

Reinventing the Broker/Advisor Model

How to Attract and Retain Business in the Post-Recession Era



An Advisor Industry Brief from Kovack Securities, Inc.

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Reinventing the Broker/Advisor Model

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EXECUTIVE SUMMARY

There's a lot of personnel movement in the investment community these days. The general ranks of U.S. financial advisors are decreasing overall. A number of those who remain are electing to change firms each year. Of the professionals who choose to make a change, many brokers are shedding their big-firm images for a place among the growing contingent of independent investment advisors.

The financial services industry is certainly in need of a strategy to bring more stability to the investment marketplace, especially at time when the large generation of baby boomers will become increasingly more demanding as their retirement nears.

According to Cerulli Associates, a Boston research and consulting firm, the number of producing financial advisors fell to 310,000 at the end of 2008, down from 314,000 in 2004.¹ With 14 percent of today's financial advisors over the age of 60,² the drop-off is likely to continue as they inch closer to retirement themselves.

But, what's driving the unrest among investment professionals who are years away from retirement? Many factors are coming into play, from the economy to the upheaval on Wall Street to their own desire to find a better balance between work and home.

Collectively dubbed "breakaway brokers," these financial professionals leave large firms to either open their own businesses or enlist with companies where they have more independence and control over the products and services they offer. Apparently, they appear to be leaving in droves. Research shows the number of brokers at major firms who serve individual clients fell below 55,000—a 14 percent decrease—during the three-year period

ending in 2008. Within the same time frame, the number of registered investment advisors (RIAs) grew 29 percent to 33,000.³

However, the Recession has forced many independent advisors to think long and hard about how they conduct business, which includes not only developing new strategies for investment management but also implementing more efficient and service-oriented operational procedures. In order for financial professionals to attract and retain business in the post-recession era, the broker/advisor model itself needs to change to reflect the new realities of investment management.

This white paper discusses how reinventing the broker/advisor model—beyond just a move from a commission-based transaction model to that of one with a fee-based model—addresses financial advisors' needs for reduced business administration, enhanced client service, improved margins, more flexibility and better strategies for building a successful, long-term practice. Financial professionals will not only learn about the framework for the new broker/advisor model, but also about the competitive business advantages they can gain by subscribing to it. The paper also provides guidance on how to select a partner that can help financial advisors navigate the new model and leverage it in new and powerful ways to drive success.

ADVISORS ARE DRIVEN TO CHANGE BY A MYRIAD OF TRENDS

A recent study of financial advisors found that approximately 12 to 13 percent of them change firms in a typical year.⁴ Contrary to popular belief, advisors are making changes for reasons outside of the lure of better compensation. Decisions to change firms are more emotionally driven than most would expect and are typically made by advisors who are disgruntled or unhappy

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over issues such as increased pressure to sell versus service clients, cumbersome operational processes, little access to upper management, lack of personalized attention, and an inability to find time for a life outside of work.

A recent survey of Kovack Securities' advisors showed that 54.8 percent of them joined the firm to get access to more personalized service and support. Better payouts was the least likely reason these advisors made the switch, behind wanting a more progressive company with vision, having access to upper management, and gaining control of their book of business.⁵

Of course, other more uncontrollable, environmental elements have also driven advisors to look for a change.

The Economy

The Recession has compelled advisors, like so many other Americans, to take stock of both their personal and professional effects. When money was flowing, investment advisors found little need to focus on practice management and implementing tools that could cut costs and streamline their operations—allowing them more time to expand and better serve their client base. However, recent economic conditions have forced a change in mindset. Advisors are now willing to evaluate new strategies, technologies and business practices that aid in creating a more efficient, scalable practice for the long term.

Wall Street

Wall Street, undoubtedly, is still feeling the effects of the economy's downturn, from failed brokerage houses to paybacks for big bailouts to high-profile mergers. Not to mention, Wall Street is facing an imminent overhaul of the financial regulations that govern its activities. Major upheaval has occurred as clients

and financial representatives alike have turned away from the Wall Street "giants" because they've lost faith in and respect for these firms. Smaller, independent investment companies are not only gaining clients who are leaving major firms, but are also attracting a large number of financial representatives—whether casualties of corporate downsizing or those who left on their own initiative to follow the flow of money to smaller boutique investment firms. Both groups—clients and representatives—are increasingly finding strength and comfort in the transparency that smaller companies can offer.

Baby Boomers

Neither a faltered economy nor turmoil on Wall Street can stop Baby Boomers from growing older. However, both have had a significant impact on this generation, which is now reaching retirement age. According to the U.S. Census, in 2011, the first of the Baby Boomers will turn 65 years old. Within the next 20 years, the number of seniors—those 65 or older—will reach 72 million and represent 20 percent of the total U.S. population.⁶ Impacted by Social Security amendments that raised the minimum retirement age, the ongoing shift from defined-benefit to defined-contribution pensions, and the recent Recession which left many with severe reductions in both retirement accounts and home equity, Baby Boomers have become more demanding—and more knowledgeable—in terms of their financial investments. One of the most consumer-oriented generations to date, Baby Boomers will demand more investment options to meet their changing needs and will require top levels of client service to keep them happy.

