THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

FINANCIAL ADVICE IN CANADA

November 2022

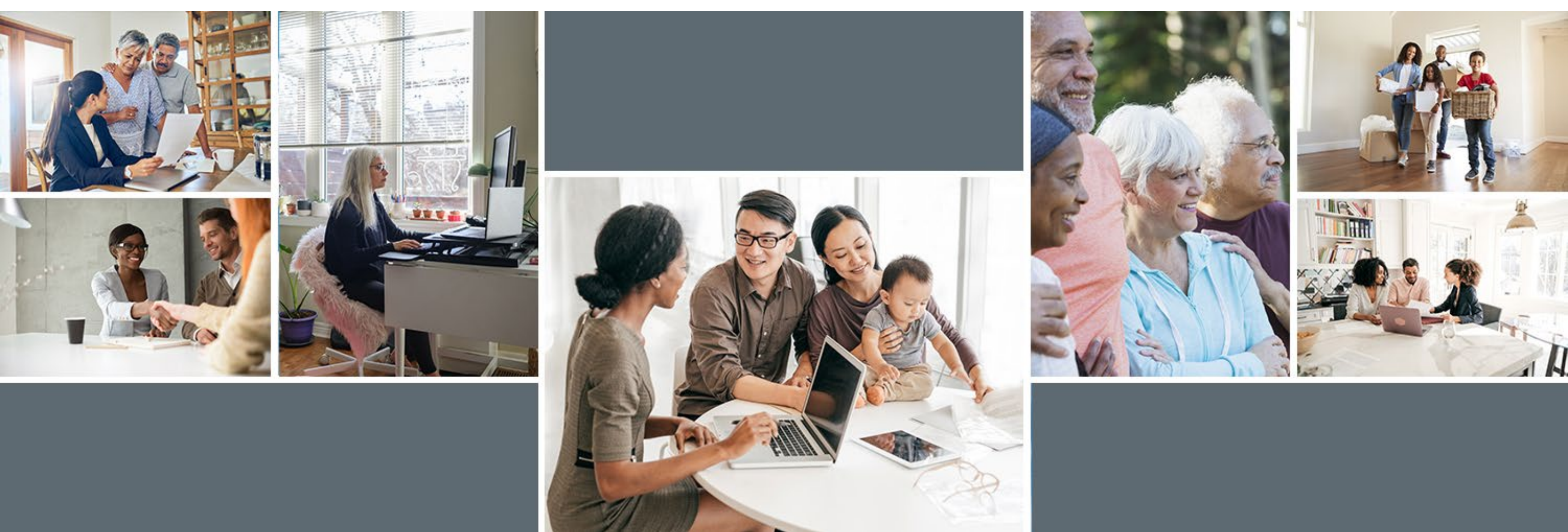

TABLE OF CONTENTS

ABOUT IFIC

The Investment Funds Institute of Canada is the voice of Canada's investment funds industry. IFIC brings together approximately 150 organizations, including fund managers, dealers, professional and back-office service providers, to strengthen the integrity of the investment funds industry, foster public confidence in investment funds, and enable investors to achieve good outcomes. By connecting savers to Canada's economy, our industry contributes significantly to Canadian economic growth and job creation.

THE LANDSCAPE

Canada is known for having large quantities of fresh water and an expansive wilderness. Canada is also a country with an abundant number of advisors -- there are 108,033 retail advisors in Canada.[1][2][3] By way of comparison, in the UK, with nearly twice the population of Canada, there are 36,377 retail advisors.[4] In the US, at nearly ten times the size of Canada, there are just over three times the number of financial advisors at 300,000.[5]

Advisors have played a key role in helping Canadians build retirement wealth. In fact, employer-based and voluntary retail savings remain the go-to retirement savings avenues for Canadians. Retail investments in Canada, which include investment funds, managed accounts, and securities holdings, account for $4.707 trillion in financial wealth, held across 16.5 million households. Of this, $3.345 trillion, or 71.1% is advised. [6]

1 IIROC Annual Report, 2020-2021.
2 MFDA Annual Report, 2021.
3 Figures include some double-counting from dual-registered advisors.
4 FCA. UK retail intermediary market.
5 Cerulli Associates and CFB Board
6 Investor Economics Household Balance Sheet, 2021 (as of December 2021).

WHAT IS ADVICE?

