AKG

Financial & Operational Strength – its role as a foundation in platform due diligence

Adviser Guide, November 2020

IN ASSOCIATION WITH: AEGON

CONTENTS

BACKGROUND

OBJECTIVES

This AKG guide focuses on the importance of platform financial strength, sustainability and operational resilience. High-level objectives for this AKG guide are to:

- Produce an independent, educational, and practical resource for advisers, paraplanners and others concerned with the resilience of platforms in order to drive positive customer outcomes and experience
- Look at the importance of the financial strength and sustainability of platform market incumbents
- Consider the potential impact on adviser businesses when and where deficiencies in platform operator financial strength, resilience and sustainability might arise
- Encourage advisers to be on the front-foot with associated due diligence and risk management processes.

MARKET RESEARCH

To support the delivery of this guide AKG posed a concise set of research questions via online survey to an adviser audience. The research was carried out on AKG's behalf by PollRight, a division of Citigate Dewe Rogerson, taking place between April 17 and May 15, with 100 survey respondents.

COVID-19

Since this AKG project was initially started we have all been impacted by the spread of the global pandemic and we have had to respond to the associated challenges presented. The guide has not been produced because of COVID-19 but this episode does coincidentally serve to further illustrate the key tenets of the guide in underlining the importance of financial strength and operational resilience in the platform sector.

EXECUTIVE SUMMARY

Due diligence requirements - The requirement to carry out robust platform due diligence and to ensure that this is more meaningful than a box-ticking exercise is crucial.

The overarching framework from which to build out robust due diligence exercises should contain three components which are spelt out in more detail in the guide. These components are – Proposition; Operational; Strength and Sustainability.

COVID-19 overlay - The impact of the pandemic is effectively serving to exacerbate and/or accelerate some of the momentum challenges for platform operators.

The headline factors from AKG's research on adviser consideration of platform switching, including levels of charges/fees and of service, indicate areas where platform operators cannot afford to go wrong, underserve or underdeliver. All of these are actually, to some degree, implicitly or explicitly reliant on financial strength to enact them.

Platform impairment or failure is not just a hypothetical risk.

And adviser research carried out for this project reinforces the importance of considering platform operator financial strength and sustainability in selection/retention processes.

There is a need for a broad criteria consideration and context within financial strength assessment - with a broad base of strength required to deal with even unknown stresses, as well as those that can or have been modelled.

"Advisers cannot be prudential regulators, but the elements of due diligence outlined in this guide provide an excellent checklist that advisers can use to interrogate platform providers."

Personal Finance Society

Keith Richards
Chief Executive Officer of the Personal Finance Society

THE VARIATION OF RATINGS IN THE PLATFORM SECTOR

AKG assesses and rates companies and other entities within specific peer groups or sectors. Such peer groups are fundamentally designed to reflect how customers and their advisers consider companies for use.

The Platform sector covers companies positioned as platforms or as providing a significant integral component of a platform service operation, i.e. companies that might be seen to compete in the delivery of platform services and capability.

The objective of the AKG rating is to provide a simple indication of the financial strength of a Platform company from the perspective of financial advisers in the UK who, when acting on behalf of their clients, need to ascertain a company's ability to deliver sustained operational provision of products or services.

"Financial strength must not just be about solvency, it has to be about maintaining trust in the market. If clients experience a serious disruption in the service they get from a platform provider, confidence in investments will suffer, and it is right that advisers should protect their own reputation and confidence in the market overall by taking financial strength into account when they choose a platform provider. Clearly, with many factors in play, opinions will differ about the financial strength of a single firm, but these ratings provide a useful starting point for the conversation."

Personal Finance Society

Keith Richards
Chief Executive Officer of the Personal Finance Society

AKG FINANCIAL STRENGTH RATINGS

Brand	Company	FS Rating
7IM	Seven Investment Management LLP	B
Advance by Embark	Sterling ISA Managers Ltd	B+
Aegon Platforms	Aegon Investment Solutions Ltd	B+
	Cofunds Ltd	B+
AJ Bell Investcentre	AJ Bell plc	B+
Alliance Trust Savings	Alliance Trust Savings Ltd	B-
Ascentric	Investment Funds Direct Ltd	B+
Aviva Platform	Aviva Wrap UK Ltd	B+
BNY Mellon | Pershing	Pershing Limited	B
Bravura	Bravura Solutions (UK) Limited	B
Embark Platform	Embark Investment Services Limited	B+
FNZ	FNZ (UK) Ltd	B+
FundsNetwork	Financial Administration Services Ltd	B
GBST	GBST Wealth Management Limited	B
Hargreaves Lansdown	Hargreaves Lansdown Asset Management Ltd	B+
Hubwise	Hubwise Securities Limited	B-
James Hay Partnership	James Hay Wrap Managers Ltd	B
Moventum	Moventum S.C.a.	C
Novia	Novia Financial plc	B
Nucleus	Nucleus Financial Services Ltd	B
Old Mutual Wealth	Old Mutual Wealth Ltd	B+
Parmenion	Parmenion Capital Partners LLP	B
Platform One	Platform One Ltd	D
Praemium	Praemium Administration Limited	C
Raymond James	Raymond James Investment Services Ltd	B
SEI	SEI Investments (Europe) Ltd	B+
Standard Life Elevate	Elevate Portfolio Services Ltd	A
Standard Life Wrap	Standard Life Savings Ltd	A
Transact	Integrated Financial Arrangements Ltd	B+
True Potential	True Potential Investments LLP	B
Wealthtime	Wealthtime Ltd	B-

Source: AKG Rating Portal as at 5 November 2020

THE SPECTRUM OF RATINGS IN THE SECTOR

Platforms are assessed by AKG in relative terms within a specific peer group of platforms.

Given the diverse pool of platform users, a range of differentiated platform businesses have evolved to inhabit the UK market, and there are challenges and opportunities regardless of where platforms operate.

All adviser platforms are aware of the differing types of advisers and clients in the market and, whichever name is used by a platform to describe its adviser/client segmentation model, every platform will have a strategy aligned to service that part of the market in which it hopes to be most successful.

Privately owned platforms have successfully developed specific / niche propositions alongside global financial companies which have developed or acquired their own platforms. There has been vertical expansion and integration in some, where platforms are, in differing degrees, now a core part of the wider proposition.

Differentiation is also seen in the facilitation of, and differing approaches to, white labelling.

