ON BALANCE…

PHILO CAPITAL ADVISERS

MAXIMISING THE VERTICAL INTEGRATION OPPORTUNITY

On Balance… is the name given to the White Papers that Philo produces from time to time. Our goal in producing these White Papers is to stimulate industry discussion on matters to do with portfolio construction and management.

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While conditions are undeniably tough for non-aligned[1] financial planning businesses at present, they have in front of them a once in a generation opportunity to implement new strategies that will simultaneously delight clients, shareholders and staff. In this article we identify what these strategies are and analyse why they are superior to competing alternatives.

Introduction

Many in the *non-aligned and independently minded* retail advice industry are once again moving rapidly down a path of vertical integration whereby they recommend investment solutions in one form or another that are provided by them or a related entity. This article explores why this is happening, what the main solutions look like and the pros and cons of each. We conclude that:

- Vertical integration strategies should be developed around the needs of investors first and foremost and any strategy that cannot demonstrate how investors will be materially better off is a strategy that is unlikely to be fully supported by clients, advisers and staff.
- Vertical integration can deliver operational efficiency and new revenue streams, but there are material differences in the attractiveness of vertical integration strategies
- Non-aligned advisers need to differentiate themselves from institutional advice and some forms of vertical integration are far better at achieving this goal than others
- There is one vertical integration strategy that stands out for providing:
  - A value proposition and service approach that will more readily win the support of advisers and staff;
  - Services to clients that better meet their needs and preferences
  - Revenue streams that are more sustainable
  - Better differentiation from financial planning services offered by banks and industry superannuation funds
- Organisations can burn material amounts of shareholder capital and waste significant amounts of time on their vertical integration strategies if they do not recognise and manage some fundamental risks
- The opportunity for the non-aligned financial planning sector has never been greater, but realising that opportunity requires clarity of purpose and commitment in execution.

Why vertically integrate?

The drivers for introducing a vertical integration strategy vary between planning firms. For any given non-aligned business the drivers are likely to be one or more of:

- A desire to “freshen up” their value proposition and client engagement
- A desire to demonstrate value in a world of increased fee disclosure obligations
- A need to create sustainable and recurring new revenue streams that will underpin business operations and valuation
- A desire to move revenue to the dealer within the loose federation that comprises most dealer groups
- A concern for control over investment and other compliance risks

[1] We use the term “non-aligned” here to refer to independently owned financial planning businesses and those who have the freedom, notwithstanding ownership, to determine their own service offering to end investors.

- A need to simplify business operations to drive costs down and lift margins
- The need to compete with institutionally owned dealer groups that have greater access to capital - largely because they are vertically integrated.

What are the most common vertical integration strategies?

We are currently seeing 3 main strategies amongst non-aligned planning firms and dealers:

1. **The Unit Trust Strategy:** The dealer group or planning business has a series of managed investment schemes (MIS) created where they can capture an investment management fee – sometimes with external assistance on the investment management and sometimes not. These are usually multi asset class fund of fund structures. The funds span a broad risk spectrum and the adviser recommends the fund that best fits the client.
2. **The Template Model on Platform Strategy:** The dealer or planning firm structures model portfolios on platform designed for typical client profiles and recommends the model portfolio that best suits each client. The platform functionality allows the dealer to rebalance all clients in the model at once, generating significant operational efficiencies and allowing for more frequent review of portfolios. This functionality is often used in conjunction the "no action letter" and a limited power of attorney that grants the operator the necessary discretion to reweight the portfolio.
3. **The Managed Discretionary Account (MDA) Strategy:** Under this strategy there is a formal MDA agreement with the client – with either the dealer or an external specialist provider as the MDA operator. This approach allows for more sophisticated tailoring of client portfolios through access to Individually Managed Account functionality. Customisation choices might include the ability to exclude or substitute funds / securities, the ability to exclude an asset class, set minimum cash levels etc.

There are variations on each of these themes in the market, but the 3 streams above capture the basic "flavours" of vertical integration activity.

Under each strategy a fee is being levied for this activity. For the Unit Trust and MDA strategy the fee is more likely to be explicit and separate from the advice fee. Under the template model on platform approach there appears to be a greater incidence of practices rolling the portfolio management activity into an overall advice and service fee. Again, these are generalisations and there are a broad variety of fee practices in the market.

