InvestmentNews

2015 ADVISER COMPENSATION & STAFFING STUDY

IN RESEARCH

THE ENSEMBLE PRACTICE

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ACKNOWLEDGMENTS

InvestmentNews

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About this study

The survey was conducted between April 8, 2015 and June 12, 2015. The data collected was analyzed and assessed by the teams at *InvestmentNews* Research and The Ensemble Practice. In total, qualified data was used from 363 firms who supplied financial information for their organizations, in addition to providing compensation, staffing, strategy, and management data on their practice.

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The data reported in this study was provided directly by participants to *InvestmentNews* Research. InvestmentNews Research was not engaged to and did not audit or review this information and, accordingly, does not express an opinion or any other form of assurance on it. The data contained in this report may not be a statistically valid representation of the entire market of financial advisory firms; rather, it is representative of the firms that elected to participate in this survey.

Acknowledgments

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The mission of *InvestmentNews* Research is to provide financial advisers with the industry's most informative practice management studies and benchmarking reports.

Our benchmarking studies are a leading source of market intelligence for advisory firms and industry partners, such as custodians, broker-dealers, service providers and professional organizations.

In 2009, *InvestmentNews* acquired two bellwether benchmarking studies from Moss Adams LLP — the Adviser Compensation & Staffing Study and the Financial Performance Study of Advisory Firms. We continue to improve and expand these two critical industry studies, while we have also introduced new studies on technology and succession planning that support the growth and development of financial advisory firms.

Led by VP and *InvestmentNews* Publisher Suzanne Siracuse, Associate Publisher Mark Bruno, and Senior Research Analyst Matt Sirinides, our studies are supported and driven by a team with over 40 years of combined experience and exposure to the ever-evolving financial advisory business.

In addition to our research studies, *InvestmentNews* Research also produces regular webcasts and regional workshops that arm advisers with actionable insights. Our events allow advisers to hear directly from some of the industry's leading experts - and also network with other advisers who are looking to improve their practices and grow their businesses.

Custom research: One of the core capabilities of *InvestmentNews* Research is providing custodians, broker-dealers and RIAs with custom benchmarking reports and white papers that leverage our deep data and analytical expertise. For more information about custom research requests and *InvestmentNews* Research, please contact Mark Bruno at 212-210-0116 and mbruno@investmentnews.com, or visit research.investmentnews.com/dashboard

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The Ensemble Practice

The Ensemble Practice LLC is the premier business consulting firm for the financial advisory industry. It is committed to helping independent financial advisers create multi-professional ensemble firms with strong organic growth and sustainable profitability. The Ensemble Practice works with the top wealth management firms in the country. The firm also hosts the "G2 Leadership Institute"—a training program for the future leaders of advisory firms. The firm is founded and led by Philip Palaveev, a highly regarded industry expert, thought leader and author of the book "The Ensemble Practice."

For more information visit www.ensemblepractice.com.

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Executive Summary

Success in wealth management is built upon recruiting the top talent and creating a productive process for delivering great services to clients; motivating staff and managing their long-term development. Today's independent advisory firm is no longer an owner-operated, small business powered by the energy and talent of the few entrepreneurial professionals who started it. Instead, it is a sizeable and growing enterprise that hires the talents of many employees in different positions from Lead Advisers to executives and support staff. It is an enterprise with sophistication and knowledge in its talent management which continues to create opportunities for career growth.

Three hundred and forty eight advisory firms submitted their full income statements and compensation data allowing us to look 'under the hood' of the independent advisory industry and examine profitability, productivity and prevailing compensation trends. What we found is a group of firms that are quickly growing and maturing. These are firms that are evolving from their entrepreneurial roots to well-developed management practices.

