

EFFECTIVE FINANCIAL ADVISOR COMPENSATION:

A strategic approach to growing advisory business.

INTRODUCTION

Settling on the right type of compensation for financial advisors in a bank investment program can be a balancing act. What are the main elements of compensation that help attract, retain and incentivize top advisors?

In this first whitepaper of a series of investment program-related topics, we examine the use of incentives to drive advisory business. We set out to explore how seven specific components of advisor compensation plans affect performance within financial institutions, and what that means for those institutions' bottom lines. To do this, Raymond James worked with Kehrer Bielan Research & Consulting, a leading source of insight in the financial services industry.

RESEARCH METHODOLOGY

Kehrer Bielan's research on compensation plans for advisors has documented a rich variety of plan features designed to influence advisor behavior – such as increased sales of a particular product – or improve business performance by such measures as increasing revenue or asset growth or improving profit margins. But beyond anecdotal evidence, little is known about whether the incentives built into advisor compensation plans in banks and credit unions achieve their objectives. Our aim was to fill that information void.

This study draws on three Kehrer Bielan surveys:

- The 2013 Advisor Compensation Plan Study, which included 63 advisor compensation plans from investment services units in 48 financial institutions
- A 2014 survey of advisor compensation plans in 21 credit unions, which was included in the analysis in Effective Financial Advisor Compensation in Credit Unions (May 2014)
- A current survey of the advisor compensation plans in bank-owned broker/dealers, which includes 29 regional and super-regional banks



KEY TAKEAWAYS

Optimizing lookbacks, grid levels and incentives provides a mechanism to expand margins while continuing to grow.

Providing special incentives and compensation plans tailored to individual advisor practices are effective tools for institutions seeking more recurring revenue.

Institutions with the most successful recruiting efforts pay on net, and largely work with third-party marketers.

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Researchers then matched the institutions in the advisor compensation plan database with the advisor and business performance data from Kehler Bielan annual benchmarking surveys of bank broker/dealers, banks that offer investments through third-party broker/dealers, and credit unions, pairing them with the performance data for the same years the compensation plans were in effect.

Finally, researchers included data from a recent survey of advisor recruitment and turnover experience so we could examine how the details in compensation plans affect how attractive the firm is to recruits, and how best to retain them once they are onboard.

The resulting database encompasses 61 banks and credit unions with detailed compensation plan profiles and data on advisor and business performance.

The study encompassed both banks (54%) and credit unions (46%). The majority (61%) provided investment services in partnership with third-party broker/dealers, but 39% were large banks with their own broker/dealers.

The institutions are also fairly evenly divided by the type of sales model deployed; 43% provide investment services through full-time financial advisors, while 57% supplement the advisors with client-facing staff licensed to sell annuities and insurance or registered to provide securities services, often called platform investment reps.

A list of the institutions studied can be found in the appendix.

ANALYSIS PLAN

We focused on the following components of advisor compensation plans:

- Incentives to reward production of advisory or life insurance business
- The time period of production covered by the payout calculation – the most recent month or a longer period such as the past year
- Whether that computation is based on gross revenue produced by the advisor or net of clearing or other expenses
- Whether there is a true base salary or a draw against commissions that the firm can recover if the advisor's production is too low
- The number of levels or tiers for the payout computation, usually referred to as the payout grid
- How the plan rewards top producers, such as the production level required to achieve a 40% payout and the top payout in the grid
- Separate compensation plans for different types of advisors, as opposed to a one-size-fits-all incentive plan



