

## How to Make Money In Wealth Management

Competitors are crowding into the industry. Clients are more demanding. Margins are vanishing. Long-term profitability is threatened. An action plan is needed

The wealth management industry has become the darling of the media, with headlines flashing “Wall Street Fights Over the Rich” and “How to Bank Like a Billionaire.” Though the trade has quietly been around for more than 150 years, all the media hype suggests a new trend is emerging.

The industry is at an inflection point. A wave of behemoth financial services players looking to serve the rich are setting up *de novo* ultra wealth management practices and gobbling up teams through “lift outs.” A number of boutiques have opened their doors in the past few years, including Quintile Wealth Management, Spruce Private Investors and Stillpoint Advisors. Additional competition—coupled with an increasing client demand for more comprehensive and personalized services at the same fee (otherwise known as service creep)—could undermine the pricing structure in the industry. Ironically, Wall Street’s recent rush to grab pieces of the wealth management business is causing margins to dwindle and endangering long-term profitability. Even in the face of rivals and clients driving hard bargains, wealth management executives must keep their heads, choose viable pricing models, educate clients about the cost of providing comprehensive services, and, rather than be all things to all clients, stick to whatever it is they do best, outsourcing the rest.

By  
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Sometimes they should even turn away new business. There is a way to make real money in wealth management. But—despite clients' big bucks—it's far from guaranteed.

### WEALTH MANAGEMENT IS...

Arguably, part of the challenge in differentiating higher-service (and what should be higher-fee) offerings from less-personalized packages is the fact that wealth management has become a catchall phrase for many forms of brokerage, financial planning and investment management.

So what is wealth management anyway?

Definitions differ from professional to professional, but two concepts seem constant: coordination and integration. "Wealth management means serving as a holistic, comprehensive advisor to our clients. Essentially, we are their chief financial officer and chief advisor," says Rodney Wood, executive vice president of Wilmington Trust Corporation and head of the firm's wealth advisory services in Wilmington, Del. Wood reasons that only wealth managers provide expertise in everything that a family may require, from asset allocation, manager research, options and credit to succession planning for family businesses and the family itself. This does not necessarily mean that the wealth manager is the vendor for all of these services, executing everything in-house. "A limited number of people are generally gatekeepers, controlling access to the family. Wilmington Trust, like everyone else, wants to sit in one of those roles," says Wood. "It is better to be in the tent with the family, than to have to be invited in by another."

The notion of quarterbacking a relationship with a wealthy family has sex appeal to the broader financial services industry. "Clients are more likely to stick with a firm that understands their complete financial picture," says John McColskey, a partner of Atlanta-based Homrich & Berg. That's because, while a more traditional investment counselor might lose client assets to death and taxes (not to mention competition), McColskey says that "the comprehensive advisor is well-positioned to work with heirs to an estate." Implicit in the wealth manager's role is not only a certain stickiness that comes from having a multi-faceted rela-

tionship with a family, but also ultimately, the client's assets and revenues. But there's a dark side: A gatekeeper must juggle multiple services and, often, the margin-draining concierge requests.

So how do wealth management firms determine what to handle in-house, what to access from the market, and how to charge for coordinating those functions?

Keith Vernon, managing principal of Bristlecone Advisors, a Seattle-based multi-family office, suggests that a "best practices" approach to wealth management is "to understand whatever the firm does best and outsource the rest." Kevin Sheehan, a consultant with Chicago-based Family Office Exchange (a for-profit association of family offices that goes by the acronym FOX), adds that firms not only need to be "smart enough to know what they are good at," but, "equally importantly, what can be offered internally at an acceptable profit margin."

According to FOX, a wealth management offering includes integrated tax, estate and personal financial planning and investment advisory, such as policy creation, strategy development, asset allocation and rebalancing, manager selection and monitoring, as well as performance analytics. More sophisticated institutions may offer strategic philanthropy and family education. Many also provide "lifestyle enhancement" services, which include insurance review, paying bills, cash flow management, consolidated reporting, partnership accounting, property management and other personal—or concierge—services. (See "Elements of Wealth Management," p. 48.)

### PRICING MODELS

It would be logical to conclude that similar offerings would be priced with similar models and at similar rates from firm to firm. Right? Wrong.

