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Wish Upon An 'IAR'

RIA or IAR? The anagram you choose will depend on how big you are and how independent you want to be.

By Eric Rasmussen

Just as the great migrations spread across Europe and overran the dissolving Roman Empire in the Middle Ages, there's a great migration happening among financial services firms today, and with those migrations, a proliferation of tribes, cultures, hierarchies, models and iconoclasts. For those going it alone, there's ample opportunity to form your own kingdom—or to be wiped out.

Generally, the move for financial advisors has been from the great wirehouses like Merrill Lynch, Smith Barney, Morgan Stanley (and to a lesser extent Wachovia and UBS) into the independent broker-dealer and RIA channels. In the latter category especially, many financial advisors have sought their own fiefdom, a reprieve from the regulatory oversight of Big Brother. The registered investment advisor has been pictured as a maverick, free to offer planning and wealth management for his or her own fee and use whatever tools needed. Meanwhile, for the privilege they can take 100% of their own payout, raise their own standard, build their own castles and forge their own legacies.

But that dream may have lost some luster. In 2004, the SEC adopted new rules under the Investment Advisers Act of 1940 requiring those advisors registered with the commission to adopt written policies and procedures to keep them from violating federal securities laws. RIAs also have to look over those policies every year to make sure they're up-to-date and name a chief compliance officer. Moreover, the new sheriff at the SEC, Mary Schapiro, is expected to increase examinations and inspections of RIAs in the near future.

"You don't just go form one of these anymore," says Dean Rager chief information officer of broker-dealer Geneos Wealth Management Inc. in the Denver suburb of Centennial, Colo. "Back in the day you could, but now an RIA has a lot of the same rules and regulations that a broker-dealer has. There's adherence to all kinds of rules and regulations that let's say two years ago really didn't exist in its modified form like they do right now. So you really have to have some expertise on staff to do this."

And it's going to likely get worse, says Andrew Daniels, a managing principal in field development at Commonwealth Financial Network in Waltham, Mass. "I think in the post-Madoff world, stand-alone registered investment advisors are going to be under greater scrutiny than they ever were before," he says, "and folks who may have gone RIA only for less Big Brother may not have that in the same capacity for that much longer."

Thus, many advisors breaking out of the commission world have been looking into another option—to instead work with a broker-dealer under its own corporate RIA structure and become an IAR, or independent advisor representative. It's the same letters in the alphabet soup, but it might make a big difference when regulators start stirring.

In other words, rather than filing their own ADV forms, filling out their own procedures manuals and more, advisors can set up tents under the suzerain of the broker-dealer's protection. Under this structure, it's the corporation being audited, not the advisor.

Bill Van Law, the national director of business development at Raymond James Financial Services in St. Petersburg, Fla., says that Raymond James has 2,900 or so advisors working under its corporate RIA, or a bit more than 90% of its advisors. LPL, meanwhile, says that of its 12,294 advisors, 94% are IAR licensed, and it is believed to be the nation's largest corporate RIA.

As far as the trend of going it alone, "I think that's slowing down," says Ryan Diachok, vice president in marketing and business development at Geneos, "mainly because the regulation is starting to catch up on the RIA side and I think that this market cycle has also caused some advisors to pause if they were considering dropping a broker-dealer affiliation and being RIA only. Once they do that, they lose the ability to sell a lot of the products that kind of round out the portfolios that are

available only through the broker-dealer community.”

In other words, in the age after the market crash when fees for assets under management have taken a dive, having those trailing fees and commissions from old business might be worth keeping a broker-dealer relationship alive.

Gimme Shelter

David A. Pickler, the chief executive and president of Pickler Wealth Advisors in Collierville, Tenn., hung out his own shingle in 2005 after spending 21 years in a shuffling series of merging wirehouses, the last of which was eventually engulfed by UBS. As a community activist in Memphis and its suburbs, he had a high profile. He was engaged in a local board of education, the Boy Scouts and a school for the deaf. Not to mention the fact that he was press friendly. All of these things put him at odds with his company.

Starting from scratch, he literally raised his own roof: erecting his own office building in an office campus (and burning the mortgage in 2006). He now regularly holds “lifestyle events” for his clients: ladies fashion shows, scotch and cigar parties and dinner theater, all with the blessing of new partner LPL Financial, which, unlike UBS, has celebrated his high community profile instead of discouraging it.

A big question for him when he made the move was what kind of business model to set up, especially since he already had his hands full with a connected law practice. He weighed the option of becoming his own RIA as he sought relationships with a lot of the major players like Raymond James, Commonwealth and LPL. One of the things that weighed on his decision was his desire to give his clients the same sense of comfort from a large-back office operation—the full-service complement they’d get at the UBSes of the world—as well as the comfort that there was a lot of capital around if something went wrong. Thus he chose to work under LPL’s corporate RIA structure.

