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nest wealth asset management inc.

Chuck Grace and Andrew Sarta wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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April 9, 2015, was a typical spring day in Toronto, Canada. Heavy rain was in the forecast, the Toronto Maple Leafs hockey team was on a losing streak, and even the city’s beloved Blue Jays baseball team had lost the night before. Randy Cass, founder and CEO of Nest Wealth Asset Management Inc. (Nest), was at home celebrating his 44th birthday. Nest was Canada’s first robo-adviser, a term that refers to automated financial advice. Cass had launched Nest 14 months earlier in February 2014. This morning Cass had not yet had time to start his morning coffee and unwrap his presents before his phone began to ring non-stop. The reason was a headline in the morning newspaper: “Power Financial Corp to invest up to $30 million[[1]](#footnote-1) in Robo-Adviser Wealthsimple Inc.”[[2]](#footnote-2)

Wealthsimple Inc. (Wealthsimple) was the second robo-adviser to be launched in Canada and Nest’s biggest competitor. Power Financial was one of Canada’s largest financial services conglomerates with interests in both wealth management and insurance businesses. The news that Nest’s biggest competitor had raised a significant sum of capital and was now aligned with one of Canada’s biggest incumbents was a game-changer for Nest. Right away, Cass realized it would be hard to compete head-to-head with a competitor that had much deeper pockets and greater distribution breadth.

Nest was not Cass’s first start-up, and if his diverse experience and education had taught him anything, it was to expect the unexpected and to adapt accordingly. The question now, of course, was how to adapt.

robo-advisors

Robo-advisors represented a new segment of the wealth management industry that relied on software, algorithms, and new processes to attract and service clients. The term Robo-advisor referred to online wealth-management services that provided automated or algorithm-based portfolio management advice without the use of human financial planners.[[3]](#footnote-3) The first Robo-advisors were established in 2008 and quickly spread across the United States, Europe, Australia, India, and China. Robo-advisors typically allocated a client’s investment assets on the basis of risk preferences and desired target return. Despite the capability of allocating a client’s assets in many investment products, Robo-advisors typically directed funds towards exchange-traded fund (ETF)[[4]](#footnote-4) portfolios as they represented a well-diversified but low-cost investment option. In 2015, the Robo-advisor segment in Canada was young and evolving, impacting both the few Robo-advisors operating and traditional, well-established wealth management organizations.

Wealth Management in Canada

In 2015, wealth management represented a $4 trillion industry in Canada.[[5]](#footnote-5) The term “wealth management” covered a lot of territory, but it generally referred to services related to increasing clients’ net worth with respect to investments, taxes, retirement planning, and legal or estate planning. Savings and investments were often the first things that came to mind, but housing, mortgages, debts, insurance, and cash-flow management could also be included in the definition (see Exhibit 1).

The Canadian wealth management industry was dominated by several large corporations that included Canada’s six largest banks and independent financial advisors that were licensed by broker organizations (see Exhibit 2). Advisors were typically licensed to offer specific products and not a complete suite of investment options, with most advisors licensed for two investment segments. Most investment advisors operated in the segments of insurance and mutual funds (see Exhibit 3) and the majority of advisors were concentrated in Canada’s largest financial institutions (see Exhibit 4). An intense regulatory framework drove the licensing regime and resulted in a thorough vetting of client risk profiles that was increasingly occupying the time commitment per client for advisors. Compensation for advisers was complex and opaque. Advisers received two sources of compensation: (1) a fee paid directly by the client to the adviser (i.e., a fee-for-service) and (2) an embedded compensation, where the client paid a fee to a mutual fund manufacturer who paid in turn a fee to the dealer and then the adviser. Within this complex and fragmented industry, a number of macro trends were challenging the status quo, including changing demographics, globalization, product commoditization, regulatory changes, and technological changes. Within this context, Robo-advisors were just one of many challenges confronting Canada’s wealth managers in 2015.

The Tides of Change

The wealth management industry was under tremendous pressure to drive down the fees for clients and costs at the firms. Products had become commoditized, as competition had created a proliferation of products and resulting complexity. Canada alone had over 60,000 unique mutual funds within the savings and investment space.[[6]](#footnote-6)

After the global financial crisis in 2008–09, regulators around the world had worked more aggressively to ensure that “main street” clients were protected from systemic risks, resulting in numerous regulatory changes that were having a profound impact on the industry. In Canada, more than six significant regulatory changes had been introduced since 2009 (see Exhibit 5). Discussions were currently taking place regarding plans for a third phase of the Client Relationship Model (CRM3), the banning of all embedded commissions, and the introduction of a fiduciary standard (see Exhibit 6). While these changes were designed to enhance clients’ best interests, each added complexity and cost for the participants.

