



Industry Remedies to the Small Household Challenge

Introduction

In our last volume of PriceMetrix *Insights*, we addressed the small household wealth management challenge. Analysis of our aggregated database representing 1.5 million investors, 200 million transactions, 1 million fee-based accounts, and \$800 billion in investment assets revealed the following:

- Advisor portfolios are concentrated in small households (we define small households as those with assets under \$100,000) and the average small household revenues do not justify the expense of maintaining or servicing them;
- There is a low probability that small households will grow into large ones (\$1 million or more in assets) over time;
- Over a typical advisor's career, household composition improves. The faster this happens, the more successful an advisor will be;
- Advisor production can significantly improve by reducing a high concentration in small households; and
- The lower the concentration in small households, the greater the likelihood an advisor will reach \$1 million in production.

This edition of *Insights* examines the small household challenge from the firm's perspective. In the summer of 2010, we interviewed executives from seven of our client firms to obtain a North American view on how firms are addressing this critical business issue. Additionally, we examined small household concentration metrics, on a variety of dimensions, for 15 of our client firms, including the seven firms we interviewed, and representing over 15,000 advisor books. To respect the confidentiality of our clients, we will refer to them generically.

PriceMetrix is a software firm that helps retail wealth management firms and their advisors optimize selling efforts, manage clients, identify growth opportunities, and enhance practice management.

Through its exclusive relationships with North American retail wealth management providers, PriceMetrix directly measures aggregated data representing 1.5 million investors, 200 million transactions, 1 million fee-based accounts, and \$800 billion 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. PriceMetrix was recently recognized in the top 250 ICT Companies Listing in the 2010 Branham300.

Our comprehensive data on the business practices of retail investment advisors and their clients inspired the development of the award-winning, patented ValueOne™, our patent pending CommissionCheck™, and our U.S. Market-Based Equity Commission Schedule. FeeCheck™ is the newest practice management innovation from PriceMetrix. It is designed to help retail wealth management firms and their financial advisors make more informed market-based pricing decisions for their fee and managed business.

Founded in 2000, PriceMetrix has its principal place of business in Toronto, Ontario, and services a notable range of clients within the United States and Canada. For more information about PriceMetrix web-based practice management solutions, please contact us at 416-955-0514 or info@pricemetrix.com.

Small Household Concentration Varies Significantly at the Firm Level

Chart 1 below shows the small household concentration ratios (small households as a percentage of total households) by firm. There is a wide variation in small household ratios across firms, ranging from 35% to 66%, with a market average of 52%. As presented in *Insights* Volume 1, the lower the concentration of small households, the better positioned the advisor is to achieve higher production levels. A 1% reduction in the proportion of small households yields \$7,700 more in annual production for the typical advisor. Aggregating this production lift at the enterprise level can have a material impact on profitability.

