THE GLOBE AND MAIL

ENDANGERED: The decline of investment advisers

The wealth-management business is in a state of upheaval as new technology and low-cost alternatives make do-it-yourself investing easier than ever. Fees are falling, and so is the outlook for people who once made good livings doling out financial advice. For advisers, the worst may be yet to come

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When Pat Brennan was fired last spring, it was the shock of his life.

A financial adviser with ScotiaMcLeod, he'd scheduled three seminars for potential clients on April 26 at the Stonebridge Golf and Country Club, just south of Ottawa. The first, a breakfast talk, went off without a hitch. Then, just as he was preparing for the second one, his phone rang. It was his branch manager.

The news was grim: Mr. Brennan was being let go. Thirty people were on their way to see him – some started arriving as he was packing his things up – but he was forced to cancel the seminar and the dinner event he'd scheduled that evening.

The jolt to Mr. Brennan's career was devastating. At 52, he had worked for Scotiabank for half his life, serving in roles such as personal banking officer and customer service manager. For the past decade he had been a financial adviser, managing $63-million, largely for professionals and small-business owners.

In total, roughly 65 Scotiabank advisers were dismissed that morning. Curiously, though, none were asked to sign non-compete contracts. In financial services it is normal for fired employees to reach an agreement with their former companies; in exchange for a better severance package, they promise not to jump to a competitor for a set period. This time around, the affected brokers weren't prevented from going to a rival.

At first they couldn't figure out why. Then they learned that former colleagues still at the bank had been given permission to poach their clients so long as those advisers paid the bank an upfront fee. The price, according to multiple advisers: 80 basis points (just less than 1 per cent) of the value of assets acquired.

Even in an industry known for cutthroat behaviour, the culling was seen as particularly harsh – mass firings were bad enough, but going after the clients of those dismissed was beyond the pale. Mr. Brennan declined to comment because he is currently suing the bank for wrongful dismissal, but the fear across the industry is that such client poaching will become the norm.

"There is no denying that the world that we're in is changing," says Glen Gowland, who oversees Scotiabank's adviser network as senior vice-president of Canadian wealth management. "The expectations are increasing. The competition is increasing."

Once a ticket to an upper-middle-class existence – or better – the financial-advice business is in a state of upheaval. Just as travel agents became an endangered species after vacations could be booked online, advisers are finding it harder to survive in a world where clients can buy and sell their own investments on their mobile phones and access financial research and guidance with a few clicks.

Compounding this digital disruption: A recent crackdown by regulators on hidden fees and commissions; the proliferation of exchange-traded funds (ETFs), passive investments with tiny fees that typically track major indexes; and the advent of low-cost online robo-advisers, which slot investors into preprogrammed portfolios of ETFs and rebalance those portfolios periodically.

Some of these forces have been building for decades, but they're converging quickly – and much of the impact will be felt as a short, sharp shock come Jan. 1. That's when advisers in Canada will be forced to disclose to their clients, clearly and in writing, exactly what they've been charging for their services.

In some cases, the sticker shock will be severe and clients will leave for cheaper alternatives. In others, they will simply start to wonder whether the service they're getting is worth what they're paying.

All of these changes are coming as the industry grapples with another symptom of disruption: Consolidation. The Big Six banks that dominate wealth management have been gobbling up fund companies and independent brokerages, and they are starting to demand more from the advisers they employ.

Canada has all sorts of advisers – some sell only mutual funds, some specialize in insurance products – but one group, the brokers who are licensed to buy and sell stocks and work for larger companies such as BMO Nesbitt Burns, CIBC Wood Gundy and Richardson GMP, are seeing their world turned upside down. In addition to the other pressures, they are part of big organizations that increasingly want to squeeze costs and juice as much profit from wealth management as possible.

These advisers also have fewer and fewer other options for employment: Thirty-six small retail firms have folded since 2011, according to the Investment Industry Association of Canada, and IIAC estimates at least 30 more similarly sized firms "are under considerable earnings stress."

Altogether, it makes for a harrowing time. "I could see there being significantly fewer investment advisers over the next five to seven years," says Jason Heath, a financial planner at Objective Financial Partners who specializes in activities such as tax and estate planning. "There's never been so much competition for a client's investment dollars."

Mike Newton: "They had everything – the hockey tickets, the concert tickets, the wines, the steak dinners."MARK BLINCH FOR THE GLOBE AND MAIL

Squeezing brokers, squeezing fees

Hustle counted for a lot when Mike Newton started working as a retail broker in the 1990s, grinding it out at firms such as Merrill Lynch Canada. He didn't have wealthy family or friends to lean on for assets, but that didn't matter much. "I'm not one of those connected Toronto guys," he explains. "What amazed me was that as a young guy, I could actually get an account."

