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LPLA.OQ - Q2 2021 LPL Financial Holdings Inc Earnings Call

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OVERVIEW:

Co. reported 2Q21 gross profit of $602m and EPS, prior to intangibles and acquisition costs, of $1.85.

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PRESENTATION

Operator

Good afternoon, and thank you for joining the Second Quarter 2021 Earnings Conference Call for LPL Financial Holdings Inc. Joining the call today are our President and Chief Executive Officer, Dan Arnold; and Chief Financial Officer, Matt Audette. Dan and Matt will offer introductory remarks, and then the call will be open for questions.

(Operator Instructions)

The company has posted its earnings press release and supplementary information on the Investor Relations section of the company's website, investor.lpl.com.

Today's call will include forward-looking statements, including statements about LPL Financial's future financial and operating results, outlook, business strategies and plans as well as other opportunities and potential risks that management foresees.

Such forward-looking statements reflect management's current estimates or beliefs and are subject to known and unknown risks and uncertainties that may cause actual results or the timing of events to differ materially from those expressed or implied in such forward-looking statements.

The company refers listeners to the disclosures set forth under the caption forward-looking statements in the earnings press release as well as the risk factors and other disclosures contained in the company's recent filings with the Securities and Exchange Commission for more information about such risks and uncertainties.

During the call, the company will also discuss certain non-GAAP financial measures. For a reconciliation of such non-GAAP financial measures to the comparable GAAP figures, please refer to the company's earnings release, which can be found at investor.lpl.com.

With that, I will now turn the call over to Mr. Arnold.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Thank you, RJ, and thanks to everyone for joining our call today. Over the past quarter, our advisors continue to provide their clients with personalized financial guidance on their clients' journey to achieve life's goals and dreams.

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And at the same time, we remain focused on our mission of taking care of our advisors so they can take care of their clients. This combination positioned us to deliver another quarter of solid results while also continuing to make progress on our strategic plan. And I'd like to review both of these areas, starting with our second quarter business results.

In the quarter, total assets reached a new high of $1.1 trillion, up more than 45% from a year ago. This increase was primarily driven by continued organic growth, our Waddell & Reed acquisition and equity market appreciation. Now with respect to organic growth, second quarter net new assets were $37 billion. This result translated to a 16% annualized growth rate, driven by continued strength across new store sales, same-store sales and retention and brought our organic growth rate to over 12% for the past year.

In the second quarter, recruited assets were $35 billion, which brought our total over the past year to $80 billion. Our continued growth in recruited assets including new quarterly and full year highs, reflects our ongoing progress on enhancing the appeal of our model and expanding our addressable markets.

During the quarter, our recruiting results increased in each of our markets with over $10 billion in our traditional independent model, over $22 billion in our institution services model and approximately $2.5 billion in our new affiliation models. These broader and more diversified results helped position us to drive higher levels of recruiting going forward.

Now looking at the same-store sales, with the backdrop of continued strong retail engagement, our advisors remain proactive and focused on serving their clients and enhancing their offering. As a result, advisors are both winning new clients and capturing more assets from existing clients, which drove same-store sales to new highs in the second quarter. At the same time, we further enhanced the advisor experience through the continued delivery of new capabilities and technology as well as the ongoing modernization of our service and operations functions. As a result, asset retention was over 98% in the second quarter and 98% over the past year.

Now our second quarter business results led to solid financial outcomes with $1.85 of EPS prior to intangibles and acquisition costs, which is an increase of 30% from a year ago.

Let's now turn to the progress we made on our strategic plan. Now as a reminder, our long-term vision is to redefine the independent model over time and by doing so, become the leader across the entire advisor-centered marketplace. Our approach is to provide a platform that is simple and straightforward for advisors to design and run their perfect practice through a breadth of affiliation models, and the ability to personally configure the components of our offering to align with each adviser's unique needs and goals.

Doing this well gives us a sustainable path to continued solid organic growth, increased market leadership and long-term shareholder value creation.

Now to execute on our strategy, we have organized our work into 4 strategic plays, which I'd like to review with you in turn. Our first strategic play involves meeting advisors where they are in the evolution of their practice by winning in our traditional markets where our leading market share is now over 15%, while also leveraging new affiliation models to expand our addressable markets.

In our traditional markets, despite advisor movement in the overall industry remaining lower in the second quarter, we continued to increase our recruiting results and gain market share. The combination of our recruiting momentum and the appeal of our model continues to expand the depth and breadth of our pipeline.

Looking at our financial institutions channel. Within the past 2 quarters, we onboarded 2 new clients, BMO Harris and M&T. Then in June, we announced that CUNA Brokerage Services made the decision to partner with us and plans to join early next year. These results reflect the market opportunity that exists to leverage our capabilities to serve large institutions.

And as we look ahead, we continue to progress prospects through the pipeline and see large financial institutions as a sustainable multiyear contributor to organic growth.

