IFA DNA

2023

Special Report

The impact of regulation and tax changes on advice firms

Adviser Solutions

Fidelity INTERNATIONAL

Introduction

Jackie Boylan, Head of Fidelity Adviser Solutions

"Welcome to this IFA DNA special report on the impact of regulation and tax changes on the advice sector. It complements our main 2023 report – entitled 'Adapting to uncertainty' – that examines the opportunities and challenges facing advice businesses today.

This is the fourth year running we have conducted our IFA DNA research and throughout this period advisers have consistently told us that regulatory change and uncertainty and the increasing burden and cost of compliance are among their biggest business challenges. This reflects the fact that, in recent years, advice firms have had to adapt to, for instance, the Senior Managers and Certification Regime, the PROD rules and guidance to ensure the fair treatment of vulnerable customers.

This year's research was undertaken at a time when firms were actively preparing for the first implementation deadline for the Consumer Duty which, based on feedback received from this research, has been a big drain on resources. There's more regulatory change on the horizon too. The FCA is exploring new rules that will require advisers to understand their clients' sustainability preferences. In addition, the regulator is currently conducting a thematic review into the advice customers are receiving on their income needs in retirement.

So, it's perhaps no surprise our qualitative interviews revealed growing frustration at the ever-increasing compliance burden on advice firms. What's more, as the main IFA DNA report highlights, job satisfaction is down with more advisers looking to sell up or exit the industry (particularly sole traders). While there may be many factors influencing the responses we received, the growing regulatory burden certainly appears to be one of them.

Fidelity Adviser Solutions fully recognises the challenges facing advice firms and one of our goals is to help advisers navigate regulatory change. Our website contains a wide range of materials designed to help practitioners stay up-to-date with the latest regulatory initiatives. This includes a dedicated Consumer Duty support zone.

I do hope you find this special report helpful and informative."

"I think the Consumer Duty has taken a fair bit of resource in terms of formalising stuff that wasn't as formalised, particularly from the compliance perspective. It's a tightening up of processes"

"We did a big piece of work on target markets at the back end of last year. I redo all my segmentation and everything in the autumn anyway. So, we just expanded that right out and did a proper 360 on the entire client bank"

"We're going to start to be a little bit more overt about what a centralised investment proposition brings. It brings oversight and governance. It allows us to take an in-depth view of what's happening... Consumer Duty requires you to really know a product when you're investing clients' money, it's in the right place and you understand and the client understands what they're investing in. When you start to go into the fund universe, how can you ensure that your clients are invested with that level of oversight?"

Contents

Methodology

Fidelity commissioned NextWealth to produce this report based on a representative sample of financial advisers from research conducted in May 2023:

- A digital survey of 200 UK financial advisers.
- In-depth qualitative interviews with 10 financial advisers.

