Private & Confidential

A Wealth Management White Paper

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<u>Wealth Management: In the Beginning & the End</u>

Wealth management, a phrase, a focus that has dominated the financial service industry through the Nineties and into this century still does not evoke a consensus in understanding and application. In the previous decade, the major banks began an acquisition diet of brokerages, investment houses and private banking concerns both domestically and internationally to architect their visions of wealth management. Owners and partners in the acquired firms received exceedingly healthy buyout premiums creating many new multi-millionaires. For their part, the banks expanded product lines, service offerings, assets under management and customer lists which would drive the revenue as enunciated in strategic releases to analysts, the press, shareholders and customers. Ads and articles began to proliferate in all forms of media announcing the solutions for wealth management.

Then September 11th hit and corporate greed was continuously exposed starting the downward avalanche of equity markets and fuelling a new round of consumer distrust in financial institutions. In two years those billions of dollar acquisitions lost hundreds of millions in value as portfolios declined and revenue streams shrunk rapidly. From the most sophisticated pension fund managers to the average investor, they saw wealth disappear. Fortunately, for many individuals their residential and investment properties gained during the same period to help preserve, or if your were not in the equity markets, to generate wealth.

What is Wealth Management?

Perhaps we should look at what has been written or spoken by the financial industry prophets first. Or, who are these banks and service providers including in their strategic statements? To some it is a percentage of individual customers who generate the most existing (not potential) profitability for the institution ranging from 2% to 20% of a customer base. Alternatively, it can be based on customers' known total or net liquid assets with many firms, but discounting the value of primary residences. Consequently, many banks and other competitors have really been defining wealth management in terms of known assets they can capture under their management and collect their implicit percentage fees as well as commissions that can be generated through market trades. As we know, both of these streams have contracted, if not dried up. But, homeowners have been saved from complete devastation!

More sophisticated financial institutions have been and are developing definitions built around specific segments such as mass affluent, emerging affluent, affluent, active rich, retired rich etc. The vast majority is still segmenting by individual versus family. Still others, especially in the banking sector, work with private banking, premium banking, priority banking, gold card or VIP banking terms and, heaven forbid, A, B, C customer classifications with A being the wealth management group.

We share a viewpoint with an industry minority that wealth management has <u>three stages</u>:

1. Wealth Generation
2. Wealth Preservation
3. Wealth Transfer

This is a holistic perspective for an individual family and implicitly incorporates the lifestyles/stages concept over a continuum. We will address the implications in more depth later in this paper. Therefore, wealth management is the chosen process whereby the generation, preservation and transfer of all tangible assets are managed to meet the needs and goals of an individual or family. Goals can be as basic as survival and as bold as a multi-million dollar plateau. Everyone has wealth management priorities and needs but not everyone has needs for a large and active range of financial services.

Why Wealth Management Products & Services?

All of us have some sense that assistance or guidance is needed to reach wealth management goals. Perhaps a lawyer to prepare a Will; a real estate agent to find that right home; a banker to help us develop a structured savings behaviour; an accountant or tax advisor to assist with the annual tax return and planning; or perhaps a partner to share a dream with. Access to advice and products is essential to minimize risks and maximize value retained for our efforts. For example, the bank that offers structured borrowing programs and repayments scheduled under a home equity umbrella, is probably offering the first material wealth management product and service to the wealth generator. As this customer grows financially, moving into a complimentary structured savings to their equity line umbrella is a natural extension with the excess funds now employed in tax savings securities or other asset accumulation choices.

The financial products targeted at wealth management customers cover everything from an array of accounts to Advisor supported investing. In some countries, banks have become active in trust and insurance services as well as providing for the development and review of individual financial assessments and plans. There is no doubt that the direct and indirect menu of services is getting more extensive and delivery dependence on effective relationship management and referral systems in financial institutions continue to grow.

For the financial institution, the wealth management goal is to capture 100% share of wallet and associated fee revenues primarily from an asset management perspective. Many banks train and motivate staff to “identify and graduate” customers into wealth management categories. This does not ensure that the bank’s wealthiest customers are identified since the process is generally predicated on what you know about the customer and how much business is held within the bank. Since most individuals deal with a number of financial institutions, a person could be recognized as a wealth management customer or candidate by all or none of the customer’s suppliers.

Why Does the Individual or Family Want and Need Wealth Management Services?

