EPISODE TRANSCRIPT

Industry Update on Recruiting: Should you go for the forgivable loan?

A Conversation with Louis Diamond

Mindy Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is an industry update on recruiting. Should you go for the forgivable loan? It's a conversation with my partner, Louis Diamond. I'm Mindy diamond, and this is Mindy diamond on Independence.

Mindy Diamond:

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Mindy Diamond:

My partner Louis Diamond recently wrote an article which was published in AdvisorHub entitled, Advisor Recruitment: The Bull and Bear Case for a Forgivable Loan, in which he explored a question many advisors who are weighing their options, ask themselves. Should I go for the short term windfall or bet on the long-term potential of my business? The truth of the matter is that there are good cases for both options. The merit of forgivable loans tied to recruiting is an ongoing argument in the wealth management industry. It's a decades long conversation for advisors considering change, especially those in the W2 world. And it's about monetizing the business by negotiating a lucrative transitioned bonus with competing organizations.

Mindy Diamond:

Yet those on the independent side often talk about building long-term enterprise value and controlling one's own destiny instead of focusing on deals. Is it wrong for an advisor to seek monetary remuneration for taking the risk and going through the hard work of a transition? Absolutely not. Is it better for advisors to sell finance their move and focus on the longer term economics of independence? Louis and I are going to explore both sides of the topic in this episode. So let's get to it.

Mindy Diamond:

Louis, thank you for joining me.

Louis Diamond:

Yeah, of course. It's such an important topic so it should be fun to dive in to.

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Mindy Diamond:

Louis, let's start by talking about deals in general. What are we seeing as far as ranges? How do deals differ depending upon the channel?

Louis Diamond:

The real comment is it really does differ depending upon if you're looking at a wirehouse firm, a regional firm, which would still be a W2 option. Maybe a boutique firm, and then certainly independent firms either offer no upfront capital or much lower deal. For a, let's say a million dollar plus business, I would expect the deal to range from anywhere from 200 to 330% of trailing 12, depending upon the quality of the business and the type of firm that advisor's going to join. And the deals it's not all paid upfront. Roughly half of the deals normally upfront, some firms will reimburse all of our portion of an advisor's unvested deferred compensation. And then there's backend components that require an advisor to transfer the business at certain intervals and then grow the business as well. And so it could be quite lucrative depending upon the firm, but really devil's in the details and advisors have to weigh the long-term implications of the firm they join versus the shorter term implications of what the financial package looks like.

Mindy Diamond:

Let's break down some of what you just shared. That was a big range. Is there a way of thinking about it? Is it that the wirehouse has offered the biggest deals? Do the regional firms fall into a certain range within that? What does that look?

Louis Diamond:

Yeah, so I would say rule of thumb that the wirehouses pay the most. They always have. But there are some outliers and exceptions. In the regional firm bucket, for example, Ameriprise and RBC tend to be at the higher end of the range, which both could be 300% or above, depending upon the advisor. And then some of the firms like Raymond James, Stifel and Janney, are usually a little lower. But they're still having remarkable recruiting success. And then if we look at some of the more boutique firms, Rockefeller, First Republic type organizations. JP Morgan as well, those all can have a three in front of it as well. So again, depends upon the type of firm and really the size of the advisor's business and the underlying quality.

Mindy Diamond:

So three in front of it, meaning a total deal of three times an advisors trailing 12 months production. Is that what you mean?

Louis Diamond:

Yes.

Mindy Diamond:

Got it. So you mentioned that's a sample deal for a million dollar producer, but what happens if it's a $5 million team?

Louis Diamond:

It's going to be relatively similar. The larger the business, the more leverage the adviser has. And the more a firm wants an advisor, they're more than willing to get creative. So it's not that a $5 million team is going to do so much better than a $3 million team. But the more the firm wants an advisor, the more economics that are in it for the firm and the more eyes and senior leadership gets involved and there's more ability for those firms to get creative.

Mindy Diamond:

And how about if two teams come together? So if an individual advisor is doing $1 million and he's going to partner with a team doing $3 million and now instead of $1 million, it's 4 million in production?

Louis Diamond:

Yeah. I would say devil's in the details there. Oftentimes advisors can package themselves for lack of a better term and be looked at as a $4 million team. But it really depends upon how coordinated or closely tied together those advisors are. It doesn't always work that way. And of course the downside is the more decision-makers you have and the more stakeholders, the harder it is for each individual advisor to land in the best possible place for them. So the short answer is sometimes it works. Sometimes firms don't really take it into account because the businesses are so different.

