411	422	3%
Aquitaine	329	342	4%
Pays de la Loire	221	236	7%
Alsace	209	213	2%
Nord-Pas de Calais Picardie	206	200	-3%
Brittany	158	164	4%
Burgundy Franche-Comte	113	111	-2%
Normandy	99	97	-2%
Overseas[1]	95	90	-5%
Centre	88	88	0%
Corsica	13	13	0%
France overall	4,909	4,990	2%



Analyst Note: [1]Overseas includes Guadeloupe, Guyana, Mayotte, Martinique, Reunion Saint Barthélemy, Saint Martin, and Saint Pierre et Miquelon; since January 2014 it has also included New Caledonia, French Polynesia, and Wallis and Futuna Islands.

Sources: Orias, Profession CGP, Cerulli Associates, The Cerulli Report – European Distribution Dynamics 2017: Managing Complexity as Opportunities Evolve

red tape, opting instead for the safety of being employed by banks, under a semi-independence remit. This is the model that prevailed in Italy, where about 10 advisor networks, usually called promotori networks, account for more than €330 billion AUM and more than €125 billion assets under administration. The ones that represent the largest opportunity for third-party managers are Intesa SanPaolo, Fideuram, Mediolanum, Fineco, and Generali. They would all happily promote third-party products for a hefty fee, which is why Italy is the most expensive market in Europe.

As the detail above illustrates, advisors in European markets have been changing their business models in various ways to address growing regulatory challenges. The changes include: M&As, which increase scalability and reduce costs; outsourcing investment allocation and other operational functions; getting support from IFA networks; focusing on wealthier clients; adopting new technologies; launching in-house asset management capabilities; and simply going out of business. The mix and the adoption rates of these approaches vary from country to country, but it is safe to say that such change will continue across Europe for years to come.