This evolution is evident in the data:

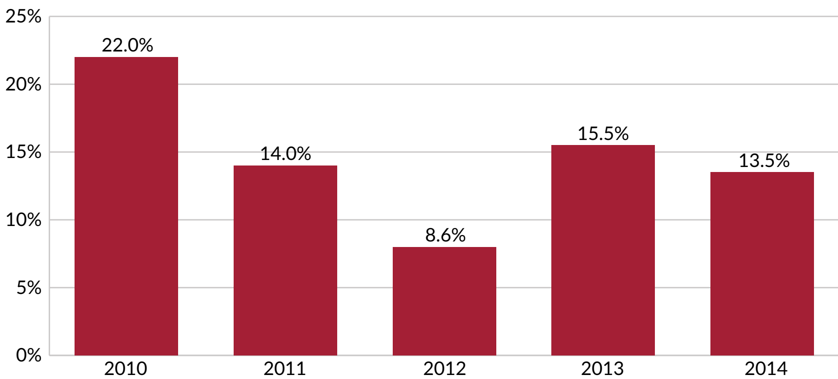
- The growth and prosperity in the industry continues and owner incomes, as well as dollar profitability, have reached record levels. The typical owner of an advisory firm generates on average $527,000 in personal pre-tax income.
- The cumulative effect of growth has doubled the size of the typical firm in the industry over the last five years. The year 2014 brought 13.5% growth in revenues and 2015 promises to build upon that.
- While firms of all shapes and sizes are growing, a cadre of Super Ensemble firms (those with over $10 million in revenue) are achieving exceptional results and demonstrating the advantages of size, providing access to better clients and perhaps better employees.
- Growth has changed the nature of the firms. Adviser ownership used to define independence; however, today there are more employee advisers in independent firms than owner-advisers. This change amplifies the importance of career tracks and growing talent. It also poses difficult questions to the culture of the firm and its competitive positioning. With the influx of employee advisers, what does "independent" mean?
- As much as growth has created opportunity and brought a wave of hires, it does not seem to have affected compensation for most positions in the last two years. Salaries for employee advisers and other key positions remain virtually unchanged.
- Incentive compensation (bonuses) and promotions, rather than salary increases, seem to fuel the growth of employee income. This is great news for the businesses and perhaps speaks to those finding a way to grow their own talent. The question still remains—is it sustainable?
- Finally, growth remains fragile. Much of the new assets continue to rely on client acquisition and the markets while the addition of new clients continues to account for only half of the increase in assets.

The challenges are clear. What we find in the data is within every size and shape of advisory firm there are business leaders who have found a way to create greater productivity and achieve better results. We hope that this report helps uncover those best practices and unlocks success for all firms. Let us examine each trend in turn.

Growth and Prosperity

Between 2010 and 2015, the typical advisory firm in the study nearly doubled in size (grew by 98%). In 2014, revenue for the participants in the study grew by 13.5%.

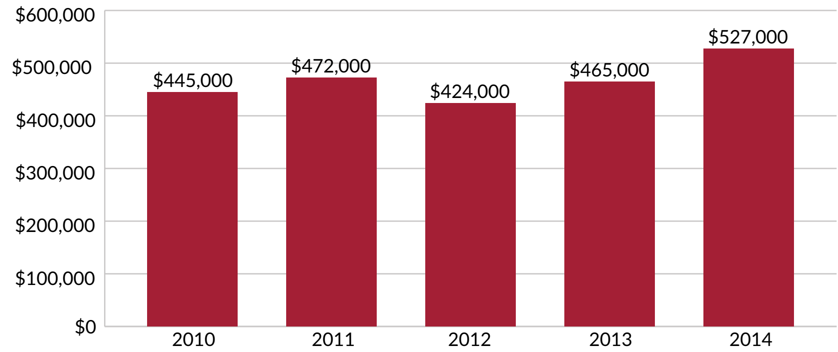
FIGURE 1: Median Revenue Growth Rate, All Firms 2010 - 2014*



*Source for all historical data: *InvestmentNews*/Moss Adams benchmarking studies

Growth came most of all from the continued business development efforts of the firm—8.9% of the new AUM came from new clients. However, we will see that firms of different sizes differ significantly in their approach to finding new clients with the largest firms turning to branding and marketing while smaller firms rely on referrals and networking. The combination of client contributions (4.5%) and market appreciation (3.9%) almost equals the new business development, which means firms are still relying on "good news" from equity markets to create opportunity.

FIGURE 2: Average Income per Owner, All Firms 2010 - 2014



Growth has richly rewarded the owners of advisory firms. The average total income per owner in the study has reached $527,000, which is a significant increase over prior years.