Mindy Diamond:

Got it. And how about deal trends? Are deals generally getting larger? Are structures changing? I've been at this for almost 25 years and every year firms warn deals could go away or deals could go lower. To my knowledge and my recollection, I've only really seen that happen once. It lasted about couple of months, it went down and then they went right back up again. So where are they going from here?

Louis Diamond:

I wouldn't say the deals are getting larger. I think the structures are becoming much more advisor friendly. So the deals, the headline numbers, have been relatively consistent the last number of years. The pull back I think you're referring to was on the heels of the Department of Labor FAQ's around recruiting deals. Firms really restructured deals for a brief period of time, but they've bounced right back up. The really good thing about deals for advisors are that there's now more viable options for an advisor to consider, which is the ultimate check that deals will remain competitive. If one firm decided to pull back, they just wouldn't win opportunities. So the more choices, the more the advisors in the driver's seat.

Louis Diamond:

And what I mean by structures are becoming more advisor friendly is that now advisors are seeing more of the deal upfront than ever before. We're seeing certain firms reimburse for deferred comp, which is relatively new and we're even seeing firms make backends based upon growth and assets versus growth and production, which is more advisor friendly. So I think overall really good time for advisors considering deals because they are at an all time high and the structures are as good as they've ever been.

Mindy Diamond:

Interesting.

Louis Diamond:

Definitely. So let me now ask you the next question. How has advisor mindset changed surrounding deals over the years? You've been at this for 25 plus years or so. Recruiting deals have always been part of the overall business model. What's been advisor's attitudes towards deals over that time?

Mindy Diamond:

I love that question and I actually share it with most advisors I talk with. When I first started the business 25 years ago, the number one statement recruiters led with and the number one question advisors asked was, "Hey, I've got a hot deal", was what the recruiter said. And the advisor said, "What's the deal? What are they paying?" That's really what drove things. That's telling for a couple of reasons. One, independence wasn't a thing in those days. So it wasn't that going independent was an option. It was either you moved for a deal to another major firm or you stayed put. It was binary.

Mindy Diamond:

But the second thing about it was that there really wasn't in advisor's minds, a lot of difference between the firms. Absolutely there are things you could say about the difference between Morgan Stanley and Merrill Lynch and Merrill Lynch and UBS and UBS and Raymond James. But for the most part, if an advisor were going to move, deal was very important. It was probably one of the most important driving characteristics. But in the last number of years, what's really changed is a couple of things. One, we're seeing younger advisors step up to the plate and say, they're beginning to look at independence, get educated on it. See the benefits of building long-term enterprise value and realizing that if I go independent at 30, instead of at 50, I've got 20 extra years to build enterprise value. And we've interviewed many guests on this podcast, younger advisors who have eschewed making that interim move to another major firm for a deal in order to go independent.

Mindy Diamond:

The second change is really probably most telling a more universal is that while if an advisor is inclined to move to another traditional W2 model, deal is certainly important. But it's not the first question. The first question is will I have more freedom and control, more agency over my business? And that's probably the number one thing that's changed is advisors value and want to make sure that their freedom to serve clients, to grow their business without limitation, and to be able to count on a fair wage without it being changed regularly. Having more agency over their professional life is probably most important.

Louis Diamond:

Yeah. I think that's well said. And it's also why we're seeing firms like Raymond James, who has very publicly had a lower deal than most of its competitors have outsized recruiting success. Because advisors look at the firm and value the culture and the flexibility, and the fact that advisors own their book of business. Another comment I'll make is what you said about younger advisors. What I've seen before our younger advisors saying, "Well, I'm young enough. I can take a 10 year recruiting deal and then I'll have a bunch of money in the bank and then I'll still be able to go independent in the future". While that's still happens and nothing wrong with that approach, we are seeing advisors skip ahead. And if they know they want to go independent, ripping off the band-aid and doing it earlier. And I think that's what's exciting about it is advisors are looking at their business as a business much more often. And of course, for advisors that still value a big deal, those are out there. And that's why so many different types of firms are successful because there's not a one size fits all approach.

Mindy Diamond:

Let's go back for a second to what you said about why firms like Raymond James and I'm assuming you're putting Stifel Nicolaus and some of the other regional firms into the same bucket, why they've had so much success. So I guess part of it is advisors are more open-minded even to come to the table. They may say, "What is the deal?" And realizes that the deal is 25% or so less than what they could get elsewhere. But advisors are more open-minded.

Mindy Diamond:

But I think the other thing is that the onus then is much more on the firm. A firm like Raymond James or Stifel Nicolaus, to prove that for every dollar they are less than the deal that they've got a better value proposition that's going to help the advisor to grow faster or have a better quality of life, et cetera. So how do they do that, for example? How does a firm like Raymond James prove to an advisor, yes we've got a smaller deal, but we're still the better play?

