

Disclosure Brochure

March 27, 2012

Phillips Financial Management, LLC

a Registered Investment Adviser

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This brochure provides information about the qualifications and business practices of Phillips Financial Management, LLC (hereinafter "PFM"). If you have any questions about the contents of this brochure, please contact Jeanine M. Herold at (260) 420-7732. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. Additional information about Phillips Financial Management, LLC is available on the SEC's website at www.adviserinfo.sec.gov.

Phillips Financial Management, LLC is an SEC registered investment adviser. Registration does not imply any level of skill or training.

Item 2. Material Changes

This Item discusses only the material changes that have occurred since PFM's last annual update dated March 31, 2011. As of May 1, 2011, PFM and its representatives no longer have any affiliation with Cambridge Investment Research.

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Item 4. Advisory Business

PFM provides financial planning, consulting, and investment management services. Prior to engaging PFM to provide any of the foregoing investment advisory services, the client is required to enter into one or more written agreements with PFM setting forth the terms and conditions under which PFM renders its services (collectively the “*Agreement*”).

PFM has been in business as an SEC registered investment adviser since July 23, 2004. Richard L. Phillips, Jr. and Shannon H. Hardiek are the principal owners of PFM. As of December 31, 2011, PFM has \$537,256,325 of discretionary assets under management.

This Disclosure Brochure describes the business of PFM. Certain sections will also describe the activities of *Supervised Persons*. *Supervised Persons* are any of PFM’s officers, partners, directors (or other persons occupying a similar status or performing similar functions), or employees, or any other person who provides investment advice on PFM’s behalf and is subject to PFM’s supervision or control.

Financial Planning and Consulting Services

PFM may provide its clients with a broad range of comprehensive financial planning and consulting services. These services include business planning, retirement, education, estate planning, pension consulting, and cash flow needs of the client.

In performing its services, PFM is not required to verify any information received from the client or from the client’s other professionals (e.g., attorney, accountant, etc.) and is expressly authorized to rely on such information. PFM may recommend the services of itself, and/or other professionals to implement its recommendations. Clients are advised that a conflict of interest exists if PFM recommends its own services. The client is under no obligation to act upon any of the recommendations made by PFM under a financial planning or consulting engagement or to engage the services of any such recommended professional, including PFM itself. The client retains absolute discretion over all such implementation decisions and is free to accept or reject any of PFM’s recommendations. Clients are advised that it remains their responsibility to promptly notify PFM if there is ever any change in their financial situation or investment objectives for the purpose of reviewing, evaluating, or revising PFM’s previous recommendations and/or services.

Investment Management Services

Clients can engage PFM to manage all or a portion of their assets on a discretionary basis.

PFM primarily allocates clients’ investment management assets among mutual funds, exchange-traded funds (“ETFs”) and individual debt securities. Occasionally, PFM will advise clients regarding certain types of options as well as the securities components of variable annuities in accordance with the investment objectives of the client.

PFM also may render non-discretionary investment management services to clients relative to variable life/annuity products that they may own, their individual employer-sponsored retirement plans, or other products that may not be held by the client's primary custodian. In so doing, PFM either directs or recommends the allocation of client assets among the various investment options that are available with the product. Client assets are maintained at the specific insurance company or custodian designated by the product.

PFM tailors its advisory services to the individual needs of clients. PFM consults with clients initially and on an ongoing basis to determine risk tolerance, time horizon and other factors that may impact the clients' investment needs. PFM seeks to ensure that clients' investments are suitable for their investment needs, goals, objectives and risk tolerance.

Clients are advised to promptly notify PFM if there are changes in their financial situation or investment objectives or if they wish to impose any reasonable restrictions upon PFM's management services. Clients may request reasonable restrictions on the management of their account which will be honored if, in PFM's sole discretion, the conditions will not materially impact the performance of a portfolio strategy or prove overly burdensome to its management efforts.

Sponsor of Wrap Programs

PFM is the sponsor of the Phillips Financial Management Wrap Program ("*Program 1*") and the Phillips Financial Wealth Management Program ("*Program 2*") (collectively, the "*Programs*"), both wrap fee programs. In the event the client participates in the *Programs*, PFM provides its investment management services and arranges for brokerage transactions under a single annualized fee. Under the *Programs*, participants may ultimately pay a higher aggregate fee than if investment management and brokerage services are purchased separately. A complete description of the *Programs*' terms and conditions (including fees) are contained in the *Programs*' wrap fee brochure.

