The Why and How of Switching to a Fee-based Practice

A BETTER BUSINESS MODEL FOR TODAY’S MARKET AND YOUR FUTURE

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Chances are you've thought about changing to a fee-based practice before

You may have noticed how today's environment of increasing regulatory scrutiny has placed downward pressure on commissions. Or, maybe you have colleagues who are fee-based, and you've wondered how life would be different with a steady stream of fee income and more certainty. The good news is, there's never been a better time to make the switch. As the chart below shows, investors are more willing to pay for advice now than at any time since the 2008 financial crisis.

The trend is toward advice-based relationships

With the expectation of a dip in 2015, investors' willingness to pay for advice has been on an upswing since 2009.

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Analyst Note: Investors were asked whether they agreed with the statement, “I am willing to pay for advice regarding my financial investments.”
Sources: Phoenix Marketing International, Cerulli Associates; The Cerulli Edge, January 2017, Issue #233

Recently, it has become increasingly clear that a fiduciary approach may be far better suited to today’s investment climate. Since the financial crisis, many areas of investing have become increasingly uncertain. Markets that seem stable one week become highly volatile the next. All evidence supports the view that a “new normal” now exists—one that includes a heightened sensitivity to economic indicators and, as a result, markets that react strongly to the financial headlines of the day.

In this new reality, investors want an advisor that acts in their best interest—a fiduciary—someone who can help them find answers to the where, when and how of investing; someone who can help them find security in an increasingly uncertain world; and most importantly, someone who can help them achieve their financial goals. It’s clear that a commissions-based approach doesn’t provide the structure to support clients in this more holistic way.

In addition to being right for the times, building a fee-based practice is essential to your ability to differentiate yourself from the competition. Investors are reconsidering not only the products in which they are invested, but also the advisors who provide those products. Many are still considering whether their advisors have what it takes to help them maximize their financial potential. The most effective way to tap into this present mood is by showing that you can be the financial consultant.

So, what does being a fiduciary involve? For starters, placing yourself squarely on the client’s side. Perhaps the most important aspect of a fee-based approach is that your success is tied directly to that of your clients. Your willingness to “take a hit” when your clients’ asset levels decline, helps firmly establish your credibility and deepen your relationships. Scott McMillan, a Houston-based advisor, switched to fee-based in 2010. When asked why he made the change, Scott explains:

“It’s a much better fit to have me sitting on the same side of the table as my clients. Now my clients know that if I suggest a change to their portfolio, it’s in their best interest. It’s an easier conversation to have with prospects, too, that you make more when their balance goes up, and less when it goes down.”
“Because the most obvious basis for conflicts of interest is diminished, and because you will have taken on the role of a higher-level advisor, a fee-based approach provides a greater opportunity to expand the scope of your services. Deeper relationships result in higher levels of satisfaction, which can potentially enable you to uncover assets that are held elsewhere and increase your number of referrals. In short, a fee-based structure provides an opportunity for greater wallet share and increased referrals—two things advisors constantly strive to achieve.”

Chris Young, an advisor based in south Texas, has experienced a dramatic increase in assets under management since switching to a fee-based structure. Chris explains, “When I sit down with clients to develop a portfolio, I tell them I want to make sure the portfolio I’m developing doesn’t overlap with other investments they may have. So I ask my clients to give me a full picture. As their trust in me has grown, I’ve been able to uncover significant assets that my clients have asked me to manage.”

Chris adds, “My clients are now starting to see me more as a go-to person for everything financial, asking questions like whether they should buy or lease a car, what type of insurance to buy, will I come with them to see their CPA. As these issues come up, they result in more business opportunities and enable me to expand my network with my clients and their other professionals.”

As you consider the path you want to take, it’s important to remember that a fee-based structure can help ensure a more predictable future for you and your family. If you stay with commissions, there’s a chance you’ll be working just as hard 20 years from now as you do today. By shifting to fee-based, you establish an annuity stream of fee income, helping to make your future more certain. The chart below shows how switching to a fee-based structure can help generate ample income over time. Keep in mind, too, that a fee-based book of business can potentially become a valuable nest egg, making your practice more attractive to prospective buyers when you are ready to retire.

“Before switching to fee-based, I woke up on January 1 of every year not knowing where my income was going to come from. I had to figure it out throughout the year,” says Chris. “Now, at the start of every year, I have a sense of the amount of fee-based income I’m going to have coming in. That’s an amazing feeling. It frees me to focus on other things.”

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**Why convert? Potential for increased revenue**

By converting your existing clients to fee-based, you can significantly increase revenue.

