



CERULLI
ASSOCIATES

2006 ADVISOR SURVEY

Complimentary for Survey Participants

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Participant Summary

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Thank you for participating in our fifth annual Cerulli Advisor Survey. We received approximately 500 completed surveys from a wide range of advisors, with all channels and practice models well represented. While our findings this year are very much in line with trends we have reported previously, we also observed a number of significant shifts that are beginning to shape the advisor marketplace.

The model for the delivery of financial advice is presently in transition. At the same time that advisors are focusing on the fundamentals of their trade-delivering advice that is both prudent and appropriate for their clients—they are also exploring alternative solutions to long-standing challenges. This is, of course, not a perfect science; these solutions are sometimes being adopted ad hoc as advisors seek to meet mounting demand for their services. Furthermore, each of these potential solutions appears to bring with it a host of new challenges.

Though many questions remain to be answered about the future role of the financial advisor, we illustrate below what we believe to be some of the most crucial issues driving change in this dynamic industry.

- ◆ **Advice is the true product:** As Baby Boomers continue to shift to the distribution phase of their lives, they are discovering that the guidance provided by advisors to be increasingly valuable. Unfortunately, advisors' time available for meeting with these new or existing Baby Boomer clients is being squeezed by demands from other areas of the practice, most notably compliance constraints. Time spent meeting with clients is increasing at the expense of other activities, notably new client acquisition. While not all advisors are endeavoring to be an all-in-one financial solution, an increasing number have moved beyond offering transaction-based investment advice or modular planning services, transitioning instead to a full-scale advice-model.

- ◆ **Fee-based pricing on the march:** The fee-based pricing model has eclipsed the commission-based model in usage. Fees not only provide a more reliable source of revenue for advisors, they also align the interests of the advisor with those of the client. Some advisors are also beginning to implement alternative fee structures for nontraditional services—fees for plans and a la carte fees, for example—to ensure they are appropriately compensated for different levels of service. Other advisors are considering charging a flat-fee to retired clients, mostly in an effort to protect against future declines in revenue as the client spends down their assets. The bottom-line significance of fee-based pricing, however, is that it provides a steady revenue stream, greatly reducing the exposure of advisors to market volatility.

- ◆ **Up-market movement:** The rising popularity of fee-based pricing and growing complexity of advice delivery is allowing more advisors to build practices that focus on a small number of high-net-worth clients. This is good for advisors who are able to build and maintain relationships with such clients, but also creates more competition in the high-net-worth market for client assets. So while the desire to serve these wealthy clients is growing, it is becoming more difficult for advisors to do so and they are often overlooking slightly less affluent investors who are currently underserved as a group.

- ◆ **Mutual funds passé?:** By increasing their assets under management, advisors are also gaining more flexibility in their vehicle choice. While mutual funds are still the most popular vehicle

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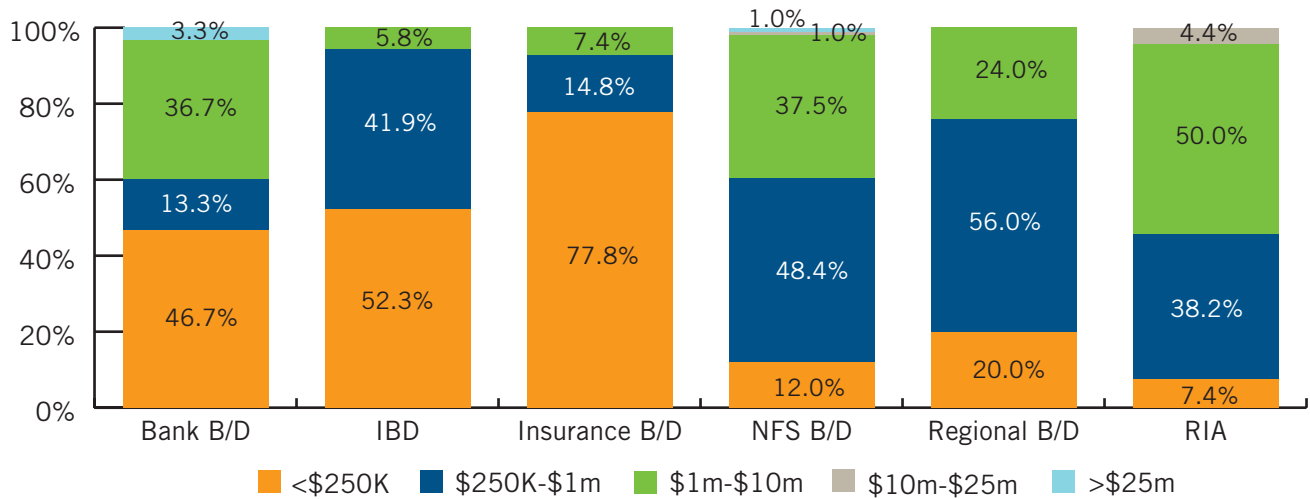
among advisors for client asset allocation, their position as top choice for client assets is not as assured as it was in previous years. Advisors are beginning to explore alternatives, notably separate accounts and exchange-traded funds (ETFs), in their quest for diversification, higher, more consistent returns, and lower expenses. Separate accounts in particular are gaining in usage due to their increased customization and cache for wealthy clients.

