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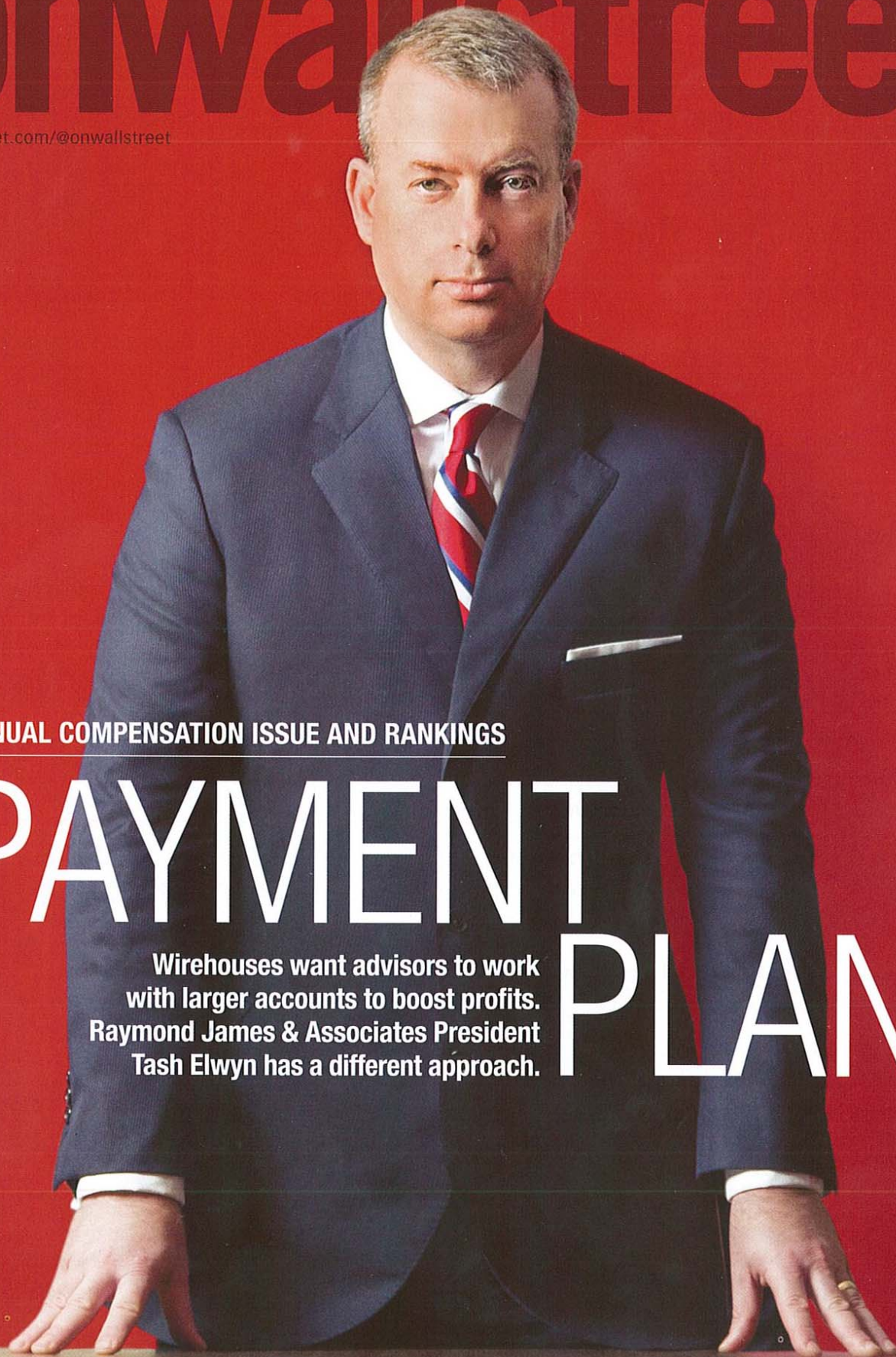
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ANNUAL COMPENSATION ISSUE AND RANKINGS

PAYMENT PLAN

Wirehouses want advisors to work with larger accounts to boost profits. Raymond James & Associates President Tash Elwyn has a different approach.



