



# THRIVING IN UNCERTAIN TIMES

TRENDS AND PRESCRIPTIONS

## **FIRMA**

Annual Fiduciary Risk Management Conference

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# RESEARCH OVERVIEW

## RESPONDING TO KEY TRENDS

### ABOUT THIS RESEARCH

This research represents our perspectives on compensation, fee realization and pricing trends in 2023, as well as our high-level advice about how firms should respond to a challenging business environment.

For a member community of leading banks and trust companies, we complement industry trend information with customized (firm-specific) advice based on real data. For example, we help firms understand the positioning of their stated fees relative to market benchmarks, and identify opportunities to capture incremental revenues at the household- and account-levels.

**Firms seeking to improve their pricing and revenue outcomes—or who simply need good-quality data to help run their businesses—are strongly encouraged to contact our team:** [david.lincoln@wiseinsights.com](mailto:david.lincoln@wiseinsights.com) or [karen.rush@wiseinsights.com](mailto:karen.rush@wiseinsights.com).

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# CHALLENGING TIMES AHEAD

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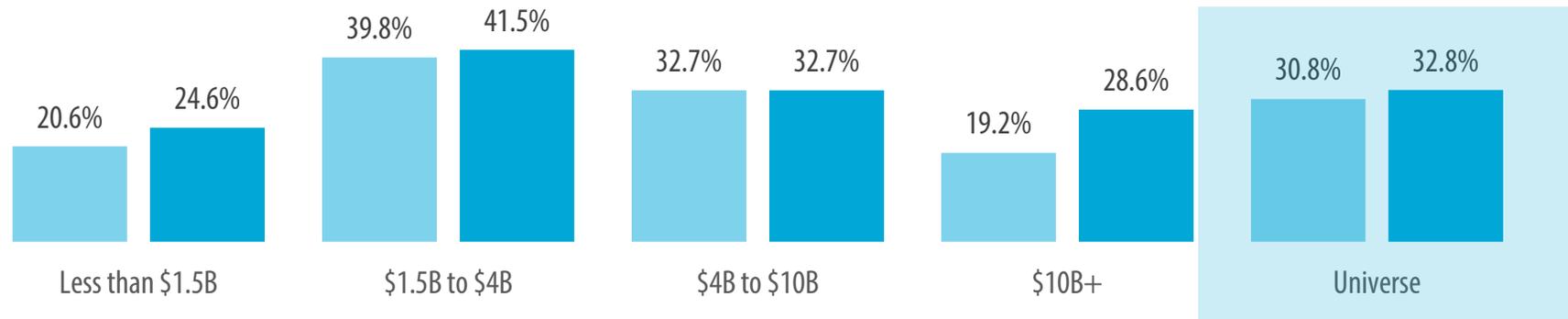


# A DISTANT MEMORY?

## 2021 MARGINS NEAR HIGH-WATER MARKS

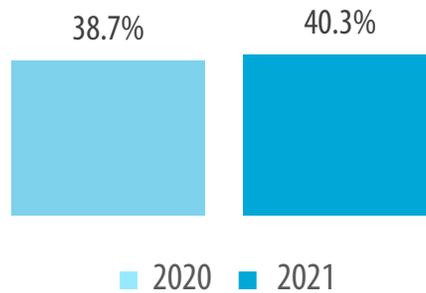
### Operating Margins, Investment Management and Trust, 2020–2021

By Total Assets Under Management



### Operating Margins, Wealth Management, 2020–2021

All Firms

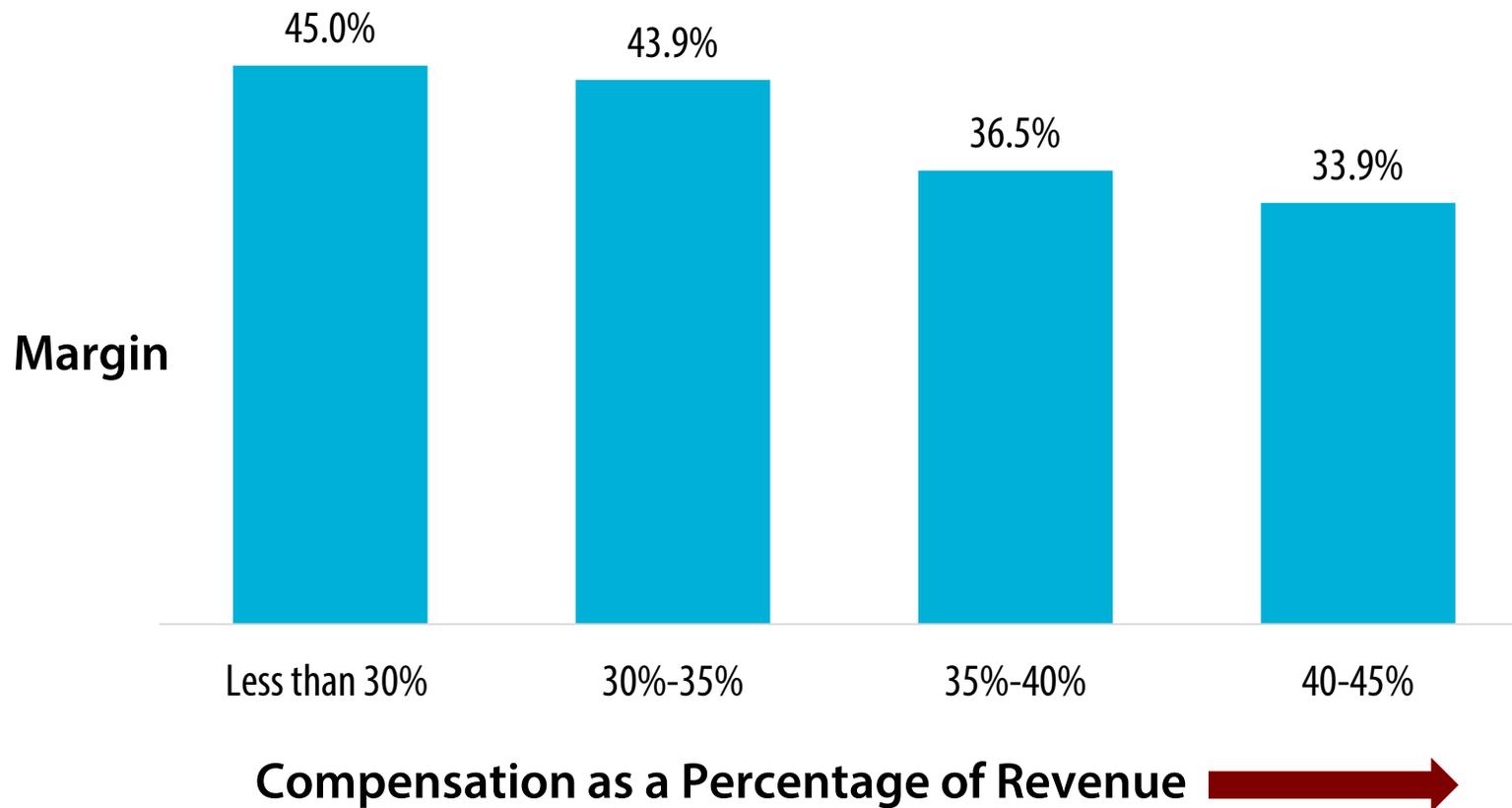


Notes: Investment Management and Trust: trust, fiduciary, and investment-related services provided to high-net-worth individuals, including services such as personal trust, investment management, custody, irrevocable, revocable trusts, individual retirement accounts, etc.; Wealth Management: the highest-level business unit in a firm that is dedicated to serving the needs of high-net-worth individuals. It may be comprised of several discrete lines of business, such as private banking, trust, and investment management. Data exclude brokerage.

