NEWS

FUTURE OF DISTRIBUTION

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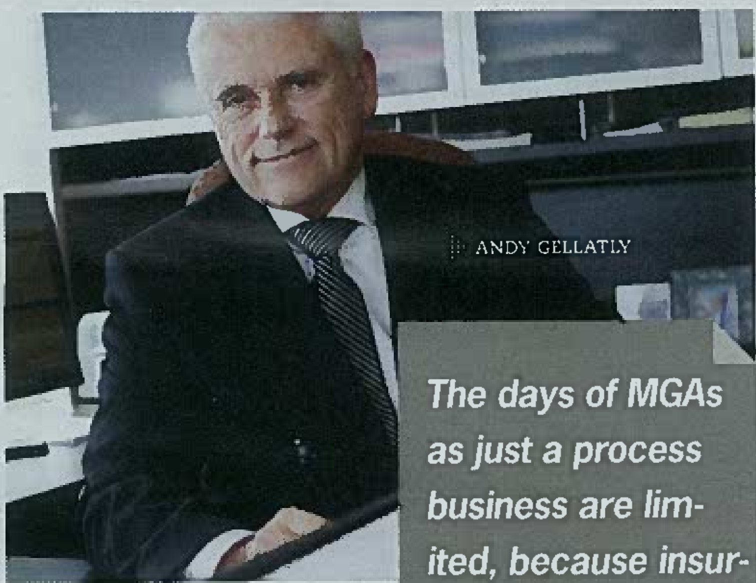
WE SPOKE TO:

- **Paul Brown**, PRESIDENT AND CEO, WORLDSOURCE INSURANCE NETWORK
- **Robert Frances**, PRESIDENT AND CEO, PEAK FINANCIAL GROUP
- **Andy Gellatly**, PRINCIPAL, IDC FINANCIAL INC.

run through the May issue of *Advisor's Edge Report* in anticipation of our annual Distributors' Summit, May 31 - June 2, 2011 at the Fallsview Casino in Niagara Falls, Ontario.

1. What direction is distribution taking?

Paul Brown: Distribution has been evolving over the last 15 years. We have seen a movement towards scalability through mergers and acquisitions, as well as the emergence of big-box distributors owned by mutual fund complexes, insurance companies and other institutions. Their strategy is to own and control distribution, with the endgame being to market their own products and services through these advisors. The large institutions have the capital and the will to build integrated businesses and push their products through it.



ANDY GELLATLY

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The smaller players have been getting squeezed out over the past 15 years. I believe the pendulum will swing back at some point. Opportunities should emerge for small, focused, niche distribution companies to recapture market share, because not every advisor wants to drink the Kool-Aid.

That said, many advisors understand the challenges faced by distributors in today's marketplace and are prepared to find solutions that meet the needs of clients and the distributor, while at the same time making practices more efficient and poised for growth.

Robert Frances: It's finally starting to take a direction where advice has a significant place on the distribution continuum. There was a time when distribution was just that — distributing financial products. Investors are asking for advice and the people involved in the industry are becoming advisors first, and product specialists second. Nobody calls a doctor a pharmaceutical distributor. They're medical advisors first. In our industry, the nomenclature has moved towards distribution, salespeople, licensed representatives, etc., which I think has done harm to part of the industry.

There's no doubt we need the distributors and salespeople working in the industry, but there are also a lot of true advisors and financial planners who advise first, and then go out and see if there are any products worth filling the need. We're seeing consumers becoming aware of this and saying, "We want good advice first, and then tell us [about] products. Where's the long-term financial plan we can follow?"

Andy Gellatly: We think the MGA channel of distribution is going to get smaller. The belief is there are too many MGAs operating in the country. If there's one insurance company that's got it tight in the amount of MGAs they want to deal with, it's Sun Life; they have 20. Manulife and Canada Life are also reducing their numbers.

Insurance companies want to deal with an MGA that has a sophisticated back office, not only for handling life business, but also the segregated fund business using Fund SERV. It cuts down on paperwork, and they know how compliant it is if an MGA has got these systems in place. It protects the insurance company, the advisor and the consumer because there's no delay in sending monies off to the insurance companies. It's expensive, however, and a lot of smaller MGAs cannot afford it.

Another reason is insurance companies want to be dealing with MGAs who have compliance standards in place for their advisors and staff. Insurance companies are afraid of dealing with a smaller MGA that may not pay close attention. If you do not have standards in place, you're leaving yourself open to criticism from consumers or potential regulators.