ADVISOR COMP: WHAT'S IN THE PIPELINE

EXECUTIVES AT THE LARGEST BROKERAGES ARE CHANGING COMPENSATION TO BOOST PROFITS. RAYMOND JAMES & ASSOCIATES PRESIDENT TASH ELWYN HAS A DIFFERENT PLAN.

BY ANDREW WELSCH

For many advisors, the guide to their firm's compensation plan seems to get longer every year. Some advisors joke that they have to rifle through dozens of pages just to find out where their pay has been cut.

But if advisors want to know where future comp changes are headed, they need only look at what the brokerage firms are promising their shareholders.

For instance, after a rough fourth quarter in which profits were dampened, Morgan Stanley CEO James Gorman told analysts his firm's wealth management unit would increase its profit margin from 20% to 25% over the next two years. Other firms have made similar commitments in the face of difficult markets and fierce competition.

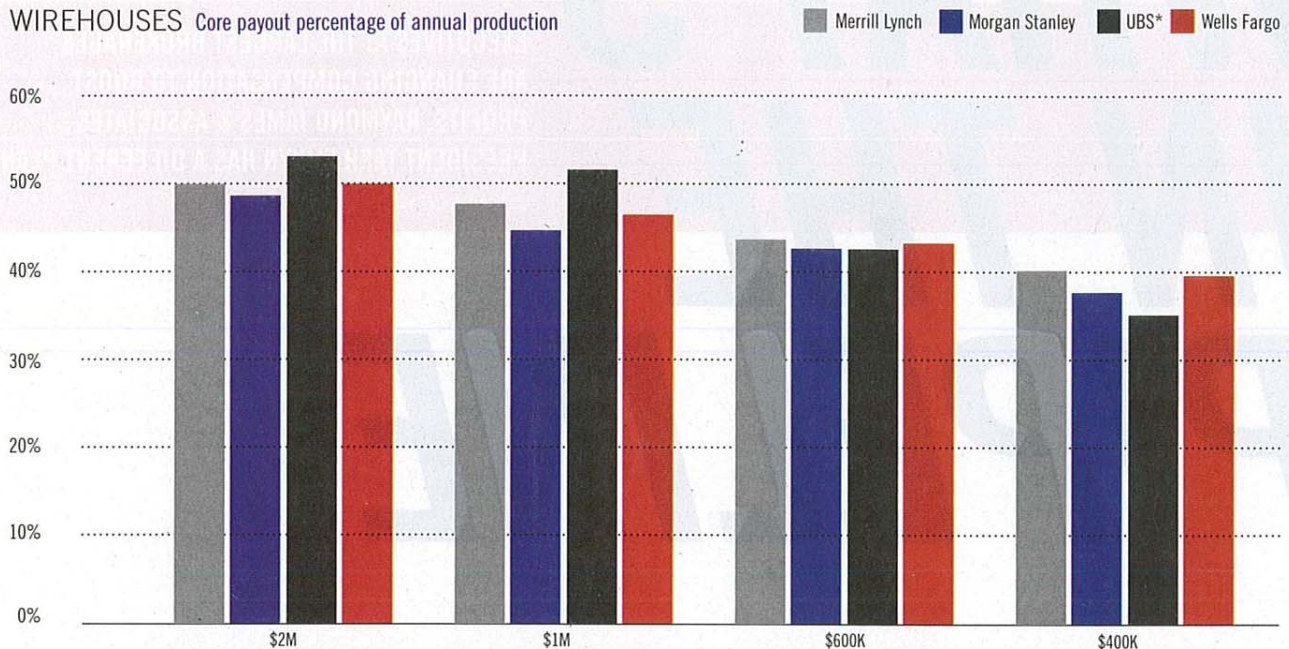
A branch manager, who asked not to be named, says there are only so many methods to reach those kinds of goals. "You see those headlines, and the smart advisors know what's coming," he says.

