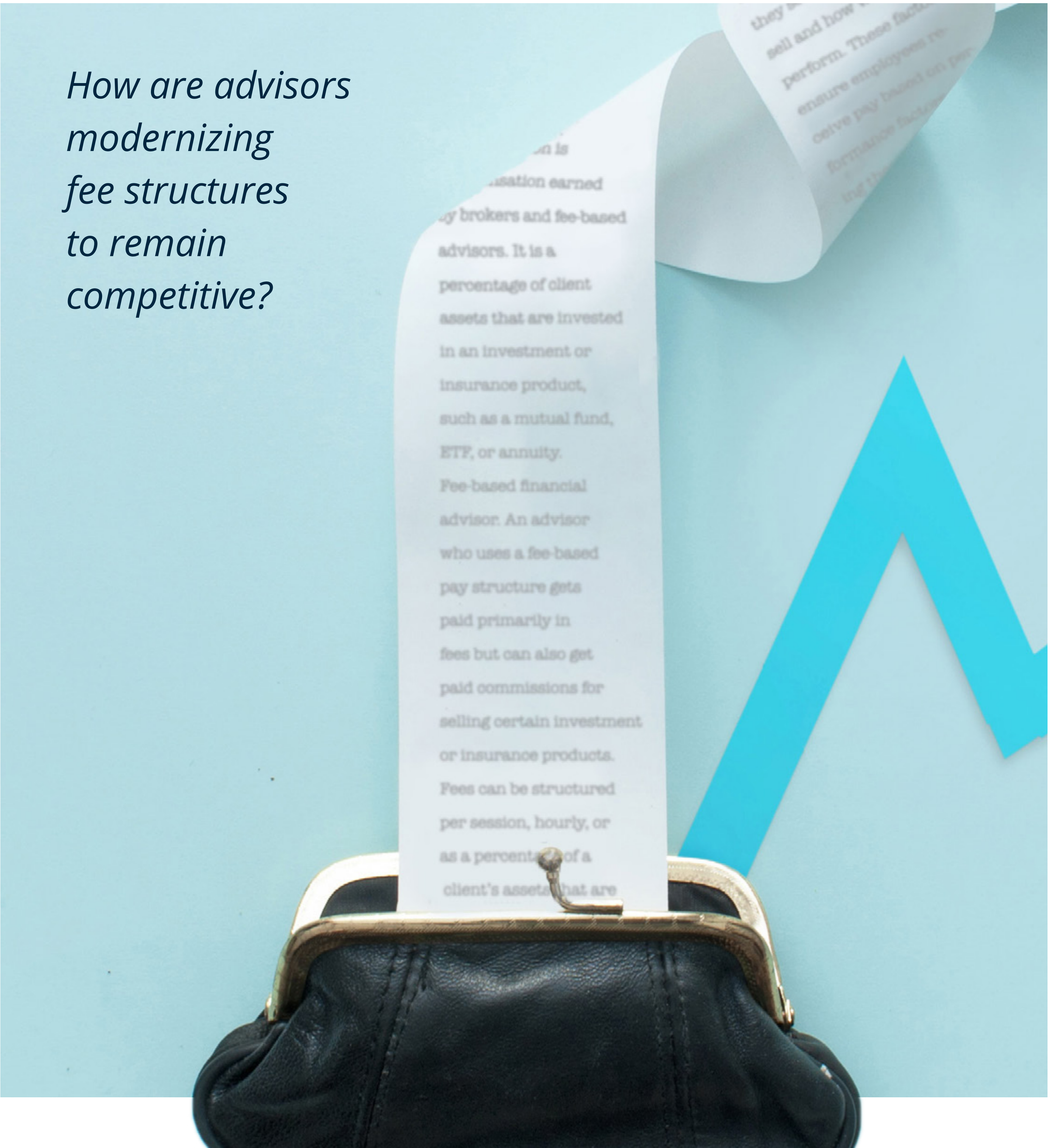
ADVISOR RESEARCH COLLABORATIVE
CERULLI ASSOCIATES

March 2023

The Price of Advice

How are advisors modernizing fee structures to remain competitive?



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The Price of Advice

A broader shift toward lower costs and greater transparency within the wealth management market is causing advisors to re-evaluate their pricing and service models. Given this evolution, it is becoming increasingly important for advisors to find the right balance between competitive services and optimal fee structures.