The Family Wealth Alliance, LLC, an Oak Brook, Ill.-based placement service for middle-market families looking for wealth managers, has identified four typical fee models. Firms charge clients for wealth management services:

(i) as a percentage of the client's assets that

A wave of behemoth financial services players are gobbling up teams through "lift outs."

## METHODS FOR BILLING CLIENTS

The wealth management industry has five pricing models, of varying popularity. Then there is the blended approach, in which firms apply different models to different services

PRICING MODEL	DESCRIPTION	ADVANTAGES	DISADVANTAGES	POPULARITY
Percentage of Assets Under Management	Traditional pricing method, in which the advisor charges fees as a percentage of assets overseen	Simple concept; aligns fees with overall portfolio performance	May encourage risk taking; more volatility associated with advisor's revenues	Most popular; extension of the traditional asset management fee model
Percentage of Net Worth	Advisor charges fees as a percentage of a client's net worth	Removes gray areas of oversight, such as restricted stock and illiquid investments	Fees charged on certain assets for which advisor may have minimal or no responsibility	Clients generally less comfortable with this approach
Flat Fee Retainer	Client and advisor agree to a flat rate up front, based on anticipated work; client is billed quarterly	Decouples fee from market's ups and downs; removes potential conflicts	Advisor not protected if work becomes more intensive during the year	Increasing in popularity, especially for client relationships in excess of \$100 million
Hourly Rate	Client is charged by the hour at pre-established rates for individual contribution	Best method to preserve profitability margins against service creep	Disincentive for client to call the advisor, because time spent is on the clock	Least popular; generally utilized by advisors who come from accounting or law firms
Unbundled (À La Carte)	Client is billed for services selected from an advisor's menu of offerings	Protects client from paying for services not used; protects advisor against service creep	Client may feel nickle and dimed	Insufficient datapoints to determine popularity
Blended Approach	Combination of flat fee pricing on holistic wealth management and AUM fee on investment oversight; intermittent project fees may be added	Leverages traditional model, but protects advisor from service creep	Still incorporates AUM fee concept, which may be an inherent conflict	Increasingly popular; shows signs of industry adoption

Source: Berkshire Capital Securities LLC, with contributions from Family Wealth Alliance, LLC

they manage (assets under management or AUM);

(2) as a percentage of the individual's or family's net worth;

(3) on an hourly basis for time spent on the client's case; or

(4) as a flat fee retainer.

But a fifth model—the unbundled approach—is emerging, in which clients can pick from a menu of services. And many firms are adopting a blended approach, in which different services are priced according to different models. (See “Methods for

Billing Clients, this page.)

Given the various pricing models, “fees are all over the map,” says Thomas Livergood, chief executive officer of The Family Wealth Alliance. “Comparing apples to apples is virtually impossible.”

Charging clients as a percentage of AUM is the most traditional of pricing methodologies, but even with such a simple concept there are shades of gray. For instance, if an executive has options and/or restricted stock, does that come under an

advisor's purview as manageable assets? What about a family with an illiquid position in a single entity or a low basis stock concentration? Does that count in the AUM mix? The simple answer is, “it depends.” Most likely, the advisor is continually assessing the position and advising the client on appropriate (and tax-efficient) liquidity strategies. There tends to be a whole lot of financial, tax and wealth-transfer planning to do with lumpy assets.

As an industry group, “we keep

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pricing ourselves like asset managers, yet we are decidedly not like asset managers," says Mary Claire Allvine, a partner with Chicago-based MFO Brownson, Rehmus & Foxworth, Inc. "We end up charging that way because we have not found the Holy Grail for charging clients for complexity, personality and longevity."

Why is it so many wealth managers are charging a percentage of assets upon which they advise? The first of two answers is "simplicity." Clients understand the implication of linking fees to assets overseen. It is an extension of the traditional asset management fee model. The second and more decisive answer is: "Everybody's doing it."

But it may not be the best approach. Some industry insiders have concluded that, when a wealth manager charges a percentage of assets—which move up and down by virtue of the underlying investments—a client's perception of the relationship changes. Livergood warns that this approach tends to create more wild fluctuations in a firm's revenues. It also creates an inherent conflict, as wealth managers seemingly are compensated to take added risks so as to record more gains, which enhance firm revenues. Allvine adds that the AUM pricing model sets up the advisor to be fired in down years just like an asset manager. But this is entirely contrary to the realities of the wealth management service model because those firms "are probably doing as much, if not more, for the client in down markets." The AUM pricing model is industry standard and easy to sell, but it is hard to sustain longer term, Allvine cautions.

