

THE FOUNTAIN OF GROWTH

Demographics and Wealth Management

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PriceMetrix[®]

REALIZE YOUR VALUE

The retail wealth management industry is undergoing a fundamental demographic transformation, as the average age rises for both financial advisors and their clients.

This seismic shift is already impacting the industry, with advisors and wealth management firms grappling with changes they need to make in order to meet the needs of an aging client base.

INTRODUCTION

The average age of clients is estimated to rise from 62 currently to over 70 within the next several years. At the same time, 53% of assets are currently held by clients over 65 years old, leaving us poised on the precipice of the greatest wealth transfer in history.

Along with these challenges, wealth management firms are also dealing with aging advisors. The average advisor is 52 years old, and 25% percent of advisors are at or near a typical retirement age. These advisors control 25% of assets, meaning most firms are facing a second, parallel material wealth transfer.

Not only will firms need to replace these advisors, they will also need to do a better job of reaching out to aging clients. Pershing reports that just one in three advisors offer family wealth management services and an even lower number of financial advisors get to know their clients' children.¹

Advisors and firms are facing a myriad of questions as they try to not only mitigate but benefit from these demographic changes.

To help answer these questions and to shed light on how demographics will impact advisor and firm growth, we delved into PriceMetrix's aggregated database covering seven million retail investors, 500 million transactions and over \$3.5 trillion 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. The insights we have uncovered in our study will help advisors and firms gain a clearer picture of the opportunities and risks inherent in their books of business in terms of the demographic shifts occurring in the industry.

As a starting point, we compared the average age of clients and their advisors. It turns out that clients are typically 10 years older than their advisor – with the average client at 62 years compared to 52 years for the average advisor. This supports the general industry belief that advisors seek older clients to meet their production and asset goals.

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¹ 30 In 30: How Advisors Can Capitalize On A \$30 Trillion Wealth Transfer Over The Next 30 Years, April 28, 2014. Pershing LLC.

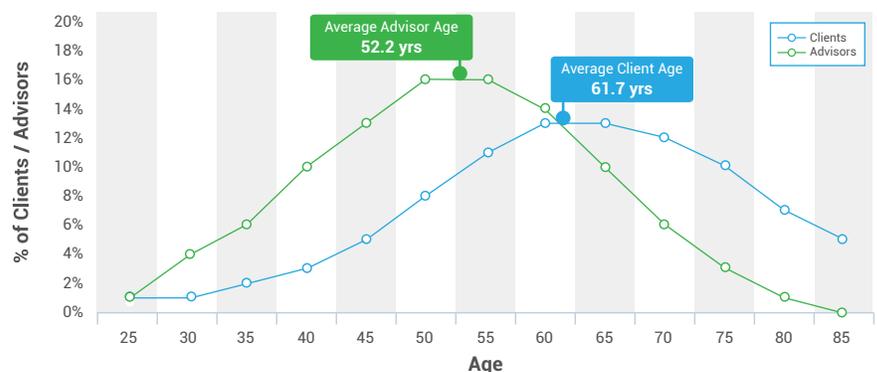
Advisors should be asking:

- How do I measure up to others in terms of “book demographics”?
- How do demographics affect my services, my growth, my production, my risk?
- Am I on track to optimize the value of my book when I retire?

Firms should be asking:

- How do the demographics of our advisors and clients compare with the industry?
- How can I help my advisors build growing, sustainable and valuable businesses?
- Does our firm have the right mix of advisors by age to achieve our firm's growth targets?

Advisor and Client Age



EVEN YOUNGER ADVISORS DON'T TARGET YOUNGER CLIENTS

The majority of advisors, both young and old, target older clients.

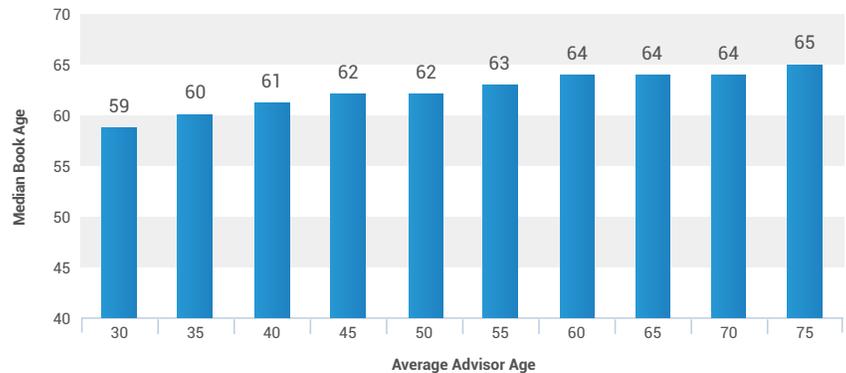
The tendency for advisors to target older clients holds true regardless of advisor age. As shown in the first chart, the average client age is very similar for advisors across a range in age, from 30 up to 75 years old.