The reasons may be as straightforward as the definition i.e. to build selected assets, preserve assets for retirement and arrange for the transfer to loved ones, which minimizes taxes and is an uncomplicated process. Therefore, people have a lifeline or lifecycle view of their wealth. At different times or stages, needs for advice and products vary and perhaps supplier relationships expand or contract. One of the greatest products in the lifecycle is continuous education on needs and solutions.

Financial planners- independent, bank-employed or otherwise, are taught and provided with tools to perform customer needs analyses periodically to categorize people by risk tolerance. The risk level generated then drives customer discussions on financial products. But perhaps this process shortchanges or generalizes the customer too simply. Do customers have multiple levels of risk tolerance depending on the subject area? Are we using equity investment risk acceptance to judge potential success with an entrepreneurial venture or the right to utilize investment leverage?

I must deviate briefly to comment on financial institutions treatment of staff and/or their families as wealth management candidates or relationship managed customers. For example, in our executive team, which retired from or spent over twenty years with one or more financial institution, no one is proactively relationship managed by their ex-employer, who have significant financial information to know each person's wealth management stage. In contacting our offices in other countries, the practice or lack thereof appears similar. One other interesting related piece of evidence is that where banks offer formal financial reviews to wealth management customers for a fee, the same fee applies to staff for the process. Consequently, staff who are not directly involved with customer reviews do not know the content or approach by their bank(s) undertaking these risk tolerance or wealth management reviews unless they pay a fee to go through the process. Is this a missing link in banks wealth management customer chain?

When Should We Start Wealth Management?

A wise grandfather once said, "Start saving as young as you can". The time to start the education process is early and often, before we reach the various stages in our lifecycles that we progress through. For example, some are:

Pre-school Beginnings
Primary School Explorer
Secondary School Adolescence
University or College Adult
Career Entrance
Marriage
Separation/Divorce
Career Change
Buying a Home
Growing a Family
Educating Children
Empty Nesters
Entering Retirement
Second Careers
Travel & Rotation Living
Death of a Spouse
Living Alone

In the initial stages, parents or family are important in shaping values, goals and behaviours such as financial management of an allowance or pay from a part time job.

Family appears to be an integral part of life stages development. No one is isolated and uninfluenced by family.

So when do we start wealth management practices – now! It is never too late to begin and to reassess needs at each stage of the cycle. Marriage and Entering Retirement are two complicated events that necessitate some serious planning. For example, before retiring, a life "graduation" plan is important to deal with the adjustments, restructured priorities and "open" times ahead.

What Do Consumers Consider as Wealth?

Their personal possessions, home, car, cash in the bank, investments and pension can all represent wealth to the holder. Consumers' wealth has objectives to meet regular cash flow needs and contingency events plus to accumulate assets or to change/build one's lifestyle for a family, individually or career appearances.

How is Wealth Management Accomplished?

The normal options are:

- self directed or managed
- advisory support/personal decisions
- contract management

The reasons for each relate to knowledge, financial resources, networks, trust and other considerations from the consumer perspective. Our research shows that regardless of the investor's age, the vast majority of investors spend time educating themselves on wealth management aspects and mostly via the Internet. There is further comment and evidence on this activity in a later section. In fact this is the natural preparation process prior to meeting with an advisor/agent to make decisions. Consequently, financial institutions should consider how access to the required information can be available through "their portal" in order to build brand and relationship value with the customer. At our company, we have a habit of testing search engines periodically with key wealth management topics to see what sites come up, especially in the top 20/30. Most of the large acquisitors mentioned earlier normally don't make that list!

Independent financial planners have for years attempted to capture business due to the aforementioned disconnects which extend beyond the Internet. Unfortunately there have been public cases that have eroded some trust in this group as well.

Financial advisors can be found inside traditional financial institutions but more probably in the fast growing franchises and agencies of dedicated organizations.
In most countries the individuals carrying the title of financial advisor or planner must complete and maintain regulatory requirements if they are engaged in certain investment advisory and sales acts. Two broad concerns exist in this area by the wealth management customers and practitioners – independence and unregulated counsel. The latter may refer to a lawyer, accountant, insurance agent or other individual known and respected by the consumer/investor.

We could even extend this to family members or friends who may offer advice but do not realize the disastrous impacts that could result financially and friendship wise.

