YOUR ROAD MAP TO INDEPENDENCE

The Investment Advisor's Guide to Going Independent

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INTRODUCTION

There is hardly an investment advisor who has not been intrigued by the idea of becoming independent. The allure of having total freedom in decision making, the attraction of maintaining full control over operations, the appeal of keeping all the revenue, and the pride of building one's own firm are all powerful motivators. What's more, the decision to become independent is described by advisors who have gone through the process as the most important decision they have made in their careers. With that in mind, TD AMERITRADE Institutional, a leading custodian to independent advisors, commissioned Moss Adams LLP to develop this report to provide advisors with a map to chart their course to independence.

To create this road map, Moss Adams interviewed over 25 independent advisors who were formerly wirehouse employees. These participants left for a variety of reasons: to serve clients better, to offer discretionary managed portfolios, to gain a higher share of fees and so on. Although not all expectations materialized, each advisor felt empowered and exhilarated by taking charge of his or her own destiny. Most importantly, all of the advisors interviewed stated that the decision to become independent was the best move of their professional lives, and that they had taken a giant step toward their personal definition of success.

That said, these advisors also reported feeling overwhelmed initially by the complexity of the issues and decisions they faced once they decided to pursue independence. This report, therefore, is intended to help advisors avoid the confusion of going independent and help foster a smooth transition to an independent business model by highlighting the best practices of advisors who have successfully made this transition.

In particular, the report provides advisors with:

+ A framework for evaluating whether or not to go independent
+ A strategic approach to the long-term implications of the decision
+ A road map for creating an efficient and effective back office

BEFORE YOU BEGIN

3 QUESTIONS

BEFORE YOU BEGIN

WHY BECOME INDEPENDENT?

Our research reveals three major reasons why advisors become independent:

Keep All the Fees. This monetary advantage of independence should be carefully measured against the cost of establishing and maintaining an independent business. The expenses associated with independence (such as rent, compliance, research, administrative and marketing) often offset the broker-dealer "haircut." It is not uncommon for advisors to find themselves taking home less income after they become independent. While higher profitability is a goal of the independent model, it is contingent upon the ability of the advisor to create a firm that is productive and cost-efficient.

Build Value. Industry research consistently confirms that profitable independent firms have higher valuations than comparably sized wirehouse practices. To realize that value, advisors must design their business from the beginning to reduce the firm's dependence on their own personality and time commitment. The design must incorporate systems and processes that institutionalize the business to ensure that the entire organization, not just the owner, will be attractive to future buyers.

Customize Service to Clients' Unique Needs. Without wirehouse compliance, pricing and product constraints, advisors are free to develop their own customized pricing and implementation strategies. The range of choices and flexibility of implementation desired by the advisor should be major factors in the selection of a broker-dealer and/or custodian for the new business.

ARE YOU READY FOR INDEPENDENCE?

That said, the freedom and promise of independence should not blind advisors to the significant challenges they face. As part of their assessment of going independent, advisors must ask themselves a number of tough questions:

Can you be a business manager? Advisors' firms often stop growing once they go independent, as they become mired in a variety of operational and organizational issues. This results in mushrooming overhead and the erosion of bottom-line profitability and service quality. The biggest challenge to advisors leaving a wirehouse, therefore, is to discover and train the business manager within himself or herself in order to build a successful and profitable business. Unfortunately, most wirehouse advisors have never had this type of experience or training. To facilitate the transition, advisors should make full use of the many resources available to them (such as help from their custodian, peers, professional organizations and other resources). Custodians can provide some of this training. TD AMERITRADE helps advisors by providing access to workshops, conferences, teleconference calls and online education to assist them with these efforts.

Can you manage people? The financial advisory business is driven by people – they are the biggest expense as well as the biggest asset. Advisors must decide if they are ready to manage people and help them become productive employees. If an advisor is inclined to deal only with clients and not spend time recruiting, training, counseling and managing employees, it may be difficult to grow an independent practice beyond individual capacity.

Are you comfortable with the risk? Independent firms face many risks, including financial, compliance and operational. Advisors should be emotionally prepared to address and mitigate these risks.

What is your personal definition of success? Money is a powerful motivator for most people, but it is not the only one. Many advisors have ambitions that go beyond the next $100,000 of income – including building a business, creating a legacy and impacting the lives of their clients and their communities. Independence can enhance advisors' ability to achieve these and similar objectives.

Is your practice big enough to be independent? Independence comes at a price. Those costs include rent, payroll, establishment and maintenance of compliance, due diligence and reporting procedures, back office duties and marketing and sales efforts. Because many expenses are fixed, we believe there is a minimum critical income base necessary to successfully become independent. Based on interviews and research, projected revenue of at least $500,000 is a reasonable threshold requirement. If an advisor is not at this threshold, it may be wise to delay the transition until the practice can meet this requirement. Conversely, the advisor might consider outsourcing a significant number of back office functions upon independence. There is an online guide, "Your Transition Assistant," on the TD AMERITRADE Web site (www.tdainstitutional.com) that will assist you in calculating estimated revenues and expenses in going independent.

WHAT ARE THE MAJOR STEPS IN BECOMING INDEPENDENT?

While the experience of each firm interviewed was unique, there are three major steps that every firm had to take in order to successfully establish independence:

3 MAJOR STEPS TO BECOMING INDEPENDENT

1

STEP 1: ADDRESS LEGAL ISSUES

Wirehouses have different policies regarding departing employees. For example, there may be issues related to bonuses, pensions and records as well as restrictions on an advisor's ability to solicit clients after the change. What's more, these issues might differ significantly from those encountered when moving from office to office within the same firm. The section beginning on page 5 addresses the most common and important legal issues that arise.