A brief history of vertical integration (& lessons arising)

Vertical integration is the original business model for the insurance and financial services industries. The Australian financial planning industry had its genesis in tied sales forces selling related party product. As the industry evolved non-aligned advisory groups emerged and proliferated in the 1980's and 90's only to be gobbled up by banks and life offices over the past decade or so as the owners of these non-aligned groups "cashed in their chips" and institutions looked to buy distribution for their higher margin products and services. As things stand today the majority of the retail financial planning industry in Australia is institutionally owned and operating under some form of vertically integrated advice model.

But what has been the experience of "non-aligned" businesses with vertical integration? In the early days of the non-aligned business model there was not a lot of vertical integration going on. Most of these businesses did not have the experience, the skills or the capital to develop or acquire the investment teams and portfolio administration systems required to create a vertically integrated business model. Moreover, most planning groups *did not want to* operate such a model. Their value proposition was to provide advice to consumers on investment selection as well as the ever increasing complexities surrounding superannuation, tax and pension / welfare rules. It suited most planning business not to vertically integrate. In a practical sense, most of the early dealers lacked the control over advisers to enforce the discipline of use of model products which was necessary to give them scale.

As the non-aligned advice segment of the industry grew, some of the more entrepreneurial groups started questioning whether there was a better way to run their business than simply advising on retail funds manufactured by others in exchange for commission. Their motivations were both to capture margin and to deliver a better solution to their businesses. Three main forms of vertical integration emerged at that time and it is interesting and instructive to view how each fared in the context of today's trend back to vertical integration. These early forms of vertical integration were:

- **Adviser as stock picker:**
- **The Unit Trust Strategy (MK1):**
- **The Master Fund (Platform) Strategy:**

We describe each below and how they fared.

Vertical Integration Strategy: Adviser as stock picker

Description:

Some groups decided it was possible to dispense with fund managers in some asset classes by picking securities themselves, usually with support of broker research or that of an internal research manager or both. This model was effectively borrowed from private client stockbroking firms with the crucial difference that the planners were mixing the direct security portfolios with managed funds to create multi asset class portfolios.

How this strategy fared:

The Adviser as Stock Picker strategy had some strong proponents, but was not taken up as broadly as other strategies. This was partly to do with the fact that the language and practice of stockbroking was foreign to many advisers and the broking industry's marketing prowess fell far short of the funds management industry. Executing trades and producing integrated reporting was also not easy to do and this hampered the growth of this business practice. The major research houses the industry was used to working with did not provide research on direct securities at that time. Finally, a lot of advisers did not have the confidence to advise on direct stock portfolios and did not want to be accountable in the eyes of their clients for stock selection. In my view more advisers may have recommended direct stocks if they had been better supported in terms of systems and independent research. Those who did often tended to be "stock enthusiasts" with subscale offerings. Outside the broking offices they lacked the IPO deal flow which provided the revenue to make the labour intensive model financially viable.

Vertical Integration Strategy: The Unit Trust Strategy (MK1)

Description:

The Unit Trust Strategy (MK1): Under this strategy the dealer / planning firm created their own range of multi asset class unit trusts across a risk spectrum. Some groups, IPAC being a good example, articulated a clear investment philosophy and hired specialist investment personnel to run the portfolios. Others were less focussed and effectively rebadged existing product or used the trusts to house more opportunistic investments rather than to provide a broad based portfolio solution.

How this strategy fared:

The Unit Trust Strategy brought operational simplicity to adviser businesses but struggled to get real traction outside the larger groups such as MLC or IPAC. Having a financial planning process that resulted in a choice between one of five or six internal funds always seemed incongruous and more of a reflection of a product distribution activity rather than an advice activity. Further, it was also harder to tailor a portfolio for a client's particular needs or preferences under this approach. How often such customisation was actually needed is a moot point. For both advisers and investors the "five sizes fits all" strategy was ultimately less satisfactory and was not supported to nearly the same extent as the Platform strategy. Costs for clients tended to be high and substantial scale was required to make this a viable option.

