4TH ANNUAL REPORT

THE STATE OF RETAIL WEALTH MANAGEMENT

PRICEMETRIX *INSIGHTS* SPECIAL EDITION, MARCH 2014

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INTRODUCTION

By many accounts, 2013 was a successful year for the retail wealth management industry, with many key indicators showing improvements over 2012. Chief among them are increases in average client assets, household revenue, and advisor production. The percentage of assets that are fee-based also continues its multi-year climb.

It would be a mistake, however, to suggest that all indicators are positive, or for the retail wealth management industry to give itself too much credit for the past year's successes. Growth in assets and revenue has been driven mainly by market appreciation, less so the efforts of advisors. Annual client retention rates have decreased. Advisors' rosters of clients are aging faster than the general population. These signs raise questions regarding the sustainability of advisors' books, and appear as the proverbial dark clouds on the horizon.

This *Insights* report highlights several trends, including:

- Continued growth in both advisor assets and advisor revenue – though largely driven by market appreciation
- Steady progress toward a fee-based business model, but continuing pressure on fees
- Increase in equity transactional volume and pricing in 2013 compared to 2012
- Continuation of the trend toward fewer, but larger, clients
- A greater number of high net worth households in advisors' books, again largely due to appreciation in the market
- Lower client retention rates in 2013 than in 2012
- A client base aging faster than the general population

In this edition of *Insights*, we examine multi-year results for key performance metrics in the North American retail wealth management industry. All results are reported as of December 31, 2013. PriceMetrix found no significant differences between the U.S. and Canadian markets, so all results presented in this paper are for the combined North American market.

This *Insights* report 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.

2013 – A YEAR OF CONTINUED GROWTH

The past year continued the trends of positive growth in assets and gross production dating back to 2009. For the overall market, total assets increased by 11 percent between 2012 and 2013, and total revenue increased by 6 percent.

Looking at the typical advisor's performance, average advisor assets grew from $80.8 million in 2012 to $90.2 million in 2013. Annual gross production also grew from $550,000 in 2012 to $578,000 in 2013. These increases appear to be driven by strong growth on North American markets in the past year (a 26 percent increase in the Dow Jones Industrial Average and a 10 percent increase in the S&P TSX 500).

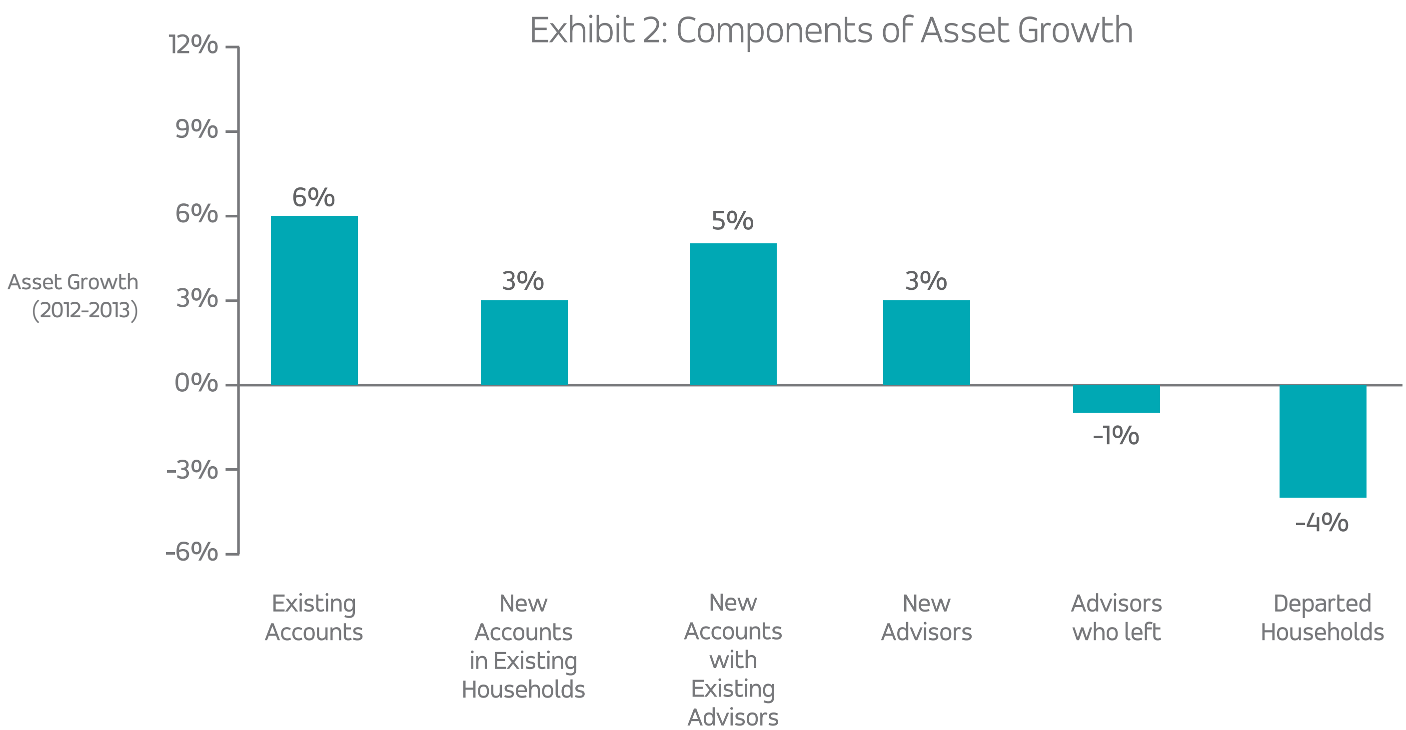
Though advisor assets and revenue have increased, average advisor revenue on assets (RoA, defined as total revenue divided by total assets under management) has decreased slightly from 0.72% to 0.68% over the past two years.

