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## SURVIVING THE PLUNGE

*Amid falling assets and revenue, advisors try to position themselves for the eventual upturn ...*

By Jeff Schlegel

For investors and those who advise them, 2008 was like a massive forest fire—nearly everyone got burned. But like a forest fire, it could ultimately be a cleansing experience that rejuvenates and strengthens the industry.

That's cold comfort to clients whose retirement assets sank like the Titanic, and to financial advisors whose revenue base is tethered to those declining client assets. But for advisors, the awful downturn is a time for soul-searching about who they are as professionals, how to best serve their clients and how they can position their business going forward. And given the financial turmoil—wirehouses in disarray, investors upset about their shrinking portfolios and, in some cases, the performance of their advisors—there could be a lot of new business had in the near future.

"There are two types of advisors in this market," says Mark Tibergien, managing director at Pershing Advisor Solutions. "Those who are paralyzed by fear and those who see this as an opportunity to retrench and see this as the next wave of growth. There's no question that every firm is under profit and revenue pressure."

Solid numbers are hard to come by, but the anecdotal picture painted by a handful of advisors is that assets under management last year declined anywhere from 20% to 40% for the average advisor. That hurts, particularly since Cerulli Associates' latest data shows 56% of advisor revenue is driven by AUM. "Given market devaluations of 35% to 40% for most assets under management, which contributes 56% of your book, that translates into revenue declines of 15% to 25%," says Cerulli analyst Scott Smith.

It especially hurts those advisors who have a lot of overhead or whose client service M.O. is to provide market-beating investment returns. "What do you do when investment returns are no longer the solution?" asks Joe Duran, CEO of United Capital, a consolidator of advisory firms based in Newport Beach, Calif. "What do you do when revenues aren't growing organically by 8% to 10% because of the markets but your expenses keep growing? Many advisors are waiting for the markets to recover, but what if they don't?"

For some advisors, the existential question centers around what's next for the business. "I think there will be an identity crisis in the next six to 12 months in the advisor community," says Michael Dubis, a certified financial planner in Madison, Wis. "We as advisors need to ask not only what we've learned from this, but what's in the value chain for the client. I think advisors need to question whether they should be offering investment management, because I don't know if that's what they wanted to do in the first place as advisors."

### Who Am I?

Advisors often get religion during bear markets—it happened after the tech crash earlier this decade, and it's happening after the global rout of '08. The market dynamics are different, but the business impact on advisory firms is similar. "Any situation where advisors see revenue go down at the same time that their work efforts and client needs go up will result in a squeeze," says Rebecca Pomeroy, a principal in charge of Moss Adams' advisory business and a practice leader at the firm's business consulting group. "These downturns are really good for the industry in terms of getting people to refocus on running their businesses well," Pomeroy says, adding that many advisors got a little lax with business management during the boom years between downturns.

Pomeroy jokes that it's during times like these that people actually start listening to her about managing costs, establishing appropriate pricing structures and setting a sensible staff size (one that's not too fat, yet big enough to handle growth). She says advisors now have to focus on financial management, business strategy and sales and marketing. "Strategic planning isn't just about how you grow," she says. "It's also about how you convey your value in the marketplace."

But "value" can vary among advisors. "We talk about planning as financial advisors,

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**Trade** 0.59  
**Change** 0.00  
**% Chg** 0.00%  
**Open** 0.00  
**High** 0.00  
**Low** 0.00  
**Volume** 0  
**Intraday** 

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but how many actually are doing strategic planning for their own business?" asks Michael Haubrich, CFP, founder of Financial Service Group in Racine, Wis.

In 2007, Haubrich's entire staff took its annual three-day retreat in Phoenix, where he keeps a second office. Here, he says, they put together a road map to move away from fees based on assets under management. "We feel handcuffed to the AUM model and all of the conversations that revolve around that," Haubrich says. "If the Dow snapped back to 14,000 in 2009, this decade would still be worse than the decade of the '30s. So it's understandable that people would ask what's the value of paying someone just to manage my money."

As part of the new plan, the firm decided to raise fees and introduce a retainer structure as part of a more holistic service model less focused on asset returns, Haubrich says. The retainer model is based on a \$5,000 fee that includes a flat fee, a percentage of total net worth and a percentage based on a client's annual income. The retainer is fixed for 24 months.