- ◆ Continued compliance trends: Home offices remain mindful of the severe penalties should they be found to be out of compliance, and are thus devoting an increasing amount of resources ensuring that their activities are up to code. As memories of past mutual fund scandals begin to fade and the financial services industry attempts to secure its spot in clients' good graces, advisors are mindful that they cannot afford to betray the trust that the industry has gained. However, this heightened level of care is a drain on advisors' time, which is already thinly spread between their many responsibilities.

- ◆ All Boomers, all the time: Though nearly all financial advisors are aware of the broad implications of the impending retirement of the Baby Boomers, there remain a number of the generation's needs that are not being met. Paradoxically, though Boomers are wealthier than their pension-dependent elders on average, many are not as prepared to retire as their parents were at the same age, due to the increasing role of self-directed retirement accounts. The Boomers are the first generation expected to manage the entirety of their retirement assets—they do not have the luxury of the regulated income inherent with the receipt of a monthly pension check. Unfortunately, many of these investors have not adequately saved for their retirement and are in desperate need of retirement income planning services and other services, such as elder care planning to ensure they are taken care of for the rest of their lives. Advisors currently not offering these services may be missing the boat once these investors begin to retire.

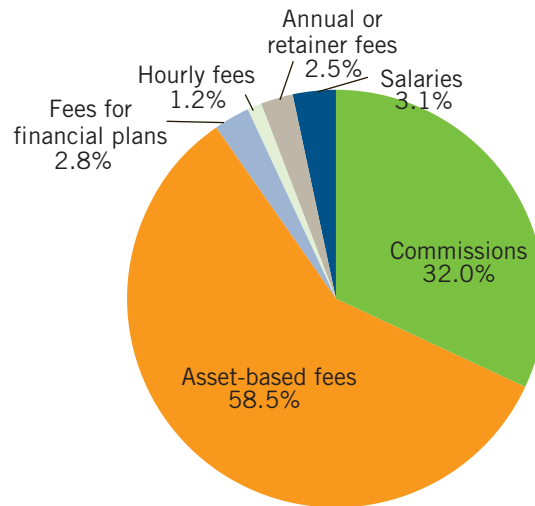
In this summary you will find these trends and others illustrated and explored in greater depth. None of these are mutually exclusive, and it is our hope to create a singular, cohesive snapshot of the fast-unfolding advisor marketplace.

Exhibit #1 Advisors' Average Client Net Worth by Broker/Dealer Type



Source: Cerulli Associates

Key Implication: With their focus on meeting the individual service needs of clients, RIAs are the top choice for the affluent seeking advice. This is evidenced by our finding that over 54% of the RIA client base boasts a net worth in excess of \$1 million. While national full-service broker/dealers (B/Ds) rank second for the high-net-worth set with 39.5% of clients with net worth greater than \$1 million, the majority of clients (48.4%) fall between \$250,000 and \$1 million in net worth. A similar figure (56.0%) is observable for regional B/Ds. Common among these channels is an advice-oriented approach to financial planning and an increasingly intricate portfolio-construction process. Meanwhile, insurance, regional, and bank B/Ds service more of the lower-net-worth crowd (relatively speaking), delivering broader, more modular advice than advisors situated in other channels.

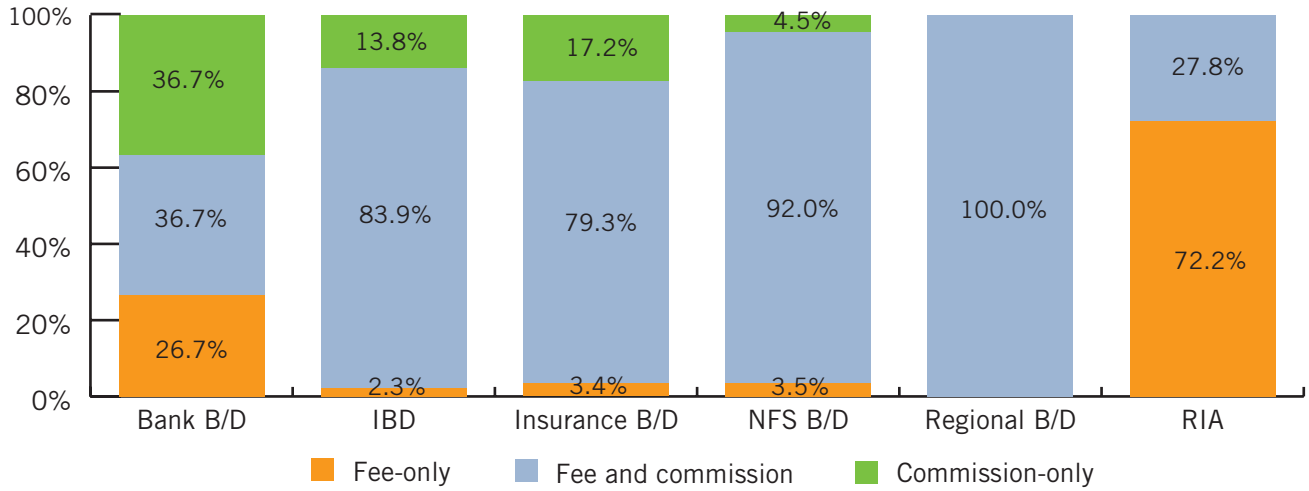
Exhibit #2 Average Advisor Revenue Type Attribution

Source: Cerulli Associates

Key Implication: As results plainly show, fee-based pricing is quickly becoming the predominant price structure among advisors. Though advisors on average still attribute 32% of revenue to commissions, we expect this figure to continue the decline it has exhibited in recent years. Any ground lost by commissions will most likely be gained by asset-based fees, which we found to comprise over 58% of advisor revenue.