Chart 1: Small Households as a Percentage of Total Households¹

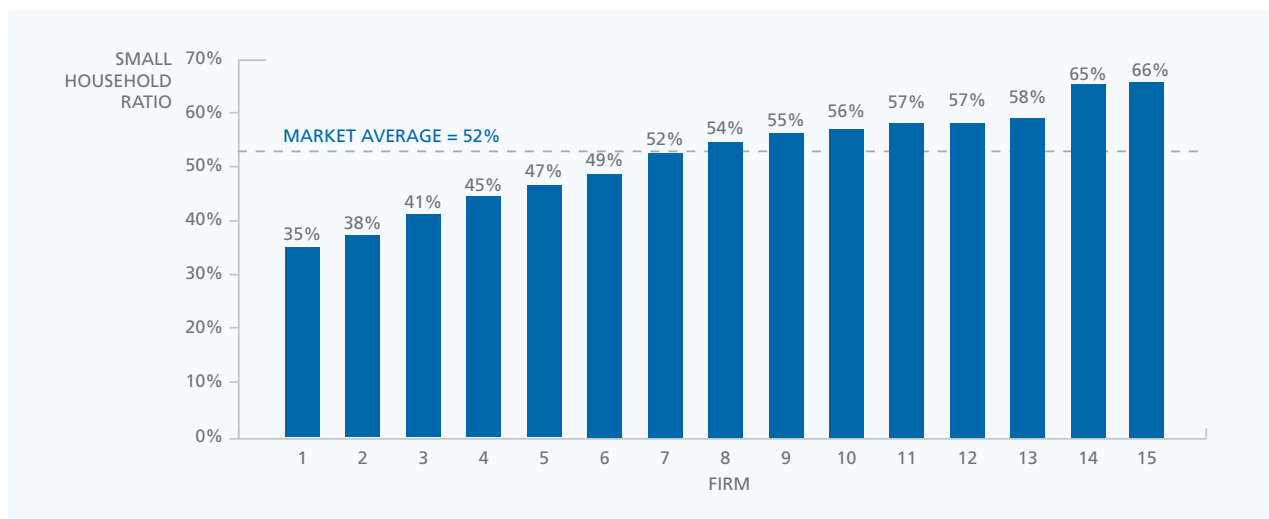
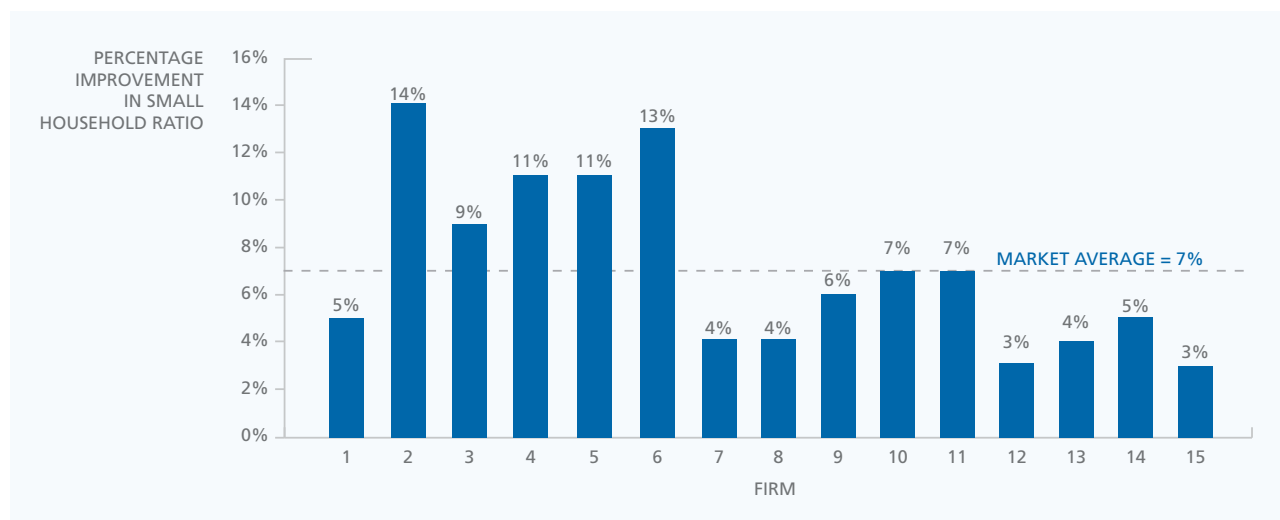


Chart 2 below shows the percentage improvement (reduction) in the small household ratio by the firms in Chart 1, from August 2009 to August 2010. All clients of PriceMetrix that were examined have reduced their small household concentration over the past year. Percentage improvements in the small household ratio ranged from 3% to 14% year over year, with an average firm improvement of 7%.

Chart 2: Percentage Improvement in Small Household Ratio - 2009 to 2010¹



¹ Based on PriceMetrix ValueOne aggregated database.

Seven Approaches to the Small Household Challenge

The above results are impressive. They reflect a significant amount of attention (and in many cases, significant resources) being applied to the small household challenge. We spoke with wealth management executives at seven client firms (see Appendix) to learn more about how they were approaching this issue. While there were definitely common themes, we found that each firm had distinctive characteristics in the structure or positioning of their approach.