Responding to questions from *On Wall Street*, Barry Goldstein, COO of field management for Morgan Stanley Wealth Management, explained how the comp plan fits with the company's strategy: "We are primarily focused on improving pretax margins by expanding top-line revenue and our business mix by incorporating more banking and lending. Controlling all expenses, including compensation, continues to be important as we strive to provide returns to our shareholders, but we will always offer a highly competitive compensation plan to reward top talent."

Of course, many advisors who are growing their practices will probably see their pay rise in 2016. But experts and insiders say comp plans, particularly at the wirehouses, will increasingly reflect the methods being employed to grow the bottom line: more emphasis on serving bigger households, achieved in part by discouraging advisors from working with less-profitable small

Comparing the Plans

WIREHOUSES Core payout percentage of annual production



*Includes core (no growth required) value from 2010 GrowthPlus award=5% (\$125,000)

Source: Company data, analyzed by Tasnady Associates

accounts, and doing more banking and lending business.

Meanwhile, Raymond James is touting the year-in, year-out consistency of its comp plan as an advantage in an ever-changing landscape. Tash Elwyn, president of Raymond James & Associates, says there is a philosophical difference between how his firm and its competitors think about the balance between the client, the advisor and the firm.

"As long as advisors feel that their parent firm is not striking the right balance, ... these are the types of irritants that will create nearly infinite recruiting opportunities for Raymond James," he says.

TOO SMALL?

Several firms have tightened their small-household policies. Two years ago, UBS raised its minimum account size to \$100,000 from \$75,000. Last year, Merrill Lynch told its 14,000-plus advisors they would be paid 20% on accounts of \$250,000 or less if those accounts made up less than a fifth of their overall book of business. If such accounts constitute more than a fifth of a book of business, then the advisors wouldn't get this payment.

Wells Fargo, under its 2016 plan, made several changes to what it calls its client segmentation strategy. For giving up household accounts to trainees, senior advisors will earn the greater of either the equal of 12-month trailing gross revenue for that household or 40 basis points on the household's AUM.

Advisors who have 75% or more of their total households over \$250,000 in AUM will earn a bonus of \$5,000 to \$20,000, depending on their production. And Wells Fargo said that it would give the full-grid payout for all household accounts for the first year, but that it would only pay at a 22% hurdle if the household remained under \$65,000 in total AUM after 12 months.

"Overall, the strategy was designed to have FAs decide how many clients they can work with, [and] satisfy all their needs. That's where we are trying to head," says David Kowach, managing director and head of Wells Fargo's Private Client Group.

It's not Wells Fargo's intention for advisors to focus on the biggest clients, Kowach says. Rather, the point is to ensure that each client is deeply served. "I feel very strongly that the future in the brokerage business is about providing customizable service to clients. And over time, we have to prove that we provide that value for clients," Kowach says.

Yet advisors, particularly those at the wirehouses, often chafe at what they view as intrusive or onerous small-household policies. "It used to be that, if they had a Social Security number, then we took them, because you didn't know which ones were going to become millionaires," says one former Morgan Stanley advisor and manager, who now works at an independent firm.

An ex-Merrill Lynch branch manager, who also asked not to be named, says that small-household restrictions can be very onerous for advisors working in smaller cities and rural areas, where there are fewer millionaire households to serve.

Indeed, the penalties can pile up, says Brian Neville, an attorney at Lax & Neville who works with advisors transitioning between firms. "I can tell you that I have recently represented folks who left the wirehouses and went to the Stifels, Raymond Jameses and Ameriprises of the world, because too many of their accounts weren't getting paid for," says the New York-based Neville.