From a ratings perspective, the strength of a platform is based upon many factors, and the mix of different platform business types and operating models described above has led to the wide range of platform ratings across the relatively small peer group.

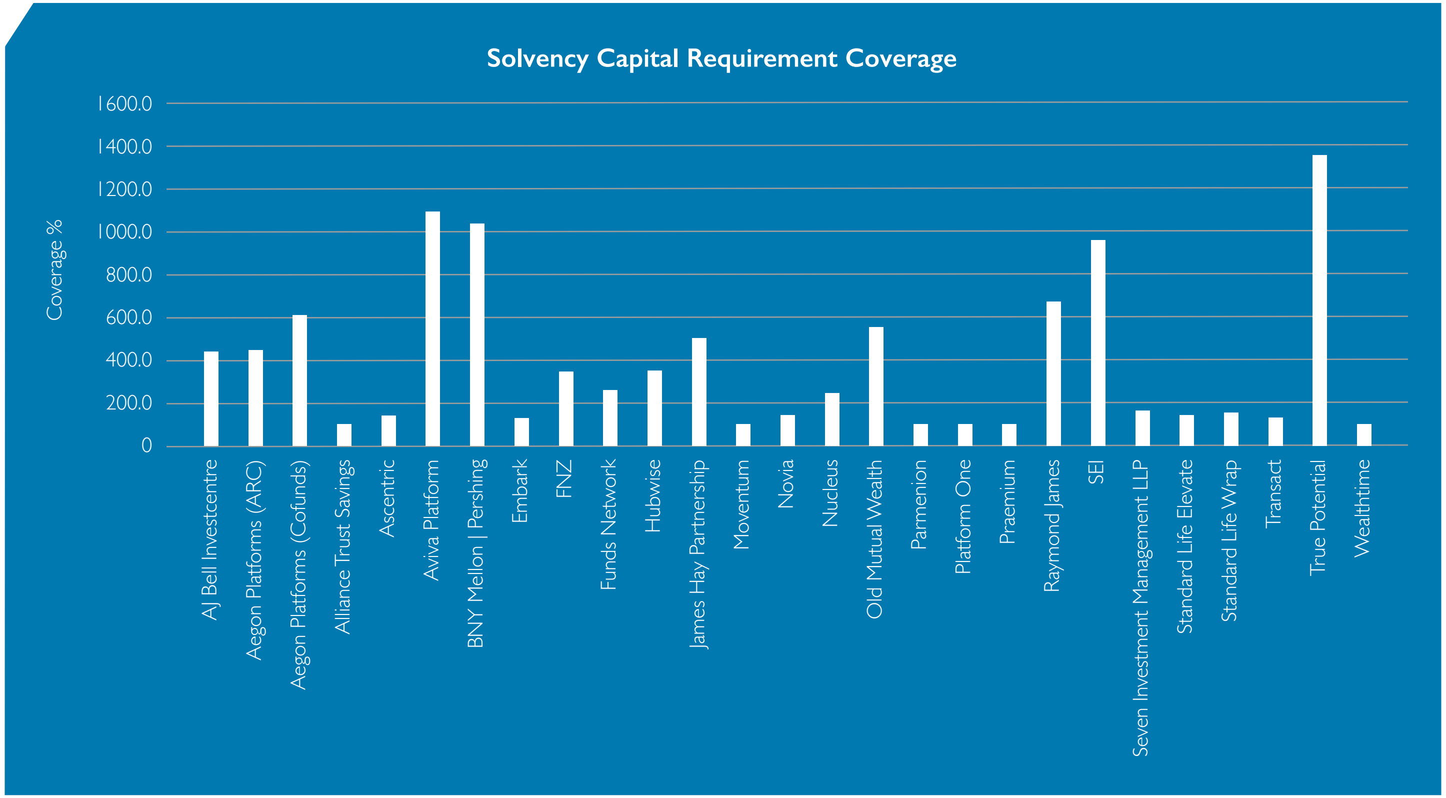
Rating Scale

A	**Superior**
B+	**Very Strong**
B	**Strong**
B-	**Satisfactory**
C	**Weak**
D	**Very Weak**

THE ESSENTIAL DIFFERENCE BETWEEN RATINGS

The rating takes into account many criteria which are seen as relevant to platforms, including: solvency, capital and asset position, expense management and profitability, parental strength (and likely attitude towards supporting the company), operational capability, management strength and capability, strategic position and rationale, strength / depth of contractual agreements, brand and image, investment in the proposition (technology, product, service features), the operating environment and ability to withstand external forces, amongst others.

An individual criterion such as, say Solvency for example, would reflect a wide disparity when looked at across the platforms:



Source: AKG, collated from platform data at latest available year-end financial statements / Pillar 3 Disclosure

AKG considers that no single factor or measure is dominant, and the assessment approach used for all AKG ratings is that of a balanced scorecard, with a combination of criteria assessed. Therefore, there may be no individual criteria which prohibits (or automatically includes) a company from (in) a specific rating category.

Some criteria nonetheless necessarily carry more weighting than others.

For instance, the size of the platform business, in whichever absolute measure is used - AUA, net balance sheet assets or any other such comparable measure - reflects a history and range of underlying factors behind it and as such a large figure cannot be ignored. As such, these larger businesses tend to compare relatively well within the AKG rating scale, tempered of course by underlying trends in asset flows, actual financial / business performance, and other factors.

Parental strength and attitude, understandably, have a considerable influence on the platform entity rating – and this can be negative as well as positive of course, depending on the parent in question. In many cases, the parent company provides key support in terms of funding (capital for investment, liquidity, regulatory requirements) and other resources such as staff or facilities supplied on a managed, rechargeable basis. The continued access to such resources and a group strategy that includes the platform as a key element will be seen as very strong influencers generally.

Within the platform sector, AKG considers the technology underlying the platform service and operational processes, and such relationships are a factor in the rating process. AKG also provides ratings on the underlying technology providers and here that relationship with the client facing platform, and the depth and type of contractual relationship they have, becomes a more significant factor for these technology companies.

The various factors within the balanced business scorecard approach therefore guide the final rating assessment into the categories in the table above. The differences between A, B, C and D ratings for example come down purely to comparisons between the companies within the peer group.

In the context of the peer group, against other platforms, a Superior (A) rated or a Very Strong (B+) rated company will show better metrics – in absolute or trend terms - across a large number of the assessment criteria compared to a B (Strong) business; and a C (Weak) platform would not exhibit the same levels as a B- (Satisfactory) rated platform.

