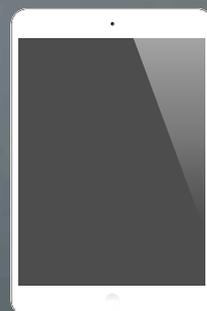


STAY OR STRAY

PUTTING SOME NUMBERS BEHIND CLIENT RETENTION



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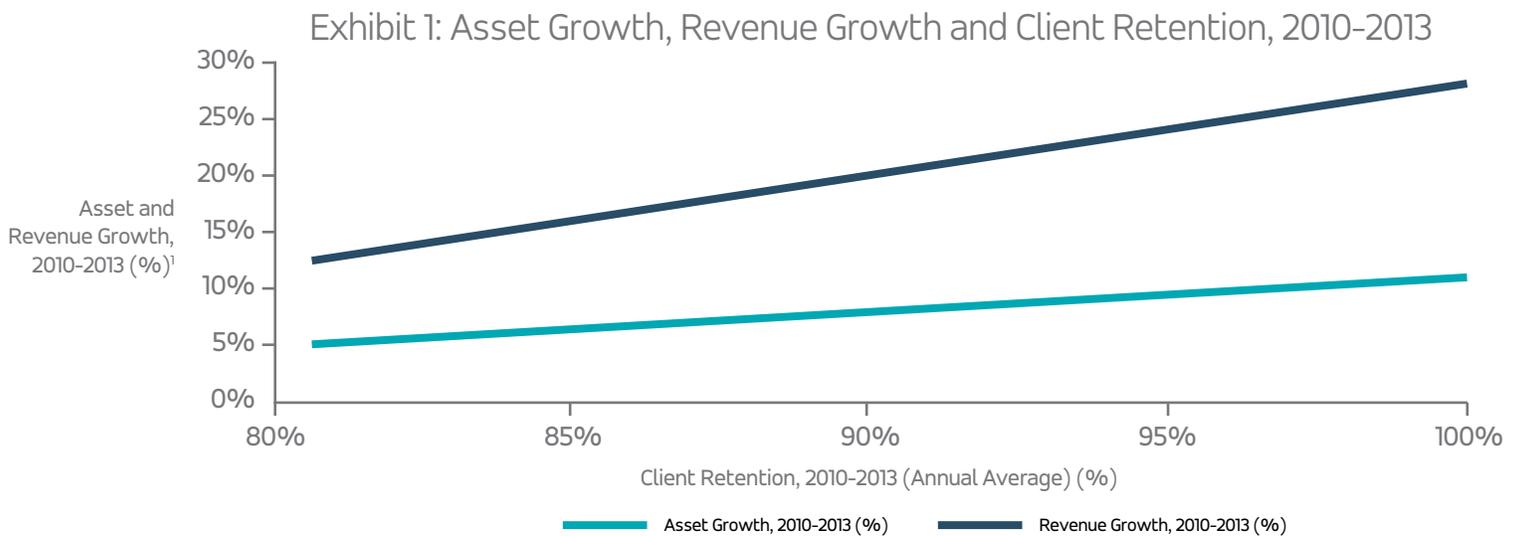
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INTRODUCTION

Client retention and attrition are metrics to which every financial advisor who wants to grow his or her business needs to pay close attention. Whether planning for growth, succession or simply increased productivity, every advisor needs to have a solid grasp of which client relationships are durable (and are likely to persist) and an understanding of which relationships are at greater risk. This PriceMetrix *Insights* report helps advisors distinguish between the two. Its central questions are:

- What are the characteristics of clients who are more likely to stay with their advisor?
- What are the characteristics of advisors who are able to retain a high proportion of their clients?

The reason for being attentive to client retention is clear: growing one's business is more challenging if one is continually trying to replace clients and assets that have moved elsewhere. As one might expect, higher client retention is associated with higher asset growth and higher revenue growth (see Exhibit 1). At the same time, not all client attrition is negative, since not all client relationships represent the same revenue opportunity for advisors.



¹This plot depicts the relationships between client retention and asset growth, and client retention and revenue growth, controlling for assets under management, revenue, household mix and advisor experience (with controls held at their mean values). Client retention is measured as the annual retention rates averaged over the 2010-2013 time period.

