After The Descent, What Colour The Phoenix?

A perspective on the development of integrated wealth management processes in the Canadian Retail Financial Services Industry

Part 2 c – Financial/Economic Crisis Related Issues – The Role of Advisors

The roles, responsibilities and relationships of advisors are complex and lie at the heart of the retail financial services' market place in Canada and, indeed, most other countries: **regulation**, current business and service processes and objectives, **established distribution methods and culture**, technological innovation and development, **portfolio theory and investment software**, and many other factors impact and influence the functionality and utility of this isthmus between the industry and the investor.

Understanding advisor roles and anticipating their evolution in the face of a burgeoning dual imperative (*the current financial crisis and competition for the retirement income planning market)* requires the ability to assess advisor roles from a number of perspectives. For example, as resources and components of a business and service process (*many advisors have direct or indirect relationships with brokerages and product providers,*) the questions are many;

1. How efficiently are advisors being resourced, organised and utilised and to what extent are organisations and advisors concerned over productivity?

2. If their roles, tools and services need to change, are the parent companies/distributor relationships aware of these dynamics, and if they are aware of these dynamics, what are the dynamics of the relationship that will facilitate or obstruct the necessary changes?

3. Conversely, are advisors themselves aware of these relationships and to what extent do they obstruct or enhance the evolution of their own roles?

4. To what extent are both parties aware of the dynamics of their relationships and their impact on the market place?

5. What is the long term brand that advisors and their employers are trying to build and what risks are they willing to take with regard to their brand? Brand risk occurs when the outcome expected by investors with a product, portfolio, solution, strategy or service deviates significantly from the actual outcome: a combination of high costs, inappropriate risk management solutions, and financial, market and economic turmoil can all create the necessary margin.

A large of part of financial services marketing research is essentially spent delivering the intelligence and analysis to unlock the details and the dynamics that answer many of these questions.

Roles of advisors

The **economic role of advisors** is to facilitate the allocation of capital within the capital markets; the **specific role of advisors** in the retail financial services market place is to take advantage of the need to allocate capital via one or more of the following:

a) To generate commission based revenue by selling products and initiating transactions (*retail, transaction driven*).

b) To increase asset based revenues (*investment counsellors/portfolio managers*).

c) To generate fees for services and advice.

Where advisors and their institutions promote themselves as providers of personalised and appropriate (*to risk aversion and financial needs*) wealth management solutions (*in particular retirement income planning*), advisors (*including institutions*) are also effectively responsible[1] for the planning and management of structures that can manage the short and long term risks of assets relative to client income and capital needs.

Advisors *(as well as institutions and product providers)* are ultimately responsible for making sure that the stated claims of a transaction, product and/or service with respect to that solution are, within reason, capable of being met[2].

The roles of advisors becomes more complex once they promote themselves as responsible and able to manage the short and long term risks to financial security central to wealth management and retirement income planning.

But, to what extent are advisors (*with parent institution/product provider relationships*), who promise wealth management solutions (*and who depend on a firm's investment resources*), responsible for making sure that the advice they give is appropriate, responsible and reasonable? This is important if we are to consider the appropriateness of roles and responsibilities for those roles, and relationships between advisors and the companies they operate within or are employed by.

> This question is important once advisors and their "employers" move from a transaction based service promise to a wealth and retirement income planning service solution framework: the responsibilities and the sophistication needed to deliver the services are much greater. Periods of financial, market and economic crisis can expose frameworks that are inappropriately structured to deliver wealth management and retirement income planning services.

In order to provide wealth management solutions, many advisors will depend on their institutions or employers to provide them with the market and economic risk assessments, the portfolio allocation tools and securities/products they can sell: most advisors do not in fact have the time, the resources or the necessary expertise to perform all the functions necessary to provide a responsible, reasonable and

[1] Market participants assume a brand liability risk where they fail to ensure that advisor roles and services manage the risk of a significant deviation from advisor initiated expectations of outcomes and actual outcomes.

[2] The liability for failure being dependent a) on regulation, and b) the impact of the omission on the ability to compete in the market place and the cost of rebuilding confidence.

appropriate wealth management solution. In fact, advisors could find it increasingly difficult to compete in the wealth management/retirement income planning market, in the current environment, without such support.

> Again consideration as to the level of support advisors need to deliver services in a more competitive industry is important to defining roles and relationships, the structure of the business and service model and the integration of its components. It is also important to note that times of stress are also associated with regulatory change and regulatory change could have a significant impact on advisor and institution roles, responsibilities and relationships.

