Is "What's Good for the Goose, Good for the Gander"?

By Peter E. Ruhlin

Introduction

It is welcome news that wealth management businesses continue to prosper and grow in the current market environment. As many businesses step back and remember when things were not so good in 2008 and look at their business models, a number of questions and issues come in to play, such as: "How are we growing?"; "Is our growth sustainable?"; "Should we be thinking about what products and services we offer?"; "What is the right mix of products and services and should we consider changing them?"; "Do we have the right business model given the changing wealth management environment and our client base, both current and prospective?"; and "Where are we in the life cycle of the business, and do we have a transition plan?"

As an owner and/or manager of a wealth management business, one has to consider all of the above in the context of several constituencies. First and foremost, what is best for the client? Without clients, the business would not exist. Second, what is best for the advisor? In many cases, the advisor, whether an employee or an owner of the business, is the principal and only contact with clients and a key participant in whether the business/ strategy is successful or not. Finally, what is best for the firm? Without the firm, and its infrastructure and product and services platform, an advisor might be unable to attract and retain clients.

Importantly, what is best for one of these core constituencies may not be best for one or more of the others. For example, most clients would relish the opportunity to see their fees lowered, whether they are advisory or transactional or both. Most firms will likely view the reduction in fees as a reduction in revenue. In reality, modifying fee structures may be a win-win situation for both the clients and their firms. It is important that the owner and/or manager of a wealth management business balance the needs of each of these constituencies, even if it gives a slight advantage to one over another for all constituencies to benefit in the long run.

The Client's Perspective

At the heart of every wealth management business are the clients. Clients come in all shapes and sizes, each with their own individual needs and preferences. Some clients may have components of their needs that are better served by being charged a fee based upon their assets under management, with other portions of their needs that might be better served by being charged a transaction fee. It is important not to confuse a marketing pitch with what is right for the client. An advisory fee-only strategy is a convenient way for an advisor to tell a client that the advisor is aligning his or her interests with the client's; however, many tools that are being deployed to meet client needs today do not fit easily into an advisory fee structure.

For instance, does it make sense to charge a client a 20-30 basis point advisory fee for a laddered municipal portfolio that yields 2%? An annual fee that equates to 10% or more of the clients annual income seems high. What about charging an annual advisory fee for an investment into a private equity fund with a seven-year (or longer) investment horizon, where the advisor has no ability to influence the investment beyond the initial decision to invest? What is best for the client is a fiduciary mindset. While advisory fee-only models require advisors to adhere to a fiduciary standard, good wealth management practices/businesses will always behave in their client's best interest, regardless of the regulatory requirements or compensation structure they operate under.

The Advisor's Perspective

As advisors evaluate their day-to-day business and what is best for them, they also face compelling, if not competing, issues. Advisors are constantly attempting to scale their processes for servicing their clients. Some advisors have chosen a selection of products and services that they apply to all of their clients. Others focus on specific client segments where they have become expert on the needs of that specific segment and repeatedly use a defined set of tools. Both strategies have merit.

Advisors who have focused exclusively on an advisory fee-only approach might be limiting their ability to service their clients. Having the ability to work with clients on both an advisory fee and a commission basis provides the independent hybrid advisor with a tool kit that responds to what most clients are seeking from advisors. For years, many independent advisors trumpeted their "open architecture" fee-only advisory platforms and the lack of conflict the platforms provide them. These advisory fee-only platforms, however, may actually limit an advisor's ability to adequately assist clients due to a narrower set of investment solutions and products. Having a hybrid capability for many independent advisors is simply pragmatic, as it provides advisors with more options to ably serve their clients.

Clients come in all shapes and sizes. Offering clients an advisory fee-only structure potentially forces the clients into solutions that maybe less than optimal. We believe that advisors can remain disciplined while simultaneously expanding the universe of potential clients by adapting a more flexible approach to how clients pay for their advice. A fiduciary mindset will guide the advisor in a direction that helps navigate the potential conflicts and protects your client's best interest, regardless of how the advisor charges for the advice.

The Firm's Perspective

Wealth management businesses face many of the same challenges that advisors do. How does the firm balance what is right for the client with maximizing revenues and profits for the firm? Firm profitability is important, but profits almost always follow good client experiences. Relentlessly focusing on what is in the client's best interest will always guide a wealth management firm towards a sustainable business model. While firms often feel a gravitational pull towards maximizing revenues that accrue from fees, firms need to adapt to pricing structures that may complicate their revenue strategy for the long-term benefit of their clients. Firms will benefit from being able to offer more services to their target market while simultaneously expanding the pool of prospective clients.

Historically, the advisory fee-only model appeared a solid alternative to the commission-based option. However, the advisory fee-only model is sometimes misrepresented as the sole driver of what is best for the client. The hybrid model, in our view, should really be a portfolio of client-centric features containing more than the ability to capture both fee and commission business. It must also consider other core components of a strong business model, including: (1) a focus on client segmentation –

i.e., which types of similar clients the business can best service; (2) implementation of organic and inorganic growth strategies; (3) leveraging integrated technology and human resources; and (4) providing a differentiating value proposition to its clients.

Final Thoughts

The convergence of the independent advisor and broker-dealer industries is not happening seamlessly. Different regulators[1] and different advisor standards, along with a dual revenue structure, will continue to bring challenges to hybrid firms. Compliance and regulatory oversight are at the top of the list. A dually registered advisor[2] has two choices: establish their own broker-dealer, or align with a third-party, introducing broker-dealer. The broker-dealer will have supervisory oversight over the dually registered advisor's advisory business as well as its own brokerage business. For some this will be a compliance benefit, and for others a source of frustration. In addition, there are operating and infrastructure costs involved which need to be evaluated when considering the benefits of a hybrid model. What model is right for your wealth management practice?

A wealth management business that focuses on clients as a priority, offers a hybrid platform, with attention to appropriate services and products, and priced accordingly, will continue to grow and increase its enterprise value more quickly than businesses that utilize a fee-only approach. For firms and advisors, and their clients, it is equally advantageous and can present a "win-win" situation.

At FallLine, we believe "what is good for the goose can be good for the gander" and that the end-game winners in wealth management will be firms that fully understand and focus on providing a portfolio of client-centric features like servicing specific client segments, applying models that capitalize on delivering both services and value to their clients, and use integrated technology to scale and leverage their business. The hybrid platform for many businesses and advisors (and their clients) fits the bill.

FallLine Securities, an industry innovator, launched the first wealth management platform designed exclusively for elite Private Wealth Advisors and their ultra-high net worth clients. FallLine is the only UHNW-focused firm that combines a broker-dealer, a turnkey technology/services platform, comprehensive transition services and a network made up exclusively of other successful Private Wealth Advisors. FallLine provides entrepreneurial Private Wealth Advisors with the only clear, unified path to their own hybrid RIA and significant wealth creation opportunities. For more information regarding our market views and services, please contact us or visit us at www.falllinesec.com.

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1. The Securities and Exchange Commission, or the applicable state regulatory authority, regulates RIAs and the Financial Industry Regulatory Authority (FINRA) primarily regulates broker-dealers.

2. Generally, dually registered wealth advisors are affiliated with a broker-dealer and maintain a registered investment advisor (RIA) registration separate from their broker-dealer. Advisors operating under a corporate RIA as an investment advisor representative (IAR) would fall outside the definition of a dually registered advisor