Less used, probably because some clients find it objectionable, is fee pricing as a percentage of a family's net worth. "In the Midwest, it is an anathema to charge the client for overseeing their net worth, which includes fixed assets like a family res-

idence," reports Allvine. "But in California, a home is considered an investment," so clients there seem more at ease with this pricing model. Allvine reports that her firm, which has an office in San Francisco, prices services based on a client's liquid assets, not net worth.

A minority of wealth managers bill by the hour; these tend to have come from accounting and law firms. It's simply the pricing model they know best. In such a high-touch, high-service business, the argument for an hourly billing model is rooted in profitability. If firms know how much they need to pay talent to serve a client, they can build in a layer of operational costs and profit. If the relationship is more service-intensive than anticipated, the model ensures margins are not compressed. But, Allvine argues, "one of the real values we lend is that calling us does not cause us to generate another bill." Wealth managers want to encourage clients to make contact before they have done something that affects their financial condition, she says, not after.

Flat fee retainers are increasingly popular. Typically, a rate is established up front and billed quarterly. The secret to a viable flat-rate pricing system—one that preserves a firm's profitability—is to delineate and communicate what services are going to be provided to a client in the coming year. It's critical, if the next year's fee is higher, that a firm explain to a client how services have been enhanced or become more intensive. For instance, if a client is selling a business or developing a philanthropy program, a wealth management firm may need to build a project fee into its retainer. However, wealth managers should be prepared to reduce their retainer fees if and when relationship activity returns to a more normal level of service.

The theory behind retainer-fee pricing is straightforward. But what

happens when a firm agrees to a price at the beginning of the year only to find the scope of the work changes midstream? “We used to measure client expenses based on activity and then, at the end of the year, discuss the projects that became more complex than originally anticipated,” says Christopher LeMothe, president of Indianapolis-based MFO Oxford Financial Group, Ltd. “Essentially, if the work was more intensive than we had originally agreed, we would ask the client to pay more.” Unsurprisingly, that tended to be a one-sided conversation, he says; clients always wanted to stick with the price quoted up front. Today, Oxford creates a “Burn Rate Report,” which tracks—by week, month and quarter—how much of the annual fee a client is using. “We have thoughtful discussions [with the client] during the course of the year about where the annual fee is headed,” LaMothe notes. At any point, Oxford’s reporting system can recalculate the annual estimate through the end of the year, based on any additional service load. If a client wants to keep the annual retainer in line with the fee anticipated at the beginning of the year, he can discuss cutting back on projects and services.

A fifth pricing model has recently emerged: the unbundled, or à la carte, approach. One of the oldest names in the wealth management business, Chicago-based Northern Trust Corporation, looks at each prospective relationship as a blank canvas. Depending on a family’s needs, an advisor and client choose from Northern Trust’s menu of offerings to construct a comprehensive program. “In an unbundled environment, you charge for the services provided,” says Steven Bell, senior vice president and head of the firm’s wealth management group. While each service tends to be a basis point charge, certain services may be set at flat rates. “Once you’ve determined what the relationship is going to look like and what ser-

vices the client is buying, we often determine a consolidated fee with the clear caveat that it will be revisited, as structure and service needs change,” says Bell, who is mindful of the realities of service creep.

With a variety of models available, the right one for a firm likely depends on the services it’s providing, its targeted client base and what its competition is doing.

The industry, as a whole, seems to be moving toward a blended approach. The overall fee may be broken down into two or three components. For the financial/estate planning and the holistic wealth advisory oversight function, flat fee pricing is the first part of the equation. On the investment side, the traditional fee as a percentage of AUM is the second part of the equation. Lastly, and intermittently, there may be a provisional component in the form of a project fee, if a client is interested in something well beyond the scope of annual services.

**SURVEY SAYS...**

From a practical standpoint, “pricing is more art than science,” says Wilmington Trust’s Wood. And, even though firms have stated fee schedules, every prospective client seems to be looking for a fee concession. Larger relationships tend to use buying power, aggregating family accounts for best pricing. (See “Fee Basis vs. Size of Relationship,” p. 49.) Though one \$100 million relationship is rarely a single individual or account, “in a market of one,” Bell notes, “negotiation is a way of life.”

