THE BEHAVIORS AND CHARACTERISTICS OF THE HIGH NET WORTH CLIENT

PRICEMETRIX *INSIGHTS*, MAY 2013

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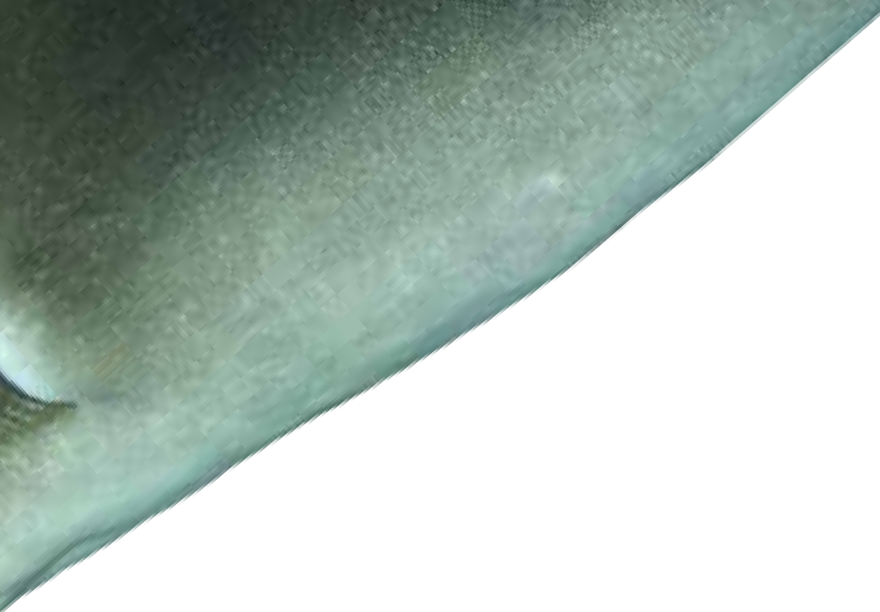


INTRODUCTION

Financial advisors devote considerable effort to attracting and retaining households with substantial assets. There is good reason for this: larger households obviously bolster an advisor's assets under management and, as previous PriceMetrix *Insights* papers have shown, increase an advisor's growth trajectory. For these reasons, talk of catching "big fish" or even landing a "whale" is commonplace in wealth management.

At the same time, discussions of high net worth households contain a certain ambiguity. What, exactly, is a high net worth household? What are their defining characteristics? Which advisors are able to attract them, and in what numbers? In the absence of benchmarks, every advisor, manager and industry analyst is left to their own working definitions. In other words, figurative talk of fish and whales occurs in the absence of data. But the clarity afforded by data is essential to an effective whale hunt, lest one follow the unfortunate example set by Captain Ahab of Moby Dick fame.

This issue of PriceMetrix *Insights* explores a range of topics relating to high net worth households. The paper provides answers to the following questions:

- What counts as "high net worth"?
- What proportion of the market is made up by high net worth households?
- Beyond assets, what are the characteristics of high net worth households?
- What do high net worth households pay their financial advisors?
- What characteristics lead to an advisor getting more than their fair share of high net worth households?

This *Insights* paper is made possible by PriceMetrix aggregated data representing 7 million retail investors, 500 million transactions, and over $3.5 trillion in investment assets. PriceMetrix combines its patented process for collecting and classifying data with proprietary measures of revenue, assets, and households to create the most insightful and granular retail wealth management database available today.

DEFINING HIGH NET WORTH

As previously mentioned, the absence of a broadly accepted definition in the brokerage industry of what constitutes a high net worth household creates confusion. Being unable to say "how high is high" leads to a proliferation of definitions grounded in little more than intuition. With market-wide data on household investable assets held with an advisor, PriceMetrix has been able to analyze this topic. The way to arrive at a data-driven definition is simply a matter of looking at the overall distribution of household assets and paying particular attention to the asset levels near the top of the distribution – for example, the 90th, 95th and 99th percentiles.[1]

This approach yields a number of important findings. First, given what is widely known about the distributions of both wealth and incomes, it will come as no surprise that the distribution of household assets for North American retail investors shows concentration in the upper tier. The majority of households have modest assets and relatively few have sizeable assets (see Fig. 1 and Table 1). To illustrate, a household with $1 million in assets with a financial advisor is at the 87th percentile; a household with $2 million in assets is at the 95th percentile. Other points to note are that the 90th percentile (top decile) for household assets is approximately $1.3 million; the 99th percentile (top percentile) is approximately $6.5 million; and the 99.9 percentile (the top one-tenth of one percent) is $27.8 million. By contrast, the median level of household assets is $210,000.

Fig. 1: Distribution of Household Assets[2]

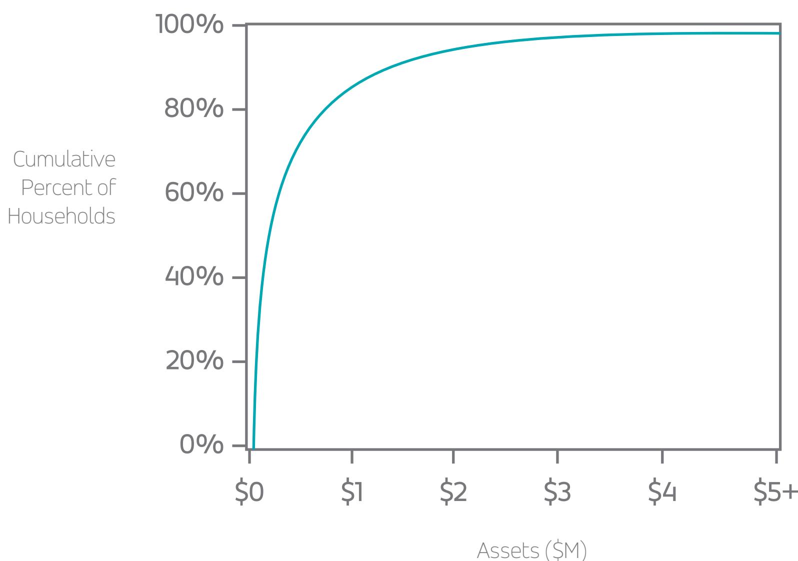


Table 1: Household Assets

Percentile	Household Assets
99.9	$27,800,000
99.5	$10,280,000
99 (top percentile)	$6,470,000
95	$2,165,000
90 (top decile)	$1,280,000
85	$905,000
80 (top quintile)	$685,000
75 (top quartile)	$540,000
50 (median)	$210,000
25 (bottom quartile)	$75,000