The pressure for the shift to fee-based pricing is twofold: home offices like fees because they produce stable earnings among advisors, reduce conflict-of-interest issues and provide a more consistent revenue stream; advisors like fees because they eliminate production pressure and allow them to attract and attain larger walletshare.

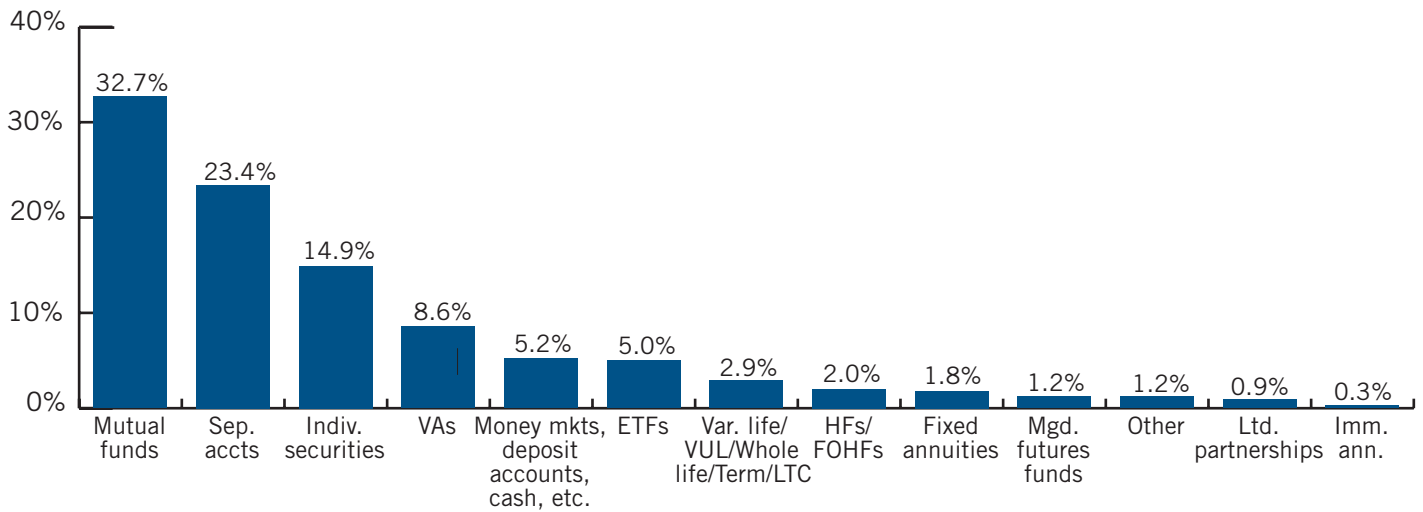
Exhibit #3 Compensation Structures by Channel



Source: Cerulli Associates

Key Implication: The RIA channel, which our analysts consider to be the bellwether for the delivery of financial advice, demonstrates the growing momentum of the fee-based pricing model. The majority of RIAs (72.2%) derive their revenue almost entirely from fees, while the balance employs a blend of fee- and commission-based schemes. The bank B/D channel, which exhibits the next-highest level (26.7%) of fee-only revenue proportionally, also leads the pack for commission-only structures with 36.7%, suggesting that some banks are more nimble (or stubborn) than others when it comes to transitioning to fees. All other channels, for the time being, employ a mix of the two price structures to derive their revenue.