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**Example:**

A $25 million book of business is converted to fee-based at a rate of $5 million per year

- Revenue from Trails
- Revenue from Advisor Fee

Assumes 25 bps on trail and 100 bps on advisory business converting $5 million per year with no market impact
The potential benefits of a fee-based structure are clear, but how do you begin the process of converting your practice? Below, we touch on the basic steps that will guide you through the transition.

The Mindset Transition

**Step 1 | Evaluate your business**

The Mindset Transition involves reframing how you see yourself as an advisor. This is the perfect time to ask yourself:

›› What types of clients do I most enjoy working with?
›› Which aspects of my business do I most enjoy?
›› Which do I enjoy least?
›› How many clients do I want to serve and how much staff will I need to support them?

Now is the time to think big about what you want your life and business to look like.

**Step 2 | Determine your value proposition**

Next, you will want to think through your value proposition, which answers the question, “Why would someone in my target market (e.g., HNW, small business owners) choose me over one of my competitors?”

The value proposition identifies a need and provides a solution—a promise of what you will do for your client. Consider:

›› Why have your clients hired you?
›› How do they perceive you, and how do you want to be perceived?
›› If there is a difference between the two, how can you bridge that gap?

Remember that becoming a fee-based advisor is all about being seen as a problem solver, a consultant and a source of sound advice.

When Chris decided he wanted to focus more on developing client relationships and less on managing his clients’ investments, he reached out to us. “I knew there were people who are much better than I am at managing assets, like SEI. They have dedicated experts watching their investments. I only had an hour and a half to spend on investments each day, which wasn’t fair to my clients.”

As a commission-based advisor, you are viewed as a:

Stock, fund or manager picker
Product provider
Salesperson
Presenter

As a fee-based advisor, you are viewed as a:

Big-picture planner
Problem solver
Consultant and advisor
Listener
**Step 3 | Choose a platform**

Take a moment to consider how you like to spend your time. If you enjoy a hands-on approach where you select fund managers, determine asset allocations, rebalance portfolios, handle fee calculations and create statements, you will want to choose a “do-it-yourself” platform.

On the other hand, advisors who prefer to focus their efforts on developing new client relationships and strengthening existing ones may choose to partner with a **third-party asset manager (TPAM)**.

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**The Business Transition**

**Step 4 | Map out your goals**

After you have decided which platform makes the most sense for you—given how you want to spend your time—you will want to think through the business side of the transition. Begin by considering:

- How long the transition is likely to take
- Which clients you’re willing to let go of
- Which clients you can transfer to a more junior colleague
- How the transition will likely affect your short- and long-term cash flows
- How much in assets under management you would like to have
- What level of account minimum makes sense for your business

Be sure to find out how your platform partner can support you throughout the process.

**Step 5 | Develop business plan to meet goals**

Once you have a better understanding of where you are currently positioned and where you want to go, you can start thinking through the details of how you will manage a fee-based business. It’s important to be realistic about the number of fee-based clients you can serve. Remember that fee-based is a full-service approach, so ask yourself:

- Will additional staff be needed to serve your clients?
- Can a junior partner take on more of your smaller accounts?

*It’s important to be realistic about the number of fee-based clients you can serve.*
The Relationship Transition

**Step 6 | Segment your clients**

When it’s time to start the conversation with clients, begin by putting all of your accounts worth $50,000 or more onto a spreadsheet. Include the value of each account, whether funds are taxable or nontaxable, and the products in which each client is invested. Using this spreadsheet, segment your clients into the following four categories according to the level of involvement they typically require in the investment process:

- **Outsourcer**
  - Has total faith in your decisions
  - Will agree to any recommendations

These clients should be targeted first for transition so you can perfect your presentation.

- **Semi-outsourcer**
  - Believes in your decisions
  - Will agree to most recommendations
  - Will typically require more information

These clients should be targeted second for transition, when you are more comfortable with the process.

- **Analytical**
  - Is more critical and will need to be convinced of the benefits of transitioning
  - Will want to see the empirical findings that will validate your recommendations

These clients should be targeted third for transition as you will need to use additional tools to compare your existing structure with the new fee-based structure.

- **Highly analytical**
  - Is highly sophisticated and analytical
  - May require a joint presentation with a representative from your platform partner

These clients should be targeted last for transition as they will probably be the most time- and resource-consuming.

Be prepared to speak confidently about your conviction that switching to a fee-based structure will help you serve your client better.
Step 7 | Plan your communications process

Be prepared to speak confidently about your conviction that switching to a fee-based structure will help you serve your client better. The following are some ways you might want to frame the change:

›› With a fee-based structure, my success is linked directly to yours. This dynamic affirms a key aspect of our relationship that has always been in place: I am on your side, and your financial success is my top priority.