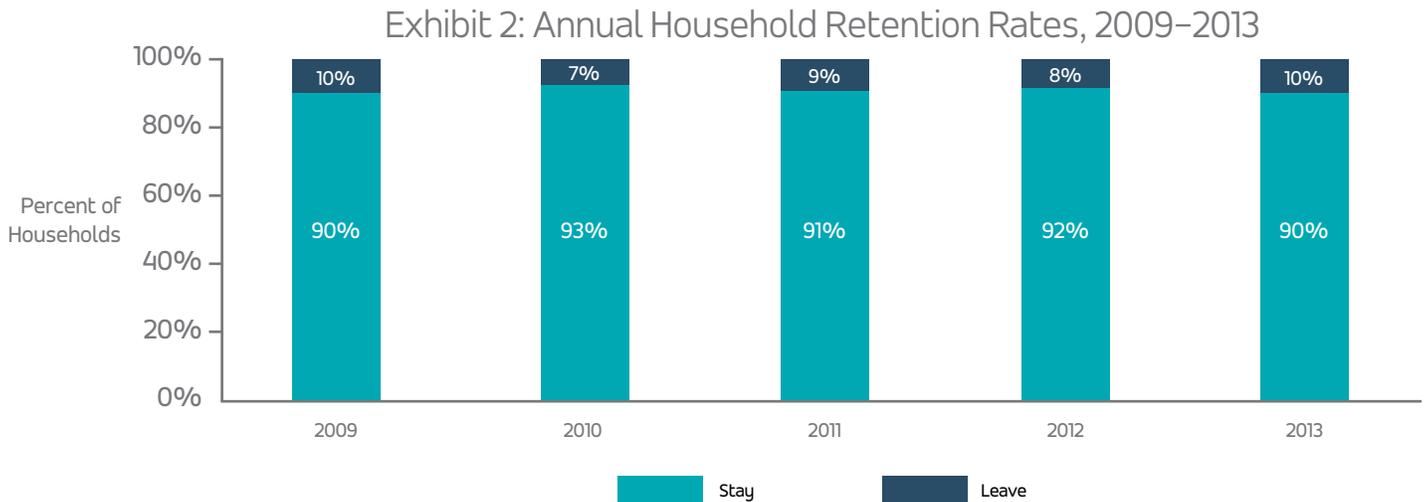
Advisors or firms that are looking to acquire a book of business should similarly be concerned about the target advisor's client retention rate. "How do I know these clients will stay?" is a question that, while perhaps not explicitly asked, underpins many book valuations, and deal or partnership structures.

In order to shed light on retention and attrition, we analyze data for clients (and advisors) from 2009 to 2013. The answers we provide give advisors a clearer picture of the opportunities and risks inherent in their books of business represented by client retention and attrition. Some of the key findings that emerge are:

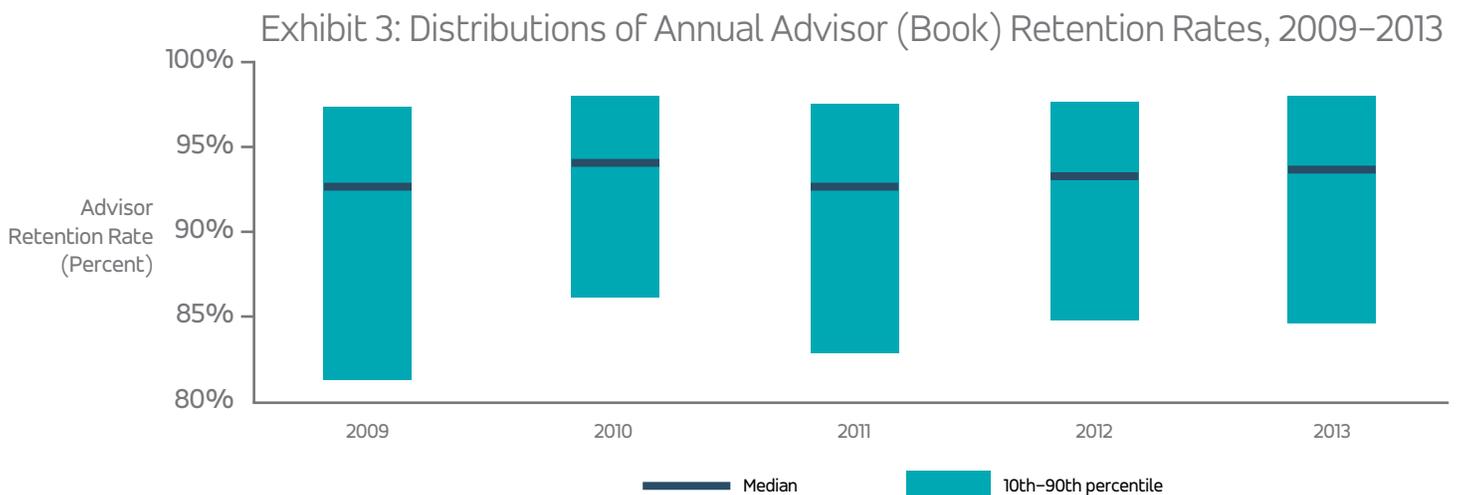
- The most critical time period for advisors to focus on client retention and attrition risk is from the one-year mark to the four-year mark in a client relationship.
- Small clients are less likely to stay with their advisor. Further, having an excess number of small clients in a book can negatively affect the retention of other clients.
- The client relationships least likely to be retained are low-priced fee-only relationships and high-priced transactional-only relationships.
- In terms of retaining clients, the industry-wide "transition" to fee is most advantageously approached as the addition of fee to transaction, where clients hold both types of accounts.
- There is no one price that optimizes client retention, rather a range of prices. Still, advisors can undermine perceptions of value by pricing too low or price themselves out of client business by pricing too high. Both lower the prospect of retaining a client.
- At the same time, despite advisor perceptions, large clients display less price sensitivity than small clients.
- Older clients are more likely to stay. Younger clients are more likely to leave.