[1] Households with less than $10,000 in assets and those with greater than $100 million in assets (approximately 0.6% of households) were excluded on the basis that they are not representative of active full-service retail wealth management clients. All figures reported in this paper are based on this subset of households.

[2] This reflects assets held with one institution.

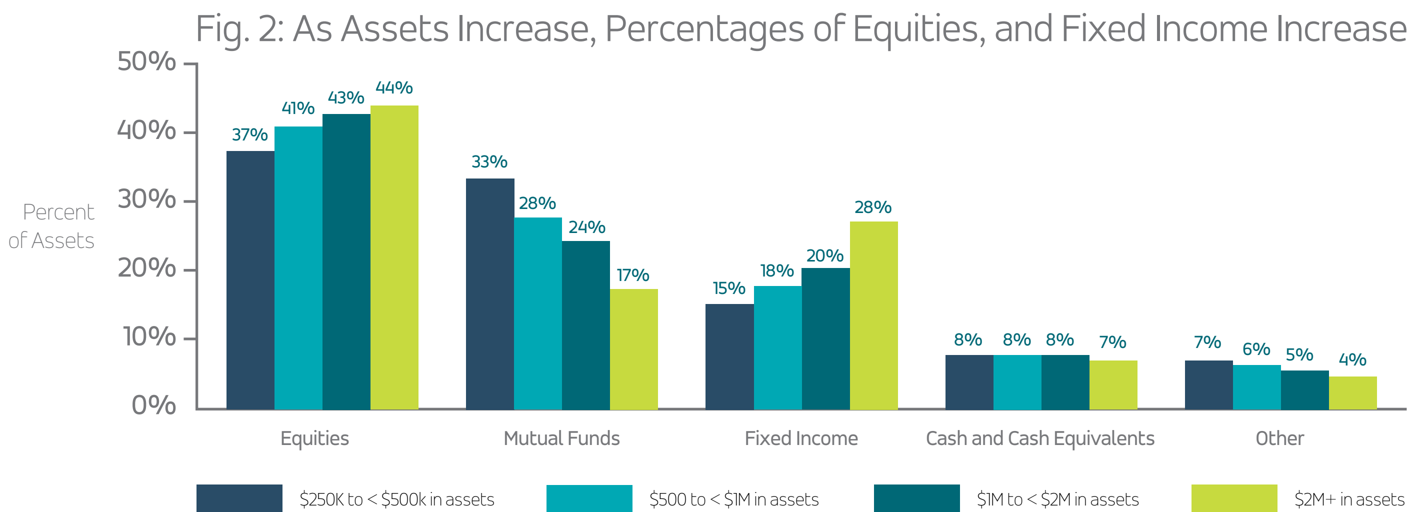
THE CHARACTERISTICS OF HIGH NET WORTH HOUSEHOLDS

For the balance of this study, we take the $2 million mark (near the 95th percentile for household assets) as our operational definition of a high net worth household and seek to describe the characteristics of such households in terms of asset mix, product mix, pricing and assets at inception. In order to assess whether high net worth households are in fact different from other households, we make explicit comparisons to households in other asset tiers.

ASSET MIX, PRODUCT MIX, AND THE HIGH NET WORTH HOUSEHOLD

Looking at asset mix, high net worth households are more likely to be weighted slightly higher in equities, lower in mutual funds, and higher in fixed income compared to households in other asset tiers. They hold a similar proportion in cash (see Fig. 2). To illustrate, a typical household with $2 million or more in assets holds 44% of their invested assets in equities (compared to 37% for a typical household with $250,000 to less than $500,000 in assets), 17% in mutual funds (compared to 33%), 28% in fixed income (compared to 15%), 4% in other assets (compared to 7%), and 7% in cash or cash equivalents (compared to 8%). The overall trend is that households replace mutual funds with discrete securities as they increase in wealth.