We measured



Compensation plan profiles



Advisor performance



Business performance

across **61** banks and credit unions



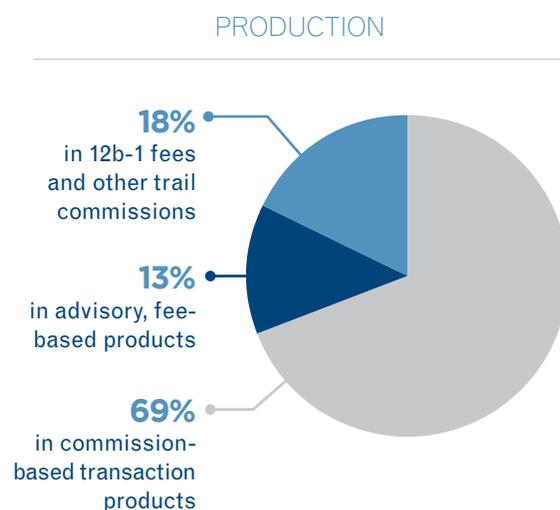
54%
Banks



46%
Credit Unions

We judged the productivity of advisors by how much gross revenue they produce, the composition of that revenue, the amount of assets they administer and the amount of new assets they acquire each year. The 61 firms in this study have average annual gross revenue per advisor of \$371,654; 69% of the production is in commission-based transaction products such as mutual funds, annuities, and stocks and bonds; 13% is in advisory, fee-based products such as separately managed accounts and wrap mutual fund accounts; and the balance is in 12b-1 fees and other trail commissions.

Using this framework, we found considerable variation in compensation plan characteristics and outcomes across the banks and credit unions studied. Which plan aspects are more successful in achieving performance objectives? In this white paper we examine the use of incentives to drive advisory business. The broader research analyzed how each element of the compensation plan affected financial advisor productivity and revenue mix, asset accumulation, penetration of the financial institution's opportunity – as measured by gross production per million of the institution's consumer deposits – and asset productivity (annual investment services revenue per assets under administration).



ASSESSING THE DETAILS OF COMPENSATION PLANS

SPECIAL INCENTIVES FOR ADVISORY BUSINESS

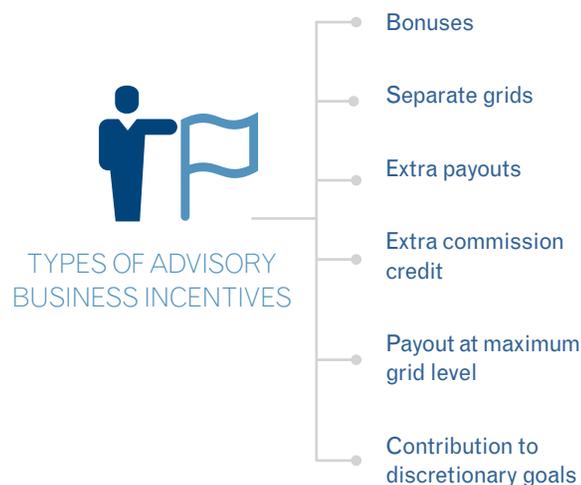
For both philosophical and financial reasons, many investment programs want to increase the amount of business their advisors do in wrap mutual funds, separately managed investment accounts and other investment products that are fee-based instead of transaction/commission-based. Fee-based business in wealth management typically generates a recurring, predictable stream of income for an institution, rather than transactional revenue which can be lumpy and unpredictable. It's also expected that over the long term, advisory business will drive profitability and help grow the business. We found that many incentive plan components do appear to impact how much advisory business is produced.

Almost half (48%) of the firms studied have special incentives to encourage advisors to do advisory business. But the prevalence of incentives for advisory business in banks was more than double that of credit unions.

The incentives include bonuses, separate grids, extra payouts and contribution to discretionary goals. The incentives some firms use to encourage a focus on advisory business are quite aggressive.

For example:

- Payment on a separate fee-based grid with payouts in the 40% to 50% range
- An addition to the grid of an incremental payout of 5% to 8%
- The advance or increase of the first year's fees to the grid, with 1.5 to 2 times the first year's fee credited to the grid
- Payment of a straight basis point amount to the advisor of up to 50 basis points on advisory assets



Paying special incentives for advisory business clearly drives advisor behavior. Advisors who are offered incentives produce 2.4 times the revenue from advisory business as advisors who are not. But as expected, that increase in advisory business comes at a cost – a 16% decline in transaction business as advisors respond to those incentives by shifting business from transactions to advisory accounts. The upshot is a small decline in total revenue per advisor in the near term.

