



A New Era of Financial Advice Delivery

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**Filtered
Research
Committee**

Introducing the Certified Financial Strategist (CFS) designation & the Filtered Research Committee (FRC) facilities.



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1. Forward – Peter Johnston Executive Director AIOFP

The global financial crisis has facilitated much needed structural change to the Australian financial services landscape. Although our nation's system is one of the most sophisticated on earth, our adviser remuneration and retail research culture needs reform. Constant political pressure from Government, regulators, consumer groups, market critics and an increasingly fast tracked educated public has also accelerated this change process.

Over the last 30 years in the industry, I have learnt that if you act in the clients best interest, everything else generally falls into place.

The very recent demise of groups like Great Southern, Timbercorp, MFS, Centro, the Storm fiasco and Westpoint has thrown the spotlight on two major issues. Firstly, why did the retail research houses have some of these products on their recommended lists in the first place and secondly, what influence did the high commissions, offered by some of these products or strategies, have on the adviser decision making process.

The retail research house culture has been fundamentally flawed for decades. The practice of charging advisers and simultaneously taking payments from product manufacturers for rating their products is a critically and comprehensively conflicted practice. In addition, the unfortunate human frailty of complacency and 'herd mentality' has seen a number of products fall through the cracks leaving advisers and their clients exposed to massive losses. The sub prime affected Basis Capital is a classic example.

The AIOFP Board has decided to emulate the highly successful investment 'filtering' processes employed by the major superannuation funds and private banks for decades. The Filtered Research Committee [FRC] will give advisers and consumers the confidence that any selected product has been critically and constantly assessed by third party professionals in a conflict free environment.

A product manufacturer directly paying advisers to select their products for a client's portfolio is a fundamental conflict, surely no one can argue with this. The other very human frailty of self interest can sometimes also be an irresistible force to advisers. The only way to overcome these conflicts is to directly negotiate and charge the client a fee for service. This fee should be fully disclosed and negotiated annually, whether it is a flat rate, hourly rate or a percentage and then the product selection process should commence. Although the perfect world of all advisers being free of product manufacturer ownership and all product manufacturers offering a wholesale price will probably never be achieved, we believe this fee structure is the best alternative option.

The AIOFP board has decided to create its own 'consumer friendly' designation that encapsulates the very best conditions and qualities a prospective investor would be looking for in their adviser. A Certified Financial Strategist (CFS) ticks all the boxes. Reliable, conflict-free monitored research and independent fee for service advice are the very core fundamentals of a professional service.

The AIOFP board is pleased to declare that it has embraced the winds of change and has facilitated what it believes is the NEW ERA IN FINANCIAL ADVICE DELIVERY in Australia.





2. Executive Summary

The purpose of this paper is to introduce and detail two initiatives the Association of Independently Owned Financial Planners (AIOFP) will be implementing over the next few months for your consideration. These initiatives are of course optional for members to participate in. The original AIOFP eligibility criteria of no institutional ownership and operating an AFSL are still relevant.

- 2.1 The AIOFP board feels there is currently a unique set of market circumstances to differentiate our members. By demonstrating leadership with the inevitable transition into a new era of fee for service advice, and highlighting our new approach to research capability, consumers and key contacts will be attracted to our value proposition.
- 2.2 The Filtered Research Committee (FRC) and Certified Financial Strategist (CFS) designation are in response to member requests for the AIOFP to have its own designation, generate new client opportunities, mitigate PI costs and present a solution and real alternative to the failed retail research culture.
- 2.3 From a commercial perspective, the AIOFP's objective is to deliver beneficial outcomes to members that also allow the AIOFP to participate in the profits to support its financial position.
- 2.4 The timing of these initiatives has complimented our quest to form a strategic alliance with ASX, industry funds and the corporate sector to deliver quality advice to their constituents.
- 2.5 The image of financial planners in general and the independent sector in particular has been smeared over the past few years with well publicised product failures. Independents are perceived to be susceptible to lower quality product distribution and conflicted by commission payments. The farcical RG146 provisions are blight on the industry, tarnishing our reputation as a worthy profession.
- 2.6 AIOFP members have around 2500 advisers nationally, each having varying degrees of competency, experience and fee structures. In order for us to deal with the ASX and others we need to segment our advisers into those who are prepared to operate on a fee for service basis, have filtered research facilities and are experienced with ASX products. We have no choice but to find a segmentation strategy to satisfy ASX, industry funds and corporate concerns.
- 2.7 In addition, the AIOFP Board is also mindful of their own image and reputation with ASX, industry funds and the corporate sector with recommending advisers to deliver advice. Naturally, we only want advisers from our network who are prepared to operate on the above prescribed conditions to represent the organisation and its members. The



implementation of CFS as our designation provides the perfect medium to segment AIOFP member advisers into a category that we believe delivers the qualities consumers and referrers are looking for when seeking advice. These advisers will be included on the AIOFP premium advisers webpage and will receive new client opportunities from ASX and others.

