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To fee or not to fee? Ageing clientele will impose new demands

Jonathan Chevreau

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Rising numbers of wealthy Canadians is good news for financial advisors seeking to serve the high-net-worth market but the competition is intensifying. Investor Economics Inc.'s latest household balance sheet shows Canada's wealth market doubling from \$2.4-trillion in 2006 to \$5.5-trillion by 2016. Counting residential real estate, the total wealth market will rise to \$8.6-trillion from \$4.5-trillion

Keith Sjogren, director of strategy consulting for Investor Economics, told the Institute of Advanced Financial Planners symposium in Montreal earlier this month that the number of millionaires (with financial assets of at least \$1-million) will more than double to 1,027,000 in 2016 from 471,000 in 2006.

But he urged advisors not to neglect the bigger Emerging Wealthy market (investment portfolios \$250,000 to \$1-million). This "mass affluent" group will go to 1,636,000 households from 883,000 in the next decade and are about to get much more attention, Mr. Sjogren said in an interview. "There's congestion on the Persian carpets of the wealthy. We're seeing some institutions begin to refocus and realize they may not have paid enough attention to the Emerging Wealth category." The mass affluent tend to be younger and more aggressive investors than the millionaires.

Indeed, it should come as no surprise that the numbers of super wealthy thin out with rising wealth. Sjogren defines three kinds of millionaires: Canada has 410,000 "mass millionaires" with \$1-million to \$5-million. But there are only 36,000 penta-millionaires (\$5-million to \$10-million) and 25,000 deca-millionaires (\$10-million plus).

Advisors need to be ready for the ageing of the workforce. The number of households headed by someone over 65 will rise 34% over the next decade. The numbers aged 75 or more will jump to 1.8 million, from 1.5 million in 2006, while the cohort between 65 and 74 will rise to 2.5 million from 1.7 million (rounded).

"Grey is gold," Sjogren told the IAFFP, since the over-65 group will control 46% of the nation's wealth by 2016, compared with 39% in 2006. The financial industry must develop products and services to meet the needs of this group once they begin to "dis-save" after 65. Passive investment products that generate income will be in demand: Sjogren cites the \$2-billion invested in the first year of Manulife Financial's Income Plus as an early harbinger of this trend.

Such products address the rising life expectancy of seniors -- 65 year-olds can expect to live 19 more years compared with just 14 in 1951. Longer lives, early retirement, the need for reliable income, volatile markets and declining pension coverage all are driving demand for advice and customized solutions. "Funding needs are far more extensive than they were 20 years ago," Sjogren says. It used to be that Canadians retired at 65 and died at 80, requiring 15 years of retirement funding. "Now it's 55 and dying at 85: a 30-year period. The issue of how to fund that is far more acute."

Wealthy and not-so-wealthy clients want more advice and solutions customized to

their risk tolerance and income needs. At the high end, separately managed accounts or wrap accounts may fit the bill, offering a choice of money managers that even some wealthy can't access directly. Expect more competition and fewer players. The consolidation we've already seen (fund companies buying distributors; banks or insurance companies buying investment counsellors) will continue over the next 10 years.

How does this affect financial planners? "If you're an investment counsellor, you're either an acquirer or a target," Sjogren says, "If you're an unaligned advisor, it may not have a material impact unless you form an alliance with a particular counselling firm."

The wealthy attribute the reason for their financial success primarily to their career choice (42% credited this) or hard work (41%) versus just 22% who credit financial planning for their success. "We've not done a good job of convincing the wealthy it's important to have a comprehensive financial plan," Sjogren, says, "The traditional financial planner will be up against a lot of competition as far as the high-net-worth market is concerned."

Advisors can adapt by adding credentials and selling a wider range of products. They could, for example, expand beyond the MFDA (Mutual Fund Dealers Association) channel to embrace the IDA platform (which lets them sell individual stocks and bonds and ex-change-traded funds).

Another highlight of the symposium, according to veteran advisor Warren Baldwin, was a talk by Shawn Brayman on the changing business model of financial planning. Brayman is founder of Plan-Plus Inc. and winner of the Financial Frontiers Award 2007 for his critique of Monte Carlo simulations.

The dilemma facing advisors is a variant of what Shakespeare's Hamlet agonized over: "To fee or not to fee." Brayman says the industry is in transition from a product focus to selling products with advice on request and ultimately making advice preeminent. Mutual fund sales people are in the middle category: If clients ask for financial plans, advisors generate them but they're still stuck in the commission mode. Most advisors are stuck there, Brayman said in an interview, "They started out to become financial planners but never really got out of product mode."

Ultimately, "advice makes more money," Brayman says. The ideal is a compensation model where advisors are paid a fee for their time or on client assets under management. Five years after this transition, fee-only or feebased advisors can make four times more revenue and 60% more profits. They also attract larger clients: the same well-heeled clientele mentioned by Sjogren.

There's plenty of room to grow. Only 2,000 of 400,000 U.S. advisors are members of the fee-only planning association. Of those, 80% use asset-based fees and 20% charges fees for their time. So only 1% or 2% of advisors are financial planners that charge for their time.

The bonus is "many would argue it's more professional," Brayman says.

The IAFP regards its Registered Financial Planner designation as a badge of this extra professionalism. There are only 500 RFPs in Canada compared with 16,000 certified financial planners. Brayman says the IAFP has relatively more members that take a feebased approach, but some are still commission-driven.

jchevreau@nationalpost.com

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