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With respect to the expansion of our addressable markets, we continue to see momentum building across all 3 of our new affiliation models. Over the past quarter, we added 5 new practices across our strategic wealth services and employee models and after relaunching the RIA-only offering in April, we have been encouraged by the positive market reaction, including a new RIA that joined in May. Looking ahead, we see a growing pipeline across all of our new affiliation models.

Now another key component of this strategic play is using M&A as a complement to organic growth. Now after closing our Waddell & Reed acquisition in April, last week, we transitioned to our platform over 900 advisors who serve approximately 98% of client assets.

Our second strategic play is focused on providing capabilities that help our existing advisors differentiate in the marketplace and drive efficiency in their practices. One of the key components of this play is helping our advisors enrich how they serve their clients through the use of advisory platforms.

In that spirit, we continue to innovate on our platform, most recently with the introduction of a number of product, pricing and capability enhancements. One new capability to highlight increases the personalization available within our centrally-managed advisory solutions.

Now 2 years ago, we introduced Advisor Sleeve, which allows advisors to personalize centrally-managed portfolios with their own asset allocation models, while outsourcing the day-to-day work of portfolio allocation and trading to us. To build on this capability, last quarter, we launched Firm Sleeve. This innovation enables larger firms, RIAs and institutions to develop models that all advisors across their firms can use and thus providing additional ways to leverage our centrally-managed platforms to help meet client needs, differentiate the marketplace and drive efficiency in advisor practices.

To date, over $9 billion of client assets is invested across Advisor Sleeve and Firm Sleeve and we will continue innovating to increase the value of these personalized investment offerings.

Let's next move to our third strategic play, which involves creating an industry-leading service experience to delight advisors and their clients and in turn, help drive advisor recruiting and retention.

A key component of this strategic play is transforming our service model into an omnichannel Client Care Model. In second quarter, we launched a Digital Help Center, a machine learning-based solution that gives advisors easy access to information that addresses their most common service-related needs. This resource puts information that's personalized, timely and relevant at their fingertips, thus positioning advisors to serve their clients in a simpler and more efficient way.

Together with our voice and chat channels, the Digital Health Center enables advisors to access industry-leading service at a time and in a manner that works best for them.

We also continue to automate and streamline key elements of our service operations through the enhancement of our digital operating model, including investing in new bots across our care organization. Now this helps us to increase both our service levels and our capacity to grow as we continue to scale our business. And we believe these investments in our client care model and the automation and streamlining of our service operations are making positive contributions to the service experience while also increasing the scalability of our platform.

Our fourth strategic play is focused on helping advisors run the most successful businesses in the independent marketplace. One of the key components of this play is our portfolio of Business Solutions, which helps advisors more effectively operate their businesses so they can focus on serving their clients and growing their practices.

Now as we discussed last quarter, we see multiple pathways for continued growth in Business Solutions, including delivering existing solutions to additional advisors and introducing new solutions to expand our product portfolio. In the second quarter, our subscription base continued to scale to approximately 2,100 monthly subscribers, more than double a year ago. This includes about 80 subscriptions with advisors who joined from Waddell & Reed.

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Now the more work on business -- now the more we work on Business Solutions, the more opportunities we find to help our advisors solve additional challenges through the expansion of our product portfolio. We now have 7 solutions available in our product portfolio, 3 additional solutions in pilot and a handful of other offerings in the incubation phase.

As we continue to add new solutions, we expect to expand the addressable market while at the same time accelerating our pace of innovation. Before closing, I want to highlight our ongoing efforts to actively shape and refine our advisor-centric culture, which is instrumental to executing our strategy.

In the second quarter, we rolled out our Advisor Promise which is a modern evolution of the advisor commitment creed our founders wrote more than 30 years ago. We will use this promise to drive further accountability for providing industry-leading advisor experience and to continue to increase the competitive advantage our advisor-centric culture provides in the marketplace.

In summary, in the second quarter, we continued to invest in the value proposition for advisors and their clients while driving growth and increasing our market leadership. As we look ahead, we remain focused on executing our strategy to help our advisors further differentiate and win in the marketplace and as a result, drive long-term shareholder value.

With that, I'll turn the call over to Matt.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

All right. Thank you, Dan, and I'm glad to speak with everyone on today's call. In the second quarter, we remain focused on serving our advisors, growing our business and delivering shareholder value. This focus led to the highest quarter of organic growth in our history.

And in addition, we have now onboarded 3 of our largest partners in BMO, M&T and Waddell & Reed, who collectively added over $100 billion of assets to our platform, helping drive our total assets to over $1.1 trillion.

Now let's turn to our second quarter business results. Starting with organic growth, total net new assets were $37 billion, which translates to a 16% annualized growth rate.

This was driven by strength across all 3 channels of growth, recruiting, same-store sales and retention. Looking more closely at recruiting. In Q2, recruited assets were the strongest in our history at $35 billion, which brought our 12-month total to a new high of $80 billion.

