CLS Advisor IQ Series

MAKING THE SWITCH: THE BENEFITS OF MOVING TO A FEE-BASED MODEL

How to make the transition from a commission-based transactional approach

advisor IQ
By CLS Investments

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Introduction

This white paper is part of CLS's Advisor IQ series of industry content, designed specifically to help advisors succeed. Continuing our focus on the top issues affecting advisors, CLS has compiled the latest thinking, research, and analysis to bring you "Making the Switch – The Benefits of Moving to a Fee-based Model."

As the wealth management industry continues to evolve, becoming more competitive and complex, advisors need to embrace new business models in order to remain successful. A key trend that is front and center in wealth management today is the movement by advisors to embrace fee-based business models and transition away from a commission-based transactional approach.

This movement has reached critical mass: Now, over half of all industry revenues come from fee-based accounts, according stats from Cerulli.

The reasons to make the switch have been well documented over the last decade, but now with the emergence of low-cost, online "robo" advisors, this trend will only accelerate due to these technology-driven competitive options.

So, how can advisors who have yet to embrace fee-based business models take action and ensure their long-term sustainability in a rapidly changing industry?

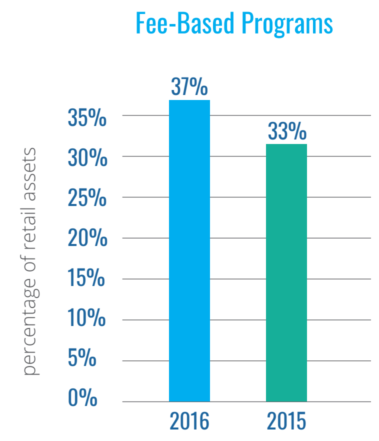
The good news is that it is never too late to begin. Accordingly, this guide will provide the industry background, trends, and business benefits for making the switch. It will also provide a detailed action plan and actionable tools and business-building resources.

We invite you to learn more about the many practice and business management resources of our Advisor IQ program by visiting [www.clsinvest.com/advisoriq.](http://www.clsinvest.com/advisoriq)

Industry Trends & Practice Management Benefits

The movement toward fees and away from commissions has been a long-term trend in wealth management. In fact, consider that Cerulli & Associates reports that there were $2.7 trillion in fee-based assets in 2014, compared to only $987 billion in fee-based accounts in 2003.

According to PriceMetrix's "The State of Retail Wealth Management 2016," 37% of retail assets were in fee-based programs in 2016, up from 33% in 2015 Also, asset-based fees accounted for 54% of the industry's overall revenues in 2016, up from 40% in 2013. Further, Cerulli & Associates reports that, on average, advisors anticipate that 66% of their revenue in 2018 will come from asset-based fees, compared to 59% in 2016. They expect revenues from commissions to drop from 32% to 23% over the same time period.



This trend is expected to continue with force, especially once the entire Department of Labor (DOL) Fiduciary Rule is finally imposed. Essentially, the new rule favors fee-based accounts because they do not provide a broker incentive to push one product over another to collect a commission, which the DOL considers a type of conflicted compensation. The rule elevates retirement account advisors to the level of fiduciary, a status that demands that advisors act in the best interests of their clients and put the clients' interests above their own.

Despite the present uncertainty of the rule, advisors are already changing how they do business. According to Cogent's "The Future of the Financial Advisor™" report, almost half (49%) of financial advisors may earn at least three-quarters of their total compensation from asset-based fees by the end of 2017, up from 38% in 2016. Additionally, according to PriceMetrix, advisors managed an average of 96 fee accounts at 2016 year-end, 45% higher than in 2013. While there is a strong industry-wide movement toward fees, it doesn't mean that advisors are completely abandoning commissions. According to PriceMetrix, in 2015:

- 65% of client relationships were transaction-only
- 13% of client relationships were fee-only
- 23% of client relationships held both fee-based and transactional accounts

This industry transition is important because experts largely agree that investors benefit more from fee-based accounts over commission products (as evidenced by the DOL rule) since they are typically able to better understand how much they're paying for investment advice and may receive better supervision of their accounts. With fees, the interest of clients and the advisor are generally better aligned – essentially, the advisor doesn't make money unless the client does. Research shows that millennials (generally described as those born between the early 1980s and mid- to late-1990s) are particularly watchful and skeptical about fees on their investments, which is further pushing advisors toward a fee-based approach where their value is more visible. According to a Cerulli survey, asset managers said that 64% of advisors plan to increase their use of I-share fee-based investment product classes by 2018 and 50% will increase their use of fee-based platform/wrap share classes during that time. Further, most asset managers surveyed said they expect advisors will decrease their use of commission-based share classes by 2018.