2

STEP 2: DESIGN AN EFFECTIVE STRATEGY

There are a number of strategic issues that arise when an advisor leaves a firm to become independent, each of which is detailed beginning on page 9.

Strategic Plan. The practice needs to define (or redefine) the characteristics that make it superior to the competition and how to systematically enhance these characteristics.

Organizational Design. The new firm needs to identify how it will be organized, who will be responsible for what roles, who reports to whom and how decisions will be made.

Compensation. The compensation of principals, and often of employees, changes once a firm becomes independent. Owners must design a compensation plan that enhances their competitive advantages, reinforces the organizational structure and motivates the desired employee behavior.

3

STEP 3: BUILD AND STREAMLINE OPERATIONS

This is the most time-consuming element of the transition process and covers everything from printing new business cards to selecting critical software and maintaining compliance. Best practices for addressing crucial operational decisions begin on page 23.

STEP 1

ADDRESS LEGAL ISSUES

STEP 1: ADDRESS LEGAL ISSUES

STEP 1

STEP 1: ADDRESS LEGAL ISSUES

Practically every wirehouse advisor who wishes to become independent faces a variety of legal issues. In order to prevent the loss of business, assets and relationships, wirehouses have established legal barriers around their clients. Therefore, the issue is not whether independence is possible – it is the cost of becoming independent. What restrictions will prevent you from taking clients to your new independent business? And what will it cost you in lost clients to become independent? In this regard, advisors considering independence (along with their legal counsel) need to determine if there are binding non-compete or non-solicitation agreements in place. If so, what are the specifics of the agreements, do they provide for "buy out" and how long do the restrictions apply?

Consulting with an attorney is critical during this process, and every advisor interviewed hired legal counsel while becoming independent. Contracts entered into during employment with a wirehouse are complex. An attorney is needed to interpret them and offer advice on how to effectively manage contractual obligations. In some cases, contract provisions may not be enforceable – wirehouses are often aggressive in installing restrictions that cannot be enforced, or at least not in all jurisdictions.

Advisors who have successfully been through this process offer a number of best practices and action steps:

+ Collect all contracts with the current employer, including employment agreements, addenda, amendments to the agreements, employee manuals and, if pertinent to departure, operations manuals. One caveat: Some material may be proprietary to the firm and should not be removed from the employer's premises. When in doubt, consult an attorney.

+ Personally review the contracts and ask legal counsel to review them to discover all existing legal binds and restrictions, including enforceability and the applicable period. Restrictions typically are centered around three areas:

  1. Non-solicitation. This prohibits soliciting the firm's existing clients during the period of employment at the firm and/or for a period of time after an employee leaves the firm.

  2. Non-compete. Some firms prohibit advisors from practicing at another firm or setting up a firm of their own for a period of time and within a certain geographic area.

  3. Non-solicitation of other employees. Advisors, especially senior advisors, may be restricted from recruiting other employees to leave with them.

+ Use an experienced securities attorney who is familiar with wirehouse contracts and who has been through this process.

+ Regulations require your broker-dealer's approval for you to establish a new business entity or to register as an RIA. This will present you with a practical problem of timing your exit from the current firm and maintaining compliance with regulatory requirements and employment agreements. You should seek and obtain qualified legal advice in this process to ensure that you won't commit a costly mistake in the very beginning of the process.

+ Resist testing the waters with clients or asking the best clients what they think about a possible transition. Wait until an experienced attorney has concluded that it is legal to do so (although it most likely will not be possible to question clients before leaving). Our findings indicate that more than 80% of clients follow their advisors.

+ Before offering a job to an administrative employee of the wirehouse, confirm with counsel that no agreements prohibit such an offer.

+ Confirm with counsel which client documents (such as new account forms and statements) can be taken. Although these and other documents may significantly expedite the transfer process of client accounts to the new firm, it is generally prohibited to remove them. Always consult with counsel prior to removing any documentation.

+ In order to ensure that the legal line is not inadvertently crossed, create a timeline related to potential legal issues and review the schedule with counsel. For example, see FIG 1 on the next page.

In addition to complying with existing agreements, advisors must set up a legal entity in which to operate. Generally, this process is driven by:

+ Tax considerations. Except for a C corporation, all legal entities (LLC, partnership, S corporation) are pass-through (i.e., all income is taxed at the individual level). In general, there are very few reasons why a practice should not be an LLC. Again, however, consult with counsel and an accountant.

+ Ownership and decision making. Different types of entities imply different ownership opportunities (the ability to have different classes of stock, stock options, etc.). Most of the time, critical decisions revolve not so much around the legal set-up as much as reaching an agreement among the team on how the current and future value of the business will be distributed. This issue is addressed in greater detail on page 19.

FIG 1. SAMPLE TIMELINE FOR LAUNCH

-4 Months	-3 Months	-14 Days	-7 Days	0	+1 Day
Establish business entity	Establish an RIA (Registered Investment Advisor)	Give notice to firm	Last day	Open office	1) Begin calling clients to inform them of the change 2) Initiate asset transfers
NOTE: Requires approval from your broker-dealer.	NOTE: Your current firm will be notified if you are listed as a principal.	NOTE: Is it also okay to inform clients that you are leaving?	NOTE: What information can you take?		NOTE: How can you collect full contact information?

STEP 2

DESIGN AN EFFECTIVE STRATEGY

STEP 2

STEP 2: DESIGN AN EFFECTIVE STRATEGY

Advisors who break away from wirehouses typically share a common strategy: Retain clients and assets throughout the transition process by persuading current clients that the new independent service model will be superior. This objective underlies the business plans of virtually all the practices interviewed, and occupied much of their attention and resources for as many as three years after the transition.