Moving on to our business mix. We continued to see positive trends in Q2. Advisory net new assets were $21 billion, or a 17% annualized growth rate. With this growth, our advisory assets are 52% of total assets, as we continue to deliver differentiated advisory capabilities and benefit from the secular trend towards advisory.

Now let's turn to our Q2 financial results. Strong organic growth combined with expense discipline, led to EPS prior to intangibles and acquisition costs of $1.85, up 30% from a year ago. Looking at our top line growth, gross profit reached a new high of $602 million, up $22 million or 4% sequentially. Looking at the components, commission and advisory fees net of payout were $197 million, up $13 million from Q1, primarily driven by organic growth and assets from Waddell & Reed.

In Q2, our payout ratio was 86.3%, up about 70 basis points from Q1 due to typical seasonality. Looking ahead to Q3, we anticipate our payout ratio will be approximately up approximately 100 basis points, driven by the expected seasonal build and production bonus as well as the onboarding of Waddell & Reed assets, which earn a slightly lower payout on their platform.

Moving on to asset-based revenues. Sponsor revenues were $189 million in Q2, up $22 million sequentially. This was driven by an increase in average assets due to organic growth, Waddell & Reed and equity market appreciation.

Turning to client cash revenues. They were $90 million, down $7 million from Q1, driven by lower ICA balances during the quarter.

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Looking at overall client cash balances, they were $48 billion, roughly flat with last quarter. Looking more closely at our ICA yield, it was 98 basis points in Q2, relatively flat with Q1. As we look ahead to Q3, given where interest rates, client rates and cash balances are today, we expect our Q3 ICA yield to be roughly flat to Q2.

Now looking at our fixed rate portfolio. As a reminder, we have a fixed-rate maturity at the end of the third quarter, which will lower our Q4 ICA yield by approximately 10 basis points. That said, I would highlight that as the yield curve steepened earlier in Q2, we saw demand start to return to the fixed rate sweep market.

As a result, we were able to enter into $600 million of new fixed rate contracts at the 3-year point, which was about 40 basis points at the time. Looking beyond Q3, and given the expectation that short-term interest rates will begin rising in late 2022 or early 2023, we thought it would be helpful to share the economic benefit of rising rates using the deposit betas we experienced in the most recent interest rate cycle.

Using our current sweep balances, a 100 basis point increase in the Fed Funds rate would translate to approximately $340 million of annual gross profit.

Moving on to Q2 transaction and fee revenues. They were $137 million, down $4 million sequentially, driven by trading volume that decreased throughout the quarter. Looking ahead to Q3, prior to Waddell & Reed, we expect transaction and fee revenue to be relatively in line with Q2 as we anticipate seasonally lower transaction volumes and IRA fees will be offset by revenues from our national adviser conference.

Turning to Business Solutions. We ended the quarter with approximately 2,100 subscriptions, which is up 400 from last quarter and more than double a year ago. These offerings now generate roughly $20 million of annual revenue, and more importantly, they help free up additional time for advisors to spend on more valuable activities, including serving their clients and growing their practices.

Now let's turn to expenses starting with core G&A. It was $252 million in Q2 and $240 million prior to Waddell & Reed. Looking ahead, we continue to anticipate full year 2021 core G&A to be in a range of $975 million to $1 billion. As a reminder, this includes cost to support BMO and M&T but is prior to expenses associated with Waddell & Reed.

Moving on to Q2 promotional expenses, they were $64 million, up $10 million sequentially. Prior to Waddell & Reed costs, promotional was $57 million, up $3 million sequentially, primarily driven by large financial institution onboarding and increased marketing expense.

Turning to Q3. Prior to Waddell & Reed, we anticipate promotional expense will increase by around $10 million as we have 2 of our largest advisor conferences in Q3. I would also note that we have shifted several conferences that are typically in the first half of the year to the fourth quarter. This will likely lead to a similar level of promotional spend in Q4. However, our plans could change depending on the environment, so we'll give you a more specific update next quarter.

Now let's move to Waddell & Reed. Overall, the transaction is progressing even better than we expected across multiple fronts. As mentioned, Waddell & Reed advisors serving approximately 98% of client assets have joined our platform, which is up from our prior estimate of 95%. Factoring in this higher level of retention, and current asset levels, we now expect the run rate EBITDA benefit to be at least $85 million, up from $80 million, and we continue to expect to reach this run rate by the middle of next year.

Moving on to capital management. Our balance sheet remained strong in Q2, with a leverage ratio at 2.3x and corporate cash of $278 million. As for capital deployment, our framework remains focused on allocating capital aligned with the returns we generate: investing in organic growth first and foremost, pursuing M&A where appropriate, and returning excess capital to shareholders.

In the first half of this year, the majority of our capital deployment was focused on supporting organic growth and M&A. Looking ahead, while we continue to see compelling opportunities to deploy capital to drive growth, we also feel well positioned to restart our share repurchase program, initially focusing on repurchasing shares to offset dilution, which we estimate to be approximately $40 million per quarter. We will, of course, remain flexible and dynamic should additional opportunities to deploy capital to drive growth emerge.