Table 1 below highlights the breadth and mix of programs that the firms we interviewed have deployed to address the small household challenge:

Table 1: Firm Tactics that Address the Small Household Challenge

Firm	Service Center For Small Households	Financial Incentives for Advisors	Financial Disincentives For Advisors	Financial Disincentives for Clients	Small Household Concentration Targets for Advisors	2009 to 2010 Improvement in Small Household Concentration
Firm 1	✓	✓		✓		5%
Firm 2			✓		✓	14%
Firm 3	✓		✓			9%
Firm 5	✓		✓	✓		11%
Firm 10						7%
Firm 12	✓	✓		✓		3%
Firm 15	✓					3%

Our discussions with the seven firms above revealed many common themes:

- Small household concentration is a significant business issue that senior executives are paying attention to;
- Most firms seek to help advisors gain more productivity; none stated they sought to reduce expenses;
- Service centers with salaried professionals to service small households are a common solution;
- To achieve results, all levels of management must support the initiatives and goals of reducing small household concentration; and
- PriceMetrix clients demonstrated that they can actively help advisors better manage the balance.

Many variations on how firms approach small household concentration also exist, including:

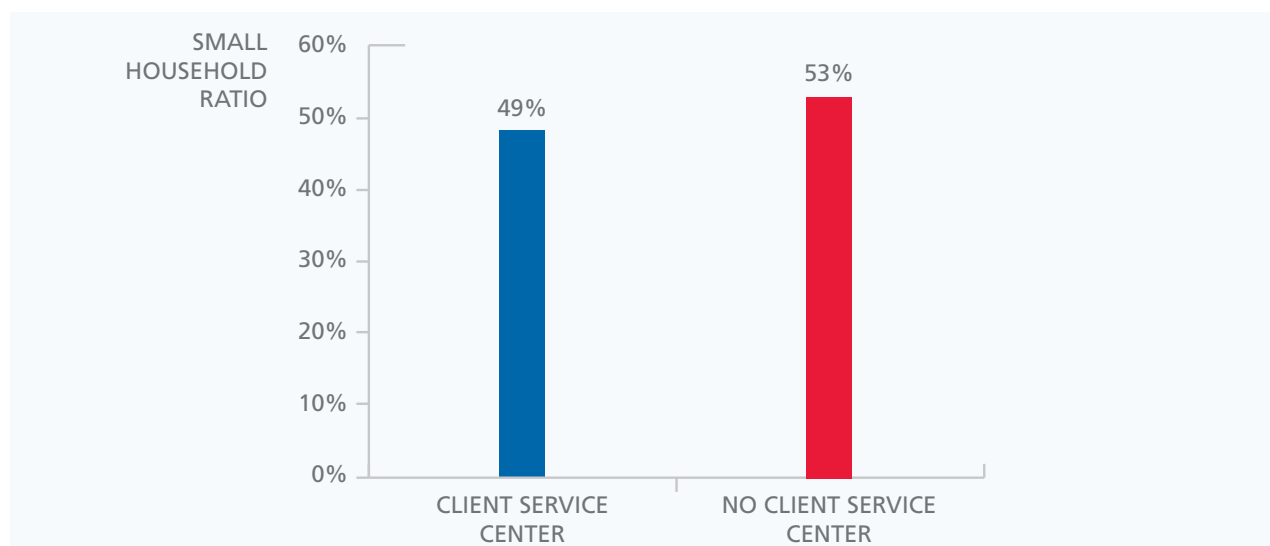
- The extent to which the programs are mandated or voluntary to advisors;
- The existence and level of incentives and disincentives to the advisor and the small household; and
- The levels of success achieved with service center efforts.

For a more detailed perspective on how each of the seven firms is addressing the small household challenge, please see the Appendix at the end of this paper.

Effectiveness of Service Center Strategies Not Conclusive

We discovered through our client interviews that many firms had implemented some form of service center strategy. We define a service center as a distinct business unit set up to specifically address the needs of smaller clients. To determine if there were notable differences between firms with and without service centers, we divided 15 of our clients into two groups: five clients that have implemented a service center strategy and ten clients that have not. We compared the August 2010 small household ratios of each group. Chart 3 below indicates firms that have deployed a service center strategy have a lower small household ratio (49%), versus firms that have not introduced a service center strategy (53%). The firms with service centers have generated approximately \$30,000 in production advantage for their advisors compared to firms without.