Advisors of all ages target older clients because that is where the largest concentration of wealth can be found.

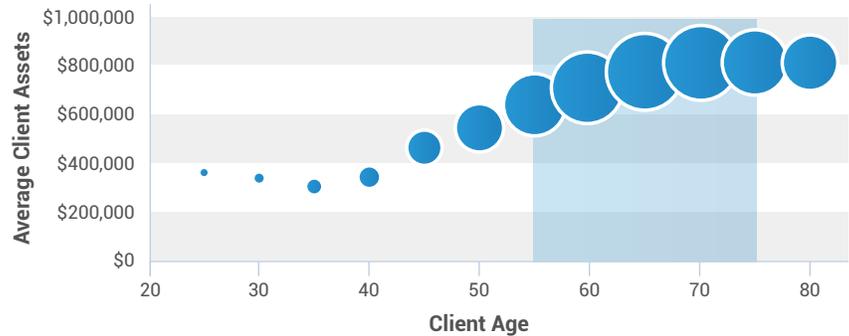
For wealth management firms, these data present a stark picture. Contrary to industry perception that younger advisors bring in younger clients, our findings show that a majority of both young and old advisors are focused on attracting older clients.

This finding is consistent with the need for young advisors to target older—and wealthier—clients to meet production and asset hurdles required to survive the early years in the business. As we will see in a moment, this trend is not necessarily healthy for firms or their advisors.

Median Book Age by Advisor Age



Client Assets by Age Range (Size Represents Share of Total Assets)



ARE ADVISORS ATTRACTING NEW AND YOUNGER CLIENTS?

The data plainly shows that this trend is expected to continue, in that advisors are not increasing the number of younger clients in their books. Overall, advisors opened an average of 3.6 relationships with younger clients (less than 45 years old) in 2012 compared to 3.7 in 2014.

The chart below shows that for advisors under 35, only one-third of new clients are less than 45 years of age. This is only marginally higher than advisors over 65 years, for whom only 28% of new clients are under 45.

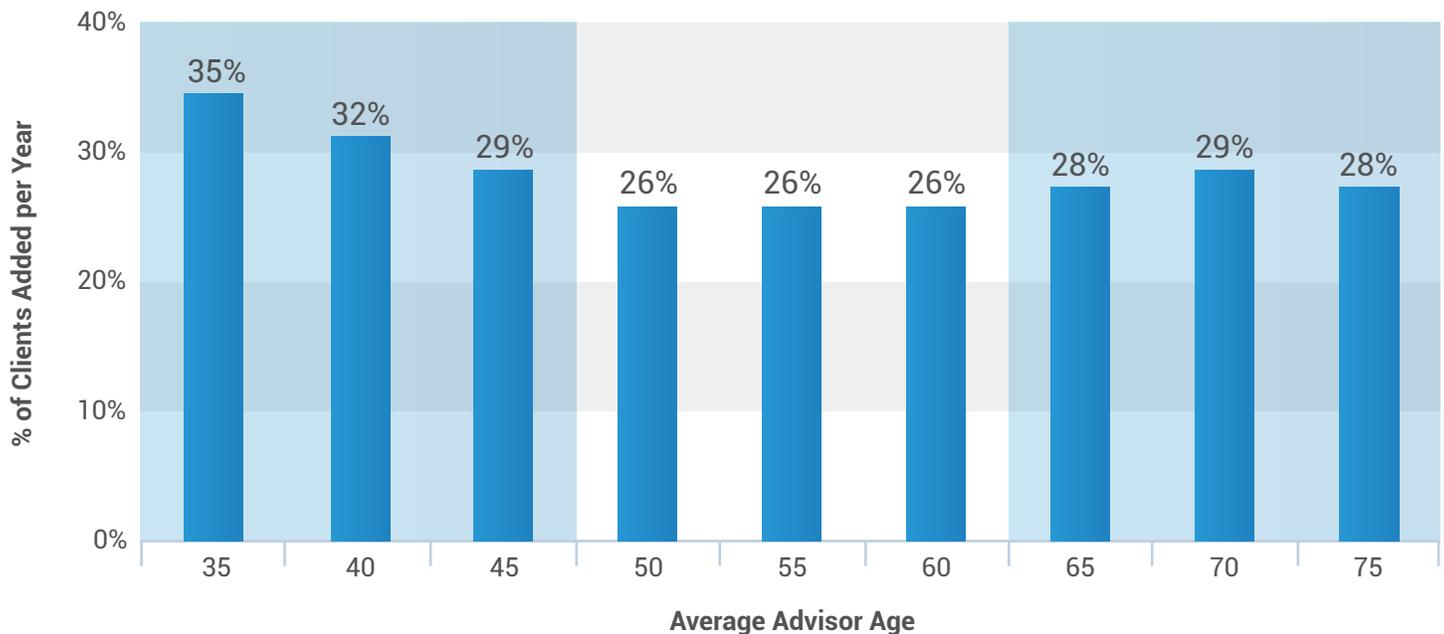
As we identified in our State of Retail Wealth Management Report, the average age of clients is rising by six to seven months a year, faster than the overall population of North America.