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Louis Diamond:

Yeah, that's a great question. So they really do have to prove it. It's through the due diligence process that they have to make tangible that an advisor's life is going to be easier, that they'll have more flexibility for clients and that culturally it's going to make sense. Because obviously if all things are equal, an advisor is going to go to the higher bidder. So it is hard for them to prove it out oftentimes, but I would say the home office visit is a really good way that they showcase it. And then every interaction that an advisor has with the firm is a lens into what it would be like to work there.

Louis Diamond:

So advisors we've worked with that have joined both firms have had higher offers, but still choose Raymond James or Stifel or fill in the blank for the firm because they felt at home. They felt like it was more comfortable and that they can do better work for clients. And ultimately they're making a 10 plus year commitment and they'd rather be at their number one choice firm rather than getting the top deal out there.

Mindy Diamond:

Interesting. I agree, actually. I see it the same way.

Louis Diamond:

How about on the other end of the spectrum. How would you talk to an advisor to help them reconcile not taking a major recruiting deal instead betting on themselves and going some version of independent?

Mindy Diamond:

Well, that's the key question because while there are models of independence that absolutely offers some transition money that's in the independent broker dealer space, there are models of supported independence that offer transition money. At the end of the day, the money in the independent space doesn't compare upfront to the money that an advisor can get by going to another traditional firm. So that is the 64, I should say, instead of $64,000, $64 million question. And the answer is this, it comes down to what an advisor values most and whether or not he or she believes in his or her growth and his or her ability to thrive in an environment outside the traditional space. So what am I mean by that?

Mindy Diamond:

The first thing is that if you are going independent, it's all about valuing building long-term enterprise value, building a business. We just walked out of our staff meeting not an hour ago and Wendy who works for us, talked about having moved $5 million plus Barry Mitchell from UBS to launch his own firm. And he launched it without a service provider so there was no capital provided upfront other than some soft dollars from the custodian. That didn't compare to the offers he would have gotten had he looked at a Morgan Stanley or a Merrill Lynch or a Wells Fargo or a Rockefeller or a First Republic or anything else.

Mindy Diamond:

But Barry was somebody that was A, offended by what worked out to be a very low net payout from UBS after he got done paying his staff. Barry was really focused on growing not only organically with more freedom and having more control over how to serve clients, but also inorganically. The notion of really building an enterprise and being able to recruit and acquire, to acquire other small businesses. And the option at the end of the day of either selling his business to his staff or to sell on the open market. And those are things he just couldn't do if he stayed within the wirehouse world.

Mindy Diamond:

So even though he walked away from a considerable amount of deferred comp, and even though the opportunity cost of other recruitment deals were things he gave up. At the end of the day, it was much more important to him to build a long-term enterprise.

Louis Diamond:

Exactly right. It's more just about mindset and orientation and risk tolerance. It's betting on yourself and being more long-term greedy. Thinking about the benefits of building enterprise value that you can sell in a tax efficient way at the end of the day, sell all or part of the business and also the benefits of a higher payout. And as the business grows, picking up operating leverage. So there isn't a right or wrong answer with any of this. But it's true on the short term an advisor's likely better off taking a recruiting deal. But if they're really bullish on their growth and have a longer term orientation, then the math of independence can make a lot of sense. And we've done episodes on that as well. And I would expect a well-run independent firm to net anywhere from 60 to 70% of revenue. And that's on every dollar. And that number changes depending upon whether someone's leveraging a supportive platform or a service provider. Of course, how much they pay their staff and what their other local expenses are. But in many cases, an advisor could almost double their take-home economy by going independent.

Mindy Diamond:

I think that's right. And to be fair, we also just moved a $7 million team to Morgan Stanley. That is a team that was interested in independence and actually most teams are. Who isn't all about wanting more freedom and control? But at the end of the day, the turnkey nature of an all under one roof platform where he or she didn't have to be responsible for putting toner in the copy machine is a common thing people say. They were just much more comfortable in the wirehouse world. And a common answer was this particular team, the lead member of the team was well into their fifties. And it's funny because that's probably not far off from where most people who go independent are, but this particular team said, "I only have probably five to seven years left to work" and wanted to do it, felt better about the short term upside of a transition deal.

Mindy Diamond:

So it really comes down to what you just said, that it's all about advisor orientation and mindset. There's no one right answer for sure. And the good news is the industry landscape has really expanded so an advisor really has his or her pick of the letter.

Louis Diamond:

Exactly right. Let's dive in then to what I called in this article for AdvisorHub, The Bull and Bear Case for Recruitment Deals. So let's switch back and forth. Why don't you take the bull case for recruiting deals and I'll take the bear case after that.

