Pricing:
Reflect Your Value

Breakout Growth™
Advanced Strategies to Attract the Right Clients

TD Ameritrade Institutional

White Paper

About This White Paper

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Who is providing this information?

This information was created by FA Insight to be provided to TD Ameritrade Institutional advisors.

FA Insight is an independent consulting and research firm that works exclusively within the financial services industry. FA Insight works closely with shareholders of advisory firms and executives of financial services institutions to solve challenging business management issues.

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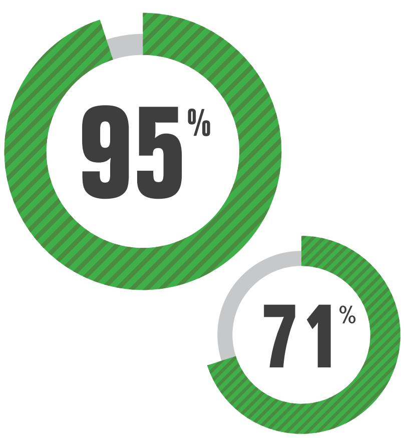
Table of Contents

Executive Summary

A multitude of factors influence a firm's ability to grow revenue and sustain desired operating margins. Your first instinct may be to focus on traditional business development strategies such as expanding existing relationships or building new referral sources. These more traditional growth strategies, however, rely on a range of external factors to gain traction and take time to develop. For the majority of firms, pricing represents an untapped opportunity for revenue growth, ensuring you are appropriately compensated for services rendered and to communicate the value you are delivering for fees incurred. Firms with a well-thought-out pricing strategy in place experience:

Benefits of an Effective Pricing Model

- Higher firm revenue
- Management during difficult market conditions
- Increase in firm valuation
- Immediate control over firm profitability
- Ease of communication with clients around value received



The Opportunity

- 95% of clients are charged asset-based pricing
- However, 71% of these firms indicate that their AUM-based fee includes services *other* than investment management

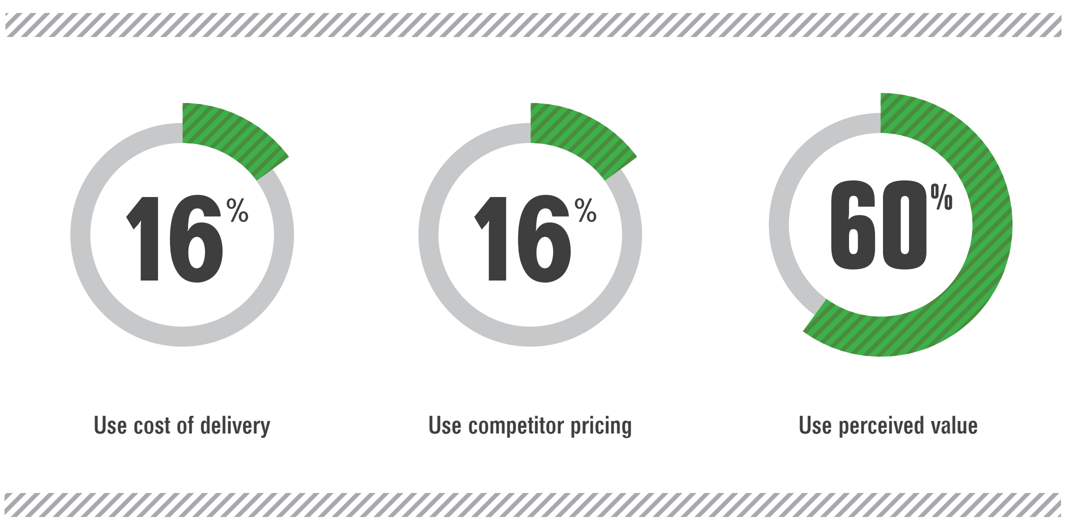
Just as a firm's service offer evolves over time with growth, the pricing strategy must also evolve in step. For example, underlying firm economics will change as head count is added, new technology is deployed or new processes are implemented. The cost of delivering to clients will invariably change concurrently, requiring that you regularly review and update your pricing strategy to accurately reflect the value you are delivering to your clients while maintaining your desired profit margin. Over time, a simple asset-based pricing model may no longer be appropriate.

While some advisors may be reluctant to implement a pricing strategy change, citing a risk to client retention rates, there is no evidence to support this view. Firms that increased pricing within the previous two years show little to no difference in client retention rates than those firms that did not. In addition, firms that increased fees experienced a faster revenue growth rate than those choosing to maintain their current strategy.

Criteria Used in Determining Price

When it comes to determining price, there are three dominant factors used by advisory firms, as shown in **Figure 1**. Just 16% of firms use the cost of delivery as a primary factor when determining their pricing. A further 16% of firms use competitor pricing as the primary means for pricing services, while 60% of firms determine price largely based on the perceived value. As is explored ahead, a cross-section of these methods often yields the most reliable foundation for pricing decisions.

Figure 1: Primary Factor—Determining Price



How Advisors Typically Approach Pricing

Firms may take different approaches when reviewing client pricing, but the majority of firms appear to be consistent with the end result. There hasn't been a lot of movement with pricing levels since 2009, but the data is showing an increase of fees with "middle market" affluent clients. In addition, on average, 95% of clients are charged only on the basis of assets under management, yet within their AUM-linked fees, 71% of firms provide services that extend beyond investment management. Almost half of all firms do not maintain a minimum client fee.

Pricing strategy is frequently an afterthought for a majority of firms despite the advantages that can be gained by having a well-thought-out approach to charging for services. While 42% of all firms increased pricing levels during the last two years, far fewer managed their pricing in a systematic way. Just 24% of firms surveyed by FA Insight review their pricing structure on an annual basis in order to determine whether changes are needed.[1]

Ensuring you have a pricing strategy that supports your firm's profitability and accurately reflects the value you are delivering to your clients is paramount to achieving and maintaining sustainable growth.

Pricing: Reflect Your Value, developed by FA Insight in collaboration with TD Ameritrade Institutional, provides education to firms on pricing their value to support firm growth and profitability. The white paper explores notable pricing trends across the industry as well as popular strategies employed by top-performing firms.[2] Directional support is supplied on how to assess your own pricing model and align the services offered with the right pricing structure. Additionally, *Pricing: Reflect Your Value* offers guidance on how to effectively plan to implement pricing changes with your clients.