Chart 3: Small Household Concentration Comparison – Firms with and without Service Centers¹



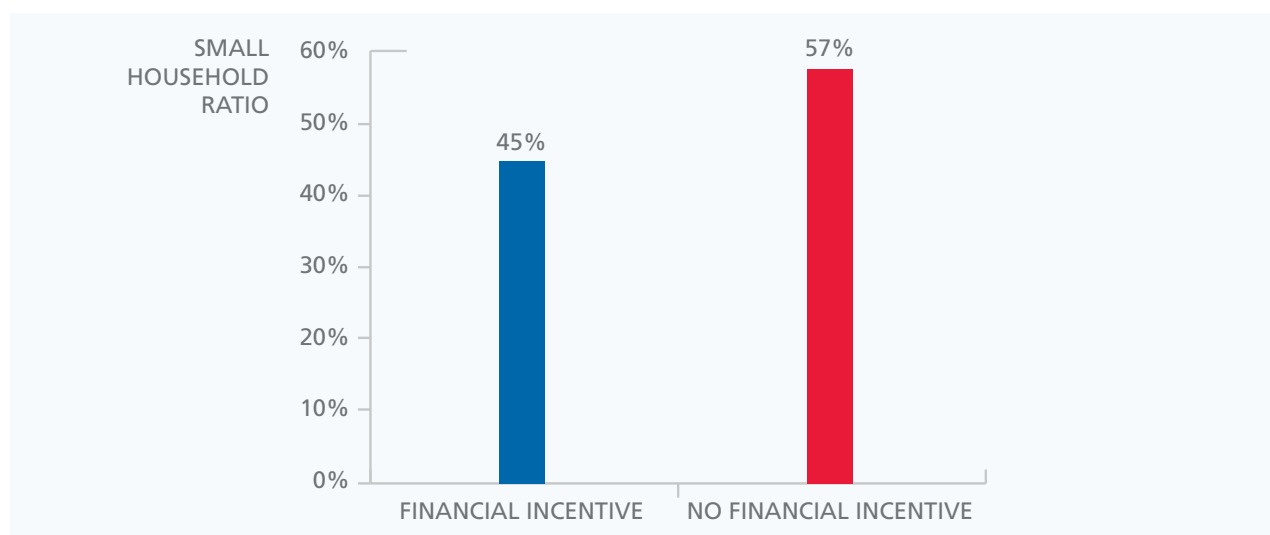
We also noted, however, that there is wide variation in the percentage reduction of small household ratios in the past year for the five firms that have implemented a service center strategy, ranging from 3% to 11%.

Financial Incentives/Penalties Produce Results

Many of the clients we interviewed had implemented some form of advisor incentive or penalty to reduce small household concentration. To determine if there were notable differences between firms with and without financial incentives, we divided 15 of our clients into two groups: six clients that have implemented financial incentives or disincentives and nine clients that have not. We compared the August 2010 small household ratios of each group. Chart 4 on the next page indicates that deploying financial incentives/disincentives has a greater impact on influencing the small household concentration than deploying a service center strategy. Firms that have introduced financial incentives have an average small household ratio of 45% versus the 57% ratio for firms that have not introduced financial incentives, approximately a \$90,000 per advisor production advantage.

¹ Based on PriceMetrix ValueOne aggregated database.

Chart 4: Small Household Concentration Comparison – Firms with and without Financial Incentives¹



Those clients offering financial incentives or disincentives are also more effective at reducing small household concentrations at a faster rate. Firms with incentives outperform those without – with the average reduction in the small household ratio of 9.2% compared to 6.8% for the rest of the market.

We also note that the four firms that are using both service centers and financial incentives to address the small household challenge have, on average, a small household ratio that is approximately 10% below the other firms.

