



CUTTING TIES: HOW TO DECLARE INDEPENDENCE
An Investnet White Paper

EXECUTIVE SUMMARY

With the dramatic reshaping of the financial services landscape in recent months, the concept of “independence” is increasingly being viewed as a profitable business model for those advisors who seek better control over their professional destinies. The resources available to independent advisors have never been more robust—from access to a broad range of investment solutions, integrated technologies and reporting capabilities to complete outsourced back-office support. The opportunity to become independent has never been more attainable.

If you are wondering if independence might be the better career path for you, you have company.

According to the 2008 Broker & Advisor Sentiment Index¹, nearly twice as many respondents were thinking of switching firms in early 2008 than had the previous year. Of the roughly 9 percent who were, nearly two-thirds of them were thinking of doing more than just switching firms and pocketing the standard sign-on bonus. They had independence on their minds.

IF YOU ARE WONDERING IF INDEPENDENCE MIGHT BE THE BETTER CAREER PATH FOR YOU, YOU HAVE COMPANY.

The extraordinary turbulence felt at many leading Wall Street wirehouse firms will likely create months, if not years, of instability. This disruption comes at a critical time in many investors’ lives. Market volatility has disrupted investment plans just as an enormous population is speeding toward retirement. For advisors, there is an urgent need to be focused on providing solutions, not on the fate of their firms. At this point, it is understandable that many advisors are now asking themselves: “At a time when the need for financial planning and retirement services is intensifying, am I practicing within the best model for delivering quality services to my clients?”

In this paper, we will examine what has changed in recent years to make independence a more viable alternative. We will also consider why those changes, especially in light of recent events, now require that advisors consider whether or not their current professional arrangement still suits their career objectives.

To help advisors survey the current landscape, we will look beyond the question of whether or not a move will be the more personally rewarding of the available options and how they would go about making a change, but also consider whether independence will better serve the interests of their clients, which is, after all, the most important component of growing a practice.

¹ Sponsored by National Financial and released in early 2008.

EVERYTHING HAS CHANGED

The decade of the 2000s has been remarkable for many reasons—among them is the dramatic change the financial advisory community has experienced. In 2000, the advantages of scale, access, technology and resources heavily favored wirehouse advisory firms. But in the ensuing years, a tremendous amount of development has spurred the independent advisory market to become very competitive with the capabilities once dominated by the largest firms on Wall Street.

The advent of the Internet also broke down many of the barriers to entry for independent advisors. It provided the independent channel with access to a broad range of research providers and investment products and the integrated technology to support their practices. The cost of transactions and efficiency of trade execution have also been leveled. Today, the environment for independent advisors actually rivals and, in some cases, exceeds what is available within the wirehouse framework.

The process of moving to become independent has also been streamlined over that same timeframe. Today, there are experienced teams that help advisors move accounts, configure and build technology, integrate their platforms with custodial partners, and transfer and reconcile historical data. The entire process has been simplified so that the time and disruption of shifting into an independent practice has declined.

Given the enhancements in the independent advisory marketplace, advisors are beginning to make their moves. It has been reported that 1,500 to 2,000 wirehouse advisors have been declaring their independence annually in recent years.²

CLIENTS HAVE BEGUN JUMPING SHIP IN SEARCH OF LESS-CONFLICTED ADVICE, CREATING AN OPPORTUNITY FOR ADVISORS.

Overall satisfaction among financial advisors is beginning to shift as well. The 2008 Financial Advisor Satisfaction Survey, which was conducted prior to September 2008 by J.D. Power and Associates, indicated that advisors at independent firms had far higher satisfaction ratings than those at the “Big 4” wirehouses (Merrill Lynch, Citigroup, UBS Financial Services and Wachovia Securities).

Recent events on Wall Street, spurred by the credit crisis, seem to be further accelerating the move toward independence.

While advisors are questioning their professional futures, investors are also thinking hard about their options. Bloomberg recently reported that “almost 90 percent of customers of major brokerages say they plan to withdraw at least some of their money, and 70 percent say they want to fire their brokers, according to a September survey by Prince & Associates Inc., which polled 351 people with more than \$1 million of investable assets. In July, about 68 percent said they planned to take money out, and 38 percent had had enough of their current adviser.”³

² Elizabeth D. Festa, “Springtime for Broker: Custodians and Independent B/Ds Roll Out the Carpet,” Investment Advisor, August, 1, 2008.