Kowach says Wells Fargo's policy entails handing the small accounts off to advisors in the same branch, likely new entrants to the business, and not to a call center. "The objective is to make sure that all our clients have a great experience with Wells Fargo," he says.

Andy Tasnady, a compensation consultant and head of Tasnady Associates, says more firms might implement new changes to their small-household policies, but the pace of acceleration may slow down at firms such as Merrill Lynch, that have already moved further along this path.

For example, there may be cost and efficiency savings to the firm to prune accounts under \$250,000, but the savings diminish as one moves further up the chain, from, say, \$250,000 to \$500,000. "It's nonlinear," Tasnady says, adding that some of the regionals may start to follow the wirehouses.

SMALL ACCOUNTS, BIG COMPETITION

"This also comes down to what a firm's overall channel strategy is," Tasnady says. "It makes more sense for Merrill Lynch, because they have the phone-based service in Merrill Edge. You don't want to cut [clients] off. You want to keep them within your brand. So you need to develop that model on the low end."

The competition on that low end of smaller clients is also becoming fiercer, as robo advisors and so-called hybrid firms, such as Personal Capital, ramp up. These digital startups have low account minimums and an approach that is appealing to at least some millennials.

Of course, these firms are still young; the robo advisor Wealthfront's AUM stands at more than \$2 billion, compared

with Merrill Lynch's roughly \$2 trillion in client balances. Still, they're projected to grow quickly, and larger firms, such as Charles Schwab, have been getting into the space.

Raymond James is employing a different strategy than some of its peers, declining the opportunity to buy a robo advisor or develop one in-house and opting instead to redouble its efforts to support advisors working with small accounts.

"It is a misguided bet that, as those clients create or inherit wealth, they will come back to the firm or [the] advisor," Elwyn says. "That is not a bet that Raymond James will make. We have committed ourselves to the human advisor."

Last year, the St. Petersburg, Fla.-based firm introduced Freedom Foundation Portfolios, which executives say is a new tool for advisors to work with smaller clients. The portfolios, which build on an earlier platform, consist of preselected funds, with a minimum account size of \$5,000, according to executives. Clients, working with an advisor, determine their risk tolerance and goals, and receive an asset mix that fits that profile.

Scott Horack, the assistant national sales manager, says the firm's advisors, including some of its larger producers, have been making use of the platform. "They like that it's the same methodology that we would use for their larger clients," he says.

The firm declined to say how many clients are using such accounts, but the average account size is just over \$20,000.

"The FAs own their book of business," says George Raffa, senior vice president of sales for the asset management group at Raymond James. "It's up to them to decide whether they want to use these accounts for their clients."

Executives acknowledge these accounts are not as lucrative for the firm. But, Raffa says, that's not the point. "My daughter is a schoolteacher," he says. "She has a small account, but that account is really important to her."

He adds, "We'll take a lower margin on this business to make sure the client comes first.

