Analysis of Key Issues

Purpose

To provide a preliminary analysis to the Board of the key issues identified by respondents to APES 230 ED and to seek the Board's direction on the way forward on the project.

Background

A total of 66 submissions were received from respondents which are organised in to general comments and specific comments tables. Comments from the 66 submissions are contained in a General Comments table and nine Specific Comments tables.

Table #	Content of Specific Comments Tables	Board Discussion Timeline for 2011
Table 1	Operative Date	January
Table 2	Conformity	January
Table 3	Scope and Application	March – Nov
Table 4	Definitions	March – Nov
Table 5	Professional Competence and Due Care	January
Table 6	Fiduciary responsibilities for Members	March – Nov
Table 7	Professional Independence Terms of Financial Advisory Services The basis of preparing and reporting Financial Advice	March – Nov
Table 8	Fee for Service	March – Nov
Table 9	Soft Dollar Benefits	March – Nov

Consideration of Key Issues

At the November 2010 APESB Board meeting, the Board agreed to issue a media release to the public advising of the major issues identified by the respondents and communicate that there will be an extension of the time frame. The key issues identified were:

- Operative date of APES 230;
- Definition of Fee for Service;
- Application to insurance and risk products;
- Fiduciary duties;
- Application to Members in Business; and
- Retrospective application.

1. Operative Date

The media release issued in December 2010 stated that APESB has received a record number of submissions in respect of APES 230 ED and that it is going to take some time to analyse and evaluate the respondents' comments. Further it indicated that the proposed start date in APES 230 ED of 1 July 2011 will not be achievable and that there will be an extension of time.

2. *Definition of Fee for Service*

The definition of Fee for Service impacts upon the allowable remuneration methods under the proposed APES 230 ED. The remuneration method APES 230 ED proposes is a pure Fee for Service method that excludes both commissions and percentage-based asset fees in order to remove the conflicts of interest that are present when a financial planner receives payments from product manufacturers or the incentive to accumulate Funds Under Management (FUM).

From all respondents (66) who made submissions to APES 230 ED, 50% (33 Submissions) protested against the Fee for Service remuneration method for Financial Advisory Services. A total of 39% (26 Submissions) of respondents applauded APESB's initiative to increase independence in remuneration methods in Financial Advisory Services and agrees with the Fee for Service method in principle. A total of 19 respondents (29%) are supportive of Fee for Service as defined in the proposed APES 230 ED.

Key Statistics in respect of Fee for Service:

% supportive of Fee for Service	**% in support of Fee for Service + hybrid Fee for Service**	**% against Fee for Service**	**Comments**
29%	39%	50%	There are 19 submissions in support of APES 230 ED in its current form. 7 submissions are in support of a hybrid Fee for Service where Fee for Service as defined in APES 230 ED is charged for initial and strategy advice and percentage-based asset fees are charged on a sliding scale (taking into account various factors) for ongoing portfolio monitoring services.

However, even the respondents who support the proposed APES 230 in principle noted that in practice there are a number of circumstances in which Fee for Service cannot be performed. These include:

- Insurance and risk products; and
- Trailing commissions with existing Clients.

Some respondents consider the definition of Financial Advice to be too broad, and urge APESB to limit the financial advice to those services generally performed by a financial planner.

Some respondents are of the view that any remuneration method can be used in an improper manner and thus the remuneration method is not important as long as it is disclosed and agreed with the Client. Theses respondents are of the view that the current remuneration methods are not conflicted as Members follow the common law fiduciary duty and have quality control policies and procedures within their practice to monitor improper behaviour.

According to research performed by Dr June Smith in her PhD thesis[1], conflicts of interest associated with the current remuneration structures within the financial planning industry have not been managed effectively by financial planning firms and represents a real reputational risk. The top ten most common forms of unethical conduct identified in her research includes issues associated with remuneration conflicts. Please refer Appendix 1 for the ten most common forms of unethical conduct in financial advice.

Dr Smith has also conducted focus group sessions on perceptions and attitudes of financial advisers and compliance officers of current ethical issues facing them. The results are given in Appendix 1. The study also identified emerging ethical issues associated with the conduct of financial planning business (Please refer to Appendix 1).

