

It's Time To Unbundle

The Future Of Mutual Fund Advice

By Mark Barnicutt CFA, *President & CEO* — HighView Financial Group

April 2010

Overview

At HighView Financial Group, we believe that Mutual Fund Dealers are currently facing the same set of pricing competitive pressures that faced Investment Dealers (ie: IIROC) during the mid/late 1980s. Specifically, it was during the mid/late 1980s that “discount” brokerage firms first started to emerge in Canada. The idea was based upon the need for investors to have access to a “discounted” set of brokerage commission rates by making their own investment decisions and placing their own trades through firms at the time such as TD Greenline and First Marathon. These competitive forces caused full-service investment dealers, especially the Canadian Bank—owned dealers, to begin rethinking their value proposition in the early/mid 1990s. The business strategy for these dealers was to move away from being “brokers” who execute securities trades for clients for a commission to becoming “advisors” who provide holistic financial advice to clients for an asset based fee. In other words, “advice” was unbundled from “the trade”. Although transaction type business still remains part of the offering of these full service dealers, the extent of fee-based, portfolio asset management programs now represents a material component of investment dealers’ client offerings.

In the year 2010, Mutual Fund Dealers, whose primary investment vehicle for clients is mutual funds, are facing similar competitive pressures. Many Mutual Fund Dealers sell funds to their clients as a “product”; in other words, it’s a transactional type service, which is similar to the investment dealer experiences of the mid/late 1980s with respect to stocks & bonds. This time, though, the primary competitive forces are not “discount brokers” but other investment vehicles now available to Mutual Fund Dealer clients such as lower cost Exchange Traded Funds (ETFs) as well as Managed Asset Programs available through investment dealers. As a result, we believe that now is the time for Mutual Fund Advisors to consider the use of fee-based portfolio programs, for a segment of their client base, in which the fees associated with “advice” are unbundled from the underlying “investment management” provided by mutual fund companies.

The purpose of this article is to review the range of investment program choices now available to investor clients together with the implications for the traditional mutual fund advisory firm and how HighView can assist Mutual Fund Dealers in evolving their business to such fee-based programs.



Client Realities – Lots Of Choice!

At HighView Financial Group, we recognize that an aging population of increasingly affluent investors is seeking a broader range of specialized investment solutions. At the same time, the array of investment options available to Advisory firms today is virtually limitless: stocks, bonds, mutual fund, pool fund, hedge product, structured products, private equity, income trusts and commodities. To simplify the delivery of this vast array of investment solutions to their clients, Advisory firms are increasingly shifting their offerings towards Managed Asset Programs that contain a prudently structured set of discretionarily managed investments with the ability to be customized for each client situation. The inclusion of ETFs in such Managed Program is also growing. Some of the key fee-based programs available to clients today include:

1. Separately Managed Accounts (SMAs):

When SMA programs were first conceived for the brokerage industry more than 15 years ago, the intent was to bring institutional money managers to individual clients in a ‘segregated security’ form that provided for ownership of individual securities and full transparency of all security holdings and transactions. There are currently two forms of such SMA programs in the wealth management industry, both of which involve accessing professional money management:

- a. Mutual Fund SMAs » Comprised of institutionally priced mutual fund units
- b. Stock & Bond SMAs » Comprised of individual equity and/or fixed income securities

2. Advisor Managed Accounts (AMAs)

During the past decade, many Investment Advisors have grown and evolved their businesses from the traditional transaction based model where compensation was derived from commissions to a portfolio based model where clients are assessed an advisory fee. For many Investment Advisors who have transitioned to this portfolio oriented approach, the next phase in their professional evolution is to manage client portfolios through a Managed Account in which the Investment Advisor is not required to seek approval from clients for each and every trade but instead “manages” client accounts according to the unique investment objectives, risk tolerances, preferences and constraints of each client. To provide such a service, though, specialized approval to become a Portfolio Manager (or an Associate Portfolio Manager), from both the investment firm and IIROC¹, is required.

¹ Investment Industry Regulatory Organization of Canada



Although AMAs have many benefits for clients, Investment Advisors and their firms, the fact that client approval is not required for each and every security transaction means that there is a heightened fiduciary obligation on the part of both the appropriately licensed Investment Advisor and their firm to ensure that they are diligently pursuing the investment objectives of each and every Managed Account.

3. Guided Portfolios (GPs)

Although it's important for Advisors to have a sound set of research for various investment products such as stocks, bonds and mutual funds, more important, though, is for them to have a prudent set of guidance on how to:

- Narrow the selection of investment products to a focused core set of investment opportunities for each client, as well as
- Combine the selected investment products into a prudent portfolio structure that ultimately meets a given client's investment objectives and risk tolerances.

Guided Portfolios are a form of managed asset solutions that provide Advisors with such “portfolio construction guidance” by using suggested portfolio models of varying asset mixes together with a focused number of investment products for each asset class.