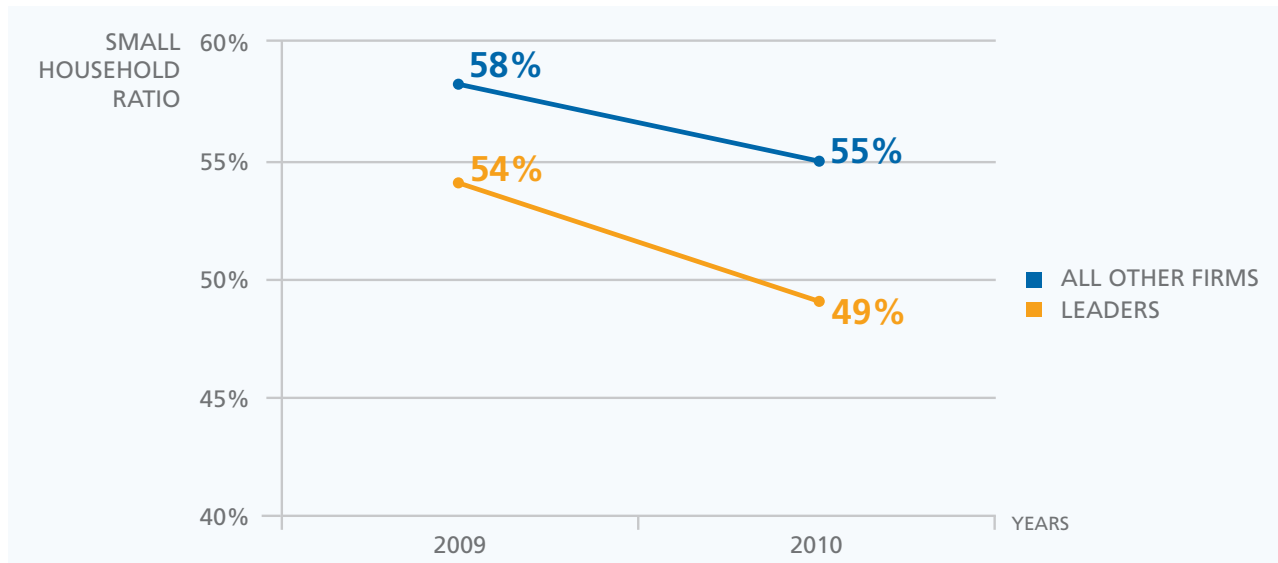
The Best Firms Are Getting Better, Faster

From 2009 to 2010, all PriceMetrix clients have reduced their small household concentrations. Some firms are improving at five times the rate of others, and as we noted earlier, the average firm improvement is 7%. We examined the year-over-year change in small household concentration ratio by comparing the eight firms that led the way in terms of reducing their small household concentrations to the rest of our client base.

Chart 5 on the next page reveals that the leaders are both starting from a more favorable position and reducing their small household concentrations at a faster rate, with a 9% year-over-year reduction in the concentration ratio from 54% to 49%, versus a 4% reduction from 58% to 55% for the other firms from August 2009 to August 2010. Those firms that have made the small household challenge a priority are continuing to pull away from firms who have not. The eight leaders added approximately \$45,000 per advisor in production by more aggressively building out the systems, policies, and infrastructure necessary to ensure that their delivery models and practices are aligned with the value that each household segment brings to the firm.

¹ Based on PriceMetrix ValueOne aggregated database.

Chart 5: Small Household Concentration Change - 2009 to 2010¹



Decide Where You Want to Be

Our analysis indicates that firms with dedicated programs to address the small household challenge are making headway at a faster rate than firms that do not have formal programs in place. Service center strategies and financial incentives are both effective. However, financial incentives appear to work more quickly in the short term.

Whether a firm chooses to build a service center, change their compensation programs, provide other financial incentives or disincentives, or some combination thereof, there are many factors to consider. The firm's culture, business model, characteristics of their market and nature of the customer base, as well as the stage of evolution in exploring and addressing this issue are all important considerations when deciding how (and how aggressively) to influence the mix of small households.

As we revealed in our first issue of *Insights*, some small households leave advisors of their own volition. Your decision is whether to allow time to improve the small household concentration, or to take action and help advisors achieve a better balance of small, medium, and large households in their business. Firms and advisors need to be confident about the upside of parting ways with a high concentration of small households. Losing a non-productive client to make room to better service priority clients will contribute to the health of the business and to the advisor's book. Perhaps the most important message to firms is exactly the same message we delivered in our last edition of *Insights*: "You decide where you want to be and how fast you want to get there."

We would like to thank the seven client executives who took time to share their perspectives and discuss their efforts to address the small household challenge. The thought-provoking insights and richness of this paper would not have been possible without their contributions. The following Appendix is a summary of these discussions.

¹ 1 Based on PriceMetrix ValueOne aggregated database.