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In closing, we delivered another quarter of strong business and financial results, including the best organic growth in our history. And just last week onboarded the advisors from Waddell & Reed. As we look forward, we remain excited about the opportunities we see to continue investing to serve our advisors, grow our business and create long-term shareholder value.

With that, operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Steven Chubak from Wolfe Research.

Steven Joseph Chubak - *Wolfe Research, LLC - Director of Equity Research*

So wanted to start off with a question on just some of the ICA dynamics. Certainly encouraging to see the interest from bank partners for some longer-dated money should help at least put some of the ICA concerns to rest. But if rates remain at 0, the bank deposit demand remains tepid, Matt, I was wondering you could just speak to the strategy for managing fixed term contracts over the next few years. And just generally, what are you hearing from your bank partners with regards to appetite to take on some additional fixed term contracts in the current environment?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, Steven, I'll take that, obviously. I think when you look at our fixed rate approach and strategy, it's really unchanged, right, even in the environment that you described, which is our goal remains getting to 50% to 75% of the portfolio fixed, of course, in an environment where there is demand that can help us do so. And I think when we're in an environment like we are now with rates low and the curve relatively flat, I think that's an environment where we would stay closer to that 50% point. And if you're in an environment where the absolute level of rates are higher and there's some steepness to that curve, I think we would naturally migrate to that 75% side of that range.

So that's been our approach for a while. I think the environment we're in really doesn't change that. I think to your point on what we're hearing from our bank partners, I think it's probably more what we're seeing in their actions, which is when there's some steepness to the curve and just looking at Q2 and it was -- the 10-year was at that 150 bps to 160 bps zone, right? There's economics on their side, and that's really when you saw them start to come back into the market and we were able to execute a relatively small amount.

But I think from a -- really an indicator of their approach and intentions, I think it spoke really, really loudly that once there is some economics to be had, that the fixed rate sweep market is something that I think would return. So we're obviously not in that environment at this very moment, but I think it's a good idea to what things could look like if rates move up again.

Steven Joseph Chubak - *Wolfe Research, LLC - Director of Equity Research*

And just my follow-up maybe for Dan. You touched on this quite a bit in your prepared remarks in terms of the better balance across all the different affiliation options and the accelerating organic growth that you're seeing.

And one of the questions that we probably feel most often from investors is just trying to unpack given some of the momentum that you're seeing, the new organic growth algorithm especially given the momentum you're seeing within the institutional channel, in particular, which seems to be adding at least 200 basis points plus of organic growth. Maybe, Dan, if you could just speak to -- given the progress you're seeing on the organic growth side, what do you think is like a new sustainable organic growth rate if some of the success that you're seeing in the nontraditional areas continues to build from here?

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Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes, that makes sense. And so perhaps as a way to -- thanks, that makes sense. It helps if I have the microphone on. Sorry about that. Yes. For context, perhaps, look, we're focused on organic growth. And over the past 3 years, the team has done a great job of expanding that. I think about that march from sort of 3% to over the last 12 months, 12%, right? So if you break that down to get at -- your question a bit, 2/3 of that has come from those traditional 3 ores in the water, we talk about new store sales, same-store sales and attrition.

And if you peel that back a little further, that contribution from those ores is really well balanced across all 3, which I think speaks to the durability of that growth, right? So that's 2/3 of that journey from 3% to 12%. And then I think if you look at the remaining 1/3, that's come from our entry into supporting large financial institutions.

And again, I think we are being very intentional about investing in our capabilities to create an appealing solution for these large institutions. As we've partnered with BMO and M&T, we continue to invest in our capabilities for institutions, which we think just enriches the appeal of the model. So we're quite optimistic about our pipeline there and our ability to continue to pull through new institutions.

And so we see that as a contributor to growth over the next several years or an ongoing contributor to growth. So that might be a way at least to think about the dynamics of how we got to from 3% to 12% and perhaps how we think about going forward, the durability around of them. Look, at the end of the day, organic growth is a key point of our strategy, and we're focused on trying to drive that rate higher.

And we've got 3 good avenues of which to continue to do that through our traditional markets. These expanded new markets and then this institutions marketplace. So I hope that gives you some color and helps.

Operator

Your next question comes from the line of Bill Katz from Citigroup.

William Raymond Katz - *Citigroup Inc., Research Division - MD & Global Head of Diversified Financials Sector*

Just want to follow-up on sort of Steve's line of questioning there. Just coming back at a slightly different cut at the organic growth. Something that we're observing is a combination of further penetration within each segment as I sort of look at where you're picking up share from and also that mandate sizes seem to be rising. So could you speak a little bit to maybe why you're seeing the better efficacy? Is this just idiosyncratic? Or is there something else afoot here as sort of the cumulative maybe time, recruitment, what have you is helping to bolster sort of that penetration?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. Thanks for the question, Bill. And it's a good one, as you point out in terms of maybe the nuance that sits underneath it. So we look at it this way. We launched these 3 new models at different times, but we launched them from a place of a hypothesis around a business model that we took to the marketplace. You get feedback. You learn as a part of that.