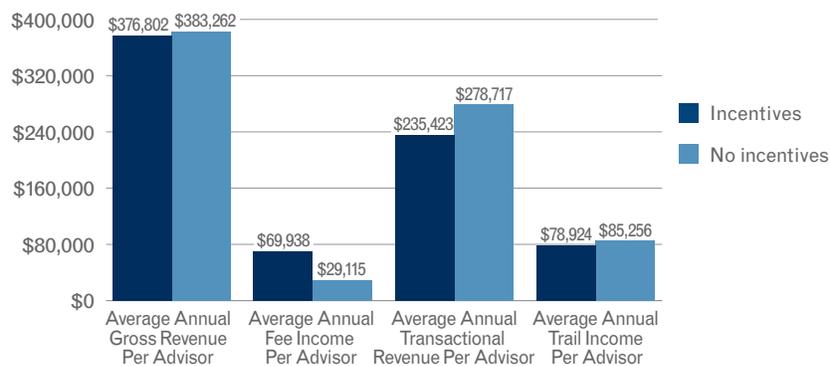
The allure of advisory business is that while it might crimp revenue in the short run, it will be much more profitable once advisors have transitioned a substantial portion of clients to fee-based products that continue to provide fees year after year.

Advisors with incentives for advisory business produced **2.4 times** the revenue from this model and are gathering average new assets of over **\$10.7 million, 82% more** than the asset acquisition pace of advisors without special advisory incentives.

Advisors incentivized to produce advisory business have slightly more assets under administration, but are accumulating assets much more quickly. They are producing average new assets of over \$10.7 million, 82% more than the asset acquisition pace of advisors without special advisory incentives.

The advisory incentives appear to encourage the advisor to gather more client assets under administration instead of earning more commissions on the same assets by periodically repositioning them.

Impact of Incentives for Advisory Business
on Advisor Productivity



Profitability

Partly due to the cost of the incentives, and perhaps also due to the higher costs of processing and maintaining the business, firms that are driving advisory business through incentives currently have lower profit margins. The average net income margin in firms that pay incentives for advisory production is 16.6%, which is 26% below the profit rate in firms that do not pay special advisory incentives; however, these institutions are likely aiming for growth over the long term as advisory assets under administration continue to grow. And once the advice model takes hold in a depository institution, bridge compensation is no longer necessary.

Revenue on assets for firms that provide advisory incentives is 0.59%, lagging 8% behind other firms. But Kehrer Bielan research on the impact of advisor tenure demonstrates that, after the first few years, the return on advisory assets is higher than on transaction assets, and that advantage grows year after year.

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Recruitment and Retention

The firms that offer incentives for advisory business have better recruiting and retention. Their annual attrition rate was only 6.5%, which is 44% lower than firms that do not provide special incentives for advisory business.

The firms with incentives for advisory business did experience much slower growth in their advisor headcount, but they already have much thicker advisor coverage, so they might not be looking to expand faster. The other firms overcame a high turnover rate by hiring enough advisors to post a solid gain in headcount.

The picture that emerges is that the firms offering incentives for advisory business are mature businesses that have expanded their advisor sales force toward optimal coverage, and are in the process of transitioning that sales force to an advice model.