The third reason is they want to deal with MGAs who have a commitment to training and education. The days of MGAs that are just a process business are limited, because insurance companies are going to be raising the production requirements for MGAs to hang on to their contracts.

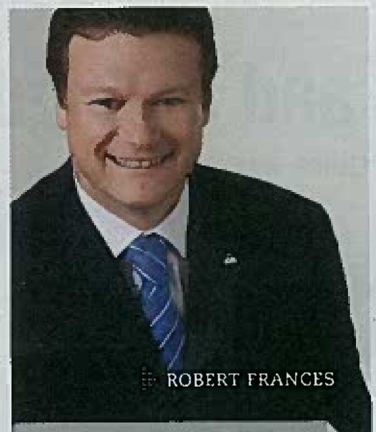
2. What is the biggest threat to the distribution model?

Paul Brown: Increasing costs, which are in no way driving revenue, is the number one challenge. Regulatory costs have grown substantially over the past five years and will continue to for the foreseeable future. In concert with increased regulatory costs is the risk to distributors from the potential misconduct of advisors. This is a particular concern with independent advisors who, by their nature, demand a degree of autonomy. The potential liability to a dealer based on the advice given by advisors is difficult to quantify. In many cases, the distributor has no control over what that advice is as they have limited supervisory authority.

Technology is the other substantial cost centre for distributors, as you need excellence in processing and client reporting in order to compete with our biggest competitor, the banks. Successful distributors have been able to leverage technology to provide efficiency gains internally and increased advisor productivity.

Robert Frances: The concentration of product and the reduction of choice will be the biggest threat. I give it a lower probability today than a few years ago, but it's still there. The day consumers have less choice on the amount and types of products and on fee structures is the day these threats become serious. Right now it's not the case. Products are getting more competitive, and there are more products by more companies, so that threat seems to be dwindling. But it's the biggest threat out there.

Andy Gellatly: We don't fear a regulator because my partners and I are running the most compliant office you could ever imagine. The only thing we fear is if there's some crazy overreaction, like what happened in England; they basically destroyed the life-insurance business with severe regulation. Of course, it's the consumer who gets hurt because there are not enough financial advisors to handle the people who require financial advice.



ROBERT FRANCES

There are countries where the word independent is a regulated title. In Canada, anyone can call themselves independent.

3. What happens to MFDA dealers if their regulator is shut down or merged into IIROC?

Paul Brown: Many MFDA dealers already have an IIROC platform as well and could move advisors quite seamlessly. I'm sure there would be levels of licensing in place that would allow advisors to continue to run their practices and service their clients in much the same way they do today. The challenge for smaller dealers would again be the cost and adoption of the new regulation, the technology they would need in order to operate and compete, and whether they would have the ability to ramp up to meet those requirements.

Robert Frances: If they were to [merge] it depends on the terms. I'm not set on an opinion on whether such a merger would be good or bad — it's the details of it, the way it's executed that would make the biggest difference. If IIROC and the MFDA come up with an arrangement that recognizes the realities of operating a mutual fund dealer, the differences in risk — it's lower risk than an IIROC dealer, but you also have less commercial benefits because you can't do certain things IIROC dealers can do — then I think it could work.

Andy Gellatly: It's possible there might not be much impact at all. Eventually, everyone will have to adapt and accommodate with the harmonization of policies and procedures. I don't think they'll lose their regulator entirely; rather, it will be blended into the shape of another entity of its previous form. Either way, it is likely they will have to adapt and form new policies under a new regime, which will take time to formulate and implement. The MFDA already has a very rigid environment and a sound compliance framework which will make a transition very easy. However, if — and I stress if — there is one National Regulation or a merger of MFDA and IIROC, there will still be the same product offering and choices for investors. Even further, they will have more choices under one umbrella, which is better for the client.

There would be an overall benefit to all parties and I am sure this plan, should it come to fruition, would be done with best interests in mind at all levels.

Since this issue is still in its infancy, the debate will continue for now and it will be interesting to see how this will all play out; like anything else, I am sure when it gets here we will learn to deal and move on. Change should be embraced, not hindered. If it is for the greater good, then let's look at the big picture: we have a fiscal responsibility to manage commerce and clients.

4. What are the biggest barriers to effective distribution?

Paul Brown: There's often a disconnect between the best interests of the advisor and the distributor. The advisor wants to be independent, dispense financial advice, and offer clients multiple products. Distributors are often accountable and liable for the advice advisors give, while having a limited ability to supervise their activity. To be effective, distributors and advisors must focus on creating a stable platform from a transaction and compliance perspective that allows them to focus on practice development and revenue growth.

