WISE

March 2023

UNLOCKING THE POWER OF PRICING

Tapping into a 10-25 BPs revenue opportunity

Why Pricing and Realization Improvements Should Be a 2023 Priority

For most bank wealth managers and trust companies, 2022's final receipts will show steep declines from stellar margin and revenue outcomes in 2021. Although private banking has shown signs of life, 2023 brings numerous red flags for firms' investment management and trust (IM&T) businesses.

Key Takeaways

- Now is a good time to prioritize pricing improvements
- There is no market price for investment management and trust services
- Many firms' fees are too low
- Firms with higher stated fees realize 10-25 BPs more in incremental revenue than those with low fees
- There is no evidence of a sales penalty for firms with higher fees
- Clients are more service sensitive than price sensitive
- Uncertain and volatile markets are periods when clients value your services most
- Firms that maintain low- or mid-level fees are disadvantaged and should reevaluate their positioning

Of greatest concern is the likelihood of sizable compensation increases in a challenging revenue environment. Thanks to both inflation and competition, compensation has increased by 4% annually for bank wealth managers overall and 6.5% for just the IM&T business since 2018. Variable compensation, in particular, has grown rapidly, reflecting strong demand for growth-oriented talent. At the same time that compensation is increasing, revenues are declining: by mid-year 2022 total revenues were down 1% versus the previous 12 months. Assets declined by nearly 6%. Margin pressure is likely for most firms.

Karen Rush
Managing Director
(847) 612-1090
karen.rush@wiseinsights.com

David Lincoln
Partner
(202) 997-5962
david.lincoln@wiseinsights.com

The only real relief from margin pressure is organic growth. To be sure, firms can and will manage their non-compensation expenses and create sales and servicing capacity through teaming, client segmentation, and productivity initiatives. Our view is that organic growth improvements are imperative for most firms, and that pricing—and, more precisely, fee realization—improvements are a best bet. Not only do most firms have opportunities to do better, but pricing improvements also provide controllable, high-impact, and incremental margin growth.

For every $1 billion in assets, a single basis point improvement in realized fees represents $100,000 in recurring fee revenue for years; the typical investment management account lasts at least 7-8 years, while a trust account has an expected duration of 15-20 years or more.

Position Your Firm's Fees in the Market

It is imperative that firms regularly check their positioning versus market benchmarks and actively manage their prices. IM&T fees show small and steady increases over time; firms who "set and forget" will eventually drift away from prevailing prices. Firms should also task a manager or committee with responsibility for managing pricing outcomes, not just approving discounts.

Listen Online

The key insights in this white paper are drawn from an online presentation
wiseinsights.com/thrivinginuncertaintimes

"But Our Fees Reflect the Market"

Many wealth management firms seek safety in numbers by aiming for the middle when setting fees. The "middle" insulates managers from pushback by sales teams and from the perceived risk of losing new business opportunities. Eighty percent of firms we surveyed that cater to high-net-worth (HNW) clients aim to align their fees with the market middle. In service-intensive ultra-HNW segments, more firms favor higher stated fees, however, about 60% of multifamily offices still target the middle.

While common, we think the conventional practice leaves revenue on the table. Our analysis shows that firms with stated fees higher than market benchmarks earn more revenue per dollar of assets than other firms.

This relationship has remained steady every year since our first pricing study in 2017. **Figure 1** shows actual (i.e., realized) revenue from a two-account household with varying asset levels for three groups of firms with varying stated fees. At every asset level, firms with premium fees (green line) realize more revenue than firms with market median or low fees (blue and red lines). After factoring in discounts and other exceptions, high-fee firms realize at least 10 to 25 BPs more than competitors with a lower fee structure.