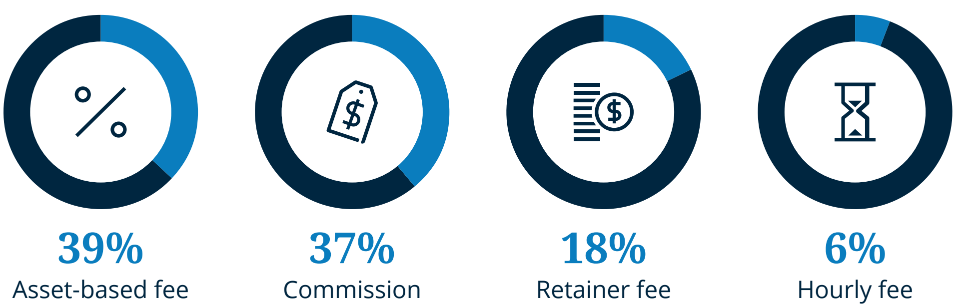
Changing client demographics and innovations in the consumer world are pushing advisors to be more creative in how they charge. While updating pricing models may provide greater flexibility, advisors should consider how their pricing aligns with the needs of their existing and target markets, as well as how profitable and efficient these models may be long term.

The Balancing Act

The ability to offer choices without overwhelming existing or potential clients is a balancing act for advisors who are exploring more creative pricing models. The idea of making the complex simple is one that many advisors embrace. It is natural to wonder whether offering creative pricing structures gets in the way of this idea, and, in an age when transparency is increasingly touted as critical, blurs the picture. Advisors need to consider the needs of their target market when developing their models and finding ways to simplify where possible.

Simplicity or choice? Both. It is difficult to predict whether alternative pricing models will differentiate advisors, attract specific client niches, and lead to greater profitability in the future. However, the financial advisors who implement such changes contend that client demand and needs are at the core of the changes, while the ability to attract clients with pricing flexibility is an added incentive. The winners in this realm will present options while keeping things as simple as possible.

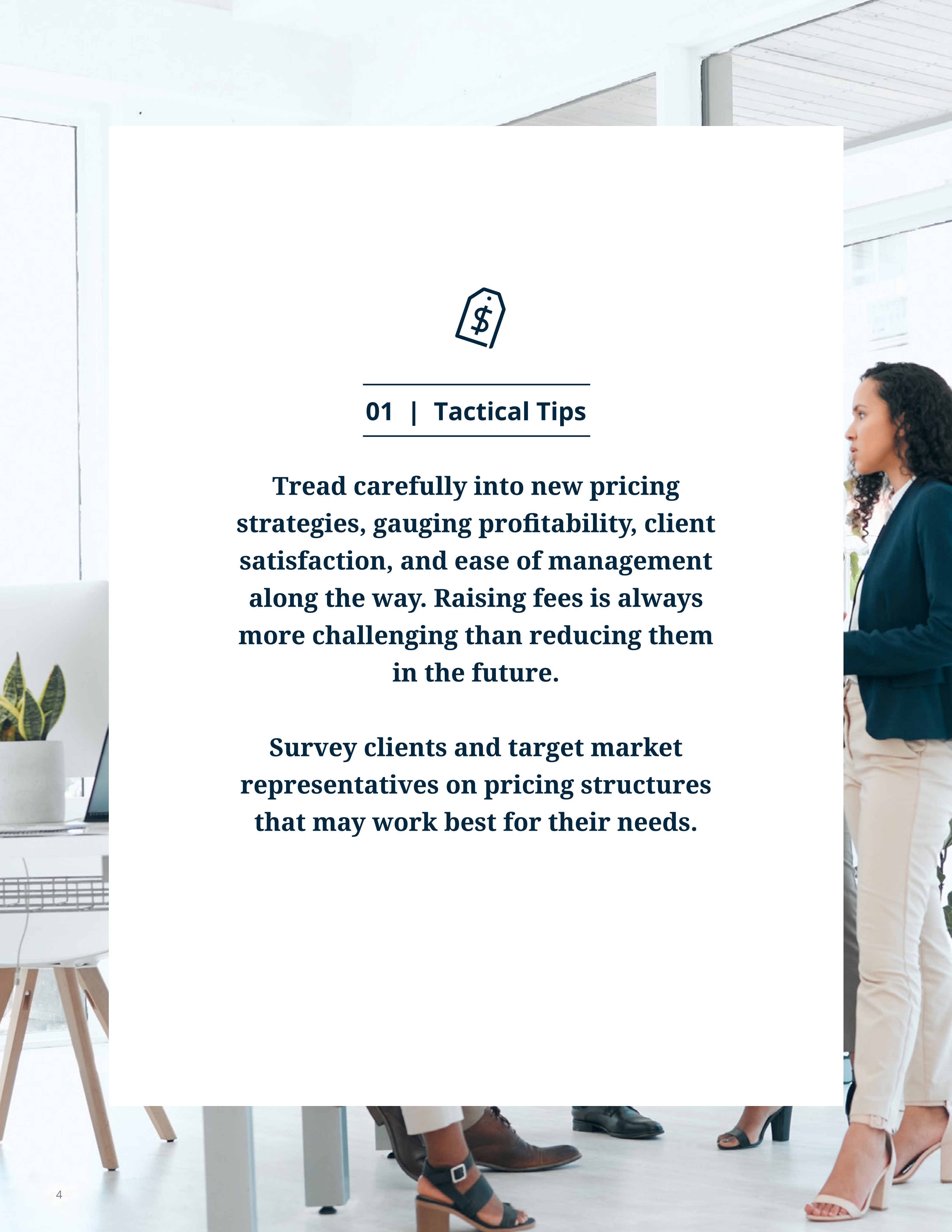
Clients' Preferred Fee Structure, 2Q 2022