# CLOUDS ON THE HORIZON

## COMPENSATION AS A PERCENTAGE OF REVENUE

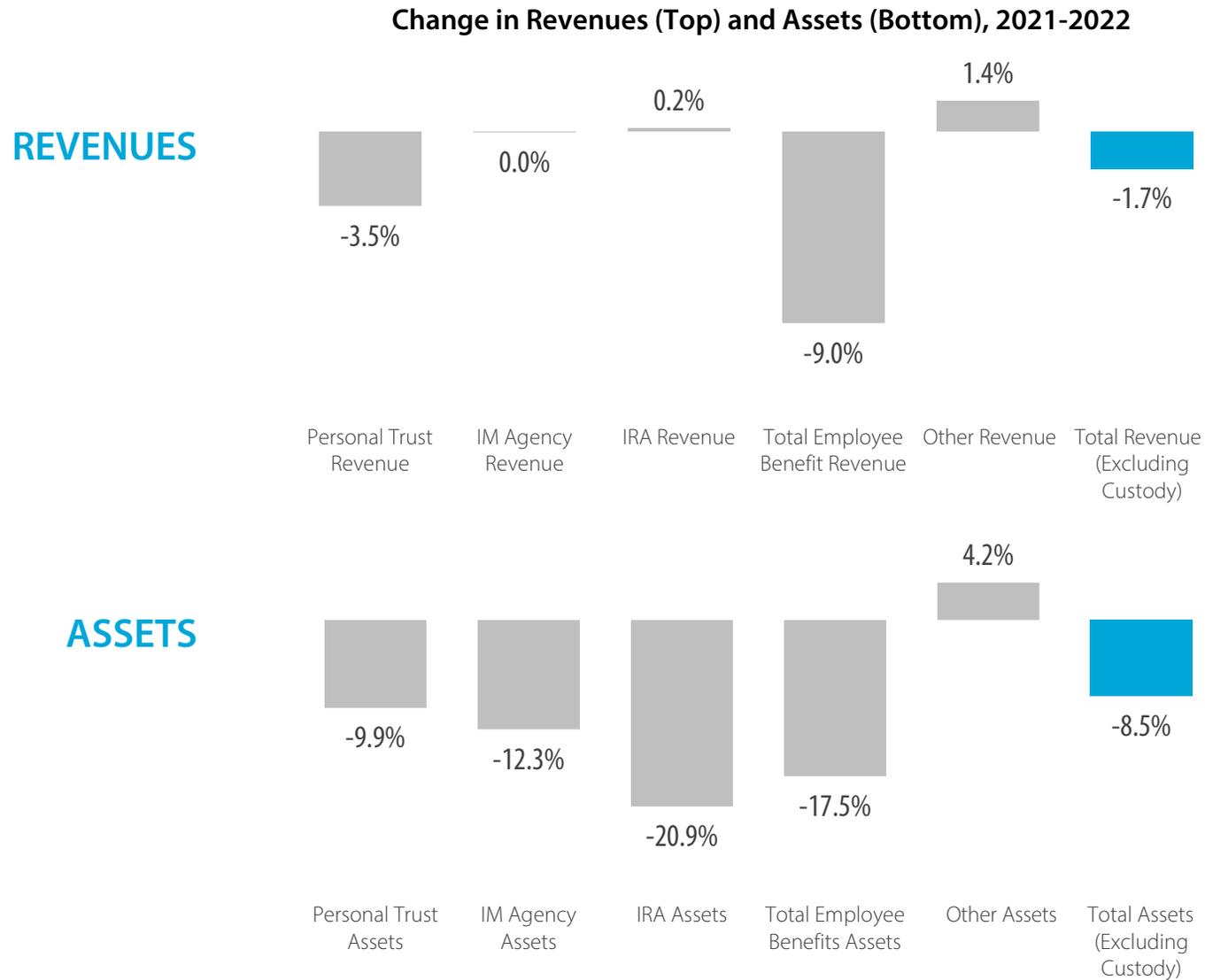
### Median Pre-tax Operating Margin *by Compensation as a Percentage of Revenue*



Notes: Margins are median pre-tax operating margins and include allocated (indirect) expenses where applicable. Data are drawn from data years 2017 to 2021. Does not include firms who spend more than 45% of their revenues on compensation and benefits. Data are for investment management and trust and exclude private banking and brokerage.

# AN ABRUPT CHANGE

## REVENUE AND ASSET GROWTH RATES, 2021-2022



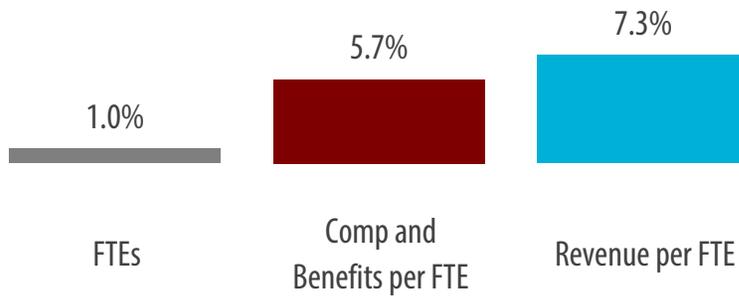
Notes: WISE analysis of FFIEC data. All figures exclude custody.

# IN THE REARVIEW MIRROR

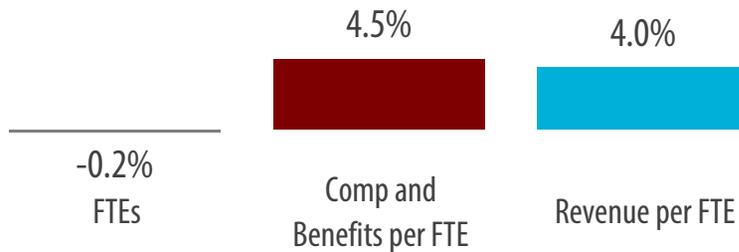
## REVENUE PER FTE AND COMPENSATION PER FTE

### Selected Growth Rates, 2018–2021 (Weighted Averages)

#### Investment Management and Trust



#### Wealth Management



### "It's Gaining on Us!"

#### Jurassic Park



Notes: Growth rates are compound annual growth rates. Full-time employees (FTE).

# SITUATION - ACTION

## RESPONDING TO KEY TRENDS

### SITUATION

1. Clients are anxious
2. A more challenging revenue environment
3. Our most valuable resource—people—is becoming more expensive

### ACTION

4. Do nothing (margin squeeze?)
5. Drive organic growth improvements (sales and expansion)
  - ↳ Improving realization—which encompasses pricing and discounting—is a 'best bet'
6. Free up capacity
7. Cut non-compensation expenses

### AND "ALSO"

8. Attract, develop, and retain great talent

# 2 RESPONDING TO RISING COMPENSATION COSTS

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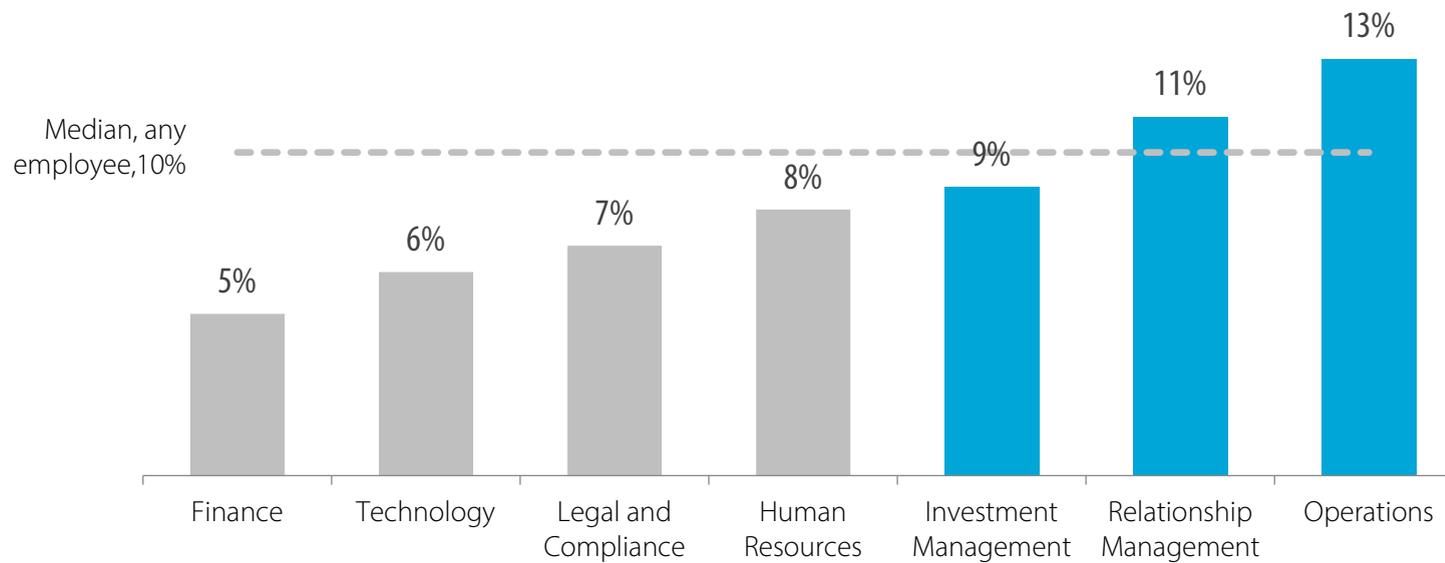
# TALENT