Today, there are two forms of Guided Portfolios available in the marketplace:

- Equity & Fixed Income Securities
- Mutual Fund Securities

The use of each type of Guided Portfolio solution depends upon each firm (ie: type of business, regulated nature of firm) as well as the nature of each client situation and their willingness & ability to accommodate the use of individual equity & fixed income securities versus mutual funds.

Implications For Mutual Fund Advisors

Unfortunately, the regulatory reality of Mutual Fund Dealers (MFDs) only permits them to offer a limited investment solution set to their clients, which is primarily mutual fund based. To date, MFDs have looked to their favourite mutual fund companies to provide “Fund Of Fund” wrap programs which incorporate multiple investment manager solutions. Although these programs can be useful for a specific mass market client segment, many Advisors at MFDs and their clients are seeking a broader array of Managed Asset Programs, which are typically available through other securities registrants such as broker-dealers (ie: IIROC) and advisers (ie: formerly ICPMs).



As a result, we believe that now is the time for Mutual Fund Advisors to consider the use of fee-based portfolio programs, for a segment of their client base, in which the fees associated with “advice” are unbundled from the underlying “investment management” provided by mutual fund companies. We hold this view as we believe that the underlying investment management is becoming increasingly commoditized while that of high quality advice (ie: structuring clients’ portfolios to truly meet their various financial goals) remains a value-added service for which clients will pay a premium.

The Future Of Mutual Fund Advice



A New Strategic Option

There are many professionals who have well-established and trusted relationships with their clients and are seeking to broaden and deepen those relationships with a discretionary asset management offering that is both comprehensive and objective. Such offerings must address a range of investment needs and risk tolerances as well as avoid the use of any proprietary investment management solutions which often create conflicts of interests. Examples of such professionals are listed on the following page:



HighView's Partner's Program™



Given the specialized nature of the discretionary asset management business, many of these professionals do not have the experience, qualifications or capabilities to offer such services to their clients. For this reason, we have created the **HighView Partners Program™**.

The HighView Partners Program provides our discretionary asset management services to the clients of a select group of professional practice firms, in partnership with them, through either a formalized **referral program** or an **integrated co-branded offering**.

Benefits Of HighView's Partners Program

The benefits of our solution:

i. Attract & Retain Advisors

As the investment advisory business continues to evolve towards an increasing use of portfolio and fee based approaches for clients, many Financial Advisors are seeking to provide a multiple manager investment experience and enhance their service offering to their clients through the use of a Managed Asset Program (MAP) offerings. As a result, MAP Programs can be an excellent offering for a dealer to attract and retain high quality and profitable Advisors looking to focus on mass affluent and high net worth client practice.



ii. Attract & Retain Clients

With the increasing levels of investable wealth in Canada, together with an aging yet active population, many clients are seeking the structure and discipline benefits derived from MAP programs. By implementing such offerings, we believe that dealers can provide an additional high value added portfolio service that can not only meet the evolving needs of their current client base but also enable them to attract new and profitable affluent clients.

iii. Create A Fee-Based Business

One of the advantages for dealers and Advisors of implementing a MAP offering is that, if structured properly, it can create a very profitable and fee-based asset management business that provides a recurring and predictable set of revenues. As a result, MAP offerings can be very complementary to a dealer's core transaction based businesses by "smoothing out" firm revenues and providing a "revenue cushion" during bear markets.

iv. Extend Your Firm's Brand

We believe that the creation of a high quality MAP Program can help extend the brand image of a dealer by augmenting its market perception beyond a "fund dealer" to also a solid and competent provider of "asset management" solutions.

v. Enhance Your Firm's Value

Given the recurring revenue nature of fee-based businesses such as MAPs, together with their typically solid operating margins, the business valuations attached to such offerings can often be very attractive and potentially relatively higher than the valuations associated with transaction based investment businesses. As a result, by building a high quality and profitable suite of fee-based asset management programs, we believe that dealers can, over time, incrementally and potentially materially, enhance the market valuation of their overall firm.

Contact

HighView is based in Bronte Harbour in Oakville, Ontario. The Town of Oakville is a beautiful community situated on Lake Ontario, just 30 minutes from Downtown Toronto.

Corporate Office

Tel: (905) 827-8540
Toll Free: (888) 827-8540
Fax: (866) 590-8234
77 Bronte Road, Suite 201
Oakville, Ontario
L6L 3B7

Gary Brent Chairman

Email: gbrent@highviewfin.com
Office: (905) 363-7152

Mark Barnicutt, CFA President & CEO

Email: mbarnicutt@highviewfin.com
Office: (905) 363-7153



Facilitating Excellence in the Management of Wealth™

HighView Financial Group is comprised of the following Legal Entities:

HighView Wealth Practices Inc.

HighView Asset Management Ltd.

Updated August, 2011