Vertical Integration Strategy: The Master Fund (Platform) Strategy:

Description:

This strategy saw the emergence of ASGARD as the original innovator in this market closely followed by Navigator. Both had associated advice groups (SECURITOR and FPI respectively) and both quickly started distributing to other advice firms. In time institutions such as BT, Macquarie and MLC were to copy the early platform operators – confirmation that not all good ideas emerge from the "big end of town". The master funds were able to access wholesale funds at a lower fee (MER) and make portfolio implementation and reporting far more efficient for planning groups. A broad menu of funds was offered from a range of providers.

How this strategy fared:

Platforms became the growth sector of the industry and are now the dominant means by which planners administer portfolios. Platforms were successful because they brought efficiencies to planning businesses but also because there was a broad choice of investments and the adviser's role was both clear and readily accepted by them. In addition, the total cost to the client was about the same as when using retail funds and they delivered a revenue stream that was more readily justified and easy to collect.

Ultimately the platforms were acquired by institutions and there are now few non-aligned planning firms with meaningful platform capability internally. The new form of vertical integration for larger firms is having a badged platform, but where this relies on rebates it is a strategy in run off as far as revenue generation is concerned.

As a commercial competition of ideas there was a very clear winner – the platform strategy. In relative terms the Unit Trust strategy and the Adviser as Stock Picker were so far behind you need binoculars to see them.

What lessons are available to us from the history of vertical integration in non-aligned businesses to date?

(As an aside, the history of vertical integration in *institutions* is far less useful as their advice businesses exist to distribute product and for no other reason. As such vertical integration is hard wired into the organisation and the lessons as to how vertical integration fared relative to competing business models tend to be that, anecdotally, the more established and successful advisers moved away from the in house diversified product. This perhaps reflects the client question "If all you are doing is putting me in one fund, what's the advice fee for?".)

These are a few of my personal observations, based on 30 years of experience:

1. **Investors value choice – whether they use it or not.** Master funds allowed advisers to offer a broad range of funds. While many advisers had their standard portfolios that they recommended, investors nonetheless

valued the perception that their advisers were choosing from a broad market place and the fact that they could query investments and request changes if needed.

2. **Advisers need to feel credible in the eyes of their clients** and to have a valuable role in both strategic advice and investment. Approaches that do not allow the adviser to make a meaningful contribution to the investment process while being properly supported will struggle. Master funds supported the role of the adviser while for most unit trust implementations there was a tension between the adviser's role and management's desire to see all investors use their unit trusts. Arguably the adviser as stock picker model met both the advisers' needs and that of their management, but it was only a minority of advisers that had the confidence to take on that role with the support that was available to them at that time.

3. **Focus and competency win out.** The organisations that prospered were those that invested in skills and systems and specialised heavily in their chosen endeavour. Those that dabbled and did not commit serious capital and leading talent to their undertakings lagged at best and sometimes failed spectacularly, damaging their own business and the reputation of the industry. This observation is true for all three vertical integration models.

4. **Detail and process matter.** The organisations that did best delivered systems and processes that made it easy for planners to use the service. ASGARD and Navigator both integrated their master fund services into their financial planning and practice management software. IPAC built a sophisticated investment proposition of which their unit trusts were but one part of the story.

5. **Investors are still waiting for it to be about them**. Vertical integration, in all its forms, has been about the interests of the dealer group or advice business, whether it be more efficient operations or capturing a greater share of the "value chain" and the associated margin. Whilst it does not necessarily follow that vertical integration cannot be good for adviser groups and investors at the same time, there are unquestionably more conflicts and agency risks for planning groups to manage. If those risks are not managed very carefully a planning group can cause serious damage to its relationship with both its clients and advisers / staff. This is of critical concern to the creation and maintenance of organisational pride and culture – two material contributors to organisational success. The lesson is clear – client interests should be at the forefront when selecting and implementing vertical integration strategies.

How does the current crop of vertical integration strategies fare against the lessons of history?

There are material differences between the main vertical integration strategies. In describing how this is so, it is important to address both the structural and execution aspects of each strategy. That is to say, some strategies are flawed at a structural level and are therefore unlikely to succeed even when executed well (the unit trust strategy) while others are sound structurally but need careful attention to implementation (the MDA strategy).