A well-resourced business with a strong proposition and positive service metrics that attracts net asset inflows in its target market(s), backed by a performing, financially strong and supportive parent, will, for instance, fall into the highest rating bands compared to the range of other platforms assessed within the peer group.

ADVISER VIEWS ON DUE DILIGENCE & RESILIENCE

This section outlines AKG's adviser research findings, compiled specifically for this guide, including questions based on what items advisers consider from a due diligence perspective and the factors that would make them switch platform.

QUESTIONS & COMMENTARY

Most important selection criteria when existing platform partner(s) selected

AKG wanted to look back and find out what advisers had taken into consideration at the time when they selected their existing platform partner(s).

For this question respondents were therefore offered a choice of 11 criteria/factors and asked to confirm their top five selection criteria/factors when carrying out selection of their existing platform partner(s).

The level of charges/fees came through first, underlining the fierce price/margin competition in the platform market, with the range of investment options a close second.

Online functionality came third and range of product wrappers and financial strength/sustainability were joint-fourth.

Notably, service levels and operational resilience came just outside of the top five selection criteria.

This may be in part because these items are perhaps harder for advisers to get a handle on when seeking to establish new business relationships. But the findings from this research question hint at the fact that original selection processes have potentially been overly focused on platform proposition-based selection criteria.

"In my role as a due diligence consultant to advisers, I see a wide variety of approaches to assessing platforms. It is interesting that advisers do not rate financial strength as the top consideration when selecting a platform. Maybe they assume that because the platform is an enabler and the assets are ring-fenced if things go wrong, that clients won't directly lose money if a platform fails. However, clients will inevitably panic if they can't view or withdraw their money. Choosing a platform with questionable financial strength is not a client relationship risk that advisers need to face."

Jon Baker, Jon Baker Consulting

What were the most important selection criteria when you selected your existing platform partner(s)?

Level of charges/fees	74%
Range of investment options	71%
Online functionality/tools	59%
Range of product wrappers	53%
Financial strength/sustainability	53%
Service levels	44%
Investment functionality	31%
Operational resilience	26%
Technical support (pensions, tax etc)	22%
Relationship management/onboarding resources	8%
Fixed fees	1%

Respondents were asked to select their top five reasons from this list of options
Source: AKG adviser survey, April/May 2020

Which market development/issues give advisers the most concern?

Through the research we were keen to identify which potential market developments/issues give advisers the greatest cause for concern when considering the operational and financial resilience of their platform partner(s), and their ongoing sustainability.

Given the sheer amount of replatforming exercises that have taken place in recent years, twinned with the fact that many of these have not gone as planned, one might have expected to see advisers expressing their concerns about the impact of such exercises. Somewhat inevitably therefore this came through in first place.

In joint second were two important but contrasting concerns. Clearly given that many client servicing models and capability within adviser firms are underpinned by platforms, complaints from clients linked to the quality and/or timeliness of the service being delivered would give cause for concern. Advisers also expressed concern around the potential impact of a change in the corporate structure and/or ownership at their preferred platform partner.

Some evidently still have an eye on the FCA's platform market review and any associated impact from ensuing regulatory activities.

When considering the operational and financial resilience of your platform partner(s), and their ongoing sustainability, which of the following potential developments/issues give you the greatest cause for concern?

Impact of replatforming exercises	52%
Impact of change in corporate structure and/or ownership	45%
Complaints from clients	45%
Impact of FCA review of platform market	34%
Impact of investment market volatility	27%
Impact of M&A activity	27%
Impact of changes in senior management team	15%
Impact of newcomers in the platform market	10%
Other (please specify)	2%

Respondents were asked to select their top five reasons from this list of options
Source: AKG adviser survey, April/May 2020

Where might impact of deficiencies in operational and financial resilience be felt?

The study wanted to find out at a high-level where advisers envisaged the impact of any deficiencies in operational and financial resilience might be felt. Two-thirds of respondents recognised that matters relating to the ongoing sustainability of their platform partner's operational and financial resilience would likely impact on BOTH their adviser business model AND their client servicing model.

When considering the operational and financial resilience of your platform partner(s), and their ongoing sustainability, do you consider this from the point of view of any associated impact on?

Both your adviser business model and client servicing model	66%
Your client servicing model and capability	27%
Your adviser business model	5%
Neither	1%

Source: AKG adviser survey, April/May 2020

Where might deficiencies be seen, or difficulties experienced?

Given that many adviser relationships with platform partners have been in situ for some time now, AKG was keen to dig deeper to find out which factors, when things weren't perhaps going so well or looking so rosy, might bring on thoughts of switching platform partner.

For this question therefore respondents were asked, should they see any deficiencies in, or experience difficulties with, any of the factors listed (respondents were offered a choice of 11 criteria/factors and asked to confirm their top five reasons) which would cause them most cause for concern and encourage consideration of platform switching.

Level of fees/charges was still at the top but now joined here, as you might expect, by service levels which had risen up the order from criteria used when existing platform(s) was selected.

Financial strength/sustainability, while retaining its positioning in the top five, had also risen up the order from the original question. Operational resilience, while just outside the top five, had also risen in importance but perhaps surprising to still see this lower down the list of considerations.

These findings start to hint at factors which are potentially more mission critical to adviser businesses than some of the more cosmetic criteria which in a heavily intermediated and competitive market one might expect to see readily available from most platform players.

Should you see deficiencies in, or experience difficulties with, any of the factors listed below which would cause you most concern and encourage consideration of platform switching?

Level of charges/fees	66%
Service levels	66%
Financial strength/sustainability	58%
Online functionality/tools	52%
Range of investment options	46%
Operational resilience	42%
Investment functionality	33%
Range of product wrappers	31%
Technical support (pensions, tax etc)	13%
Relationship management/onboarding resources	11%
Fixed fees	2%

Respondents were asked to select their top five reasons from this list of options
Source: AKG adviser survey, April/May 2020

WHAT IS THE FINANCIAL STRENGTH/ SUSTAINABILITY ASSESSMENT PROCESS DESIGNED TO APPRAISE?

RATING SECTOR ORIGIN AND EVOLUTION

Prior to the introduction of Platforms AKG's focus had been predominantly on life companies. However, in light of the growing impact of platforms and the transformation that this brought to the financial services market in the UK, there was an increasing demand from intermediaries in particular to widen the scope of entities. Fast forward and AKG's platform sector will be 10 years old in December 2020.

