THE GRASS IS ONLY GREENER IF THEY SEE IT

HELPING WIREHOUSE ADVISORS TO VIEW YOUR FIRM AS A DESTINATION

AN aRIA CASE STUDY

BY NEAL SIMON
FOUNDER & CEO, HIGHLINE WEALTH MANAGEMENT

OVERVIEW:

There's a prevailing belief that while successful wirehouse advisors frequently move between the *"big four,"* they rarely transition to full independence under the RIA model. Yet over the past eight years, during some of the most difficult and turbulent markets in recent memory, RIAs have seen their market share grow by more than 30%, while the market share of wirehouses has dropped by nearly 20%. And it's not just clients and assets in transition, it's also advisors. The number of advisors in the RIA channel has steadily grown during that time by 25%, compared to a decrease of 21% by their wirehouse counterparts.

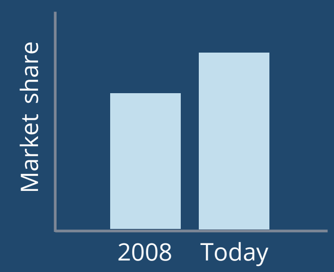
If you don't think some of the most successful wirehouse wealth management teams are peering over the fence at independence you're sorely mistaken. They are. And a growing number of them are making the move. What you need to ask yourself, however, is whether you're prepared to make the case for why **YOUR** firm is the right destination?

When I founded Highline Wealth Management eleven years ago, I wanted this firm to be greater than just a practice – I wanted it to become a business – one that was more than merely the product of my own intellectual capital. I believed then, and still do, that to deliver the best client experience and institutionalize wealth management services, you need talented professionals who are not only terrific financial advisors, but who also can infuse fresh ideas into the firm's thought leadership.

Despite a personal aversion to a business model that's rife with conflicts of interest and ultimately not in the best interest of clients, I realized that there's much to be admired and emulated in the way wirehouses have institutionalized and systematized numerous processes and procedures. And for that reason, I've never shied away from recruiting wirehouse advisors. It's an approach that has truly been transformational for Highline – but not without some pitfalls and roadblocks along the way.

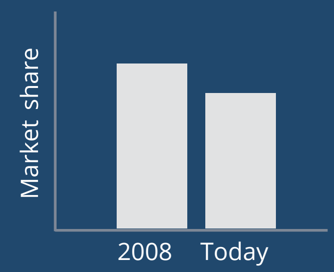
Despite different key issues, concerns and values, since 2008 we've successfully transitioned two wirehouse advisors with total AUM of well over $200MM.

IN THE PAST EIGHT YEARS



RIAs

RIAs market share have grown by more than 30% ...



Wirehouses

... while market share of wirehouses have dropped by nearly 20%.

KEY TAKEAWAYS:

1. There is significant advisor talent in the wirehouse universe.
2. It can work! Although not a universal growth strategy for every firm, wirehouse advisors can not only fit, but thrive, in the right RIA.
3. Education is your greatest challenge. You can't overemphasize the differences and benefits of your service model and compensation structure.

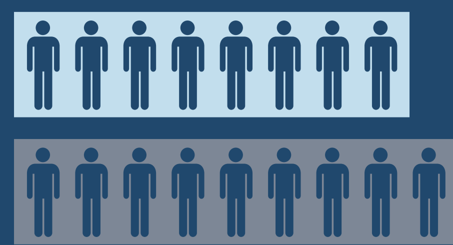
INTRODUCTION & EXECUTIVE SUMMARY:

There's no question that ten, or even five years ago, the thought of transitioning to an RIA would have been highly problematic and relatively unattractive for all but the bravest wirehouse advisors. Back then, the more transactional commission-based nature of their book of business would have made the change to a mostly (if not entirely) fee-based environment a veritable non-starter. Today, however, the landscape has dramatically shifted. Wrap fee business has become a significant part of many wirehouse advisors' books, and continues to grow at a rapid pace. As a result, both their portfolios and their billing structures are much more closely aligned to the RIA model than ever before, significantly alleviating much of the past complexity associated with transitioning.

This begs the important question: Given a great deal of high-end advisory talent at the wirehouses, coupled with the fact that so many RIAs are eager to recruit high-quality people to help fuel their firm's future growth, why isn't there a mass exodus of wirehouse advisors moving from their current firm to establish a new RIA or join an existing one? Is it cultural? Is it the upfront payments (really forgivable loans) or *"checks"* that the wirehouses use as both recruitment lures and retention handcuffs?