Program 1 is generally unavailable to new clients. *Program 2* is available only to those clients who engage PFM to manage at least \$500,000 in assets. Clients who engage PFM to manage less than \$500,000 in assets are not eligible to participate in *Program 2*.

Generally, management of accounts in the *Programs* is conducted in the same manner as accounts that are ineligible under the *Programs*. However, participants in *Program 2* are likely to hold more investment positions representing each individual asset class due to the size of their accounts; also, individual bonds and/or certificates of deposit may be used. For smaller accounts, PFM may invest in fewer funds (representing broader indexes). In addition, non-wrap accounts typically do not include individual fixed income securities.

Educational Services

PFM may provide non-personalized investment-related training to certain institutional clients as part of its educational services. PFM's institutional educational services generally address issues involving employee participation in an employer-sponsored retirement plan. Although PFM may charge a fixed and/or hourly fee for these services, it generally does not charge 401k or other pension plans for which it provides advisory services. Should any of the employer's participants later engage PFM to render additional services, such work shall be done pursuant to a separate written agreement between the employer's participant and PFM, independent of the employer's engagement for educational services.

PFM may also provide continuing education courses for a local university. The curriculum for these courses is agreed upon between the university and PFM. PFM receives a fee from the university for providing these services. Should any of the students later engage PFM to render additional services, such work shall be done pursuant to a separate written agreement between the individual and PFM.

Item 5. Fees and Compensation

PFM offers its services on a fee basis, which may include hourly and/or fixed fees, as well as fees based upon assets under management. Additionally, certain of PFM's *Supervised Persons*, in their individual capacities, may offer insurance products under a commission arrangement.

Financial Planning and Consulting Fees

PFM may charge a fixed fee and/or hourly fee for financial planning and consulting services. These fees are negotiable, but generally range from \$1,500 to \$30,000 on a fixed fee basis and/or from \$100 to \$300 on an hourly rate basis, depending upon the level and scope of the services and the professional rendering the financial planning and/or the consulting services.

Prior to engaging PFM to provide financial planning and/or consulting services, the client is required to enter into a written agreement with PFM setting forth the terms and conditions of the engagement. Generally, PFM requires one-half of the financial planning and/or consulting fee (estimated hourly or fixed) payable upon entering the written agreement. The balance is generally due upon delivery of the financial plan or completion of the agreed upon services.

Investment Management Fee

PFM provides investment management services for an annual fee based upon a percentage of the market value of the assets being managed by PFM. For those clients not participating in one of the *Programs*, PFM's annual fee is exclusive of, and in addition to brokerage commissions, transaction fees, and other related costs and expenses which are incurred by the client. PFM does not, however, receive any portion of these commissions, fees, and costs. PFM's annual fee is prorated and charged quarterly, in advance, based upon the market value of the assets being managed by PFM on the last day of the

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previous quarter. The annual fee varies depending upon the market value of the assets under management and the type of investment management services to be rendered, as follows:

For Individuals, Foundations and Endowments:

<u>PORTFOLIO VALUE</u>	<u>ANNUAL FEE</u>
up to \$100,000	1.00%
\$100,000 - \$249,999	0.90%
\$250,000 - \$499,999	0.80%
\$500,000 - \$749,999	0.70%
\$750,000 - \$999,999	0.65%
\$1,000,000 - \$1,999,999	0.60%
\$2,000,000 - \$2,999,999	0.55%
\$3,000,000 - \$3,999,999	0.50%
\$4,000,000 - \$4,999,999	0.45%
\$5,000,000 - \$9,999,999	0.40%
\$10,000,000 and over	0.35%

For Pension and 401(k) Plans:

<u>PORTFOLIO VALUE</u>	<u>ANNUAL FEE</u>
up to \$5,000,000	0.40%
next \$5,000,000	0.30%
next \$10,000,000	0.20%
next \$30,000,000	0.15%
above \$50,000,000	0.10%

