News

MASTER OF THE GAME

By Janine Mace on 5 November 2010 0 comments

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While the financial planning industry is undergoing a period of significant change, one thing that isn't changing is the dominance of masterfund vehicles in the industry.

Whichever sector you look at in the masterfund market — wraps, master trusts or platforms — these products remain at the heart of the financial advice industry in Australia.

And this situation is unlikely to change any time soon, according to Investment Trends principal Mark Johnston. He believes these vehicles remain central to the way the industry operates.

"It is clear that platforms remain the dominant and preferred transaction engines for financial planners. There remains a strong preference for using platforms by financial planners," he says.

This preference is reflected in the continuing growth in total funds under management (FUM) in the masterfund market (platforms, wraps and master trusts combined). In the past year, the market grew by $44.8 billion or 12.7 per cent to stand at $399 billion, according to the latest data from research firm Plan for Life.

Total inflows for the year reached $96.8 billion, which was well up on the previous year's result of $87.5 billion. This was slightly offset by rising outflows of $79.8 billion (up from $74.4 billion) compared with the year to June 2009.

"Most major companies reported decent growth over the year," according to Plan for Life managing director Simon Solomon.

The research firm's data shows both the wrap and platform sectors of the market continued to grow in 2009-10, while the market share for the master trust sector declined (see table 1).

Wraps now have $139.1 billion in FUM, which represents 34.9 per cent of the total market and is marginally up on the 33.4 per cent market share a year ago. Growth for the year was 15 per cent, with inflows of $44.7 billion and outflows of $8.5 billion. These inflows represent 46.2 per cent of total inflows for the market.

BT Financial, Macquarie and NAB/MLC are the leading players in the wrap market, with BT Financial holding 48 per cent of FUM when both its own products and those it badges for other firms are combined.

In the platform sector, which now represents 50.5 per cent of the total market, FUM was up 13.2 per cent over the year to 30 June 2010 to a total of $201.4 billion. Inflows for the year were $41.2 billion (which represented 42.5 per cent of all market inflows) although significant outflows of $34.3 billion were also experienced.

The platform market continues to be dominated by a small number of key players, with five groups each holding over $20 billion in platform FUM. These companies are led by NAB/MLC, which holds $45.4 billion and Commonwealth/Colonial ($43.6 billion).

The decline in the market share of master trusts continued in the past year, reaching 14.6 per cent in the June 2010 quarter. Total FUM for the master trust sector now stands at $58.4 billion, with total inflows of $10.9 billion for the year. Master trusts only attracted 11.3 per cent of total market inflows.

Consolidation trend slows

The period since the global financial crisis has been marked by significant consolidation within most

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sectors of the financial services industry, and the masterfund market has not been immune — with providers seeking to gain scale as pressure on margins has increased across the market.

The consolidation flowing from events such as the NAB/MLC acquisition of Aviva's wealth management business (which gave it control of the Navigator platform) and Westpac's acquisition of St George Bank (which provided control of the Asgard platform) has seen control of much of the sector concentrated in the hands of the major banks.

This concentration is reflected in FUM market share (see table 2), with the top five groups holding over 60 per cent of the FUM in the broader masterfund market. The same five groups dominate the funds under administration (FUA), with the key difference being BT's move into the top spot in the FUA rankings given its extensive badged business (see table 3).

The provision of badged (or 'white label') vehicles continues to represent a major market for product providers. In the past year, BT Wrap announced deals to supply badged platform solutions to Merrill Lynch's group of investment advisers and also renewed existing badging deals with Shadforth Financial Group and DKN Financial Group.

Industry analyst and managing director of market research firm DEXX&R Mark Kachor believes these deals highlight an ongoing trend. He cites the announcement in March by Colonial First State (CFS) that it had agreed to badge its CFS Custom Solutions product for Guardian Financial Planning (which is part of the Suncorp Group), as another example of the ubiquitous nature of the vehicles marketed by the big players.

According to CFS Custom Solutions general manager Chris Stevens, the Guardian agreement is "the first of a number" of new badging agreements with advisory groups to be announced. "We are continually looking for opportunities to enhance our service. This development is a result of our ongoing commitment to platform innovation."

This trend is further reinforcing the high concentration when it comes to net funds flow. Funds flow is dominated by the top three groups (NAB/MLC, Macquarie and Commonwealth/Colonial), which together represent 56 per cent of the net funds flow into the masterfund market (see table 4). When the flows for AMP, BT and the BT Wrap badged products are added, these five groups alone receive 92 per cent of all the net funds flowing into the masterfund market.

The fastest growth recorded this year among the various market players occurred in the Australian Unity Group, which recorded growth of 220.6 per cent off a low $34.08 million in FUM as at June 2009. In contrast, the next fastest growing group was NAB/MLC with 50.2 per cent, but this was off a much higher June 2009 FUM level of $49 billion (see table 5).

Concerns about competition

While the domination of the masterfund market by a few key players does not look set to change any time soon, the recent trend towards continuing market consolidation slowed over the past 12 months and may have been halted for a time following the intervention of the Australian Competition and Consumer Commission (ACCC).

Kachor believes further consolidation looks unlikely at this stage. "How much more concentrated can you get?" he asks.

"The rats and mice in the market might get mopped up, but we are not seeing any new players emerging."

Concern about concentration and reduced competition in the retail platform market were cited as the reasons for the ACCC's decision in late April to reject NAB's proposed acquisition of AXA Asia Pacific Holdings and its later rejection of the undertaking to divest the North platform administration business to IOOF.

According to ACCC chairman Graeme Samuel, the merger would have resulted in a substantial reduction of competition in the platform market for investors with complex investment needs and would "remove competitive tension".

