

# What Role Do You Play in the Future of Your Business?

Steve Prendeville



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# Royal Commission Recommendations

## Change is upon us. Recalculate.

The past year will be forever marked by the shocking revelations of the royal commission.

Filled with anticipation and suspense, the fear in most cases seemed greater than reality.

Hayne's findings include the good, the bad and the ugly. However, for financial planners, these changes as a whole should ultimately lead to better and more profitable businesses in the future.



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# Royal Commission Recommendations

## Good

- Client annual renewal
- Nominating services to be provided and exact fees to be charged
  - Fixed fees are specific rather than percentage-based fees that are at risk to market volatility
  - Additionally, shouldn't be packaged as Platinum, Gold, Silver – should be specific to client's needs
- Advisers may neither permit nor require payment of fees from any client's account except with the client's written authority
- All AFSLs to give effect to reference checking
- All AFSLs to report serious compliance concerns quarterly



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# Royal Commission Recommendations

## Good

- Given sufficient information that an adviser has engaged in misconduct, AFSLs must tell affected clients and remediate those clients promptly
- Written statement why the adviser is not independent, impartial or unbiased
  - Increased exodus from vertically integrated solutions
- Review in three years by 30 June 2022 to assess whether “safe harbor” provision is necessary
- New disciplinary system
- Hawking of insurance prohibited
- Avoidance of life insurance payouts has been made more difficult



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# Royal Commission Recommendations

## Good

- Removal of claims handling exemption
  - The handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definitions of “financial service”
- Accountability regime
- Compensation scheme of last resort
- Simplifying the law – removal of exceptions and limitations
- Mortgage brokers owe borrowers a best interest duty – same duty as advisers
- Mortgage brokers to be subject to and regulated by the same laws as financial advisers



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# Royal Commission Recommendations

## Good

- Enforcement of trustee – conflict of interest, duty of care, advisers disclosing any lack of independence
- Civil penalties for breach of trustee and director covenants and obligations under the SIS Act
- Co-operations of ASIC, APRA and new governing body
- Increasing protections
- Ban volume-based commissions



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# Royal Commission Recommendations

## Bad

- Grandfathering provision for conflicted remuneration should be repealed as soon as reasonably practical
  - Grandfathered revenue is trading at no value, previously two times



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# Royal Commission Recommendations

## Ugly

- ASIC conducts review further reducing the cap on commissions in respect of life insurance commissions; the cap should ultimately be reduced to zero
  - Valuations unknown due to move to fee for service like advice – no commission
  - UK tried the same model a few years ago and it led to chronic underinsurance
- Mortgage trails to be banned by 1 July 2020 with a review three years after
  - Borrower pays – Dutch/Canadian example: 1.1%, currently 0.7% in Australia
- Momentum Intelligence survey found that 58% of consumers are not willing to pay a broker a fee
  - 3.5% would pay up to \$2,000
  - 1% would pay up to \$5,000



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# Royal Commission Recommendations

## Ugly

- Advice businesses are now under the microscope if they cannot demonstrate that the services they provide now or have provided in the past are of a fair value for the ongoing fees they are receiving
- These fees will need to be partly or, where no services have not been provided, fully repaid
- Any failure to do so will be a breach of adviser's obligations to provide financial services efficiently, honestly and fairly



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# Royal Commission Recommendations

## Summary

- Silent on vertical integration
- Needs to be a clearer link between the service being provided and the cost of that service
- Ongoing service fees should reflect the complexity and volume of work involved in providing the services to the client
- “The services to be provided under ongoing service arrangements were, and still are, often not well defined” and “may not give the client a benefit commensurate with their cost”. – Commissioner Hayne
- Changes not seismic
- Fear greater than reality



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# Case Study

## Alpha background prior to 3-year transformational period

- Established in 2001
- Moved to a smaller licensee in 2013
- Principal aged 53
- Staff included a para/junior adviser and 2.5 administrative personnel
- 176 clients, predominately SME owners
- Mainly used high-rated active managed funds with some ASX 200 stocks and some direct fixed interest assets



