an increased emphasis on cost containment.” The BCG report concludes with the following:

Pay and Performance were not always fully aligned, but compensation ratios (measured by employee compensation as a percentage of revenues) appeared to be stabilizing at around 40% ... the trend is toward rising back-office costs and declining front-office costs ... with many managers coping through striving for greater frontline efficiency ... many RM's [relationship managers] manage larger books ... revenue per RM has increased.

In other words: client-facing professionals are working harder, and when not formulaic, their compensation is not rising as fast as their increased workload. As a result, we must conclude that formulaic incentive compensation is critical in the current environment.

Growth of Private Wealth

The second trend that has resulted in a profound change in the wealth-management climate is the enormous growth of private wealth since the crash.

According to Cap Gemini's 2014 World Wealth Report, compensation is not rising as fast as the 17.7-percent growth of high-net-worth (HNW) assets.

The number of HNW individuals in the United States has grown to 4 million. With the U.S. population at 320 million, this means that the one-percenters are now the one-and-a-quarter-percenters.

To put this in perspective, in a similar speech I delivered to the American Bankers Association...
The hardest-hit and most-troubled members of the wealth-management community will be brokers, for Cerulli Associates also points out that "more than half of the advisor population is within fifteen years of expected retirement; 43% of advisors are over 55, the average age of all the advisors is 51 ..." and "... a significant percentage of older advisors are their firms' highest performers" (Cerulli Associates Advisor Metrics 2013).

When examining how these aging high-performers are paid, if we average the production grids of the top five wirehouses, we see that a producer of $3 million or more will earn 45 percent on regular business and 48 percent on wrap products—on a recurring basis, with additional kickers for new revenue (called net new money).

These people are used to significant sign-on bonuses when they move. Bonuses paid as employee forgivable loans (EFLs) are based on the past 12 months of the broker's total revenues—the "trailing twelve" or T-12. A large portion of the bonus is paid up-front, with success-triggered back-end components that yield up to 325 percent of T-12; or $3,250,000 for each million dollars of production. These EFLs typically amortize over a nine-year period, and the FA or hiring company would be obligated to repay the unamortized portion.

Yet if one wishes to hire a top FA, a further wrinkle makes matters even more restrictive. After decades of costly litigation, the large wirehouses created "The Protocol," which allows portability of clients among participants of this Wall Street Geneva Convention. FAs are obligated to sign nonsolicitation agreements in the event they are recruited by non-protocol firms, and they are prohibited from soliciting clients for a period of one year. Although participants in The Protocol now include non-wirehouses and even some registered investment advisors, I am amazed at how few firms seem to even be aware of its existence or its dire ramifications.

So, in answer to the American Bankers Association request that I construct a compensation plan capable of recruiting from wirehouses, the following list contains the reasons why I feel such a move might be unwise:

1. Wirehouse brokers are highly paid professionals; they are so highly paid that their firms pay them 45 percent of revenue annually and these firms do not break even until after year nine of their employment.
2. Wirehouse brokers probably have less than 10 years left to work in the field.
3. A wirehouse broker who is ready to move probably has not attracted significant new assets in a very long time.
4. Wirehouse brokers come from a legacy of transactional business.
5. Wirehouse brokers probably are not comfortable with holistic wealth management.
6. Wirehouse brokers are used to receiving enormous sign-on bonuses to leave (more than 300 percent of T-12).
7. Wirehouse brokers are restricted on portability of assets when they move to non-protocol firms.

In conclusion, therefore we do not want to construct a compensation plan that competes with wirehouses as they are currently conducting business.

We need to construct a compensation plan that attracts top producers from all peer groups of wealth management, including wirehouses, based on the way they will conduct business in the next five years.

Future Compensation Models

So let’s consider future wirehouse models. As the brokerage community continues to age, wirehouses will be forced to find ways to retain assets/clients. The most likely scenario will be that retiring brokers sell their books to their firms and fade away, and young brokers will be assigned these books with compensation models resembling private banks. Banking, trusts and estates, and planning will be more integrated into their brokerage offerings.