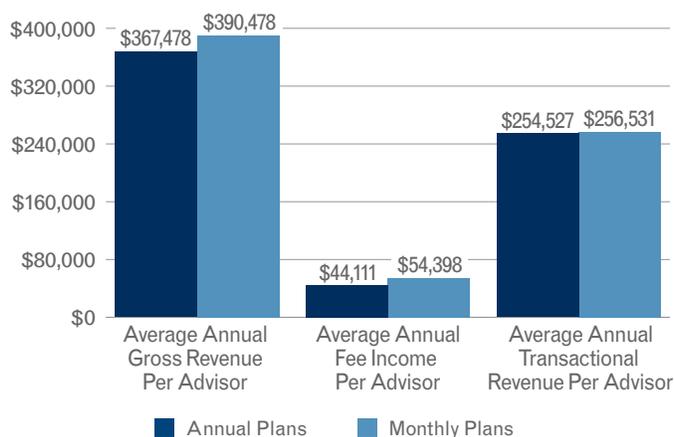
PRODUCTION LOOKBACK

Advisor compensation plans in financial institutions generally calculate the current month's compensation in one of two ways: yearly (annual lookback plans) or monthly (monthly lookback plans).

More than half (58%) of the firms use the monthly computation method, although annual lookback plans are much more popular among credit unions. (A few firms that base compensation on production in the previous six months were included in the annual group.)

Firms that use a monthly lookback have average annual gross per advisor of \$390,478 (versus the average of \$367,478 for the 61 studied firms). That is just 6% more than advisors with an annual lookback. However, the advisors with a monthly lookback do produce \$54,398 in advisory revenue – 23% more than advisors with an annual lookback. Advisors with either lookback formula produce similar transaction revenue, on average.

Impact of Lookback Duration on Advisor Productivity



The monthly lookback methodology provides an incentive for advisors to work to achieve a higher level of productivity within a year, and benefit more quickly. This can be compelling when recruiting advisors.

As a side note, less than 20% of institutions were able to report on new assets acquired during the preceding year. Even less were able to provide net new assets, which is perhaps an even more important statistic to measure. This is an important statistic that is useful for tracking advisor growth and productivity that Raymond James provides through its reporting capabilities.

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GROSS VS. NET PAYOUT

Slightly more than half (54%) of financial institutions base the payout calculation on the gross production of the advisor, i.e., the gross revenue from the sales commissions on investment products and the fees from the assets under the advisor's administration. The balance of the firms studied compute the advisor's payout from revenue net of their broker/dealer fees. Generally firms whose advisors are associated with third-party broker/dealers base compensation on net revenue, while the bank-owned broker/dealers pay on gross. Three bank-owned broker/dealers pass through ticket charges to the advisors, but these typically amount to 1% or 2% of production.

The firms that pay on net revenue have average annual gross revenue per advisor of \$394,253 – 8% higher than the firms that base compensation on gross revenue. Advisors in firms paying on net produce somewhat more transaction business than their peers who are paid on gross.

This leads us to believe that paying advisors net of broker/dealer fees (administrative and clearing fees) is often a more effective way to manage profitability of an investment program, versus paying on gross and adjusting payout levels to account for broker/dealer fees.

Most programs associated with a third-party marketer (broker/dealers that provide retail investment services to banks) pay on net, which results in higher margins. This leads us to conclude that outsourcing brokerage clearing to a third-party marketer assists banks and credit unions with optimizing their program margins.

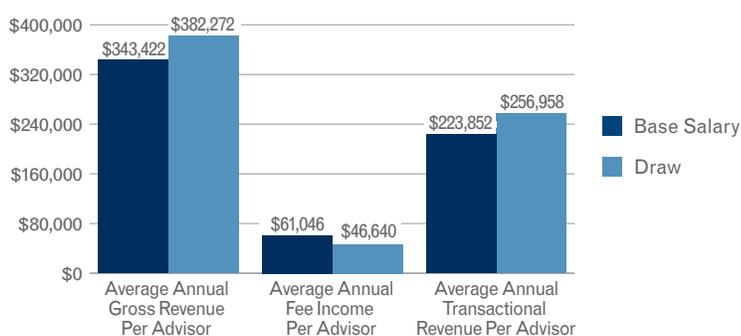
BASE SALARY VS. DRAW

Utilizing a base salary compensation structure remains relatively rare, with only 15% of institutions studied taking this approach. Base salaries were more prevalent in banks than credit unions.

