

INDEPENDENT THINKING ON:
THE WEALTH
MANAGEMENT IMPERATIVE



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EXECUTIVE SUMMARY



Despite the bursting of the late 1990s tech bubble and the resulting bear market in 2000–2002, the final two decades of the 20th century yielded an unprecedented era of wealth creation in the United States. Millionaire households now number about 2.3 million, up 171% from 850,000 just 10 years ago,¹ and the annual *World Wealth Report* forecasts that the financial wealth of high-net-worth individuals in North America will grow at an average annual rate of nearly 11% between 2003 and 2008.² About two-thirds of wealthy households are currently headed by someone aged 55 or older and, collectively, investable assets controlled by this group is expected to increase from \$6.4 trillion in 2003 to over \$19 trillion by 2012.³

As this group of affluent investors continues to age, there may be an increasing need to help them address the issue of how to efficiently preserve and transfer a significant amount of wealth to future generations, and how to manage that wealth after it is transferred. It would appear for advisors that adopting, or evolving into, a wealth management model may be the best course of action to take. Or is it?

This report provides insight gathered from interviews conducted with more than 400 registered investment advisors about the wealth management business. In particular, it explores what “wealth management” means to established, as well as aspiring wealth managers, and the challenges advisors have faced or are facing as they consider moving their practice into the wealth management space. Based on lessons learned from RIAs, including experienced wealth managers, the report outlines what they consider the critical success drivers that help distinguish accomplished wealth managers from other types of advisory firms, including:

- **The ability to leverage the resources of strategic partners and other providers of expert services;**
- **Carefully managing business growth to avoid disruption to existing client relationships and ensure that the infrastructure is in place to support new relationships and service expectations;**
- **Developing broad and deep relationships with all clients, managing as much of their financial life as possible; and**
- **Taking advantage of product and service developments to bring the very best to their clients.**

¹ *The Future of the Money Management Industry 2003*, Empirical Research Partners

² *World Wealth Report 2004*, Merrill Lynch and Capgemini

³ *The Cerulli Edge, August 2004*, Cerulli Associates

INCREASING MIGRATION TO A WEALTH MANAGEMENT MODEL

According to study findings, an increasing number of financial planners and investment managers have migrated, or are considering migrating, to a wealth management model for a variety of reasons:

- **Client demand for a more comprehensive set of advisory services;**
- **Advisor interest in working with a broader range of sophisticated products;**
- **The opportunity to expand and strengthen relationships with existing clients; and**
- **The potential to attract new, wealthier clients who may be substantially more profitable to the firm.**

Despite these potential benefits, wealth management may not be for everyone as RIAs cite considerable challenges both in transitioning to this model as well as maintaining a successful wealth management practice. Challenges include:

- **Expanded product and service demands that raise outsourcing and staffing issues, as well as the need to acquire more knowledge and new skills;**
- **A likelihood of higher expenses and resulting profitability squeeze during the transition phase, which may require new pricing and a reassessment of existing client relationships;**
- **The possibility of increased liability as a result of entering new product and service areas;**
- **A need to deal with greater complexity and possible loss of strategic focus; and**
- **The need to effectively differentiate the service offering.**

This paper is designed to help advisors who are considering making the transition to wealth management (or might already be in the midst of that transition) evaluate and fine-tune their course, as well as help experienced wealth managers benchmark their practices against their peers to continue to drive success.

“We examine every aspect of our clients’ lives and match various financial instruments and planning tools to the events that occur and will occur in their lives.”
— *Wealth Manager*

Survey Methodology

The Fidelity-sponsored study, “The Evolution of Wealth Management,” was conducted in the fall of 2004 by Evanston, Illinois-based Richard Day Research, Inc. (RDR). RDR first conducted in-depth qualitative interviews with 12 wealth managers to gain insight into how wealth managers view and distinguish themselves from other financial advisors. RDR then conducted over 400 interviews nationwide with investment advisors, including 201 wealth managers,¹ 102 financial planners, and 105 investment managers. Clients of Fidelity Registered Investment Advisor Group represented 39% of respondents.

Of the participating advisor firms:

- Over one-third of the wealth management and investment management firms reported more than \$200 million in assets under management (AUM)
- One in five financial planning firms reported over \$50M in AUM
- On average, all firms have been in business for 16 years
- One in four wealth management firms (24%) report 200+ clients, and about as many (23%) report fewer than 25 clients

Of the survey respondents:

- At least 74% were the president, owner or CEO of their firm; the rest were partners
- The average age of these advisors is 50; also, 13% of financial planners and 23% of wealth managers are under age 40
- One out of five financial planners were women, as were one in ten of wealth managers and investment managers

¹Wealth managers include advisors who reported that they provide estate planning and/or trust services, along with comprehensive financial planning, and who report an average client relationship of at least \$500,000. Those who reported that they provide wealth manager services but did not meet these criteria were asked if they consider themselves closer to a financial planner or an investment manager, and were categorized accordingly.

DEFINING WEALTH MANAGEMENT

The term “wealth management” has been bandied about the financial advisory industry for most of the past decade with no universally accepted definition. Some advisors view it as nothing more than an industry buzzword or marketing jargon. Others have embraced it as the way they manage their business. Based on our research of wealth managers, it is clear that the term does have real meaning.