Back then, clients were easier to win over. Brokers were a big deal and regular investors completely relied on them for access to the markets. Getting a call from a big-name broker was a window into a foreign and exciting world – it was exhilarating.

Stock markets soared for much of the 1980s and '90s and interest rates plummeted. Everyone wanted in and mutual funds offered regular investors the opportunity to profit, even if they weren't sophisticated.

Lucky for advisers, the mutual fund had rich fees baked right in. When a fund was sold to a client, it was common for the adviser and his or her firm to split a fee worth 5 per cent of the amount invested right away. Annual trailer fees were layered on top, offering yearly payments worth about 1 per cent of the money invested.

That river of fees paid for a lot of perks. Powerful, independent mutual fund companies such as AGF Management Ltd., Mackenzie Financial Corp. and Trimark Financial showered brokers with gifts to influence them and win business. "They had everything – the hockey tickets, the concert tickets, the wines, the steak dinners," Mr. Newton recalls.

That all feels so long ago. Many of the big perks began evaporating when the tech bubble burst back in 2000, but now an industry revolution is squeezing the fees as well, rewriting the norms that brokers have long lived by.

A new army of asset-management companies is dethroning the mutual fund giants as the influence of low-cost fund providers, such as BlackRock Inc. and Vanguard, grows exponentially. These firms offer ETFs that track established stock indexes, rather than paying a portfolio manager to select specific stocks. BlackRock's iShares ETF business now manages $1.3-trillion (U.S.) in assets globally.

Investors like ETFs for many reasons, but their low fees are paramount. Back when market returns were higher – such as the period between 1992 and 2007, when the TSX produced an annual return of 9.8 per cent – it was easier for a typical mutual fund's 2.5-per-cent annual fee to go unnoticed.

But they're a harder sell when returns are only 4 per cent or 5 per cent – returns that are more common in today's era of record low interest rates. After all, investors don't want to give half of their gains away. Thus the popularity of ETFs, such as BlackRock's flagship Canadian fund, which tracks the S&P/TSX Composite Index and costs just 0.06 per cent each year.

It’s also easier for investors to find and buy such low-cost funds. In the late 1990s and early aughts, discount brokerages grew popular, allowing users to manage their own investments. In more recent years, the ‘fintech’ revolution has spawned a new market that offers simple, cheap investment portfolios that invest in a collection of ETFs and can be purchased with a few taps on a smartphone screen.

Such services are primarily aimed at millennials, who may not know what discount brokerages are, and for the segment of the population that finds managing their own money much too intimidating. Top players in this niche include Wealthsimple and Bank of Montreal’s SmartFolio, and the strategies they use have caught on.

Today, about $82-billion (U.S.) is invested in ETFs in Canada, according to ETFGI, a more than sixfold increase over the past decade. However, mutual funds still dominate. As of Oct. 31, Canadians had $1.32-trillion (Canadian) invested in mutual funds, according to the Investment Funds Institute of Canada.

Canadian regulators are also forcing reforms. Until very recently, our mutual fund fees were some of the highest in the world, but a crackdown has begun.

In December, 2012, the Ontario Securities Commission announced a sweeping review of mutual fund fees, with a particular focus on trailer fees. Around the same time, the Investment Industry Regulatory Organization of Canada pressed ahead with plans to force brokers to give clients a summary of all the adviser fees they pay annually – in dollars, not percentages.

Such oversight has sparked a fundamental shift in the way brokers make their living around the world. Historically, clients paid advisers through per-trade commissions, along with fees tied to specific investment products such as mutual fund trailers. In 2012, regulators in the United Kingdom and Australia went so far as to ban commissions of all kinds, forcing brokers to use fee-based accounts. In such accounts clients pay a clearly articulated annual fee, often between 1 and 1.5 per cent of their assets under management, and nothing else.

In Canada, the trend is catching on due to market forces. Under the new model, many advisers started requiring that clients have at least $500,000 in investable assets. Below that level the accounts weren’t worth their while, as advisers earned less than $7,500 a year, half of which had to be split with their firms.

Already, the Big Six banks are quickly adopting minimum account sizes. At Toronto-Dominion Bank, full-service advisers have been told they shouldn’t serve anyone with less than $100,000 in investable assets.

In this new world, scale matters. The business of managing money is tilting heavily in favour of veteran brokers who oversee massive portfolios. Mr. Newton, now one of Scotiabank’s top brokers, can’t fathom how he’d make it in the industry if he didn’t already have a big book of clients, built over 20 years. “I just can’t imagine starting out from scratch,” he says.