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# Financial Metrics 2015–2016

FUM:	\$82m (average client FUM \$354k)
Gross revenue:	\$590,000
Recurring revenue:	\$565,000 (average fee 68 bps)
EBIT after principal salary \$150,000:	\$170,000
Valuation:	Rec rev 3 x \$1,695,000 or EBIT 6 x \$1,320,000



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# Case Study

## Key Strengths

- Segmented service offer
- Good long-term referral partners
- Tenure and retention of clients
- Tenure and retention of staff reflects positive culture
- Management and reporting structures
- Total income is sustainable
- Service offer and pricing is competitive
- The average balance of FUM per active client is good
- FOFA compliant
- Excellent compliance history
- Defensive asset allocation with use of mainstream asset managers and platform providers
- No over-exposure to key clients
- High-touch service and competitive pricing for the client base
- Experience and education of principal



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# Case Study

## Key Weaknesses

- Lack of new business being generated
- Fees are not fixed and linked to underlying assets
- There is a lack of client referrals being experienced (3) which may point to a disenfranchised or unengaged client base
- There is no targeted marketing
- There is little new business being witnessed
- The client age demographics is aging – 16.69% of clients aged over 70 representing mortality risk
- There is significant key person risk
- There has been little growth in revenue, FUM or profitability for an extended period of time
- Profitability is low



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# Case Study

## Client Perspective of Alpha

- Client survey conducted by a third party
- Findings were universally positive, but the common complaints were centred around paperwork and paper-based marketing that wasn't personalised and barely reviewed

## Business Perspective of Alpha

- Business was experiencing increasing costs in the areas of compliance and PI insurance
- While 17% of the clients said they would refer others, the business was only experiencing up to 3% of actual referrals per annum
- Static profitability
- Staff utilisation was at full capacity



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# Strategy for Change

## Review:

- Operational functionality
- Client value proposition
- Pricing
- Platform technology

## **An external consultant was engaged and recommended a 3-year programme:**

- Repositioning the client value proposition
- Segmenting the client service
- Repricing to fixed fees
- Outsourcing asset management
- Increasing marketing, especially digital
- Updating website including client portal
- Restructuring the business re roles. Responsibilities, increase efficiencies, profitability and eventually decreasing key person risk
- The reduction of key person risk was introduced as the principal sought to increase work/life balance

# Year 1 2015–2016

## Year 1

- Run tenders to select the Managed Account provider and the outsourced asset management
- Tender and selection process took 4 to 6 months
- Not exposed to “guru risk”
- Moved from a percentage-based fee structure to a fixed fee structure
  - Where the service would be scaled according to the level of activity
  - Not susceptible to market change
- Business Health Research found the time spent on a new client was:
  - Full Advice FP 28 hours (Adviser 13.5, Para 9, Admin 3.5)
  - Risk & Super 20 hours (Adviser 10, Para 5, Admin 5)
  - Life Risk 13 hours (Adviser 6, Para 3.5, Admin 3.5)