When asked to describe what distinguishes their services from other types of financial advisors, **wealth managers emphasize the uniqueness of their client relationships** — relationships that are **broad** in terms of encompassing all areas of a client’s financial life and **deep** with respect to the advisor’s intimate knowledge of a client’s values and priorities. In fact, 73% of wealth managers, 55% of financial planners, and 35% of investment managers cited either deeper or broader client relationships as distinguishing factors of a wealth manager.

In turn, this breadth and depth of relationship enables the wealth manager to develop and implement highly customized solutions that address virtually all aspects of a client's financial well-being. At a minimum, the following three criteria surface as essential in differentiating a firm as a wealth manager:

- 1** *The relationship that wealth managers have with their clients* — 51% of surveyed wealth managers emphasized the breadth of their client relationships, using terms such as “holistic,” “comprehensive,” and “all-inclusive,” while 29% also highlighted the depth of those relationships, referencing the “intimate” and “individualized” nature of them. While fewer financial planners and investment managers identified the breadth and depth of client relationships as a key criteria in defining wealth management, their numbers were still significant.
- 2** *The specific products and services that wealth managers provide to clients* — 47% of wealth managers, 40% of financial planners, and 53% of investment managers all stress the specific products and services provided to clients as being a key part of how they define wealth management. A particular emphasis is placed on estate planning and multigenerational planning services, as well as tax strategy expertise and alternative investments.
- 3** *The specific goals/objectives of wealthy clients* — at least 15% of wealth managers and investment managers, and 26% of financial planners, cited specific client goals/objectives (e.g., wealth preservation and wealth transfer) as an important component in differentiating wealth management from other practice models.

Whether wealth managers differentiate their practices on the basis of the breadth and depth of their client relationships or on the services they offer, one thing is clear: advisors who have or will adopt a wealth management model confront challenges that other advisors may not. The all-encompassing relationship the wealth manager has with wealthy clients coupled with their complex financial needs lead to both high expectations and strong demands that require comprehensive advice. Considering these challenges, what forces motivated wealth managers to adopt a wealth management advisory model in the first place?

“Our approach is holistic. It focuses on the overall perspective as far as what goals they are trying to accomplish as opposed to just building wealth or just looking at tax strategies.”
— *Wealth Manager*

MOTIVATIONS FOR ADOPTING A WEALTH MANAGEMENT MODEL

CLIENTS NEED MORE COMPREHENSIVE SERVICES

When advisors were asked what prompted them to pursue becoming a wealth manager, the most common response was that **they recognize that their clients needed, and expected, more comprehensive advice and management.** Basic financial planning or investment management alone would not be sufficient.

Motivators to Transitioning to Wealth Management — Exhibit 1

Q. (WMs): Thinking back, why did you decide to make the transition to wealth management? What prompted you to pursue becoming a wealth manager? What were you hoping to accomplish? What opportunities did you perceive? (most frequent open-ended responses)



Source: The Evolution of Wealth Management, 2004. Fidelity Investments.

In fact, in a recent study of affluent investors, **53% of high-net-worth and ultra-high-net-worth individuals prefer to work with a single advisor to address a comprehensive range of financial needs.**³ These clients often prefer that the advisor receive assistance from attorneys, accountants, or other specialists, but nevertheless want a single “face” with which they can develop a trusted relationship.

PREFERRED ADVISOR WORKING RELATIONSHIP

Most high-net-worth investors prefer working with a single advisor with additional assistance from outside specialists (28%), to manage investments (28%), or to access a comprehensive range of services (25%). Relatively few embrace working with multiple advisors (13%) or any individual advisor managing other advisors (quarterback approach, 5%).

Preferred Advisor Working Relationship — Exhibit 2



Note: Respondents could choose more than one response. Source: Wealth and Advice, 2004. Fidelity Investments.

³ Wealth & Advice, 2004, by HNW and Survey.com for Fidelity Investments. High-net-worth investors are those with \$1 million to \$5 million in investable, non-retirement assets, and ultra-high-net-worth are investors with over \$5 million in investable assets.

INTEREST IN EXPANDING AND DEEPENING CLIENT RELATIONSHIPS

Along with client demand for holistic solutions is the advisor's interest in providing a more comprehensive set of services. By doing so, the wealth manager could expand and strengthen relationships with existing clients and potentially attract new clients who may be more profitable to the firm. As a result, deeper client relationships may lead to greater probability of success for both advisor and client.

The Relationship-Profitability Cycle — Exhibit 3



Opportunity for Higher Compensation and Greater Profitability

While higher levels of compensation was not the primary driver for most — only about 13% of wealth managers interviewed say they pursued wealth management to achieve a more profitable practice — the potential for it is there. It is certainly consistent with providing a broader range of services to appeal to wealthier clientele. But transitioning to wealth management can bring a host of challenges, and it is not an easy gateway to higher profits.

Given the increased product and service demands associated with the wealth management model, it is not at all uncommon for practices to experience a short-term profitability squeeze when migrating to this type of model. Avoiding longer-term profitability issues, however, is often predicated on the firm's ability to migrate from a practice to a business (i.e., moving from being totally dependent on the principals to being able to function as an ongoing concern).