Technical staff have identified the following matters which require for further discussion with key stakeholders based on the respondents' comments for Fee for Service in Financial Advisory Services:

- Members of the professional accounting bodies will be disadvantaged compared to other planners who will not have to comply with the proposed APES 230 ED (refer below);
- APES 230 ED is a commercial inconvenience and it will be a major cost/time burden for the practices that need to transition and the associated difficulties;
- The retrospective nature of the standard is not appropriate and it should only be prospective;
- Fee for Service should not be mandated for Members in Business (refer below);
- Clients with small pool of investment funds will not have the ability to pay upfront and thus will be disadvantaged if this remuneration method is adopted;
- A significant number of respondents noted that there are a number of scenarios where Fee for Service cannot be performed such as insurance and risk products and that these are not services but rather products that are sold to Clients (refer below);
- Trailing commissions with existing Clients should be allowed to continue;
- The treatment of legacy products;
- Are mortgage broking and lending covered by APES 230 ED? And if yes the difficulties associated with Fee for Service in these instances.

A respondent has obtained a legal opinion on the acceptable remuneration methods in the financial planning industry and note that the remuneration methods (commissions and percentage-based asset fees) prohibited by the proposed APES 230 ED are acceptable as long as the Member does not breach the "profit rule" and "conflict rule".

However, most of the respondents have not performed a detailed analysis of the various remuneration methods against the fundamental principles of the Code.

Another argument that has been submitted is that APES 230 should be a principles based document that only results in guidance for Members of the professional accounting bodies. All the professional standards issued by APESB are principles based documents and it is just that the application of the principles results in mandatory requirements or in certain instances mandatory prohibitions. Further it should be noted that even the Australian Accounting Standards and the Australian Auditing Standards are principles based Standards similar to APESB's Professional Standards.

Respondents have also drawn the Board's attention to the government's reform process - Future of Financial Advice (*FoFA*) and recommended that the Board wait till the *FoFA* reform process is complete. According to the Treasury's *FoFA* public information session held in Melbourne on 28 February 2011, the major decisions on *FoFA* reforms such as opt in will be announced by the Minister in April 2011.

[1] Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

Proponents who are supportive of Fee for Service note the following matters in favour of Fee for Service remuneration in Financial Advisory Services:

- Accountants working in the financial planning area who have adopted a true Fee for Service arrangement have been met with high level of trust as their Client perceive them to be both ethical and acting in the best interest of the Client rather being part of a product distribution network of a product manufacturer or trying to accumulate Funds Under Management in order to charge a higher fee;
- Insurance and risk advice such as life insurance can be transitioned to Fee for Service and not simply sold as products. Clients benefit in a pure Fee for Service environment as commissions are rebated to them and the Fee for Service charge will be based on the initial set up cost of insurance plan and flat annual fees;
- Respondents' who have successfully transitioned to Fee for Service argue that in the financial planning industry where percentage-based asset fees are charged, the financial planner would require the Client to own a reasonable level of assets on which to charge their fees. Consequentially, many financial planners gear up the Client's assets (i.e. Storm example) and subject the Client to gearing risk or alternatively may recommend strategies that are aimed at acquiring assets or funds that are not in the best interests of the Client. The fact that financial planners fully disclose to Clients the amount and method of charging does not reduce the risk of conflicts of interests occurring;
- Clients most in need of financial advice, especially those Client who do not own a large pool of 'investible assets', usually need advice in areas such as budgeting, estate planning and taxation. However, these instances do not give rise to the ability of a planner to charge a percentage-based fee model; and
- There are consulting firms offering specialist implementation services to financial planners wishing to make the change. From a commercial perspective, a financial planner who had adopted the Fee for Service arrangement should have had sustainable growth of income even during the GFC when so many other financial planners have had significant reductions in their income due to the market downturn.

Technical Staff – Preliminary comments on Fee for Service and way forward

As per the Stakeholder Engagement Plan presented to the Board on 31st January 2011, Technical Staff will hold meetings with key stakeholders in the coming months to discuss the issues identified above. In due course the key stakeholders will also be invited to future Board meetings to present on the key issues.

Potential options

Subject to further consultations, the potential options to consider in respect of remuneration methods are:

- Adopt Fee for Service as defined in APES 230 ED;
- Consider adopting a hybrid Fee for Service which is being used by some respondents;
- Allow all remuneration methods and allow Clients to choose their preferred remuneration model; and
- Proposed APES 230 to include Fee for Service as guidance. This will be the same position as the existing APS 12.