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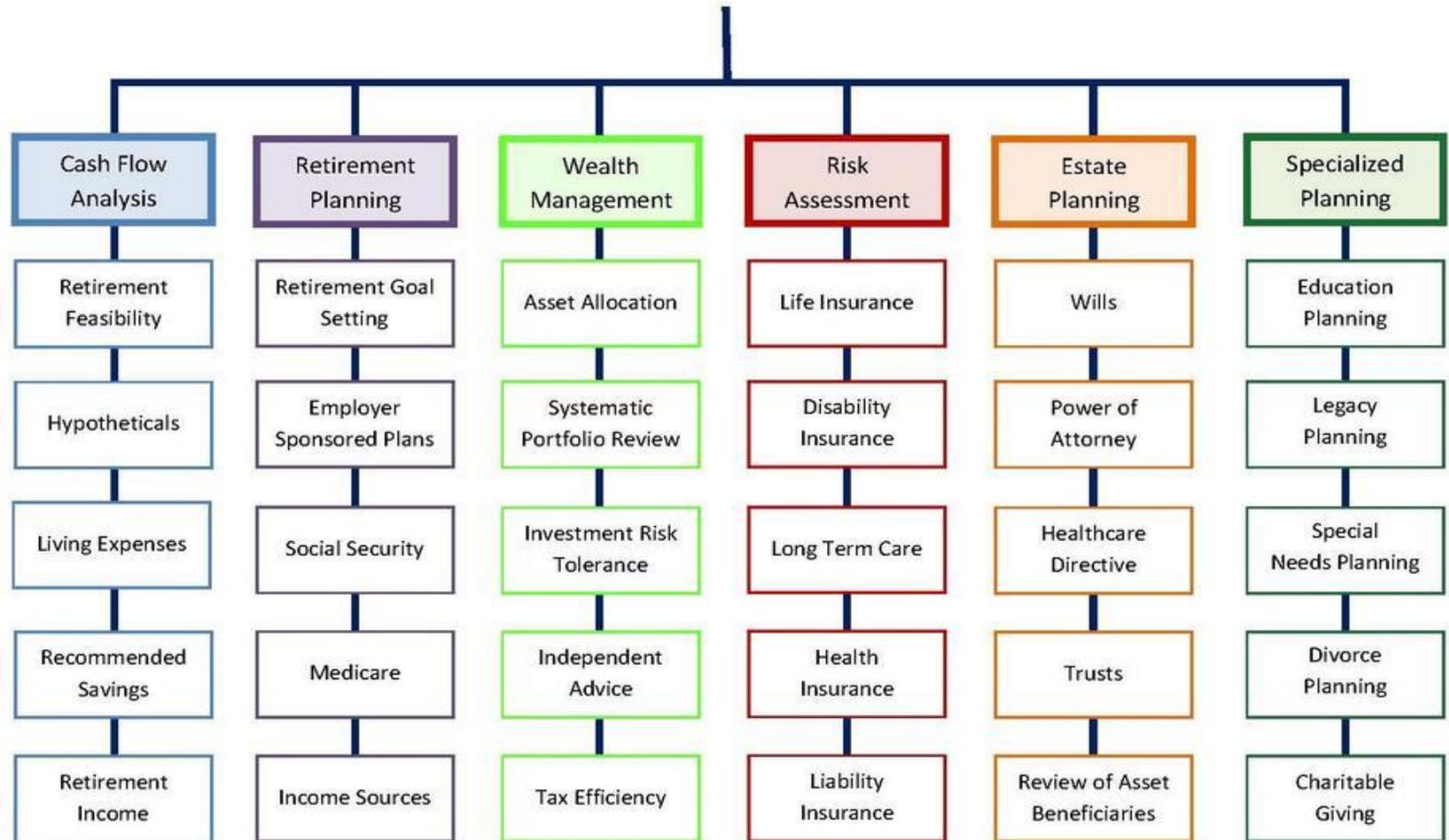
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# Fixed Fees

As a comprehensive financial planning firm, our services encompass each area listed below.



# Managed Accounts 4-Step Transition Process



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# Year 2 2016–2017

FUM:	\$93m (average client FUM \$492k)
Gross revenue:	\$832,400
Recurring revenue:	\$799,800 (average fee 86 bps)
EBIT after principal salary \$150,000:	\$352,400
Valuation:	Rec rev 3 x \$2,400,000 or EBIT 6 x \$2,100,000



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# Year 2 2016–2017

## Year 2

- Under-charging for their services in most cases, and over-charging in a few select cases
- Approximately 40% of clients had migrated FUM to the new offer in the first 12 months
- Monthly information flows from the asset managers
- Majority welcomed the electronic and individually tailored communication
- Whilst the principal acknowledges that the practice enjoyed positive markets over the 12-month period, and that 13 new clients were introduced, the real lift of revenue and profitability can be attributed to the new segmented service fees



