Becoming an RIA? Should You Consider Going Hybrid?

Key Questions for Finding a Broker-Dealer for Your Commission Business

TD Ameritrade Institutional

Perspective

Executive Summary

Becoming a Registered Investment Advisor (RIA) is a big step, and advisors often find themselves asking many questions during the consideration phase:

- Will my clients follow me?
- Do I have to start my own firm to become an RIA?
- Should I keep my commission business?

While the decision to become an RIA is a big one, over 90% of RIAs say they are glad they did it.[1] A solid understanding of the options for your business model, as well as careful planning before making a move, can help to ease the transition for you.

This paper specifically addresses the considerations of keeping commission business, and outlines the key questions advisors should ask when selecting a broker-dealer to facilitate their commission-based securities. As of 2011, there were over 1,000 independent broker-dealers in the United States.[2] Asking these key questions to find the broker-dealer most appropriate for the needs of your business and your clients can make your ultimate decision easier.

Your Step-by-Step Guide to Becoming an RIA

Whether you are ready to become an RIA now, or just exploring your options to make a move, our Bridge to Independence program brings you a comprehensive suite of resources, services, and tools to guide you through a smooth and successful transition.

[1] Advisor Evolution Study, *Registered Rep.* magazine, 2010

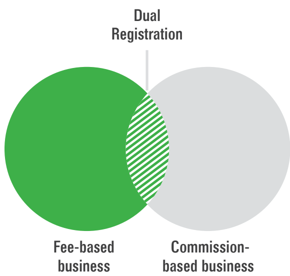
[2] Cerulli Client files, 2011

Key Questions to Ask a Potential Broker-Dealer for Your Commission Business

Key Questions to Ask	
1	How does your firm integrate RIA business with brokerage business from a technology perspective?
2	What is your compliance and approval process for communications with the public?
3	What annual or monthly fees should I expect to pay that are beyond the payout agreement for value added services your firm provides beyond core brokerage services?
4	What is your firm's net capital?
5	How many "net new" advisors does your firm attract annually?
6	Can you provide a detailed overview of all investment products available to advisors, including the process for how new products get added?
7	Can you tell me more about your advisors, including the mix of hybrid and commission-only advisors on your platform?
8	Can you provide details of any pending complaints or any major regulatory events highlighted in your last FINRA audit?
9	What is the ratio of advisors to your support staff?
10	Why should your firm be selected as broker-dealer versus all other alternatives available?

Choosing a Path

Hybrid RIA Model



Advisors who choose to keep their commission business are often referred to as "hybrid" or "dually registered" advisors.

When transitioning to the RIA model, advisors have the opportunity to keep some, or all, of their commission-based business. Advisors who choose to keep their commission business are often referred to as "hybrid" or " dually registered" advisors. This approach is not uncommon—in fact, over one-third of all RIAs are "hybrid."[3]

There are independent broker-dealers that specialize in serving hybrid advisors—these firms usually embrace open architecture custody and technology platforms while tailoring solutions to their RIA clients.

Additional Guidance

At TD Ameritrade Institutional, we can introduce you to broker-dealers serving hybrid advisors and help you evaluate the firm most likely to be able to meet your needs.

Notes:

[3] Cerulli Quantitative Update, Advisor Metrics, 2012

Weighing the Considerations of Becoming a Fee-Only or Hybrid Advisor

While thinking through a transition, advisors should weigh the benefits and considerations involved in becoming a hybrid advisor versus transitioning to fee-only business. Becoming a hybrid advisor offers benefits for those seeking to build a broad set of wealth management, advisory, and product capabilities and also introduces regulatory and technical complexities to consider. See below for key considerations of both the hybrid and fee-only approaches.

Benefits and Considerations with the Hybrid Model

Benefits	Considerations
Expanded access to products only accessible on a commission basis	Oversight from FINRA, in addition to SEC and/or state regulations for RIA business
The ability for advisors in transition to transfer business “in kind” without any negative consequences to clients from a tax, asset protection, or portfolio management perspective	Need to manage multiple revenue streams given dual relationship
The ability for the advisor to retain revenue related to past and future commissionable sales	Responsible for integrating systems, processes, statements and communications
The ability to deliver a broader set of solutions outside of investments (e.g. insurance products, alternative investments, etc.)	Responsible for following broker-dealer compliance guidelines

Additional Guidance

You may decide to join a firm that already has a broker-dealer solution in place. Through our RIAConnect™ program, you will be matched with, and introduced to, some of the leading firms in the industry, many of which operate as hybrids.

The Benefits and Considerations of Becoming a Hybrid Advisor

While thinking through a transition, advisors should weigh the benefits and considerations involved in becoming a hybrid advisor versus transitioning to fee-only business.