Many advisors initially overlook the need to redefine their strategies and redesign their firms to fit their new independent model, including issues related to pricing, services, organizational structure and compensation. As a result, very few of the firms we interviewed had reached or exceeded the revenues they enjoyed prior to the transition. Under the immediate pressure to reassure clients, establish operations and prove financial feasibility in the short term, the firms often ignore developing the characteristics that will help them grow in the future.

We believe there is a more effective process advisors should follow that will improve the retention of existing clients during the transition and enhance future growth. Early in the process of becoming independent, we suggest advisors consider the following questions:

+ What will differentiate you from the competition (including your old firm)?
+ What will the new target market be once transferred clients are exhausted?
+ How will the pricing structure and service mix change to reflect the firm's overall strategy?
+ How can the firm be structured to systematically enhance the characteristics that make it different from and superior to the competition?
+ How can compensation be designed to drive behavior that will make the firm successful?

DIFFERENTIATORS

The breakaway advisors we interviewed had a good notion of what the first two years of independence entailed. The firms focused almost entirely on existing clients and spent less time and resources on attracting new prospects. This focus on the core client base is only natural, but eventually may lead to slower growth beyond the base. The transition to independence is, in fact, an opportunity for advisors to look at their business strategically and consider not only what will help the firm keep its existing clients, but also what will help it grow over time.

To begin formulating a strategy, we suggest writing down answers to the following questions.

STRATEGY QUESTIONS	
1	Why did clients come to you in the past?
2	What factors that brought clients to you in the past will no longer be present once you become independent?
3	What are the reasons existing clients will follow you?
4	What are the costs for existing clients to follow you?
5	Why would new clients come to the firm?

One respondent on the verge of completing the transition provided the following responses:
(Differentiators which are no longer available are crossed out)

RESPONDENT RESPONSES

	Before the Transition	Why Would Your Clients Follow You?	What Are the Costs for Existing Clients to Follow You?	Why Will New Clients Come to the Firm?
1	~~Brand name~~	Relationship with advisors	Transaction fees	Reputations of the advisors
2	~~Institutional referral network~~	Investment performance	Time spent considering and accepting new solution	High-profile clients who are well-known in the community
3	Reputations of the advisors	The cost and risk of searching for new advisors or establishing a new relationship with the old firm	Time spent completing paperwork	Investment approach
4	High-profile high net worth clients			Comprehensive solutions
5	Investment approach			

Ultimately, you should develop a list of three or four reasons why new and existing clients would come to your new firm and not go elsewhere. There are six main differentiators used by advisors in the marketplace:

+ Dominating the market. The largest firm in a geographic market benefits from the "top-of-the-mind effect." Very few breakaway firms are able to instantly claim dominance, of course, but this differentiator still could be considered for a new strategy over the long term.

+ Superior products and service. This is perhaps the most overused strategy, claimed by practically every firm from the smallest to the largest. Realize that while service quality is easy to advertise, it is difficult to measure.

+ Niche strategy. Developing niche expertise is perhaps the most lasting and transferable differentiator. Two participating firms had well-defined niche strategies even before they moved out of their wirehouse environments. These two firms experienced practically no loss of revenue and grew quickly after the transition period.

+ Famous person. Having a famous advisor on the team is a valuable and transferable differentiator. However, that fame must be leveraged across the entire firm in order to avoid over-dependence on the one individual.

+ Business model. For most advisors, this reflects the transition from commissions to fee-based services. Be realistic about the large number of firms offering fee-based services and the fact that most wirehouses also offer fee-based accounts. The question here is whether clients will quickly recognize this as a differentiating factor. Consider that:

    1. The independent model not only frees the advisor to do fee-based work, but also increases the number of investment options compared to the choices offered by wirehouses.

    2. Fee-based pricing does not ensure that the advisor has no internal conflicts of interest. Many wirehouse fee-based accounts still offer compensation based on the investments selected inside the account.

    3. Independence allows the advisor to fully customize the investment policy to the needs of each investor, compared to the "template" portfolios used by many wirehouses.

+ Cost. It is possible to lower the cost to clients as an independent and communicate those savings to clients. For example, one advisor developed a spreadsheet comparing commissions that clients paid at the old firm to the lower cost of the new independent pricing model.

TARGET CLIENTS

When advisors were asked to estimate what percentage of their clients they retained upon going independent, practically all responded in terms of the clients they wanted to keep. On average, practices retained slightly over 80% of the clients they wanted to retain.

There are many ways to segment client relationships for the purpose of targeting ideal clients. Assets under management is common, but it is not the only criteria for determining whether a client is worth keeping. Clients most likely to follow an advisor shared the following characteristics:

+ A relationship with the advisor of longer than five years.

+ Limited or no exposure to other services offered by the wirehouse or other professionals inside the firm. The team approach strengthens the relationship between the client and the institution and lowers the probability that a client will follow the advisor (unless, of course, the entire team leaves).

+ Had been serviced by a model similar to the advisor's new independent model.

The more distinct the practice identity while at the wirehouse, the more likely clients are to follow. Practices that focus on a niche, for example, are very well-positioned to earn the loyalty of their clients in the transition. Specialized practices also were quite successful in retaining clients (for example, one large practice specialized in providing tax advice and tax-conscious investment management to clients).

The following worksheet can be used to help segment both the most attractive clients and those clients that may be best left behind during the transition.

