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LETTER FROM THE PRESIDENT

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The Future of the Wealth Business
Observations from the 2019 SIFMA Private Client Conference

HIGHLIGHTS:

The U.S. wealth industry has gone through seismic changes in recent years; changes in investor behaviour, sweeping demographic shifts and advances in technology and digitalization have been key factors.

Increased professionalism, change in business practice, aggressive adaption of technology and renewed focus on service, trust and convenience in delivering financial services, are also driving forces.

Advisors have moved to the epi-centre of the client's financial life to advise over the life-cycle, against a tailored financial plan that sets and tracks goals–a radically different approach from the focus on single transaction/ discretionary portfolios to accumulate financial assets.

On April 10-11, I attended the SIFMA Private Client Conference, which focused on the dramatic transformation in the operations and structure of the U.S. wealth business in response to:

- the application of game-changing technology;
- changes in investor behavior; and
- the challenges from ongoing regulatory reform.

This President's Letter draws together observations and themes at the conference to paint a picture of the future direction of the U.S. wealth industry, now taking shape, to better discern and understand the future trends in the Canadian industry.

TECHNOLOGY: THE CATALYST FOR EFFICIENCY AND CHANGE

The impact of big data on the wealth business is a major change. The algorithms and tools developed from data patterns will generate efficiencies for the front, middle and back offices of the firms. For example, the compilation of revenue and advisor compensation data, and client transactions and portfolio data, provides firms with tools to monitor advisor payouts to gauge performance and establish compliance alerts to monitor transactions and portfolio concentrations, and other patterns across client segments. For the front office, machine learning and predictive analytics on client data will enable advisors to anticipate needed client decisions, providing timely information and investment recommendations. Some third-party service vendors are developing tools to harvest digital information related to the interaction of advisors and clients across "omni-channels" to develop tools to provide follow up documents and alerts to the advisor, such as timing of suitability reviews.

INJECTING QUALITY AND BREADTH INTO THE ADVISORY BUSINESS

The U.S. industry has placed heavy emphasis—and has already made significant headway—in improving the quality of the wealth management business for client, who want comprehensive wealth management services delivered through a trusted advisor. Clients are increasingly recognizing the value of human touch and are prepared to pay for that value.

A strong interactive relationship between the client and the advisor is fundamental to a successful advisory practice. This relationship's most important attribute is prioritizing listening to the client to understand their needs and wants—*not* to articulate what the firm wants for the client. The client perspective should be the foremost consideration, particularly in determining life goals and risk appetite. The advisor must provide full access to the client, on the client's terms, through digital and other channels, with the timing of access at the discretion of the client. The advisory door should be fully open: firms are striving for a standard and level of client experience in the digital world equivalent to the tech giants such as Amazon.

Large and small firms have modified and strengthened their business models to meet this changing demand for holistic wealth services, taking a number of fundamental steps: first, firms recognize that client service and convenience is significantly enhanced by leveraging technology and have implemented a wide range of applications, often relying on third-party providers, to improve the client experience—centered on service and convenience; second, firms recognize investors need online wealth solutions for stock and portfolio execution as a complementary wealth tool—online wealth models are not an existential threat to the conventional advisory business; and third, human advice and strong human interaction with the client is indispensable to achieving the financial and life goals of the client.

The successful wealth management approach starts with a broad integrated shelf of products and services, a full range of advisory options, access to global research, cash management and lending options and specialized solutions, such as trust services and family offices. The wealth advisory process is anchored with a tailored financial plan that sets and tracks goals and focuses importantly on client risk tolerance and tax efficiencies.

GROUNDING QUALITY SERVICE IN CULTURE

The importance of achieving a firm culture of "doing the best for people"—providing a fulfilling experience for the client—is now front and centre, thanks to:

- the evolution to comprehensive wealth platforms;
- increased professionalism in the industry;
- the pivotal role of the advisor at the epi-center of the client's financial needs; and
- focus on providing added value and changing the narrative and perception of what the industry does in terms of benefitting the client.

This culture is achieved by leveraging technology, providing support to the advisor and extensive advisor training.

The opportunities to build added value and positive culture are numerous—proliferating new technology such as big data applications, the availability of new techniques, such as tools to offer client "longevity planning", namely a plan to meet eventual needs for geriatric services, assisted-care living, and plan for the intergenerational transfer of wealth. The ageing cohort of advisors, where one in four advisors will retire in the next ten years, provides another opportunity to inject specialized knowledge and higher productivity through training and transition to new younger advisors. The over-arching managerial structure—'the complex manager'—oversees branch operations and provides added focus on broad strategic issues and management practices to improve advisor/firm service and productivity, and facilitate needed restructuring such as advisor transition.

The challenge for advisors and firms is adapting to the changing demographics in the marketplace—a younger clientele, greater diversity of the client base (especially women), and more knowledgeable and tech savvy clients.

