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# Executive Summary

## Background

Financial advisors provide a range of services to clients through the provision of investment, retirement and risk planning and advice as well as the sale of one or more financial products; specifically, mutual funds, securities and life and health insurance. They sell products through a variety of distribution channels, ranging from Canada's largest banks to small local businesses with a single employee.

The small and medium-sized business (SMB) financial advice industry segment is an important component of the broader

financial advice industry, comprising approximately 80% of the total number of financial advisors.<sup>1</sup> It includes financial advisors operating out of independent mutual fund and securities dealers, independent insurance agencies, exclusive agents of insurance companies and full service securities brokerages that are not affiliated with large financial institutions (e.g. credit unions and the "Big-Six" banks).

## The Financial Advice Industry in Canada

The Canadian financial advice industry is bracing for significant change. Global economic volatility has led to investor uncertainty in equity markets. Recent periods of low savings rates and the trend away from defined benefit pension plans have heightened anxiety about preparedness for retirement, especially within the baby boomer generation. Customer preferences, particularly those of younger segments of the population, are shifting toward a desire for increased knowledge and control of a household's financial situation and investment status.

Additionally, new regulatory requirements regarding financial advisors' relationships with their clients are being contemplated in Canada and the US. In the wake of the financial crisis and a number of well-publicized cases of investment fraud, such regulations

have already been adopted in the UK and Australia. Such changes have, in some cases, had unexpected consequences on the small and medium-sized (SMB) financial advice segment of the industry.

Here in Canada, financial advisors in the SMB segment are already under pressure to consider new business models, products, customer segments and channels to maintain their unique value proposition and be sustainable in the future. Whether this segment of the industry is able to adapt will have a significant impact on the approximately 80,000 financial advisors working in the segment today, on the 12 million Canadian households considered part of their mass market customer base and on the Canadian economy as a whole.

## Study Objectives

To assist in developing a robust understanding of the financial advice industry in Canada, The Financial Advisors Association of Canada (Advocis) engaged PricewaterhouseCoopers LLP (PwC) to conduct a comprehensive and objective analysis of the industry, the issues and challenges faced by the SMB financial advice segment, and an analysis of the industry's economic impact. PwC conducted the economic impact study in conjunction with HDR Corporation.

This study seeks to inform the public, key policy makers and regulators on the impact of SMB financial advisors across Canada. These advisors run their own businesses advising millions of individuals, families and companies (i.e. typically entrepreneurs and small businesses) on a wide range of financial matters to assist them in meeting their long term financial goals.

## Approach

In order to complete the study, a variety of primary and secondary research approaches were used, including:

- Industry research on the composition and key characteristics of the SMB financial advice segment, in addition to consumer characteristics and emerging industry trends.
- A review of regulatory frameworks in Canada and in other jurisdictions (i.e. the UK, US and Australia), in order to understand recent and proposed regulatory changes and their estimated impacts.

- An SMB Financial Advisor Survey of approximately 1,800 SMB financial advisors across Canada in order to obtain specific data regarding demographics, revenues, expenses and employees.
- An estimate of the economic impacts of the industry based on the results of the SMB Financial Advisor Survey, and information from Investor Economics and Statistics Canada.

## Summary of Key Findings

Following the research phase of the study, PwC identified a number of key findings related to the SMB financial advice industry. Highlights of these key findings are identified below.

**SMB financial advisors play a unique role in the financial advice industry by virtue of the range of products and services they provide, the range of consumers they serve and the value they provide those consumers.**