I believe the answer is "yes" to both of these questions for most advisors. But I also believe that the RIA path could and would prove much more attractive to many, if only they were better educated as to the compelling benefits they would realize – from both a service model and compensation perspective – by joining forces with an existing RIA.

A CHANGING OF THE GUARD



2014

1st year that advisors affiliated with RIAs are expected to outnumber those working at wirehouses.

Avoid making the all too common mistake of disrespecting the people and passion that exists within a large wirehouse. Over the years I've met a number of incredibly smart, zealous, and genuinely driven advisors at these firms – advisors who care deeply about their clients, and consistently look out for their best interests. One of those advisors was Bill Schwartz, a successful $1MM+ producer with Merrill Lynch.

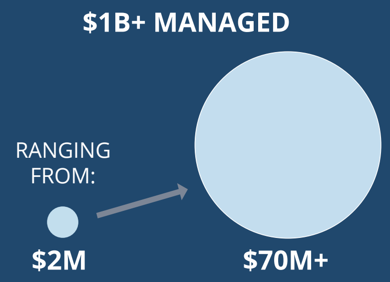
Not only had Bill amassed an impressive business built on exceedingly strong client relationships, his book of business appeared to have remarkably strong synergies with Highline's client mix. Like ours, his roster of approximately 50 clients included a heavy concentration of smart, savvy entrepreneurs and corporate executives. Despite working in a wirehouse environment, his revenues were almost entirely fee-based. And his recommended portfolios were diversified much like Highline's.

When I began talking with Bill, I was immediately intrigued by his background – he had both CFP and CPA designations, so he was already providing wealth management advice, not just investment recommendations. Culturally, I could tell early on that Bill would be a tremendous fit at Highline. But, despite his familiarity with the RIA model from his early working years, I knew that getting anyone to make a move that would necessitate transitioning all their clients' assets would be a significant challenge.

FIRM OVERVIEW:

Rockville-based Highline Wealth Management is an SEC-registered investment advisor that manages more than $1BB in assets for families and institutions across the nation. Clients range in size from $2MM to more than $70MM, and turn to us for investment management and counseling on major financial strategies and decisions. The firm has experienced tremendous growth through challenging economic times, and now manages more than $1BB in assets with a client retention rate in excess of 99% and generating nearly 75% of new business through referrals from existing clients. Highline and its principals have been recognized as top investment advisors by Barron's, Washingtonian and Wealth Manager Magazine.

HIGHLINE WEALTH MANAGEMENT OVERVIEW



Manages more than $1 billion in assets with clients ranging from $2 million to more than $70 million.

CHALLENGE:

Effective recruiting of wirehouse advisors requires an understanding not just of the challenges, but also of the key competitive advantages associated with working for a large firm with deep pockets and extensive resources. These are the principal hurdles I knew that I needed to overcome in my discussions with Bill, and at least strive to demonstrate that our firm could offer enough parity that his business wouldn't suffer as a result. At Merrill Lynch, he was accustomed to:

- A turnkey operation with most administrative and compliance functions handled by the firm.
- A substantial annual technology budget and an integrated and seamless technology platform that included account values/ statements, trading, research and more.
- A massive annual marketing and branding budget, ensuring greater firm awareness, opening doors and providing a better opportunity to impress prospects and convert them into clients.
- Investment bankers who, depending on the politics of the office, serve as an excellent referral source.
- Internal firm research on a host of different companies, stocks and bonds, mutual funds, ETFs, and other investment products.
- Access to robust trading desks and proprietary products of all shapes and sizes.
- The ability to sell various insurance products, which could aid in the implementation of estate planning ideas.
- Access to product specialists in banking/lending, insurance, and more.

Luckily, however, given his prior experience working on the independent side of the fence, Bill was definitely cognizant of the numerous downsides associated with working under the wirehouse model. The many wirehouse issues we explored during his recruitment included:

- Constant headline risk as firms seemingly compete for who can tarnish their brand the most, paying the largest fines for current and past transgressions.

- Being viewed (both internally and externally) as more of a salesperson than advisor, and dealing with the perception that you're less technically competent than independent advisors.

- Not being a fiduciary, and having considerable client conflicts when it comes to compensation and advice.

- Long-term billing issues related to fee-in-lieu of commissions.

- An *"eat what you kill"* environment that fosters internal competition, with little or no teamwork across the organization.

- Corporate bureaucracy and office politics that can more resemble a "frat house" than a professional enterprise.

