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

LETTER FROM THE PRESIDENT

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Improving advisor productivity and performance in the wealth management business to bring greater benefit to clients and maintain earnings momentum

HIGHLIGHTS:

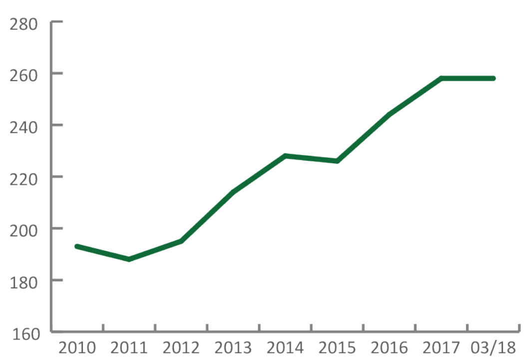
The past five years have resulted in a dramatic explosion in retirement savings, with RRSP assets alone up one-third to $260 billion. This asset accumulation has been accompanied by an expanding array of services, from financial planning to estate and tax planning.

Operating costs have escalated steeply in the same period, increasing at an average annual rate of 5.0 percent, squeezing operating margins, notably at the retail boutique firms.

Advisors and firms will need to improve expertise to serve clients across an increasingly complex array of products and services on dealer wealth platforms. These performance gains are key to generate sufficient revenue to keep ahead of rising costs, and the eventual slowing in equity market momentum.

There has been an unprecedented increase in savings and accumulation of financial assets in the 10 years since the financial crisis. Much of the increase in savings has been channeled into the investment industry to build retirement nest-eggs for the baby boomer generation. Canadians have accumulated substantial savings in RRSPs, RRIFs, TSFAs and ESOPs. RRSP assets at investment dealers have increased one-third in the past 10 years, to reach approximately $260 billion in 2017.

RRSP Assets Held with Full-Service Brokers
$ billions

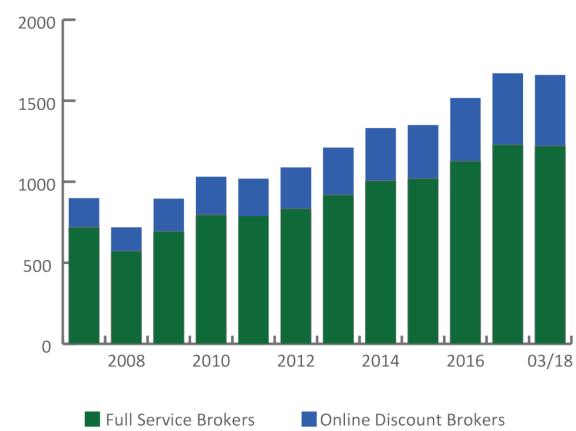


Source: Investor Economics/Strategic Insights Research

The flow of savings has been accompanied by increased demand for an expanding array of financial services, especially financial advice and planning, but also estate and tax planning; different types of accounts, from transactional to discretionary; and various investing techniques such as robo-investing and self-directed investing.

Client financial assets held by investment dealers vaulted 85 percent since 2009, reaching $1.6 billion in 2017. Revenue earned from the retail operations at the dealers virtually doubled in the period, accounting for almost two-thirds of total firm revenue, up from roughly 50 percent share in 2008-09. The large integrated firms and independent small and mid-sized dealers have benefited from the savings inflows and demand for financial advice and other services. 2017 was a record year for retail revenues at both the integrated firms and at the smaller independent retail firms. While competition for the wealth business has been brisk in the latest five years, and the large firms have had the advantage of scale, the smaller independent dealers have performed well. Operating profit at the independent retail firms rose 45 percent in the past five years.