Appendix – Seven Client Approaches to Addressing the Small Household Challenge

Firm 1

Firm 1 acknowledged the challenges that exist in trying to grow small households into larger ones, especially if the advisor style is to actively manage their clients' portfolios. "They never get to the 'C' clients. And, not surprisingly, most complaints come from the smaller clients because they are not well serviced."

Firm 1 has implemented a program to address the small household challenge with the primary objective of enhancing advisor productivity. The program entails providing incentives to advisors and seeking cost recovery to service the small household. Like many firms we spoke to, Firm 1 set up a dedicated service center to service small households. If the household is generating less than \$500 in annual revenue, Firm 1 gives the advisor three options:

- They may keep the household in their book and charge the client a \$250 annual fee. There is no payout to the advisor on the annual fee.
- The advisor can refer the small household to the service center and charge the client the \$250 annual fee. In this case the advisor does receive a payout on the annual fee.
- They can refer the small household to the service center and waive the first year fee to the client in which case the advisor also forgoes the payout.

Advisors are allowed to identify five to ten households that would be exempt from the program.

Firm 1's dedicated service center is a special service unit consisting of salaried and variable compensation advisors who work with small households. The special unit offers a limited product line, including mutual funds, bonds, ETFs, money market funds and managed portfolios. The advisors' target compensation is in the \$100,000 range and is a combination of salary plus access to a variable pool based on objectives achieved. These advisors are typically chosen based on profiles that do not exhibit the "hunter" (business development) mentality.

At the time of the interview, Firm 1 had just implemented the program and was optimistic about its ability to address the small household challenge. As noted in Charts 1 and 2, Firm 1 had the lowest small household concentration of the 15 firms we examined at 35% and had reduced that concentration by 5% from August 2009 to August 2010.

Firm 2

In June 2009, while using PriceMetrix ValueOne business intelligence, Firm 2 realized that households with assets under \$50,000 represented almost 1/3 of their client base, and were contributing 4% of the firm's revenue. The median household in this group had \$74 in annual revenue.

Firm 2 set a firm-wide goal to reduce their concentration of small households to less than 25% of all households. Their principal methods were to close small accounts, transfer them to their self-serve online brokerage, transfer them to a financial planner at the parent company bank, or grow them. This would allow advisors to use the time gained from not servicing small households on more valuable households.

Firm 2 initially conducted a regional pilot to transfer small households to financial planners at the bank. They sent letters to households, called them, and offered them loyalty program points to switch to a bank relationship. During a six-month trial, they received two responses, indicating that this approach was not effective. A higher degree of success came in regions that had a point person in charge of the strategy – in most cases a divisional administrator. Firm 2's small household efforts then focused on reporting to and coaching advisors about the drag on productivity that small households represent. Customized reporting and dashboards were developed at the enterprise and divisional levels. Revenue per market hour was a key metric that Firm 2 wanted advisors to focus on and to improve. Advisors and branch managers were given a goal of reducing small households to represent no more than 15% of their book. All asset shifts in households with less than \$50,000 in assets were removed from calculations (in and out) for bonus payouts.

As of July 2010, Firm 2 had approximately 49,000 small households representing approximately 24% of all households with median revenue of \$78 per year. As noted in Charts 1 and 2, Firm 2 had the second lowest small household concentration of the 15 firms we examined at 38%, and reduced that concentration by 14% from August 2009 to August 2010 - the best improvement of all 15 firms.

Firm 3

Firm 3 has implemented a program to address the small household challenge in response to advisor demand. Advisors said that they wanted an easy solution for small households that would free-up their time and create more capacity to focus on other areas of their businesses. Advisors were willing to lose the household if the transition was simple.

Firm 3 set up a service center exclusively for small households. They started with a pilot in one region. A list of all small households was sent to each branch and the managers were asked to work with their advisors to determine which households could be moved. Branch managers identified the advisors in their branch who would benefit from the opportunity the most and who would be interested. Initially, a cap was put on the size of household that could be moved - \$75,000 in assets. Most were households with inactive mutual fund accounts. The process was presented as optional to the advisors. The advisor had the final say on whether the household stayed or not; however, if they moved a household, they relinquished the relationship completely with no compensation. Any profits from the transferred households would be kept by the service center.

