



THE ADVICE BUSINESS OF THE FUTURE

How the 'advice collective' can change the face of financial planning

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KEY POINTS

1 Since the early 2000s the Australian financial advice industry has become dominated by a small number of large financial institutions, who collectively control almost half of all advisers operating in the market through a handful of Australian financial services licensees (AFSLs).

2 Business models of the institutions have become vertically integrated, controlling the wealth management chain from manufacture to what they perceive as “distribution”. Costs of running of institutional licensees have been subsidised from other parts of the wealth management chain.

3 The financial advice environment in Australia is being reshaped by regulation and consumer demands, changing the economics of the advice and licensee businesses and driving up costs across the industry.

4 Links between product and advice are being dismantled, requiring advice businesses to focus on the profitable delivery of “advice as the offering”, without subsidies from other parts of the wealth management chain.

5 The traditional licensee-advice business relationship will not generate the efficiencies needed to significantly lower the cost of delivering advice to consumers and drive advice businesses profitability and growth.

6 Greater efficiencies are available by moving to a shared-services model, similar to a partnership, where advice businesses share costs but retain high-level autonomy and responsibility for their own revenue.

7

The licensee proposition to advice businesses must therefore focus on expanding the advice margin by generating substantial scale benefits in the provision of services. To support the provision of cost-effective services, the licensee must share in the revenue generated from the delivery of advice.

8

The concept of the “advice collective” addresses the issues advisers face in moving to more corporatised business models, underpinned by investment in high-quality services, with costs shared among businesses.

9

The economies of scale available through the creation of large advice collectives will empower advice businesses to grow while delivering high-quality, affordable advice to more Australians.

10

Forward-thinking licensees are already mapping out pathways to new licensee-adviser relationships.



BACKGROUND, INDUSTRY STRUCTURE AND INTRODUCTION TO THE ‘ADVICE COLLECTIVE’

With the introduction of the *Financial Services Reform Act 2001* (FSR) regime in September 2001 (although most provisions commenced in March 2002), all financial services providers were required to obtain an Australian financial services licence (AFSL), irrespective of whether they were dealing with wholesale or retail clients.

The AFSL regime replaced the previous system under which separate licences were required for securities dealers and investment advisers, futures advisers and brokers, general and life insurance brokers and foreign exchange dealers.

Under FSR all clients were deemed to be “retail” clients unless they met specific criteria that classified them as wholesale clients – for example, if the client was a member of a super fund with assets of more than a certain value, or if the amount invested in a financial product exceeded a certain limit.

FSR was structured such that the financial services provided by a licensee would be carried out by the licensee’s representatives. They may be its employees or directors, or employees or directors of its related bodies corporate, or other authorised representatives and other people acting on the licensee’s behalf.

Under FSR, the licensee was made liable for the acts and omissions of its representatives, and it provided a range of services and support to authorised representatives (and their businesses) in return:

*Financial planners or advisers can organise and operate in dealer groups (also known as financial advisory networks). Under this structure, a corporate entity in the group will hold an AFSL, permitting the financial advisers who are members of the dealer group to operate as its authorised representatives and provide financial advice to consumers on its behalf. Such financial advisers provide financial advice to consumers under both the AFSL and the commercial brand of the dealer group. **In return, dealer groups provide its members centralised back office services to support their operations, such as information technology systems, arrangements to manage compliance and regulatory obligations and client administration services.** [Emphasis added.]*¹

“Every business needs a core set of services, like brokerage, compliance, education, advice documentation and technology. Those core things could be shared amongst the group. There could be other value-added options that you could select for an additional cost, like coaching, marketing, managed accounts, investment research and so on.”

Paul Dobbrick
Practice principal and
financial planner
Dobbrick Financial Services

¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial services Industry, Background Paper 6 (Part A) - *Some Features of the Australian Financial Planning Industry*



No formal definition of the term “dealer group” exists; but a paper published in 2011 by the Australasian Accounting, Business and Finance Journal adopts the following definition:

*A dealer group is defined as “the distribution arm typically of funds management groups or banking institutions designed to offer investors financial planning services. Dealer groups often employ large numbers of financial planners, offering them training, licensing and support services. They also **often provide financial planners with lists of recommended investment products** from which to service their clients”. [Emphasis added.]*²

With the introduction of FSR, institutions seized upon the chance to control more links in the wealth management chain, from manufacturing to distribution, by establishing and acquiring licensee businesses and networks of financial planners.