These options will be explored further during the Stakeholder consultation process.

Transitioning to Fee for Service

According to the respondents, one of the biggest obstacles against Fee for Service is the issue of commercial inconvenience for practices that need to transition to the proposed new method of remuneration. A significant number of respondents note that the transition process is difficult, commercially inconvenient or not achievable.

The Board to consider engaging an industry expert to provide a report on issues associated with transitioning to Fee for Service.

There are a number of books that have been published by the following consultants in this regard such as:

- *Jim Stackpool, "What Price Advice?", Strategic Consulting and Training, 2009;*
- *Sue Viskovic, "Pricing Advice", Elixir Consulting, 2010; and*
- *Johnny Grohavaz, "The Financial Adviser's Guide to Fee for Service", 2010.*

Please refer to Appendix 2 for the introduction from Jim Stackpool's book 'What Price Advice' extract. Jim has successfully helped his Clients transition to Fee for Service as defined in APES 230 ED.

<u>Members will be disadvantaged if the proposed APES 230 is adopted</u>

A significant number of respondents raised the issue that Members of the Professional Accounting Bodies will be disadvantaged against those non members with regard to commercial competitiveness in the financial planning industry. The reduction in competitiveness is largely due to the flexibility in remuneration arrangements that non-members will have compared to members.

Key statistics on respondents who raised the issue of Members being disadvantaged:

% of all respondents who raised the issue	**% of respondents who raised the issue and noted that it creates a disadvantage in the market place**	**Comments**
62%	89%	Members will be disadvantaged if APES 230 is implemented as financial planners who are not Members of the professional accounting bodies do not have to comply with APES 230 ED.

3. <u>Application to Insurance and Risk Products</u>

Respondents argue that Fee for Service cannot be applied to insurance/risk products because they are not services but rather a product which is sold to Clients. This sentiment is shared by the majority of the submissions.

According to the Treasury's *FoFA* public information session held in Melbourne on 28 February 2011, a formal consultation process has commenced in January 2011 to discuss whether to extend the ban on commissions to Insurance and Risk Products.

Accordingly, further discussions will be held with the key stakeholders regarding the application of APES 230 ED to insurance/risk products.

Technical Staff – Preliminary comments on Application to Insurance and Risk Products

As per the Stakeholder Engagement Plan presented to the Board on 31st January 2011, Technical Staff will hold meetings with key stakeholders in the coming months to discuss this issue. In due course the key stakeholders will also be invited to future Board meetings to present on the key issues.

Possible options to consider include:

- Adopt Fee for Service as defined in APES 230 ED;
- Exclude insurance/risk products from APES 230 ED's scope;
- Allow Clients to have the option to choose between Fee for Service remuneration or commissions on insurance/risk products (refer proposal in Bongiorno's Submission); and
- Provide further guidance on how Fee for Service can be applied for insurance or risk products by either developing a high level Transition to Fee for Service document or developing further guidance in the proposed standard.

These options will be explored further during the Stakeholder consultation process.

4. Fiduciary Responsibilities of Members

Based on Dr June Smith's PhD Thesis, *Ethics and Financial Advice: The Final Frontier*, the top ethical issue facing the financial planners in the provision of advice is to always act in the best interest of the Client[2].

This issue is addressed in APES 230 ED Paragraph 4 *Fiduciary Responsibilities for Members*. APESB drafted this section in APES 230 ED based on the NZICA's equivalent standard on Financial Advisory Engagements which was issued in New Zealand in November 2009 and was effective from 1 July 2010. Please see Appendix 3 for an extract on Fiduciary Duty from NZICA – *Financial Advisory Engagements*.

The financial advisory industry has commonly accepted the existence of fiduciary responsibility between the adviser and the Client, this responsibility is also embedded in common law. The government's *FoFA* reform is also considering imposing a best interest duty on all Australian Financial Services Licensees and their representatives.
Technical Staff will monitor the progress of *FoFA* reforms. Please see Appendix 4 for comparison table on the major elements between *FoFA* and APES 230 ED.

