

Advice: Cut Your Costs of Wealth Management (Part 2)

Understanding Cost Drivers and Pricing Models in Wealth Management

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In the first part of our series on how to cut the costs of wealth management we showed how small changes in costs will have a high impact on the overall performance. In the second part we analyse the various cost drivers and pricing models of wealth management. Only if a client understands all factors influencing his costs he will be able to reduce them. For in-depth information please check our guide on [wealth management costs](#).

In many cases, wealth managers have internal performance targets per managed client portfolio, of 2% - 4% p.a. Since the communicated costs to the client are normally significantly lower, it is important to understand the other costs you are paying and how the various cost drivers play together.

Cost Drivers in Wealth Management

clients have to pay for four major cost drivers in wealth management, directly or indirectly:

- **Management:** A wealth manager charges his clients for the pure management of his portfolio, not including cost for third parties. A management fee is charged per year, calculated as a certain percentage of the total assets under management. The majority of wealth managers will charge between 0.8% to 1.2% per year.
- **Banking:** Depending on the extent that banking services are used for managing a client portfolio, various costs will occur. Banks usually charge a custodian-fee, based on the total asset volume placed at the bank. However, the main cost driver is the number of transactions, such as buying and selling stocks, bonds, funds, etc. These costs also include fees that will be charged by the bank, but actually go to the government, such as stamp tax. However, banks sometimes introduce fees that sound official, but nonetheless are pocketed by the banks themselves, such as "Ticket Fees".
- **Products:** For all investments in managed products e.g., mutual funds, hedge funds and structured products, the client has to pay for one-time or on-going costs. He is charged mainly through front-loads (issue surcharges),

management-fees and wide spreads between buying and selling price. The number of managed products in the portfolio and the amount of direct and hidden costs for each product drives the total costs of products.

- Performance: When the client's portfolio performs well, his total assets will grow. If the client has opted for a performance fee to pay his wealth manager (completely or partly), his fee will grow through the increasing returns on his assets. Even if he has chosen not to pay based on performance, but rather an annual management-fee or per transaction, his absolute costs will increase. Through the growth of his assets, the basis for calculating the management-fee as well the average transaction size will grow.

Pricing models only report the direct costs

If you do not manage your portfolio yourself and instead entrust it to a wealth manager, you will be offered one or more of the following pricing models. Each of them is based on different drivers (number of transactions, performance, total assets under management), but have one factor in common; they only take the direct costs into account:

- Transaction fees: The central element of this pricing model is the individual billing of every single transaction to the client. Usually he will pay a percentage of the transaction volume every time he buys or sells an asset. Independent of the transaction volume is a "ticket fee", which is often charged as a fixed sum every time a transaction occurs. This pricing model is advantageous for clients with a limited and foreseeable number of transactions. They should also be able to keep a close look on their portfolio, to monitor whether unnecessary transactions are executed.
- Performance fees: Performance-fees are based on the profit the wealth manager generates of your portfolio, and are calculated as a percentage of the overall performance. He will often receive kickbacks on top of the performance-fees. Often a "high water mark" is introduced, requiring that performance fees will only be charged after losses of preceding years are recovered. The advantage for the client is that he only pays the wealth manager once a positive return over a certain threshold has been reached. The problem is to distinguish between the performance of the wealth manager and the overall development of the markets. The main risk of a performance-fee model is that the wealth manager takes on too risky investments and potentially violates the long term objectives of the client.
- "Flat-fee": This pricing model offers a "flat-fee" which either covers all costs for the management of the portfolio or for all transactions or both. Usually, "flat-fees" are calculated as a yearly percentage of the total investment amount.

Pricing models offering a comprehensive “flat-fee”, covering the management of the portfolio and all costs for custody and transactions, are usually labeled “all-in-fees”. Normally not included are ticket-fees and various hidden costs, such as the whole range of product-fees. These “all-in-fees” can vary significantly.