CLIENT SEGMENTATION WORKSHEET

NAME ______________________________

ANNUAL REVENUE	HOUSEHOLD INCOME
$	$

SERVICE LEVEL	SERVICE NEEDS
❑ A Level	❑ Complex Estate
❑ B Level	❑ Complex Tax
❑ C Level	❑ Closely Held Business
❑ D Level	❑ Multi-generational

AGE RANGE	EDUCATION
❑ Under 35	❑ High School
❑ 35-45	❑ Bachelors
❑ 45-55	❑ Masters
❑ 55-65	❑ Doctorate
❑ 65-75	❑ Professional
❑ 75-85	
❑ Over 85	

BEHAVIORAL CHARACTERISTICS	OTHER CHARACTERISTICS
❑ Delegator	❑
❑ Family Steward	❑
❑ Accumulator	❑
❑ Independent	❑
❑ Innovator	❑
❑ Mogul	❑
❑ Gambler	❑
❑ VIP	❑

VALUE CLUSTER

❑ Charitably Minded
❑ Socially Conscious
❑ Multi-Family
❑ Other

EMPLOYMENT STATUS

❑ Corporate Executive
❑ Closely Held Business Owner
❑ Professional (e.g., Attorney, Accountant)
❑ Medical Doctor
❑ Sales
❑ Retired

SPECIAL NEEDS

❑ Asset Protection
❑ Widow/Widower
❑ Divorce
❑ Disabled Child
❑ Gay or Lesbian Family
❑ Other

PRICING AND SERVICE MIX

Advisors who complete the transition to independence often take their existing pricing structures and try to reduce clients' costs. This typically is done through lower transaction fees offered by their new custodial platform and through lower AUM fees. For example, approximately 50% of the advisors who completed the transition chose to lower their AUM fees to clients as an additional incentive to retain the relationships.

Instead, we recommend that newly independent advisors define an optimal pricing strategy rather than simply adopt the old pricing plus discount.

The questions to consider include:

What should the minimum account size or the minimum fees be? Often, commission-based accounts are converted en masse to fees and sometimes those relationships are not large enough to justify the level of service.

Will AUM be the only pricing method? Practices increasingly are charging retainers for planning-related services rather than trying to bundle them with the investment management fee.

What services will be offered? Typically, advisors break away to focus on one core service rather than diversify further. Therefore, consider partnering formally or informally with another practice that has capabilities or specialties that were dropped after the transition (such as insurance case designs).

ORGANIZATIONAL STRUCTURE

The organizational structure of two-thirds of the breakaway practices was fairly simple – one advisor assisted by one or two administrative employees. However, for teams considering the change or for those practices that are considering adding partners or employees after the transition, consider the following:

Who owns the clients? Typically, advisors who break away as a team decide on "joint custody" of all clients. To a significant degree, this is a reaction to the world of personal commission compensation and an expression of the desire to service clients using a different model. The implications of this decision must be fully understood. For example, joint custody of clients implies that revenue is also jointly owned and that advisors often will be working together on clients. If there are significant discrepancies between the revenue-generating capacity of the advisors, a compensation plan that deals with the contribution and reward structures must be created. Joint custody also implies that the new practice will endure and that the team will not split. An analogy would be to enter into a marriage without a prenuptial agreement.

We strongly encourage advisors to move away from personal ownership of revenue and clients. Of course, this decision must be acceptable to all involved and a carefully designed compensation structure must be in place to deal with any inequality in contribution.

What are the job descriptions of all employees? Job descriptions may seem unnecessary at a relatively small firm, but they are effective in resolving resource and compensation issues. Most advisors fear that job descriptions will cause their employees to say, "That's not my job." However, we find that if the owners/managers of the firm do not draft job descriptions, employees will create their own definitions for themselves and still say, "That's not my job."

In addition, job functions of administrative staff will change significantly in the process and their workload will increase as a result of the changes. It's best to formalize these changes and address them proactively from resource and compensation standpoints. On average, practices that broke away offered a 20% increase in compensation to their staff. While the larger number of tasks certainly was a factor – and always should be – not all of that increase was motivated by the additional responsibilities. Other factors such as benefit packages and loyalty played a part.

Are there any logical modules/departments in the practice? Advisors who have functioned as a team tend to form specialized units and might consider creating separate departments if the new practice is large enough. For example, some firms have a financial planning department and an investment management department. Breakaway practices are rarely of a size where this is necessary, but the idea should be considered.

How can you organize the practice to enhance the characteristics that make you superior to the competition? The organizational design needs to support the firm's strategy. The positions, job descriptions and responsibilities you design should directly reflect the strengths that differentiate the practice. For example, say if during the strategy exercise (see page 11) you determine that clients will come to you due to:

+ A famous advisor. What is the best use of the famous person? How can you most effectively leverage his/her reputation and convert it to a firm reputation? In most cases, such firms will use the famous person as a rainmaker and build a service team around him/her. These firms also find a strong internal manager – someone who can create and manage the service delivery team. The challenge for such a practice will be to gradually convert the individual reputation into an institutional one.

+ Comprehensive services. What services are included under "comprehensive?" Who are the specialists delivering the solutions? How will you support such a diverse array of services? Firms using this strategy typically seek to organize by departments and create specialized resources in each one. It also is common to find a layer of professional management at these firms (CEO, CFO) who focus internally and have relatively few client responsibilities.

Is there a growth path for employees? In a 2002 research study, Moss Adams found that a lack of confidence in management and the lack of a career path are the most common reasons why young advisors leave a firm. Although there are different possible career paths for a professional employee, a career typically is divided into three stages:

+ Developing an internal market. Learning to service and be responsible for tasks within the services provided by other advisors.

+ Servicing existing relationships. Over time, the advisors start assuming responsibility for existing relationships, thereby gaining experience in managing client expectations and delivering solutions.

+ Building a practice. The previous two steps should build the employee into a technically proficient advisor who is capable of servicing clients and who has developed specialized expertise or niche understanding that will enable him/her to develop new clients for the firm.