“Clients were demanding [more comprehensive] services, and we thought it was a more profitable model than what we were doing.”
— *Wealth Manager*

CHALLENGES OF ADOPTING A WEALTH MANAGEMENT MODEL

REASONS WHY ADVISORS DO NOT PURSUE WEALTH MANAGEMENT

While wealth management holds significant allure for many, fully 59% of financial planners and 63% of investment managers interviewed say that they have never considered transitioning to wealth management. They offer a variety of reasons to support their position. Many financial planners and investment managers say they do not have the requisite knowledge or experience

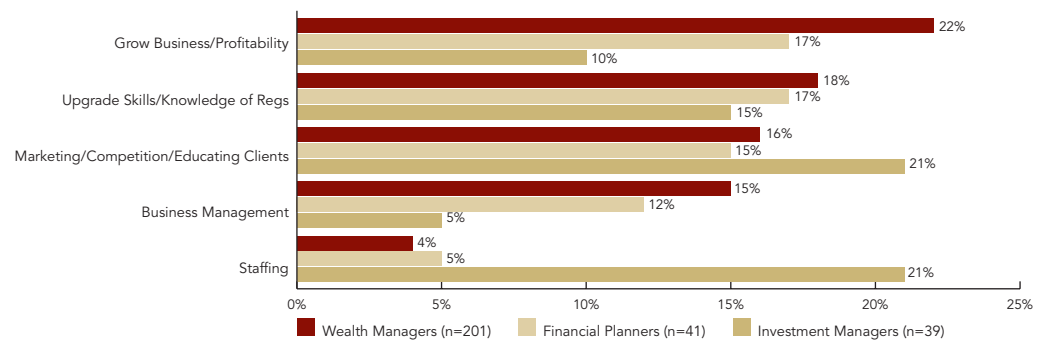
“Our value proposition is that we are great money managers, not great wealth managers.”
— Investment Manager

and, in some cases, are not motivated to acquire it. Others believe that wealth management is just a marketing term, with financial planners maintaining that it’s not really different from what they’re doing currently. Some financial planners also say they prefer to continue working with a broader demographic group of mass-affluent and middle-market clients instead of turning their full attention to high-net-worth clients. Among investment managers, many are content to remain focused on managing portfolios and do not want the burden of adding staff and infrastructure to offer additional services. In addition, they say they enjoy their current practice model and have no desire to change.

Challenges in Transitioning to Wealth Management — Exhibit 4

Q. (WMs): As you made the transition to wealth management, what was the biggest difficulty/challenge that you encountered?

Q. (FPs/IMs considering transition): What do you anticipate will be the biggest challenge/hurdle in making a transition to a wealth management model?



Source: The Evolution of Wealth Management, 2004. Fidelity Investments.

HIGHER EXPENSES AND PROFIT PRESSURES

The process of delivering as a true wealth manager has multiple challenges, according to experienced wealth managers (see Exhibit 4). Probably the biggest one they face, especially in the early stages of building a wealth management practice, is **the likelihood of higher expenses and resulting profitability squeeze**. Expanding services adds complexity and cost to a practice and may require additional full- or part-time staff. Costs can be controlled through better use of technology and outsourcing. But technology will need to be acquired, and outsourcing relationships will need to be managed carefully to help ensure high service standards.

A critical issue for any successful practice is the need to institutionalize their business to help ensure long-term profitability. The following four steps offer guidance in this process:

- 1 Be clear about who you want to be (positioning statement/value proposition, ideal client profile, commonality of needs, etc.)
- 2 Determine which services are core to your offering and provided in-house vs. those which should more properly be outsourced
- 3 Carefully analyze the revenue/cost benefits of each service provided
- 4 Institutionalize/systematize how you provide services, and ensure you are adequately compensated for the value you deliver to your clients

Clearly, there are additional ways that firms can address this transition-induced profit squeeze. Here are a few:

- **Assess the profitability of existing clients to determine whether service levels should be modified to better match the profitability of the relationship**
- **Reconfigure your client base to try to end up with fewer, more profitable relationships**
- **Reexamine account minimums to help ensure you are only working with clients who are most likely in need of, and are willing to pay for, the full range of your services**

The purpose of determining client profitability is pretty straightforward: you want to find out how much each client costs the firm versus how much revenue they generate. One formula for calculating individual client profitability is the following:⁴

Individual client revenues **minus**

- 1 Individual client hours **x** staff cost per hour **+**
 - 2 Individual client hours **x** (principal's comp \div total hours with clients) **+**
 - 3 Annual overhead \div number of clients
- Equals** Individual client profitability

In a service business like wealth management, cost really boils down to the time the principal(s) and staff spend on each client. The calculation for principals, however, can be tricky because per-hour cost isn't always clear. The best approach is to estimate the total time spent with clients and divide that by the principal's annual compensation. Include only the time actually spent meeting or communicating with clients. Do not include time spent on other activities (e.g., business management, creating financial plans, etc.).

This analysis will help enable the firm to evaluate marginal clients for growth potential, share of wallet, or referrals. Also, it will allow the firm to determine whether a tiered service offering with an appropriate tiered fee structure based on the client's anticipated profitability would yield a better business model. The firm could then apply this new fee structure to new wealth management clients that will be acquired. In effect, this positions the firm to spend the most time with the highest-value clients and may yield fewer, but more profitable, client relationships.

