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# ADVISOR'S EDGE REPORT

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**ADVISOR Q&A**

## Getting Visible

Firm forgoes casino-style payoffs in favour of steady advice platform

BY SCOT BLYTHE

*Fee-only financial planning is a growing trend in Canada, and so is passive investing. Montreal-headquartered PWL pioneered this approach in 1996. AER spoke with PWL founder Anthony Layton about his ideal client – and his ideal advisor.*

**Q** Tell me, how did PWL come to be?

**A** Three of us – me, James Parkyn and Laurent Wermenlinger – got together in '96. We'd known each other from earlier days at various competitors and were all members and executives of the Quebec chapter of the Canadian Association of Financial Planners. Fee-only financial planning was in the process of evolving. So we looked at each other at a lunch one day and said, "you know, we could probably put together a company [with] a much clearer

vision, and a much clearer platform in which to integrate investment work, tax work and the projection work" – whether it's retirement projections or longer-term savings projections. Tie all that together into a visible and transparent platform, and provide clients with a much greater bang for their buck.

**Q** Which side did you start out on – mutual fund or brokerage?

**A** All three of us were fee-only financial planners; there really is no platform for that. We did a lot of research to determine which platform would best suit the needs of the high-end client and we came to the IDA, now IIROC, platform. It

We are looking for people who have the courage to bring their clients over to the passive side of investing.

**Anthony Layton**



meant we had to get registered as investment advisors, but that platform has served us well. We use it as you would a trust company – to hold clients' assets.

We are a fee-only system. We are not doing a lot of transactions, and there is no pressure for transactions from a commission point of view. So, we were looking for a platform where we could

actually have a hands-on approach in looking after our clients' cash administration and cash management needs. That tends to be a service clients really appreciate – they get their instalments done and we get their monthly cheque out to them. We felt the IIROC platform was more accommodating than the MFDA.

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## Getting Visible

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**Q** Sounds a little like a private banker?

**A** That was really how the thing was envisioned and structured.

We've been called that a number of times. We are a virtual banker – we do not encourage clients to use our accounts as bank accounts



Layton

because that's a whole other business – but yes, at the level of service that one thinks of when one uses the term 'private bank' – that's what we are, essentially.

**Q** What does your ideal client look like?

**A** Let me backtrack: There are a dozen advisors in the firm and each and every one has specific client niches they are trying to develop. Those niches range from young business owners just starting their businesses, to older business owners who are in the process of taking capital out of their businesses. We've got professionals – a bunch of lawyer clients, a whole slew of corporate executives – [who are either] currently working, in the process of retirement or already in retirement.

In terms of minimum size, our documentation speaks to a \$1 million minimum, but we certainly accept clients way under that – clients with \$500,000, providing there is room for growth in the future.

We like to do the planning work at the same time as the tax work – we do income tax returns for private individuals inside the firm and probably 50% of our clients have their taxes done with us. There are sophisticated, complex cases, so we have CGAs and senior planners on board to do that work. We also outsource trust tax returns and holding company tax returns.

**Everybody wants to do something better. The question is: are you willing to change and make a leap?**

**Q** What do you look for when you bring on a new advisor?

**A** We are looking for people who have the courage to bring their client over to the passive side of investing. The active side is really the legacy or classical situation in Canada, where everyone sits around buying stocks and if you don't have enough money to buy stocks, then you buy mutual funds. Canadians are well-entrenched to think that's the only way to do it when, in fact, it's not. The use of

exchange-traded funds and pools that are index-based is an institutional style of investing and there are very few retail advisors – be they brokers, mutual fund advisors or investment counsellors – who are actually there right now.

When you actually sit down and look at the results and the logic and the lower risk associated with this type of investing, it makes eminent sense. We can all agree that it's an incredible system, but when it comes down to actually stand[ing] up in front of your clients and tell[ing] them to move from the traditional approach – the go-to-the-casino-and-pick-stock approach – to a lower-risk institutional type of investment style, that's a big leap, and we know it's a big leap. So, we spend a lot of time and effort looking for people who want to do things better for their client. Everybody wants to do something better. The question is: are you willing to change and make a leap? That's where the courage comes in.

The second thing is that on the fee-only side – because all of this is done on a fee basis – the revenues to the advisors, from our point of view, are very handsome. But you are not going to have the massive commission payouts that some brokers and advisors get on the trailer side. Is it a drop in pay? It probably is, but it's a smoother ride. The fees are like an annuity, they do keep coming in as long as you keep the client happy. Some advisors don't want to do that. They want the rock n' roll, but we're clearly anti-rock n' roll, as far as that is concerned.

The other piece is that the firm is deeply entrenched in the wealth management process. We have something called "defined objectives," which is a framework for delivering the pieces of the wealth management solution to the individual client and any advisor we deal with has got to buy into that, more or less. We don't want someone who is uniquely focused on the client's investments, because we don't believe that is in the best interests of the client. You need to know the client's overall objectives and their tax situation. We do all that work inside, so we are looking for special advisors who understand all of that and are willing to implement that.