AKG believes that one of the major considerations for an intermediary in considering a platform is the comfort and assurance that can be obtained from an independent, external assessment.

OPERATIONAL FINANCIAL STRENGTH AND THE ADVISER/CUSTOMER FOCUS

AKG's approach to and definition of financial strength is to consider a company's strength to sustain an operation and continue to meet the needs of customers and their advisers.

This is fundamentally different to other ratings and assessments, such as credit ratings, designed to satisfy market investors. The strength and sustainability interests of market investors and customers are different and may even be at odds.

So, ensuring a customer-oriented focus to financial strength is key and sustainability revolves around a company's ability to maintain operational capability to meet the needs of customers. Expectations include the ongoing delivery of appropriate operational service. Hence a company needs strength and sustainability to do this, meeting various challenges over time.

BEYOND JUST SOLVENCY OR RETURN OF MONEY TO CUSTOMERS?

There are a couple of common, but understandable misconceptions associated with financial strength assessment.

Firstly, that financial strength is purely about solvency. It is not. Whilst solvency will always be important and a factor in financial strength assessment, it is not the whole picture.

The definition of customer oriented and operational financial strength is useful here and at AKG we believe that a financial strength assessment should include the following objective definition:

...to go beyond purely a consideration of solvency (albeit this will always be an important part of the mix) and consider in what format an organisation may be able to survive to meet the reasonable expectations of customers and their advisers. Expectations, which must include the experience encountered by these two groups, will therefore include ongoing operational abilities and performance.

This definition is then also relevant to the misconception of believing that financial strength is just about the recovery of client assets. Recovery of assets is of course crucial, but to restrict financial strength consideration to this could be misleading and falls below the requirement to deliver a broader set of customer outcomes. Many businesses such as platforms, DFMs, asset managers, or even financial advisers can sometimes make this mistake. Thinking that, 'well, the assets sit with a custodian, or there is a policyholder protection scheme which will kick in, and so my financial strength won't matter'.

Is that good enough? Effectively saying that if that part of the customer value chain, somehow fails or is impaired, there will be no change in customer experience.

Unfortunately, that simply is not the case. The route to asset recovery or protection funds/ compensation is not the experience the customer reasonably expected when they signed up. And the uncertainty, delay and distress cannot be so easily dismissed.

OUTLINE OF AKG'S BALANCED SCORECARD APPROACH TO ASSESSMENT

Financial Strength ratings communicate AKG's customer orientated assessment of a company's ability to maintain operational capability to meet the needs of customers. These ratings are specifically designed for use by advisers, working on behalf of these customers, their clients.

It is solely this customer perspective, reflected in AKG's rating approach, which is relevant for adviser due diligence and selection activity to deliver the required customer outcome perspective. The assessment approach used for all AKG ratings is that of a balanced scorecard, with a combination of criteria assessed and no single factor or measure being dominant.

The assessment and rating take into account those of the following criteria which are most relevant:

- capital and asset position
- expense position and profitability
- structure (and size) of funds within the company
- parental strength (and likely attitude towards supporting the company)
- operational capability, management strength and capability
- strategic position and rationale
- brand and image
- typical fund performance achievements or product / service features
- its operating environment and ability to withstand external forces

At a high-level and using the AKG assessment report structure as a guide these criteria combine to consider attributes in four overarching areas:

- Capital
- Strategy
- Administration
- Risk & Governance

> *"To me, financial strength can be seen as a proxy for the overall health of a platform. It is crucial that the platform provider has the ability to readily invest in and continually improve functionality, user experience and security. If a provider cannot regularly upgrade the platform, which can cost many millions of pounds per year, then there is a risk to the resilience and sustainability of that platform."*
>
> **Jon Baker, Jon Baker Consulting**

ROLE OF PLATFORM DUE DILIGENCE

THE REQUIREMENT FOR, AND BENEFITS OF, DUE DILIGENCE

It is in the best interests of adviser businesses to carry out robust, repeatable, and recordable research and due diligence exercises when selecting partners for their business, including platform operators. These exercises should be done to facilitate best practice within the adviser business and, crucially, to support the delivery of good customer outcomes. Furthermore, the regulator remains keen to see evidence of deeper and more engaged due diligence being carried out by advisers.

In a market which continues to experience great change and challenge, due diligence continues to increase in importance and is something which, in an ideal world, needs to be done when first identifying and selecting partners, and then revisited on a regular basis.

PLATFORM FIT – A BALANCING ACT

Most things in life are about striking the right balance and, at a high level, finding the right platform fit is also a balancing act, where the aim is to identify and corroborate a choice of platforms which can:

1. Support the delivery of customer services proposition and optimise customer outcomes (across different customer segments/types where relevant).

2. Work in collaboration with your adviser business, its staff, technology, structure, and processes.

PLATFORM AGILITY

Because of the various challenges, platform operators need to illustrate agility in their business and in their proposition, including the technology/digital component. This is not necessarily all about size and resource, although capital reserves and ongoing investment will inevitably be required. But displaying an ability to respond to market changes and developments while keeping abreast of evolving adviser and customer requirements is key. Platform survival is a marathon, not a sprint, although with various obstacles to success in place, perhaps steeplechase could even be more appropriate!

REASONS TO REVIEW

It would be fair to say that there has been plenty of water under the proverbial bridge since adviser businesses first started to utilise investment platforms in the UK. And hence relationships with one, or several, platform operators will most likely already be in place.

But the requirement to carry out comprehensive research and due diligence exercises to support platform partner selection and/or retention remains. And hence there is likely to be an element of reflection when carrying out ongoing review work which accommodates the sentiment of the adviser business towards the proposition, service etc. being delivered by existing platform partners.

Similarly, some beliefs and approaches within the adviser business might have changed in this intervening period, for example the composition and delivery of investment proposition for customers. Ensuring the fit of existing and/or new platforms in terms of determining their ability to service this investment proposition may therefore be relevant.

STAYING ON THE FRONT FOOT

By adopting robust due diligence processes, adviser businesses will put themselves on the front foot with regards to establishing and sustaining winning relationships with platform operators, delivering positive customer outcomes and being able to better respond to change and challenge.

