OPINION

Banks must offer more than just their own financial products

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Bank towers on Bay Street in Toronto's financial district, on June 16, 2010.

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We've both been bank executives, finding the work immensely rewarding, with many former colleagues still close friends. But our experiences were different. Andrew first worked in banking as a university student, so he was familiar with how financial institutions worked from the beginning of his career.
Jean, however, joined a bank mid-career, leaving the private practice of law to take an executive role in wealth services in the Prairies. A big surprise awaited her. Although she'd become good at client development in her area of wills and estates, somehow she had missed the memo that banks are, first and foremost, sales organizations with wide portfolios of services and products.

Yet despite this wide range, there is a real issue: limited product choice for personal investing in bank branches.
Most Canadians access their investment advice from bank branches. As a result, millions are offered products exclusively manufactured by the bank, resulting in a much narrower selection of products compared with investors who deal with providers outside the branch system.
Shopping at Loblaws, Canadians choose at the very least from President's Choice and Heinz ketchup, arguably a less-important decision than mutual funds used for retirement plans. Many countries have addressed these conflicts; as an example, Britain implemented ring-fencing rules for banks as a guardrail between product manufacturing and distribution.

When accessing investment advice outside bank branches, there are significant

regulatory requirements relating to the distribution of both in-house and non-proprietary investment products. In order to access investment managers outside the bank branch system, advisers often require a minimum investment balance such as $250,000, an amount well beyond the level of most Canadian households.

This means a Canadian household with less to invest and needing the best array of options to accumulate savings has access to *fewer* products.

Various government initiatives have tried to address the situation. The Ontario government issued a series of recommendations through its 2021 Capital Markets Modernization Taskforce that dealt with proprietary-only product availability in branches, pointing out the need to more clearly disclose the lack of independent advice when buying these products. Additionally, the task force recommended increased access to non-bank investment products in branches.

The Canadian Securities Administrators, the umbrella organization of provincial regulators, implemented Client Focused Reforms in 2021. CFR introduced specific requirements when selling both proprietary and non-proprietary products, pointing out the potential for a material conflict of interest.

The requirement is on the company and adviser to demonstrate that the sale of proprietary products is always in the best interest of the client. This standard is also paramount in the regulations for brokers and advisers regarding “Know Your Client” and “Know Your Product” requirements to ensure significant due diligence on the appropriate nature of a product for a particular client.

Unfortunately, as a result of the CFR implementation, the handful of banks offering non-proprietary products *removed* them from their branches. Rules that were intended to foster broader access to products for branch clients had created the opposite effect. Nevertheless, the banks and Ottawa will continue to parry on this topic: Earlier this month, Ottawa announced it will be reviewing the banks’ decision to stop selling third-party investment funds.

Another positive change in bank branches would be a broader distribution of exchange traded funds. ETFs are investment funds traded publicly in the same way as individual stocks. ETFs hold a collection of securities, providing low-cost diversification. The management expense ratio (MER) for equity mutual funds offered to Canadians in bank branches is around 2 per cent compared with ETF MERs of .10 per cent.

Applying this to an example, if you have $10,000 in a mutual fund with an MER of 2 per cent, you’ll pay $200 in fees compared with the $10 in fees you’d pay in an ETF with an MER of .10 per cent.

If you’re thinking that the active management offered by mutual funds makes up for the difference in fees, this is usually not the case. Last year, the underlying

indices that ETFs replicate *outperformed* Canadian equity active managers 85 per cent of the time and over the past five years, the passive market outperformed active managers 93 per cent of the time. These numbers – published by the S&P – show that ETFs are a practical low-cost alternative to actively managed mutual funds in bank branches.

We have well-run and stable banks in Canada. But we need to have a continued discussion about offering greater choice to Canadians who rely on bank branches for their saving and investment needs.