INVESTMENT
INDUSTRY ASSOCIATION
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# *Letter from the President*

## *A New Age of Wealth Management:* Takeaways from the SIFMA Private Client Conference

### *New York City, April 22-23, 2010*

The theme and discussion at the SIFMA Private Client Conference echoed the impact of the financial crisis in 2008 and its aftermath on U.S. investors and wealth management businesses. Based on conference presentations, strategies for the private client sector focused primarily on restoring investor trust and confidence, far more damaged in the U.S. than in Canada, and dealing with the regulatory whirlwind in the wake of the crisis. The consensus is that U.S. investors are confused, scared, gun-shy and searching for second opinions. The record holdings of money market funds, despite recent strong stock market performance and improving fundamentals in earnings and the economy, are symptomatic of investor hesitancy and caution. Most commentators expect it will be a long time before the consequences of the financial shock start to dissipate.

### Changing Trends: Keeping Up with Baby Boomer Needs and Providing Real-Time Client Access to Information

The private client industry recognizes the need to design business strategies that bolster investor confidence and rebuild client relationships as the baby boom generation shifts investment focus from accumulation to distribution of assets, and to address the needed application of technology to enable investors real-time access to their portfolio status, offered financial services, and information on markets and investments.

Charles D. Johnston, President and COO, at Morgan Stanley Smith Barney, pointed out that strategies to rebuild investor confidence and improve client perceptions of competency and professionalism must adapt to the underlying trends taking place in the U.S. wealth management business. This entails recognizing that financial advisors have moved from asset managers to "problem solvers" for their clients, a shift in focus driven partly by reliance on advisory platforms to manage client assets. Johnston noted that his firm's statistics demonstrate that performance results stemming from these platforms are on average better than non-advisory platforms. He described the investment process as evolving to a more commoditized business. This shift has fortuitously coincided with increased investor demand for a range of other products and services from advisors.

Indeed, many conference speeches addressed the growing client preference for "one-stop" shopping, as clients look to their broker-dealers for many financial services, including mortgage financing and consumer lending. The key client driver is the need for tax planning, estate and family planning services as older clients examine financial options and mechanisms for the distribution of accumulated assets to finance an anticipated longer retirement. There is also a need to manage the transition of assets to the next generation. It was no surprise to hear firms talk about launching seminars and workshops for family members, as well as websites and materials related to retirement goals and financial strategies. The pro-active push into estate and family planning also assists the advisor in making the transition from serving the existing client to serving the next generation. Two key broker-dealer requirements to successfully meet these client demands are an effective asset platform and significant investment in investment advisor (IA) training programs.

### Drilling Down into the Client Relationship: Understanding Client Goals – Explaining How They're Being Achieved

The success in strengthening the client relationship depends critically on understanding client needs and wants

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in this post-crisis environment, and communicating appropriate solutions to clients. There was a consensus at the conference that many clients have reset risk tolerances at lower levels and the overriding priority is preservation of capital, given retirement-destined baby boomers and the 2008 financial crash. The financial crisis revealed, for the first time, portfolio vulnerability to market meltdowns on a scale never before anticipated. Clients are now more focused on portfolio performance and investment competency. The prevailing question among clients is "will I have enough to retire on?". In this regard, U.S. advisors now recognize something Canadian IAs have always known: the importance of international diversification, particularly in view of expected continued devaluation of the U.S. dollar.

Sallie L. Krawcheck, President, Global Wealth & Investment Management, Bank of America Corporation, stressed client communication must be taken to a much higher level. In effect, IAs and their firms need to "drill down" in the client relationship to improve both the caliber of communication and portfolio performance consistent with new risk tolerances, meet expanding financial needs and, as a result, restore investor confidence. Advisors must listen carefully and work with their clients to identify financial goals and risk tolerances. They must provide timely and effective feedback, avoid financial jargon, carefully explain all documentation and simplify client statements to the greatest extent possible. Improved and focused communication will contribute to better client understanding and portfolio results. Some firms are in fact embracing new strategic thinking that focuses on return on customers as a strategic asset versus more traditional measures that focus on return on capital or investment (Martha Rogers, Peppers & Rogers Group).