## MEDIAN CHANGE IN BASE SALARY BY CATEGORY

### Case Example: Change in Base Compensation by Role, 2021-2022

Sample: 16 firms specializing in ultra-HNW clients; 1100+ employees

Almost all firms are registered investment advisors (RIAs)



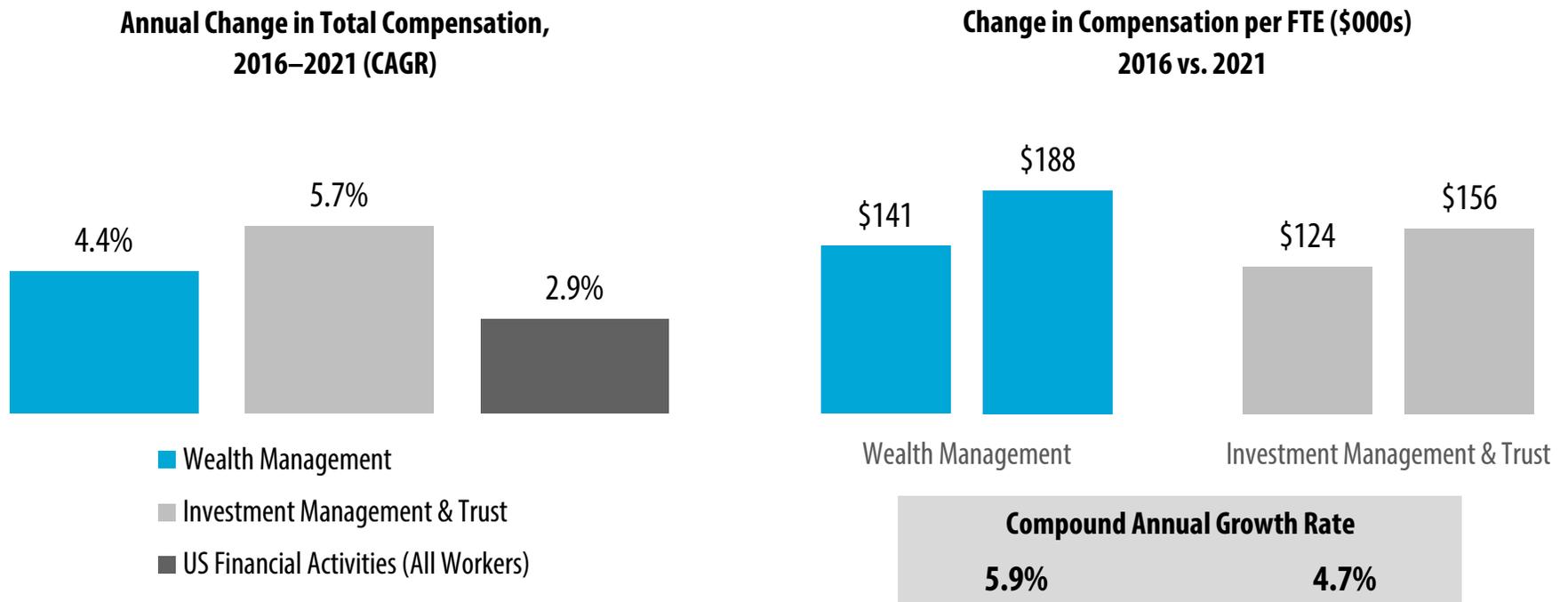
### Reason for Base Salary Increase

Cost of Living/Inflation	61.3%
Performance or Merit-Based	38.6%
Other Reason	<1%

Notes: respondents entered data for individual employees for about 30 unique job titles within the seven categories shown above. Each role had standardized definitions for job characteristics and responsibilities.

# TALENT

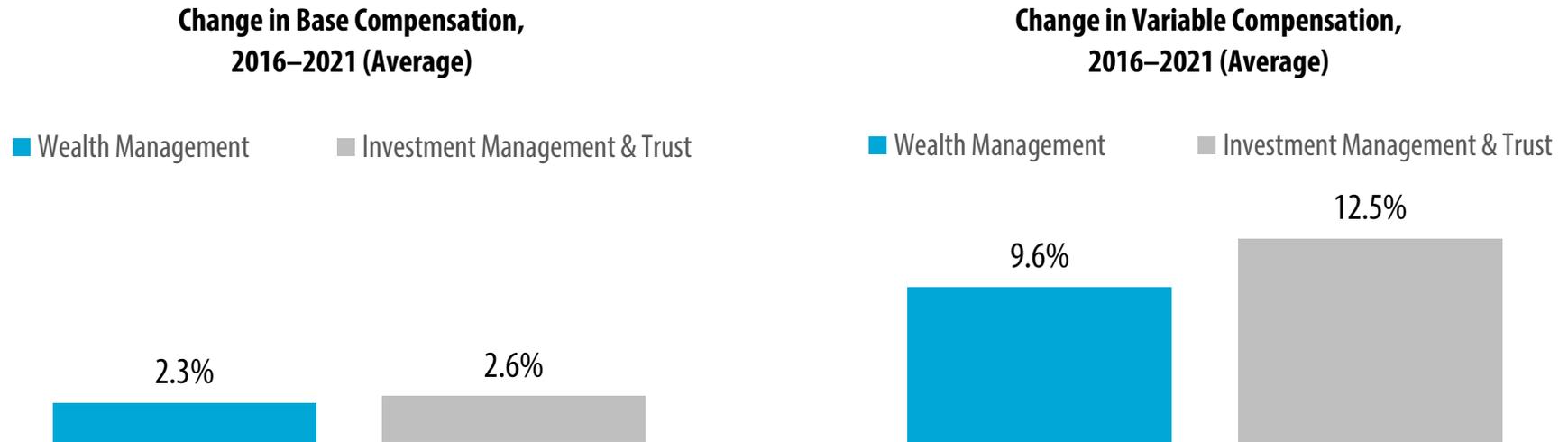
## TOTAL COMPENSATION AND COMPENSATION PER FTE



Notes: US Financial Activities Data from the Bureau of Labor Statistics. Charts are excerpted from the WISE white paper "It's Payday! Responding to Rising Compensation Expenses" (April 2023)

# TALENT

## CHANGE IN BASE VS. VARIABLE COMPENSATION



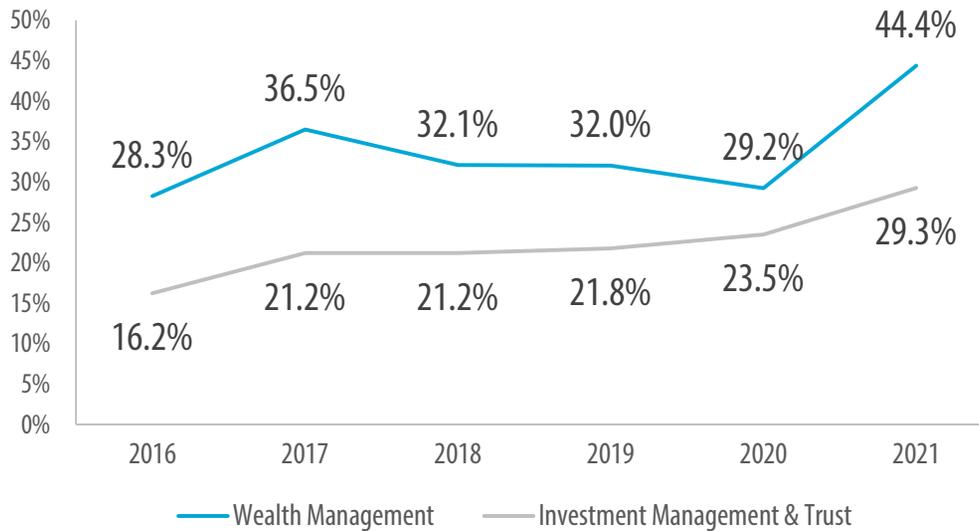
### Incentive Plans: More Generous, Less Efficient ... or Both?