Culture change and corporatization

The fee squeeze is only half the battle. Today, full-service advisers, the ones who buy and sell everything from bonds to mutual funds, and who mostly work for bank-owned dealers, such as RBC Dominion Securities and ScotiaMcLeod, must also contend with widespread cultural change.

In the past, Canada's big banks have largely split their adviser networks in two. Some advisers work solely in the branches, and mostly sold mutual funds. Working for the full-service adviser networks, meanwhile, carried some prestige, and these advisers were mostly separated from the broader organization, allowing the brokers to do their own thing.

That imaginary wall is quickly breaking down: The goal now is to better integrate brokers with retail banking divisions.

Canadian Imperial Bank of Commerce is particularly enthusiastic about this idea. Lately, the lender has heavily marketed its Imperial Service offering, which provides clients with a financial adviser who serves as a single point of contact for all banking and financial planning needs – everything from their mortgage to tax and estate planning.

Programs like this one can create culture clashes with advisers, particularly those who came up in a world where they were allowed to be independent. One particularly vocal broker contacted for this story initially said he'd love to talk; a day later, he had to renege because the marketing department wanted to approve of his answers. "I know this is cumbersome, but welcome to our world of ever-growing regulatory requirements," he wrote in an e-mail.

These shifts are redefining what it means to be an adviser. It used to be that when bank branches referred new clients to brokers, the brokers had to split a portion of their commissions with the branch manager, and that was it. At TD today, brokers are encouraged to sign clients up for bank products such as credit cards, according to someone familiar with the new rules.

Closer integration with the branches raises questions about who owns the client – the retail adviser or the bank? This battle came to light when Scotiabank slashed the size of its adviser network this past spring. By allowing its remaining brokers to go after the clients of those advisers who had been dismissed, the bank clearly stated it didn't think accounts belonged to the brokers.

Raymond James is betting that some brokers won't put up with such heavy-handed treatment. The independent company does not have a massive fund-manufacturing arm, so its advisers are free to choose whatever products they want, and when recruiting brokers, the firm makes it clear that advisers own their clients.

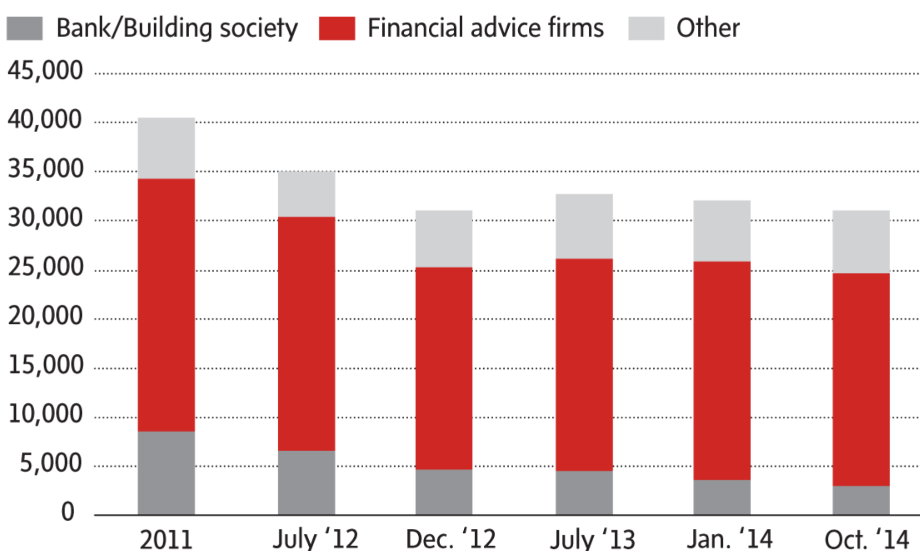
"We put it in writing that you own your book," says Paul Allison, the firm's Canadian head. "So when you leave, your client isn't going to get a call from Raymond James."

Who will look after the middle class?

Advisers wondering what their business could look like in a few years can look to the United Kingdom for some clues. Even if regulators here don't go as far as their British counterparts and demand that all accounts must be fee-based, market forces are already pushing the industry in that direction.

This March, roughly four years after fee-based accounts were mandated in Britain, the Financial Conduct Authority and Her Majesty's Treasury released a report. The good news: "The move to fee-based advice on retail investment products has improved transparency and ended conflicts of interest caused by a mainly commission-driven model."

