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The Landscape of the Financial Services Industry

2016

For a profession that has the perception of being relatively static, the past decade has demonstrated that the financial services industry is anything but.

Since our last update of the landscape of the industry in 2014, we have continued to see the entry of new players, particularly in the independent space, that have offered financial advisors opportunities to explore diverse practice models. Firms like Robertson Stephens Wealth Management, Steward Partners, William Blair (Chicago) and Snowden Lane have emerged to offer new and exciting options to advisors who are looking for career alternatives. Additionally, firms such as Focus Financial Partners, Dynasty Financial Partners and HighTower Advisors, that were born about the same time as the onset of the financial crisis, have continued to be exceedingly successful in attracting high net worth teams to their platforms with what seems like almost weekly press releases announcing the addition of another successful recruiting scenario.

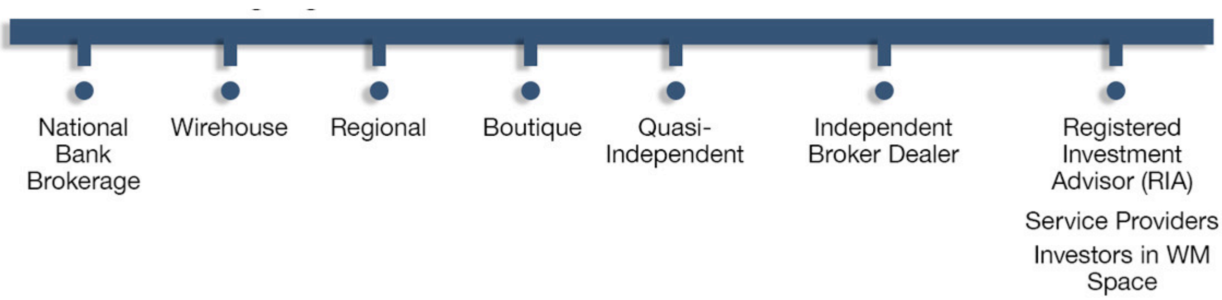
Not surprisingly, the wirehouses continue to offer the most robust deals on the street (often times approaching 350% or more of trailing 12 month's production for first quintile, corner office teams) in a strident effort to attract top talent and assets. While some advisors are loathe to consider a wirehouse firm for reasons ranging from excessive bureaucracy to concerns over bank ownership and a sense that "they are all created equal", the fact of the matter is that wirehouses still remain the ideal home for a large swath of the advisor population.

The regional firm space remains an attractive and viable alternative for advisors looking for a solution that often harkens back to the "good old days" when they started in the business with long extinct brokerages such as Alex Brown, Piper Jaffray and A.G. Edwards. Historically, regional firms such as Raymond James, Stifel Nicolaus and Janney Montgomery Scott were considered "also rans" in the eyes of most wealth advisors. Whether this perception was accurate or not, in the latter part of 2013 and through this year, regional firms have become recruiting juggernauts and legitimate landing pads for large wirehouse teams who are looking to leave their firms. Perhaps most notably, Raymond James continues to "knock the cover off of the ball" with their ramped up successful recruiting efforts. It would seem that advisors of all sizes are valuing smaller firm culture, easier access to top management and less bureaucracy more than they might value the bigger transition packages offered by the wirehouses.

Because so many of the conversations we have with advisors center around the landscape of the industry, providing a fresh take on the most recent changes, as well as revisiting the old standard bearers is something that we regularly strive to provide to those with whom we work.

It is our hope that this updated piece will provide you with a good overview of just how robust the options are for quality financial advisors. It truly is a seller's market and the financial advisor is in the driver's seat when it comes to where, when and how he wants to run his business. As always, we are here as a resource for you and would be happy to speak with you about any questions that this landscape discussion may raise. We would be honored to be your guide should you choose to venture into this vibrant marketplace, or if you would just like to become better educated about what's out there.

(Looking at the illustration below, we will move from left to right; from the most restrictive to the most flexible and entrepreneurial).