Questions Addressed by This White Paper

- What benefits can an advisory firm achieve with a change in pricing strategy?
- What popular strategies are other advisory firms using with respect to pricing?
- What are the key elements in crafting a pricing model?
- How can an advisor determine if their current pricing structure is aligned with the value they are delivering to their clients?
- How can an advisor effectively implement a pricing change minimizing the impact to their clients?

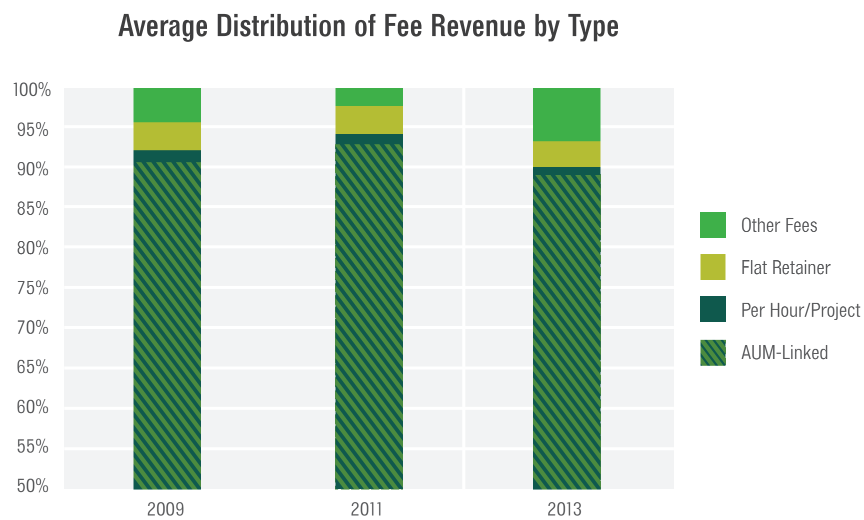
[1] All statistics cited originate from *The 2014 FA Insight Study of Advisory Firms: Growth by Design*, sponsored by TD Ameritrade Institutional.

[2] FA Insight's methodology ranks firms according to their percentage growth in revenue during 2013, and firms are ranked based on their ability to convert revenue into owner income. Both the growth and income rankings are then combined with equal weighting. Based on the blended ranking, firms in the top 25% of each development stage are deemed Standouts or "top-performing."

Pricing Trends To Watch

Whether an hourly rate, flat advice fee or an asset-based fee, how you get paid emphasizes what you do and how you deliver value to clients. As shown in **Figure 2**, the AUM-linked fee predominates among the various fee revenue sources, responsible for around 90% of fee revenue in recent years.

Figure 2: Average Distribution of Fee Revenue by Type of Fee

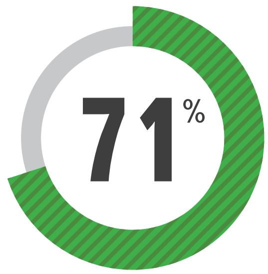


Retainer-based fees were a distant second as an alternative means of charging clients, as they accounted for just 3% of revenues. In **Figure 2**, "Other Fees" includes a range of fee types such as account setup or account transfer fees, tax preparation fees, loan fees or bill paying fees. The use of such fee types will vary by service model. Assistance in determining how to charge based on a firm's service model is provided in the "Assessing Your Pricing Structure" chapter ahead.

Despite the potential disconnect between service models and pricing, the heavy reliance on asset-based fees has persisted for several years and will likely continue to dominate for many more.

Pure Asset-Based Pricing Continues to Dominate

Throughout the industry, asset-based pricing continues to be the preferred pricing model used by most advisory firms, despite the broad range of services offered by many firms.



- 71% of firms indicated that their AUM-based fee includes services other than investment management

In 2014, firms reported an overwhelming 95% of clients are charged under a purely asset-based pricing model with firms compensated directly for the levels of assets they manage. Of those firms, 71% indicated that their AUM-based fee includes services other than investment management. This all-encompassing fee strategy can make it challenging to convey to clients the specific value delivered beyond investment management or differentiate from other offerings in the marketplace.

Pricing Levels Show Limited Movement

Overall, fee levels have shown little movement across smaller portfolios since 2010, but recent increases are evident in larger portfolios in recognition of the growing effort required to serve clients. Pricing levels have changed only marginally, if at all, in recent years. Typical revenue collected per dollar of AUM measured 72 basis points (bps) in 2013, which was identical to average revenue per AUM dollar from 2009 to 2013. Perhaps of greatest interest to firm owners and advisors is what the typical firm is charging clients across various relationship sizes.

Figure 3: Median Fees Demonstrate Limited Upward Movement

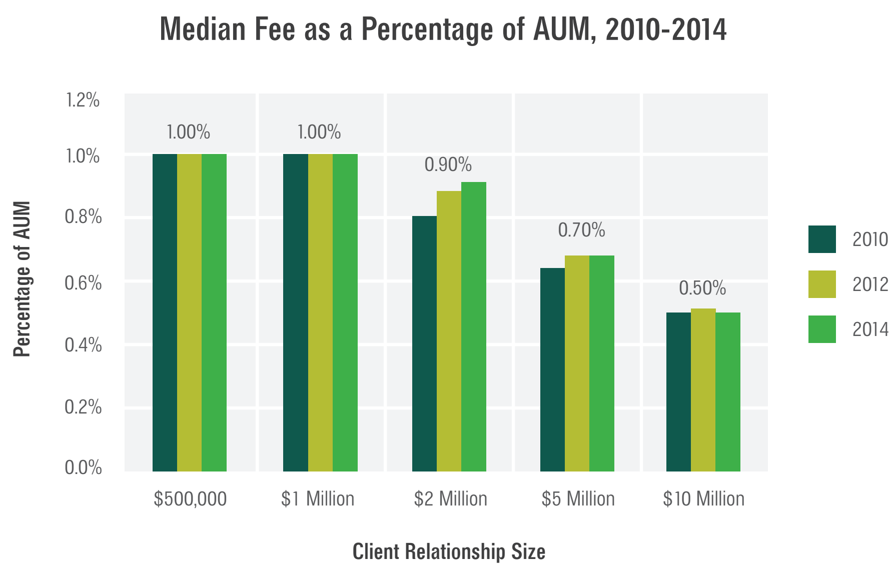
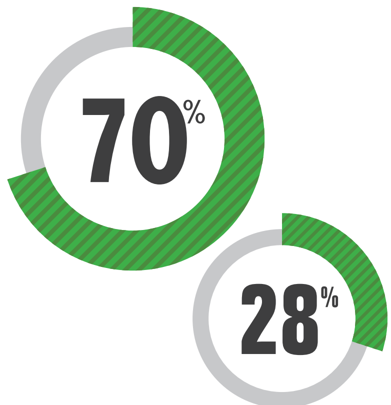


Figure 3 provides valuable benchmarks for firms as they review their own pricing levels. However, a word of caution: No two firms are the same, and drawing direct comparisons with respect to pricing levels has limitations. For example, the median number of services reported by the typical firm in 2014 was 10, up from nine in 2013. Both the number and depth of services delivered by firms can vary dramatically, which challenges direct comparisons with respect to price.