Sources: MarketCast, Cerulli Associates | Analyst Note: Participants were asked: How would you prefer to compensate your primary provider for the services you receive?
- I would prefer my provider is paid each time I make a transaction (e.g., a commission)
- I would prefer to pay my provider a percentage fee based on my level of assets
- I would prefer to pay my provider a retainer fee for a set amount
- I would prefer to pay my provider an hourly fee

Key Findings

- More than half (60%) of all U.S. households agree or strongly agree that they are willing to pay for financial advice.
- Overall, 37% of investors express a preference for paying transactional commissions to providers, while 63% prefer some version of a fee-based option.
- High-net-worth (HNW) investors with $5 million or more in investable assets are most likely to prefer asset-based fees.



01 | Tactical Tips

Tread carefully into new pricing strategies, gauging profitability, client satisfaction, and ease of management along the way. Raising fees is always more challenging than reducing them in the future.

Survey clients and target market representatives on pricing structures that may work best for their needs.

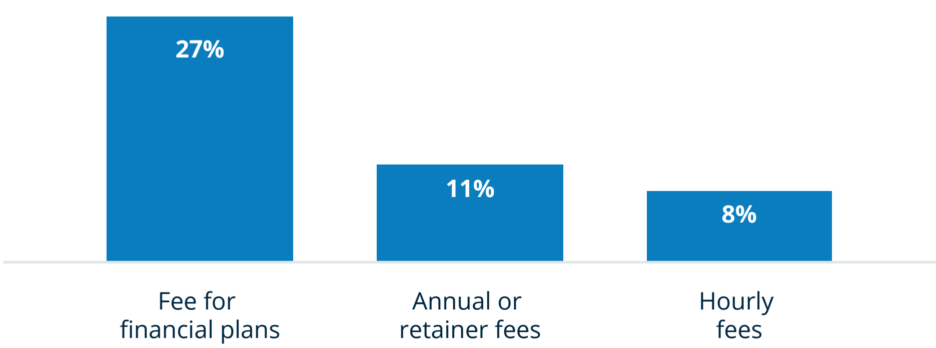
Beyond Fee-Based?

Cerulli expects fee business to increase across the wealth management landscape, but there is also likely to be an uptick in different types of fees and payment methods as advisors seek to meet the needs of varied clients for whom traditional pricing approaches may be less appealing or profitable.

On average, almost three-fourths (71%) of advisor compensation is now derived from asset-based fees, and this percentage is expected to reach 75% by year-end 2024.

