TRANSITIONING TO FEE

Don't **switch tracks** without **knowing the facts.**

PRICEMETRIX *INSIGHTS* VOLUME 6, AUGUST 2012

PriceMetrix®
REALIZE YOUR VALUE

INTRODUCTION

One of the most important trends in the retail brokerage industry over the past decade has been a shift away from traditional, commission-based business toward arrangements where clients pay an advisory fee based on the value of the holdings in the account. In the past three years alone, the percentage of industry assets in fee-based accounts has grown from 21% to 28%.

While many investment firms have encouraged advisors to transition their accounts and households to a fee-based model, advisors tend to lack guidance as to what the best approach is in making the transition, and what the financial impact might be.

In this edition of PriceMetrix *Insights* we show that:

- There are few 'purely fee' or 'purely transactional' advisors - almost all books contain both;
- Increasingly, individual clients are choosing to hold both kinds of accounts;
- An increase in fee asset concentration of an advisor's book leads to an increase in the overall return on assets;
- The pace at which advisors choose to transition their books to fee varies widely;
- The pace at which advisors choose to transition has a meaningful impact on results, not only in terms of asset and revenue growth, but also in terms of the quality of the overall book.

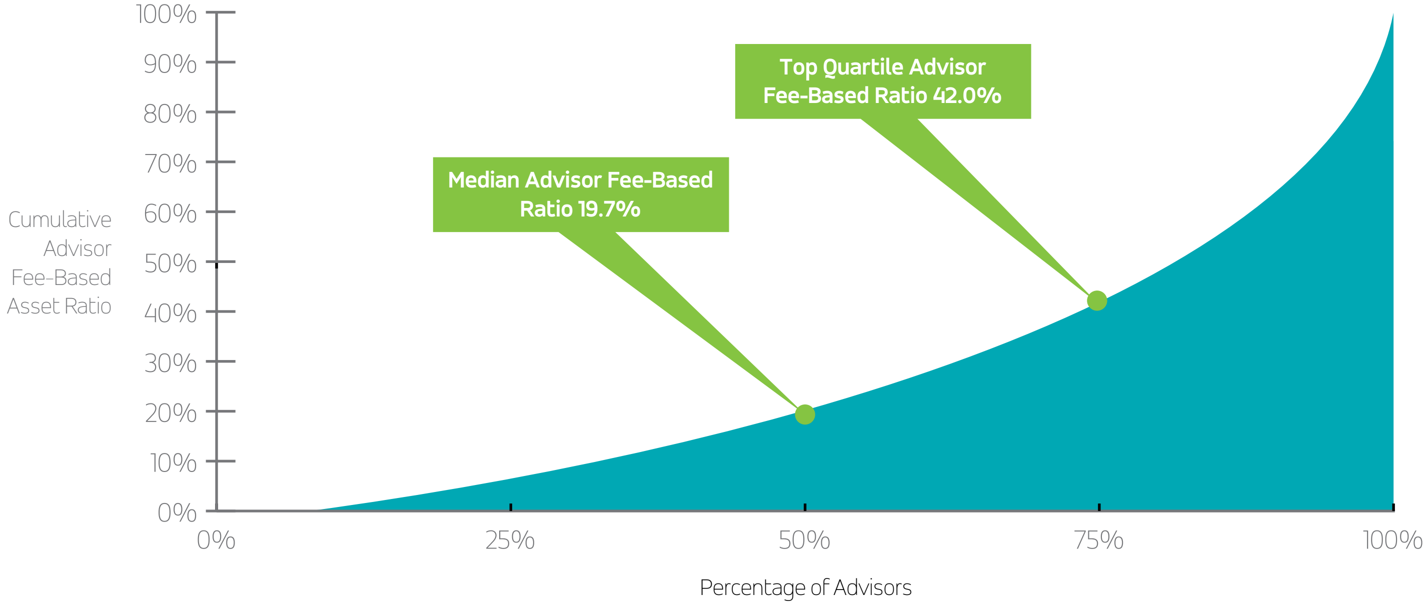
This report is made possible by PriceMetrix aggregated retail brokerage data representing 3.2 million investors, 500 million transactions, 1 million fee-based accounts, 4 million transactional accounts, and over $900 billion in investment assets. PriceMetrix combines its patented process for collecting and classifying data with proprietary measures of revenue, assets, and households to create the most insightful and granular retail wealth management database available today.

All results are reported as of May 2012. PriceMetrix found no significant difference between the U.S. and Canadian markets, so all results presented in this paper are for the combined North American market.

