ADVISORS

PURSUING THE RIA DREAM:

New Transition Models for Billion-Dollar Breakaway Advisor Teams

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INTRODUCTION

This is the first in a series of industry content from PFI Advisors designed to help advisors build their dream firm and achieve Pure Financial Independence.

One of the biggest trends happening in wealth management today is the movement of advisors from captive, employee models to independence. The attractiveness of open architecture, transparency and having a conflict-free business model is resonating with high net worth clients, so much so, that the advisors that service them are actively transitioning their businesses in order to provide this higher level of service to remain competitive.

In fact, the fastest growing segment of financial advisors is the independent Registered Investment Advisor (RIA) model, driven not only from investor dissatisfaction with Wall Street, but also from advisor migration to independence.

The 2008 financial crisis inflicted irreparable brand damage to the legacy wirehouse firms from scandals, bankruptcies and product failures, driving many large advisors to look to transition their businesses to an independent model. This migration was started not only to do right by their clients and stop apologizing for their firms, but also to be able to take home more income, provide a platform for growth as well as monetize their practices at a higher valuation upon retirement or sale of the business.

This movement, combined with advancements in technology that provide a better operating model, is causing the trend to independence to accelerate. For many billion-dollar teams, however, transitioning to an independent business model has its complexities that may be preventing them from making the move, despite the many client, business and economic benefits inherent in the RIA model.

Due to their size and complexity, larger advisor teams feel there is no experienced transition support available to them in an affordable platform. Many advisors, particularly the billion-dollar teams, are reporting that they are left to their own resources if they don't want to give up valuable equity, a percentage of future earnings or pay steep AUM basis point fees just to get up and running.

Paying for transition services and support with equity is a very expensive option, with far-reaching implications for the breakaway teams. When running the numbers, large advisor teams realize that it is not economical to make the move to an expensive aggregator or platform provider solution simply to get transition support, and as a result, end up staying with their wirehouse firm — a suboptimal outcome not only for their clients, but also for themselves and the industry as a whole.

The good news is that there is now a new, consulting-driven solution available that can facilitate the transition for billion-dollar teams, while making the cost a predictable, one-time component – ultimately, making the transition to an RIA not only economical, but also a long-term growth strategy.

This white paper will highlight the independent trend, detail the costs of transition and propose a superior, more customized and cost effective solution for billion-dollar breakaway teams.

BENEFITS OF CHOOSING THE INDEPENDENT RIA MODEL

What is becoming painfully clear to the financial advisors in the employee channel is that the wirehouse model is broken. Clients want a new wealth management experience that is transparent, not product-focused, does not have compensation conflicts and is client-centric.

While there has been much hype recently about the wirehouses looking to reinvent themselves as financial planning-based institutions, they still refuse to accept a fiduciary standard of care that puts the clients' interests ahead of their own. This dramatic gap is not sustainable and has resulted in client defections and less than optimal results for both wirehouse advisors and their firms.

As a result, the movement toward becoming an independent RIA is growing steadily – and it is easy to see why, when comparing operating as an advisor in a wirehouse vs. at an RIA.

One of the biggest drivers to independence is having the peace of mind that you own your own destiny and are not subject to the whims of a distant management team looking to enhance their bottom line at the expense of yours. As an RIA, advisors are the business owner and get to make the decisions that provide them and their clients with a better experience and outcome.

- **"WE WANTED TO GO INDEPENDENT ON OUR OWN SO WE COULD OWN 100% OF OUR BOTTOM LINE AND HAVE THE FLEXIBILITY TO INVEST BACK INTO THE BUSINESS."**

  – AJAY GUPTA

  FOUNDER AND CEO
  GUPTA WEALTH MANAGEMENT

- **"NOW, AS A TRUE FIDUCIARY, WE ARE ABLE TO PROVIDE UTMOST TRANSPARENCY TO OUR CLIENTS AND AVOID ALL THE CONFLICTS OF INTEREST THAT I WAS EXPOSED TO WHEN I WAS AFFILIATED WITH A LARGE BROKERAGE FIRM."**

  – AJAY GUPTA

RIAs now have access to industry-leading technologies, fully optimized for mobile devices to better manage client relationships and provide an outstanding client service experience. No longer are advisors subject to being provided with antiquated tools and infrastructure designed for the "lowest common denominator." RIAs are able to do right by their clients, serving in a fiduciary role that is in great demand by investors of all sizes.

The economic benefits are also clear when advisors realize that not only are they generating more personal income for their hard work, they are also building a business asset that can be monetized upon their retirement or exit from the business. Consider that after paying for all business-operating expenses, RIA principals keep approximately 70% of their revenues. Compare this to the wirehouse production "grid" which caps out at around 40%. It is clear, particularly for billion-dollar teams, that "paying" for operating expenses in the wirehouse model is a costly proposition.

THE POWER OF RIA COMPOUNDING

When comparing the two compensation models, wirehouse vs. RIA, there are marked differences, chief among them the opportunity for operating leverage.

Operating leverage is a simple, yet powerful business concept where every dollar of additional revenue is more profitable than the last, because operating expenses don't grow at the same rate as revenue. In the wirehouse example, an advisor's payout percentage doesn't change once they top out on the production grid, resulting in no operating leverage. RIAs, however, enjoy economies of scale and own 100% of their revenues, and do gain leverage from each incremental revenue dollar.