You continue to invest and enrich your capabilities within that model. You successfully deliver it to clients. You begin to build a reputation with those clients around the success of that model. And between new capabilities in the building reputation, that supports momentum, that supports confidence in prospects, exploring further this opportunity.

And I think naturally leads to, in many cases, larger opportunities because of that building credibility. So I think that's how we think about the SWS model, and that's the most mature of the new models.

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We're seeing sort of a similar flight pattern, if you will, with Linsco. It's just 6, 7, 8 months behind the trajectory of SWS. And then RIA, we just obviously relaunched in April. So hopefully, that helps. But we do think it's that growing credibility with delivering a good solution that is serving clients well and the continued evolution of capabilities will create that natural lift on larger clients, bigger demand, growing pipelines and what we're trying to do is drive a much bigger contribution from those models.

William Raymond Katz - *Citigroup Inc., Research Division - MD & Global Head of Diversified Financials Sector*

Okay. That's helpful. And maybe one for Matt. Certainly glad to see the buyback kicking a little bit sooner than maybe we were modeling. How did you arrive at just sort of the dilution offset? So we think about the opportunity to grow organically opportunity for anything else on the M&A side of the equation. And then what are some of the other metrics we should be looking at to think about the potentially you need to upsize that buyback as we look ahead?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, Bill, I think the key thing is just our capital allocation framework. I think we're continuing to deploy capital, as you can see in the quarter in organic growth and M&A. But at the same time, I think when you go back 6 months ago, I think we're through some of the chunkier capital deployments on those first 2 categories.

I think we've got a little bit more excess capital to deploy. And when you run it through that framework, while we continue to have opportunities in those first 2 categories, I think we feel quite comfortable allocating capital to share repurchases given both the capital level and the returns they generate. And I think as we look forward to your question, I think we'll continue to look at it from that same lens with the principles of making sure we maintain a strong balance sheet as that's quite supportive of our organic growth.

And if the opportunities to allocate to organic growth and M&A increase, we'd move capital to there. And if returning capital to shareholders is the primary place where it makes sense, we move capital to there. It's all about applying the framework. So that's how we'll continue to approach it going forward.

Operator

Your next question comes from the line of Michael Cyprys from Morgan Stanley.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

Just on the Waddell transaction, I was hoping you could elaborate a little bit on the contribution in the quarter in terms of some of the puts and takes. I think there were also some onetime costs or some drag that was maybe partially offsetting some things there as well. So hoping you could elaborate a little bit on that and how we should be thinking about the timing of the ramp here, particularly as we go into the second half of the year in terms of the contributions from Waddell?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. Sure. Sure, Michael. I think when you -- we've got hopefully some good disclosures on that, that as I talk here, you can look at or maybe even look at later in our key metrics deck on Slide 8 that I think helps with that. I'll get a little bit of color here. I think when you look in the second quarter, really the main action or activity was closing on the transaction. And we're actually able to get some of that kind of first round of expense synergies a little bit earlier than we had expected a quarter ago. That's why you see that run rate hitting $50 million from an annual basis for the 2 months that we had Waddell on board in the quarter.

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As we look ahead to Q3, it's really about onboarding is the key integration activity, which happened just last weekend. So that will lead to some more gross profit synergies also moving the Waddell advisors on to our payout grid, which is a little bit higher and then eliminating the cost of their custodian. Now those things coincidentally kind of net out, which is why you see Q3 still being at that same $50 million run rate, but a lot of activity is happening.

And then from this point forward, meaning in Q4 through the middle of next year is really about the rest of the expense synergies and integration. And those are the activities that will bring us to that $85 million plus run rate by about the middle of next year. So that's the path on the integration and run rate side. Your question on the kind of one-timers, I think, the acquisition costs, which we now estimate are a total -- will be a total of around $100 million. That shows up in that acquisition cost line item, which you saw that really increase in the second quarter from the closing. And then I'd highlight the third quarter is probably going to be the quarter with the largest amount of that $100 million.

Our estimate right now is in the $40 million to $50 million range. And that's really tied to the onboarding activities which are -- which is the activity that naturally incurs to those costs. So I hope that helps.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

Super. Just a quick follow-up on the ICA balances. We saw the overflow balances decline a bit in the quarter. Just curious what appetite or ability is there to sort of expand the variable balances and really take those overflows down to 0. What's the potential to do that, would you say?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Well, I think that gets back to just when there's demand from the banks, right? I talked a little bit earlier about on the fixed rate side when rates move up along the curve, meaning that 3- to 5-year point, there's some demand there. On the floating rate side, I think it's really going to come back to the amount of liquidity that's in the market and banks needing liquidity for their balance sheets. And I think where we sit today, there's still just a substantial amount of liquidity in the market. But I think we're now in the second quarter in a row where you're starting to see some signs of activity that ultimately would lead to that demand returning, right?