For clients who have not engaged PFM for financial planning services during the prior twelve months, the firm may charge a modified fee schedule, as follows:

<u>PORTFOLIO VALUE</u>	<u>ANNUAL FEE</u>
up to \$250,000	1.00%
\$250,000 - \$499,999	0.90%
\$500,000 - \$749,999	0.80%
\$750,000 - \$999,999	0.70%
\$1,000,000 - \$1,999,999	0.65%
\$2,000,000 - \$2,999,999	0.60%
\$3,000,000 - \$3,999,999	0.53%
\$4,000,000 - \$4,999,999	0.48%

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\$5,000,000 - \$9,999,999	0.42%
\$10,000,000 and over	0.37%

In addition to its management fee, PFM may charge new clients an additional up-front fee of \$100-\$1,000 to cover costs associated with establishing the relationship (i.e. set up accounts, assistance with account transfers, establishing an investment policy, and initial trading to bring portfolio into line with new account objectives).

PFM may negotiate to charge a lesser management fee based upon certain criteria (i.e., anticipated future earning capacity, anticipated future additional assets, dollar amount of assets to be managed, related accounts, account composition, pre-existing client, account retention, *pro bono* activities, etc.).

Fees Charged by Financial Institutions

As further discussed in response to Item 12 (below), PFM generally recommends that clients utilize the brokerage and clearing services of Fidelity Institutional Wealth Services ("*Fidelity*"). PFM may only implement its investment management recommendations after the client has arranged for and furnished PFM with all information and authorization regarding accounts with appropriate financial institutions. Financial institutions include, but are not limited to, *Fidelity*, any other broker-dealer recommended by PFM, broker-dealer directed by the client, trust companies, banks etc. (collectively referred to herein as the "*Financial Institutions*").

Clients may incur certain charges imposed by the *Financial Institutions* and other third parties such as fees charged by *Independent Managers* (as defined below), custodial fees, charges imposed directly by a mutual fund or ETF in the account, which are disclosed in the fund's prospectus (e.g., fund management fees and other fund expenses), deferred sales charges, odd-lot differentials, transfer taxes, wire transfer and electronic fund fees, transfer-out fees, and other fees and taxes on brokerage accounts and securities transactions. Additionally, for assets outside of any wrap fee programs, clients may incur brokerage commissions and transaction fees. Such charges and fees are exclusive of and in addition to PFM's fee.

PFM's *Agreement* and the separate agreement with any *Financial Institutions* may authorize PFM or *Independent Managers* to debit the client's account for the amount of PFM's fee and to directly remit that management fee to PFM or the *Independent Managers*. Any *Financial Institutions* recommended by PFM have agreed to send a statement to the client, at least quarterly, indicating all amounts disbursed from the account including the amount of management fees paid directly to PFM.

Fees for Management During Partial Quarters of Service

For the initial period of investment management services, the fees are calculated on a *pro rata* basis.

The *Agreement* between PFM and the client will continue in effect until terminated by either party pursuant to the terms of the *Agreement*. PFM's fees are prorated through the date of termination and any remaining balance is charged or refunded to the client, as appropriate.

Clients may make additions to and withdrawals from their account at any time, subject to PFM's right to terminate an account. Additions may be in cash or securities provided that PFM reserves the right to liquidate any transferred securities or decline to accept particular securities into a client's account. Clients may withdraw account assets on notice to PFM, subject to the usual and customary securities settlement procedures. However, PFM designs its portfolios as long-term investments and the withdrawal of assets may impair the achievement of a client's investment objectives. PFM may consult with its clients about the options and ramifications of transferring securities. However, clients are advised that when transferred securities are liquidated, they are subject to transaction fees, fees assessed at the mutual fund level (i.e. contingent deferred sales charge) and/or tax ramifications.

If assets are deposited into or withdrawn from an account after the inception of a quarter that exceed \$50,000, the fee payable with respect to such assets will be prorated based on the number of days remaining in the quarter. For partial withdrawals in excess of \$50,000 within a billing period, the unearned fee with respect to such assets will be adjusted based on the number of days remaining in the quarter, and refunded to the client's account. However, additions or withdrawals occurring on or after the 15th day of the final month of a quarter (i.e. the final 15 or 16 days of any given quarter, as applicable) will not be subject to being adjusted or prorated.