Firms Also Should Consider Whether Their New-Account Minimums Are High Enough

At least 58% of investment managers and financial planners expecting to transition to a wealth management model believe they will increase their firm's account minimums for their prospective wealth management clients.

Recent trends among all RIA models appear to support this view. The median minimum account size across all firms rose to \$310,000 in 2003 vs. \$225,000 in 2002, and those firms with assets under management in excess of \$500 million have minimums as high as \$725,000.⁵

**"I'm a middle-market planner and wouldn't want to put anyone off with a term that implies that I only work with affluent people."
— Financial Planner**

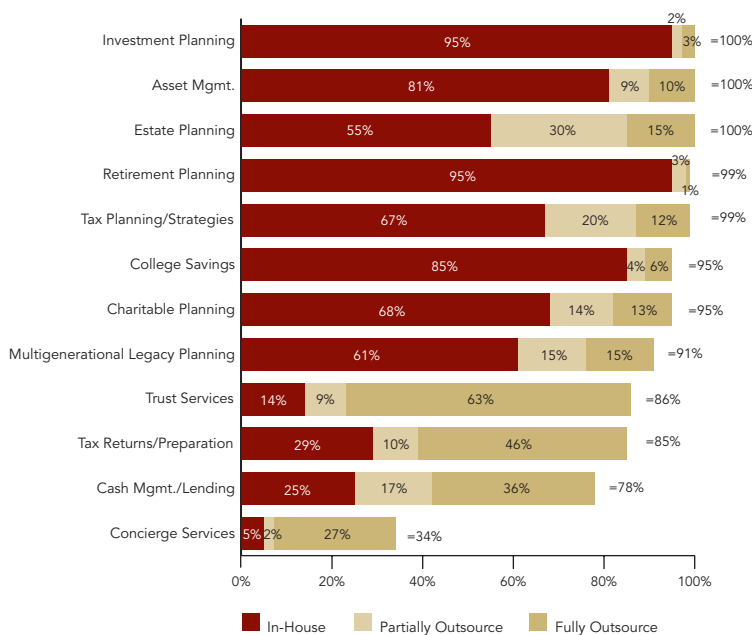
⁴ "The Intelligent Creation of Wealth," *Financial Planning*, February 2003

⁵ *The Evolution of the RIA Firm 2004 Edition*, Rydex Advisor Benchmarking Research Study

THE OUTSOURCING PARADOX: GREATER EFFICIENCY BUT SERVICE DELIVERY MUST BE MANAGED CAREFULLY

The decision to outsource certain services should be driven by fiduciary considerations, as well as cost. If a service is not part of a firm’s core offering and competency, **it may be more cost-effective, and prudent, to hire outside specialists.** In the end, this service will be provided more efficiently, with a greater degree of confidence, and at a lower total cost. This is exactly what many of the established wealth managers interviewed have done. While an overwhelming majority of wealth managers (at least 81%) provide investment, retirement, and college education planning, and asset management services in-house, over 70% partially or completely outsource trust services. In addition, 56% of wealth managers outsource tax preparation and 53% outsource cash management/lending services (see Exhibit 5).

Wealth Management Services Offered: In-House vs. Outsourced — Exhibit 5



Source: The Evolution of Wealth Management, 2004. Fidelity Investments.

Many wealth managers have increased the efficiency of their practice by outsourcing other functions not reflected in Exhibit 5. For example, many have outsourced office management and administrative support duties, while others have outsourced data downloading and account reconciliation for client portfolio accounting. Still others have increased efficiency by embracing the “paperless office” concept, whereby all the documents necessary for client files are scanned into the firm’s computer system, reducing the need for voluminous paper files.

MANAGING OUTSOURCED PROVIDERS

While the efficiency and cost-saving benefits of outsourcing are undeniable, the process itself should be managed carefully to help ensure that high client service levels are maintained. Moreover, it is recommended that advisors have a standard process for monitoring the interactions between clients and outsourced providers. The most common approaches to due diligence include participating in all interactions between clients and outsourced providers, or checking with the client on a periodic basis about their experience (see Exhibit 6).

Exhibit 6: How Wealth Managers Ensure that Outsourced Providers Meet Client Service Standards	
Activity	% of Responses: Wealth Managers
Take part in all interactions between clients and providers	26%
Periodically communicate with clients about their experience	25%
Conduct formal post-interaction surveys with clients	16%
Rely only on providers with whom firm has long-standing relationships	14%
Conduct formal performance reviews of outsourced providers	10%

Source: The Evolution of Wealth Management, 2004. Fidelity Investments..

It is also critical for an advisor to ensure that the firm is copied on all client documents an outsourced provider produces. Making sure that happens consistently requires a level of relationship monitoring and practice organization that keeps the firm on top of all interactions, and helps to avoid problems down the road.

The key point is that **whatever methods are chosen, they should be made a regular part of the firm's standard operating procedures.** Moreover, these procedures should be implemented throughout the firm so that all personnel — principals, planners, junior associates, and support staff — are on the same page regarding how the firm is managing its outsourced relationships. Only then can an advisory firm be sure that the outsourced provider is meeting the same high service expectations that clients experience when they are interacting directly with the firm itself.