Advice can cover a broad range of possible activities. Some are required by law, for example, the "Know Your Client" (KYC) rule requires all advisors to assess their clients and ensure that the advice provided is suitable to their individual needs. The advice people want and need may change as people move through different life stages. Also, some clients are looking for more basic services, such as help understanding how much money to set aside on a regular basis and in picking suitable investments. Others are looking to establish more complex goals and financial plans, and need advice with respect to educational savings, tax planning or deaccumulation in retirement.

WHAT ADVICE MEANS TO INVESTORS

In 2017, IFIC commissioned the Brondesbury Group to explore how investors themselves understand advice. The report found that financial services clients understand advice to be "personalized communication" that responded to specific questions and concerns, in the context of an ongoing trusting relationship.[7]

The research found that two-thirds of Canadian financial-service clients saw themselves as part of an ongoing advisory relationship.

7 Anatomy of Advice. Brondesbury Group. 2017.

ADVICE AND THE MODEST INVESTOR

One of the features of the Canadian landscape is that Canadians of very limited means can gain access to financial advice. In fact, according to research commissioned by the Investor Advisory Panel (IAP) of the Ontario Securities Commission[8], the majority of advised investors in Canada (53%) have less than $100,000 in investible assets. For mutual fund investors, the proportion of advised investors with smaller accounts is even higher. The Mutual Fund Dealer Association Client Research report found that 79% of households with an advisor have less than $100,000 in financial wealth.[9]

In terms of the advice received by modest investors, the IAP research found that 74% of investors who had between $50,000 and $100,000 said that they received advice on planning for financial goals, the same percentage as those with more than $250,000 in investible assets. For those with less than $50,000, 60% said they received this advice. When it comes to advisors helping to save more, just slightly fewer investors with less than $100,000 said this, compared to those with over $250,000, a positive sign for the equitable distribution of advice in the Canadian market.

8 A measure of advice: how much of it do investors with small and medium-sized portfolios receive? OSC, Investor Advisory Panel, July 29, 2019.
9 MFDA Client Research Report, 2020.

TRUST AND SATISFACTION WITH ADVICE

The important role that individual savings play in the Canadian retirement and savings landscape must in part be explained by the relatively high levels of trust and satisfaction investors have in their advisors.

In a global survey of investors conducted by the Institute of Certified Financial Planners (CFP) Canadian investors had the highest level of trust in financial advisors, compared to all other comparable jurisdictions such as the UK, the US, Australia and all European countries. As seen in the underlying data provided by the CFP, 97% of Canadian investors surveyed stated that they trust or completely trust their financial advisor.[10]

According to a study from the Investment Industry Regulatory Organization of Canada (IIROC) a majority of investors indicated that they trust the integrity of their investment advisor (72%) and the firm they deal with (71%), and that they felt that their advisor had their best interests at heart (63%).[11]

The Canadian Pollara Investor Survey has run for 17 years and consistently demonstrates high levels of satisfaction with financial advisors. The 2022 survey found that 92% of mutual fund and ETF investors are satisfied with their advisers.[12]

10 Enhancing Investors' Trust. CFA Institute. 2022. Data file. Note that only Singapore had a higher trust score than Canada, but it is not considered by IFIC as a comparable jurisdiction
11 Investor Awareness Tracking Survey. IIROC. May 2020.
12 Pollara Mutual Fund and ETF Investor Survey. October 2022.

VALUE OF ADVICE RESEARCH

There are many aspects to the value of advice. Some of the value is intangible, and often it is very specific to an individual investor's needs. However, there is a substantial and growing body of research that demonstrates a measurable ***quantitative value*** of financial advice. Five key studies in this area from around the world are summarized below.

Simply put, most investors who work with advisors build more wealth over time. The research shows that the quantitative and measurable aspects of advice come from a combination of asset allocation, savings discipline, and coaching to avoid costly mistakes.

VALUE OF ADVICE RESEARCH

CANADA

CIRANO Institute - The Gamma Factor and the Value of Financial Advice

The quantitative value of advice has been demonstrated in three separate studies led by Professor Claude Montmarquette at the Centre interuniversitaire de recherche en analyse des organisations (CIRANO Institute)[13]. This research used detailed Ipsos survey data gathered over several years to compare similar investors who work with an advisor and those that don't. To compare similar investors, the research controls for 50 social and economic factors, such as level of wealth, education, income, and financial literacy.