Structural Review	Implementation Review
The Unit Trust Strategy:	
Relatively speaking multi manager unit trusts have not been a successful strategy for non-aligned dealer groups in the past and there seems no particular reason things will be different this time. The structure is less attractive to advisers and investors for the reasons set out above. i.e. ▪ Investors want to feel their individual needs are being attended to ▪ Advisers don't feel comfortable with a process culminates in a choice between 5 or 6 pre-set products ▪ There are material agency risks if performance is poor – the adviser cannot "sack the fund manager" ▪ Advice groups often lack the scale to be cost competitive against other readily available alternatives ▪ Sub-optimal taxation management ▪ Lack of transparency	▪ Using an internal range of unit trusts simplifies execution with financial planning operations. ▪ The regulatory framework is reasonably stable ▪ Running a unit trust is complex and requires specialist skills. ▪ Most implementations require the unit trusts to be on a platform to provide online access and the ability to include other investments in selected portfolios ▪ The unit trust strategy requires finding an outsourced Responsible Entity or becoming one (with associated regulatory capital requirements) ▪ Integration of existing assets, frozen products, direct property etc into advice is difficult. ▪ Difficult to customise a portfolio when using multi asset class unit trusts ▪ Regarding the trusts we have seen from non-aligned planning firms: – they appear well structured, but in some cases are quite expensive; – Often there is no perceivable "edge" in so far as the process for managing the underlying funds is concerned (to be fair the same can be said for many funds offered by institutions). – They tend to have low levels of FUM, despite being open for a reasonable period of time.
The Template Model on Platform Strategy:	
On the face of it, this strategy looks far better than the Unit Trust strategy from a structural point of view in that there is the capability to create new template portfolios where existing templates do not meet a particular investor's needs. Investors could therefore perceive the available service is more flexible. However, advisers are still likely to feel disenfranchised if they do not define the template portfolios. This functionality is often used to enable advice firms to design portfolios themselves, usually supported by research house reviews of funds and broker stock recommendations. As such agency risks is still material.	Users of template model functionality like the fact it has enabled them to review client portfolios more often than under the old style statement of advice process. This functionality is also embedded into their chosen platform, making it convenient to access. Thus on the face of it, this strategy has strong implementation benefits for both planning firms and clients. However, when it comes to implementation detail, the Template Model on Platform Strategy has some material limitations. Some of the issues are: ▪ Creating new templates to deal with individual investor needs can mean the process quickly becomes unwieldy and so planning firms tend to limit the number of templates that can be created. Tailoring for

Structural Review	Implementation Review
Businesses currently using template models are expecting that ASIC will terminate the no action letter and require full MDA licensing. Most users of the no action letter are finding that getting the MDA Operator authorisation on their existing AFSL is difficult and the potential capital requirements prohibitive. Those who are working within a larger dealer group may find their dealer is able to obtain the MDA Operator authorisation but then hesitate to grant individual advisers an authority to use their template model service as a full discretionary service because of the compliance risks.	clients is sacrificed or compromised in favour of scalability for the advisory firm. ▪ Where firms allow the number of template models to proliferate, they create operational risks, particularly if there have been distinct service levels agreed with clients. ▪ Managing some specific client preferences is generally not catered for or not done well. Examples include a preference to retain a security, to exclude a security or to tranche the implementation of the portfolio or to manage tax efficiently. ▪ On most platforms, template functionality cannot handle reweighting of term deposit portfolios and this leads to advisers excluding them from portfolios. This compromises investment performance at times when term deposits are good relative value (like now). ▪ On some platforms template functionality cannot handle setting of minimum cash preferences, thus creating a need to maintain cash in separate accounts. ▪ Some platforms do not allow direct equities to be bulk traded and thus every share trade is subject to minimum brokerage fees, often at steep rates. For some investors these fees will greatly diminish the value of direct investment. They can also lead to advisers reweighting portfolios less frequently in an effort to reduce fee impact on clients, potentially compromising investment performance. ▪ Template functionality tends to struggle with managing the differing needs of continuing investors and new investors to the template. So for example where stocks in a portfolio run up in value existing investors may be happy to retain them, but they may be considered expensive for new investors to buy them. This creates a dilemma for the person managing the template settings. ▪ Some users of this functionality have been providing the service as part of an existing fee structure. As such it is not the opportunity to create a new revenue stream through providing investors with an incremental benefit. ▪ Only now, driven by FoFA are platforms providing the fee flexibility which allows the levy of a separate fee for the template model (as distinct from the advice fee)