The majority of firms have not increased their pricing levels in the last two years. In particular, firms appear inactive when it comes to managing pricing levels for portfolios with less than $1 million in assets. Median pricing for portfolios of this size has remained constant since 2009 at 1%. The typical firm in 2014 reported a median AUM per client of $817,000. Firms may be confident in their ability to serve client relationships of this size efficiently and profitably at current fee levels. Alternatively, where firms are not reviewing their pricing on a regular basis, this lack of attention to pricing may represent a clear-cut opportunity for improving profitability.

In recent years a notable movement in asset-based fees was observed for relationship sizes between $2 million and $5 million. This increase suggests that firms reassessed the effort required to effectively serve middle-market affluent clients. With increased client sophistication and complexity comes a need to deepen firm expertise and capabilities impacting the value delivered to clients and the firm's cost structure, both likely factors in driving recent pricing increases within this portfolio size range.



Expected Fee Increases

- 70% of firms surveyed expect to hold fees constant
- 28% of firms expect to increase their pricing levels over the next two years

Competing with Cut-Rate Advice

Strong client retention levels among independent advisory firms are evident despite the many discounted advice options that have surfaced in recent years. The emergence of low-cost, robo-advisor offerings has many in the industry questioning the potential impact on future RIA pricing and growth. Will the availability of discounted limited investment advice challenge the intrinsic value of and demand for comprehensive financial advice? Downward pressure on the fee levels of independent advisory firms resulting from low-cost offerings is yet to be proven. Distinguishing a firm's offer and effectively articulating the value delivered will be vital as lower-cost competition continues to emerge. Advisors should develop their pricing strategy to reflect the value they are providing and be ready to discuss how low-cost options differ in the areas of accessibility, investment options, service levels, etc., to ensure that investors are clear on what they are getting for the price.

Managing the Margins

A look back at the financial performance of the typical advisory firm reveals that costs were well contained **(Figure 4)**. Direct expenses (including professional expenses such as salaries, bonus payments or performance incentives) have decreased as a percentage of revenue in recent years. In 2013, operating expense margin (which includes items such as all non-professional compensation and benefits, rent, technology and marketing-related costs) as a share of revenue was at a low of 36.8%. Except for 2009, the lowest point of the security market, margins for the typical advisory firm have withstood competitive pressure.

Figure 4: **Firms Sustain Healthy Margins Post-Recession**

Median	2008	2009	2010	2011	2012	2013
Direct Expense Margin	40.7%	47.6%	43.0%	46.6%	41.4%	41.1%
Gross Margin	59.3%	52.4%	57.0%	53.4%	58.6%	58.9%
Operating Expense Margin	41.7%	41.1%	38.1%	39.2%	38.1%	36.8%
Operating Profit Margin	17.6%	11.3%	18.9%	14.2%	20.5%	22.1%

According to these results, the market conditions in recent years are not driving costs up or forcing prices down. For the majority of firms, expenses are under control and profit margins are healthy. While this may suggest a limited need for raising revenue through revised pricing, strong profitability also suggests the firm may have untapped pricing power.

Protecting Profitability Through Diverse Market Conditions

While margin compression is not evident, the results from 2009 highlight the impact a market decline can have on both gross and operating profit margins. A firm's pricing structure can go a long way in protecting revenue and profit under difficult market conditions. In short, the pricing practices implemented in more favorable markets will either bolster or destabilize margins during tougher times. With this in mind, firms might be well served by taking advantage of the current operating environment, adjusting pricing or pricing structure at a time when clients are most receptive to change.

While the results indicate that the economics of advice delivery are typically strong, unfortunately not all firms demonstrate effective expense management or strong operating profit. Where firms are challenged to manage their gross and operating profit margins, a pricing strategy review may need to be prioritized.

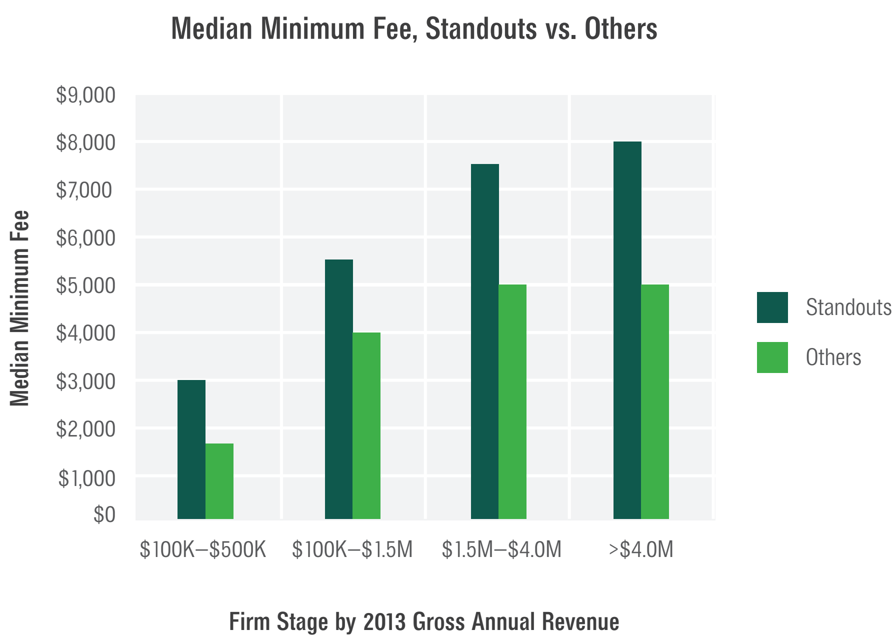
Leveraging Minimum Fees

The pricing practices of the industry's most successful firms reveal valuable lessons. FA Insight defines the industry's Standout[3] performers as the top 25% of all firms based on revenue growth and total owner income. This industry-leading group of firms reveals a clear ability to extract greater revenue per dollar of AUM.

