THE STATE OF RETAIL WEALTH MANAGEMENT

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THE STATE OF RETAIL WEALTH MANAGEMENT 2016

Assets under management (AUM) at North American wealth management firms hit record highs last year, buoyed by the tailwind of a continuing bull market – the MSCI World Index returned 7.5% in 2016. Advisors have been successfully transitioning more of their business from transactional revenue to fee-based revenue. Client relationships have become more broad-based, and advisors are building stronger, deeper relationships. Generational wealth transfer is beginning to impact client composition with Baby Boomers now accounting for half the client base at wealth management firms.

Despite these positive signs, wealth management firms faced difficulties in growing their revenues in 2016. Advisors added fewer new accounts, and they achieved little penetration among Generation X or Generation Y investors to date. Lower trading volumes, pressure on fees, and the scarcity of new relationships are undercutting growth, so that advisor production, measured on a "same-store" basis, declined for a second consecutive year.

In this edition of *The State of Retail Wealth Management*, we examine the most critical trends impacting full-service retail wealth management firms in North America. Our data reveal several market dynamics that will challenge core strategies, and with organic growth more elusive than ever, wealth management firms will need to chart new courses back to robust growth.

This report is based on insights drawn from PriceMetrix's proprietary database, representing 24 North American wealth management firms, with over $5 trillion in assets under management, more than 60,000 financial advisors, 10 million retail investors and 500 million transactions. PriceMetrix's data set, collected at the enterprise level, is the most comprehensive and granular of its kind, covering nearly one-third of retail assets managed by full service financial advisors. Unless otherwise noted, all data is reported as of December 31, 2016.

2016 Highlights Include:

- A second consecutive year of decline in gross production, despite record highs in assets per advisor.
- Growth slowed by fewer new client relationships, declining trade volumes, and a reduction in price levels across fees and transactions.
- Continuing trend of creating deeper client relationships, but working with fewer clients.
- Further increase in the proportion of fee-based revenues and assets, with stronger growth in discretionary accounts.
- Shifting demographics, with Baby Boomers representing the majority of industry assets under management, and weak penetration of Generations X and Y markets.

GROWTH FALTERS

Average AUM per advisor grew to a record $92 million in 2016, up 6% from 2015. Revenues per advisor decreased for a second consecutive year, however, dropping 1% from $591,000 in 2015 to $583,000 in 2016. This trend is particularly disturbing in light of the strong equity market performance during that period.

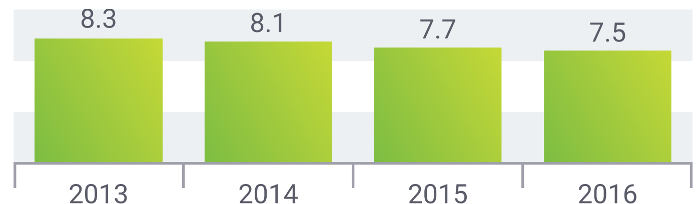
Average AUM per advisor grew to a record $92 million in 2016

	2013	2014	2015	2016
Median assets per advisor (million)	$86	$91	$87	$92
Median revenue per advisor (thousand)	$572	$606	$591	$583

Over the past several years, advisors have added fewer new clients

One of the key drivers of asset and revenue growth is the addition of new client relationships. Over the past several years, advisors have added fewer new clients, and 2016 saw a new low, with an average of just 7.5 new household relationships.

New Household Relationships per Advisor



BROADENING CLIENT RELATIONSHIPS

Previous PriceMetrix research[1] has established the benefits of creating deep relationships. Clients who hold more products exhibit higher levels of satisfaction with their advisors and tend to stay with firms longer.

Advisors have succeeded at deepening their client relationships, in part by working with fewer clients.

In 2016, accounts per household edged higher to a new record of 2.8, while single account households dropped to a record low of 41%. Both indicators have improved steadily over time, suggesting either that clients rely on their advisors to solve increasingly complex needs or that they are consolidating their financial needs with fewer providers.