Fig. 2: As Assets Increase, Percentages of Equities, and Fixed Income Increase

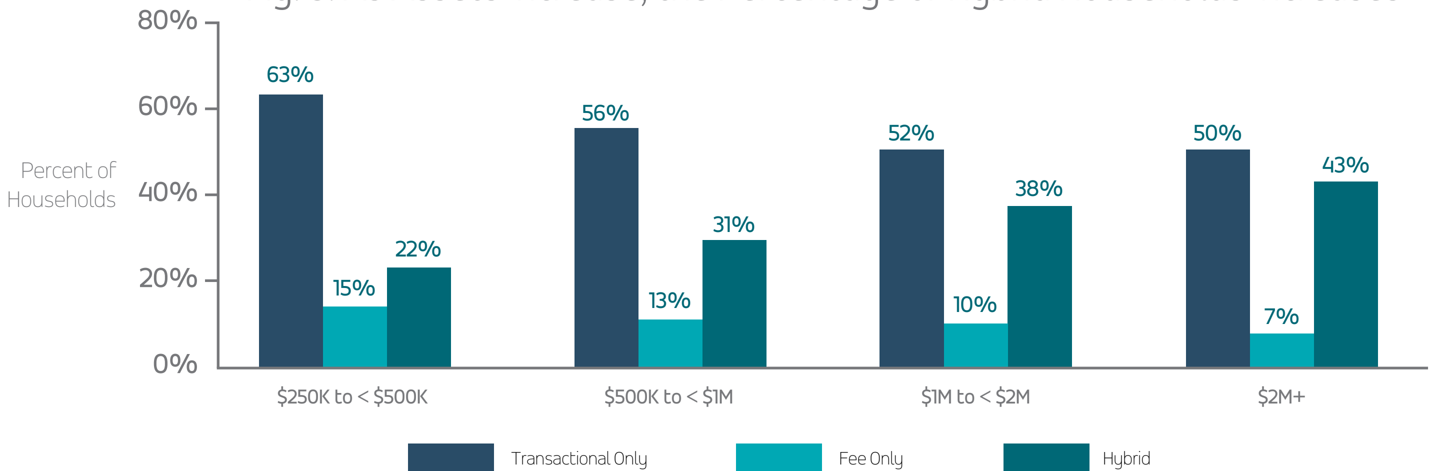


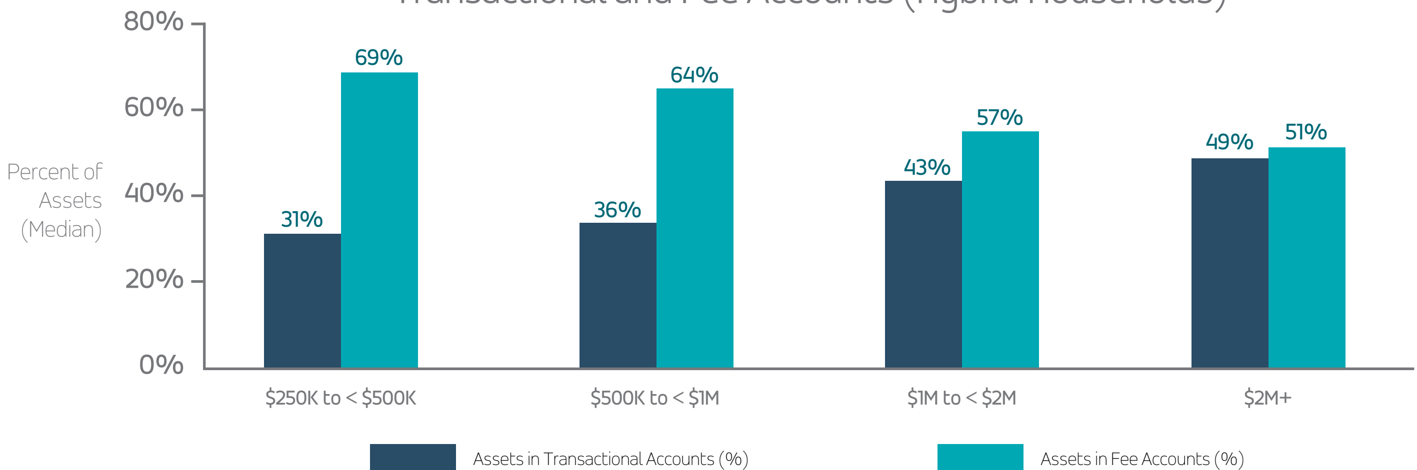
Looking at product mix, high net worth households are not substantially more likely to hold transactional accounts than households at other asset levels: 92% of households with $2 million or more in assets hold transactional accounts compared to 85% of households with $250,000 to less than $500,000 in assets. Nor are high net worth households more likely to hold retirement accounts; they are in fact slightly less likely to do so: 69% of households with $2 million or more in assets hold retirement accounts compared to 75% of households with $250,000 to less than $500,000 in assets. This likely speaks to an increased tendency among high net worth investors to spread their wealth across providers.

High net worth households are, however, more likely to hold fee accounts. While 51% of households with $2 million or more in assets hold fee accounts, only 36% of households with $250,000 to less than $500,000 in assets have fee accounts.

What truly distinguishes high net worth households from households in other asset categories, though, is the breadth of products held. They are more likely to be "hybrid" households, holding both transactional and fee accounts: 43% of households with $2 million or more in assets are hybrid households compared to 22% of households with $250,000 to less than $500,000 in assets (see Fig. 3). This should be unsurprising, given that households with greater assets will have more complex wealth management needs and will require a mix of products to manage them.

Hybrid high net worth households also tend to divide their assets between transactional and fee accounts more evenly than households in other asset tiers, which tend to place greater proportions of their assets in fee accounts. For example, the median hybrid household with $2 million or more in assets has 49% of its assets in transactional accounts and 51% in fee; the median hybrid household with $250,000 to less than $500,000 in assets has 31% of its assets in transactional accounts and 69% in fee (see Fig. 4).



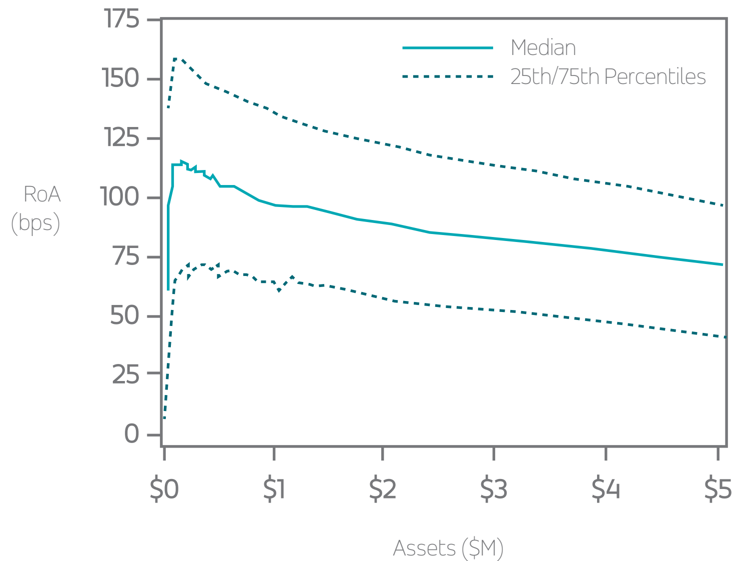


HIGH NET WORTH HOUSEHOLDS AND PRICING

The prevailing view in the wealth management industry is that larger households, while attractive for advisors from an asset perspective, tend to generate lower revenue (in percent terms) on fee-based assets. Though the data bear this out, it is worth noting that the distribution of fee Revenue on Assets (RoA) across different household asset levels displays a distinct curved, increasing-then-decreasing pattern. Fee RoA quickly increases from $50,000 up to approximately $250,000 before gradually declining (see Fig. 5).

