White Paper

Attributes of Best Practices Bank Brokerage Firms

As the bank brokerage industry matures and competition increases, there is heightened interest in improving bank brokerage performance. To meet this need, Pershing LLC, an affiliate of The Bank of New York, commissioned Dr. Kenneth Kehrer to identify the attributes of best practices bank brokerage firms. This white paper will be the first in a series of white papers on topics including Advisor Productivity, Sales and Marketing, and Technology and Operations. Dr. Kenneth Kehrer will draw upon the extensive proprietary data on bank brokerage collected over the past 15 years by Kehrer–LIMRA and his predecessor firm, Kenneth Kehrer Associates.

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Introduction

There are several measures of top performance—advisor productivity, revenue, and profitability, among others. In other analyses, we have examined brokerage revenue to assess best practices. Banks are not in the brokerage business just to generate revenue, but to contribute net revenue, or profit, to the overall banking enterprise. Consequently, we have focused on the profit contribution of bank brokerage as the measure of success.

We believe that the most important metrics for a bank are those that compare the brokerage unit's performance relative to its opportunity. The primary objective of most bank brokerage firms is to capture the investment business of the bank's customers. Doing business with the general public is helpful, but the success of the bank's brokerage unit should be gauged against how well it penetrates the customer opportunity that the bank provides.

Focusing on penetration of the bank's opportunity also enables us to compare the performance of banks and credit unions of different sizes. We would expect the brokerage business at larger banks to generate much more revenue and net income than at smaller banks and credit unions. However, the latter might actually be doing a better job of penetrating their opportunities.

There are several potential measures of the size of the bank's opportunity—bank assets, retail deposits, the number of bank customer households, or the number of bank branches—and over the years we have analyzed all of them. For this study, we will use household profit penetration—the brokerage profit contribution per bank customer household—to identify the best practices brokerage firms. This enables us to compare the profit contribution of banks of varying sizes.

For this white paper, we will compare the attributes of the bank brokerage firms in the top 25 percent of profit contribution per bank customer household with other bank brokerage firms.

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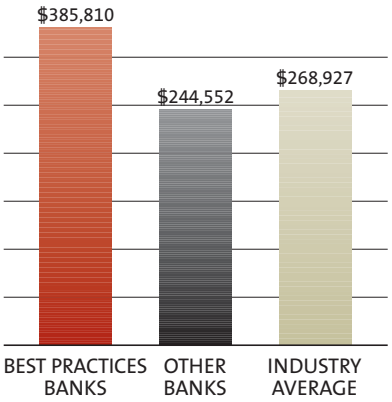
Attributes of Best Practices Bank Brokerage Firms

Evaluating Advisor Productivity

Not surprisingly, bank brokerage firms in the top quartile of profit contribution per bank customer household have higher advisor sales productivity than in other banks. The average annual gross revenue produced by advisors in the best practices banks was $385,810 in 2005, 58 percent greater productivity than their counterparts in other banks.

Annual Gross Commission Revenue per Advisor



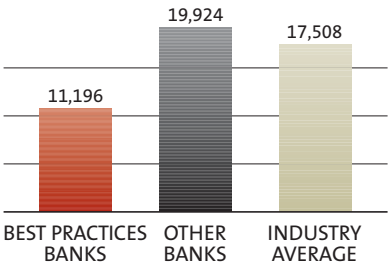
Advisors employed by best practices bank brokerage firms average 58 percent higher sales production.

Over the years, we have consistently found that best practices bank brokerage firms have higher average advisor productivity than other banks, but in 2005, the productivity advantage widened substantially. In contrast, in 2003, the advisors in top performing banks had average productivity that was 39 percent greater than their counterparts in other banks.

Advisor Coverage and Household Penetration

Perhaps an even more important driver of best practices bank brokerage firms is the number of advisors relative to the size of the opportunity. Best practices bank brokerage firms average one advisor for every 11,196 bank customer households. In other words, the "sales territory" of a advisor in a best practices bank is 43 percent smaller than an advisors' territory in other banks. This implies that non-best practices firms would have to increase the number of advisors they employ by 72 percent to perform at the level of a top performing bank brokerage firm.