Wirehouses of the future will begin to resemble major money centers and regional banks, and their compensation models will morph into those used in banks.

There is much to be said for improving the compensation models currently used among all peer groups of wealth management,
without skewing them in a way to attract brokers.

For discussion purposes, let’s divide the remaining members of the wealth-management community into the following peer groups: international money centers, regional banks, trust companies/asset management companies, and registered investment advisors/multi-family officers.

As a general rule, during the past decade virtually all international money centers have migrated from partially formulaic bonuses to purely discretionary bonuses for private bankers. As a result, international money centers have been forced to pay ever-increasing base pay (in some cases exceeding $350,000) and to offer one- and sometimes two-year minimum guarantees. This is the worst form of incentive, and it yields the predictable responses of uncertainty and ultimately attrition. We witness this in the almost daily game of musical chairs among money-center bankers. I call this type of compensation “A Night at the Oscars” because just like at the annual Academy Awards, winners and losers learn their fates when the envelope is opened, and only a few have reason to thank the academy.

On the other hand, most regional banks, trust companies, and asset-management companies use formulaic incentives to reward revenue-producers. Almost all regional banks and trust companies still use the business development officer (BDO) model, in which the BDO garners new-client assets and hands them over to a team. The top-tier formulaic incentives for these professionals often exceed 50 percent of first-year revenues.

There has been a movement among a number of super-regional banks to eliminate the pure BDO and increase the sales responsibilities of relationship managers. In about half of these cases the incentive has become formulaic. Although it does not top out at more than 50 percent of revenues as do many BDO models, it does offer a transparent link between success and reward, which is essential in today’s challenging environment.

Three super-regionals have adopted trailers for revenue-producing relationship managers, which I believe is the single most innovative and motivating trend we have seen since the crash.

The final peer groups to address are the registered investment advisors (RIAs)/multi-family offices (MFOs). There are more than 20,000 RIAs and fewer than 100 MFOs, and the only thing they have in common from a compensation standpoint is their extreme diversity.

If there are any major trends among this group, they would include the use of equity to augment cash compensation; however, in the frequent absence of a clearly articulated monetization strategy, the perceived value of this illiquid asset soon fades. Only one firm focusing on rolling-up RIAs has created a mechanism in which partners may borrow against their ownership shares, or sell them back to the company using a predetermined metric. In this case the equity becomes a viable form of compensation. Too often, however, overly caffeinated entrepreneurs sell naïve candidates unrealistic business plans, and overly optimistic valuations—often complicated by incomprehensible classes of shares. It is perhaps the absurdly exaggerated expectations of most RIA shareholders that result in the minuscule and decreasing number of RIA transactions each year. In 2014, fewer than 35 were sold nationally.

So, we have discussed a number of things not to do, including the following:

- Refrain from recruiting brokers to private bankers
- Avoid discretionary bonuses for revenue producers
- Do not delude the new hire with illiquid equity

Let us conclude by suggesting some things that we should be doing, including the following:

1. Pay obscenely for first-year revenues
2. Allow business development officers to keep select relationships
3. Allow private bankers a release valve for swollen books
4. Pay a real life-time trailer
5. Pay a fair base pay (but not so rich that it eliminates the drive for high incentive)
6. Keep new recruits whole when they arrive (i.e., do not short-change them and start off with a negative perception)
7. Creative alternatives to guarantees (e.g., double first-year payout)
8. Create golden handcuffs with life-time trailers and restricted stock

Conclusion

No one compensation model fits all institutions and all producers. It is, however, a sad fact that unless revenue producers are paid formulaically, they fall prey to the unfortunate trend of allowing their success to subsidize enormous back-office costs. They need not be paid as extravagantly as FAs, but the elements that attract solid sales personalities to wirehouses can be utilized modestly among all peer groups of wealth management. 😕

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Endnotes

5. Knightsbridge Advisors Survey, 2014 (see endnote 3), assisted by Jamie McLaughlin of J. H. McLaughlin & Co., LLC.