Standout firms are more aggressive in protecting profitability through the use of premium minimum fees. As reported in 2014, those Standout firms generating more than $1.5 million in revenue demonstrated that they are more likely to have implemented a minimum fee relative to all other firms.

Additionally, minimum fees for Standouts at every development stage are significantly higher than other firms, which helps to support their performance advantage **(Figure 5)**.

Figure 5: Minimum Fees Support Profitability for Industry's Best Firms



[3] For additional insight into the practices of the industry's Standout firms, refer to the complete *The 2014 FA Insight Study of Advisory Firms: Growth by Design* sponsored by TD Ameritrade Institutional.

You can purchase a copy of the study through FA Insight at fainsight.com.

Pricing practices designed to protect firm revenue and profitability under all market conditions hold clear long-term benefits irrespective of a firm's size or service model. Despite the proven benefits, firms are understandably reluctant to revise their pricing, fearing changes may spur client defections, which will in turn lead to other detrimental effects on firm performance.

MYTH: RAISING PRICES PUTS CLIENT RELATIONSHIPS AT RISK

In another powerful finding from the analysis of our survey data, no correlation exists between raising prices and weaker firm performance **(Figure 6)**. Firms that raised prices over the last two years achieved stronger revenue growth and similar profitability relative to other firms.

Figure 6: Firms That Increased Price Maintained Strong Client Retention

	Increased Pricing Within Previous Two Years	No Change in Pricing
Client Retention	97.9%	97.4%
Revenue Growth	16.1%	13.8%
Operating Profit Margin	20.8%	20.8%

Perhaps more telling, however, is that firms that increased prices showed no tendency to lose clients at a greater rate than others. For these firms, client retention was a healthy 97.9% in 2013, nearly identical to the 97.4% achieved by firms that did not increase their price. Lack of a discernible retention difference fails to support the theory that increasing prices leads to client loss.

This ability to increase fees and simultaneously ensure high rates of client growth and retention is, however, influenced by each firm's ability to demonstrate value through the advice relationship.

CHAPTER 2

Assessing Your Pricing Structure

Many firms determine a pricing structure in the very early days of establishing a business and rarely review or adjust that structure. Invariably, a firm's business model will evolve over time in response to new market opportunities and growing client needs. Changes in marketing, service model, advice offer, client mix and client experience are factors that may warrant a pricing strategy review and update.

Does Your Pricing Structure Suit Your Business?

Each firm is unique. Two firms might both consider themselves to be wealth managers; however, the combination of services delivered by each firm, the depth of the advice delivered and the client experience will likely vary. As a result, each firm may require a different pricing structure to ensure it is compensated for its unique brand of wealth management services. **Figure 7** provides a list of initial questions intended to help firms identify potential challenges within their pricing structure.

Figure 7: Considerations for Assessing the Suitability of Your Pricing Structure

Pricing Structure Considerations
▸ In what areas does your firm currently deliver advice? How broad is your offering with respect to the services delivered?
▸ Has your advice offered to clients evolved or grown with the maturity of your firm? Has your pricing structure changed in step with your advice offer?
▸ When describing your services to clients, what do you emphasize? For example, are you primarily communicating your investment-related services, or do you emphasize the value of your other capabilities (such as tax planning or comprehensive financial planning)?
▸ In which areas of advice do you believe you deliver the most value to clients (for example, investments, cash flow management or financial planning)?
▸ Are your non-investment services currently bundled into one asset-based fee? If so, from your client's perspective, does this structure in any way devalue your non-investment-related services?

Pricing Structures and Suitability

For some firms, these questions may reveal a need to realign their pricing structure to better reflect the firm's current service offer. To further assist in assessing the suitability of a firm's pricing model, **Figure 8** summarizes a range of pricing structures as well as considerations for when each structure might be most appropriate. Depending on how you answered the questions in **Figure 7**, some combination of these example pricing structures may be optimal.

Figure 8: Sample Pricing Structures and Suitability

Pricing Structure	Example	Considerations for Suitability
Percentage of AUM Pure Asset-Based Pricing	**$200,000–$1.5M AUM:** 100 bps **$1.5M–$3M AUM:** 90 bps **$3M–$5M AUM:** 75 bps	▶ Reinforces investment management and investment returns as core value delivered ▶ When used in isolation, this model may not reward adequately for services beyond investment management ▶ **May be appropriate for:** Investment management, asset management, wealth management (when combined with other pricing structures)
Percentage of Total Assets Under Advisement	**$3M–$5M AUM:** 90 bps **$5M–$10M AUM:** 75 bps	▶ May be most appropriate for firms that work with high-net-worth clients actively managing a broad range of investments including alternative and illiquid assets ▶ Reinforces the effort necessary to advise on a client's complete investment portfolio ▶ **May be appropriate for:** Family office, investment management, asset management, wealth management
Flat or Tiered Advice Fee or Advice Retainer	**Flat Advice Fee:** $5,000 or **Tiered Advice Fee:** A Clients—$7,500 B Clients—$5,000 C Clients—$3,500	▶ May be most appropriate for firms that deliver advice beyond investment management—e.g., financial planning services or advice delivered in areas such as tax planning, estate planning or cash flow management ▶ Can be applied in combination with a percentage of AUM structure ▶ Used to support profitability on non-investment services ▶ **May be appropriate for:** Family office, financial planning, wealth management or investment management, and asset management firms that deliver non-investment advice

Continued on Page 13

Figure 8: Sample Pricing Structures and Suitability (Continued)

Pricing Structure	Example	Considerations for Suitability
Hourly Rate	**Lead Advisor:** $300/hour **Associate Advisor:** $200/hour	▸ May be most appropriate for firms that deliver limited or ad hoc advice to clients beyond investment management ▸ Could be used in combination with other pricing models to help support profitability ▸ Under an hourly rate structure, advisor time is emphasized as key to the value delivered ▸ Revenue generated under this model is limited by time ▸ Model may be perceived by client as rewarding inefficiency ▸ **May be appropriate for:** Investment manager who provides limited/ad hoc advice beyond investments or the delivery of traditional accounting services within an advisory firm
Minimum Fee	Flat fee to support the achievement of a minimum operating profit margin. Example: Minimum fee of $7,000 applied to all relationships.	▸ Can be used in conjunction with an asset-based pricing model to protect firm profitability ▸ Of particular benefit during a market downturn when portfolios decline and firm workload increases or remains the same ▸ **May be appropriate for:** All service models

Is a Mix of Pricing Structures Right for Your Firm?