- 2.8 Although consumer surveys suggest that the public takes little notice of professional qualifications (they probably assume their adviser is appropriately qualified anyway), we see the CFS standard as a powerful, credible influence with third party referrers and the public to deliver new client opportunities. It is no longer good enough for advisers to present the same pre-crisis value proposition. The last 2 years has highlighted critical flaws in research delivery and commission structures that need addressing.
- 2.9 We've had only praise from our centres of influence about the eligibility criteria of becoming a CFS. We will also suggest members use its features in their own referral networks and in client reception areas, as a promotional and credibility tool. Members at the recent AIOFP Koh Samui conference unanimously supported the CFS eligibility criteria.
- 2.10 Research is arguably the most critical function of a practice. Product failure and poor advice can destroy your business and your private life. The retail research industry has performed poorly over the years with conflicts of interests, complacency and poor decisions which have left advisers exposed. Advisers are the soft target for the lawyers, ASIC, FOS, the media and eventually the courts. The conundrum that advisers face is that they are expected to personally inspect assets they recommend, but do not have the expertise and/or time to do it. An outdated research paper has proven to be overwhelmingly insufficient as a defence with ASIC, FOS and the courts. It seems the only real workable solution is to put a strategy in place that eliminates product failure in the first place.
- 2.11 Private banks, large superannuation funds and large planning practices have used an internal 'filtering committee' for many years to mitigate risk. FRC is therefore nothing new to the industry but now available to AIOFP members in a cost effective and convenient manner. Up until now, independents have had little choice but to use the retail research options. This has now changed. FRC will give you and your clients comfort that you have a professional team overseeing and constantly monitoring investment options on your behalf.
- 2.12 Due to the fixed cost nature of operating FRC we are able to not only reduce the upfront cost per adviser but as more members use the service it will actually reduce over time without affecting quality. Combine this with a reduction in PI premiums, of around 15% (for mitigating risk), and elimination of your current facilities, you have a compelling scenario of confidence, quality and cost reductions.



- 2.13 Some members already have a filtered research facility alternative by using third party professionals to ‘filter’ their APL. This will also qualify under the CFS guidelines. If you want to get involved with the program, your structure will need to be passed by our independent auditor, Clive Perring, the Director of the International Centre for Financial Services, a division of the University of Adelaide. Clive will be acting independently of the university in his capacity as our auditor, but will have its resources to assist his duties. Clive has an extensive history in the financial services industry.
- 2.14 A recent discussion with our PI brokers Marsh (the world’s largest and most influential), revealed that filtered research methodology will become the minimum benchmark for practices to mitigate risk and reduce premiums. Product failure from flawed APL’s is the big ticket item underwriters want to avoid (see attached email – appendix 7.1).
- 2.15 The past 5 years of product failure has clearly demonstrated that an effective PI policy is critically important to both advisers and clients if things do not go according to plan. Marsh has agreed to construct a scheme exclusively for AIOFP members that will deliver a highly effective and competitive product focussed on price and definitions to protect all parties.
- 2.16 The CFS specifications form the foundation of excellence in advice delivery. Although the FRC component is an integral component, it is also available to members who do not wish to comply with the other demands of CFS eligibility.



3. Certified Financial Strategist (CFS) Designation

The CFS designated adviser carries the very best credentials consumers are looking for when seeking advice. It has been designed to eliminate the two most obvious conflicts of interests ingrained in the financial services industry – product manufacturer ownership of advisers and advisers who accept commissions from product manufacturers. Both can have an enormous influence on what type of advice a client may get (see the Who Owns Who list – appendix 7.2).