Technology was also changing the face of wealth management. Robo-advisers such as Nest and Wealthsimple were a specific segment of the financial technology (fintech) industry—a term that referred to the intersection of financial services and technology, with firms providing financial services electronically via the internet or mobile phones. While the financial-services industry had used technology to drive innovation for many years, the term fintech became widely used by the media after the global financial crisis of 2008 to report customer-facing technologies such as apps on mobile phones or online investment tools. Start-ups used technology to offer existing financial services at lower costs or to create new technology-driven solutions. Technologies such as investing algorithms, machine learning, big data analytics, and biometrics allowed firms to offer new and unprecedented products with an extraordinarily short time to market. While the term fintech was often associated with start-ups companies, incumbent financial institutions were also looking to the same technologies to drive innovation, lower costs, and compete more effectively.

Randy Cass

Cass graduated from the undergraduate Honors Business Administration (HBA) program at Ivey Business School at Western University in Ontario in 1993. After completing a bachelor of law degree at the University of Toronto in 1996, he decided a law career did not fit his interests. He returned to Ivey to complete a Master of Business Administration (MBA) degree in 1998, and the Chartered Financial Analyst (CFA) designation shortly thereafter. With a knack for quantitative analysis, Cass moved into the wealth-management industry where he traded quantitative portfolios at the Ontario Teachers Pension Plan from 1999 to 2003. In 2003, Cass left to start up Orchard Global Asset Management Ltd., a boutique hedge fund that specialized in quantitative investing strategies. When Orchard was sold in 2005, Cass co-founded First Coverage Inc., which delivered an industry-leading optimization solution to the institutional investment community. With its innovative web application, First Coverage optimized the relationship between investment professionals and their sell-side coverage.[[7]](#footnote-7) His start-up won multiple awards including a Morningstar award for best use of technology in financial services in Canada.

During Cass’s leadership at First Coverage, he raised two rounds of venture capital (VC) financing totalling over US$15 million. In March 2011, when the business was experiencing strong growth and increasing its potential, the VC backers who held majority control sold the business to the TIM Group, against the wishes of Cass who wanted to remain independent. Too late, Cass recognized that seeking external financing to grow his business had ultimately placed limits on his ability to control the future of his venture. From this experience Cass took away the belief that a start-up with the right business model should generate positive cash flow from the outset, relieving pressure to seek external capital to scale up prematurely.

Selling First Coverage, however, afforded Cass the time and opportunity to plan his next venture. While exploring opportunities, he maintained his relationships within the Canadian investing community by hosting the Market Sense program on the Business News Network (BNN) from 2011 to 2014, where he discussed stocks, sectors, strategies and success. He knew it would involve investing and technology, but was waiting for the right opportunity to step in again.

Nest Wealth asset management Inc.

Cass founded Nest as Canada’s first robo-adviser in February 2014. Cass eyed an opportunity to better serve Canadians with a personalized and professional digital wealth-management solution. Within a year, Nest would be followed by a dozen other competitors including Wealthsimple.[[8]](#footnote-8)

Nest’s philosophy was that investing could be made easier by using smart, sophisticated technology and proven investment principles. Cass believed that by leveraging technology, he could offer sophisticated advice that saved investors both time and money. Internally, Cass leveraged his entrepreneurial experience to inform Nest’s structure. Operating on lower margins, fintech firms consistently sought rapid growth in an attempt to gain the necessary scale that would ensure profitability, and robo-advice in financial services was no different. In contrast, Cass set out from the beginning to structure Nest’s revenue and costs so that growth could occur slowly and profitably.

Nest’s pricing was unique compared with that of other Canadian robo-advisers and the broader wealth-management industry. Rather than pricing fees on a percentage basis determined by the value of assets under management, Nest used a subscription-based pricing model. Investors in Nest paid a $20 monthly subscription for portfolios under $75,000, a $40 monthly subscription for portfolios between $75,000 and $150,000, and an $80 monthly subscription for portfolios in excess of $150,000. The subscription fee was waived for investors who had portfolios of less than $10,000. Subscribers received a sophisticated, custom-built portfolio that was based on their life goals. The subscription-based pricing model ensured that investors would never pay more than $80 per month in fees and also enticed investors to hold larger portfolios.

One of Nest’s primary advantages was the cap on fees for larger portfolios.[[9]](#footnote-9) Investors had a greater incentive to invest with Nest as their portfolio grew since they would never pay more than $80 per month in fees. This pricing model meant the company had a different clientele from other robo-advisers. The average investor with Nest was 44 years old and had a portfolio in excess of $146,000. While Nest had fewer clients, each account was larger, which allowed Nest to achieve profitability earlier than other robo-advisers in Canada. Another advantage was the cost-management strategy Cass employed to limit his marketing spending. The high cost of traditional customer acquisition—estimated at $500 to $1,000 per client—would inhibit Nest’s ability to retain early profits. Instead, Nest acquired customers primarily through referrals and word of mouth.

Nest built every client’s portfolio using low-cost ETFs across seven different asset classes. Interested subscribers were not classified by the standard high, medium, and low risk-tolerance categories that were common with competing financial advisers. Instead, Nest built each portfolio on the aspirations of the subscriber—for example, on the goals of a secure retirement, a better education, or a bigger house.