"At the heart of the ACCC's decisions are concerns about innovation, and as a consequence future rigorous and effective competition between retail investment platforms," he said.

According to the competition regulator, in the absence of competitive pressure from AXA's platform, existing platform providers were either "unlikely to have the incentive to drive innovation in the foreseeable future, or lacked the capacity to do so".

While the ACCC's decision may have put paid to further significant consolidation for the time being, it acknowledged the platform market was unlikely to become more competitive, with new entrants unlikely to

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emerge because of the high barriers to entry.

“Potential entrants need significant scale and established relationships with financial advisers to justify the initial and ongoing investments to enter with a platform,” Samuel said.

The distribution issue was cited as one of the factors behind the ACCC’s rejection of the NAB/AXA undertaking to divest the North platform. The regulator noted the undertaking placed a “heavy reliance upon IOOF having sufficient distribution capability to provide an effective competitive constraint upon existing key players in the foreseeable future”.

Observing the current market, Kachor acknowledges the validity of the ACCC’s comments on distribution and believes there is little on the horizon likely to substantially disrupt the existing situation.

“IOOF is growing organically and trying to rationalise what it has taken on [with the Skandia business], but distribution is a problem,” Kachor notes.

“Distribution is the key to success in financial services.”

Kachor believes further significant consolidation is unlikely to occur in the masterfund market unless the Government’s ‘Four Pillar’ policy changes. “If the big banks were able to merge, there would be immediate consolidation in the market.”

Slowing in client inflows

While total annual net flows into the masterfund market were up over $17 billion in the year to 30 June 2010, one of the interesting trends in the market at the moment is a slight decline in the percentage of new client dollars moving into these vehicles — the first in almost a decade.

“The percentage of inflows is slightly lower, with platforms now receiving 75 per cent of total new inflows and this is expected to fall to 72 per cent within a few years,” Johnston says.

“We have moved from a world where it was consistently 78 per cent of inflows. But even with this slowing, we are still seeing 7 in every 10 dollars in inflows going to platforms.”

He believes it is important not to overstate the decline, which is largely due to changes in client preferences.

“It reflects changes in the mix of assets in inflows. We are seeing an increase in inflows to term deposits and direct shares,” Johnston says.

“In the past couple of years we have seen increasing use of fixed interest and term deposits on platforms. Financial planners prefer to do this on platforms, but clients are not always prepared to pay the administration fees and this is leading to slight reductions in inflows.”

The growing popularity of direct investments such as direct equities and exchange-traded funds (ETFs) could represent something of a challenge when it comes to maintaining the future growth rate of the masterfund market.

“Clients are not prepared to pay administration fees for direct equities since they can use Internet trading,” Johnston says.

This issue is ensuring there is strong competition among providers to ensure their products incorporate the latest functionality needed to remain competitive.

“Increasingly financial planners are using direct equities and ETFs, so there is something of an ‘arms race’ in the platform space at the moment to improve their functionality in direct equities,” Johnston says.

“In the next few years we would not be surprised to see price competition emerge this area.”

Kachor agrees there is strong interest in having this functionality on platforms as a selling point when planners are working with clients, but believes many advisers are not really all that interested in actually using it.

“The majority of planners are not keen to become stockbrokers and often they set up the facility so the client can do it, which is what happens with the North product,” he says.

“Planners want access to direct equities, but they are not necessarily going to use it with clients.”

The demand for access to direct equities through platforms was highlighted in the latest Investment

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Trends research, which showed planners are expecting the level of direct share investments going through platforms to rise to 46 per cent over the next few years — up from its current level of 34 per cent.

Planners stay put

Despite these trends, the level of churn within the masterfund market remains fairly low at the planner level.

“There is always movement around the platform market each year, with our research showing 32 per cent of financial planners stop using a platform provider they have been using, so the platform market is very competitive in terms of the functionality on offer as they need to stay competitive,” Johnston says.

At the dealer group level, however, there appears to be limited interest — and value — in moving between platform providers.

“Dealer groups are not going to move unless someone else can offer them something better,” Kachor says.

“A dealer group’s bargaining power is directly related to FUM, so they have more leverage by staying with one provider than splitting their FUM between two providers.”

He believes the flow-on effects of the Future of Financial Advice reform package may have more of an impact on the masterfund market than greater competition or changes in planner preferences.

Kachor believes the proposed reforms could lead to significant shifts in the industry. “If the Government goes down the path it is proposing, then it will have a dramatic impact on the financial planning industry.”

One of the key results could be an even greater dominance of the masterfund market by the banks, he says. “Those who will come out the best are likely to be the ‘big four’ banks as they are own the product and the distribution network. As they are vertically integrated, they can absorb the costs and spread it along the value chain.”

This is much more difficult for non-bank advisory groups and is likely to see issues such as cost control and profitability move even more to the fore.

“Many firms believe the new rules mean they will not be able to afford to support low-balance clients. They will need to concentrate on clients with higher balances,” Johnston notes.

Despite the concern about how the regulatory proposals will affect the masterfund industry, Kachor believes there is still a lot of water to flow under the bridge before the final shape of the new regime is clear.

“Politically, it will be interesting to see what happens given the hung parliament and the different views of the various players such as the Greens, Steve Fielding and the rural independents. The result could be very different to what is expected,” he says. MM While the financial planning industry is undergoing a period of significant change, one thing that isn’t changing is the dominance of masterfund vehicles in the industry.

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The period since the global financial crisis has been marked by significant consolidation within most sectors of the financial services industry, and the masterfund market has not been immune — with providers seeking to gain scale as pressure on margins has increased across the market.

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The demand for access to direct equities through platforms was highlighted in the latest Investment Trends research, which showed planners are expecting the level of direct share investments going through platforms to rise to 46 per cent over the next few years — up from its current level of 34 per cent.

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