> *"Platforms are a crucial component in many adviser businesses, and changing platforms and migrating assets can be expensive and time-consuming. Inertia and familiarity also play a part. However, it is like your home insurance, the insurer, policy conditions and premium may have been right last year, but it doesn't necessarily follow it will this year. Ongoing due diligence is essential."*
>
> **Jon Baker, Jon Baker Consulting**

APPROACHES FOR ADVISERS CONDUCTING DUE DILIGENCE AND ASSESSING FINANCIAL STRENGTH

Here we outline four suggested approaches and elements that adviser firms might wish to use to support their due diligence and assessment exercises, whether these be done in-house and/or with the support of third-party resources.

FRAMEWORK

We start by providing a suggested overarching framework for intermediary firms from which to build out due diligence exercises, looking at three core components – **Proposition; Operational; Strength and Sustainability** - and present example items within each, which should represent key due diligence areas for consideration when selecting and re-appraising platform partners.

Proposition

- The right blend of products, tax wrappers and investment options to meet adviser business and customer segment requirements.
- A charging structure which can dovetail with the adviser business's customer charging framework.
- Tools and services which can support the delivery of advice and wealth management servicing.

Operational

- Strong risk and governance culture with associated structure and processes in place.
- Safe custody of customer assets and customer data security.
- Functional interaction with external third parties, including adviser back office systems, asset managers and DFMs.
- Reliable and timely delivery of helpful online and offline adviser/customer tools and services.

Strength and Sustainability

- Ability to invest in continued platform improvements, including infrastructure and technology.
- Strong and resilient key business performance indicators.
- Brand and distribution reach/traction.
- Clear business growth and development strategy in place, short and longer term.
- Well blended Senior Management Team with grasp of regulatory and legislative direction of travel.

CONSIDERING ONGOING FACTORS AND PARAMETERS

Ongoing assessment - Indicative list of potential factors relating to a Platform

Here is a list of some factors which might be considered by adviser firms when seeking to assess/consider key platform business performance indicators, categorised for example purposes as Business Assessment, Financial Assessment and Sustainability Assessment. Again, this type of exercise may be something that the adviser business elects to carry out in-house and/or with the support of specialist third party resources.

Business Assessment	Financial Assessment	Sustainability Assessment
• Industry Ranking/Market Share • Industry & Geographic Trends • Mergers and Acquisitions • Business Strategy • Management Strength • Macroeconomic Risks • Geopolitical Risks • Regulation • Revenue Diversification – Group Companies/ Contagion Risks • Supply Side Constraints	• Revenue Growth • Profitability • Turnover Ratios • Management Efficiency Ratios • Cost Structure • Liquidity Position • Operating Leverage • Cash Flow Analysis • Platform Space/Sector failure on replatforming • Solvency • Brexit impact	• Environmental Performance • Employee Knowledge / Training/Skills • Supply Chain Management – Outsourced IT functions • Customer Engagement • CSR • Ethical Conduct • Corporate Governance • Information Security • Any Parent Company Commitment questions • Business Continuity Plan

Ongoing monitoring - Indicative list of parameters to monitored

Whilst key business performance indicators might be monitored on an ongoing basis, it would also be useful for the adviser firm to consider some parameters which might be applied for the ongoing monitoring of a platform's fortunes. Here are some examples of factors which might be considered for ongoing monitoring from a provider specific angle and from a broader platform sector specific angle. Again, this type of exercise may be something that the adviser business elects to carry out in-house and/or with the support of specialist third party resources.

Platform Provider Monitoring	Platform Sector Monitoring
• Financial Penalties • Mergers & Acquisitions • Information security breach • Change in financial strength rating • Strategic Announcements • Client Wins/Losses • Management change • Growth/ Expansion Plans • Product/ IT – Platform Service Upgrades • Litigations and Lawsuits • Awards and Recognition	• Industry Trends • Regulatory Updates • Competitor Strategy • Market Growth • Technological Developments • Commentator and Analyst Opinion • New offerings by Key Players

THE FACTORS AND PLATFORM BUSINESS MODEL TYPES WHICH MIGHT PROVIDE ELEMENTS OF COMFORT OR CONCERN

A spectrum of factors, each of which tends to have a gradation and each of which may represent positive or negative aspects and for which a platform business may typically display a combination. These might include:

Management

TIGHT — BROAD

Smaller businesses might characteristically have smaller, tight management structures with a specific individual or a few individuals with significant experience, whereas larger groups will have often wide-ranging management structures, a combination of experience and access to wider pools of talent. The ability to recruit and restructure may also be different.

Scale

SMALL — LARGE

Scale can have a number of relevant aspects. Cost efficiencies of greater scale, flexibility at smaller scale.

Access to Capital

RESTRICTED — DEEP

Access to capital to deliver planned development activities but also react in timely way to change required either quickly, and/or unexpectedly, by market pressures and changes, can be a major strength and conversely a challenge.

Disclosure & Transparency

PRIVATE — CORPORATE

There will be differences in the disclosures required and also the voluntary levels of transparency by different business. A lack of transparency either through what is not required or volunteered, whilst it might not obscure any issues, will necessarily be a cause of caution.

System Architecture

NEWER — OLDER

'Future-Proofing' has been a much talked about objective in recent years and whilst this must be understood as impossible to ever be absolute, it is a key consideration given a landscape of multiple and interacting change factors. These include customer behavioural and regulatory for example and there is a clear need for any platform business to be able to accommodate the needs of such change within its technology architecture or to swiftly adjust to such.

LOOKING OUT FOR WARNING SIGNS

Importance of operational strength and sustainability

So, we can see through the adviser research exercise, with the findings shown earlier that financial strength matters to advisers and that it is likely to increase in importance where deficiencies or difficulties are sensed.

Back to AKG's overarching raison d'etre to consideration of financial strength in that:

From the customer perspective, the financial strength of companies needs to be focused at an operational level, specifically on the company that is effecting the product or service that a customer is selecting. This is important, because from the customer's perspective it is that company (not some higher corporate entity) that needs to survive in a form that maintains the requisite operational characteristics to meet their fairly held requirements. And it is thus at this level that the selection needs of the customers' advisers must be met.

Explore pressures and where things might have gone wrong

Clearly a quick and catastrophic collapse of a financial services company would lead to immediate impacts on advisers and customers experience of engaging with the products and services of the embattled company. This may in turn lead to drawn out compensation claims via engagement with the appointed administrators and/or the Financial Services Compensation Scheme (FSCS).