Item 6. Performance-Based Fees and Side-by-Side Management

PFM does not provide any services for performance-based fees. Performance-based fees are those based on a share of capital gains on or capital appreciation of the assets of a client.

Item 7. Types of Clients

PFM provides its services to individuals, pension and profit sharing plans, trusts, estates, charitable organizations, corporations and business entities.

Item 8. Method of Analysis, Investment Strategies and Risk of Loss

Method of Analysis

Investment Selection Process

PFM's Chief Investment Officer, in conjunction with PFM's Investment Committee, are responsible for monitoring investment research and initiating discussion on topics that may cause PFM to review its philosophy and strategy. For example, PFM periodically reviews the asset classes that are included in its

model portfolios. As a result, over the years PFM has added some sub-asset classes for consideration in certain types of portfolios.

PFM's Investment Committee also reviews market and industry trends to determine if any other types of changes should be made to PFM's strategies. In general, PFM does not advocate making large changes in the client allocation and rebalancing process because of current market volatility. However, PFM is conscious of the potential impact of current and projected market conditions on client portfolios and determines how to manage client expectations and modify holdings where appropriate.

In addition, PFM periodically reviews the acceptable indices to be used to assess the performance of the market, such as S&P, MSCI, Wilshire, etc. PFM reviews literature discussing the pros and cons of various index construction methods to determine which indices most appropriately reflect the performance of the market.

PFM also reviews the specific fund companies and funds to be used. As a result, PFM has developed a list of funds that are generally (but not exclusively) selected for client portfolios. PFM's review of funds is based on various factors, such as quality and expertise of the fund company, expense ratio, consistency in tracking the index, stated objective of the fund (especially for non-index funds), tenure of the fund, and the index being tracked. PFM allows its investment adviser representatives to choose the specific funds for each account.

In conducting research, PFM utilizes industry publications, websites, prospectuses, and research papers. However, PFM does not engage in technical analysis as this is not consistent with PFM's philosophy.

Investment Strategies

Investment Philosophy

PFM follows an investment philosophy of passive investing using ETFs and mutual funds that track a specific index. PFM also utilizes individual bonds and certificates of deposits for larger portfolios, as well as low-cost bond mutual funds that are structured similar to a buy-and-hold ladder bond portfolio.

PFM's review of studies and research indicates that achieving returns that are better than market performance (i.e. "beating" the market) occurs infrequently and unsystematically. Furthermore, such attempts to "beat" the market often result in performance that is below the average market return. Therefore, PFM strives to achieve average market performance (as measured by widely recognized indices) through consistent exposure to broad market indices. This approach allows for low-cost investing, as there are lower expenses associated with research, administration and transaction fees (due to less frequent trading). This approach also can be more tax efficient than active management approaches.

Management Process

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Through the use of a Risk Tolerance Questionnaire, review of a client's financial situation, and discussions with the client, PFM selects the model portfolio that most closely matches the client's needs. Many client portfolios are managed very similarly to one of the models. However, PFM may make adjustments to the model portfolio based on the client's specific needs.

In managing client portfolios, PFM starts with a group of model portfolios developed and redesigned over the course of several years. The model portfolios specify target percentages for broad asset classes (such as U.S. stocks, international and emerging markets stocks, and fixed income). PFM does not allocate according to narrow sectors or highly specified regions. However PFM does utilize sub asset classes like small and mid-size stocks, and high yield versus investment grade bonds, as well as different bond maturities.

The types of securities used in client portfolios include mutual funds, ETFs and individual bonds and certificates of deposit. Occasionally, a variable annuity is used if a particular client has a nonqualified annuity with significant gain. Also, PFM will permit individual stocks to be held in managed accounts, but will only provide advice to the extent of assisting the client diversify out of the positions over time. PFM does not provide research or due diligence on individual company stocks. The decision to sell the individual stock is ultimately the client's decision.

