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WAR BREAKS OUT FOR WIREHOUSE BROKERS

The fee-based/fee-only RIA models are the practices of choice for high-end advisors with an entrepreneurial spirit.

By Gail Liberman

The economic crisis on Wall Street, among many other things, is causing wirehouse brokers to reconsider the value proposition offered by giant financial service firms with brand names like UBS, Morgan Stanley and Wachovia. A cloud has fallen over these names as the credit crisis, large write-downs and the auction-rate securities scandal cause headline risk.

As brokers break away with large books of business to set up tent elsewhere—many choosing to go it alone in a fee-based or fee-only model—independent broker-dealers are helping to ease their transition. These B-Ds have been dedicating divisions, services and/or staff to registered investment advisors.

The fee-based/fee-only RIA models are the practices of choice for high-end advisors with an entrepreneurial spirit, says Scott Smith, a senior analyst with Cerulli Associates in Boston. Experts cite market loss of confidence in the wirehouse model as well as more clients seeking advice in a topsy-turvy market as the reason for this business model preference. Advisors who once might have thought that working under the banner of a big, well-known brand was a necessity, now find it a hindrance or an embarrassment, says Michael DiGirolamo, managing director of the seven-year-old investment advisors division of Raymond James Financial in St. Petersburg, Fla.

DiGirolamo's division at Raymond James claims to have added more than 20 independent RIA firms in the last year, going from 65 firms to 93, and surpassing the firm's correspondent division, which clears for broker-dealers.
"We're at about $6 billion of advisor assets here," he says. "We think we can grow that, based on our size, 30% to 50% a year."

Darin Manis, the CEO of RJ & Makay, a Colorado Springs financial services recruiting firm, says it's true the independent B-Ds are bound to have some success since there are more than 16,000 wirehouse advisors who can be wooed away from the big Wall Street firms. But Manis, whose clients are larger wirehouses, also thinks independent B-Ds won't have the same high-net-worth client base. Nor does he expect the independents to have adequate transitional support or a comparable platform of products and services.

"Right now," he says, "the high-net-worth investor wants to be on the biggest ship during a big storm—not a sailboat."

Nevertheless, the independents are taking an aggressive stance. To lure advisors, independent broker-dealers often offer transition packages to help them make the switch. Among the deals in these packages, the B-Ds offer up-front funds to move money and cover automated customer account transfer (ACAT) fees, says Jonathan Henschen, the president of Henschen & Associates in Marine on St. Croix, Minn., whose company is on retainer to place advisors with 75 independent broker-dealers.

"Usually there are five- or six-year forgivable loans," Henschen says.

Raymond James now offers loans to help breakaway advisors start up their new

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business. Typically, these loans are forgiven in three years depending on the asset levels their RIAs bring in.

"We can provide repayable business loans on top of that," DiGirolamo says. "We enhanced [our transition package] about three years ago."

Packages offered to fee-only advisors may be less than those to fee-based advisors, DiGirolamo acknowledges.
By contrast, Fidelity Investments offers no "hard dollar up-front payment to capture business," says Scott Dell'Orfano, vice president of Fidelity Institutional Wealth Services. Currently, the firm's heavy advertising and brand recognition alone have been doing the trick.

Fidelity, which has been focusing heavily on recruiting RIAs for two years, claims to have attracted 55 "breakaway" brokers, bringing in more than $7 billion in assets during the first six months of 2008—double the volume in all 2007.

But Dell'Orfano says Fidelity is reviewing its strategy, given the volume in the last couple of weeks. Could more enhancements be forthcoming?

DiGirolamo says he largely is seeking advisors with at least $30 million in assets under management, mostly fee-based advisors. Most often, they come from wirehouses and independent contractor firms. The platform, he says, makes integration particularly easy for brokers coming from Merrill, Smith Barney, Wachovia and UBS.

Generally the independent B-Ds have taken aim at fee-based RIAs (as opposed to fee-only), says Henschen, whose company is on retainer to place advisors with 75 independent broker-dealers. Fee-based advisors generally manage money for an annual fee but also can sell commission products, unlike their fee-only cousins.

The fee-based business generates the highest revenues and earns the most income from each client for the financial advisor, according to Tiburon Strategic Advisors, a Tiburon, Calif.-based market research and strategy consulting firm. But the wirehouses and other broker-dealers typically pay out less than the 70% to 100% rate offered by independent broker-dealers. A financial advisor can reap the highest earnings by having costs covered by a firm.

Few independent broker-dealers actually seek out those on the fee-only side, Henschen says. "Typically, the independent [B-D] channel loses reps to the fee-only structure," Henschen says. Once the advisor's fee assets climb to 90% of his or her revenue mix, the advisor doesn't want to be under the thumb of FINRA anymore. After they've jumped onto the fee-only bandwagon, some change their tune, Henschen says. Often, they decide they want to go back to the broker-dealer structure to do deals in REITs, oil and gas, and variable annuities.

