The great compensation shift: From solo stars to team players

by Charles Paikert for Financial Planning

Anne Marie Stonich knew she had to make a change.

After five years at Brighton Jones, a large Seattle RIA, Stonich and two colleagues at the firm wanted to run a business their own way.

"We felt we could play an even bigger role in our clients' lives, and have more control of our own," she says.

In 2004, Stonich, Josh Harris and EJ Brink founded Paracle, their own RIA in Mercer Island, a suburb of Seattle.

Stonich was thrilled: An avid cyclist, she was able to ride her bike to work from her home in Seattle, cultivate up-and-coming local tech execs from Microsoft and Amazon, and offer them customized financial plans.

At first, the firm's compensation strategy mirrored the industry standard, which was derived from the wirehouse model: After sharing baseline expenses, payout was then tied to how much revenue each partner brought in and managed.

The RIA compensation model is shifting from solo stars to a team-oriented approach.

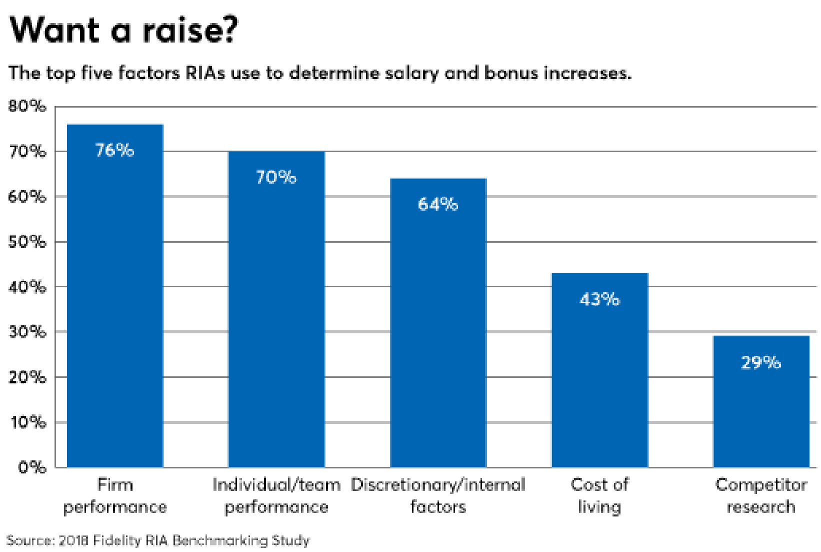
But after about five years, the Paracle partners realized they needed to change their compensation model.

"As we added clients and staff, we realized we did not want to be incentivized to just manage clients ourselves," Stonich says. "We wanted to be incentivized to work with the team we were building."

The partners started to pay themselves a salary, and paid Paracle advisors variable compensation based on the amount of revenue they managed. But after another five years, the Paracle partners realized this payout structure wasn't matching their firm-oriented service model.

Individual advisors had been incentivized to take on and serve new clients. But as the firm grew, it shifted to a collaborative model: Every client is now assigned a partner, advisor, associate advisor and administrator.

Salary is based on years of experience, expectations for their role and industry-wide compensation surveys.



Employees now participate in a profit-sharing plan that includes cash payments. Anyone with a Series 65 who introduces a new client to the firm receives 50% of the client's first-year fees. There are also surprise spot bonuses for work the partners consider to exceed the employee's job description, such as making an extra effort to help a client, or improving one of the firm's business operations.

For example, two administrative staffers were given a spot bonus last year for working closely with the architect the firm hired for an office expansion and remodel project. And an advisor was awarded a spot bonus for overseeing the build-out of a new business segment for Paracle.

"It's very much a team-based environment, not a solo one," Stonich says. "It's a big departure from the historical model that most of us were used to."

This shift is gathering steam among the industry's most innovative firms, say industry experts. The eat-what-you-kill compensation model prevalent at brokerage firms and some RIAs is being replaced by a more harmonious one-for-all-and-all-for-one approach.

Over three-quarters of advisory firms surveyed by Fidelity's 2018 RIA Benchmarking Study now take firm performance into consideration when determining salary and bonus increases. 2018 was the first year the Fidelity study began to ask questions about how compensation is structured.

Paracle managing director Anne Marie Stonich rides from her home in Seattle to the firm's offices on Mercer Island.

"Firm performance is becoming increasingly important as a compensation factor," says Anand Sekhar, vice president of practice management and consulting at Fidelity Investments. "We're seeing a strong alignment between individual accountability and a firm's vision and strategy."

John Furey, an industry consultant who specializes in compensation plans for RIAs, agrees.

Around 10% of RIAs still work off a payout grid model where what you bring in is what you earn, a drop of approximately 5% from five years ago, according to Furey, who is principal of Advisor Growth Strategies in Phoenix.

"While the old model does link professional competence to revenue, it doesn't promote teamwork or client service, and that's what firms are increasingly emphasizing," Furey says.

Indeed, Cable Hill Partners in Portland, Oregon, has developed a compensation plan around building what it calls an "ensemble" firm, says David Christian, a managing director at the firm.

Founded three years ago after Christian, Brian Hefele and Jeffrey Krum left Merrill Lynch, Cable Hill wanted to move away from the previous model of simply rewarding top revenue performers.