Figure 1. IM Agency and Irrevocable Trust Household Realized Fees

Household Split 50/50 Between Services

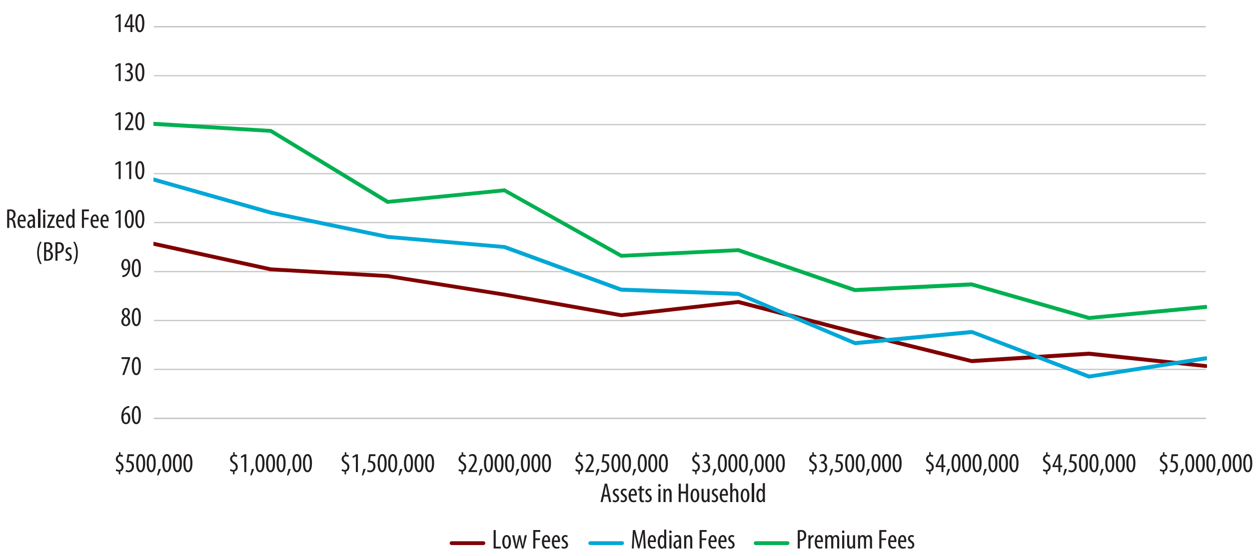

Figure 1. Firms that start high also end high. Firms with premium fees (green line) realize more revenue than other firms serving a two-account household with varying asset levels. Taking discounts and other exceptions into account, high-fee firms realize at least 10 to 25 basis points more than competitors with a lower starting fee.

Pricing and Realization Best Practices

This white paper makes an evidence-based case in favor of charging higher-than-market stated fees. Data are suggestive of many other opportunities to realize a higher return on assets. Six practice areas, below, summarize our thinking around pricing and fee realization best practices.

- **Actively manage price**
  Manage outcomes, not just discounts
- **Maintain fee integrity**
  Oversight and rules
- **Limit pricing discretion**
  At all levels of the org chart
- **Price with pride**
  Wealth management is a premium service
- **Measure price performance**
  Realization rates; gaps-to-market fees
- **Debunk pricing myths**
  Especially around geography

Why Higher Stated Fees Yield More Revenue per Dollar of Assets

There are at least four reasons why firms with higher stated fees ultimately realize more revenue than others.

Reason #1: Firms with higher fees have a larger potential revenue pool for each relationship.

Firms do not price over 100% of their stated fees. Their fee schedules, therefore, establish a ceiling on the total revenues they can earn from a given relationship. As documented extensively, the schedules themselves—and therefore the size of the total revenue pool—can vary from 30% to 40% by firm. Real data pulled from over 1,800 fee schedules contradicts Economics 101: there is no "market clearing price" for investment management and trust services.

A critical implication is that firms have latitude in defining the total revenue they can potentially earn from each piece of business. Firms with low stated fees have a much smaller potential revenue pool than others. **Figure 2** shows the range of stated fees for a two-account household with varying levels of assets. Premium stated fees are about 20-25 BPs more than fees at low-fee firms.