BENCHMARKING RETENTION AND ATTRITION IN RETAIL WEALTH MANAGEMENT

To set the context, recent years have seen annual household retention rates of 90 percent or higher in the retail wealth management industry – meaning that in any given year, 9 in 10 households (or more) remain with their financial advisor (see Exhibit 2). The client retention rate of 90 percent in 2009 (the first full calendar year following the financial crisis) was the lowest in recent years, as more clients than usual were seeking new advisors. Retention in 2013 was again low at 90 percent.



At the same time, retention rates vary considerably across advisors. To illustrate, the median advisor in 2013 retained 94 percent of households. The advisor at the 10th percentile retained only 84 percent of clients, while the advisor at the 90th percentile retained 98 percent (see Exhibit 3). Again, we see that 2009 was a particularly challenging year for some advisors. While the top half and median rates of attrition were in line with historical norms, many advisors had retention rates below historical norms. The bottom 10 percent of advisors lost nearly one in five of their client relationships in 2009.

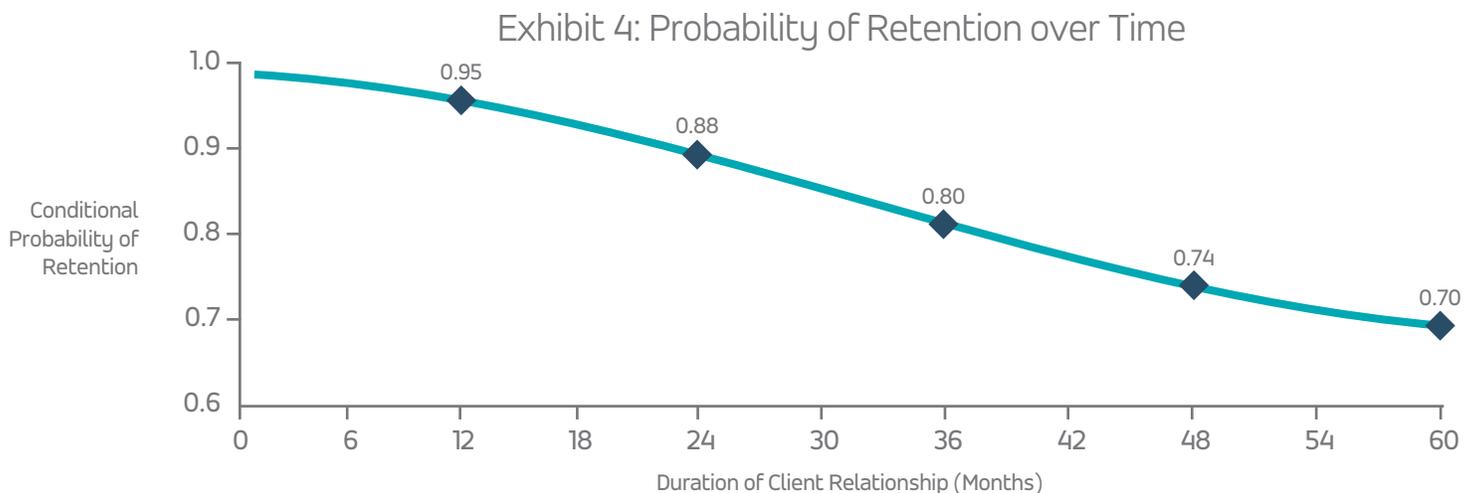


RETENTION AND ATTRITION OVER THE CLIENT ‘LIFE COURSE’

Client retention and attrition – whether in wealth management or any other industry – is a time-dependent process. By this we mean that retention metrics always measure a client relationship at a particular point in time. Similar to actuarial tables used in life insurance where the probability of surviving to a particular age depends on how long one has already lived, our approach to client retention involves examining conditional probabilities.² These are interpreted as the probability that an advisor will retain a client in a given month, conditional on the client having stayed with their advisor up to the previous month. In plain language, conditional probabilities answer the question: “What is the likelihood that I will keep a client for 24 months, given than I’ve already kept their business for the last 23 months?”

Our analysis indicates that the conditional probability of retention at first decreases only slowly. The probability of retaining a client in the first year is high (0.95 at 12 months). There is a ‘honeymoon’ period in wealth management advisor/client relationships! The probability of retention decreases between 12 and 48 months – from 0.95 to 0.74. It appears that it is during this time clients determine whether the advisor relationship meets their needs, and if not, they decide to leave. Around the 48-month mark, retention tends to stabilize, with the probability of retention decreasing from 0.74 at 48 months to 0.70 at 60 months (see Exhibit 4).³ This suggests that clients who have remained with their advisor for five years have by this time elected to remain for the long term.

In working to retain (and grow) their business with their clients, advisors should keep these different stages of the client relationship in mind, and redouble efforts to demonstrate the value they provide during the critical first-year to fourth-year time period. The data indicate that it is during this time period that clients make the decision to leave or stay for the long term.



²These conditional probabilities are one of the outputs from a type of time series analysis known as a discrete time logit model.

³This analysis was conducted separately with all households and also using only new households (those who began a relationship with their advisor during the time period under study). The differences between the two analyses were negligible, so the results from all households are reported here.

