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INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

LETTER FROM THE PRESIDENT

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The Technology Whirlwind Blowing Through the Wealth Management Business: Lessons for Regulators

HIGHLIGHTS:

Digitalization and innovation are rapidly transforming the dealer wealth platform. Technology has enabled new fintech applications, like robo-investing, the electronic integration of financial products and services across the platform, and more personalized service using data analytics to better predict and serve client needs.

Regulators will need to respond to digitalization, not just to facilitate new fintech participants in the market, but to ensure similar rules apply to all registrants offering the same financial services.

The regulatory paradigm will need to shift from a silo'd approach as digitalization enables greater integration of financial services.

DIGITALIZATION IN THE RETAIL BUSINESS

The financial advisory business has gone through the crucible of structural and technological change at an accelerating pace over the past five years, and is facing an avalanche of even more change. These changes have transformed dealer practices and operations. The digitalization or computer application, and steady innovation, have been adopted at both the large and the specialized retail firms, and supported by service vendors, carrying brokers and the efforts of individual firms. The content and pace of the digital revolution has occurred in response to i) client demand for a widening array of products and services, delivered with an emphasis on value, convenience and transparency; ii) firms' imperatives to improve advisor productivity and cost-effective operations; iii) complex compliance requirements; and iv) implementation of effective cyber defenses to protect client confidentiality and portfolio assets.

This response to client and regulatory demands has set in train a virtuous as well as a vicious circle. A wider shelf of financial products, integrated with financial advice and delivered with increased technology, has improved the value of financial services and the convenience of access for clients, setting high standards for service and raising client expectations. The costs of digitalization have in turn forced increased applications of technology to achieve operating efficiencies and lower costs.

Many small boutique firms with limited resources needed to define long-term strategy and deploy needed technology have been unable to stay the whirlwind of client demand and regulatory reform, and the related need for digitalization. In the past five years, 17 retail independent firms have succumbed to mergers and acquisitions, or shuttered operations. However, the real story is that, despite major adjustments in business operations and structure, and need for technology and systems, some 90 independent retail dealers are still in the game, meeting the expanding needs and expectations of their clients in a highly competitive marketplace, as well as the compliance demands of regulators. The clear winners have been the clients of these firms.

RELIEVING THE ADMINISTRATIVE BURDEN

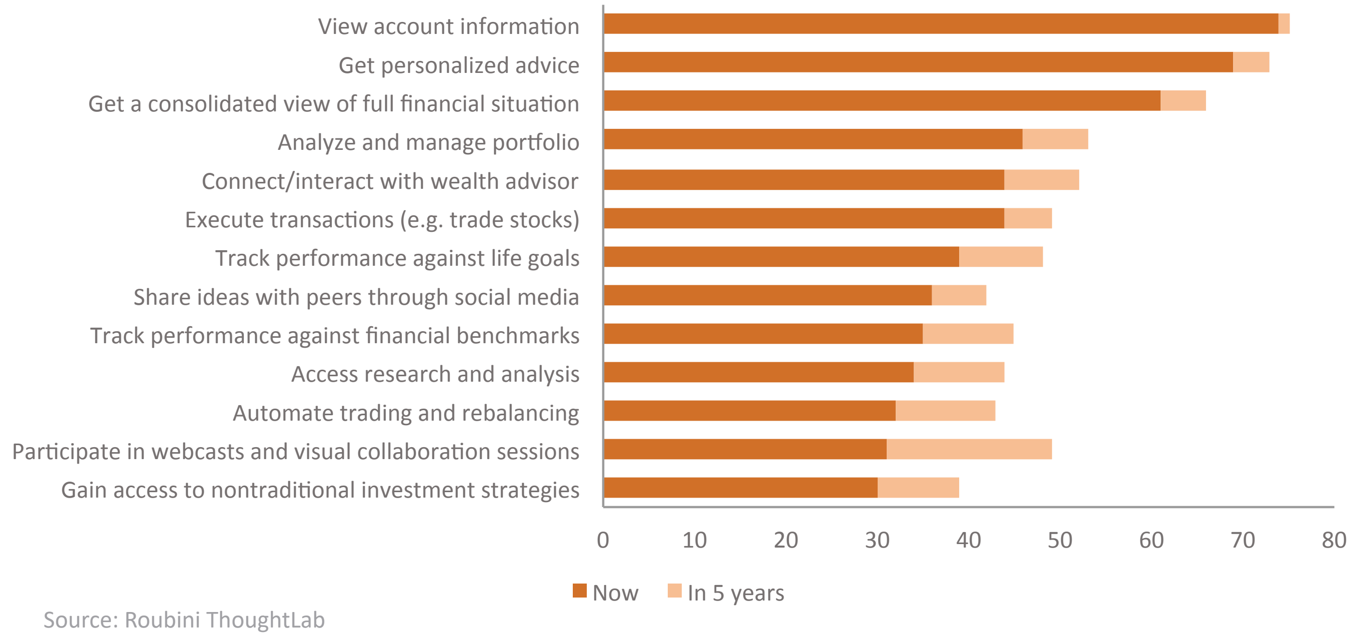
It is evident from surveys, focus groups and the recent experience of online wealth platforms, that financial advice is at the core of a successful full-service wealth management practice. Digitalization has been introduced to manage more of the administrative tasks related to the advisory process, both front and back-office systems, to give advisors more face time with their clients. Dealers are also using technology to harness client data to improve the quality of advice, in particular, to identify the key "touch points", say, the maturation dates of securities, portfolio rebalancing and key dates, such as milestone ages that impact financial planning decisions.