Advisors on a draw have average annual gross of \$382,272 – 11% higher than advisors who have a base salary. But the composition of their respective businesses is quite different. Advisors on a draw produce only \$46,640 each in advisory revenue, 24% below the advisory production of advisors with a base salary. Instead, advisors on a draw produce \$256,958 in transactional revenue, 15% more than the advisors with a base salary.

Utilizing a base salary compensation structure remains relatively rare, with only **15%** of institutions studied taking this approach.

Impact of Salary Structure on Advisor Productivity



NUMBER OF GRID LEVELS

In the early years of investment services in financial institutions, the compensation plans were quite simple, and the payout calculation was often just a flat percentage of the advisor's production. But some plans paid a higher percentage to the advisor if gross revenue exceeded one or more thresholds. Over time the number of steps in the advisor's payout formula grew, as management introduced incentives to achieve a higher payout. With few grid levels, the next threshold might seem to be too high to attain.

Today the advisor in a typical bank has a payout grid with nine levels, while his or her colleague in a credit union has seven grid levels. Only 37% of the firms studied have fewer than seven grid levels.

The number of grid levels does not appear to make a difference in advisor revenue productivity, or the mix between advisory and transaction business. The average annual gross of advisors with six or fewer grids is essentially the same as the production in firms with more grid levels. Similar to more frequent (monthly) lookbacks, it appears the bias is to include more grid levels to encourage and reward advisor growth.

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COMPENSATION TO TOP PRODUCERS

Threshold for 40% Payout

Some firms use their compensation resources to provide extra rewards to their top producers. One way to assess whether a compensation plan is skewed to top producers is to look at the level of production required to achieve a 40% payout on new business. About 4 out of 10 of the investment services units use a payout of 40% below a production level of \$500,000 a year. In this respect, advisor compensation plans in banks and credit unions are quite similar.

Firms that provide a 40% payout before a financial advisor produces \$500,000 have average annual revenue productivity that is 11% higher than firms that do not pay out 40% until production reaches or exceeds that threshold. And advisors with a lower 40% threshold produce 30% more advisory business.

These numbers suggest that financial institutions can attract top advisors with an attractive (recurring/fee-based) product mix at a 40% payout.

Top of the Grid

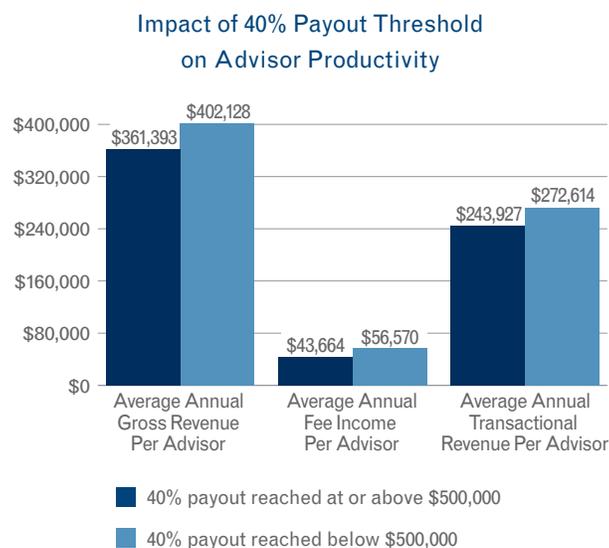
Firms with a high top payout are attractive to top producers. Almost 3 in 10 have a top payout of at least 45%. Compensation plans in credit unions are somewhat more lucrative for top producers than in banks.

The average annual gross revenue per advisor in the firms with a payout of 45% at some level of production is \$356,280, actually 8% less than in firms where the payout never reaches 45%. And advisors in firms that include a 45% payout level produce just \$40,803 in advisory revenue per advisor, 21% below the advisory production in firms with no 45% payout.

It may be that firms with a high top payout are not particularly attractive to the advisor looking to build a business around advisory accounts, but are attractive to advisors grounded in transaction business, who need a higher payout if they are to achieve the next step up financially. They do not have the base earnings from assets under administration that they can build on year after year.

