CLOSING THE BACK DOOR:

DRIVING GROWTH BY STEMMING ADVISOR ATTRITION

Research Report

Study conducted by:

Kehrer Bielan Research & Consulting

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LPL Financial

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Recruiting financial advisors has occupied center stage in discussions of how to grow the investment services franchise in banks and credit unions. Kehrer Bielan research has demonstrated that the typical financial institution has far fewer advisors than it needs to capitalize on its opportunity, and that the opportunity is growing faster than the institution's ability to recruit advisors—meaning the institution is falling further and further behind. Coupled with the growing scarcity of experienced advisors, some have said that recruiting is the number-one job for investment sales managers.

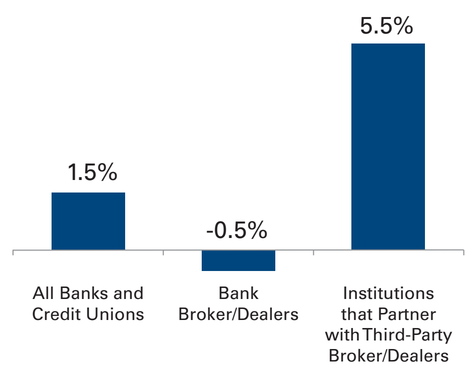
According to the Kehrer Bielan *Annual Industry Checkup,* the number of advisors working in financial institutions grew only 1.5% last year, despite the focus on recruiting. The overall growth figure masks a small decline in the number of advisors that work in the large banks that maintain their own broker/dealer. Institutions that partner with third-party broker/dealers experienced a fairly robust increase in their advisor headcount.

But the focus on recruiting may be neglecting another important determinant of growing the advisor force: advisor retention. Many firms report losing an advisor for every one they recruit. To examine this issue, LPL Financial commissioned Kehrer Bielan to survey the advisor retention experience of three dozen banks and credit unions.

The average firm in our survey lost 11.2% of its advisors during the previous year, but the average advisor attrition rate—the number of advisors who left the 36 firms during the year divided by the number of advisors in place at the start of the year in those firms—was 20.4%.

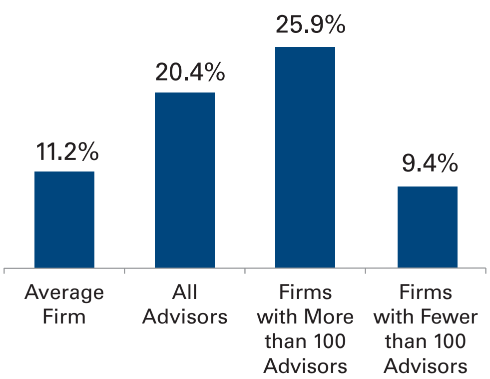
That's because the larger banks, which have relatively more advisors, experienced much higher advisor attrition rates. When we control for the size of the firm, we see that banks with more than 100 advisors lost more than one-fourth of their advisors during the year, compared to less than one in ten among smaller firms. No wonder

Change in Advisor Headcount During 2015

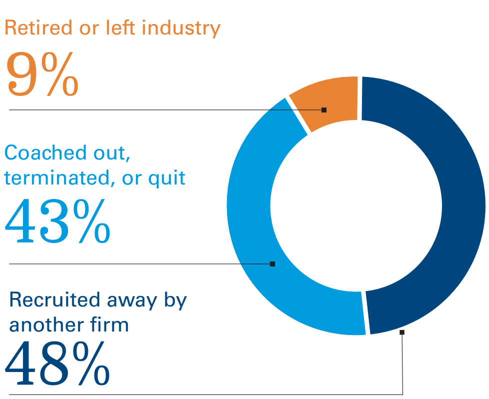


Source: Kehrer Bielan Annual Industry Checkup 2015–2016

Annual Advisor Attrition Rate



Causes of Attrition



management at larger banks say they have to work hard to hire advisors just to stay even.