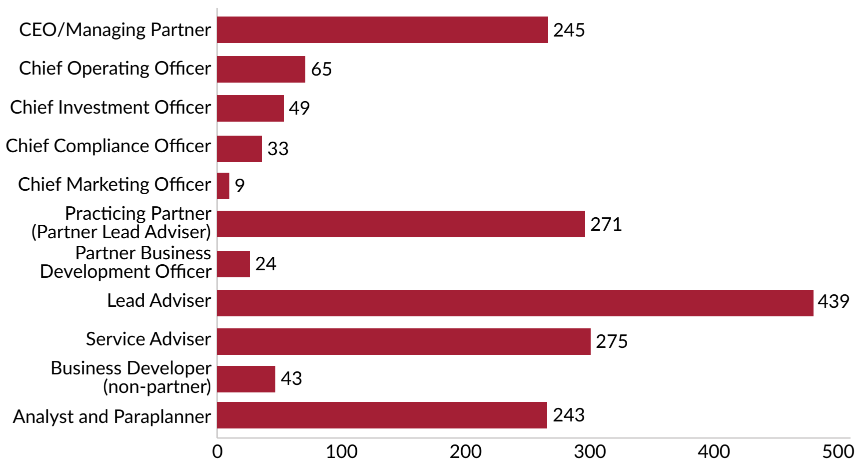
We define "owner" as anyone who owns any amount of shares in the firm. In our experience, most firms are fairly restrictive about who can buy shares in the firm. "Owner" usually also describes a highly productive and highly performing individual working at the firm. We asked participants to identify the number of "active" owners to avoid the ratio being influenced by "investors" in the firm (i.e. excluding those not actively employed in the firm but simply providing capital).

Employee Advisers Outnumber Owners

The dramatic increase in owner income can be attributed, to a substantial degree, to one factor: leverage. Leverage is the use of non-owner professionals at lower levels of compensation to "leverage" the experience and skills of the highly paid owners. The leverage effect allows owners to delegate on average $478,000 in revenue responsibility to a Lead Adviser who receives $143,000 in median total compensation and achieve a 70% gross margin. This leverage effect is much more visible in larger firms but even within smaller Ensemble firms we find owners using the help of Service Advisers and Paraplanners.

As a result, the overall composition of the independent advisory industry has changed. The single most common position today is not a "practicing owner" or "solo adviser" but rather a Lead Adviser – meaning an employee who independently manages client relationships on behalf of the firm.

FIGURE 3: Incumbents Reported by Position, All Firms



The notion that only owners can manage client relationships or that employee advisers will "break out" with their clients has long been dispelled. Super Ensembles have been building their employee teams for many years and now we see the same effect among smaller Ensembles and Enterprise Ensembles.

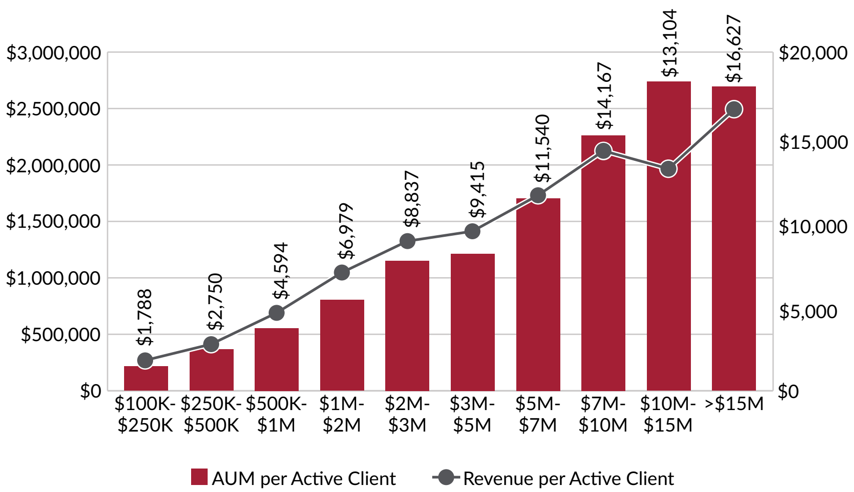
Size Becoming a Decisive Advantage

Super Ensembles lead the way for the industry in terms of productivity, profitability (as measured by average owner income) and size of client relationships. Size is clearly an advantage in the advisory industry. The advantage; however, is not in the form of "economies of scale" and lower overhead but rather the access to the top clients and perhaps the access to the top talent. If having the best people is the key to success, then Super Ensembles hold that key.

