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5 Reasons Going RIA Beats the IBD Model

What You Need to Know

- **Many larger BDs are shutting the door on dual clearing.**
- **Marketing is easier and paperwork less burdensome on the RIA side.**
- **The requirement for CFPs to uphold a fiduciary standard will further drive advisors to go RIA.**

Two primary threats to independent broker-dealers are advisors retiring or going the RIA/dual-clearing route.

Even though many broker-dealers have become friendly to advisors who to want operate with a hybrid approach, many of the larger BDs have been shutting the door to dual clearing, which generally lets advisors custody advisory assets with the BDs' own clearing firm(s) and at TD Ameritrade, Schwab, Fidelity Institutional Wealth Services (IWS) or Interactive Brokers.

Broker-dealer profit motives are the primary driver of the split from dual clearing since assets held with their own clearing firm are far more profitable than those held outside of it.

With certified financial planners now required to uphold **a fiduciary standard of care** for client investments, we see a clash of interests that will further drive advisors to go RIA and hold advisory assets outside of their BDs' clearing firms. As a recruiting firm evolving deeper into the RIA space, these five factors are what we see as the primary drivers of growth in the RIA/dual-clearing model.

1. Greater Transparency

In a recent conversation with an advisor who's been considering going RIA, I asked about client costs for the unified managed accounts, or UMAs, he works with. He had no idea what they are and the same is often true when I ask advisors about the administration fees for advisor-directed assets.

Further muddying the waters are broker-dealers charging **platform fees**, markups on third-party money management fees and markups on mutual fund management fees, for instance.

The RIA world reduces many of these costs and does away with platform fees and markups. Advisor-directed administration fees can run from 10 to 20 basis points on assets in the clearing firm world.

But in the RIA world, a flat $50 to $100 per account annual charge is the norm, which means the cost for clients in this one area drops by up to 90%. Costs for separately managed accounts, or SMAs, and UMAs are similar to wirehouse fees (which tend to be substantially less than at many IBDs). Also, there's no more mystery when it comes to these expenses; both advisors and clients get full transparency about what they are being charged.

2. Broader Product Choices

Around 2016, driven by proposed regulations at the time, many broker-dealers cut back on the number of money managers they worked with, which resulted in them making more profits on revenue-sharing arrangements via the consolidation of their assets with fewer vendors.

We saw a sharp drop from as many as 200 third-party money managers selling agreements per BD down to a range of 20 to 50. BDs also favored larger managers with long track records.

If you're an RIA with dual clearing, the world can be your oyster. You'll have a much broader selection of managers, as well as new, up-and-coming managers with stellar performance histories and/or unique allocations like highly concentrated positions (i.e., an investment with just 15 stocks).

Many manager choices that advisors have access to at Schwab/TD Ameritrade or Fidelity IWS are not available at broker-dealers because the managers may not be large enough or have long enough track records, or the BDs simply don't want to add more managers to their platforms.

3. More Turnkey Options for Less Money, Time and Liability

Historically, when you wanted to go RIA, you needed to establish and maintain your own RIA with all the setup and ongoing compliance being your responsibility or being outsourced to various vendors.

Over the past few years, there's been a growing trend of more advisors joining large RIAs, where they save a great deal of time and liability while bringing cost savings to their clients and their businesses thanks to the scale of these big RIAs.

For around 10 basis points, these turnkey RIAs provide compliance, errors and omissions insurance, performance reporting/billing via Black Diamond or Orion software, private banking options and technology.

When you consider the fact that many broker-dealers charge 10 basis points or more for performance reporting and billing alone, you see the real value in affiliating with a large RIA for both advisors and clients. The time savings and reduced liability alone make the turnkey RIA option very attractive.

4. Limited Paperwork

The amount of paperwork needed to transfer and open accounts can be oppressively long at many broker-dealers, who mistakenly believe that the greater length of paperwork will protect their ties to advisors and clients.