National Bank Brokerage

National bank brokerage is generally the most restrictive model insofar as advisors typically have less freedom to run their practices the way they want.   These institutions, typified by firms such as Bank of America, PNC and Wells Fargo Bank, offer lower payouts than other practice models but if an advisor's priority is to build an asset base, it is a great option largely because of the built in referral source. Banks are by nature an interdependent genre where bankers and brokers rely upon each other for referrals and support. Banks have come to realize that they are in the unique position to obtain greater client wallet share through the development of wealth management programs that seek to obtain control of all customer assets – personal, business and retirement. Features of a bank brokerage affiliation are as follows:

- Banks pay transition deals, but generally 20 – 75% of trailing twelve month's production (t-12)
- Oftentimes compensation is salary plus a bonus
- Banks accept advisors with minimum production at or around $250,000
- Best source of referrals for advisors
- Many banks have advisors sit in their branches to better service clients
- Clients seen to be more loyal to the bank than to the advisor. So, that if an advisor wants to leave a bank brokerage model he will need to worry about the portability of his business and employment agreements containing restrictive covenants as the bank "owns" the clients

Wirehouse Firms

The big four wirehouses, Morgan Stanley, Bank of America/Merrill Lynch, UBS and Wells Fargo, continue to be the most recognized wealth management firms in the industry. As a group, they offer world-class platform, outstanding technology and a solid training ground. They also tend to be the most bureaucratic with heavy-handed compliance and more layers of management allowing for less flexibility than other alternatives. These firms used to be known for offering the most sophisticated and diverse platforms, but regionals and particularly independents have largely caught up here, leveling the playing field. More than ever, wirehouses are less inclined to support longer-tenured advisors producing less than $500K in annual revenue, yet most still value rising stars (i.e., earlier tenured advisors and whose revenue and assets are growing). Major differentiating points about the wirehouse firms are:

- They offer the largest transition packages (currently upward of 350%), based on trailing twelve month's production (t-12) and the portability of an advisor's book of business, and can be higher for the larger first quintile advisor
- Upfront signing bonuses are structured as 9 – 10 forgivable loans
- Potential to be reimbursed for unvested deferred compensation on a 5 – 8 year cliff vest
- Cash payouts typically ranging from 38 – 44%
- Relatively open architecture for products and services and cutting edge technology
- Average advisor production is around $800,000

Regional Firms

One of the most refreshing shifts that we have observed over the last several years is the dramatic success of the regional firms. These firms have clearly hit on a compelling formula where their combination of great culture, reputation, easy access to senior leadership, more freedom, flexibility and control, and fewer advisors has served to land some of the leading wirehouse teams. Firms such as Raymond James, RBC, Stifel Nicolaus, Robert Baird and Janney Montgomery Scott have also upped their games and have made very dramatic inroads into recruiting top talent by offering competitive platforms, technology and payouts. Some defining features of the regional firms are:

- Transition packages of between 80 - 250% of trailing 12 month's production
- Fewer levels of management and more entrepreneurial than the wirehouses
- Compared to the wirehouses, production minimums are lower and average advisor production is around $400,000
- A smaller firm feel that can be very appealing to a percentage of big firm advisors, especially those that began their careers in the regional space and who had their firms acquired by a wirehouse

Boutique Firms

Boutique brokerage firms are always intriguing to advisors since the perception is that they have a certain cache that other firms lack. Credit Suisse, Deutsche Bank, JP Morgan Securities, and Goldman Sachs cater to high net worth and ultra-high net worth clients and are generally limited in geography to larger metropolitan areas. Many of these firms have jettisoned their wealth management units (e.g. Barclays selling to Stifel Nicolaus) with rumors abounding that this trend will continue with other firms. These firms never have to compete with the larger transition packages being offered by wirehouses; the deals here are not the draw. Differentiating factors of the boutique firms are:

- Transition deals in the 200 – 250% range of t-12 (part cash and part stock)
- Higher minimum account sizes; meaning advisors often have to give up smaller household accounts (Goldman Sachs has a client account minimum of $10 million, while the others typically hover around $2 million)
- Much smaller than either their wirehouse or regional counterparts with approximately 400 – 500 advisors nationwide so access to senior management is greater
- Much more nimble than the larger firms
- More selective about the advisors they hire
- Synergies between investment banking and wealth management can often lead to a referral mechanism for high quality advisors and teams
- Platforms are not as diverse as some of the other models (usually lack lending and insurance capabilities)

