Financial advisor compensation

The changing approach to advisor incentives
The wealth management (WM) industry is facing a strategic shift in how it approaches compensation. As the independent registered investment advisor (RIA) channel grows and the current generation of financial advisors (FAs) retires, firms have been forced to re-evaluate how they attract and retain top talent. Questions around the right balance of fee-based, salary and commission-based compensation are at the forefront of the discussion, even as new strategic and behavioral incentives are gaining momentum. Similarly, unprecedented access to industry information has given FAs and clients new insight into how firms are compensating advisors and has raised questions regarding whether their current approach should be updated.

Searching for the right mix
Primary compensation approaches and compensation mixes vary widely in the industry
Financial advisor compensation — the changing approach to advisor incentives

To keep pace with changes in the industry and maintain their appeal among top advisors, firms must understand the key drivers for these changes within compensation.

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<th>Topic area</th>
<th>Driver</th>
<th>Trend</th>
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| Client demands           | Increased client awareness and buying power are pushing advisors to illustrate that their incentives align with those of their clients. | • Clients don't feel they have an adequate understanding of their advisors’ compensation, with 35% stating they don't know how much they pay their advisors annually.  
  • Forty-three percent of clients said their advisors received a salary or a combination of salary and commission. In contrast, advisors revealed that only 20% were paid partly by salary, and just 2% said they received only a salary.  
  • Clients are more attracted to asset-based fees due to the model simplicity and alignment with asset growth, contributing to the expected asset-based fee growth to 70% of wire house and 57% of regional advisors' compensation by 2015, up from 58% and 42%, respectively, in 2012. |
| Firm and practice needs  | Desire for more stable revenue flows and demographic shifts are driving a need for new compensation methods.                  | • The majority of advisors have demonstrated a preference for fee-based compensation as it enables greater transparency, aligns advisor and client incentives, and avoids the “stigma of sales” associated with traditional commission-based compensation.  
  • Firms desire more fee-based compensation to establish stable and consistent revenue flows.  
  • Gen X and Y advisors favor simplicity in sales-based compensation, and new non-sales-based compensation components, more than their predecessors.  
  • Wealth management firms are introducing more team-based retention and client-book-size incentives to drive target accounts and combat advisor attrition. |
| Regulatory requirements  | Regulators are requiring greater clarity and transparency in advisor compensation to avoid conflicts of interest with clients.  | • The Financial Industry Regulatory Authority (FINRA) and the SEC are continuing to push for a uniform standard of care for all broker-dealers and investment advisors, which would require greater simplicity and transparency in wealth management compensation models.  
  • FINRA has proposed a rule that would require advisors to provide disclosures to their clients regarding compensation they receive for switching firms. |
The five key trends in transforming advisor incentives

In response to these drivers for change, firms have begun to rethink their approach to incentivizing advisors. Though variations in advisor preferences, firm characteristics and system capabilities prevent a “one size fits all” solution to advisor compensation, there are five emerging strategies:

1. Moving to fee-based models
2. Simplifying compensation plans
3. Driving strategic growth
4. Increasing behavioral incentives
5. Enhancing compensation platforms

The firms that incorporate these strategies will be able to achieve a significant advantage in attracting and retaining advisors and develop a competitive edge. The table below summarizes these strategies, as well as key trends and examples within each strategy.