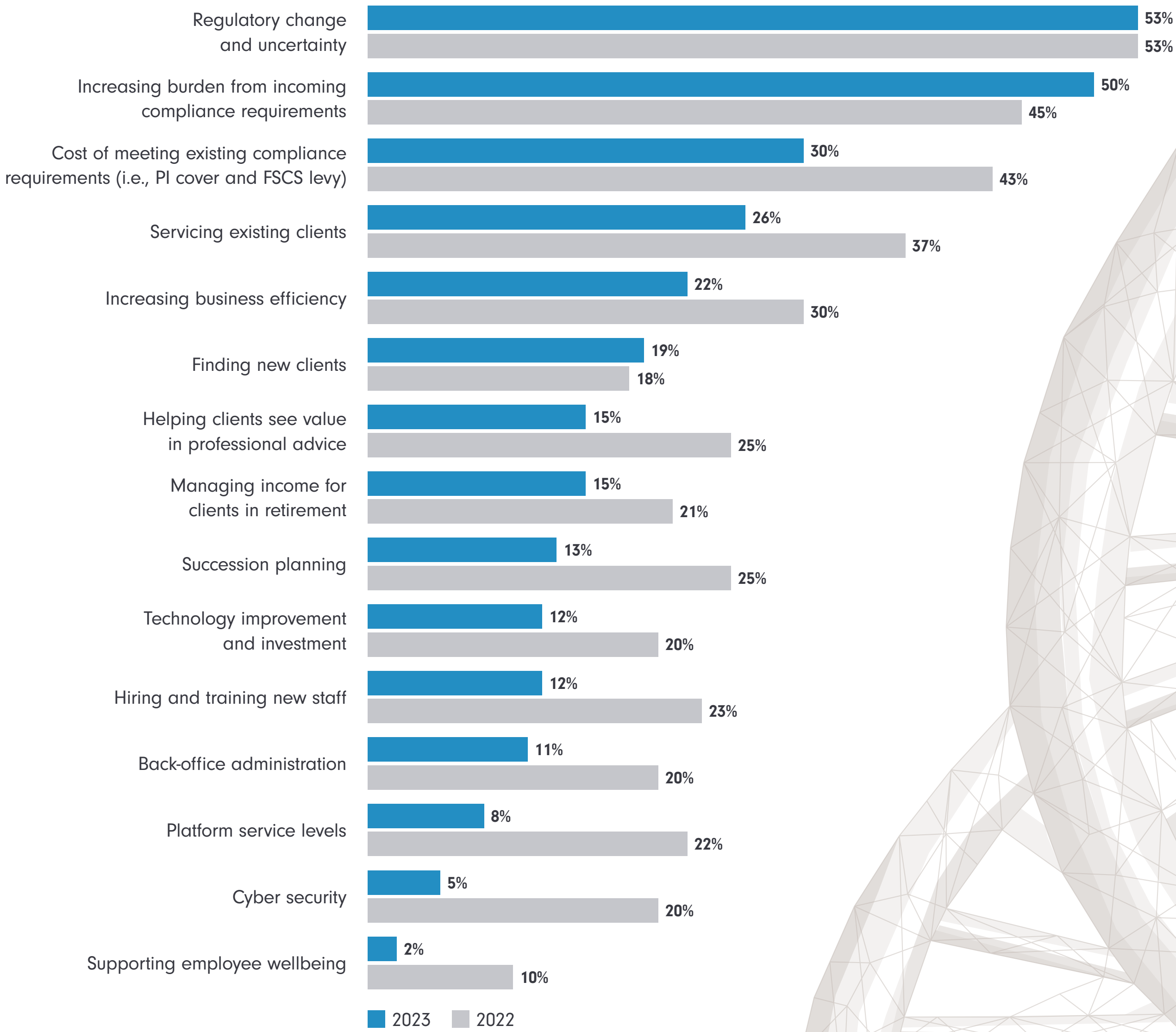
The interviewees were chosen to represent a full range of age and experience from firms large and small.