Key statistics in respect of issues raised by respondents:

% Based on total number of submissions	% Based on total Respondent who have expressed a view on the issue	Comments
11%	39%	Inclusion of fiduciary responsibility paragraph unnecessary as there are already provisions for such responsibilities embedded in common law.
17%	61%	Inclusion of fiduciary responsibility may conflict with *FoFA*'s proposed statutory fiduciary duty once that is implemented.

[2] Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

Based on the Treasury's *FoFA* public information session on 28 February 2011, it seems unlikely that a Statutory Fiduciary duty will be implemented. Treasury is speaking of implementing a best interest test in addition to the fiduciary duty that already exists.

Technical Staff – Preliminary comments on Fiduciary Duties

As per the Stakeholder Engagement Plan presented to the Board on 31st January 2011, Technical Staff will hold meetings with key stakeholders in the coming months to discuss this issue. In due course the key stakeholders will also be invited to future Board meetings to present on the key issues. Technical Staff will also monitor the *FoFA* reform process.

5. Members in Business

Respondents have argued that Members in Business needs to be excluded from the application of the Standard as they are not the main decision makers or may not have the authority to change organisational policy of the employing organisation.

Some respondents have also noted that this standard should be relocated to the APES 300 series and should be made applicable to Members in Public Practice only. However, it should be noted that APS 12 has been drafted in a manner to apply to all members with different sections applicable to Members in Public Practice. This is similar to most APES 200 series professional standards which are written in a manner to apply to all members and at times will have mandatory requirements for Members in Public Practice and guidance for Members in Business.

Technical Staff – Preliminary comments on Members in Business

Technical Staff will revise the Standard similar to that of other APES 200 Series Standards where a Member in Business has the appropriate flexibility in certain instances where the similar requirement will be mandatory for Members in Public Practice. For example, APES 225 Valuation Services mandates the Valuation Report for Members in Public Practice but provides the flexibility for Members in Business to use the similar provisions as guidance.

6. Retrospective Application

A number of respondents oppose the move to apply the requirements proposed in APES 230 retrospectively. Their main arguments are the legal ramifications of cancelling contracts previously entered into with Clients and the commercial inconvenience of retrospective implementation. Some respondents have also noted that there will be instances where it is not in the Clients' best interest to revise the existing arrangements (unfavourable tax consequences).

Key statistics of respondents comments on retrospective application:

% of all respondents who raised the issue	% of respondents who raised the issue and did not agree with retrospective application	Comments
26%	77%	Retrospective application of the Standard not supported.

Joint Accounting Bodies has also raised the issue of ‘Legacy Product’ and the relevant retrospective application issues. The joint accounting bodies have proposed that a new provision be inserted to APES 230 ED that states that where a Member is unable to change a legacy product that it be placed in a designated register.

Technical Staff – Preliminary comments on Retrospective application

As per the Stakeholder Engagement Plan presented to the Board on 31st January 2011, Technical Staff will hold meetings with key stakeholders in the coming months to discuss this issue. In due course the key stakeholders will also be invited to future Board meetings to present on the key issues.

Potential options to consider are:

- Consider the prospective application of the proposed Standard; and
- Engage an industry expert to comment on the issues associated with retrospective application.

Way Forward

Subject to the Board’s comments on the matters identified above Technical Staff recommends the following:

- Technical Staff will hold meetings with key stakeholders in the coming months to discuss the key issues identified in this preliminary analysis of respondents comments to APES 230 ED. In due course the key stakeholders will also be invited to present their views to the Board;
- Engage an industry expert to prepare a report on transition issues and issues associated with applying the proposed APES 230 retrospectively;
- Perform a detailed analysis of APES 230 ED’s compliance with the fundamental principles of the Code; and
- Review editorial changes suggested by respondents during final drafting stage of APES 230 ED