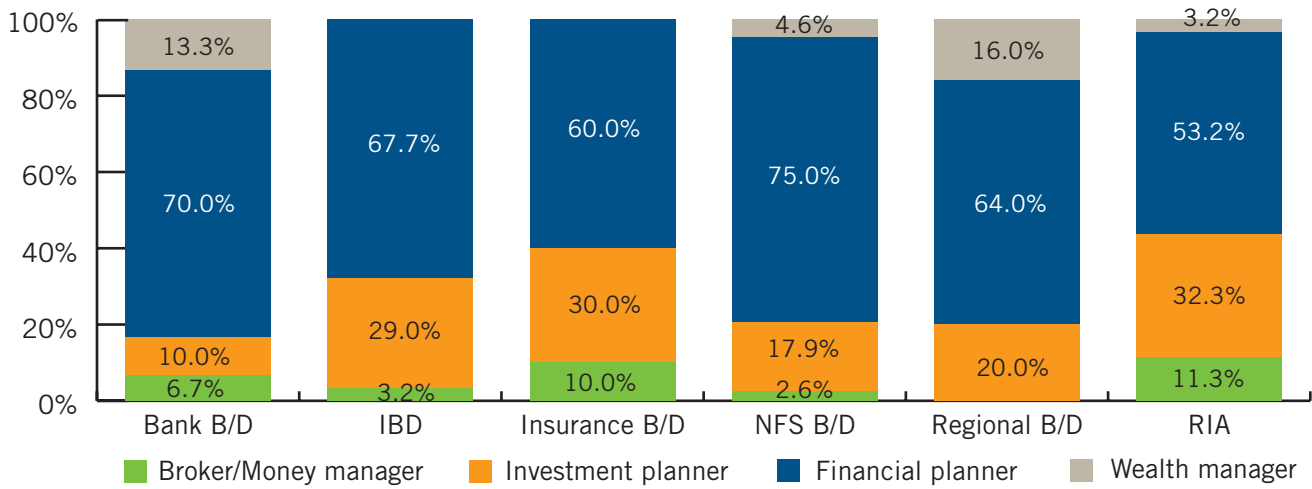
Exhibit #4 Product Usage



Source: Cerulli Associates

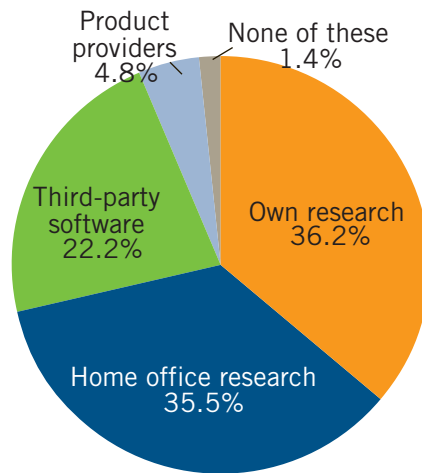
Key Implication: Mutual funds remain the investment vehicle of choice for financial advisors, garnering 32.7% of client assets. However, the rise of fee-based pricing is leading to a decline in the proportion of client assets advisors are allocating to mutual funds, which are giving way to products that better fit the fee-based model. Separate accounts are growing in popularity through offering increased tax efficiency, personalized management, and lower fees relative to mutual funds. In addition to the advisor time-crunch, reduced minimum investment levels have helped make these investments more available to a wider number of investors. Furthermore, individual securities remained popular (14.9% of client assets), while ETFs (5.0%) gained in popularity, up 1.55% from last year.

Exhibit #5 Distribution of Advisors by Practice and Broker/Dealer Types



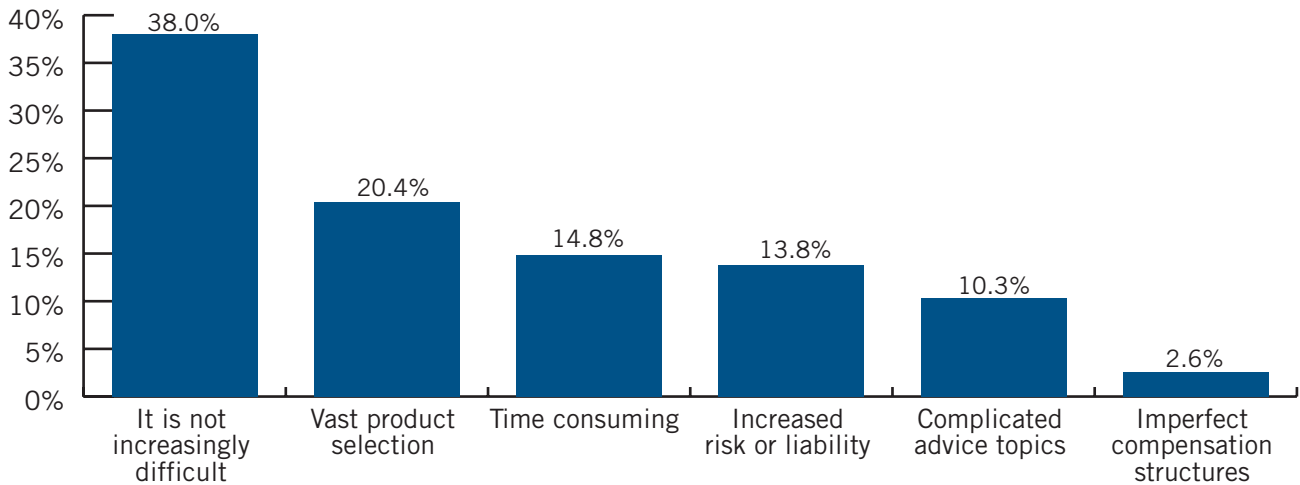
Source: Cerulli Associates

Key Implication: Though most advisors describe themselves as a financial planner, many of them would be more accurately described as investment planners. As investors demand more comprehensive advice and advisors become more responsive to the needs of their clients, an increased number of advisors will be forced to expand their practice beyond investment guidance. If home offices truly want their advisors to offer comprehensive financial planning, however, they must expect to expend resources training former investment planners how to handle the vast array of client needs. As we have prescribed before, this should come in the form of learning tools and programs—though where advisors will find the time for such things remains to be seen.