- Rewarding market appreciation
- Paying too much for team sales
- Incentives are not aligned with skills
- Internal referrals are too expensive

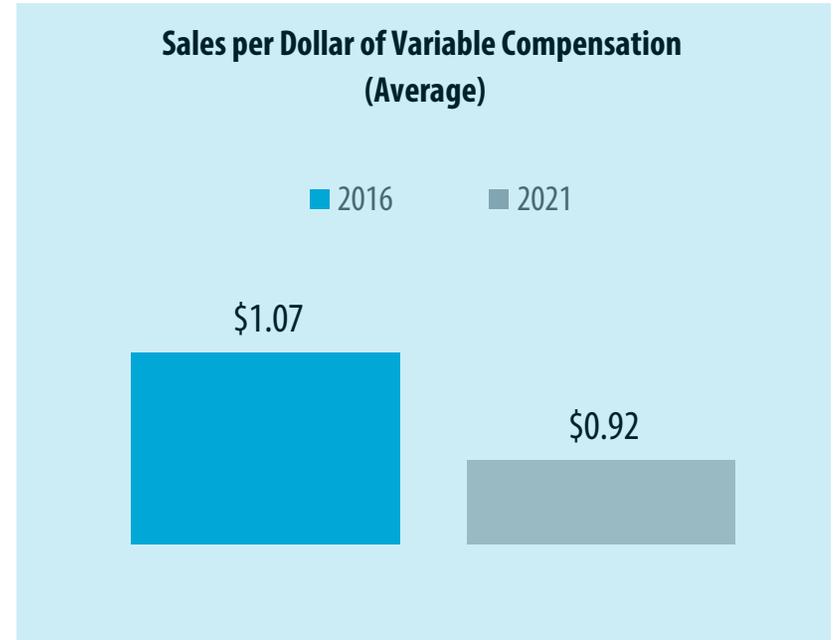
# TALENT

## SALES PER DOLLAR OF VARIABLE COMPENSATION

**Variable Compensation as Percentage of Base Compensation  
2016–2021 (Median)**



**Sales per Dollar of Variable Compensation  
(Average)**



# TALENT

## RESPONDING TO KEY TRENDS

*The talent 'issue' comprises several discrete pieces*

### • **Compete for good people**

- Retain good people (and their clients)  
Teams are key
- Build or rebuild training and development capacities
- Encourage adoption of new technologies and services
- Diversify teams
- Maintain culture as firms grow and scale

### **I. Adopt more flexible talent sourcing strategies**

- The pool of advisors will shrink 0.3% per year through at least 2024<sup>1</sup>
- On an asset basis RIAs were the biggest beneficiaries of advisors in motion in 2021
- Training, nontraditional hires, and "recruiting as a KPI" have promise

### **II. Develop a compelling value proposition for best fit talent**

*Corollary: Money isn't everything*

Develop a compelling offer tailored to prospective employees who are the best fit *for your business*:

- Compensation;
- Business model;
- Reputation;
- Ease of driving business (access to referral sources and existing clients);
- Community
- "There is a segment of advisors who are like ER doctors who hate practice management. They just want to be a doctor and practice medicine. We have a job that is 100% service. We do the lead gen for them"
- "There are good people in all channels. You need to find out what people are good at and keep those who fit your mission"

### **III. Solve the wealth creation problem**

- Compensation model is an advantage for RIAs; "you have to solve the wealth creation problem to compete with RIAs for talent."; compensation ceilings can lead to the loss of good workers
- Long-term incentives and team incentives are very important tools. Firms need to protect talent in a bank/trust environment by finding ways for them to create long-term wealth without giving away the store
- "Banks are setup to do thousands of retail transactions. There is a necessary rigidity and uniformity in the way they approach things. That doesn't work for [wealth] talent. If you want good growth-oriented people you have to pay them. Our job is to deal with organizational headwind and make top people successful"

Notes:

<sup>1</sup>McKinsey Data. "Advisors" includes those working in the IBD, bank, insurance, wirehouse, regional BD and RIA channels.

# 3 THE CASE FOR ~~PRICING~~ REALIZATION

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# PERFORMANCE ENHANCER

## A Powerful Lever

"Pricing right is the fastest and most effective way for managers to increase profits. **Consider the average income statement of an S&P 1500 company: a price rise of 1 percent, if volumes remained stable, would generate an 8 percent increase in operating profits**—an impact nearly 50 percent greater than that of a 1 percent fall in variable costs such as materials and direct labor and more than three times greater than the impact of a 1 percent increase in volume."

McKinsey Quarterly, "The Power of Pricing", February 1, 2003



## Service Goals: Pricing and Discounting

Improve pricing and return on asset outcomes by aggregating data, sharing best practices, and providing forums for exchanging ideas and insights.

# WITHIN OUR CONTROL

## TWO TRUTHS ABOUT PRICING, DISCOUNTING, AND RETURNS ON ASSETS

### **It's Not the Market**

Wealth management fee and discounting practices **are only modestly influenced by external factors.**

### **It's Us**

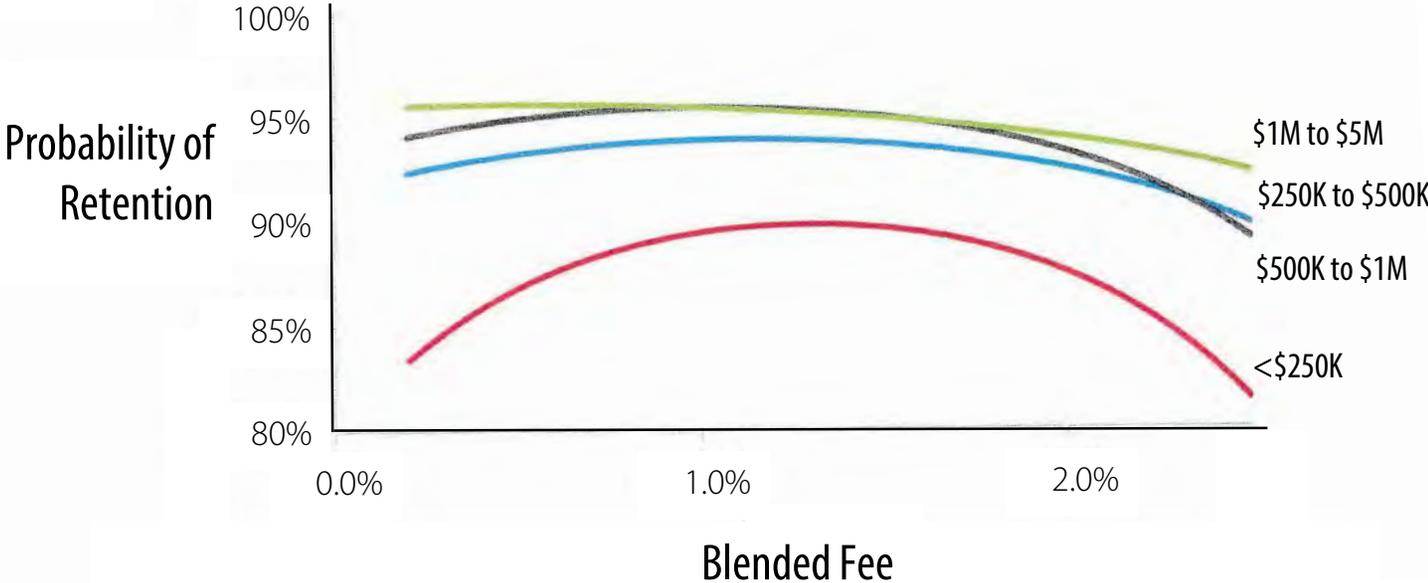
Where a firm **chooses** to set its fees and **the processes it creates to govern discounts** are disproportionately determinative of its returns on assets.

# STATED FEES

## THE CLIENT PERSPECTIVE

Observation: Pricing is not as important to clients as we think it is.

### Probability of Retaining Business



Source: PriceMetrix

# STATED FEES

## OUR PERSPECTIVE

Observation: Pricing is very important to our business.

### Predicted Incremental Return on Assets per Extra 10 Basis Points (BPs) in Stated Fees<sup>1</sup>

Personal trust, in basis points

Investment management agency, in basis points

3.9

4.6



Each incremental 10 BPs in stated fees is associated with an incremental 3.9 BPs in returns on assets.



Incremental Increase in Returns (Predicted)

Incremental Increase in Returns (Predicted)

For individual firms, the change in returns will also be heavily impacted by variations in discounting practices, the overall distribution of account sizes, and other factors.

