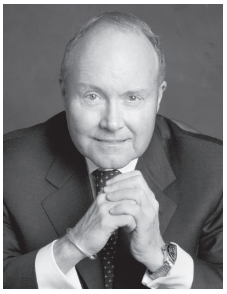


Letter from the President

The Post-2008 Client: Responding to Their Wealth Management Needs and Demands

The SIFMA Private Client Conference
Boston, April 2012

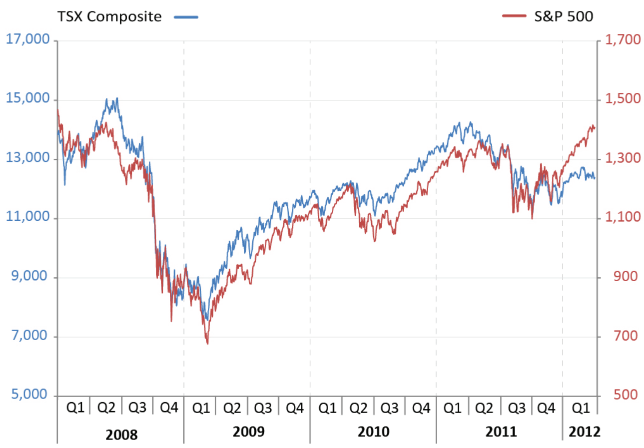
How to win back the confidence of clients skeptical of financial institutions in the wake of the 2008 financial meltdown and spooked by more recent market collapses? That was the subject of the third annual one-day Private Client Conference of the U.S. Securities Industry and Financial Markets Association (SIFMA).

Much of the discussion at the conference last month in Boston focused on developments in the wealth management business in the post-2008 financial crisis, especially changes in the thinking and behavior of the individual investor in the past three years; the strategic initiatives in the securities industry to restore trust and confidence, and increase market participation; and the business challenges facing both large and small firms.

Skittish Investors: Firms Need to Re-Build Trust – and Cut Costs

Despite three years of regulatory reform and ongoing engagement of the client base, the majority of investors still have a profound skepticism and distrust of financial institutions. This attitude was only accentuated by the volatility and wild swings in market prices throughout 2009-2012, reflected in the “flash crash” in May 2010 and last summer’s collapse in equity markets triggered by the U.S. debt ceiling debate and European sovereign debt crisis, leaving investors increasingly risk adverse and believing the deck is stacked against them.

U.S. Markets Outperform in 2012



Source: S&P

Kathleen Murphy of Fidelity Investments, with $1 trillion in assets and $800 million in high net worth assets, summarized recent survey results indicating 52% of investors surveyed don’t trust financial institutions, and the proportion of investors seeking advice from professionals has fallen from 33% two years ago to 21% today. A Wells Fargo survey reinforced these dismal conclusions. Only a quarter of the Wells Fargo clients surveyed had much confidence in equities, and 60% felt they had no control over the investment process to build savings. Wells found their survey results indicated the percentage of investors in equities had fallen from 52% pre-crisis to 35% today. Correspondingly, investments in mutual funds and ETFs rose from 28% to 50%.

Several conference presenters referred to the behavioral contradiction between the treatment of equities and debt. While many investors are prepared to forego return in equities for greater certainty, many are willing to stretch for yield (and risk) in debt investments.

Several speakers and panelists noted their own firms’ surveys indicate clients are more cost-conscious that ever before.

> ***It is thus not surprising that many investors, especially those without advisors, have pulled completely out of the market, severely handicapping financial performance.***

The Fidelity survey results also indicated Americans are not saving enough for retirement. Americans 45 years and older have suffered a 28% drop in retirement savings in the past four years. Based on current savings patterns, 40% of Americans will not have enough income to cover their monthly expenses in retirement. The retirement savings dilemma even extends to the Gen X generation (30s to late 40s).

We know the same holds true in Canada.

The overriding conclusion of the conference participants is that the multi-varied regulatory reform in U.S. markets from the introduction of the Dodd-Frank Bill to the creation of the Financial Stability Oversight Council will not be sufficient to rebuild investor trust and encourage savings and market

11 King Street West, Suite 1600, Toronto, Ontario M5H 4C7 • Tel: 416.865.3036 • Fax: 416.364.4861 • irussell@iiac.ca • www.iiac.ca

participation. Investor market participation and renewed trust are affected far more through active client engagement, by advisors and their firms, education, different types of financial planning programs and guidance for investing.

Education and Financial Planning: Making Sure Clients Know Where They Stand

Investors have limited understanding of financial investments, and the importance of concepts like portfolio allocation and time horizon. It was noted there is often a disconnect between investors focused on portfolio return and income and the advisor recommending products, asset classes and accumulation, etc. Targeted education programs aimed at the individual client and launched through a variety of channels from online website portals, to seminars and written materials play a key role in enabling the client to understand the advice given by the advisor.