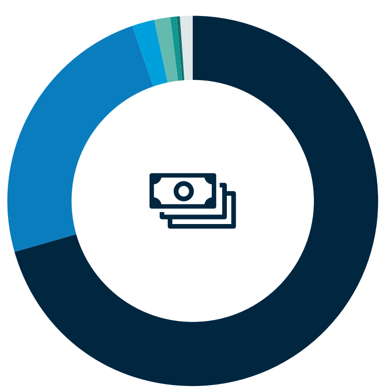
Alternatives to the traditional fee and commission models include subscriptions, retainers/annual fees, hourly fees, and combinations of various methods to accommodate unique client situations. While some advisors see the evolution of payment methods as a necessary change to meet consumer expectations, others view alternative pricing models as a distraction—added options that do not result in meaningful differences for the clients and may ultimately result in advisors being less efficient, consistent, and profitable.

Percent of Adviors Charging Nontraditional Fees, 2022



Advisor Compensation, 2022

- Asset-based fees: **70.6%**
- Commissions: **24.2%**
- Fees for financial plans: **2.0%**
- Annual or retainer fees: **1.5%**
- Monthly or ongoing subscription fees: **0.5%**
- Hourly fees: **0.4%**
- Other: **0.9%**



Source: Cerulli Associates | Analyst Note: Average compensation data excludes senior advisors or principals/ owners who receive a salary.

Key Findings

- On average, asset-based fees make up 71% of an advisor's compensation.
- Commissions comprise 24% of an average advisor's compensation.
- Nontraditional fees (retainers/ annual fees, hourly fees, and fees for financial plans) collectively account for only 5% of an advisor's compensation, on average.
- Nearly half (44%) of advisors generate 90% or more of their revenue from asset-based fees, and this percentage is expected to surpass 53% by 2024.

02 | Tactical Tips

Assess current pricing and service models to see whether improvements may be made to the traditional methods. Understand the profitability of the existing structure to inform any innovations.

Consider forming a client advisory committee to give feedback on this subject and other key potential practice changes. Not only will asking for input provide insight, but it also strengthens relationships and prepares clients for upcoming changes.

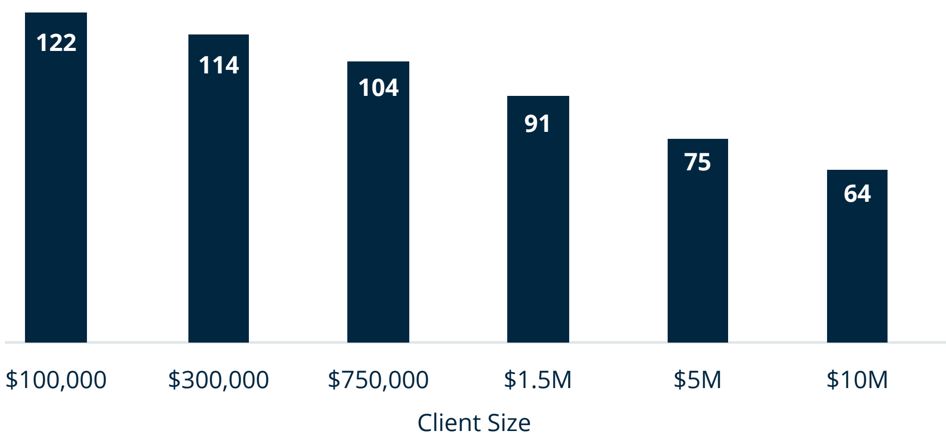
Hourly fees are more prevalent among firms serving clients with greater than $5 million in AUM (14% of advisors with this core market charge hourly fees). Only 8% of all advisors charge these types of fees, and hourly arrangements are not likely to increase significantly. Although hourly fees are not reserved for higher asset clients, some advisors are considering offering flat, annual fees for those clients with lower asset bases, which would not garner significant asset-based fees relative to the time the advisor spends on oversight. This is typically positioned as a "wealth builder" program for investors who may grow in to traditional asset-based pricing over time.