NEXTWEALTH

The impact of regulation and tax changes on the advice sector

Main business challenges

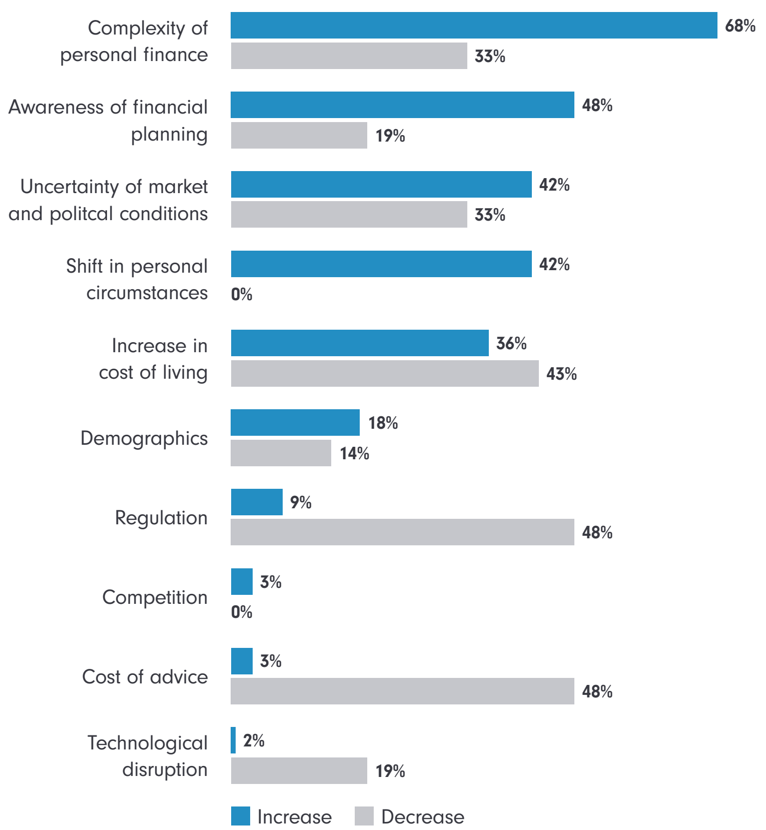
Ever-changing regulation and the increasing burden of compliance are comfortably viewed as the two biggest challenges facing advice firms. Perhaps this is unsurprising given the introduction of the Consumer Duty this year and that other regulatory initiatives are on the horizon. A strong theme from this year's survey was a feeling of frustration – advisers feel misunderstood by a regulator focused, in their view, on product rather than the true value of advice.



"We can't plan; everything is so up in the air... lifetime allowance, they're niggling away at CGT, income tax. We can handle the regulation but we don't know who to trust, markets are going to be spooked for a very long time. We need clarity on pensions"

The factors driving the demand for advice

Advisers also identify regulation and the cost of advice as the biggest factors that could harm consumer demand for advice over the next five years, although it's true to say the majority of advisers (51%) expect demand to grow over this period.



Adapting to new regulation

Preparations for the Consumer Duty

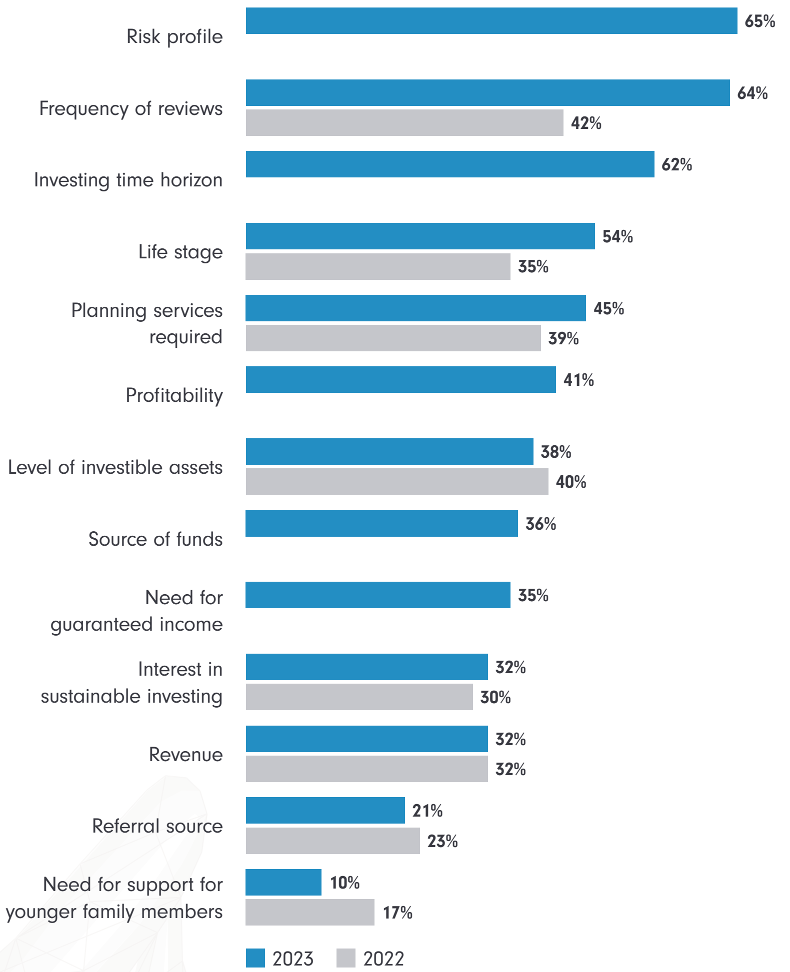
Our research was conducted when firms were busily preparing for the first major implementation deadline for the new Consumer Duty. Getting ready for this important regulatory directive has clearly been a challenge for many advice firms. However, judging from comments made in the qualitative interviews, there is a general recognition that it will lead to better outcomes for clients.