The development of a financial plan and investment guidance for the client is integral to programs that strengthen financial knowledge. Wells Fargo found that 90% of the clients that participate in their "Envision Program" planning sessions know where they stand with their finances and objectives, and feel more in control of the investment process.

As Benjamin Franklin once pointed out, "in this world nothing can be said to be certain except death and taxes." Even dedicated self-directed investors are increasingly aware of their own mortality, and have begun, many for the first time, to seek out an advisor to create a financial and estate plan. Further, the tax impact is often the biggest expense diminishing portfolio performance. Expertise is needed to construct tax-efficient portfolios.

When it comes to managing the transfer of financial assets across family generations, firms have developed innovative approaches: engaging younger family members and developing "family mission statements."

> ***Firms recognize that significant effort must be made to gain the confidence and participation of the younger generation, as statistics show that only 30% of the next generation of high net worth clients will do business with the same firm.***

The industry recognizes that it has not done enough to engage the Gen X and Gen Y generations, tomorrow's clients. The average broker, now in his/her mid-fifties, is out of step with the younger generation and faces a serious communication gap, both in terms of product and service demands and methods of communication. The Gen X and Y groups emphasize qualifications and expertise more than loyalty and experience, and communicate through mobile apps, text messaging, internet and social media. The industry is addressing this generational divide by actively recruiting young professionals into broker teams. However, this is a more difficult proposition for the many smaller firms in the industry with limited resources. The firms are employing different business approaches in delivering the planning and advice services. In larger firms, advisors can draw on specific expertise to meet client needs. In many firms, advisors work in teams, ensuring a wide range of complementary skills. Speakers and panelists pointed to the value of strong communication across broker teams to gather insights on investing, tax and planning methodology. The many small independent broker-dealers and RIAs leverage their clearing firm to provide the planning tools and expertise, complementing compliance, training and recruiting services.

Firms have found that client education programs, planning and guidance tools empower the client to approach the investment process more confidently. Wells Fargo surveyed clients participating in their "Envision Program" and found 57% would act on investment advice and 45% made significant portfolio allocation changes resulting in better investment performance.

Building a Culture of Trust

Another independent factor important to client empowerment, and renewed trust and confidence, is a culture and ethos within the firm that puts the clients' interests first in all dealings, delivering effective stewardship. Both Chet Helck, Executive Vice President at Raymond James Financial, and John Taft, CEO of RBC Wealth Management, referred to the proposed fiduciary standard that would be applied to broker-dealers. Mr. Helck described the brokerage business as a complex integration of product manufacture and distribution, together with the provision of financial advice. This integration poses significant potential conflicts of interest, not unlike other professions; as he pointed out, surgeons who advise patients on whether they need surgery may end up performing the prescribed operation. He warned that segmenting products and services from advice could disadvantage the client and argued the high professional standard in the industry – through a duty of client care, combined with mechanisms that describe the "rules of the game" or terms of engagement and appropriate disclosure – adequately address possible conflict of interest concerns in the brokerage business.

> ***John Taft argued that getting the client culture right and providing the core principle of stewardship of client assets would have a far-reaching impact on rebuilding investor trust and confidence.***

Taft felt that, if the proposed fiduciary standard can be judiciously implemented, it would reinforce efforts to strengthen a client-first ethos in individual securities firms.

The Wealth Management Business Outlook: A Tougher Game, Tougher Competitors

The conference speakers and panelists recognized that even if trust and confidence return to the investing public the longer-term prospects for the wealth management business will be challenging. Through much of the 1990s and in the five years leading to the 2008 crash, most of the portfolio returns to clients, and related fee revenue to the industry, derived from steady appreciation in asset values reflecting buoyant equity and debt markets. The economic fundamentals suggest modest growth prospects for the global economy with some inflation bias, presaging tepid stock market performance and rising bond yields. In this environment the industry will find it challenging to generate needed portfolio returns to meet financial objectives. Moreover, earnings and ROE in the securities industry will depend on growth in the client base. As a result firms are focused on work practices and efficiencies, such as standardized forms, specialized assistance and technology, to improve broker productivity. This will reduce back office and administrative tasks for advisors, giving them more time for client engagement and prospecting.

Advisors are improving their game. Complex products are scrutinized more carefully to fully understand the risks and communicate the risk-return characteristics clearly to clients. Advisors are looking at a range of suitable guaranteed products that contribute to capital preservation, and they are doing a better job of listening to their clients. Many advisors have adopted strategies that enable rapid and disciplined adjustments into and out of cash to seize opportunities and protect against market downturns.

Overcoming the fear and distrust sowed by a major market collapse and several deep dips is not easy. But it is possible – by putting the client first, addressing the needs for education and planning, and providing the full range of financial products and services. The insights provided at the SIFMA conference should be helpful to many firms.

Yours sincerely,

Ian C. W. Russell, FCSI
President & CEO, IIAC
May 2012