Nest leveraged computer algorithms to efficiently and automatically generate portfolios that were diversified across seven asset classes, rebalanced on a regular basis, and invested in low-cost ETFs. The algorithmic approach afforded Nest the ability to operate at lower costs than traditional financial advisers.

Nest’s structure allowed it to distinguish itself from competitors in the marketplace. Priding itself on transparency, customization, and low cost, Nest offered increased customization relative to its main competitors and at a lower cost for clients. Consumers received the benefit of an average management expense ratio (MER) of 0.17 per cent, compared with 0.35 per cent for Wealthsimple or 2.10 per cent for a typical mutual fund.

WealthSimple

Nest’s main competitor in the Canadian robo-advice industry was Wealthsimple. Founded in September 2014 by another Ivey alumnus Michael Katchen, Wealthsimple used algorithmic, customized financial advice to provide clients with a diversified, balanced portfolio of low-cost ETFs. Nest and Wealthsimple shared a similar investment philosophy: both advocated a passive approach to investing with low fees and automated rebalancing. Despite the similarities, Wealthsimple and Nest differed in their strategies for acquiring clientele and generating profit.

Wealthsimple recognized that the long-standing trust many people had in their investment advisers made it difficult to take market share from large financial institutions, especially for a start-up robo-adviser. Wealthsimple began by targeting millennials who were just starting their careers and had money to invest, although at lower nominal amounts than traditional investors at larger institutions. This underserved customer segment was referred to in the wealth management industry as “HENRY”s—high earning but not rich yet. To entice these younger consumers, Wealthsimple offered a lower-cost entry point, pricing its services as a percentage of assets invested. Wealthsimple managed accounts with less than $5,000 invested free of charge and charged a fee of 0.5 per cent on portfolios of less than $100,000. Investing $25,000 with Wealthsimple would cost $125 annually, instead of the $240 it would cost with Nest. The pricing model employed by Wealthsimple therefore became more attractive for individuals with smaller portfolios.

The Wealthsimple onboarding process included a questionnaire that asked about individual risk tolerance in order to determine whether to recommend a conservative, balanced, or growth asset mix. The company provided automatic daily portfolio rebalancing, auto-deposits, and dividend reinvesting. Wealthsimple raised its first $2 million seed round in May 2014. By April 2015, they had acquired 1,000 clients with 10 per cent week-over-week growth in funded clients for 20 consecutive weeks.[[10]](#footnote-10) This growth attracted the attention of Power Financial Corporation, who saw Wealthsimple as a disruptor in this conservative wealth management industry.

Power Financial Corporation

Power Financial Corporation described itself as “a diversified management and holding company that [had] interests, directly or indirectly, in companies in the financial services sector in Canada, the United States, and Europe.”[[11]](#footnote-11) With holdings in well-established investment companies, including Investors Group Inc., Mackenzie Investments, and Investment Planning Counsel, Power Financial offered Wealthsimple a significant network of financial advisers and experience in wealth management. Power Financial also had holdings in insurance through large companies such as Great-West Life. Together, the Power Financial group of companies represented approximately 12,000 Canadian financial advisers working within the standard industry models noted above.

The diversified nature of Power Financial offered distinct advantages for Wealthsimple. First, its presence provided Wealthsimple with a significant funding advantage—extending the time available for Wealthsimple to acquire customers and ultimately scale the company to a size necessary for generating profit. Second, its vast network provided expansion routes that would allow Wealthsimple to cross-sell multiple offerings to customers who might seek insurance to complement their investment portfolios. Finally, its knowledge of the financial advice industry could provide management expertise to the young team at Wealthsimple.

While Power Financial brought deep resources, it also represented companies that were competitors to Wealthsimple. Some questioned whether Power Financial could manage multiple companies that had competing interests. Was Power Financial making a strategic bet on the future of financial advice, or was it seeking to integrate Wealthsimple with its existing companies? Regardless, the presence of Power Financial represented a clear threat to Nest.

Options in a New Competitive Landscape

With the announcement of Power Financial’s $30 million investment in his main competitor, Cass needed to reconsider all of his options. He met with his team who spent 48 hours debating several options regarding the future of Nest and his company’s business model. Cass believed two opportunities warranted significant consideration. First, he could maintain the current business-to-consumer (B2C) model by maintaining a focus on scaling and expanding Nest’s consumer base. Second, he could explore a business-to-business (B2B) model by leveraging Nest’s technological capability and offering his software solution to human advisers. The B2B option represented a move toward a Software-as-a-Service (SaaS) business model. Ultimately, Nest could become a technology provider that had little or no client-facing brand. Both models would be entirely new in the wealth-management industry, which left Cass asking a fundamental question: should he compete in the existing market against a well-funded competitor or create an entirely new market?