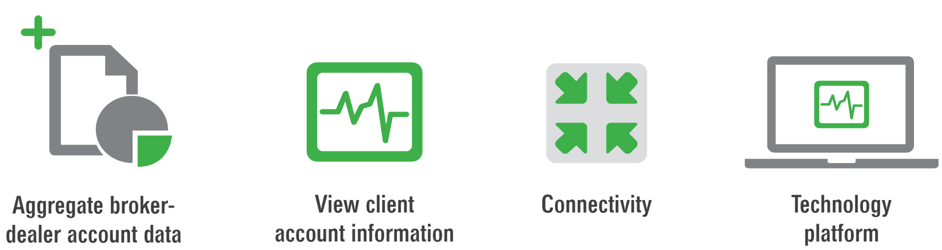
Question 1: How does your firm integrate RIA business with brokerage business from a technology perspective? What tools or platforms do you offer that allow a view of my fee- and commission-based business?

By moving to the hybrid model, by definition, you will work with a broker-dealer and an asset custodian. The benefits of this type of model are clear; however, integration between the custodian and the broker-dealer should be considered, as well as the tools or platform the broker-dealer offers to allow a holistic view of your business. Custodians and broker-dealers are making investments to improve integration between each other. You can take the opportunity to understand the broker-dealer's broader technology capability and how it will integrate with the asset custodian.

Some of the key integration points you will want to look for include:

- The ability to aggregate broker-dealer account data into your portfolio accounting and performance reporting system
- The ability to integrate and view client account information via your computer desktop and have a holistic view of both your commission and fee business
- Connectivity between your portfolio rebalancing and trade order management system
- The ability for your broker-dealer's technology platform to inform any other key elements of your technology infrastructure that may include a client relationship management system (CRM) and client Web portal (to access client data via the Web or mobile device)

Key Integration Points You will Want to Look For



Takeaway 1

Understand the broker-dealer's broader technology capability and philosophy.

Question 2: What is your compliance and approval process for communications with the public?

One of the primary reasons in making the move could be to get greater control over your advisory business. This could include communications with the public for key items such as marketing materials, reporting, website content, social media, and event presentations. Given the benefits of greater control of communications, you will want to be sure the broker-dealer you are considering has policies and procedures in place to meet your communications plans. A less than optimal outcome would be a scenario where you want to communicate with your clients in a certain way, but are unable to because of the policies and procedures of the broker-dealer.

You should ask for the firm's approval policy around communications with the public and the process of getting materials approved for use. There may be a wide disparity between broker-dealers in terms of their processes, flexibility, and levels of support. You may want to ask for references provided by the broker-dealer for its experience with communications prior to making any final decisions. Equally important is to understand the broker-dealer's exception process and turnaround time for approving client communications. You will want to be sure your expectations around approving communications are in alignment with the firm you choose.

Know Your Firms Approval Policy

Takeaway 2

Ask for the firm's approval policy around communications with the public.

Question 3: What annual or monthly fees should I expect to pay that are beyond the payout agreement? Are there value added services your firm provides beyond core brokerage services that have incremental pricing?

Any advisor who has picked up a recent trade publication will quickly see independent broker-dealers advertising high payouts (the amount of revenue the advisor keeps versus sharing with the broker-dealers). Although a payout is important, it is equally important to understand what you get in terms of support in exchange for the amount the broker-dealer keeps. Indeed, some advisors may value incremental support in terms of practice management, compliance, and sales support and may be willing to share more of their fee. In addition, broker-dealers may have different payouts for RIA business versus commission-based business.

While most broker-dealer charges are clearly listed, you should dig deeper to understand what additional charges may exist. For example, a broker-dealer may charge an additional fee to monitor an advisor's independent RIA. Most broker-dealers will also charge or pass through fees for technology, E&O insurance, FINRA and state registrations, among other fees that are in addition to the payout.

Broker-dealers may also specialize or seek to add value in different ways. For example, a broker-dealer may have an inside sales team to help an advisor with insurance cases, or provide access to research capabilities that an advisor may value. Understanding what support services you will get from a broker-dealer will better help you select the right one. Certain broker-dealers may also choose to create affinity programs with third parties that can deliver value added services that complement the broker-dealer. This could include research, asset management platforms, insurance providers, and practice management entities, among other things. This could be an attractive alternative to certain advisors, given that the advisor can "pay as they go" and gain access to expertise outside of the broker-dealer. Broker-dealers may also drive value through these providers via discounts and other incentives.

A best practice may be for you to ask for a complete list of all fees you might be charged as well as incremental pricing for value added services.

Takeaway 3

Ask for a complete list of all fees you might be charged and understand value added services and incremental pricing.

