



The battle for the high net-worth market

Brokerages line up against investment counsellors

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By Lara Hertel

A battle is heating up on Bay Street as an emerging trend toward discretionary money management has retail brokerages and investment-counselling firms muscling into the same space to scoop up million-dollar accounts.

With dozens of investment-counselling firms popping up across Canada in the past year — adding up to an estimated 500 investment counsellors in total — the investment dealers have no choice but to ramp up their offerings to get in on the big-dollar action.

“There certainly is a trend toward discretionary money management, both with the larger firms and banks,” says Gwyer Moore, president of the Toronto-based Investment Counsel Association of Canada, which has 80 members managing in excess of \$500 billion in private client and institutional assets. “At the same time, we’re seeing growth in this area among the smaller firms.

“People are looking for more tailored solutions to their investment needs. They want to put the onus on a professional to make investment decisions — and hold those professionals accountable,” he says.

The shift to discretionary management appears to be driven by a number of factors, depending on whom you ask. Investment counsellors say high mutual fund fees are driving investors to fee-based alternatives. Investment dealers say a growing need for tailored investments is spurring an interest in customized portfolios.

The one thing both sides agree on is Canadians are getting wealthier, and the demand for managing their money is increasing. ICAC research indicates that approximately 300,000 Canadians have investible assets of \$1 million or more, a figure that is expected to double in the next 10 years as the baby boomers’ find themselves on the receiving end of a transfer of wealth through inheritances.

For the past few years, the banks and the bank-owned dealers have been trying to tap into this high net-worth market — once dominated by investment counsellors — with a number of fee-based wrap accounts and access to third-party money managers. But as the demand for discretionary management rises, an increasing number of advisors are seeking their portfolio manager licence to service their clients directly.

Roberta Wilton, president and CEO of the Canadian Securities Institute, says there’s been an upswing in interest among advisors wanting to know what courses qualify them to be discretionary-licensed. For advisors in the Investment Dealers Association of Canada world, there are two options for obtaining the portfolio manager licence. The first is successful completion of the chartered financial analyst designation, offered by the CFA Institute, based in Charlottesville, Va.

The second option is obtaining the Canadian investment manager designation, offered by the CSI, and completing the first year of the CFA program. In both cases, the candidate must have five years of employment experience performing research involving financial analysis of

investments, three of which are under the supervision of a registered advisor managing no less than \$5 million on a discretionary basis.

For their part, the banks are trying to facilitate advisors' transition to portfolio managers with their own training programs. At BMO Nesbitt Burns Inc., 64 advisors are enrolled in a week-long portfolio theory curriculum, up from 55 in 2004. The interest in discretionary management has prompted the firm to ramp up its training program offering in 2006.

"Advisors are trying to be, and offer, more to their clients than a simple stock idea," says Sarah Widmeyer, vice president and managing director of Nesbitt Burns in Toronto. "They don't want to be seen as just the next hot idea, the new issue. There's an emerging attitude that they want to partner with their clients in more ways and bring more to the relationship."

At RBC Dominion Securities Inc., more than 225 advisors are offering discretionary management to some degree. That number could reach 400 in the next two to three years, as more and more advisors target high net-worth clients through customized programs.

"Discretionary management is really where the future is taking us," says Mike Scott, regional director at DS in Toronto. "We want to be on the forefront of that, because on a day-to-day basis, the investment-counsel firms are our biggest competitors," he says.

Still, not every advisor is cut out for discretionary management, he adds. Candidates must have five years of investment experience and manage \$50 million in assets before being considered by the DS's board. "We're very stringent about who we allow onto this platform," Scott says. "People want to run the kind of business they're comfortable with, and this isn't for everyone."

The lure of discretionary management has even prompted some independent brokerages to consider dropping their status as an IDA member in favour of adopting a full-out investment-counselling platform. Brent McLean, president and CEO of Calgary-based McLean & Partners Wealth Management Ltd., calls his firm the perfect hybrid of a traditional brokerage and an investment-counselling/ portfolio manager (ICPM). Formed in 1999, the firm's discretionary-management business has grown to account for 80% of the firm's \$885 million in assets under management, up from 20% in 2003.