Advisors in the firms with a 45% payout also have 16% less in assets under administration, and are bringing in half the amount of new assets as advisors in other firms.

All of this data points to the conclusion that financial institutions don't need an exceptionally high top-level payout to attract top advisors.



Banks and credit unions can attract top advisors with an attractive (recurring/fee-based) product mix at a **40%** payout.

DIFFERENT PLANS FOR DIFFERENT ADVISORS

Some investment services firms in financial institutions have established separate plans for different classifications of advisors. In addition to an incentive plan for a core Series 7 advisor who works in a bank or credit union branch, there might be separate plans for a senior advisor and the associate advisor he or she is mentoring, an advisor who has graduated from relying on referrals to working a book of clients (sometimes called a “second story” advisor), and advisors working as a team. This is more common in large banks where some advisors have been embedded in trust, private banking or wealth management. That difference shows in our data; banks are twice as likely as credit unions to have different plans for different advisors. Finally, some firms have different payout schedules for advisors with limited opportunity, e.g., a small branch or difficult geography to cover. Overall, 28% of the firms have more than one advisor compensation plan.

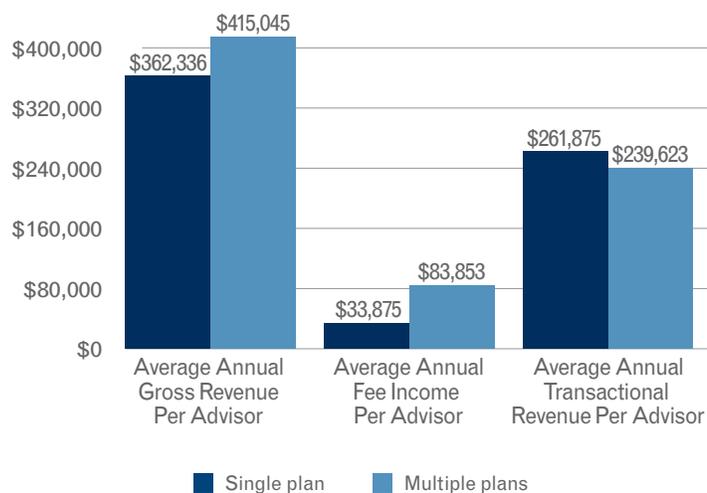
The firms with multiple advisor compensation plans perform quite well. Compared to firms that have a one-size-fits-all incentive plan, these firms' advisors have 15% higher average annual gross revenue, produce 148% more advisory business, and administer 19% more assets. This profile is consistent with a longer-tenured advisor who no longer needs to rely on referrals and prefers to manage assets for long-standing clients.

| | RJ – FID | INDUSTRY | MULTIPLE |
|----------------------|-----------|-----------|----------|
| Avg. FA Production | \$532,000 | \$300,600 | 1.7 x |
| Advisory Fee Revenue | 39% | 13% | 3.0 x |
| Recurring Revenue | 72% | 30% | 2.4 x |

INDUSTRY BENCHMARKS

*Kehrer Bielan TPM survey | BISRA Benchmarking study

Impact of Targeted Compensation Plans
on Advisor Productivity



WHAT THIS MEANS FOR YOUR BUSINESS

The compensation plan components studied may hold the key to improving profitability, increasing recurring revenue and improving advisor retention.

The research shows that compensation design is one way an investment program can impact profit margins. Optimizing lookbacks, grid levels and incentives provides a mechanism to expand margins while continuing to grow.

For institutions seeking more recurring revenue, specifically advisory revenue, providing special incentives and compensation plans tailored to individual advisor practices are effective tools. A focus on advisory business also appears to drive asset growth, which translates into higher revenue and broader margins over time. It is important to remain focused on the longer-term goal, however, as short-term results may be affected as advisors make the transition from transactional to fee-based income.