Other key findings from the interviews in relation to the preparatory work are as follows:

- The focus on demonstrating value is giving more structure around service delivery and charging. Some firms are setting out tiers of service with tangible deliverables such as a defined number of face-to-face meetings and other contact points. More consideration is being given to fixed fees as a 'cleaner' way to align fees and work delivered (further consideration is given to adviser fee models on page 10).
- Firms are contemplating making changes to their investment strategy – some firms are considering moving away from in-house CIPs to outsourced models due, in part, to concerns over being classified as a manufacturer (and the extra regulatory responsibilities this entails) and to manage the ongoing burden of assessing suitability for target market needs.
- Thought is being given to the use of tools, such as cashflow modelling, to visually demonstrate the value delivered to clients.

Methods of client segmentation

In terms of client segmentation, consideration is evolving towards target market analysis. Advisers are thinking about their proposition for different groups of clients with risk profile, frequency of reviews, the investing time horizon and life stage the most widely used methods of segmenting clients. Firms are then looking at the proposition for each of their target markets, including potential investment partners, tech solutions and tiered fee structures.



Some response categories did not appear in the 2022 research

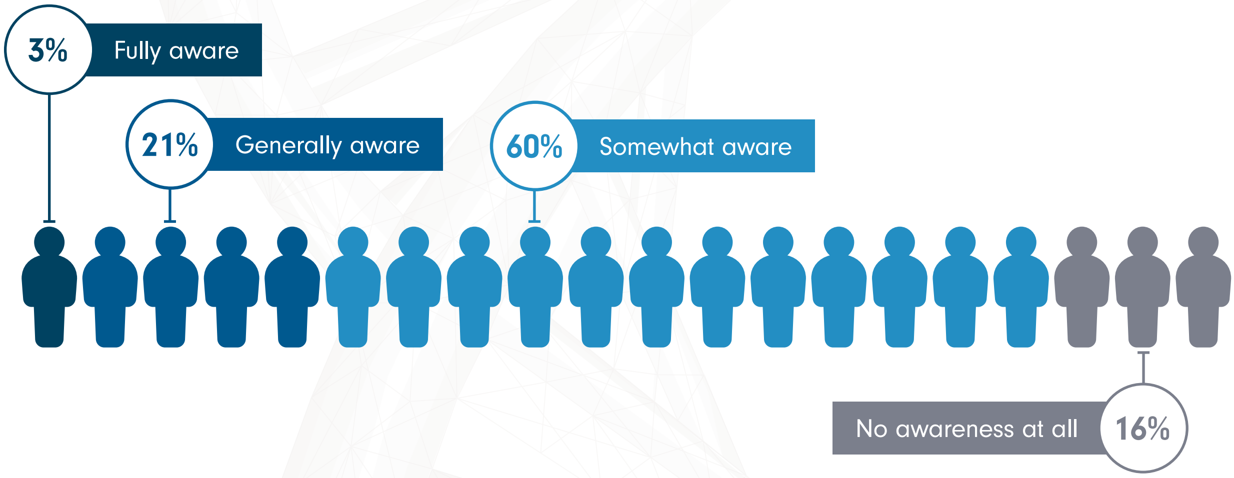
> **"By and large, it's a question of how much can you afford to save? What level of risk are you willing to take? What do you want the journey to look like?"**

Pensions dashboards

The FCA has been consulting on the proposed regulatory framework for pensions dashboard service firms – secure digital interfaces that will allow consumers to find their pensions and view basic information about them.* However, only 3% of advisers are fully aware of pensions dashboards with 60% only somewhat aware.