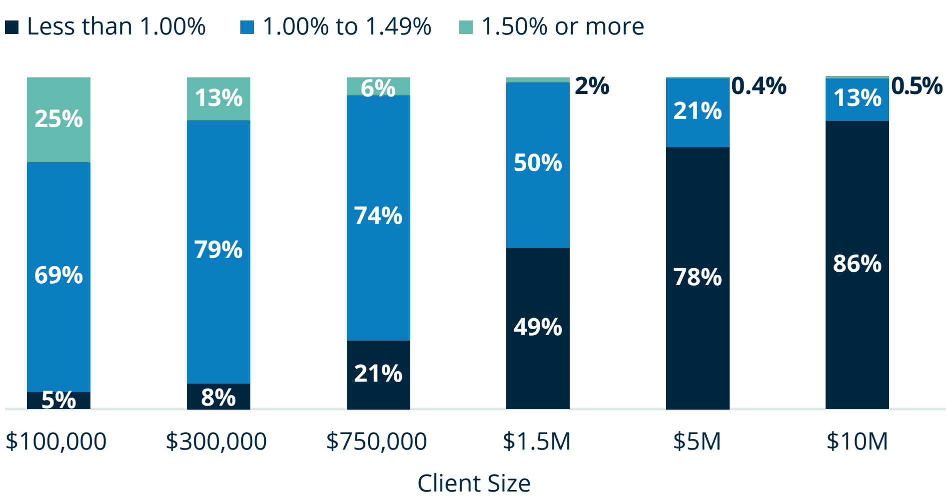
The other end of the spectrum also exists, with larger clients being charged a retainer fee—as may be the norm with other professionals, such as attorneys. While this idea has existed for a long time, the implementation of these fees has remained steady in the past few years, with 11% of all advisors charging retainers or annual fees.

Recently popularized by large providers, subscription pricing is also generating buzz, although it remains to be seen whether it will gain meaningful traction among advisors. Advisors who serve a younger demographic are experimenting with this method to align with how these clients pay for other services.

AUM-Based Advisory Fees, 2022

(basis points)





Source: Cerulli Associates | Analyst Note: Advisory fees exclude products' embedded management fees and are self-reported by advisors.

Key Findings

- By 2024, 78% of practices focused on affluent investors—households with $2 million or more in investable assets—plan to generate a minimum of 90% of their revenue from asset-based fees.
- Advisors who serve a younger demographic are experimenting with subscription pricing to align with how these clients pay for other services.
- The average advisory fee schedule steadily decreases in correlation to clients' wealth.

03 | Tactical Tips

Prepare a communication suite to announce any new options and determine how they will be offered to new and existing clients. Be sure to update websites and printed firm brochures.

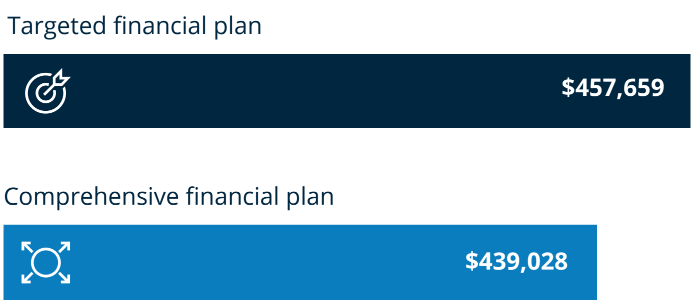
Seek home-office and other partner support where possible to gain objective insight into your approach and learn what peers are doing inside and outside of your firm.

Financial Planning Fees

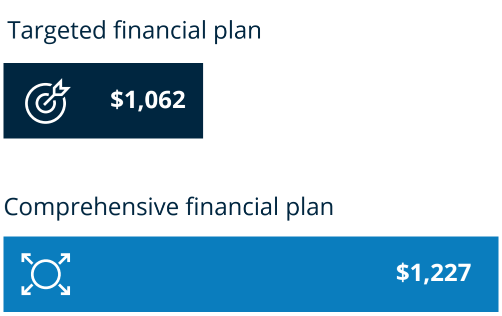
On average, advisors charge clients between 64 and 122 basis points based on client size, excluding asset manager fees. This had served advisors well in a long-standing bull market but can create strain in volatile or down markets. If an advisor is largely fee-based, their revenues shrink in down markets when they are asked to perform one of their toughest roles—coaching clients to stay invested and weather the volatility. AUM-based fees are ideal in bull markets but inevitably become less predictable in volatile markets.

Additionally, advisors with aging clients shifting into the decumulation phase of retirement could face shrinking asset pools—and thus fees—while their clients are simultaneously entering a life phase where their need for personalized advice is amplified. A fixed fee for financial planning can help to offset some variability but can also pose its own challenges.

Minimum Asset Requirement for Financial Planning, 2022



Minimum Fee for Financial Planning, 2022



Source: Cerulli Associates | Analyst Note: Includes only advisors who charge either a targeted or comprehensive planning fee. The minimum fee for financial planning represents the average across all advisors.

Key Findings

On average, advisors who impose a fee for comprehensive financial plans require approximately $440,000 in assets and charge $2,325 per plan.

