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Advisor income drops as markets tank

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With markets down about 30% year-to-date, clients aren't the only ones worried about how much they're bringing home at the end of the day — advisors are taking a financial hit as well.

With financial compensation often tied into a percentage of assets, or commissions from fund companies, the harder the markets fall, the lower the revenues for advisors.

"In general, advisors' primary source of income is trailers," says Robert Abboud, president of Wealth Strategies, an Orleans, Ontario-based financial planning firm. "If a portfolio is down 20%, our trailers are down 20%, which means revenue is down by the same amount."

Frank Wiginton, a CFP and senior financial partner with Toronto-based Tri-Delta Partners, admits he's making slightly less money because of the credit crisis. His overall assets are only down 8%, however. "We're not taking as big a hit, but yes, it does reduce the overall income you make," he says.

Advisors who will be most affected by the market downturn will be the ones who still take a deferred sales charge (DSC) commission. In most cases, that nets the investment professional about 5% when an investment is made, and includes a half a percentage point trailer fee. If clients aren't investing, advisors won't get that initial fee.

"This is really going to kill advisors who count on DSC on a monthly basis," says Abboud. "Their income will be down significantly."

Abboud has a no-load fee structure with a 1% trailer fee. He chose that model because he didn't want to lock clients into one specific fund company, which often happens with front-end load compensation. He'll still get hit as clients invest less, and possibly pull out their investments, but he's prepared if his income drops.

"You have to run a lean, mean machine," he explains. "Keep debts to a minimum. It's very much like a personal balance. You spend less and pay yourself a little less."

He adds that now's a good time to rethink fee structure, and implores DSC-based advisors to switch to a no-load trailer commission. That way they don't rely on the upfront fee — which they're not getting right now anyway — and can increase their trailer fees by half a basis point.

If Abboud's revenue does decline significantly, he's built up cash reserves and has a "monster-sized" line of credit. So far he hasn't had to tap into that, but he expects business will be tight for the next six to 12 months.

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Wiginton hasn't made any significant changes to his business, but suggests advisors should "stop going to steakhouses," in order to save money. "If they're smart, they'll be spending extra time in the office, working hard to generate more business to make up for the loss of income," he says.

Cutting back is obviously helpful to the bottom line, but advisors should be wary of taking a hatchet to their marketing budgets. Wiginton says now's the time to find new clients.

"Many people out there are confused about what's going on," he explains. "They haven't heard from their broker or advisor, as these people have been hiding under the tables throughout the chaos. When markets are up 20%, people say, there's no way I'm going to change advisors because he's making me a fortune. When the markets are down, that's when people are most likely to change."

That's exactly the mentality that fee-only advisors have. Scott Plaskett, CFP and CEO of Toronto-based IRONSHIELD Financial Planning, says his business is booming as more people realize that now might be a good time to create a comprehensive financial plan.

While Plaskett also receives compensation on a percentage of invested assets — and that part of his business is down — the new clients and the regular planning fees, which don't fluctuate based on market conditions, are helping to pay the bills.

"This type of market is when our firm tends to do exceedingly well," he says. "People can't rely on rate-of-return anymore. When markets are doing well, people think that because they're earning an above-average rate of return, their financial plan must be on track. When markets are down, they question what theyâ€™re doing to reach their long-term goal."

Warren Baldwin, regional vice-president at Toronto's T.E. Wealth, agrees. The fee-for-service advisor says his phone is ringing off the hook. "People look at their portfolio and say 'oh my god, I didn't really plan, now look what's happened.' They want to talk to someone who can give them a roadmap."

Like Plaskett, a big chunk of Baldwin's income comes from fees related to his client's investments, but the new business will help the advisor overcome any financial setbacks.

Another way to mitigate financial losses is to diversify. Just as clients need to invest in a number of different funds and bonds to protect themselves from a market drop, advisors might want to consider spreading out their business.

Take Plaskett, who is also licensed on the insurance side. He's able to draw enough revenue from multiple sources that he can actually increase spending on things like marketing and developing a new website, even though markets are down.

"It all comes back to rule number one," he says. "Don't put all your eggs in one basket. If advisors follow the fundamentals in how we practice our own business, then everything works out in the end."

Diversification isn't the only rule advisors might want to follow during tough market conditions. Some of them might want to take their "buy now" speech to heart, and search for a new book of business to purchase.

"Most advisors came into this in the mid-to-late 90s, and all they've really seen is a bear market," says Abboud. "The fatigue is wearing on them, they're older — the average age of an advisor is 55-plus — and they're getting to a stage that they might be done with this.

"Some advisors I've spoken to feel they don't know what to say to their clients and when they feel lost that usually means that they're ready to throw in the towel."

The upside in buying a book of business now is that they're cheaper than usual, because client portfolios are down. Sure, advisors will have some short-term pain, but like you tell your clients, it's the long-term investment that counts.

Wiginton agrees that now could be a good time to expand, but it's risky. "The problem is when a guy burns out, that means the book of business has been devastated and the upside to that practice is limited. You have to deal with highly upset clients, so maybe pay more for the book on the boom side and you'll negate the downside risks."

Some advisors might think they'll be fine, but Abboud says it's only a matter of time until every advisor's wallet gets a bit lighter. "Whatever happens to a book results in our income going down. We won't see it until the following month, so we better get ready."

Filed by Bryan Borzykowski, Advisor.ca, bryan.borzykowski@advisor.rogers.com

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