The employees of Super Ensembles, across many of the critical positions, are better compensated and perhaps better qualified. For example, employee Lead Advisers in Super Ensembles have a median total compensation (salary and incentive) of $165,000 compared to a median total compensation of $143,000 for all other firms. The same is true for the Service Adviser position where the median compensation for Super Ensembles is $97,000 compared to $83,000 for all other firms. Finally, 62% of Lead Advisers in Super Ensembles are CFP compared with 52% in all other firms.

In addition to having access to the top talent, large firms also have better quality client relationships. We have observed this relationship in every edition of the study: the larger the firm the larger the client relationships. The correlation is very strong and holds true for all firm sizes until the very largest of Super Ensembles.

FIGURE 4: Median Revenue per Client and AUM per Client, by Firm Size



We speculate the reasons why larger firms attract better clients are:

- They have a more prominent presence in the marketplace and appear "safer" and more "prestigious".
- Firms that begin with larger client relationships tend to attract other larger client relationships. Existing clients are a key source of referral and tend to refer clients of similar affluence.
- The top firms in any geographic location are likely to align with and receive referrals from the top CPAs and law firms.
- Large firms tend to be located in the largest markets where there is also a proliferation of wealthy families.

The advantage of large firms is in their ability to attract top talent and the largest client relationships. That said, firms of all sizes have grown significantly and have been hiring employees across all positions.

Who Are the Super Ensembles?

The Super Ensemble firms in the industry fall in two distinct categories with different structures and different strategies. Both business models enjoy the advantages of size we describe but they achieve their profitability in different ways.

- Wealth Management Super Ensembles—These are firms delivering wealth management services to high-net-worth and ultra-high-net-worth clients. The firms usually have one or perhaps two offices and follow the traditional wealth management career tracks and organizational structure. The business model is characterized by very high assets per client and revenue per client and very high productivity of professionals coming for the leverage of a team-based service model.
- Multi-Office Super Ensembles—Increasingly, we see in the survey, Super Ensembles that have multiple offices. Each office represents a separate practice with several professionals and its own local market and strategy. In a sense these are firms that are a national or regional collection of Ensemble firms – a federation of firms. Here the target market is made up of affluent (rather than

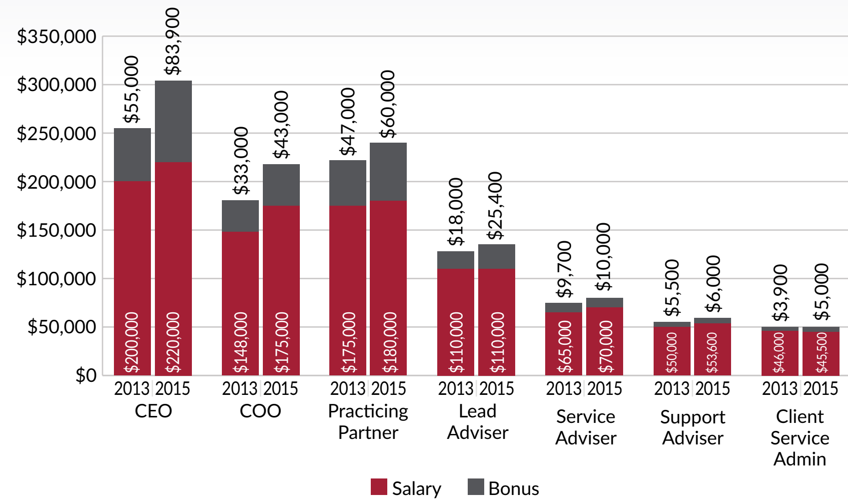
high-net-worth) clients and the productivity can closely resemble the productivity of Ensemble firms. The high profitability here comes from the economies of scale at the infrastructure level and the favorable gross margins at the local level where compensation may be somewhat lower than the Wealth Management firms.

The presence of the two different business models explains some of the counter-intuitive and, at times, contradictory data from the Super Ensemble category. The presence of the multi-office firms at times produces lower revenues per client, or revenue per adviser, than we would expect. That said, multi-office firms are a significant part of the industry and ultimately compete in the same talent pool as their wealth management Super Ensemble peers.