Bank Customer Households per Advisor



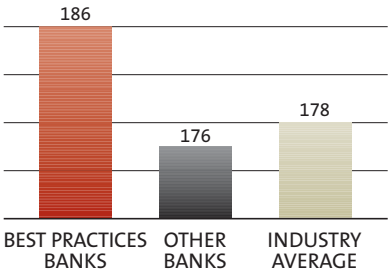
Greater advisor coverage drives sales performance.

If household coverage is such an important driver of top performing bank brokerage firms, why don't banks dramatically increase their sales forces? One reason is the difficulty in recruiting top performing advisors. The principal reason why so many bank sales forces are undermanned is because they are concerned that adding advisors will adversely affect the productivity of their existing sales force and result in advisor disgruntlement and higher turnover. Note that best practices banks brokerage firms have more intensive advisor coverage and much higher advisor productivity.

The Impact of Referrals

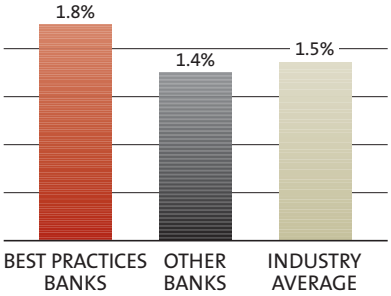
Advisors in best practices banks receive 186 referrals per year from the banking staff, only 5 percent more than advisors in the other banks. In prior years, referrals have been a key driver of performance, but since 2001 referrals per advisor have declined 35 percent. Advisors in the best practices banks appear to be doing a better job of managing their opportunities—relying less on referrals than their counterparts in other banks.

Referrals per Year per Advisor



However, when one accounts for the size of each bank's opportunity, best practices banks produce relatively more referrals than other banks. However, those referrals are spread among many more advisors, because best practices bank brokerage firms have much more intensive household coverage. In 2005, the top performing banks referred 1.8 percent of their customer households to advisors, 28 percent more referrals than other banks, controlling for their respective sizes.

Referrals per Year as a Percent of Customer Households



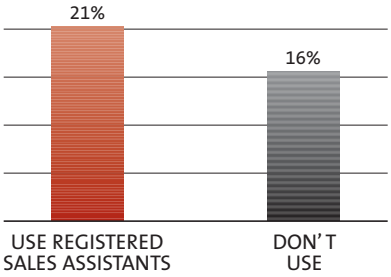
Investing in Sales Assistants

One potential way to enhance the productivity of advisors is to provide sales assistant support. We examined the use of both registered and unregistered sales assistants for both best practices bank brokerage firms and their counterparts in other banks.

Leveraging sales assistants enhances both the top line and bottom line revenues of bank investment programs.

Twenty-one percent of the bank brokerage firms that use registered sales assistants are among the best practices brokerage firms, compared to only 16 percent of banks that eschew registered sales assistants. Thus, bank brokerage firms that use registered sales assistants are 29 percent more likely to achieve top performance. However, compared to other factors we examined, registered sales assistants are not as important in driving top performance as they have been in past years.

Best Practices Bank Brokerages Use of Registered Sales Assistants

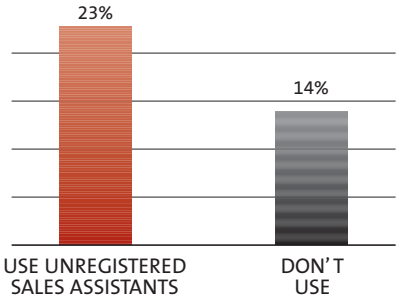


On the other hand, the use of unregistered sales assistants appears to have more leverage in reaching the top quartile in profit contribution per bank customer household than the use of registered assistants. Twenty-three percent of bank brokerage firms that deploy unregistered sales assistants are among the best practices bank brokerage firms, compared to only 14 percent of other bank brokerage firms. Thus, bank brokerage firms that deploy

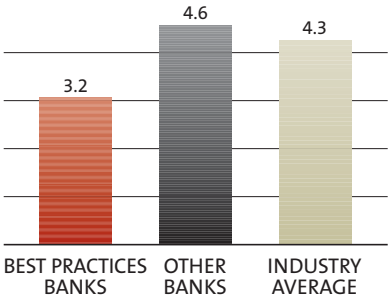
unregistered sales assistants are 64 percent more likely to be a top performing firm than bank brokerage firms without unregistered sales assistants.