In 2016, accounts per household edged higher to a new record of 2.8

	2013	2014	2015	2016
Median accounts per household	2.5	2.6	2.7	2.8
Proportion of households with one account	45%	43%	42%	41%

One way to measure the depth of a relationship is the presence of a retirement account

A challenge for wealth management firms is to build on this success by rewarding their advisors for cultivating deeper relationships, while remaining mindful of the increased scrutiny on advisor conduct and sales practices.

One way to measure the depth of a relationship is the presence of a retirement account. In 2016, 67% of retail wealth management relationships included a retirement account, up from 62% in 2013. Although 27% of overall AUM resides in retirement accounts, relationships that include retirement accounts represent two-thirds of assets under management in the wealth management industry.

Relationships with at least one retirement account also produce higher revenue. Although AUM levels are comparable, relationships with retirement accounts produced revenues averaging $5,400 in 2016, versus $3,800 for those without a retirement account.

% of Households with Retirement Accounts

[1]Stay or Stray, PriceMetrix December 2013

TRANSACTIONAL VERSUS FEE-BASED ACCOUNTS

Wealth management firms, advisors and investors have for years exhibited a growing preference for accounts that charge fees as a percentage of assets managed, rather than per transaction. Thirty-seven percent of retail assets were in fee-based programs in 2016, up from 33% a year earlier, and asset-based fees accounted for 54% of the industry's overall revenues, up from 49%. Moreover, advisors managed on average 96 fee accounts at year-end 2016 - 45% higher than in 2013.

	2013	2014	2015	2016
Fee-based revenue	40%	46%	49%	54%
Fee-based assets	28%	31%	33%	37%
Fee-based accounts per advisor	66	72	79	96

The majority of clients in retail wealth management do not have any fee-based accounts

From a different angle, the vast majority of clients in retail wealth management do not have any fee-based accounts: At the end of 2015, 65% of relationships were transaction-only, while 13% were fee-only. The remaining 23% of client relationships held both fee-based and transactional accounts.

The increased prevalence of hybrid relationships, where clients hold both fee and transactional accounts, is challenging the traditional economics of the wealth management industry. In 2013, 18% of clients held both types of accounts (versus 23% in 2016). One potential reason for clients clinging to transactional accounts while transitioning, in part, to fee-based relationships, is to reduce their overall fees as a proportion of assets. Whatever the reason, this trend is disruptive to traditional pricing models – where revenue is generated either from trading or asset-based fees – and may be a catalyst for wealth management firms to consider "total client relationship" pricing.

	2013	2014	2015	2016
Fee-only households	8%	10%	11%	13%
Transaction-only households	74%	72%	69%	65%
Hybrid households (mix of fee and transaction)	18%	19%	20%	23%

Breakaway Growth for Discretionary Accounts

Another important trend in fee-based accounts is the proliferation of discretionary accounts, which many in the industry consider to be an effective strategy to help advisors grow their businesses. In 2016, 19% of advisors had 25% or more of their client assets in discretionary accounts, up sharply from 12% of advisors in 2013. Overall, assets in discretionary accounts grew from 8% of total AUM to 12% between 2013 and 2016.

North American Industry	2013	2014	2015	2016
Advisors with 25% or more of client AUM in discretionary accounts	12%	14%	16%	19%
Client assets in discretionary accounts	8%	10%	11%	12%

THE IMPACT OF DECLINING FEE RATES

Fees as a percentage of assets fell in 2016 to 1.13%, down from 1.16% in 2015. This decline follows several years of stability, and raises concerns that advisors may be succumbing to the price pressure from new wealth management competitors, such as robo-advisors. For new accounts, fees have fallen even further, to 1.07% in 2016 from 1.15% in 2013.

Fee rates for households with managed assets of $1 million to $1.5 million	2013	2014	2015	2016
Average fees	1.16%	1.16%	1.16%	1.13%
Fees on new accounts (opened within the previous 12 months)	1.15%	1.13%	1.12%	1.07%

Revenue from transactions is also declining

The number of commissionable equity trades per advisor hit a low of 214 in 2016 , down 22% from 2013. With a material drop in trade volumes and more clients transitioning to fee-based accounts, the proportion of advisors with predominantly transactional businesses fell from 28% in 2013 to 16% in 2016. Even among that group, though, the average trade volume fell 7% from 650 trades per year in 2013 to 602 trades in 2016. Accordingly, transactional revenues as a percentage of AUM have fallen, from 0.54% of average advisor assets in 2013 to 0.44% in 2016.

