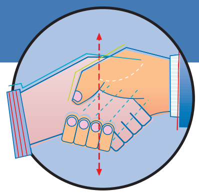

Moving Up-Market

Is raising account minimums the right thing to do?

BY ED MCCARTHY

KEY POINTS

- Higher account minimums can relieve strains on a firm's capacity and boost profits.
- Before implementing such a change, firms should set a policy for handling existing subminimum clients and subminimum referrals.
- Some advisers are moving away from setting account size minimums and, instead, are charging minimum fees.

Private wealth advisers, in what appears to be an accelerating trend, are raising their account minimums for new clients. Two main factors are driving this development. The first is affluence. By one estimate, almost three million U.S. families have more than US$1 million in financial assets; consequently, many advisers are experiencing greater demand for their services and can afford to be selective about new clients. The second major factor is operating leverage. Most firms' variable expenses don't increase in direct proportion to account size. Thus, serving a single US$4 million account may be more profitable than serving two accounts of US$2 million each—even if the single US$4 million account pays a reduced asset management rate because of its larger size.

On close examination, however, the behavior of asset managers is more complex than simply raising minimum account sizes. Some advisers are choosing to accommodate existing clients whose accounts fall below the new minimum, and others are trying to push smaller clients out the door. The decision to raise minimums must take into account a manager's business model, management style, and relationships with clients. Results can range from a narrowing focus to an expanded business model.

Motivations

Capacity constraints are frequently cited as a reason to raise minimums. Wetherby Asset Management in San Francisco increased its minimum to US$10 million this past year because the growing burden on its staff of 42 was posing problems. "Our ability to grow is contingent on the people we have to serve clients," says Debra Wetherby, CFA, a principal with the firm. "We try to gauge if people have capacity to take on new things or are stressed out. We raised our minimum because our sense was that people had more than enough on their plate and we wanted to slow things down a bit."

The firm's business model played an important role in the decision to raise minimums. Because each portfolio is customized, the firm lacks the scalability that other wealth managers may have. "For people who have businesses that are more scalable, if you have a sliding fee scale, you can earn more from ten US$5 million accounts than one US$50 million account," she says. "But from our perspective, it's not as profitable because it's ten relationships versus one. So, the fact that you collect less revenue on that one US$50 million account is justified, in a way, because it's less work in our model. Not that the big clients aren't a lot of work—they are—but so are US$5 million clients."

Small firms face the same constraint and are likely to encounter their capacity limits more quickly than large firms do. David Blain, CFA, owner of D.L. Blain & Company in New Bern, NC, works with 40 families and manages approximately US$60 million with a staff of three, including himself. He has been unable to attract other advisers to work with him in his small town, so he is the sole adviser in the firm. Blain increased his minimum from US$250,000 to US$500,000 at the beginning of 2007 after analyzing his revenues and capacity. "I looked at what we charge and the revenue that generates and then all the services that we provide," he says. "We do all the financial planning, and other than an initial planning fee, in subsequent years, we don't charge extra for it. It just was not profitable with our current structure to service those smaller clients."

Increased Exclusivity

Raising the minimum can provide another benefit: increasing a firm's perceived exclusivity among prospects. Blain says that the higher minimum makes some clients feel "like a member of somewhat of an exclusive club." In Wetherby's experience, raising the minimum has unexpectedly made the firm more attractive to a "whole different kind" of client.

Pacific Portfolio Consulting in Seattle has had a similar experience since it raised its minimum from US$100,000 to US$500,000. Previously, Doug Hockersmith, CFA, a portfolio manager with the firm, would meet numerous prospects with US$300,000 or US$400,000 to invest, but now he sees many more portfolios with more than US$1 million. "I don't know if that would have anything to do with our minimums," he says, "but in raising it from US$100,000 to US$500,000, the new accounts that we have attracted have been significantly above US$500,000. And we've been blessed to have some very large accounts come over recently. So, I think some of this is just differentiation within the marketplace."

Managing Existing Clients

Any time a firm raises its minimums, some existing clients probably won't meet the higher standard. One suggested approach to resolving this dilemma is to "fire" smaller clients. If clients don't meet the minimum and they lack an intangible value, such as being the relative of a large client, the firm can politely suggest they take their business elsewhere.