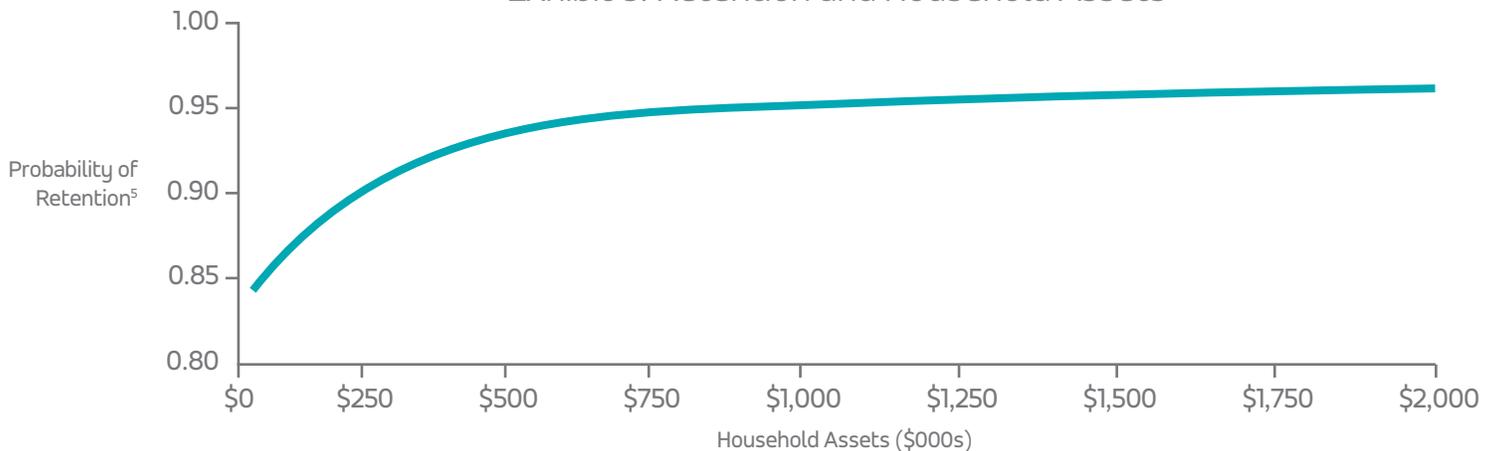
GREATER HOUSEHOLD ASSETS MEAN HIGHER LIKELIHOOD OF RETENTION

PriceMetrix research has previously found that small households (those with less than \$250,000 in assets) slow an advisor's growth rate, and impede their ability to attract high net worth households.⁴ We also find here that small households are significantly less likely to stay with their advisor.

Since clients may be drawing down assets as a relationship nears its end, we use median assets over the time period under study (2009-2013) in order to obtain a representative measure of client assets.

The data reveal that, as household assets increase, the probability of retention increases. Households with less than \$250,000 in assets are notably less likely to remain with their financial advisor than those with greater assets. To illustrate, in any given year, a household with \$100,000 in assets has a probability of retention of 0.87. A household with \$500,000 in assets has a probability of retention of 0.94, while the probability of retention of a household with \$1 million in assets is not substantially larger at 0.95 (see Exhibit 5). The implication, then, is that business development aimed at larger households will yield better results over time, as they will require less replenishment.

Exhibit 5: Retention and Household Assets



In addition to the client-level relationship between retention and assets, there is a further book-level dynamic with lower retention for advisors with larger proportions of their client base comprised of small households. For example, an advisor with 10 percent of his or her clients having less than \$250,000 in investable assets is expected to have an annual retention rate of 97 percent; an advisor with 90 percent of his or her clients having less than \$250,000 in investable assets is expected to have an annual retention rate of 91 percent.

⁴“Moneyball for Advisors,” PriceMetrix Insights White Paper, October 2012; “Big Fish: The Behaviors and Characteristics of the High Net Worth Client,” PriceMetrix Insights White Paper, May 2013.

⁵The time series analysis underpinning these results models retention and attrition in a specific month. To make interpretation easier, results are presented as the probability of retention in a given 12-month (one-year) time period.

It is important to note that this book-level phenomenon is driven partly (but not entirely) by small households' lower propensity to stay with their advisors. Retention among large clients (those with \$250,000 in assets or more) is lower in books with a substantial proportion of small clients. For example, an advisor with 20 percent of his or her clients having less than \$250,000 in investable assets is expected to have an annual large-client retention rate of 97 percent; an advisor with 80 percent of his or her clients having less than \$250,000 in investable assets is expected to have an annual retention rate of 94 percent (see Exhibit 6).

Advisors should therefore be mindful of the time and resources they devote to small clients given their reduced likelihood of staying. More importantly, advisors should recognize the often imperceptible damage that small clients can cause to relationships with larger clients.