Simply put, there aren't enough young clients coming in to offset the aging of existing clients.

Similarly, the average age of advisors is rising faster than the overall population, at over 4 months per year – leaving firms to focus on recruiting younger advisors, as well as teaming, to balance the increasing rate of attrition due to advisor retirement.

Advisors of all ages are less focused on adding young clients.

% of Clients (less than 45 years) Added per Year



WHAT DO OLDER ADVISORS AND AGING BOOKS MEAN FOR ADVISOR AND FIRM GROWTH?

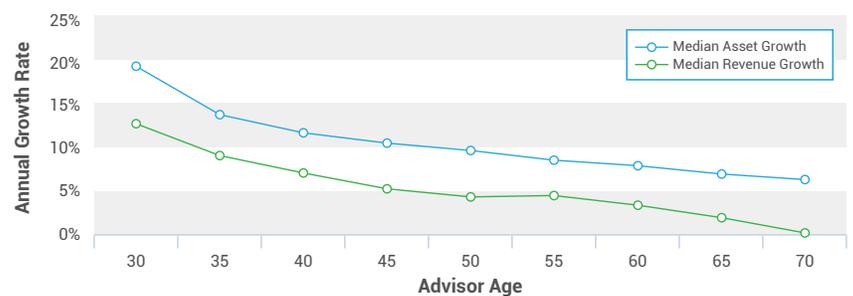
Whether you're an advisor or running an advisory firm, the critical question that needs to be addressed is how will this impact my growth?

For firms, the implications of aging advisors are troubling. The growth rate for advisors, in terms of both revenues and assets, declines with age. Growth declines rapidly between ages 30 and 40 before beginning a more gradual but continuous decline until an advisor reaches retirement.

As a start, firms should consider the potentially enormous impact on growth by investing in younger advisors and attracting younger clients. Firms with accelerated growth targets should consider their compensation plans and other policies in the context of shifting demographics.

Advisor growth declines with age.

Asset and Revenue Growth by Advisor Age

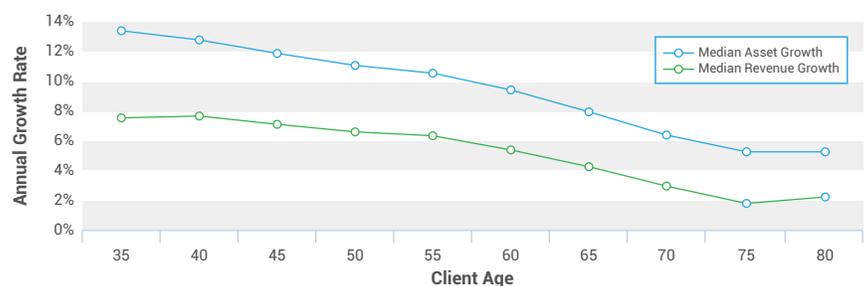


The combined effect of aging clients and older advisors poses a considerable threat to their future businesses. Growth rates will almost certainly slow down if these trends continue. Younger clients provide higher levels of growth for advisors – across all stages of an advisors' career (i.e., from 40 to retirement). Normalizing for an advisor's age, advisors with younger clients, grow faster over the long term than advisors with older clients.

The question for advisors then is whether you are growing above the natural asset accumulation rate of your clients or below it? Are you unknowingly falling behind in your business because age-related "easy" growth is really what's driving your business?

Advisors with younger clients grow faster over the long term than advisors with older clients.

Asset and Revenue Growth by Client Age



TRADING OFF—HIGHER REVENUE TODAY VERSUS LONG TERM GROWTH

Advisors and firms who wish to accelerate their growth need to carefully consider their options. Older clients have more assets and generate higher revenue but younger ones will grow more rapidly and can be more valuable over the long run. Fortunately, the tradeoff may not be that painful.