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# Year 3 Financial Metrics 2017–18

FUM:	\$107m (average client FUM \$492k)
Gross revenue:	\$1,096,522
Recurring revenue:	\$1,047,044 (average fee 97 bps)
EBIT after principal salary \$150,000:	\$412,522
Valuation:	Rec rev <b>3.3</b> x \$3,455,000 or EBIT <b>6.5</b> x \$2,681,000 *premium multiple



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# Year 3 2017–2018

## Year 3

- Migration process was primarily complete (89% of FUM)
- Board of advice was created
- A general manager was appointed
- Para-planner was elevated to financial planner
- The fixed cost impost of the new structure was an additional \$180,000
- Principal was relieved of some of the face-to-face clients and was able to take more holidays and reduce work hours
- Principal is confident business is built for the future or can adapt quickly if required



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# Year 3 Case Study - Structure

ADVISER  
(OWNER)



PARA PLANNER



ADMIN SUPPORT



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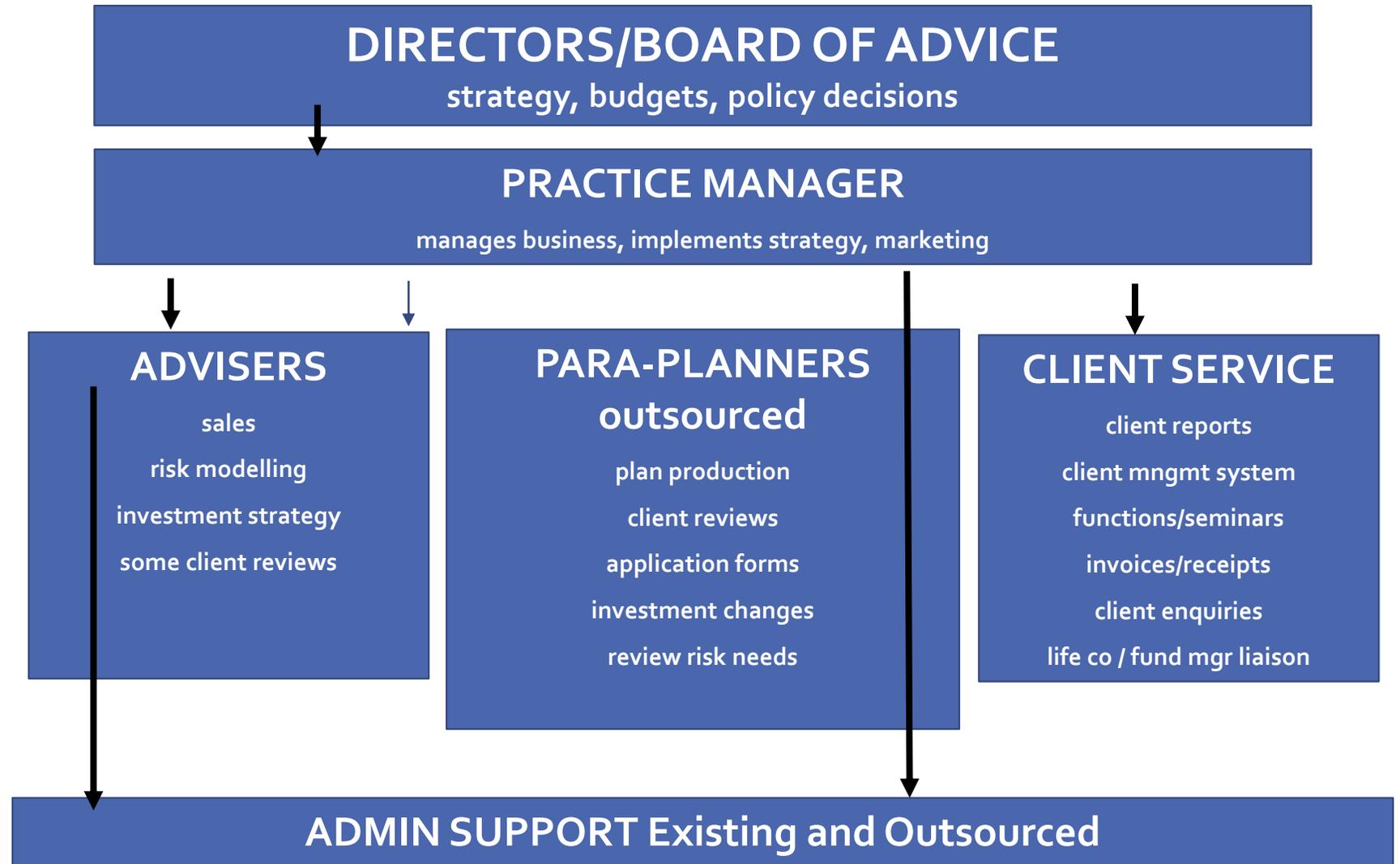


