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Fee-Only vs. Subscription-Based Pricing

Trends and Technology’s Impact

Abstract

As recently as a decade ago, financial advisors made most of their income through commissions. They didn't see the same client again unless there was another relevant product to sell.

Tired of the hamster wheel that is commission-based pay, advisors looked to build more lasting relationships with their clients. Financial planning is one way to do that. Combined with regulatory efforts such as the SEC's Regulation Best Interest, commission-based fee structures are becoming far less desirable.

But as RIAs move toward fee-based pricing, consumers are dictating another shift. The modern consumer subscribes to about anything, including streaming services, rideshares, food delivery, and even coffee. Does such a system make sense in financial planning?

RIAs must take a long-term view of pricing and billing for their services and adopt software that scales based on industry trends and overall growth. This paper discusses those trends and how firms can prepare.

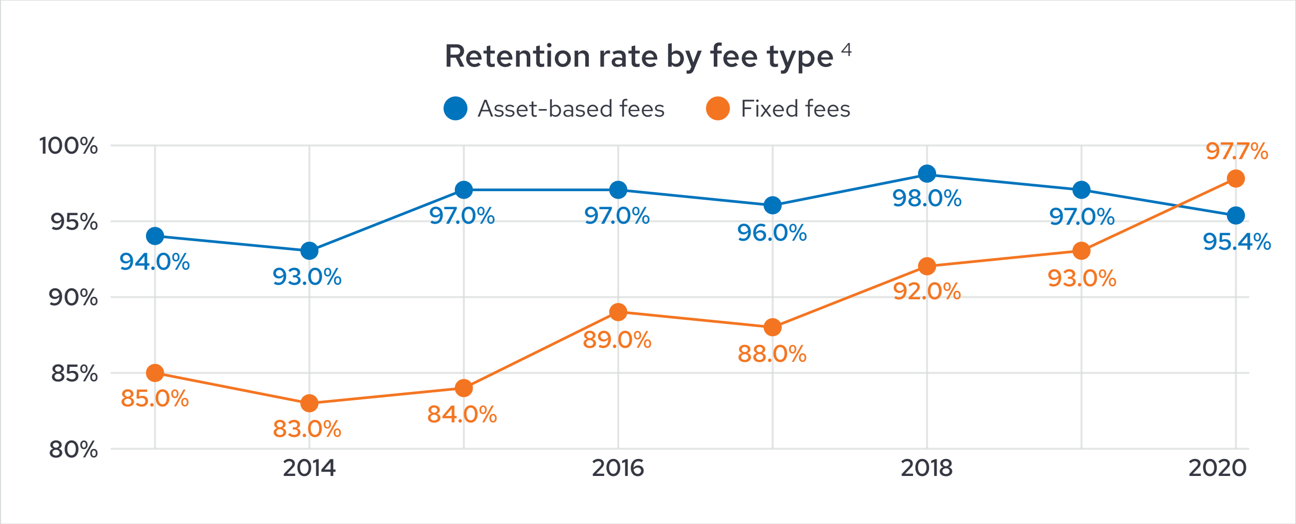
Pricing trends

As the industry moves away from commissions, fee and subscription-based pricing structures are taking their place. Clients are often charged a fee based on a percentage of AUM, which is the most common non-commission source of revenue. Such a system is in use in approximately 90% of firms, according to data compiled by InvestmentNews[1].

That same study also showed flat fees gaining popularity, now used by a quarter of firms. Flat-fee-based pricing removes ambiguity around what the client pays and is a good fit for clients who may have pushed back on the variability of AUM fees.

Regardless of the fee type, commission-based pricing is on its way out. InvestmentNews' 2013 survey of the top 25 firms pegged commissions as 52% of revenue and fees 34%, practically the opposite of today, where commissions made up 34%, but fees 54% of revenue[2]. Part of the improvement may be due to drastically improved retention rates among fixed-fee clients.

Today's alternative fee structures perform just as well as traditional models. RIA advisory firm Herbert & Company found that from 2013 through 2020, retention rates for AUM clients generally stayed around 95% or higher[3].



The same was not true of fixed-fee pricing. In 2014, RIAs retained an average of 83% of those clients. However, by 2021 nearly 98% of fixed-fee clients maintained their relationship with their advisor as retention of asset-based clients fell to its lowest point since 2014.

While 95% of clients paying asset-based fees are still retained, the rising popularity of fixed-fee pricing is important to note. The improvement in retention rates is likely due to both aggressive pricing strategies by fixed-fee firms and overall improvement in the value of fixed-fee services.