Moreover, among bank brokerage firms with sales assistants, the firms in the top quartile of household profit penetration use sales assistants more intensively than other bank brokerage firms. Best practices bank brokerage firms have one sales assistant (whether registered or unregistered) for every 3.2 advisors, compared to one sales assistant for every 4.6 advisors in other bank brokerage firms. Their counterparts would have to increase their sales assistant headcount by 44 percent to match the same ratio of advisors to sales assistants as the best practices bank brokerage firms.

Best Practices Bank Brokerages Use of Unregistered Sales Assistants



Advisor Headcount Divided by Total of Registered and Unregistered Sales Assistants

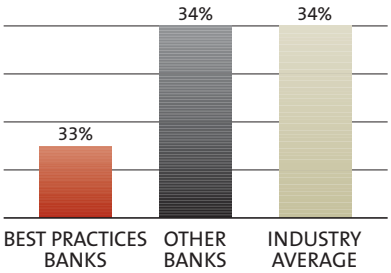


Dealing with Deposit Disintermediation

Contrary to the belief of many, best practices brokerage firms have lower disintermediation rates than other banks.

Some believe that bank brokerage firms with high advisor productivity, top revenue, and profit penetration achieve that level of performance by cannibalizing the bank's deposit base. But best practices bank brokerage firms actually have slightly lower disintermediation rates than other banks. Both bank brokerage firms above and below the top quartile in household profit penetration fund about one-third of their investment sales by drawing on the bank's own interest-bearing deposits.

Percent of Investment Sales Funded by Bank's Own Interest-Bearing Deposits

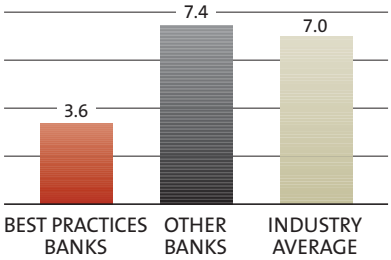


Complaint Rates

Best practices bank brokerage firms have 51 percent fewer complaints.

Similarly, some believe that the top performing bank brokerage firms might be pushing the compliance envelope, resulting in a higher volume of customer complaints and other embarrassments for the bank. Our research indicates that, in 2005, best practices bank brokerage firms received 3.6 written complaints for every 10,000 brokerage transactions, 51 percent fewer complaints than their counterparts in other banks, controlling for the size of their respective brokerage businesses. Thus, the best practices bank brokerage firms not only sell more, but they sell more compliantly.

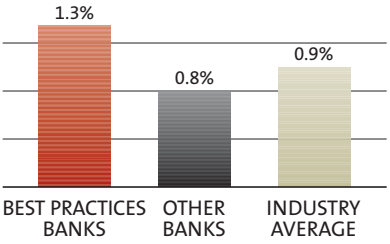
Written Complaints per 10,000 Investment Transactions



Product Mix

In general, bank brokerage firms have focused more on annuity sales than other brokerage firms, and best practices bank brokerage firms are no exception. Best practices bank brokerage firms had fixed annuity sales equal to 1.3 percent of their retail deposits, two-thirds higher fixed annuity sales penetration than other bank brokerage firms. While bank fixed annuity sales have fallen by 40 percent since 2001, they have held up better in the top bank brokerage firms.

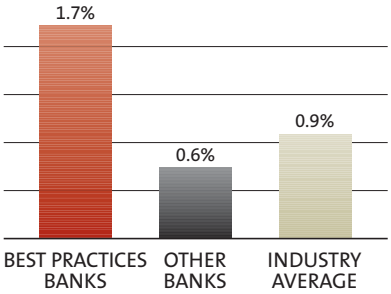
Fixed Annuity Sales as Percent of Bank Retail Deposits



Fixed annuity sales continue to be a critical component of best practices bank brokerage firms.

Variable annuity sales are an even greater differentiator of the best practices bank brokerage firms. The bank brokerage firms in the top quartile of profit per bank customer households had variable annuity sales penetration of their retail deposits of 1.7 percent in 2005, 2.6 times the variable annuity sales of their counterparts at other banks. Thus, high sales of annuities characterize the bank brokerage firms that contribute the most profit to the banking enterprise, relative to the bank's opportunity.

Annual Variable Annuity Sales as Percent of Bank Retail Deposits

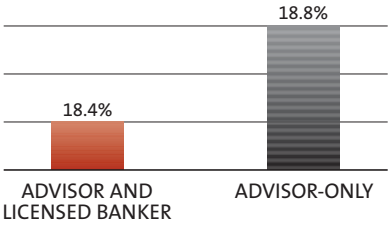


Variable annuity sales are significantly higher in the more profitable programs.

Leveraging Platform Sales Forces

In prior years, banks that supplemented their advisor sales forces with platform bankers licensed to sell annuities and mutual funds were much more likely to be top performers than bank brokerage firms that relied solely on advisors. However, in 2005, with deterioration in fixed annuity sales and platform financial advisor productivity, banks with licensed platform bankers lost their advantage. Advisor-only bank brokerage firms were slightly more likely to be a best practices firm.

Advisor and Licensed Banker Versus Advisor-Only



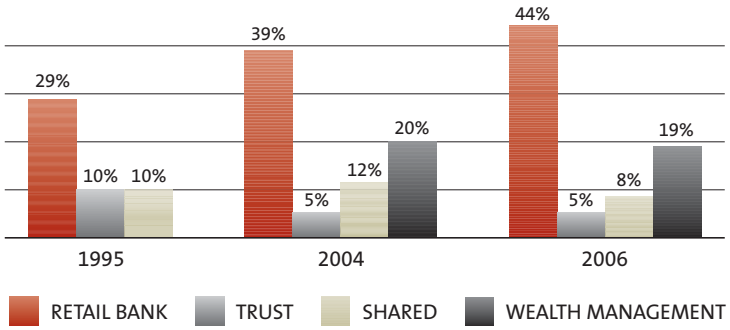
Advisor-only bank brokerage firms are slightly more likely to be best practices firms.

The Evolving Landscape of Bank Organizational Structures

When banks first introduced retail securities brokerage, it was unclear how to graft this business on to existing bank silos. Some banks nested retail brokerage in their institutional brokerage unit. Others found a home for retail brokerage in the trust department. Still others placed management responsibility for brokerage in the retail bank or the bank's insurance agency affiliate. One bank even attached brokerage to its credit card division. And some banks, unable to resolve where brokerage belonged, developed shared management structures, with a separate brokerage subsidiary reporting to, for example, both the retail bank and trust.

As the brokerage business matured, more and more banks shifted retail brokerage into the retail bank.

Trends in Reporting Structure for Bank Brokerages

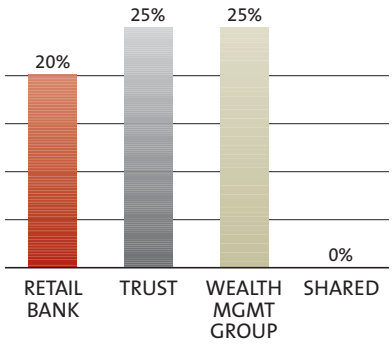


More recently, banks have been creating wealth management units that encompass elements of trust, private banking, retail brokerage, and life insurance estate planning. In some cases, all retail brokerage operations have become part of wealth management, but in other cases the part of brokerage that caters to middle market or mass affluent bank customers was left in the retail bank, while brokerage focused on private clients became part of wealth management.

Bank brokerage firms that report to trust or wealth management are more likely to have top performance.

Does the placement of brokerage in the bank's organizational structure make a difference in performance? One-fourth of brokerages that report to trust, or are part of a wealth management unit, are in the top quartile of profit per bank customer household, compared to one-fifth of brokerages that are part of the retail bank. Thus, bank brokerage firms that report to trust or wealth management are 25 percent more likely to have top performance.