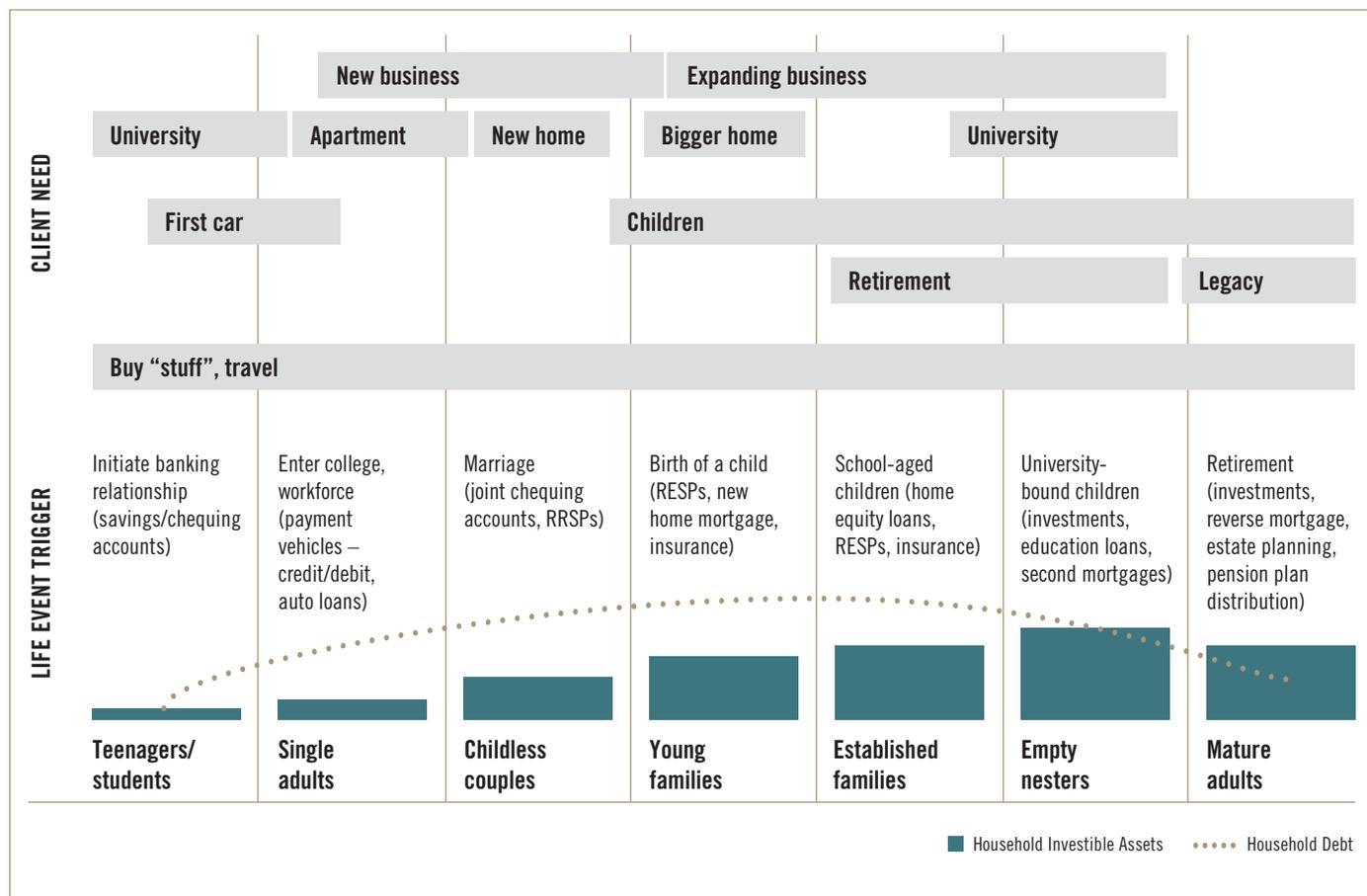
SMB financial advisors have a distinctive and varied role when it comes to providing advice to their client-base. Specifically, they enhance consumer access and choice in the financial advice industry by:

- Providing advice on and selling mutual funds and securities.
- Providing advice on and selling individual (i.e. non-group creditor) life insurance – which cannot be provided by advisors or loan personnel working in bank branches due to prohibiting legislation.<sup>2</sup>
- Providing specialty services and competitive products (key components of financial advice – see diagram on next page) to clients with lower levels of investible income on average. This client segment represents a significant part of the market, given that 80% of Canadian households have fewer than \$100,000 in financial assets.
  - Clients of SMB full service brokerages have an average of \$169,000 in investible assets, compared to an average of \$430,000 for clients at full service brokerages owned by Canada's largest banks.
  - Clients of SMB financial advisors licensed to sell mutual funds have an average \$44,000 in assets, compared to an average of \$109,000 in assets held by clients of branch-based financial advisors (i.e. advisors licensed to sell securities or mutual funds only).

- Providing an integrated approach to addressing the financial needs and goals of their clients. SMB financial advisors work with their clients to incorporate a range of disciplines into their financial planning (e.g. financial and tax planning, portfolio risk diversification, insurance policy selection).
- Educating their clients on financial matters – from savings and investment discipline to the impact of short-term financial decisions on long term goals.
- Helping to increase the net worth of their clients from an investment perspective, as compared to investors who do not have a financial advisor.
  - Studies have shown that financial advice correlates with higher investor net worth. Specifically, studies have found that investors with financial advisors have a higher net worth as compared to those without, that this differential increases over the course of an investor's relationship with a financial advisor, and that there is a significant benefit to investor net worth when they obtain tax planning assistance from an advisor.<sup>3</sup>
  - Controlling for other factors, one study found that investors who did not have a financial advisor generated approximately half the net worth of investors who had a financial advisor over 10 to 14 years.<sup>4</sup>

Most importantly, many SMB financial advisors have the flexibility to assist their clients across all stages of the financial advice lifecycle (see figure below). Regardless of where a client is in the lifecycle, SMB financial advisors can assist them with financial and investment planning so that they can meet their financial goals and objectives.