Question 4: What is your firm's net capital? Please provide a P&L and balance sheet.

You should do due diligence on the financials of your prospective broker-dealer. Although net capital requirements can vary, each broker-dealer is required by FINRA to have net capital of at least $50,000[4] if it is accepting client deposits and has a clearing relationship with another firm. For example, a broker-dealer may clear through a larger broker-dealer, instead of working on a "self-clearing" basis. You may also consider reviewing a broker-dealer's clearing firm's net capital requirements as well, to assess the stability of that entity. Although this is the minimum, significant excess net capital could speak to the long-term commitment of the broker-dealer to its advisors, employees, and community.

Minimum Net Capital Required by FINRA

$50,000

Why is net capital important? Because it helps ensure broker-dealers can meet their financial obligations to customers and creditors. For advisors that are seeking to evaluate financial institutions in terms of their default risk and financial stability, net capital is a key metric to investigate. Larger institutions with trading desks that take proprietary positions on securities are more sensitive to net capital requirements; however, independent broker-dealers still need to hold net capital to ensure liquidity to customers. Firms with stronger net capital positions may provide confidence to advisors that their financial position is secure.

You should also try to gain access to a prospective broker-dealer's financials. Although it does not have to provide this data if its financials are confidential, broker-dealers that provide transparency send a strong message about its willingness to share the details of its financial condition. Most independent broker-dealers are not publicly traded, so you may only be able to evaluate financials that are public domain. Information about broker-dealers is available via FINRA at brokercheck.finra.org/Search/Search.aspx.

Takeaway 4

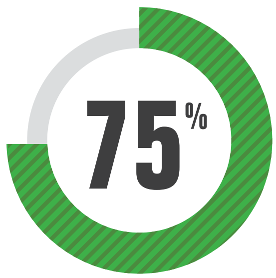
Do due diligence on the financials of your prospective broker-dealer.

[4] FINRA SEA Rule 15c-1(a)(2)(iv), SEC Release No. 34-31511

Question 5: How many "net new" advisors does your firm attract annually?

It may seem as if there are a myriad of firms to choose from with over 1,000 independent broker-dealers in the United States. That being said, the 35 largest independent broker-dealers have over three-quarters of all advisors nationally![5] In addition, the number of independent broker-dealers has steadily declined over the past several years due to competitive forces.

% of Advisors Nationally with the 35 Largest Independent Broker-dealers[5]



Understanding whether the broker-dealer you are considering is adding or losing representatives is critical. You should also have a sense of why advisors left the broker-dealer in the past. Asking detailed questions to see whether the broker-dealer is in "growth mode" will help give you insight into the stability of the firm you are considering.

Takeaway 5

Understand whether the broker-dealer is in "growth mode".

Question 6: Please provide a detailed overview of all investment products available to advisors, including how you match your investment philosophy with the strengths of your investment products. Describe the process of how new investment products get added. How long does that take? What investments will you not approve?

Going independent provides advisors with the opportunity to have greater product access via open architecture. RIAs have the ability to obtain investment solutions as they see fit under the construct of the SEC's fiduciary standard. However, becoming a hybrid advisor introduces the FINRA regulatory construct, and broker-dealers are responsible for approving all investment product solutions you select, including investment solutions that are offered under your independent RIA.

[5] Cerulli Client files, 2011

Given this construct, you must understand the current product lineup on the broker-dealer's commission platform and what investments will be approved for your independent RIA. Most broker-dealers will provide an investment review for advisors considering their platform—which is a recommended exercise to engage in. In addition, dig deep on their process for adding investment solutions. Certain broker-dealers may take this process very seriously, and the amount of time and effort to get investments added may be far longer than you might expect.

New Investment Products and Approval Times

Takeaway 6

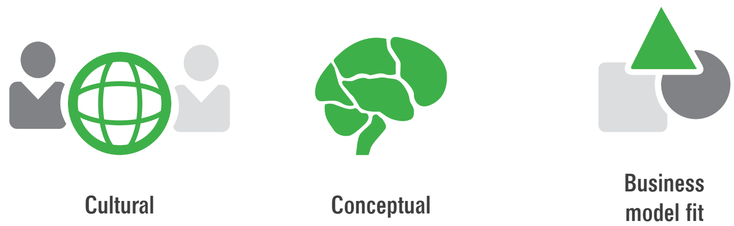
Understand the current investment product lineup.

Question 7: Tell me about your advisors. What is their average production? AUM? What is the mix of hybrid and commission-only advisors on your platform?

When considering aligning with a broker-dealer, a critical element is to understand what kind of advisor it currently serves. Many specialize in a certain type of advisor or size of advisor.

