

Make sure you're getting value from your licensee

DO THE SUMS ON YOUR DEALER

Traditional revenue sources for licensees, such as volume bonuses and shelf-space fees, will dry up as the planning industry moves towards fee-for-service. In this climate, groups may lift the fees they charge their advisers, and the focus will be on value for money, Leng Yeow reports.

Financial planning businesses can pay hundreds of thousands of dollars in dealer fees or splits in exchange for benefits such as research, software, training and a slice of product rebates. But with the regulators threatening to ban rebates and the onus increasingly falling on financial planners to conduct their own research and due diligence on products, more principals are questioning the value dealer groups add for the price they command.

President of the Boutique Financial Planning Principals Group Claude Santucci says a crackdown on rebates – and other product-based profit and equity sharing schemes – will make it harder and harder for dealer groups to deliver top-class services profitably, ultimately pushing dealer fees up and leading large businesses to gain their own licence.

BFPPG members each hold their own Australian Financial Services licence; manage their own licensing and compliance requirements and costs; and leverage off the buying power of the BFPPG to attain services including research and software.

"Our members clearly don't see the value in belonging to a dealer group, and that's not to say that some don't add value because at some stage almost all our members used to be part of a dealer, but they've outgrown that proposition," Santucci says.

"Eventually all of the 80 firms in the association came to the same conclusion, and chose to get their own licence, manage their expenses and compliance, and be masters of their destiny."

Santucci himself started his financial planning career at Pembroke Financial Planners in 1987, before joining Buck Consultants and later setting up HN Financial Partners, in 2000, under its own licence. He recently retired as a director of HN Financial Partners.

He acknowledges that joining a dealer group makes sense for some, such as newcomers to financial planning, but once a business reaches a certain level of maturity, builds a strong client base, and recognises the importance of unbiased, conflict-free advice, the case for venturing out alone becomes undeniable.

"I was part of a dealer group for many years and I didn't get a lot of value from that relationship for the money I was paying," he says. "As is often the case in dealer groups, the large practices that are successful and write a lot of business are subsidising a long tail of small, unproductive practices."

"And because it costs money for dealer groups to support all their planners, including the poor performers, they need to come up with ways to make money and that looks like partnerships with product manufacturers in order to get a cut of profits and sales. The pressure on dealer groups to make money sees them conflicted and the institutional dealers are all about product distribution, not quality advice."

Peter Townsend, principal of Townsends Business & Corporate Lawyers, says financial planners should regularly assess the value their dealer group provides.

"Considering the relative ease with which people can get their own licence, and the growing desire of a lot of players to gain their independence, it make sense that financial planners regularly question the value of their dealer group," he says.

"Those who have been in the game for a long time, and have built a good personal brand, will be assessing the costs of going out alone. That's not to say they will all come to the same conclusion, but there will be more asking serious questions in the future."

Ian Knox, managing director of Paragem Partners, agrees that there will be far more questions. "Large practices, in the last three years, have been demanding a higher percentage of rebates, but if that disappears and fund managers and platforms stop paying shelf space and rebates to licensees then those businesses will leave," he says.

"It's ironic that dealer groups are supposed to help their advisers develop their

value proposition to clients, and build sustainable profitable business models, yet many dealer groups would collapse without rebates.

"The big institutional groups boast about the strength of their offerings yet each time a practice threatens to go, they either promise larger rebates and margin splits, remind a practice about their BOLR [buyer of last resort] scheme, or lay claim to the planner's underlying client base. That's a questionable proposition."

Knox predicts that dealer fees will rise because licensees can't count on ongoing revenue from rebates and product margins.

He notes some groups are passing on a greater share of rebates to underlying member firms not as a sign of their generosity but rather it is an indication that they think rebates will disappear or at least shrink dramatically.

"They're attempting to shift the uncertainty to their practices, and the only certainty that principals will have after that is higher dealer fees," Knox says.

He describes the role of a dealer group as being to provide "a uniformity of procedures, systemised processes, compliance and training, and tools like SOA [statement of advice] templates".

In addition to compliance, rebates and revenue sharing, Townsend cites research as a fundamental service that dealer groups provide, but recent legal action and rulings, such as the 2008 case of *Delmenico v Brannelly & Anor* and the Financial Ombudsman Service's June 2009 ruling in Determination 18959, prove financial planners cannot out-source responsibility for research, asset allocation and fund manager selection to their dealer group, or rely on the recommendations and ratings of external research houses.