Industry Trends & Practice Management Benefits

In addition to allowing advisors to meet a higher fiduciary standard, many industry experts advocate a fee structure from a business growth standpoint. Commission-based business is transactional, meaning its growth is constrained by the number of clients to which an advisor can sell products. Conversely, advisors operating in a fee-based structure can instead focus on servicing clients, rather than selling to them. With a commission-based business, the advisor earns nothing if he or she does not sell a product to a client. However, an advisory business can still be successful with no new clients as long as the advisor is effectively servicing the ones he or she already has. Additionally, fee revenue is generally more predicable and steady than commission-based revenue, which can be more greatly affected by market volatility. According to Morningstar, Inc., fee-based accounts may yield as much as 50% more revenue than commission accounts.

By moving away from time-consuming transactions, advisors free themselves from having to constantly “sell” investment products to meet revenue goals. By “annuitizing” their book, they generate a renewable and predictable revenue stream by accessing professional, institutional-caliber third party money managers for ongoing outsourced investment management. The increase in an advisor’s time and productivity translates directly into the ability to better service clients, develop stronger relationships, and pursue new business development opportunities.

Additionally, the emergence of online fund “supermarkets” offering “no-load” funds, and low- or no-trading cost ETFs, makes perceived “high commissions” even more visible. When this is combined with the recent emergence of low-cost (or even free) automated robo advisor investing programs, traditional investment product commissions will become increasingly questionable to clients and the personal finance media.

The practice and business management benefits a fee-based practice may offer are dramatic. As mentioned, most notably, using a fee-based model provides predictable revenue and provides advisors with confidence in their business outlook. Fee-based advisors do not start each year with $0 in revenue like commission-based advisors do, which automatically puts them into production mode and takes valuable time away from highervalue activities such as strategic planning, prospecting, and relationship management. Additionally, by outsourcing the timeconsuming tasks of portfolio management, trading, rebalancing, and reporting to professional third party money managers, advisors free up valuable internal resources. This can lower costs and enhance productivity, which adds up to enhanced profitability and the ability to drive higher incomes.

Another benefit to fee-based management and to utilizing a third party money manager is the ability to provide improved service to clients. By outsourcing the investment component, the advisor and his or her staff have more productive time to spend on resolving client issues, developing better relationships, and providing an enhanced client service experience. The additional productive time can also be applied to new business development, as advisors can dedicate more of their day to prospecting for, cultivating, and closing new business.

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Industry Trends & Practice Management Benefits

When measured from a business valuation standpoint, a feebased business can deliver incremental business value that can be monetized upon retirement or sale of the business. According to industry valuation experts, commission-based businesses typically receive a 1x multiple on revenues, while fee-based businesses typically receive a 2x multiple on revenues. For example, a $1 million revenue fee-based business would be worth $1 million more than a similarly-valued commission-based business. That is a very dramatic difference!

As the industry continues to evolve, advisors must provide more financial planning and wealth management services in order to justify costs and differentiate their firms from low-cost, online rivals. Also, research shows that investors increasingly prefer paying their advisors fees for ongoing financial advice. Financial plans typically call for ongoing savings and investing plans to meet various goals, such as retirement or college funding. By outsourcing the investment management of these goals, advisors can better monitor results and ensure the financial plan is being implemented over time.

Additionally, managed account platforms and broker-dealers have made a tremendous investment in providing advisors with the best technology, as well as in choice and flexibility of various investment products, such as funds and other securities. Particularly for those platforms that specialize in ETFs, advisors can now benefit from the tax efficiencies and precision of managers who are experts in this area.

When asked, many advisors who have not made the switch to feebased management often use misperceptions about the process as excuses not to move forward. However, most of these objections are not reality. In many cases, advisors who have made the switch to fees look back on their journey and say, “I wish I had done it sooner.”

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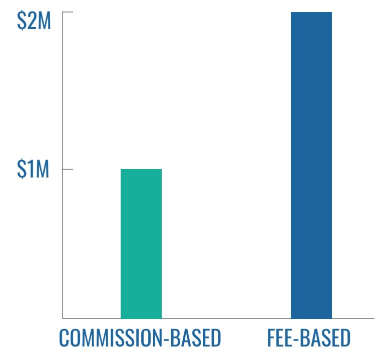

Overcoming Perceived Challenges

According to a 2016 Cerulli survey, in 2008, 40% of investors surveyed were interested in paying ongoing management fees to an advisor, compared to 50% by the third quarter of 2016. The survey also found that investors under 40 were the most interested in financial advice. Financial plans typically call for ongoing savings and investing plans to meet various goals, such as retirement or college funding. By outsourcing the investment management of these goals, advisors can better monitor results and ensure the financial plan is being implemented over time.

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According to Pershing, some perceived challenges of switching to a fee-based management approach are: "It's not the right time." The markets can be volatile, which makes advisors hesitant to change. However, by making the switch to fees, they can shift the focus from investment performance to ongoing advice and guidance. These are things clients are typically more comfortable with, since no one can control the direction of the markets.

