Transfer Time – When Decoding B/D Transfer Options, Don't Focus on The Money

by Jonathan Henschen, CFS and featured on Henschen Associates May, 2008:

For advisors pondering a move from a wirehouse to an independent broker/dealer with visions of large, forgivable transition loans dancing in their heads, it's time for a reality check.

That's because, as an esteemed economist famously said, there's no such thing as a free lunch! With reps at independent B/D reps earning 90% payouts, independent firms have much smaller margins to work with than do their wirehouse counterparts.

Times have certainly changed when it comes to a broker's transfer options. It was once common for reps joining a firm to be responsible for covering all their own expenses, including registration costs, business cards, stationery and ACAT transfer fees. While some firms still take that approach, the trend in recent years has evolved to where firms worry that if they don't offer something to brokers contemplating a switch, they won't be able to compete.

In spite of their thin margins, more and more independent firms are becoming increasingly aggressive with their transition packages as way of competing in a highly competitive marketplace. But don't deceive yourselves: the sky is definitely not the limit.

So to inject a note of sanity into these proceedings, here is a comprehensive summary of transition money options now being offered advisors by independent broker/dealers.

[frame]Offer No. 1: 2% to 3% of Trailing 12-Month Production[/frame]

A majority of broker/dealers find this offer fair and equitable for both sides. Money is offered at the time of placement with no strings attached. In the case of large producers, firms may cover ACAT transfer fees in addition to two to three percent support. Firms are comfortable with this option because it's a reasonable hit for their profit spreads, and covers most advisors' transition expenses, but not their downtime or new-office expenses.

[frame]Offer No. 2: Accelerated Payouts Up to 100% for Upto a Year[/frame]

A less common option we've been seeing are firms offering 100% payouts for three months to a year. The motive here for broker/dealers is to help reps recoup transition expenses and lost revenue due to downtime.

Broker/dealers using this approach don't have to bother with forgivable notes or making capital commitments on their end. A few firms are offering combinations of forgivable loans of up to 10% along with accelerated payouts. When wirehouse representatives are transferring, the reps' ability to transfer their books can run into problems, either through contractual restrictions or a manager allowing in-house reps to go after the accounts being transferred.

For independent broker/dealers in these situations, accelerated payouts may make more sense than upfront money, since the latter requires production to be maintained at or near a rep's prior-year level. Though this option has a lot going for it, reps usually prefer receiving money at the time of placement, or a combination of upfront money and accelerated payouts.

[frame]Offer No. 3: Upfront Loans Paid Back Through a Lower Payout[/frame]

Large capital outlays are often required for advisors leaving wirehouses for independent firms. Besides large ACAT fees, reps also have capital outlays for computers, software, new office space, and furniture for that space. Further complicating some transitions are forgivable loans reps may still owe their former firms.

We’ve seen some broker/dealers offer loans of up to 20% of trailing 12-month production. In return, advisor payouts will be dropped by 5% to 10%, or enough so that the payback period is completed within a couple of years.

A few larger independent firms have been combining forgivable notes with additional amounts repaid with lower payouts. A common ratio being used in these cases is 5% with a forgivable note and 5% repaid through lower payouts for a total of 10% of trailing 12-month production. This type of loan has become standard with a few firms when needed to seal advisor commitments, but is not typically advertised.

[frame]Offer No. 4: Forgivable 5% to 10% Loans[/frame]

Over the past two years, at least eight firms we know of have been willing to offer more than the usual 2% to 3% of trailing 12-month production to help with transitions. To sweeten the deal, advisor commitments for forgivable 5% to 10% notes running for three to five years are now being offered.

[frame]Offer No. 5: Forgivable 10% to 30% Loans[/frame]

This offer is as good as it gets in the independent channel. Forgivable notes in this range will have forgivable note timelines running four to six years. With these loans, reps will be required to maintain 80% to 100% of the production upon which their loans are based. If production falls below the predetermined benchmark, the broker/dealer can do any of the following:

1. Extend the loan period.

2. Charge interest on the loan.
3. Call the note and request payment of the outstanding balance.
4. Take the rep’s home and first-born child (just kidding!).

How much you are offered as a percentage usually depends on how much production you’re bringing to the table. For example, $200,000 to $499,999 of production will bring you a 10% forgivable loan, while $500,000 to $999,999 will get you 15%. To reach the 20%-plus level, you’ll need production of $1 million or more! In the past, it was the broker/dealers with deep-pocketed parent companies that offered forgivable loans, but this, too, has changed, with firms as small as 250 reps being open to structuring a loan package.

Seeing the Big Picture

Now that you’ve read all the above, forget those dollar signs dancing before your eyes. Advisors too often fixate on transition dollars, which can, and far too often does, keep them from seeing or even looking for the big picture. Advisors can often earn much more over time with firms offering lower ticket charges or advisory administrative fees than what they bring home in the form of transition money. Also, we’ve seen time and again that any rep’s satisfaction with his or her firm, ultimately depends on the firm’s culture and philosophies meshing with those of the advisor. This is one of those instances where the marketing messages sent by a company are actually true: culture is more important than cash.

Over the years in our business of matching reps with independent B/Ds, we’ve had countless conversations with reps who have taken large transition loans only to realize a year or two later that they and the firm are not a good fit. They are invariably miserable, wanting out, but are stuck for another four years servicing those forgivable loans for which they were once so hot. Not surprisingly, their production drops soon after the transfer and they end up spending much of their loan money. The result?

They're trapped in an unsustainable situation. If only they had exercised a bit of forethought and read this article they could easily have avoided their sorry fate.

The Real Bottom Line

If you're an advisor seeking or considering large, forgivable loans, you should be coming at those loans from the correct perspective: The money is only the icing on the cake, not the cake itself, or, for that matter, the main course. If all the broker/dealer requirements you're looking for are in the picture with a generous transfer package as an added bonus you can then commit to the offer and to firm without doing so blindly.

Read the Fine Print

Just as it's wise to read prospectuses before investing, be sure to read loan contracts in detail before you transfer, because some firms structure transition loan contracts so that instead of being paid off incrementally, the amount owed is stacked at the end of the contract period. As a result, instead of the loan being forgiven at a rate of 1/5 per year for five years, you can end up leaving the firm during the fourth year still owing 80% of the original loan amount. Yes, those loan contracts can be fascinating reading!