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Date: 28 February 2011

Appendix 1

Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

<u>Top ten most common forms of unethical conduct in financial advice</u>

No.	Theme	Summary of Unethical Conduct	Primary Ethical Principles	No. of breaches
1	Integrity Issues	Misleading statements as to performance, product features or security, business reputations	Integrity, Professionalism	35
2	Integrity Issues	Using client funds for own purpose	Integrity, Professionalism	29
3	Appropriateness of Advice	Advice did not meet client objectives or circumstances and had no reasonable basis	Competence Objectivity	28
4	Research into product/strategy	Lack of financial product research/ inadequate understanding of financial product recommended	Competence Diligence	23
5	Disclosure obligations	Failure to disclose remuneration benefits and conflicts of interest	Objectivity Integrity Fairness	23
6	Disclosure obligations	Failure to disclose information relevant to client decision	Objectivity Diligence Fairness	22
7	Recommendations/ Advice	Inadequate written advice or failure to tailor advice to client	Diligence Fairness	21
8	Appropriateness of Advice	Inadequate explanation and examination of risks associated with investment	Competence Diligence Fairness	19
9	Integrity Issues	Inadequate explanation of the risks associated with financial product	Integrity, Professionalism	16
10	Compliance	Failure to follow internal procedures and policies of the AFS Licensee	Integrity Diligence	13

Appendix 1

Focus group perceptions of the top five ethical issues facing financial planners in the provision of advice to consumers

No.	Ethical Issues Identified by Participants	Corresponding Ethical Principle	Ranking Score
1	To always act in best interest of client.	Professionalism	**50**
2	Conflict within current advisory models between time pressures; the need for advisers to produce income for themselves (and licensee) and the desire to provide appropriate advice and undertake appropriate research.	Diligence	**45**
3	Determining an appropriate risk tolerance for clients.	Competence	**38**
4	To be honest.	Integrity	**37**
5	Conflicts of interest associated with ownership of financial products by larger financial services organisations/ fund managers. Pressure / conflict between advice in the interests of the client and the Licensee's Approved Product List and possible quotas.	Objectivity	**30**

Appendix 1

Emerging ethical issues associated with the conduct of financial planning businesses

Theme	Sub Theme	Contextual and Business Issues Associated with the Theme
Objectivity	Links to Distribution networks	The ownership, structure and links between financial services organisations; the distribution of financial products through advisory divisions within larger organisations; the sales practices adopted by financial services organisations; links between product manufacturers and advisory groups.
Integrity	Business Imperatives	Profit pressures and resultant trade-offs in the quality of advice and the enforcement of conduct standards; meeting budgets versus ensuring best practice; competing business goals; the commercial settlements of client complaints at FOS; reconciling management values and objectives with professional and compliant practice; a lack of resources; significant time pressures in the advice process; the multinational nature of some financial advisory firms.
Objectivity	Remuneration Structures	The influence of volume and incentive payments and other soft dollar payments; the setting of fee and commission charges and rates; the impact of sales quotas on quality advice; the links between remuneration structures and conflict of interest; overcharging practices by the AFS Licensee.
Objectivity/ Fairness	Churning/ Switching of financial product	How to undertake an effective gap analysis; the commercial pressure to switch clients who transfer from another dealership into financial products on the new Licensee's approved product list.
Competence/ Diligence	Research and Ratings	The reliance by advisers and AFS Licensees on research houses to research financial products and the impact on advice quality; managing the risk that research committees will set appropriate approved product lists; the validity and veracity of the research conducted, balancing approved product lists and financial product variety and number.
Integrity/ Objectivity	Risk management trade offs	Obtaining balance between managing risk and allowing adviser independence; enforcement tradeoffs between disciplining advisers for unethical conduct and the achievement of commercial objectives; the commercial and professional trade-offs associated with professional indemnity insurance claims management.
Compliance	Independence	Restrictions on the independence of the compliance function; it's opinions; its ability to enforce rules and procedures across the organisation; restrictions on independence of external and internal review of compliance functions, the appropriateness and scale of compliance systems.

Appendix 2

Acknowledgements and Introduction to 'What Price Advice' – Jim Stackpool

Acknowledgements

This book did not take long to write, but it's been long in the making. It would not have been possible without the following people.

Firstly, my clients. I am a privileged consultant who has been blessed with great clients. I am sure I have learnt more from them than they have from me, yet they allowed me into their business worlds, paid my fees, and kept coming back. These clients are courageously challenging 'normal' business paradigms regarding how to build great advice firms. They have been implementing their own theories long before I was lucky enough to meet them and become a small part of their never-ending development journey. I will always be grateful for their insights. Secondly, Roland Fishman's Writers' Studio; Roland has something unique for aspiring writers, and I was lucky to find him years ago. He and Kathleen Allen have been, and will continue to be, the inspiration for many of us who believe there is a book or two in there, but we don't have the tools to get them out.
…………

Introduction

Too many good advisers are not earning the rewards they deserve because they price their services on poor models. Compared to advances in technology support, product development, and workplace reforms, pricing theory has languished for decades.