- An expectation and pressure to cross-sell unrelated or unnecessary products and services.

- Inconsistent product specialists, some excellent, some a waste of time.

- Little/poorly conceived succession planning options with no significant equity ownership potential.

Like many wirehouse advisors, Bill had a generally positive experience as a successful producer at Merrill Lynch. But as his practice grew and his client relationships deepened, he was becoming increasingly conflicted with the disconnect that often occurred between doing what was in the best interest of his clients and what was in the best interest of his firm. He clearly had a drive to function in more of a fiduciary capacity, to eliminate the current conflicts of interest that plagued him, and to build a practice that had long-term equity value.

In other words, he longed to operate in the RIA model.

SOLUTION:

For Bill, as is often the case with wirehouse advisors, the qualitative factors weighed heavily towards joining an existing RIA. It was apparent that if the quantitative aspects of a deal could work, then he was ready to make the move. This is an area where your custodian partners can help, as most have robust transition data and materials including financial calculators that will allow them to model their current compensation structure (including forgivable loans) and view

COMPLETE CONTROL!

It's your ace-in-the-hole when recruiting a wirehouse advisor, and all things being equal, it's likely to be your single strongest transition motivator. The ability to completely control of all aspects of their business and their livelihood including:

- ✓ ***Firm culture and vision***
- ✓ ***Investment products and client services offering***
- ✓ ***Custodian selection***
- ✓ ***Hiring and staffing***
- ✓ ***Compliance policies and procedures***
- ✓ ***Marketing and branding***
- ✓ ***Billing and compensation***

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how it translates into the RIA world both short-term and long-term with the overlay of firm equity.

Merrill's payout grid at the time entitled Bill to roughly forty-five percent of his production (significantly lower than his revenues and a constant source of frustration). And after firm deductions, his actual compensation was in fact closer to thirty-three percent. By running a couple of hypotheticals, it was relatively simple to show him that the combination of a fixed salary, revenue sharing, and profit distributions at Highline would at least equal, if not exceed, his current wirehouse payouts.

With production well over $1MM, Bill could expect to receive a loan in excess of $3MM to stay. And although that money wouldn't truly be earned until after seven or nine years, it's hard to turn down that much paid up-front in a lump sum. One thing that made it easier was Bill's strong interest in equity. He had the foresight and vision to realize that the equity he currently had and could continue to build, would potentially be worth far more than the retention incentive being offered by Merrill.

Although it can be difficult to value an equity stake, Bill and I calculated the likely current and future value of his ownership interest in the firm. Aside from the value being held in equity rather than cash, it appeared equal. In fact, our calculations turned out to be exceedingly conservative, as Bill's equity stake has now almost doubled in value.

It may take any number of active working sessions to get an advisor comfortable with the financial aspects of a deal, but with very few exceptions, the total compensation package received by a wirehouse advisor moving to an RIA can generally equal if not exceed the recruitment package they'd receive for moving to another wirehouse or as a retention bonus from their current firm. In Bill's case, a truly open architecture environment with no conflicts of interest and a spirit of collaboration rather than competition were enough to seal the deal.

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RESULTS:

With the expansion of the Broker Protocol to encompass the vast majority of larger RIA firms including Highline, Bill didn't have to concern himself with the specter of any potential litigation roadblocks to his transition. Like any transition, there were inevitably some challenges associated with transferring forty large ($2MM+) client relationships and over 100 accounts to a new custodian, as well as in translating Bill's existing portfolios to Highline's investment philosophy and model.

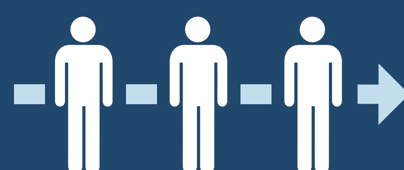
We knew he was putting his livelihood on the line, so we were exceedingly attentive to ensure that everything went well. Transitioning any advisor into your firm will inevitably be disruptive, but wirehouse advisors often add additional complexity, so don't short-change the transition planning process and give yourself a longer transition window than you think you'll need. In Bill's case, the transition was a phenomenal success. We were able to convert 97% of his accounts and 98% of his assets under management.

"As for challenges, these changes impacted the fundamental culture of the firm and had some unintended consequences."

Bill has become a key member of both our management team and our investment committee, and through coaching and mentoring our junior staff has helped raise the overall competency level within the firm.