"I'm too busy." Any business model change involves work; however, advisors don't have to do it all at once. The shift can occur over 6 to 12 months, and broker-dealers and money managers typically offer many practice management resources to help in the process.

"Clients will wonder." Advisors may think clients will react negatively when they make a pricing change; however, by using a thoughtful explanation, advisors can approach their clients with confidence. This report contains a sample letter that can be used with clients to communicate the rationale for making the change. With proper communication, clients are typically not resistant to fees, contrary to industry perceptions.

"I'm not experienced with fees." Some advisors may fear that their lack of knowledge will hold them back from deploying a fee-based approach. Yet, many customizable and cost-effective managed account platform solutions offer the ability to outsource a majority of the process to professional, third-party money managers.

"I'm too old." Advisors are never too old to make a change. In fact, business valuations are higher when the business is fee-based. When planning for retirement, a move to fees may be the best thing an older advisor can do to build business value to monetize upon for retirement.

"Revenues will go down." While a slight dip in income may occur during the transition, fee-based accounts may deliver more than 50% more revenue over the long term than commission-based accounts. Thus, taking a long-term view of this strategic issue helps provide the impetus to make a change.

While there is a definite imperativeness for advisors to move to fees, most don't have to immediately abandon commissions altogether. Rather, commission-based advisors can gradually transition their book over time.

Developing the Transition Plan

To remove much of the uncertainty surrounding switching from commissions to fees, advisors can develop their own personalized transition plans to break down the change into manageable steps. Additionally, advisors can work with their broker-dealers to tap into available practice management resources and consultants.

According to industry experts, the best way to begin this transition is by developing a 12-month plan with corresponding action steps, timetables, assigned tasks, and accountabilities. This can be done by using a simple Excel spreadsheet, or with comprehensive, collaborative project management software. It is easy to become overwhelmed, so taking it one step at a time can greatly simplify the process.

As part of the planning, the advisor will need to develop a forwardlooking profit/loss statement for his or her business in order to set goals and provide metrics for assets under management, minimum account sizes, and other measures. By having these numbers available, the advisor can see which clients are eligible for conversion and schedule communications accordingly.

Before reaching out directly, advisors will need to identify the thirdparty money management platforms and managed accounts that they will leverage to get clients on a managed money approach. Researching broker-dealers is a great place to begin, along with doing other industry due diligence, such as interviewing platforms, reading industry articles, and attending industry conferences.

Once the target clients are identified and the preferred managed account platform is selected, an operational plan should be developed. This ensures that all paperwork, transfers, and other administrative procedures are documented and become part of the daily new account opening process. By perfecting this operational aspect, advisors can quickly onboard new clients directly into feebased accounts, as well as smoothly transition existing clients.

With the internal infrastructure and operational procedures documented, the new approach should be communicated in all marketing and client-facing materials. A corporate brochure and website is a good starting place to explain the fee-based approach and corresponding client benefits. The advisor's staff should also be educated on the fee-based philosophy so they can clearly articulate the rationale and approach to fee-based business.

From there, the advisor can begin contacting clients and top prospects to introduce these new capabilities. The fee-conversion worksheet and sample client letter in the appendix of this white paper can be leveraged and customized for the advisor's own style and approach. Over time, the advisor's book of business can gradually be transitioned to fees and the advisor can begin to reap the many benefits of a sustainable, higher-value business.

WHAT TO LOOK FOR IN A THIRD-PARTY MONEY MANAGER:

1. Strong track record of performance over multiple market cycles.
2. Expertise in specific asset classes.
3. Transparency of investing philosophy.
4. Easy to understand client and avisor marketing materials.
5. Flexible managed account types and solutions.
6. Advanced technology to make the onboarding, account monitoring, and reporting process simple and easy.
7. Ongoing advisor to client communications.
8. Value added practice management resources and other advisor education materials.

Profiles of Success

CHRIS BOGGS
SRS WEALTH MANAGEMENT GROUP

Like many of his peers, Chris Boggs began his career as a financial advisor working in a transaction, commission-based business model.

“Back in 2000 when I started, I would say that 99% of people in the industry were trained on a commission style investment process,” said Boggs. “Being fee-based wasn’t even a discussion back then.”

However, after a few years of running his own firm - SRS Wealth Management, based in Baton Rouge, LA - Boggs began educating himself on the emerging trend of moving to an advisory model in order to better enhance his business and better serve his clients. “With a focus on active management, I really liked the methodology of being paid on a fee basis,” Boggs notes. “It is much more clear to the client as to how their account is being managed, there is more transparency, and clients better understand your value as a financial advisor.”