FIGURE 1

	2011	2012	2013	Change 2012–2013
Average Advisor Assets (M)	$74.0	$80.8	$90.2	12%
Average Advisor Revenue (000s)	$537	$550	$578	5%
Average Revenue on Assets (%)	0.72	0.69	0.68	-2%

Parsing out this past year's growth in assets into its constituent parts, we see that growth came primarily from existing accounts (6 percent). Smaller contributions came from advisors expanding their business to new households (5 percent), and also from newly-hired advisors (3 percent).

Households that closed their accounts acted as a damper on overall growth (-5 percent asset growth). These results indicate that the overall growth in assets (driven by market appreciation) masks a critical, underlying problem in the retail wealth management industry: client attrition, and the assets lost as a consequence of attrition. The industry therefore needs to measure and closely manage client attrition – a theme we return to later in this paper.



SUSTAINED PROGRESS TOWARD A FEE-BASED MODEL, CONTINUED DOWNWARD PRESSURE ON PRICING

Last year's State of Retail Wealth Management report and the PriceMetrix *Insights* paper Transitioning to Fee highlighted the growing prevalence of the fee-based model in the retail wealth management industry. Data from 2013 point to a continuation of this trend, with the proportion of fee-based assets, the proportion of fee-based revenue and the number of fee accounts per advisor all continuing a steady increase. From 2012 to 2013, fee-based assets increased from 28% to 31%, and fee-based revenue increased from 45% to 47%. The average number of fee accounts per advisor also increased from 92 to 101.

The industry-wide transition to a fee-based model has happened at the same time as the downward trend in pricing for fee-based accounts continues. Average fee account RoA decreased from 1.14% in 2011 to 1.06% in 2012, and decreased further to 0.99% in 2013. Looking at new fee accounts, average RoA decreased from 1.21% in 2011 to 1.04% in 2012, decreasing slightly to 1.02% in 2013. These trends are in part explained by the increase in average fee account assets (up from $258,000 in 2012 to $293,000 in 2013) and the lower RoA that larger households tend to generate.

FIGURE 3

	2011	2012	2013	Change 2012-2013
Fee-Based Assets (% of Total Assets)	26%	28%	31%	11%
Fee-Based Revenue (% of Total Revenue)	43%	45%	47%	5%
Fee Accounts per Advisor	85	92	101	10%

FIGURE 4

	2011	2012	2013	Change 2012-2013
Average Fee Account Assets ($000s)	$240	$258	$293	14%
Average Fee Account RoA (%)	1.14%	1.06%	0.99%	-7%
Average New Fee Account RoA (%)	1.21%	1.04%	1.02%	-2%

REBOUND IN TRANSACTIONAL VOLUME, AND A SLIGHT INCREASE IN PRICING

While declining equity trade volumes were a key theme of 2012, the past year saw a modest rebound. Equity trades per advisor, average trade size and average ticket size all increased between 2012 and 2013. Transactional pricing also increased.

From 2012 to 2013, average trade size increased from $22,240 to $22,730, and average ticket size increased from $242 to $254. Similarly, the number of equity trades per advisor increased from 346 to 357. The ratio of ticket price to principal traded also increased from 1.09% to 1.12%.

FIGURE 5

	2011	2012	2013	Change 2012-2013
Commissionable Equity Trades per Advisor	386	346	357	3%
Average Trade Size	$23,150	$22,240	$22,730	2%
Average Ticket Size	$248	$242	$254	5%
Price to Principal Ratio	1.07%	1.09%	1.12%	2%

FEWER CLIENTS, LARGER CLIENTS

While advisors continue to increase their assets and revenue, they have not done so by expanding their client base. Rather, advisors are becoming more selective, choosing to serve fewer and (on average) larger clients. The data also indicate that advisors have been steadily moving small households (those with less than $100,000 in investable assets) out of their books.

The average number of clients in an advisor's book decreased from 159 in 2012 to 156 in 2013, while the average household assets increased from $490,000 to $562,000 over the same time period. Average household revenue has followed the same trend as household assets. In 2012, average household revenue was $3,300, increasing to $3,670 in 2013.

