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What Financial Advisors Need to Know Before Receiving An Offer

An offer to join a new firm can come in various forms with characteristics many people aren't familiar with. Having a better sense of how these characteristics can be used to your benefit and the actions that can be taken to avoid disappointing surprises is crucial to ensuring you're ultimately satisfied with your move to a new firm. Over the years we've developed a list of the most important aspects for you to be aware of as you start seriously considering a move to a new firm.

1. **Upfront Award (loan)** - This is the portion of an offer that usually jumps off the page and grabs people's attention first. It's typically a function of the verified trailing 12 months (TTM) for your practice and is usually paid to an advisor shortly after becoming formally registered with a new firm. Many of these awards are attached to a **promissory note** that requires you to stay with the company in order to keep money, and awards are earned over time with a **bonus agreement**. What does this actually mean? Well let's say the upfront award (loan) is $1,000,000 amortized over 10 years. In this case, the $1,000,000 is paid to you shortly after joining, the company attaches it to a promissory note, but the money is actually considered a loan for tax purposes. Since loans are required to have an interest rate associated with them (otherwise it could be considered a gift), a minimum interest rate is set by the IRS. Now the company you join will typically provide a bonus agreement where so long as you remain with the firm, payments will be made on your behalf to pay down this loan.

2. **Amortization Schedule** - After reading about upfront awards it may still be unclear how bonus agreement payments are determined. This is where the amortization schedule comes into play. The amount a firm decides to amortize (or forgive) off the loan balance is based on:

   - the number of years the offer lasts; and
   - the set percentage forgiven for each particular year.

   Even more importantly firms come up with amortization schedules that take on a variety of forms. When reviewing an offer keep an eye out for whether the amortization schedule is graduated or levelized. Terms can also vary on frequency in the form of monthly versus annually. Higher frequency (or monthly rather than annually) can often be more

favorable, in case something happens midway through the year. If you decided to leave before fulfilling the length of your agreement, the unamortized amount will likely need to be paid back to the firm. Here are two examples of advisors who were given $1,000,000 upfront amounts to join a firm over a five-year deal term and have very different situations unfolding.

Example 1: Graduated Amortization - If you leave the firm at the end of year two, you owe back $850,000 to the firm.

Year 1	Year 2	Year 3	Year 4	Year 5
5%	10%	20%	25%	40%

Example 2: Levelized Amortization - If you leave the firm at the end of year two, you owe back $600,000 to the firm.

Year 1	Year 2	Year 3	Year 4	Year 5
20%	20%	20%	20%	20%

3. **Phantom Income** - Based on the outstanding balance of your promissory note, the company will need to pay off the loan balance based on the terms of your bonus agreement. Remember, the upfront you receive is in the form of a loan with an interest rate, and when loans are paid the following characteristics shown in this example bonus agreement should be given special attention:
   a. Starting Balance: $1,000,000
   b. Monthly Payment: $17,571.54
   c. Principal: $15,821.54
   d. Interest: $1,750.00
   e. Balance: $984,178.46

While the principal balance is slowly forgiven based on the amortization schedule, it's important to know the income you actually realize is based on the total payment made, $17,571.54. As you evaluate an offer, do so with knowing that phantom income can be frustrating at a minimum, but likely challenging to plan for if not taken into consideration. If phantom income is something you'd like to discuss further or you'd like to chat through different deal structures like bonus-only deals, please reach out.

4. **Backend Production Awards** - These awards typically come in the form of a bonus, also considered a loan, and are paid off over time based on a bonus agreement. In most cases, they will be fully paid off by the same date determined by the term of the upfront deal, essentially making you free and clear to move as of this date without needing to pay anything associated with these deals back the firm. The piece worth highlighting is whether the award, which will be written in the form of a percentage of TTM, is written as uncapped or capped. Also note, some of these awards are guaranteed, while others are attached to a hurdle (to be explained later).

   The examples below illustrate how they work and can be very different in use:

   Example 1: Advisor Jane Doe with TTM of $1,000,000 is offered a production award at the time of hire. Uncapped bonuses are based on future TTM, and capped example bonuses are based on verified TTM at the time of hire, as seen in the following examples:

Uncapped Production Award			
Years After Transition	Future TTM	Bonus %	Bonus Earned
1	$1,000,000	20%	$200,000
2	$1,200,000	20%	$240,000
3	$1,400,000	20%	$280,000
4	$1,600,000	20%	$320,000
		TOTAL	$1,040,000

Capped Production Award				
Years After Transition	Verified TTM	Future TTM	Bonus %	Bonus Earned
1	$1,000,000	$1,000,000	20%	$200,000
2	$1,000,000	$1,200,000	20%	$200,000
3	$1,000,000	$1,400,000	20%	$200,000
4	$1,000,000	$1,600,000	20%	$200,000
			TOTAL	$800,000

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Based on these examples, by having an uncapped production award Jane earned an extra $240,000 because the bonuses were based on what her TTM was in the future, so for someone who expects to do more business in the future than they did in the past, this can be very appealing. In the case of the capped production award example, the fact that Jane did more business in years two, three and four was irrelevant for the purpose of increasing her bonus as the amounts were capped.