The true cost of providing advice to consumers was typically subsidised from elsewhere in the wealth management chain – typically product and platform. This approach introduced a number of potential conflicts of interest, including advisers favouring (and being incentivised to recommend) “in-house” investment products over other, potentially more competitive products.

² Santacruz, Lujer, “Dealer Group or Financial Planning Group? A Brief Technical Note”, *Australasian Accounting, Business and Finance Journal*, 5(2), 2011, 127-134.



Institutionally branded and institutionally owned financial advice networks or dealer groups became the dominant model (measured by adviser numbers) and from the introduction of FSR to the present day, the number of advisers – authorised representatives – operating in the market has become increasingly concentrated under a handful of licensees.

The number of financial advisers has increased by 41 per cent since November 2009, with about 44 per cent of advisers operating under a licence controlled by the largest 10 financial institutions¹.

However, the subsidised advice model has come under increasing pressure, most notably through the Future of Financial Advice (FoFA) laws in 2013, which introduced a best interest duty on all financial advisers and planners; a ban on conflicted remuneration (including commissions on investment and superannuation products); and the requirement to charge ongoing fees to clients and obtain an active opt-in from clients at least every two years.

More recently, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, which is due to release its final recommendations before February 2019, has highlighted practices and conflicts that lead to outcomes contrary to consumers' interests. Consequently, a number of major institutions, including Commonwealth Bank and National Australia Bank, have announced plans to divest their wealth businesses.

¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial services Industry, Background Paper 6 (Part A) - *Some Features of the Australian Financial Planning Industry*.

In an environment where links between product and advice are being gradually dismantled, a focus naturally falls on how subsidies that have supported advice can be replaced so the true cost of delivering high-quality financial planning does not price the service out of the reach of consumers.

Financial planners require support and assistance to reduce costs through scale benefits and business efficiencies. At the same time, licensees are seeking to be adequately remunerated for the services they provide, reflecting appropriately the risks involved, but without unduly increasing the financial burden on advisers.

Licensees and advisers need to work together to develop new relationships, whether under the existing licensing regime or under any future approach (for example, individual licensing of advisers, or a professional registration regime).

This white paper examines one such potential relationship, designed to meet the challenges of providing high-quality, non-conflicted and affordable advice to more Australians. At the same time, it ensures financial planning businesses remain financially healthy, and that the entities supporting advisers in the provision of services remain economically viable and relevant.

The model is referred to in this white paper as the “Professional advice collective”.

“For most financial planners, their core skill-set is being good financial planners. They do not necessarily possess the skill-set required for the broad-based management of a business. At this time, support services tend to focus on professional development, advice coaching and business fundamentals, and so on, which ultimately may or may not have an indirect impact on business growth. With it being their primary business and legal function, licensees will tend to focus - as they should - on being a complying licensee. As a result, the support and services they offer are consistent with achieving that outcome. Whilst no one would argue that there is a vital role for licensees to play in ensuring that advice to consumers is of a high standard, the jump to be made is above and beyond this. There is a need to build competencies in providing services to practices in areas such as HR, technology, marketing, strategic planning and management that have a direct impact on the growth of their business.”

Matt Fenning

Managing director and financial adviser
Fortuity Strategic Advisors

THE CHANGING RELATIONSHIP BETWEEN THE LICENSEE AND THE ADVICE BUSINESS

As increasing regulation and other factors drive up the costs of doing business, the owners and principals of advice businesses are facing an increased squeeze on margins and the prospect of having to raise the cost of services to consumers.

The traditional role of the licensee has been to deliver a range of services to small advice businesses. In future, the advice and licensee functions must converge, and focus on making the advice proposition profitable but also affordable for consumers.

A licensee must generate far more value for an adviser than just providing traditional licensee services. It must have the capacity to transfer genuine scale-related benefits back through the advice business to the end consumer, whether that be in the form of cost-effective investment solutions, or through investment in systems, processes and tools to support advisers to deliver advice more profitably.

The value proposition of the licensee must become, in effect, that it will expand the advice margin for the adviser, through efficiencies driven by scale. As an industry, the existing licensee entity needs to transform itself into a business that is more tightly integrated to the delivery of advice, which helps to increase the profitability of the advice business. Profitability generated by the provision of advice – ultimately paid for by the client – must be shared by both adviser and licensee.