With all this turmoil brewing in the financial investment world today, the question becomes: How can advisors keep pace? In short, the answer comes from reinventing the advisor model.

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As most advisors know, the commission-based model depends on the ability to generate increased revenue by maximizing the number of investment transactions. Advisors' success, then, is essentially based on selling and performance—and on them “selling their own performance.” However, many broker/dealer firms have successfully found a happy medium that incorporates both commission- and fee-based models.

CURRENT ADVISOR MODELS CANNOT SUPPORT TODAY'S REALITIES

Notwithstanding the recent financial events that have certainly made even the hardiest of investors a little gun shy, there are a large number of clients who have fled their firms because of common practices such as recommending expensive and possibly unnecessary products, charging high commissions, and providing little to no customer service. These practices, more often than naught, are the direct by-products of the commission-based advisor model—which the investment industry has traditionally relied on for years.

Around 2003, the advisor model began to evolve more toward fee-based compensation, allowing financial professionals to charge flat, hourly rates for their services instead of taking commissions on investment transactions. Along with this shift, advisors gravitated toward more holistic analysis of clients' full portfolios of assets, including real estate, college and retirement planning as well as tax preparation and planning.

A large number of investment programs today are actually “hybrid” models, where advisors are registered with the Securities and Exchange Commission (SEC) for fee-based services, and with the Financial Industry Regulatory Authority (FINRA) so they can offer commission-based products.

Unfortunately, to date, these models have been unable to totally address the realities of today's investment world and deliver what independent advisors need to build and maintain a healthy, long-term client base.

ADVISORS' NEEDS ALIGN WITH THOSE OF THEIR CLIENTS

A study released in July 2010 found that 84 percent of independent advisors are looking to grow their business “aggressively” or “moderately” in the next five years despite the economy.⁷ These types of numbers indicate the growing appeal of the independent adviser model for clients.

However, the model itself needs to be adjusted to help independent advisors implement more efficient and service-oriented operational procedures to meet the needs of their current clients, while developing strategies and tactics to attract and retain new business.

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As stated earlier, a majority of advisors, above all else, want more personalized service and support from their broker-dealers. Advisors want, for example, advice on streamlining business operations, becoming more efficient and adding more control as they go from point-of-sale to positioned-for-service—and beyond. They want to learn more about leveraging technology and other tools that help them work smarter, not harder. And, advisors want their counsel to come from upper management at partner companies with enough vision to develop ongoing best practices and innovative strategies aimed at helping them stay competitive and agile enough to weather future economic disruptions.

Advisors essentially want from their partner companies many of the same things that their clients are asking for: reliable service, ongoing engagement, transparent reporting, knowledge, experience and quality advice—bundled together to provide an overall peace of mind. Very similar to clients, advisors also want to receive a comfortable income, protect their capital and grow their earning potential.

In order to accomplish this, the new advisor model encompasses much more than a move to fee-based programs.

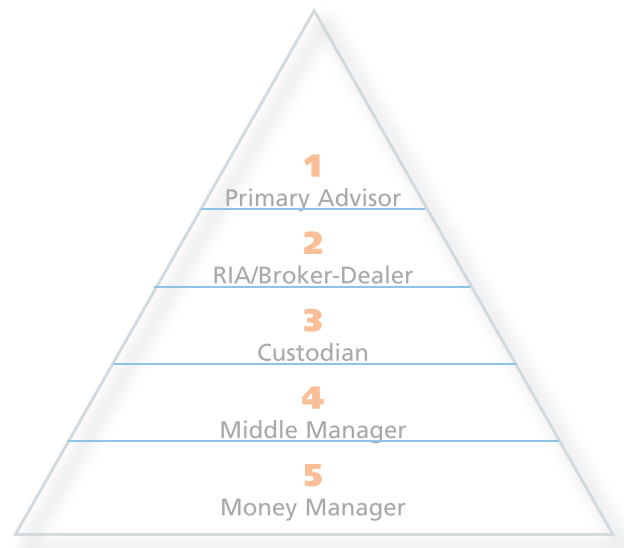
THE NEW BROKER/ADVISOR MODEL REMOVES LAYER OF MANAGEMENT, BUT PROVIDES MORE CONTROL

Perhaps one of the biggest, yet one of the simplest, changes within the new advisor model involves the removal of a layer of management, known as the “manager of managers,” which has contributed to the poor service, pricey delivery and superfluous fees associated with previous versions.