Mindy Diamond:

Perfect. So the bull case for recruiting deals. First of all, it can be life-changing money. And for an advisor that's got a lot of his net worth tied up in his business, in the production of his business, the notion of being able to take some really nice chips off the table mid-career and essentially still own the business. Still continue to make good money. That's a pretty good gig. It always was and it always will be. So if you're talking 3x, in some cases we've seen even close to 4x deals. Again, not all upfront, life-changing money. The second thing it does is de-risk the move. The bottom line is that an advisor who again has a lot of his or her net worth tied up in his business. It's a notion of taking chips off the table, but it really takes the sting out of a move and helps an advisor get more comfortable.

Mindy Diamond:

So those early months can be scary. And for an advisor that may be either less comfortable about their growth, or just generally speaking, isn't comfortable with a whole lot of risk. A transition deal can certainly mitigate what may be surprises of down earning months or the like. The next thing it does is it's a reward for hard work. Somebody who goes independent and issues a transition deal is really betting it all on the long-term and long-term could be five to seven years where it really begins to pay off. So the notion is that they've worked hard to build a business and a deal rewards them for the hard work. And perhaps, maybe even lets them ease up for a bit of time to focus on living their best business life.

Mindy Diamond:

The next thing is it incentivizes future growth. Deals have backend components we've talked about. It's a certain amount upfront and then there are back ends that advisors can earn based upon hitting pre-agreed production and asset hurdles. And by doing so, if an advisor grows, it's really an annuity for probably the first five years of the deal to be extra motivated to go out there and grow. And probably the last reason is it makes a good move even better. The notion is the deal should not be the reason you choose to go to a firm or choose to move at all, but it should be cherry on top. Or it certainly can be cherry on top. And so if you have identified the best possible firm and at the same time can get paid at life-changing money in order to go there, that can be a home run. So how about the bear case?

Louis Diamond:

Yeah, I'll take the bear case. So I got, I would say seven reasons against a recruiting deal. Number one is you're locked in for the long-term. Some of these larger recruitment deals are a minimum of nine years. Normally it's 10 years. And if an advisor hits backends, we've seen some deals that can extend to 14 or 15 years of financial obligations. So while an advisor can always be a free agent by only spending the transition money at the rate at which it forgives, there's still the mental and real handcuffs of having a long-term commitment to a firm. The second reason is you're losing a large portion of the deal to taxes. A deal in any of your ongoing payout is ordinary income tax versus the long-term capital gains of selling a business as an independent. And if you are running an independent business, you get the tax benefits of running certain expenses through the business and other ways you can structure compensation again versus a W2 payout.

Louis Diamond:

Third reason is an advisor is giving up more control when they're taking a recruiting deal, especially versus going independent. As more advisors are tied into forgivable notes, sunset programs and the like, the more firms have leverage to make certain changes. Whether it's changes to compensation, changes to policies and advisors then are somewhat beholden to any and all outcomes a firm throws their way. Next one is we have seen some advisors, I would say it's the minority of advisors opting to go to the highest bidder, which may be their second or third choice firm. And this can be to the detriment of their clients. So it does create somewhat of a conflict.

Louis Diamond:

Another related topic is we've seen teams with conflicting views of the short-term versus the long-term where maybe it's because of age and runway in the business. Let's say it's a younger advisor who really wants to be independent or wants to go to a firm that provides more flexibility and control. But the older advisor is looking for the top deal. We've seen partnerships break up because of this. Oftentimes it's an irreconcilable difference because it's such a different amount of money and no one can fault someone who's looking more at the short-term versus more looking at the long-term.

Louis Diamond:

Next reason is any time an advisor joins a W2 firm with some mild exceptions, they're really selling the business to a new firm. Legally, most W2 firms own the business. So when they're paying recruiting deal, they're really buying the book from the previous employer as opposed to going independent and an advisor owning the business. It's also a reason why we're talking about Raymond James. Raymond James is one of the only W2 firms when an advisor owns their buck. Part of the reason why their deals lower, same thing with companies like LPL is because the advisor is owning their book of business versus the firm. And finally advisors taking a recruiting deal, especially when they're looking at the recruiting deal as part of their retirement plan, are selling the business normally for a lower purchase price than if the business was sold on the open market.

Louis Diamond:

So if an independent advisor sells their business to a private equity firm to another RIA, or even let's say to a bank, they're getting long-term capital gains for sale the business. And there's going to be multiple bidders who can all come up with a customized structure. So businesses sold as an independent, normally value on a multiple of EBITDA versus a multiple of trailing 12 or GDC in the W2 world. So depending upon the size of the business multiples have never been higher for independent businesses. So we would expect a much better after tax net benefit to the advisor who's selling their business as an independent versus recruiting deals at W2.