Exhibit #6 Resources Used in Determining Asset Allocation Strategies

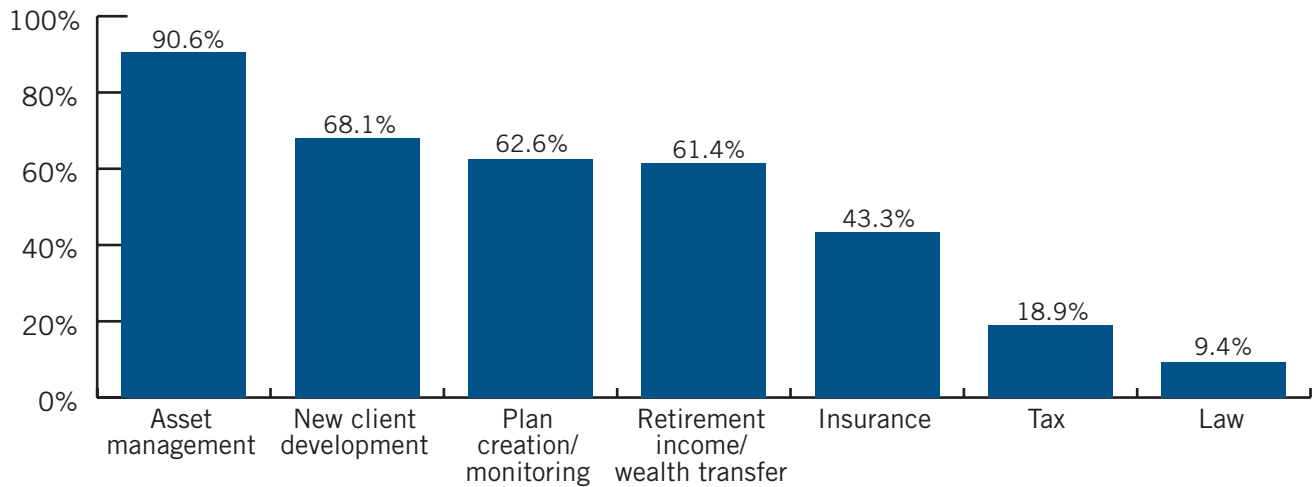
Source: Cerulli Associates

Key Implication: When allocating client assets, advisors currently rely primarily on their own research slightly more often than they do the research conducted by their home office (36.2% of the time for the former, versus 35.5% for the latter). This will likely change. Faced with a worsening time crunch and heightened compliance pressures, advisors will begin to spend less time conducting their own research, and turn instead to their home office research and third-party software. An exception to this general trend will be high-end advisors with fewer and more demanding clients, who will continue to distinguish their services through their own painstaking research.

Exhibit #7 Is Portfolio Management More Difficult?

Source: Cerulli Associates

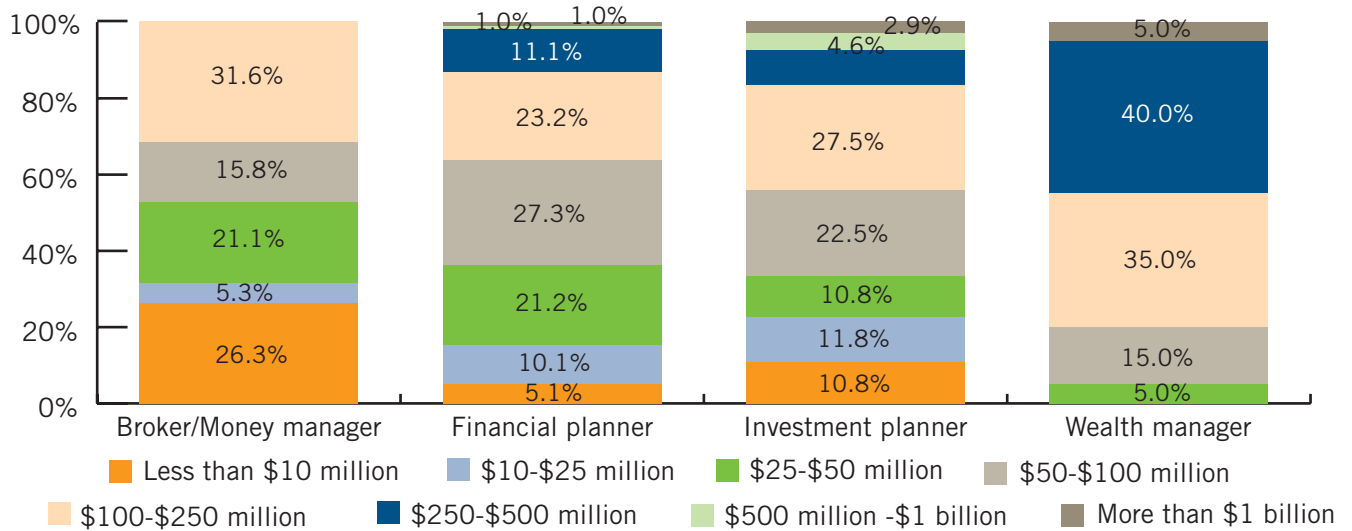
Key Implication: While 38% of advisors surveyed do not believe that portfolio management is becoming increasingly difficult (compared to 50.7% in 2005), the balance does. Complaints are certainly interrelated: 20.4% are troubled by a vast product selection, 14.8% find the process time-consuming, and 13.8% are wary of the increased risk or liability that comes with investing client assets. Ironically, the introduction of new products is often geared towards alleviating these complaints; many separate account programs allow advisors to outsource the portfolio management process to a third party, thus reducing liability and reducing the amount of time the advisor must spend monitoring client investments. Provided that they receive adequate educational support from their home offices, advisors should be well-equipped to counter a good number of their portfolio management difficulties.