“Our motto was, ‘If it reeks like a silo, get rid of it,’ ” Christian says.

Compensation at Cable Hill is determined by a base salary and bonus that is usually up to 25% of the salary.

A large percentage of that bonus is determined by factors that are emblematic of another industry trend — a move away from basing compensation on hard-number metrics such as percentage of net new assets and increasingly incorporating softer components based on actions such as client outreach.

“Around 70% of our bonus is behavior related,” Christian says. “We look at five firm values: collaboration, family, excellence, integrity and education. The other 30% is based on client retention and the employees’ professional and technical growth.

“For example,” he adds, “how well they learn our planning software, or how well they are able to prepare and present to the client.”

Compensation at Cable Hill is built around the client experience, Christian says. Accordingly, staffers are rated from one to five on goals such as engagement, teamwork and successful communication.

“We want clients bonded with the team and not the person,” Christian says. “Everybody wins because the more trust clients have in the team, the more growth we see.”

Another RIA that is moving away from hard metric numbers is Verdence Capital Advisors in suburban Baltimore.

“We don’t like tying bonuses to fee numbers,” says Leo Kelly, Verdence’s CEO. “Bonuses should incent behavior that makes the business better, not just bigger.”

Bonuses are determined by ongoing feedback about client satisfaction. And performance regarding contact frequency, quality and execution of tasks is tracked through the CRM technology.

Everyone receives performance reviews, even partners, Kelly says. For example, a director of strategy will be evaluated on performance of their portfolio models, but also design, implementation on ongoing maintenance and monitoring of the portfolios.

While technical components are easily measured in performance reviews, the most important qualitative factor is, ‘Are you enhancing our culture?’ according to Kelly.

“If employees can answer yes, then clients, partners and associates’ experiences are all enhanced by their work,” Kelly says. “Home run!”

At Paracle, each team member assigned to a client household is evaluated on key performance indicators to help determine salary increases, profit participation and bonuses.

When managing client relationships, for example, advisors are expected to retain at least 97% of those relationships and proactively contact all clients at least twice a year, “with little or no agenda,” Stonich says.

Advisors are also expected to help build the firm’s brand by sourcing two to five new clients each year, and “meet or exceed expectations” for criteria including monthly client referral activities and getting in touch with attorneys, accountants and other influential professionals in the community, Stonich says.

Setting these goals drives “the best service possible,” which in turn generates internal growth “that everyone benefits from,” according to Stonich.

In Indianapolis, Valeo Financial Advisors has crafted an incentive-only variation on the traditional compensation model.

Advisors hired out of college are given a base salary and work with senior wealth managers servicing clients. But after several years, they are phased into Valeo’s unusual payment structure.

All money Valeo pays out is based on two metrics: Advisors are paid 30% of fees generated by a client for life if they service that client, and 30% of every fee dollar if they originated the client’s relationship with the firm.

The pot is sweetened because clients are billed on their net worth, not investable assets.

“We found that advisors were tired of salary and bonus,” says Gregory Fulk, Valeo’s chief operating officer. “They were willing to take a brief step back [in pay] so they can control their income.”

Advisors are limited to 40 clients, so senior advisors will transfer servicing clients to junior employees when they reach their limit.

“This model is really like a little annuity,” Fulk says. “But it’s only as good as the service the client receives, so everyone is incented to do well, and the firm grows as word spreads.” Indeed, being able to retain — and attract — advisors in a market where demand far exceeds supply is making compensation structure more critical than ever for RIAs.

“Talent is the thing [driving compensation],” says Lisa Salvi, vice president, business consulting and education, for Schwab Advisor Services.

“Nearly three-quarters of the firms we surveyed for our RIA Benchmarking study are trying to hire,” Salvi says. “They are structuring their incentive compensation to appeal to the available talent pool and to link with the firm’s strategic goals.”

Salaries for advisors increased 4% in 2017 from the previous year, and bonuses increased 10% for the same period, according to Fidelity’s study.

For wealth managers who can close deals with high-net-worth clients, total cash compensation has increased by around 20%, industry consultant Ken Hoffman, president of consultancy for Optima Group, estimates.

“It’s a very competitive market, and firms are spending to get top talent,” Hoffman says. “We’ve seen guarantees extending up to two years after recruitment for both base salary and bonuses.”

RIAs are increasingly targeting relationship managers they can “bond to the firm,” versus a lone wolf salesperson who will move on the next best offer, Hoffman says.

But he adds that tying compensation to individual sales and revenue metrics remains a staple strategy for many firms.

“Everyone is looking for advisors who can bring over assets and generate new business,” says Louis Diamond, executive vice president for Diamond Consultants. “These advisors are used to a generous payout of the revenue they’ve generated, and they expect to do much better in negotiating their next compensation package.”

In fact, nearly one-quarter of firms surveyed by Fidelity said they used both revenue and individual performance goals as factors when structuring incentive compensation for advisors who were not owners.

Still, firm performance was cited by a slightly larger percentage of RIAs as a criterion for incentive comp.

And that trend should continue, says Fidelity’s Sekhar.

“Incentive goals that are leading indicators of future performance, such as how many meetings with prospects and clients have been set up, are being increasingly emphasized,” Sekhar says. “More firms are thinking about the business looking ahead on the dashboard, not in the rearview mirror.”