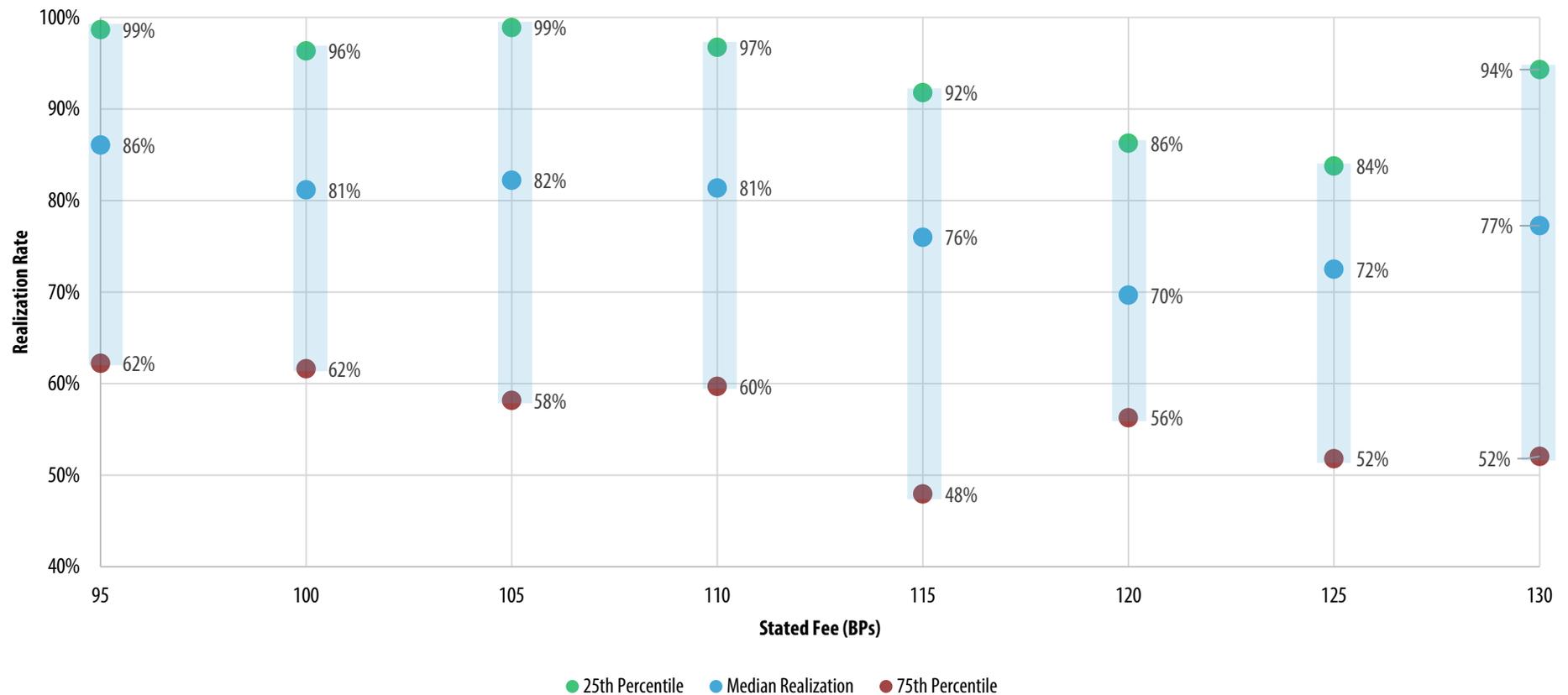
# STATED FEES

## REALIZATION RATES BY STATED FEE

Stated fees do not appear to have a significant impact on realization rates (AKA "what you keep").

### Rate Per Account for Different Stated Fee Levels

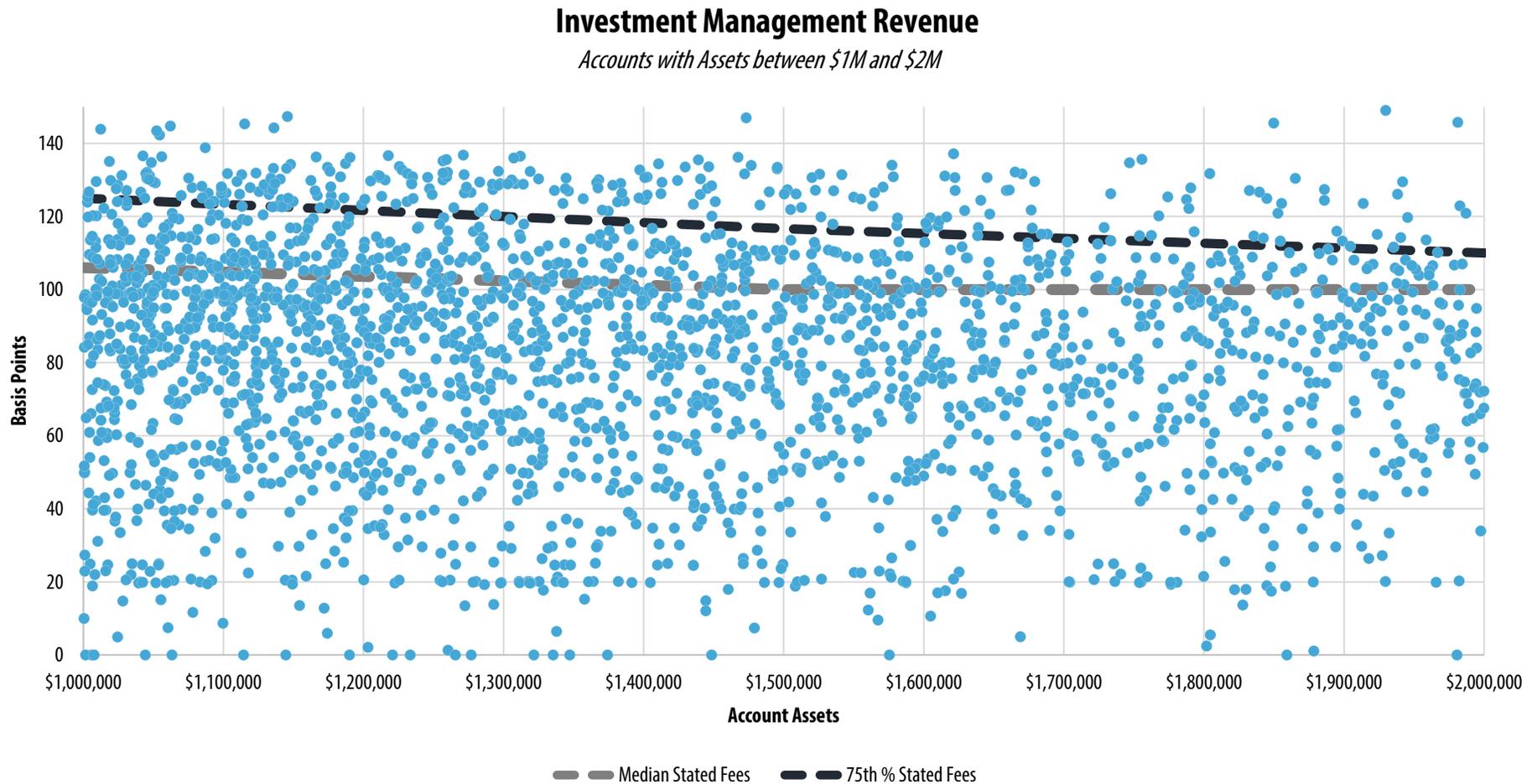
IM Accounts between \$1M and \$2M



# REALIZED FEES

## OPPORTUNITY (OR CAUTIONARY TALE?)

The combined effects of 1) many different 'pricers' and 2) multiple generations of pricers, 3) sales discounts, 4) family discounts, 5) relationship discounts, 6) legacy fee schedules, 7) multiple fee schedules, and 8) myriad other exceptions **yields a high degree of randomness in revenue outcomes.**



Notes: Y-axis capped at 140 basis points for visual purposes. Accounts with revenue over the stated fee line were likely charged for additional services, are in the process of being drawn down, or their price was set at a fixed basis point rate regardless of assets.

# REALIZATION BEST PRACTICES

## IMPROVING RETURNS ON ASSETS: PRACTICES

### Evidence-based Pricing and Discounting Best Practices

#### 1. ACTIVELY MANAGE PRICE

##### Observations

- Prices are often static/unmanaged ("set and forget"); schedules are old
- Clients are accustomed to price increases
- Firms face continual expectations to improve the service experience (e.g., digital)

##### Action

- Empower a senior manager (or committee) with responsibility for managing pricing outcomes, not just approving discounts.

#### 2. MAINTAIN FEE INTEGRITY

##### Observation

- Discounts remain widespread; they impair business economics and create brand and discrimination risks

##### Action

- Oversight committees, codified rules, discount tracking, discounts that expire are examples of good practice
- Put in place 'hard' minimum fees (non-circumventable) at the account or household level, as well as minimum annual revenue thresholds
- Firms need transparency around relationship pricing practices to limit their substantial costs, e.g., codified rules and prices

#### 3. LIMIT PRICING DISCRETION

##### Observation

- Many firms trade fees for short-term new business goals
- Discretion causes variability in outcomes, which yields subpar results
- Most employees lack information to make good pricing decisions

##### Action

- RMs, FAs, sales officers, and also managers should be given only limited or no discretion to give discounts or set fees without approval

#### 4. PRICE WITH PRIDE

##### Observation

- Wealth management is a premium service. In sales situations, conversations about fees often reflect a failure to convey value
- Firms are better off losing poorly-price business; "No" helps strengthen culture

##### Action

- Firms need to practice effective value conversations at the individual RM/sale officer level (sources of differentiation)
- Employees must be empowered to say no (if not, they are price takers).