Exhibit #8 Team Specialists

Source: Cerulli Associates

Key Implication: Advisors are able to greatly alleviate the time crunch created by such activities as portfolio management through participation in teams. Unsurprisingly, the most common feature of teams is an individual or group dedicated to asset management—90.6% of advisors report having access to such a resource. New client development is also a top priority for teams, but less so this year (68.1%, down from 81.0%). Regardless of shifts in specialization, however, our analysts believe that a team approach to advisory services is the most effective way for the majority of advisors to approach their relationships with clients, as it ensures that the strengths of advisors are leveraged to the fullest extent, giving the team practice more scale making it easier to carry more clients and manage more assets.

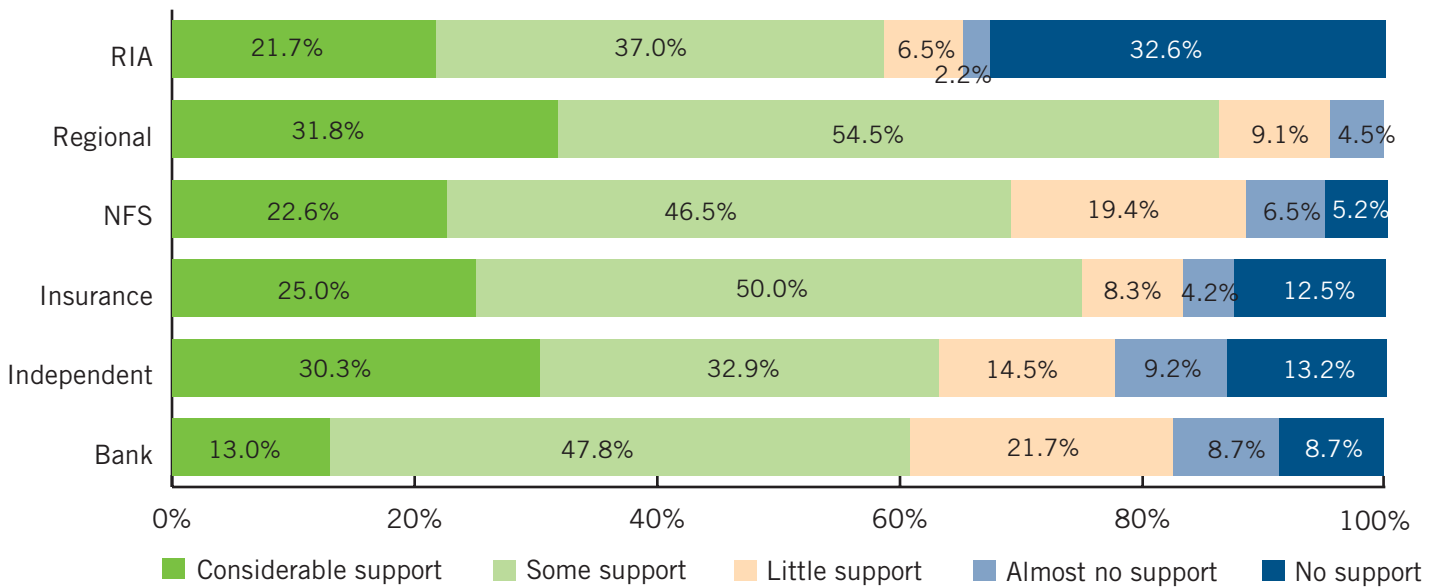
Exhibit #9 Assets Under Management by Practice Type



Source: Cerulli Associates

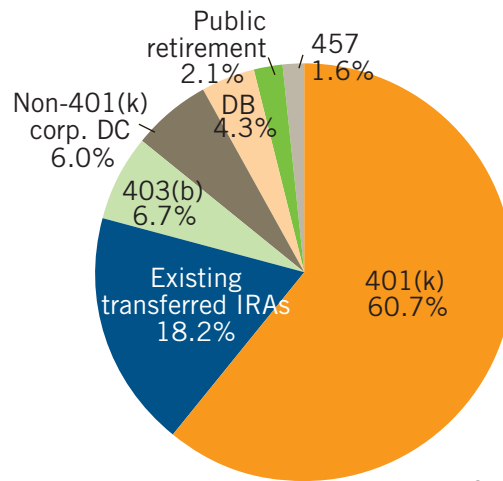
Key Implication: Wealth managers, who specialize in complex wealth management and transfer issues, including complex trust and estate planning, charitable giving, and tax planning, typically have larger amounts of assets under management than those who provide relatively less complex advice services. Our survey found that 80.0% of wealth managers report more than \$100 million in assets under management; nearly 35% more than any other practice type. While we expect that many advisors will be moving toward offering more full-scale financial planning, wealth managers have already found their niche and are in better position than advisors in other practice types to win new clients seeking more comprehensive advice. Common to all practices, though, is a proportional decline since 2005 in low-net-worth relationships, suggesting that advisors are keeping profitability in mind in cultivating new client relationships.