	2013	2014	2015	2016
Commissionable equity trades per advisor (All advisors)	274	266	237	214
High-transaction advisors (generating > 75% of revenues from transactions)	28%	24%	21%	16%
Commissionable equity trades per ‘transactional’ advisor	650	675	593	602
Overall transactional RoA (revenue as a percentage of assets)	0.54%	0.51%	0.50%	0.44%

Pricing of transactions is also weakening, with equity transactional revenue as a percentage of principal traded down from 1.37% in 2013 to 1.26% in 2016. Pricing can vary with the size of trades, but the average trade size has been consistent over the period. Rather, advisors are providing bigger discounts from stated commission schedules. In 2016, the average discount was 39%, up from 34% in 2013.

	2013	2014	2015	2016
Average trade size (thousand)	$15.5	$15.5	$15.1	$15.6
Transactional revenue/trade principal	1.37%	1.34%	1.31%	1.26%
Average discount from ‘list price’	34%	36%	37%	39%

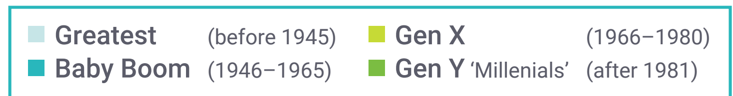
Wealth management firms stand at a crossroads of advisor pricing and value

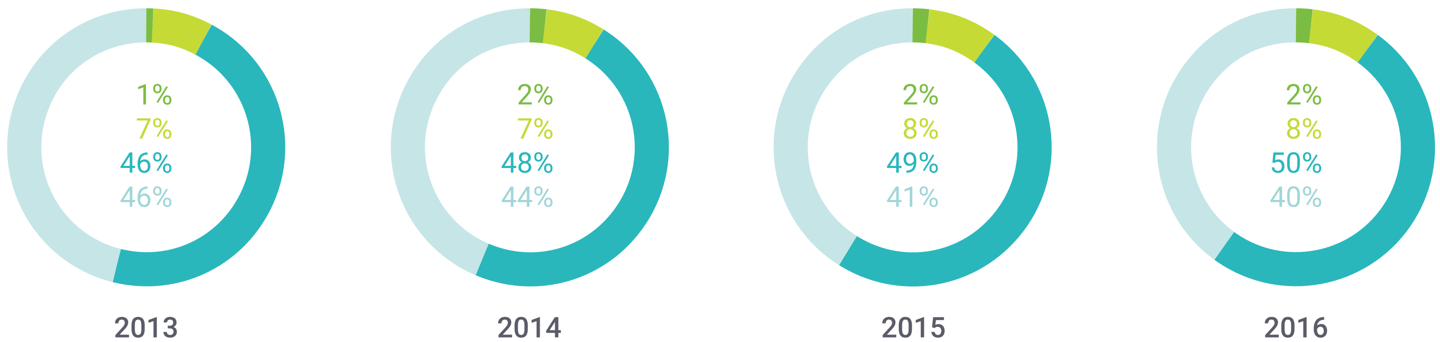
With broad-based rate declines across both fee-based and transactional product lines, firms should take a proactive stance on pricing. New market entrants and a trend toward increased pricing transparency will continue to challenge advisor self-confidence. Programs that encourage advisors to communicate their value to clients and defend commission and fee levels are essential.

BEYOND THE BABY BOOM

Baby Boomers (1946-1965) now own half of the AUM controlled by North American financial advisors, up from 46% in 2013. The share of the Greatest Generation (born before 1945), which was equal to that of Baby Boomers three years ago, has fallen to 40%. Millennials (1981-1995) represent only 2% of assets managed by the full-service retail wealth management industry, although given their age and economic situation, this group does have fewer investable assets. Perhaps most troubling is the lack of growth in AUM from Generation X (1966-1980), which represent only 8% of advisor assets. Attracting this group of clients, many of whom have entered their peak earning and saving years, will be vital to the industry's continued growth over the next 20 years.