In the FOS determination, a financial planner who recommended failed hedge fund manager Basis Capital, based on research generated by an external ratings agency and endorsed by his dealer group, was ordered to reimburse a former client \$103,382 plus interest (the maximum compensation possible under FOS).

The ruling reinforced that under the Corporations Act, planners must "know their client and know their product", and shows that planners must undertake their own due diligence on products before recommending them to clients, or risk being liable should the client suffer a loss in the future.

"Dealer groups often just pass on research from external ratings houses, and construct an approved product list based on that information, so if a planner can access that information direct at the same cost, given legally there's no added layer of protection by adhering to a licensee's APL, as the Basis Capital case demonstrated, then is there value paying a dealer group?" Townsend says.

"If the planner is liable in any case, but pays a dealer group for research and PI [professional indemnity] insurance, they need to think about whether they can get insurance and research more cheaply."

One of the most important ways dealer groups can add value is by helping planners keep abreast of changes to the law and their legal obligations, says Peter Bobbin, lawyer at the Argyle Partnership.

This will be particularly crucial next year as the federal Treasury plans to release its draft Future of Financial Advice (FOFA) reforms mid-year, and introduce changes by July 1, 2012.

"Advisers are going to need a lot of guidance interpreting the law and how it should be administered and that, alongside a solid approved product list and robust, well-structured financial planning process, are things dealer groups must deliver, otherwise it does beg the question, what are they doing?" Bobbin says.

**Greg Miller, MLC
Advice Solutions:
Where dealer groups
can really help their
advisers is in running
a small business.
MLC has an army of
practice development
managers to support
its network.**



"FOFA will be the big issue in 2011 and planners are going to need guidance and leadership. Treasury is ramping up its industry consultation around FOFA, and it's a long way from finalised. Exactly what does it mean to be a fiduciary for tied and aligned planners, and is this possible for planners that have a limited APL or authority? These are issues that must be addressed because FOFA is the biggest shake-up facing this industry since FSRA [Financial Services Reform Act]."

NAB/MLC took a leadership stance in 2006 when it began phasing out commissions and platform rebates, and mandated a fee-based model across its aligned channels including Apogee, Garvan, Godfrey Pembroke and MLC Financial Planning. MLC's decision made it extremely unpopular at the time but arguably sees MLC better positioned than its peers to comply under the FOFA rules.

Greg Miller, general manager of MLC Advice Solutions, says leadership requires the courage to act in the best long-term interests of clients and advisers, and not be influenced by needless complaints and short-term noise.



MICHEL O'SULLIVAN

He says some of the most valuable services MLC has delivered to its planners in the past three years include help developing and articulating their value proposition as part of the transition to fees; and the skills and tools needed to run a successful small business.

Miller says services such as research, technical training and support, compliance, and software are key ingredients in a dealer's proposition but they are "commodities", more or less. "Any reasonable licensee should be doing all that stuff, but where dealer groups can really help their advisers is with running a small business," he says.

"Running a financial planning business can be a lonely and difficult journey, especially for people in regional areas, and having someone to talk to, bounce ideas off, is crucial. Even if it is just a PDM [practice development manager] listening to your ideas, that's invaluable to a small technician."

MLC employs an army of PDMs to support its network. There's about one for every 20 MLC-aligned practices, and each practice gets a visit from their PDM at least once a month.

During the stress of the global financial crisis, this contact was extremely important, Miller says.

Next year, MLC will focus on helping advisers develop a business growth plan, which will consist of four primary components: generating referrals, marketing, building a strong local brand, and capitalising on opportunities in their existing client base.

"Some dealer groups have been so focused on tangible items rather than delivering sound financial planning and business management skills," Miller says. "And at the heart of the debate around fees and being a fiduciary are questions about how to build a sustainable, profitable business and develop an advice proposition that clients are prepared to pay for."

He's unapologetic that MLC charges some of its largest practices in excess of \$100,000 a year in licensing fees; he says they're getting value for money. In addition to licensing fees, practices pay about \$2800 per planner for professional indemnity insurance.

"When it comes to PI, we're not just providing buying power, we're setting high standards so we can prove to our insurer that we're adhering to the highest standards and minimising the risk of something going wrong," Miller says.

"That not only leads to a good rate but also good coverage."