Retail Brokerage Industry Assets
$ billions

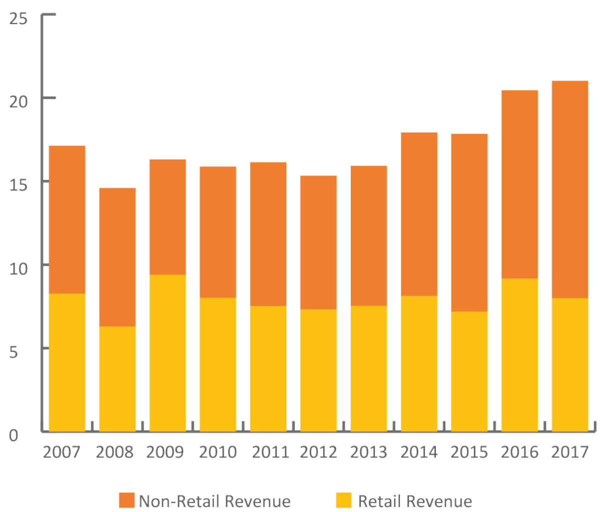


Source: Investor Economics/Strategic Insights Research

The general consensus is for a positive outlook for the wealth management business. Baby-boomer demand for retirement-related services has considerable momentum, reflecting the continued move towards and into retirement and related need for financial advice. Moreover, demand for wealth services continues well beyond retirement as emphasis shifts to estate planning and specialized insurance needs. The wealth business gets a further boost from the Gen Xers and millennials as income and savings expand.

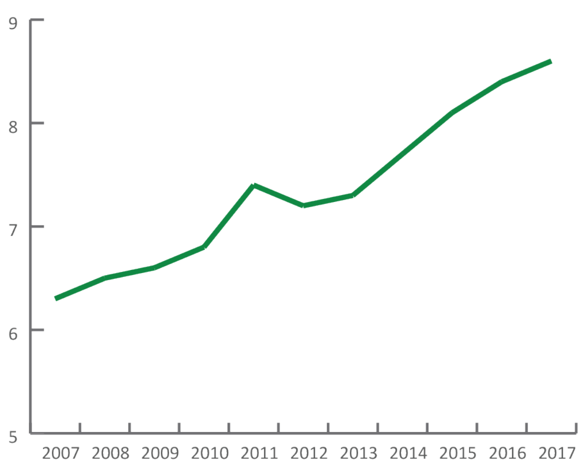
This optimistic outlook for the future of the wealth management business is, however, clouded by two negative undercurrents. First, operating costs in the industry have increased significantly and steadily, up an average 5.0 percent annually in the past five years ending 2017, accelerating in the more recent three years ended June 2018. Further, operating margins have been squeezed significantly, a compression of one-third for the independent retail firms in the latest three years. The large volumes of business in recent years have masked the impact of escalating costs and offset tightening margins.

Retail Revenue versus Non-Retail Revenue
$ billions



Source: IIROC Monthly Financial Reports (MFR)

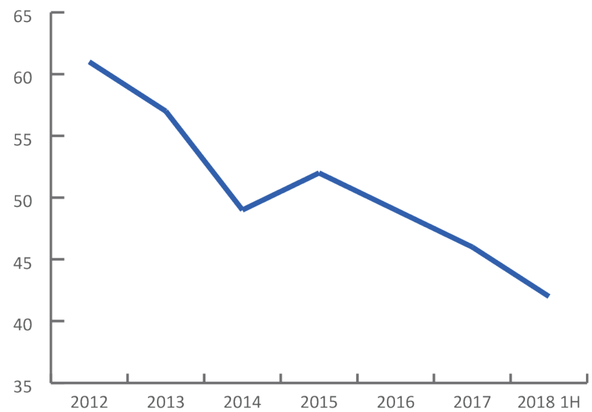
Total Industry Operating Costs
$ billions



Source: IIROC Monthly Financial Reports (MFR)

Operating costs will ramp up ever higher in the next couple of years as firms implement compliance requirements for the targeted reforms and embedded fees. Further, increased client demand for convenience and efficiency, and firm efforts to constrain fixed and operating costs will increase the application of new and emerging technology for the wealth business. These proliferating technologies will add significantly to costs.