### THE FINANCIAL ADVICE LIFECYCLE



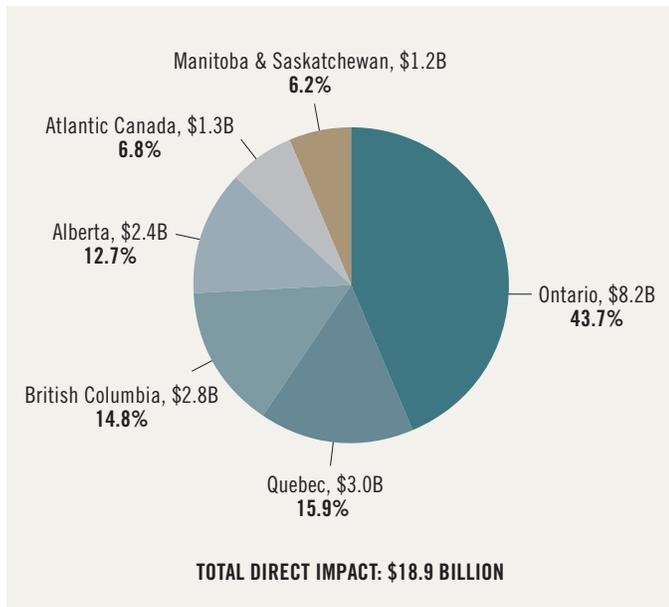
### THE COMPONENTS OF FINANCIAL ADVICE

FINANCIAL PLANNING	INSURANCE PLANNING & RISK MANAGEMENT ADVICE	INVESTMENT ADVICE & PLANNING	RETIREMENT PLANNING & ESTATE PLANNING	ADDITIONAL SERVICES
<ul style="list-style-type: none"> <li>Budgeting and creating a financial plan</li> <li>Managing debt (mortgage, line of credit, student loans)</li> <li>Preparation for financial contingencies and milestones</li> <li>Financial goal-setting</li> <li>Savings</li> </ul>	<ul style="list-style-type: none"> <li>Renters/Home insurance</li> <li>Life insurance</li> <li>Disability insurance</li> <li>Critical illness insurance</li> <li>Personal health insurance</li> <li>Portfolio risk analysis</li> </ul>	<ul style="list-style-type: none"> <li>Portfolio management (mutual funds, stocks, bonds, GICs, etc.)</li> <li>Portfolio diversification and balancing</li> <li>RRSPs, TFSAs, RESPs</li> </ul>	<ul style="list-style-type: none"> <li>Retirement income planning</li> <li>Pension</li> <li>Wills and trusts</li> </ul>	<ul style="list-style-type: none"> <li>Tax planning</li> <li>Small business planning</li> <li>Relationships with other service providers</li> <li>Client education and awareness</li> </ul>

**The SMB segment of the financial advice industry in Canada has a direct economic impact of approximately \$19 billion in GDP and 180,000 jobs.**

Economic impact modelling based on the results of a survey of the SMB financial advice industry conducted as a part of this study show that the direct industry impacts include approximately \$19 billion in GDP and 180,000 jobs. The regional breakdown of these impacts is shown in the figure below.

**REGIONAL BREAKDOWN OF GDP IMPACTS FROM THE SMB FINANCIAL ADVICE INDUSTRY**



Taking into account indirect effects (i.e. the spillover effects of spending on supplies and services by the industry) and induced effects (i.e. the ripple effects of spending by individuals who are employed by the industry or its suppliers), the total economic impact of the SMB financial advice industry is approximately \$25 billion in GDP and 240,000 jobs.<sup>5</sup>

As shown in the table below, the SMB financial advice industry is also a significant component of the finance and insurance industry in Canada. It represents over 15% of the GDP contribution of the entire finance and insurance industry and 30% of the jobs contribution. These economic impacts exceed those of the motor vehicle manufacturing industry, the pharmaceuticals industry and the aerospace industry.

