Best new compensation plans for advisers

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How should firms distribute, determine and design compensation packages for advisers and support staff?

Compensation makes up the single largest cost for RIAs, according Schwab's most-recent RIA Benchmarking Study, yet many firms do not have a well-defined incentive package in place to reward and retain talent.

Putting a plan in place may seem intimidating at first, three compensation experts who spoke at a *Financial Planning* webinar on best practices for structuring firm-wide compensation plans acknowledged.

But it can be done, they said, if owners focus on aligning compensation with measurable performance targets that contribute to the overall goals of the firm.

FORGET THE BENCHMARKS

Many advisory firms still take a bottoms-up approach by consulting benchmark data and paying employees whatever the market rate is, said John Furey, founder and principal of Advisor Growth Strategies, a Phoenix-based consulting firm that specializes in RIA management.

That strategy is not the most effective however, as benchmark reports only provide you with set compensation figures, but don't actually reveal how that number is constructed, Furey explained. As a result, their adaptability is limited, he said.

Instead, a better way to build incentive plans is via a top-down approach, Furey said. Start by defining what the firm is trying to achieve. Then, use that to establish specific targets for professionals such as advisers and senior management, and another set of targets for the support staff.

An industry leader's compensation approach

	Salary	Performance -based bonus	Origination fee	Service fee	Equity compensation
Administrative	✓	✓	✓		
Advisers	✓	✓	✓	✓	
Senior Adviser	✓	✓	✓	✓	✓
Key Operational Staff	✓	✓	✓		✓
Management	✓		✓		✓

Source: Bronfman E.F. Rothschild

"Manage it strategically rather than tactically," he advised.

There is no one-size-fits-all formula when it comes to compensation, Furey stressed. The incentives that will drive business growth at a measured pace, compared to maximizing returns for the owners or boosting the market value of a firm for potential sale, are all completely different, he declared.

MEASURABLE SUCCESS

Setting performance targets is tricky. Indeed, 56.8% of webinar participants, responding to a live poll, do not document measurable performance goals and 67% lack a defined career path for new recruits.

The absence of such components can be detrimental to a firm's success in attracting and keeping talent, said Grant Rawdin, founder and CEO of Wescott Financial Advisory Group, a Philadelphia-based RIA with $2 billion in AUM.

While compensation is obviously about money, it is also about job satisfaction, which comes from knowing where your career is going and how to get there, Rawdin said. "Lack of job satisfaction is the number one reason people leave," he added.

Losing staff, especially top-producing advisers, is a difficult and costly process. Not only does it drain the time of owners who are tasked with finding replacements, Rawdin said, the loss is also highly disruptive to firm culture and clients.

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- 6 Compensation Myths

INTERNAL BENCHMARKS ARE BETTER

Rawdin agreed with Furey that compensation structures should be based on internal factors rather than external metrics. Wescott employs what they call "adviser profitability analysis" to determine the margin each adviser is required to produce to earn a certain tier of compensation.

They do this by assigning revenue gained from every client to the adviser in charge of servicing that client, and then subtracting overhead as well as other support costs such as marketing from that revenue to arrive at a net profit figure.

“Treat advisers as independent business units,” Rawdin said. “Think about their contribution and how to enable them to do better.”

DEFINE A CAREER PATH

Wescott also has a career roadmap that shows how much experience and clients an adviser must have to earn a promotion, as well as the additional compensation that follows.

For example, a full-fledged financial adviser must have a CFP certification or be working towards an advanced degree, four years of experience at Wescott or equivalent, as well as 20 primary client relationships, 20 secondary relationships and 10 reviewer relationships. At this level, the adviser will earn X salary and Y% in bonuses.

Financial adviser compensation & career path

Title	Experience	Additional criteria	Compensation
Senior FA	8 years of Wescott experience, 5 years of FA exp w/JD, MBA or CPA, or 7 years FA exp.	40-50 primary client relationships and management responsibilities. Present subject matter expertise to clients/ prospective and professional community. New clients and new assets goals.	Base + Bonus (x-z%)
Principal/ Senior FA	Senior FA plus 2 years Wescott exp.	40-50 primary client relationships and management responsibilities. Present subject matter expertise to clients/prospective and professional community. New clients and new assets goals.	Base + Tier 1 Bonus (x-z%) or Tier 2 Bonus (Profit Sharing)

Source: Wescott Financial Advisory Group

To become a principal, an adviser would need an additional 10 years of experience and 20-to-30 more client relationships. Once the adviser reaches this milestone, he or she will be eligible for profit sharing in addition to a raised salary plus bonus.

"When someone comes in and they understand that there's a defined career path and what they have to achieve and how we as owners are going to participate, it's very helpful and increases job satisfaction," Rawdin said.

HAVE 'SKIN IN THE GAME'

In addition to conventional incentives like salary and bonus, Furey urged owners to consider equity compensation if the tradeoff is worth the rewards in the long run. He acknowledged that a lot of owners are hesitant to do so because they don't want to share economics about the firm or dilute their ownership.

Indeed, 64% of webinar participants do not currently offer equity compensation. However, 94% said they think it's important for employees to have "skin in the game."

Activating key professionals through equity is important because it provides a retention effect Furey said. If the equity distribution is minor, he added, it won't impact the firm's bottom line that much.

Neal Simon, chief executive of Bronfman E.L. Rothschild, agreed. After selling his previous firm, Highline Wealth Management, last year, he now oversees 75 employees, including 31 advisers.

ADVANTAGES OF PROFIT SHARING

At each stage of major business development for his firms, Simon used some form of profit-sharing to incentivize key partners and employees. In 2010, he distributed phantom equity to three top advisers, which allowed them to directly benefit from current cash flow and gain a tangible sense of ownership in the firm.

Simon has also issued equity appreciation rights, options, restricted LP units and LLC units, all of which have their individual pros and cons, but were effective nevertheless in giving top employees a vested interest in seeing the firm perform well.

Conversely, the outright grant of real equity and company-financed equity purchases are compensations Simon does not believe in. According to him, they tend to be less valued by employees and are tax inefficient.

Simon added that if owners oversimplify compensation structures, then they have to be willing to live with the result. Rewarding employees on percent of revenue or assets alone will inevitably lead to a heavy sales culture, he explained. On the other hand, introducing equity or profit sharing will encourage people to grow the firm as a whole.

“Try to combine the best of both worlds,” he said.