Consumer spending picking up, right? That's coming out of checkings and savings accounts at the banks. Loan balances beginning to grow, meaning they're loaning out that cash. So I think if you continue to see the trends there, I think those are the things that would ultimately lead to that demand picking up.

Operator

Your next question comes from the line of Kyle Voigt from KBW.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

So maybe a 2-part question. I think you changed some of the rate sensitivities in your deck on the gross profit benefit from rate hikes. And you noted that the beta was 2.5% through your first 4 hikes during the last cycle. So I guess the first question is, should we take the sensitivity to mean you expect similar beta dynamics during the next hiking cycle? And the second part of the question is really, like, if you look back during the last rate hiking cycle, you took advantage of the gross profit benefit to really increase technology spending and reinvest in the platform.

However, you're in a different spot today in terms of ongoing reinvestment into the platform. So as we look ahead towards the next rate hiking cycle and as you kind of outlined very meaningful gross profit benefits, how should we think about how much of that could fall to the bottom line versus wanting to take advantage of the environment to reinvest in the business and increase spending?

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Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. Yes. I think on the sensitivities, and I think that what we were trying to do there is really give some empirical data on -- from the last interest rate cycle, right? Now market demand and market pricing ultimately drives where deposit betas go. But I think from our chair, the best information to look at to get an expectation of what would happen is what happened most recently. And I think that's what we updated our metrics to show, which was an average beta of 15% that period of 2015 to 2019. But in the early part of the cycle, it was 2.5% and then later part of the cycle 25%. So I think the market dynamics will determine where that goes. But I think looking at the history from our chair is probably the best thing to look at.

Now to your point on what to do with that revenue, I think it will go back to our capital allocation framework, right? The same thing that we're applying today on where the highest and best returns are. And when you look at investing in the platform, those are things that drive organic growth.

And if there are things that can drive a return there, we focus there, and then to M&A and then returning capital to shareholders, which, from a gross profit standpoint, can show up in the form of just incremental op margin and delivering operating leverage. So it will just be based on our opportunity set at that time. And I'd just emphasize, I think when we take a step back and even just building on what Dan was talking about earlier and our opportunities in the different channels and models we have, I think we're excited about an environment where we could continue to grow further.

Operator

Your next question comes from the line of Alex Blostein from Goldman Sachs.

Alexander Blostein - *Goldman Sachs Group, Inc., Research Division - Lead Capital Markets Analyst*

So I wanted to start with a question around some of the larger mandates, BMO, M&T and Waddell, that you onboarded in the second quarter. Can you talk a little bit about the financial advisors' appetite to uptake all of the sort of enhanced capabilities that LPL can offer? Sort of what resonates most there? And then maybe just putting some numbers around that sort of gross profit ROA on that $100 billion of assets or so, kind of where is that now? And where do you think that could ultimately go?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Let me take the first half of that, Matt, and you take the second. So yes, Alex, with respect to the advisors, look, the typical principles that one large institution might choose or used to make the selection to partner with us typically has to do with enhanced technology capabilities. So can we provide them technology automated workflows, et cetera, to drive efficiency into their practices, free up time for them and their teams to spend on clients and prospects. And so that is a priority, and we spend a good bit of time making sure that you do the appropriate level of training, coaching and work to ensure that they can leverage that sort of comprehensive technology offering. And that takes time. They don't get that on day 1, but you continue to work on it and they become proficient at it quickly, and that becomes a big leverage point. So that is one area that they tend to look at.

A second one would be the advisory platform that we have and the breadth of options and alternatives we give them from a capability set, from an investment content, from a pricing standpoint, from a vertical integration and ease of doing business. That certainly is a way for them to provide expanded or enhanced value of advice to their end clients, ultimately help them differentiate and support their growth aspirations.

And so there, you get a great client experience at the end of the day, matched with also some tailwinds for growth. And so that would be a second area that I would tend to highlight. And if you look at the institutions at a macro level, right, our ability to partner and provide a good deal of support and advice through the compliance and risk management support that we can provide shifts the risk profile for them with this business initiative, and I think creates, at an institutional level, an important element of value.

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A second one is just improved and enhanced economics, typically shifting from a model where you've got the entire cost structure and then have to make the investment in labor and technology, et cetera, to do it, and you can go to a more outsourced arrangement, we typically see an improvement and enhancement in overall economics. So I'll stop there, but those are maybe some high-level things that are in it for the advisors and their clients, as well as the institution as a whole.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

And then, Alex, just on the gross profit on the return side. When you look at the financial institutions channel, right, they're typically much larger -- to the point on the first part of your question, a little bit heavily focused on the brokerage side. So you get ROAs that are -- that as a starting point, are closer to where brokerage ROAs are, so I think 15 basis points. A little bit of additional color on CUNA. They're a network of credit unions, so we share some of that gross profit with them. So for that particular opportunity, be more in the 10 to 15 basis points zone.