Institutions (*that aim to be competitive in the wealth management/retirement income planning market*) will ultimately be responsible for ensuring that advisors have processes and procedures that allow them to implement, responsible, reasonable and appropriate wealth management solutions. It is also a moot point as to what extent institutions can and should make sure advisors follow these processes and procedures: deviation from appropriate investment disciplines and structures poses a risk for both advisors and institutions, but system design (*integrated processes with hard and soft coded decision rules*) can allow for variation in disciplines and styles whilst managing such liabilities[3].

However, where advisors are involved only in selling transactions, the above is not the case. But, can advisors stay rooted to the transaction model and survive?

While much of the Canadian retail financial services industry is still considered a brokerage/transaction orientated industry, it has become much more involved in promoting itself as a provider of wealth management solutions, and is developing more sophisticated retirement income planning solutions. In other words, its legacy framework is one structured around transactions, while its promoted business objectives and service solutions are service driven; the two are in conflict, with significant potential liabilities to market participants who fail to recognise the liabilities associated with such a shift.

> Admittedly, it has been easier, for a short period of time at least, for the industry to retain the legacy infrastructure to deliver a bigger message (change is not without initial costs and risks), but this bigger message requires a different platform and the liabilities of operating under two competing paradigms are significant.

Advisors and institutions who still operate a largely transaction driven model while trying to deliver a sophisticated solution are likely to be experiencing the greatest challenges and risks in the current environment.

[3] Development of processes (and systems) needs to be able to accommodate differences in advisor disciplines and processes while making sure that portfolio outputs are appropriate, responsible and reasonable.

The roles and responsibilities of those who only sell transactions and individual securities, without selling the risk/return management benefits of the whole package, are much simpler, but the business model is most likely in decline. Selling complex stand alone products may well provide a backstop to the transaction model, but these products are also much more easily sold direct to the consumer, and, indeed, much of the marketing in these new products has been directed at the consumer – this issue is addressed in specific subject perspectives on transactions versus service processes and internet delivery.

Whether "*what an advisor can and cannot do*" remains appropriate, depends on competitive market forces, the advisor's position within the market place (*niche and operational model*[4]), and the needs, wishes and objectives of suppliers (*if advisor is constrained by suppliers or corporate structure*) and buyers of products and services. Regulation also impacts "*what an advisor can and cannot do*" – issues regarding regulation and the impact of regulation on the industry will be explored in subject specific perspectives.

It is possible for advisors and institutions to remain within a transaction driven framework while promoting a service orientated business model, as long as the liabilities (risks) associated with such a framework are not exposed.

Dual Imperatives

The roles of advisors and their associated business models are currently being questioned (*and exposed*) by dual imperatives;

a) the financial, market and economic crisis (*which is exposing liabilities associated with flaws and weaknesses in existing frameworks and services*), and

b) the drive to develop products and services capable of managing retirement income planning (*which are improving and integrating business and service processes*) and ultimately total asset, life cycle wealth management.

The first has exposed the validity of existing transaction based distribution frameworks, practises, tools and solutions in providing wealth management solutions; the second is set to improve, challenge and change processes and control of the components of the process.

[4] Sales reps, investment counsellors, financial planners/MFDA, independent, brokerages, commission/fee based etc.

The current financial, market and economic crisis

The immediate financial crisis is an exogenous event that is placing stress on the competitive fabric of the market place; some of these consequences will be positive[5]. An industry with a large transaction based component structure is exposed to and less able to prepare for and manage the risks of the current event.

The significant gap between investor expectations of product and service outcomes and actual outcomes, that has arisen in the current environment, risks causing a reappraisal of industry standards, regulation, advisors' roles (*whether they be investment counsellors, portfolio managers, investment/insurance advisors, financial planners with securities licences*[6]), their expertise, disciplines and the products, solutions and services they provide.

- Should individual advisors (*or even small advisor groups*) be determining their own asset allocation, security selection, portfolio construction, planning and management strategies (*even where the building blocks are provided by their parent firms*) where **a)** this role can be better handled by a centralised resource and service process (*distributed via sophisticated software or complex stand alone products*) within a parent organisation, **b)** many of the loosely structured wealth management solutions developed under a transaction framework are unlikely to be able to manage the risks they once promised to deal with, especially when set against the benefits of centrally resourced platforms.