Quasi-Independent Firms

For those who are looking for an option offering more independence than they currently have, yet still want ties to an employee model, then a quasi-independent might be right. According to some alternative-seeking advisors, this is what's been missing from the solution set; a model that offers superior take-home economics, cash up front, equity ownership, and an infrastructure to leverage. The advisor is a W-2 employee and is not operationally responsible for staff salaries, rent, technology, marketing materials and entertainment expenses, etc. Quasi-independent models offer all of the benefits of the independent world without the trials and tribulations of setting up your own business with the added plus of receiving upfront transition money. Some traditional examples of firms that offer a quasi-independent platform are Raymond James Advisor Select and RBC's FA Select. There is also persistent rumor that Wells Fargo will be resurrecting its popular Profit Formula program which will certainly be an attraction to many FA's who are looking for the middle ground between being an employee and total independence.

Quasi-Independent Firms *(con't)*

HighTower Advisors was the firm that was at the forefront of this wave of emerging models. HighTower figured out what had been confounding many independent firms for years: How to attract wirehouse advisors who were longing for independence but couldn't pull the trigger without some form of upfront monetization. With HighTower, there is an upfront cash component together with an equity kicker, offering the prospect of a "second bite of the apple" if the firm goes public down the road. Some specific features of the quasi-independent model are as follows:

- Transition packages in the 80 – 100% of t-12
- The ability to build own identity and "self-brand"
- Control over P&L
- Open architecture and the ability to use multiple custodians
- Access to the industry's top thought leadership and best in class products, service and solutions
- Much greater control, flexibility and freedom than traditional employee models
- Payouts approximating 50 – 60%
- Full back office support including payroll, accounts payable, H.R., marketing, IT, legal, accounting, etc.
- Equity ownership giving an advisor a voice in building the firm
- Firm can handle the complexities that come along with finding office space, setting up technology, managing compliance, or handling legalities
- Ability to get the best of the traditional brokerage and the independent worlds in one place

Independent Broker Dealers

The independent broker dealer (IBD) model offers advisors greater freedom, flexibility, and open architecture where the advisor becomes a business owner with a gross payout of 80-94% with the balance going to the B/D it supports on a national level. This model bridges the gap for advisors who feel the tug of wanting to be an entrepreneur, but who still want the safety and stability of a B-D behind them. The advisor is responsible for managing all the "heavy lifting" on a local level such as handling real estate, staff, office equipment, etc. Alternatively, advisors can plug into an existing independent office thus avoiding many of the start-up costs associated with opening a new office, and take advantage of other cost reduction/shared cost opportunities. Examples of IBDs include LPL, Royal Alliance, Securities America, Wells Fargo Financial Network (Fi-Net), Raymond James Financial Services, and Commonwealth Financial Network. The downside to the IBD model is that advisors at higher levels of production ($500 million in assets under management or greater) often feel limited by the B-D. Many of these enterprise-building firms find that the IBD's are expensive as they have many costs associated with them. Notable features of practicing in an independent broker-dealer model are:

Independent Broker Dealers *(con't)*

- Offer 10 – 25% of t-12 to help defray start-up costs. Larger IBD's offer from 40 – 100% of t-12
- Take home payout is typically 55-70% after expenses
- Strong research and advisor back office support
- Appropriate for the advisor whose book is a mix of fee based and transactional business
- Ability to build advisor's own brand with complete autonomy to decide what is right for the client
- Absolute ownership of clients and accounts
- Ability to structure and control overhead to better manage "bottom line"
- Freedom to monetize and sell book on the open market
- Easier to transition to full independence (an RIA) if desired down the road
- Relatively rigid compliance
- Average production of advisors is approximately $400,000

RIAs (Registered Investment Advisory firms)/Hybrids

For the ultimate in freedom, independence, open architecture, and client-centric holistic practice, the RIA model is optimal. In this "buy side" model, the advisor has the ultimate say as to where clients' assets are custodied and who manages them, can provide an easier to understand pricing model for clients, and have greater predictability in revenue.