For tangible examples of how this operating leverage plays out, consider the results of the well documented case of Luminous Capital, a $1.7 billion Merrill Lynch team that broke away in 2008 as a brand new RIA. Luminous more than tripled the firm in only a few years, ultimately monetizing their business for more than $100 million in a sale to First Republic Bank just 4 1/2 years later.

Baker Street Advisors left Deutsche Bank Alex Brown in 2003, and grew their assets to over $5 billion, monetizing their efforts in a blockbuster sale to AMG Wealth Partners in 2015.

Constellation Wealth Advisors has a similar story to Luminous, breaking away from Citigroup's Family Office division in 2007, growing to $6 billion in AUM and also monetizing for more than $100 million in a sale to First Republic Bank.

These dramatic success stories are occurring more and more frequently, creating a new way for the billion-dollar wirehouse teams to transform their hard work and career dedication into an extremely valuable asset.

Large advisors are ultimately asking themselves,

"WHY DOES THE NEXT ACCOUNT WE OPEN COST US 60% OF REVENUES?"

The wirehouse model effectively eliminates all operating leverage. As a business grows and adds more clients/AUM, profit margins should increase, not remain stagnant.

CURRENT TRANSITION MODELS DON'T WORK FOR BILLION-DOLLAR TEAMS

The current independent wealth management aggregator and "plug and play" platforms provide a valuable, necessary service. However, the economics of these models tend to break down when applied to billion-dollar teams.

These models provide transition services, such as real estate, office setup, technology, branding, website, etc. – all necessary items, but the aggregators want a percentage of firm ownership and platform providers charge expensive basis points on AUM. These costs or contract requirements, to pay for services that billion-dollar RIAs can readily acquire on their own (with the assistance of experienced consultants), become extremely expensive over time.

As an example,

CONSIDER THE ECONOMICS BEHIND THESE COMMON BREAK-AWAY OPTIONS FOR A $2 BILLION RIA, WITH $15 MILLION IN REVENUES AND $10 MILLION IN OPERATING EARNINGS.

Model	Aggregator (Buying 50% Equity)	Platform Provider (Charging 5 bps on AUM)
Cost	$5 million per year, in perpetuity	$1 million per year, with a minimum 2 year contract

"GOING INDEPENDENT WITHOUT BEING PART OF A LARGE PLATFORM HAS GIVEN US MORE FLEXIBILITY WHEN INVESTING OUR CASHFLOW BACK INTO THE BUSINESS."

THE NEW TRANSITION SOLUTION TO PURSUE THE RIA DREAM

There is a better way.

Ultimately, what billion-dollar breakaways need in order to make the transition to their own RIA is to build a business footprint for their new firm as well as the RIA infrastructure necessary to become operational.

While this sounds like a big challenge that keeps many breakaway advisors in their wirehouse seats, upon further analysis this can actually be a very manageable process by outsourcing this project on a consulting basis.

There is no need to pay for these services through the aggregators or platform providers. Rather, by tapping into the deep expertise and knowledge of industry transition consultants – those that are independent and not tied to a specific platform - advisors can achieve a quick start up with the latest transition needs.

Billion-dollar breakaway teams can pursue their RIA dreams in confidence, knowing that they have the right advice and support to build their dream firm the right way, without having to give up hard-earned equity or pay expensive basis points on AUM.

THIS IS THE NEW SOLUTION THAT MANY BILLION-DOLLAR BREAKAWAYS HAVE BEEN WAITING FOR. ADVISORS OWE IT TO THEMSELVES, THEIR CLIENTS AND STAFF TO LEARN MORE ABOUT MAKING THE MOVE AND GETTING STARTED ON THEIR DREAM FIRM TODAY.

"PURE FINANCIAL INDEPENDENCE."

Today, wirehouse advisors looking to establish their own RIA are looking for guidance and support that won't require them to mortgage their future.

PFI Advisors was founded in 2015 to service that unmet need. PFI Advisors provides office infrastructure, RIA infrastructure, transition services, and billing support for a simple consulting fee. There is no complicated long-term AUM fee structure or equity stake required to build the firm's future and provide advisors Pure Financial Independence.

For existing RIAs, PFI Advisors is available to consult on many of the operational and strategic issues facing larger firms as they continue to grow and need scale:

- **Technology Assessments**
- **Technology Conversions**
- **Opening New Office Locations**
- **M&A Prep and Integration Services**

About the Author

Prior to founding PFI Advisors, Matt Sonnen learned the ins and outs of the wirehouse model at Merrill Lynch in the late '90s. After leaving Merrill in 2005, he was introduced to the RIA marketplace a few years later when he helped build the infrastructure for Luminous Capital prior to their founding in 2008. As COO and CCO at Luminous, he navigated the technology and compliance challenges as the firm grew from $1.7 billion in assets to nearly $6 billion in less than five years. Luminous Capital sold to First Republic Bank for more than $100 million in 2012, after which Matt headed to Focus Financial Partners in New York City. There, he helped breakaway teams and recently-formed RIAs develop strategic initiatives to benefit from best practices, streamline operations, and improve efficiency before heading back to California to launch PFI Advisors with his wife and business partner.