“I think it was two things,” he says. “The fact that I was unwilling to take on the burden of all the compliance responsibilities at that point and the second was, I believe the stability from a staffing standpoint of being able to outsource all of those other responsibilities to LPL was to me the overriding reason why we chose to practice in the model that we are.”

Working under the corporate RIA of a broker-dealer could be considered an intermediate step to total freedom later on, but in a new turn of events, say the B-D execs, the RIAs are in some cases fleeing the RIA independence, making a reverse migration and coming under the corporate RIA wing. One such advisory is D.B. Root & Company Inc. in Pittsburgh, which converted to Commonwealth’s corporate RIA around the year 2000.

“We made the decision to do that for a number of reasons,” says Carrie Coghill Kuntz, the company’s president and partner. “Even just looking at our cost to maintain compliance, we had a full-time person that was doing all of the reporting and the downloads and everything. When we compared the costs to the services that we would be picking up by moving [to Commonwealth] it made a lot of sense for us. From there you know what we’ve learned since and what we’re very thankful for ... is that level of technology support that we get under the corporate RIA, the reporting and the compliance issues.”

Among other things, she cites Commonwealth’s online reporting and its performance reports and market commentary as powerful tools in her hands when she’s connecting with clients. She also says that RIAs continue to struggle today with things like alternative investments when they’re on their own.

Bill Morrissey, LPL’s executive vice president of branch development, says that in many ways the IAR and RIA experience is the same, except that an advisor can rely on his broker-dealer’s technology and open architecture. “They can gain access to the same programs that they had at a wirehouse and the logistics of going independent have never been easier,” he says. “If you don’t already have a space, we can help you find a space and build it out. We offer a group health care plan. In either model, the advisor owns their own business.”

First Affirmative Financial Network LLC in Colorado Springs, an SEC registered investment advisor, has about 35 advisors working as IARs, according to president Steven Schueth. He says that there are three things that independent advisors need to do well to operate as an independent: the administrative piece, the client relationship marketing and the money management.

To go all the way to independence, he says, requires the person to “have not only high capabilities but let’s say a pain threshold around filings and compliance-related things.” From there, he says, the decision about whether to become an IAR

is one of due diligence—figuring out the costs, the trade-offs and the hassles of working with the broker-dealer. Because, after all, the relationship isn't free. "There's going to be some cost involved, and [the advisors are] not going to get 100% of the fees that they charged the client."

The amount of payout the advisor hands over to the broker-dealer in an IAR relationship can vary—from 5% to 20%, depending on the different pay schedules.

For these and other reasons, there's a certain point at which it's worth the extra trouble for an advisor to go it alone and to work either as an independent RIA affiliated with a broker-dealer—or as his own RIA totally free from such an affiliation who custodies his assets at a Charles Schwab or Fidelity. After a company reaches the gold standard level—a continuous \$25 million in assets under management—it can then register with the SEC as an RIA, submit an ADV form, drop FINRA licenses and declare freedom (with fewer assets than that, the advisor has to register instead as an RIA within its own state).

Gregory Gardner, a CFP and RIA with the Gardner Group in Dallas, struck out on his own about six years ago after working under LPL's corporate RIA for about ten years and working with the company's fee products. He says that at the time he could only offer pure financial planning advice and couldn't manage money under his own RIA. He says it was nice not dealing with the infrastructure of reporting or fee collecting, and he liked LPL. But he says the business he was building forced him to make a change. He eventually wanted to offer more products at more places, to use multiple custodians and to use performance software of his own choosing. He also said compliance as a stand-alone made more sense because there is only one set of rules to follow when you're an RIA. After all, the corporate RIAs, for their own legal reasons, have to make sure their IARs are in compliance, and sometimes, simply because they are also broker-dealers, they are still thinking in terms of FINRA rules, not just SEC rules, and that's something that's reflected in the audits.

"I am an entrepreneur at heart and I wanted to build a better mousetrap for my clients," Gardner says. "When I started to figure out where the money was made in this business, I knew we could legally cut some corners and reduce costs for our clients, so we were able to shave 10% to 25% in expenses to our clients and give them a much more open architecture and an a la carte offering."

Still, he says, "To be a pure RIA, it's pretty darn expensive. I would say it's ludicrous with under \$25 million [in assets under management] and it's pretty darn expensive under \$50 million."

Steve Stocker, the managing partner and founder of RIA firm Investment Partners LTD in New Philadelphia, Ohio, says that being an RIA offers other kinds of flexibility as well. "Certainly I guess a couple of reasons to consider your own RIA would in fact be the flexibility you enjoy at designing your own programs," he says. Furthermore, "There's a good chance that my own RIA will hold greater potential value in a sale or merger circumstance than my client list as an IAR of the broker-dealer."

But the downside, again, is the tremendously elevated level of compliance.

"I have a person who spends about 50% of her time doing compliance related issues," Stocker concedes.

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