The Managed Discretionary Account (MDA) Strategy:

Structural Review

Pragmatically speaking, the MDA structure offers the non-aligned financial planning industry the best chance yet to deliver investment services that meet the needs of financial planning business owners, advisers and investors. This is because MDAs support both portfolio customisation and scalability. With the ability to customise comes a meaningful investment role for advisers.

MDAs can generate cost savings within a business at the same time as delivering a better experience to investors.

Taken overall, the quality of experience that can be delivered with an MDA is superior to both that of a multi asset class fund of funds and template model functionality and is an experience that can justify a separate fee.

With power comes responsibility and the MDA regulations are quite onerous on the level of servicing and advice required. This makes this form of account uneconomic for smaller clients who cannot afford to pay for advice.

Potential users of MDA functionality need to be aware that ASIC has actively canvassed applying capital requirements on MDA Operators that did not previously exist. (See ASIC's consultation paper 200) If implemented this will make obtaining an MDA Operator endorsement on their AFSL prohibitive for many non-aligned advice firms

However we understand that ASIC intends to consult further with the industry on the scenario where an MDA Operator uses a regulated platform to hold assets and manage transactions. If capital requirements are imposed, there is still the option to use a third party MDA service. We consider this to be the superior approach in any event, for the reasons set out later in this paper.

Implementation Review

MDAs have been around in various forms for close to 20 years and yet they have not achieved significant growth outside of a few businesses that have been the notable exceptions. There have been a number of reasons for this.

- Large institutions have only made token attempts to develop MDA functionality in the past as they see a risk that MDAs will cannibalise their funds management businesses.
- Pricing policies that have made them uncompetitive
- Few providers have offered a true multi asset class service (most have focussed on direct Australian shares) thus limiting their attractiveness and utility in "whole of portfolio" advice.
- Lack of integration between investment and operational personnel leading to sub optimal portfolio trading
- The variety of ways that MDA's can be constructed and implemented has led to confusion. There are still very few people who truly understand MDA's and how to operate them successfully.
- Adviser firms have not had the incentive to move away from platform rebates – until now.
- The compliance risk of MDAs are not well understood – they are sometimes considered to be an increased compliance risk when in fact the opposite is true.
- Failure of most MDA providers to properly integrate investment administration and portfolio management

On a more positive front, there have been MDAs developed that have overcome these hurdles and delivered some material implementation benefits. These include:

- Customised portfolios with scalable administration
- Material cost savings from operational efficiencies with the planning business
- Introduction of a dynamic asset allocation approach that integrates with portfolio management at a fund / security level
- High levels of adviser satisfaction and reduction in adviser workloads

Structural Review	Implementation Review
	▪ More advisers confident to use direct security portfolios ▪ Bulk share trading with cheaper brokerage and better trade execution ▪ Introduction of a separate fee for portfolio management

Is there a "do nothing" option?

Financial planning firms need to find ways to engage with their existing clients and deliver value in their clients' eyes. Whilst the FoFA opt-in obligations look likely to be revoked by the new coalition government, the levels of fee disclosure that planners are obliged to provide in future will inevitably create increased investor scrutiny of fees and a need to be able to demonstrate the value delivered.

Further, there are tens of thousands of Australians with many billions of dollars of long term savings (much of this in SMSFs) looking for a better way of managing their portfolios. They are looking forward - not back - for solutions. New channels are being developed to compete for their funds. These include direct solutions delivered over the internet and a retooled offer from the accounting profession as they enter the financial planning market with a fresh perspective. Ignore them at your peril.

For planning groups that need to replace platform rebate and commission revenue that is now in run off, there is a heightened sense of urgency to this issue. Without finding that replacement revenue either or both their cost structures and profitability will have to fall.