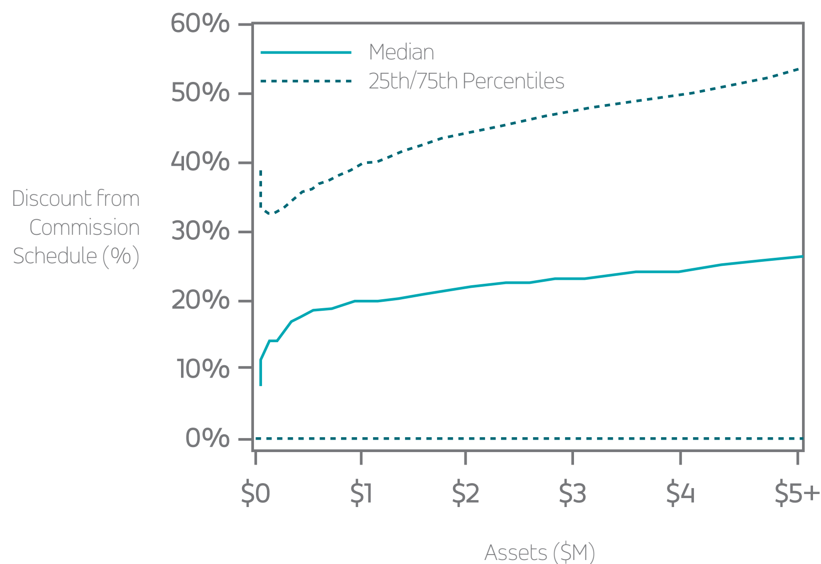
The median fee RoA for a household with $2 million or more in assets is 0.76%. But more importantly, the graph also shows significant variation in fee pricing for high net worth households. The 25th percentile fee RoA for households with $2 million or more in assets is 0.45%; the 75th percentile is 1.06%. The top decile fee RoA for households with $2 million or more in assets is 1.45%. In fact, 29% of high net worth households pay 1% or more in RoA on fee accounts.

Fig. 5: Distribution of Fee RoA across Asset Levels



Looking at pricing for transactional accounts, similar themes emerge. There is a general pattern of increasing discounts on commissions charged (against the scheduled commission) as household assets increase. But compared to revenue on fee-based assets, discounting on transactional accounts exhibits greater variation (see Fig. 6). The median discount for a household with $2 million or more in assets is 25%. The discount for a $2 million-plus household at the 25th percentile is actually full price (zero discount), while the discount at the 75th percentile is 50%. In fact, 27% of households with $2 million or more in assets receive no discount at all; a nearly equal number (26%) get half or more off the scheduled price. Two percent of high net worth households do their trading for free – a 100% discount.

Fig. 6: Distribution of EquityTransactional Discounting across Asset Levels



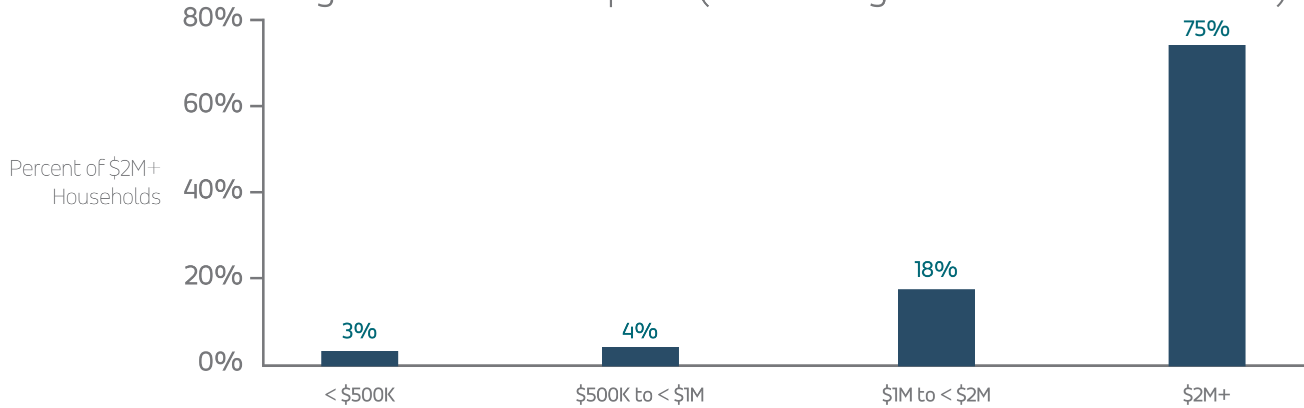
HIGH NET WORTH RELATIONSHIPS AREN'T FARMED – THEY'RE HUNTED

One of the often-cited motivating factors behind advisors acquiring (and keeping) small households in their books is the prospect of these households (or at least a few of them) acquiring significant wealth in the future. Our previous paper on Small Household Metrics established that the probability of a small household growing into a large one was minimal. Our analysis here reconfirms this finding.