Salaries Remain Unchanged

The wave of new hires has swelled the staff ranks inside advisory firms but surprisingly it has not translated into salary growth. For most positions inside advisory firms, the level of salaries has either remained the same or grown only slightly. For example the Lead Adviser position had a median salary of $110,000 in 2013 and has remained unchanged in 2015. The same is essentially true for the Service Adviser position where in the last two years the median salary has only grown by 8% from $65,000 to $70,000.

FIGURE 5: Median Professional Compensation, 2013 vs. 2015



There has been some growth in compensation across the industry but in the form of incentive compensation rather than salaries. This trend of keeping salaries steady and growing bonuses is very prudent and beneficial for firms but it is surprising that new hires have not had the leverage to negotiate higher levels of compensation. Perhaps the shortage of advisers is not as severe as we thought.

Building a Growth Engine

The industry has nearly doubled in size in the last five years. Growth in revenue has come to firms of every size but the way in which firms grow has been somewhat different. First, it is notable that smaller firms showed the fastest growth in 2014 while the largest firms slowed down. The Solo firms grew by 22.4% compared to Ensembles at 14.6%, Enterprise Ensembles at 10.8% and Super Ensembles at 8.5%. Mathematically this makes sense, after all the denominator of the calculation (current AUM) favors smaller firms where the addition of $10 million in new AUM may very well represent 10% growth versus a large $1 billion firm where the same AUM growth only adds 1% growth.

The size of the firm seems to influence its ability to generate new relationships from the firm's branding and marketing activities. Super Ensembles added 4.8% in new assets from firm-level business development while other practices have a lower percentage from such projects.

FIGURE 6: Year-Over-Year Change in Firm AUM by Evolutionary Stage

	Solo	Ensemble	Enterprise	Super Ensemble
New assets from new clients	9.9%	11.8%	6.3%	7.7%
New assets from client referrals	4.3%	4.4%	1.9%	1.5%
New assets from professional referrals	2.2%	3.7%	1.3%	1.4%
New assets from firm business development	3.4%	3.7%	3.1%	4.8%
New assets from existing clients	10.6%	2.9%	5.3%	5.2%
Lost assets from lost clients	-1.7%	-1.8%	-2.0%	-2.7%
Lost assets from existing clients	-2.0%	-2.2%	-2.1%	-5.8%
Change due to performance	5.4%	3.9%	3.4%	4.1%
Net Change	22.4%	14.6%	10.8%	8.5%

At the same time, it is interesting that the largest firms are not generating much in terms of new client referrals—and are losing significantly more clients than their smaller competitors. Does this perhaps suggest that large firms have become "too large" and are losing some of the magnetism and close relationships that drove their success in the past? The 2.7% level of losing assets due to lost clients is still low, but it is higher than it has been in past studies and therefore deserves our attention.

An alternative view for the largest firms is that they are ahead-of-the-curve and have exhausted their existing referral networks; and therefore, they are currently moving their focus to creating new networks. Large firms have historically been the best at growing from client and professional referrals. A shift in emphasis for Super Ensembles to focus on new organic business development may signal the need to draw new clients to the firm who will bring with them new networks for referrals. Coupled with the higher-than-average loss of clients, it is possible that large firms are willingly releasing clients that do not align with the firm's target demographic. This is highly speculative, however as a means of positioning for future competition, including other large firms and virtual offerings. Experientially we see some advisory firms focusing on the clients who will offer the most value and pay for the firm's service offering.

Finally, it seems that the largest firms are experiencing double the rate of distributions than others. In addition, the contributions versus distributions balance for Super Ensembles are in the negative for the first time in our study. Perhaps this suggests that the largest clients are also the oldest clients and Super Ensembles are the first to enter into a distribution mode.

Conclusion

Aristotle once wrote “We are what we repeatedly do. Excellence, then, is not an act, but a habit” and the results of the 2015 *InvestmentNews* Adviser Compensation & Staffing Study confirms this is also true for managing advisory firms. Throughout the study we find that the firms achieving the highest levels of performance are firms that focus on the fundamentals of management: attracting top talent, motivating employees and implementing a well-thought out strategy. Growth forces advisory firms to grow their expertise in managing people and we hope that this report will become a valuable resource for the leaders of independent firms.

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