Robert Frances: First, the lack of clarity on the role and registration of the advisor. You can be a financial planner, a registered representative, a financial advisor, a financial counselor, a salesperson, a registered salesperson — the consumer is completely confused as to what all those things mean. In the insurance industry a long time ago, you were either an agent for a company, or a broker, and you're independent and you look after all

PHOTO: ANDY GELLATLY BY ERIC FORGET

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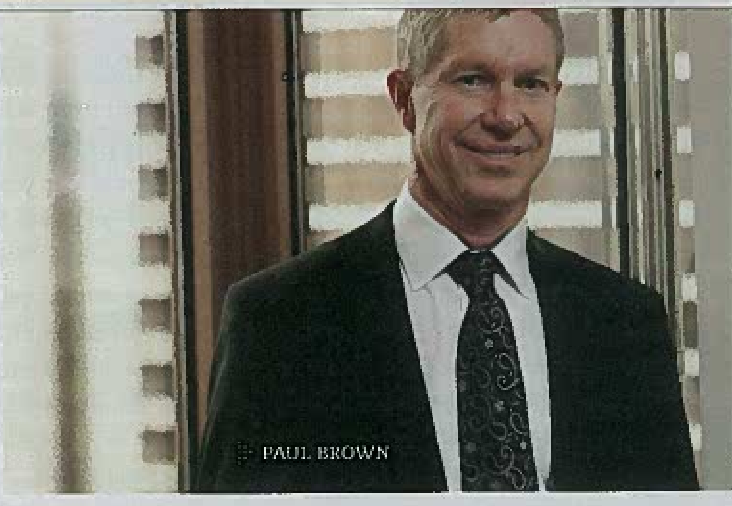
PAUL BROWN

Opportunities should emerge for small, focused, niche distribution companies to re-capture market share.

of them, so that would be useful.

The second area is the word independent. There are countries where the word independent is a regulated title, and there are criteria [to be met]. In Canada, anyone can call themselves independent.

The third barrier is regulatory arbitrage, where people can choose different forms of registration based on different forms of regulation. For example, if you're selling a mutual fund versus a segregated fund, the rules are different. They're almost identical products. It makes it difficult for the investor to get clarity.

Andy Gellatly: [On the mutual fund side] we think it is just being choked on over-regulation and stiff compliance standards.

5. What changes would help you serve both advisors and the investing public better?

Paul Brown: At the advisor level, the bar has to be raised in terms of competency and professionalism. If you look at any profession, there's a minimum educational requirement. There's also a fiduciary responsibility, and I think that when you take on the title of advisor, you have that responsibility to your client. You're not just selling them an investment solution; you're accountable for giving them advice that's in their best interest. A large majority of advisors do this now and I have high regard for many advisors. But that really doesn't matter, as long as you're part of an industry that has advisors working for their own self-interest. Unfortunately, all advisors will be painted with the same brush.

We need to get to the point where new advisors are educated at the university level and are capable of adhering to a strict code of conduct. Right now, we're in a position where advisors want to be considered professionals, but in reality they're licensed, regulated and supervised like salespeople.

From a distributor perspective, a higher bar for advisors would enhance our ability to provide value in the form of practice management, business development and client-focused initiatives.

Robert Frances: I'd get clarity on the different investment types and make sure regulation is similar for similar products. And I would encourage the regulators to take a good look at the question of independence so titles will be clear. What's a distributor, an advisor, an independent source, an integrated versus an independent? Let's get those things out there so it's easier for everybody to understand how it's working.

Andy Gellatly: We have no problem with having a regulator [for the MGA channel of distribution]. If we get a regulator, however, it must fully understand how an advisor and MGA work in harmony; this would help advisors and the investing public.

We want the regulator to understand the absolute commitment we have to training and education. A better trained advisor is obviously better equipped to deal with clients and we think this training and education should be required by any regulator that emerges for the MGA channel of distribution.

An independent advisor can say, "I will have my Canada Life and Sun Life contract through your MGA, but I'm not going to give you all of my business. I'm going to place my other contracts with other MGAs." He or she could do business with four or five different MGAs. Our feeling, from the point of view of training and compliance, is if they were told they have to have all of their business with one MGA, it would make for greater consistency and stability. AER

DEAN DiSPALATRO *is Advisor Group Senior Editor.*

MARK COHENE