We examined the initial asset balance in the relationship for households who currently have $2 million or more in assets; we further limited the set of households to those whose relationships with their current advisors began between one and five years prior to the current period[3]. Examining this subset of high net worth households, we find that a substantial majority (75%) began the relationship already holding $2 million or more in assets. Another 18% began the relationship holding $1 million to less than $2 million or more in assets (see Fig. 7). Only a very small proportion of households began with less than $1 million in assets (7%), and fewer still began with less than $500,000 in assets (3%).

The data therefore point to the need to set aside the belief that relationships with small households, properly cultivated, will mature into relationships with high net worth households. Such occurrences are too uncommon to merit an advisor's attention and resources.

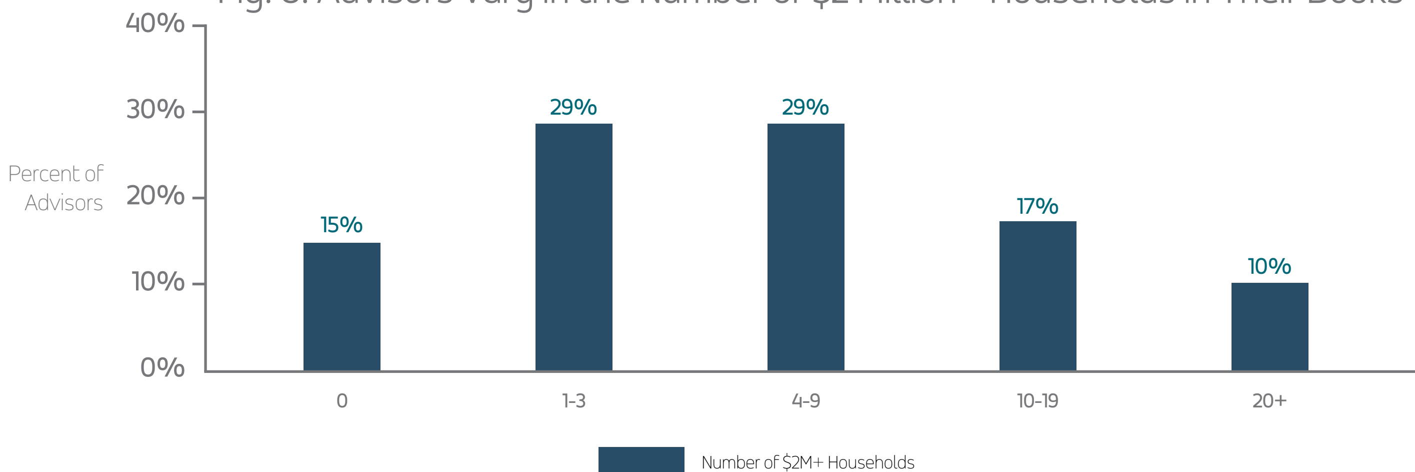
[3] Our measure of initial assets is assets as of the six-month mark of a household's relationship with an advisor. This provides us with a measure of household asset levels near the beginning of a household's relationship with an advisor while allowing for the time required to transfer in assets.



THE DISTRIBUTION OF HIGH NET WORTH HOUSEHOLDS ACROSS ADVISORS

In addition to the question of what counts as "high net worth," another basic (but important) question to answer is how many high net worth households an advisor can reasonably expect to have in his or her book. Put another way, one might ask, "What is my fair share of high net worth households?" Market-wide data provide a ready answer to this question by looking at the overall distribution across advisors of households with $2 million or more in assets.

An examination of the data yields a number of important findings. First, the count of households with $2 million or more in assets across advisors is highly unequal: the majority of advisors have few high net worth households – in absolute and in proportional terms. To illustrate, an advisor with four households with $2 million or more in assets is at the median for all advisors. A top-quartile (75th percentile) advisor has 10 households with $2 million or more in assets while a top-decile (90th percentile) advisor has 20 (see Fig. 8).

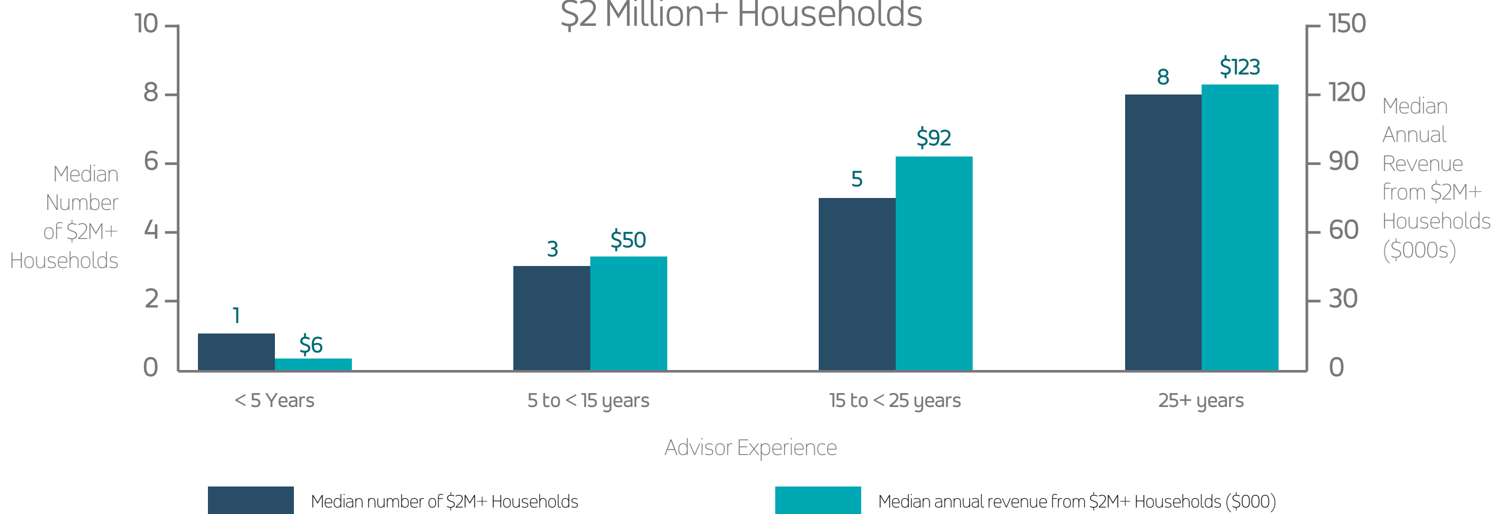


THE CHARACTERISTICS OF ADVISORS WHO HAVE HIGH NET WORTH HOUSEHOLDS

What is clear from the above analysis is that there is substantial variation in the number and proportion of high net worth households in advisors' books. This naturally leads to the question of what distinguishes those advisors who count many high net worth households among their clients from those who have few or none.