The optimal pricing structure should account for the various ways in which the firm delivers value to clients. For many firms, this may mean using more than one of the options outlined in **Figure 8** in order to compensate for the range of services delivered. The optimal pricing structure should also be easily understood by clients to ensure they recognize the value they receive for the fees paid.

Case Study: Cost-of-Service Review Leads to a Combination Pricing Structure

Berno Financial Management, Inc., has created a unique fee structure to address both firm profitability and value received by clients. Based on analysis done by the firm's president, Bruce J. Berno, the firm went from an AUM-based-only fee to a combination fee including an AUM-based fee and an annual fee across all households. The annual fee covers operating costs incurred across all accounts while a sliding AUM-based fee is charged based on the complexity/size of the relationship. "We implemented a hybrid fee/percentage-of-market-value fee to better communicate to clients the value of the comprehensive services that we provide. We are proud to have been an industry leader in this strategy long before it was commonly discussed in the industry press," said Berno.

To download the full case study, visit tdainstitutional.com/attractclients.

CHAPTER 3

Reviewing Pricing Principles to Determine Fees

Once you have identified the best pricing structure for your firm based on your business model and services offered to clients, your next step is to determine the specific fees you will charge. Where should you begin? Before determining your pricing schedule, you will want to collect some information to ensure you are in line with the market based on the services you provide. You will need to obtain a general understanding of the going rate in the market, firm costs and the value that your firm delivers to clients. These three fundamental considerations should influence your firm pricing levels. Determining the right amount to charge will support the achievement of firm profitability and reward for the value delivered.

Understand the Competitive Landscape

In understanding your competitive environment, industry pricing data can serve as a useful reference point for assessing your own pricing model. However, market-based pricing alone will not suffice. For example, in 2014 the typical firm routinely offered 10 different services to clients. The most common offerings included retirement planning, financial plan development, estate planning, investment management and cash flow management. Not only will the combination of services offered between firms differ, but so too will the breadth and depth of each service component. This makes a direct comparison of firm pricing a clear challenge and will require further analysis of competitor offerings to ensure you are comparing apples to apples.

The market for advice is constantly evolving. Irrespective of whom they compete with, firms should always ensure a strong understanding of how immediate competitors are positioning and pricing their services. This information should be used to inform but not dictate a firm's pricing model.

The Simplest Approach: Cost-Led Pricing

Cost-led pricing in its simplest form is calculating your costs and adding a markup to create your desired profit margin. Interestingly, just 16% of all firms surveyed by FA Insight use cost of delivery as the primary factor when determining how to price their services. While the task can seem daunting, a simple approach can be taken to assess how firm costs impact price.

UNDERSTAND THE EFFORT AND COST TO SERVE DIFFERENT TYPES OF CLIENTS

Some clients will require a high-touch, labor-intensive level of service. Other relationships may be somewhat inactive in nature and require only occasional assistance. As a result, the cost basis for delivering to different types of clients can vary significantly. Before determining an appropriate pricing schedule, you will need to understand your profitability per client. This understanding will enable you to calculate the appropriate pricing levels to achieve the desired operating profit.

BEGIN WITH BASIC CLIENT SEGMENTATION

A basic segmentation exercise can assist you with gaining a better understanding of the complexity of your client relationships and the time spent to serve them. **Figure 9** includes a simple way to consider the segmentation of clients or households according to general levels of effort required to serve.

Figure 9: Basic Segmentation Example—Levels of Effort to Serve by Client Type

Client Type	Client Description	Effort to Serve
A	High-complexity needs Approximately $5 million or more AUM	High—twice the effort of a B client
B	Medium-complexity needs Approximately $1 million to $5 million AUM	Medium—average effort to serve
C	Low-complexity needs Less than $1 million AUM	Low—one-third of the effort of a B client

To help determine the cost of serving these different types of clients, the example client types described in **Figure 9** are further expanded in the following sections.

CONFIRM DIRECT EXPENSES—PROFESSIONAL COMPENSATION

When determining cost to serve, both direct and operating expenses must be considered. FA Insight defines direct expenses as all expenses related to professionals, such as salaries, bonus payments or performance incentives. Professionals include all individuals responsible for the delivery of advice to clients or business development activities. Based on each professional's total compensation (excluding profit distributions), determine the hourly rate for each professional and how many hours they contribute to servicing the typical B client. See example provided in **Figure 10**.

CONFIRM OVERHEAD EXPENSES—NON-PROFESSIONAL COMPENSATION

Overhead expenses include general business expenses, such as all non-professional compensation. When determining the cost of delivering to clients, consider your non-professional compensation expenses. FA Insight defines non-professional compensation as all expenses related to non-professionals, such as salaries, bonus payments or performance incentives. Non-professionals include all individuals who are not responsible for the delivery of advice to clients, including management, technical specialists, and support and administrative positions. Determine the hourly rate of each non-professional position and how many hours they contribute to servicing the typical B client. See example provided in **Figure 10**.

CONFIRM ALL OTHER OVERHEAD EXPENSES

Lastly, consider all other overhead expenses, such as retirement and insurance benefits, marketing, information technology, office rent, etc. Each of these business expenses will also need to be apportioned to client relationships.

There are many ways to determine your cost basis for advice. **Figure 10** and **Figure 11** provide a simple framework to serve as a foundation for more detailed cost modeling. This example focuses on the cost of serving an existing B client who requires a medium/average level of effort to serve relative to other clients **(Figure 9)**. A similar exercise would be required to determine the cost of A and C clients as well as new relationships.

In this example, calculating the total cost base for a B, or average, client is determined as follows:

Cost Basis = Total Labor Cost per Client + Average Overhead per Client

As a first step, calculate the labor costs associated with delivering to a B client.