1. The B2C Option

Offering wealth-management services directly to consumers was Nest’s entire business model. The company was already profitable, but remaining profitable with its current business model required a low marketing investment. Cass suspected that the surge in capital that Wealthsimple had raised through its partnership with Power Financial was earmarked for customer acquisition and marketing investment, which would place further pressure on Nest’s ability to expand. If Wealthsimple could generate increased brand presence in the market, would a strong and recognizable Wealthsimple brand siphon off some of Cass’s clients?

Cass knew where Nest had an advantage. He could offer lower rates compared with both Wealthsimple and traditional financial advisers for any client that held a portfolio of more than $100,000. As portfolios increased in size, Nest’s benefits over the alternatives become much more compelling. Cass believed that he could continue to grow his client base, but he needed to estimate his growth potential based on a benchmark. Prior to the influx of capital, Wealthsimple had obtained 1,000 clients over a period of eight months. While he did not know precisely what Wealthsimple spent on marketing, Cass knew it outspent Nest. Cass was concerned that maintaining the status quo would potentially hurt Nest’s future. Wealthsimple was almost certain to accelerate, and he worried that Nest would be a target for acquisition simply because of its technology base.

If Cass were to grow the business and compete in the B2C market, he needed to target the clients of traditional financial advisers or clients who held larger portfolios at Wealthsimple. Drawing these clients to Nest would require a more concerted marketing effort; customer-acquisition costs ranged from $500 to $1,000. Cass felt it was worth investigating a two-pronged strategy that included an altered pricing model and a focused marketing effort. With Nest’s average portfolio approaching $150,000, its top pricing tier, could Cass effectively alter the pricing model while still providing a cost advantage to his clients? Furthermore, would his customers readily accept a change in pricing? He would need to handle any pricing change delicately to avoid losing or upsetting clients.

A new pricing model would allow Cass to leverage any additional revenue to fund a focused marketing campaign that targeted clients of traditional financial advisers. The traditional wealth-management landscape was vast, with competitors of varying sizes and strengths. Cass needed to determine which customers Nest could effectively acquire from within this competitive set. He also needed to carefully calculate the response he might receive from traditional advisers. The size of the average client portfolios and the number of clients available varied by segment within the industry (see Exhibit 7). Cass would need to determine whether a broad or a narrow focus would maximize Nest’s profitability from any additional marketing spend.

2. The B2B Option

In contrast to a B2C strategy, the B2B strategy called for Nest to collaborate with one of its primary competitors—a large financial institution already in the wealth-management space.

In addition to the intense competitive pressures noted above, Canadian advisers and their dealers were coping with changing client needs, regulatory burdens, and compression of revenues. The baby-boom generation was approaching retirement, and both their savings and insurance needs were shifting with them. From an investment perspective, baby boomers were quickly approaching a point where they would no longer be saving but would instead begin consuming their savings. This deceleration in savings was exacerbated by the situation facing the millennial generation, which was struggling to start saving because of inadequate job stability, steep housing prices, and unprecedented student debt.

Regulatory changes had created significant cost pressure in an industry where the fundamental revenue patterns had not changed since 1997. The most significant sources of revenue for dealers (who in turn paid the advisers) were commissions and servicing trailers embedded in product fees such as mutual fund management expenses. Product fees were generally calculated as a percentage of the asset value (the amount invested), so revenues grew only if sales increased or markets grew, and both sales and markets were challenged by demographic trends.

Dealers and their advisers were struggling to remain profitable and relevant in this scenario. Cass had learned first-hand about some of the issues facing dealers in a conversation with Chris Enright, president and managing director of Aligned Capital Partners Inc.

Adviser Bandwidth

Advisers were struggling to find time for business development and client service because more of their time was consumed by unproductive activities associated with paperwork, compliance, and responding to client queries around inflammatory headlines. Enright estimated that the average adviser now had only 15 hours a week for client meetings—down from 30 hours a week 10 years earlier.

NIGOs

Paperwork received by dealers that was not in good order (NIGO) could not be entered into the administration systems, which resulted in delays in placing trades and significant inefficiencies in the dealers’ processes. Enright estimated that approximately 40 per cent of the paperwork Aligned Capital Partners received had to be returned to the adviser for correction and often required a follow-up meeting with the client. No one was happy with this process.

Compliance

Over the past 15 years, as the Canadian regulatory regime had become increasingly assertive, compliance had become the fastest-growing area of his business. Staffing in this area was growing by 20 per cent a year. Enright feared that, as the market became more complex and regulators less tolerant, compliance staffing could only go up.

Cost

Enright estimated that it currently cost $14 to $15 per month to administer a client account. At this level, most dealers were running at net profit margins or earnings before interest, tax, depreciation, and amortization (EBITDA) in the 3 per cent to 5 per cent range. With the industry-wide compression in fees and the possibility of banning mutual fund trailing commissions, there was no room for an increase in costs. In fact, it was becoming urgent to find areas for significant cost reductions.