The advisers interviewed for this article eschew that cut-and-dried approach. Blain says that as long as clients continue to be the "same good clients they were when we started," he would not ask them to leave. There is another aspect to that issue, he notes. Some clients, particularly retirees, are forced to spend their principal. "They've gone from being a half-million-dollar client down to US$200,000," he says. "They really need me now."

Still, servicing clients whose portfolios vary widely in size can become an operational problem. Wetherby resisted the practice of giving up clients voluntarily for most of her firm's history. "For 15 years, I was really unwilling to do it because I felt such a loyalty to those clients," she says. "But what caused me to change was the realization that because alternative investments are such a big part of our strategies and those clients can't do them, it's probably better for them. So, until I got to the point where it was better for them instead of just being better for us, I wasn't willing to go there."

Wetherby's solution was to find other local advisers whose practices are more suitable for the clients. She says those firms focus their asset allocation strategies, research, and manager selections for portfolios similar to the referred clients' portfolios. That approach results in a better match for all parties, she believes, and her firm has referred approximately 80 clients in the past three years.

Alternative Solutions

Some advisers avoid the problem of disqualifying existing clients by raising their minimum annual fees instead of their account minimums. Doing so allows clients who fall below the minimum but wish to remain with the adviser to do so. Advisory firm Greenbaum & Orecchio in Old Tappan, NJ, has taken this approach in its portfolio management and wealth management services. "For those clients that had been with us for a while, we felt we owed it to them to grandfather them in," says Thomas Orecchio, CFA, a principal with the firm. "For those that stayed with us, we told them that we would be applying a minimum fee going forward to their portfolios. We tried to set that minimum fee so that it wasn't onerous and they'd stick around if they chose to."

Greenbaum & Orecchio set its minimum annual portfolio management fee at US$8,000, which translates to a portfolio minimum of approximately US$750,000. The firm prefers US$1 million-plus portfolios, Orecchio says, but it has approximately six clients with US$500,000 portfolios who are grandfathered in and pay a minimum fee of US$5,000. The minimum wealth management fee is US$12,000, which includes financial planning and investment management services.

Truepoint Capital in Cincinnati has developed an innovative solution for servicing smaller clients. The firm had an account minimum of US$2 million, and the average new client was closer to the US$5 million mark, but the arrangement was causing some problems. "We were still providing a more limited scope of services to long-time clients of more modest portfolio sizes," says Steven Condon, CFA, director of investment advisory services. "Additionally, we found ourselves declining the opportunity to work with young professionals in the accumulation phase as our services and high minimums did not present an appropriate fit."

Instead of referring smaller clients to other advisers, the firm created a new division: Truepath Financial. The underlying investment management service is the same for both divisions, but Truepath Financial's guidance focuses on such areas as retirement income planning, withdrawal rate analysis, and education planning. In addition, the account minimum for Truepath Financial is only US$500,000, which opens up the service to a host of new clients. The firm transferred some Truepoint Capital clients to Truepath Financial, where the minimum annual fee is US$3,000 (versus US$13,000 for Truepoint Capital).

Condon says most clients have responded enthusiastically to the new structure, which has opened up new markets for the firm. "One [market] is young professionals. Another is retirees of more modest portfolio sizes who are just looking for an investment approach that will lead to a stable, reliable income. They want someone whom they can bounce general questions off of without needing to pay for ongoing and detailed financial or tax or estate planning guidance."

Retaining Flexibility

Those interviewed for this story who have raised their minimums agree on a key point: There should always be exceptions to the rules. As Hockersmith notes, wealth management is a relationship business. Pacific Portfolio continues to take clients, for example, who don't meet the minimum but have a personal relationship with an existing client. The firm also recognizes that some subminimum clients are solid long-term prospects. "We do a fair amount of work with doctors," says Orecchio. "So, a doctor may come in and say, 'I have a US$900,000 portfolio, but I'm saving at the rate of say US$150,000–US$300,000 a year and I'd like to avail myself of your services now. Will you take me on for wealth management?' Sure we will. In the first year, it will be a bit expensive for them, but in successive years, they'll be above our minimum and it won't be an issue."

Ed McCarthy is a freelance writer in Pascoag, RI.

RECOMMENDED RESOURCES

"Overview and Trends in the Wealth Management Business"
2007 CFA Institute Webcast
(cfawebcasts.org)

"Achieving Client Delight!"
2007 CFA Institute Webcast
(cfawebcasts.org)

"Consulting to the Ultra Affluent"
CFA Institute Conference Proceedings Quarterly
(March 2008)
(cfapubs.org)