Charging for advice on an hourly rate or percentage of financial products sold is old pricing theory.

Tying value to hours worked and charging accordingly only makes sense when clients want to buy effort—not when they want to buy outcomes. Similarly, pricing financial advice on the quantity of products sold, rather than the quality of advice provided, is a throwback to an era when the financial product manufacturers dominated the emerging financial advice profession.

Purchasers of advice don't want our efforts or our products. They want results and outcomes that allow them to live better lives.

The clients of professional advisers are seeking more transparency and authenticity from their advisers, and they need new pricing paradigms.

The aim of What Price Advice is to assist the development of new pricing paradigms for good advisory firms.

Good advisers provide their clients with an intangible 'peace of mind'.

Capturing this foundational, defining element of an adviser's service, in a price that reflects value to a Client, is difficult. It matches the challenges good advisers endured as they amassed the necessary experience that enabled them to deliver their valuable advice.

As always, there are many charlatans out there, masquerading as professionals, proclaiming to provide 'peace of mind', when the core of their proposition is a product or service that benefits the *supplier more than it benefits the Client. These opportunists are inevitable and they're everywhere, making it harder for intending purchasers and the 'peace of mind' providers to find each other in the marketplace.*

Good advisers are seeing opportunities galore.

The advice profession needs to gear up for the largest migration it has ever witnessed—the patient queue of baby boomers about to change their lifestyles from work to semi- or permanent retirement.

Preparations have been afoot deep in the bowels of the wealth management industry's financial product factories for years. Their deeply ingrained product psyche will need a significant tilt if they are to address the challenges this queue of baby boomer advice-seekers will provide. A study of the collapse of the entrenched computer hardware industry of the 1980s, who failed to anticipate the growth of the many software groups that now dominate world markets, might help.
Opportunities also abound in the small-to-medium enterprise marketplace. The busy owners and workers in these firms have unique
and differing financial complexities in their business lives on a daily basis. They have relied on hard-working accountants, who are often losing their own time battles to proactively service their needs.

The markets for advice are booming.

Good advisers are re- inventing themselves.

From a purchaser's perspective, professions naturally merge.

Like a patient seeking relief, who cares little which vein of speciality they require provided they find a cure; or the home renovator seeking new living spaces, who doesn't wish or need to understand the type of tradesperson required; these purchasers are driven not by the 'how' but by the outcome they seek—the 'what'. To support purchasers obtain the 'what', pricing is evolving to assist them obtain the ir desired outcomes without having to force them to pay for components of the process.

The financial advice profession has been illogically divided into artificial and technical boundaries of banking, insurance, law, accounting, investments and others. The profession is evolving to allow purchasers to assess promised outcomes against a price that represents value to them across all technical disciplines.

Integration of technical disciplines has been tried and has failed many times. But it's been missing three crucial elements: good pricing, good Client management and good project management. Ironically, few of these elements are taught as mainstream subjects for aspiring professionals, either at pre- or postgraduate levels. Mastery of these elements will accelerate the integration of professions quicker than any other time in our professional history. A new paradigm on pricing is a catalyst for the evolution.

Good advisers realise that advisory behaviours and ethics are strongly challenged if there is any impropriety to the basis of their rewards.

The harshest criticisms of capitalism are rightly reserved for those who cultivate practices that feather their own self- indulgent working nests rather than their clients.

It's not only consumers, governments, regulators and clients that insist on a change in methods of payment, but also professionals themselves who will challenge former deceitful behaviours.

Good advisers are experimenting with pricing trends that allow sunlight into their pricing processes. They aren't complacently basing their pricing on percentages of financial product, or hiding behind full timesheets as evidence of hard work.
They realise authentic purchasers of advice are not interested in how many hours were worked or how much product the y require. These purchasers want understandable results and outcomes in their lives thanks to their advisers, and they will pay handsomely for those outcomes.

Good advisers can easily articulate the value they provide their clients.

Many financial advisers are caught without a value proposition they can clearly articulate whenever financial markets fall or favourable legislation is altered. If the proposition is only favourable due to conditions in the hands of external markets or political legislators, any so-called advice proposition has shallow foundations.