The bank-owned broker/dealers might be experiencing higher rates of advisor attrition because their advisors are particularly appealing to outside firms looking for new recruits. Compared to advisors in smaller firms, those in bank-owned broker/dealers have average annual production that is 59% higher, with substantially larger books of business that are weighted more heavily towards advisory business. Average annual gross production in the bank broker/dealers was $415,869 last year, as compared to $262,024 in smaller firms. Advisory revenue accounts for 41% of total revenue in the bank broker/dealers on average, whereas it accounts for just 19% of total revenue in smaller firms. These factors make the advisors that work in larger banks more likely to be targeted by competitor firms for recruitment. Management at these larger banks may feel like a victim of their own success.

Despite losing a large number of advisors to attrition each year, the large banks with their own broker/dealer are able to add just as many, maintaining overall headcount. But one-fourth of their advisors are turning over every year, which comes at a significant cost to the firm. We'll explore that issue later in this paper.

On the other hand, smaller institutions acquire relatively fewer new advisors, but lose much fewer to attrition. As a result, the average institution partnering with a third-party broker/dealer is able to grow its advisor sales force year-over-year.

Of course, not all advisor attrition is voluntary. For the firms in our survey, 43% of departing advisors were terminated, coached out, or quit. Another 9% retired or decided to abandon a career as an advisor. But, almost half of the advisors who left were "regretted attrition;" they left to join another firm.

The impact of advisor attrition is so large as to warrant as much managerial attention as advisor recruiting. After all, if the average firm that grew its advisor headcount by 1.5% last year could cut its regretted attrition in half, it would nearly triple its year-over-year advisor headcount growth rate (to 4.2%), just by recruiting the same number of new advisors. For the same firm to grow its advisor headcount at that rate without lowering attrition, it would need to increase recruitment by 20%. Retaining advisors is key to growing the franchise in an environment where recruiting is so challenging.

The impact of the revolving door of losing as many advisors as a firm recruits has a substantial negative impact on revenue.

WHO LEAVES THE FIRM?

For the firms in our survey, the advisors who leave for another firm have substantially less experience with the firm than the advisors who stay. The average tenure of those advisors lost to regretted attrition was 4.7 years, compared to 8.1 years of average tenure for the advisors who remained with the firm at the end of the year.

Once again, however, the attrition experience varies by the size of the firm. Firms with at least 100 advisors lost advisors with considerably more tenure compared to the average advisor lost to regretted attrition in smaller firms.

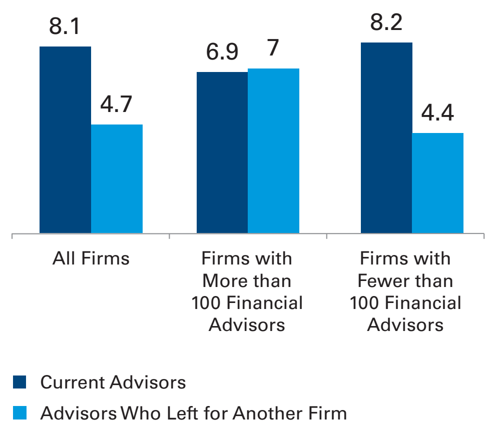
This may be because the larger firms generally have advisors with larger average annual gross production, more advisory assets, and perhaps a broader skill set, making them probably more likely to be targeted by competitor firms.

The gap in average tenure between those advisors being recruited away from larger firms and advisors recruited away from smaller firms may help us to identify the type of advisor most at risk to regretted attrition in each type of firm. Steps can then be deployed that are meaningful to the targeted advisors to reduce attrition. In larger firms, advisors with above-average tenure, and presumably above-average production and assets under administration, are clearly at the most risk of being recruited away. This makes intuitive sense, as these long-tenured, high-producing advisors will be most attractive to competitor firms.

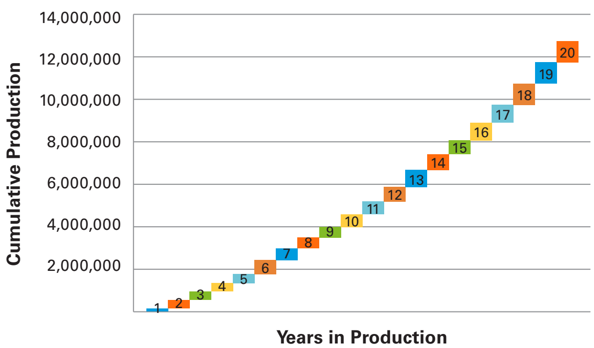
In smaller firms, however, the advisors most likely to depart for another firm have substantially fewer years of tenure with the firm compared with the other advisors in the firm. Unlike those being recruited away from the bank broker/dealers, these advisors are less established, have not yet built strong ties with the firm, and could be motivated to leave because they aren't satisfied with their experience during their first few years.