Figure 2. IM Agency and Irrevocable Trust Household Stated Fees

Household Split 50/50 Between Services

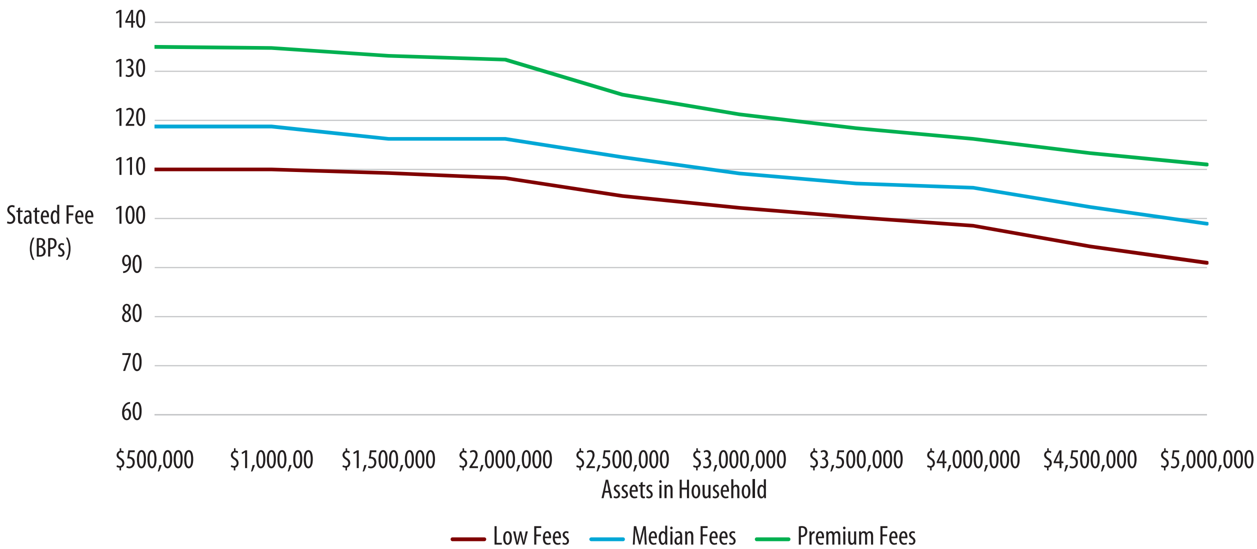

Figure 2. Disparities in stated fees imply a 30% to 40% difference in total potential revenue for a given relationship. Firms with median (blue) and low fees (red) need to capture a much higher share of their fee schedule to achieve the same revenue outcomes as firms with premium fees (green).

Reason #2: Stated fees have only a modest impact on the revenue firms keep.

The proportion of a firm's fee schedule that it earns as revenue is also known as its realization rate. In precise terms, realization rate is the actual revenue realized as a percentage of implied revenue based on its stated fees.

Our analysis indicates a firm's stated fees have a weak impact on its realization rates. For example, the median realization rate for a set of investment management accounts with a stated fee of 100 BPs (**Figure 3**) is 81%. But the realization rate is also 81% for a set of accounts whose stated fee is 110 BPs. The median realization rate dips at 115 and 120 BPs but recovers at 130 BPs. Overall, the relationship between stated fees and realization rates is weak.

Figure 3. Realization Rate for Accounts with Different Stated Fee Levels

IM Agency Accounts between $1M and $2M in Assets

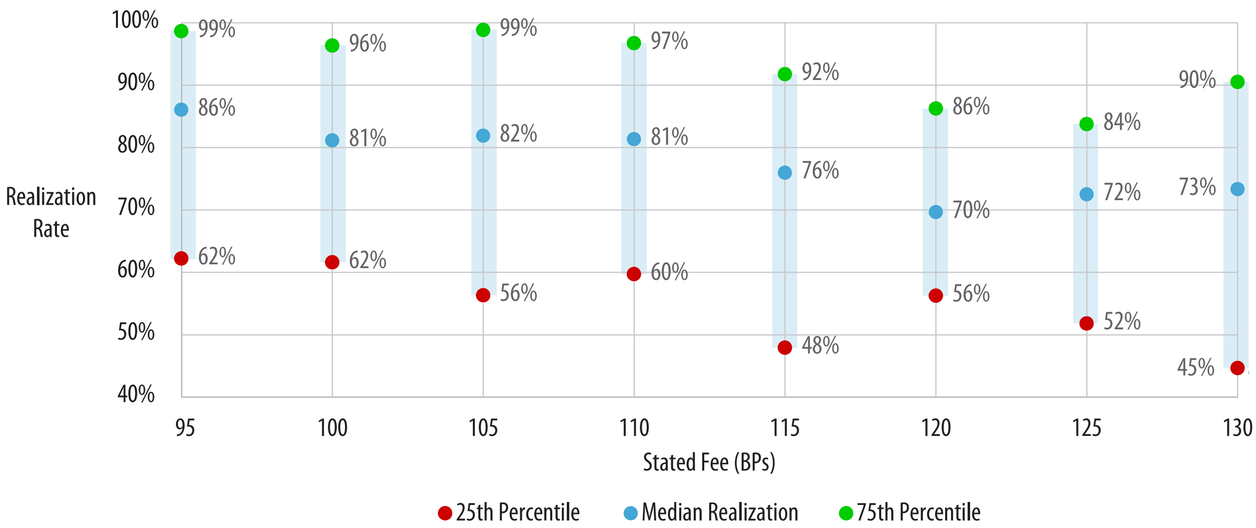

Figure 3. Firms' stated fees are not strongly correlated with what they keep. At 100 BPs, the median realization rate is 81 BPs. At 110 BPs it is also 81 BPs. Median realization drops from 115 BPs to 120 BPs and goes up again at 125 BPs and 130 BPs. These patterns suggest a firm's stated fee doesn't have a big effect on what it takes home at the end of the day. Other factors are more determinative, such as discounting controls and service value conversations.

Even if stated fees have at least some negative effect on realization rates, larger total revenue pools still favor higher fee levels. In simple terms, it's better to have a smaller share of a larger pool. For example:

- At 100 BPs, an 81% realization rate implies 81 BPs in actual (realized) revenue
- At 120 BPs, a 70% realization rate implies 84 BPs in actual (realized) revenues

In this example, a stated fee of 120 BPs yields more revenue.

Higher stated fees necessarily mean a larger potential revenue pool.

They don't necessarily mean that high-fee firms earn a smaller share of that pool.

Reason #3: Many factors unrelated to a firm's stated fees determine what it realizes.