Adviser Value

Finally, in the midst of these other changes, Enright felt that his advisers were facing an identity crisis. He explained that the abilities advisers had historically used to articulate their value to clients—investment selection and due diligence, portfolio construction and asset mix, performance, and timing and reaction—were being either replaced by technology or threatened by changes in the market. Whereas finding the very best investment choices for clients had required dedicated research time 15 years ago and the conclusions were often proprietary to the adviser, the same analysis could be replicated today in a couple of minutes on Google. While portfolio construction (i.e., determining the optimum asset mix based on a client’s goals, risk tolerance, and time horizon) had once been a sophisticated art form, a portfolio could now be pulled together quickly and accurately with algorithms and widely available software programs. A number of advisers continued to assert that they had sufficient skill to deliver unusual high or alpha performance to their clients. However, the advent of highly efficient markets and the resulting popularity of passive investing (e.g., ETFs) was making this promise increasingly difficult, if not impossible, to deliver. Some advisers maintained that one of their points of value was their ability to anticipate market changes and to either take advantage of these changes by capturing higher returns or defend against unusual losses. However, complex and volatile global markets were making it difficult to also keep this promise.

Enright felt that the introduction of both robo-advice technologies and regulatory changes meant that his advisers needed to re-invent their value proposition. The question, of course, was where and how to do so. Where should advisers articulate a new, unique value proposition that was competitive and sustainable? How should they and their clients make the transition?

An obvious and critical aspect to defining value was cost. Enright explained that typical advisers currently earned approximately 100 basis points (1 per cent) on their assets under administration. That meant the adviser for a client with $1 million in investment assets would earn revenues of approximately $10,000 a year. Nest was prepared to manage the same $1 million for $80 per month or $960 a year, excluding any fees charged by the investment product manufacturer. The gap between $10,000 and $960 was significant, and advisers would need to work hard to justify the incremental cost to clients.

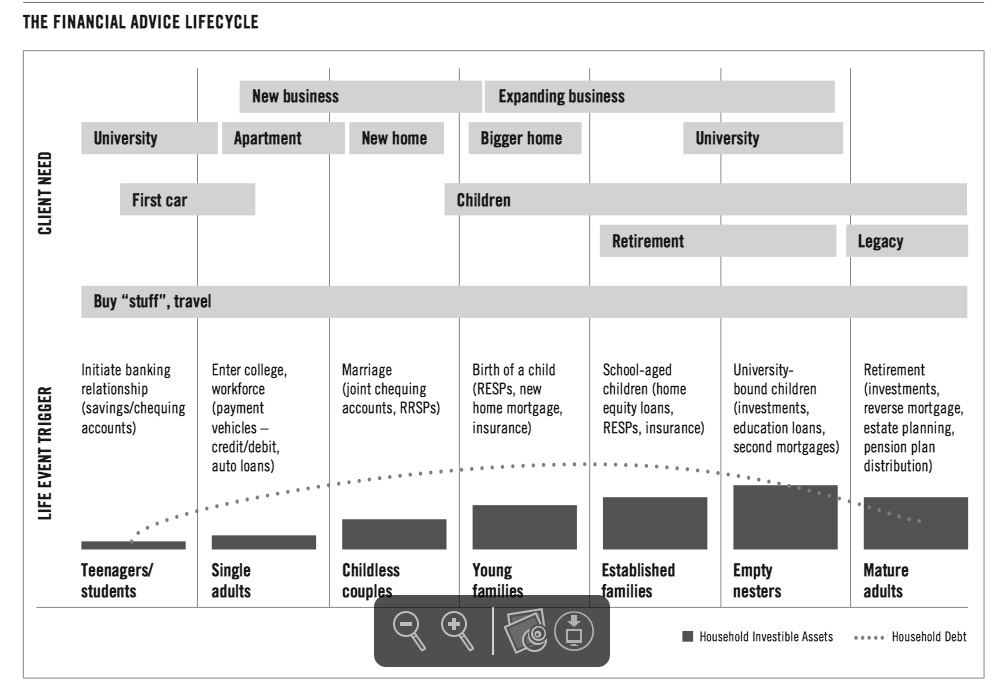
Before Lighting the Birthday Cake Candles

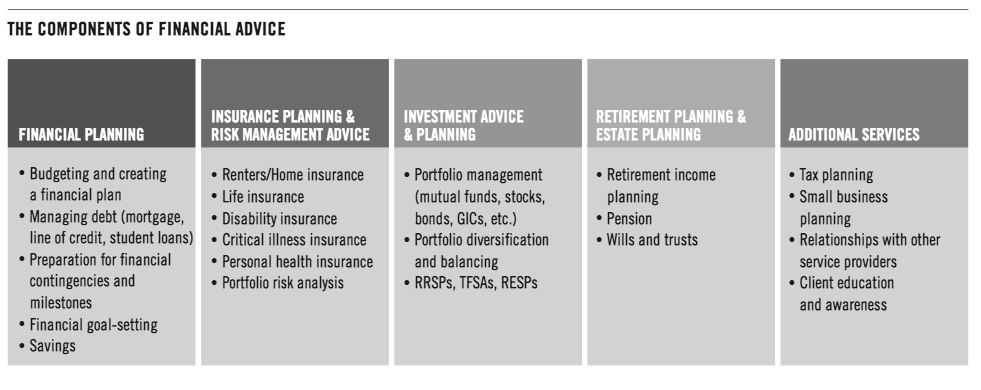
Following the conversation with Enright, Cass began to wonder whether the dealers were his competition or an opportunity to leverage his technology. Cass was confident his technology could solve a number of Enright’s issues, but it would have to be at a price point that was both attractive to Nest and affordable for dealers in light of their cost constraints. However, the biggest issue Cass anticipated was channel conflict: how could Nest provide a valuable service to Aligned Capital Partners while simultaneously selling against the traditional dealers through the B2C strategy?