While Herbert & Company didn't look at commission-based pricing, other data supports a continuation of declining revenues there. Many brokers lowered commissions to zero in 2019[5], and SEC actions such as Regulation Best Interest further accelerated the move to alternative pricing structures.

The pandemic may also be playing a role. The economic shocks are still reverberating, directly affecting client AUM and, in turn, fee income. Firms may see flat-fee price structures as a way to protect their bottom lines from ongoing market uncertainty.

The end of commission-based pay also hasn't hurt the industry as some may have feared. InvestmentNews found that the top 25 IBDs reported more than 50% of their revenue from fees on average for the first time in 2021 while posting record revenues of $33.9 billion[6].

The industry warms up to subscription pricing

Subscription-based pricing has existed for decades but was only available in financial services at scale within the past several years[7]. Charles Schwab was the first major firm to do so in 2019.

Instead of a 0.28% AUM fee, customers pay a $300 set-up fee and $30 per month[8]. Schwab's service includes portfolio management, planning, and unlimited advice.

Within three months, Schwab already had $1 billion in AUM[9], and its success spurred others to experiment. Merrill Lynch and others have followed suit, each with varying degrees of AI (robo-advisors) versus human involvement. So how can smaller firms offer similar packages to their clients?

While they can't compete on price with the big firms of the world, the convenience of a subscription with personalized service may be a better fit for clients who want to be more involved in planning and investment decisions. This is especially true for firms focusing on a particular asset category or client type, as the big-name subscription services are designed to appeal to the broader market.

Potential advantages of subscription billing

Subscription billing eliminates the guesswork around budgeting, giving firms a steady and dependable monthly revenue stream. Firms that depend on commission or fee-based pricing structures are affected more by external factors, including market movements, significant withdrawals of assets prior to the end of a period, other adverse changes in AUM, etc., than those that use a subscription-based model.

Flexibility is another possible benefit. Advisors can offer service tiers with progressively more services or cater packages to specific client types. As needs change, service packages can, too. Clients don't get charged more simply because their investments performed well when the advisor didn't do substantially more work.

There's also the overall trend toward subscription-based pricing to consider. A 2021 study for Zuora by the Harris Poll10 found that eight in ten households subscribed to at least one service, and nearly three-quarters want to pay for what they use rather than a flat fee.

Harris also found that consumers often cited convenience and cost savings as reasons to subscribe to a service. With a subscription, clients have a convenient way to maintain it, and have clear expectations on what services to expect, and depending on the package, more cost-effective for lower-income clients.

Hybrid billing

Firms offering financial advice and portfolio management for their clients might find a hybrid pricing structure attractive. For example, a firm might maintain its AUM fees but offer the advisory portion as a value-added subscription.

Such a structure also works well for firms catering to age-diverse clientele. According to Javelin Research[11], 86% of those 18-34 held a subscription to a service versus 69% of those 55+. Firms may find that older investors stick with what they're accustomed to, while younger investors gravitate towards subscriptions.

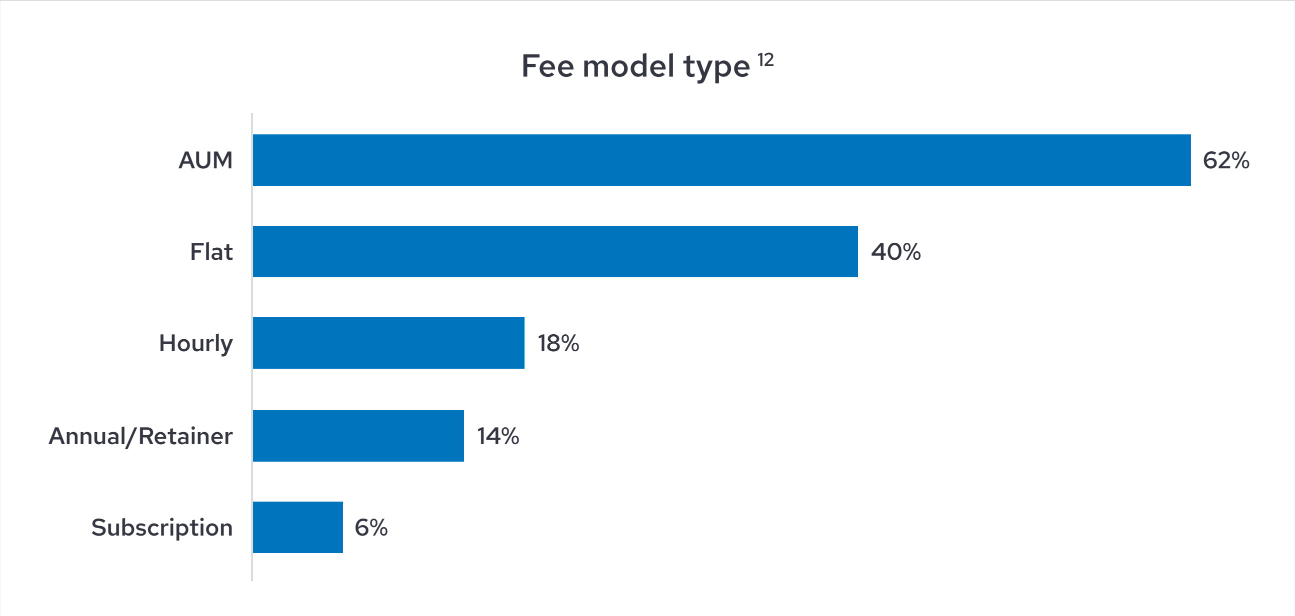
If you choose this latter path, your billing system must be able to handle multiple pricing structures natively, or billing may become quite complicated.