Advice networks therefore need to operate increasingly as large-scale collectives, rather than as networks of individual businesses. A well-recognised expression of the collective mentality is the partnership, whose partners remain responsible for generating revenue, but who draw on shared services, values and outcomes – and share the costs – to support their respective activities.

The need for cultural alignment of advice business and licensee cannot be overstated. In a collective structure, the advice and licensee business must work more closely than in the traditional arrangement. Possessing a similar mindset regarding the delivery of advice to clients becomes paramount to ensure the relationship delivers the expected benefits for all parties.

An opportunity exists for a scaled version of the collective approach in financial advice. But the existing structure of the financial planning industry – dominated as it is by small advice businesses – means it is impractical to expect or seek to impose a “big bang” restructuring. The transition will be gradual.

Solutions will naturally evolve as advisers build up capability within their advice businesses by coming together, and running each business as a separate entity, with separate profit and loss (P&L) accounts, but sharing costs.



THIS IS NOT A JOURNEY FOR EVERYONE

A large-scale advice collective empowers advisers to operate with flexibility within a framework. The framework provides structure and support, allowing advisers to target the market segments they want to, and develop advice propositions they want to.

The objective of the collective is to support and enhance the individual value proposition of each advice business but allow it to be delivered to clients more efficiently. This stands in contrast to models featuring salaried advisers (employees), where an advice proposition must be far more homogeneous, and by definition, less tailored to the adviser's preferred market segment.

The advisers and advice businesses that will prosper within a collective structure are those aligned to the philosophy that a collective can create significant scale benefits to be passed back to consumers. Within the collective, scale benefits can be created right across the advice businesses' activities.

Understandably, the collective structure will not suit all advisers or businesses. While it's a legitimate business decision for an advice business to remain an "island", businesses and advisers for whom a collective structure works well, see themselves as part of something bigger – taking advantage of scale, and supporting mutual alignment of objectives and outcomes.

CORPORATISATION, NOT BUREAUCRACY

The collective must be large enough to have the necessary scale to provide meaningful cost savings to businesses and consumers, and to support the delivery of advice in an efficient and cost effective open architecture approach with a multitude of selected service providers. For example, based on adviser numbers only, meaningful scale for a traditional advice network might have been around 400 advisers. Under the proposed collective model, the number is much larger – possibly as many as 1000 advisers.

Within the collective, the advice businesses themselves must also be large, as well as increasingly corporatised. It is understandable that those who founded the business – typically, highly motivated and entrepreneurial individuals – should wish to fill many of the business's most important roles as it grows and develops. But in reaching the required scale, an advice business may reach the limit of its founder's ability to manage it.

A corporatised structure is needed as a business reaches a point where robust management systems and processes become critical to ongoing profitability. Importantly, there is a fundamental difference between corporatisation, institutionalisation and creating a bureaucracy. Institutions tend to focus on profit at the expense of customisation, and bureaucracies tend to focus on process above all else. However, corporatisation (as applied to the advice collective) is focused on how to maximise efficiency to deliver an advice proposition that is designed and crafted to satisfy a clearly identified market segment – and to do so profitably.

“You need to be with the right people. You can’t recruit just anyone. The businesses need to have a similar kind of ethos. If you’ve got businesses that are too different or think too differently, or are doing too broad a range of things, then it probably doesn’t work. You need to be on similar journeys. You can be doing it in your own way, but you need to have the right kind of ethos and culture across all of the practices. In that environment it can work really well.”

Scott Dawkins

Principal, director and financial adviser
Griffin Financial Services

WHAT’S THE FUTURE FOR SMALL BUSINESSES?

Running a small advice business will become increasingly challenging in future unless it is part of a broader collective. Some businesses will achieve sufficient size to begin realising some minor scale benefits. Even so, they will find themselves at a competitive disadvantage to the larger advice collectives with a demonstrable ability to harness scale benefits from a large number of advice businesses, with corporatised structures, sharing value, services and costs.

There is opportunity in the “advice market of the future” for businesses that can control such elements for themselves at an individual business or micro level, but they will always fall short of the economies of scale that can be delivered by larger collectives.

Beyond a simple reduction in costs, large-scale collectives will bring other benefits that smaller businesses will struggle to match, including extracting greater value/quality from suppliers, and industrialised controls and standards.



SCALE ACROSS THE BOARD

A major element of a licensee's value proposition centres on technology support for the delivery of advice and the tools and structures necessary to do that. That includes compliance, supervision and auditing; training to ensure competence; and business development.