**ECONOMIC IMPACT BY CANADIAN INDUSTRY**

Industry	GDP	Employment
<b>SMB Financial Advice Industry</b>		
<b>Direct Impacts</b>	<b>1.1%</b>	<b>1.2%</b>
<b>Total Impacts</b>	<b>1.4%</b>	<b>1.5%</b>
<b>Other Industries: Direct Impacts Only</b>		
Finance and Insurance	6.6%	4.6%
Mining, Oil and Gas Extraction	4.3%	1.5%
Pharmaceuticals	0.3%	0.2%
Motor Vehicle Manufacturing	0.9%	0.3%
Aerospace	0.6%	0.2%

**The SMB financial advice industry is facing unprecedented changes. These changes will likely have a significant impact on SMB financial advisors and the services they provide.**

The environment in which SMB financial advisors do business is shifting rapidly. Over the coming years, a number of issues are expected to have an impact on the ability of SMB financial advisors to successfully meet the needs of their clients in a cost-effective and sustainable way. Key changes facing the industry include:

- **Client behaviour, demographics and preferences are changing rapidly.** With the development of new consumer technologies, investors are increasingly expressing a preference to retain control of, and receive real-time information regarding, their investments. However, the use of self-directed investment services is also on the rise, partly due to an investing environment where consumers have increasing uncertainty in their ability to meet investment goals (e.g. saving enough for retirement), desire to do their own research and have better control over their investment and financial matters. Consumers are also researching and purchasing insurance online at an increasing rate.

These shifting demands are putting pressure on SMB financial advisors to innovate and scale their businesses to maintain their unique value proposition and communicate it to their clients.
- **Potential and in-progress regulatory reforms may have a profound impact on this industry.** New model regulations, including Client Relationship Model Phase 2 (CRM2), and Point of Sale (POS), in Canada represent a significant expansion in transparency requirements and could affect the relationship of advisors with their clients. Reforms regarding embedded financial advisor compensation and fiduciary duty measures are also in discussion with the intention to better protect and inform consumers.

These reforms, however, could have unintended consequences similar to those experienced in the UK and Australia. For example, some reports have indicated that financial advisors in these jurisdictions have moved away from providing affordable and accessible comprehensive financial advice, leaving mass market and lower income consumers with access only to “do-it-yourself” or modular advice.

- Following the introduction of retail distribution reforms in the UK banning advisor commissions, implementing new requirements regarding the clarity of advice and introducing new professional educational requirements, the number of financial advisors dropped by approximately 25%, or 10,000 advisors.<sup>6</sup> At the same time, the revenue per client necessary to maintain a viable financial advisory business increased, causing advisors to target clients with a higher net worth and reduce their focus on those with less investible income.<sup>7</sup>
- In Australia, the Future of Financial Advice (FOFA) reforms banned embedded commissions and other types of remuneration, established a best interests legal duty, introduced mandatory client opt-in measures and expanded requirements regarding fee disclosure. These changes have increased the costs associated with serving clients to financial advisors by more than 30%.<sup>8</sup> In total, industry organizations estimate

that the compliance costs related to FOFA reforms have been \$700 million AUD so far.<sup>9</sup> This has led industry commentators to express concern that advisors cannot achieve advantages of scale in their businesses without re-focusing their attention on clients with a higher net worth.

Given that the vast majority of Canadian households fall into the mass-market segment (i.e. households with less than \$100,000 in investible assets), proposed reforms could result in reduced access and a reported lack of consumer willingness to pay an appropriate fee for financial advice.

- **SMB financial advisors face significant barriers and industry competition, which heightens the need for a differentiated value proposition.** Most successful SMB financial advisors rely on established client bases cultivated over time through word of mouth and good relationship management. This poses a significant barrier to entry as hiring new advisors comes with a significant risk and cost for SMB distributors or product manufacturers. Non-SMB financial advisors selling mutual funds in bank branches also have significant competitive advantages over SMB financial advisors, including exposure, presence, potential product integration and access to marketing resources.

## Conclusion

*The SMB financial advice industry segment is a critical subset of the financial advice industry; SMB advisors serve a broad customer base, provide unique value and have a significant economic impact on Canada. While change is necessary, regulatory reform must be carefully balanced and managed to achieve desired outcomes while avoiding unintended consequences.*

From the research conducted as a part of this study, a number of conclusions were identified with respect to the important role of the SMB financial advice sector and activities that would help Canada implement appropriate regulatory changes while recognizing the importance of fostering SMB financial advisors’ ability to continue helping their unique client-base meet and exceed their financial goals and objectives.

**To be successful, SMB financial advisors need to adapt their business models and product and service offerings to enhance their unique value proposition.**

SMB financial advisors have a distinctive value proposition based on their ability to provide a holistic approach to financial planning to their clients. These advisors need to be proactive when it comes to addressing and exceeding proposed transparency requirements and the desire of their clients to obtain more information so they can assess the services they receive relative to the fees that they pay. By acting proactively, SMB financial advisors can maintain their status as trusted business advisors, even among clients who are more informed than ever regarding their investment opportunities.