For this the firm would monitor the client's ability to reach his life objectives within prescribed timelines under the financial plan, and would also manage all the various components of net worth, from the client's investments and real estate to his debt. The firm's services also include tax planning and preparation, as well as career advice.

He planned to roll out his new pricing plan at the start of 2009, but says he decided to delay it a few months to avoid the impression that he's changing the rules of the game on clients at a time when their assets have gone south.

### AUM Debate

The market downturn puts the spotlight on fee structures, particularly those based on AUM. This fee model is great when the market is up and new accounts are gushing in, but it's a huge drag when markets tank. And even in good times, some advisors question the wisdom of the AUM format.

"I always thought that billing under AUM was a faulty model to begin with," says Carolyn McClanahan, a planner and founder of Life Planning Partners Inc. in Jacksonville, Fla. "I switched entirely to flat retainers a couple of years ago. I have consistent cash flow, don't have to calculate fees, and my clients love it. I feel this greatly reduces the mixed message that investments are more important than financial planning, as investments are only part of financial planning."

A retainer model looks a whole lot better now to a lot of advisors. "I was committed to moving from AUM to a retainer model but didn't do it in time," says Eve Kaplan, a planner in Berkeley Heights, N.J. "I'm pretty sure many advisors will consider some retainer model that doesn't tie them to markets as much. We've all learned a bitter lesson from the market declines."

Haubrich puts it more emphatically. "Even for firms like us who do a lot of holistic planning, we got addicted to the dope of the AUM model."

But not everybody is ready to trash that model. Retainers may work great in flat or down markets, but aren't great in up markets because you can't get leverage.

"Pricing isn't just a function of what drives profitability," says Tibergien from Pershing. Whether the fee is asset-based, paid as a retainer or paid hourly, it should be "what's best aligned with your service model," he says. He adds that asset-based pricing might be best suited for advisors who position themselves as investment managers, while those who consider themselves wealth managers might consider supplementing asset management fees with hourly project or retainer-based pricing.

Philip Palaveev, the president of Fusion Advisor Network and a longtime industry consultant, believes AUM is a good model because it aligns the interests of advisors and clients. "I think it's a complete fallacy to say, now that revenue is down, that you should abandon the AUM model and charge in different ways," he says.

He notes that a 100-basis-point asset fee—more or less the industry standard—is a healthy rate that anticipates markets going down every five years or so. "We have to remember that we've had some really good times in this industry, and we should be financially prepared to weather this storm," he says.

An asset-based fee structure might look ugly now, but at least one industry watcher expects it to remain king. "I think factors linked to holistic planning are becoming a way to meet the needs of aging clients, and might be of more interest to advisors because the standard AUM model isn't as lucrative as it used to be," says Chip Roame, managing principal at Tiburon Strategic Advisors in Tiburon, Calif.

"But ten years from today, we're still going to be 90% AUM," he continues. "We'll write lots of articles and will talk about changing it, and a few people will go there, but AUM will remain the rule. Big industries change very slowly."

As for advisors now stuck in the AUM muck, Roame suggests holding the line on fees. "I don't think defending your revenue base is a good thing to do when clients are seeing their retirement plans tumble," he says. "I think the thing to do is take it on the chops and help them, and not find new ways to make money off of them."

### Cost Cutting

Steven Podnos, who runs a one-man shop called Wealth Care LLC in Merritt Island, Fla., estimates his asset base declined 20% to 30% during the downturn from a peak of \$120 million, and even though all but a few of his roughly 70 clients pay their fees based on a percentage of assets under management, he's not sweating it. Trained in

increasingly needing to develop a more personal understanding of their aging clients, and not just because it's a smart business play.

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## Discussion

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pulmonary critical care, Podnos was a full-time physician for about 20 years before he became a full-time planner seven years ago, and he says lessons learned from his past career come in handy now.

"Having done a medical practice for many years, I understand overhead and staffing," he says. "I set out with the goal to keep overhead as low as possible so my fees can be reasonable. My fees are a little lower than average, but I get to keep more of it myself. So even though my asset base is taking a big hit, I'm still making decent income and I don't feel any great pressure. I'll have less income, but will spend a little less until the money comes back."