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# Year 3 Case Study - Structure



# Review of 3-Year Plan

## Overview

- Business is imminently scalable with the ability to onboard new clients without any additional personnel costs
- Business review:
  - Increased corporate governance
  - Reduced key person risk
  - Enhanced client retention and attraction
  - Reduced market risk to revenue
- Well positioned for future growth and deserving of a premium to market average



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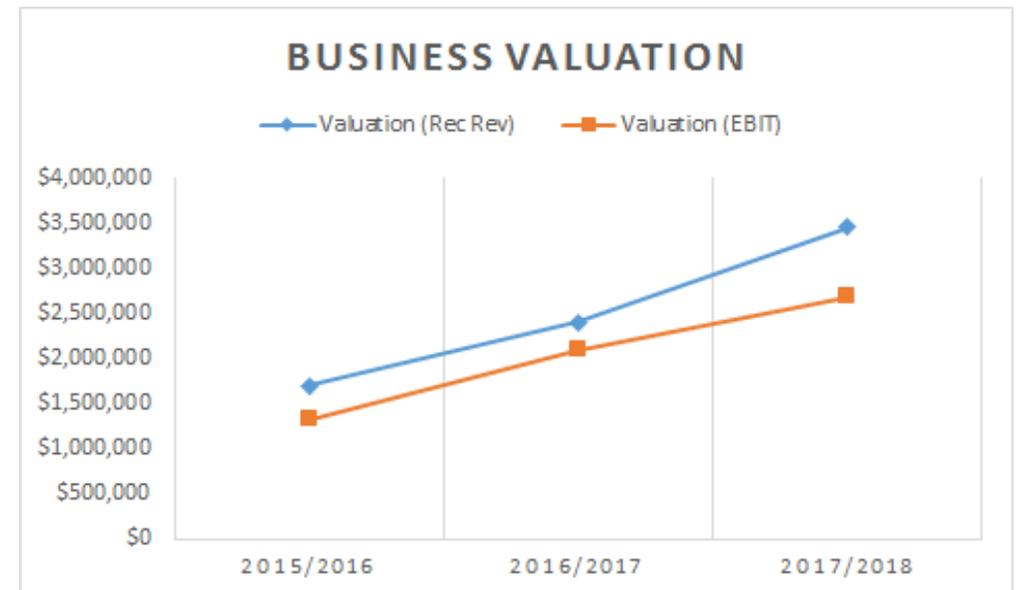
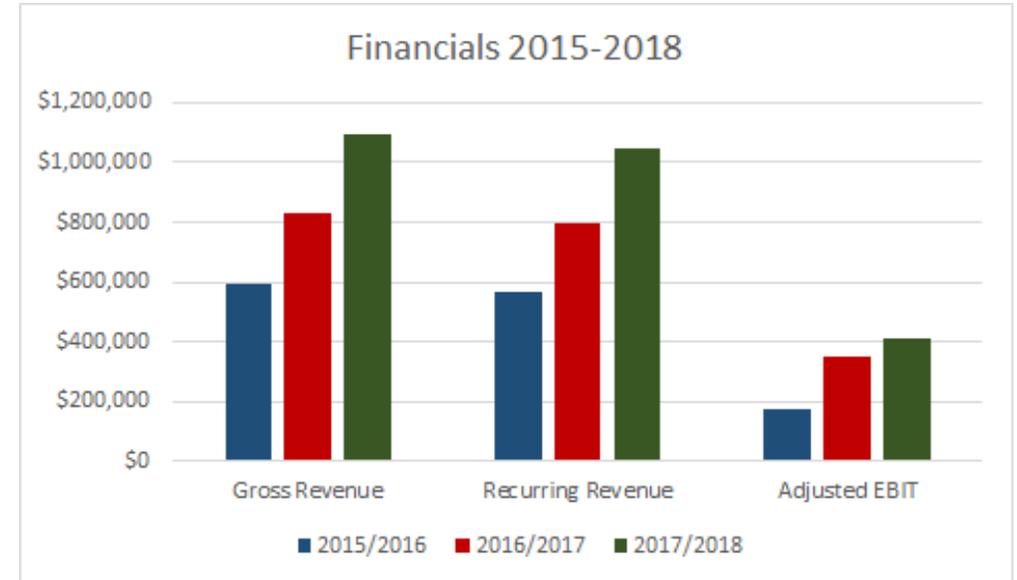