FULL STEAM AHEAD FOR FEE

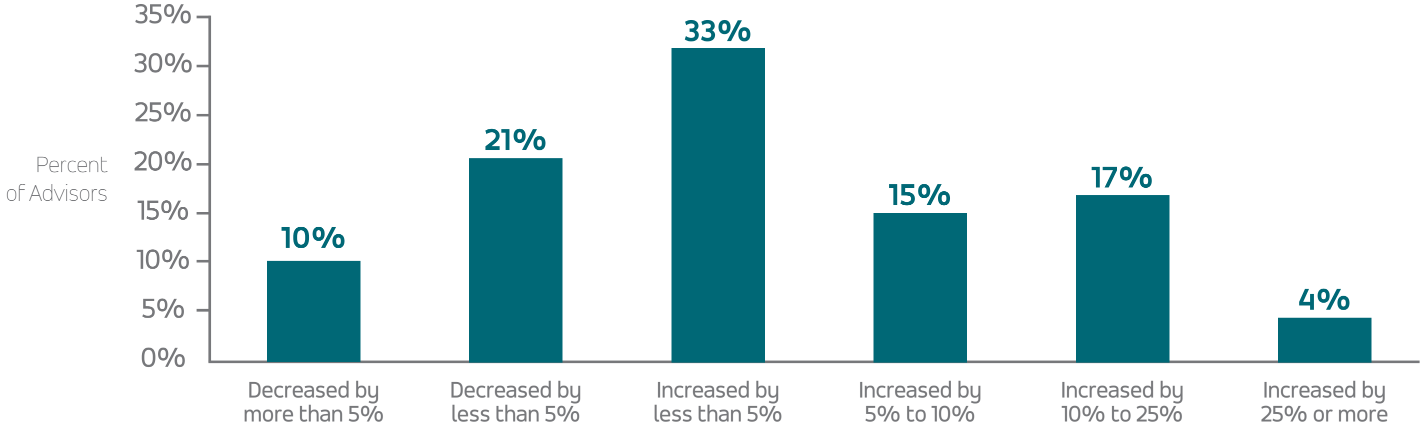
The proliferation of fee accounts is hard to ignore: 91% of advisors in the North American retail wealth management industry have at least one fee account in their book of business. While fee-based accounts are increasingly a part of everyday life, few advisors have completely abandoned the transactional model - in fact only 1% of advisors have 90% or more of their assets in fee accounts. Although advisors often think of themselves as having a 'fee-based' or 'transactional' book, the truth is, most have (at least a little of) both. That said, the trend towards higher concentrations of fee-based assets shows little sign of abating - and as the market for fee-based products matures, both clients and firms are demanding that advisors offer a breadth of products and services to satisfy a wide variety of client objectives.

Figure 1 – Distribution of Advisors by Fee-Based Asset Ratio



Over the past three years, more than two-thirds of advisors have increased their total concentration in fee-based products with 35% of advisors raising it by 5 percentage points or more (see Figure 2). Surprisingly, 10% of advisors have reduced their percentage of fee-based assets by a material amount. Much of the increase in fee-based assets has come from adding new relationships, with two thirds of new fee-based accounts opened in new client-advisor relationships. The remaining one-third of new fee-based accounts are opened in existing households, of which 90% have transactional accounts.

Figure 2 – Distribution of Advisors by Percentage Change in Fee-Based Asset Ratio 2009-2012



ADDING FEE ASSETS INCREASES REVENUE

Advisors who increased their assets in fee-based accounts by 25 percentage points or more have seen revenue growth of 47% over 3 years, more than double the average growth rate of 21%. That is compared to a revenue growth of 19% for advisors who increased their assets in fee-based accounts by less than 5 percentage points in the same period (see Figure 3).

Figure 3 – Three-Year Revenue Growth by Advisor Fee-Based Asset Ratio Growth 2009-2012

	Increased by less than 5%	Increased by 5% to 10%	Increased by 10% to 25%	Increased by 25% or more
3-Year Revenue Growth	19%	25%	31%	47%