CONCLUSION:

We can't imagine Highline being a $1BB firm without partners who are moving in the same direction – to grow the firm and continuously improve the client experience and outcomes. Growth fueled by advisor recruitment, however, isn't for everyone. The recruitment process can be long and there are no guarantees. Months of discussion and negotiation can all fall apart at the eleventh hour.



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But when you find the right individual who proves to be a good cultural fit, the infusion not only of assets and clients but also new skills and knowledge can become the lifeblood of your organization that fuels continued growth and process improvement. The first recruit inevitably is the hardest one. Once we experienced success with Bill, however, it set us on a rapid growth trajectory. Over the past five years, Highline has recruited five advisors from a variety of channels. Without our success with Bill, I'm not sure we would have had the confidence to move forward with this inorganic growth strategy.

BEST PRACTICES:

- **Understand that if M&A is going to be part of your growth strategy, you'll need to dedicate considerable time and resources to it.** At Highline, we've hired an experienced professional who's 100% dedicated to meeting with, screening, recruiting and integrating advisors and I personally spend more than 25% of my time on M&A activities.

- **Decide what qualities are important to you, so you can more quickly and efficiently screen candidates.** We care a great deal about investment philosophy and culture, geographic proximity and average client size. Based on an advisor's responses to basic questions we ask early on, we eliminate over 90% of acquisition candidates.

- **Structure win-win relationships that factor in a variety of possible outcomes.** What if the new advisor brings in double the projected assets? What if it's only half? Make sure your deal structure works for both parties. We open our books to our new partners to show them our economics, work with them to make sure we also understand their economics, and then strive to structure a deal that compensates both parties fairly across all possible outcomes.

EXHIBIT 1: WIREHOUSE ADVISOR QUESTIONNAIRE

Make sure you try to answer all of the following questions when recruiting a wirehouse advisor to your firm.

1. What is the ownership structure of the RIA?
2. What would be my role at the RIA? My responsibilities? My career opportunities?
3. Where does the RIA see itself in three years? Five years? Ten years?
4. What would be considered a successful transition? Not successful?
5. If things do not work out well with the RIA, what is the dissolution plan?
6. How am I compensated? What other benefits are provided?

(CONTINUED ON NEXT PAGE)

EXHIBIT 1: WIREHOUSE ADVISOR QUESTIONNAIRE *(CONTINUED)*

7. Do you have any way for me to keep my licenses, especially insurance? How do you handle trailing commissions?
8. What is the investment philosophy of the RIA? What does the RIA believe in?
9. Where does the RIA custody assets? Can I continue to hold my current investments? Will I have to change my investments? If so, how quickly?
10. What services, other than investing, does the RIA provide clients?
11. What support will the RIA provide me and my clients? Will I be making my own trades? Answering my own phone?
12. What opportunities are there for me to bring my support staff?
13. What is the best way for me to continue to grow my practice at the RIA? How does the RIA market to prospective clients?
14. What is the minimum account that would be acceptable to the RIA?
15. What is the fee schedule of the RIA? Any discretion or flexibility with pricing?
16. How does the RIA perform investment research? Other research?
17. What technology does the RIA utilize? What software?
18. Are there any processes or procedures, unique to the RIA, which I need to be aware of?

ABOUT HIGHLINE WEALTH MANAGEMENT:

Highline Wealth Management is a wealth management company located in Rockville, MD. Highline applies integrated, quantitative analyses that incorporate the unique personal objectives of each client. In its effort to design efficient, high performance portfolios, Highline uses the latest optimization and allocation models including Monte Carlo simulation.

To learn more about Highline Wealth Management, visit www.highlinewealth.com, or call Aisling Carroll at 301-339-6099.

ABOUT aRIA

aRIA, the alliance for RIAs, is a think tank study group composed of six elite RIA firms that collectively manage more than $20 billion in client assets, and Advisor Growth Strategies, a leading consulting firm serving the wealth management industry. The group offers insight for advisors considering ways to enhance their firms' enterprise value.

Members include Brent Brodeski, CEO of Savant Capital; John Burns, Principal at Exencial Wealth Advisors; Ron Carson, CEO of Carson Wealth Management Group; Jeff Concepcion, CEO of Stratos Wealth Partners; Matt Cooper, President of Beacon Pointe Advisors; Neal Simon, CEO of Highline Wealth Management; and John Furey, Principal of Advisor Growth Strategies, LLC. The group meets regularly, releasing thought leadership pieces of interest to both independent and wirehouse advisors interested in exploring long-term growth strategies.

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