For instance, while clients recognise that global falls are not the fault of their individual adviser, they quickly extrapolate that the rises are also not due to the skill of their adviser. What exactly is the value these so-called advisers provide, when markets are the biggest contributor to returns or losses?

Lazy wealth management advisers have used long-term investment gains as the foundation of their value propositions. Long term investment gains are perennial, but the financial fears on the short term roller coaster are very real.

Good advisers recognise that not every Client wants advice.

They understand that the fundamental starting point is focussing on the most fertile spots to aim their advisory efforts. That is, identifying clients who are seeking advice versus those who are seeking products. They don't waste their advice propositions on those clients who don't want it. They realise that's as effective as taking a golf stick onto a tennis court.

Good advisers never forget their original reason for being: providing advice to clients.

They and their team constantly re-focus their efforts on the relationship-based clients who seek advisers to help them make smart decisions regarding their financial lives.

Good advisers recognise they are good advisers.

They never forget their role as adviser. They don't allow clients to take charge in the advisory relationship, insisting on alternative methods of engagement, or pricing or delivery. Advisers must be confident and trust their methods enough to maintain flexibility, but not compromise outcomes because a Client may not be confident in the advisory methods taken.

Especially when exploring new advice work, the adviser must maintain the lead role, guiding their clients as a mountaineer would guide his team using trusted methods built on lesser peaks.
Good advisers make an extraordinary effort re-educating their clients on their role as an adviser— not a product salesperson.

They aren't trying to sell anyone anything. They aren't cultivating various slick marketing strategies. They rely upon the time-tested means of developing new business via satisfied clients. They focus on determining if their firm is the best firm to assist their targeted clients make the smartest decisions regarding their financial lives.

They would never consider outsourcing the core skills of client management, project management or strategic management outside their advice firms. If they did, they wouldn't be able to deliver on their proposition, which is to maximise the probability of their clients achieving their financial goals.

Good advisers are focussing on specific market segments who they enjoy working with, and can offer ongoing value to via their financial advice.

They spend as much time researching the complexities of their selected markets as they do in their own professional development. They understand that their advice clients will only pay their fees year after year if they are adding value year after year by providing relevant advice on real and ever-changing financial complexities.

Good advisers realise that the movement to 'fee-only' advisers is, for most, mainly a marketing tactic rather than a advisory tactic. They know that many advisers scrambling hard to jump on the 'fee-only' truck don't appreciate that that truck is heading to a product-based destination.

Good advisers are well aware that the topic of pricing will always be tough and emotional. They know that good pricing isn't just about facts and figures; it's more about professional courage and value.

They believe it isn't about getting a 'perfect' price. Rather, it's about trying to get their price 'less wrong'. They sense if their pricing process isn't emotional, tough or challenging, then their firm is either charging too little or far too much.

They don't want their income in the years ahead to be primarily linked to their own personal exertion. They want to ensure their future success is based upon profits and dividends earned from an advice group irrespective of anyone's personal efforts.

Good advisers recognise that pricing is the advice industry's Berlin Wall. Visiting the Wall in 1986 left me thinking it was so ingrained in the surrounding culture and way of life that it seemed impregnable. It was down two years later.

Like dismantling the Berlin Wall, good advisers are dismantling the existing pricing paradigms of hourly rate charging or product-based pricing still so evident in our industry. Current paradigms are stopping too many great advisers from understanding that they can price their services much more effectively than a reliance upon hours and products.

Good advisers don't want to link their revenues to factors beyond their control, such as legislation, market performance or product failures. They want to control their destiny.

They realise many advisers suffer from the ridiculous situation where their revenues contract when markets decline, regardless of the quality of their advice. This is often the reason many good advisers started exploring other pricing methods. Just when clients need most reassurance, most confidence and most leadership towards achieving their long-term objectives, good advisers don't want to have to restrict their advice and services because they are being paid on the quantity of product rather than quality of advice.

Good advisers don't want any connection to ugly product subsidies provided by manufacturers. These non-Client based practices only serve to inflate Client pricing for the wrong reasons. If the *only reason that distribution remains aligned to manufacturers is due to subsidies, we have little hope of gaining the trust of our current or future clients.*

Good advisers realise that the word 'commissions' is on the way out. They realise that it's all about sentiment. The practice is dead and commissions need to be forgotten as a means of pricing.