- Is the transaction based model conducive to delivering effective wealth management solutions, can it be adapted to be so, and, if not, how can it be restructured to meet the future direction of the industry?

    - Many of the structures and strategies (*as well as service components such as effective communication*) needed to manage retirement income planning effectively do not lead to transactions, meaning there is no return in a transaction structure, while a transaction driven business model often runs counter to the consistency and discipline appropriate to long term retirement income planning. Further discussion of transaction and service based models and retirement income planning are discussed in specific subject perspectives.

- The scale of the current crisis is seeing a large fall in demand for retail financial services in general: this will place stress on all components of the industry, especially on transaction driven infrastructures, and, force it to seek more efficient distribution methods and/or more efficient distribution channels.

    - Both advisors and institutions are likely to see pressure on earnings and margins and hence focus will need to be on improving the productivity of process while cutting operational costs.

This final reappraisal of the industry is likely to come from a number of quarters; consumers, regulators, product and service providers and advisors themselves.

[5] If productivity rises, costs come down, (long term) gains to shareholders and value to customers rises and the transaction cost of capital in the market falls.

[6] This spectrum may appear diverse but all advisor roles and relationships are governed by the same fundamental factors impacting the delivery of wealth management services and solutions.

Transaction based roles in upward and downward markets

In a rising market, returns to transaction based business models increase the fewer restrictions there are on advisor roles and responsibilities (*the likely liabilities to brand will also increase*), but in downward markets, the risks associated with a prior excess will become evident, and the ability (*in a transaction model*) to provide the necessary discipline required to develop and support brand in the market place, will be less.

Additionally, if we consider that transaction models can become overly focussed on short term themes, we have yet another reason why wealth management and retirement income planning in particular require service based models with greater consistency of earnings as well as investment solutions: that is if a company wants to compete effectively in the retirement income planning market.

Retirement income planning products and platforms

There has been an increasing focus on retirement income planning, and on what this perspective would term total life cycle wealth management (*seen in Manulife's GMWB product*[7]). This focus is seeing financial services move into process driven service/complex product structures; whether or not a move to process driven service structures is intentional or not is unclear.

The trend towards process will impact the roles and responsibilities of advisors: providing a service that manages all an investors needs over time involves directly or indirectly managing the disposition of all assets and all financial needs over time; such a process is a big responsibility and implies managing all factors impacting risk to the ability of assets to meet financial needs, something which a transaction framework is not designed to do. Such a responsibility is also a liability if the framework cannot deliver, within reason, the expected contractual obligations.

Process implies a focus on automation *(needed to make implementation of process viable),* integration *(needed to effectively deliver process)* and formalisation (*of rules, structures and disciplines underpinning structures, relationships and/or solutions*). Process, and its automation, ultimately implies hard coded decision rules[8] for virtually every component of the financial and investment planning process.

Advanced processes are highly competitive methods of distributing wealth management expertise, solutions, services as well as transactions and products; these frameworks are also flexible with respect to the mode of distribution (*either on line, or by various levels of advisor input*). Should process driven solutions take centre stage, advisor roles will in future be beholden to such platforms, and, hence, advisor relationships with those that control process and the resources needed to fund process will become much closer.

When implementing process, care needs to be taken with respect to current advisor roles and relationships; this is especially the case with complex products with closed processes[9], since part of the

[7] Manulife have pushed back the time frame of their product to those well outside pre retirement and is looking to incorporate much younger investors into what is now effectively a long term wealth management product.

[8] Hard coded decision rules imply much greater functionality, flexibility and higher levels of personalisation for wealth management services: they also mean less freedom to move outside those core decision rules in structuring, planning and managing assets. Soft coded (the ability to amend parameters and rules) for advanced users is a must.

[9] Closed processes provide limited advisor input once instituted and are less flexible.

advisor role is to add value over a long term relationship with their clients. Open processes (flexible platforms) are more appropriate for advisors looking to add value – discussion of open and closed processes is dealt with in specific subject perspectives dealing with integrated systems.

The development of process is likely to split into two components, complex stand alone products capable of being delivered within the current transaction framework and flexible wealth management platforms. Both these formats will ultimately challenge advisor roles and relationships.