Percent of Bank Brokerages in Top 25% of Profit Contribution per Bank Customer Household



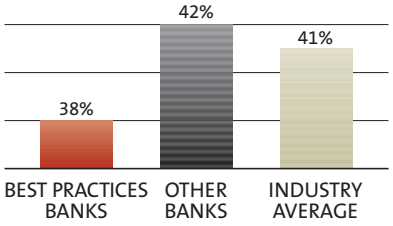
Bank brokerage has long been hindered by being walled off from the wealthiest customers of the bank by segmentation schemes that required all customers with assets above a specified threshold to be referred to trust. The creation of new wealth management structures may be breaking down these walls, enabling the broader banking enterprise to better serve its wealthier customers, and thus improving the profit contribution of the bank brokerage business.

We should note that in previous years, brokerages that reported to the retail bank tended to be somewhat more likely to achieve higher performance levels than brokerages that reported to trust or wealth management. The relative decline in the prevalence of best practices bank brokerage firms that are ultimately managed by the retail bank is probably related to the recent deterioration in fixed annuity sales and platform advisor productivity. Banks where brokerage reports to the retail bank are much more likely to deploy licensed platform sales forces.

Monitoring Expense Controls—Advisor Payout

Since we are using a measure of profit or net income to identify best practices bank brokerage firms, the ability of some brokerages to manage their business with relatively low expenses would lift them into the top quartile of profit contribution per bank customer household. Because sales force expenses are such a large part of total brokerage expenses, the share of commission revenue paid out to advisors could be an important driver of best practices performance. Indeed, average payout to financial advisors in the best practices bank brokerage firms was 38 percent of sales revenue, including trail commissions, in 2005. Best practices brokerage firms paid out 4 percentage points less than their counterparts, or 10 percent less overall. Nonetheless, the advisors in the best practices bank brokerage firms produced 58 percent more revenue than their peers in other banks who received, on average, a higher share of their production.

Percentage of Brokerage Commission Revenue (including trailers) Paid Out to the Advisor Sales Force



Average payout to advisors in the best practices bank brokerage firms was 38 percent of sales revenue, including trail commissions—4 percent less than other programs.

Conclusion

The attributes of the bank brokerage firms that are the top performers in profit contribution per bank customer household include:

- Greater advisor sales productivity
- Relatively more advisors compared to the size of the bank
- Lower commission payouts.

Thus, the best practices bank brokerages achieve higher revenue per advisor despite providing the advisors with smaller territories and lower payouts.

The higher sales productivity and profit contribution of the top performing bank brokerage firms appears not to be due to advisors pushing the compliance envelope or attacking the bank's deposit base. The best practices bank brokerages experience much fewer customer complaints and deposit disintermediation rates that are not higher than other bank brokerage firms.

The banks with top performing brokerage businesses do refer a higher percentage of their customer base to advisors, but those referrals are doled out to a much larger advisor sales force. The superior performance of advisors in best practices bank brokerages is not the result of the number of referrals but rather how they managed the referrals they received.

Other factors that differentiate the best practices bank brokerage firms from their peers are the more extensive use of sales assistants and greater annuity sales penetration. How the brokerage business fits into the overall organizational structure of the banking enterprise might also influence brokerage performance.

Appendix

Data. Bank brokerages have been participating in Dr. Kehrer's annual benchmarking survey since 1991. The survey examines sales and revenue penetration, product mix, sales force productivity, and sales management issues. Each year a large number of bank programs participate. For example, during 2006, 83 firms, which collectively account for over half of all bank and credit union investment sales, completed detailed questionnaires. The cumulative database provides a rich source of information to benchmark bank brokerages and analyze the determinants of top performance.

Methodology. First we select a measure of top performance. Then we compare the characteristics of the top performing bank brokerages with other banks to identify what sets the best practices banks apart.

Using the 2005 benchmarking data, we identified the bank brokerages that were in the top quartile in profit contribution per bank customer household. Then we compared those banks with bank brokerages that were not in the top 25 percent in household profit penetration to see how they are different.

This first white paper provides an overview of the key attributes of top performing bank brokerages. Subsequent white papers will provide a more detailed examination of best practices in:

- Advisor productivity
- Sales and marketing
- Technology and operations

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