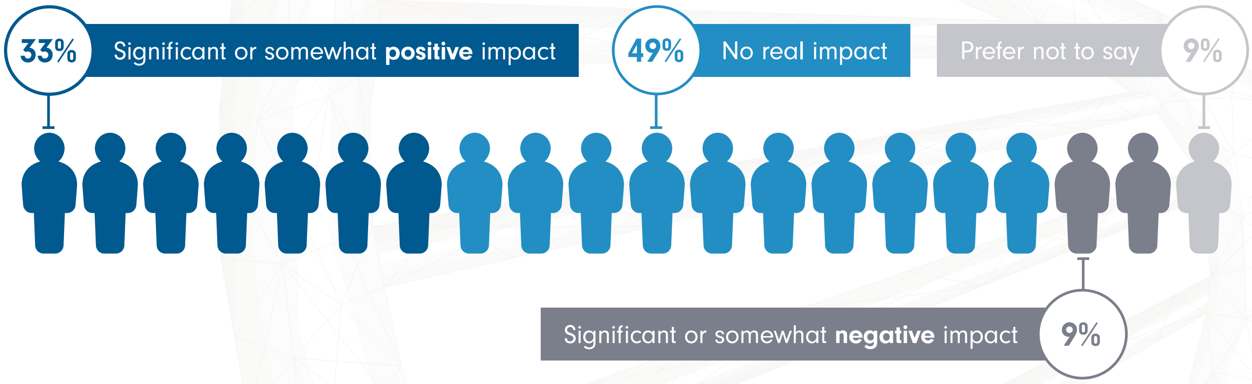
*Since this research was undertaken, the regulator has announced an extension to the deadline for pension providers to connect with the digital architecture operated by the pensions dashboard programme.

Awareness of pensions dashboards and the functionality they will provide



The impact pensions dashboards will have on advice given to clients

When asked about the impact of pensions dashboards on the advice they will give, only a third of advisers believe they will have a positive effect while around half believe they will have no impact at all.



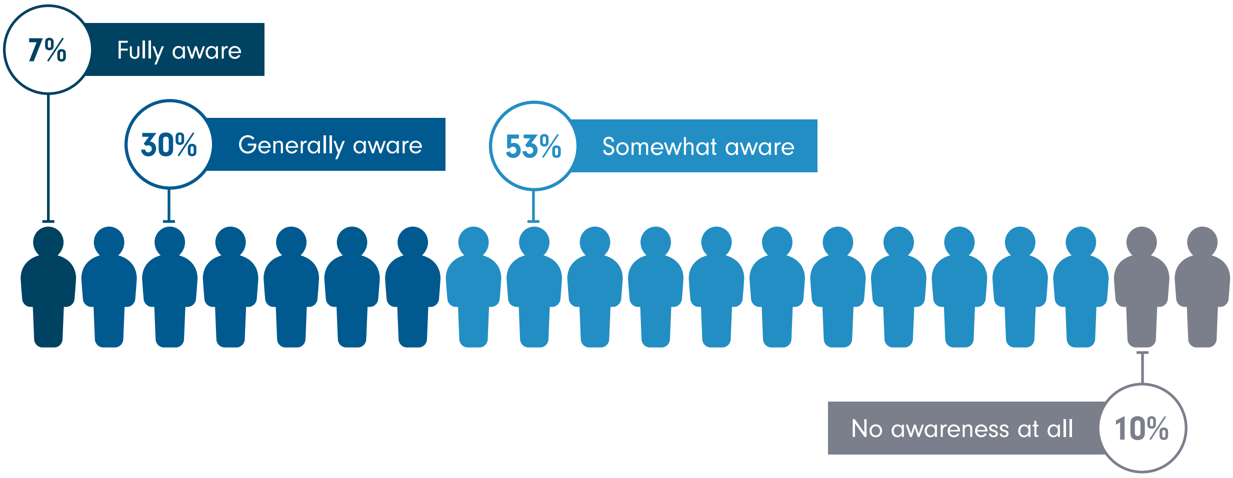
"In my advice career, I've only worked with high-net-worth clients who are pretty sophisticated. And pensions dashboards probably won't impact those clients too much... they won't be that fragmented"

FCA thematic review

The FCA is currently conducting a thematic review into the advice customers are receiving on their income needs in retirement. Its focus is on the Government's pension freedom reforms and the way customers access their retirement savings and the significant shift to drawing an income from pension funds that remain invested. The regulator believes the results, which are due in the fourth quarter of 2023, will be an important indicator of how firms are implementing the Consumer Duty.