Complex products such as the Variable Annuity with a GMWB rider were originally introduced to manage the retirement income problem (*and to reinvigorate segregated fund sales*) and have spread to life cycle wealth management objectives. While these products are designed to be sold within a transaction based distribution model, they are really heavily process orientated. While this particular perspective is not intended to discuss particular products, this will be dealt with in specific perspectives, it is intended to introduce factors that impact advisor roles and relationships. As such, both complex products and sophisticated processes tie the advisor into much closer relationships with product and platform providers and much more closely with process orientated service outcomes than stand alone simple transactions.

Advisor spectrum and business model relevance

Much of the retail market is transaction driven: advisors are remunerated by the number of transactions they execute and organisations look to maximise the number of transactions their advisors execute. Advisors are therefore important to those companies that directly or indirectly derive their livelihood from transactions and product sales[10].

Other areas of the retail market are fee for service based (or a hybrid of commission and fees), with advisors remunerated by assets under management, and organisations looking to maximise assets under management.

- Services that charge fees have fixed costs associated with substantial non transaction service components for which value is received and consideration needs to be made.

- Transaction based services focus on the transaction and have limited (*or rudimentary*) non transaction service components: it is therefore difficult for a transaction based service to provide an optimal wealth management/retirement income planning service model (*you may not be getting paid for much of your service component work)* or to move to a fee basis *(you would need to enhance non transaction service components*)[11].

- Those that intend to stray transaction and commission driven will need to use complex process driven products such as GMWBs (with rudimentary product biased wealth management

[10] Most companies that sell products generate their returns from longer term activities (asset management) and not the transaction, which, is a cost of doing business and not a return: the more notable of these activities is the return on managing assets or insuring liabilities. A move towards process would shift competition away from remuneration towards value added by financial services' providers.

[11] It is important to note the differences between a transaction driven sale's process and a service based process in terms of the rationale for charging and the limitations and scope of the services provided. This is addressed further in the perspective dealing specifically with the differences between transaction based and service based processes.

platforms), while those who intend to be service process driven will need to use sophisticated wealth management platforms.

- Both areas, the future transaction and the future service based components, will be pressured by any development in online wealth management systems and services and regulatory changes that foster greater competition in the market place.
  - Note that there are a whole host of pressures on the current business model that may ultimately favour much lower cost integrated, automated service processes that will impact both transaction and service based processes.

Both basic models (*transaction/service based*) are looking to maximise revenue growth and shades of both models operate at different levels of most organisations: discount brokerages, full service brokerages and investment counsellors are options available on most financial services entities' websites.

The reasons for the number of different models operating under one roof are many and include (as a major factor) the cost and complexity of providing optimal asset and liability management solutions.

If there were systems in place that took away the complexity of delivering sophisticated asset and liability management (*key to delivering optimal retirement income planning*), there would be fewer reasons to retain a transaction driven infrastructure at the wealth management service level, and fewer reasons for complex process driven products; in fact, in such an instance, processes for structuring, planning and management could ultimately be uniform throughout the net worth spectrum[12].

In terms of the physics of the wealth management investment solution, the output for a high net worth investor should be no different for that for a low net worth investor: personal service and the trappings of a personal service would differ, but the fundamental investment solution should be the same.

The barriers to implementing advanced systems and more efficient processes are significant in well established transaction driven market places.

While this perspective focuses specifically on advisor roles and responsibilities, competitive business models and processes (*which are assessed in separate specific subject perspectives*) for the retail financial services industry are joined at the hip with advisor roles and relationships. Also, as implied by the above discussion, industry service segregation (*broker/investment counsellor/hybrid, transaction/assets under management/competitive fee based)* is a function of physical characteristics of delivering a service and the regulation, technology and competition specific to each service segment. Awareness of each relationship is key to understanding the dynamics of advisor roles, responsibilities and relationships.

Institutions therefore need to be clear as to the future viability of a particular business model with respect to advisor roles and relationships and the reasons why their business model continues to remain relevant or not, as the case may be. They also need to be clear as to how their business model and the role and responsibilities of their advisors within that business model will need to change in response to changes in factors impacting the physical delivery of wealth management solutions.

[12] Making retirement income planning services profitable for lower net worth investors depends on high levels of automation and less advisor interaction: this reduces unit costs and increases volume with lower fixed costs.

In Canada advisor roles are heavily influenced by **a)** the special relationships between advisors and the business arrangements in which they operate, **b)** the specific regulated industry segment (IDA, MFDA, Insurance) that determines the securities and products available, and **c)** regulation, industry standards and transparency.