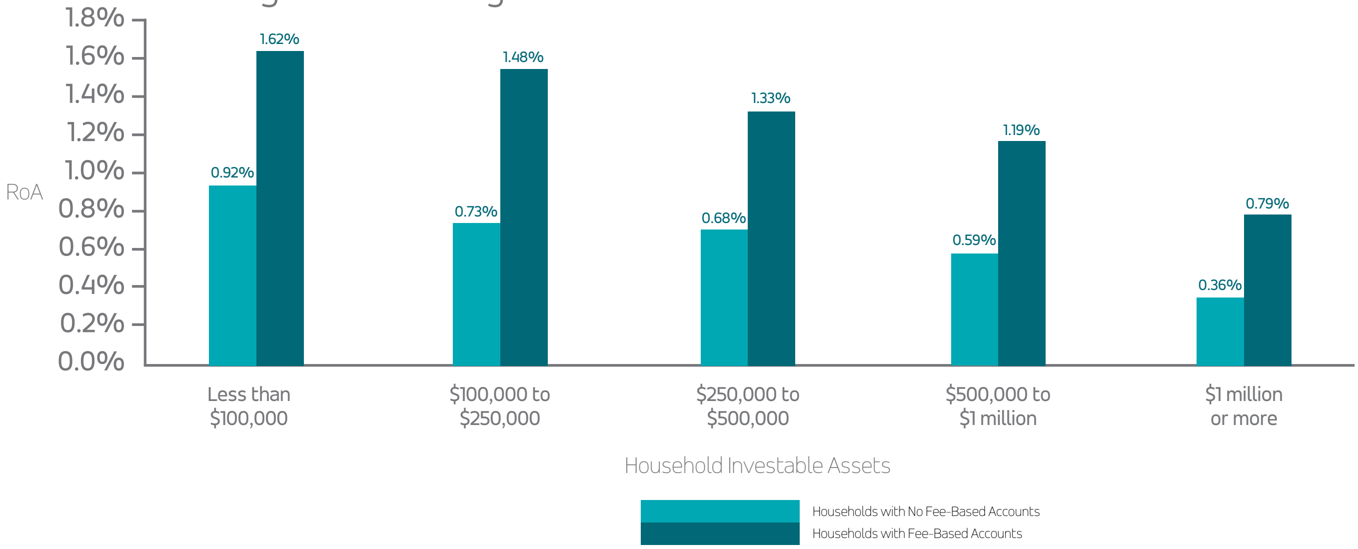
Investors appear to be willing to pay a premium for fee programs. One of the reasons the fee-based model tends to command a higher revenue on assets (RoA) is because it forces the advisor to define and clarify the value proposition that will be delivered[1]. The average fee-based account is 46% larger than the average transactional account and generates revenue that is more than three times higher (see Figure 4). Households that have one or more fee accounts generate an RoA that is 40-70 basis points higher, regardless of household size, than households that are purely transactional, across all household sizes examined (see Figure 5).

[1] Source: Kenneth Haman, The Advisor Institute

Figure 4 – Average Account Size and RoA for Fee and Traditional Accounts 2009-2012

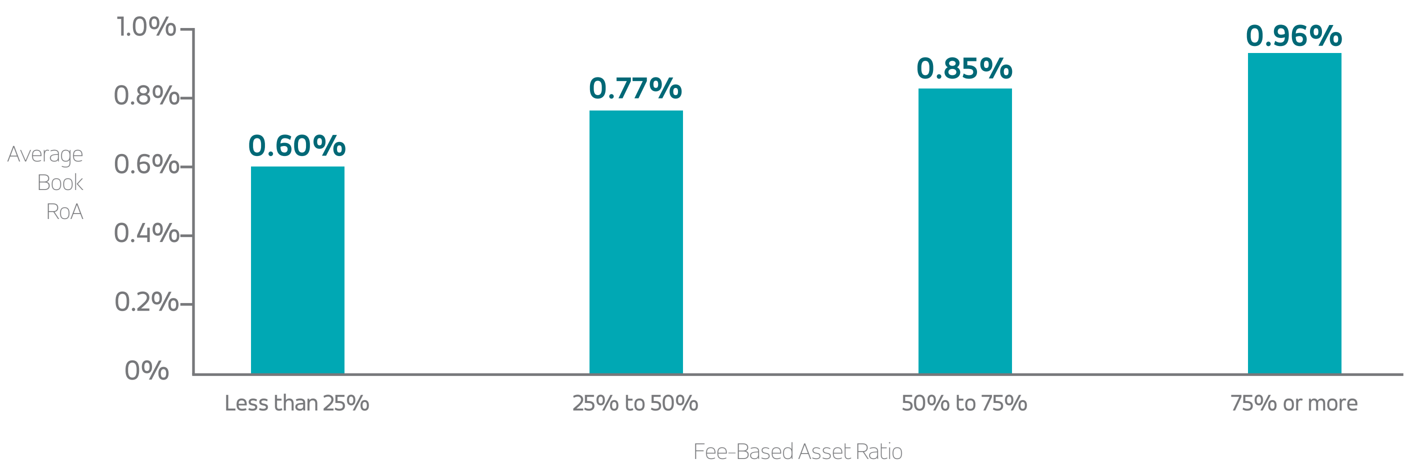
	Fee Accounts	Transactional Accounts
Average Account RoA	1.18%	0.54%
Average Account Assets	$256,400	$175,200
Average Account Revenue	$2,900	$870

Figure 5 – RoA by Household Size and Fee-Based Penetration 2012



It comes as no surprise that advisors with a higher concentration of fee assets in a book have a higher overall book RoA (see Figure 6).

Figure 6 – Return on Assets by Advisor Fee-Based Asset Ratio 2012



HYBRID HOUSEHOLDS

Increasingly, clients are choosing to hold both fee-based accounts and transactional accounts. The percentage of these "hybrid" households has grown 41% in three years (see Figure 7). Hybrid households (households with at least one fee-based account and one transactional account) have a higher RoA than households with no fee-based accounts and significantly greater average assets and revenues than single product households (see Figure 8).