Many dealers view professional indemnity insurance as a critical part of their offering. However, there's a general reluctance from dealer groups to promote PI as a major trump card, Bobbin says, and smart advisers should have their own PI policy.

"Everyone is too afraid to say, 'I have a great PI policy' because at the end of the day, neither the dealer nor the planner have control over whether an insurer pays a claim, so it's impossible for a dealer to guarantee protection," he says.

"Personally, if I was a planner I'd be taking PI cover out myself. My dealer can assist me but I'd assume that I'm a come-and-go planner that owns my client base, and if I choose to change dealer groups, I'll take my client base with me and I'll keep my PI intact. Changing PI insurers creates a liability gap and that can be a problem."

Boutique dealer group Madison Financial Group offers its advisers PI insurance, but has spent the past 12 months developing a suite of innovative products and solutions for its 13 practices and 80 authorised reps, including a separately managed account.

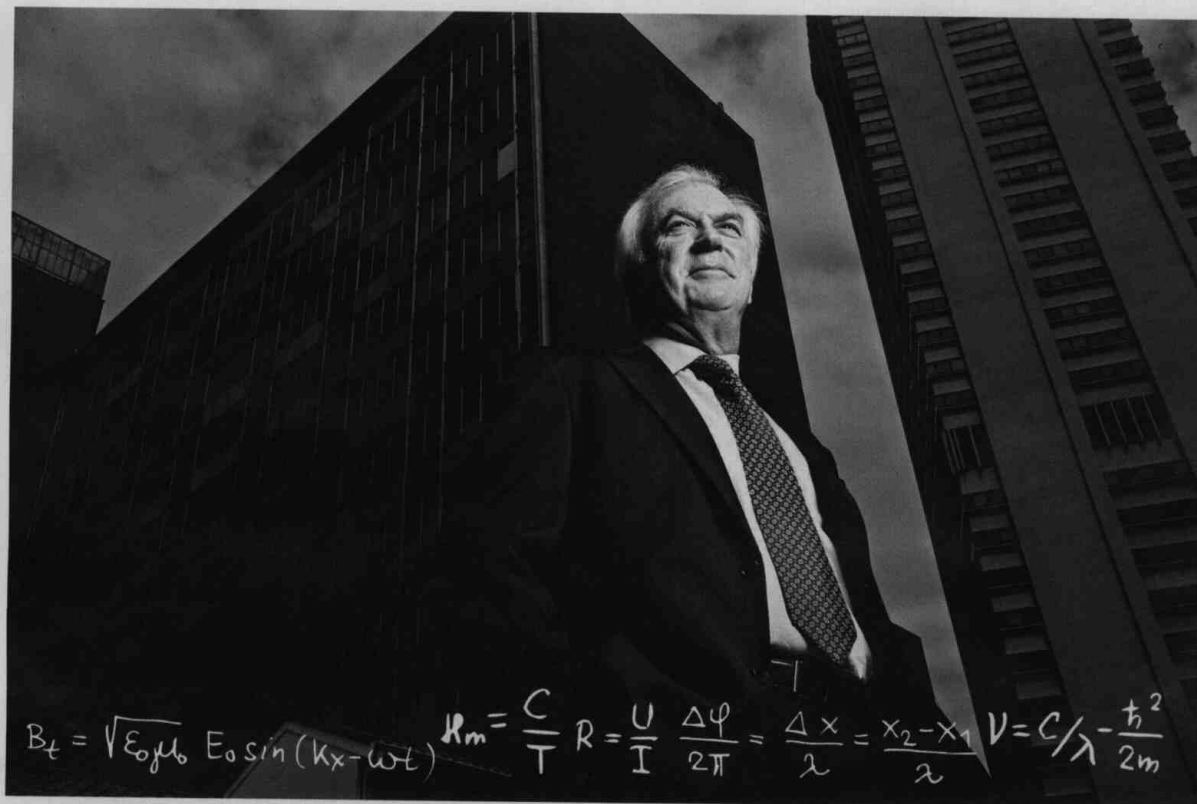
In September this year, the group launched WealthPortal, which Peter Mullens, a director of Madison Financial Group and principal of Halcyon Wealth Advisers, describes as a universal managed account. Mullens says WealthPortal is an important part of Madison's value proposition because an increasing number of financial planners are expressing a desire to stop using traditional master trust platforms and wrap accounts.

"There's demand for solutions that are cheaper, better structured and more efficient," he says.