The advisor controls his practice and is fully responsible for its success or failure – which takes a certain self-confidence that not everyone possesses. The advisor is responsible for his own compliance and oversight and has the freedom to set fees for advice, charge more for sophisticated financial planning, bill clients for assets under management, and charge clients for ancillary services such as tax preparation, estate planning, concierge services, insurance, etc. Custodial firms include Schwab, Fidelity, Pershing and TD Ameritrade. As an RIA, you are free to custody with one or multiple custodians. For the advisor who does not want to "go it" entirely alone, or doesn't have adequate resources to do so, there is the potential to "tuck into" an existing firm. Most advisors do not run 100% fee based businesses and so the hybrid model (the ability to do both RIA and brokerage business) is usually the preferred route. In this way, an advisor can still be paid on commission and ancillary insurance business through the assistance of a friendly broker dealer. Relevant factors and considerations of RIA's are as follows:

RIAs/Hybrids *(con't)*

- Little or no upfront money
- Payouts start at 100%, with an expected 35% of gross revenues going to the cost of doing business
- Favorable long-term economics
- Ability to create one's own culture
- Advisor creates competition for price and service to better serve clients
- RIA is responsible for own compliance, oversight, costs and expenses which translates into additional time spent "on the business" rather than "in the business"
- Ability to leverage entire breadth and scope of services and support from custodian and other third party providers together with access to "best in class" products and services on a completely open architecture basis by becoming buy side advocates for clients
- Ability to retain operating leverage
- Completely conflict free; advisor acts as true fiduciary, creating competition for price and service
- Ideal way to maximize enterprise value and grow inorganically
- Can still continue to do commission business through a "friendly" broker dealer

Service Providers

As more and more advisors moved to independence and sought to duplicate the resources and services they received while at full service brokerage firms, the service provider/consultancy model came about to support these stand-alone firms and to offer a completion strategy to them. A prime example of this model is Dynasty Financial Partners which offers a customized open-architecture platform that integrates technology, reporting, custody, investment management and alternative strategies as one cohesive deliverable. Unlike aggregators (see below), service providers like Dynasty support fully independent firms and don't take an equity stake in their client firms thus allowing their affiliated firms complete control over their businesses. By partnering with these firms, advisors retain their independence but gain access to products, services and technology to which they would not otherwise have access such as transition support, operations and compliance support, practice management and portfolio & wealth management support. In essence, the service providers help "turbo charge" the advisor's practice. This option is ideal for the advisor who is going independent and is looking for a full suite of services and offerings to complement those offered by the custodians. A few of the compelling features of the service providers are:

Service Providers *(con't)*

- Provides access to institutional research capabilities, innovative and cutting edge technology, planning, and consolidated reporting, etc. at enterprise level pricing
- Turnkey solution for establishing an independent practice. Acts as "general contractor"
- Complete independence for the advisor firms without giving up equity
- Offers growth solutions with access to financing for "tuck-ins" and acquisitions.
- Provides back and middle office, administration, billing, compliance and other support services
- Provides advisor with comprehensive and high touch support that is normally only available at large and boutique firms
- Advisor retains 100% equity and control

Investors in Wealth Management Space

As a whole, there is no shortage of minority investors looking to get in on the action in wealth management. As such, private equity firms, private investors, and banks, to name a few, have demonstrated interest in placing bets on highly annuitized, growth oriented, successful advisors that are already independent and looking to expand their enterprises or on wirehouse advisors committed to becoming entrepreneurs. In addition, firms such as Focus Financial Partners and United Capital Partners, industry aggregators as they are called, have each acquired minority stakes in many high quality RIAs.

In the aggregator model, an advisor sells a portion of cash flow to the acquirer in return for cash taxed at long-term capital gains plus equity in the overall entity. When an advisor chooses to sell a portion of his equity to an investor of any kind, he is gaining access to more than capital. He also gets:

- Ability to mitigate risk and take "chips off the table"
- To retain majority ownership so has almost complete operational control; still has ability to sell remaining percentage of business at a later date
- Ability to leverage thought leadership and strategic guidance from investors and other likeminded business owners
- Ability to leverage a built in and funded succession plan for partners and principals
- Ability to leverage capital to invest in infrastructure and to acquire other practices
- Ideal for firms that believe that they will experience significant future growth and need a capital source to do so