Cass could instead seek the same strategy as Wealthsimple—external financing. Raising external financing to fund growth came with its own set of challenges. Stipulations of external financing, including venture capital or angel investing, often resulted in reduced control for owners. Cass would need to consider the amount of equity he would be willing to give up in order to secure financing for Nest’s growth. He knew from previous experience that he did not want his ownership stake to be less than 50 per cent, but external financing could allow Cass to compete directly with Wealthsimple in the B2C space.

In any scenario, Cass needed to determine how many clients per year he would need to acquire in order to remain sustainable. With 12 million clients under management across 100,000 traditional financial advisers across Canada,[[12]](#footnote-12) was the Canadian market large enough to hold Wealthsimple, Nest, and traditional advisers? Cass knew one thing for certain: $30 million of funding for Wealthsimple changed the landscape considerably, and he needed to find unique alternatives to fund his company’s growth.

Exhibit 1: Illustrations of the Components of Financial advice





Note: RRSPs = registered retirement savings plans; RESPs = registered educational savings plans; GICs = guaranteed investment certificates; TFSAs = tax-free savings accounts;

Source: Stephen Martin, Byren Innes, Davis Yoo, and James Mancini, Sound Advice: Insights into Canada’s Financial Advice Industry, July 2014, PwC and Advocis, accessed June 28, 2017, www.advocis.ca/sareport.pdf. Used with permission.

Exhibit 2: Wealth Management in Canada

|  |  |  |
| --- | --- | --- |
| **Distributor** | **Total Number** | **Description** |
| Chartered Banks | 89 | Regulated deposit-taking institutions that include the 6 largest banks in Canada, which account for 90% of all deposits |
| Insurance Companies | 68 | Regulated companies that offer insurance primarily in the forms of life insurance, property insurance, and casualty insurance |
| Credit Unions | 623 | Autonomous entities that differ from banks in that they act as cooperatives that are accountable to their members |
| Investment Industry Regulatory Organization of Canada (IIROC) | 187 | An independent regulatory body that licenses financial advisors for the sales of stocks, bonds, and other marketable securities |
| Mutual Fund Dealers Association of Canada (MFDA) | 110 | An independent regulatory body that licenses financial advisors for the sales of mutual funds without the ability to sell stocks, bonds, and other marketable securities |

Source: Created by authors using data from Office of the Superintendent of Financial Institutions (OSFI), accessed July 11, 2017 www.osfi-bsif.gc.ca/Eng/fi-if/dti-id/Pages/default.aspx; “Credit Unions in Canada,” Central 1 Credit Union, accessed May 25, 2017, www.central1.com/about-us/credit-union-system; Investment Industry Regulatory Organization of Canada, Public Interest Regulator: Annual Report 2014–2015, 2015, accessed May 18, 2017, www.iiroc.ca/Documents/2015/b203b6f7-1aff-484b-909d-f5cacdb19b8f\_en.pdf#search=annual%20statement; Mutual Fund Dealers Association of Canada, On Course: 2014 Annual Report, 2014, accessed May 18, 2017, http://mfda.ca/wp-content/uploads/AR2014.pdf.

Exhibit 3: Canadian Financial Advisers by Segment, 2014

|  |  |  |
| --- | --- | --- |
| **Segment** | **Number of Advisers** | **Description** |
| Insurance | 44,074 | Independent, contracted, or career insurance advisers who provided advice on and sold insurance products |
| Financial Adviser Dealer | 32,459 | Advisers who operated outside of the deposit-taking branch network and provided access to a wide range of services, including planning, investment, and insurance services: these advisers were often dually licensed for both insurance and investment funds (through MFDA). |
| Branch Advice | 13,177 | Advisers who offered a limited range of financial planning and investment products and services through branches of deposit-taking institutions (e.g., banks and credit unions) |
| Full-Service Brokerage | 10,162 | Advisers who worked through full-service brokerage firms and provided financial advice and a wide range of discretionary and non-discretionary investment services based on funds, individual securities, and insurance |
| Private Investment Council | 1,107 | Portfolio managers who provided investment counselling and discretionary investment management services to affluent individuals and families |
| Fee-Only Planners | 450 | Financial advisers who provided objective financial counselling and associated services for a negotiated fee and did not directly offer either proprietary or third-party financial products |
| Private Banking | 413 | Relationship managers who offered sophisticated banking services to affluent individuals and families through a network of dedicated offices |
| Estate and Trust | 375 | Advisers based in either bank-owned or independent trust companies who provided estate planning, estate settlement, executor, trustee, and associated services |
| Total | 102,217 |  |

Note: MFDA = Mutual Fund Dealers Association of Canada

Source: Created by case authors based on Stephen Martin, Byren Innes, Davis Yoo, and James Mancini, Sound Advice: Insights into Canada’s Financial Advice Industry, July 2014, PwC and Advocis, accessed June 28, 2017, www.advocis.ca/sareport.pdf.