It turns out that advisors can achieve higher growth rates with a relatively modest tradeoff in current revenue.

Normalizing for advisor age (40-60 year old advisors), the chart below shows higher growth rates for books with an average client age of 50 to 55 compared to books with an average age of 65 to 70.

Advisors may concede some current revenue but may feel it is worth it to capture stronger growth.

Looking at the age composition of the fastest growing book (50-55 average client age) reveals that clients under 45 make up almost 30% of the book, compared to the slowest growing book (65-70 average client age) which is composed of just 7% younger clients.

Which book would you rather have?

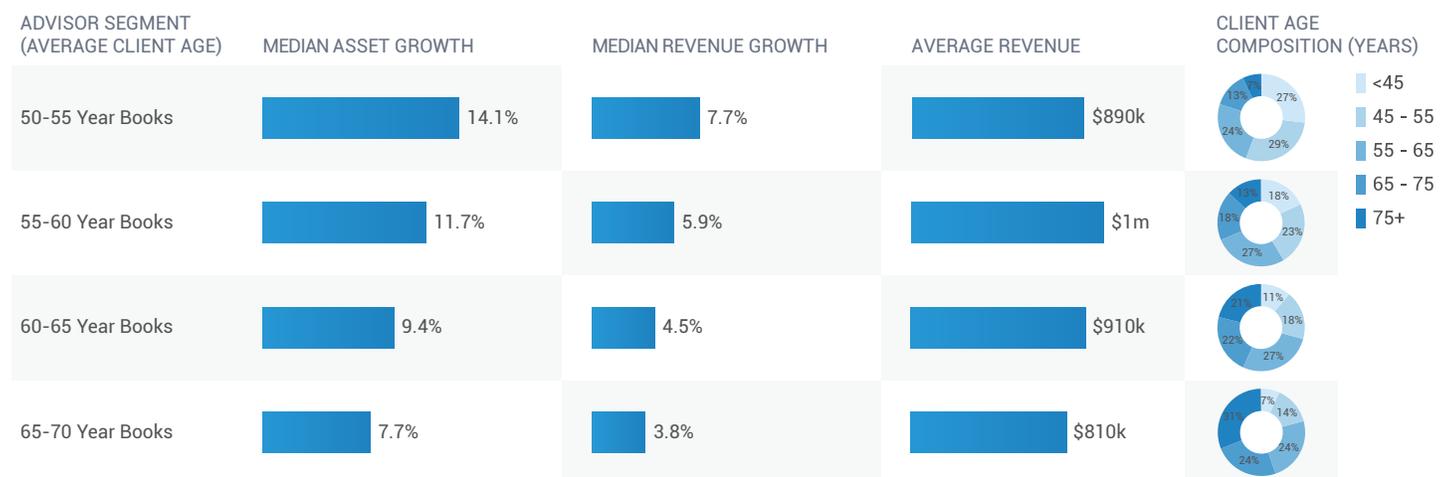
- Earning \$890K per year, growing 14.1% per year with 20% of clients over 65 year; or
- Earning \$810K per year, growing 7.7% per year with 55% of clients over 65

Today, most firms will reward the two similarly.

Our analysis indicates that younger clients, who are typically smaller clients, are still attractive in terms of driving overall growth. Advisors who incorporate younger clients in their practices grow both their revenue and assets at a faster rate.

Younger clients are attractive in terms of driving overall growth.

40-60 Year Old Advisor Growth Rates by Average Client Age



ALIGNING AGE AND ASSETS – WHAT’S THE BEST MIX?

Given the tradeoffs identified between assets, growth and age, advisors and firms need to rethink what truly is the best mix of clients. They should strive to create the proper combination of older, higher revenue clients with younger, faster growing clients.

Early on, young clients tend to grow assets rapidly because they are starting from a low base and even small increments generate large percentage increases. Interestingly though, as shown below, younger clients tend to grow revenue at a faster rate than older clients – across all asset levels.

This matrix shows the revenue growth advisors can expect, depending on the age of the client and amount of their assets. While the chart underlines the obvious attractiveness of younger clients with greater assets relative to older clients with fewer assets, it provides perspective on:

- The impact on advisors targeting small clients as a business strategy
- Production tradeoffs between clients of different ages and asset levels

Generally, advisors have been wise to avoid targeting clients with less than \$250,000 in assets because they divert attention away from bigger, more profitable clients.