Operating Margins - Retail Boutiques
Operating Costs as a share of Operating Revenue (%)



Source: IIROC Monthly Financial Reports (MFR)

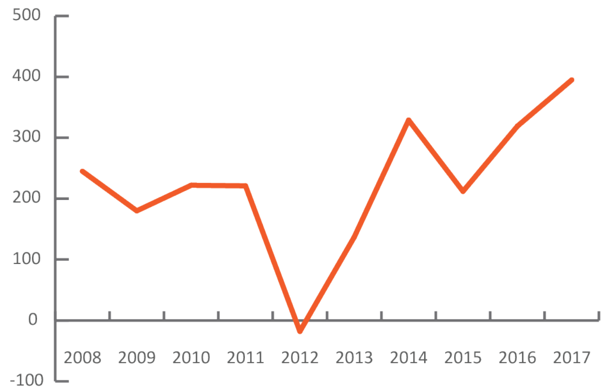
Further, firms cannot rely on the steady upward momentum in equity markets to boost portfolio performance and fee increases. In the past three years, the S&P/TSX Composite Index has risen close to 20 percent and the S&P 500 Composite Index over 45 percent. A sideways or downward move in Canadian and US equity markets would put a dent in fee income and have a major impact on performance in the wealth business.

The challenge for advisors and firms over the next several years will be to build and develop expertise to serve clients effectively across an increasingly complex array of products and services on wealth platforms. Performance gains are key to generate sufficient revenue to keep ahead of rising costs and the eventual slowing in market momentum.

The answer is to improve advisor productivity and performance in the wealth management business. Firms have already taken steps to strengthen advisor performance and client relationship-building, giving advisors the tools and products to design high performing and cost-effective portfolios in the context of a financial plan, and implementing innovative solutions such as online account opening, electronic signatures for documentation, and systems to manage securities orders and processing. These efforts have reduced the administrative burden and provided greater client convenience through digitalization of accounts and real-time access to information. Advisors and firms have also offered a broad selection of traditional brokerage accounts, and fee-based transactional and discretionary accounts, as well as self-directed and robo-investing options.

The opportunities for future gains in advisor productivity and performance relate to facilitating the proactive, and interactive delivery of an expanding, diverse and increasingly complex array of financial services, such as comprehensive estate planning needs, specialized insurance needs, and integrated tax planning. The effective provision of these financial services has the potential to deliver further value-add benefits to clients and their families, while increasing fee revenue for the advisor and firms. Moreover, a successful strategy of effective client interaction builds referrals, contributing to the advisor revenue base.

Operating Profit: Retail Boutiques
$ millions



Source: IIROC Monthly Financial Reports (MFR)

The benefits of this complex array of financial services to meet the expanding and evolving needs of the client can only be realized if advisors can understand, identify and articulate the utility of financial services to their clients. An outsourcing model can work, but only if the advisor recognizes the client need.

Regulators have an important role to play. First, the existing proficiency standards for advisors need to be updated. Second, regulators should recognize existing rules and requirements can interfere with advisors carrying out their responsibilities across an integrated wealth platform. Registration requirements should be streamlined, and legal barriers removed so that advisors have the scope to meet the needs of their clients. Finally, while new rules should encourage a best interest-client first conduct, care should be taken not to obstruct the flexibility of advisors.

The retail business has remained consistently profitable in recent years, despite rapidly escalating costs, because of strong client demand for wealth services, and higher portfolio valuations from an upward trending stock market. However, these conditions cannot be taken for granted. Firms need to build out advisor capabilities to exploit the expanding shelf of wealth products and services to the benefit of clients. Regulators can also help to facilitate the advisory process and delivery of wealth services to investors through higher proficiency standards and reduced legal and regulatory barriers.

Yours sincerely,

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