Exhibit 4: Top Canadian Advisory Firms in 2015

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Advisers** | **Distribution Channels** | | | | |
|  | **IIROC** | **MFDA** | **Deposits** | **Insurance** | **Portfolio Management** |
| RBC | 11,500 | ✔ | ✔ | ✔ | ✔ | ✔ |
| BMO | 10,500 | ✔ | ✔ | ✔ | ✔ | ✔ |
| Scotia | 6,738 | ✔ | ✔ | ✔ | ✔ | ✔ |
| Investors Group | 6,294 | ✔ | ✔ | ✔ |  | ✔ |
| GWL | 5,353 |  | ✔ |  | ✔ | ✔ |
| Industrial Alliance | 4,299 | ✔ | ✔ |  | ✔ | ✔ |
| CIBC | 4,100 | ✔ | ✔ | ✔ | ✔ | ✔ |
| Sun Life | 3,700 |  | ✔ |  | ✔ | ✔ |
| TD Canada Trust | 3,600 | ✔ | ✔ | ✔ | ✔ | ✔ |
| Desjardins | 2,351 | ✔ | ✔ | ✔ | ✔ | ✔ |
| Remaining Firms (210) | 41,500 |  |  |  |  |  |

Note: IIROC = Investment Industry Regulatory Organization of Canada; MFDA = Mutual Fund Dealers Association of Canada

Source: Created by the case authors based on information from firms’ annual reports, regulatory filings, industry publications, and press releases.

Exhibit 5: Significant Regulatory Changes for Canadian Wealth Managers

The following regulatory changes led to significant systems development by Canadian dealers and wealth managers:

* **Financial Transactions and Reports Analysis Centre of Canada** (**FINTRAC) (July 2000):** This centre required wealth managers to comply with reporting and point-of-sale requirements to establish the identity of clients and the source of the funds they are investing.
* **Foreign Account Tax Compliance Act (FATCA) (March 2010):** This act, passed in the United States in 2010, required foreign financial institutions and certain other non-financial foreign entities to report on the foreign assets held by their U.S. account holders.
* **Point-of-Sale Disclosures (2011):** Effective January 1, 2011, fund managers were required to prepare and file simple fund facts for each class or series of each of their mutual funds and to post the fund facts to their websites. As of 2016, dealers were required to deliver the fund facts to purchasers before accepting instructions for the purchase of mutual funds.
* Client Relationship Model Phase 1 **(CRM1)** (2012): Phase 1 of this model required dealers to provide retail clients with extensive information regarding the relationship they were entering into, including details about the types of products and services offered by the dealer, the processes used by the dealer, any potential conflicts of interest faced by the dealer, fees and costs associated with operating the account, and the dealer’s responsibilities related to reporting information to the client.
* **Client Relationship Model Phase 2 (CRM2) (2013):** Phase 2 of this model introduced new requirements for reporting to clients about the costs and performance of their investments and the content of their accounts.
* **Canadian Securities Administrators (CSA) Fund Risk Classification (2016):** This classification required fund managers to use a standardized CSA mutual fund risk classification methodology to determine the investment risk level of conventional mutual funds and exchange-traded funds.

Sources: Created by the case authors based on information from the Government of Canada, Internal Revenue Service, Canadian Securities Administrators, Investment Industry Regulator Organization of Canada, Mutual Fund Dealers Association, and Government of Ontario.

Exhibit 6: Proposed Regulatory Changes

* **Fiduciary Standard:** In 2016, the Canadian Securities Administrators (CSA) issued *Consultation Paper 33-404*, asking for industry input on proposals to enhance the obligations of advisers, dealers, and representatives toward their clients and on the appropriateness of a statutory best-interest standard.
* **Embedded Commissions:** In 2017, the CSA issued *Consultation Paper 81-408*, asking for industry input on an option to discontinue embedded commissions.
* **Client Relationship Model Phase 3 (CRM3):** In 2016, the CSA issued a consultation paper\* asking for industry input on further proposals to enhance registration requirements, exemptions, and ongoing registrant obligations and to introduce further cost and performance reporting.
* **Financial Services Regulatory Authority of Ontario:** In 2017, the Ontario government announced the establishment of the Financial Services Regulatory Authority of Ontario to oversee financial services and pensions. Ontario was considering a number of other consumer-protection measures recommended by a recent panel on financial planning and advisory services. Among the policies under consideration were a registry of financial planners and advisors, limitations on the use of professional titles that might confuse consumers, and a statutory duty to act in the best interests of consumers.

