2013 Fixed Income Trading in Wealth Management

Marketing, Pricing and Support Practices – A Summary of Findings

2013

Patpatia & Associates, Inc.

In July 2013 Patpatia & Associates conducted the *2013 Fixed Income Trading in Wealth Management* study, which analyzed the fixed income marketing, pricing, and support practices of wealth management channels.

Over 15 firms, including national full-service firms, regional and independent broker dealers, and discount brokerage and clearing firms, were included in the study; all of which indicated that fixed income is an area of growth and focus for their firms.

As firms continue to see increased competition for wealth management assets, they view Fixed Income as a strategically important asset class that can provide a competitive advantage in asset gathering, as well as serve as a source of higher transactional revenue when compared to other investments, such as equities and mutual funds.

Through both qualitative and quantitative data and analysis, which included surveys and in-person interviews with members of each firm, we were able to conclude several key items about fixed income pricing, marketing, and support services.

1) Fixed Income Pricing Practices and Policies

All the firms surveyed in the study employ one or more mark-up & mark-down pricing grids. The grids specify mark-up & mark-down policies along one or many of the following dimensions in order of frequency of usage by respondents:

1. Security Type (all respondents): Generally more liquid and less complex securities received lower mark-ups & mark-downs than less liquid, more complex securities
2. Maturity (90+% of respondents): Securities with shorter times to maturity generally received lower mark-ups & mark-downs than those with longer maturity
3. Transaction Size/# of securities (~50% of respondents): larger transactions generally received lower mark-ups & mark-downs than smaller transactions
4. Next Call (~25% of respondents): Similar to maturity, for each security type, a shorter time to Next Call received lower mark-ups & mark-downs than those with a longer time remaining until Next Call

When the maturity dimension was employed, it was applied across all security types. Firms that also employed Transaction Size and/or Next Call, in their mark-up/mark-down grids, typically used them for a majority of (75+%), but not all, security types.

1) Fixed Income Pricing Practices and Policies (continued)

In general, the pricing grids specify Minimum, Suggested, and Maximum mark-up and mark-down policies.

- All firms specified Suggested and Maximum mark-ups/mark-downs (for a subset of firms, Suggested and Maximum values are equivalent – i.e. the standard recommendation was the maximum market-up/ mark-down)

- A subset of firms specify Minimum mark-ups/mark-downs, with the rest either not specifying a grid, or setting the minimums at zero. The firms who do not specify a minimum provide the financial advisor the latitude to reduce or eliminate the mark-up/mark-down (*frequently subject to the approval of the fixed income trading desk or fixed income specialist*) based on the overall client relationship & market environment.

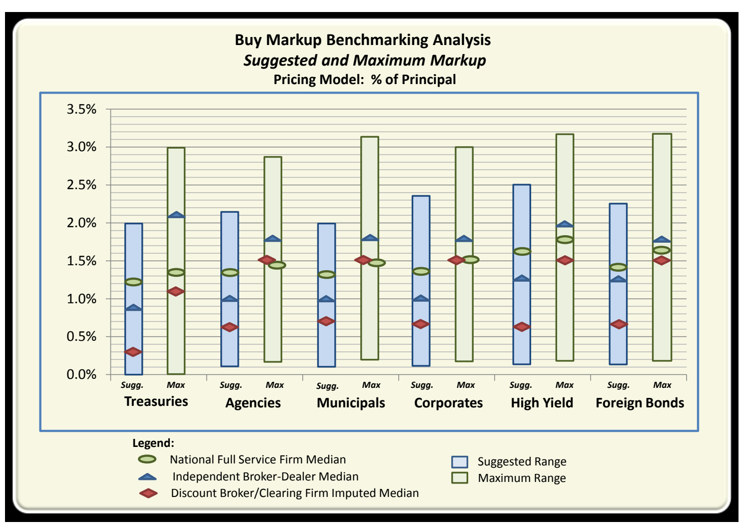
The firms surveyed employ one or a combination of the following grid models for specifying mark-ups/mark-downs.