Exhibit 6: Book-Level Retention and Client Mix



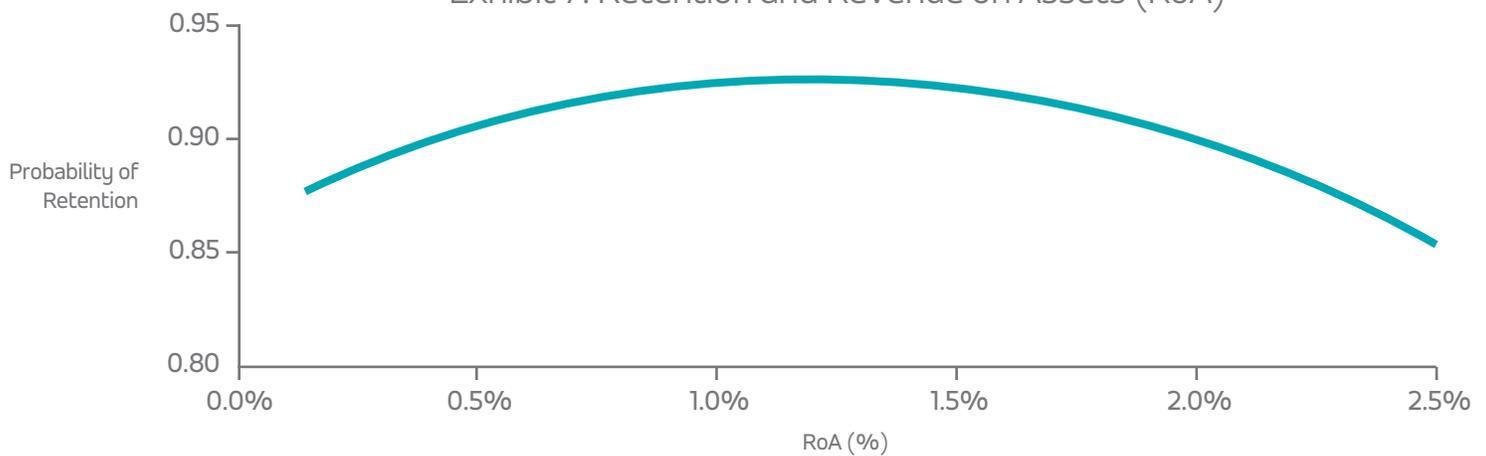
MAINTAIN HIGH CLIENT RETENTION THROUGH OPTIMAL PRICING

Taking the median for RoA over the time period analyzed, we see that households that are priced relatively low (for example, below 0.5 percent for overall RoA) or relatively high (above 2 percent for overall RoA) are less likely to be retained than those in the range of 1 to 1.5 percent. Retention is therefore highest in an optimal range (neither too low nor too high) and lowest among low-priced and high-priced clients (see Exhibit 7).

These results suggest that advisors who price their services low may undercut client perceptions of value; those who price high run the risk of creating an insurmountable service expectation. Both can make client retention more challenging. At the same time, the middle “optimal” range we identify is quite broad, allowing for a number of advisor business models and value propositions, and consequently different price levels.

Still, as those who are familiar with the wealth management industry know, household assets play a role in determining RoA, and as shown above, assets also affect the probability of retention. To further understand the interplay between client retention, pricing and assets, we examined the relationship between retention and

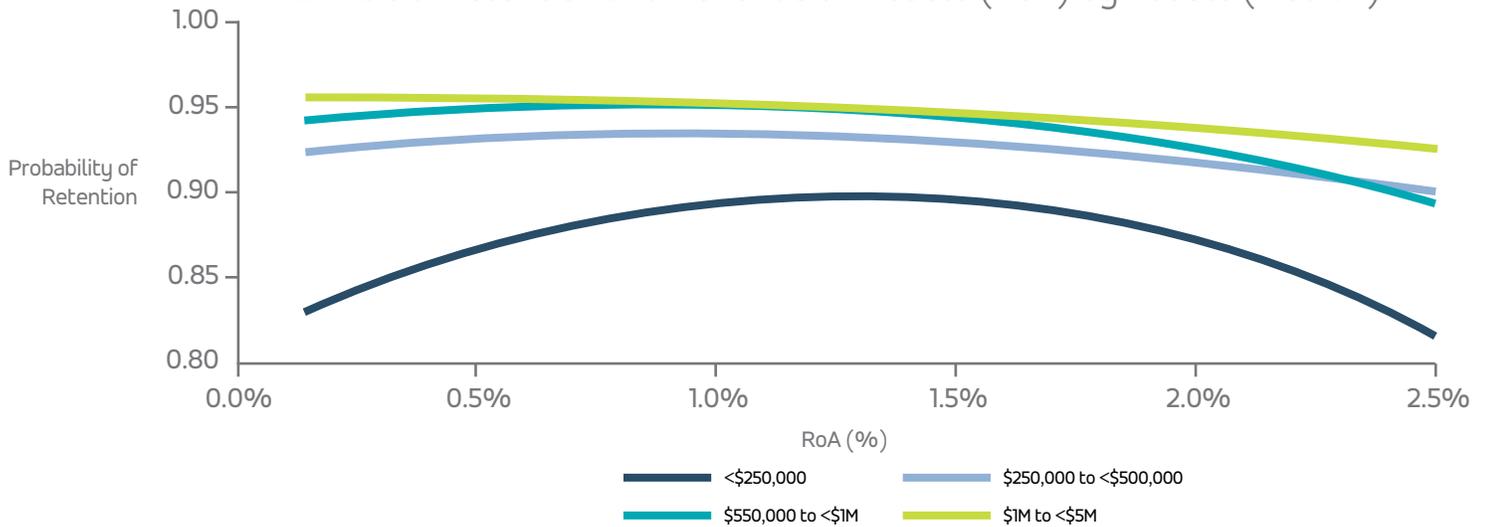
Exhibit 7: Retention and Revenue on Assets (RoA)



pricing for different asset tiers. Parsing out the data in this way reveals that households with \$250,000 or more in assets are all quite similar in their retention behavior, and appear to be less price sensitive (the probability of retention does not decrease steeply as RoA increases). Households with less than \$250,000 are both less likely to remain with the financial advisor and exhibit the most price sensitivity, with retention rates lower below 1 percent and above 2 percent (see Exhibit 8).