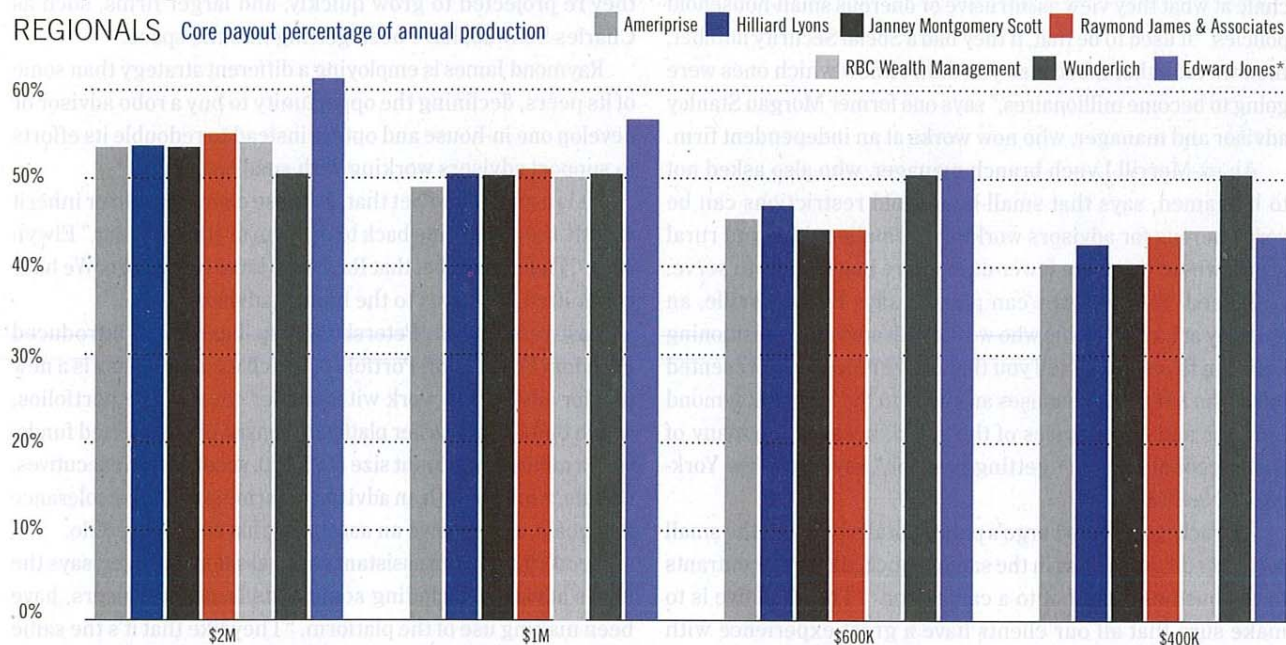
If you look all around, sure they are not as profitable. You just take care of the client first, and they'll take care of you."

Elwyn says it's an extension of the firm's mission. "I think the takeaway is not that Raymond James has a small-client focus. Rather, I think it's that we are continuing to support our advisors with the resources they need, paired with the autonomy to work with clients

Advisors, particularly those at the wirehouses, often chafe at what they view as intrusive or onerous small-household policies.

Comparing the Plans

REGIONALS Core payout percentage of annual production



*Average data provided by Edward Jones, individual FA totals may vary.

Source: Company data, analyzed by Tasnady Associates

as they deem fit," he says.

Yet a focus on larger accounts — even if accompanied by restrictions on small clients — does provide some upside to the advisor, Tasnady says.

"If you run the math and do the analysis, which we have done, it's very hard to get to \$1 million in production without at least a handful of very large accounts," he says. "You can't get there with a lot of small accounts, because you run out of time."

NO EXCEPTIONS

While some firms are discouraging advisors from working with small accounts, nearly all firms are encouraging advisors to do more business with large clients.

Besides offering bonuses for gaining net new millionaire households, firms are tweaking comp plans to encourage advisors to do more lending and banking business.

Last year, Merrill Lynch required each team to refer a client to another division of Bank of America, such as the investment bank or commercial bank. And under its 2016 comp plan, Merrill now requires each advisor to make a referral (it need not result in business).

While this business is quite profitable for brokerage firms, executives say it's also good for clients.

"By having a holistic view of a client's cash management and liability needs, FAs can experience multiple touch points to identify suitable opportunities and rethink strategies, which in turn can lead to deeper relationships and more successful outcomes for each client's personal goals," Morgan's Goldstein says.

Meanwhile, firms are also becoming more reluctant to allow exceptions to the rules. Ross Intelisano, a New York-based attorney at Rich, Intelisano & Katz, who works with transitioning advisors, says he spends a lot of time working on comp issues with advisors, including on small-household exemptions.

Intelisano also says lending services and rates are particularly important for advisors leaving high-end brokerages such as Credit Suisse and Barclays. "The larger clients and the larger advisors are used to being able to get exemptions," he says.