A) % of Principal: used by 50% of respondents to specify suggested mark-ups and mark-downs, and by 75% of respondents to specify maximum mark-ups/mark-downs

B) Fee per # of securities in the transaction ($/bond): used by 40% of respondents to specify Suggested mark-ups and mark-downs, and by less than 20% of respondents to specify Maximum mark-ups and mark-downs

C) Flat fee per transaction: used by 25% or respondents used to specify Minimum mark-ups and mark-downs, and by a minimal number of respondents to specify Suggested and/or Maximums

For example:



1) Fixed Income Pricing Practices and Policies (continued)

With respect to mark-ups and mark-downs, all firms provide their Wealth Management channel Financial Advisors and RIAs some level of discretion for going above or below the suggested mark-ups/mark-downs. For most, these are subject to approval by compliance, the trading desk, or fixed income support specialists, depending on the firm.

2) Marketing & Support

Consistently, all firms responding to our survey indicated that fixed income is an area of focus for asset and revenue growth for the firm. Fixed income is viewed as an asset class that can yield higher transaction revenue than equities, and it is viewed as a critical asset class for overall asset gathering by relationship managers.

All firms surveyed offer, at minimum, tools or access to fixed income specialists which enable wealth management advisors to develop focused fixed income investment strategies and portfolios for their clients. In general, this support includes one or more of the following, depending on the firm:

- Access to dedicated fixed income specialists when developing and executing investment plans and strategies
- Direct access to Fixed Income trading desks to structure and price transactions
- Access to fixed income research & investment strategies (e.g. bond ladders, economic forecasts) from the firms in-house and/or third party research groups
- Investment planning tools that integrate fixed income assets into client investment plans & strategies

Our study found the majority of respondents do not restrict the number or type of institutional clients that Financial Advisors and RIAs in the Wealth Management channel may service. Wealth Advisors are generally able to offer these clients access to all the investment & pricing options available to any client in the channel, including trade execution and mark-up/mark-down practices and policies. However, a minority of respondents limit the number and/or type of institutions a Wealth Management channel advisor may by either setting a maximum account size for an institution ($200-$500M) or more commonly the share of institutional assets in the FA's portfolio (25-35%).

3) Conclusions

There are a number of general conclusions and trends that we have been able to identify as firms look to meet the investment management needs of wealth clients, who have become increasingly more knowledgeable about investments and are demanding increasingly more sophisticated and diversified investment plans and strategies:

- Fixed income is an area of increasing focus in the wealth segment. It is viewed as an asset class that can generate a competitive advantage in asset gathering efforts, and an area that can generate incremental revenue and increase profitability for the firm

- Access to primary issuance is viewed as an area of significant competitive advantage in the wealth management segment, especially with Ultra High Net Worth and smaller institutional investors services through this channel

- In the majority of firms surveyed, fixed income is fully integrated as an asset class into the financial and investment strategies that advisors develop for their clients. *Most firms who have not yet fully integrated fixed income, plan to, or are in the process of implementing this in the near future.*

- Most firms view the ability by financial advisors to develop focused fixed income investment strategies for their clients as critical to asset growth and client retention. These firms provide financial advisors with tools and increasingly, unlimited access to fixed income research and specialists on the trading desks to facilitate planning & ensure best execution of strategies.

- Increasingly firms provide the ability for their financial advisors in the Wealth Management Channel to market and solicit trades in all fixed income security types, removing any restrictions they have had in the past.

- There continues to be a difference in approach with respect to servicing institutional clients via the wealth channel. In our survey, less than half the firms limited the amount and/or type of institutional business that an FA in the wealth channel may manage, while the majority placed no restrictions on the financial advisor

On this last point, we believe policies and practices will continue to evolve as client needs and demands also evolve – particularly the increasing alignment of investment management needs of ultra high net worth and small institutional investors.