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Leveraging expertise to expand your value proposition

Ray Miles and Neil Younger

This paper comprises an excerpt from Fortnum Private Wealth's *The inevitable advice journey: Where professional advisory firms are set to land report*.

The report found that the majority of advice businesses are not yet achieving their full potential and are vulnerable, despite having a compelling value proposition and robust systems and processes, because they are not scalable and lack a clear strategy to get to scale.

It also identified the critical ingredients needed to build an advice business of significant economic value, and outlined the path advisers need to take to bulk up, reduce their vulnerability to external shocks and significantly enhance their capital value.

Considerations for a better value proposition

No matter how compelling and competitive a business's value proposition, it will still need support to ensure the efficient, if not excellent, execution of that service. Here are some key observations.

A compelling value proposition is the cornerstone of business success.

When evolving your value proposition, there are two critical aspects to consider:

1. *Share of wallet*—the broader your value proposition, the greater relevance your service has to a client.
2. *Depth of value*—value cannot be superficial. It must be supported by evidence of capability, continuous improvement and superior outcomes.

Where both these elements exist, businesses perform strongly.

Not only do advisers need to articulate and demonstrate the

value they deliver to clients, they must also be prepared to prove the effectiveness of their philosophy, processes and systems if requested by the regulator.

This is particularly important in relation to investment advice, given 84% of financial advisers spend the majority of their time providing strategic advice on superannuation and investments, according to the *2020 Investment Trends Planner Risk Report*, based on a survey of 524 financial planners.

As such, a critical component of any professional advice business is the capability and capacity to provide an effective, compliant investment advice solution.

This is especially pertinent, given the federal government's focus is likely to shift to strategic investment advice, once it has completed its Quality of Advice and Life Insurance Framework review.

This is likely to coincide with the inevitable end of Australia's near-three-decade record run of economic prosperity and the retirement of millions of Baby Boomers.

Advisers should prepare for hard questions about their approach to managing other people's money. They must be able to articulate and demonstrate the robustness of their investment philosophy, processes and performance including how they build and customise portfolios, how they manage risk and how they monitor and measure ongoing performance.

For some advisers, luck has undoubtedly played a significant role in their success to date. Critically, this represents a major risk going forward.

For the past 20 years, Australian equities, which make up roughly 21% of the average MySuper fund, have returned over 8% p.a. Over the past decade, global equities, which represent 29% of

the average MySuper fund, have delivered 8.6% p.a. (see Figure 1).

Performance attribution analysis of the average advised portfolio would probably reveal that market movement (not skill), generated the bulk of returns. A rising tide lifts all boats.

This is not to discount the importance of diversification and asset allocation, which one study (Brinson, Singer & Beebower 1991, 'Determinants of Portfolio Performance II: An Update') suggests accounts for more than 91.5% of a portfolio's return. However, it questions if strategic asset allocation or—for that matter—stock and manager selection and market timing are part of the strategic advice proposition.

In most cases, these are inputs into the investment process.

A structured approach

There is no standard approach to managing superannuation and investments in the financial planning industry. Every practice does things differently.

Some rely heavily on research and recommendations from their licensee to construct portfolios. Some have developed their own rules and systems to manage money. Others adopt a laissez-faire approach.

In some cases, there are no formal processes and written manuals, but rather information exists only in the head of a practice principal or employee.

When it comes to managing other people's money and being a profession, this approach is unacceptable. It does not pass any test.

A key benefit of belonging to a licensee is the investment support available.

This support takes four key forms, namely:

- 1) guidance on asset allocation
- 2) investment product research (for managed funds and shares etc.).
- 3) approved product lists (APLs).
- 4) model portfolios, which advisers can replicate, reject completely or cherry-pick what they like.

As long as advisers operate within the prescribed asset allocation and APL boundaries, they are more or less left to provide strategic investment advice as they see fit. This statement does not imply judgment, but honest assessment.

This traditional approach is under pressure for two main reasons outlined in the following discussion.