PFM manages client portfolios within acceptable tolerance levels. Generally if a particular asset class becomes more than 25% out of range of the target percentage, it will be rebalanced. However, this is not an automatic process. Meetings are held at least annually with each client, at which time accounts are rebalanced as appropriate. In addition, accounts are reviewed quarterly. Tax consequences may be considered when initiating transactions in client accounts, depending on the client's particular needs and circumstances. In some accounts, there are concentrated individual stock positions at the client's request, which may skew allocations.

Although PFM may utilize model portfolios as a starting point for developing an appropriate strategy for the client, PFM does not take an automated, one-size-fits-all, approach to managing accounts. Client accounts are managed individually by specific investment adviser representatives in the firm. As such, no promises are made that accounts of similarly situated individuals are managed in "the same" manner. Investment adviser representatives have the freedom to choose among a variety of funds. PFM is committed to using low-cost funds, while not necessarily the cheapest fund, in every category. While preferences for different funds and indices change and evolve over time, PFM does not automatically sell a particular security because of a change in preference. PFM does not trade in blocks.

Risks of Loss

Mutual Funds and Exchange Traded Funds (ETFs)

An investment in a mutual fund or ETF involves risk, including the loss of principal. Mutual fund and ETF shareholders are necessarily subject to the risks stemming from the individual issuers of the fund's

underlying portfolio securities. Such shareholders are also liable for taxes on any fund-level capital gains, as mutual funds and ETFs are required by law to distribute capital gains in the event they sell securities for a profit that cannot be offset by a corresponding loss.

Shares of mutual funds are generally distributed and redeemed on an ongoing basis by the fund itself or a broker acting on its behalf. The trading price at which a share is transacted is equal to a fund's stated daily per share net asset value ("NAV"), plus any shareholders fees (e.g., sales loads, purchase fees, redemption fees). The per share NAV of a mutual fund is calculated at the end of each business day, although the actual NAV fluctuates with intraday changes to the market value of the fund's holdings. The trading prices of a mutual fund's shares may differ significantly from the NAV during periods of market volatility, which may, among other factors, lead to the mutual fund's shares trading at a premium or discount to NAV.

Shares of ETFs are listed on securities exchanges and transacted at negotiated prices in the secondary market. Generally, ETF shares trade at or near their most recent NAV, which is generally calculated at least once daily for indexed-based ETFs and more frequently for actively managed ETFs. However, certain inefficiencies may cause the shares to trade at a premium or discount to their pro rata NAV. There is also no guarantee that an active secondary market for such shares will develop or continue to exist. Generally, an ETF only redeems shares when aggregated as creation units (usually 50,000 shares or more). Therefore, if a liquid secondary market ceases to exist for shares of a particular ETF, a shareholder may have no way to dispose of such shares.

Market Risks

All securities, particularly individual equity and debt securities are subject to market volatility, economic factors and certain other market risks. The success of an investment may depend to a great extent upon correctly assessing the future course of price movements of stocks and bonds. In accordance with its independent philosophy, PFM makes no attempt to predict price movements or to "time" the purchase and sale of securities accordingly.

Management Through Similarly Managed Accounts

PFM manages portfolios by allocating portfolio assets among various securities using one or more of its proprietary investment strategies (collectively referred to as "*investment strategy*"). In so doing, PFM buys, sells, exchanges and/or transfers securities based upon the *investment strategy*.

PFM's management using the *investment strategy* complies with the requirements of Rule 3a-4 of the Investment Company Act of 1940, as amended. Rule 3a-4 provides similarly managed accounts, such as the *investment strategy*, with a safe harbor from the definition of an investment company.

Tax consequences may be considered when initiating transactions in client accounts, depending on the client's particular needs and circumstances.

General Risk of Loss

Investing in securities involves the risk of loss. Clients should be prepared to bear such loss.

Item 9. Disciplinary Information

PFM is required to disclose the facts of any legal or disciplinary events that are material to a client's evaluation of its advisory business or the integrity of management. PFM does not have any required disclosures to this Item.

Item 10. Other Financial Industry Activities and Affiliations

PFM is required to disclose any relationship or arrangement that is material to its advisory business or to its clients with certain related persons. PFM has described such relationships and arrangements below.