The evidence from the U.S. securities industry suggests advisors are not fully utilizing digital channels of communication in reaching out to clients. This is explained in part by the relatively early stage of digitalization, with advisors overwhelmed by differing technologies and systems, and determining which communications should be advisor-based. Further, older advisors, in the majority in Canada and the U.S., are likely to exhibit greater inertia in relying on digital communications technology. Finally, firms have been cautious in designating permitted digital channels, given the need for effective compliance oversight of the client conversations.

ONLINE ROBO-INVESTING

The nine standalone online wealth platforms still have an important place in the domestic retail business as a specialized service, not unlike the order-execution only model. However, the robo investing platform has been integrated on the broad, firm-wide wealth platform of the traditional investment dealer through third party licensing, or new investment, as a specialized option for the clients of full-service dealers. Millennial and older investors alike can access robo-investing tools and self-directed transactions, with differing quantum of advice, tailored to their needs. The robo-investing option, combined with direct financial advice provided at distinct intervals at account opening or portfolio rebalancing, times of market stress and client age milestones, enables advisors and firms to service small investors and portfolios on economically-viable terms. This is a win-win for smaller dealers.

Investment activities enabled through digital (% of investment providers offering digital access to:)



Source: Roubini ThoughtLab

Many firms have built out a wide spectrum of financial products and services on their wealth platforms, and tied these platforms electronically to advisors and clients. Account opening documentation and client financial statements linked to asset execution and portfolio holdings, as well as performance, have been built out electronically. Further, these securities and managed product are nested in different types of accounts, from fee-based advisor managed accounts and transaction accounts, to traditional brokerage accounts. Clients can move easily across the wealth platform to adjust portfolio allocation, and clients with expanding income and portfolio size, notably millennials, can shift across the platform to more sophisticated products and services.

Firms have made significant efforts at digitalization, to improve communications with clients through emails, social media and texting, enabling broad client access to computers and mobile devices, constrained only by the need to monitor and oversee advisor communication for compliance purposes. Firms typically segment communications between the “one-to-many” for high-end communication from the firms to the broad client base, and the “one-to-one” communication, the private communication between advisor and client for personal financial advice. By utilizing more advanced fintech and analytics, firms can more effectively analyze client data and target client communication so that the client feels that even the one-to-many communications are personalized.

REGULATORY RESPONSE TO FINTECH

The regulatory framework will need to accommodate this transformation in business operating practices and structure. The regulatory adjustment is, in part, to identify evolving gaps in investor protection, such as ensuring firms take steps to protect client personal data and ensure cyber defenses are adequate.

The Canadian regulators, particularly IIROC, have moved in this direction, in efforts to improve cyber standards and engage in cyber testing of individual firm systems. However, it is as important that regulators begin to review and assess whether the existing rule framework needs to accommodate adjustments in internal firm operations from technological innovation. From a regulatory perspective, the financial technology focus has, to date, been more about regulating new fintech entrants than how the existing regulatory framework should change in response to technology and ongoing innovation in the overall wealth business.

Regulatory systems have traditionally been segmented across different registrant categories that offered different types of financial products and services. Financial innovation, however, is driving greater integration of the financial advisory business onto single digitalized platforms. Technology has enabled the concentration of a wide array of product and services onto the dealer platform, which increasingly includes registered entities as online robo-investing models and portfolio managers. Mutual fund registrants offering limited product could also be included on the firm-wide digitalized wealth platform. The current regulatory silo’d approach between registrants does not accommodate the ways in which technology could allow information to be shared among all relevant service providers to deliver a seamless, efficient and comprehensive financial services picture and experience for clients.

This approach would require a change in the structure of the regulation of the industry. However, there are several incremental approaches that could be taken in the short run to increase efficiency and enhance the client experience without sacrificing investor protection.

For example, regulators could facilitate the evolving business practices through stream-lined onboarding requirements for clients of online robo investors to apply similarly to clients of investment dealers onboarding clients as robo investors. In effect,

How investor expectations of wealth providers are changing (% of investors demanding that wealth providers:)

Source: Roubini ThoughtLab

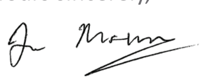
the rules and regulations modified for fintech players should apply equally to investment dealers and other registrants if they offer these particular technology platforms to clients. The broader principle at play here is that rules and regulations are often drafted in the context of existing business practices and systems. Further, regulations could permit the sharing of information on clients within the same firm dealing with different registrants or across different sub-platforms.

Technology is having a profound impact on the way business is conducted. Regulators must monitor and develop a better understanding of the technology innovations adapted in the industry and the way in which it is impacting practices and operations at dealers. They should prioritize efforts to uncover and remove road blocks to efficient practices, and find a means to adapt regulation to the current environment without jeopardizing investor protection. This effort is likely to result in a greater reliance on principle-based regulation and the need to give auditors greater discretion and judgment in assessing compliance with the rulebooks. The IIAC has supported initiatives such as the IIROC Plain Language Rulebook, as a means to recalibrate rules. Efforts should be re-doubled as the pace of innovation accelerates in the industry. The IIAC is pleased IIROC is undertaking a study in collaboration with Accenture, involving a focused consultation with industry participants to understand how current rules impact the evolution of advice and service offerings, and where there may be opportunities for improvement.

CONCLUSION

Technology is transforming the business operations and structure of the wealth business at an accelerating pace in response to client demand and competitive pressures. These new tools will leverage the fundamental skills of our highly trained and committed professionals to provide enhanced value to their clients. To ensure clients are able to access the best possible advice through channels with appropriate and established oversight, regulators need to be fully aware and engaged in this business transformation to ensure regulations are properly modified to accommodate this technology zeitgeist and ensure investors are adequately protected.

Yours sincerely,



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