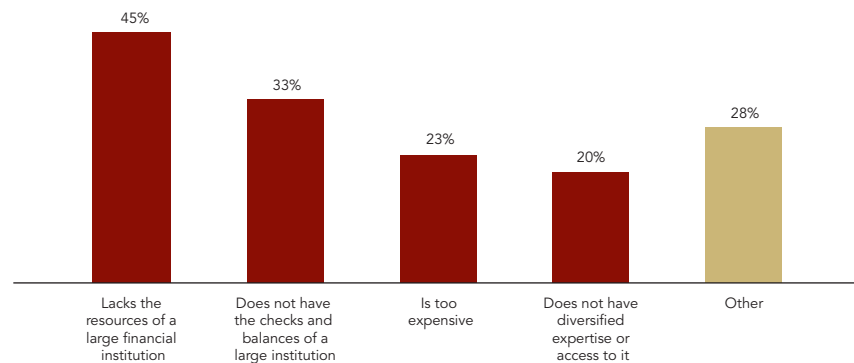
Properly accessed and managed, outsourcing non-core services and functions may give an advisory firm a powerful competitive advantage. **Leveraging the resources of specialists and managing a network of outside experts effectively may enable a wealth management practice to improve its profitability substantially.** In fact, anecdotal evidence suggests that many established wealth managers maintain that skills in network and alliance management have a greater impact on profitability than functional skills (i.e., investment management, estate planning, etc.).

In addition, **utilizing and managing a network of outsourced providers levels the playing field with larger firms,** which is a top-of-mind issue for high-net-worth individuals. In research of wealthy households, **the top reason cited for not using an independent advisor (45% of respondents) was that he or she lacked the resources of a large financial institution** (see Exhibit 7). Thus, in order to compete successfully, it is vital for wealth managers — existing and aspiring — to have access to the full range of resources that advisors working for wirehouses, banks, regional brokerages, and other larger institutions have, including:

- The ability to provide clients with secure online access to statements and account information;
- An easy-to-use system for aggregating all of a client's accounts;
- Access to a broad array of alternative investment products, including separately managed accounts, hedge funds, ETFs, derivatives, etc.;
- Trustee and fiduciary services;
- Specialized services for high-net-worth and ultra-high-net-worth clients (e.g., portfolio lending, assistance with restricted stock positions, access to structured equity products, support for charitable gifting objectives);
- Cash management and lending services; and
- Access to an institutional-quality, fixed-income trading desk.

Reasons Not to Use an Independent Advisor — Exhibit 7

The main objections to using independent advisors, among those not currently or unlikely to do so, are a perceived lack of resources compared to large providers (45%) or the lack of checks and balances of large providers (33%).



Note: Respondents could choose more than one response
 Source: Wealth and Advice, 2004. Fidelity Investments.

UPGRADING SKILLS AND EXPANDING THE KNOWLEDGE BASE

Another significant challenge that successful wealth managers have had to face and address is **the need to upgrade one's skills and develop knowledge of a broader and more complex range of products, services, and planning techniques.** This challenge is critical not only to help ensure the firm's competence in dealing with clients who have more complicated needs, but also to help protect the firm against the increased liability exposure inherent in providing a wider array of products and services.

The issue of compliance — particularly in light of new federal regulations that have passed or are expected to pass in the near future — was a major concern of registered investment

advisors researched by The Financial Planning Association in 2003. Advisors indicated a substantial need for information to help them understand the impact of these regulations on their practices and what they need to do to help ensure they are in compliance.⁶

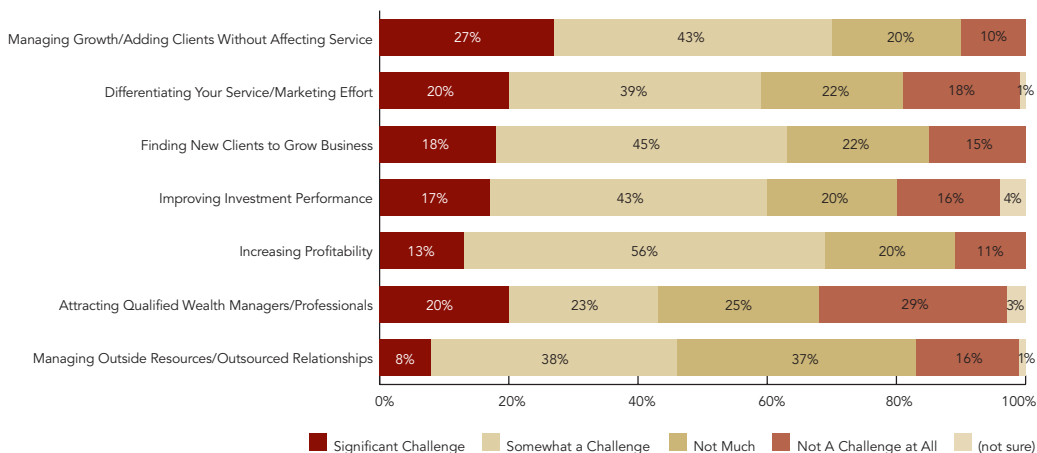
Clearly, firms can hire accountants and other specialists to provide the necessary monitoring and controls. However, **the supervisory challenge becomes greater when a firm has multiple offices**, as well as multiple outsourcing partners. Firms have to ensure not only adequate regulatory compliance but also that the same quality of advice is delivered to each client. Advisory personnel in remote offices must maintain the firm's fiduciary standards while having ready access to updated client information any time there is a material change that affects the client's financial situation (e.g., marriage, divorce, retirement, layoff, disability, death of a spouse, significant change in income, marriage of a child, etc.). This process will help ensure that the planning techniques or products that are recommended are appropriate in light of the client's changed circumstances.