Additionally, every advisor should have the ability to bill only for financial planning services, or any other service that their advisory practice offers, especially for those clients that are considered HENRYs (High Earners, Not Rich Yet). Advisors without such a strategy, or the systems, to bill new clients for planning services, may be limiting the growth of their practice. It's common for advisors to make the determination of when to include financial planning fees as a component of their AUM-based investment management fees. For example, an advisor may establish that once a client hits $500,000 in investment assets, the separate planning fee discontinues, and that service is now included in the AUM-based management fee. However, depending on the complexity of the financial planning services for a given client, some advisors may choose to continue to charge for their planning services separately, regardless of the AUM they are managing for that client.

Billing is more than just asset-based fees

While asset-based fees make up most of the revenue for firms involved in portfolio management, fee-only planners bill for their services instead, regardless of the client's investments. Some firms charge a performance-based fee or charge for services on an a la carte basis.

There are also different structures to consider, whether hourly, flat, tiered, or by class. Billing can become complicated and time-consuming, especially when the firm's billing platform requires a significant amount of human involvement.



Which billing platform a firm chooses is as important as their CRM, portfolio management, or financial planning software. The more time advisors spend mired in administrative work, the less time they spend helping clients or seeking new business.

With most advisors already struggling to manage their workloads in a typical 40-hour work week[13], inefficient billing software makes matters worse. Some of the best billing solutions automate much of this process.

Leveraging fee-for-planning billing technology

As advisor pricing structures become more complicated, having an easy-to-use and scalable billing solution is critical. Envestnet offers both AUM and subscription fee billing solutions via BillFin and Payments.

AUM billing capabilities

Our platform supports a variety of pricing structures—including flat, tiered, and banded AUM fees. BillFin also allows you to set firm-level, household-level, and account-level asset class, or individual security exclusions, giving you complete control over how, what, and when your clients are billed.

Accurate and easy-to-understand invoices are the key to getting paid correctly and can help meet state-registered firm requirements. BillFin allows you to customize your invoices to match your branding yet clearly indicate what's being charged, limiting confusion.

Collecting fees is simplified through built-in exporting functionality. In just a few clicks, BillFin can create a file ready to upload to your custodian or can even send directly to Schwab, for example.

Finally, splitting fees between your fellow advisors, banks, solicitors, consultants, etc. is automatically calculated as part of the billing process. BillFin's report is generated as a firm summary or for the individual payee.

Unlike competing solutions or services that require weeks of preparation and implementation, self-service onboarding built into BillFin allows you to easily import households, accounts, fee billing rules, and fee schedules. You can be up and running in less than a day.

One-time and recurring fee capabilities

For advisors billing beyond AUM, Envestnet Payments creates and distributes invoices, and securely processes credit card and ACH payments. The advisor dashboard provides insight into your book of business, including collected fees, upcoming fees, and more. To help satisfy compliance requirements, you avoid custody concerns since the client enters their own payment information and the advisor does not have access to that information. Plus, its integration with MoneyGuide enables advisors to seamlessly launch from a financial plan to billing.

As advisors embrace various fee models, its critical to have billing technology that can meet each client's needs. See how Envestnet can help you with your billing technology by requesting a demo or starting a free trial of BillFin or Payments at https://www.envestnet.com/schedule-demo.

Sources

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