Research demonstrates that consumers pay little attention to professional's formal qualifications; they naturally assume their adviser is qualified to deliver the service anyway. A recent survey of our 400,000 member clients revealed that not one client ever asked whether they were a CFP (the FPA's designation) before appointing them. CFS is designed to take a holistic approach to advice delivery by addressing all the critical factors that can influence advice decisions.

CFS is not designed to compete with the certified planning designation. CFS is a consumer orientated designation that ticks off the best features consumers look for when seeking advice.

CFS advisers operate on the following criteria:

- fee for service with no commission/trail payments from manufacturers
- filtered research committee or similar facilities
- appropriate educational qualifications and experience (3 yrs/min. and DFP)
- work for an independently owned practice
- educated on ASX and industry funds

Working for an independently owned practice, being fee for service and using FRC eliminates the conflicts of interest, whilst the education and experience requirement ensures that clients get a balanced view of the entire product market options.

The positives of being a CFS are not just for consumers. As part of our market research we surveyed a number of union secretaries, human resource managers and corporate executives on their attitudes to financial advisers and the conditions under which advice was given. Not surprisingly (avoiding) commissions, independence and experience were at the top of their desired characteristics.

Another key element for this group was the potential litigation and political ramifications against them personally and the company/union if things did not go according to plan. Our response to this concern was two fold. The obvious one was the mitigation of risk by using the FRC process (therefore hopefully nothing will go wrong). The second was the structure of the AIOFP premium adviser webpage where consumers have a choice of practices and advisers distancing the referrer from the consumer's decision on who they will use to deliver advice.





4. Filtered Research Committee Structure

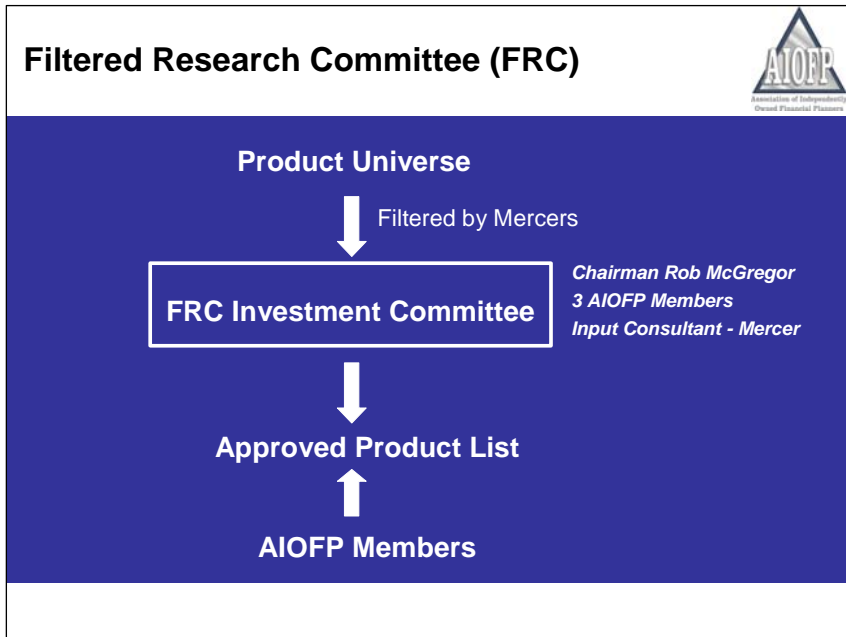
Filtered Research Committee (FRC) is a committee of professionals acting on behalf of subscribing AIOFP members to deliver a concise, approved recommended list (APL), containing investment products and strategies that have passed their scrutiny and are monitored on an ongoing basis.

FRC has eliminated the two most conflicted features of the outdated retail research culture – accepting payments from product manufacturers to assess their own products and the resultant ‘rubber stamping’ of products to appease the paying client. The other structural and logistical flaw with the retail culture is irregular assessment of the products and large unwieldy APL’s that are difficult and expensive to monitor. Recent history has clearly demonstrated that products do ‘fall through the cracks’ leaving devastated clients and advisers.

FRC is funded by the AIOFP members and advisers to constantly monitor an APL which is characterised by quality, integrity and reliability.