#### 5. MEASURE PRICE PERFORMANCE

##### Observation

- Median realization rates are only  $\approx 70$  percent of stated fees
- Individual employees develop pricing habits. When pricing outcomes are opaque, effectiveness is difficult to measure

##### Action

- Quantify your gap to industry realized fees, set recapture goals
- Include gap to industry realization as a core metric for evaluating sales
- Create transparency around pricing and realization outcomes to enable coaching and development, e.g., percent of fee schedule realized by employees

#### 6. DEBUNK MYTHS

##### Observation

- Pricing myths help people avoid difficult conversations and explain suboptimal outcomes ("It is different in my market")
- There is no evidence that 1) firms pay a sales penalty for having higher fees or 2) that pricing outcomes vary significantly by geography

##### Action

- Myths fill leadership vacuums; adopt a posture of polite skepticism

# MAINTAIN PRICE INTEGRITY

## IMPROVING RETURNS ON ASSETS: PRACTICES

### Observations

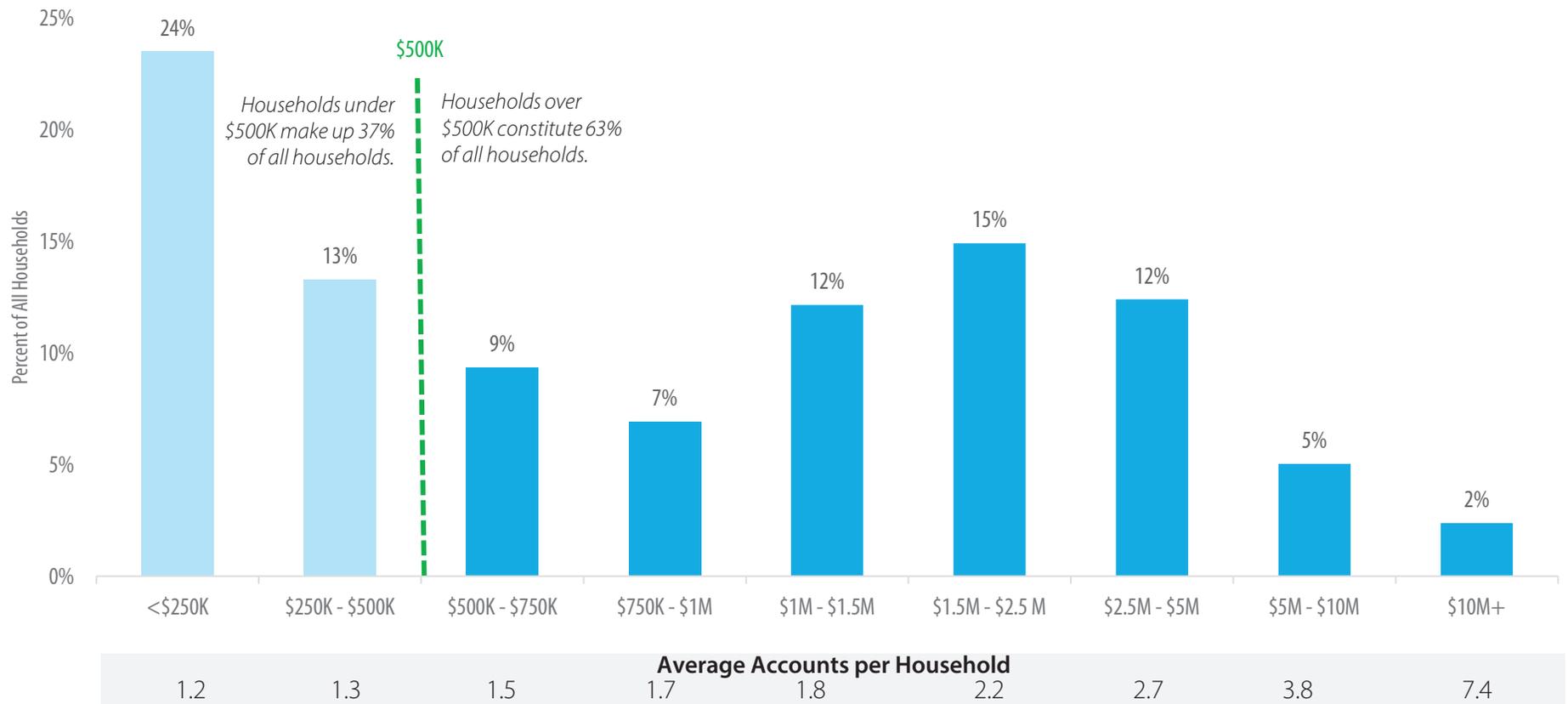
- It is critical to your culture to avoid exceptions to win business
- Word 'gets out' – to accountants, lawyers, and fellow RMs
- Be prepared to justify to third-parties why some clients received advantaged rates over others
  - Can lead to arguments of discrimination
  - Can lead to arguments of price gouging when list price is achieved
- Price integrity is also critical to supporting pride
- There are no fact-based arguments in favor of treating similar clients differently
- Decide on acceptable levels by client/HH segment, and enforce – if a client seeks a lower rate, they are empowered, they can bring additional business
- Removes allowing irrational competitors from imposing chaos – no price guarantee/match

# MAINTAIN PRICE INTEGRITY

## HOUSEHOLDS BY ASSET SIZE

Despite members publicly stating that they do not actively seek clients with less than \$500K in assets, more than one-third of all relationships fall into this category. 37% of households have less than \$500K in assets. Many of these households consist of only a single account (gray box, below). These small households burn relationship managers' time and decrease business capacity.

**Distribution of Households by Total Assets**



# MAINTAIN PRICE INTEGRITY

## SMALL ACCOUNT MYTHS AND MINIMUM FEE GAPS

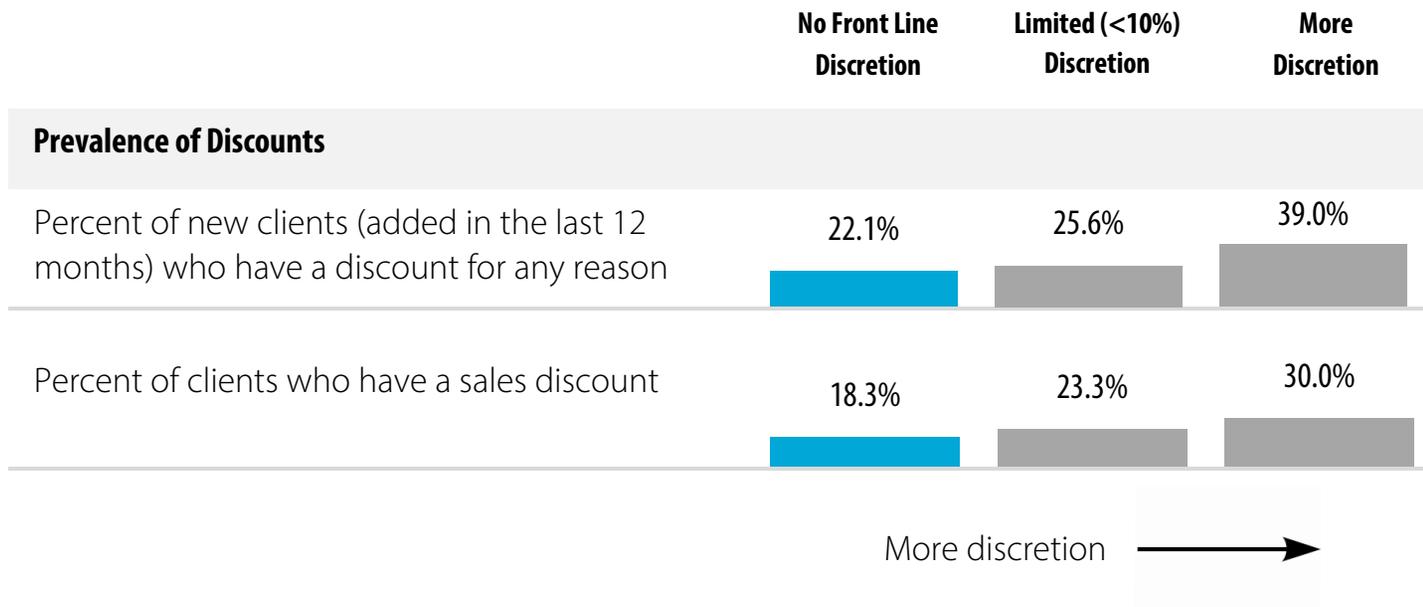
### Q. WHY ARE THERE SO MANY SMALL ACCOUNTS?