FIGURE 6

	2011	2012	2013	Change 2012-2013
Average Households per Advisor	165	159	156	-2%
Average Household Assets (000s)	$435	$490	$562	15%
Households with < $100,000 Assets (%)	44%	39%	35%	-11%
Average Household Revenue	$3,175	$3,300	$3,670	11%

LOWER RATES OF CLIENT RETENTION

The dynamics of client retention and attrition are the topic of a recent PriceMetrix *Insights* paper titled Stay or Stray. Here, we present aggregate levels of client retention for the past three years. These results indicate that advisors lose roughly one in ten clients every year. Further, the results for 2013 point to a moderate decrease in overall client retention across the industry compared to the previous year: the annual retention rate decreased from 92% in 2012 to 90% in 2013.

The most likely explanations for this finding are the lower likelihood of retention among smaller households (documented in Stay or Stray) and initiatives by advisors to move smaller households out of their books. It is important to note that retention rates decreased for all tiers of clients. In fact, the largest decrease in annual retention rates occurred among households with $1 million or more in investable assets, decreasing from 96 percent in 2012 to 93 percent in 2013.

It is also important to note that retention rates have decreased just as markets have risen. Good returns – such as those experienced in the last year – therefore do not equate to a lower risk of client attrition.

FIGURE 7	2011	2012	2013	Change 2012-2013
Client Retention Rate (Annual %)	91%	92%	90%	-2%
< $250,000 in Assets	86%	87%	85%	-2%
$250,000 to <$1M in Assets	94%	94%	92%	-2%
$1M+ in Assets	95%	96%	93%	-3%

AN AGING CLIENT BASE

Looking at the age composition of clients reveals a market that is getting steadily older. The average age among retail clients is increasing at a rate of roughly 6 to 7 months per year. While census statistics confirm that the American and Canadian populations are indeed aging, these demographic trends represent only slow increases in any given year. The most plausible explanation remains that advisors are increasingly focusing their efforts on older clients, who typically have more investable assets. It also reflects the fact that advisors are not replenishing their books with younger investors.

FIGURE 8	2011	2012	2013	Change 2012-2013
Average Client Age (Years)	60.0	60.5	61.1	1%

GROWING NUMBER OF HIGH NET WORTH HOUSEHOLDS, BUT FEWER BEING ATTRACTED

A recent PriceMetrix *Insights* paper provided a detailed examination of high net worth households – or Big Fish. Here, we use the same definition of "high net worth" – $2 million or more in investable assets (roughly the 95th percentile) – employed in that report. We find that that the number of high net worth households in advisors' books has increased steadily over the past three years. In 2012, the average advisor had 6.5 high net worth households in his or her book, increasing to 7.7 in 2013.

The number of households with $2 million or more in investable assets tracks the rate of market appreciation, suggesting that it is market appreciation that is driving the number of high net worth households, rather than advisors' success in attracting them. The decrease in the number of new households with $2 million or more in assets between 2012 and 2013 supports the interpretation that advisors are attracting fewer "big fish" than in the past.

FIGURE 9

	2011	2012	2013	Change 2012-2013
$2MM+ Households in Book	5.7	6.5	7.7	19%
New $2MM+ Households	1.0	1.0	0.9	-10%

A SUCCESSFUL YEAR, BUT WARNING SIGNS AHEAD

The surface-level story for the retail wealth management industry in 2013 is a positive one, with the continuation of a number of trends observed in previous PriceMetrix State of Retail Wealth Management reports. Underwritten by strong market appreciation, advisor assets and revenue continue to increase. Advisors also continue to focus their business on a smaller, select group of clients. Fee-based business – as a proportion of assets and a proportion of revenue – also continues its multi-year upward trend.

Underlying these trends, however, are signs that are cause for concern. Fee-based account pricing continues its downward trend. Annual client retention decreased between 2012 and 2013 for clients of all sizes, including high net worth households. Modest success in attracting new big clients and an aging client base represent challenges to the sustainability of advisors' books.

Advisors and firms therefore have much to consider with respect to these trends. A key challenge remains how to create, articulate, and deliver a value proposition that helps to attract and keep desirable wealth management clients. Another challenge is how to respond to downward pressure on fees. Yet another is how to create a sustainable book that is not overly reliant on a constant set of aging clients. Related to this is how to connect with the next generation of clients, whether the successors of existing clients, or new clients.

To be sure, some advisors have met these challenges and are thriving. For example, among the top quartile of advisors for growth in fee and managed assets, the average growth on this metric was 86 percent. Top-quartile advisors on new households with $2 million or more in assets attracted an average of 4.5 high net worth households. Top-quartile advisors on client retention also retained fully 99.4 percent of their clients over 2013.

This upper tier of advisors exceeded the simple advisor-level average on each metric by a wide margin. They have, in effect, forged ahead of the market rather than allow themselves to be carried by the tide. The challenge in front of firms is to replicate the success of these outperformers across their cadre of advisors.

FIGURE 10

	Average, Top-Quartile Advisors	Average, All Advisors
Fee and Managed Assets (% Growth, 2012-2013)	86%	32%
New $2MM+ Households (2013)	4.5	0.9
Client Retention (2013 Annual %)	99.4%	92.5%

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 Shaun Wilkes, Client Analyst.

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