4.1 FRC Structure

- Our legal advisers recommend that the Filtered Research Committee (FRC) be a proprietary limited company with the AIOFP being its only shareholder.
- The FRC committee will comprise leading independent research analyst Robert McGregor, 3 experienced AIOFP members (including a rotated AIOFP Director) with world renowned research group MERCER as the committee input consultant (see MMC corporate overview – appendix 7.3).
- The committee will meet at least quarterly, with Mercer in attendance. It is envisaged the committee will also meet monthly, without Mercer physically attending, but they will be available on conference call if required.
- For members wanting ASX direct products, a panel of ASX recommended brokers will be available for both advice and transaction capabilities.
- A comprehensive PI insurance policy will be put in place to cover the FRC committee members and protect advisers and clients if things do not go according to plan.



4.2 FRC Benefits to AIOFP Members and Clients

The following benefits apply to advisers and their clients:

- mitigation of risk - peace of mind for advisers and clients
- ongoing monitoring of all products on the APL
- wholesale pricing and scale benefits
- PI insurance discount
- a real point of difference for clients and referrers
- monitored blended options and platform compatibility with the APL



4.3 FRC Subscriber Benefits

The following benefits apply to FRC subscribers:

- full SOA inserts
- best of breed products you can rely upon
- best of breed model portfolios
- quality direct equities and advice
- monthly commentary and web cast presentations from FRC (CPD points)
- restricted list of tax effective/agri/structured products
- a comprehensive PI cover for FRC
- political and practical support from the AIOFP board
- PI insurance premium discount

ASIC and the courts attitude to advisers acting like 'asset consultants' with client investment recommendations is a real concern. Recent court decisions against advisers in favour of client losses in Westpoint left no doubt that the courts are holding the adviser responsible for all product recommendations. In the Brannelly case, Brannelly's defence was their principle had Westpoint on the recommended list and they were following instructions. They lost! Many advisers are deciding to outsource the advice function to multi manager or model portfolios with professional teams making the asset allocation decisions. FRC will contain market leading options.



5. Professional Indemnity Insurance Solution (For members and clients)

The confusion in both the professional indemnity and financial services market over the past 5 years has certainly dealt some very valuable lessons on price, definitions and quality. The adage of 'you pay for what you get' has handed out some very expensive outcomes to advisers and clients that many may never recover from. These lessons are:-

- a) PI cover should always be bought on a combination of price and quality. It is false economy going for price only, exclusions and conditions can leave you and your clients exposed and isolated. Cover should always be bought on the assumption you will make a claim.
- b) Brokers with real market presence are the best type to have onside when claims occur. It's the 'law of the jungle'; the bigger you are the more influence you have. Again, it's at the point of claim that matters most to your clients and your personal assets. Small brokers simply do not have the clout when it comes to the crunch.
- c) Being a part of a collective, or a scheme where premiums are pooled, not only delivers better outcomes on price and conditions with economies of scale but political and commercial leverage with the underwriter and broker if a claim should occur.

Even though the AIOFP's culture is primarily boutique orientated, when it comes to research and PI cover we cannot afford to get it wrong. Marsh is the globe's biggest broker and has the market power and expertise to deliver a scheme to AIOFP members.

For this to occur members need to assist Marsh with providing information on a confidential basis:-

- (1) current PI insurer & limit purchased, i.e. \$2M, \$5M
- (2) current premium
- (3) details of claims
- (4) PI renewal date
- (5) professional fees generated over the last twelve months

Marsh needs member co operation to present the best possible case to the underwriters. The greater the number of potential participants, the more leverage we and Marsh have to keep the price down and the benefits up. This can only translate into better protection for members and their clients.





6. Pricing

The Filtered Research Committee is available to all members. However, the Certified Financial Strategist designation is only available to advisers who satisfy the 5 major criteria. We cannot take any short cuts or integrity will be lost.

6.1 Certified Financial Strategist (CFS)

Members at the Koh Samui conference approved the annual cost of the CFS designation to be \$650+GST per annum, with an application fee of \$90+GST to research your application. CFS advisers will then be included on the AIOFP premium adviser web page to receive new client opportunities from the following organisations:

1. ASX – a free look exists to September 1st when we need to supply an audit report to ASX.
2. Corporate client opportunities – groups like John Holland (staff, not the Brisconnect venture) Coke, One Steel etc will be potential clients as they are already clients of AFCC.
3. Industry funds – we are developing relationships.
4. General public enquiries – AIOFP premium adviser webpage and CFS will be promoted through the press and directly to the market.
5. Union members directly from their websites.