Despite impressive growth, the firm's compliance fees are onerous, McLean says. He estimates it costs \$250,000 a year to be compliant with the IDA, despite the fact that it doesn't participate in underwriting, mergers and acquisitions or any of the other activities that put brokerages at regulatory risk. As an ICPM, the compliance costs would be a fraction of what they are now, he says.

Investment-counselling firms are registered directly with the provincial securities commission. As its securities are held with its custodian, the regulatory burden is shifted. By contrast, investment dealers must register through the IDA and assume all the regulatory risk, thereby necessitating a full-time compliance department and regular reporting to the IDA.

Running a brokerage that's steadily moving toward an ICPM model, McLean has a lot to consider. "We're reviewing our options right now in terms of what business model we're going to pursue," he says. "We really do believe that we are overregulated for what we do."

But with 20% of his clients still non-discretionary, he's hesitant to abandon the IDA model entirely. His clients — who own significant positions in publicly traded companies, for instance — are better served by a brokerage that can carry out a hedge transaction to offset risk, he says. What's more, he believes the current regulatory environment will mean increasing compliance requirements — and the associated costs — for ICPMs.

"For right now, we think the brokerage platform offers more flexibility in dealing with high net-worth clients than an ICPM," he says.

Others such as Jim Steel have abandoned the brokerage platform altogether. The 39-year-old investment counsellor spent 11 years selling wrap accounts and mutual funds at DS before deciding that investment counselling was the way to go. His \$80-million book at DS was based largely on index products, and he wanted to pursue that business model with as much “independence and objectivity” as possible.

After earning his CFA designation, he got his feet wet in discretionary management with a one-year stint at PWL Capital Inc. before joining industry veterans Stephen Watson and Gabriel Di Primio to form Ottawa-based Watson Di Primio and Steel Investment Management Ltd. in October 2004. Today, the firm has 100 private clients and \$50 million in assets.

“What we’re doing here is bringing institutional management to the retail client,” he says. “With all the new technology available to us for reporting and review, we can offer this on a very cost-effective basis for our clients.”

Minimum accounts start at \$150,000, but the partners are flexible with younger clients just starting their careers. Fees begin at 1.35% for the first \$500,000 and scale down to 0.75% above that.

Steel says two things drew him to the ICPM platform. The first is the flexibility in offering clients the investment style they’re comfortable with. He and his partners abide by their own investment philosophies, but they consult with each other regarding the management of the portfolios they handle on their own. It’s a freedom they never had at bank-owned brokerages, he says.

The second draw was lower costs — both for the firm as a start-up, and for clients accustomed to paying the fees associated with bundled accounts.

“If you own a wrap account or a mutual fund, the average expense ratio is slightly less than 3% a year — and that doesn’t include the hidden costs. You’re looking at 6% or 7% to own a mutual fund in a 8% return environment,” says Steel. “You need to be able to unbundle those costs for clients and remove all the hidden layers of fees.”

Being located in Ottawa gives the firm a competitive advantage as well. Steel estimates there are only a half-dozen ICPMs in the area, and he has the time to give clients the individual attention they need.

It’s an advantage that the ICAC’s Moore says could be significant. “In almost every instance, the most important element of the services provided is the personal relationship an investment counsellor has with the client. And that’s something the small firms can deliver very effectively,” he says. “It’s one of the ways the small firms are able to compete against larger firms that may be able to offer a broader range of service.”

Still, the banks remain the dominant players. Moore estimates the bank-owned private counselling firms control more than 50% of private client assets in Canada: “People still have ties with the larger financial institutions, particularly ones that offer tailored solutions and personal relationships.”

For now, that’s not deterring Steel. “We look at all the assets the banks have and think, ‘If we get just 1% of that, we’ll be fine,’” he says. IE