The more important issue is – independence. People can be certified as financial planners but do the regulators really understand the sources of compensation and the related behaviour impacts? There are financial organizations offering leverage loans through planners to consumers to build up their equity holdings and to write off the associated loan interest for tax purposes. The advisor or planner may or may not receive referral fees from the financial institutions but obviously the assets under management and related brokerage services do positively impact the advisor. Also there are certified financial planners who are employees of large organizations and are under the operating directive to only sell or recommend the employer's securities. Shouldn't independence be a feature of the advisor's requirements or are regulators avoiding this reality? If someone is offering wealth management advice for the generation and preservation or transfer of an individual's well being, shouldn't it be in the customer's interest to receive uncontaminated professionalism. Otherwise, if one is receiving remuneration from customers, and employers (assigning directives) and third party suppliers, are they really capable of looking after the customers' priority rights or do they compromise this responsibility and try to balance everyone's interest including their own?

The Inevitable-Taxes! How to Manage Through the Constant Attack?

Government tax policies, at all levels of government (municipal, regional and national) have major influences on wealth management plans and actions of individuals with discretionary wealth. At certain resource levels, consumers search for tax advice in order to minimize "the tax hits" while generating, preserving or transferring wealth. These advisory services are valuable to the investor and there is a willingness to pay for these services if the benefits are forthcoming. Some tax consultants will, at predetermined cutoff points, direct investments, and even residency, overseas to the benefit of the investor.

In Canada for example, federal and provincial income taxes of a salaried, high-end employee are over 50% of gross income. When you add other taxes and government fees, for example, sales taxes, energy taxes, licencing fees etc. the real tax bite can be around 70% unless there is professional advice to avoid the total tax hit possible. Taxes are disincentives but governments don't seem to monitor the critical hurdle rates over which the taxpayer becomes more sensitive to enacting avoidance. Because of these tax burdens in many countries, the underground economy flourishes from house painting projects to "garage sales". Public investments from consumer and business savings help build productive assets that create jobs. Therefore, high taxes that discourage the formation of new capital should be curbed so that economic opportunities grow for society and individual investors.

Risk Acceptance Changes: How Do You Adjust Lifestyles to Balance Risks?

Investors, consciously or unconsciously, assess and accept various levels of risk and reward. Generally, these choices are rational and not driven by greed where unrealistic expectations are drivers of potentially unacceptable risk levels.

Understanding and accepting levels of risk changes with objectives, resources, knowledge and timing but the majority are not gamblers nor can they afford the related consequences.

As risk tolerance changes with a lifecycle, the investor's counsel or advisor must help in adjusting the related investment parameters. Every significant lifestyle event will impact the acceptable risk level from the birth of a child to a pending retirement.

What is Wealth Management Besides a Universal Catch-all for a Variety of Moneyed Solutions and Situations from Either a Consumer or a Service Supplier's Perspective?

Despite all the attempts to identify wealth management customers, present and future, there seems to be a dichotomy between the customer driven and supplier driven viewpoints. In the current decade, wealth management has reached a high pitched focus of the financial industry fuelling acquisitions, mergers and new definitions, strategies, distribution channels, products etc. emanating from progressive players. Although specific customers are the foundation of suppliers' activities, do the financial players really know what customers think and prefer? Is the focus by the individual or the supplier one of family or just the singular person? Is there real potential congruence between customers and suppliers beliefs and actions? Or are they divergent views? Can the industry afford to generalize using its seasoned institution management and market size? If suppliers covet this business focus as their future success, when will the customer and supplier viewpoints merge? Will the latter do the necessary to bridge the understanding or continue to use their own preferences to deal with those of consumers?

Regardless of one's absolute income level, the majority of human beings in developed societies strive to improve their standard of life positions and personally grow through education and experience.

By necessity this philosophy results in a type of formal or informal goal setting as well as a degree of directional discipline to reach the objectives. The latter can range from purchasing transportation to establishing an entrepreneurial business. The dedicated direction generally requires a disciplined series of programmed payments of savings depending on the tolerance of the person to wait for the asset acquisition. Some people start to accumulate assets at early ages on a borrowing or debt platform. Consequently, most peoples' lives are built around cash flow payment plans – from pay cheque to pay cheque at the beginning.

Where is the Virtual Library that Holds the Education Keys?

At a recent conference I chaired, there was a wealth management "customer panel" presented to the attendees. The panel consisted of a dozen "wealth management customers" (investors) from 28 years old to 65 years young; both men and women; primary and postgraduate degrees and from a variety of income levels. First, there was a universal criticism of financial institutions' approaches to them. Additionally, all the panel participants confirmed their use of the Internet, as mentioned earlier, to improve their education as well as prepare insight and questions for their advisor, agent or banker meetings.