How can principals best leverage their time? The principals of any advisory firm divide their time between business development, client service, firm management and personnel development. Ideally, no time is spent on administration, but in reality most principals spend a substantial amount of time dealing with paperwork. The key lesson learned from the advisors interviewed is to never underestimate the time necessary to create and manage the firm's back office. Several practices designated an experienced office manager as a "COO" and were grateful to be relieved of the need to deal with day-to-day issues. Outsourcing arrangements also may be a viable option and are discussed on page 23.

COMPENSATION

Moss Adams has an industry-leading compensation practice that specializes in working with advisory firms. The vast majority of these engagements are driven by compensation decisions made at the time the firm was established. These decisions were made quickly and never revisited until they led to problems.

Therefore, it's best to plan compensation carefully when breaking away, especially since there also will be a fresh strategy and organizational design. Important considerations should include:

Distinguish between ownership compensation and labor compensation. Advisors often mistakenly treat the owner compensation as "what's left after expenses." This approach ignores the fact that an owner of an independent business is exposed to financial and liability risks. As financial theory suggests, risks should be commensurate with returns and the owners should generate a return for their investment in the practice. If owner compensation is simply "everything that's left," it will be difficult to measure the ownership return and ensure that an adequate return is being achieved.

We suggest the following process to formalize owner compensation:

+ Decide on a salary for the owners. As discussed above, owners have particular responsibilities that form their job description. Use it to determine an appropriate salary for that job. There are a number of industry sources that supply data on the appropriate salary levels, such as the FPA Compensation Study.

+ Decide on a profit distribution method. For a solo owner, the profit after all expenses are paid would be the return on investment. If there are multiple owners, appropriate allocations need to be determined. As discussed previously, most practices make everyone an equal owner and as a result choose to divide profits equally. If this plan is not satisfactory, there are a number of alternate distribution methods, such as:
  • according to ownership percentage;
  • according to revenue generated (note that revenue needs to be tracked separately); and
  • dividing money into pools and allocating them based on different criteria (for example, 50% of all profits divided according to ownership percentage and the remaining 50% according to a list of responsibilities, such as serving on the investment committee, serving as compliance officer, performing the CFO function, etc.).

Use benchmarks. Industry compensation studies provide the first step in compensation analysis. Use the studies to establish a salary range for a position (such as $40,000 to $55,000). Then determine the appropriate criteria for placing the person inside a particular range. Criteria may include experience, tenure, degrees and designations and secondary responsibilities.

Consider incentive plans. During the transition stage, the advisors we interviewed were inclined to offer their employees discretionary bonuses rather than formula-driven incentive compensation. This practice may be acceptable for the period of time when the new firm's economics remain uncertain. Over the long term, however, discretionary bonuses have significant drawbacks that may hinder the ability of the bonus to motivate employees. Because employees don't know if they'll receive discretionary bonuses (or why), such bonuses fail to drive intended behavior. What's more, the amount is arbitrary, making it unclear to employees how they should perform to increase the size of their bonuses. Finally, discretionary bonuses quickly become an expectation that, if unmet in a particular year, can leave employees feeling that their compensation has been reduced.

Rather than offering discretionary bonuses, successful advisory firms implement formula-driven incentive plans that link compensation to factors such as revenue, profitability, client retention and employee evaluation.

FINANCIALS

Once you have decided on a strategy, model your estimated revenues and expenses. Be careful about treating the numbers as facts, however. They are nothing but the outcome of assumptions made.

+ We have developed a tool that will walk you through the entire process of financial modeling, complete with estimates on the cost of certain common items and start-up expenses. You will find the tool at www.goindependent.com.

Estimates used in the electronic tool are gathered from research and recruiting publications, including but not limited to:

- Industry publications, such as Registered Rep and Financial Advisor
- Industry surveys, such as the 2003 FPA Compensation & Staffing Study
- Recruiting materials from broker/dealers
- Vendor product and pricing information

This tool provides estimates of the costs of breaking away from a broker/dealer. It is intended to be a guideline and workbook. Benchmarks and comparisons contained are not meant as recommendations on the part of TD AMERITRADE or Moss Adams LLP. Each business is unique, and while the information provided aids in understanding the financial implications of a decision, it cannot be used in isolation. If the information raises questions about your future course of action, you should seek appropriate resources for further guidance. Neither TD AMERITRADE nor Moss Adams LLP shall be liable for the result of actions taken by users of this tool.

STEP 3

BUILD AND STREAMLINE OPERATIONS

STEP 3

STEP 3

STEP 3: BUILD AND STREAMLINE OPERATIONS

The size and complexity of an advisory firm's operational needs cannot be underestimated. Most advisors, including those we interviewed, have never worked outside of a wirehouse firm. As a result, the world of the back office is often unfamiliar and overwhelming to advisors setting up independent practices. However, the experience of advisors who have successfully completed the process offers a number of crucial lessons regarding key operational goals and the best practices for accomplishing them.

When establishing an independent practice, it is key to create the back office early in the process. Without it, the start of operations and, therefore, revenue generation cannot begin. What's more, advisors' clients likely will be solicited by the old firm and its brokers during the transfer. It's critical, therefore, to establish back-office capabilities quickly. However, such efforts also must be thoroughly and carefully planned to avoid potential compliance and client satisfaction problems.

Note: Regulations require your broker-dealer's approval for you to establish a new business entity or to register as an RIA as discussed on Page 6. This will present you with a practical problem of timing your exit from the current firm and maintaining compliance with regulatory requirements and employment agreements. You should seek and obtain qualified legal advice in this process to ensure that you won't commit a costly mistake in the very beginning of the process.