- A. Family relationships
- B. Depleting trusts
- C. Large credit relationship
- D. They're going to become a big account
- E. "At least they pay our minimum fee"

# LIMIT PRICE DISCRETION

## IMPROVING RETURNS ON ASSETS: PRACTICES

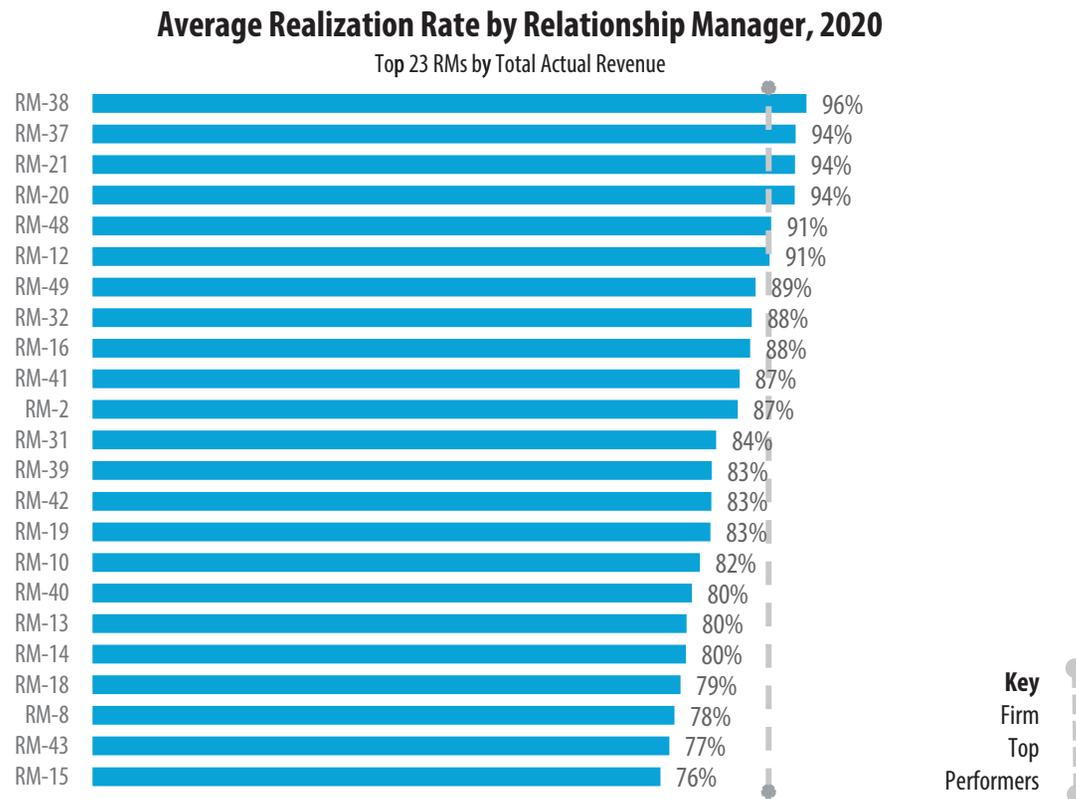
Firms who give more discretion to RMs and sales officers to give discounts report giving more discounts in total.



# LIMIT PRICE DISCRETION

## PERCENT OF FIRM'S STATED FEES REALIZED

Case Example: Moving all of Firm A's RMs to the 75th percentile for all RMs in the same firm is at least an \$11M opportunity.



# LIMIT PRICE DISCRETION

## IMPROVING RETURNS ON ASSETS: PRACTICES

### Observations

- At all levels
- Wide price discretion results in price chaos and a lack of integrity
- Exceptions are grenades without pins, they damage all within a radius
- Most RMs and regional managers lack the information and training to make effective price decisions
- Most firms have asset and revenue goals, but lack price 'realization' goals
- People are eager to trade price to meet asset/new business goals because few firms have reliable profit analytics at the customer level
- Studies show clients like a discount. the degree is less relevant, it's 'are you playing fair?'
- You are better off economically to lose poorly-priced business to a competitor than to book it
- Clients are skilled at misleading and threatening divorce, but rarely act on threats, the switching costs are too high

# PRICE WITH PRIDE

## IMPROVING RETURNS ON ASSETS: PRACTICES

### **The Primacy of Pricing Power**

"Basically, **the single most important decision in evaluating a business is pricing power**. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising the price by a tenth of a cent, then you've got a terrible business."

*Warren Buffet*

*Testimony to the Financial Crisis Inquiry Commission, 2011*

### **What's Our Value Proposition?**

"There is very little appetite at the moment, given current capital market conditions, to tackle repricing in any material way."

*Company A, 2023*

# PRICE WITH PRIDE

## GOOD VALUE DURING TOUGH TIMES

It is our perspective that weak markets present an opportune time for our members to apply order to chaos.

### Helping Clients Survive (and Thrive) During Periods of Volatility Reinforces Firms' Value Propositions



# PRICE WITH PRIDE

## IMPROVING RETURNS ON ASSETS: PRACTICES

### Observations

- Do you believe there is anything that differentiates you from substitutes in the market?  
You must empower your teams with that messaging
  - Price power is manifested in the courage to increase price on existing and new customers
  - There is no rule anywhere that says last year's price is this year's
  - It requires strength to tell RMs they can lose business (missing in almost all firms)
    - RMs will do so especially if poorly priced business affects their KPIs and "standing"
  - Without the strength to say "no", you are destined to be a price taker forever
  - If you are concerned about your ability to raise price and not lose business, then you need to reassess the components of your value proposition
- Build the skill, give your field forces confidence through role plays to articulate why your services are more valuable, and why you are not lowering price, video and test them on it
- Top management cannot relent on its willingness to reward employees that let poorly priced business 'go'

# DEBUNK MYTHS

## IMPROVING RETURNS ON ASSETS: PRACTICES

### Observations

- Myths abound and rise up again even after they've been previously debunked
- The most common are:
  - 'The market made me do it'
  - 'Discounting gets us more business'
  - 'I discount when markets are bad' – sympathy pricing
  - 'I make it up elsewhere'
  - 'You don't understand, it's different here in [name any] market'
- In the absence of strong leadership, people will take solace in these myths

# DEBUNK MYTHS

## IMPROVING RETURNS ON ASSETS: PRACTICES

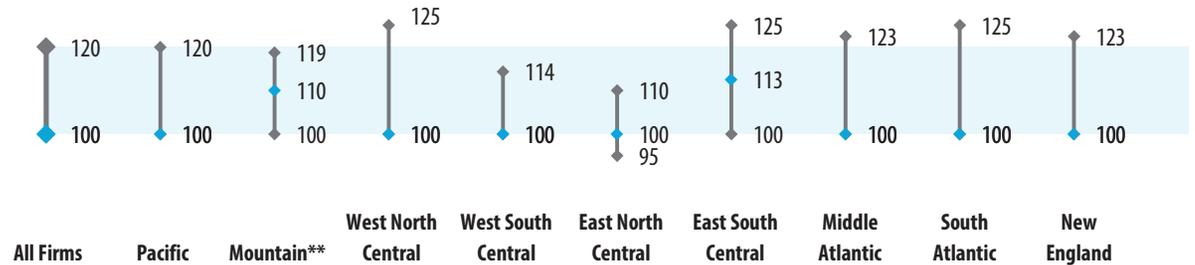
Our stated fee research has shown relatively little variation in fees by region. The chart to the right divides the country into nine regions and shows the fee range for each. The rectangular blue box represents the range for the entire United States.

Why there may be fewer differences than expected:

- Geographic differences may be present at more granular levels than regions or states (e.g., major cities versus rural areas).
- There is anecdotal evidence that firms who operate in multiple states or nationally are more likely to use a single fee schedule across markets today than in the past.
- Real and perceived fiduciary obligations may discourage price discrimination by geography.