How effectively sales and service teams convey "value" in sales conversations is just one of many factors that determine how much revenue firms realize. Whether a firm charges 100 or 110 BPs likely has little or no bearing on the quality of these conversations.

Discounting controls are another determinative factor. For example, many business development officers give discounts habitually, irrespective of the firm's list price. Discounts are the feel-good culmination of the sales process. Rules or other controls limiting such practices improve revenue realization rates.

Reason #4: Clients aren't very price sensitive.

A WISE member firm once described the trust business as "the least price-sensitive business in all of asset management." For consideration:

- Firms rarely or never report significant attrition from fee-lift initiatives.
- In many market research studies, fees usually aren't among prospects' most important selection criteria. Perceived quality of advice and investment performance rank higher.
- For existing clients, fees usually do not have a big impact on satisfaction, especially relative to key service attributes such as communication quality and frequency.
- There is only a weak relationship between fees and attrition among full-service brokerage clients according to PriceMetrix data.

You won't pay a sales penalty for having high fees.

Objections to higher-than-market fees understandably come from sales teams worried about meeting their growth goals. However, our analysis has yet to find evidence of a sales penalty for premium-fee firms. For example:

- In 2017 we analyzed sales outcomes for firms with strong and weak discounting cultures and found no relationship.
- In 2022, we analyzed the number of new accounts that low-, median- and premium-fee firms added to their books in the previous calendar year. There was no relationship between stated fees and new account volumes.

Sales managers should view claims to the contrary with polite skepticism. The idea of a sales penalty for high fees is a myth. Its longevity arose from being a conveniently uncontrollable scapegoat for negative sales outcomes. In other words, "we lost this business because our fees are too high," rather than due to the effectiveness of sales conversations or perceived quality of the service. While some prospects may be price-sensitive there is no evidence this is true writ large.

"Who is 'the market,' and why do my relationship managers always find that the market is lower than our price?"

Price-sensitive Clients Should Probably Go Elsewhere

Clients with differing service preferences likely affect our research through some degree of "self-sorting." In other words, our research is likely more reflective of clients who prefer full-service advisory offers. Sizable segments of the HNW market, however, identify as "do-it-yourselfers" (DIY), or are only occasional advice-seekers, especially during extended periods of strong market performance. DIY is also enabled by a raft of recent service and technology innovations.

That doesn't mean, however, that firms should offer low-fee or discounted advice-based services. By definition, DIY clients don't perceive a need for an advisor; low fees or steep discounts for a service proposition with limited intrinsic appeal isn't a winning strategy. Our view is firms should continue to "price with pride" for advice-seeking clients. Firms seeking to appeal to a broader cross-section of the market should develop different services for clients seeking different approaches.

What Wise Insights Mean for Your Pricing Strategies

Firms setting stated fees to match the market middle are forgoing revenue for no apparent reason. Our strong advice:

- If you want to offset margin pressure, assess where your fee schedules sit relative to your competitors. If you're not in the highest third of fee schedules, you can add 10-25 BPs in realized fee revenue by increasing your pricing.
- Periods of uncertainty—difficult markets, inflation, economic concerns—are when clients value their advisors the most. Periods of uncertainty, therefore, are a good time for reassessing fees and implementing changes. In a prolonged bull market, who needs help?
- At a minimum, firms should set fees somewhat higher than market rates and invest time and energy in other business practices affecting realization rates. This includes discounting controls, active price management, and high-quality service value conversations.

WISE PRICE INSIGHTS

In 2017 WISE launched its first-ever pricing initiative, beginning with a comprehensive, nationwide canvassing of fee schedules from banks and trust companies. That effort has evolved into a database of pricing data encompassing 1,800 fee schedules. While our focus remains on bank wealth managers and trust companies, our database also includes registered investment advisers and multifamily office fees.

In 2020, we launched a companion effort to document fee realization rates. In short: how much revenue "should" your firm realize given various characteristics (service type, size, and others)? This new database already comprises asset- and revenue data from more than 200,000 accounts.

ABOUT WISE

WISE is a boutique analytics and advisory firm founded on the belief that wealth managers and trust companies deserve the same high-quality data analysis that is increasingly common in other industries. We apply rigor to analyzing firms' performance, including growth, sales, pricing, productivity, and profitability. Our network of members shares data and insights with us, enabling us to identify and promote best practices.

WISE members are the largest firms in wealth management, as well as innovative midsize and small firms in every region of the country. Members include bank wealth managers, independent trust companies, and trust companies affiliated with brokerage and insurance firms. For member firms, our team provides comparative data and insight about their firm's performance, peer networking opportunities, industry insight, and stakeholder education. Our service model specializes in private banks, registered investment advisors, brokers, independent trust companies, and single and multi-family offices. We are experts in the high-net-worth and ultra-high-net-worth spaces.