³ Edgar Ortega, “Broken Wall Street Means Merrill Model Succumbs to Independents,” Bloomberg.com, October 6, 2008.

Such client dissatisfaction comes at a time when a very large population of investors is at a critical stage of retirement planning. These are traditionally important years for advice. It is possible that investors will not patiently wait for the corporate theater to play out on Wall Street, but instead will search for less-conflicted advice from independent sources. This would create an opportunity for advisors to better differentiate themselves and demonstrate the value they bring to their consultation by pursuing independence.

In short, the stage is set for the independent advisor. Going independent has become more operationally and financially feasible. The availability of investment product, technology and resources has been leveled. And the ability to control your own destiny as an independent has been underscored by the current turbulence on Wall Street.

WHAT'S IN IT FOR YOU?

One of the first things advisors gain from declaring their independence is the ability to practice what they preach. In other words, they are free to develop a practice around the solutions and services that best suit the needs of their clients. There is no top-down mandate, nor are there sales quotas. They are simply free to focus on the best interests of their clients. As a result, independents tend to have the flexibility to take a more active role in developing client strategy and tailoring their advice to the situation at hand. Their credibility with clients is enhanced as they shift from a proprietary-based model to one built on greater objectivity.

But beyond personalizing the way they conduct business, an advisor's independence means a different revenue model. Rather than yielding more than 60 percent of the revenue to the firm, there are typically much higher payouts in the independent model. True, there are additional expenses (e.g., office space and staff), but the ability to manage these costs is in the hands of the advisor rather than the firm.

Being independent also means having the opportunity to create long-term value in the business. Instead of building a book of business that enriches the firm, advisors are in a position to literally take ownership of their book. Independents create a business with a salable value that can be capitalized upon retirement or transitioned to hand-picked successors. And that serves the entrepreneurial spirit behind every good advisor who has built or is working to build a book of business. It is also an aspect of independence that is particularly valuable to those near the start of their careers.

5

REASONS FOR GOING INDEPENDENT

1. Practice what **you** preach
2. Offer investment strategies and products **you** support
3. Create value for **yourself**, not for an employer
4. Retain high percent of the revenue **you** generate
5. Achieve a more objective offering for **your** clients

BUT ARE YOU READY FOR INDEPENDENCE?

If independence is the answer, the question then becomes: Why have you and the vast majority of your colleagues not considered it before this?

For starters, until recently the high barriers to entry seemed to outweigh the positives for many would-be independents.

It was more than just the control of information and monumental task of setting up a back office and selecting the technology to run it, along with the full load of practice management issues. With 100 percent of the revenues comes 100 percent of the responsibility for operating costs and personnel issues. Compliance requirements, which have intensified in recent decades, can also be intimidating.

But, while the degree of difficulty associated with independence has been a legitimate one, it is far from an insurmountable one, especially today. An industry of platform, custodial and broker dealer providers has formed to serve the independent business model.

On the technology front, they have created state-of-the-art back offices and trading platforms that are flexible enough to accommodate any size practice. But best of all, product lines have also gained their freedom. Independent advisors have access to the industry's full range of products. Independents also have the ability to seek the type of retirement solutions products that do not traditionally reside within wirehouses, including many insurance-based solutions aimed at the burgeoning baby boomer market.

What cannot be fully outsourced, however, is accountability. No longer covered by a firm's policies or subject to their internal practices, independents bear the responsibility and liability for compliance reporting and for compliance on the part of their subordinates. However, more and more providers are adding services that help with this task, including compliance reporting assistance and better access to insurance coverage.

Still, for many, taking on the increased responsibilities and liabilities is worthwhile, and it helps strengthen relationships with clients. Independents are no longer the middle men between the client and the firm. They are the firm, meaning the clients are dealing with the owner, creating a chain of empowerment.

HOW TO BREAK FREE

Wirehouse advisors have options for making a move away from the wirehouse. They can affiliate with an independent broker dealer or become an independent Registered Investment Adviser (RIA) or choose to operate in a hybrid model carrying dual registration. Platforms and custodians are available for all three options.