Expanding specific knowledge and skill sets is an area where custodians and other service providers can help the aspiring wealth manager by providing educational programs and materials, and access to industry experts to help them take their business to the next level. Advisors may want to evaluate their existing network of valued partners to determine if they can leverage their expertise, skills, and knowledge, and whether it may be more beneficial to have fewer, but deeper, strategic relationships.

MAINTAINING A SUCCESSFUL WEALTH MANAGEMENT PRACTICE

Challenges Currently Facing Wealth Managers — Exhibit 8

Q. (WMs): Please indicate if each of the following is a significant challenge to your firm, somewhat of a challenge, not much of a challenge, or not at challenge at all.



Source: The Evolution of Wealth Management, 2004. Fidelity Investments.

⁶ *The Support, Tools and Services Financial Planning Professionals Value Most*, The Financial Planning Association, 2003

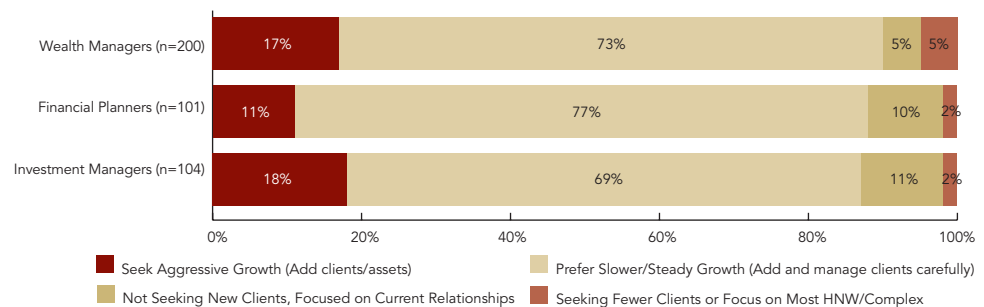
MANAGING GROWTH

Growing the business and managing that growth effectively is an ever-present challenge (see Exhibit 8). There may be a trade-off between adding new clients and maintaining high service levels to existing clients. Among wealth managers interviewed, this issue was of particular concern to firms that had been in this business for 6 to 10 years, and among those looking to grow their revenues aggressively over the next 2 years. But managing growth is an ongoing balancing act for all firms.

Relatively few of the firms we spoke with are planning to grow their businesses aggressively. Instead, nearly three-quarters of the wealth managers interviewed say they preferred slow, steady growth that allowed them to add clients and new services carefully and avoid disrupting their current client relationships (see Exhibit 9).

Business Growth Models — Exhibit 9

Q. Which one statement best applies to your firm (regarding business growth models):



Source: The Evolution of Wealth Management, 2004. Fidelity Investments.

GROWTH THROUGH ACQUISITION

About half of the wealth managers interviewed are either very or somewhat interested in growing their business through acquisition. Those most likely to express at least some interest in acquisition fall into two groups: larger firms (i.e., \$500 million or more in assets under management and/or 15 or more employees) and firms with smaller client relationships (i.e., less than \$1 million per client on average).

The larger, more established, wealth managers in this camp apparently believe that, given their size, the only way to make the firm appreciably bigger in a reasonable amount of time is to acquire other, presumably smaller, practices. The wealth managers with smaller client relationships, meanwhile, may view acquisition as a faster route to upgrading their client base. In light of their client profile, however, and compared to larger wealth managers, this latter segment of wealth managers likely will face considerable difficulties with locating and identifying potential sellers, negotiating favorable terms, and financing the deal. For the majority of smaller firms, buying a practice is probably a one-time event, so there may be little internal expertise to navigate through these challenges. There are, however, a growing number of resources available to help smaller firms overcome these obstacles.

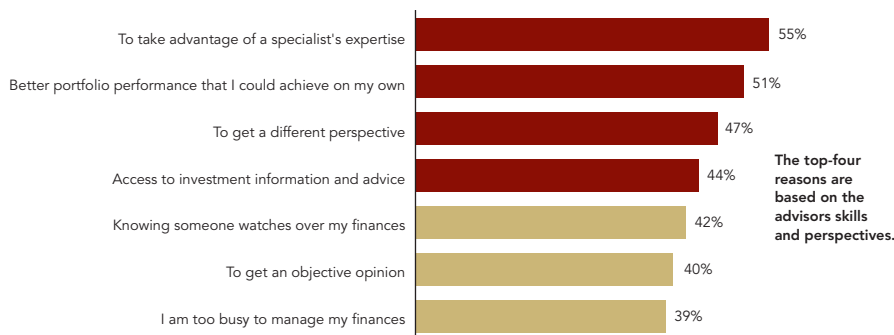
MANAGING CLIENTS' PERFORMANCE EXPECTATIONS

Established advisors know that if they've done a good job of targeting and acquiring the types of clients they want to work with, most of these clients will not (under most circumstances) fixate on investment performance to an unreasonable degree. But the ones who do can be exceedingly tough to manage. Less experienced advisors, meanwhile, who are still trying to get their client base to critical mass may have more "performance hawks" in their client base than they care to admit.