THE CHANGING DEMOGRAPHIC FOOTPRINT

The wealth business' future success depends on meeting the changing client profile in the industry. Millennials will have a growing influence in the business, in terms of expanding portfolio size and a need for advice and planning. Millennials already out-number the baby-boomers (81 million millennials in the U.S. market). Recent surveys indicate millennials are tech savvy, cautious and knowledgeable, and, perhaps most importantly, value the human element in advice and financial planning. The majority of these millennials are female, requiring firms to better reflect this diversity with female advisors and senior managers within the firm. Advisors and firms will also have to re-orient business operations to cater to the ageing baby-boom generation, with continued focus on portfolio adjustments to accommodate extended periods of mixed work-retirement in post-retirement, and place greater emphasis on longevity and estate planning. SIFMA, the regulators and industry firms have focused on business practices to identify and take the needed remedial steps to address cognitive deterioration of clients and manage cases of client abuse.

A NEW STRUCTURAL LANDSCAPE EMERGES

As the business has moved to a comprehensive wealth model, and as costs from technology and compliance have increased, the structure of both firms and the industry itself is undergoing massive change.

For many firms, the focus is on advisor teams and a move away from the traditional single financial advisor. The team concept is not simply about customer services improvement and the ability to better facilitate transition between older, retiring advisors to new advisors. It is more about the effective delivery of specialized services on the product shelf, such as financial and estate planning, and longevity planning, dealing with family offices, and the ability to respond more effectively to certain groups of clients, whether millennials or older clients. The advisor teams have become an important instrument to enhance productivity and the quality of service to clients of the firm.

Many firms are also moving away from the advisor discretionary-managed portfolios to customized portfolio model-based solutions offered through third parties. This frees up the advisor's time to focus more intensely on the client relationship. The shift to portfolio solutions is a recognition that investment performance is no longer a key differentiating competitive factor. The shift to third party customized portfolio models has become a sophisticated exercise, enlisting the large asset managers equipped with portfolio and product solutions, and practice management techniques. Asset managers, such as Capital Group, Invesco, and BlackRock, have set up practice management groups to work with the registered investment advisors (RIAs) and firms to develop customized portfolio solutions for financial advisors and their firms. The portfolio solutions include a selection of new fund products, portfolio composition, and streamlining of the firm's existing product shelf. This independent advice on customizing client portfolios benefits the wealth management firms and their clients, and provides asset managers, through this ancillary service, access to the firm's wealth platform.

The wealth operations of individual firms have widened, in terms of product and service shelf, rapid application of technologies to improve operating efficiencies and digitalized access for clients, and extensive reliance on out-sourcing through third-party vendors for services such as customized portfolio modelling; financial, tax and estate planning; and insurance and banking services. Further, new online FinTech players have come on the scene to compete for securities execution and online portfolio investing and have established significant market share.

While wealth management operations within individual firms have broadened, the industry has also witnessed the consolidation of firms across the industry through mergers and acquisitions. This consolidation not only reflects higher fixed and operating costs and a need for scale and product breadth, but compression of fees and charges in response to intense competition. As the demand and scope for comprehensive wealth services has opened up, and the pressure to deliver greater value services has increased, many firms have reached the limits of operating capacity. Firms are managing business constraints by expanding size through organic growth and acquisition and driving greater productivity and efficiencies through technology solutions.

REGULATORY REFORM TO PROMOTE "CLIENT-FIRST" CULTURE

Extensive regulatory reforms in the wealth business have occurred throughout the ten years since the financial crisis, similar to the Canadian experience. Small U.S. broker-dealer RIAs have proportionately larger account size and revenues than their Canadian counterparts, enabling these firms to more easily shoulder the compliance cost burden. The foremost regulatory initiative in the U.S. industry is the implementation of SEC Rule BI, the best interest standard for broker-dealers. Reg BI defines a set of principles, key amongst them the disclosure of conflicts of interest, and will also be accompanied by a set of rules related to the mitigation and elimination of these conflicts. The new best interest regulation is supported by broker-dealer firms in the industry because the SEC approach preserves client choice; covers all client accounts (unlike the DOL fiduciary standard); and is principle-based. While the SEC has not yet finalized the core rules, eagerly anticipated by the industry, these rules and related guidance are anticipated within the year given the SEC priority to implement Reg BI, bringing closure to extended consultations on the client best interest standard.

CONCLUSION

The U.S. wealth industry has transformed dramatically in recent years and will undergo even more change in coming years. This transformation is a response to external factors, such as changing investor attitudes and behavior and the changing demographics in the marketplace. However, the evidence on the ground from conferences such as the SIFMA event, suggest the transformation also reflects the competitive drive at broker-dealer and RIA firms to meet client demands more effectively across the full spectrum of services, by improving standards of business practice and professionalism, and leveraging emerging technology to the full.

Yours sincerely,

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