The shortest jump from the wirehouse is the independent broker dealer path. This route enables flexibility for an advisor with the backstop of services and support from a broker dealer. By selecting to move to a broker dealer with a platform to support their entrepreneurial effort, where they basically join up with a ready-to-go platform, advisors can get help meeting their compliance and marketing needs and mitigate their cost and liability exposures. While payouts will increase dramatically—to roughly 85 percent—this move aligns advisors with a well-known firm and its reputation.

The hybrid alternative, which allows for dual registration—as both a registered representative and as an RIA—represents the ability to continue to hold securities licenses at a broker dealer and do brokerage business, while using the advisor’s own RIA to offer advisory services to clients.

The third alternative is to go fully independent. This option places all of an advisor’s business under his or her own RIA. The most “turnkey” way of doing this—shifting to a “pure” RIA model—is to collaborate with a provider who offers a broad platform of services and features on which to build an independent practice. Doing so raises the compliance burden the advisor faces, but it also maximizes the advisor’s share of the practice’s revenue to 100 percent.

THE ACTION PLAN

The first step toward independence is to start shopping around to develop a better understanding of the landscape. This involves discovering who offers the best match for access to investment product, research, portfolio consulting, technology, performance reporting, financial planning, back-office support, trading and execution, and compliance. The overall objective is to determine which provider offers the best prospects for helping you develop the practice you want.

To do this, talk to a variety of providers about their services. Then map their product offerings to those of your clients. What you are looking for is the broadest set of products. Even if your clients do not use these products now, you want to be able to meet their future needs, especially their needs as they enter retirement.

Next, seek out those solutions that will be the least disruptive to your clients. That will make following you as you transition to an independent practice much less of a decision for them. It is likely that they will want to follow you; after all, you are someone they trust. Having to start all over with someone new at your old firm is not going to be the “A” answer, unless they think the move of assets involves too much effort and disruption for them.

Doing your due diligence on providers also requires looking into the flexibility of their technology, back-office support, productivity options and administration. Due to the significance of the back office to the smooth operation of a practice, it is important to determine whether or not this function will be there for you. More to the point: Will they be there to solve the types of problems your wirehouse’s back office used to solve for you?

THE KEY HERE IS TO FIND THE SOLUTION THAT WILL BE THE LEAST DISRUPTIVE TO YOUR CLIENTS.

Another area to examine is what the conversion process from the wirehouse will entail for you. Will the provider be able to support the migration of accounts, and what will it involve? What will the fee structure look like? Does the transition to independence raise your profitability? Are your clients’ fees consistent from the wirehouse to independent? And as you grow, will you be credited for growth over time? How will fees be represented to clients? Ideally, you are looking for the most seamless and profitable transition possible.

Lastly, the softer issues should be assessed. Specifically, you need to know if, and how, the provider plans to assist you in managing your practice. Do they offer any marketing support or continuing education on compliance? And how responsive are they to your inquiries and due diligence efforts?

Once you have answered these questions and have a feel for how the move will be supported, along with how the operational aspect of your business would proceed, step back and ask yourself if the provider has sufficient resources to be a valued partner as you move along this new career path. The provider you choose should be the one you think will help you prosper the most—it is, after all, collaboration.

Once you have developed an understanding of your options and the costs, the next step is to develop a business plan. It is time to determine what type of office you will set up, how it will be staffed and what your plan for growing your business will be.

Setting up the office, renting a space and paying a staff are actually a relatively small cost of doing business as an RIA. But it is one that will not necessarily be covered right away. Allow for a reasonable period of time for client assets to transfer over to your practice, so you will need a plan and some liquidity to wait out the transfers.

5

STEPS TO INDEPENDENCE

1. Shop providers
2. Map current clients' needs to providers' resources
3. Set up an office
4. Proceed with the transfer of clients' assets from old firm to new
5. Grow the business

LEARNING FROM THOSE WHO WENT BEFORE YOU

Though the road to independence is relatively smooth, there are a few speed bumps you will want to be on the lookout for as you move forward:

→ Ignoring large gaps between current client needs and the new platform

The point is to provide even better service and product selection to clients. If the new platform cannot accommodate the types of products already in use, such as some retirement solutions or alternative investments, then it will be harder to justify to a client that moving from the old firm to your new practice is going to benefit them as much as it will you.