Receipt of Insurance Commission

PFM is under common control with Phillips Financial Services, Inc., a duly licensed insurance agency. Certain of PFM's *Supervised Persons*, in their individual capacities, are also licensed insurance agents with Phillips Financial Services, Inc., as well as other insurance companies, and in such capacity, may recommend, on a fully-disclosed commission basis, the purchase of certain insurance products. While PFM does not sell such insurance products to its investment advisory clients, PFM does permit its *Supervised Persons*, in their individual capacities as licensed insurance agents, to sell insurance products to its investment advisory clients. A conflict of interest exists to the extent that PFM recommends the purchase of insurance products where PFM's *Supervised Persons* receive insurance commissions or other additional compensation.

Fiduciary Training Program

PFM may provide non-personalized fiduciary training seminars to certain clients and potential referral sources. PFM's fiduciary training seminars generally address best practices for properly meeting the fiduciary standard of care. PFM will charge a fixed fee for these seminars and may offer these services to its investment advisory clients. A conflict of interest exists to the extent that clients may select PFM based solely on its status as an instructor on the fiduciary standard of care rather than other criteria. PFM may accept referrals of advisory clients from those persons engaging PFM for fiduciary training seminars.

Relationship with Other Investment Advisers

As discussed above, PFM recommends that certain clients authorize the active discretionary management of a portion of their assets by and/or among certain *Independent Managers*. As further disclosed in response to Item 14 (below), PFM has a relationship with Merion Wealth Partners, LLC

(“*Merion*”) where *Merion* will provide access to certain services to PFM and/or PFM’s clients. PFM also has a referral arrangement with *Merion*.

Item 11. Code of Ethics

PFM does not buy nor sell for itself securities that it also recommends to clients. However, persons associated with PFM (“Associated Persons”) are permitted to buy or sell securities that are also recommended to clients consistent with PFM’s policies and procedures.

PFM has adopted a code of ethics that sets forth the standards of conduct expected of its associated persons and requires compliance with applicable securities laws (“*Code of Ethics*”). In accordance with Section 204A of the Investment Advisers Act of 1940 (the “Advisers Act”), its *Code of Ethics* contains written policies reasonably designed to prevent the unlawful use of material non-public information by PFM or any of its associated persons. The *Code of Ethics* also requires that certain of PFM’s personnel (called “*Access Persons*”) report their personal securities holdings and transactions and obtain pre-approval of certain investments such as initial public offerings and limited offerings.

Unless specifically permitted in PFM’s *Code of Ethics*, none of PFM’s *Access Persons* may effect for themselves or for their immediate family (i.e., spouse, minor children, and adults living in the same household as the *Access Person*) any transactions in a security which is being actively purchased or sold, or is being considered for purchase or sale, on behalf of any of PFM’s clients.

When PFM is purchasing or considering for purchase any security on behalf of a client, no *Access Person* may effect a transaction in that security prior to the completion of the purchase or until a decision has been made not to purchase such security. Similarly, when PFM is selling or considering the sale of any security on behalf of a client, no *Access Person* may effect a transaction in that security prior to the completion of the sale or until a decision has been made not to sell such security. These requirements are not applicable to: (i) direct obligations of the Government of the United States; (ii) money market instruments, bankers’ acceptances, bank certificates of deposit, commercial paper, repurchase agreements and other high quality short-term debt instruments, including repurchase agreements; (iii) shares issued by mutual funds or money market funds; and (iv) shares issued by unit investment trusts that are invested exclusively in one or more mutual funds.

Clients and prospective clients may contact PFM to request a copy of its *Code of Ethics*.

Item 12. Brokerage Practices

As discussed above, in Item 5, PFM generally recommends that clients utilize the brokerage and clearing services of *Fidelity*.

Factors which PFM considers in recommending *Fidelity* or any other broker-dealer to clients include their respective financial strength, reputation, execution, pricing, research and service. The commissions

and/or transaction fees charged by *Fidelity* may be higher or lower than those charged by other *Financial Institutions*.

The transaction fees paid by PFM's clients comply with PFM's duty to obtain "best execution." Clients may pay commissions that are higher than another qualified *Financial Institution* might charge to effect the same transaction where PFM determines that the commissions are reasonable in relation to the value of the brokerage and research services received. In seeking best execution, the determinative factor is not the lowest possible cost, but whether the transaction represents the best qualitative execution, taking into consideration the full range of a *Financial Institution's* services, including among others, the value of research provided, execution capability, commission rates, and responsiveness. PFM seeks competitive rates but may not necessarily obtain the lowest possible commission rates for client transactions.