One method for expediting the creation of the back office – and in fact, the entire process of going independent – is to acquire or merge with an existing practice. This strategy provides advisors with instant access to a business entity, an SEC registration, established operations and, possibly, experienced staff. The issue here is whether the advisor is able to find another firm with compatible goals and a similar vision for the future. If a compatible candidate is identified, we strongly recommend that advisors consider a merger or acquisition. The structure and negotiations of such an arrangement are the subject of another report. However, if compatibility exists, the contracts and structures typically follow naturally and TD AMERITRADE can assist you in finding a partner.*

Advisors also should explore the many back-office outsourcing offerings available. By outsourcing activities that fall out of their core competencies or that are cost-inefficient, advisors can save staffing costs as well as time and energy that can be devoted to profit-generating activities. Commonly outsourced functions include human resources, payroll, comprehensive planning preparation and data aggregation/maintenance.

Furthermore, many custodians and vendors effectively structure support systems offsite. For example, some custodians offer TAMPs (Turnkey Asset Management Programs) that handle an advisory firm's key functions – such as marketing, portfolio implementation and ongoing reporting (including the printing and mailing of portfolio performance reports). Although such programs often restrict advisors to using pre-determined asset classes and allocations, they do save the time and costs associated with setting up an in-house back office. Other outsourcing arrangements may provide for the downloading, posting, cleaning and delivery of client

*In rendering such assistance, TD AMERITRADE does not endorse or recommend any particular party or course of action and disclaims any and all responsibility.

data to advisors via the Internet. For instance, TD AMERITRADE offers Advent's Axys* solution fully integrated to their platform. This software alleviates many of the back-office functions of data downloading and reconciliation. Through a secure Internet connection, the reports are simply printed when needed. Discuss with prospective custodians the outsourcing arrangements that are available and how to best use them to maximize efficiency and cost structures.

In planning and implementing operations for the new firm, we advise using the following principles:

Institutionalize. The back office must be driven by policies, systems and procedures – not by discretionary decisions made by people reacting to circumstances. The goal of the back-office is to implement as consistently and effectively as possible while minimizing the number and seriousness of mistakes.

Delegate. Different types of personalities may be more successful in managing the back office than those that are successful in creating and maintaining relationships with clients. We encourage the creation of an office manager position to be involved in the design and implementation process. Alternatively, if breaking away as a group, consider designating one of the partners as a COO.

*Advent Software is not affiliated with TD AMERITRADE Institutional. TD AMERITRADE does not guarantee nor is it responsible for the quality or accuracy of any vendor's product or service. In no instance should the listing of a vendor be construed as a recommendation or endorsement by TD AMERITRADE. Furthermore, TD AMERITRADE does not recommend or endorse any security described by any vendor. For more information about Advent Software, please go to www.advent.com.

TIMELINE FOR ESTABLISHING ORGANIZATION

-4 Months	-3 Months	-2 Months	-1 Month	Opening Day
Establish Business Entity	Register RIA	Lease Office Space	Marketing Collateral	Open Office
CPA (Tax)	Attorney (Securities Specialist)		Portfolio Management System	
Attorney (General)	Compliance Consultant		Internal Information Systems (email, servers, etc.)	
			Web site	
			Compliance Policies	
			Internal Accounting	
			Phone, Internet, etc.	

12 STEPS TO CREATING THE BACK OFFICE

For advisors who choose to build their back-office operations in-house, these 12 steps (reviewed in detail below) should be followed in chronological order:

1. Select a custodian
2. Consider affiliating with a broker-dealer
3. Complete licensing and registration
4. Standardize practice support systems
5. Systematize prospect, client and investment policies
6. Purchase necessary insurance policies
7. Address compliance issues
8. Select and secure a location
9. Select software systems
10. Select hardware
11. Address supply and printing needs
12. Formalize recruiting and human resource policies

STEP #1: SELECT A CUSTODIAN

Given their desire to create independent practices, it's not surprising that most advisors interviewed preferred to use independent institutional custodial services and build and customize their own back office. Today, custodians provide transition kits that support the switch to independence. These kits outline the steps that need to be taken and the forms that need to be completed by the advisor or clients. The goal is to ensure a smooth, painless transition. TD AMERITRADE, for example, has a dedicated Account Transfer Team to help qualified* advisors expedite the transition process.

Advisors should review the following questions when evaluating potential custodians and assessing their needs:

1. **What types of securities will you trade, and what is your typical trading size?** Mutual fund transactions usually are priced differently than stock trades, and firms have varying minimum charges. Naturally, it's best to select the most cost-effective method for the kinds of business performed.

2. **Can you get access to all the securities that you wish to use?** Some custodians have particular strengths in the mutual fund marketplace – providing access to thousands of funds – while others have extensive experience in the equity markets or with alternative investments. If a custodian currently does not offer the full spectrum of investments you need, ask how easy it is to get them to add new options.

3. **How often do you trade? What is your average account size?** Custodial companies generally factor these elements into their overall pricing models. Thus, a firm that may seem relatively expensive upon a simple review of its standard pricing schedule may in fact be less expensive after factoring in the unique nature of your practice.

4. **How do you fit in with the custodian's target market?** In other words, do they want you as a client?

*Firm qualifications apply.

5. **What kind of software/hardware and other services can they help make available to you?** Some custodians have partnered with vendors who offer software/hardware products to make discounts available to the RIAs who work with them. For example, TD AMERITRADE has a list of over 60 Affinity Service relationships who offer products and services at a discount to advisors working with them.*

6. **Will you be assigned a transition team that will work with you initially?** Is this team dedicated to transition issues? How long will the transition team work with you?