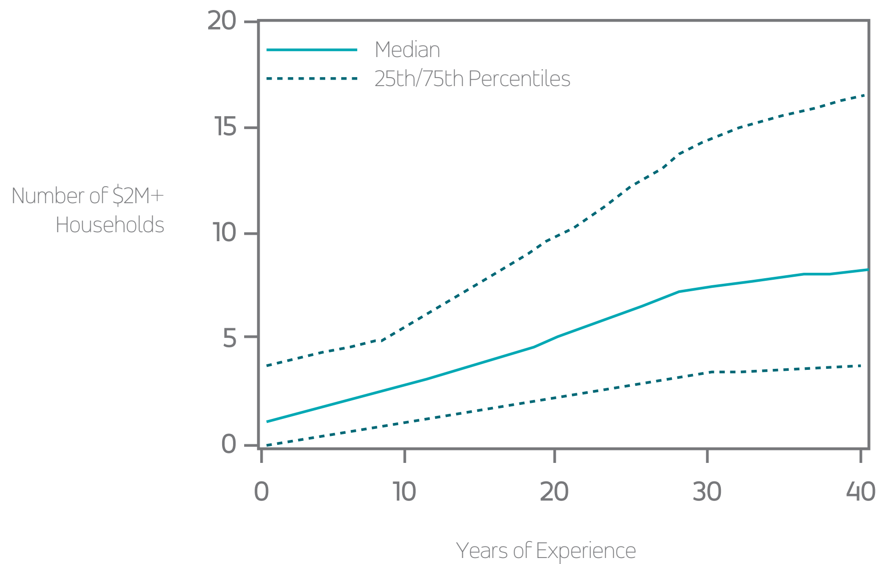
ADVISOR EXPERIENCE

Predictably, advisor experience is positively correlated with both the number of high net worth households in a book and production from high net worth households (see Fig. 9). The typical (median) advisor with less than five years of experience has one household with $2 million or more in assets (accounting for $6,000 in production); the median advisor with 25 years of experience or more has eight households with $2 million or more in assets (accounting for $123,000 in production).



The importance of the relationship between advisor experience and the number of high net worth households in an advisor's book should not, however, be overstated. First, experience is not something that advisors have any control over. Second, there is still considerable variation in the number of high net worth households at all levels of experience. Advisors vary substantially in their rates of high net worth household acquisition, as Fig. 10 shows. To illustrate, an advisor with less than five years of experience at the 25th percentile for the number of households with $2 million or more in assets has none; an advisor at the 75th percentile has four. By contrast, an advisor with 25 years of experience at the 25th percentile for the number of households with $2 million or more in assets has three; an advisor at the 75th percentile has 15. In short, while the number of high net worth households tends to increase over time, not all advisors are on the same acquisition trajectory.

Fig. 10: Advisors Vary in Their Number of $2 Million+ Households



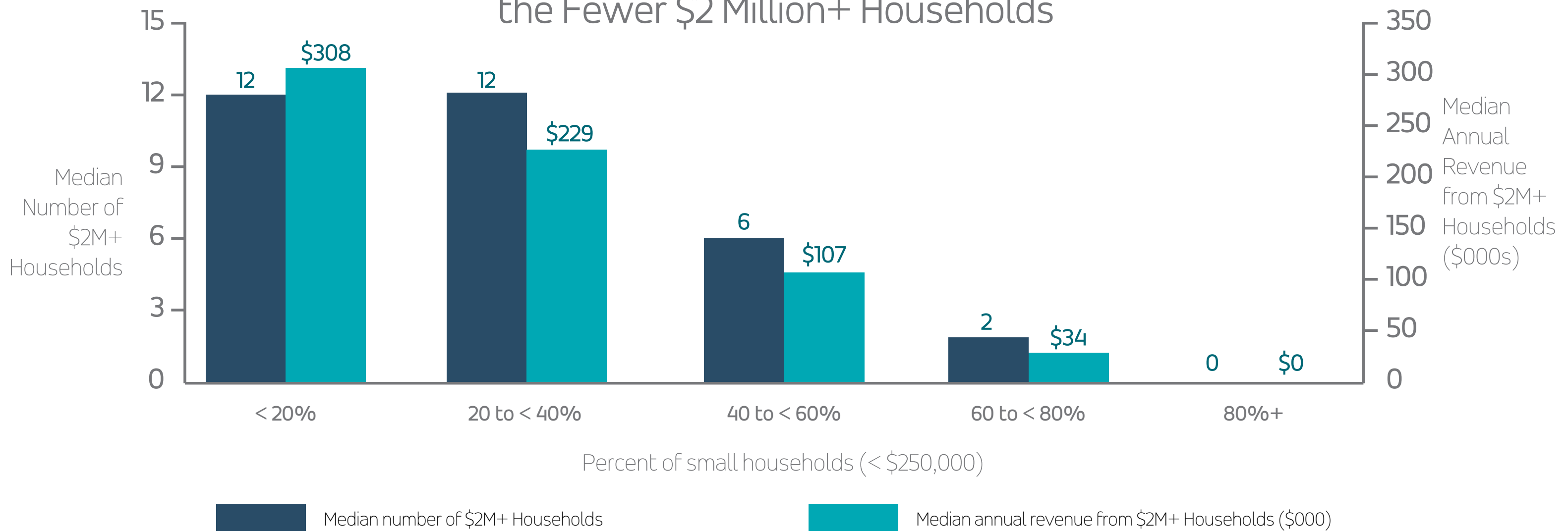
WHALES AND MINNOWS: THEY DON'T MIX

One lever that influences the number of high net worth households in a book and that is readily within the control of advisors is the proportion of small households (those with less than $250,000 in assets). Our analysis revealed that the larger the proportion of small households in a book, the smaller the number of high net worth households. Those advisors who have the highest median number of high net worth households (and further, the most productive relationships with their high net worth households) have the smallest proportion of small households in their books (see Fig. 11).