Madison's parent Pharos Group owns WealthPortal, which is a badge of OneVue. Mullens chairs the group's investment committee, which also consists of independent members Tim Farrelly, former executive director of Macquarie Bank; James Purvis, principal of Active Portfolios and co-founder of van Eyk Research; and a representative from seven firms in the Madison network.

"Our investment committee is a real string to our bow and it strengthens our offering to planners and clients," Mullens says.

"The FOS case says you can't just rely on research houses and as an individual planner you must do some research too, which is hard to do



Peter Mullens, Halcyon Wealth Advisers and Madison Financial Group: There's a demand for solutions that are cheaper, better structured and more efficient.

when you're running your own business. Dealers definitely need to do more in the product space to keep their authorised reps happy.

"The institutional groups are guilty of constructing APLs that suit the needs of their parent but as a boutique that's owned and controlled by advisers our primary focus is the delivering solutions that meet the needs of clients."

Halcyon Wealth Advisers generates around \$1.2 million in revenue and pays Madison 3 per cent for dealer services. PI insurance is extra. In recent years, the dealer group has added four practices, where principals relinquished their Australian Financial Services licence for the comfort of joining a group that offered advantages such as scale, support and community.

Mullens says there is also increasing interest from practices aligned to institutional dealers.

Lax, inconsistent support from institutional dealer groups coupled with rising dealer fees is creating opportunities for cheaper and non-traditional operators to pop up, Mullen says.

These models include back-office compliance firms such as Paragem Partners and flat-fee dealer groups like Morrison Carr.

Morrison Carr charges its principal authorised representatives a fixed fee of \$1400 a month, plus \$600 for each additional adviser.

The annual fee of about \$16,800 is roughly in line with market rates, but the fixed price means advisers are not penalised for making more money and becoming more successful, says Dennis Cardakaris, managing director of Morrison Carr.

It also enables the dealer group to budget effectively because it knows its annual revenue upfront and can use funds appropriately. "The adviser pays us one fee per month, there are no preferred

platforms that pay the dealer a cut, and no rebates for anyone," he says.

"It's strictly licensing and compliance, which includes education and training, and PI insurance. This model helps principals budget because they know exactly what they're up for each month and all the essentials they need are included in the package."

Cardakaris says the group's fees price it out of reach for planners starting out, but it's cheap for larger practices.

Morrison Carr has been quietly promoting this model for nine years and has 45 authorised representatives.

"This is the dealer model of the future because taking a split penalises the large, productive practices," Cardakaris says.

"Our advisers love it, demonstrated by the fact we don't lose planners unless we choose to get rid of them.

"We don't promise things we can't deliver like equity or rebates, we don't take a percentage of advisers' income, but we have unlicensed a couple of people over the years because compliance is so important to us."

The problem with models like Morrison Carr's is that underlying practices are not building an asset, Mullens says.



Dennis Cardakaris, Morrison Carr: The fixed price means advisers are not penalised for making more money and becoming more successful. Taking a split penalises larger productive practices.

"Joining an association or linking together with other like-minded practices to get scale, and at the same time maintain independence, is one way to avoid being part of an institutional dealer group, but ultimately you're not building anything of particular value," he says.

Madison's member firms collectively own 40 per cent of the dealer group. The group management team, including managing director Tony Hartley, owns 10 per cent and the remaining 50 per cent is in performance-based shares.

Townsend predicts that as the industry phases out commissions and travels along the path set by Future of Financial Advice, flat-fee dealer models will become increasingly popular.

"If commissions are banned and planners can only accept fees then the remuneration model between dealer groups and their authorised reps has to change, because most models are based on splits," the Townsends Business & Corporate Lawyers principal says.

"Under the current model, dealers take their percentage of commissions as they pass from the manufacturer to the planner, but if

clients pay fees directly to the planner, there will be more effort on the part of the dealer to monitor how planners are being paid and ensure they also get paid."

Groups will use platforms to administer client fees, but it's still not entirely clear how all this is going to look. This dilemma of how dealer groups get paid highlights a major flaw with the traditional model and the need for ideas and innovation.

"With each new issue that arises, more people will start to question if the model the industry has grown up with, which was inherited more or less from the insurance and stockbroking industries, is appropriate for financial planning," Townsend says.

"It looks like the insurance industry might get to keep their commissions so the current dealer group model might remain intact for those advisers, but if the model is deemed inappropriate for financial planners then it'll have to be considered again."