In any case, regretted attrition is having the opposite effect on average tenure in larger firms than it is in smaller firms. The impact of regretted attrition in the larger firms appears to be reducing the average tenure in those firms, while it's increasing average tenure in the smaller firms, because the advisors who leave have substantially less tenure than those that stay. This results in the same problem manifested in different ways for small and large firms. In a large firm, it's difficult to grow average production when the higher producers are leaving. In small firms, it's difficult to develop high producers when less experienced advisors leave before they have matured at the firm.

Advisor Tenure



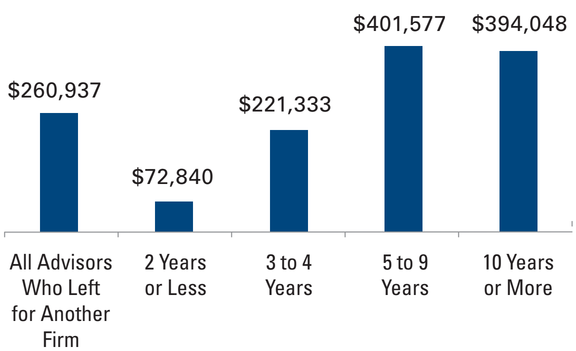
Cumulative Production Over a 20-Year Career



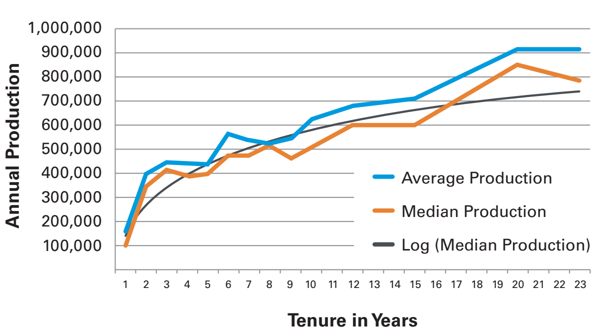
Source: Advisor Tenure Study—Benchmarking key business metrics of advisors throughout their career (Kehrer Bielan)

Current Production Lost When Advisor Leaves, by Tenure

Average Annual Gross Revenue Per Advisor



Average Production by Tenure



Source: Advisor Tenure Study—Benchmarking key business metrics of advisors throughout their career (Kehrer Bielan)

LOST REVENUE

The differential impact on tenure is important, of course, because advisors with longer tenure tend to have much higher average annual production than advisors with less experience with the firm. Advisors with tenure of five to nine years have almost double the annual average gross of advisors who have been with the firm for only three or four years.

Of course, when an advisor is lured away, the firm loses the advisor's future production as well. Kehrer Bielan's research on the impact of advisor tenure confirms that annual production tends to grow year-by-year as the advisor builds a practice.

Over a twenty-year career, an average advisor can be expected to produce $12 million in revenue. So when an advisor with five years of tenure—the average tenure of regretted attrition—joins another firm, the advisor is taking $10.8 million in future production away from the previous firm. Regretted attrition of an advisor with eight years of tenure—the average in bank broker/dealers—costs the firm $9.2 million in future revenue.

The present value of the future lost production of the typical advisor who leaves for another firm is $8.1 million. Doesn't it make sense to spend some of that money to keep the advisors, before it walks out the door with them?

REPLACING THE LOST REVENUE

Not all of the production is lost, however. A new advisor will be recruited and assigned to serve the departed advisor's clients and referral sources. The new advisor won't be as productive as the departed advisor for some time though—typically, for five years in the case of regretted attrition of a five-year veteran and for eight years for an advisor with eight years of tenure. The revenue lost in the meantime is lost forever. If the advisors had not left, revenue would continue to grow year after year. The gap between what the departed advisor would have produced and what the new advisor produced will persist year after year.