To illustrate, advisors with less than 20% of their books comprised of small households had a median of 12 households with $2 million or more in assets (accounting for a median of $308,000 in production). Interestingly, advisors with 20% to 39% of their books comprised of small households had an equal number of $2 million-plus households, but their relationships were substantially less productive (accounting for a median of $229,000 in production).

Advisors with 60% to 79% of their books comprised of households with assets less than $250,000 had a median of two households with $2 million or more in assets (accounting for a median of $34,000 in production). Advisors with 80% or more of their book consisting of households with less than $250,000 in assets had a median of zero households with $2 million or more in assets.

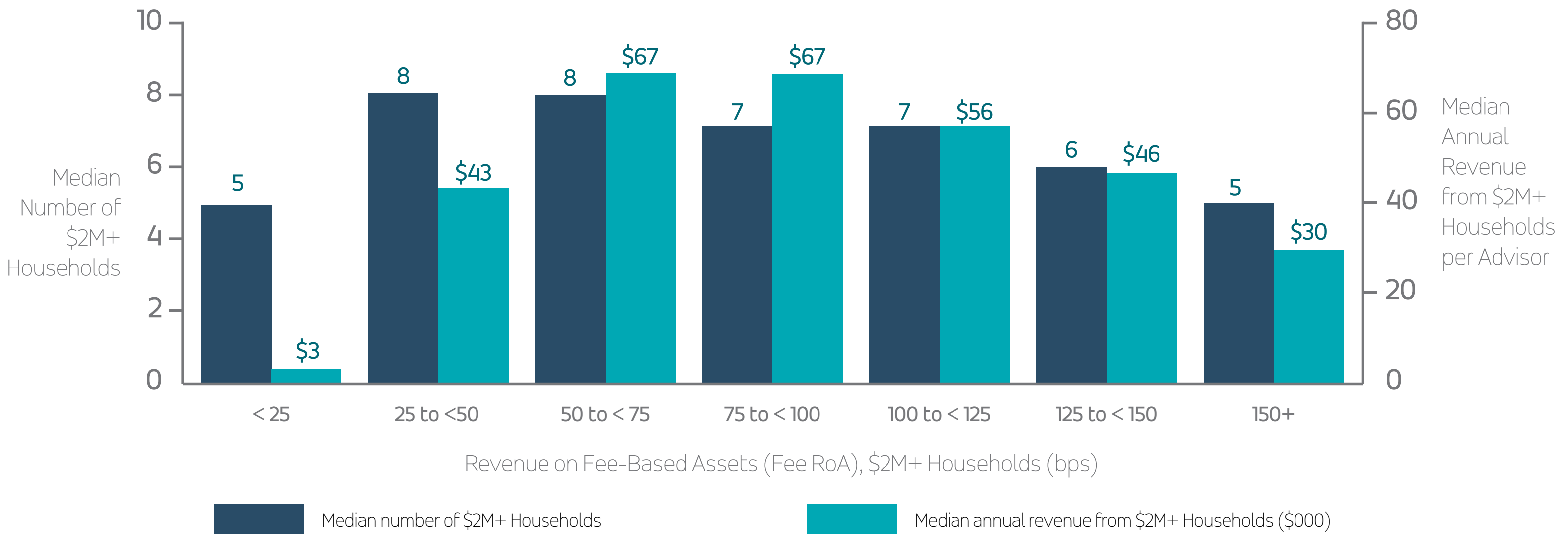
The lesson, then, is that to attract high net worth households, one needs to make room for them. In this respect keeping the percentage of small households in one's book to less than 40% stands out as a key metric: the number of high net worth households and the production derived from them decline significantly above this point.