Across all channels, 27% of advisors charge a fixed fee for financial plans. These fees represent 10% of an advisor's total revenue, among advisors who charge separately for financial planning.

Even among financial planners, who focus their practice on conducting comprehensive financial plans, less than half charge separately for planning.

04 | Tactical Tips

Consider a pilot program with new clients to gauge effectiveness of any new strategies, providing the ability to make changes without major impact on the practice until the right approach is identified.

Create a clear, written piece that discusses your pricing and payment methods, making each option as transparent as possible. If possible, use real numbers and dollar amounts to make pricing more understandable.

In 2022, nearly half (46%) of advisors' clients received ongoing comprehensive planning advice, up from 33% a decade ago. Advisors expect that number to climb even higher—to over half of their client base by 2024. The adoption of ongoing, comprehensive planning in advisors' practices is steadily rising over time, but as advisors continue to expand the percentage of clients who receive these services, they will need to consider how their pricing models align with this shift.

With growing adoption of financial planning, some advisors charge a separate fixed fee for creating a financial plan, although it remains a relatively small portion of revenue. This fee is typically charged in addition to an asset-based fee. The fixed fee covers the planning services offered by the advisor, whereas the asset-based fee covers investment management activities. While 27% of advisors charge a fixed fee for financial plans, these fees represent only 2% of an advisor's total revenue. Adding to this retainer, subscription, and hourly fees, the average advisor generates just 5% of their revenue from nontraditional fee sources.

There can be both benefits and drawbacks of charging separately for financial planning:

Benefits

Some advisors believe that bundling planning and investment management fees weakens the value of their planning services.

Clients are more likely to take planning seriously when they have skin in the game and see a tangible dollar amount attached to it. Planning is time-consuming and resource-intensive, making it harder to justify when clients see only an investment management fee.

A fixed planning fee can equalize revenue for smaller clients if the advisor spends time on financial planning activities. For many advisors, revenue is heavily skewed toward the largest clients, especially when fees are based on AUM levels.

Drawbacks

By putting a dollar figure on the fee, the explicit amount can sometimes cause greater resistance from clients and prospects—even when asset-based fees could be higher, but they are instead just expressed as a percentage.

An AUM fee will naturally rise with inflation and market appreciation (and fall during market corrections) but a fixed planning fee remains just that—fixed. Any changes to that fee need to be reviewed with clients, drawing attention to the increase.

For advisors who have not historically charged a planning fee but want to start, it can be difficult to ask clients to pay this fee if they historically perceived planning to be bundled with the asset-based fee, and now they need to begin paying extra.

05 | Tactical Tip

Ensure you communicate pricing changes to strategic partners and referral sources so they can convey the new options and understand whether these changes may trigger different opportunities for referrals.

TACTICAL TIPS

- Tread carefully into new pricing strategies, gauging profitability, client satisfaction, and ease of management along the way. Raising fees is always more challenging than reducing them in the future.

- Survey clients and target market representatives on pricing structures that may work best for their needs.

- Consider forming a client advisory committee to give feedback on this subject and other key potential practice changes. Not only will asking for input provide insight, but it also strengthens relationships and prepares clients for upcoming changes.

- Assess current pricing and service models to see whether improvements may be made to the traditional methods. Understand the profitability of the existing structure to inform any innovations.

- Prepare a communication suite to announce any new options and determine how they will be offered to new and existing clients. Be sure to update websites and printed firm brochures. Also ensure you communicate to strategic partners and referral sources so they can convey the new options and understand whether these changes may trigger different opportunities for referrals.

- Consider a pilot program with new clients to gauge effectiveness of any new strategies, providing the ability to make changes without major impact on the practice until the right approach is identified.

- Seek home-office and other partner support where possible to gain objective insight into your approach and learn what peers are doing inside and outside of your firm.

- Create a clear, written piece that discusses your pricing and payment methods, making each option as transparent as possible. If possible, use real numbers and dollar amounts to make pricing more understandable.

ARC

Advisor Research Collaborative

Cerulli's Advisor Research Collaborative (ARC) is the largest financial advisor research network in the U.S. For over 30 years, it has served as the foundation for Cerulli's strategic intelligence on the U.S. wealth management marketplace. More than 1,500 financial advisors regularly participate in the Collaborative to benefit from shared insights and recommendations.

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