The combination of shrewd money in motion and so many entrants looking to add assets is turning wealth management into a commodity business. “The industry is negotiating itself into a hole,” says Steven Lockshin, chief executive officer of Rockville, Md.-based Lydian Wealth Management. Lockshin says that, during the recent recession, firms took low-margin business, driving rates

down. But this short-term approach meant “cash flow at the cost of profits.” It cannot, he warns, be sustained over the long haul.

Sara Hamilton, FOX’s chief executive officer, studied the cost of operating a dedicated single family office and found that “the advice layer costs a client 25 basis points and the back-office layer probably adds another 25 basis points.” Given FOX’s research, Hamilton is surprised that “most institutions are not able to command that kind of aggregate fee, though they have more depth and scale to do much more for the family than an SFO.” Lockshin echoes the sentiment, adding that “by serving multiple clients in a variety of situations, the ability for the wealth manager to bring families fresh ideas is enhanced.”

Hamilton’s golden rule is “the more customized the scope of the relationship, the higher the fee.” Those who are looking for the most



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tailored, customized service are sometimes those who think they should get the whole kit-and-caboodle for a mere five basis points. “Advisors must be firm, saying: ‘You can have customization or cost efficiency, but not both,’” Hamilton advises. “Until everybody learns to say the word ‘no,’ the industry as a whole will suffer.” Ultimately, there is a point at which the family should conclude that establishing an SFO is the way to achieve the ultimate level of customization they desire.

**CONCIERGE PROBLEM**

In the absence of an SFO, individuals and families of substantial means look to the trusted advisor for assistance with various types of requests. Lifestyle-enhancement services tend to be a lower-margin business, on average, unless a firm has an institutionalized process for handling such requests.

Many industry professionals say bill paying in particular is a low-to no-margin activity worthy of outsourcing to those who make a business out of it. Done internally, FOX’s

Sheehan cautions, it must be “charged for independently of other services, as the usage is different for each client.” As with many of the other lifestyle-enhancement services like property management, human resources and travel, Sheehan says, “if one service bogs down the process and takes away from the macro picture, perhaps it should be outsourced.”

While a \$20 million client might pay just \$12,000 to \$18,000 more for bill paying and cash-flow reporting, some wealth managers still believe it’s critical to keep these functions in-house, irrespective of the margin drain, because these activities provide a tremendous amount of information about a client. Bill paying “helps the advisor understand the client’s spending habits,” explains Bristlecone’s Vernon, whose group uses the information to drive the cash-flow forecasts, which then is incorporated into its investment models. Additionally, Vernon’s team drops the information into monthly budgets and reports to the client. Although spending discipline can be

a challenge for families of substantial means, Bristlecone’s bill-pay platform turns data into useful information, from which clients can make meaningful budget decisions. Vernon’s clients clearly appreciate the capability. One client jokes: “When your outgo exceeds your income, your upkeep becomes your downfall.”