Intelisano adds: "I probably spend more time on that than the numbers, because the numbers are what they are these days. So it comes down to the pricing and what the best fit is for my business. Most of my time is spent talking about those

types of things.”

Advisors moving between firms are increasingly looking to get whatever they can in writing, Neville, the other New York attorney, says. “The reason that they want it in writing is because, 10 years ago, when they were moving, a manager would say, ‘Don’t worry, I have plenty of discretion.’ But a manager can’t say that in good faith anymore,” Neville says.

UNDER PRESSURE

All these compensation changes may ultimately add up to greater profits, but will they also produce greater attrition rates? Chris Dupuy, an executive at Focus Financial and a former Merrill executive, says advisors are well aware that their compensation is under pressure and that there has been a slow progression of small cuts to their pay, noting Merrill’s grid stretch under its 2016 plan.

He says it’s easier for advisors to take those changes in stride when the markets are in an upswing. “It’s a delicate balance for [executives] because they have to consider, how far can we push this comp agenda without sending every advisor to the door?”

However, other industry insiders aren’t sure many more advisors will bolt. “I think [the wirehouses] count on a certain amount of attrition, but at the end of the day, they’ll still be more profitable,” says a branch manager who requested anonymity to be able to discuss the likely impacts.

Elwyn says the wirehouses’ annual tweaking of compensation contrasts sharply with Raymond James’ consistency; the firm hasn’t overhauled comp in nearly four years. This strategy helps with recruiting, but more important, it helps with retention, Elwyn says.

“If you get the value-add to clients and the value-add to the financial advisors right, then retention can be so strong that the recruiting can be additive and accretive, rather than what you see so many competitors engaged in: an expensive churn,” Elwyn says.

Unique among the wirehouses this year, UBS made only one change to its comp plan. Jason Chandler, who oversees advisors in the eastern United States, says the current comp plan fits the firm’s strategy for attracting high-net-worth and ultrahigh-net-worth clients.

“Obviously, our decision was intentional, but it rested on the foundation of that we like our plan. It rewards faster-growing teams, and it recognizes advisors who are providing advice beyond investing,” Chandler says.

One UBS advisor, who likes the comp plan and requested anonymity to be able to discuss it, says he wishes the firm

would simply lock it in place.

“Every year, you wait with bated breath,” he says. “In most jobs, your comp plan doesn’t change year to year. So it’s weird that it does [for us]. Which makes it weird that UBS didn’t make any changes.”

Chandler declined to say whether the firm would consider leaving it unchanged again next year.

“I would just reinforce that all of the changes of the last couple of years, including 2016, reflect firmly that we want to be the firm of choice for high-net-worth and ultrahigh-net-worth clients and the industry’s most successful teams that serve them,” he says.

For his part, the UBS advisor says, “I actually think it would be well-received if they came out and said, ‘This is your comp plan for the next five years.’ You must know what you need to do for the next five years, so why change it? To the extent you value your sales force, why mess with the comp plan every year? I think if you kept the comp plan the same every year, that’d be a huge recruiting tool.” “Frankly, I don’t even see how they benefit from changing it every year,” he adds.

KNOWN UNKNOWNNS

But the urge to tinker is hard to resist, industry insiders say. And executives will face new uncertainties in the year ahead. Markets may remain volatile and growth muted. The Department of Labor’s proposed fiduciary rule is expected to become official this spring.

While the rule has been welcomed by some as a necessary tool to combat unscrupulous brokers, critics say it will make it unprofitable to provide small investors with retirement advice in many circumstances. “That might just put additional pressure on everyone,” Tasnady says.

If profits drop, then executives will have to find somewhere else to make up for the losses, insiders say. “Wall Street always counts more paper clips during a downturn,” one industry veteran says. **OWS**

ANDREW WELSCH is senior editor of *On Wall Street*. Follow him on Twitter at @AndrewWelsch.

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