Figure 10: Apportioning Labor Costs Example—B Client (Average Effort to Serve)

Professional and Non-Professional Compensation-Related Expenses			
Role	**Hourly Rate**	**Hours Required to Serve Existing B Client Annually**	**Labor Cost for B Client**
Lead Advisor	$200	5	$1,000
Support Advisor	$45	8	$225
Client Services Manager	$25	3	$75
		Total Labor Cost for B Client	$1,300

Next, allocate overhead expenses per client. Estimate the proportion of overhead expenses required to serve new clients versus existing clients. In this example, 65% (or $260,000) of firm overhead is allocated to serve existing clients. Using the total number of existing clients, the average overhead cost per client can be determined.

Figure 11: Allocating Overhead Expenses Example—Existing B Client (Average Effort to Serve)

Overhead Expenses (Excludes Non-Professional Compensation)	
Total Overhead Expenses (excluding non-professional compensation)	$400,000
Overhead Expenses Allocated to Serve New Clients[4] (approx. 35% of firm overhead)	$140,000
Overhead Expenses Allocated to Serve Existing Clients (approx. 65% of firm overhead)	$260,000
Total Number of Existing Clients	**150**
Average Overhead (Non-Compensation) for Average Client (B Client)	**$1,733**
Total Cost Base of Average Client (B Client) = Labor + Overhead	**$3,033**

Figure 9 outlines the differences in effort to serve A, B and C clients. In this example, a B client is considered an average client. An A client would require double the effort of a B client; a C client would require one-third the effort of a B client. These example multiples could be used to adjust cost by client type.

Using the cost base of $3,033 in **Figure 11**, a target profit margin can then be factored into the pricing model. As an example, if the firm targets a 25% operating profit, to support profitability an existing B client would necessitate a minimum fee of $4,045.

[4] In addition to understanding the effort required to serve existing clients, consider how much effort the firm expends in developing new relationships. The effort required to induct a new client may be much greater than the maintenance of an existing relationship. Be sure to consider the number of new clients your firm acquires each year and the relative effort to onboard a new client.

Client Type	Effort to Serve	Cost to Serve	Minimum Fee
A	High—twice the effort of a B Client	$6,066	$8,088
B	Medium—average effort to serve	$3,033	$4,045
C	Low—one-third of the effort of a B Client	$1,011	$1,348

As additional background, firms reported a healthy operating profit of 22.1% in 2013. For the typical firm in 2014, operating profit per client was approximately $1,100. This number varies dramatically by firm size, with the industry's largest firms achieving almost $2,600 in operating profit per client, which reflects the impact of economies of scale.

Case Study: Client Segmentation Reviews Lead to Pricing Changes and Productivity Increases

Beacon Pointe Advisors, LLC, regularly conducts client segmentation exercises. The numerous insights gained over the years from these exercises have influenced firm strategy. The last client segmentation exercise was conducted in 2013 in order to assess the effectiveness of the firm's current pricing strategy. The results not only identified the cost per service per client, which helped determine a minimum profitability level, but also unexpectedly uncovered numerous inefficiencies in how the staff performed their roles. As Matt Cooper, president of the Private Client Group, states, "The investment of time spent on thoughtfully segmenting our client base was invaluable for long-term success of our firm."

To download the full case study, visit tdainstitutional.com/attractclients.

Pricing Your Value

Value-based pricing extends pricing methodology beyond the "cost plus profit" model described previously. Value-based pricing compensates a firm for the value delivered through the advice relationship. For many firms, the value delivered to the client may be well beyond the level of fee paid under the cost-plus-profit model. As an example, consider the financial impact that can be achieved for a client through the following advice:

- Tax savings achieved following the restructuring of a client's assets
- Interest saved after restructuring of client debt
- Lower investment fees following the implementation of a new investment portfolio

A value-based fee could take the form of a flat dollar fee. Alternatively, a broader asset-based fee could be used to enable the firm to be compensated for the broader advice delivered to a client beyond asset management.

> "Price is what you pay. Value is what you get."
>
> –Warren Buffett

STRENGTHEN YOUR VALUE STORY

Prior to implementing your pricing change, you will want to be confident in communicating your value to clients, using supporting facts and prepared talking points to counter anticipated resistance.

Crafting a Compelling Value Proposition

For additional support in developing your unique client value proposition or value story, TD Ameritrade Institutional offers the *Branding: Express Your Difference* guidebook, available at tdainstitutional.com/attractclients.

Once you have identified the ideal pricing structure for your firm, determined appropriate pricing levels and revised, if necessary, your value proposition, you can begin implementing a pricing change with your clients and prospects.

CHAPTER 4

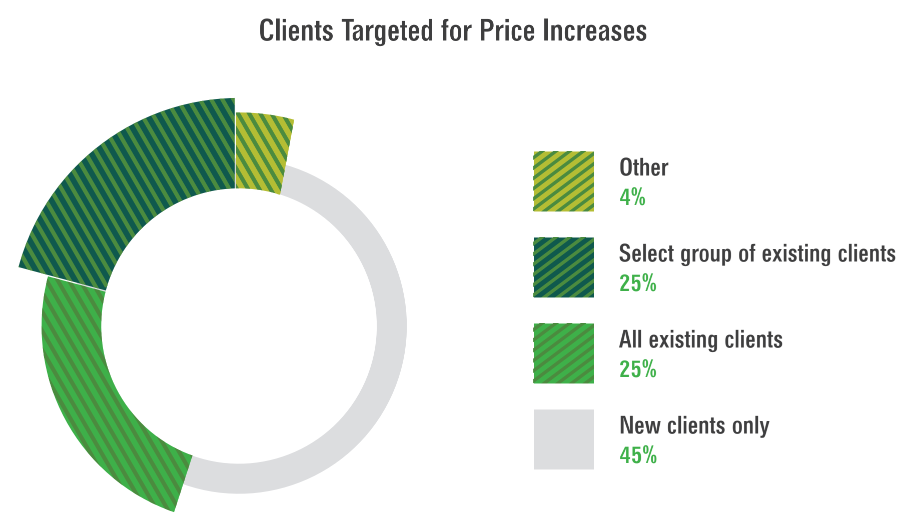
Implementing a Pricing Change

Changing pricing levels can be stressful. It is understandable that advisors may be concerned with how their clients will respond to a price increase and envision many difficult conversations ahead. With a clearly defined value proposition and a comprehensive plan, however, you can implement a pricing change in an efficient manner that minimizes disruption and lays the foundation for a smooth transition.

