Investment Advisors and Broker-Dealer Affiliation Models

Investment News
Summary

• The majority of “advisors” are seeking to position themselves as advisors – not brokers, sales people or reps
• The independent business models have established themselves as a mainstream part of the investment business
• Independent advisors enjoy high profitability and equity value
Most Critical Aspects of Relationship

- “My advisor is trustworthy.” 97%
- “My account is handled with few errors.” 85%
- “I am confident in the skills of my advisor’s team.” 80%
- “Any problems I encounter are resolved quickly.” 78%
- “My advisor understands my goals for the future.” 77%
- “My advisor is proactive in managing our relationship.” 75%
- “I am comfortable with the level of risk in my portfolio.” 71%
- “I have a clear plan in place to meet retirement goals.” 69%
- “The return on my plan/portfolio meets my expectations.” 61%

Source: Advisor Impact, 2005.
Affiliation Models Overview

1. Complete Control
   - Wirehouses
   - Banks
   - Trust Companies
   - CPA Firms
   - Regional firms
   - Advisors are employees of the parent

2. Agency Systems
   - Insurance Firms
   - Franchise Systems
   - Advisors have both an employment contract and an independent contract

3. Broker-Dealer Independence
   - IBDs
   - Advisors are independent contractors

4. RIA Independence
   - RIAs
   - Advisors are self-employed
Comparative Positioning: Who’s the RIA and Who is The Broker-Dealer?

- Our Wealth Managers listen to your concerns, goals, and requirements
- …incorporate your evolving objectives…into a rational strategy to achieve those goals
- Our ongoing, customized financial planning will adapt as your situation changes
- Each portfolio is customized based on the number of unique considerations
- …provide advice regarding a client's financial situation, and at any time we can tell you how your portfolio is performing
- Develop a thorough understanding of your financial goals and objectives
- Review and analyze your current financial situation
- Identify and tailor solutions that can help you meet your individual needs
- Implement your customized strategy, including personalized services and benefits
- Monitor progress, periodically review strategies, and we will maintain an ongoing commitment to you
Independent Firms Are Growing

Growth in Assets Under Management (AUM)

<table>
<thead>
<tr>
<th>Year</th>
<th>AUM ($millions)</th>
<th>Percentage Growth - Year to Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>$123</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>$155</td>
<td>25.3%</td>
</tr>
<tr>
<td>2005</td>
<td>$186</td>
<td>20.3%</td>
</tr>
<tr>
<td>2006</td>
<td>$228</td>
<td>22.7%</td>
</tr>
</tbody>
</table>
The Advisory Proposition is Working

Sources of New Asset Growth

- New Clients: 13.3%
- New Assets from Existing Clients: 6.5%
- Performance: 5.9%
- Lost Clients: -2.7%
- Distributions: -2.6%
Client Satisfaction with Advisory Firms

Average Rating: 4.6

Clients at Risk: 7%

Very Satisfied: 71%
Somewhat Satisfied: 21%
Neutral: 4%
Somewhat Dissatisfied: 2%
Very Dissatisfied: 1%

Source: Advisor Impact, Client Audit.
Record M&A Activity for Advisors

- High volume of M&A activity is a result of an increasingly crowded landscape of buyers and a continued interest from advisory firms
- Activity in 2007 was up 53% since 2006 and double the level of deals in 2003
- 58 deals were consummated in 2007, but short-term slowdown is appearing in 2008

![Number of Transactions Graph]

- YTD April 2008
Two Ways of Thinking of Advisors

• The distribution approach
  – Sell and customize (as necessary) financial products as directed by the firm
  – Develop new business within the brand framework
  – Focus on production and top-line results
  – Utilize and leverage the firm resources
  – No strategic level decision-making power

• The business approach
  – Create and manage client relationships
  – Develop new business based on their value proposition to clients
  – Focus on business results, including profitability
  – Choose what resources to use and how
  – Have full or substantial control of their own strategy
The Legacy of Distribution Models

• Operations role of the broker-dealer is becoming commoditized:
• In the interaction between the “brand” of the professional and the “brand” of the firm the focus is shifting to the professional
• The requirement for commissions to be paid personally to the “producer” damages the ability of broker-dealer affiliated practices to create larger organizational structures
• The culture of “production” is sustained by commission pay practices
• The bottom line – If having a broker-dealer was not a regulatory requirement, how many advisors will have one?
## Economics of the Full-Service Advisor

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue</td>
<td>100%</td>
</tr>
<tr>
<td>Broker-Dealer</td>
<td>55%</td>
</tr>
<tr>
<td>Financial Advisor Gross Payout</td>
<td>45%</td>
</tr>
<tr>
<td>Out-of-Pocket Expenses</td>
<td>5%</td>
</tr>
<tr>
<td>Take-Home Pre-Tax</td>
<td>40%</td>
</tr>
</tbody>
</table>