His fees start at 75 basis points annually on the first \$1 million. The second million dollars is billed at 50 basis points per year, and everything over that is billed at 25. "I view it as a boutique practice," he says, adding that his office probably costs about \$10,000 a year and that his total overhead runs about 15% to 20% of gross income.

Others aren't as nimble. Joe Duran from United Capital says his company held discussions with one sizable advisory firm whose revenue dropped from \$8 million to \$5 million and was forced to fire half of its 35-employee staff. "How will they maintain service standards and growth projections?" he asks. "What we've seen in the past is that advisors are way too slow to adjust their cost structures. Today, there's a serious fork in the road and I think we'll see a lot of financial advisors fail."

The current market maelstrom is testing advisors in more ways than one. "It's a time to earn your keep as a financial advisor," Tibergien says, "but it's a time when you prove your worth as a manager, too."

Cost-cutting isn't the key to long-term prosperity, he says, but it can be a short-term aid in tough times. Tibergien's suggestions: divide expenses between "need to have" and "nice to have" categories. The former includes certain key employees, who should be well compensated for their work. The latter includes a range of items that, though they may be desirable, can be resisted—industry conferences you can skip, travel you can limit, or computer and software purchases you can postpone.

"If short-term decisions don't materially enhance your business," Tibergien says, "you should probably put them on ice."

Ross Levin, founder of Accredited Investors Inc. in Edina, Minn., is pondering what to put in the ice bucket. His firm has roughly 35 employees, but staff cuts aren't in the works for now. "If we maintain and grow our client base, which is what we're doing, I don't see how we can cut back on staff," he says.

Levin estimated that his firm's asset base was at about \$600 million in early 2009, down about 19% from the previous year. He says he invests a lot in his staff—everyone gets five personal charity days a year; a yoga instructor comes into the office once a week; and all of the CFP licensees on staff get an annual \$3,000 education allowance.

"We're looking at all of these things to see what makes sense to cut back, change or delay," Levin says. "Yet we have to recognize our staff is working very hard during this period and we want to continue to reward them."

The company owns its office building, which Levin says is a big help financially. He's been through several downturns during his 25 years in the business, and while none are worse than this, he exudes a sense of optimism that both his firm and the industry will see better days again.

In the meantime, he has one eye on cutting back non-essentials and the other eye on investing for the future. He said the company is contemplating a switch from its proprietary database to a public one, such as Junxure, where the initial investment is higher but is ultimately more scalable. The company also recently upgraded its research staff by hiring a new certified financial analyst, and its principals want to upgrade client services by adding legacy planning capabilities such as video ethical wills.

They've put some projects on hold for the time being to focus on customers, both by serving current ones and bringing in new ones. "We think this market is a great opportunity to bring in new clients," Levin says.

#### **All Things Must Pass**

The markets will recover someday, and so will client assets and advisor revenue. But to quote a popular catchphrase, a crisis is a terrible thing to waste. In that vein, industry consultants such as Rebecca Pomeroy of Moss Adams see this as an ideal time for advisors—particularly those who have positioned themselves as wealth managers focused on holistic planning—to gain new clients from the wirehouses, and also to take clients from those advisory firms who sold their story based on investment returns but who failed to deliver the goods.

"In most cases, firms who are losing clients now didn't tell their story right," she says. "At Moss Adams we told clients we're a goals-based organization, that markets go up and down, and their portfolios are structured around their risk tolerance and time frame. We're not losing clients, because they knew what to expect."

Palaveev is telling his network of wealth managers to invest in their firms during the downturn. "If anything, we're telling our advisors to increase their service levels," he says. "There are a lot of good people who are available because they're getting laid off, so you should bring them on board if you can afford it."

"I think the revenue will be there for the better practices," he continues. "I think the strength of business development—there are a lot of opportunities now to add clients and increase market share—will help most advisors weather the storm."

Palaveev said it took a few years after the '00-'02 bear market for money to rush back into the market. And when it did, the advisory industry in 2004 saw revenue growth zoom by 40%. And those who followed best practices in the areas of financial management, business strategy and marketing did best of all.

"What you do in a time of crisis tends to define your position over the next five to six years," he says.

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