Good advisers thrive when discussing their clients' financial circumstances, values and fears. They enjoy the conversations that lead to a deep insight of the financial complexities challenging the attainment of their clients' financial goals and hopes. In fact, they know they can't be the advisers they aspire to be without a clear understanding and knowledge of these issues.

Good advisers traverse the times of adversity better prepared than most so-called advisers whose proposition is fundamentally linked to factors beyond their control.

When their clients need financial leadership more than ever, they are just as busy delivering on their proposition to maximise the probability of their Client's achieving their financial destiny. The reassurance they deliver in these times is the glue that holds their overall financial strategy together.

They realise that most of the market's advisory proposition resembles a loose collection of product offerings (i.e. accounting, investments, cash flow, insurances) held together by a market sentiment or legislation they have little control over.

You'll never alter the impressions of some of your clients, no matter what you do. But there are clients and prospects who represent your new advice future. These are people who are seeking connections with great advisers who focus on the outcomes they desire. They are also willing to be held accountable to a financial relationship unique to them, which maximises the probability of achieving everything that's important in their financial lives.

This book aims to help those good advisers to continue the growth of their great advisory firms with pricing theories, frameworks, principles and models.
If this provides just one thought, one technique, one principle that assists, its purpose has been served.

Jim Stackpool

Appendix 3

NZICA – *Financial Advisory Engagements* extract on Fiduciary Duty

Fiduciary Relationship with the Client

9. A fiduciary relationship will usually exist between the financial adviser and the client in a financial advisory engagement. Such a relationship arises because the adviser has the following professional obligations to the client as part of undertaking such engagements:

    (a) to act at all times in the best interests of the client, and not out of self- interest or in the interests of a third party; and
    (b) to provide full and fair disclosure to the client of all material facts and information relevant to the relationship with the client and to the engagement, including disclosure of any conflict or potential conflict of interest the adviser may have relating to the relationship or the engagement; and
    (c) to take appropriate steps to either:
        (i) manage and control identified actual or potential conflicts of interest; or
        (ii) avoid conflicts of interest where they are of such significance in terms of their impact on the relationship with the client or the quality of the advice and/or services to be provided that the only way to adequately manage those conflicts is to decline the engagement; and
    (d) to ensure that all information available to the adviser which relates to the client's affairs is made available to the client, subject only to binding obligations as to confidentiality owed to other clients or third parties; and
    (e) to ensure that information obtained in confidence from the client is only used for the benefit of the client, and not for the benefit or advantage of the member or firm, or that of any other party.

10. The full extent of an adviser's obligations deriving from their fiduciary relationship with a client will depend on the particular circumstances of the engagement, the specific facts of their relationship with each client, and the nature of the advice and related services provided under the agreed engagement terms. Members must be aware that further care and obligations may be required in some engagements.

Appendix 4

Comparison Table of key elements of proposed *FoFA* reform and APES 230 ED

Issue	***FoFA***	**APES 230 ED**
Application	New Clients Implementation commences 1/7/2012	All Clients TBA
Remuneration for Financial Advice	Fee for Service as defined in APES 230 ED – when there is gearing. Asset based fees allowable if there is no gearing.	Fee for Service as defined in APES 230 ED. Asset based fees prohibited
Remuneration for Insurance and Risk Products	Initially this was exempt and current practices such as commissions were going to be allowed. However, based on Treasury's update on 28th February 2011, it appears that a prohibition on commissions is currently being considered.	Fee for Service as defined in APES 230 ED. Commissions are prohibited.
Remuneration from Product/product providers	Initial/upfront commission – not permitted Trail commission – not permitted Volume based – not permitted Shelf space fee that are not based on volume (e.g. product access payment)– permitted	Prohibited in all cases
Distinction between retail and wholesale Clients	Yes	No
Fiduciary Duty	Best interest test to be introduced. *FoFA* also includes a 'reasonable steps' qualification and 'best interest' formulation.	Fiduciary Duty section in paragraph 4.
Opt In	*FoFA* includes a requirement for retail Clients to agree to the fees and to annually renew (by opting in) to an adviser's continued services.	Paragraph 6.3, applicable to all Clients