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Why a Silicon Valley Advisor Became an RIA

There's a big difference between broker-dealer and RIA expenses, as one advisor with $100 million in assets and UHNW clients discovered.

Recently, our firm worked with an advisor whose experience went against many of the narratives that broker-dealers promote. The process was illuminating, and this advisor invited me to share his story.

A Silicon valley-based advisor, Palash Islam had a long-standing relationship at a mid-sized BD, which had brought value and relationships he enjoyed.

He came to me seeking options when his firm was soon to be merged into a larger one. Early on in our conversation, I was upfront with the suggestion that Palash should establish his own RIA, as he had over $100 million of assets under management and only a small amount of residual trailing commissions.

During this journey, Palash looked at his current expenses vs. the anticipated expenses at the new firm he was being merged into. We also looked at another firm well known for its advisory focus.

Palash manages his clients' assets by investing in stocks and bonds on a discretionary basis, so advisory administrative fee expenses were a major issue. Here's how the numbers worked out based on $1 million of baseline revenue:

Cost Comparison: Broker-Dealer Vs. RIA

Business Model/	Advisory Administration Fee/	Payout/	Misc. Costs/	Total Revenue/	Cost vs. RIA
Current IBD	$32,500	95%	$16,380	$919,125	$54,355
Merge IBD	$78,000	95%	$15,390	$875,900	$97,580
Backup IBD	$169,000	95%	$12,312	$789,450	$184,030
RIA Only	$11,500	100%	$15,020	$973,480	

Palash's firm is based in the San Francisco Bay Area, which hosts a preponderance of wealthy and ultra-wealthy clients in the tech industry.

Given these demographics, I estimated that his elite clientele would be interested in investments geared toward accredited and qualified investors, which would include investments such as hedge funds, REITs, business development corporations, oil & gas partnerships, private equity, etc.

Really in Clients' Best Interest?

It turns out that the assumptions the industry has led us believe to be true were generally wrong in this case, as Palash explains in these comments:

"One of my favorite quotes from Steve Jobs is, 'Simplicity is the ultimate sophistication.' My clients are savvy, educated and smart. They want things simple and transparent.

"Over the years, I have found that the layers of fees, lack of transparency and complicated structures of broker-dealers and various alternative investments are contrary to what I believe the clients want.

"I'm in the business of results to increase our client's net worth. It seems things are unnecessarily complex in our industry.

"Fundamentally, if there are multiple disclosures to sign which protect the broker dealer and investment company, then is it really in the client's best interest?"

Weighing Cost and Value

Having done the due diligence on the firm he would be merged into as well as a backup broker dealer, I asked Palash what he thought of the two firm's value propositions. According to Palash:

"My business is unique because of the multifamily office model. It would have been impossible to build it without the support of my current broker dealer.

"But it's important to realize that as a smaller broker-dealer in the industry, their size and ability to thoughtfully work through opportunities was a huge advantage. The way it was run insulated me from how the broker-dealer world has changed over the past decade.

"My firm has been called a unicorn within financial services. We have been virtual since 2007 and big enough to be SEC registered while working with a very select clientele.

"In discussing my model, all the broker-dealers agreed that my business revenues were comparable to a branch with multiple advisors, however with a fraction of the typical client base.

"When it came down to numbers, the best offer, between the administration fee and payout, was going to cost $100,000 to $200,000 more than the cost of running my own RIA, with that number increasing as my business grew. There would be no issue in paying that additional cost if they could justify their value."

The New Normal for BDs Doesn't Always Fit

Palash says working through this process made him realize that the broker-dealer model is fundamentally broken when it comes to keeping firms like his. He shares:

"A comment I made to one broker-dealer was that it seemed that they were in the 1800s, and they were trying to show me all the ways they could get a horse to transport me faster to my destination, while not fundamentally understanding that there are firms who are innovating and building a car.

"The new normal for broker dealers is that they have less administrative support for more advisors. They also have to run things within parameters they set; not wanting much individuality with the practices they support.

"As I interviewed various broker dealers in the industry, it was clear what they were looking for; it wasn't someone like me."

Exploring Another Option

Besides due diligence on the merging firm and his backup broker-dealer, we explored BDs that would pay 100% on his RIA business and only take a haircut on any trail and commission business.

After realizing that these 100% RIA broker-dealers would also need to be intrusive on any venture capital opportunities for him and his clients, Palash closed the door on broker-dealers, commenting:

"In the end I just couldn't stomach partnering with another broker dealer. The ambitions of my firm, to find outside ventures in and out of Silicon Valley, and the need for a white glove approach led me to the conclusion that a broker dealer partnership is not the way for my future.

"The business and economic risk was too high to take a chance on any type of broker dealer. Why was this different from my partnership with my current broker dealer?

"We worked well together because they were supportive and had the infrastructure with their compliance team to understand what I was doing with outside businesses for both myself as well as my clients.

"With the overall consolidation of the industry, the broker-dealer support teams are getting smaller. and the number of advisors they support is getting larger. I questioned whether the broker dealer infrastructure could propel my business."

Look Closely at Admin Fees & Forgivable Loans

Concluding his thoughts on his journey to fee only, Palash feels it is important for advisors to understand the difference between payout and administration fees on advisory assets:

"Payout is certainly important, but the administration fee is singularly the largest silent killer of profits. My due diligence saw a low end of 6 basis points to a high of 14 basis points on administrative fees.

"How important is this? That range of $1 million in revenue and/or $100 million in assets can cost you $60,000 to $140,000 annually.

"If you're transitioning to a new firm and they offer you a forgivable note, don't get blinded by the upfront check. Using $1 million as a baseline, if a broker dealer offers $300,000 upfront, they will recoup it within just a few years primarily due to the administrative fees.

"In my analysis, the broker dealer that offered me the most money upfront also was the highest average annual cost over a 6-year period. They were higher than the next closest firm by 20% in increased average annual cost."

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