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<th>Strategy</th>
<th>Summary</th>
<th>Trend</th>
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<td>Moving to fee-based models</td>
<td>WM firms are designing models and goals to augment the fee-based component of overall advisor compensation.</td>
<td>• Firms are reducing commission-based accounts, down to 72% of industry assets, from 79% in 2010.</td>
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<td>• Firms have established specific targets for fee-based growth, with the most aggressive participants targeting 50% of accounts and 60% of total revenue to be fee-based within the next one to two years.</td>
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<td>• Industry leaders have increased bonuses for fee-based referrals, which has increased fee-based inflows, exceeding targets by about $500 million per month in many cases.</td>
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<td>Simplifying compensation plans</td>
<td>Firms are adjusting compensation models to reduce advisor focus on achieving a new grid tier for a given period. Firms are reducing product-based incentives in an effort to enable greater focus on client needs and simplify advisor compensation.</td>
<td>• In 2011, 35% of advisors had no basic salary component to their compensation; that number has since shrunk to 16% in 2013.</td>
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<td>• Many firms are considering a flat compensation model, wherein advisors receive a flat compensation of about 50% on all production above a target tier (e.g., $250,000 in production).</td>
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<td>• Firms that are aggressively simplifying compensation have removed all product sales incentives in place of a base salary.</td>
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<td>• Many grid-based brokers have increased grid tiers to reduced requirements for reaching a new grid.</td>
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<td><strong>Driving strategic growth</strong></td>
<td>Firms are adjusting compensation methods to drive growth within target client segments and account sizes.</td>
<td>• Forty percent of WM clients with advisors are very unprofitable (paying less than $100 a year), which is driving firms to shed the lowest-value accounts or move them to a self-directed model.</td>
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<td>• Industry leaders have introduced incentives to drive high-net-worth (HNW) accounts by rewarding advisors who have 80% or more of their book in households with at least $250,000.</td>
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<td>• The desire to grow HNW and ultra-high-net-worth (UHNW) accounts has caused firms to introduce cash bonuses for advisors with a book consisting of 150 accounts or fewer.</td>
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<td>• Some firms are implementing new compensation models to drive retirement accounts by offering 50% pay on new retirement plan revenues, plus 15% to help advisors fund future business growth. That 65% potential payout is significantly higher than the 30% to 46% that the average advisor is earning from his or her production.</td>
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<td><strong>Increasing behavioral incentives</strong></td>
<td>Firms are enhancing incentives that drive desired advisor behavior regarding non-sales-related goals. Firms are building perceived level of fairness, nature of work, level of effort and broader targets into their incentive structure.</td>
<td>• Firms are introducing client retention incentives, rewarding advisors for retaining 98% or more of the previous year’s clients.</td>
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<td>• Incentives around cross-sale targets have been established in many wealth management firms.</td>
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<td>• Firms have begun offering bonuses to advisors who had helped clients identify and track their goals (saving for their children’s college education, paying down their mortgage, saving for retirement, etc.).</td>
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<td>• Numerous industry leaders are introducing team-based incentives by offering all advisors a base compensation rate at the highest team member’s production level for a given period; firms with team-based incentives grew revenue 50% faster than firms without team-based incentives.</td>
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<td>• Firms of all sizes have increased retention bonuses and equity-sharing to drive advisor loyalty and reduce attrition.</td>
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<td><strong>Enhancing compensation platforms</strong></td>
<td>Firms are seeking platforms that can track complex and/or non-revenue compensation metrics. Firms are integrating platforms across units to support the holistic client experience.</td>
<td>• Several wire houses have begun integrating compensation systems to enable visibility across the organization, rationalize back-end compensation support and account for non-revenue incentives.</td>
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<td>• Compensation vendors have increased their focus on wealth management firms and are offering more specialized capabilities, such as client retention tracking, commission discount bonuses and dynamic team splits.</td>
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<td>• Firms are enhancing technology to enable tracking and compensation of client referrals and cross-selling across retirement, private banking, trust, brokerage, consumer banking, etc.</td>
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Effectiveness through technology

Many firms are turning to technology providers to help reinvent their compensation capabilities and focus the efforts of advisors in areas prioritized by leadership. Historically, many firms have used basic vendor or home-grown solutions to track and pay advisor compensation. Those solutions focused on more simple revenue-based calculations, such as commissions and assets under management, and generated a total payout for a fixed time period. However, some firms are now using technology initially designed for large-scale business-to-business (B2B) and business-to-consumer (B2C) sales forces and tailored for sales performance. These tools will allow firms to set specific incentive-laden targets aligned to product, regions, segments and more, as well as allow the home office to track progress on a regular basis.

Some of the vendors in this space are smaller and newer to financial services, such as CallidusCloud, Synygy and Xactly. Others are large firms that purchased smaller solutions to expand their offering, such as IBM (purchased Varicent) and Oracle (purchased Siebel, which had previously developed a sales performance management solution along with its CRM solution).

All of the above vendors can offer firms a much broader set of sales performance management capabilities. These capabilities include:

- Comprehensive management for tracking how advisors are compensated for specific targets
- Territory management for helping branch managers oversee larger teams
- Forecasting and optimization tools to determine how well a particular incentive is performing
- Objectives (MBO) management to support HR and managers in tracking advisor progress-to-goals
- Recruiting and onboarding tools to support new advisors and teams joining the firm
- Coaching and development tools that are targeted toward helping advisors strategically grow their book of business

The net result of these capabilities is that there are many tools to motivate advisors, capitalize on opportunities, and promote products and services that support overall goals.
Where EY can help

We assist firms reorganize advisor compensation models to align with their broader firm strategy. This includes comparing strategic priorities with those of the industry, identifying gaps between advisor incentives and strategic priorities and outlining prioritized road maps for closing the gaps between a firm’s future state vision and current incentives.

We perform compensation system vendor assessments to support dynamic and rationalized incentive support. This is accomplished by working with firms to identify core capability needs and pain points, designing RFIs/RFPs to identify the leading approaches, performing proof of concepts, and testing and integrating the selected compensation option.

By leveraging the insight of our former FAs and front-office teams we help firms align incentives with the needs of advisors. The team combines industry thought leadership, advisor interviews and our experience at peer firms to introduce a compensation approach that is clear, balanced and motivational to FAs.

Advisor incentives that clearly support the firm’s strategic vision and objectives

Efficient systems that improve advisor productivity, support dynamic incentives and reduce non-value-added processes

Redesigned incentives that support advisor retention as well as next-generation advisor recruiting

EY has been helping wealth management firms across the industry understand and leverage the five strategies for enhanced advisor incentives. The table above summarizes how EY can help clients optimize their compensation approach from a strategic, technological and advisor standpoint.

Wealth management leaders understand that the heart of their industry is ultimately the advisor, and that advisor’s ability to attract and retain clients. By adopting the five compensation strategies, firms can cultivate a motivated base of top advisors who understand how their incentive structure drives their own development and the ultimate strategic vision of firm. In a people-focused industry, the firms that succeed in solidifying a foundation of gifted and motivated advisors will be best positioned to flourish in the upcoming decade of unprecedented growth.

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