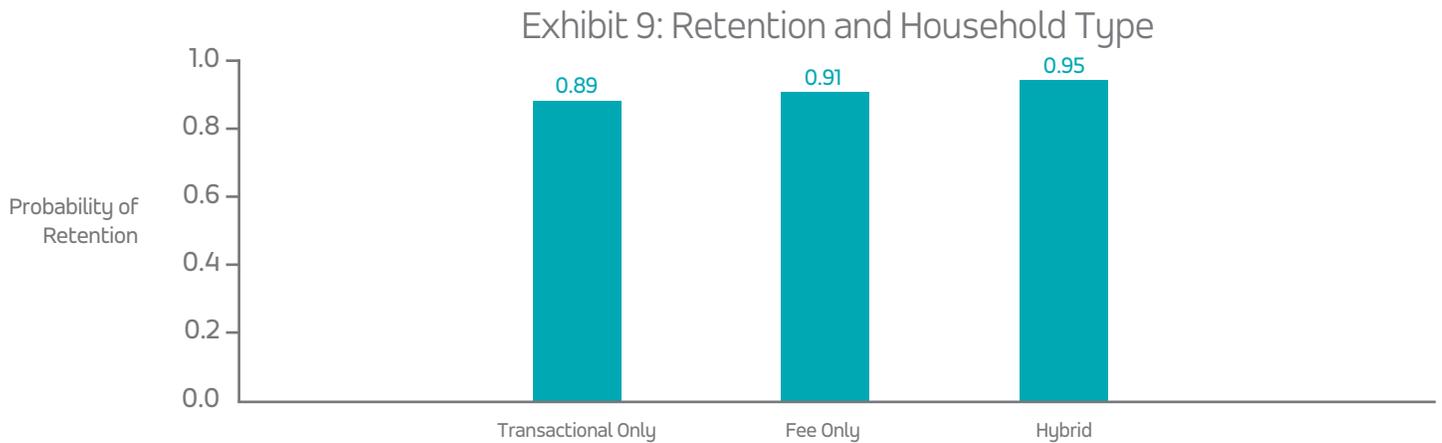
What these results suggest is the concern advisors occasionally express about price sensitivity among their clients, especially among their largest clients, may be overstated. For example, reducing one's price for a client with a \$1 million or more in assets from 1 percent to 0.5 percent produces no discernible improvement in the probability of retaining that client (it remains at 0.95). Reducing one's price with the goal of holding on to client business is therefore ineffective and costly.

Exhibit 8: Retention and Revenue on Assets (RoA) by Assets (Median)



