BROKER VILLAGE
When the Math Matters

Advisor Proof Statement

Moving New Assets to Fees Makes Lots of Sense

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*1.5%/5 = 0.6%/yr). Clients pay, on average, 4% for A-shares, you get 3.25%, and a 0.25%/yr trail starts in year one.

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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.

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