Figure 7 – Percentage of Households that are Hybrid (at least one fee-based account and one transactional account) 2009 - 2012

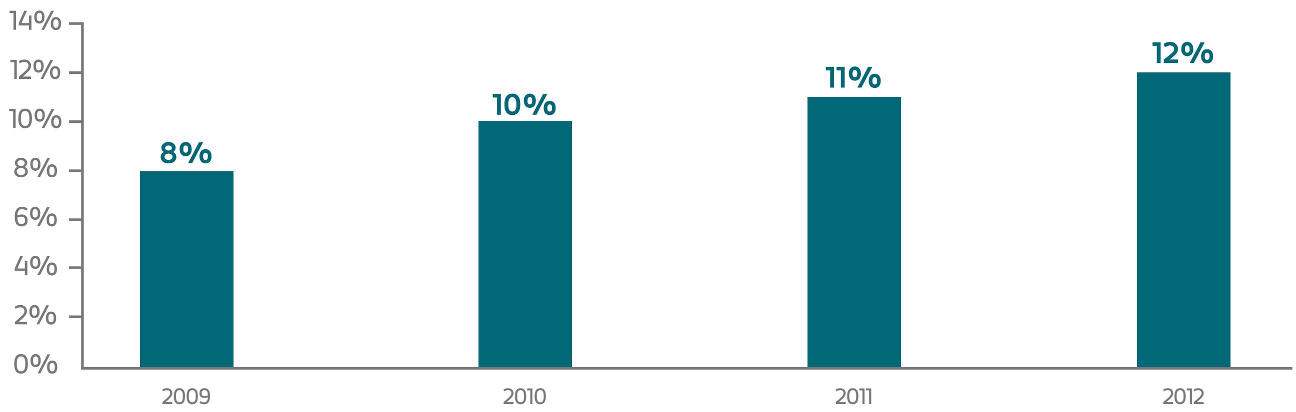
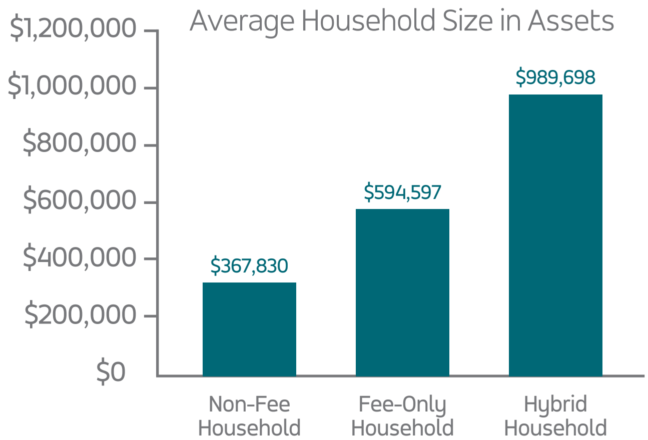
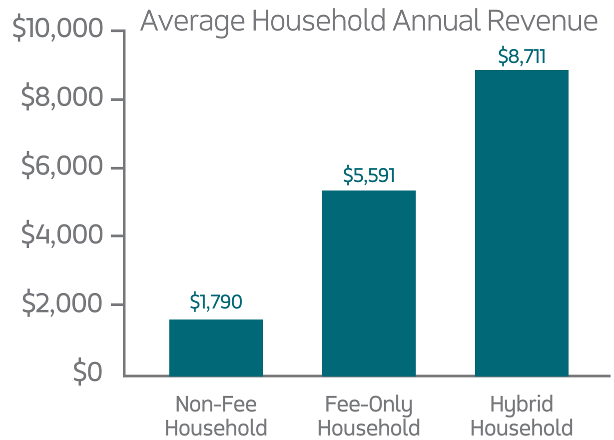


Figure 8 – Average Household Size and Annual Revenue for Hybrid & Non-Hybrid Households 2012