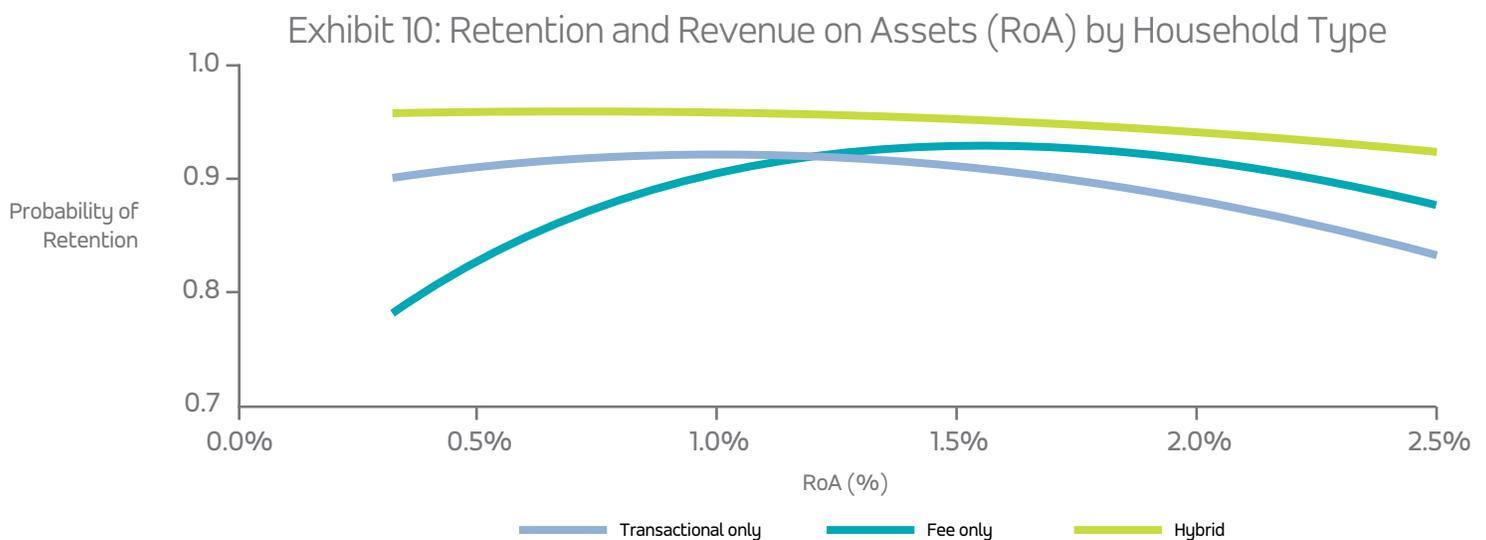
HIGHER RETENTION AMONG FEE-AND-TRANSACTIONAL CLIENTS

Our analysis also revealed important differences in the staying and leaving behaviors of clients who hold transactional accounts only, fee accounts only, or who are hybrid clients (holding both transactional and fee accounts). While transactional-only and fee-only households are similar in their probabilities of retention (0.89 compared to 0.91), hybrid households exhibit the highest probability of retention at 0.95 (see Exhibit 9). These results hold even when controlling for client assets.



It is worth emphasizing that the client relationships least likely to be retained are low-priced fee-only relationships. These are followed by high-priced transactional-only relationships. As suggested before, advisors may be eroding perceptions of value through low pricing in the former case, while pricing themselves out of the market in the latter. Irrespective of their price level, hybrid households remain more likely to stay with their financial advisor (see Exhibit 10).

What these results indicate is that the industry-wide move toward fee and managed business should be reassessed. In short, a strategy of moving to a hybrid model of transactional and fee-based business fares better than a strictly fee-based model.



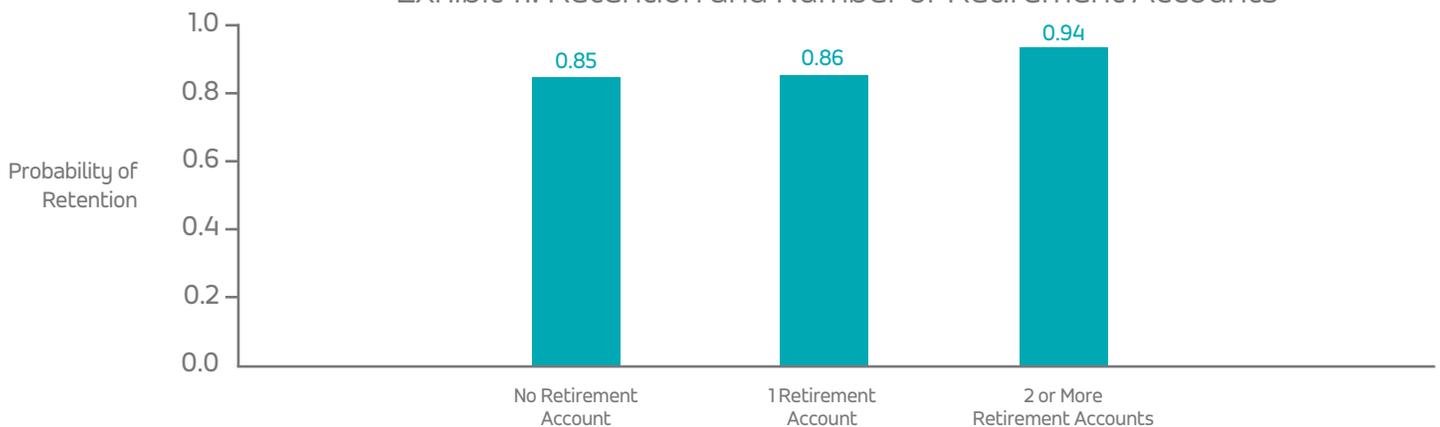
DEEPER CLIENT RELATIONSHIPS, GREATER LIKELIHOOD OF RETENTION

Our analysis also revealed – not surprisingly – that clients with deeper relationships with their advisor are more likely to be retained; those with thinner relationships are less likely to be retained. Two primary measures of relationship depth are the number of accounts held by a household with an advisor and the presence of retirement accounts in the household. Our analysis finds that a single-account household has a probability of retention of 0.86, a household with two accounts has probability of retention of 0.89. By contrast, a household with five accounts has a probability of retention of 0.94.

Examining the presence or absence of retirement accounts in a household, we find little difference in the probability of retention of households with no retirement account and those with a single retirement account (0.85 vs. 0.86). Households with two or more retirement accounts, however, are significantly more likely to be retained (0.94) (see Exhibit 12).

The counsel that flows from these results is both clear and simple: when advisors (often correctly) surmise that they have only a share of a client’s investable assets, they should endeavor to increase their share, since doing so improves the prospect of retaining that client.