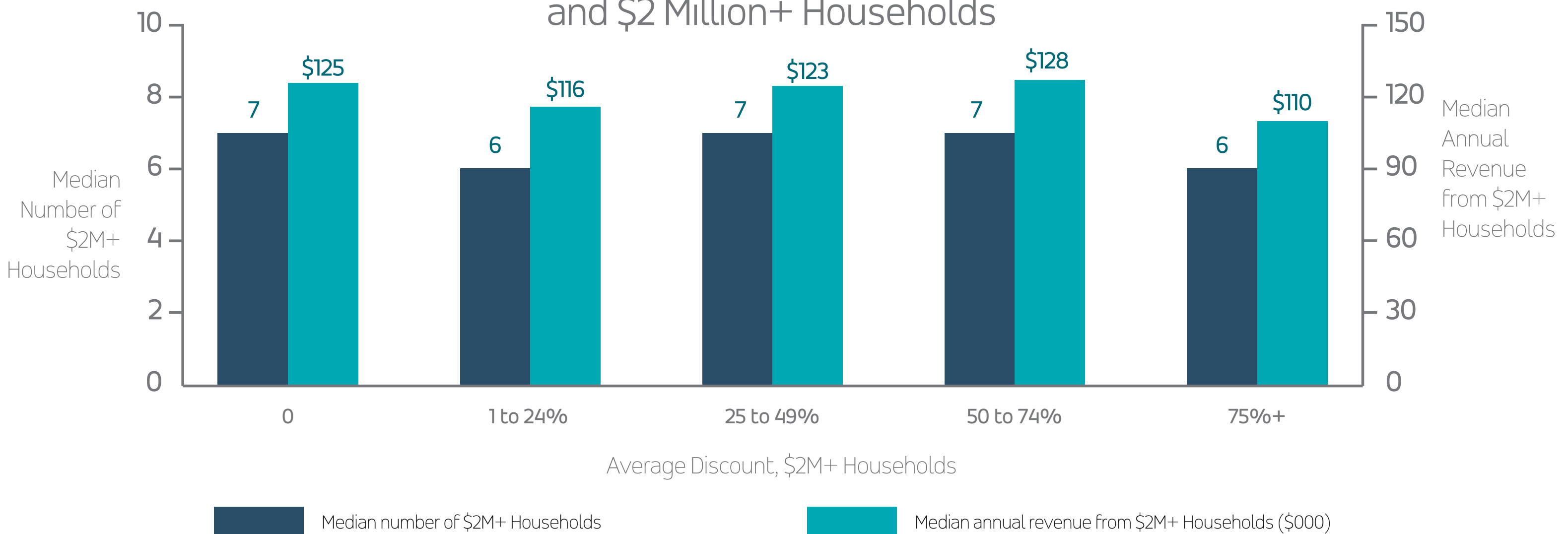
ATTRACTING AND RETAINING HIGH NET WORTH HOUSEHOLDS BY OPTIMIZING PRICE

A commonly-held view in the wealth management industry is that clients – especially high net worth clients – are price sensitive. According to this view, discounting serves to attract new clients and retain existing clients; failing to discount causes clients to leave. Our analysis of market-wide data finds no benefit to competing on price in this way. The data indicate that there is a price range that optimizes the number of high net worth households and the production derived from those relationships, and it is not a severely discounted price. One can price oneself out of consideration by pricing too high; at the same time, discounting too much can erode perceptions of value. The data indicate that both overpricing and underpricing result in less success with high net worth households.

With RoA on fee-based assets, the optimal range for high net worth households is between 0.5% and 0.99%. In this range, the number of high net worth households and the production from those relationships is optimized. To illustrate, the median advisor whose book has an overall fee-based RoA in this range for households with $2 million or more in assets has seven or eight households with $2 million or more in assets and generates $67,000 in fee-based production from those relationships. By pricing below this range (0.25% to 0.49%) or above this range (1% to 1.24%), the median advisor has the same number of households with $2 million or more in assets, but these relationships are substantially less productive (see Fig. 12).



With respect to pricing on transactional accounts, the story is rather different: there is no discernible relationship between the level of discounting (i.e., reducing price from the scheduled price) and the number (and production from) high net worth households (see Fig. 13). Given the absence of a relationship between discounting on transactional accounts and the number of (and production from) high net worth households, there would appear to be no justification for discounting at all, thereby protecting the perception of the value advisors bring to their clients.

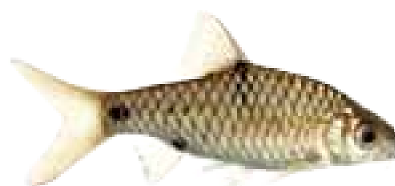


PREPARING FOR THE WHALE HUNT

This study set out to put some parameters around the sometimes vague notions of which clients meet the definition of "high net worth" and better understand the needs, tendencies, and characteristics of these high net worth households.

Our key findings are:

- A high net worth household is best defined as one with $2 million or more invested with a financial advisor; 5% of relationships in the retail wealth management industry meet this definition.
- High net worth households indeed differ from less affluent households in their asset mix (weighted more toward equities and fixed income, less in mutual funds), product mix (more likely to hold both transactional and fee accounts), and distribution of assets between transactional and fee accounts (more likely to be evenly divided between the two).
- Though high net worth households tend to pay a lower RoA on fee-based accounts and receive a greater discount on transactional business, it is important not to lose sight of the fact that pricing varies widely across households. For high net worth clients, the range is 75 basis points.
- Most high net worth clients were high net worth clients when they started working with their financial advisor.
- Advisors vary widely in their ability to attract high net worth households. Some advisors have many; some advisors have few (or none).
- More tenure, and a lower number of small household relationships, increase an advisor's chances of attracting high net worth households.
- Lowering price significantly does not increase an advisor's chances of attracting high net worth households.
- Advisors that do not discount equity transactions attract just as many high net worth households, generate just as much revenue, and average higher revenue per equity ticket than those who discount 50% or greater.



Advisors looking to increase the number of, or breadth of, relationships with high net worth households should keep the following in mind:

- Be aware of high net worth client product needs and tendencies. They will likely be less willing to move all of their assets into a fee based relationship.
- Ensure you have the capacity to serve the more complex needs of high net worth clients by lowering the proportion of small households in your book.
- Seek to become the primary provider for high net worth clients, or deepen the breadth of relationship with them. (For example, ensure you have their retirement accounts).
- Don't lower your price aggressively to attract high net worth clients.
- Build your value proposition, and proactively seek high net worth clients! Minnows likely won't become whales while they are with you.

Firms can capitalize on these opportunities by investing in practice management tools that help advisors and managers identify opportunities, set objectives, take action, and track results.

For assistance with understanding the opportunities your firm, branch, and/or book of business represents, or to provide your feedback on this issue of *Insights*, please contact Patrick Kennedy, Vice President, Product and Client Services at (416) 955-1728 or patrick.kennedy@pricemetrix.com.

The analysis in this edition of *Insights* is made possible by our aggregated market data and is the result of a collaborative effort by Patrick Kennedy, Vice President, Product and Client Services,Tim Gravelle, Principal Scientist and Director, *Insights* Lab, and Corey Schreiber, Client Analyst.

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