Performance is clearly on the minds of high-net-worth individuals. According to a survey of affluent investors, **half of those surveyed say they use an advisor to achieve better portfolio performance than they could on their own** (see Exhibit 10). In addition, one of the top reasons cited for switching advisors is poor portfolio performance (see Exhibit 11). That's the bad news. The good news is that nearly half the respondents (45%) say they would be willing to pay higher fees for better investment performance.

Why Do You Use an Investment Advisor? — Exhibit 10

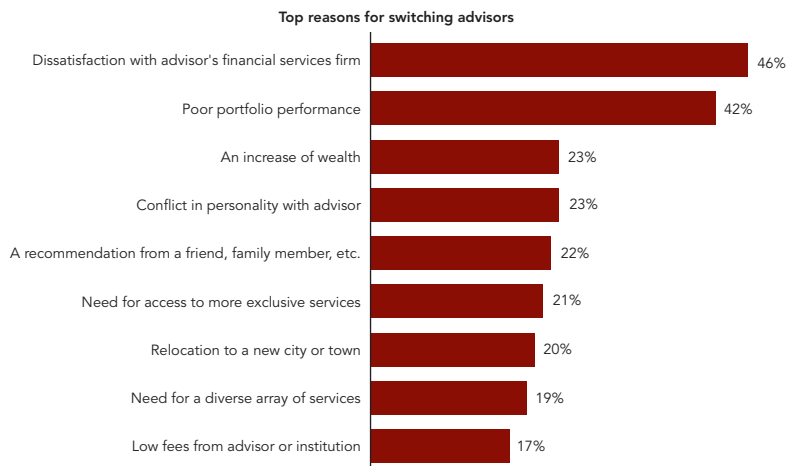
Most use an advisor to access their specialist's expertise (55%) and to achieve better investment performance than managing on their own (51%).



Note: Respondents could choose more than one response. Source: Wealth and Advice, 2004. Fidelity Investments.

Top Reasons for Switching Advisors — Exhibit 11

Most common reasons for voluntary switching are dissatisfaction with the advisor's firm (46%) as well as poor investment performance (42%).

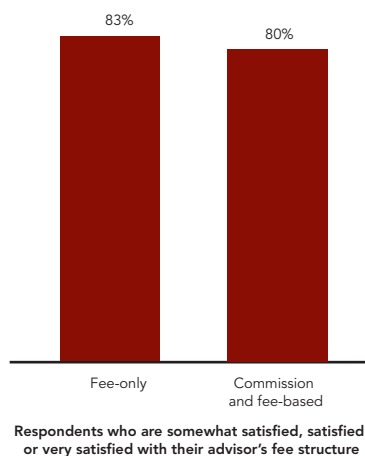


Fee-only clients are more likely to complain about the advisor's firm (52% vs. 39%), but no specific type of firm (e.g., financial planner) generates higher dissatisfaction.

Note: Respondents could choose more than one response. Source: Wealth and Advice, 2004. Fidelity Investments.

Client Satisfaction with Current Fee Structure — Exhibit 12

Most clients are at least somewhat satisfied with their primary advisor's fee structure, with no major difference between fee-only clients versus those paying some commissions.



Source: Wealth and Advice, 2004. Fidelity Investments.

It is apparent from these findings that, for a certain percentage of clients, investment performance is an important determinant of their satisfaction with the advisor. As a challenge to be managed and overcome, this issue brings the unique, holistic approach of the wealth manager front and center. **In working with performance-centric clients, it is even more important for the wealth manager to focus the client on the fact that they are working with an advisor who provides a complete, integrated solution to all their financial problems.** This is not to say that investment performance can be an afterthought. But it may be necessary to challenge some of the client's assumptions about performance and what is realistic to expect from various investment vehicles and asset classes. It is also likely that the wealth manager will need to educate (and reeducate) the client as to what are the appropriate performance benchmarks for various investments in their portfolio. Finally, discussing suitable asset allocation approaches given the client's life stage and objectives may provide the client with the context needed to more accurately assess performance.

That being said, if a wealth manager's performance across client portfolios and various investment objectives is decidedly sub-par, the firm can consider outsourcing asset management, or at least part of it. Clients have a right to expect better-than-average performance within the framework of their specific investment objectives. If the firm cannot deliver that consistently, it should not be viewed as a core competency and should be outsourced.

SUCCESSION PLANNING AND RETAINING CLIENTS

Our references to transition up to this point have all focused on advisors who are making the transition to wealth management, or are considering doing so. Another equally important aspect of transition is when the principal(s) of a wealth management firm is preparing to exit the business and retire. Almost half (47%) of the wealth managers interviewed are 50 or older, with 19% age 60 or older. Notwithstanding the fact that people are living longer and healthier lives and thus working longer, for many of these individuals, the prospect of retiring from the business is getting closer on the horizon.