A telephone communication with the households started the process. Some in-person visits with clients were required. If contact with the households was not made in person or via a phone call, a letter was sent to the households about the transfer to the service center. Overall, the client feedback has been extremely positive. Firm 3 has rolled out the program firm-wide over the past year.

Other methods of addressing the small household challenge at Firm 3 include:

- If a senior advisor and a junior advisor are teaming up for the purposes of succession planning (senior advisor retiring), the senior advisor is not permitted to transfer small households to the junior advisor. Additionally, when the time comes for the book to be fully transitioned, the junior advisor must give up their small households to make room for the newly acquired households.
- If an advisor leaves the firm, all small households are sent to the service center; they are not given to junior advisors in the branch.

- When recruiting new advisors, the recruiting bonus does not include assets in small households. The new advisor is told to leave those accounts at their former firm.

As noted in Charts 1 and 2, Firm 3 had the third lowest small household concentration of the 15 firms we examined at 41%, and had reduced that concentration by 9% from August 2009 to August 2010.

Firm 5

Firm 5 had recently implemented a program to address the small household challenge. Of its base of households, 52% are referred by their parent bank and 50% of accounts have \$100,000 or less in assets, generating \$500 or less in revenue. Firm 5's target was to reduce their small household concentration by 20%.

Firm 5 introduced a call center that has licensed advisors who are typically new to the industry. They see the center as a training ground for advisors. If an advisor builds their book to \$15 million in assets they progress to the broker/dealer.

Accounts that generate less than \$500 in revenue annually are subject to a \$100 annual charge to both the account and the advisor (50 exceptions are provided per advisor). Advisors are given a list of small accounts and three weeks to tag their 50 accounts; the others are sent to the call center. Part of the advisor's bonus structure is based on their ability to manage their small household concentration.

A written communication is sent to the household from the enterprise (not the advisor) regarding the option of paying a fee or moving to the call center. Households are asked to contact the call center. The call center advisors encourage the household to pay the fee or move to another offer – mutual funds or back to the bank; 77% of households go back to the bank.

Firm 5 ran a pilot of this program for six months. The firm now runs the program for three branches every two months due to the large volumes. Advisors are positive about the program as it takes unproductive business away and gives them more time to do business with more productive households.

As noted in Charts 1 and 2, Firm 5 had a small household concentration of 47%, and reduced that concentration by 11% from August 2009 to August 2010.

Firm 10

Firm 10 chose not to implement a formal service center or compensation program to address the small household challenge. Firm 10 had 56% of households generating 10% of revenues; therefore, the small household concentration was a significant strategic issue. However, Firm 10 believes that the small household challenge is inherent with the business and firms cannot eliminate it altogether. "Advisors are bred to take all business. Gathering assets/clients is the name of the game. Additionally, advisors in small local centers do not want to fire clients, as word gets around quickly and their reputation can be damaged."

Firm 10 believes that the call center option may be better suited to a wirehouse/national broker dealer and less effective for a regional firm. In addition, the call center option creates a completely new value proposition that may be more challenging for some senior management to embrace.

Firm 10 believes that programs should be voluntary and that the management team must be behind any effort. Its approach has been to educate advisors about the impact that small households have on their business and to encourage them to manage their business to optimize their productivity. Firm 10 uses advisor teams strategically with the junior advisors servicing the small households. They believe giving trainees small households to grow on a salaried basis is a reasonable approach. Having advisors share their success stories is key.

Firm 10 found that the productivity of advisors increased if they were successful in reducing the number of small households in their portfolios. Advisors were more productive with fewer households as they could pay more attention to their best clients. Freeing up good advisors is essential to improving productivity.

As noted in Charts 1 and 2, Firm 10 had a small household concentration of 56%, and had reduced that concentration by 7% from August 2009 to August 2010. Given that Firm 10 took a moral suasion approach only, and empowered advisors with good business intelligence to allow them to make better decisions, these are notable results.

Firm 12

Firm 12 acknowledged that a high small household concentration is a huge strategic issue and a “production killer.” Firm 12 believes that advisors hoard small households and that no one is doing a great job of dealing with this issue. Firm 12 has implemented a variety of programs to improve advisor production.