Creating the ideal vertical integration strategy

My advice to the senior management team of a non-aligned advice business looking to introduce a vertical integration strategy to their business would include the following elements:

1. Start with the needs of your clients. Give them what they want <u>and</u> what they need. In our experience that means a tailored portfolio, conflict free investment selection, active asset allocation and risk management, true expertise in each aspect of service delivery, frequent portfolio review across a full range of investment assets, meaningful communication and well trained advisers that can provide leadership and insight. Most of all they want their goals met and that means you need a credible process to understand those goals and improve the probability of a satisfactory outcome.

2. Make sure your strategy reinforces your non-aligned status. You are competing with banks, life offices and industry superannuation funds – make sure you look different, not the same (more on what that looks like later). There is no intrinsic merit in their business model for a non-aligned planning business that makes it worth emulating them. Their models make sense for them, not for you.

3. Recognise and respect that the group with the furthest to travel are advisers who need to move their mindset and their existing client base from a position where the adviser is responsible for investment selection to one where the adviser has a strategic, counselling and client specific role – not being a part time fund manager.

4. Get your investment philosophy clear. If you are not sure what to believe in when it comes to investment, get someone to help you work it out. <u>Don't just accept someone else's story</u>, no matter how credible it may seem at first. Test and scrutinise – there are some zealots out there with ideas that seem plausible and even attractive, but which fall apart under close scrutiny. Compare the logic. If you believe in what you are doing and your advisers believe it, your clients will feel it and they will buy in.

5. Build your solutions around your beliefs – make sure that everything you do has a consistent logic to and works as an integrated whole. That means portfolio design processes, policy frameworks for advisers, fund / security selection, portfolio management, portfolio administration, asset allocation review, client communication, adviser training etc – all designed to work together and all an expression of what you believe.
6. Make sure that every person involved in the investment and portfolio administration process is a bone fide expert in what they do. The responsibility of managing the long term savings of Australians is a profound one. Do it right. That means full time and expert investment analysts, portfolio managers, portfolio administrators, market strategists. If your business is not big enough to support this then outsource for those skills and associated systems. Don't compromise on quality – your clients will sense the difference.
7. Think about the experience you are providing your client as a product management responsibility and a way of expressing your philosophy around service and investment. Break the experience you want to deliver your client down into steps or components and consciously design each one. Having done so, your value proposition to your clients should naturally fall out.
8. Introducing a vertical integration strategy invariably means some reengineering in your business. Take the time to do it properly. That includes taking time to understand the potential trade offs between client preferences, adviser preferences, investment philosophy, organisational branding, insourcing vs outsourcing considerations and operational efficiency.
9. Don't be too concerned if on reflection your new beliefs and not consistent with past statements to clients. So long as you have good and clear reasons for change and these are well explained, clients will respect the fact that your organisation is learning and developing. Obviously tact and consistency of message is required, but there is no reason to be held back by past beliefs or approaches that you can no longer commit to.

More specifically, when looking at the merits of the three most prominent vertical integration strategies being considered today my general conclusions are:

- Non-aligned businesses looking to create a revenue stream through a vertical integration strategy should look beyond the strategies of creating multi asset class unit trusts. History tells us this solution has been judged to be relatively inferior when competing with alternatives that offer choice and the weaknesses are still there. While trusts can work to a limited degree, it is hard to see any business reaching its true potential with this approach. However unit trusts can be a valuable tool for housing single sector investment opportunities where those opportunities are not already generally available in an Australian domiciled trust or on the ASX. They can also be useful for very small portfolios where the cost of advice to meet MDA regulatory guide obligations cannot be justified.
- Template Models run on your favourite platform can work and many businesses have been happy with this solution. However changing regulation and implementation limitations make this a short term solution at best.
- MDAs represent an outstanding opportunity for the non-aligned advice industry to differentiate itself with a service providing choice, improved service, customisation ability, better investment outcomes and more. There is compelling logic for MDAs to be at the core of any group's vertical integration strategy.

To illustrate in a more visual form how an MDA based strategy may help non-aligned firms differentiate themselves, please see figure 1 below:

Figure 1.