Previous advisor models consisted of five layers:

1. Primary Advisor
2. RIA/Broker-Dealer
3. Custodian
4. Middle Manager
5. Money Manager

The new model removes that “Middle Manager” layer, giving advisors faster access to decision makers, more accountability for their clients, and better payouts for themselves.



**PREVIOUS
Broker/Advisor Model**



**NEW
Broker/Advisor Model**

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The other components of the new advisor model include:

- **Fee-based programs.** Based on charging an annual fee—typically billed quarterly—fee-based programs allow an advisor to become more of a relationship manager versus a transaction-based asset manager. Advisors are no longer compelled by the number of investment transactions they make, but by the establishment of sustainable client relationships and making appropriate investment recommendations with a common goal of growing assets under management.
- **Open investment architecture.** Non-proprietary products and access to multiple clearing firms allow advisors to make truly objective recommendations with zero conflicts of interest. Without pressure from the “home office” regarding which products to use and where to custody assets, advisors and clients can make better decisions as to the most suitable investment and clearing combinations.
- **Innovative technology.** Technology, from client relationship management to online proposal generation, research, market news and web-based performance reporting will increasingly become a key differentiator for a competitive, sustainable and successful business model. In particular, technologies that seamlessly provide a single user interface to simplify and streamline business logistics as well as facilitate client service will help advisors gain more control of their practices, work smarter and conduct more efficient business.
- **Training.** Competitive and relevant education and training will help advisors expand their knowledge beyond general information on the latest investment options. Based on industry best practices and proven methodologies, the new model will focus on business development and operations, investment strategies for a very demanding client base, and training on the latest technology tools.

The new broker/advisor model offers many benefits for financial professionals, as they can:

- Focus on the needs and goals of clients rather than logistics;
- Improve margins;
- Provide better all-around client service;
- Establish a more competitive and transferrable practice for the long term;
- Be more flexible and agile to respond to an ever-changing economy and a shift in client expectations; and
- Gain more control of their business in key areas such as outsourcing, hiring, client evaluation, services and products.

Partner With an Expert

Advisors should seek a partner that has the pulse of the independent Broker/Advisor market. A Broker/Advisor partner is independent, strong and supportive. In this environment and beyond, it is reasonable and intelligent to ask a potential partner the following:

- **Is your firm owned by a bank or insurance company? Are you privately owned?**
- **Describe your company's regulatory history along with any complaints.**
- **Who are your custodians and clearing firms?**
- **Will I own my own book of business?**
- **What are your monthly and/or annual fees?**
- **Describe the character of management. Who are your owners and/or executives?**

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CONCLUSION

The independent investment advisory market will only continue to grow as an inherent reaction to changing economic and client-driven demands. Cerulli Associates projects that by 2012, the share of investment money managed by independent advisers will rise from 19 percent to 23 percent, while the major brokerage firms will lose market share—falling from handling 48 percent of the money to 41 percent.⁸

Changes in regulation, financial models, client-service expectations, pricing and the economy will continue to impact advisers. Advisers need to be agile and flexible with sound business practices to weather any changes the future brings.

The new broker/advisor model is built to address these issues—and more. And there's evidence that this model works. A recent Kovack Securities survey of financial advisers who have moved to the new model showed that:

- **71 percent** felt they were more productive;
- **81 percent** believed they had improved their client service;
- **45 percent** experienced a better work-life balance; and
- **42 percent** saw improvement in their revenues by at least 30 percent.

Successful firms, using the new advisor model, will know how to translate external forces into positive internal changes that will help attract and retain business in the post-recession era.

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ABOUT KOVACK SECURITIES

Kovack Securities Inc. (KSI) is a privately-owned, national independent broker/dealer and Kovack Advisors is a registered independent advisor (RIA) based in Ft. Lauderdale, FL. with nearly 300 independent registered representatives. KSI is a broker/dealer member of FINRA and SIPC. Founded in 1997 by Ron Kovack, PhD, CFP, and Brian Kovack, JD, CRCP, the firm is continually ranked as one of the country's top 75 independent broker/dealers.

KSI is a powerful partner for entrepreneurial financial advisors seeking to create their own successful businesses. Kovack Securities' primary focus is helping financial representatives and advisors establish competitive, independent practices. KSI's successful independent financial advisors share the company's vision in providing the quality of financial advice every client deserves.

Kovack Securities and its sister firm, Kovack Advisors, provides advisors with the services, support, tools, resources, training and infrastructure to help them manage the complexities of owning their own practices. In turn, advisors are able to focus on the needs and goals of their clients rather than logistics. KSI is committed to the success of the financial advisors they serve. KSI's open product architecture and innovative fee-based programs, coupled with multiple Clearing Firms (National Financial, Pershing, Fidelity Institutional Wealth Services, and TD Ameritrade) provide advisors with the tools and flexibility to develop investment programs best suited for their clients.

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