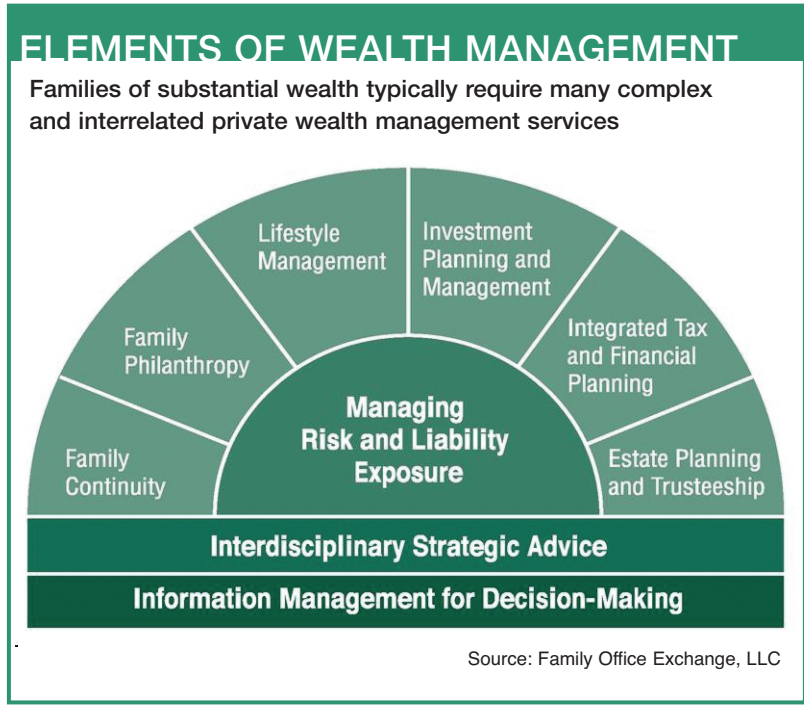
Bill paying and cash-flow management are among the easier lifestyle enhancements to price as a separate service, but what about the dog walking, jet leasing, helipad booking and other sometimes out-of-the-ordinary client requests? While some firms market personal services, most do not, as there is no industry-wide pricing scheme for charging for these types of advice or event coordination. Generally, the man-hours lost to such undertakings are part of the overall relationship fee. One industry insider likened the concierge business to an all-you-can-eat buffet, with “some clients bellying up for third and fourth helpings.”

Opinions vary on the offering and pricing of concierge services. At Lydian, “we do everything,” says Lockshin. “We are a service company that happens to be in the investment business.” Lockshin believes you facilitate as much as you can for the client. “There are areas where you gain expertise and other areas where you call on outside experts.” How are these services priced? Lydian doesn’t bill by the hour, nor charge a retainer fee, rather fees are tailored to a client’s service requirements. “Money is made on the margin.” But Lockshin points out that, because the vast majority of the players in the industry undercharge to begin with, margins are squeezed even tighter when concierge services are added to the mix.

**RECIPE FOR PROFITS**

So how do you make a buck in the wealth management industry?

(1) *Let ‘em know what you’re worth and stick to your guns on pric-*

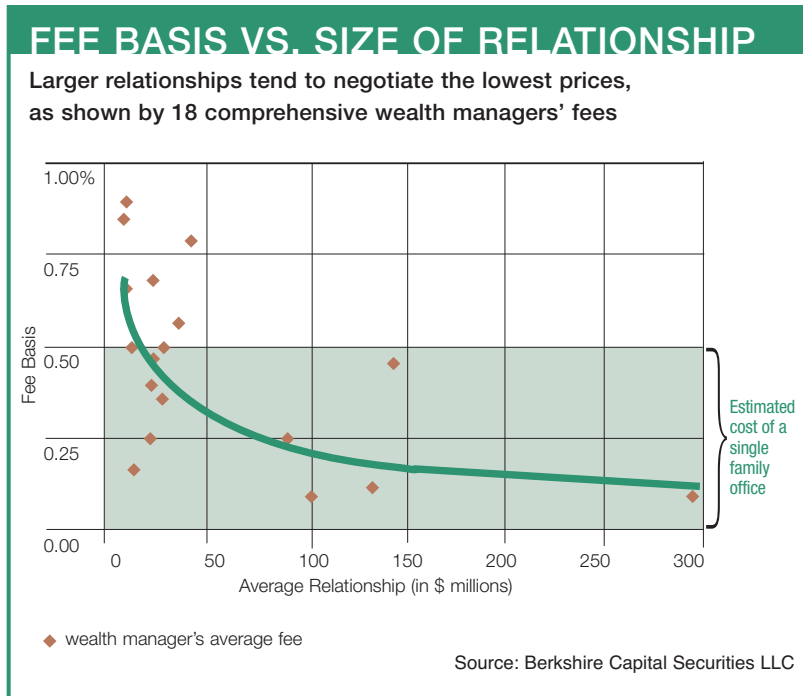


ing. Charge fees that are commensurate with services offered, do it with full transparency and take the time to articulate complexity. “As long as you are selling intellectual capital, there will always be the battle of what the value of that is,” says Oxford’s LaMothe. “The price the client is ultimately willing to pay can vary hugely on the same service package merely by the clients’ perception of the value added,” adds Kaycee Krysty, president and chief executive officer of Laird Norton Tyee, a Seattle-based MFO. “The tradition in the old money part of the business was to quietly serve. That leads to undervaluation,” notes Krysty, “We tell our people ‘Do a great job for your clients and make sure they know about it.’”