Fortunately, this worst-case scenario is a relatively rare occurrence in the UK financial services market, but examples have been seen in recent years including SIPP operators and DFMs.

Ultimately where a business might be experiencing challenges with its financial strength and sustainability and/or operational capability and resilience this might be seen in a variety of warning signs, some of which might include the following:

- Lack of transparency in reporting of key financial data/metrics
- Indifferent performance against key financial data/metrics
- Parental indifference to operational subsidiary
- Lack of access to development capital
- Inability to raise investment funds
- Operational cost cutting which might include organisational restructuring, office closure or staff redundancies
- Abrupt changes in strategic direction or corporate restructuring
- Raft of senior management departures
- Inability to complete operational or strategic development projects
- Operational systems and/or servicing difficulties
- Sluggish response to key regulatory changes
- Subject of specific, individual regulatory scrutiny and/or fines

While not necessarily in isolation (more likely in combination) these might cause concerns.

AVALON CASE STUDY

The failure of Avalon provides a particularly good case study to articulate in this guide, giving life to the key point that without depth of resource and resilience, unexpected issues can dramatically impact on platform sustainability and hence adviser and client experience and create significant anxieties.

BACKGROUND

The Avalon platform was provided by Avalon Investment Services Ltd (AIS), a UK based company held in private ownership, authorised, and regulated by the FCA. AIS was founded by Harry Kerr in 1999 and in total there were around 20 individual private shareholders.

Little was known of the ability of the shareholders to provide additional capital to fund losses or development costs. The company had posted improving profit levels over the few years prior to its failure, but the balance sheet was always fairly minimal in comparison to the majority of platform peers.

AIS was also never the most transparent of platform operations in terms of information on its financial performance or operating progress and Pillar 3 capital information was not readily disclosed.

The principal activity of the company was as an administrator of investment products. It was a small operation, with average numbers of employees between 2014 and 2016 being in the 20s.

As at 18 June 2015, Avalon claimed to support around 46,500 clients, with £300m AuA. The clients' average portfolio size was stated as being around £60k in 2016.

Avalon Investment Services entered administration in February 2016 after it lost a civil claim, related to Harry Kerr (who was subsequently bankrupted and faced fraud charges), but also brought against it, by an individual businessman, Michael Bennett and the decision cost the company £2m. Avalon lacked the resources to absorb this claim and resultant regulatory intervention meant the closure of the platform and the business being placed in administration. It remained closed and crucially was inaccessible to advisers and clients for a period, with a significant degree of uncertainty created as to potential length of closure, outcomes, and future access to assets, until its purchase out of administration.

KEY LESSONS

- The question of maintaining the experience for customers and advisers is very much shown as not an academic point.
- The effects of failure or impairment, as shown in the case of Avalon, are very real in terms of the removal of operational capability of a business to meet basic and reasonably held ongoing customer and adviser needs. And what if ring-fencing doesn't play out in as full, or as timely a fashion as expected. In the absence of an acquisition, and with administrators in situ, what anxiety may still remain over asset safety and access?
- Similarly, the anxiety caused by failure of a platform, even if the 'closure' is for a limited period, cannot be underestimated.
- Any sustained period where a customer or their adviser cannot access the platform and thus their investments is a major concern.
- This is made particularly worse by the need for advisers to communicate (and potentially reassure clients) at a time when they are unlikely to have all the answers. Not least because the situation is likely to be changing rapidly and given that multiple parties, including potentially a regulator and administrator, could be involved. Also, the adviser may themselves, because of the platform's closure, be increasingly considered in the same light and/or with suspicion. The relationship management skills of the adviser and closeness of relationship between client and adviser in this and the ability of the adviser to navigate such a problematic time cannot be understated.
- During the failure or impairment of a platform partner, advisers may be relatively powerless to influence the direction of developments, such as a rescue purchase. However, this does not mean that significant extra work will not be required. Not least in trying to establish what is happening. This will include liaison with the different parties involved, perhaps the regulator directly and potentially an administrator. They will also be working rapidly, so options and as a result, messages, may change day to day or party to party. And then the need to manage messages out, to staff and other parties, and particularly to clients could become a full-time job at a very senior level, within an affected advisory business

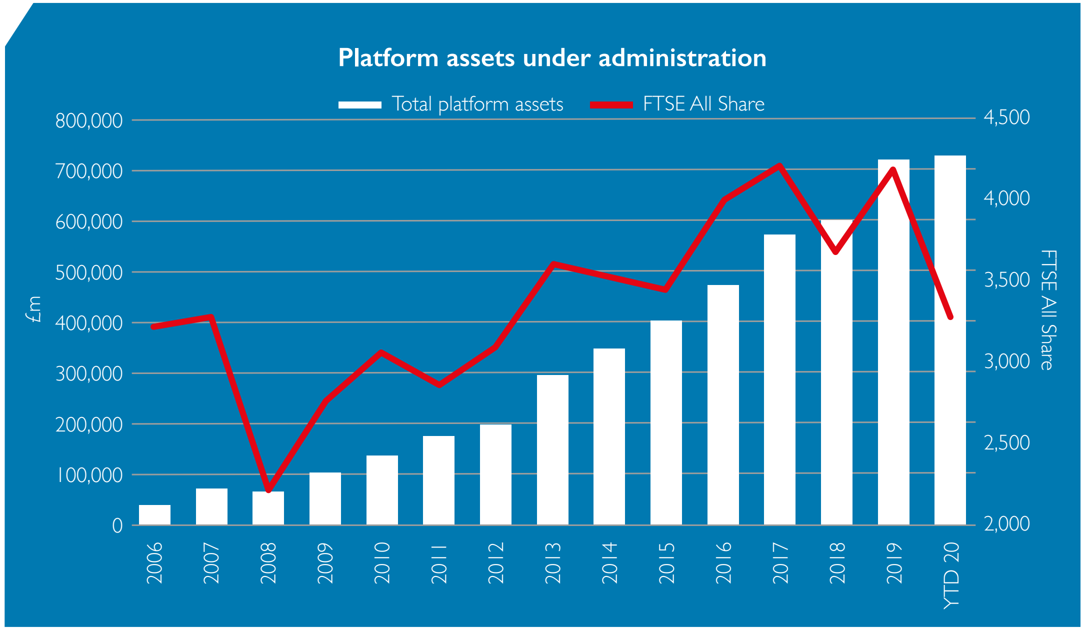
STATE OF THE PLATFORM NATION - MARKET DATA AND COMMENTARY

For those readers keen to get a potted history of the UK platform market from an asset flow perspective we have provided here, sourced from Fundscape, some illustrations of platform flows and assets under management on an annual basis running from 2006 to 2020.