Identify and Prioritize Clients for a Pricing Change

You will need to determine who will be affected by the pricing change. Many advisory firms choose to implement pricing changes for new clients only. Others will change pricing for clients within a particular segment or a combination of clients and prospects. Of those firms that have implemented an increase in fees in the last two years, 45% implemented their new pricing structure with new clients only **(Figure 12)**. This emphasizes the level of concern that firms have in approaching existing clients with a price increase.

Figure 12: Pricing Changes Most Commonly Start with New Clients



Implementing a price change with new clients only is clearly a lower-risk strategy, but there are trade-offs. Firms cannot expect to see an immediate impact on revenue growth or profitability with this approach.

Just 25% of firms that made a change to their pricing implemented the new pricing structure across all existing clients. This strategy is likely to have the most immediate impact on firm financial performance and, in turn, firm value. Understandably, not all firms will be comfortable with this level of change (at least, not all at once).

Who Will Be Impacted?

As a middle ground and perhaps as an interim step, a further 25% of firms implemented their new pricing model with a select group of existing clients. With this approach, firms can first identify those clients who may be most receptive to a change in price. Additionally, low-profit clients may be moved to the new structure as a matter of priority. This approach provides an opportunity for advisors to become practiced at explaining the new pricing model and handling client objections before moving other existing clients to the new pricing model.

LEVERAGING CLIENT PROFITABILITY TO DEVELOP A TRANSITION TIMELINE

Most firms will agree that revenue generated from some clients subsidizes other clients. Low-profitability clients should be identified to help firms prioritize which clients should be moved to the new pricing structure.

A detailed client-by-client profitability analysis may prove too time-consuming and complicated for many firms. As a minimum, some simple analysis is suggested to help firms set precedence for the implementation of a new pricing structure. An exercise, such as the example in **Figure 13**, provides a guide for identifying those clients who may need to be prioritized for induction into the new pricing model in order to best support future profitability.

Figure 13: Example—Identifying and Planning Priority Pricing Changes

Basic Considerations	Number of Clients	Ideal Time Frame for Transition to New Pricing Model
Identify clients whose advice needs have grown over time and where additional advice and service are now being delivered under an old pricing structure. **Example: The firm might be delivering new financial planning services to select long-term clients at no additional cost.**	40	Within 6 months
Identify legacy clients who may be paying significantly less due to long-standing outdated arrangements. **Example: The firm may have acquired a book of clients in the past that were not effectively integrated into the business at the time and where fees are well below the new pricing structure.**	50	Within 12 months
Identify highly demanding, high-touch clients who have requested more support than what was anticipated when they were inducted. **Example: Clients who frequently call the firm requiring assistance or who request more regular in-person review meetings than was originally anticipated.**	5	Within 6 months

This simple assessment can be used to identify the first round of pricing changes to implement. In this example, the firm seeks to implement the new pricing structure with these priority clients within a six- to 12-month period. At the same time, the new structure could be implemented with all new clients. As an example, the firm may target two years for the transition of all other existing clients to the new pricing structure. This type of approach will also help firms set realistic revenue growth targets related to the pricing increase and track revenue increases during the implementation period.

Managing the Implementation of a Pricing Change

Like most significant business changes, planning is core to success. However, just 22% of firms that implemented a new pricing model in recent years established an implementation plan, including proposed timing and a schedule for communicating the new pricing model to clients. To assist firms in managing a pricing change, a quick reference checklist is provided in **Figure 14**. Some of the more complex steps within this checklist are explored in more detail ahead.

Figure 14: Pricing Implementation Checklist

- ☐ Understand current levels of client profitability (**Figure 13**).
- ☐ Prioritize clients for induction to the new pricing model in order to best support future profitability (**Figure 13**).
- ☐ Meet with staff to explain the what/why/when/how of the pricing change.
- ☐ Consult your compliance team to ensure full compliance with all legislation related to the disclosure of the firm's pricing model.
- ☐ Determine the means for communicating the change with clients, e.g., client review meeting, email, phone call, etc.
- ☐ Prepare your client billing system for the implementation of pricing changes.
- ☐ Update all marketing materials to reflect both your value story and your new pricing model.
- ☐ Prepare a new client pricing agreement for use at review meetings as well as distribution via email and mail.
- ☐ Prepare for client objections. Ensure all advisors are comfortable with the positioning of the firm's value story and pricing model prior to meeting with clients.
- ☐ Begin implementation with clients.

Communicating a Pricing Change

Once priority pricing changes and the time frame for implementation have been determined, consider the most appropriate means of communicating the pricing change with clients. Understandably, 41% of firms opted to implement their new pricing model at an in-person meeting with clients. A further 21% of firms communicated the change by phone, via email or using some other method. An emphasis on in-person communication is suggested for active relationships that are of significant value to the firm and where retention is necessary. For inactive clients, communicating via phone or email may be more appropriate. In some cases, the use of a "negative consent" letter for inactive clients may be most suitable, assuming appropriate negative-consent provisions exist within the advisory contract.

Communicating a Pricing Change

41% of firms opted to implement their new pricing model at an in-person meeting with clients

21% of firms communicated the change by phone, via email or using some other method

HANDLING CLIENT OBJECTIONS

In all likelihood, not all clients will be amenable to an increase in price. Some will challenge the increase and will want to better understand what has changed to justify the increase. The solution for tough pricing discussions is to be prepared. Most advisors will know in advance which clients are likely to object to an increase. They probably also have a good sense for what objections will be raised. To prepare, create a list of anticipated client objections and plan example responses that all advisors in the firm can draw upon during client meetings **(Figure 15)**.

Figure 15: List Anticipated Objections and Responses

Example Objection	Example Response
Why am I paying two fees now instead of one?	"Our new pricing structure more accurately reflects the services we provide to you. We have lowered our percentage fee on assets under management to offset the new annual fee, which includes payment for our additional services beyond investment management. Some of these services include financial plans, tax document preparation and insurance coverage reviews."
Why are you requiring a minimum fee?	"We have spent the last few years reinvesting in the business on technology and additional staff. Our goals are to offer you the most current tools (for example, our new client portal) and the highest level of service as we continue to grow. We have determined that this minimum fee accurately reflects our services and continued reinvestments."