6.2 Filtered Research Committee (FRC)

Filtered Research Committee has been designed to deliver a service and APL you can rely upon. AIOFP scale advantages and the 'not for profit' theme of its operational culture gives a real opportunity for the annual subscription price to reduce over time without compromising quality. Put simply, the more members that subscribe the lower the price for everyone.

1. Price per adviser will be \$950+GST per annum.
2. This price has been capped at \$38,000+GST to encourage our larger members to get involved (i.e. pay for a maximum of 40 advisers).
3. A discount of 10% in the first year will apply to those members paying upfront. Otherwise quarterly subscription will be available.

The overall cost savings once you eliminate your current research facilities and enjoy a discount on your PI premiums gives you a very compelling proposition to support a strategy that supports the independent sector.



7. Summary

If anything positive can be taken out of the global economic crisis the accelerated reform of Australia's financial services system will be one desired feature. Research, fee and education reform can only deliver positive outcomes for consumers and the industry's image going forward.

The farcical RG146 compliancy guidelines must be immediately abolished. In an era when the industry is commanding a more professional status, to have the opportunity to study online with no previous experience or education and be 'qualified' within 7 days to give advice to the public is absolute lunacy to say the least.

The very fundamental tool an adviser must get right when delivering professional advice to clients is research. Competent, uncompromised research directly translates into a recommended list of products and strategies that both the client and the adviser can rely upon. Get it wrong, and you can destroy the client relationship, your business and possibly your private life.

Over the past 20 years the retail research process has developed systemic, corruptive elements that have led to massive conflicts of interests and complacency resulting in disastrously poor product selections. Recent history has shown that research houses hide behind disclaimers and lawyers when product failure occurs, leaving the adviser and the client to fend for themselves. The irony is both ASIC and the courts give little weight to research information as a justification for advice, with both looking for what processes the adviser put in place to assess the product. Unfortunately reality will show that in the far majority of cases advisers do not have the time or expertise to comprehensively assess products leaving them at the mercy of the research process.

This conundrum facing advisers over ASIC expectations, and the short comings of retail research, leaves advisers no option but to seek a facility where research information can be relied upon. FRC has the critical features clients and advisers are looking for to achieve objectives and peace of mind. Globally respected MERCER acting as the product filter, in conjunction with a highly competent committee delivering ongoing surveillance over a tight quality APL, should tick all boxes for the client's and adviser's peace of mind and expectations.

To complete the ideal environment for consumers to seek advice, AIOFP appointed global broker Marsh to develop a group PI scheme that protects all parties including the client if things do not go according to plan.



8. Appendices

8.1 Email from Stephen Hunter, Marsh

From: Hunter, Stephen [mailto:Stephen.Hunter@marsh.com]
To: Peter Johnston
Subject: Re : AIOFP - Filtered Research Committee

Dear Peter,

It was good to catch up with you again last Thursday & I am pleased to hear that AIOFP are close to " sign off " with Mercer to act as the " filter " for the Filtered Research Committee (FRC) which AIOFP are establishing to evaluate, approve & monitor products for the Approved Product List (APL) for AIOFP members.

As previously advised, two of the major PI insurers which Marsh utilise for the placement of PI Insurance for AIOFP members, namely Vero Insurance Limited (via APUA or directly) and Axis Australia (formerly Dexta Corporation), have previously provided qualified support for this initiative and have indicated that they would perceive AIOFP members in a more positive light than the financial planning industry generally and this would be reflected in insurers consideration of both scope of policy coverage and premium levels. We believe other major PI Insurers of financial planners will view this initiative similarly when the full detail is available for review.

It is difficult to estimate, at this stage, the extent of premium reductions / discounts which insurers might apply to AIOFP members PI Insurance without the full detail, and it also needs to be recognised that the market dynamics for this class of insurance have changed from, say, 12 months ago with the onset of the global financial crisis and it's effects on PI insurers. Most PI insurers writing PI Insurance for financial planners have been increasing base premium rates & deductibles over the last six months in response to a deteriorating claims experience on their portfolios & reduced profitability with lower investment returns being generated.

In fact, it could be argued that PI insurers are now looking at these types of initiatives as being essential to their risk management assessment of financial planners and may well become minimum type requirements to obtain affordable coverage. However, our best " guestimate " at this point is (providing, of course, insurers are satisfied with the detail of this initiative) that premium reductions / discounts on PI insurers new base premium rates of 10 - 15 percent might apply.

