

Don't Fear the Fee

Goal: Growing your business.

Problem: You fear converting to fees. You have done transaction-based business for your whole career. You wonder about the effect on your business. Your questions, and the answers, are at the bottom of the page.

Your Book-of-Business: You have been a producer for ten years and work in a 5-person independent branch.

- \$100 million under management, mainly in stocks, bonds, and funds. You are at the top in the branch.
- \$650,000 in gross commissions (GDC). For the past five years GDC rose 10%/year. 40% is fee-based.
- \$10 million in net new assets are added this year. You add 10% more a year (e.g., \$11 million next year).
- 45/80 rule applies. The top 20% of clients (ranked by ROA) have 45% of assets & generate 80% of GDC.

Scenarios: The scenarios pertain to the \$10 million in net new assets. Existing assets are unchanged. Your average client favors stock and stock funds and earns 8% a year. Fees will not change in the future.

- *Scenario one is fee-based.* You put \$5 million into both managed money and fund wrap programs. The client fee and amount you keep are 2% and 1.5% for managed money and 1.25% and 1.15% for the fund wrap. We assume a complete shift to fees. Admittedly extreme, it clearly illustrates the following points.
- *Scenario two is transaction-based.* You use individual securities (stocks and bonds) and A-shares evenly. As a proxy for your annual commission rate, your return on assets (ROA) of 0.65% is used (\$325,000/\$50 million). That's close, assuming a 5-year average holding period and 1.5% to buy and sell ($2 \times 1.5\% / 5 = 0.6\% / \text{yr}$). Clients pay, on average, 4% for A-shares, you get 3.25%, and a 0.25%/yr trail starts in year one.

How are clients affected? If returns are equal, assets are roughly \$216 million by year 5. There's a small advantage to transaction business by year 10.

Will your pay drop in year one? No. Under Sc.1 it rises 25% from \$650,000 to \$813,800! True, it's not as high as Sc.2's \$884,780, but it does rise.

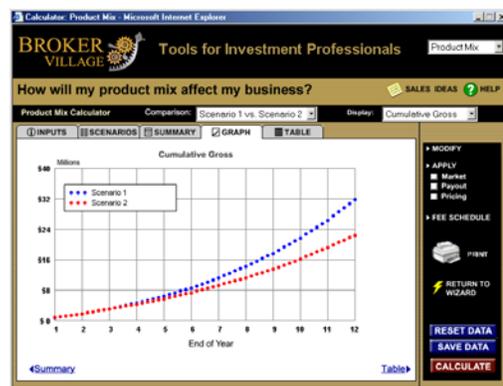
What's the annual break-even point? Shorter than you think. By year 2 you earn slightly more with fees than with transactions (\$1.02 vs. \$1.00 million).

What's the cumulative break-even? Only 3 years. With fees you earn \$3.1 vs. \$3.0 million.

What about a bear market? By year 3 GDC rises to \$863,085 with fees even if clients *lose 10%/yr for the next 3!* Break-evens move back just one year.

What is the long-term benefit? By year 5, GDC is \$693,563 higher. By year 10, the practice is worth about \$8 million vs. \$2.6 mm. Valuation multiples slide from 2X fee-based GDC to 1X non-fee GDC.

This evaluation utilized the Product Mix Calculator offered by Broker Village: www.brokervillage.com. Visit us to access more business-building tools.



	Year 1	Year 2	Year 3	Year 4	Year 5
Scenario 1					
Assets, End of Year	\$17,095,000	\$136,182,740	\$160,808,917	\$166,506,674	\$215,190,419
Annual Gross	\$813,800	\$1,021,253	\$1,257,204	\$1,524,982	\$1,828,275
Cumulative Gross	\$813,800	\$1,835,053	\$3,092,257	\$4,617,239	\$6,445,513
Scenario 2					
Assets, End of Year	\$17,274,200	\$136,149,810	\$161,114,816	\$167,880,000	\$216,471,744
Annual Gross	\$884,780	\$1,032,660	\$1,134,651	\$1,282,246	\$1,447,513
Cumulative Gross	\$884,780	\$1,917,440	\$3,052,091	\$4,334,337	\$5,781,850