We wondered if the financial institution representatives undertook equally serious preparations tailored to the individual customers. Has the Internet become the virtual library for wealth management customers? This is not a fad but a resource to build an educational foundation in any wealth management subject or product. To the panel people it doesn't matter if they are "private banking" customers or if they deal with financial planners, insurance agents, investment centres/counsel, or brokers – they are better prepared than ever before to discuss their wealth management. From windfalls to Wills, the increase in financial and technological literacy will improve application outcomes for the consumer.

What are Consumers Searching for in Their Wealth Management Cycles?

In the Generation Stage, there are generally needs for growth, diversified risk and cost minimization with durable assets. But, there are other needs that become priorities when consumers are preparing for marriage, a family, a home acquisition, supplemental education, or even career changes. This is when a Will should be prepared; insurance acquired to protect against possible expensive contingences and the loss of earning power; and a network is established with specialists in many disciplines e.g. law, finance, insurance, tax planning, real estate and community service. Normally family members are influential in recommending these support service resources if the specialists don't exist in current personal and business circles.

Bank research on the 25 to 45 year olds in many countries represents how solid relationships are or are not in this wealth generation stage. Unfortunately, these are the net borrowers who demonstrate lower satisfaction and loyalty to financial institutions and therefore have the highest propensity to switch organizations due to lower satisfaction with service access, rates and charges or errors. Within this demographic group there are characteristics in descriptive elements such as education that can help predict a higher than average lifecycle income level and hence probability for greater wealth. As we have found in many financial institutions, this group or segment is not normally assessed on potential future family income and relationship profitability. Instead it is existing dealings and the related service/product profitability or loss in current products used with a specific supplier by an individual. Many future wealth preservers become disenchanted with financial service suppliers at this stage and are skeptical when the institutions start approaching them with asset management services when their known net liquid wealth exceeds pre-set hurdles.

In summary, wealth generators need solid partnerships and economical solutions. One positive financial example is the umbrella home equity line of credit (mentioned earlier) that consolidates all borrowings at a reasonable mortgage rate rather than individual product rates that can be extremely high on credit cards and consumer loans. Many financial institutions have been reluctant to offer these products due to the net margin erosion or even to meet the market trend for a no fee chequing account.

How do Consumers Protect What They Have?

Despite the information available from consumers, if asked, many wealth preservation suppliers fail to realize the true value of many customers who have allocated their balances and assets to a variety of separate financial institutions and competing non-financial institution organizations. At this stage, Wealth Preservation, we find a specific series of new lifecycle events shaping the individual and family perspectives such as empty nesting, children's university educations and marriages, as well as pre-retirement preparation. Generally looked upon as the 45 to 65 year olds, these people begin to feel the solicitations of many asset management representatives as if these emerging candidates were non-existent in the past. Many wealth preservers because of past experiences are reluctant to consolidate relationships that were built during their wealth generation stage with a variety of "trusted individuals" who represent an equally diverse set of suppliers. As the investors enter the preservation stage, risk aversion grows as does the desire for certain enjoyments or comforts including recreational properties, international vacations and hobbies which in some cases can evolve into cottage businesses. This assumes that family creation commenced in the adults twenties but as we know the Nexus generation can prefer to build careers first and only start child rearing in their late thirties which can defer entrance to actual wealth preservation until 55 plus. The principles still apply. It is a timing question due to lifestyle influences. At Wealth Preservation the variety of interests expand and current hobbies can attract more attention e.g. art collecting, theatre attendance, charitable works and yes, riding motorcycles. In financial affairs, preferences towards universal information consolidation, programmed investments and targeted lifestyle education are dominant. More and more of these needs can be self directed; built through a shared partnership or managed by "trusted" expert services. Research still shows a strong skepticism towards a single supplier gathering and knowing or acting on 100% knowledge of the customer's financial affairs. In exceptional cases, a trusted advisor may develop a universal statement for the customer but privacy and confidentiality needs to be respected in that no information should be shared within an organization with specific requests and approvals.

Can Consumers Objectively Establish a Wealth Transfer Plan?