**Q** Getting back to the investment process, how do you go about creating an investment management plan?

**A** There are some basic assumptions. Number one is the efficient market theory, which says

that all information is available to all of us. There's no documentation of anybody consistently beating the market, except possibly Buffett, and [even] he says that he's been extraordinarily lucky. So, if the market is efficient and all assets are priced efficiently, we set up portfolios that do not take the risks that an alpha seeker, an active manager, would. Our portfolios are passively constructed.

**Q** I wanted to pick through the "defined objectives" pyramid and how the pieces fit together.

**A** Let's get to the ETFs and Dimensional Fund Advisors stuff. It's based on the efficient market theory from William Sharpe and other Nobel Economics Prize winners, that says assets are not mispriced, so don't bother trying to find mispriced assets – just buy the entire market.

With the help of Dimensional in Santa Monica, we've split up both the equity side of the equation into nine sub-asset classes, and we split the income side into seven sub-asset classes. So, what you end up with is about 16 sub-asset classes. For example, in Canada, you would have Canadian large cap, Canadian large value and Canadian small cap. It's the same deal with the U.S. and with Europe/Asia, and [even] emerging [markets].

When you look at those nine sub-asset classes over time, they really do different things. They have ups and downs at different times in market cycles – that's called correlation. What we are looking for is the largest number of safe asset classes that have the least amount of correlation. If they are all correlated as one, then there is no point in diversifying. They are all going to go up and down at the same time. But when you break it into the nine, you have a nine-cylinder engine working for you and at no time is any one cylinder in exactly the same position as the one on either side of it. That is risk reduction. In other words, having that non-correlation provides lower volatility in a portfolio and lower risk because you are pushing across different continents, different countries and inside the countries, different sectors.

In our portfolios, in the pools that we hold through ETFs and DFA funds, we hold over 6,000 companies. This is a massive diversification; but it doesn't cost the client anything. Any number of them could go down and we couldn't care less. So, we find a way to invest in these nine asset classes; we've spent five or six

years of research in the U.S. with Dimensional, and with Barclays, Vanguard and State Street here in Canada. We put together a portfolio that uses the cheapest tools we can find, but that best represents the actual sub-asset classes that we've researched. Then we purchase those things and they sit in a client's portfolio. So, whether you have a portfolio of \$100,000 or \$20 million, you are basically holding exactly the same securities, just in larger or smaller amounts.

**We set up portfolios that do not take the risks that an alpha-seeker, an active manager, would.**

**Q** Do you do the portfolio construction or does each individual advisor?

**A** We have a managed account committee because they are all done on a discretionary basis. This is very important: we don't take non-discretionary accounts. The managed account committee sets the rules for how the portfolios are to be legally structured. Then our investment committee, which is led by our director of research, Raymond Kerzérho, builds three or four different models – if you are a large client, small client, registered client or non-registered client. At the investment committee, these models are debated regularly and consensus is reached. Then individual portfolio managers, who operate in teams, implement the decision of the investment committee in their client portfolios.

Each portfolio manager does have their own discretion. They are not bound by the investment committee decisions. In practice, we limit the variety of securities that can be used, so, what has happened over the years is that all the portfolio managers' portfolios are almost identical.

Inside the firm, we work in teams and each portfolio manager has his own client base and builds their own teams around that. The firm provides certain tax planning and financial planning resources to those teams so that clients interface with seasoned investment advisors. It's not an investment counsel model where you have asset gatherers and then the guys in the back of the room – the portfolio managers – who never meet clients. All of our portfolio managers constantly meet clients.

**Q** How do you bill for investment management, how do you bill for the retirement and estate planning, how do you bill for tax management? Is it all one fee for those services or do you bill each component separately?

**A** On the investment side, which we are calling in our "triangle model" the institutional side portfolio management – the component right in the middle – that process has got four or five steps that take anywhere from three or four months to bring in a client. We start off with getting to know the clients with questionnaires, and during that process of learning about the client and their tax profile, we also do a retirement projection. We do the projections for the client and all of that work is part of an asset management fee that ranges from 1.85% to 50 basis points, depending on the size of the client and the type of portfolio.

If the client wants to have a more in-depth financial plan, we go through that in our discussions in more detail. In other words, 'tell me what to put in the will, or take a look at my insurance and tell me if I'm over or under-insured.'

If the client is interested in that sort of work, then that's a separate fee; we'll quote on that and it could range from a couple of thousand bucks to over \$5,000 or \$6,000, depending on the complexity of the client. In addition to that, the annual tax returns for the individual and any holding companies they may have, are billed out on an hourly basis. Those resources are inside the firm; they work under a company called PWL Advisors side by side with PWL Capital, which is the portfolio management firm.

**Q** What is the future for a firm like yours? Do you see more people attracted to the fee model? Do you see more people doing this institutional-style investing?

**A** I was looking at an article written for *Investment Executive* by Don MacDonald back in 2003 and I answered the same question and the answer is: Yes!

Intellectually, it only makes sense that this sort of firm grows, because it's clearly in the best interests of the client. The client gets a much better investment experience.

Is the firm growing? Yes, but very slowly and it's taking time to find advisors with the courage to come across. When we get in front of the client, once they get it, they are converts forever. A much greater percentage of [the younger] population get passive investing and the reduced risk involved. But we're convinced. There's no doubt that it is the best way to go. The issue is finding people with the courage to change the legacy gambling system to a system with less risk.