I hope this will be of assistance to you for your present requirements & I will look forward to receiving the full detail of this initiative when finalised in order that further discussions with PI insurers on the subject can continue.

Regards

Stephen Hunter
Managing Principal
Finpro Placement Services
Marsh Pty Ltd





8.2 WOW LIST (Who Owns Who)

This table identifies the partial or full ownership of the larger financial planning practices by the financial institutions. What it does not show is the thousands of small practices operating under obscure trading names but ultimately licensed and controlled by financial institutions. Asking the adviser who owns the AFS License will reveal the type of product recommendations you are likely to get. Typically, the AFS owner's products are dominant.

ADVISER GROUPS	INSTITUTIONAL OWNERSHIP DETAILS
Advisor Investment Services	ING
AETUS	AXA
Apogee	NAB
Bleakleys	ING
Bridges Financial Services	Australian Wealth Managers
Cameron Walsh	Royal Sun Alliance
Charter Financial Planning	AXA
Chifley	Aberdeen
Commonwealth Financial Planning	Commonwealth Bank
Consultum	IOOF
Financial Wisdom	Commonwealth Bank
Garrisons	AXA
Garvan Financial Planning	National Australia Bank
Genesys	AXA
Godfrey Pembroke	National Australia Bank
Guardian	Royal Sun Alliance
Hartley Poynton	Royal Bank of Canada
Hillross Financial Planning	AMP
Investor Security Group	Perpetual
Industry Fund Financial Planning	25 Industry Funds
IPAC Securities	AXA
KPMG Financial Planning	Westpac
Lend Lease Financial Planning	National Australia Bank
Lynx	ING
Meritom	Aviva
Milenium 3	ING
MLC	NAB
PACT Accountants Investment Group	St George Bank
Partnership Planning	ING
Professional Investment Services	AVIVA
Protax	ANZ
Quadrant	Garrisons/Challenger
Retireinvest	ING
Securitor Financial Group	Westpac
Winchcombe Carson	IOOF
Whitaker McNaught	Commonwealth Bank



8.3. MMC Corporate Overview

MMC (Marsh & McLennan Companies) is the premier global professional services firm providing advice and solutions in risk, strategy and human capital. Through our market leading brands, colleagues in more than 100 countries help clients identify, plan for and respond to critical business issues and risks.

Risk and Insurance Services

Marsh is the world leader in delivering risk and insurance services and solutions to clients. It provides global risk management, risk consulting, insurance broking, alternative risk financing, and insurance program management services for businesses, public entities, associations, professional services organizations, and private clients. Marsh is organized by client, industry, and risk categories to facilitate the global delivery of highly specialized products and services covering a wide spectrum of risks.

Guy Carpenter is the world's leading risk and reinsurance specialist, creating and executing reinsurance and risk management solutions for clients worldwide. It provides risk assessment analytics, actuarial services, highly specialized product knowledge, and trading relationships with reinsurance markets throughout the world. Client services also include contract and claims management and fiduciary accounting. Run-off services and other reinsurance and insurance administration solutions are offered through Guy Carpenter subsidiaries on a fee basis.

Consulting

Mercer is a leading global provider of consulting, outsourcing and investment services. Mercer consultants help clients design and manage health, retirement and other benefits, and optimize human capital. The firm also provides customized administration, technology and total benefit outsourcing solutions. Mercer's investment services include global leadership in investment consulting and multi-manager investment management. Mercer's global network ensures integrated, worldwide solutions for clients who wish to establish global policies and procedures while allowing for the flexibility to accommodate local cultural, legal and regulatory requirements. The firm's locally based professionals are also available to serve midsize companies and to address country-specific issues and opportunities.

The **Oliver Wyman Group** delivers advisory services to clients through three operating units, each of which is a leader in its field. **Oliver Wyman** is a top-tier global management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. Lippincott helps clients create, develop, and manage their corporate branding, identity, and image. NERA Economic Consulting advises corporations, law firms, and government entities on the economics of competition, regulation, public policy, finance, and litigation.

Risk Consulting and Technology

Kroll, the world's leading risk consulting company, provides a wide range of investigative, intelligence, financial, security, and technology services to help clients solve problems and capitalize on opportunities. Kroll serves a global clientele of law firms, financial institutions, corporations, nonprofits, government agencies, and individuals.

Source: <http://www.mmc.com/about/index.php>