One advisor told us that he wants to bring on millennial clients. But when these prospects see the stack of forms that must be reviewed and signed, they are turned off. Paperwork complexity raises red flags to potential clients, eroding trust. Millennials are also more familiar with the name brands of outside custodians like Schwab, TD Ameritrade and Fidelity than the names of clearing firms, which they have little to no knowledge of.

While recently switching my own brokerage accounts from NFS to Fidelity IWS, I was pleasantly surprised at the simplicity of the process. An Automated Customer Account Transfer service (or ACAT) of my SEP-IRA account, for instance, was done electronically on a tablet—displaying five windows of disclosures with print that was large and easy to review, and I just needed to fill in one signature.

The new client account form has four windows to review disclosures and requires only one signature and one set of initials. Compare that to what you have to deal with at the broker-dealer level!

5. Easier Marketing

The marketing differences under the rules of the Financial Industry Regulatory Authority and the Securities and Exchange Commission are both subtle and obvious.

"On the nuanced side, one difference is how testimonials are treated," Michelle Atlas-Quinn, managing associate of AdvisorLaw LLC, points out. "While both FINRA and the SEC require disclosure of noncash compensation or conflicts of interest, under FINRA if there is $100 in value paid, maybe just a nice meal, the testimonial must be disclosed as paid."

With the new SEC Marketing Rule, compensation for testimonials and endorsements "is subject to a de minimis threshold of $1,000 during the previous 12 months; compensation for testimonials and endorsements that do not reach this threshold are therefore treated as uncompensated promotions," Atlas-Quinn explains.

"An area of greater difference between FINRA and the SEC is in 'Past Specific Recommendations,' where FINRA sets specific guidelines and time frames in place while the SEC rule permits them as long as they meet the 'fair and balanced' standard," she says.

FINRA rules "set forth the requirement that members file retail communications concerning certain types of securities prior to first use and, in some cases, withhold them from publication pending review by the department [FINRA rule 2210(c)(2-3)]," according to Atlas-Quinn.

"On the RIA side, there are far fewer hoops to jump through as Rule 206(4)-1 does not prescribe any requirements for review by any regulatory authority of advertisements distributed by investment advisers," she states. "When you own your own RIA or join an outside RIA, you can be much nimbler with your marketing strategy."

The Main Barrier to Going RIA

For most independent advisors at broker-dealers considering taking the plunge to RIA, one primary reason they don't is they often expect to monetize their production (i.e., their fees and commissions) when they make any sort of move. One recruiter focused primarily on the wirehouse channel commented recently that advisors don't join a firm over cost but rather culture.

It's telling that these firms that tout their corporate cultures always write advisors a big check to entice them to join. For an advisor to adhere to a fiduciary standard, though, costs and product choices cannot have any conflict of interest, and client interests must be placed above advisor interests.

An article I wrote for Michael Kitces' website Kitces.com, **"Why Broker-Dealer Forgivable Notes Aren't Forgiven and Are Instead Ultimately Paid Back by Clients,"** included a side-by-side comparison, which shows an advisor with $90 million of assets and $900,000 of gross production (sales, commissions and fees) with a 35% upfront note of $315,000 tied to a seven-year forgiveness period.

This contrasts with what's available at a fiduciary-focused BD that has a flat administration fee, no platform fees, no markups and no forgivable note, along with ACAT fees largely covered by the custodian.

The cost that clients bear for the seven-year note period came to $1.155 million, while client expenses at the fiduciary-focused BD were $87,500 over the same seven years. For a rep going 100% RIA, these client expenses are potentially even less than those at fiduciary-focused BDs.

When advisors profess to put client interests above their own but pass along substantial extra costs to clients for the sake of getting $315,000 upfront, conflict-of-interest red flags should start to wave.

It's not by chance that the RIA channel is the fastest growing, with IBDs ranking second in terms of recent growth. The channel losing the most representatives is that of the wirehouse firms, followed by insurance broker-dealers and bank BDs.

Regulation Best Interest is making commission business increasingly difficult, and the Financial Planning Coalition's requirement that CFPs adhere to a fiduciary standard on their clients' investments will further accelerate the drive to the RIA channel.

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