Exhibit 11: Retention and Number of Retirement Accounts

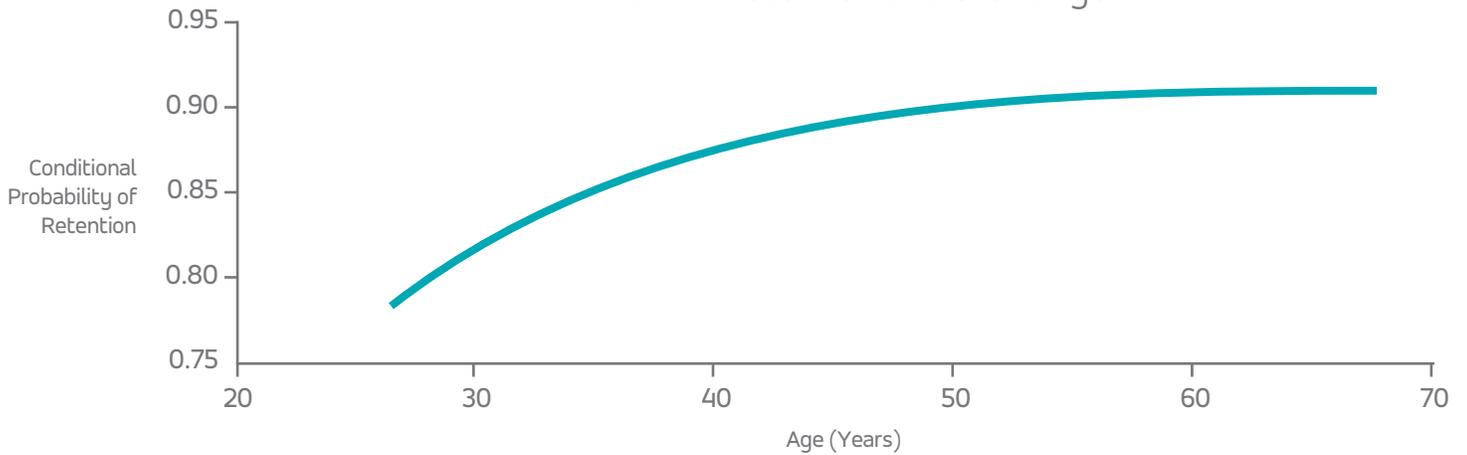


OLDER CLIENTS ARE MORE LIKELY TO STAY THAN YOUNGER CLIENTS

In addition to assets, pricing (RoA), household type and depth of relationship, client age also exerts an effect on client retention. Simply put, younger clients are less likely to remain with their advisor and more likely to leave. For example, a 30-year old client has a probability of retention of 0.82, a 40-year old client 0.87, a 50-year old client 0.90 and a 60-year old client 0.91 (see Exhibit 13).

These results should give pause to those advisors who might expect (or hope) that pursuing younger clients will yield long-term client relationships. While younger clients may have longer time horizons with respect to their financial plans, the data do not support the claim that they intend to spend many years with one advisor.

Exhibit 12: Retention and Client Age





DEPARTURES



CLIENT RETENTION AND THE SUCCESSFUL ADVISOR

There are few characteristics of advisor books that are more important and less understood than client retention. Our analysis began with the observation that advisors with higher client retention rates grow their assets and revenue faster. These are compelling reasons for developing – and executing – a retention strategy. Such a strategy should take into account the key findings from this study.

1. The likelihood of retention varies across time: different stages of the client relationship are more attrition-prone than others. Though advisors may have annual check-ins with their clients, our analysis suggests that relationships in the second, third and fourth years should be critically looked at and managed, as it is during this period that the probability of retention experiences its sharpest decline.
2. Both small clients and younger clients are significantly less likely to stay. Advisors should therefore recognize the reduced likelihood of holding onto the business of these clients, critically evaluate the importance of such relationships, and make a conscious decision about the time and resources that ought to be devoted to them.
3. Not only are small clients less likely to stay with their advisors, but books with an excess of small clients have lower retention among their larger households. Advisors should thus also recognize that time and resources put into small clients may have negative consequences for what they are able to do for their large clients (and may bear on one's large clients' decisions to stay or leave).
4. While retention is higher among clients with fee and managed accounts compared to transactional accounts, it is clients with both types of accounts who have the highest likelihood of being retained. This somewhat counterintuitively suggests that advisors who aim to hold on to their clients' business are better served by transitioning only some – and not all – of their business to a fee-based model.

TIME	FROM	FLI
09: 00	LONDON	DO
09: 10	MADRID	CL
09: 30	DUBLIN	RD
10: 00	BARCELONA	FL



ARRIVALS



5. We also find a reduced likelihood of retaining very low-priced and very high-priced clients, but relatively little difference in the probability of retention across a broad middle range. This suggests that a range of prices can exist simultaneously in the market, and it also points to the need to build and execute a pricing strategy to ensure that one's pricing and value proposition are aligned and consistently administered. Advisors should know their business model, how their pricing is supported by their value proposition (and informed by market data), and communicate the value they provide to their clients.
6. Deeper client relationships imply a higher likelihood of client retention. Where advisors know they have only part of the share of investable assets in a household - for example, only one spouse, or only non-retirement accounts - they should work to deepen those relationships. This may work in tandem with efforts to transition transactional business to a fee-based model (or to add fee accounts to existing transactional business).

Finally, it is worth noting that while this Insights report has focused on the client and advisor characteristics that shape the likelihood of clients staying or leaving, it does not address the question of client behaviors and circumstances i.e., 'events'.

Key questions left outstanding are: what types of client behaviors or events are predictive of a client leaving and can serve as early warning signs of client attrition? How can advisors identify clients at risk of leaving, allowing them to attempt to retain those they want? We plan to address these questions in a future piece of research.

FLIGHT	STATUS
6290	ON TIME
332	ON TIME
090	ON TIME
667	ON TIME

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 Mathew Duffy, Client Manager.

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