Awareness of this initiative amongst advisers is only slightly greater than of the FCA's pensions dashboard work, with 7% fully aware and 53% only somewhat aware.

Awareness of the FCA's thematic review and the changes it will bring



The impact the FCA's thematic review will have on advice given to clients

In terms of the impact this review will have on the advice given to clients, over half of advisers think it will have no real impact (52%). This is perhaps surprising given the review is specifically considering how the retirement income advice market is functioning.

> **"Retirement planning advice is our bread and butter... it for us is much more a question about trying to tailor the level of income to what the client requires. But using cashflow models to try and evidence the sustainability of that. And that's largely because client income needs throughout retirement are rarely uniform"**

Regulation and fee models

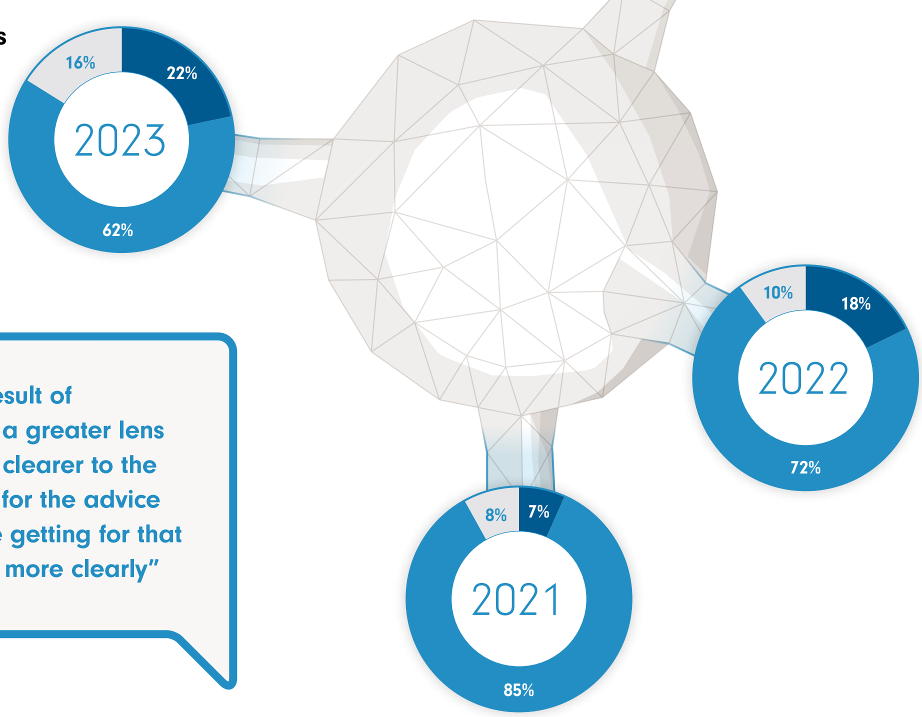
A key element of the Consumer Duty is the four outcomes, one of which is fair value. Firms need to ensure their services offer good outcomes in terms of price and value. For advice firms, this means the fees clients pay must be reasonable compared to the overall benefits they receive.

The FCA has stated that, in a well-functioning market, they would normally expect there to be a broad distribution of charges – reflecting factors like different service levels, underlying costs to advice firms, and incentives for firms to compete on price. However, their analysis has found significant clustering of adviser charges. As such, the regulator has said it's important that firms think carefully about whether their charging model is fair value for different groups of consumers.