1. Global economic uncertainty and political unrest exacerbated by COVID-19

The strong historical performance of Australian equities and property has masked loose investment processes inside some advice practices.

It is against a future outlook of subdued economic growth, extreme market volatility and prolonged ultra-low interest rates (see Figure 2) that advisers will need to demonstrate their worth and justify their fees.

2. Greater focus on the value of advice

The shift to fees paid directly by the client is placing greater emphasis on value for money.

It is more important than ever for advisers to refine their value proposition and be clear about the services they do and do not provide.

For example, it might be tempting to take credit for asset allocation in the good times, but consistently picking the best-performing asset classes is very difficult. Advisers must accurately represent their services—after all, they are not fund managers or asset consultants.

They do not set asset allocation targets, conduct in-depth manager and stock research or actively trade.



The quote

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Figure 1. Share price accumulation indices

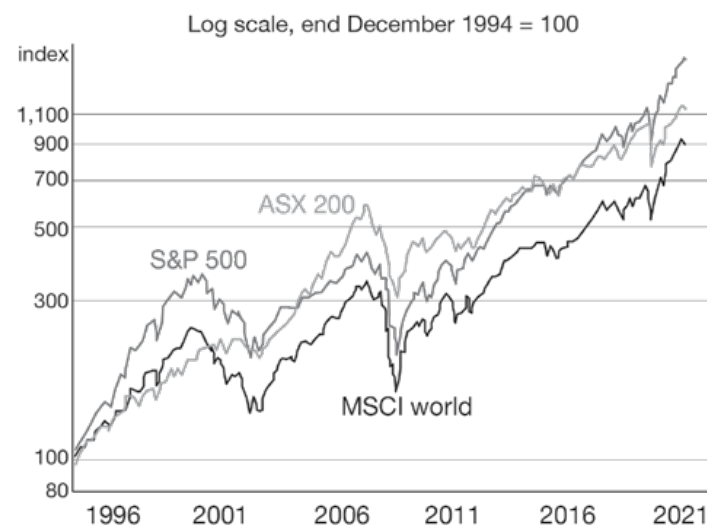
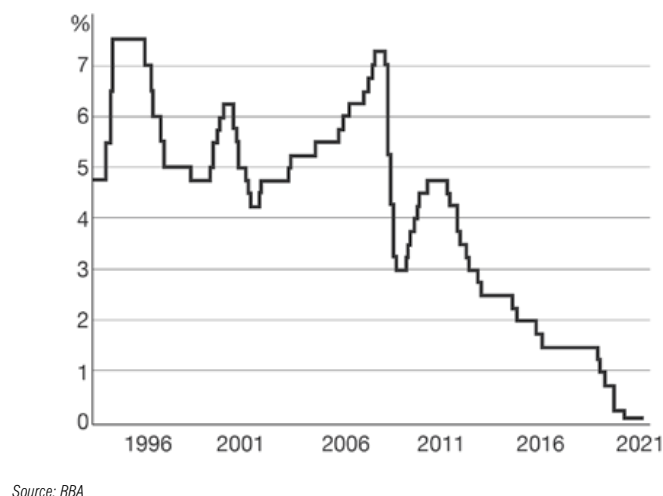


Figure 2. Australian cash rate target





The quote

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Advisers provide personal strategic advice. As part of their role, they leverage external insights and inputs to construct customised portfolios to meet a client's unique needs, objectives and risk appetite.

As such, the performance benchmarks that some advisers use are not conventional, but they still need to be relevant. This is necessary for demonstrating that strict governance and risk management controls are in place.

Too many advisers use outdated benchmarks that do not pass the 'pub test'. For example, if CPI plus 2% is their benchmark and they delivered CPI plus 4%, they may believe they outperformed even if the rest of the market delivered CPI plus 7% for the same level of risk and fees.

This is fraught with danger for all involved.