Platforms have clearly been challenged from an operational perspective due to the impact of COVID-19 during the year. It is therefore interesting to see how 2020 YTD flows are holding/shaping up, in comparison to previous years, and then to consider what the flow prospects might look like for the latter part of the year and beyond.

PLATFORM ASSETS UNDER ADMINISTRATION

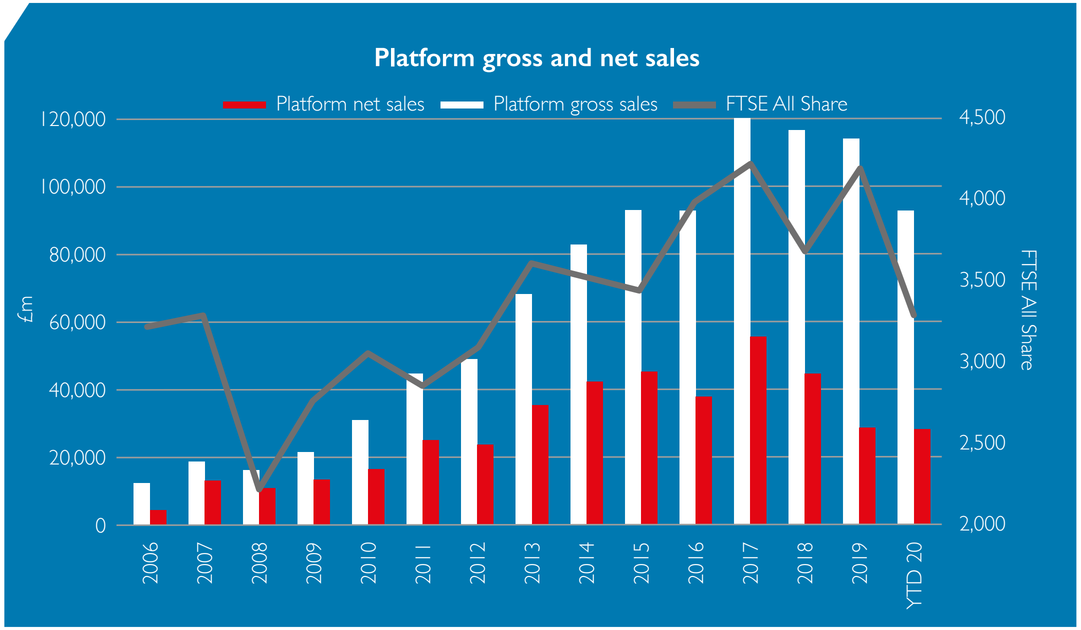
2020 figures provided by Fundscape are assets under administration up to Q3 2020.



Source: Fundscape, October 2020

PLATFORM GROSS AND NET SALES

2020 figures provided by Fundscape are YTD flows up to and including Q3 2020.



Source: Fundscape, October 2020

IMPACT OF FACTORS SUCH AS MARKET VOLATILITY, THE SLOWDOWN IN DEFINED BENEFIT TRANSFERS AND THE MACRO-ECONOMIC ENVIRONMENT ON CURRENT PLATFORM PROVIDERS

As previously referenced AKG has been assessing the platform market for 10 years and during this time has seen platform providers deal with a huge range of challenges, some related to the performance of financial markets, to competition and margin pressures, through to individual strategic group and platform operational requirements. However, it could easily be argued that the current business environment is more challenging than at any point in the last ten years.

As Fundscape's Bella Caridade-Ferreira outlines in the next section, fierce competition, the slowdown of defined benefit transfers, and the still unknown extent of the economic fallout of COVID-19, plus Brexit fall-out, it's clear that platforms have their work cut out to grow and be profitable.

There's a significant likelihood that platforms will struggle to hit the kind of growth levels they have experienced in recent years and as the Fundscape analysis in the next section shows, this could be a longer-term trend which lasts well beyond 2020.

Each platform sits in its own specific set of circumstances and AKG's rating reflects a view on how well those circumstances position them in a way that they would be able to respond to challenges which might impact negatively on them – be that in financial, operational or service terms.

Those platforms at the weaker end of the rating spectrum will likely find such challenges more difficult to overcome and therefore are at higher risk of suffering in the face of difficult circumstances, related to the sector or experienced by the platform directly.

The ratings are compiled on a balanced business scorecard basis and as such there is not usually one particular element that has a more significant effect than all the others combined.

However, some events, for instance a big market contraction or much lowered overall growth expectation will be felt by all platforms; but are likely impact more on those platforms rated at a lower level. The impact of such pressures will potentially lead to more significant issues for those platforms less well equipped to respond.

Platform asset trends in 2020

Fundscape reported the following in respect of 2020 asset growth.

	Q419	Q220	Q320	Q320 Grth £m	Q320 Grth %	YTD Grth £m	YTD Grth %
Aegon[1]	145,763.8	142,660.6	144,338.0	1,677.4	1.2	-1,425.8	-1.0
HL[2]	103,734.0	101,774.0	104,600.0	2,800.0	2.8	866.0	0.8
Fidelity	92,657.3	91,184.6	92,261.0	1,076.4	1.2	-396.3	-0.4
Standard Life[3]	62,561.3	61,166.2	63,050.0	1,883.8	3.1	488.7	0.8
Quilter Wealth	58,557.2	57,460.4	58,933.7	1,473.3	2.6	376.5	0.6
AJ Bell	47,200.0	47,700.0	49,700.0	2,000.0	4.2	2,500.0	5.3
Transact	39,312.0	39,711.0	41,093.0	1,382.0	3.5	1,781.0	4.5
Aviva	29,084.7	30,181.3	31,353.0	1,171.7	3.9	2,268.3	7.8
James Hay	27,587.2	26,354.0	26,932.7	578.7	2.2	-654.5	-2.4
Nucleus	16,141.3	15,824.6	16,103.2	278.6	1.8	-38.1	-0.2
ATS[4]	16,207.8	15,707.0	16,030.0	323.0	2.1	-177.8	-1.1
Ascentric	16,100.0	15,472.5	15,617.7	145.2	0.9	-482.3	-3.0
Advance[5]	15,575.0	15,578.0	16,103.3	525.3	3.4	528.3	3.4
TPI	10,442.3	11,216.2	12,071.7	855.5	7.6	1,629.4	15.6
7im	10,705.6	10,747.9	11,024.4	276.5	2.6	318.8	3.0
Parmenion[6]	6,960.3	7,296.6	7,535.4	238.8	3.3	575.1	8.3
Praemium[6]	1,680.5	1,802.1	1,918.9	116.8	6.5	238.4	14.2
Next three[7]	19,995.0	20,570.0	21,550.0	955.0	4.6	1,555.0	7.8
Total	**720,265.3**	**712,406.9**	**730,216.0**	**17,809.1**	**2.5**	**9,950.7**	**1.4**