Attribute	Non Aligned MDA	Bank[2]	Industry Fund[3]
Ability to customise for client needs / preferences	✓	✓	×
Asset allocation is dynamic with wide ranges	✓	?	?
Broad investment choice	✓	✓	×
Centralised and expert investment team	✓	✓	✓
Centralised and expert portfolio administration	✓	✓	✓
Investor perceives advice to be uncompromised	✓	×	×
Choice of investment style (active / passive, listed / unlisted)	✓	✓	×
Greater ability to manage taxation at investor level	✓	✓	×
Ability to incorporate specialist investments for selected clients	✓	×	×
Advisers feel empowered	✓	×	×
Value proposition for both advice and investment bears serious investor scrutiny	✓	×	×
Direct equity trades can be bulked for cost saving	✓	×	×
Cash and term deposits can be rebalanced, per investor	✓	?	✓
Investors feel “special”	✓	×	×

Note: I have completed the above table based on my detailed understanding of the MDA services offered by Philo Capital Advisers and compared it to what I believe to be generally true of the services offered via banks and industry funds. I have then tested my understanding with industry colleagues. There may well be exceptions where a specific bank or Industry superannuation fund is concerned.

Conclusion

There has been much anxiety across non-aligned advisory groups in recent years, generated in the aftermath of the global financial crisis and by regulatory change. This anxiety is justified; a minority of Australians have a financial planner, industry growth has stagnated and new forms of competition are coming – both via direct and intermediated channels.

Whilst it is natural to be anxious in times of change, there is the potential for this to be a time of renewal for non-aligned advisory firms and a chance to differentiate their services from their institutional competitors. In particular there is a once in a generation opportunity to conceive and implement a vertical integration strategy that will take client, shareholder and adviser satisfaction to new heights as well as generating operational efficiency and risk management.

We advocate careful assessment of the options available for vertical integration – the differences between them are significant and the wrong choice could mean many thousands of wasted dollars and several wasted years.

[2] Assumes bank adviser using bank APL via bank platform
[3] Assumes industry fund member getting advice from related planning firm

As we have seen, the notion of vertical integration is not new and nor is the idea of generating a fee for strategic advice and a separate fee for portfolio construction and management. What is different is that we have the experiences of those that have gone before to learn from and innovative new service providers to choose between.

For most non-aligned organisations they will not have the time, scale or budget to build their own solutions. Others will simply want to move quickly to equip their organisations for the future using systems and providers who have already proven their services commercially. In this regard my colleagues and I at Philo Capital Advisers welcome enquiries from financial planning firms wanting to understand the MDA opportunity in more detail or who simply wish to make a comparison of Philo's services with competing alternatives. Our contact details and a brief overview of Philo are provided below.

Brett Sanders
Joint CEO – Philo Capital Advisers
November 2013

Acknowledgement:

I would like to acknowledge the contribution of those that reviewed this article and suggested amendments that both aided clarity and delivered additional insights. Thank you so much.

Disclosure of Interest and Philo Overview

Philo Capital Advisers is a provider of a range of portfolio construction and management services, including Managed Discretionary Accounts. It is only fair to acknowledge therefore that the analysis cannot be entirely objective. Philo stands to benefit from the growth in use of MDAs.

On the other hand Ashley Owen, my colleagues and I established Philo Capital Advisers with MDA capability because of a deep belief in MDAs borne of first hand experience operating them and seeing them applied to financial planning relationships. The commit to MDAs came first and we acted on that conviction by "putting our money where our mouth is".

At the time of writing Philo administers and provides portfolio management for over \$2.7billion in MDA funds in addition to managing \$1.3billion of non MDA money. In the past 2 years we have been averaging growth in MDA funds of over \$100million per month. Our investment approach has been running with live portfolios for 3 years at the end of December 2013 and performance has been excellent. Philo's role in achieving these successes extends beyond investment management functions such as asset allocation, portfolio management and MDA administration to a range of implementation and support services. These have included training, policy creation, client communications and much more.

We have also had the great fortune to work with committed management and advisers at our foundation client and we thank them sincerely for their support and patronage.

Philo welcomes enquiries from any organisation wishing to investigate the potential for integrated MDA services to help grow their business and drive their profitability.

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and ask for Brett Sanders, Mathew Birch or Ashley Owen