7. **What work will the transition team provide assistance with?** For example, will they assist with your transfer forms, provide training and education for your staff, and be available in various ways to assist your clients in understanding and embracing your new business model?

8. **What is the team response time to problems?**

9. **How long do transfers (TOAs) usually take, and how can you get information to follow their progress?**

10. **What research do you require, and what will they offer you?**

11. **Do they offer access to ancillary programs such as compliance programs, practice management, marketing support and/or referral programs?**

12. **If you trade individual stocks or individual bonds, who will you be working with, and what resources do they have (e.g., market makers, block trading specialists)?**

13. **Do they provide other products and services that your clients may request, such as banking, mortgages and/or insurance?**

*Access to Affinity Services Program vendors is provided solely as a service to financial advisors using the brokerage, execution and custody services of TD AMERITRADE Institutional. These services are offered at a discount directly through the participating vendors. Participating vendors are independent and are not employees or agents of TD AMERITRADE. TD AMERITRADE does not guarantee nor is it responsible for the quality or accuracy of any vendor's product or service. In no instance should the listing of a vendor be construed as a recommendation or endorsement by TD AMERITRADE. Furthermore, TD AMERITRADE does not recommend or endorse any security described by any vendor.

STEP #2: CONSIDER AFFILIATING WITH A BROKER-DEALER

The advisors we interviewed generally chose to let their FINRA licenses lapse and did not affiliate with a broker-dealer after leaving the wirehouse. The common reaction was, "I just left a broker-dealer, why do I need another one?" Indeed, with the change in environment, most advisors want to fully transition to fee-based services. Commissions are no longer important.

Assuming that a fee-based model has been chosen, the reasons to remain affiliated with a broker-dealer have to do with retaining access to product lines that generally are available on a commission basis (such as variable life, variable annuities and some types of mutual funds). In these cases, the decision is relatively straightforward and is purely cost-benefit driven (i.e., the revenue from these products versus the cost of broker-dealer compliance and the broker-dealer haircut).

Retaining trail commission revenue can be another factor driving advisors to seek a broker-dealer. Such advisors need to inquire with potential broker-dealers regarding their policy toward independent RIA firms. Approximately half of the broker-dealers allow their firms to have an RIA. Several broker-dealers also are friendly toward firms that do most of their business through a fee platform. Ultimately, however, the affiliation will give the broker-dealer compliance oversight over the firm and may impose some limitations. Advisors looking for a broker–dealer only as a means of offering variable insurance should ask their custodian about the availability of no-load insurance solutions.

STEP #3: COMPLETE LICENSING AND REGISTRATION

Before beginning the licensing and registration process, make sure there are no signed restrictive covenants that will interfere with a smooth exit from the current broker-dealer. If there are such documents, an attorney should review them to ensure awareness of any restrictions that may require modifying the transition plans. It bears repeating that exit plans can be disrupted significantly if legal matters are not given full attention.

It is prudent and cost-efficient to get professional help to establish the legal entity for the new business (S-Corp, C-Corp, LLC, etc.) and to ensure that all the required applications, books and records have been completed. During the due diligence process and while selecting a custodian, get recommendations for appropriate consultants to offer assistance here. It's also wise to obtain professional advice from a securities attorney or compliance-consulting firm for the preparation of the Form ADV and the completion of securities applications and licenses. These tasks are complicated and time-consuming, and errors can significantly delay the opening of a new practice.

Investment advisory registration varies from state to state and is based on the amount of assets under management. The alternatives are state registration and federal registration with the SEC. If there is less than $25 million under management, it is only necessary to file with the state in which the business is located and where business is conducted. Advisors who do business in other states will need to determine whether registration is required there as well. Contact the Investment Advisory Registration Depository (IARD) at www.iard.com to file a U-4 for each agent registering. IARD is a Web-based database that allows investment advisors to register electronically. Fingerprint cards are required if they are not already on file with the FINRA.

To qualify for SEC registration, the business must have more than $25 million under management. Again, the IARD registration must be completed and the ADV forms filed online. Contact the Securities and Exchange Commission at www.sec.org for more information on registering as a Registered Investment Advisor.

STEP #4: STANDARDIZE PRACTICE SUPPORT SYSTEMS

Once the licensing process has begun, start thinking about how the business will operate. Starting from scratch offers two big benefits: old habits from the existing firm likely will not be transferred to the new entity, and workflow can be mapped as much as possible to systematize all activities. Keep in mind that any process that is done more than once (either frequently or infrequently) or where more than one person is involved should be standardized.

One of the most effective ways to standardize the back office is to map out processes, people and systems. The resulting process map then serves as a guide to determine resource requirements and whether or not stages are fully transitioned. There is a sample on the following page. Note that an advisor who is a sole practitioner may serve as both advisor and analyst. However, it's important to separate these functions as the new practice grows.

SAMPLE PRACTICE

	TASK	RESPONSIBLE	SYSTEM
1	Assemble telephone interview team	Admin	CRM system
2	Letter confirming the meeting	Admin	Email
3	Meeting occurs/proposal of the meeting	Admin	Meeting notes in CRM
4	Client accepts	Admin	Copy to compliance
5	Retainer or asset transfer	Advisor	
6	Schedule second meeting	Admin	Notes in CRM
7	Cash flow analysis, insurance and estate plan	Analyst	Financial planning software
8	Analysis created	Advisor	Partner review
9	Implementation	Analyst	Portfolio management
10	Reporting	Analyst	Portfolio management

STEP #5: SYSTEMATIZE PROSPECT, CLIENT AND INVESTMENT POLICIES

All processes relating to a firm's prospects, clients and investments should be systematized. Systems that promote standardization across a business help produce greater efficiency, stronger productivity and, ultimately, higher profits. Standardized policies and formats also make it easier to train new employees and keep track of each client's status and needs. For example, it may be beneficial to develop a Client Qualification Questionnaire with a list of pre-qualifying questions to assist in prospecting efforts.