The preservation stage can be, if we are fortunate, the longest period of our adult lives when we prefer not to face financial shocks as those racked up by the equity markets in the past two years or by "acts of God" not covered in insurance policies. Once retirement is actually entered into, the post trauma should have been minimized by lifestyle adjustment (graduation) preparations with one's spouse or partner. Besides having one's financial inventory protected, one must face transfer preparations. Wealth transfer requires difficult personal decisions and expert advice on legalities and taxation.

The Last Will and Testament needs to be kept up to date to synchronize with an individual's preferences and evolving (family) situation. A regular review timeframe is always recommended, perhaps annually. Likewise, how to minimize taxes takes on a new set of options with trusts and related transactions. The personal portfolio of preferences should include funeral arrangements and other such desires. During these preparations for wealth transfer, the estate wealth management suppliers are focused on assisting with all requirements and holding the relative documents in safekeeping.

The proactive advisors generally develop "Will Banks" which are manual or automated records of customers' Last Will and Testaments plus related preferences. This permits the "trusted advisor" to know beneficiaries, and with the customer's approval and referral, offer them his/her services for their wealth management needs. Will Banks can provide an element of business continuation insurance which increases the value of the advisor's portfolio over those that only deal with current asset management needs and end up disbursing/distributing an estate's funds in many directions. For years insurance companies have had this knowledge with their specified beneficiary policy but it was not a normal practice to ask for business referrals hence they write cheques in the end to disburse funds elsewhere.

The wealth transfer stage attaches significant personal emotions as well as preferences and therefore sensitivity training can be an asset for any financial advisor in addition to funeral directors who undergo that now.

Is Wealth Management an Integrated Subset of the Lifecycle Plan?

Wealth management is the financial thread in a lifecycle knitting of events. Everyone goes through key stages from beginning to end. Financial service suppliers and their relationship representative can be continuous partners in weaving support or competing to be ad hoc commodity providers at various times. Today, the market majority fall in the latter category and most congregate at the asset management offerings as temporary passengers in life journeys.

What is the Financial Planners' Future Mandate?

Individuals today are more sophisticated financially and more technologically literate, developing more knowledge faster than ever before which results in a stronger confidence level in self directed initiatives. Those financial service providers who "are in touch" with consumers total lifecycle will always have an opportunity for offering partnership solutions as long as privacy and performance are maintained in line with consumer expectations. People with the empathetic processes and support technology, not just a portfolio of products, will build wealth management for their customers, their employers and themselves. There still are many lifecycle opportunities for wealth management innovators to build strong businesses. Listen to customer preferences, provide the lifecycle choices, and build a total financial experience through wealth generation, preservation and transfer.

An Eagle's Viewpoint!

Where Eagles Soar Inc. works with clients and prospects in many international and domestic locations on developing customized customer centric distribution and marketing solutions for financial service suppliers. All institutions are involved in or are trying to address a "wealth management strategy" from small credit unions to large banks. Generally, either products are the focus or an access avenue to a brokerage channel that is deemed essential to build or retain "the right customers/members". The majority have not conducted dynamic research or undertaken regular formal performance surveys on what and how their holistic delivery is rated by wealth management customers at all stages.

Instead, they hire experienced asset managers who "know what the market/customers need". Alternatively, the customer- focused organizations are starting their strategic reviews with priority customer segments based on their life stages. Some, for example, are working with pre-retirees to determine how to better retain and build loyal relationships. A very select few now have an eye on wealth transfer and all it means to their customers and themselves.

Today most financial suppliers deliver a version of a wealth management proposition to the top end of the market. But, you normally won't find a "customer proposition" delivered by well-trained professionals with the right mental attitude or empathy and a suite of customer-centric solutions to all wealth management segments. Another extremely critical supplier resource vacuum is proper costing data in terms of channel sales options, set-up activities and transaction processes for products and services, and maintenance workflows. Without these costs, customer profitability becomes guesstimates at the discretion or intuition of various executives. The lack of proper profitability information is a show-stopper or the framework for a financial catastrophe. We could author pages on this subject but we'll save it for a future WESI white-paper.

We, in our business, continue to consult on the full lifecycle spectrum of wealth management to differentiate our clients, today and in the future, for a win-win situation. Naturally, a customer centric foundation and set of building blocks within an integrated plan are required as the financial roadmap from the wealth generator's beginning to the final transfer of preserved wealth. For the customer-focused supplier that understands the formula and gets it right, the rewards can be massive. The customer proposition needs to cover the full landscape from ***the Beginnings of New Lifecycles to the End!*** There are huge opportunities for the builders who listen to the customers.