PFM periodically and systematically reviews its policies and procedures regarding its recommendation of *Financial Institutions* in light of its duty to obtain best execution.

The client may direct PFM in writing to use a particular *Financial Institution* to execute some or all transactions for the client. In that case, the client will negotiate terms and arrangements for the account with that *Financial Institution*, and PFM will not seek better execution services or prices from other *Financial Institutions* or be able to "batch" client transactions for execution through other *Financial Institutions* with orders for other accounts managed by PFM (as described below). As a result, the client may pay higher commissions or other transaction costs or greater spreads, or receive less favorable net prices, on transactions for the account than would otherwise be the case. Subject to its duty of best execution, PFM may decline a client's request to direct brokerage if, in PFM's sole discretion, such directed brokerage arrangements would result in additional operational difficulties.

Consistent with obtaining best execution, brokerage transactions may be directed to certain custodian broker-dealers in return for investment research products and/or services which assist PFM in its investment decision-making process. Such research generally will be used to service all of PFM's clients, but brokerage commissions paid by one client may be used to pay for research that is not used in managing that client's portfolio. The receipt of investment research products and/or services as well as the allocation of the benefit of such investment research products and/or services poses a conflict of interest because PFM does not have to produce or pay for the products or services.

Receipt of Soft Dollars

In addition to the research services described above, PFM may be offered other non-monetary benefits by broker-dealers that it may engage to execute securities transactions on behalf of clients. These benefits may take the form of special execution capabilities, clearance, settlement, online pricing, block trading and block positioning capabilities, willingness to execute related or unrelated difficult transactions in the future, order of call, online access to computerized data regarding client's accounts, performance measurement data, consultations, economic and market information, portfolio strategy advice, industry

and company comments, technical data, recommendations, general reports, efficiency of execution and error resolution, availability of stocks to borrow for short trades, custody, travel, recordkeeping and similar services. These services may also include the payment of all or a portion of clients' or PFM's administrative costs and expenses of operation for technology expenditures such as more sophisticated performance reporting programs and other reasonable expenses as determined by PFM. The availability of these benefits influence PFM to select one broker rather than another based on PFM's interest rather than on client's interests in receiving most favorable execution. Nevertheless, PFM will assure that the fees and costs for services provided to clients by brokers offering these benefits are not materially greater than they would be if the services were performed by brokers not offering these services.

The use of brokerage commissions to obtain research products and/or other services and to pay for other non-research services creates a conflict of interest because clients pay for such products and services that are not exclusively for the benefit of clients and may be primarily or exclusively for the benefit of PFM.

Software and Support Provided by Financial Institutions

PFM may receive from *Fidelity*, without cost to PFM, computer software and related systems support, which allow PFM to better monitor client accounts maintained at *Fidelity*. PFM may receive the software and related support without cost because PFM renders investment management services to clients that maintain assets at *Fidelity*. The software and related systems support may benefit PFM, but not its clients directly. In fulfilling its duties to its clients, PFM endeavors at all times to put the interests of its clients first. Clients should be aware, however, that PFM's receipt of economic benefits from a broker-dealer creates a conflict of interest since these benefits may influence PFM's choice of broker-dealer over another broker-dealer that does not furnish similar software, systems support, or services.

Additionally, PFM may receive the following benefits from *Fidelity* through the Fidelity Institutional Wealth Services Group: receipt of duplicate client confirmations and bundled duplicate statements; access to a trading desk that exclusively services its Institutional Wealth Services Group participants; access to block trading which provides the ability to aggregate securities transactions and then allocate the appropriate shares to client accounts; and access to an electronic communication network for client order entry and account information. In addition, during PFM's transition to recommending *Fidelity*, *Fidelity* has agreed to pay certain postage expenses of delivery documents to clients, as well as providing support for the set up of client accounts.

