PriceMetrix
by McKinsey

Global Banking Practice

The state of North American retail wealth management

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The state of North American retail wealth management

As the COVID-19 pandemic plays out, the human tragedy is clear, but the end state impact on populations, governments and financial markets remains unknown. The crisis is also presenting unprecedented challenges to North America's wealth managers.

The relationships between advisors and clients will be tested in the months ahead, as advisors are called upon to bring strength, stability, and perspective to their clients when they need it most.

The good news is that advisors entered this difficult period from a position of strength. A prolonged period of growth followed the last bear market, as advisors reached record levels of assets and revenues in 2019. Over the course of the last decade, many advisors changed how they work with clients. With digital entrants and lower-cost service offerings challenging the value of portfolio construction and monitoring, advisors responded by recentering their propositions on more comprehensive planning for more complex clients. They've also transformed how they get paid, with more than two thirds of revenues coming from asset-based fees, compared to one third just ten years ago. Relationships are deeper, client retention rates have peaked, and advisors are more resilient than ever.

In this latest edition of our annual State of Retail Wealth Management, we'll take a special look at how the decisions made by financial advisors over the past decade have prepared them to endure the path ahead. We'll also reflect on some lessons learned from the 2008 financial crisis that can help advisors succeed in a less than certain future.

This report is based on the PriceMetrix proprietary database collected from more than 25 wealth management firms in North America. Our data is built from detailed client holdings and transaction information from 65,000 financial advisors.[1] Because data is refreshed continuously, PriceMetrix offers an unmatched view into the behaviors and characteristics of wealth management clients, and insights into how advisor decisions affect growth and client outcomes. Unless otherwise noted, all data is reported as of December 31, 2019.

A long bull run for wealth managers

The year 2019 capped off a long bull run for clients as well as for wealth managers (Exhibit 1). Median assets per advisor ended 2019 at $120 million, up 8 percent per year since 2015, while revenues per advisor grew by 5 percent per year to $717,000 in 2019.

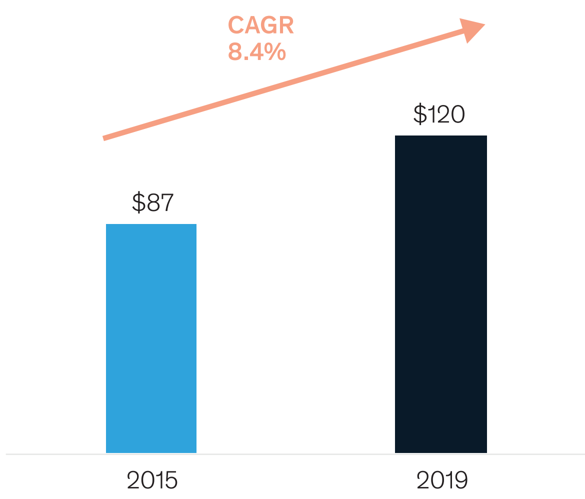
This growth was a result of two predominant forces. As financial markets continued to deliver positive results to investor portfolios, advisors benefitted from the larger asset pool. And with the rising popularity of fee programs (Exhibit 2) (clients pay per dollar invested) over transactional products (clients pay per trade), revenue growth has become tightly linked to asset growth. One result of asset-based fees is that advisor pay will decline in bear markets, as 2020 will mercilessly demonstrate.

[1] The financial advisory services captured in this research include personalized wealth planning, portfolio construction, and investment selection delivered by licensed financial advisors (and does not include banking, discount brokerage, or direct investing).

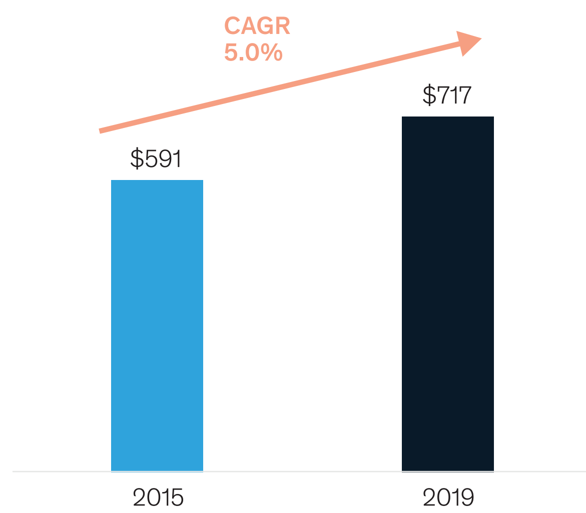
Exhibit 1

2019 capped off a long bull run for North American wealth managers and their clients.

Median assets per advisor
Millions



Median revenue per advisor
Thousands

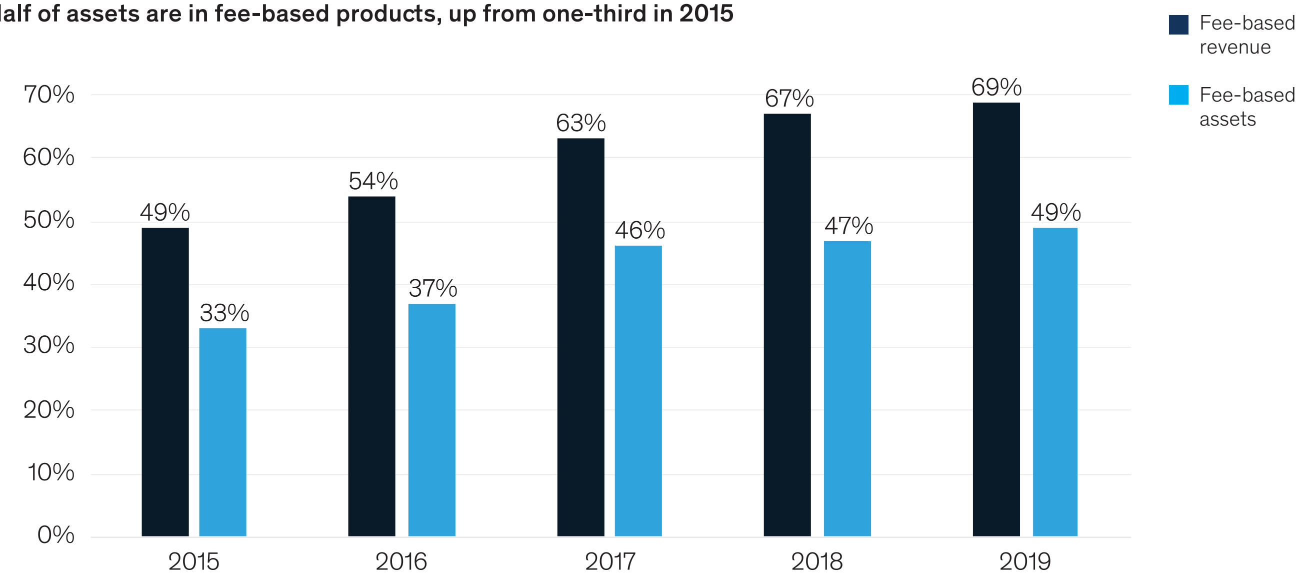


Source: PriceMetrix

Exhibit 2

Fee-based revenue now contributes 69% of overall gross production for financial advisors, up from 49% in 2015.

Half of assets are in fee-based products, up from one-third in 2015

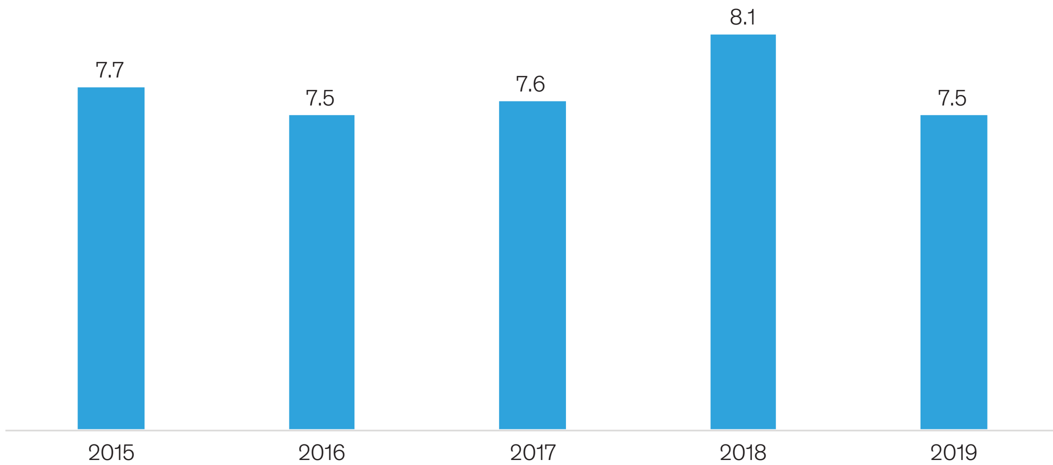


Source: PriceMetrix

Exhibit 3

In 2019, North American advisors opened 7.5 new client relationships, the same number they opened in 2016.

New household relationships per advisor



Source: PriceMetrix

With so much growth coming from existing relationships, advisors have had less incentive to add new clients. In 2019, advisors opened 7.5 new client relationships,[2] the same number they opened in 2016 (Exhibit 3).

More clients likely in play in the year ahead

Past PriceMetrix studies have shown that clients are more likely to switch advisors during a market downturn. [3] In 2009, 10 percent of clients left their advisor, the highest level of the last 12 years. Moreover, advisors who focus on adding new clients outperform their peers during market downturns.[4] More clients are being served today by digital advice platforms than in 2008, introducing a new dynamic which shines a spotlight on the value of human advice. Whether clients are more likely to seek new advice in poor markets, or advisors are more likely to seek new clients, the implications are clear—new client acquisition represents a viable strategy for advisors looking to maintain market-led growth rates of the last several years.

Some advisors will be more resilient to client attrition than others

In recent years, many advisors have prioritized relationship quality over quantity, choosing to serve fewer affluent clients more comprehensively. Even after adjusting for market performance, average client size has increased by 13 percent from 2015 to 2019.

With a preference to serve clients more holistically (rather than serve clients who may be spreading their assets across different advice providers), advisors are benefiting from deeper relationships. Accounts per household continue to climb, up to 3.1 in 2019 compared to 2.7 in 2015. And the percentage of households with retirement[5] accounts has also increased from 65 percent to 72 percent in that same time (Exhibit 4).

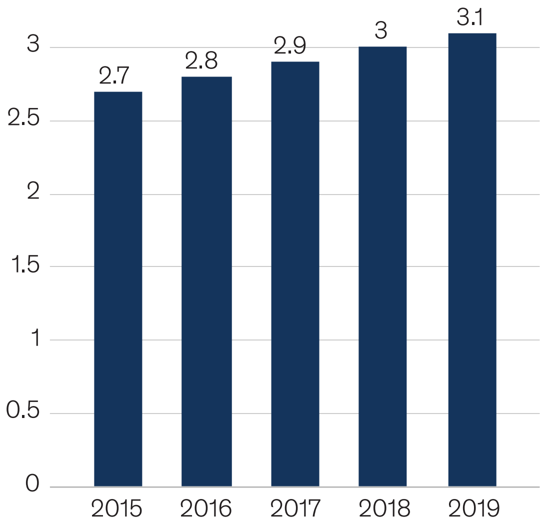
To illustrate the importance of relationship depth, we contrast the characteristics of advisors who have high levels of retention with those who have relatively low client retention (Exhibit 5).

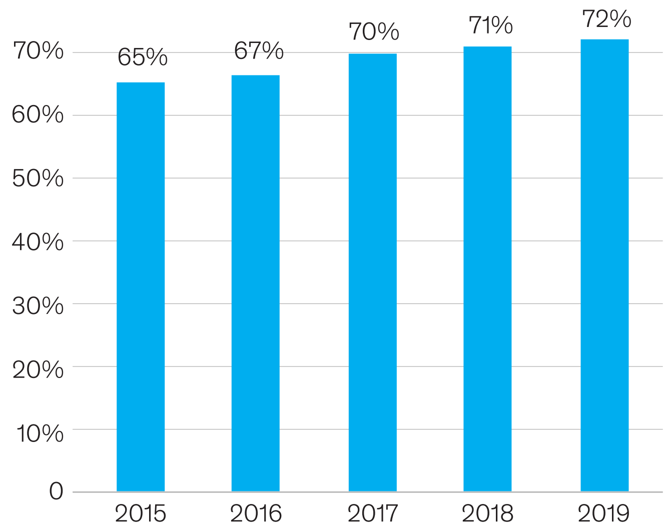
Top advisors (in terms of client retention), have deeper relationships and fewer client relationships.

[2] Average number of new households served per advisor.
[3] *Stay or Stray*, PriceMetrix, December 2013.
[4] *The Anatomy of Outperformers*, November 2011.
[5] Investors are less likely to spread retirement accounts across multiple advice providers.

Exhibit 4

The percentage of North American households with retirement accounts increased from 65% to 72% from 2015 to 2019.





Source: PriceMetrix

Exhibit 5

Top advisors (in terms of client retention) have deeper and fewer client relationships.

Annual retention rate of households (with more than $250k in assets)	3-year asset CAGR	Number of households served (total)	Accounts per household	Percent of households with retirement accounts	Annual Attrition rate of $250k+ households
Top 25% of advisors	8.0%	140	3.4	76%	1%
Bottom 25% of advisors	6.5%	153	2.6	62%	8%

Source: PriceMetrix

Clients value time and attention from their advisor—the fewer clients an advisor's time is spread across, the more attention each receives. This dynamic is particularly relevant in periods of market uncertainty, when advisor time and personal attention is even more valuable to clients.

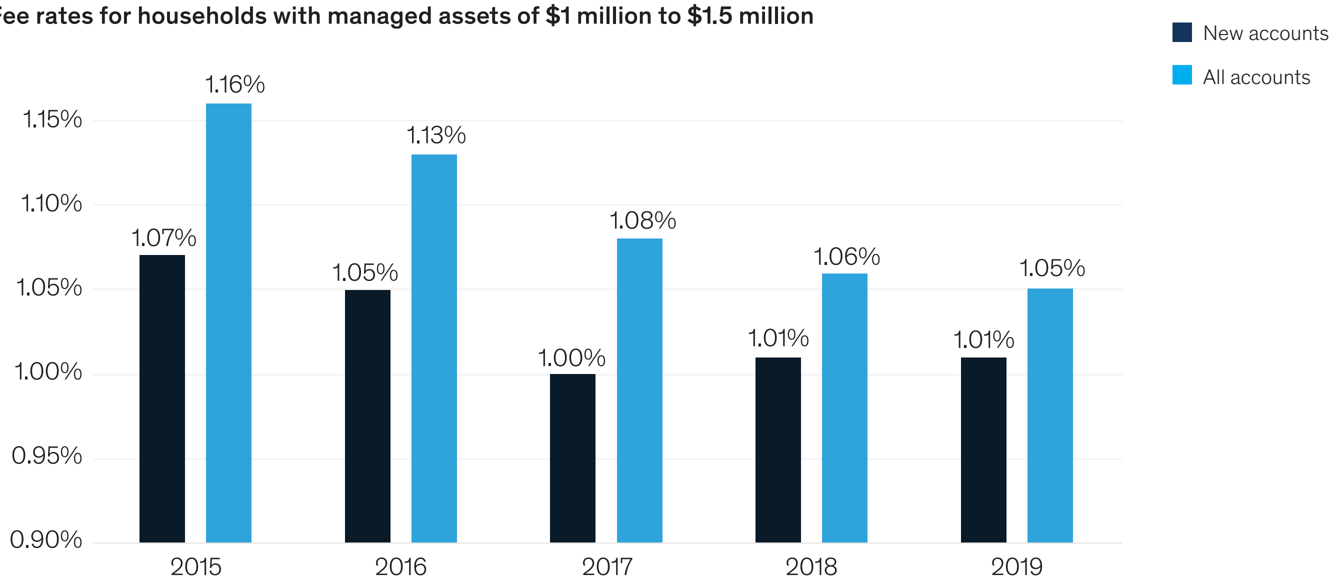
(Fee)quilibrium

Wealth management pricing has seen steep declines over recent years, tempering revenue growth driven by market performance. In 2019, we saw a second consecutive year of stability, particularly on new fee accounts, suggesting a possible new normal in aggregate price levels. Annual fees for new accounts (for households with $1 million to $1.5 million invested) averaged 1.01 percent in 2019, essentially flat since 2017, but down from 1.07 percent in 2015 (Exhibit 6). Pricing on all (new plus existing) accounts continues to decline, but the stability in new account pricing suggests that the two will converge sooner rather than later.

Exhibit 6

Annual fees for new accounts have been essentially flat since 2017, but down from 1.07% in 2015.

Fee rates for households with managed assets of $1 million to $1.5 million



Source: PriceMetrix

Pricing the bear

History suggests that bear markets can be a particularly challenging time for some advisors with respect to pricing. During and following the 2008 financial crisis, PriceMetrix observed that 17 percent of advisors increased their level of discounting (priced lower), and while their price levels increased after the recovery, they stabilized at a rate halfway between pre-crisis levels and the bottom of their pricing (that is, they only recovered half of what they gave up). "Sympathy pricers," as we called them, followed the market on the way down, but were reluctant to reset their pricing as quickly when the market trended upward.

What's different 12 years later is that significantly more revenues are earned in the form of asset-based fees than they were in 2008 (69 percent compared to 38 percent). Therefore, as markets retreat, so will the income of advisors. While fee-based accounts have several benefits, one drawback is that in a period where advisors will likely be providing a lot more in terms of service (research, communication, guidance) they will actually be paid less.

Lessons from the last crisis

The 2008 financial crisis tested advisor-client relationships. Advisors saw client attrition spike to 10 percent in the first full year following the market decline. In the decade that's followed, the core value proposition of the financial advisor has come of age. Stock advice and trading evolved into portfolio design and execution, and now seems more deeply rooted in holistic wealth planning and coaching. Client relationships (net of market performance) are larger, relationships are deeper, and advisors are more likely to be the primary financial advice provider for the clients they work with. As a result of all these changes, client attrition rates fell to an all-time low of 5 percent in 2019.

This broader, personalized, and service-oriented proposition is now facing an incredible litmus test, as advisors prepare to guide clients (both their emotions and their portfolios) through a period of tremendous uncertainty. Unlike the 2008 crisis, the COVID-19 pandemic crisis affects clients disproportionately, with many business owners suffering both business losses as well as portfolio losses. There is likely to be a higher rate of client attrition in the year ahead, and advisors who are passive and reluctant to step up and serve their clients will see disproportionately more client leave.

As mentioned earlier, some advisors were more likely to discount their services through a bear market. Sympathy pricing was a transaction pricing phenomenon, as the majority of revenue in 2008 still came in the form of trades. Today, advisor revenues are more tightly linked to client assets, with nearly 70 percent of revenues coming in the form of recurring fees. With this new economic model, advisors may feel less compelled to discount, as their fees will be lowered proportionately with client portfolio values. Sympathy pricers were never able to return their price levels to their starting point, and suffered permanent damage to their revenue stream as a result. By contrast, today's fee-based advisors should see their revenues return as the market returns to bull territory.

Market pullbacks present challenges. The demands placed on advisors to ingest, process, and deliver relevant information to their clients will be extreme. The stress level of clients, particularly those past retirement age, will be justifiably elevated. And for the majority of advisors who earn revenue in the form of asset-driven fees, they will be providing more service and more value, while earning less themselves. As advisors earn less, so too will firms. Lower fee and interest revenues is likely to put pressure on investment spending. The prioritization of that spending may also change with a higher premium placed on digital client service tools.

There will also be opportunities for growth. Clients have demonstrated more willingness to switch advisors[6] and channels in the face of adversity, and advisors who are proactive in this next cycle can create opportunities to serve more clients, deepen existing relationships, and demographically diversify their client base. As firms do prioritize investments in digital servicing tools, the adoption by clients and advisors may be greatly accelerated. And there has never been a more important time for firms to ensure that their compensation plans are designed and calibrated to reward advisor growth and client engagement.

Long-term growth will be anchored on the solid foundation that advisors have already built within their practices. Nothing will pay more dividends to advisors in the long run than deeply servicing their existing clients, being their trusted advisor, and helping guide them through the months ahead. Financial advice has never been more important.

To adapt and succeed over the next several months, wealth managers will face a new set of questions:

— How have the needs of my clients' changed, and what have I done to change and meet those needs?

— Are there things I should stop doing?

— Are there ways to extend my services to others whose needs are not being met by their current advisors?

— As both my clients and I become more comfortable interacting digitally, should I make permanent changes to my service model? Perhaps expand my offering to serve clients in other jurisdictions?

— With market performance enticing younger investors into the capital markets, am I doing enough to manage the demographics of my business through marketing, segmentation, and service delivery?

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[6] *The Anatomy of Outperformers,* November 2011.

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