We used the data from our Advisor Tenure study, which includes production and tenure data on more than 1,500 advisors, to model the pace by which a new recruit would be expected to replace the revenue lost when an advisor with five years of tenure leaves for another firm. The production of the advisor who leaves the firm is the average revenue of an advisor for each of the remaining 15 years of a 20-year career.

The production of the replacement advisor is the year-by-year production of the average advisor as tenure increases. Over those 15 years, the new advisor never matches the production of the departed advisor, if he or she had stayed and had average performance. The gap represents the year-by-year shortfall in revenue that results from regretted attrition, and the area between the lines is the cumulative lost revenue. In the case of an advisor with five years of tenure who leaves for another firm, the total shortfall over the 15 years is $2.7 million. The present value of that lost revenue, at a discount rate of 5%, is $1.9 million.

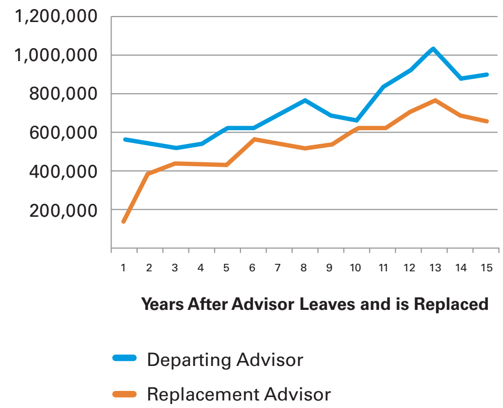
Of course, if the firm is able to hire an above-average advisor, there will be less of a shortfall. This means that the replacement advisor would have to be a better producer than the previous advisor, and ratchet up production year by year faster. But, with many advisors leaving in the first few years of hire, the newly hired advisor may not become a long-term employee either, which starts the cycle over again with even more tenure and production to make up.

We conducted similar analyses for regretted attrition for advisors with tenure of 8, 12, and 15 years. In each case, the gap persisted through the remainder of what would have been the departed advisor's 20-year tenure with the firm. The present value of the lost revenue to the firm was over $2 million.

The typical investment services profit margin in banks and credit unions is about 25%. Our analysis suggests that when regretted attrition occurs, it costs the firm at least $500,000 in profit per advisor, no matter what the tenure of the departing advisor is.

Once again, doesn't it make sense to spend some of that lost profit on trying to keep advisors from leaving?

Average Annual Gross Production



Revenue Lost from Regretted Attrition, by Tenure of Advisor Who Left (in millions)

Tenure at Attrition	Cumulative Revenue That Departed Advisor Would Have Produced	Cumulative Revenue Replaced by New Advisor	Shortfall	Present Value of Shortfall
5 Years	$10.8	$8.1	$2.7	$1.9
8 Years	$9.2	$5.9	$3.3	$2.4
12 Years	$6.7	$3.4	$3.3	$2.6
15 Years	$4.6	$1.8	$2.8	$2.4

ASSET ATTRITION

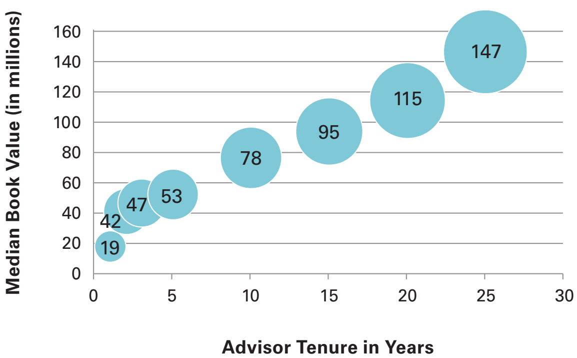
An alternative approach to assessing the financial impact of an advisor leaving for another firm is to value the lost assets. The longer tenured advisor is administering a much larger asset base. An advisor with 10 years of tenure administers a book of $78 million in assets, on average, 47% more than the advisor with five years of experience with the firm.

Experience from a Kehrer Bielan survey on assets lost through regretted advisor attrition indicates that advisors are able to take between 10% and 15% of the assets with them, with the longer tenured advisors taking more than the less tenured. That suggests the typical advisor with five years of tenure would leave with about $5 million in assets, and the eight-year advisor would leave with about $10 million. The departing advisor will spend more effort courting those clients with the best business potential than ones with dead assets in their account, so the percentage of clients following the advisor to the new firm usually represents more revenue potential than their assets would reflect.