Before implementation, ensure that all client-facing staff members are comfortable with the terms of the new pricing strategy. In addition, all advisors at your firm will need to be able to describe the new pricing changes and handle objections. Advisors may benefit from role-playing these objections to ensure they are comfortable articulating the responses in client meetings. This may be especially valuable for associate advisors.

WHAT IF CLIENTS REFUSE A PRICE INCREASE?

There may be some clients who refuse to accept an increase in their fees. In these isolated cases, clients may be required to move to a lower service package more in line with their fee structure. Alternatively, while not necessarily ideal, a transition to the higher fee might be implemented over a two-year period to help ease the impact on the client. Failing either of these options, the firm might be best served by referring the client to a lower-cost provider that may be better positioned to serve them.

Summary

Pricing presents an opportunity for you to better align your services and fees to more accurately reflect the value you deliver to your clients on a regular basis. You should regularly review pricing practices to better support your firm's success.

As previously mentioned, 71% of firms deliver advice beyond investment management under a purely asset-based pricing model. Just 51% of firms have implemented a minimum fee to compensate for the value delivered irrespective of security market conditions. For many firms, a pure asset-based pricing model may be limiting control over operating profit margins. A well-conceived pricing structure can work to support a firm in ensuring profitability under a range of market conditions.

Both gross and operating profit margins remain strong for the typical advisory firm, suggesting no evidence of margin compression. The competitive environment is not imposing upward pressure on costs or downward pressure on fees. It is under these more receptive market conditions that firms might be best placed to consider a price change with clients in order to protect future firm performance.

Determining the right amount to charge will support the achievement of firm profitability and reward for the value delivered through the advice relationship. Similarly, a firm's pricing structure should support profitability by complementing and aligning with the services delivered. How you get paid (i.e., your pricing structure) should reinforce how you deliver value to clients.

Finally, planning is key to supporting the implementation of a new pricing model. The development of a pricing transition plan for clients is suggested to help your firm more rapidly realize improved revenue and profitability. With the aid of a well-defined value proposition and a plan for handling objections, clients can be transitioned to a new pricing model with minimal impact.

APPENDIX A

Resources

TD Ameritrade Institutional offers additional resources to help you uncover potential opportunities to service your clients and exceed their expectations.

- **Breakout Growth™: Advanced Strategies to Attract the Right Clients.** An integrated thought leadership program providing you with the resources, tools and guided support you need to proactively grow your firm through branding, niche marketing, pricing, strategic introductions and high-impact events.

  To learn more about this program, please visit tdainstitutional.com/attractclients.

- **Dedicated Strategic Relationship Consultants.** These focused professionals understand your business and can deliver personalized solutions to meet your unique needs and goals. Call on their innovative thinking to help you create an action plan designed to move your business forward.

- **Roadmap™.** Whatever your business needs, our Strategic Relationship Consultants are ready to help you take your business to the next level. We use an innovative online planning tool called Roadmap to translate your high-level business objectives into action plans.

- **The Education Center.** A comprehensive learning management system and knowledge center offering for advisors and their staff to continue to develop professionally. It provides complimentary access to professional development resources, tools and continuing-education credits in one convenient place.

  To access the Education Center, visit tdainstitutional.com/educationcenter.

- **Affinity Services.** This program brings together more than 100 third-party providers with a wide range of offerings to give advisors access to business-building and operational tools at preferred rates.

  To learn more about this program, visit Veo® > Resource Center > Practice Management > Affinity Services.

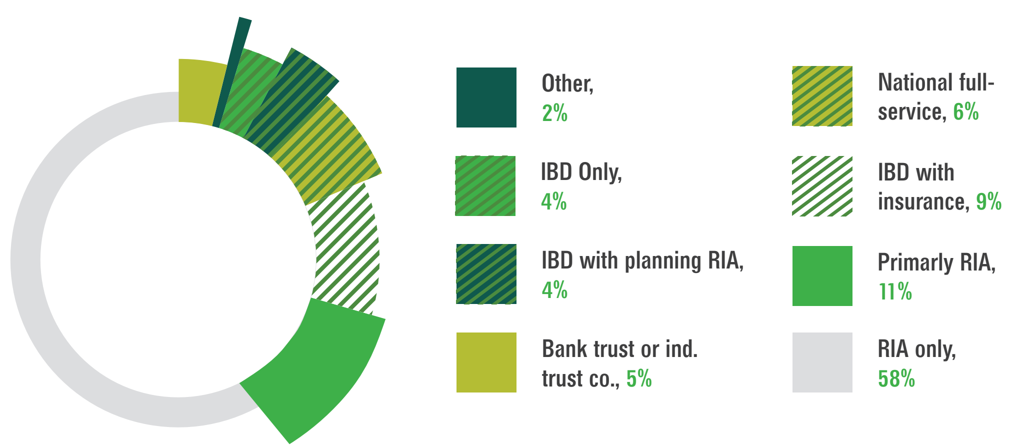
White Paper Methodology

In developing this white paper, FA Insight utilized special tabulations of its advisory firm survey database, covering advisory firm performance and operating characteristics from 2008 to 2014. Advisory firm data referenced in the report was sourced from the last six FA Insight studies—the 2009, 2011 and 2013 *FA Insight Study of Advisory Firms: People and Pay* and the 2010, 2012 and 2014 *FA Insight Study of Advisory Firms: Growth by Design*.

Each of these studies garnered detailed financial, operating and staffing characteristics from hundreds of advisory firms. Collectively, more than 1,300 firms participated in the six studies. The survey respondents included a wide range of firm sizes. Respondents tended to be solely independent RIAs with regard to affiliation.

To produce case studies and to yield other direct advisory firm examples and references, TD Ameritrade Institutional conducted a series of interviews with RIA executives who are successfully managing their pricing strategy to support growth and profitability.

Figure 16: Participating Firms by Affiliation Model



APPENDIX C

About the Authors

About FA Insight

Dan Inveen and Eliza De Pardo established FA Insight in 2008 in order to address financial advisors' growing needs for business-building assistance. The firm works exclusively with financial advisors or entities that service financial advisors. Located in the Pacific Northwest, FA Insight research and consulting supports clients across the U.S.

To learn more, visit fainsight.com.

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For more information about this research or the services of TD Ameritrade Institutional,
please call 800-934-6124 or visit tdainstitutional.com.

APPENDIX D

Acknowledgements

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