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/.

Industry Trends

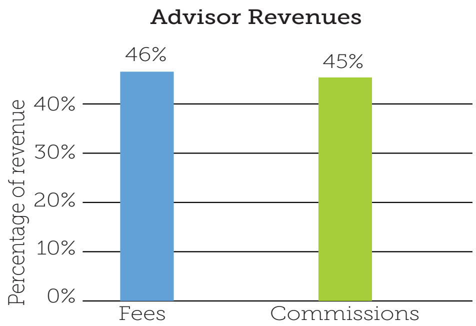
The movement toward fees and away from commissions has been a long-term trend in wealth management. Consider that in 2003 there were $987 billion in fee-based accounts, a considerable number in its own right. However, with the growth in this trend, that number has now tripled to over $2.7 trillion in assets, according to Cerulli.

Additionally, advisors now derive 46% of their total revenues from fees, versus 45% in commissions. This is the first time in the financial industry's history that fees have overtaken commissions. In the coming years, advisors are expected to derive more than 55% of their revenues from fees.

While these numbers indicate a strong movement toward fees, it doesn't mean that advisors are completely abandoning commissions. In fact, the largest segment of advisors are those using fees plus commissions to broadly service their clients. In 2014, according to Cerulli:

- 11% of advisors were commission only
- 23% of advisors were fee only
- 23% of advisors were using a mix of fees and commissions, and of that 23%, less than half of revenues were from fee-based business
- 43% of advisors were using a mix of fees and commissions of that mix, more than 50% were fee-based

In sum, two-thirds of advisors are using fee-based management for over half of their business. This is a trend that has been on the upswing and is predicted to continue as the industry standard.



While there is a definite urgency for advisors to move to fees, most advisors don't have to abandon commissions altogether. Commission-based advisors are able to gradually transition their book over time. Many advisors who have made the switch to fees, often say they've accrued many business benefits in doing so. They also note that they are able to provide enhanced service to their clients.

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 enhanced relationships, and pursue new business development opportunities.

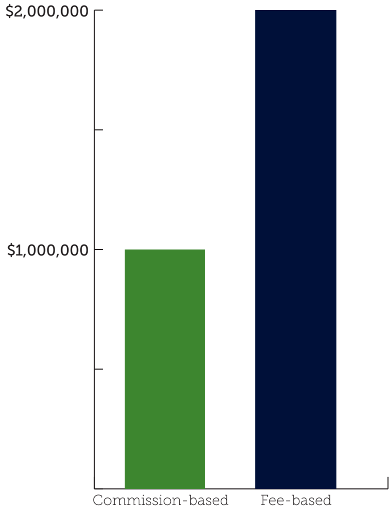
Additionally, the emergence of online fund "supermarkets" offering "no-load" funds, and low- or no-trading cost ETFs, makes perceived "high commissions" even more visible. When this is combined with the recent emergence of low-cost (or even free) automated robo advisor investing programs, traditional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

Another key issue that is roiling the investing community is the impact that a mandated fiduciary standard could have on the industry. The Department of Labor (DoL) which oversees retirement assets is pushing an agenda that may seriously impact the viability of traditional commissions in retirement plans, including IRAs. When taken to the extreme, regulators may make commissions obsolete, similar to what has happened in the U.K. and Australia, where commissions have been outright banned.

The practice and business management benefits that can be gained from moving to a fee-based model are dramatic. Most notably, using a fee-based model provides predictable revenue and provides advisors with confidence in their business outlook.

Practice Management Benefits

Commission-based businesses typically receive a 1x multiple on revenues, while fee-based businesses typically recieve a 2x multiple on revenues.



Fee-based advisors no longer have to start each year with $0 in revenue, which automatically puts them into production mode and takes valuable time away from higher-value activities such as strategic planning, prospecting, and relationship management. Additionally, by outsourcing the time-consuming 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 an enhanced service level to clients. By outsourcing the investment component, both the advisor and his or her staff have more productive time to spend on solving client issues, developing better relationships, and provide an enhanced client service experience. The additional productive time can also be applied to new business development, as advisors are able to dedicate more of their day to prospecting, cultivating, and closing new business.

When measured from a business valuation standpoint, a fee-based 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 dollar revenue fee-based business would be worth $1 million more than a similarly-valued commission-based business. That is a very dramatic difference!

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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. 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 haven't made the switch to fee-based management often use misperceptions about the process and what will happen to their business as excuses not to move forward. However, these perceived objections are not reality. In many cases, advisors who have made the switch to fees and look back on their journey, consistently say, "I wish I had done it sooner."

Overcoming Perceived Challenges

According to Pershing, some perceived challenges of switching to a fee-based management appproach are:

"It's not the right time." – The markets can be volatile, which makes advisors hesitant to make a change. However, by making a change, 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. It can be spread out over 6 to 12 months, and there are typically many practice management resources offered by broker-dealers and money managers to help in the process.

"Clients will wonder." – Advisors may think that 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." – There is never a time when advisors are too old to make a change. In fact, business valuations are higher when the business is fee-based. When planning for retirement, the best thing an older advisor can do to build business value to monetize upon for retirement, is to move to fees.

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

Developing The Transition Plan

To remove much of the uncertainty surrounding switching from comissions 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 breaking down the process into manageable pieces, developing a 12-month plan with corresponding action steps. It is easy to become overwhelmed, so taking it one step at a time can be a great way to simplify the process.

The first step in this plan should be to develop an overall project plan with timetables, assigned tasks, and accountabilities. This can be done by using a simple Excel spreadsheet, or with comprehensive, collaborative project management software.

As part of the planning, the advisor will need to develop a forward looking 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 is be able to see which clients are eligible for conversion and can schedule communications accordingly.

Before reaching out directly, advisors will need to identify the third-party 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 fee-based 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 can be a starting place to clearly articulate 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 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 advisor 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.

Chris Boggs
SRS Wealth Management Group

"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."

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 advises that "new advisors that are building a practice, fee-based should be an immediate part of your business model." Although he suggested 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 twenty years ago, but thankfully is now.

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 on his business in 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."

Annonymous
Advisor

This advisor founded his eponymous financial advisory practice in 1992. His experience over the last 20+ 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."

Sample Client Letter

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 select group of institutional-caliber, professional money managers. 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

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. CLS can support you by helping you determine which clients would be a good fit for managed accounts through CLS.

Begin the process by completing the table below, which is designed to take 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.

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