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# Review of 3-Year Plan

## Statistics

- Over the 3-year period FUM increased by 30%
- Client attraction was modest with an increase from 176 to 217
- Gross revenue increased by 85%
- EBIT rose by 142%
- Subsequently business value moved from \$1.7m to \$3.4m, a rise of 100% within 3 years
- This growth was achieved by challenging the status quo, especially in regard to service delivery



# Alpha's Secrets to Success

## Learning Points

- Listening to clients and awareness of market developments
- The tender process illustrates clients' best interest and fiduciary care
- Appointment of an experienced consultant
- A collegiate dealer or peer group where fellow principals shared their experiences for the benefit of others
- The success of the tender process which increased knowledge of Managed Accounts functionality and points of difference
- Strengthening of investment philosophy and communication
- Client survey to clearly identify issues
- Setting realistic timelines



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# Alpha's Secrets to Success

## Learning Points

- The Managed Account provider should have experienced transition teams that have a culture that understands that the practice is their client
- Effective communication between the project team and the practice, with regular and structured reporting and meetings
- Education of all stakeholders
- Leadership from the principal was essential with a clearly articulated vision of the future and the benefit to all stakeholders
- The principal demonstrably showing support and understanding of team's needs and welfare in a period of change



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# Uplift Factors Experienced by Practice

- Enhanced and consistent client service
- Increased client retention and attraction
- Timely client communication increasing financial literacy
- Back-office efficiencies via reduced paper-based administration
- Time savings for clients and practice
- Well-documented workflow processes
- Robust and documented investment process
- Increased participation and revenue in the value chain
- Greater control and reporting of asset management
- Scalable advice



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# Uplift Factors Experienced by Practice

- Enhanced and tailored client communication
- Greater compliance
- Increased management reporting
- Demonstrable clients best interest application with platform and asset management
- Clear value proposition and delivery
- Enhanced corporate governance
- Interfaces with other “best of breed” technology
- Greater control and ability to adapt to change
- Increased top and bottom lines
- Increased business enterprise value



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# Summary

- As demonstrated, change is not immediate, but once you make a single but significant change, it allows for more change to be introduced
- Fixed fees
- Clients irrespective of age are embracing technology
- The three-year change will pay dividends for years to come
- Clients want you to be the subject matter expert on what is best for them given their personal situation
- Success was determined by the team culture and enabled by technology



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A man with short, light-colored hair, wearing a black suit jacket and a black shirt, is looking down and to his left. He is standing against a solid green background. The text "Discover the secret of F1 drivers." is overlaid on the image in white, bold, sans-serif font.

**Discover the secret  
of F1 drivers.**





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