Source: Fundscape as at October 2020

1 Aegon ARC and Aegon Platform (ex-Cofunds business) now reported together.
2 Hargreaves Lansdown reports in arrears. Assets are actual but sales are estimated for Q320.
3 Includes Elevate but excludes Parmenion. Standard Life publishes its results every six months so figures are estimated.
4 ATS figures estimated for Q320.
5 Advance formerly known as Zurich Intermediary Platform. The acquisition was completed on 1st May 2020. Includes Embark figures too.
6 Parmenion and Praemium added from Q419.
7 Hubwise, Novia and Raymond James.

FUNDSCAPE PLATFORM PROJECTIONS

In terms of flow projections, given fierce ongoing competition for business in the platform sector and ongoing regulatory review, further headwinds will likely be experienced by platform operators. This will be exacerbated should the investment markets experience consistently volatile behaviour moving forward and/or the impact of a post-COVID-19 recessionary economy be seen.

Fundscape has provided some asset growth projections to inform the discussion/debate.

Fundscape Platform Projections, £m

	2019 (actual)	Q320 (actual)	2020	2021	2022	2023	2024	2025	Growth rate
Pessimistic	720,265	730,216	730,000	788,400	851,472	919,590	993,157	1,072,609	8%
Realistic	720,265	730,216	750,000	851,200	953,344	1,067,745	1,195,875	1,339,380	12%
Optimistic	720,265	730,216	800,000	944,000	1,113,920	1,314,426	1,551,022	1,830,206	18%

Source: Fundscape, October 2020

THE NEXT FIVE YEARS – FUNDSCAPE PREDICTIONS

Forecasts are all the more hazardous as we adapt to a new life under a COVID-19 pandemic and the unknown economic implications. The situation will be compounded by the UK's seemingly inevitable exit from the EU without a deal. But regardless of these issues, people still need to save and prepare for the future.

Pension freedoms generated a steady stream of defined benefit transfer business for platforms until early 2019. Low-hanging fruit has been caught and transferred, but the prohibitive cost of PI insurance and the FCA's regulatory focus have also acted as a major deterrent for advisers and the pipeline has slowed to a trickle.

Nonetheless, there is a significant stream of household assets waiting to be mined over the next 20 to 30 years. Household wealth stood at £6.7trn at end 2018 with just £601bn on platform. The proportion of wealth in cash and deposits rose to 25% (£1.7trn), and technical reserves and assets in pension schemes had shrunk slightly but represented a significant 55% (£3.7trn) of household financial wealth. The bulk of these pension assets and reserves is in the hands of people in their 50s and above, so there will be a steady stream of pension assets coming on platform over the mid to the long term.

In the short term, environmental factors are likely to weigh on the industry. The Brexit question affected sentiment in 2019 and investors sat on the sidelines. The decisive election result in December 2019 unlocked that money and led to substantial flows in the first two months of 2020 — gross sales hit a record high of £36bn in Q1 — before the virus hit home.

Re-set ISA and pension allowances helped to generate new business in Q1 and early Q2. Quarterly flows remained buoyant, but as the second quarter unfolded new money was harder to come by and lockdown made it difficult to find new clients. The third quarter lived up to our fears and business was flatter than it had been in many years.

Pessimistic scenario

Historical analysis shows that even during difficult periods, industry assets continue to grow at a modest rate. Our pessimistic scenario assumes a forward growth rate of just 8%, putting assets on course for £1trn by 2025. In this scenario, a long recession is likely with economic recovery slow and sluggish. The government's response to the pandemic will leave the Bank of England little room for manoeuvre.

The outlook for platforms could be eased by the steady trickle of pension business and the precautionary motive to save and invest. However, higher interest rates and economic uncertainty could keep investors away from investments. Interest rate rises would also put pressure on disposable household income and depress savings levels. Platform activity will be subdued.

Realistic scenario

The realistic scenario assumes a forward growth rate of 12% taking assets to £1.3trn by 2025. This figure may seem high, but experience shows us that even in the worst market conditions, after the initial shock assets resume growth at a modest rate. This scenario assumes that the economy experiences a mainly v-shaped recovery although in some sectors, like aviation, it will be u-shaped.

Optimistic scenario

In the optimistic scenario, assets will grow at around 18% to reach £1.8trn by 2025. For an optimistic scenario, this growth rate is unusually low, but given the unprecedented pandemic situation a conservative approach is best. In this scenario, the UK has come through the pandemic with modest economic growth and has also successfully concluded Brexit negotiations. The fallout from Brexit will have a more moderate impact on the economy, although an undercurrent of geopolitical risk will be ever present.

Bella Caridade-Ferreira, Chief Executive Officer of Fundscape

KEY POINTS

- Platform strength can at times still be an under-considered factor in adviser due diligence
- Financial strength is not a hypothetical risk
- Due diligence is an ongoing process and requires regular consideration
- There are core approaches and key elements that advisers should have in mind when preparing a framework to conduct due diligence
- The outlook within the sector has more challenges than it has for some time

"A key point of this guide is that financial strength is not a hypothetical risk. Given the stresses and strains on platform providers caused by COVID-19, that point cannot be emphasised strongly enough."

Jon Baker, Jon Baker Consulting

AKG Financial Analytics Ltd
Anderton House, 92 South Street
Dorking, Surrey RH4 2EW

+44 (0)1306 876439
akg@akg.co.uk
www.akg.co.uk

AKG is an independent organisation specialising in the provision of assessment, ratings, information and consultancy to the financial services industry

ISSUED 19 November 2020

IN ASSOCIATION WITH: