MAKING CHOICES, FINDING GROWTH

The State of Retail Wealth Management

8th Annual Report

PriceMetrix
Part of McKinsey & Company

Financial advisors at North American wealth management firms grew revenues to a record high in 2018. Remarkably, they did so without the market performance tailwinds that have propelled them for the past several years. They did so by attracting more new clients and by increasing their services to existing clients. Many advisors found growth by managing the demographics of their book and by adding more ‘Next Gen’ clients—that is, clients born after 1965.

This edition of our annual State of Retail Wealth Management looks critically at several aspects of growth. How have so many advisors been successful at achieving growth? What roles do demographics and pricing play? What threats lie ahead for both advisors and executives? What actions can firms take to achieve long-term, sustainable growth?

This report is drawn from PriceMetrix data collected from more than 25 wealth management firms in North America, and includes detailed positions and transactions information representing 12 million retail investors and $6 trillion in assets. Because data is refreshed continuously, PriceMetrix offers an unmatched view into the behaviors and characteristics of financial advisors and insights into how decisions affect advisor growth and client outcomes.

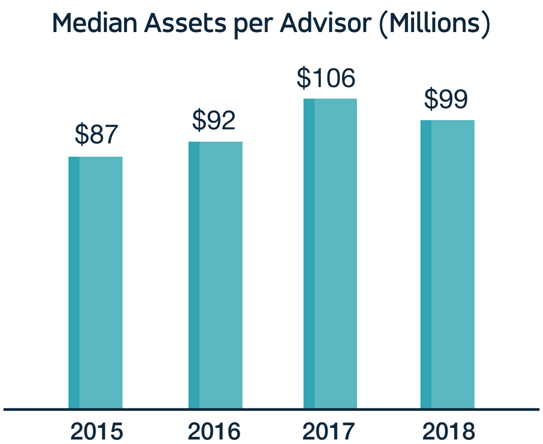
Unless otherwise noted, all data is reported as of December 31, 2018.

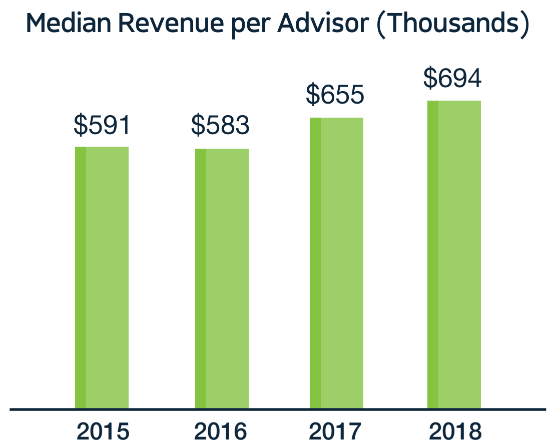
2018 Highlights

- Record high advisor revenue despite a market-driven drop in assets.
- Material improvement in the number of new client relationships established per advisor.
- Continued growth in fee assets and revenues as well as deeper client relationships.
- Early signs of stabilization in aggregate price levels, though significant variation persists.
- Emergence of both Next Gen clients and Next Gen advisors as catalysts for growth.

Advisors Found Ways to Grow Despite Market Performance

After several years of growth largely fueled by market performance, assets managed per advisor declined 7% in 2018 to $99 million. Despite this asset decline, revenues continued to grow, up 6% in 2018, and now sit at a record $694,000 per advisor.





More and Deeper Client Relationships

One of the ways advisors maintained revenue growth, even when faced with more turbulent markets, was through an increased focus on new client relationships. In 2018, advisors opened 8.1 new client relationships, up from 7.6 in 2017 – a clear spike over recent years.

In addition to adding more new client relationships, advisors continued a recent trend of deepening existing relationships. In 2018, several key relationship depth indicators hit record levels: the proportion of multi-account households, median accounts per household and the percentage of households with retirement accounts. These important indicators, all linked to client retention[1], point to continued improvement in the depth and quality of advisor/client relationships.

New Household Relationships per Advisor

2015	2016	2017	2018
7.7	7.5	7.6	8.1

	2015	2016	2017	2018
Proportion of Multi-account Households	58%	59%	61%	62%
Median Accounts per Household	2.7	2.8	2.9	3.0
% of Households with Retirement Accounts	65%	67%	70%	71%

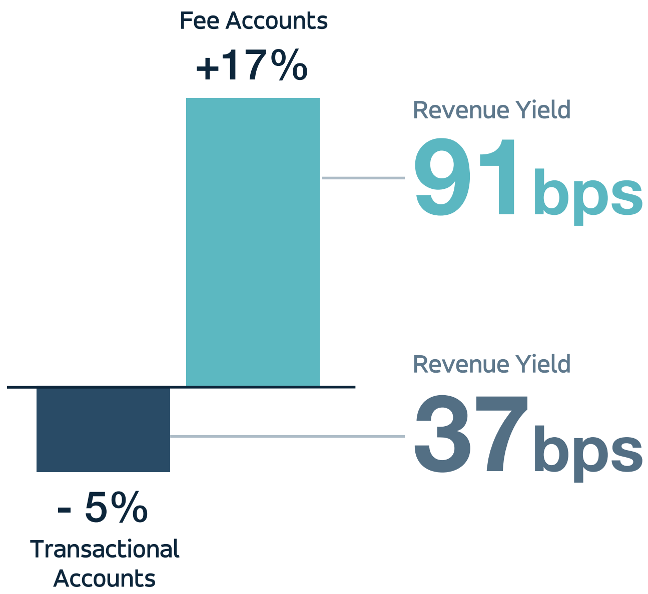
[1]PriceMetrix Stay or Stray, 2014.

Growth Driven by Recurring Revenue

Another key driver of advisor revenue growth was the continued proliferation of fee-based accounts. Revenues from fee accounts grew by 17% in 2018 over 2017, while revenues from transactional accounts declined by 5% year over year. Revenue growth was further propelled by the fact that fee assets are more productive than transactional assets. Average revenue yield (revenue over assets) for fee accounts was 0.91% in 2018 compared to 0.37% for transactional accounts.

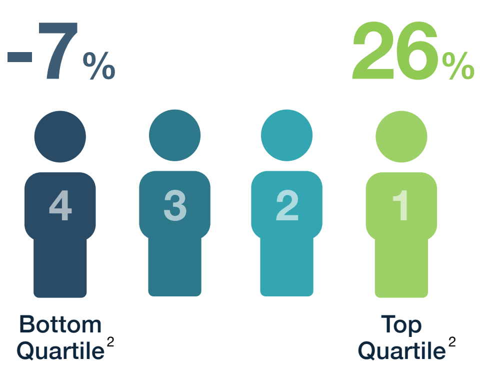
52% of client relationships now contain at least one fee-based account, up from 31% in 2015. Fee-based revenue now represents a record two-thirds of advisor revenue, and fee-based assets grew from representing 33% of all assets in 2015 to now representing 47% of all advisor assets.

2018 Year-over-Year Revenue Growth
by Account Type



	2015	2016	2017	2018
Fee-based Revenue	49%	54%	63%	67%
Fee-based Assets	33%	37%	46%	47%
Percentage of Households with Fee Accounts	31%	36%	46%	52%

2018 Year-over-Year Revenue Growth
by Advisor



Disparity in Growth Performance

While the median revenue growth rate for advisors was an encouraging 6% year over year, there is a wide gap in growth performance. The top quartile of advisors grew by an impressive 26%, while the bottom quartile experienced a year over year revenue decline of 7%. There is significant value to be unlocked by firms that can identify and replicate the behaviors of top performers, across their entire advisor base.

[2]Based on revenue growth

The Next Generation of Wealth: The Youth Movement is Taking Hold

Clients born after 1965 (predominantly generations X and Y) now represent 21% of wealth management clients, up from 16% in 2015. While this may still seem like a small proportion of overall clients, consider the fact that the average assets of these clients have grown by 6.1% over that same time period, compared to 3.5% for those born before 1965. This growth outperformance can provide a boost to advisors who are choosing to work with Next Gen clients.

2015-2018 Asset Growth
Compound Annual Growth Rate

Next Gen Clients **6.1%**

Older Clients **3.5%**

Proportion of Total Client Relationships

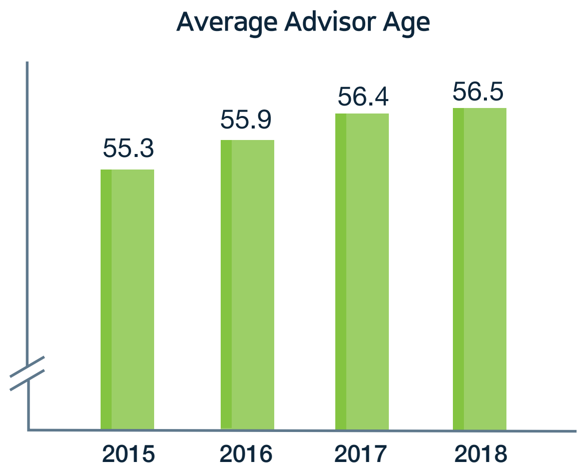
	2015	2016	2017	2018
Next Gen Clients (born after 1965)	16%	19%	20%	21%
Older Clients (born 1965 or before)	84%	81%	80%	79%

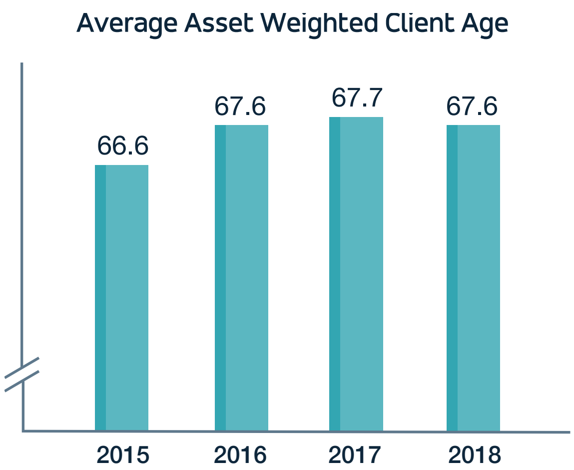
Advisors vary in their willingness (and/or ability) to attract Next Gen clients. Advisors in the top-quartile have 37% of their clients born after 1965. For bottom-quartile advisors, the figure is 12%. Interestingly, the two advisor groups have similar revenues on average, but the advisors with younger books are growing at a faster rate than those with older books, reinforcing the impact that Next Gen clients can have on growth. Wealth management leaders will need to deeply understand the product and service preferences of Next Gen clients, to adapt and ensure they can continue to attract these important clients in the years to come.

	Bottom 25% of Advisors[3]	Top 25% of Advisors[3]
Percentage of Clients that are 'Next Gen'	12%	37%
Median Advisor Revenue	$688K	$686K
2018 Year over Year Revenue Growth	8%	12%

[3]Based on percentage of clients born after 1965

Another indicator that client demographic changes are really taking hold is that, for the first time in several years, the (asset-weighted) average client age actually *declined*, an encouraging sign indeed for the future of the North American wealth management industry.





Along with the emergence of Next Gen clients, advisors themselves are showing evidence of a youth movement. After a multi-year trend in which average advisor age increased by 6 months per year, in 2018 the average age stabilized.

The most common way for new advisors to enter the wealth management industry is by joining an established team: 68 percent of advisors under 40 years of age work as part of a team. Working as part of an established team allows new advisors to build experience and expertise. And the team benefits as well: teams with Next Gen advisors grow at a faster rate, add more clients, and lose fewer clients than their counterparts.

	Teams with Next Gen Members	Teams without Next Gen Members
Percent of Teams	33%	66%
Revenue Growth	11%	9%
New Clients	8.3	7.7
Lost Clients	8.1	8.8

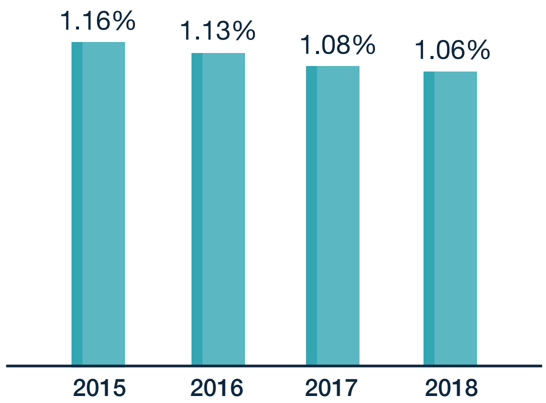
Is Price Stabilization on the Horizon?

In recent years, there has been a precipitous decline in the price charged for wealth advice. Increased transparency brought about by regulatory changes and new competitive entrants continue to challenge the traditional advice model. While some advisors have responded by extending the breadth and depth of their services, others have chosen to lower their prices.

In 2018, fee pricing continued to decline; however, the rate of decline slowed. For households with $1 million to $1.5 million invested, fee account pricing dropped 2 bps (from 1.08% in 2017 to 1.06% in 2018), compared to a drop of 5 bps the previous year.

In the current dynamic pricing environment, with some advisors lowering prices while others are maintaining or even raising them, a wide range in price levels exists. For that same household segment (those with $1 million to $1.5 million in assets), the top 10% of clients (based on rate paid) pay 1.40%, while the bottom 10% pay 0.73%, or half as much as the top 10%.

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



Price for Wealth Advice[4]

[4]For households with $1 million to $1.5 million in managed assets
[5]Based on fee rate paid

For some, this wide disparity in prices might signal instability. But when we look at the attrition rates of both the top- and bottom-priced clients, we see higher client attrition rates for those that pay a lower rate. In 2018, 3.2% of clients that were priced in the bottom decile left their advisor, compared to 2.2% of clients priced in the top decile.

Clearly, advice in wealth management is not a commodity. Even today, when pricing is more transparent than ever, some clients are just as satisfied paying double what others pay. Premium propositions, with premium price tags, resonate just as well as cheaper ones. The challenge for advisors (and the firms they work for) is to ensure that the value they deliver aligns with the price they charge.

'Enough' – An Emerging Threat to Future Growth

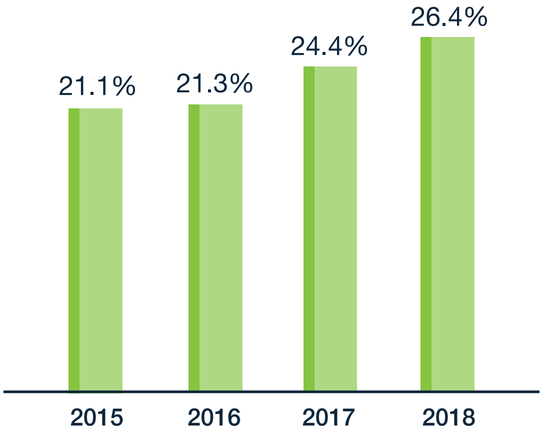
Many of the characteristics we've outlined highlight positive growth trends in the wealth management industry. We've seen deeper relationships, more new relationships, more recurring revenue, and more Next Gen clients and advisors. Clearly, advisors are making choices that are helping them scale more effectively and grow faster.

One of the results of more advisors finding the right growth formula is that the industry is seeing more 'big producers.' The percentage of FAs who gross more than $2 million in production has grown from 6.1% in 2015 to 8.4% in 2018, and the assets controlled by these top producers have increased from 21.1% to 26.4% in that same time period.

	Large[6] and Growing[7]	Large and Stagnant[8]
Population	32%	68%
Revenue	$3.0M	$2.7M
Revenue Growth Rate	14%	8%
Fee Revenue Percentage	66%	62%
Overall Fee Rate	0.84%	0.82%
Average HH Assets	$2.4M	$1.7M

[6]Greater than $2 million in annual gross production
[7]Year over year growth in assets
[8]Year over year decline in assets

Percent of Assets Controlled by Top Producers[6]



However, with more big producers than ever before, firms are more exposed to one of the biggest threats to growth – the size of advisors themselves. When advisors achieve a certain size, many choose to stop growing – in essence, they achieve "enough." If not managed, this inertia can have a dramatic impact on the performance of wealth management firms overall.

To delve deeper into this issue, we look at top producers, and profile those who continue to grow, and those who achieve "enough." Advisors who are large, and who continue to grow, have a higher proportion of revenues from fees, service larger clients, and charge higher rates. Even at these very large book sizes, advisors can make decisions that will lead to continued growth. Perhaps the bigger challenge for firm executives is managing the desire for continued growth amongst their top producers.

Most wealth management firms spend a disproportionate amount of resources to retain large advisors. Higher payout rates, reward clubs, titles, and many other components of compensation are directed toward high-revenue producers. To avoid the drag on growth that can come from inertia and the "enough" phenomenon, executives need to adjust these reward programs to ensure that they encourage sustainable growth.

By all accounts, 2018 was a terrific year for North American financial advisors. They deepened existing client relationships. They added more new clients. They grew revenues despite emerging instability in market performance.

Two specific areas that have a profound impact on advisor growth are pricing and client demographics. Each can be a driver of growth as well as a drain. With respect to pricing, some advisors view emerging digital competitors as an opportunity to highlight their added value, while others view them as a threat and lower their price in response. Similarly, advisors who are deliberately making connections with younger clients (while continuing to service clients across different generations), are seeing faster growth. Most importantly, advisors are learning that both pricing and demographics are not events that are happening to them, but rather forces that they control, and that they can leverage to unlock breakaway growth.

The reward for firms that help their advisors make informed choices about pricing and demographics is worth a substantial investment. Firms can impact their revenue growth rate by 3 to 5% by encouraging advisors to pursue new Next Gen client relationships. Programs that help advisors price with confidence can add 5 to 7% in additional revenues.

Just as pricing and demographics are choices, so too is growth itself. For wealth management firms to grow, they need their advisors to know how to grow, and they also need their advisors to want to grow. That means finding the right advisors, investing in their capabilities with practice management analytics and coaching, and shifting the compensation model from rewarding the results of growth to rewarding the drivers of growth.

For more information on this research, contact:

Patrick Kennedy

Chief Customer Office at PriceMetrix

416-955-0514 or patrick.kennedy@pricemetrix.com

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