Generational AUM





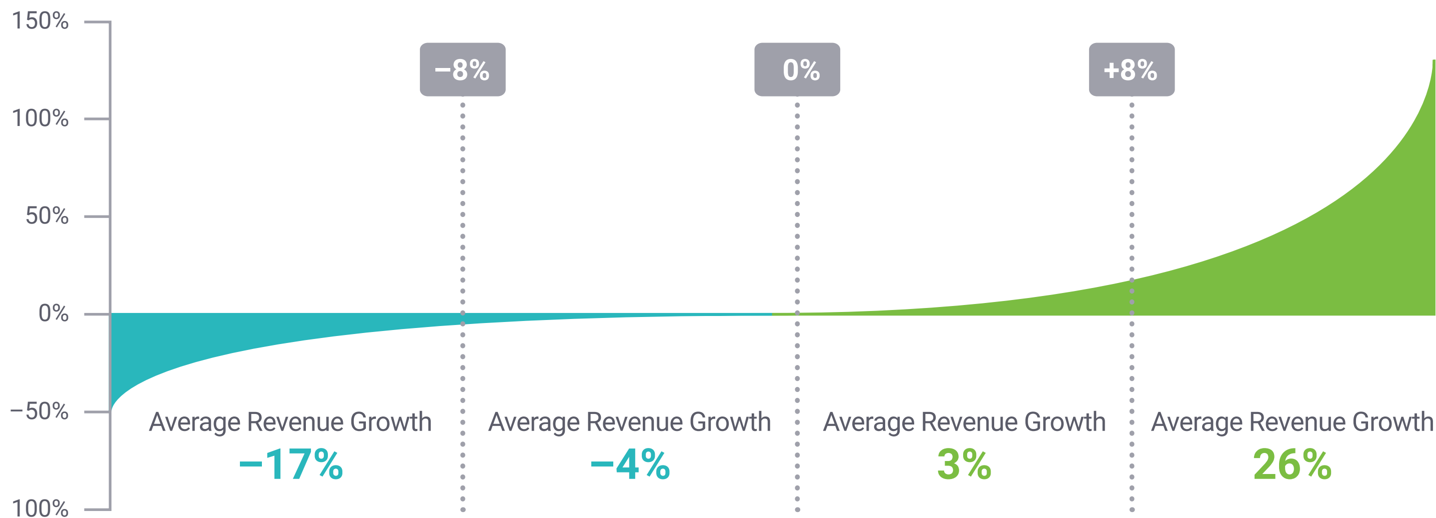
Among all the challenges facing wealth managers, the lack of growth in assets from Generation Y, and especially Generation X, clients may be the most serious

What will it take to attract these investors and grow their assets over the long term? The question is central to all aspects of a wealth management strategy. Value proposition, product menus, service models, pricing, and digital advisory will all have to be addressed to ensure that leading firms can bring aboard the next generations of investors.

THE PATH TO RENEWED GROWTH

Warning signs surfaced for wealth management firms during 2016. Advisor production declined despite record levels of client assets. Advisors earned less from clients, despite managing deeper relationships. Moreover, advisors are attracting fewer new clients.

However, opportunities lie behind these disappointing statistics. Revenue growth for the median advisor was nil, but the top quartile of advisors managed to increase revenue by 26% on average, while the bottom quartile saw a year-over-year decline of 17%. Top-quartile



advisors added 8.7 new client relationships, well ahead of 5.6 for the bottom quartile. The fast growers realized 47% of their revenues from fees, versus 41% for the slow growers. Lastly, the leaders had gathered 9% of their assets from Generation X clients, compared to 6% for laggards. Thus, some advisors are growing their books of business by adding new client relationships, building scalable businesses, and connecting with the next generations of investors. Wealth management firms that identify and replicate the success of their fastest-growing advisors could unlock 10% to 15% in additional revenue growth for their firms.

For wealth management firms, generating additional growth will require addressing several questions:

- Do advisors have the tools, and are they motivated to target the right clients? Can they add enough of these clients to support growth expectations?
- How can the firm ensure comprehensive service for each client and meet their clients' growing needs with a full service product line?
- How will the service expectations of the next generation of investors differ from the Baby Boomers, and how can they be met?
- How can the firm help advisors navigate the choppy waters of pricing, given the industry's new competitors, greater transparency, and evolving client expectations around service?

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