However, adding age to the mix adds a new consideration. Advisors might consider targeting 40 year old clients with just \$100,000 in assets because they will grow faster than any other group with a 7.0 percent compound annual growth rate. Older clients with fewer assets, on the other hand, are clearly less attractive target clients.

Asset or revenue minimums that are applied universally across a book or business may be overly simplistic. Firms should consider demographics and life stage to create more sophisticated thresholds for policy purposes.

The matrix demonstrates the tradeoffs associated with selecting clients across different age and asset size categories.

For example, an advisor with a 45 year old client that has \$200,000 in assets can generate more revenue within five years than a 75 year old client with \$500,000 in assets.

Age-Adjusted Expected Growth and Revenue

Average Client Age	Average Client Assets		
	\$100k-\$250k Assets	\$250k-\$1M Assets	\$1M-\$2M Assets
40-55 Years	7.0% Revenue Growth \$1,900 Annual Revenue	5.7% \$5,200	3.4% \$13,100
55-70 Years	5.9% \$1,800	3.8% \$5,100	2.9% \$12,000
70-85 Years	2.8% \$1,500	2.7% \$4,200	2.3% \$9,900

7%+ Revenue Growth
 5-7% Revenue Growth
 3-5% Revenue Growth
 <3% Revenue Growth

EASING THE PAIN

Trading higher current revenue for longer term growth can still be unappetizing, even if the tradeoff makes sense over the lifetime value of a relationship. However, the data show there are other significant advantages which should at least ease some of the pain.

The chart below shows:

- **Return on assets is 25 percent higher** in books with younger clients – indicating these clients are more willing to pay a premium and are more productive for the advisor.
- There are **fewer household relationships to manage** in younger books – contributing to a lower cost to service and higher ROA.
- **A higher proportion of fee-based accounts** in younger books – highlighting the fact that these clients may be seeking longer-term, advice-based relationships with their advisors.

Advisors can benefit from having a younger book – in terms of higher return on assets, fee based ratio and lower service costs.

Firms should also gain a better understanding of the needs of younger clients, to build products and service that better address those needs.

Key Advisor Performance Metrics

	Fee Based Ratio	ROA	# of Clients
50-55 Year Books	 43%	 88 bps	 139
55-60 Year Books	 36%	 72 bps	 184
60-65 Year Books	 33%	 69 bps	 196
65-70 Year Books	 24%	 61 bps	 185

SUMMARY

The demographics confronting the retail wealth management industry are fundamentally changing as both advisors and clients are getting older. Advisors and firms need to understand the dynamics of these changes and consider ways to adapt and take advantage of the shift.

The data suggest that firms and advisors can improve their performance and accelerate growth by better understanding their clients' demographic characteristics and employing new strategies to attract and better service demographic sub-segments.

Advisor Conclusions

Advisors need to take into consideration the demographics of their book as they consider the best ways to build and manage their business. Advisors should consider strategies to target clients across various demographics, if they want to build a sustainable book.

Advisors overall should continue to be discerning about which clients they choose to do business with, but in doing so, should consider the life stage of a client, their own expertise, and the full value of a well serviced relationship over time.

Firm Conclusions

Firms are facing slower overall growth rates as both advisors and their clients get older. As a result, firms need to develop new plans for hiring advisors, succession and building new advisor teams.

If firms are interested in attracting younger clients, firms should consider asset and account minimums that are adjusted to the life stage of clients (i.e., accumulators / decumulators).

Firms should also gain a better understanding of the needs of younger clients to build products and services that better address those needs.

Advisors and firms can use this research, by taking the following actions, to proactively consider the demographic opportunities and challenges facing their business.

Advisor Actions

- ▶ Compare the average age of your book to the chart showing distribution of industry average book age.
- ▶ Look at your client mix by age and by asset level to understand how it compares to the industry and to other advisors
- ▶ Using the Age Adjusted Expected Growth and Revenue chart, compare some or all of your clients in each cell to the expected growth rates to determine if you are growing faster or slower than average
- ▶ Develop a strategy to target younger clients. What services will appeal to them? How do I find them? How do I attract / close them?

Firm Actions

- ▶ Compare your firm's demographics to the client and age distribution chart. Are your firm's clients and advisors younger or older than the industry?
- ▶ Help your advisors understand the demographics of their books and the implications this will have on their growth and legacy.
- ▶ Compare your firm against the data showing the number and percentage of new, younger clients being signed up in the industry. Is your firm keeping up?

Over the coming months, PriceMetrix will work with our clients to explore this topic further to better understand and take action to address these fundamental issues.