›› Today’s financial markets are volatile, calling for greater diligence and oftentimes more frequent changes to portfolio strategy. A fee-based structure gives me the flexibility to respond to critical market changes without added costs to you from trading activity.

›› I’m moving my clients up to a better way of doing things. While commissions are focused on specific financial products, a fee-based approach stresses a broader, more important goal of ensuring that your whole financial picture is in good shape.

›› I’d like to recommend a new, better way. Ask your client which type of food is their favorite. They may respond, “Italian,” or something similar. Let’s say you then recommend an Italian restaurant that has great food, good service and terrific ambiance, all at a great price. When that client goes to the restaurant and has a great experience, they’ll probably think the world of you since your recommendation turned out so well. Well, let’s say you go back to that person a year or two down the road and tell them that you have good news for them, that you have an even better Italian restaurant for them to try out. The food, service and ambiance are even better, and it all comes at a better cost. What will that client think of you? They already think highly of you and view you as their trusted advisor. So, simply, they’re going to say, “Yes.”

When Chris began to speak to his clients about making the change to fee-based, he used this approach: “I broke it down logically for them, asking, ‘How often do you think a change should be made to your portfolio?’ The overwhelming answer was at least once a year. I said, ‘Well, I agree. This new way will allow us to do that without incurring extra costs. Not only can we rebalance once a year, we can do it four times a year to make sure your investments stay in line with your goals.’”

By the way, if you haven’t spoken to your clients about their financial goals, now would certainly be a good time.

Don’t make assumptions: Ask the question and then be ready to listen. Assure them that you will be providing:

›› A full understanding of their goals for themselves, their families and their community
›› A continuous balancing of their wealth management toward those life goals
›› Identification of their specific investment objectives and their risk tolerance for each one
›› A highly personalized, professional experience

Step 8 | Execute the transition

Now that you’ve thought through the details of how you will run your fee-based business, it’s time to develop an implementation timeline that will move you from your initial conversations with your Outsourcer clients all the way through to your Highly Analytical ones.

As you prepare to get started, you’ll want to create a marketing activity calendar, planning when to hold meetings and events, and when to send letters and make phone calls. You’ll also want to build upon the master Excel spreadsheet you started in step 6 of all your accounts over $50,000. The spreadsheet would show each client’s:

›› Client category (Outsourcer, Analytical, etc.)
›› Type of implementation (mutual funds, separate accounts, tax-managed)
›› Target dates for executing the transition, as well as any other process steps along the way

Remember to have all paperwork necessary to complete the transition filled out ahead of time so that it’s ready for a signature at the end of your meeting.

Once a client has signed on, you will need to determine how to redeploy their assets into a fee-based platform. The size of their holdings will likely determine whether you will place them in mutual funds or separate accounts. Talk to your platform partner to find out how they can assist you with this.

As you begin speaking with clients, think through where it makes sense to direct your energy and time. “There were two or three clients who I decided to redirect elsewhere,” explains Chris. “It just came out in the transition process how combative they were. I told them, ‘This is the direction I’m taking my business. Given that you prefer a commissions environment, I think you’d be better served by a traditional broker.’ They were understanding about it.”
We Can Help

Throughout this article, we have mentioned the importance of choosing a platform partner who is willing and able to support you through your transition. We have a proven process in place to help advisors like you transition to a fee-based structure. As you research potential partners, we think you will find that we stand alone in our dedication and ability to help you achieve your goals.

From the start, we assign you a dedicated business transition team that can help you through each step of the conversion process. This team of specialists will help you develop your Fiduciary Action Plan, audit and segment your client base, and provide all account transfer paperwork. In addition, you will have access to well-crafted, customized communications that take the guesswork out of what to say to your clients. Our client-approved letters and scripted PowerPoint presentations make it easy to explain how a switch to a fee-based structure will help you serve your clients better. Your dedicated SEI team can help with investment policy statements and expanding the range of services you provide to your clients. For group meetings or presentations to more challenging clients, your SEI practice consultant can come along to help get your message across.

While transitioning to a fee-based platform is a hurdle that will require added diligence and patience in the short run, it’s important to keep your eye on the goal. Remember that a fee-based business will bring you:

- The chance to change from a product salesperson to your clients’ financial consultant
- Deeper client relationships that result in the potential for greater wallet share and increased referrals
- Fee income that can help you build a more predictable future for your family
- The potential for a more salable business as you head into retirement

To learn more, contact us at 888-734-2679 or visit seic.com/advisors