From Boggs’ experience, he found that he was in a much better position in a fee-based advisory capacity to discuss changes in his clients’ investment direction. As a result, clients were more confident in his recommendations. “For clients, it is very clear for them to see the fee come out of their accounts versus a bunch of transactional trade confirmation. Thus, they know that I am working in their best interest.”

Boggs doesn’t downplay the initial work he had to do when he began transitioning his clients over to the fee-based side of his business. “It was not an easy thing to do; however, by being direct and straightforward with clients on why we were making the change, cleints definitely responded positively.”

Boggs’ advice to new advisors who are building a practice: “feebased should be an immediate part of your business model.” He also suggests that advisors who have been in the business for a while and are considering a change should start off right away with an explanation that “fee-based was simply not a prominent or even basic option 15 and 20 years ago, but thankfully is now.”

Boogs continues, “clients should know that much has changed in the industry, and that there are outstanding new options for them. You now have a better method for managing assets and receiving compensation.” Another talking point Boggs uses is, “being in an advisory capacity allows us to spend more time and focus on the service side, ensuring that we can take care of all of your financial needs.”

On a personal note, Boggs prefers to look long-term at his business and how he has grown it to over $100 million in AUM, with just one other advisor in his firm. “Working on a fee-basis creates a lot of inner comfort that we are not constantly focused on our profits and losses or having to continually bring in new clients just to generate revenue. We have peace of mind in our business and are able to make better decisions for our clients as a result.”

Being in an advisory capacity allows us to spend more time and focus on the service side, ensuring that we can take care of all of your financial needs.”

Profiles of Success

ANONYMOUS ADVISOR
25+ YEARS FINANCIAL ADVISORY EXPERIENCE

This advisor founded his eponymous financial advisory practice in 1992. His experience over the last 25+ years is a very good barometer for how the industry has changed, fueling the growth of his practice.

“When I started, I was just like everyone else in doing business on a transactional basis,” he said. “But it wasn’t until four years later, when I was introduced to doing business on a fee-basis, that I saw the tremendous benefits of annuitizing my practice.”

Not only did making the switch to fees enhance his client relationships, it also had a transformation impact on his business. By outsourcing much of his back office, he was able to benefit from operational leverage to grow his practice and serve more clients. “Because of my fee-based approach, I’m able to manage over $80 million with just two licensed assistants in a 1,300 square foot office,” he said.

Ultimately, he is excited that he is out of the “betting” business and into the “planning” business. “Switching to fees allows me to lead with the clients’ goals, help them articulate those, and then design a strategy to meet them. This is a very different approach that allows me to show them that working in an advisory capacity tends to lower their risk, reduces their concentrated positions, and promotes a planning approach.”

Finally, when asked why he thinks advisors considering the switch to fees should definitely pursue that strategy, he says, “If your goal is to sell your business one day, the multiple is much higher for advisory than transaction. No matter how old you are, there is still time to take advantage.”

“No matter how old you are, there is still time to take advantage.”

Appendix

Dear Client,

We are writing to inform you of a change in how we manage your financial situation – a change that we believe will be extremely beneficial to you.

When we first began working together, our job was to help you invest in quality products to help you reach your financial goals. We kept you informed on your situation and provided a valuable investing service.

While that was a sound approach, we now operate in a much different and more complex market as the industry has dramatically changed. We are living in a global economy that is interconnected, complex, and constantly changing with markets operating around the clock.

In order to stay on top of this new investing environment, we believe that you will be better served through our new investing approach, which is to work with a professional money manager. These professionals have the latest technology, investment insight, and capabilities to stay on top of your account. We believe that this combination of our personal service and relationship, combined with professional money management, will provide you with a more beneficial investing experience.

We will be in touch shortly to transition your accounts. In the meantime, please feel free to reach out with any questions. We truly value your relationship and thank you for your business. We look forward to providing these and other financial services in a more comprehensive manner.

Sincerely,

Financial Advisor

Appendix

This Fee Conversion Worksheet is designed to help you determine which of your existing clients could benefit from CLS active management through a fee-based (as opposed to commission-based) approach.

Begin the process by completing the table below, which is will help facilitate a systematic approach in converting clients.

Client Name	Client Account Balance	Where does the client hold his/her account (i.e. American Funds, Franklin, Templeton, Pacific Life, etc.)?	Indicate how likely the client would be to take your advice to move to a fee-based approach. Rank from 1-5, with 1 being very unlikely and 5 being very likely.

Next, examine your list and identify commonalities among them. For example, do you have a group of clients with lower account balances and a high ease of conversion ranking? Do you have a group of clients who could stay with American Funds but could benefit from an actively managed account? By starting with lower balance, "simple" conversions, you will gain confidence in your approach, and will eventually be equipped to show your larger clients the value of a professional money manager.

CLS INVESTMENTS

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