SMB financial advisors also need to focus on developing a customer-centric business model which leverages technology and responds to changing client needs and preferences. These business models must be sufficiently scalable to allow advisors to serve clients in different market segments, particularly the mass market consumer segment (i.e. households with less than \$100,000 in investible assets), the mass affluent consumer segment (i.e. households with \$100,000 to \$250,000 in investible assets), and the 60% of Canadian households that do not have insurance or recognize that their insurance coverage is insufficient.<sup>10</sup> These market segments include the majority of Canadians, yet are not the primary focus of many larger financial advisory firms.

Additionally, SMB financial advisors could better meet changing market needs by shifting from a traditional delegated advice service model, wherein a client relies on an advisor to provide all information and execute all transactions, to a guided self-service model. A guided self-service model would provide investors with the opportunity to have more control over their investments, while benefitting from advice when they are not confident regarding particular decisions.

In reality, while many financial service firms offer online brokerage services and other tools on their websites, most have not integrated these offerings into a full digital advisor-based user experience (i.e. through mobile access to advice and social media connectivity). It is important to note that there are potential regulatory implications to this model. For example, regulators are currently looking at addressing concerns regarding the provision of advice over social media.

## Limitations

This study was conducted in accordance with PwC's engagement letter dated January 27, 2014 and is subject to the terms and conditions included therein. To conduct the study, PwC relied upon the completeness, accuracy and fair presentation of all information, data, advice, opinions or representations obtained from various sources which were not audited or otherwise verified. These sources (collectively, the "Information"), included:

- Investor Economics.
- Data obtained from advisors responding to the SMB Financial Advisor Survey.
- Publicly available studies and reports.
- Other publicly available data and information.

The findings of this study are conditional upon such completeness, accuracy and fair presentation of the information, which has not been verified or audited by PwC. This study was limited to the analysis described herein. PwC provides no opinion, attestation or other form of assurance with respect to the results of this study.

PwC reserves the right at its discretion to withdraw or make revisions to this study should we be made aware of facts existing at the date of the study that were not known to us when we prepared this study. The findings are as of May 31, 2014. PwC is under no obligation to advise any person of any change or matter brought to its attention after such date which would affect the findings, and PwC reserves the right to change or withdraw this study.

Input-output analysis, used to estimate economic impacts, does not address whether the inputs have been used in the most productive manner or whether the use of these inputs in a given industry promotes economic growth by more than their use in

## Regulatory reform needs to be balanced and consider potential impacts on client choice and client benefits associated with access to SMB financial advisors.

Regulatory reform in the financial advice industry should consider the experience of similar efforts in the UK and Australia, where regulatory change intended to protect and inform consumers appears to have led to a decline in access to financial advice for the majority of consumers and a decrease in the number of SMB financial advisors.

Canada needs to undertake balanced, needs-based reforms that recognize the important role SMB financial advisors have with respect to providing services to specific market segments, in addition to their contribution to the Canadian economy as a whole.<sup>11</sup> This balance is essential to ensure reforms benefit the financial advice industry while not impairing the accessibility or affordability of financial advice for the 80% of Canadians in the mass market segment.

another industry or economic activity. Nor does input-output analysis evaluate whether, when or where these inputs might be employed elsewhere in the economy if they were not employed in a given industry at this time. Input-output analysis studies the direct, indirect and induced economic impacts that can reasonably be expected to result in the economy when these inputs are used in a given industry, based on historical relationships within the economy.

This study has been prepared solely for the use and benefit of, and pursuant to a client relationship exclusively with, Advocis. PwC disclaims any contractual or other responsibility to others based on its use and, accordingly, this information may not be relied upon by anyone other than Advocis.

Any third party reader of this study:

- Understands that it was conducted by PwC in accordance with instructions provided by Advocis and was conducted exclusively for Advocis' sole benefit and use;
- Acknowledges that this study may not include all information or analysis deemed necessary for the purposes of the third party; and
- Agrees that PwC, its partners, employees and agents neither owe nor accept any duty or responsibility to it, whether in contract or in tort (including without limitation, negligence and breach of statutory duty), and shall not be liable in respect of any loss, damage or expense of whatsoever nature which is caused by any use, decisions made, or actions taken by the third party reader based on this study or which is otherwise consequent upon the gaining of access to this study by the third party reader.

## ENDNOTES

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- 11 Further information regarding regulatory related implications, opportunities and success factors can be found in Section 6 of this study.