→ Rushing out the door to independence, only to realize that everything has to change

It is very important to make sure that the provider you choose can handle the transition, leaving the client account intact. Otherwise, clients may endure significant transaction costs to reestablish their accounts with your new firm. That, in turn, could create unnecessary tax liabilities for them. Make sure the provider has tax transition strategies to help bridge any product gaps.

→ Choosing the wrong broker dealer

The new broker dealer should offer sufficient flexibility to accommodate your trading needs and style. They should also be able to help you with your license, if you have one you need to house somewhere.

→ Not stating up front what your expectations are

As in many things, it is best to make sure, going into a new relationship, that your expectations for service quality and features match the provider's capabilities. This is why you need to ask a lot of questions and make no assumptions.

→ **Not taking the time to familiarize yourself with operational and compliance matters**

Wirehouses make account set-up and compliance very easy. But when you go out on your own, you will need to know how to do this for yourself, because you ultimately retain the liability for any infractions in this area.

→ **Choosing the wrong custodian**

Is it brand, cost, capabilities or the people that make the most difference for you? Make certain to understand the differences between providers.

→ **Not anticipating conversion issues**

When seeking a vendor, look for one who can offer a seamless product conversion for client assets. You will want to spend your time marketing your new business, not talking on the phone trying to track down missing assets.

→ **Not accurately anticipating technology needs**

Technology should work for you, facilitate customer communication and be capable of upgrading and adapting to future needs.

CONCLUSION

Given the developments that rocked Wall Street and the makeup of the financial industry during the fall of 2008, doing business within the wirehouse model is likely to become more challenging. The fallout from the credit crisis will linger. Management's attention is bound to be complicated by the new landscape they are working in. Retaining staff, dealing with new regulatory requirements and refurbishing the tarnished images of their brands will consume much of the firms' energy and resources in the near future. With some of these firms merging or becoming commercial banking entities and others entering new organizational structures, we believe it may take years to reestablish brand credibility for many of these firms. Meanwhile, compensation will also take time to restore, especially in light of new Congressional attention on this area.

Layoffs are inevitable, and the advisors who remain within the wirehouse are very likely to be left to "practice inside a box," given the expected constraints. Latitude and discretion will no doubt become even more limited as top-down risk management intensifies.

In such an environment, only a wirehouse's largest producers are likely to prosper. Yet even they are going to be asking themselves: What is the next disruption clients will be asked to face, and is there something new I can say to reassure them this time?

For advisors, the clearest signal they may receive as to whether or not a move away from the wirehouse model is right for them may be found in a simple question: Are you spending more time talking about the state of the business or about client portfolios? If explaining the brokerage firm's viability is receiving more attention than portfolios, then how well are clients really being served by your current business model?

When it comes right down to it, advisors are only as effective as the solutions they offer their clients. To do that effectively, they need to be able to provide objective advice. They cannot afford to be perceived as biased toward the product they offer, and they cannot appear to be touting the latest directive from the home office. The depth of their client relationship, after all, is based on trust.

Given that trust is the primary casualty of the credit crisis, it may be a good time to consider protecting your own good name and go independent. It is the best way to gain control of your destiny.

Sites of interest for information on declaring independence:

- The Financial Planning Association, <http://www.fpanet.org>
- The National Association of Personal Financial Advisors, <http://www.napfa.org>
- Financial Advisor, <http://www.fa-mag.com>
- Investnet.com, <http://www.investnetadvisor.com/independence>

This article is not intended as and should not be used to provide investment advice and does not address or account for individual investor circumstances. Investment decisions should always be made based on the client's specific financial needs and objectives, goals, time horizon and risk tolerance. The statements contained herein are based upon the opinions of Envestnet and third party sources. Information obtained from third party sources are believed to be reliable but not guaranteed. All opinions and views constitute our judgments as of the date of writing and are subject to change at any time without notice. Past performance is no guarantee of future results.