Through three separate years of investigation, the researchers found that Canadians using a financial advisor accumulated substantially more assets than comparable non-advised investors. The impact of advice varied across the studies and associated economic conditions. The research found that after 15 years, investors accumulated 2.7 times more assets in 2010, 3.9 times in 2014 and 2.3 times in 2018 than comparable non-advised investors. In explaining why advised investors saved more, the researchers identified higher savings rates, a greater allocation of non-cash investments, and disciplined behaviours acquired through financial advice (for example, not selling through market downturns).[14 15]

The term 'gamma', used by the authors, refers to the additional value that advice provides by helping clients make better and more informed financial decisions. Gamma is building on the concept of 'alpha', which refers to the value that portfolio management adds by actively picking securities that exceed the market's risk-adjusted return.

13 Centre Interuniversitaire de Recherche en Analyse des Organisations is a research center that brings together researchers from several universities in Montreal, Canada with the purpose of creation and transfer of knowledge. It facilitates research in a variety of disciplines, including, economics, finance, management, information systems, computer science and operational research, psychology, sociology, political science, law, history, and medicine.
14 More on the Value of Advice. C. Montmarquette, A. Prud'homme. CIRANO, 2020.
15 The Gamma Factor and the Value of Financial Advice, C. Montmarquette, Nathalie Viennot-Briot, August 2016.
Economics Annals of Economics and Finance.
Econometric Value on the Value of Advice of a Financial Advisor. C. Montmarquette, N. Viennot-Briot. CIRANO, 2012.

UNITED KINGDOM

International Longevity Centre – The Value of Financial Advice

In groundbreaking research, the International Longevity Centre (ILC) used 14 years of data from the UK's Wealth and Assets (WAS) Survey to evaluate the quantitative value of advice. The WAS is a national longitudinal survey that interviewed individuals and households across Great Britain. Wave one achieved approximately 30,000 household interviews, and wave four achieved approximately 20,000 household interviews. The data from these two waves were used in the analysis.

Building on the approach undertaken by CIRANO to control for social and economic variables, this research used "propensity score matching" to identify two similar groups of individuals within the data and then assessed the impact of advice on one group (the treatment group) versus the other without advice (the control group), thereby mimicking a scientific experiment. The real power of this study is that it was able to follow specific individuals and households over the years.

The study found an overall positive impact of financial advice for individuals and for both those that are wealthy and those that are less wealthy. Specifically, those who had received advice between 2001-2007 had more investible assets in the period, 2012-2014, than a similar group who had not. The "affluent but advised" group had 17% more than the equivalent non-advised group and the "just getting by" group had 39% more than the equivalent non-advised group.[16]

In explaining the differential accumulation in wealth, the report specifically identified savings behaviour and directing savings to equity assets. Specifically, receiving advice between 2001 and 2007 raised the probability of saving in 2012-2014 by 8.6% and raised the likelihood of owning equity assets by 10.4% compared to those without advice.

16 The Value of Financial Advice. A research report from ILC-UK. July 2017.

UNITED STATES

The Impact Of Financial Advisors on the Subsequent Wealth of Older Adults

In this academic study[17], the authors used individual data from the US Study of Assets and Health Dynamics Among the Oldest Old (AHEAD).[18] The study measured net wealth every two years between 1993 and 2008 for individuals who were at least age 60 in 1993. The researchers split the sample into two groups, those who had an advisor in 1993, and those who did not. The study found that, even after controlling for several variables, including, initial wealth, net income, and education, having a financial advisor in 1993 was significantly and positively related to subsequent net worth. In other words, those with an advisor in 1993 experienced greater wealth accumulation (or retention) over 15 years compared to those who did not have an advisor. Like the CIRANO studies, the impact on net worth for advised individuals was greatest by the end of study period, suggesting that the impact of a financial advisor grows over time. In seeking to determine why advised individuals did better in terms of wealth accumulation (or retention), the authors found that advised individuals benefited from having greater allocations to equities. Indeed, this is consistent with earlier research undertaken in the US that found that individuals who met a financial advisor prior to the 2008 financial crisis on average lost significantly less money (6% less on a risk adjusted basis) than those that did not, in part because those who met with an advisor were less likely to have made costly mistakes, such as selling equities in a downturn thereby crystallizing losses.[19]

17 The Impact of Financial Advisors on the Subsequent Wealth of Older Adults. Benjamin F. Cummings, Russell N. James, III. Journal of Personal Finance; Middletown Vol. 21,1, 2022, 31-50.
18 The AHEAD includes responses to detailed interview questions administered every two years of a nationally representative sample of older Americans. The survey is administered by the National Institute on Aging (NIA) and the Institute for Social Research (ISR) at the University of Michigan
19 Reducing Wealth Volatility: The Value of Financial Advice as Measured by Zeta. JE Grable, S Chatterjee, Journal of Financial Planning.