Any factor that can impact competition in the market place (*regulation, market environment, technology, supply of services and products, needs and preferences of consumers*) will impact the viability of a business model and hence advisor roles and relationships within that business model. The current dual imperatives discussed are significant, and, in this context, firms need to proactive with regard to the direction and development of advisor roles and responsibilities; in a changing or exacting market place, advisors should embody the culture, disciplines and ethos of their business model and brand. Brand, as discussed in the specific subject perspective is far more important in an organisation looking to develop wealth management and retirement income planning services in particular, than an organisation looking to merely provide a receptacle for client transactions and product sales.

Points for consideration and research

Advisor roles are under stress for two main reasons as discussed: the financial, market and economic crisis and the drive towards more sophisticated processes for the management of the retirement income planning/wealth management problem. These two reasons will also impact regulatory and technological factors associated with competitive markets as well as the important consumer demand preferences for financial services and products. If advisor roles are stressed, so will the business models under which they operate.

Advisor roles could clearly change with greater control moving towards providers of advanced service processes (platforms) and with advisors favouring added value service process offerings in preference to higher transaction remuneration. Therefore, building advanced service offerings, offering training and facilitating assimilation into new service programmes are also issues the retail financial services industry needs to consider.

Understanding your own business model, its current and future direction, its strengths and its weaknesses relative to dynamics forcing change in the industry is a prerequisite to understanding advisor roles and responsibilities.

Advisor roles and responsibilities are under pressure to change and given their importance in revenue generation, it is important that both advisors and institutions are geared towards enhancing their ability to compete in a much more competitive market place.

But, change will not be without challenge as much of the current distribution framework and culture is incompatible with higher productivity, integrated business service processes. Awareness by both advisors and parent company/employers is key to dealing with these challenges.

This series of perspectives and reports will look at the dynamics impacting the roles, relationships and responsibilities of advisors, with future research mapping and exploring the developing dynamics of change and the issues likely to impede, help or shape change itself.

Companies that operate integrated process driven service solutions would likely centralise security selection, asset allocation, investment and investment planning decisions leaving advisors to implement this and to develop client advisor relationships.

This type of structure would limit advisor say in selecting products, and tie the advisor to the institution or wealth management solution provider concerned.

Many advisors may resent such intrusion and view it as a limitation of their roles (which it would be for transaction based advisors), but it is reasonable to assume that many advisors would also appreciate the greater flexibility (afforded by advanced systems in terms of planning and risk management), and control over factors likely to impact service and asset management outcomes.

Advisors who compete on service would decide who to align themselves with service providers with competitive processes and services as opposed to greater share of transaction remuneration. Many advisors would no longer be brokers or transaction conduits but investment planners, relationship managers and communicators of a service process. Aspects of the transaction market place would continue to operate for some time but would likely be at risk as marginal demand for services moved to service based frameworks.

Of course, not all advisors are looking to provide solutions to the management of retirement income planning issues: many just want to be able to sell products and transactions. Institutions will need to decide what type of advisors they will be looking to attract or focus on within their business models, since this will impact the service process they can deliver, the experience clients will receive and associate with their brand.

With much of the current distribution system focussed on transaction based relationships, as opposed to advanced service based processes, moving towards a service based process could risk alienating distribution based advisors, but it could also risk alienating companies from their future market place.

Summary conclusion

If companies believe that advisors continue to represent a very important source of revenue, a very important method of distribution and an important method of delivering their brand message, they will need to seriously address how the current crisis and the drive towards process are likely to impact the role of advisors, and how advisors can be used to support their own competitive position in the market place through development of appropriate products, services and processes.

Some will no doubt see no need to change their roles, whereas other companies may start pushing the envelope in their attempt to develop their business model, their wealth management brands, their competitive position and their service proposition with a view to maintaining margins and protecting and growing revenue.

It is important to note that if companies are to develop a wealth management/retirement income planning brand, they will need to make sure that this is directly reflected in advisor processes: advisors roles will effectively be determined by business and service process disciplines and decision rules under pinning systems delivering services.

If solutions are indeed to be found in automated integrated processes, this will allow for lower costs to investors, higher added value and lower costs to wealth management service providers. Automated integrated processes will protect margins and enhance competition, but they will significantly change advisor roles from those found in transaction based models.

Future perspectives and research will look at specific advisor roles and market, regulatory, product, technological, competitive, international, and other trends and issues impacting the roles, relationships and responsibilities of advisors.

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