Item 13. Review of Accounts

For those clients to whom PFM provides investment management services, PFM monitors those portfolios as part of an ongoing process, while regular account reviews are conducted on at least an annual basis. For those clients to whom PFM provides financial planning and/or consulting services, reviews are conducted on an "as needed" basis. Such reviews are conducted by one or more of PFM's investment adviser representatives. All investment advisory clients are encouraged to discuss their

needs, goals, and objectives with PFM and to keep PFM informed of any changes thereto. PFM contacts ongoing investment advisory clients at least annually to review its previous services and/or recommendations and to discuss the impact resulting from any changes in the client's financial situation and/or investment objectives.

Unless otherwise agreed upon, clients are provided with transaction confirmation notices and regular summary account statements directly from the broker-dealer or custodian for the client accounts. Those clients to whom PFM provides investment advisory services will also receive a report from PFM that may include such relevant account and/or market-related information such as an inventory of account holdings and account performance on a quarterly basis. Clients should compare the account statements they receive from their custodian with those they receive from PFM.

Those clients to whom PFM provides financial planning and/or consulting services will receive reports from PFM summarizing its analysis and conclusions as requested by the client or otherwise agreed to in writing by PFM.

Item 14. Client Referrals and Other Compensation

PFM is required to disclose any relationship or arrangement where it receives an economic benefit from a third party (non-client) for providing advisory services. In addition, PFM is required to disclose any direct or indirect compensation that it provides for client referrals.

If a client is introduced to PFM by either an unaffiliated or an affiliated solicitor, PFM may pay that solicitor a referral fee in accordance with the requirements of Rule 206(4)-3 of the Advisers Act and any corresponding state securities law requirements. Any such referral fee is paid solely from PFM's investment management fee, and does not result in any additional charge to the client. If the client is introduced to PFM by an unaffiliated solicitor, the solicitor provides the client with a copy of PFM's written disclosure brochure which meets the requirements of Rule 204-3 of the Advisers Act and a copy of the solicitor's disclosure statement containing the terms and conditions of the solicitation arrangement including compensation. Any affiliated solicitor of PFM discloses the nature of his/her relationship to prospective clients at the time of the solicitation and will provide all prospective clients with a copy of PFM's written disclosure brochure at the time of the solicitation.

In addition, PFM has a relationship with *Merion* where *Merion* will provide access to certain services to PFM and/or PFM's clients. These services may include support for insurance services, sub-advisory services, and commission based securities brokerage services for non-investment advisory assets. PFM will receive compensation from *Merion* for referring clients to *Merion* for such services. *Merion* may also refer clients to PFM, for which PFM may pay *Merion* a referral fee. In addition, PFM may also manage model portfolios for *Merion*'s clients where PFM will act as a subadvisor for *Merion*.

Item 15. Custody

PFM's *Agreement* and/or the separate agreement with any *Financial Institution* may authorize PFM through such *Financial Institution* to debit the client's account for the amount of PFM's fee and to directly remit that management fee to PFM in accordance with applicable custody rules.

The *Financial Institutions* recommended by PFM have agreed to send a statement to the client, at least quarterly, indicating all amounts disbursed from the account including the amount of management fees paid directly to PFM. In addition, as discussed in Item 13, PFM also sends periodic supplemental reports to clients. Clients should carefully review the statements sent directly by the *Financial Institutions* and compare them to those received from PFM.

Item 16. Investment Discretion

PFM is given the authority to exercise discretion on behalf of clients. PFM is considered to exercise investment discretion over a client's account if it can effect transactions for the client without first having to seek the client's consent. PFM is given this authority through a power-of-attorney included in the agreement between PFM and the client. Clients may request a limitation on this authority (such as certain securities not to be bought or sold). PFM takes discretion over the following activities:

- The securities to be purchased or sold;
- The amount of securities to be purchased or sold; and
- When transactions are made.

Item 17. Voting Client Securities

PFM is required to disclose if it accepts authority to vote client securities. PFM does not vote client securities on behalf of its clients. Clients receive proxies directly from the *Financial Institutions*.

Item 18. Financial Information

PFM does not require or solicit the prepayment of more than \$1,200 in fees six months or more in advance. In addition, PFM is required to disclose any financial condition that is reasonably likely to impair its ability to meet contractual commitments to clients. PFM has no disclosures pursuant to this Item.

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