The problem with the fee-only structure, he says, is that as more advisors jump into it, the fees drop and business must be made up in volume. Also, "you're one of many people offering the same thing."

Raymond James provides services for fees, but it also accepts those advisors who prefer a fee-only model. It can process transactions for them and it charges reduced commissions for trades. Advisors may keep 100% of the fees they charge clients, and then Raymond James reaps commission income and any income earned off cash balances. It also offers to manage accounts.

"An advisor can enable their clients to buy and sell securities on their own directly," he says. "We have the ability to do that."

Some other independent B-Ds, for example, such as Commonwealth Financial in Waltham, Mass., are only interested in being outsourcers. The firm lets registered investment advisors outsource their whole back office—"from performance reporting to practice management services," says managing principal Wayne Bloom.

"There's more interest in folks wanting to drop their FINRA registration," Bloom explains of its latest desire to recruit fee-only advisors. "Compliance requirements [for a registered investment advisor] are less stringent."

Commonwealth has 1,300 financial advisors. All are registered with FINRA. But about 200 also have their own registered investment advisor registration and more than 800 are affiliated under Commonwealth's own corporate RIA umbrella. "We have forgivable loans commensurate with the amount of business they bring to the firm," Bloom says. "We also provide transition assistance to cover client expenses." Packages are evaluated on a case-by-case basis. "We don't want to suggest that we're buying business," Bloom stresses. "We stand on a value proposition for a long-term relationship."

Another independent broker-dealer, LPL Financial, Boston, launched an initiative earlier this year for advisors who are dually registered—both as RIAs and as FINRA-

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registered reps. LPL also serves advisors operating under three other business models: 8,000 independent advisors who operate under LPL's corporate RIA registration; independent advisors who operate under their own RIA and use LPL as their broker-dealer; and advisors who are registered reps with commission business.

LPL's transition support is designed to help the advisor cover a portion of the fixed and variable cost of either changing broker-dealers or going independent.

LPL, which boasts no retail affiliates or proprietary products, declined to provide specifics regarding its packages. But Jennifer Gill, spokesperson, says that LPL does not purchase practices or client goodwill. Instead, the company helps the advisor open his or her small business.

"The advisor benefits from the increased payout, the autonomy of controlling their expenses locally and building equity in their own business," she says.

By contrast, some smaller broker-dealer firms create a niche business by going the dual-license route and acquiring registered investment advisor firms. Hazlett, Burt & Watson Inc. of Wheeling, W.Va., has 15 to 17 employees, all with dual registrations—under FINRA as registered reps and under the SEC as RIAs, says Michael T. Barickman, executive vice president of sales. His immediate goal is to see the number of such dual licensees employed by the firm grow by 50%.

Before 2006, all the employees were registered reps. Right now, he says, about 50% of its revenue comes from the RIA model. The RIAs are not new—they are skilled salespeople coming over from broker-dealers. His company offers competitive transition packages. Plus, he says his employee-owned firm offers trust services, investment advisory services and wealth transfer services through insurance.

"We're trying to attract registered investment advisors, but we're not neglecting the models of the past," Barickman says. "We're small, we're approachable, we're professional and we do not subscribe to product pushing and are not tied to any large corporate interest."

Despite the greater interest in luring these advisors over, Henschen says that, particularly over the last six months, independent broker-dealers have actually been cutting their recruiting budgets.

Manis agrees that transition packages, offered to make it worthwhile for advisors to leave, in general are declining. An advisor typically gets a percentage of a firm's trailing-12-month revenues as an up-front bonus. Say a producer generates $100 million in revenues for Merrill Lynch. That advisor now might get $1 million to $1.25 million up front, and the rest is typically spread over two to three years, with back-end bonuses, based on how successful he or she was in bringing over assets. Previously, the deals would be two to three times that. Manis attributes the decline to industry consolidation leading to less competition.

"I expect in the first quarter of 2009, they certainly will be taking another step down," he says.

Depending on the relationship selected, experts say you need to evaluate transition packages carefully.

Advisors should also match the nature of their book of business with the capabilities of the broker-dealer.
Commission fees are important. Some custodians might discount their equity trades to $9, for example, DiGirolamo says, while charging more—like $12—for mutual fund trades.

Stephen Zweig, a partner in the New York office of Ford & Harrison LLP, Atlanta, warns that with all the different business models around, both advisors and their broker-dealers need to use care in structuring their relationships.

There has been quite a bit of scrutiny and litigation lately, he says, over independent contractor relationships, which have different definitions under different laws.

"You need to memorialize the independent contractor relationship in an agreement," he says. Independent contractors want to minimize the risk of being termed an employee, he says, with all the adverse consequences.

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