And then on the cost side, I think the cost to serve is lower, just given that size and then the TA and the underwriting factors in all those economics. So you bring it down to the bottom line. And if you look at our EBITDA operating margins, they're quite accretive to that with one caveat that deals of this size and the nature of this channel usually come with some incentives in the early terms of the deal, think first year and second year. So those economics grow over time as you get deeper into the contract. So I hope that helps.

Alexander Blostein - *Goldman Sachs Group, Inc., Research Division - Lead Capital Markets Analyst*

Yes, that helps. And just maybe a quick clarification around the ICA dynamics. So clearly, LPL continues to have a significant amount of upside to higher interest rates. And I appreciate you guys highlighting the low deposit bid as well. That's obviously very helpful from the last cycle. How do you think about the trade-off, I guess, here between fixing out kind of at 40 bps for 3 years if the demand picks up again sort of versus waiting for potentially a much more material upside, 12 to 18 months out?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. I think it goes back to that 50% to 75% approach, Alex. I think we're really focused on having a stable earnings stream in this area and not trying to be folks that pick the points where interest rates make sense and don't make sense. I think we've got a principle that is we'll hedge a little bit lower on the percent if the economics look like they're at the lower point and a little bit higher on the percentage if we look like they're at a higher point. But once you get below that, we're not trying to tactically pick those points. I think specific to this quarter, I think when you're in the market that I think we're all collectively in, when a bank comes up and has demand for sweep deposits, I think most people would say yes and deploy that. And that's what we did on that particular opportunity.

Operator

Your next question comes from the line of Gerry O'Hara from Jefferies.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

I was hoping maybe we could get a little extra color on the Business Solutions. It sounds like Dan may have mentioned 3 in pilot, a handful of others that are perhaps on the come. I don't know if it's too early, but would certainly love to hear a little bit about those. And then also, what has been really resonating, I think it sounded like 80 or so, if my notes are right, that have already been kind of picked up from some of the Waddell advisors. So anything additional there would be, I think, of use.

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Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes, maybe I'll give you just a quick snapshot of the product portfolio. And then I can answer your question about maybe some of the early interest from the Waddell & Reed folks and then happy to share the 3 that we've got in pilot phase. And so if you look at the solutions today, as I mentioned, there are 7. There's the original 3, which were Admin Solutions, CFO and Marketing. With respect to Waddell & Reed, the most popular one for them thus far has been Admin Solutions, which makes sense if you're thinking about coming in and learning a new environment and making the transition. So -- and you've got people in the LPL ecosystem that are experienced in supporting and helping do that.

I think that's a logical place to look for a leverage point. And if you didn't have access to that admin at the market rates of hiring someone directly, this is actually a new service and a good alternative lower cost way to do that.

With respect to the solutions then that we've added to that original portfolio, you've got the Assurance Plan which is we just rolled out the Resilience Plan and those 2 are ways of which to support and help advisors plan for unexpected and/or expected transitions from the business.

So Assurance Plan was the old plan that if unfortunately, it kind of gave someone downside production if something happened to them unexpectedly and the business had to be transitioned. This gives them an orderly way to make that transition to do that.

Resilience Plan was added as an ideation from that in a learning and a feedback that advisors really like the Assurance Plan, but they also said, well, what if we have a short-term disruption in our ability to operate or run the business? Could you help us with that as well? And so that's where we came up with this idea with the Resilience Plan that gives them some support in a backstop. If they had an unexpected problem, think about disability or something like that, or if they even have a planned need to have an extended leave from the business such as paternity or maternity type of leaves. And so pretty cool innovation that came from the feedback and the appeal of the Assurance Plan.

There's also M&A Solutions that we launched earlier in the year and Remote Office Solutions that emerged during the pandemic. The 3 that are in pilot real quickly. You've got a bookkeeping solution that we're experimenting with that was borne out of the CFO Solution and our continued innovation from the feedback that our clients give us on their needs. There's a paraplanning solution in pilot. And then finally, something we call it Client Engage, which is meant to be a way to support and help the advisors managing successfully the servicing and communications with their clients. I'll pause there, but that gives you a quick snapshot of the portfolio.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

Helpful. And I appreciate that. And then maybe just one for Matt. If you might have a comment or 2 just on the environment around transition assistance, what you're seeing? What you're hearing? I think we'd all appreciate that as well.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. I think the headline is we're seeing a pretty consistent environment, which is the overall value prop at the firm is what matters the most. And I think when you get -- then click down into transition assistance to help facilitate the move from one firm to another, I think we're seeing pretty similar levels that we've seen in the last few quarters. So no change on that on our end.