It is significant that no more than half of the wealth managers surveyed (52%) have a succession plan in place. Those least likely to have a succession plan (48%) tend to include firms with fewer than five employees, and firms that have been providing wealth management services for less than five years.

When broken out by age of the principals, the survey data shows that there is essentially no relationship by age. Specifically, 53% of principals age 40 to 49 and 53% age 50 to 59 have succession plans in place versus just 50% of principals age 60 and over. Thus it appears that **the incidence of having a succession plan is correlated less to the age of the principal(s) and more to the size of the practice.**

Larger wealth managers — in terms of both staff and assets under management — and more established wealth managers are far more likely to have succession plans in place. Fully 87% of the firms with \$500 million in AUM and 76% of the firms with between \$200 and \$500 million have succession plans. In addition, 84% of firms with 15 or more employees and 66% of those with 5 to 14 employees have succession plans. Finally, 78% of the firms that have been providing wealth management services for at least 20 years have succession plans.

Relatively few of the wealth managers with succession plans have stipulated an external sale of the business, favoring instead a transfer to someone inside the firm. Clearly when a principal leaves the firm he or she wants to do so in a way that creates minimal disruption and provides clients with a sense of orderly transition and continuity.

Based on research of high-net-worth and ultra-high-net-worth households, **this approach helps to minimize client defections.** While 45% of respondents say they were likely to leave their current advisor's firm if the advisor left, 55% say they would stay. The top reasons cited for staying were that they are comfortable with the practice (32%) or comfortable with their advisor's chosen successor (27%) (see Exhibit 13).

Reasons Clients Stay with a Practice After an Advisor's Retirement — Exhibit 13

When an advisor retires, presumably in a planned fashion, it is more common for the practice to retain the customer's business. The main reasons for staying were comfort with the practice and/or the advisor's chosen successor.



Source: Wealth and Advice, 2004. Fidelity Investments.

For smaller firms, however, an internal transition may not be a viable option. If there is a single principal, and the employees are not capable of or interested in running the firm, locating an external buyer may be necessary. Data from the *2004 RIA Transitions Report* paint a highly favorable picture for sales of fee-based practices to an external party.⁷ Consider the following:

- **There was an average of 35 interested buyers for every seller**
- **Transactions were valued as high as 2.1 times annual recurring revenues**
- **Cash down payments averaged 34% of sale price**
- **The average client retention rate was an impressive 98%**

Source: RIA Transitions 2004 Transitions Report

While many sole practitioners had “employees or friends to sell to, these individuals couldn’t come close to matching the offers and the quality of buyers in the open marketplace.” Thus, from the standpoint of realizing maximum value for the practice, a sale to an outside third party could be a decidedly advantageous decision.

THE DRIVERS OF A SUCCESSFUL WEALTH MANAGEMENT PRACTICE

Despite the challenges of expanded skills, growth, profitability, client expectations, and transition, **the wealth management model provides considerable opportunities for the advisor to differentiate his or her practice from the competition.** With a growing number of high-net-worth individuals — many of whom are fast approaching retirement — the need for the broad and deep expertise of the wealth manager is greater than ever before. In addition, wealth management offers the advisory firm the potential to manage a smaller number of highly profitable, and loyal, client relationships. Finally, a wealth management approach positions the firm for greater future value, giving principals the prospect of realizing maximum value upon disposition of their shares of the business.

Based on the insights gathered from experienced wealth managers, those advisors who are currently wealth managers as well as those aspiring toward this practice model may want to consider the following drivers of a successful wealth management practice:

- ***Thoughtful, conscious strategic decisions (avoid one-offs)* — The commitment to a wealth management model should be thought through and carefully planned.**
- ***Steady, sustained growth* — Most successful wealth managers add clients and new services slowly and carefully to avoid disrupting their current client relationships.**
- ***Broad and deep client relationships* — This is the essential point of differentiation between wealth managers and other types of advisors, and speaks to the wealth manager’s holistic approach to service delivery.**

⁷ RIA Transitions 2004 Transitions Report, Business Transitions LLC

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- *The ability to leverage the resources of strategic partners and other providers of expert services* — Managing a network of outsourced providers effectively will level the playing field with larger firms, and is likely to have a greater impact on profitability than functional skills (i.e., investment management, estate planning, etc.).
 - *An institutionalized/systematized service model* — This helps ensure that the infrastructure is in place to support new relationships, more effectively manage expectations, and sustain service levels.
 - *Awareness of new products and solutions* — Successful wealth managers keep abreast of technology developments that may enable them to run a more efficient and profitable business. In addition, they are alert to investment product and service developments and take a discerning approach to the best new solutions for their clients.
 - *Flexibility and the readiness to transition* — Successful wealth managers are keenly aware of their clients' needs and expectations. As such, when the time comes to transition the practice to a wealth management model, they are prepared to do so. Moreover, they continue to evolve the firm to meet changing client needs and a dynamic competitive environment. Finally, they have prepared a succession plan to facilitate a successful transition of the business when they are ready to retire.

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