5. **Asset Awards** - Just like the other major components in an offer, asset awards are also typically structured in the form of Loan > Promissory Note > Bonus Agreement, amortized over a time period. Since most firms pay asset awards measured by basis points (bps) on assets transferred from 6–12 months after an advisor joins, we'll illustrate a popular example with a hurdle at 80% of assets transferred where one advisor earns the award and the other doesn't:

Asset Award Earned					
Assets Under Management At Hire	Six Month Hurdle	Asset Hurdle	Assets Transferred at six months	Basis Points (bps) Award on Asset	Award Earned
$100,000,000	80%	$80,000,000	$90,000,000	20 bps	$180,000

Asset Award Missed					
Assets Under Management At Hire	Six Month Hurdle	Asset Hurdle	Assets Transferred at six months	Basis Points (bps) Award on Asset	Award Earned
$100,000,000	80%	$80,000,000	$75,000,000	20 bps	$0

As we can see in these examples, the 80% hurdle resulted in no award for the advisor who transferred $75,000,000 in assets, as opposed to the advisor who earned $180,000 for exceeding the hurdle and bringing $90,000,000. Although most asset awards are used as an incentive for advisors to transition assets in their practice over to the new firm over several months, a new theme is starting to emerge at a few firms where the asset award is paid around the time an advisor joins and is clawed back if a certain percentage of assets doesn't transition. We're also seeing asset awards that have hurdles, but the award is paid as a percentage of TTM, instead of as bps on assets transferred.

6. **Payout Rate Lock** - Just like you want a nice long healthy life, you also want a nice long healthy payout rate lock. Payouts differ considerably based on firm, platform, and level of support, but one thing they all have in common, advisors should pay close attention to how long a payout rate is locked before "going to the grid". An advisor who transitions to a new firm and fails to ramp back up their business to its previous level faces the dooming fate of falling off the lock and down the grid. This can have a disastrous financial impact on an advisor, and is a big reason why many people decide to leave for a new firm. The important things to pay close attention to are how long can you get your payout rate lock set, and projecting the level your business will be after the lock ends and reviewing the firm's current compensation schedule to estimate what your future payout rate will be. It's also best to run a proforma with each firm you consider and be sure to review the underlying costs of doing business at those firms to determine the effective net payout rate over a 5-10 year period.

7. **Going To The Grid** - If there's one thing that drives advisors nuts more than anything, it's facing unnecessary distractions that take them away from providing objective advice to their clients. Inevitably, the time will come where the payout rate lock ends, and it's time to go to the grid. Hopefully you're at the right firm and your business is where you want it to be, but there are several firms out there that have crept away from financial advice and are distracted by credit cards, adding new people to a certain product, or signing up clients online for a variety of reasons. Whatever the case may be, be on the lookout for how a firm determines the payout rate advisors receive when they're on the grid. If you speak to someone about the compensation plan and the payout rate can't be explained in under 30 seconds, it might be a red flag and cause for a closer look. Anything beyond measuring TTM and/or assets under management should be paid close attention to when it comes down to determining your payout rate.

8. **Covered Transition Costs** - These are like the sprinkles on your dessert that slowly add up to be a big deal down the road. As most advisors become excited by all the awards and opportunities to earn bonuses, don't forget there are real costs associated with moving your practice. If you join an independent platform there are factors to consider that, if gone unchecked, can be a kick in the shin later on. A few items to look out for in the fine print of your offer:

   - Automated Customer Account Transfer (ACAT) Fees - Depending on the size of your practice, ACAT fees can add up to six figures pretty quickly. Some advisors might be fiduciaries on their clients' accounts, or just fee conscious in general, so confirm that the firm you join is willing to cover account transfer fees associated with moving to a new firm.

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- New Account Overnight Mail - Even though most firms that advisors are joining today utilize electronic account setup, there will still be many instances where overnight mail is required to get the business back up and running at a new firm. Make sure to check whether your new firm covers these costs, which can add up to four or five digits.
- Signage - Not all firms have their own branding that advisors need to display in the office, but if you're joining a firm that requires company branding, just remember there will be a cost associated with the task of displaying the signage in and on the outside of your office. Take a look to see what the estimates for these costs will be and who will pay for them.
- Technology Package - There's a good chance setting up a new office will require the purchase of computers for the advisors and staff in the office, along with setting up a server for the practice. Take this into consideration and plan on $5-$10,000 going into this purchase.