*For illustrative purposes only. Individual results may vary.*
Economics of RIAs

Total Revenue 100%

Broker-Dealer 0%

Office Overhead 40%

Take-Home Pre-Tax 60%

For illustrative purposes only. Individual results may vary.
Creating a Business is Rewarding
Productivity is Racing Compensation

Source: 2007 Moss Adams LLP Compensation and Staffing Study of Advisory Firms.
Your Time Is The Most Valuable Resource

Percent of Time Spent by Function by Firm Size

Firm Size by Revenue

- Other
- Business Development
- Operations
- Portfolio Management
- Business Management
- Client Service
The Client Mix

Target Client Mix

Percent of Firm Targeting

Less than $500,000 | $500,000 - $1M | $1M - $5M | Over $5M

Ensembles:
- 10% (Less than $500,000)
- 31% ($500,000 - $1M)
- 53% ($1M - $5M)
- 6% (Over $5M)

Solos:
- 7% (Less than $500,000)
- 47% ($500,000 - $1M)
- 38% ($1M - $5M)
- 7% (Over $5M)
The Overhead

Average Expense Percent
(Shown as a Percentage of Revenue)

<table>
<thead>
<tr>
<th>Enrollment Stage</th>
<th>Direct Expense</th>
<th>Overhead Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early Solos</td>
<td>26%</td>
<td>43%</td>
</tr>
<tr>
<td>Mature Solos</td>
<td>30%</td>
<td>44%</td>
</tr>
<tr>
<td>Early Ensembles</td>
<td>41%</td>
<td>42%</td>
</tr>
<tr>
<td>Mature Ensembles</td>
<td>43%</td>
<td>42%</td>
</tr>
<tr>
<td>Market Dominators</td>
<td>41%</td>
<td>41%</td>
</tr>
</tbody>
</table>
Solo Practitioners Achieve Financial Success

Pretax Income per Owner, All Solo Practitioners By Firm Size

- $75,817
- $183,895
- $369,069
- $789,478

Number of Participants

- <$250K: 171
- $250K - $500K: 102
- $500K - $1M: 49
- >$1M: 12
Staffing and Leverage

Non-Professional Per Professional Position
by Firm Type

Early Solos | Mature Solos | Early Ensembles | Mature Ensembles | Market Dominators

Full-Time Equivalents

0.0 | 0.2 | 0.4 | 0.6 | 0.8 | 1.0 | 1.2 | 1.4 | 1.6 | 1.8 | 2.0

Legend:
- Administrative Staff
- Support or Technical Staff
- Dedicated Management
## Clients Seek Trust

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Cited by</th>
</tr>
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<tbody>
<tr>
<td>Trustworthy</td>
<td>95%</td>
</tr>
<tr>
<td>Understands my situation and concerns</td>
<td>83%</td>
</tr>
<tr>
<td>Keeps me informed without being too aggressive</td>
<td>75%</td>
</tr>
<tr>
<td>Top performer in his/her field</td>
<td>69%</td>
</tr>
<tr>
<td>Well educated</td>
<td>59%</td>
</tr>
<tr>
<td>Well known</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: U.S. Trust Survey of the Affluent
Client Loyalty is with the Advisor

- In interviews with advisors who went independent over 80% of the assets transferred within a year of leaving
- Over 90% of clients follow the advisor
Who Should be Independent

Advisors who:

• Desire to be a business owners
• Have a focus on ongoing relationships and a client base with 5+ years of relationship with the advisor
• Critical mass in revenue to be independent
• Strategic thinkers
• Interested in growing and developing
The Transition Barriers

The questions to answer:

• What are the legal barriers to independence?
• What are the strategic issues that arise upon breaking away?
• How are the operations of the new independent firm going to be set up?
• What will the economics (financials) of the independent firm look like?
Avoid the Landmines

Avoid the most common land-mines:

• No planning for how the practice will grow after the transition leads to slow or no growth for the next three years
• Hastily and poorly structured partnership/ownership contracts
• Poorly defined compensation to employees
• Offering ownership to everyone
• Underestimating the support needs (not enough employees)
• Discounting fees too much
The Rise of the Advisor

- Advisors understand their negotiating power
- Advisors look to define success beyond high income
- Advice is recognized and valued by clients as separate from product
- The prominence of the advisor is increasing while the firm brands are suffering
- Shortage of experienced and productive advisors
- Economic power of the successful advisors is growing
  - Income is higher than ever
  - Recruiting bonuses are higher than ever
  - Equity values are higher than ever
Providing quality audit, tax, and consulting services for over 90 years.