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Why IBDs Are Changing Their Recruiting Deals

Commonwealth now bases forgivable notes on AUM instead of production levels, following a similar move by LPL.

By Jeff Berman | February 09, 2022

The shift that first LPL Financial and now Commonwealth Financial Network have made from production rates to asset levels when calculating transition assistance for recruited advisors makes sense based on the evolution of advisor books to an increased percentage of advisory assets, according to industry recruiters.

With books of business increasingly being made up substantially of advisory assets, “evolving to transition money based on basis points rather than a percentage of gross dealer concession is a logical move” for the independent broker-dealers, Jon Henschen, founder of Henschen & Associates, told ThinkAdvisor in a phone interview.

The shift in strategy stands to also help IBDs trying to compete with RIA custodians and other IBDs for advisors, Louis Diamond, president of Diamond Consultants, said Monday.

Similarly, Andy Tasnady, managing partner of Tasnady Associates, told ThinkAdvisor by email Monday that the moves by LPL and now Commonwealth “makes sense now that the retail investment world (and its revenues) are now fee-based rather than the older school transaction (trade) based.”

After all, the “biggest revenue sources now are fees from managed money and, to a lesser extent, spreads on cash balances,” Tasnady added.

Commonwealth’s Decision

Commonwealth is now offering advisors it recruits forgivable notes that are based on the advisor’s asset level instead of a percentage of production as had been the case for the firm and the sector overall in the past.

“We formally switched that over right in the beginning of the year,” according to Wayne Bloom, Commonwealth CEO. The change was made because the new method better “reflects how we do business today,” he told ThinkAdvisor in a phone interview on Wednesday.

Although Commonwealth remains a BD and “transactional, commission-based business is still appropriate in certain instances,” he explained, “in 2021, about 86% of our advisor revenue was fees, so Commonwealth is more like a national RIA than it is a broker-dealer.”

Commission and production are just “not what resonates with advisors” now, he said, adding, “they’re more focused on being fiduciaries and doing a great job for their clients.”

Noting that the change in formula has received a positive reaction from advisors joining Commonwealth, he said: "It seems a little outdated that you're rewarding people or basing their transition on the amount of commissions" they're charging clients.

The firm's shift was first reported by Wealthmanagement.com (https://www.wealthmanagement.com/industry/commonwealth-lpl-now-using-asset-levels-not-production-rates-calculate-recruiting-deals#menu), which said the deals range from 30 to 35 basis points on assets.

The basis points are "unique to each individual," Bloom told ThinkAdvisor, noting: "There are some higher. There are some lower. But that's in the range," he said of the 30-35, calling that about the average basis points recruited advisors are receiving.

More Profitability, Less Churning

"Firms have been focusing note money more on profitability," Henschen said, noting Commonwealth's move followed LPL's, more than a year ago.

LPL confirmed it started using asset levels instead of production rates to calculate recruiting deals. But it didn't say when or why it made the change.

Paying on basis points, meanwhile, is "just now starting to spread" in the sector in recent months, Henschen added.

More BDs will now "pick apart the book" of business the advisor has; "they'll run it through a matrix and it'll spit out a number that they're going to pay for the note amount and that number it determines is based on profitability," Henschen explained. "So they're paying more for advisory business and less on other business including assets held away from the BD."

What is driving this shift? "It is the ever-increasing amount of fee-based business being done," according to Henschen.

"Before, when a percentage was paid on total production, irrespective of what the product mix was, you could have the same amount paid on a book that was all mutual funds and variable annuities held direct versus a much more profitable book for the broker-dealer that is primarily advisory assets," he explained.

"We've been seeing larger broker-dealers pushing platforms for attracting wirehouse advisors," he added. "These platforms provide most everything for an office except staff but for that, they get lower payouts than a standard independent advisor would receive.

"Further enticement for attracting this model is note amounts over 100% of trailing 12 or higher upfront and backend amounts offered with the backend bonus based on assets brought over. With these larger amounts being offered, you also have a longer commitment of nine years before the notes are forgiven versus the typical forgiveness period of five to seven years.

"IBDs love this model because wirehouse advisors hold all their assets in brokerage accounts, and they have substantial advisory assets, which are both highly sought after."

Another plus: "The broker-dealer makes at least twice the profit on this office-supplied model than they do with the standard independent reps that have their own office," he said.

Henschen, meanwhile, likes the basis-points formula for incentive deals because it's based on AUM, he said. "For those that aren't churning, they're rewarded with more transition money because it's based on assets under management," he noted.

However, on the other hand, “if you have somebody that doesn’t have a lot of assets but is generating a lot of revenue off those assets — you can call it churning or doing high-commission products — they would benefit less from that model of paying on assets under management,” he explained.

“So I think it’s a way of paying that rewards ethics and pays less for those that have a propensity to churn and make more off a smaller amount of assets,” he added.

Staying Competitive

The shift by Commonwealth, Diamond said, “makes sense for a few reasons.”

First, “Commonwealth and many other IBDs charge an advisor an administrative or platform fee that calculated as basis points on assets. So offering a recruitment deal that aligns with how they charge advisors seems to make sense.

“We’ve also seen a shift within Commonwealth and some of their peers to charge advisors a flat fee (based on basis points on assets) which would bundle the traditional grid payout (ie: 90% payout), trading costs, platform fees, and additional services associated with starting up the business. So once again, this shift in how they write recruitment deals jibes with this new approach.”

Second, “practices are much more advisory heavy so this rewards fee-based practices.”

Third, Commonwealth’s biggest competitors are often RIA custodians who offer “business development dollars” or startup funds to offset a transitioning advisor’s expenses during the transition.

Finally, it “helps them compete with how LPL and other BDs are structuring deals.”

Pictured: Commonwealth CEO Wayne Bloom

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