According to our benchmarking research, the average return on assets is 65 basis points, but the longer tenured advisors tend to administer assets that produce somewhat higher annual revenue, because they have accumulated more advisory assets. On the other hand, when advisors sell their practices, the market appears to assign a value of 1.5% of the investment assets, more if the assets are largely advisory and less if the assets are predominantly transactional. That would suggest that the market value of the assets lost to an advisor with five years of tenure who leaves for another firm is about $50,000 (i.e., 1% of $5 million). For an advisor with eight years of experience with the firm, the value of the lost assets would be approximately 1.5% of $10 million, or $150,000.

Nonetheless, the actual financial loss of regretted attrition is more than the value of the lost assets. The remaining assets will not be as productive as they were for the advisor who left, as time elapses while a replacement advisor is hired and begins to work with the departed advisor's clients. It also takes time for the new advisor to develop relationships with the institution's referral sources. These are the same reasons why a new advisor will not be as productive as a more tenured advisor, and the new advisor will never recoup that difference over time.

Advisor Book Value



The bubble size represents the median advisor's book in millions of dollars.

Source: Advisor Tenure Study—Benchmarking key business metrics of advisors throughout their career (Kehrer Bielan)

ADVISOR RETENTION

What are firms doing to stem advisor attrition? For the three dozen firms in our survey, the most common tactic is to try to prevent advisors who leave from taking their customers and their assets with them. Almost half of the firms surveyed rely on non-compete agreements to discourage advisors from moving to another firm.

Firms also employ incentives to encourage advisors to stay, as opposed to discouraging them from leaving. One-fourth of firms surveyed provide deferred compensation—golden handcuffs that evaporate if the advisor leaves before becoming vested. Another fourth of firms provide profit sharing or equity grants. Additionally, a few firms provide a higher payout or bonus based on tenure with the firm.

Some firms have focused on advisors approaching retirement, developing succession plans that help monetize the advisor's practice without moving to another firm. The succession plan might involve teaming the advisor with a younger colleague, sharing revenue as the older advisor phases out of the business, and perhaps a forgivable loan based on asset retention.

Given the large impact of advisor attrition, it's somewhat surprising that 11% of firms have no systematic plans in place to keep advisors in the fold.

How do the retention tactics work? The typical firm in the survey lost almost 6% of its advisor force to regretted attrition. The firms that relied on non-compete agreements to keep their advisors actually had twice the regretted attrition rate of firms that did not have non-compete agreements.

Deferred compensation and equity grants appear to have no, or little, effect on retaining advisors. On the other hand, profit sharing appears to be a very successful retention strategy. None of the firms that provided profit sharing experienced any regretted attrition.

Perhaps the most striking finding, however, is that the advisor retention experience of firms that have no formal plans in place to retain advisors is three-and-a-half times better than the firms that do have retention incentives and penalties for leaving.

This suggests that there are other factors that are more important than incentives and penalties in keeping advisors. Some investment services executives are focusing on the ease of doing business, including upgrading sales support structures,

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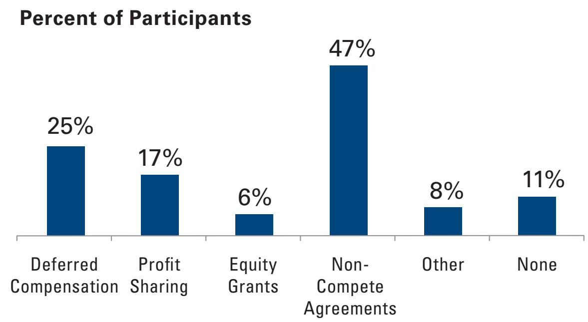
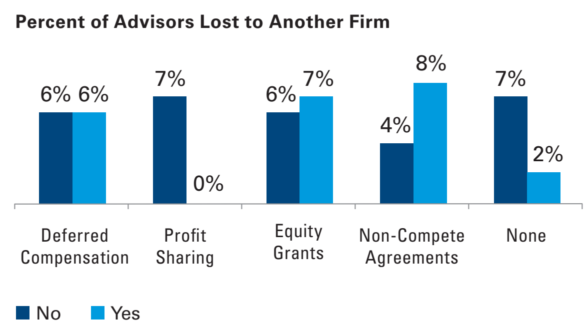
Use of Retention Incentives