VALUE OF ADVICE RESEARCH

AUSTRALIA

CPS Australia - The Value of Advice

In a study sponsored by the Certified Practicing Accountant (CPA) Australia[20], a sample of Australian investors at different life stages were surveyed on a number of questions, including personal income and the use of financial advice. The results were then used in a macroeconomic lifelong income model to project the relative impact of financial advice at different life stages. Based on the economic modelling, the study concluded that financial advice provides an equivalent benefit of up to 30.6% of an individual's total personal income per year. While the study lacks the large number of control variables that were used in the CIRANO and ILC research, the study was supported by a qualitative element that demonstrated high levels of perceived value of advice as reported by advised clients.

20 Value of Advice. CPA Australia.

PERCEIVED ECONOMIC VALUE OF ADVICE

While the research referenced in the previous section demonstrates the quantitative value of advice, it is notable that investors also believe that advice has economic value. For many years, the Pollara Investor Survey has asked mutual fund and ETF investors several questions on the perceived value of advice. In 2022, 80% of mutual fund investors and 73% of ETF investors state that they believe that they get a better return on investments due to their financial advisor and 84% of mutual fund and 78% of ETF investors feel more confident that they will reach their investment goals when using a financial advisor.[21] Furthermore, 74% of mutual fund investors and 68% of ETF investors state that, because of their advisors, they have better saving and investment habits.

21 Pollara Mutual Fund and ETF Investor Survey. October 2022.

ECONOMIC BENEFIT OF ADVICE

The Conference Board of Canada, in its report *Saving for the Future: Impacts of Financial Advice on the Canadian Economy*, uses the CIRANO findings to project the specific impact of receiving financial advice on individual savings and the resulting positive effects on the Canadian economy.

The individual impact analysis of the report is based on a hypothetical comparison of two individual savers – one who has a financial advisor and one who does not. The report found that having a financial advisor leads to an increase of 55 to 60 per cent in retirement savings.[22]

The report's economic impact analysis was based on a hypothetical scenario in which 10 per cent of individuals who did not previously use a financial advisor begin a relationship with one and started saving at a higher rate. The report found that by 2060, if 10 per cent more Canadian investors were to use a financial advisor it would lead to:

- An increase of $2.0 billion in household wealth;
- An increase of $900 million in real GDP; and
- An increase of $7.0 billion in tax contributions.

22 Conference Board of Canada, in its report, Saving for the Future: Impacts of Financial Advice on the Canadian Economy.

THE FUTURE OF ADVICE

As observed in the Investor Economics 2021 *Household Balance Sheet* report, demand for advice will intensify in the years ahead as Canadian households “face multiple and conflicting demands on their financial resources, including retirement funding, healthcare expenses, deleveraging, housing costs, insurance needs, etc.” But as observed in the report, the nature of advice, and how it is delivered will undergo changes over the course of the decade.[23]

While we have seen the growth of robo-advice options in Canada and around the world and the impact of social media on investing trends, it must be the case that we are only at the beginning of technologic disruption in the wealth management industry. What will be the impact over time of big data and artificial Intelligence, blockchain, biometrics, natural language processing, and perhaps even augmented or virtual reality?

While technology creates an opportunity for better or even more widespread use of financial advice, it has yet to be proven that any technological solution will be able to replace or replicate the proven economic value that advisors bring to their clients. It may be that that the biggest impact of technology will be to augment the work of human advisors, rather than take it away. C.D. Howe Commentary, *Next-Gen Financial Advice: Digital Innovation and Canada’s Policymakers*, makes the following observation: “There are some tasks that are better performed by machines, while others only work in the hands of humans. If these are integrated into our financial services industry in the right way, the evidence suggests that they will lead to better outcomes for clients.”[24] Perhaps. But for advice to be effective, and to refer back to the Brondesbury study referenced above, it will have to be personalized and capable of answering clients’ very specific questions and concerns and be founded on a trusting relationship.





23 Investor Economics Household Balance Sheet, Client Report, 2021.
24 C.D. Howe. Commentary No. 538. Next-Gen Financial Advice: Digital Innovation and Canada’s Policymakers. Chuck Grace. March 2019.