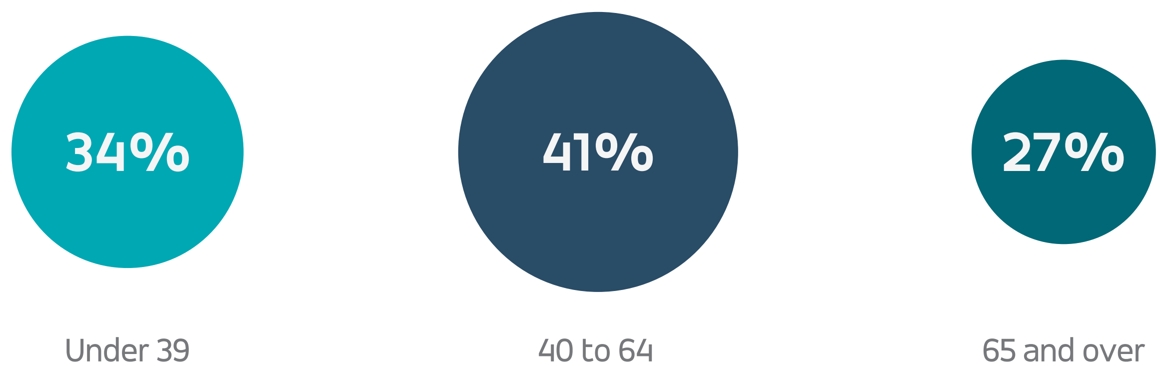




AGE MATTERS: FOR INVESTORS AND ADVISORS

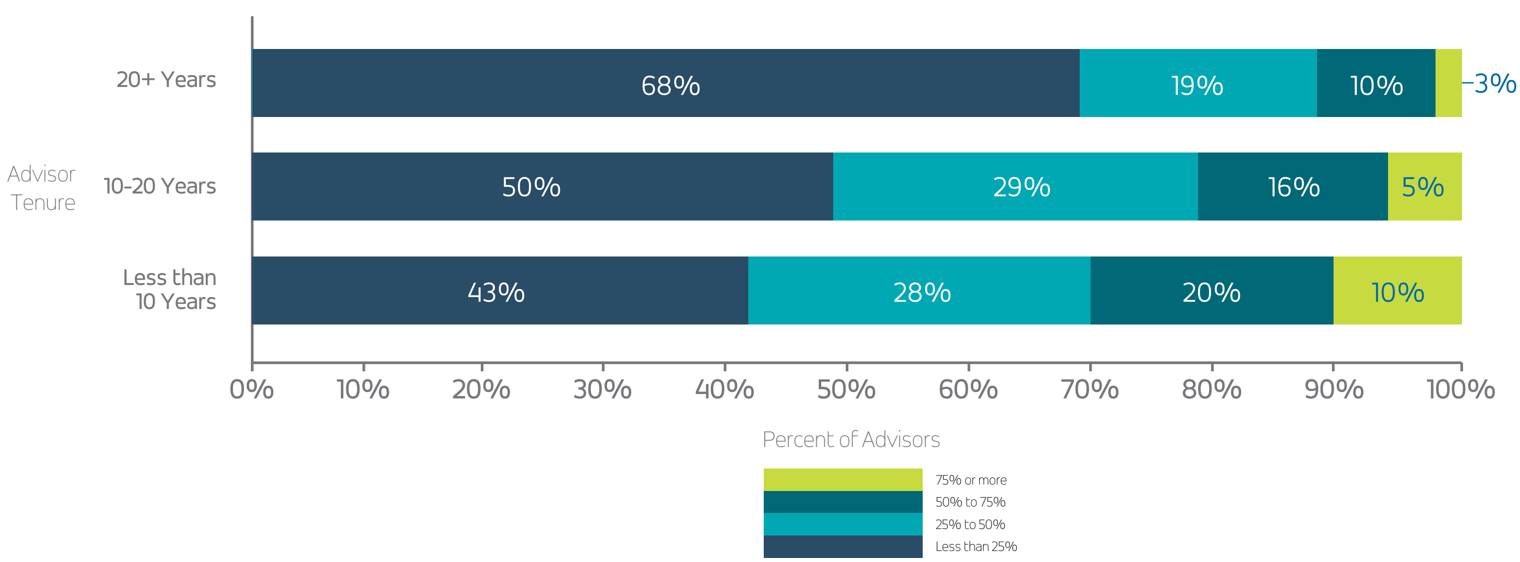
The fee-based financial relationship has historically held the most appeal for investors between 40 and 64 years of age. It appears as though investors over the age of 65 have been hesitant to convert to the new style of business, while many younger investors lack the asset base required to access the many benefits offered by fee-based platforms. Even when we restrict the universe of investors to those with between $250,000 and $500,000 in assets, we find only 34% of younger (less than 40 years old) households have fee-based accounts compared to 41% in the 40-64 age category.

Figure 9 – Percentage of Households, with $250,000 to $500,000 in Assets, with Fee-Based Accounts by Household Age 2012



Looking at the demographics of advisors reveals that less experienced advisors have been much more eager to adopt a heavily fee-based business style. A majority of advisors that have been in the industry for a decade or less have books with 25% or more of their assets in fee-based products, and, two-thirds of advisors licensed for 20 years or more maintain books with less than 25% in fee assets.

Figure 10 – Distribution of Advisors by Fee-Based Asset Ratio and Length of Service



ADVISORS WHO MADE THE CHANGE

Clearly, there is a broad industry trend toward a fee-based model with average assets in fee products growing from 21% of industry assets to 28% over 3 years. Behind the averages, however, you see advisors transitioning at different rates. To better understand the impact that this can have, we analyzed 3 groups of advisors:

- Group 1: Advisors who increased their fee-based ratio by 25 percentage points or more over 3 years;
- Group 2: Advisors who increased their fee-based ratio by 10-25 percentage points over 3 years; and
- Group 3: Advisors who increased their fee-based ratio by less than 10 percentage points over 3 years

The results are striking. Advisors who made a concentrated effort to transition their book to fee-based business saw above average growth across key metrics. They improved the quality of their households, the return on their assets under management, and transformed their revenue stream to be more than two-thirds recurring.