The licensee must create scale in each of these areas so value is created for the end consumer by driving down costs and/or improvement in the service. Understandably, those outcomes are a given. However, a significant part of the licensee's role – often unseen by the adviser – is to manage the risks associated with the provision of financial advice to clients.

Licensees today share the risk with advice businesses. However, if the underlying advice businesses do not have the capacity to address that risk, either because they are inadequately capitalised or lack sufficient PI cover, responsibility ultimately then passes back to the licensee.

Costs associated with risk in the advice industry have increased significantly but pricing models have not changed accordingly. The disconnect is clearly illustrated in the proliferation of self-licensed and in "licensee of last resort" solutions, signalling that advisers do not prescribe adequate value for licensees to manage risk.

Large-scale advice collectives can address the issues of risk on multiple levels. They have the capacity to establish industrial-strength systems and processes to ensure the delivery of high quality advice, and the scale to drive benefits through negotiation of attractive PI cover.



A ROADMAP FOR INVESTING IN TECHNOLOGY

The relative cost of technology implementation is declining. The value for technology-spend is increasing; but at the same time, it is not cheap and not easy to implement technology efficiently, make it useful, and maintain it. It still requires a scale solution to support assessment capabilities, and a commitment to invest.

A step-change is needed in investment in technology to address the costs of delivering advice, to improve accessibility, and increase profitability.

It is imperative that the new collective solve this issue in both the management and the utility of data. Managing data is not necessarily part of the skill-set of the traditional advice business. Furthermore, with outsourcing the management of data comes the need for comprehensive management of suppliers.

The shared-cost approach to an advice collective provides the potential to:

- adequately resource data management, starting with the efficient collection and organisation of data;
- achieve more effective client engagement that aligns more closely to individual client objectives; and
- allow sufficient flexibility to cater to changing client needs over time.

HOW LONG UNTIL WE SEE REAL CHANGE?

Advice collectives will begin to emerge from licensee structures, as they exist today, as the rules of engagement are realigned for participants within those businesses. Importantly, advice businesses will not have long to start adjusting their business model to suit the new world of advice.

It's a timeline in the order of five years for the industry to readjust to the emerging reality. This may be accelerated as institutions exit their advice business divisions, spinning off "new" participants, already of sufficient scale, outside institutional distribution models.

These developments present a challenge for non-institutionally owned licensees and the advisers within their networks to keep pace and remain competitive in the marketplace. Forward-thinking licensees are already laying the groundwork for how the transition should look, and the time it should take.

“ I think the success of the collective would very much depend on aligning with the right people, philosophy and operating model. It can be an attractive proposition for advisers, who in partnership with the right collective, could access significant scale benefits for clients, as well as over time, increase and unlock business value. ”

Chris Fallico
Principal and financial adviser
Acadia Wealth Advice

WHERE TO FROM HERE?

Fortnum Private Wealth is already constructed as a type of collective, in which advisers own the licensee. Stand-alone advice businesses deliver services to clients and pay a licensee fee to Fortnum. To the extent that Fortnum is profitable, its advice businesses prosper, as shareholders receiving returns in the form of dividends and increased enterprise value.

Within the current structure, there is further opportunity over time to begin to blend the P&Ls of what have been traditionally two distinct businesses – the advice businesses and the AFSL.

Consumers will benefit further from an increased number of collective structured advice networks, via a decrease in the cost of delivering strategic, holistic advice, achieved through a reduction in the advice business's operating costs and access to shared support and resources.

The ultimate benefit to the client is predicated on maximising scale benefits.

THIS IS NOT A NEW CONCEPT

The idea of blending the P&Ls of the advice and licensee business is by no means new. An adviser who obtains their own AFSL has – whether consciously or not – already considered the issue. Equally, advice businesses that employ salaried advisers have effectively addressed the same issue.

The collective model does the same thing at significantly larger scale. It is a structure designed to increase and unlock, not dilute, the value of the business owner's interest in the advice business.

It is an approach of taking the best of the entrepreneurial spirit that exists in the financial planning industry and nurturing it in an environment where significant scale confers meaningful benefits to both businesses and consumers.



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Fortnum is committed to finding better ways to deliver financial advice to clients.

If you would like to learn more about Fortnum or speak with Neil, please contact us on 02 9904 2792 or email info@fortnum.com.au.

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