

DAVID INTERVIEWS MACCHIA

Mark Casady

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OVER THE COURSE OF TWO lengthy conversations with Mark Casady I came to understand more than a few things about the man who leads the nation's largest independent broker-dealer. Many business leaders have a genuine passion for their work. Casady's passion is palpable, and it is, in part, reflected in his efforts to maintain the tradition of innovation, technology-leadership and meritocracy introduced by LPL's founder, Todd Robinson.

"Balanced" and "humble" are two additional adjectives I would say appropriately describe Casady. I came away from our conversations feeling that he is a man who, in a quiet, confident manner, clearly recognizes his strengths and talents, but is equally aware of his limits.

I also came away with the impressions that no one in LPL's management structure takes success for granted, that there is a continuing process of re-invention in place, and that the best interests of the firm's customers are always the top priority.

Macchia: What do you define as the component parts of a great leader?

Casady: I think that the first part is to not confuse brains with a bull market, to be blunt. And that everything in life has a rhythm to it. Whether it's sports or whether it's a business situation or whether it's a relationship, there's a rhythm to these things. You can definitely change a rhythm to a business; you can change a rhythm to a cycle. But there are certain cycles you can't change. We here at LPL cannot affect the American economy much. We can't make the stock market go up and we can't make it go down much. It is impor-

tant for a leader is to understand when they're in the right rhythm with the forces that are beyond their control.

And that implies, as you said, a recognition of one's limits.

Yes, exactly. I think the second thing that's really important in a great leader is humility. And I will say that I try every day to make sure that as a leader I guide with humility.

There must be many advantages with being No. 1. But I'm wondering, what are some of the disadvantages?

One disadvantage is that you can believe that you're No. 1, for some reason, beyond the day-to-day work you do. We've been No. 1 for, I think, 12 years now. When I arrived five years ago, what I said to the management team was, "Hey, you've been No. 1 for seven years. Pat yourself on the back and forget about it, because if you let yourself fall into the belief that that somehow gives you a privilege in the marketplace, you somehow fall into the belief that you don't have to work as hard."

And so the downside is that it tends to foster a lack of humility and...being No. 1 attracts a lot of attention and ... therefore, a lot of imitators.

After setting a record price multiple in your recent private-equity buyout, do you feel that more firms are strategic takeover targets for LPL?

Well, I don't think it really has to do with our price. I think our price is quite appropriate by any measure. I've done probably 22 or 23 transactions corporately, taking companies public...And so I've gotten some deal experience.

If you can acquire a firm at 1X GDC and make them worth 2X GDC, that's a pretty good business strategy. You don't disagree, I presume.

Actually, I do disagree. If your business strategy is to buy a business at 1X because your company gets a 2X multiple from the market, that's not a good strategy at all because that's just a roll-up strategy. You've got no value by that. What you have to do is you have to be able to say, I can take a property that's for sale at one time, I can do something to it that changes its characteristics to look like the rest of my business that's worth 2X. It's a completely different way of saying it. And I'm rather sensitive about it because I see a lot of companies that have roll-up strategies. I've seen a lot of announcements in our business about people who are doing roll-up purchases of RIA practices or roll-up purchases of securities license professionals, and I think those strategies are ultimately doomed to strategic failure because they don't change the value equation. They merely rely on inaccurate pricing from one level of the market to another.

Now, that's not a strategy, that's an arbitrage. And so when you look at the specific broker-dealers, we purchase them using this metaphor of 1X, whatever. And they will be worth 2X, whatever, they're not worth that today because they need a significant investment in their technology and a significant investment in their capabilities for them to get to that point. And we think it'll probably take us a good three years, maybe two years, to get them to the point in which we say, hey, we've done the blood, sweat and tears work to get them to have an environment in which their advisors

can grow their businesses and be even more successful.

What made LPL conclude that technology was going to be so important in the future?

I think we had a seminal vision by our founder and by his president, Dave Butterfield. Todd and Dave put every nickel back in this company up until they sold it in 2005. So they never took any kind of significant money out of the business until they did the transaction. And that's why we've invested literally hundreds of millions of dollars in technology. And the logic that Todd and Dave used was that it would make the profits just that much more efficient, so that he would sometimes joke about it by saying, "Well, I'm just too cheap. I don't want to hire 100 people to have to do the work that with technology we could do with 10 people." And if you have 100 people, as good as they are, they're going to have an error rate, whereas a straight-through process for processing a trade is going to be 100 percent accurate if it was entered accurately in the first place.

With all the talk we hear about explosive growth in RIAs, do you think there are challenges, going forward, of keeping a traditional BD relevant?

The question we ask ourselves is what do we think is going to happen in the world that will make us irrelevant? If you were starting the business today, David, and you were in our space, what would your business look like? If we looked at pricing, an advisor who's here who would look like a registered investment advisor but isn't, they're part of our corporate RIA; they were paying us a premium at high levels that might be as much as \$200,000 a year more than they would pay a custodian for the

same work. Because we've said to ourselves, "Well, that's not going to last," right, because those people are going to maximize their profits by finding ways to do this cheaper. So we announced in August at our national conference that starting January 1st of '08, we're completely changing our pricing for our advisory platform in two ways.

One is we're reducing our ticket charges for mutual funds so that basically 60 percent of all mutual fund trades will be free and about 20 percent will be at \$4.50, and then the last 20 percent will be at \$26.50. And it's an enormous group of funds, something like 7,000 different funds that you can trade there. And then secondly, we're going to give you an advisory fee rebate, so we charge an administrative fee for an advisory count so that now if you're that same advisor who was paying us \$200,000 more, they're only going to pay us about \$15,000 more than they would a custodian. So we've really leveled pricing at that end. And why would they even pay \$15,000 more? Well, because we do everything for them. We provide all their client statements, and we provide E&O coverage. We do all the privacy mailings, so they basically outsource their operational activity to us for a very slight cost over and above a custodian.

If they were at the custodian, they would have to do all that work themselves, and it would be much more expensive for them to go to a custodian model. So I think what happened is, our view was that basically there's a space in the market where these distinctions between a brokerage firm and a custodian firm are really only a result of a historical accident and not a result of economics.

Your answer implies the question: Can a small broker-dealer

reasonably compete and survive well today?

Well, I think in business, it doesn't matter whether it's broker-dealers or whether it's steel— steel is probably a bad example— in most businesses, there comes a time in the maturity cycle for that sector in which something happens, and that is that the big get bigger and the small stay very focused in the world, and the middle-sized companies are the ones that get squeezed. And that's the phase we're in for broker-dealers today.

We were in that phase that money managers were in probably ten years ago, and that industry really consolidated. People say that the money management industry didn't consolidate; I argue no, no, it consolidated. It created some mammoth giant players. The difference is it has a very vibrant small firm sector because it's an easy business to get in to. And I'd argue broker-dealers are probably somewhat the same in that if you follow that logic that any industry is going to have the very large and then the very small, then the small broker-dealers can certainly do fine. And that might be defined as a broker-dealer with like five people in it, or a broker/dealer with 100 advisors in it, because there's something about that relationship set or their physical location that makes it a unique offering for them, and that's their distinction.

They won't be able to distinguish themselves on technology or capabilities, because that will be too expensive. And so for people who say, "Hey, I want that relationship type of feel in that kind of setting," or, "I'm with my buddies who I used to be an employee with somewhere, and that's what's most important to me," then I'm sure that model will be fine. And particularly with technology and service companies, scale matters a lot. Therefore,

scale allows you to do something we call the virtual circle.

The virtual circle is the way we explained it to the private equity firms in '05. For instance, if we create a technology like iDoc, which basically images all paper in your office as an advisor, then you kind of eliminate the paper. In every office, do you know what the most expensive space user is for them? It's the paper file cabinets. And this is nerdy stuff, but this is the stuff we saw. Seriously, if you look at their footprint of their businesses, literally, the foot print of their physical space, and you look at their P&Ls, and if you look at dead space, which paper files are about as dead as they can go, it's actually the biggest use of space in their office. It's usually bigger than their conference rooms, it almost always equals to the size of an office that could be used for another investment professional or for a planner or whatever they want from there.

So we just simply set out to create a system that would allow them to eliminate that paper, make their life a lot easier because they can look at it online, and then you basically eliminate the need for the use of that space, which they can either take to their bottom line because they shrunk their space footprint, which is a real savings. Or B, they can put someone in that space who actually is productive and they can turn it into revenue. And that's a simple example of making the investment through technology. The other thing that we do in the virtual circles is we say that by lowering prices, if you're a believer in supply side economics, your volume goes up. And so the other explicit part of our virtual cycle is to give back to advisors lower prices. That allows them to be more competitive with their clients and with their prospective clients, and lo

and behold, their business grows. And when their business grows, because we've made it more efficient through something like iDoc or through the lowering of prices, guess what happens to us? Our business grows, because we're just reflecting of their success, and that new business grows and turns into profits, and therefore, that's helping share holders get paid. And then it all starts over again.

As employees, the fun we get to have is thinking about how we're going to make that virtual circle happen. And really we're excited by things like iDoc, and we're excited by thinking about how pricing works and we're excited by the growth of advisors and their success. So everybody gets a seat at the table there, whether you're an employee, or a shareholder, or a client.

What certainly is not mechanized or technological is something that I get from you in large volumes right now, and that's passion. How does passion get communicated through an organization?

I think first of all, you have to start with yourself. I think the first part is you have to ask yourself whether you have a passion about your clients and the business you're in. And if you have that passion, then you've got to want to find a bunch of other passionate people that you can share it with. And that's what struck me about LPL. I knew LPL as a client from my previous firm, and when you talked to people at LPL, they were very passionate about what they did, they were very passionate about their clients.

In fact, if you come here and you're not passionate about those things, you tend to stand out, and you're not very successful. We're really very zealous leaders, and guard this passionate view of what we're doing.

These changes that you mentioned are not the kinds that elicit protest from advisors, correct?

Last year when he did it, the production bonus changed. It went up to 98%. It got 17 rounds of applause. This year it only got 12, so they're pretty happy.

What you think about when you look at this 30-odd trillion dollar transference, the greatest movement of money we'll ever see in our lifetimes. How do you see LPL's role playing into that opportunity?

And the transference is that money going from retirement ...

Yes, from accumulated retirement assets into distributed income.

It's interesting, and of course, it's been going on for a while. I mean, my mother did it 15 years ago when she retired. So I look at it and say what is really happening is a change in volume, not a change in type. And so it's been happening since time began that people go from accumulation to distribution, and the question is, how do you do that at scale, and what makes you unique in the world?

So I think the first way we think about it is what products will get created by manufacturers that we think are interesting for our advisors to understand or represent sort of a different way of looking at this issue. And we think that there's a lot of innovation occurring, particularly among the insurance companies around issues that are going to be relevant to people who are going through that change. And the second thing we look at is what should change about the way we think and the kind of service we provide in terms of information to our clients' advisors that they can use for their clients, the end consumer? So what our statements look like, what kind of information is on statements, and so forth.

And what it's led us to is to believe in what we describe as a wide spectrum approach, meaning that what you're seeing is, again, sort of the pig of the pipeline go through, in which there's still going to be a lot of people accumulating after this generation retires, but the reality is that pig of the pipeline gets a lot of attention, and therefore you have to have a competitive response to it. We actually think it's probably a little early in the cycle and we're trying to understand a little bit more of what others are doing. And then we will come along with some innovations that start to recognize, perhaps, a different way of communicating to end clients and identifying the best products that are being created by manufacturers. So we're still on the exploration phase of how we think that changes the dialogue and the work.

If you were to accept the fact that most advisors over the past two or three decades have squarely been in the accumulation mindset, and if you further accept that the tax strategies and techniques of placing accumulative assets into a distribution mode require different strategies, and then what's implied by that is that it requires a level of education for advisors that may not be supplied in the correct amounts right now. Is that something that you think about?

It's interesting, because I don't see it quite that same way, David. What I see is—I spend a lot of time on our clients. And so I've been in the business a long time, and I can tell you that back in the mid-eighties, we worried about how to deal with families that were going through enormous wealth creation or were in the distribution phases, or were in the income generation phases because the work part of their life, or

the wealth creation part of their life really had ended. But those obviously are very wealthy families, so it was clearly very upper-end.

But when I talk to advisors here, whether their practice is focused towards the wealthy or whether their practice is focused more towards the middle income American, the issues are the same. And the very best advisors here have dealt with this issue for a long time. And as I said, I think what's changing is that, there is a bigger market opportunity to help them, because more of their book will be converting to the income payout phase, and therefore they can't do at scale what they could have done at scale before. Instead of 5% of their book in that phase, it's going to be 50% or 40%. But that's what we see is an opportunity for us to help our advisors manage the complexity of having to create information on a larger scale. It's what led us to put in the system called Wealth Vision, which is our partnership with eMoney. It is a very powerful tool because it is modular and it sets up the issues through financial planning methodology. It helps the clients think about the kind of income they will need in retirement.

So I always come back to people who are very good at this business already doing a reasonable amount of it, they just don't have to do it at scale yet. And so it's not a complex problem.

I agree with you that the challenge we face in any part of our business—and we think training is one of the four pillars under which we're successful, so we say technology, service, investment research, and training are the four pillars that build LPL. And so in our training programs we focus on providing programs that help advisors with retirement and legacy issues. We also need to help the manufacturers

offer more of those educational opportunities and the things they're doing as they bring advisors into their shops and so forth as a way to help the broader group maybe see some of that and understand how to manage it.

What do you think about the idea of improving the forward projection of communications?

To be honest with you, I'm not sure how to visualize that, because that, to me, sounds like a technique.

Demographics would imply that there aren't enough advisors to personally interact in the manner that they currently do with all of the prospects who may need guidance in the distribution phase. Will there be web-based strategies that allow advisors to reach people in novel ways?

Yes. I have a good friend that uses the word, "modality," which I always think is a funny word — because I looked it up once. It's the definition of different ways people take data, which I never knew until I started to use it. And so if we think about the innovation of the cell phone, what's A versus B, the land line that was just a change in modality. And so I fully agree with you that the way that we interact with an advisor today is quite different than how we interacted with them five years ago. And today we use a variety of technologies that are web-based, CD-based, or a whole range of ways to educate and inform that are quite different techniques than we used before. Those haven't made their way to the end client as much, but they certainly will, I completely agree with that.

If I could somehow convey to you a magic wand, and by waving this magic wand you could effect any

two changes at all that you'd wish to make in the world of financial services, what would they be?

I think the first thing I would do hope for the country to deal with the broader Social Security issues. Let's call it a retirement security problem, because you really have three groups of people in the world, or in the U.S. You've got folks who, generally speaking, make more than \$200,000 a year who are going to be fine no matter what. Then you've got people who make \$40,000 a year to \$200,000 a year that aren't going to be so fine. But there are corporate processes like 401(k) plans, and there's tax incentives and things that could be dealt with, and there's folks who make less than \$40,000 a year—just to use rough math here—that are in real trouble if Social Security is insolvent.

The second one, that's an interesting one. I would be tempted to probably wave it towards some rationalization of the regulatory world, meaning that—the U.S. market is a very odd market. I spent a lot of time overseas for Scudder Investments, and a little bit of time for Northern Trust, and what I was struck by the sameness of regulation in those countries. So there's one regulator in the U.K. for financial activities towards retail consumers and towards institutions, and here we have at least three, if not four or five that are involved in that kind of work. So if there were another wand to wave, I think I'd probably wave it towards some form of uniformity approach towards regulatory matters. Because it would clear up a lot of gray areas in the way things are done. And it would, I think, create a better regulatory environment in the sense that it would be more effective. Because our problem in this industry is that people who do bad things are, luckily, fairly rare, but

quite difficult to find. And therefore the costs get created to try to find them, but really tax the rest of the 99.9% of the systems that are all fine. And I probably would wave it towards that, because I think that would help consumers and I think it would help the industry with consistency of approach. So those are some things that come to mind.

If you were not the chairman and CEO of LPL, but instead could have any other occupation in any other type of industry, what would you choose to be?

Excuse this one. Far and away, and if I weren't here I'd be in the same job somewhere else in the same industry, because I love what I do. If it were more esoteric, meaning that I was just ready to have a different phase in my life, which I'm not, I love music, and I'd do something related to the music industry. I've always thought I'd like to have a record label and I'd like to do concert promotions, and I'd like to have a chain of clubs, kind of like the House of Blues. Those are all the sort of fantasy worlds that were there. I'm certainly not ready for that, but just for the normal course of saying if you couldn't do this, what would you do completely different, that would be the completely different thing I would do.

If you were to imagine your own retirement in its most conceivably perfect form, where would you be and what would you be doing?

That's a good question. I don't know what that is. Work would have to be involved in some way, David, because I've learned a long time ago that for me, doing something—maybe not as intense as what I do now—but doing something beyond board work is going to be a big

part of my life for a long, long time. And so what I try to do is— Bob Pozen is a good example of it—here's a guy who's working as the chairman of MFS, that implies less of an operating role than the CEO. He's obviously on some boards and he is a big contributor to the industry. He's done some work in the state government here in Massachusetts. And I look at people like that and think, well, is that a model? And I think, well, I'm not sure I'd really like the government part of it, because that's not part of who I am. But I sure admire the fact that he's found interesting ways to be stimulated well beyond the years that one might normally want to do it.

Frank Zarb's another one I know who is part of Hellman and Friedman, and Todd is very close to Frank. I don't know how well you know him, but he took over as chairman of AIG when Hank Greenberg had to step down. And he's another person who is in government. He was in the Ford administration, and then he went into industry when they ran the NASD when it used to have the NASDAQ market as part of it, and split out NASDAQ and became the head of the NASDAQ, and then retired from that role and then went into Hellman and Friedman as kind of an executive in residence.

I just think those people have interesting lives because they've

stayed actively involved. And so I've always envisioned that my retirement life would be certainly having more time to go to Chatham and more time to go to California and more time to do the things I like to do. I love to travel and go to music festivals and other things. I'd like to have more hours in the week to do that, no doubt about that. But I'd always have to have something to do two or three days a week that's business related or nonprofit related, because I love that stimulation. **B**

David Macchia runs Wealth2K, www.wealth2k.com, a financial-services media and marketing company focused on retirement income.