In the three year period between 2009 and 2012, advisors who increased their Fee-Based Ratio by 25 percentage points or more grew overall assets to an average of $130 million per advisor – a 49% increase (see Figure 11). Their overall revenue grew by 47%, compared to growth of 31% and 21% for Groups 2 and 3 respectively (see Figure 12).

Figure 11 – Asset Growth 2009-2012

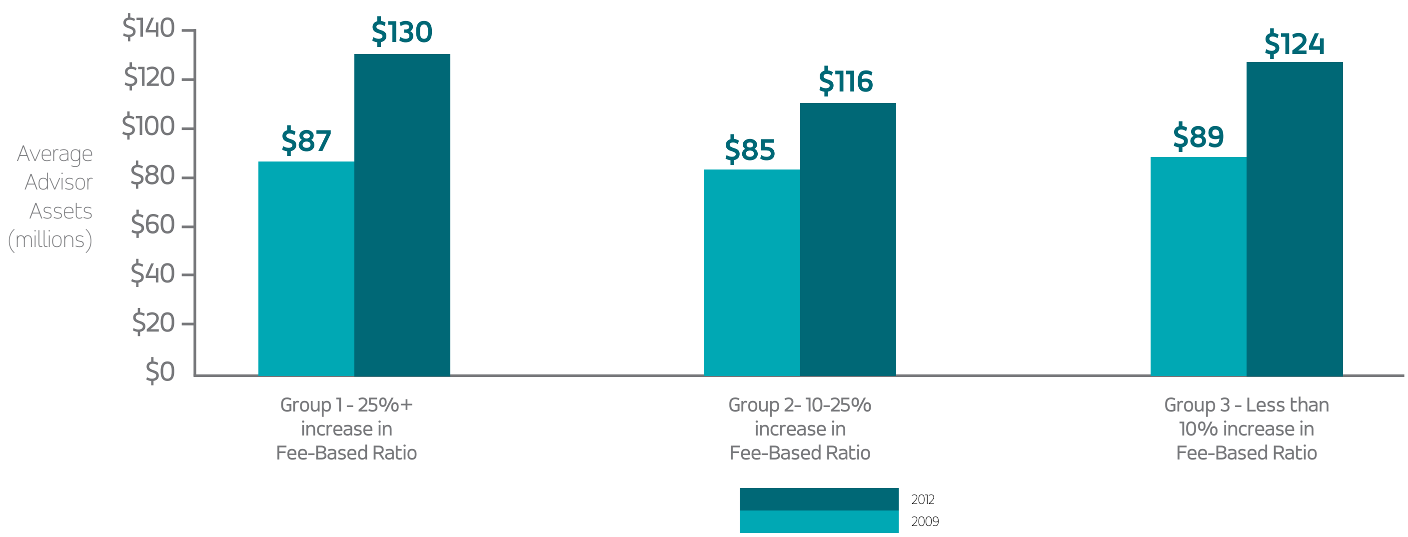
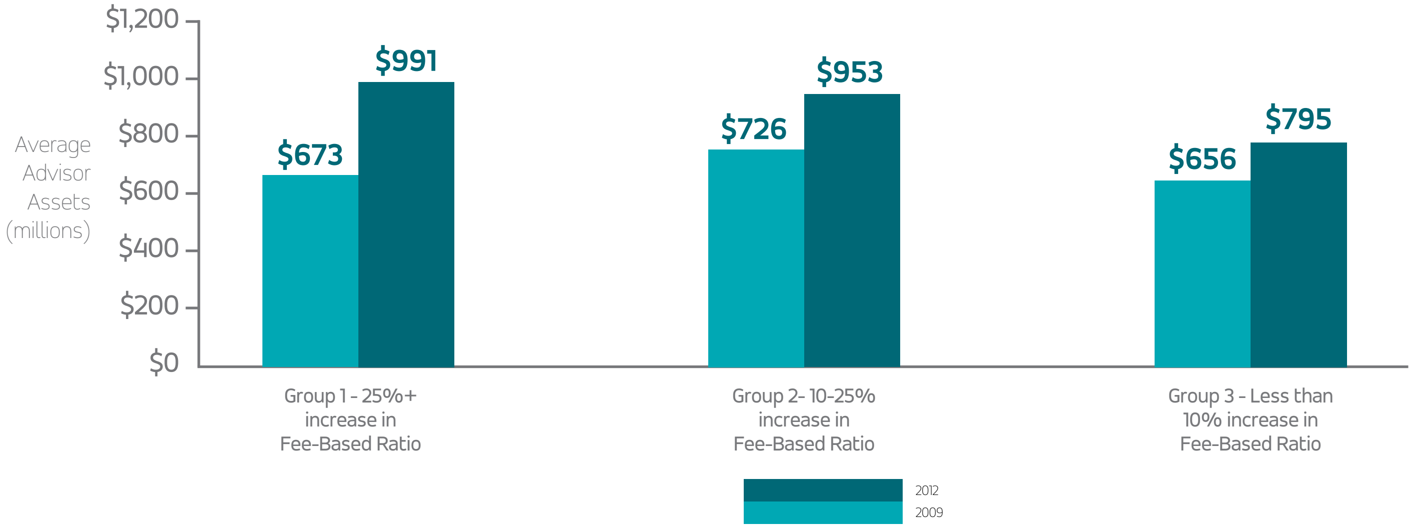
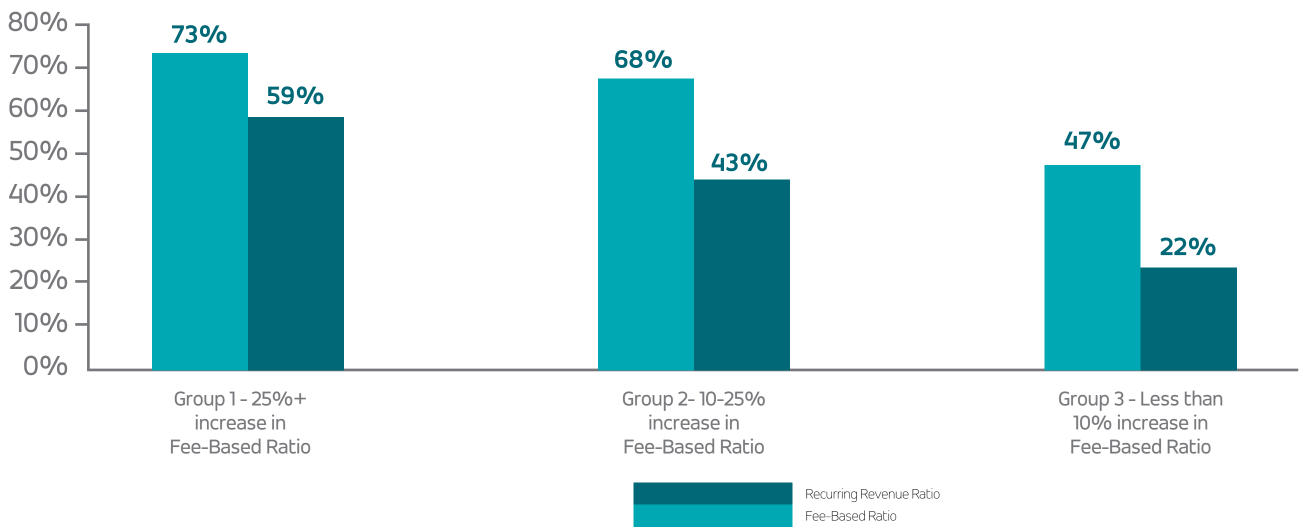