The Argyle Partnership's Bobbin rejects suggestions that the traditional dealer group model is redundant, evidenced by the fact that the majority of financial planners belong to an institutional dealer group.

"There are so many different models, and the number of dealer groups has been pretty stable, so the ones that exist must be doing their job," he says. "There's a reason why planners engage dealer groups and that's mainly to lessen to compliance burden and be part of a collegiate environment."

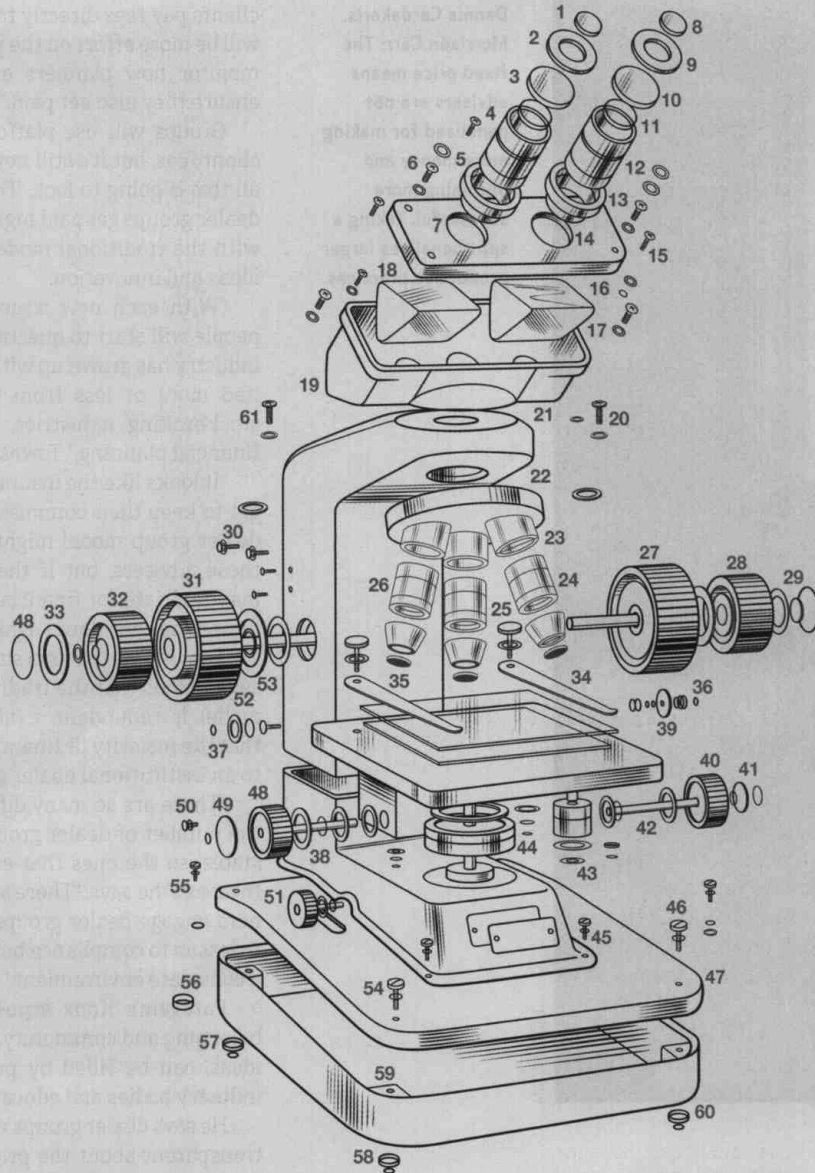
Paragem's Knox argues that a sense of belonging and community, and the sharing of ideas, can be filled by professional groups, industry bodies and educational institutions.

He says dealer groups will need to be more transparent about the pricing of services, in the same way financial planners and funds managers are being forced to unbundle and disclose their fees in dollar terms.

"Dealer groups are not transparent about the revenue they get from product manufacturers or their members and one of the most common complaints I hear from large groups is that they subsidise small practices," he says.

"Paragem has the view that bigger practices can control their capital better in a fee-based environment by getting their own licence and managing their costs, and if that is true then in the next couple of years, contrary to all this talk about consolidation, there'll be a disintermediation of the large practices from the institutions because they'll have outgrown their value proposition." ✉

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