When it comes to attracting top advisors, we noted that the institutions with the most successful recruiting efforts pay on net, and largely work with third-party marketers. In addition to providing increased profit opportunities, the resources available at these broker/dealers are likely an attractive component of the recruiting proposition.

CONCLUSION

As this study shows, a well-designed compensation plan for advisors can make a crucial difference in revenue growth, recruitment and retention. The Raymond James Financial Institutions Division understands this because they've been serving banks and credit unions for the past 28 years. Raymond James offers innovation in recruiting, technology, fee-based business and marketing that can give your institution the power to transform your investment program.



To learn more about how our Financial Institutions Division can help you grow your revenue potential through a strategic compensation plan, visit us at RJFID.com or call 866.661.0215.

ABOUT THE RESEARCHERS

KENNETH KEHRER, PH.D.

Dr. Kehrer, a principal of Kehrer Bielan Research & Consulting, has been studying the transformation of banks and credit unions to financial services stores since the early 1980s. His research has influenced the metrics a generation of industry practitioners now use to assess their businesses and assimilate best industry practices.

Dr. Kehrer has also consulted for scores of banks and credit unions and over 100 product and service providers – insurers, investment companies, securities firms, technology providers, management consultants and marketing organizations – on the development of strategies for distribution through financial institutions. In 2004 he received the Lifetime Achievement Award from the Bank Insurance and Securities Association for his contribution to the industry. He earned a Ph.D. in economics from Yale University.

TIM KEHRER

Tim is a senior research analyst who contributes his extensive experience in the interpretation of survey data to KBR&C's robust research program. He was formerly a political operative who served on three winning campaigns for the U.S. Senate, most recently managing the largest research department of any Senate campaign in the country. Prior to that he worked for the independent expenditure arm of a national political party committee where he studied public opinion surveys and focus group research from across the country as part of the production and deployment of television and radio advertisements.

At KBR&C, he directs the annual benchmarking surveys of investment services in credit unions and bank broker/dealers, and the annual TPM Survey. He is co-author of *The Opportunity for Credit Unions in Investment and Life Insurance Services*.

ABOUT KEHRER BIELAN RESEARCH & CONSULTING

KBR&C provides the financial advice industry with insights based on a melding of research and experience in managing the delivery of investment, insurance and wealth management services. The firm provides performance assessment and benchmarking, human resource management and development, due diligence, consumer insights, and interrelation of industry trends through its original research, unbiased consulting and peer study groups.

Please visit us at www.KehrerBielan.com or email info@kehrerbielan.com for more information.

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APPENDIX: PARTICIPATING INSTITUTIONS

| | |
|---------------------------------|------------------------------|
| Affinity Federal Credit Union | Golden 1 Credit Union |
| Affinity Plus Credit Union | Hancock Bank |
| Arvest | Heartland Financial Services |
| Associated Bank | Huntington Bank |
| Bank of Oklahoma | Key Bank |
| Bank of the West | Lake Trust Credit Union |
| BankUnited | Langley Federal Credit Union |
| BB&T | M & T Bank |
| BBVA Compass | Merck Employees FCU |
| BMO Harris | Navy Federal Credit Union |
| CapitalOne | Patelco Credit Union |
| Citizens Equity First | People's United Bank |
| Clearview Federal Credit Union | PNC |
| Collins Community Credit Union | Popular Community Bank |
| Commerce Bank | Premier America Credit Union |
| CommunityAmerica | Red Canoe Credit Union |
| Country Club Bank | RTN Federal Credit Union |
| Elevations Credit Union | Sandia Labs Credit Union |
| Eli Lilly FCU | Santander Sovereign Bank |
| ESL Federal Credit Union | South State Bank |
| Fibre Federal Credit Union | Summit Credit Union |
| Fifth Third | SunTrust |
| First Bank (Missouri) | Synovus |
| First Citizens | TDECU |
| First Federal Bank (Louisiana) | U.S. Bancorp |
| First Midwest | UNFCU |
| First Niagara | Veridian Credit Union |
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