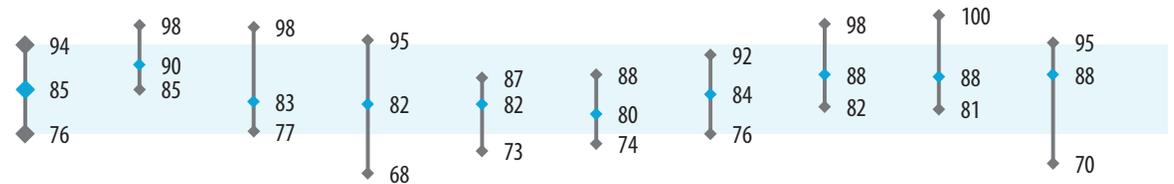
### Blended Price by Geography\*

#### \$1M Investment Management Agency Account



The Pacific has the highest median fee at \$5M. It also has high trust fees (page 17).

#### \$5M Investment Management Agency Account



#### What to Watch For:

- ◆ 75th Percentile
- ◆ Median
- ◆ 25th Percentile

□ Middle 50%, All Firms

All Firms	Pacific	Mountain**	West North Central	West South Central	East North Central	East South Central	Middle Atlantic	South Atlantic	New England
	Alaska	Arizona	Iowa	Arkansas	Illinois	Alabama	New Jersey	Delaware	Connecticut
	California	Colorado	Kansas	Louisiana	Indiana	Kentucky	New York	DC	Maine
	Hawaii	Idaho	Minnesota	Oklahoma	Michigan	Mississippi	Penn.	Florida	Mass.
	Oregon	Montana	Missouri	Texas	Ohio	Tennessee		Georgia	New Hamp.
	Washington	Nevada	Nebraska		Wisconsin			Maryland	Rhode Is.
		New Mexico	N. Dakota					N. Carolina	Vermont
		Utah	S. Dakota					S. Carolina	
		Wyoming						Virginia	
								W. Virginia	

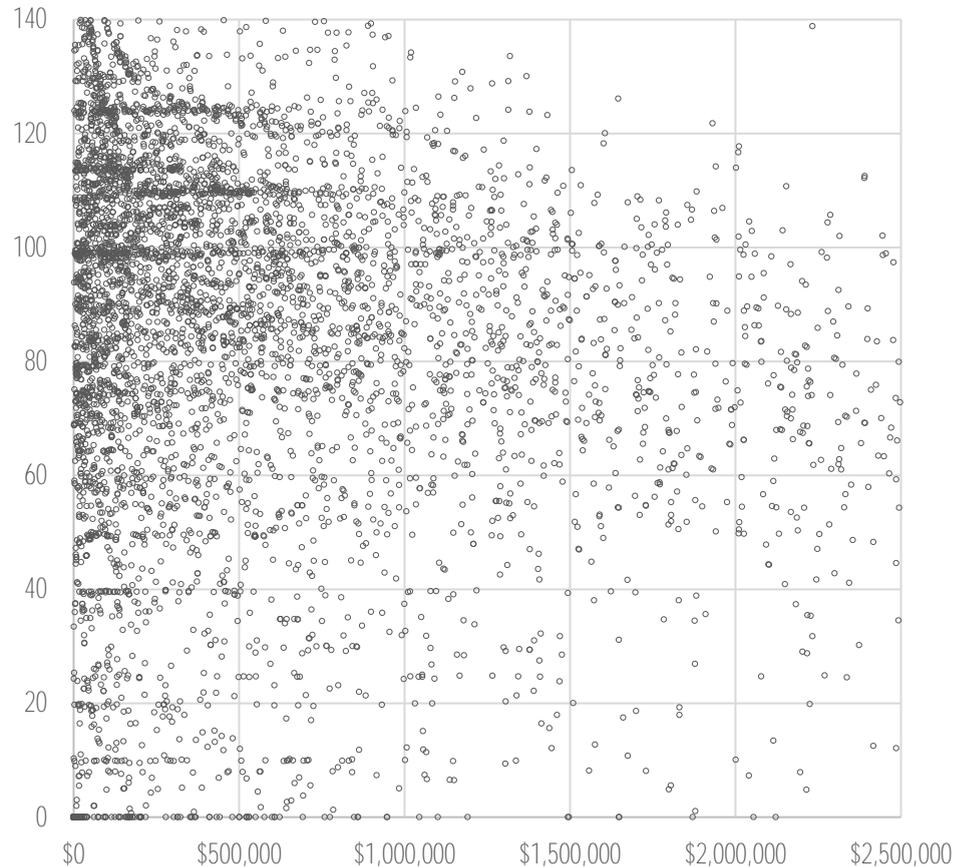
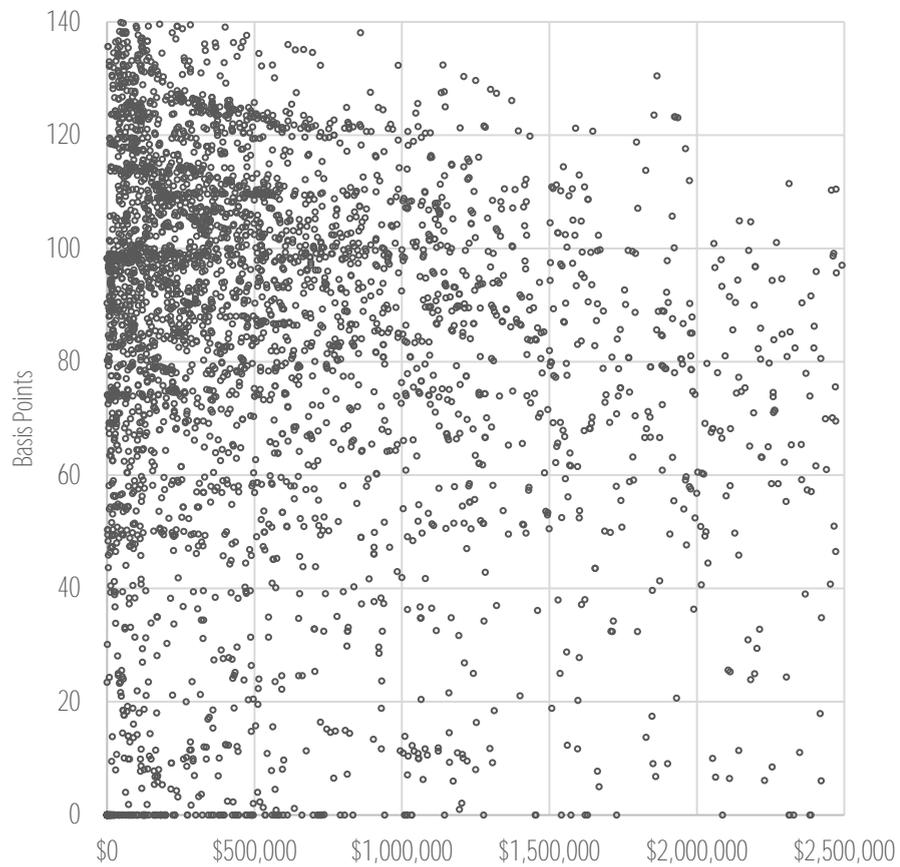
Notes: Regions are the nine US Census Bureau divisions. Blended fee: the blend of all asset-based fee tiers for a given account size, including base or flat-dollar fees. \*Includes banks, trust companies, and RIAs. \*\*Sample size under 10 firms.

# DEBUNK MYTHS

## IMPROVING RETURNS ON ASSETS: PRACTICES

The charts below show the difference in actual (realized) revenue per account for small versus large cities.

Realized Fees by Average Assets, Large and Small Cities  
All Account Types



Notes: Large and small city are defined by the median population, about 30,000

# DEBUNK MYTHS

## IMPROVING RETURNS ON ASSETS: PRACTICES

### Observations

- Actively use facts and data to dispel complacency and ever regenerating myths
- Myths allow doers to justify their actions to themselves, and they use them to 'snow' their managers/leaders
- Be aware that myths are a crutch, and are emotive for people
- The debunking must be persistent and relentless, because people naturally revert to emotively held beliefs that defend their poor actions
- Managers cannot capitulate. Facts are facts, data has no emotion
- "But its competitive here in New York"
  - No, it is not, there is no evidence, it is well supplied, there is a difference
- This requires resolve and steadfast leadership

# IMPROVING REVENUE OUTCOMES

## TOWARDS BETTER REALIZATION RATES

### **Occasion and Opportunity**

- The good times might be over
- Realization: controllable, cost effective, most have opportunities
- Realization > pricing > stated fees

### **Good Practices**

- Actively manage your book
- Make it more expensive to give discounts
- Price with pride
- **Good practice reduces variability in outcomes**

### **Discussion Questions (Places to Look)**

- Are we giving out too many discounts? Do we consistently enforce our minimums?
- What are our best 'pricers' doing to improve realization?
- Do we define service value effectively?

# Helping you make **WISE** decisions

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