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B/D BRIEFING

A Trend Confirmed?

Advisory fees overtake commission revenue at Commonwealth

BY KATHLEEN M. MCBRIDE

FEE-BASED ADVISORY revenues are higher than traditional commission-based revenues, for the first time, at Commonwealth Financial Network. It's not a change to advisory accounts from fee-based brokerage; Commonwealth doesn't do fee-based brokerage. The firm started a formal fee program in the early 1990s, perhaps earlier than some other broker/dealers. So what does this mean for the independent broker/dealer industry? Will other firms soon reach the point at which fee revenue dominates?

Data gathered for the 2007 *IA* Broker/Dealer Directory, conducted last April, show that of the 76 independent broker/dealers that reported both gross and fee-based revenues for 2005 and 2006, all but one firm saw equivalent or higher 2006 fee revenue.

Revenue derived from advisory fees at Commonwealth so far in 2007 is running in the "mid-50s" as a percentage of all revenue, while in 2006 it was in "the low 40s," according to Wayne Bloom, a managing principal at Commonwealth, which has home offices in Waltham, Massachusetts, and San Diego.

Commonwealth's fee business is all done by investment advisors affiliated with the firm's own RIA. This is "not fee in lieu of brokerage, we've never done that business; this is advisory business," Bloom explains. The firm's growth in the fee business is not related to the unwinding of the broker/dealer exemption rule, which exempted brokers from regulation as an investment advisor even when they were being paid fees for advice in fee-based brokerage accounts. The economics of fee in lieu of brokerage never appealed to Bloom: "There were very few clients that I felt would be at fair value—you would either have clients who underutilized the trading capacity so they'd be paying too much; then you'd have people who really wanted to do a ton of trading, and they'd be sort of stressing the system from a pricing standpoint."

Commonwealth says it's the only broker/dealer other than Cambridge Investment Research, in Fairfield, Iowa, to get to the point where fees have overtaken commission revenues. The fee business at Commonwealth has been evolving for a long time. "In the mid-'80s our chairman, Joe Deitch, had a firm, Cambridge Analytic, that had this neat idea that maybe they should sell mutual funds—no-loads—and wrap them with a fee. Joe was a little bit ahead of his time back then, but we've been doing fee-based business for years and years," Bloom notes.

Commonwealth started fee-based services in the "early '90s in a program with Fidelity Advisor Funds," launching its own program in 1996, Bloom recalls. "We've supported it for a long, long time, and we've continued to build it out and improve the pricing." Bloom thinks of the model as "my advisors [are] in the advisory business," and Commonwealth is "in the infrastructure business." As use of Commonwealth's platform has grown to include more than 1,000 representatives, the firm has lowered fees and increased payouts. Some advisors want to manage clients' money themselves; some want help from Commonwealth's home office; some get help from the firm's research sources. The "fastest-growing group" of advisors within Commonwealth, however, wants to "outsource the money management." Bloom asserts that "whether the advisor wants to efficiently do it on his own or bring in third parties, whether it's traditional separate accounts—even some of the TAMPS—we've tried to contract with [them] directly. Rather than do it on their platform, we'll do it on ours."

"The alignment of the financial interests of the advisor and the investor has been driving fee-based [advisory] business since way back when. What continues to drive it is the shift to more holistic planning where the advisors want to work more and more, and go a lot deeper, with each one of their clients. The fee-based relationship is really the model that allows them to do that." Where previously Bloom saw advisors bundling their services for clients' "asset management, retirement accounts, corporate 401(k)," now he sees advisors splitting the asset management fees away from planning. "They can do hourly, they can do flat fee, they can have clients on a retainer," so fees are commensurate with the services advisors are actually providing for a client. What is really important, he notes, is making "sure that clients value the non-asset management portion of their advice." Bloom talks a lot about "fair value pricing" for the client. If a client with $1 million of assets under management just wants money management, should they pay the same amount as one who wants the same money management, as well as 20 hours of advice about other wealth-related topics? "There should be a differentiation in what those two clients pay."

A THIRD-PARTY TREND

Bloom sees a big surge in third-party money management. An advisor's "most valuable commodity is time. It's very difficult to hands-on manage all the money, and manage the relationships, and at the same time go very deep with these planning issues." He sees advisors using third parties to manage the assets, but even more often sees advisors using third-party money management to help segment their book. "They may say… 'We won't take any new clients under $250,000.' But what they'll also say is, 'If it's not at least $1 million, we'll use one of the approved third-party [managers].'" Advisor-managed accounts still hold the lion's share of assets, but "year over year," he points out, third-party asset management is "doing very, very well. And it's certainly keeping the pressure on us to make sure we keep adding robust managers to our platform." **IA**

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