Given the FCA's focus on fees and the value of advice given, our research asked firms whether they were exploring different fee models. Approximately one in five firms (22%) say that they are, a small increase from last year (18%). Interestingly, 62% state they are not contemplating the introduction of different fee models.

Firms exploring different fee models

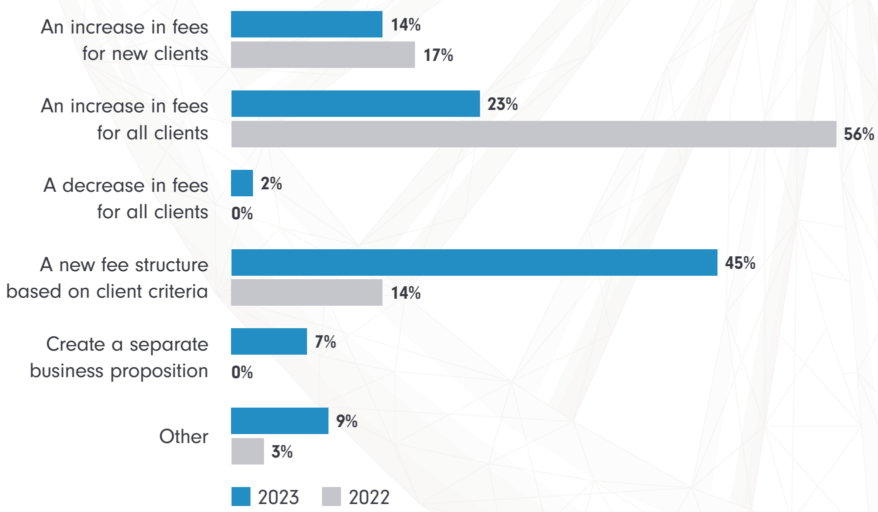
Yes No Prefer not to say



"We're looking at fees as a direct result of Consumer Duty; we definitely have a greater lens on fixed fee charging, because it's clearer to the client; what they're being charged for the advice and more importantly, what they're getting for that charge. You can demonstrate it far more clearly"

Likely changes for those firms exploring different fee models

For those firms stating they are exploring different fee models, 45% say they are considering a new fee structure based on certain client criteria. In terms of fee levels, 23% are considering higher fees for all clients – which is sharply down on 2022 – while 14% are contemplating fee increases for new clients. Just 2% are thinking about reducing fees for all clients.



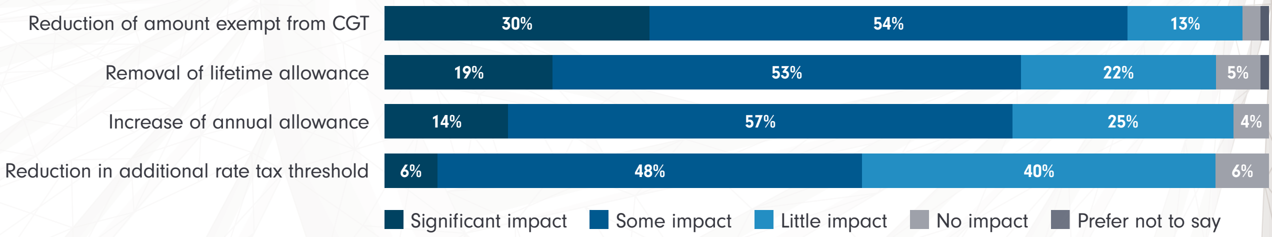
"Fixed fees are cleaner... easier for clients to understand. Business owners, for example, who have used solicitors and accountants for a long time, who typically do fixed fee stuff or hourly rate, understand it. And particularly as I'm working with ultra-high-net-worths, it might just be cleaner"

Tax changes and client advice

Alongside the regulatory pressures firms are facing, continuous changes to the tax system have required advisers to respond and adapt – leaving many with a feeling of frustration, as illustrated by the quote below. That said, certain changes announced in the Spring Budget – such as the proposed removal of the pension lifetime allowance – could well create new business opportunities for advisers.