Firm 12 set up a service center to specifically address the small household challenge. Service center advisors are paid a salary plus bonus and they are encouraged to build their capabilities and move to the broker/dealer. So the service center also manufactures brokers – the good ones move into their own practice. Firm 12 does not force advisors to use the service center. “It is driven by the complex manager, and is education based.”

The complex managers have specific goals to reduce small household concentrations. They encourage advisors to grow the small household account, transfer it to the service center, charge a \$60 fee, or terminate the relationship. The \$60 fee can be paid by the advisor or the client, at the advisor’s option. This fee can be waived if the small household meets one of ten established criteria. Examples of the criteria include small households that are affiliated with a larger household and households that have produced a specified minimum amount of revenue in the last 24 months.

All communication with the household is done by the advisor. Enlightened advisors realize that reducing the proportion of small accounts creates time for more productive business. Firm 12 finds it helpful to spotlight strong branches and show others that reducing small households can be done. They have had a positive experience with customers going to the service center; households are happy to hear from someone and the firm has had 99% positive feedback.

Firm 12 has implemented additional programs, such as offering advisors incentives for reducing small household concentrations and making the reduction of small household concentrations one of four criteria in the advisor’s bonus structure, while requiring that advisors achieve a minimum in all four categories.

Firm 12 is reluctant to mandate any of their programs and acknowledges the need to customize by branch. It also acknowledges that addressing the small household challenge needs to be marketed to both management and advisors.

Firm 12's magic number is to get to 35% small household concentration. As noted in Charts 1 and 2, Firm 12 had a small household concentration of 57%, and had reduced that concentration by 3% from August 2009 to August 2010.

Firm 15

Firm 15 points to a specific culprit in analyzing their small household problem – advisor turnover. Specifically, high advisor turnover rates lead to a significant number of small books/households passed on to the firm when the advisor leaves. It is a systemic problem – a lot of small accounts with no place to go.

Firm 15 created a client service center to manage small households. The advisor is not compensated or given an incentive to move small households. Instead, Firm 15 stresses the idea of practice management and improved productivity. Service center advisors are salaried and they receive bonuses and referral fees. Bonuses come from a pool. Service center advisors are usually younger and the centre is a stepping stone and training ground for them. The service center also provides support to the broker/dealer advisors and to sales associates on the administrative side of their business – processing, and so on.

At the head office level, Firm 15 compiles small household records, and lets households know that they have been reassigned to their service center. This communication initiative was done in waves. The first wave hit the inactive households. The firm's experience was that households were mostly satisfied. Some households said they wanted to work with an advisor so advisors tried to generate more business from them. Failing that, the households were moved out of the firm. About 5% of the inactive households closed and the firm was successful at getting more business from about half of those who remained. The other half went to the service center.

The second wave was initiated once the advisor got used to the movement of accounts. Advisors were encouraged to identify clients/households they deemed to be challenging (time consuming) or not profitable (lower assets). Firm 15 had a good response from advisors. Approximately 95% of this second wave of households was retained in the service center. Firm 15 acknowledged that it was very important to educate advisors about the service center, and how early adopters had improved their business by utilizing it.

The service center is responsible for re-qualifying households. The firm pays a referral fee to service center advisors who identify high potential households. Qualified leads are then given to a new advisor who has 90 days to improve the relationship or the household goes back to the service center.

Firm 15 has also run a campaign that encourages advisors to transition out of or grow small households. Advisors received points towards marketing dollars for doing either.

At the time of the interview, Firm 15 had about 15% of households in the service center. Medium and large households are more productive. Firm 15's small household concentration was approximately 68% in January 2010. They consider their six-month efforts to be successful. As noted in Charts 1 and 2, Firm 15 had a small household concentration of 66%, and had reduced that concentration by 3% from August 2009 to August 2010.

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The quantitative analysis delivered in this paper is made possible by the aggregated ValueOne database and is the result of a collaborative PriceMetrix effort by Patrick Kennedy, Vice President Research & Development, Madeleine Cruickshank, Manager, Client Analytics & Advisory, and Dylan Martz, Client Analyst. For assistance with improving the household mix of your business, to provide your feedback on this issue of *Insights*, or to offer suggestions for future topics, please contact Doug Trott, President and CEO of PriceMetrix, at 416-955-4498 or email Doug at Doug.Trott@pricemetrix.com.

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