However, policy always comes with tradeoffs, and one glaring change is that the broker ranks have dwindled since the new rules were implemented, dropping from 40,000 in 2011 to 31,000 in 2014.



It has also become harder for clients with modest wealth to get advice. The proportion of British brokerages that demand their clients have more than £100,000 ($168,000) in their portfolios has jumped to 32 per cent in 2015 from 13 per cent in 2013.

A similar situation is already playing out in this country. Although the number of advisers employed by Canadian full-service brokerage firms has remained around roughly 10,000 for the past five years, according to Investor Economics, the banks now increasingly want only high net-worth clients.

When ScotiaMcLeod cut its ranks this spring, the brokerage targeted advisers who brought in annual revenues of $650,000 or less, including some who were managing assets of $75-million to $100-million – a level that previously allowed advisers to qualify for bonuses. BMO Nesbitt Burns made a similar move in June, cutting roughly 30 brokers who brought in $600,000 or less in annual revenues.

The result is that clients in their 40s and 50s with a few hundred thousand dollars in their retirement accounts can get less tailored advice. Some bank-owned networks still want to serve them, but only when managed by an adviser who already has a large business, which means he or she has less time for one-on-one meetings.

Another option is they get punted to the branch network, and Scotiabank's Mr. Gowland, who heads Canadian wealth management, argues that middle-class investors get much better advice on their money there than they used to. "The level of advice and expertise you get today going into a bank branch relative to what it was 15 years ago is night and day," he says. Employees there aren't just bank tellers anymore; they're often certified personal financial planners.

He also argues many clients don't need high-touch advice. To illustrate the point, Mr. Gowland makes an analogy: "If you've got somebody who works out a little bit on weekends and they've got a doctor to make sure they're healthy, that's probably all they need. But if I make my living as a professional athlete, I'm going to need a physical therapist, a chiropractor, a nutritionist, a massage therapist."

But there are critics of this approach. David O'Leary is a financial planner with Eden Valley Partners, a three-person team in Toronto, and he has spent more than a decade in the business. He says that young Canadians with fewer investable assets are at a disadvantage under the new model.

"They are the people who can benefit the most from [detailed planning]," he argues, because they have the time horizon to benefit from compounding returns. "If somebody's already two years away from retirement, I can't make up that gap."

While some smaller clients with, say, $50,000 in investable assets are possibly best-suited for a robo adviser, Mr. O'Leary argues "mid-level investors, with a few hundred-thousand dollars, do need some serious financial advice."

Financial literacy, or lack thereof, is one of the key reasons. When Mr. O'Leary first talks with clients, he sits down for meetings that often run two hours to go over detailed questions about how much money they will need and what they will need it for. "Most people have no idea," he says.

What's bad for advisers could be good for clients

Add it all up – the fee crunch, the new disclosures on commissions, the dominance of the big banks, the emergence of computer-generated portfolios – and what emerges is a classic story of disruption, one driven by easy access to data and low-cost products.

"The access to information that an investor can get is infinite now, and it's almost exclusively free," says John O'Connell, who used to be one of RBC's top-performing brokers before he left in 2010 to run asset manager Davis-Rea Ltd., which provides discretionary money management services to individuals, companies, institutions and foundations. "It seems to me that the adviser is stuck in a very awkward position."

To survive, brokers will need to evolve. Instead of making his money off stock-trading commissions and mutual fund fees, Scotiabank's Mr. Newton now runs his business to look a little more like that of a low-cost fund manager. He now oversees five model portfolios and his practice is solely fee-based, charging between 1 per cent and 1.5 per cent a year, depending on the value of assets a client has under his watch.

He also espouses a unique investing philosophy compared with the traditional stockbroker. "I'm a big believer that you can control what you can lose," he says. "Whereas most advisers sell on what they're going to make you."

At a recent conference he was asked flat out whether retail brokers are dead in this new world. His response: "No, but the marginal adviser is." In any disrupted industry, the easy money is always the first to disappear.

One possible outcome of all this is that Canadian money management will become a two-tier system: Clients with the larger accounts will get access to professional advice, while the average investor will be folded into mass-market products.

That may not be an entirely bad thing for investors. Under the old model, brokers who managed a mix of account sizes typically paid the most attention to their richest clients, anyway.

At least average investors won't pay for services they don't use. Nor will it be easy to take advantage of them by, say, collecting trailer fees simply for keeping them invested in a certain mutual fund.

For advisers, though, the harsh reality is that many advisers might not make it. "It's not a lack of empathy," Mr. O'Connell says of this fact. "The people who worked at Kodak in the 1980s, they lost their jobs too. You can't stop progress."