When specifically asked about the changes announced in the last Budget, advisers say the reduction to the capital gains tax allowance will have the biggest impact on the advice they give. In total, 84% of advisers say this will have a significant or some impact while 72% say the removal of the lifetime allowance will affect the advice they give.

The impact of the changes announced in the Spring Budget on advice given



"We can't plan; everything is so up in the air... lifetime allowance, they're niggling away at CGT, income tax. We can handle the regulation but we don't know who to trust, markets are going to be spooked for a very long time. We need clarity on pensions"

53% Reduce client assets in General Investment Accounts

50% Incease use of onshore and offshore bonds

Likely changes to recommendations due to the reduction of the CGT allowance

When asked about how the capital gains tax changes will affect advice, over half of advisers (53%) say it is likely they will recommend reducing client assets in Investment Accounts. A similar number (50%) say they are more likely to recommend onshore and offshore bonds.

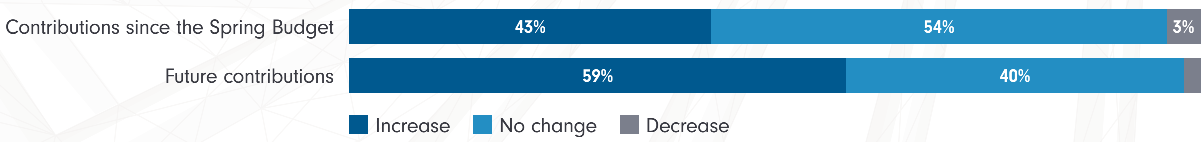
25% Change investment options (e.g., use multi-asset funds over model portfolios)

21% Recommend more tax advantaged schemes (e.g., EIS and VCTs)

> **"There is certainly a big conversation around General Investment Accounts versus bonds, and things are probably moving more towards investment bonds nowadays"**

Client pension contributions following the Spring Budget

The surprise abolition of the pension lifetime allowance* has had an immediate impact on client pension contributions. In our survey, 43% of advisers say clients have increased their contributions while an even greater number (59%) anticipate clients increasing contributions in the future.



*This is still currently subject to legislation, although the lifetime allowance tax charge has been removed.

Summary

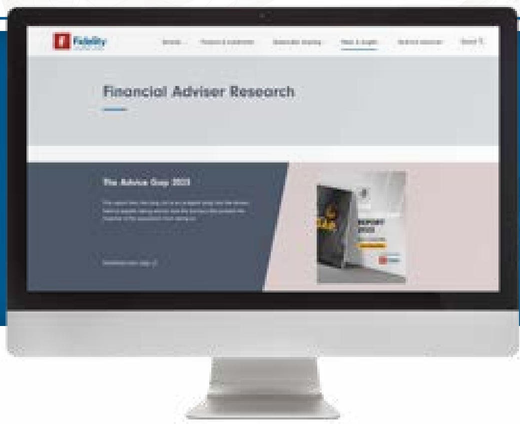
Constantly changing regulation and an increasing burden of compliance on advice firms are clearly causing frustration amongst the advisers and planners who participated in our research. These issues are comfortably viewed as the two biggest challenges facing firms. Perhaps this is why regulation and the cost of advice are identified as the biggest factors that could harm consumer demand for advice over the next five years.

From Fidelity's perspective, we welcome any measures that help build consumer confidence in the financial services and advice industries. However, we fully recognise the pressures on advice firms from the growing regulatory burden, particularly given it's highly unlikely to decrease in the foreseeable future. Indeed, other regulatory initiatives affecting the advice sector are already underway.

As a business, we've always worked very closely with advice firms and one of our aims is to support advisers and planners in any way we can. So, for instance, we provide a wide range of technical resources related to pensions, retirement and tax. In addition, we offer advice on combating the increasing threat of cybercrime. Importantly, as highlighted in the introduction, we also place great importance on helping advisers navigate the ever-shifting regulatory environment. Indeed, lots of content is available on our website and practitioners can access our support materials through visiting our Compliance and regulatory matters hub or our dedicated Consumer Duty support zone.

Read more research on how advice firms are adapting to change and other business challenges

fidelityadvisersolutions.co.uk/ifadna



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