If the biggest indictment on the industry to date has been fees-for-no-service, then the next big test for advisers will be demonstrating value for service in their investment proposition, especially if clients are being charged separately for that service.

Building an effective, robust and compliant advice investment service

The focus of regulatory and consumer action to date has been on the quality and appropriateness of advice rather than value for service.

In the face of imminent harsher market conditions, advisers will need to demonstrate value for money.

With the comfortable retirement of millions of Australians at stake, this will not be a routine exercise.

Advisers may be called on by the Australian Securities and Investments Commission to produce hard evidence of their ability to provide high quality investment services to retail clients.

This will likely include appropriate qualifications and experience, documented processes, efficient systems, and formal risk management and governance controls.

A practice may not have proof of such things readily available.

The most effective way to satisfy these critical responsibilities is to formally engage the required expertise—be that an internal resource, external asset consultant or support from an experienced licensee.

Three critical features regulators expect to see

If and when the appointed time comes, there are three must-haves for advice businesses.

1. Customised advice and solutions

The biggest problem with Storm Financial was that every client got the same solution. They all received the investment equivalent of Panadol, regardless of their needs, circumstances and objectives, not to mention point-in-time asset valuations and market conditions.

Similarly, the main criticism of the vertically integrated model is that it revolves around products rather than clients. Both these roads lead to an in-house product sales construct (whether by design or inadvertently).

Despite it being more than a decade on, the memory of Storm Financial is still fresh in the regulator's mind, so it will be compelled to look for evidence of thoughtful, bespoke advice in each and every client situation.

It wants to see advisers acting as fiduciaries because that leaves no room for predetermined outcomes.

There is also no appetite for arbitrary fees. In the past, it may have been okay for practices to have a medley of active and inactive clients with some, for instance, paying \$6,000 and others paying \$1,000 but everyone more or less receiving the same homogenous solution.

Commercially, and also from a regulatory perspective, there must now be greater alignment between a practice's value proposition and the fees charged.

It is an adviser's fundamental duty to understand a client's unique needs, circumstances and goals. Then, based on that information, customise solutions to maximise the probability of them achieving their agreed goals.

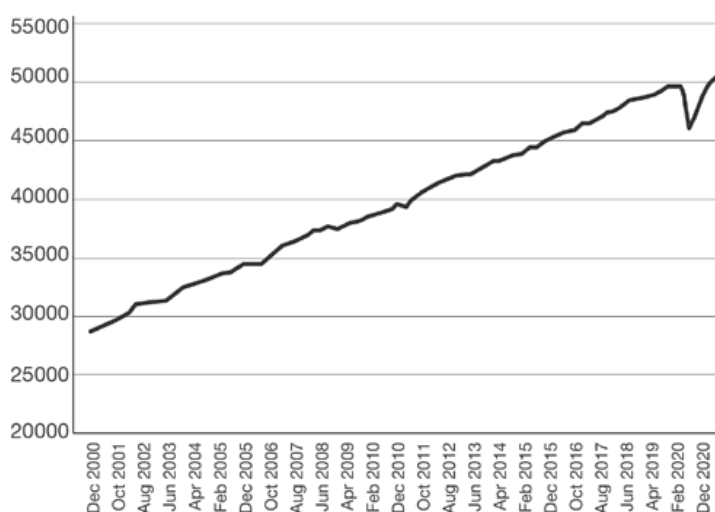
2. An efficient execution model

While advisers should be guided by a consistent investment philosophy and steadfast principles, personal advice starts with the individual. Advisers need to be able to articulate their philosophy, systems and processes, evidence their veracity and demonstrate how it meets clients' best interests.

Advisers need a model that can accommodate a client's personal preferences even if they conflict with their own.

For example, investors may want to bring existing funds, assets and insurances with them. If they use a

Figure 3. Australian real gross domestic product



Source: ABS

particular administration platform or do not want to use a platform at all, flexibility in solutions would be required to satisfy their needs.