Asking for key metrics around advisor size and type will help you understand if there is a cultural, conceptual, and business model fit. Additionally, many broker-dealers will have offsite meetings with their representatives to build affinity and share new developments regarding their platform. You may be able to create affinity groups with other like-minded advisors that are also affiliated, thereby providing an opportunity to share best practices. You may also want to ask for a referral list of advisors that use the broker-dealer.

Determine the Kind of Advisor the Broker-dealer is Serving



Takeaway 7

Determine if there is a cultural, conceptual, and business model fit.

Question 8: Please describe any major regulatory events highlighted in your last FINRA audit. Can you provide the details around the event in writing? Does your firm have any pending regulatory complaints?

Independent broker-dealers have oversight responsibility for the advisors and registered representatives By affiliating with any broker-dealer, you should understand any major regulatory issues the broker-dealer has previously experienced. A simple way to better understand this is by asking for, and reviewing, the broker-dealer's most recent FINRA audit. This will help you understand if there are systemic business or compliance issues and gauge how effective the broker-dealer is in the eyes of the regulators.

Understand Any Major Regulatory Issues

This is critical to understand, as you may not want to have a relationship with a broker-dealer that has advisors who have had serious client complaints or FINRA violations. These types of complaints should be taken seriously as they could impact the broker-dealer's viability if a lawsuit or fine from a regulator turns out to be material. You should also ask for the broker-dealer's insurance policies and how the firm protects itself.

Pending regulatory complaints are important to be aware of as well, given that the outcome for these complaints is still unknown and can have unforeseen consequences.

Takeaway 8

Understand if there are any systematic business or compliance issues.

Question 9: Describe your advisor support model. What is the ratio of advisors to your support staff?

A broker-dealer is responsible for supervising its advisors and providing support in terms of sales, operations, and compliance. A key metric in understanding the level of support you will receive is the number of advisors per the number of support associates. Although there is no "standard" ratio, usually a ratio of 5 advisors to 1 support associate at a broker-dealer is adequate.

Five Advisors to One Support Associate

You can also probe a broker-dealer to understand how service requests and inquiries are handled. This includes a broad range of support including product questions, access to technology and compliance associates, and the ability to help resolve routine advisor inquires and requests. Understanding how service is delivered (whether it is a team-based approach or via a dedicated support associate) is critical. You could also inquire about the average tenure of support staff, as this can be a proxy for the level of support you might expect to receive.

Takeaway 9

Understand how service requests and inquiries are handled.

Question 10: Why should your firm be selected as broker-dealer versus all other alternatives available?

This final question is very broad by nature and design. Conceptually, you should ask the prospective broker-dealer to provide a valid business reason as to why you should hire that broker-dealer as the firm for your commission-based business. You should seek an answer that meets your concept of independence, and clearly differentiates the broker-dealer from other candidates you are considering.

Takeaway 10

Determine what differentiates one firm from another.

Conclusion

The industry is evolving and more advisors are realizing the benefits of establishing a hybrid RIA—more control of your business, maintaining your commission-based business, and building the business you've always wanted. Selecting the right broker-dealer is an important step in the process, and knowing the right questions to ask will steer you to the most appropriate broker-dealer and can make your decision easier.

In addition to these key questions, you may want to create a systematic approach to evaluating providers. This could include a simple scorecard representing the various attributes that are most important to an advisor, such as economics (payout and fees charged by the broker-dealer), product access, advisor support model, stability of the broker-dealer, etc.

Take the opportunity to better understand all the implications of moving to a hybrid model, and make an informed decision for your business. We have transitioned thousands of advisors. Our experience can help you and your clients through a smooth transition, giving you the ability to build enterprise value from day one.

At TD Ameritrade Institutional, we seek to educate, collaborate, and consult with advisors like you to help you through any potential transition. From the moment you determine you want to make a change, TD Ameritrade Institutional is committed to you every step of the way.

To learn more, please call us or visit our website:

800-444-6100
tdainstitutional.com

About the Contributor

Biography

Scott Collins, Director of Hybrid and Advisor Transitions. Scott leads TD Ameritrade Institutional's recruiting and consulting efforts for brokers and advisors considering becoming a hybrid or fee-only RIA. Scott has nearly 20 years of experience in the advisory industry. Prior to joining TD Ameritrade Institutional, he was the managing partner and CEO of FirstPoint Partners, a boutique consulting firm providing strategy and guidance to advisors considering transitioning to the independent advisor channel. Prior to FirstPoint, Scott spent 13 years at LPL Financial in a variety of recruiting roles, most recently as senior vice president of business development. Scott began his career as a financial advisor with Merrill Lynch.

Scott earned a Bachelor of Science degree in Psychology from Texas A&M University and holds Series 7, and 63 licenses.

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