## Effective Technology: It Has to Be As Useful and User-Friendly as Amazon

It was observed that clients have enthusiastically taken up on-line access to their accounts to monitor portfolio performance, obtain financial information and access webcasts. Perhaps surprisingly, the fastest growing users of the internet are affluent older Americans, not the young. In terms of technology, the first priority is to build a user-friendly client interface platform to enable effective client navigation of the firm's website to find needed information. It was pointed out that clients assess the caliber and quality of their firm's internet site not through comparisons with competitors' sites, but with popular non-financial websites such as Amazon and Expedia. In effect, customer usage of a broker-dealer website has become an integral part of the client's daily internet surfing activity. Over and over, it was stressed that client demands are driving technological advances in the securities industry. Second, effective technology is needed to sort efficiently through the massive inventory of financial information to enable both IAs and their clients to retrieve required information on a timely basis.

## Securities Industry Challenges: Tougher Regulation of the Industry, Higher Taxes on Clients

The U.S. securities industry faces two key challenges as it retools the client relationship to restore confidence and trust, and tackle client demands from the baby boom generation for retirement strategies. The industry is confronted with an aggressive assault from politicians and regulators for extensive regulatory reform. While this reform embraces a macro agenda, such as systemic regulation, the Volcker rule and a Resolution Authority, reforms also include significant initiatives aimed at the wealth management practice. In addition, investors will be faced with a higher tax burden mainly from the expiration of the Bush tax cuts this year.

The key regulatory initiative is the proposed imposition of a fiduciary standard on Registered Representatives. Industry concerns have been mitigated somewhat over the past year as House and Senate legislation has evolved, particularly in response to industry and client concerns. While nothing can be taken for granted, there is greater likelihood that certain activities, notably commission-based transactions and the distribution of proprietary products and newly issued securities, will be permitted under the fiduciary standard – with the proviso these activities are accompanied with increased disclosure and other requirements. The House legislation mandates the SEC to draw up the fiduciary rule, while the Senate legislation starts with the Investment Advisors Act of 1948 and removes the exemption for RRs. The Senate legislation, however, proposes the SEC further study the extension of the fiduciary standard before implementing the proposed legislation.

Other regulatory challenges for the U.S. securities industry include a proposal to study pre-dispute arbitration and possibly authorize the SEC to prohibit pre-dispute arbitration clauses in retail account agreements. Additionally, there is a proposed requirement that investment advisors with client assets of greater than $10 million use an independent custodian. Finally, advisors with custody of client assets must have an independent public accountant registered with the Public Company Accounting Oversight Board perform a surprise custody examination.

The expiration of the Bush tax cuts this year will increase capital gains tax rates from 15% to 20% and dividends will be taxed as ordinary income (at about a 39% rate), unless an exemption is extended by Congress. Further, new health care legislation will impose a 3.8% medicare tax. The expanding U.S. deficit raises investor and industry concerns about further tax increases. Likely options are increased personal tax rates and a VAT tax. The industry is somewhat confident that a financial transaction tax will not be imposed on capital market transactions.

## Conclusion: Rebuilding Client Trust and Meeting New Client Needs

The financial crisis and its aftermath have shaken the private client business in the United States to its foundations. The conference presentations suggest U.S. broker-dealers are responding aggressively with strategies to rebuild client trust and meet the demands of older clients as the investment paradigm shifts to retirement concerns. These strategies have increased the breadth of financial and advisory services offered by the securities industry, mainly in response to the retirement agenda. The asset management business will be focused on conventional financial products and investments with increased global orientation, given investment opportunities and reduced risk tolerances. This business will in many cases be outsourced through advisory platforms. At the same time, strengthening the advisor-client relationship and effective application of technology will result in more interactive and effective client participation benefitting the investment process.

For an industry accustomed to change, the scale of transformation in the past year has been unprecedented. The evidence suggests clients and investors will remain conservative. As the recent financial shock and prospects of retirement overshadow client investment decision-making, clients will also be more demanding of investment performance and ideas for portfolio repositioning. One conference participant referred to client mobility, citing a statistic that 80% of 401K funds that roll over move to another advisor. The upshot is that clients have been more open and receptive to building new investor and broker-dealer relationships. This indicates the desire for competent and effective retirement planning. Similarly, many IAs are also on the move, pushed by restraint at the large wire house firms, and looking for new opportunities at other firms. As in Canada, the small regional firms, many reliant on effective clearing platforms such as Pershing, have become strong competitors in this transformed retail marketplace. It will be interesting to see how these trends and developments unfold over the next several years.

Yours sincerely,

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