Resist the temptation to under-price services to get additional business. Fees that are too low mean a firm can’t justify keeping high-priced talent in-house. Fees that are too high mean clients are likely to take their business elsewhere. A savvy client understands that the lowest fee is not necessarily the best fee in a non-commodity service.

(2) *Set the client-to-advisor ratio at an appropriate level and leverage a team structure.* Human capital is the most expensive ticket item; it must be allocated wisely. Be mindful of the resource drain associated with extremely large relationships. In dealing with complicated, multigenerational families, Northern Trust’s Bell says, “It’s critical to determine the appropriate team size and the players that surround the client.” In his group, no relationship has fewer than four people with a dedicated responsibility to a particular family, and the largest, most complex relationship has upwards of 30. No matter what size a team is, though, it’s able to draw on the resources of the broader organization. Good team management ensures profitability.

(3) *Pay market rates to keep top talent.* Turnover can quickly devas-



tate a bottom line. Implement a compensation system that “aligns the employee’s interests with the client’s first, the firm’s second and the individual’s last,” suggests Wood. If staff is given incentives only to bring in business, then the quality of the assets is at risk and the model is not aligned to deliver longer-term profitability. Given that profitability of an individual relationship is lower in the first few years when service requirements are most intensive, it is better to keep existing clients than to bring in new ones. Higher margins for the advisor, within reason, generally translate into greater stability of the service team and higher-quality service, enhancing the overall relationship experience for the client.

(4) *Find every opportunity to institutionalize the business and use technology as a leverage point.* The end game is to find as much leverage through mass customization, without sacrificing personal service. While there may be a unique client situation on the front end—with particular service, reporting and asset allocation needs—common reporting and

investment platforms are essential to create a maximum level of gearing in the business.

(5) *Learn how to tell a good client from a bad one.* Unfortunately, experience is the best guide, but look for telltale signs upfront. Know which clients would be well-served by the firm’s core competencies. Be mindful of the degree of customization: Don’t over-promise and under-deliver. What makes a good client? “Realistic expectations,” says Hamilton. “The best firms in the business are very careful about which clients they will accept.”

### DEFINING “SUCCESS”

As for clients, they need to be proactive to ensure they are partnering with a firm that is successful over the long run. While “you can see a lot by just observing,” as Yogi Berra says, clients should ask the right questions before entering into an advisory relationship. They should ask, for example: How does the firm see its business model growing so that it can reinvest in the next generation (and sustain itself beyond the original

founders, if it is independent)? Clients need to ask about a firm's profitability. "An enlightened client would like to be working with a firm that is financially successful, though that may be contrary to their desire to get cheaper services," says Wood. Clearly, a firm can't reinvest in its business if it doesn't make money. Clients also should ask how the firm compensates its staff.

How should a firm define its success? "Remain cutting edge in everything you do to bring in the best possible solutions for clients, the best possible staff, and better than average financial results for your shareholders," says Wood. Despite market pressures, the business of wealth management can be viable over the long haul. "If it wasn't so viable, everybody and their brother wouldn't be trying to get into it," jokes Wood.

Clearly, the industry will get a boost in coming years given demographic trends suggesting organic

growth in excess of 7 percent a year in the number of affluent households.

Still, for individual firms to survive and thrive they must examine their pricing structure and the degree to

One industry insider likened the concierge business to an all-you-can-eat buffet, observing that "some clients are bellying up for third and fourth helpings."

which both they and their clients are really being served.

The industry also must be careful not to self-destruct. The greatest risk to the viability of the industry is perpetuating the downward spiral of under-pricing services, which hurts

profitability, constrains resources and, ultimately, leads to the delivery of mediocre advice and disillusioned clients. "The greatest conflict that exists in wealth management is that

we are in a for-profit business," says Lockshin. "If we don't charge enough, everyone is going to compete for who can lose more money in volume," warns Lockshin. Then, to quote Yogi Berra, the wealth management industry may find that "the future ain't what it used to be." ■

Endnotes

1. "Lift out" is when Firm A entices away a team of professionals who work together at Firm B servicing a group of clients. Firm A hopes that a meaningful portion of the team's clients will come along for the ride.

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