Operator

Your next question comes from the line of Devin Ryan from JMP Securities.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD and Equity Research Analyst*

Great. Maybe I start here with just a bigger picture question. As we watch the business scale and increase affiliation options with a lot of success bringing in larger advisors that have more complex businesses. Does the thinking evolved at all around potentially reexploring the merits of

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becoming a bank? And I appreciate it's complicated. And obviously, you guys decided not to years ago, but just given those dynamics of how the business is evolving, maybe coupled with some of the near-term dynamics around rates, I'm just curious if it kind of comes back on or the pendulum swings in one direction there.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. Maybe we both can give some color on that. I'll start, Matt, you feel free to provide any insight. So obviously, from a strategic standpoint, we have a significant set of considerations that you always think about and you're diligent around always evolving your assessment given changes in the marketplace, changes in the business, changes in the competitive landscape.

And so potentially being a bank is one of those things that we would always keep active sort of that assessment and that consideration. And I think we would look at it from a strategic standpoint, are there capabilities that could potentially support advisors and their value to clients? And is it a better way to manage ultimately, our cash balances and/or ultimately deploy and execute against some of that expanded capability that I was mentioning earlier. And so I think we always look at it from the standpoint of what's the best way to do that, right? The old do we do it ourselves? Or do we outsource it? The marketplace has given us lots of options of which to find different ways to provide capabilities and to effectively manage our cash balances using someone else's balance sheet to do that.

And we think that strategically makes sense in the short run as long as we find the options and alternatives to do that, and we can deliver the capabilities that our clients need. And that's kind of how we see it in the short run. But I think we continually look at the different market dynamics and keep that assessment alive just so it's fresh, we're clear and have the most informed view that we can about our set of options. I'll pause there. Do you want to add anything to that?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. That was well said, I'd just emphasize a couple of things. I think the key Devin, is making sure that we're in a position to deliver the products and capabilities that matter to our advisors and their clients. And do you need a bank charter to do that? And I think to Dan's point, the marketplace has given us plenty of options where you don't. And I think the second part of the question is, what's the best return on capital, right, deposits on our balance sheet versus someone else's? And I think you run that math, especially in an environment like this, and the return on capital of having a bank is not a pretty picture.

So I think it makes sense where we are now. But to Dan's point, I think we always look to make sure if the world changes that we'd be aware of that.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD and Equity Research Analyst*

Sure. Okay. Appreciate the update there. And then the follow-up, I guess, shorter-term or smaller topic. You guys talked about streamlining, automating the service offering, which is interesting. And as we think about just the bigger opportunity to automate the platform and utilize technology to kind of scale the business from here. How should we think about like the expense buckets and maybe where there's incremental operating leverage in the model. Like so service feels like that's one example where there's a number of people doing jobs where, in some cases, new technology may be able to step in and disintermediate some of that and save some money for LPL. I guess is there any way to frame that? And are there any other areas like that, that could be kind of margin enhancing?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. That's a good -- it's a great question. And it's one from an operational execution standpoint, I think we're keen on exploring what are those sort of world of possibilities and how we might best do that. So if I just gave you a little color on areas that we think about. There's certainly leveraging robotics, as you say, for more repetitive type of work, whereas you expand and you grow and you can transform that work into a more automated type of solution makes tons of sense in the short run from potential expense synergies but adds a lot from a scalability standpoint.

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So across our operations and our compliance organizations, you see opportunities for robotics. You also have opportunities to use AI for quicker assessments and more robust, broader spectrum assessment. So think about the efficacy of oversight of our compliance controls, our risk management controls, and that's a place where you could use AI to step in as a real leverage point for the work that our folks do.

And in that case, that may not eliminate jobs, but that may create lots of scalability as you go forward because of the more efficient and effective use of automation to assess greater and greater volumes of business.

So that would be another example, I think, where you could use newer technology with you, if you will, or automation and deploy it within the organization. Maybe I'll pause there, and I don't know if you want to take on the implications or contribution that may occur from that.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, I'd just emphasize what Dan said. I think the biggest opportunities are really in investing in and deploying technology that allows us to scale, right? So for every dollar of assets we're adding, we're adding less expense than we had to add for the prior asset, right? I think that thematically, that's the primary approach. I think when you look at what that could deliver, I think it gets back to our principles of the amount that we would invest.

We're going to be focused on both investing to support that growth, but at the same time, delivering operating leverage, right? And I think that you see us doing that, I think, right now, and I think that same approach as what we would have going forward.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. I'll leave you with this. Think about it as using automation and technology and our modern technology to drive the future advisor and end-client experience, the efficacy of your risk management oversight and finally, third, scalability in the overall operations.

Operator

And there are no other questions over the phone line at this time. I would now like to turn the call over back to Mr. Dan Arnold for closing remarks. Sir?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Thanks much, RJ, and thanks, everyone, for taking the time to join us this afternoon. We really appreciate it, and we look forward to speaking with you again next quarter. Have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. We thank you all for participating. You may now disconnect.

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