Impact of Retention Incentives on Advisors Recruited Away

Percentage of an average firm's financial advisors that were recruited away: 5.9%



fostering teams with other advisors, finding alternative internal referral sources beyond the branch, and organizing the institution's marketing machine to generate leads to replace the dwindling flow of referrals from the branches. A robust product set and tools that help facilitate business are becoming table stakes to remain competitive. Other institutions are involving advisors in the business decisions of the firm, through advisory groups or advisor councils. These are all efforts to make the firm a better place to work, and to help advisors make a career by winning them over as their employer of choice every day. The cultural aspects of a firm may outweigh the financial aspects when advisors are making long-term career decisions.

SUMMARY: GROWTH THROUGH RETENTION

This analysis suggests that a core objective of investment sales management in a bank or credit union should be to increase the average tenure of the advisor team every year. Firms should do more to retain advisors, because they become more valuable the longer they are in place. In a sense they're irreplaceable, because their replacement will likely never recover the revenue lost when they leave for another firm. Investment services businesses are tasked by their host institutions to generate double-digit annual revenue growth. Given any attrition, just maintaining the advisor headcount makes growing revenue almost impossible, because the replacement advisors will produce so much less than the departing advisors that the revenue shortfall will undercut the natural growth in revenue from the advisors who stay with the firm.

Advisors become more valuable the longer they are in place.

Among the tools that firms have used to stem advisor attrition, profit sharing has been demonstrably more successful than non-compete agreements, deferred compensation, and equity grants. Recently, more firms have been installing succession plans that help monetize the advisor's practice in place, instead of leaving the firm. Early results suggest that these initiatives are being embraced by senior advisors, and they incur minimal costs to the firm.

Perhaps as important, some firms have created a work environment where advisors are comfortable and productive, and feel at home. Involving them in strategic decisions of the firm appears to help create that culture, as does investments in technology and processes that make it easier to do business and identify prospects.

Given the financial impact of regretted attrition, firms can spend much more resources than they have historically to keep their successful advisors. Fortunately, some of that spending accomplishes more than just sharing more of the firm's success with the advisors—it also helps to make the firm more profitable in the future.

To borrow a conclusion from our Advisor Tenure study, firms should adopt a business plan of "Stay Another Year."

ABOUT THE AUTHORS

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Dr. Kenneth Kehrer, a principal of Kehrer Bielan Research & Consulting, has been studying the transformation of banks and credit unions to financial services stores since the early 1980s. His research has influenced the metrics that a generation of industry practitioners now use to assess their businesses and assimilate best industry practices.

Dr. Kehrer has also consulted for scores of banks and credit unions and over one hundred product and service providers—insurers, investment companies, securities firms, technology providers, management consultants, and marketing organizations—on the development of strategies for distribution through financial institutions. In 2004, he received the Lifetime Achievement Award from the Bank Insurance and Securities Association for his contribution to the industry. He earned a PhD in economics from Yale University.

TIM KEHRER

Tim Kehrer is a senior research analyst who contributes his extensive experience in the interpretation of survey data to KBR&C's robust research program, including consumer research using the Consumer Financial Decision's *MacroMonitor* database. He is a co-author of the firm's highly regarded study of *The Value of an Investment Client,* as well as studies of investment services in credit unions, advisor compensation plan design, and financial planning. Previously, he was a political operative with experience as a field organizer and campaign research director, and interpreted polling data for the development of media campaigns for a national political party. At KBR&C, he directs the annual benchmarking surveys of investment services in bank broker/dealers, regional and community banks, and credit unions, and the annual TPM Survey.

ABOUT KEHRER BIELAN RESEARCH & CONSULTING

KBR&C provides the financial advice industry with insights based on a melding of research and experience in managing the delivery of investment, insurance, and wealth management services. The firm provides performance assessment and benchmarking, human resource management and development, due diligence, consumer insights, and interpretation of industry trends through its original research, unbiased consulting, and peer study groups.

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