Advisers need a model that can facilitate efficient access to a broad range of direct and managed options; capture timely investment opportunities; adjust portfolios as required; dump and replace underperforming managers; and continuously track, measure and report performance.

They need to be able to do this across multiple clients without any administrative delays as they progress through the advice process.

3. Requisite scale or the potential to achieve requisite scale

Value and price are inextricably linked. Theoretically, the higher the fee, the greater the value add.

Importantly, the underlying cost for advisers to service clients is rising, due largely to mounting compliance requirements and the end of passive income streams.

Practice profitability is under growing pressure. Many advisers have been forced to increase fees.

However, in a post-Hayne world, pulling that lever requires advisers to justify their fees and demonstrate a commensurate increase in value.

A business with scale is in a stronger position to manage costs, meet their compliance obligations and keep fees steady than a small practice.

As such, the regulator will want to see profitable, scalable businesses or at least businesses on the right trajectory. After all, quality bespoke advice and effective systems are irrelevant if businesses are not around to fulfil their obligations to clients, staff and other stakeholders.

To secure these three critical elements, advisers need not 'reinvent the wheel'. A licensee with the requisite capability and capacity can assist advisers to establish, articulate and execute investment advice services for the benefit of clients.

Wealth protection observations

The pioneers of financial planning in Australia started out as passionate life agents. This industry is built on a legacy of life insurance sales yet, for the past decade, advisers have been distancing themselves from risk advice.

Wealth protection is becoming a smaller and smaller part of their value proposition.

In 2020, risk-related revenue represented less than a quarter of the average practice's income compared with 32% in 2012, according to the *2020 Investment Trends Planner Risk Report*.

The report found that only 16% of advisers were considered risk specialists (those who derived 50% or more of their revenue from risk), 47% were risk generalists (those who generated 20-49% of their revenue from risk) and the rest were considered superannuation and investment specialists.

This dilemma has come about for a number of reasons, namely:

- the rising cost and complexity of delivering risk advice
- a greater focus on superannuation and investment platforms
- falling commission rates and the unwillingness of consumers to pay a fee for insurance advice
- higher product-related costs and premium increases
- poor underwriting and claims experiences.

The culmination of these factors has put risk advice in the 'too-hard basket', even though adequate life insurance is the foundation of prudent wealth management.

The question then is how can advisers offer a compelling risk advice proposition and execute it efficiently.

Based on Fortnum Private Wealth's observations, the businesses that are doing this well offer advice on life insurance as part of a broader end-to-end wealth protection strategy that encompasses estate planning.

Given households come in all different shapes and sizes, of which the traditional nuclear family is increasingly rare, specialist advice on estate planning and life insurance is critically important. Add to the mix Australia's impending intergenerational wealth transfer, and the need for advisers who can connect the dots can add considerable value by foreshadowing the likely outcome of poor planning, addressing key concerns, developing and implementing a wealth protection strategy and saving their clients stress, pain and money.

Since the inception of Australia's life insurance industry, people's lives have become more complicated. Second and third marriages are increasingly common, as is mental illness. When looking after a client's estate planning needs, advisers must manage difficult, sometimes messy, situations such as children who are alcoholics, have a gambling addiction and live under the constant threat of divorce.

Increasingly complex lives requires more sophisticated advice solutions. A dynamic proposition that changes as a person's circumstances and needs change, and considers a person's life insurance needs in the context of their broader wealth management and wealth protection needs, is necessary. Life insurance advice is still critical, but it has to go beyond simply facilitating access to the right products.

While investment specialists are often perceived as more sophisticated advisers, life insurance is one of the most complicated aspects of financial planning. There are so many possible scenarios and preferences that need to be explored, and life insurance products are complex with many variables and moving parts.

Addressing issues properly elongates the advice process and adds to the cost.

Licensees can help their risk specialists and risk generalists deliver advice more cost effectively by creating efficiencies. That means investing in technology to automate manual, repetitive processes and speed up processing times. **FS**



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