Mindy Diamond:

So help me to understand, is there a way for an advisor to think about the difference? Is there a percentage difference between the two or how long does an advisor, would an advisor have to be independent before they can take advantage of those extra multiples? How does that work?

Louis Diamond:

Yeah, that's a great question. So first off we mentioned it earlier, there could be forgivable loans for an advisor going independent. That's what independent broker dealers, whether it's the independent arm of Raymond James, or Wells Fargo or Ameriprise, LPL, et cetera. And then even some supported platforms, be it Sanctuary Wealth partners or otherwise, they do provide some upfront capital. So it's not mutually exclusive that you have to be W2 to get a deal and that you have to go independent without taking any upfront cash. But we normally say it really depends upon the growth of the business and how well a business transitions. It's likely a five to six year payback period between taking a recruitment deal. So taking more of the short-term financial gain and the lower payout versus getting little or no upfront cash as an independent and getting a higher payout.

Louis Diamond:

And as the business grows, they're able to, I think narrow that gap even sooner, still not a guarantee. You're still betting on yourself again, but there is a path forward. And advisors can definitely reconcile the short-term versus long-term if they really think about their business as a business and they get very clear on what they're trying to sell it for. Which I think is a perfect segue into our last segment, which is talking about some of the key questions that advisors should ask themselves and consider before deciding whether a forgivable loan is right for them. So I'll turn the question to you. What's one of the questions that advisors should ask themselves as they're thinking through this decision?

Mindy Diamond:

So I think first and foremost, it's do I have a short-term financial perspective or am I willing to think more long-term greedy? And you use the term long-term greedy before and I think that that's right. That an advisor needs to be really clear on what's most important to them and most advisors are. Do I have the stomach or risk tolerance to bet it all on the long-term?

Louis Diamond:

Yeah, exactly right. The second question I would say is where do I believe I can best serve clients and live my best business life? Is it as a W2 employee or is it as an independent business owner? And again, you can still get a forgivable note by going independent, but that's really the philosophical divide. It's am I more comfortable with the scaffolding and support and turnkey nature of a more familiar W2 model? Or do I really get excited about the idea of business ownership? So some of this is certainly not about the economics. It's more about lifestyle. It's how you want to live your business life. And it's what's going to get you most excited for the next 10, 12, 15 plus years of your career.

Mindy Diamond:

Yeah. And actually if you ask me, I think that that should be the most important guide for step forward is in terms of the philosophical, what am I going to be most excited about? What is going to get me the most excited? How do I live my best life? But I'd say the third question is what stage of my career am I in and what's my risk tolerance? So I mentioned a little while earlier, an advisor that's got five to seven years left to go until he or she retires. There are some that may say, "Five to seven years is more than enough time to grow the business, to groom my next generation and to really build this enterprise". And there are many others that would say, "If I were 10 years younger, if I were 40 or I were 30, I would absolutely want to go independent, but I definitely don't because five to seven just isn't enough time to make up". So it's about risk tolerance and amount of time till the end of the runway.

Louis Diamond:

Absolutely. To me, those are the three major questions an advisor should ask themselves, but there's many, many more. And we have a, call it our, Defining Your Best Business Life Self-Assessment. A little plug for the Seminole resource that we have. So anyone who would like to really dig into some of those questions can reach out and we're happy to walk them through our assessment process.

Mindy Diamond:

Yeah. Great point. So this episode will probably not settle the debate over whether you should opt for a forgivable loan or not because the truth is there is no right answer. But hopefully it gave you some food for thought when considering what's right for you. The exciting thing about the landscape today is that regardless of how you answer the above questions, the result is that there are plenty of destinations to choose from and a lot of middle grounds. I think it used to be binary, big deal or no deal at all. And now there are many shades of gray in between and that's what's so exciting. So Louis, once again, thank you for joining me.

Louis Diamond:

Yeah, of course.

Mindy Diamond:

And I thank you for listening. I encourage you to visit our website diamond-consultants.com and click on the tools and resources link for valuable content. You'll also find a link to subscribe for regular updates to the series. And if you're not a recipient of our weekly email Perspectives for Advisors, click on the articles link to browse recent topics. These written pieces are an ideal way to stay informed about what's going on in the wealth management space without expanding the energy that full-on exploration requires. Feel free to email or call me if you have specific questions I can be reached at 973-476-8578 or my email at mdiamond@diamond-consultants.com.

Mindy Diamond:

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