9. **Clawback Provisions** - If it isn't clear by now that offers from different firms can vary wildly, take a moment to think about how a clawback could impact your business. What is a clawback? Well, when firms provide offers to advisors they need to balance the risk of providing enough upfront money to advisors with the possibility of an advisor not producing enough for the company to earn enough to stay profitable. One tactic some firms employ to mitigate this risk is a clawback provision. A clawback is just a fancy term for a firm having the right to pull back a portion of what was given to an advisor if something happens or fails to happen. An example of a clawback is an advisor is given an upfront award to join the firm, and if a certain percentage of assets isn't transferred over by a given timeframe, a portion of the award money is taken back from the advisor. Clawback provisions are often seen at firms that are struggling to recruit advisors, but want to appear to be offering the best upfront deals while knowing all too well that there's a good chance a portion gets clawed back. It's a sneaky tactic to offer the advisor something great, but have a built-in safety net to take it back if the advisor doesn't meet a specific target.
10. **Hurdles** - Similar to clawbacks, but structured much differently, we've seen the reemergence of production and asset hurdles at a number of different firms. Over the years hurdles have come and gone based on regulatory changes and/or the competitive landscape. Several of the examples we've shared illustrate how hurdles work, and most are considered "cliff hurdles", meaning if the hurdle isn't met then nothing is earned, and the amount earned goes abruptly downward! The key difference between clawbacks and hurdles is that hurdle awards are only paid if the goal is met, whereas awards with a clawback provision are paid right away and taken back if the goal is not met.

11. **No Hurdle Deal** - In an ideal situation financial advisors get their hands on a best-of-both-worlds deal, with the opportunity to earn high backend awards with no hurdle required to earn the amount. Over the past several years as regulations and risk taking by firms for the purposes of recruiting have changed, so have deals where backend awards are paid regardless of whether the advisor met a certain goal. In a no hurdle deal, there's no cliff like the one shown in the Asset Award Example. Rather, the 20 bps is paid on assets transferred regardless of whether the amount transferred is greater or less than $80,000,000. Imagine being a few dollars short of your target, therefore missing the hurdle and losing out on the entire $180,000 bonus! This would be a scenario where a no hurdle deal would make a HUGE difference to your business.

12. **Revenue from Certain Products Excluded from Your Deal** - In recent years many firms have interpreted regulations much differently, which can impact the numbers a firm uses to structure your deal. Before an offer is ever created, a firm will compute a series of calculations based around the assets in your practice, how much revenue comes from those assets, and what, if any, of that revenue will not be factored into their calculations. After providing financial statements to a firm (which should never include confidential client information), make sure to ask them for a portability assessment of your practice. This should show what assets/revenue will be excluded from your deal either due to their firm policies or issues with portability of products within your practice. A few common revenue streams that tend to get excluded depending on the firm you speak with are lending revenue, proprietary annuities, and revenue associated with certain retirement plans. Depending on the structure of your practice, this might have big implications on ramping up your business at a new firm and the amount advisors receive in their offers. If some part of your practice is impacted by these items then make sure to include them as part of your negotiation.

13. **What happens if I die before my deal is fully amortized?** - As a financial planner it's always best to think about the unexpected, and your own situation shouldn't be the exception. Offers will vary based on whether you join an employee or independent platform, but in any event take a look to see how a firm will treat your deal if you become fully disabled or unexpectedly pass away. If you have concerns about the possibility of serious issues arising take a moment to closely review your offer to determine if unpaid bonuses will be accelerated so remaining promissory loan balances will be paid off, and in effect allowing you (your estate) to retain what was previously paid to you. If you're still uncertain about how the Loan > Promissory Note > Bonus Agreement structure works, let's have a detailed conversation before jumping into what a death and/or disability addendum can do for your personal situation.

14. **Total Package** - In the end the offer you sign is just a component of deciding which firm to join. While not everything, it's certainly important. The figures shown throughout the offer are merely pieces that go into a proforma to determine how you'll be affected if certain scenarios do or do not play out. The most important thing to do after reviewing an offer is to list out the questions that are top of mind, determine what would need changing to make the offer more appealing, and project several scenarios (bad good, and great) of how your resulting business may be effected. Looking at these scenarios will highlight what could happen if anything unexpected were to come up in the process.

15. **Succession/Sunset/Goodnight** - Whatever your firm calls its program that advisors participate in to sell their practice, all too often financial advisors overlook this element of joining a firm. As you review the offer to join the company, also review the offer or programs in place with the company for advisors to use when selling their practice. We've seen employee firms offer pennies on the dollar for what other firms are willing to pay an advisor to sell their business. It's CRITICALLY important to take a look at the program offered by either the firm you're with, or thinking about joining, to get a better understanding of these terms. While the financial elements of the program are important, so are the aspects of getting unilateral control in deciding who your successor will be and the amount of time you'll have to continue working.

We hope you're feeling more informed now than you were before about the characteristics of an offer and the implications they can have on your practice and personal finances. While you educate your clients on their personal financial matters every day, we're glad you're taking the time to focus on the important topics that affect you and your business. To learn more about how we can help you strategize for the financial situation of your practice, please contact us.