Exhibit #10 Firm Support for Retirement Business



Source: Cerulli Associates

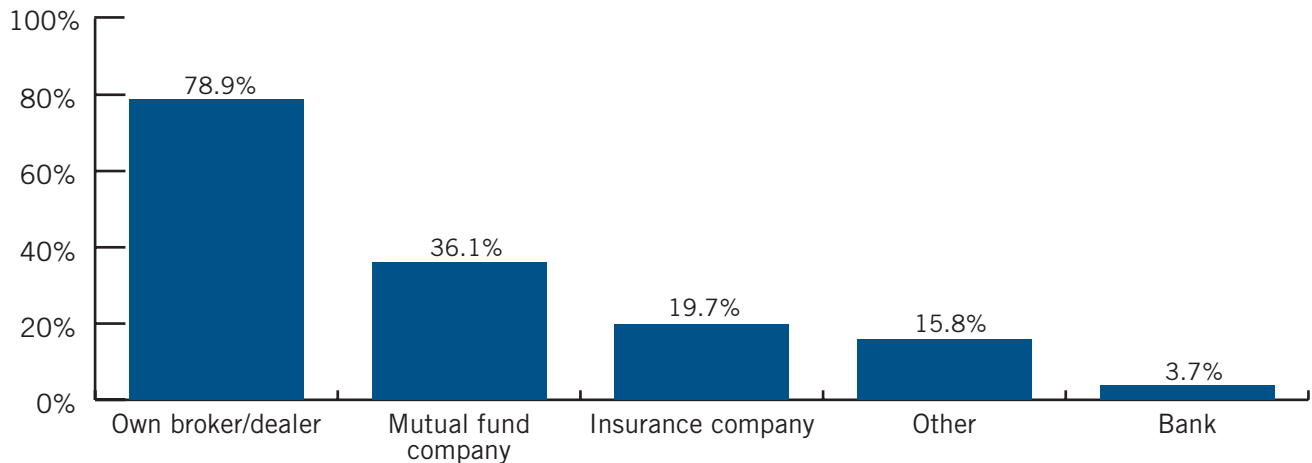
Key Implication: Advisors in the NFS and regional B/D channels again reported high levels of firm support for their retirement business: 86.3% of regional advisors said their firm provides them with a least some support (up 18.3% from 2005), compared to 68.9% for NFS advisors (up 1.9%). The largest increase, however, came from the insurance channel, with 75.0% of advisors reporting at least some support—an increase of 40% from 2005. Even with these high levels of support in the three aforementioned channels, firms across all channels will likely continue to increase their support as the demand for retirement income planning increases in coming years. This will help standardize basic practices within firms, allowing advisors to tailor their services to the particular needs of their clients.

Exhibit #11 Sources of IRA Rollover Assets

Source: Cerulli Associates

Key Implication: Consistent with previous findings, the majority of IRA rollover assets (60.7%) come from 401(k) plans. This should not come as a surprise, considering the high frequency of job change among clients. While the share of 401(k) assets is likely to increase in the long run as options such as defined benefit plans finish flowing into IRAs, it is equally likely that rollovers from preexisting IRAs will increase as firms continue to compete for retirement assets by offering lower fees, better service, and comprehensive retirement solutions that encourage clients to consolidate their assets.

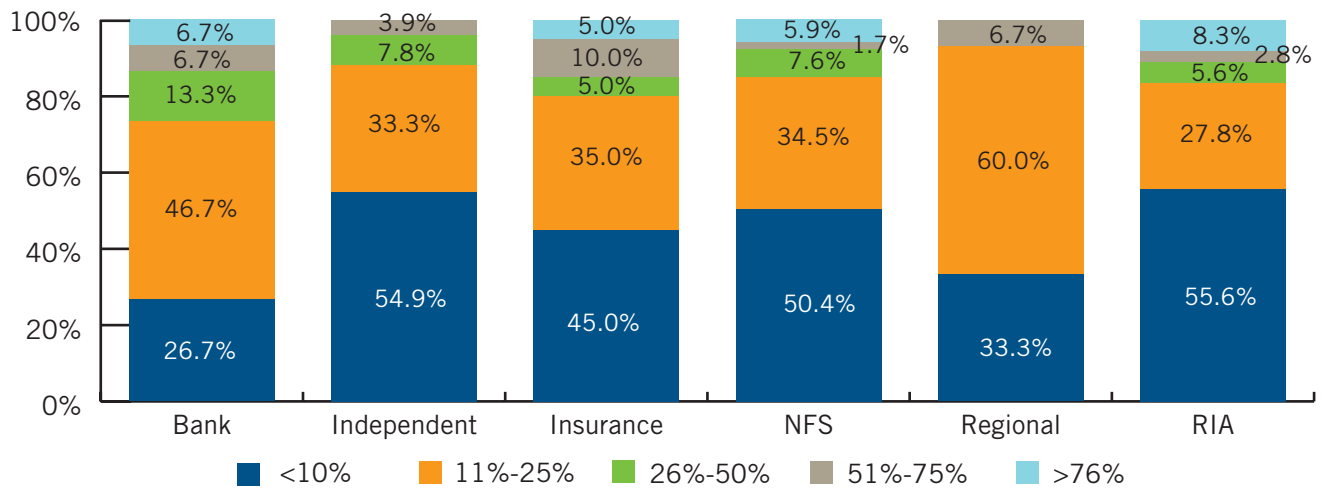
Exhibit #12 IRA Rollover Products Usage



Source: Cerulli Associates

Key Implication: For most advisors, the easiest way for advisors to manage client assets is to keep them all with the same firm. Thus, 51.2% of advisors will turn to their own B/D to supply the solutions to meet at least a part, if not all, of their clients' needs. Though the firm establishment of open architecture and the decline of the commission-based pricing model will likely also reduce advisors' knee-jerk reaction to place the assets they gather into their firm's account, simple loyalty to their employer and the incentive of easier navigation through back-office issues will cause advisors to think twice before using another firm's product. Currently, however, 23.4% of advisors use another mutual fund company's product, and 12.8% use that of an insurance company, suggesting that keeping clients' best interests in mind plays a strong role in product selection for a significant number of advisors.