Figure 12 – Revenue Growth 2009-2012



Advisors in Group 1, those who increased their fee-based ratio by 25% or more, saw a corresponding 41% jump in their recurring revenue ratio (percent of revenue coming from recurring streams such as fees or trailers). Advisors in Group 1 have a Fee-Based Ratio of 73%, and 59% of their annual revenue stream is recurring (see Figure 13).

Figure 13– Recurring Revenue & Fee-Based Ratio 2012



The increased efficiency of the transitioned books can be seen in Group 1's average Core Household Ratio (the percentage of households generating $5,000 or more in annual revenue) - which increased from 12% to 21%, as well as the Stagnant Household Ratio (the percentage of households generating $500 or less in annual revenue) which fell from 45% to 28% of all households (see Figure 14). Through their more aggressive transition to fee, Group 1 advisors far outperformed their peers in improving these important measures of book productivity.

Figure 14a – Core Household Ratio 2009-2012

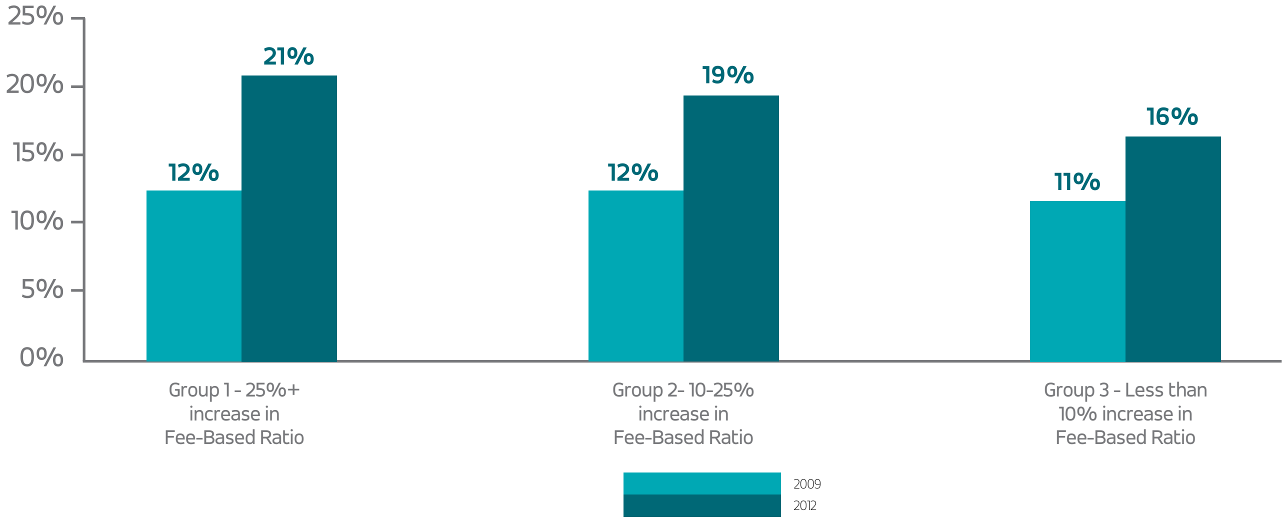
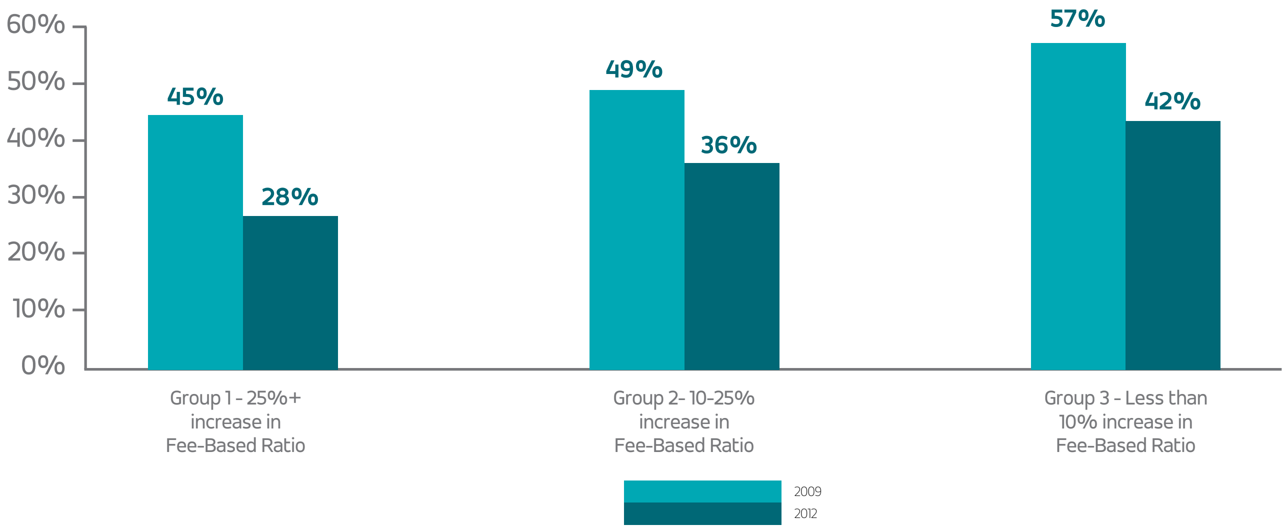


Figure 14b – Stagnant Household Ratio 2009-2012



CONCLUSIONS

While the industry is seeing an evolution towards the fee-based model and away from transactional pricing, advisors have a decision to make. They can “go with the flow” and see their book slowly evolve, relying on investors to demonstrate their interest in a fee-based model before adapting their offerings to serve their clientele . Or they can be more aggressive in transitioning their book. Advisors who are more aggressive and move a significant percentage of their assets into fee-based accounts benefit more quickly from higher RoA, revenue, and assets. They also use the opportunity to part ways with small households and reawaken dormant ones. Results will be less dramatic and materialize more slowly for advisors who take a reactionary approach.

As an advisor, what should you do to address the changing needs and demands of your clients?

- Learn to service both fee-based and transactional accounts. Be able to define the features and benefits of both and explain the differences in pricing models;
- Many clients want to have both types of accounts. Learn to spot and capitalize on those opportunities;
- Find the right business mix for your book and plot your course as you transition your book from non-fee to fee;
- An aggressive shift in business model is an excellent opportunity to prune your book of non-strategic clients. Review your client roster and determine which clients might be better suited for a different business model;
- Understand the demographics of your book: young and very old investors may find less appeal in fee products.

PriceMetrix clients can use this report to find out what approaches work the best in transitioning clients and assets to fee-based products.

For assistance with understanding the opportunities your book of business presents, or to provide your feedback on this issue of *Insights*, please contact Patrick Kennedy, Vice President, Product and Client Services at +1 (416) 955-1728 and email him at patrick.kennedy@pricemetrix.com.

The analysis delivered 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, Madeleine Cruickshank, Director, Analytics, and Dylan Martz, Associate Client Manager.

PriceMetrix®

REALIZE YOUR VALUE