Note: \* CSA Notice and Request for Comment - Proposed Amendments to NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations, NI 33-109 Registration Information and Related Forms, accessed July 11, 2017, www.osc.gov.on.ca/en/SecuritiesLaw\_csa\_20160707\_31-103\_rfc-proposed-amendments.htm.

Source: Canadian Securities Administrators, accessed July 6, 2017, www.securities-administrators.ca/aboutcsa.aspx?id=1544; Ontario Securities Administrator, accessed July 6, 2017, www.osc.gov.on.ca/en/SecuritiesLaw\_csa\_20160707\_31-103\_rfc-proposed-amendments.htm; Province of Ontario, accessed July 6, 2017, www.ontario.ca/laws/statute/16f37.

Exhibit 7: Average Asset Size by Segment (in Ca$)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Asset Base** | **IIROC-Licensed Advisers at Financial Adviser Dealers** | **IIROC-Licensed Advisers at Full-Service Brokerages (Not Big Six Banks)** | **IIROC-Licensed Advisers at Full-Service Brokerages**  **(Big Six Banks)** | **MFDA-Licensed Advisers** |
| Assets under Management (AUM) | $57 billion | $189 billion | $733 billion | $239 billion |
| Average Assets under Management per Adviser | $35 million | $50 million | $114 million | Approximately $8 million |
| Average Assets per Client | $110,000 | $170,000 | $430,000 | Approximately $40,000 |

Note: IIROC = Investment Industry Regulatory Organization of Canada; MFDA = Mutual Fund Dealers Association of Canada

Source: Stephen Martin, Byren Innes, Davis Yoo, and James Mancini, Sound Advice: Insights into Canada’s Financial Advice Industry, July 2014, PwC and Advocis, accessed June 28, 2017, www.advocis.ca/sareport.pdf.

1. All currency amounts are shown in Canadian dollars unless otherwise specified. [↑](#footnote-ref-1)
2. David Pett, “Power Financial Corp to Invest up to $30-Million in Robo-Adviser Wealthsimple,” *Financial Post*, April 9, 2015, accessed May 16, 2017, http://business.financialpost.com/news/fp-street/power-financial-corp-to-invest-up-to-30-million-in-robo-adviser-wealthsimple. [↑](#footnote-ref-2)
3. In Canada, the name robo-adviser (or robo-advisor) was a bit of a misnomer since regulations required investors to interact with a human adviser at some point in the onboarding process. [↑](#footnote-ref-3)
4. An exchange-traded fund refers to a marketable security that tracks an index representing a basket of stocks, bonds, or commodities [↑](#footnote-ref-4)
5. Statistics Canada, “Table 205-0002: Survey of Financial Security (SFS), Composition of Assets (Including Employer Pension Plans Valued on a Termination Basis) and Debts Held by All Family Units, by Age Group, Canada and Provinces,” (database), accessed June 28, 2017, www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=2050002&&pattern=&

   stByVal=1&p1=1&p2=31&tabMode=dataTable&csid.=. [↑](#footnote-ref-5)
6. Mutual Fund Dealers Association of Canada, Client Research Report: A Detailed Look into Members, Advisors, Clients, 2017, accessed June 28, 2017, http://mfda.ca/wp-content/uploads/2017\_MFDA\_ClientResearchReport.pdf. [↑](#footnote-ref-6)
7. “Company Overview of First Coverage, Inc.,” Bloomberg, accessed May 16, 2017, www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=27079808, First Coverage provided web-based financial-information management solutions primarily focused on independent research companies and boutique brokers. It measured industry- and sector-level sentiment ratings based on real-time data derived from changes and shifts in mainstream news, micro-news sites, and aggregated sell-side communications to buy-side clients. [↑](#footnote-ref-7)
8. Investor Economics, Fintech Advisory Service Report, Fall 2016. [↑](#footnote-ref-8)
9. Investor Economics’ 2016 Fintech Advisory Services report estimated the median cost for Robo-Advise client investing $500,000 at 45 bps. The equivalent cost at Nest was estimated at 19 bps. [↑](#footnote-ref-9)
10. Peter J. Thompson, “Wealthsimple Aims to Turn Financial Services Industry on Its Head with New Low-Cost Approach to Investing,” Financial Post, April 10, 2015. Mike Katchen, “How my startup raised $30-million from Power Corp”, *Globe and Mail*, September 30, 2015. [↑](#footnote-ref-10)
11. Power Financial Corporation home page, accessed June 29, 2017, www.powerfinancial.com/en/. [↑](#footnote-ref-11)
12. Stephen Martin, Byren Innes, Davis Yoo, and James Mancini, Sound Advice: Insights into Canada’s Financial Advice Industry, July 2014, PwC and Advocis, accessed June 28, 2017, www.advocis.ca/sareport.pdf. [↑](#footnote-ref-12)