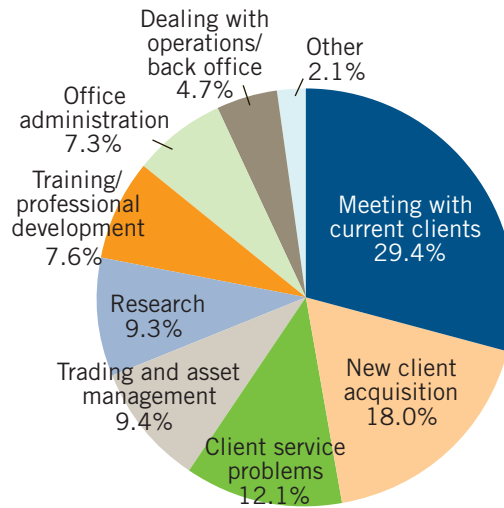
Exhibit #13 Time Spent on Wealth Transfer Advice Delivery



Source: Cerulli Associates

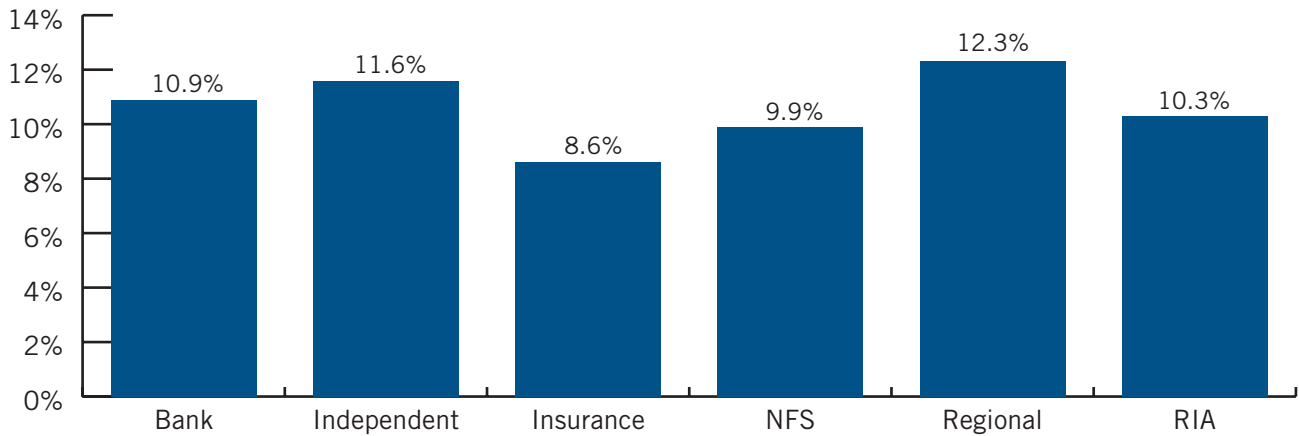
Key Implication: For individuals fortunate enough to not have to worry about outliving their retirement savings, the challenge then becomes how to transfer that residual wealth. With the majority of advisors busy planning clients' retirement, wealth transfer can occasionally become an overlooked topic, especially if that transfer is relatively small. Presently, 14.6% of NFS B/D advisors spend more than 25% of their time on wealth transfer issues. This is not necessarily indicative of a problematically low level of service; the percent of advisors who spend between 26% and 50% of their time on wealth transfer issues is often counterbalanced by the same percent of advisors who spend over 75% of their time on this topic. This statistic suggests that wealth transfer is, in most cases, best left to a specialist.

Exhibit #14 Advisor Time Allocation



Source: Cerulli Associates

Key Implication: Advisors are continually faced with a time crunch. Furthermore, an increasing number are expected to be a complete financial planning solution for their clients, and are thus required to split their time among a seemingly endless string of tasks. Time spent on a given task varies slightly across channels, but our findings general suggest that variations are due to the nature of the channels business, rather than higher operational efficiency. Furthermore, each model forces tradeoffs: the advisors affiliated with an insurance B/D channel spend more time proportionally on meeting with current clients and new client acquisition (52.6% combined) than do advisors in the RIA channel (41.5%), they are then forced to spend more time dealing with client service problems (14.1% versus 10.2%).

Exhibit #15 Time Spent on Compliance-Related Issues in Past Year

Source: Cerulli Associates

Key Implication: Though memories of mutual fund shenanigans have begun to fade, advisors still feel the sting of tightened regulations that followed in their wake. While our research has found that some firms have been able to outsource compliance oversight, they still keep a strong focus on advisors, who are closest to the end user of their products and must also occasionally play the role of public relations liaison. Advisors are increasingly spending more time on compliance, and despite their time constraints, advisors will remain willing to spend a portion of the time making sure their practice is up to code, as they are aware of the painful cost future scandals would bring.