Systematizing each client's investment policy is another important step. In order to leverage time, control costs and consistently provide quality service to clients, systems need to be developed in the following areas:

1. Investment policy
   - + Active, passive
   - + Dynamic, strategic or tactical
   - + Rebalancing parameters

2. Asset allocation strategies
   - + Non-traditional asset classes
   - + Separate accounts

3. Investment philosophy
   - + Client uniqueness
     - —Return requirement
     - —Risk tolerance
     - —Tax status
   - + Process
     - —Lifestyle
     - —Judgmental
     - —Optimization – anchoring
   - + Asset allocation models – risk and return
     - —Investments
     - —Bonds – taxable/tax-free
     - —Stocks
     - —Large, small
     - —Core, growth, value
     - —International
     - —Other
     - —Assumptions
     - —Historical (period), forward-looking
     - —Time frame – returns, correlations, standard deviation
     - —Total return, nominal return, real return
     - —Return premiums
     - —Rebalancing
     - —Calendar, contingent
     - —Magnitude
     - —Class, style
   - + Selection process
     - —Returns – estimation, capital needs
     - —Risk tolerance – estimation, questionnaire (depth, coaching)
   - + Number of portfolios
     - —Taxable/sheltered
     - —International
     - —Styles
   - + Reporting
     - —Period (month, quarter, YTD, annual)
     - —Benchmarks (individual, portfolio)
     - —Frequency
     - —Monthly, quarterly, semi-annually, request
     - —Calendar quarterly, varied quarters
     - —Taxes
     - —Graphs, tables, commentary
     - —Customization – inclusion, ordering
   - + Managing
     - —Tax trading
   - + Ongoing monitoring
     - —Process
     - —Daily, weekly, monthly, quarterly
     - —Policy revision
     - —Manager changes
   - + Investment committee – Decide who will be on the committee and who will be responsible for the ongoing due diligence of investment selections.
   - + Application issues
   - + Research: What research will you require on an ongoing basis?
   - + Portfolio analysis: What criteria will you use to set your investment polices?
     - —Optimization
     - —Fund and manager analysis
     - —Stock analysis
   - + Recommendations
     - —Standardization of action items
     - —Plan delivery
   - + Execution
     - —Trading – minimums or not?
     - —Rebalancing
   - + Portfolio models
   - + Reporting
     - —Aggregation
     - —Special reporting
     - —Flexibility

4. Financial planning
   - + Risk profiling, coaching, identification
   - + Data gathering
   - + Analysis
     - —Cash flow
     - —Capital needs
     - —Taxes

5. Estate planning

   If financial planning services are offered, address estate planning systems as part of the business plan. Estate planning advice also is a good outsourcing candidate. Advisors often develop relationships with attorneys and/or insurance specialists to review clients' current situations and provide recommendations.

STEP #6: PURCHASE NECESSARY INSURANCE POLICIES

Many advisors do not carry the insurance they need to practice in the current environment. Unfortunately, we live in a litigious society and the longer in practice, the higher the risk that someone will file a legal suit. We recommend:

+ **Errors & Omissions (E&O) insurance.** You will need to communicate a clear business model to the insurance agent to get a reliable quote. Some E&O insurance coverage has high premiums and a high deductible. Some E&O policies are very restrictive, so be sure that you understand exactly what is covered in the event of an incident.

+ **Business insurance.** This includes Property and Casualty as well as related policies such as business interruption insurance. Once you have identified your new firm's location, you will be able to accurately determine your business insurance needs.

STEP #7: ADDRESS COMPLIANCE ISSUES

Compliance is an ongoing responsibility – simply filing an ADV with the proper authorities does not complete the job. Therefore, retain an outside compliance vendor or a securities attorney on an ongoing basis to help address compliance issues as needed. Even when using a vendor, it's best to select a compliance officer from within the firm. The ideal candidate is a partner or employee with the authority to make the necessary changes to keep the office compliant with SEC and/or FINRA rules. Compliance policies that must be addressed include:

+ Disaster policy

+ Compliance procedures

+ Mandated policies (such as proxy voting and soft dollars)

+ Privacy policy

STEP #8: SELECT AND SECURE A LOCATION

Consider the resources currently used as well as requirements for the future. Initially, it may be cheaper to sublease space in the offices of an existing professional group (sharing reception and other office amenities). Also consider renting a suite at an executive office building that provides pre-wired, furnished office space, centralized administrative and secretarial support, conference rooms, video conferencing and other office support systems.

By working with TD AMERITRADE, you will be eligible to receive negotiated pricing from suppliers like Lenovo, previously IBM's personal computing division, and the Regus Group, a global office space provider. Access to these relationships can significantly help you in finding and setting up your new office.

If you lease new space, consider these valuable tips:

+ Opt for smaller offices and more than one conference room. This provides valuable workspace without the hassle of keeping it tidy for visitors.
+ Consider built-in whiteboards, corkboards and other collaborative items for conference rooms.
+ Have a small kitchen for preparing refreshments for clients and prospects, and for staff usage.
+ A paperless office requires less storage and filing space.
+ Soundproofed cubicles are less expensive than providing offices for support staff.
+ Plan an open area for report preparation and mailing (fax, copy, scanning, postage and other machines can take up considerable space).
+ Buy an expandable phone system.
+ Check the space for the possible use of a wireless LAN.
+ Plan for expansion within the first two years.
+ Don't underestimate the need for extensive power and computer outlets. Future flexibility often depends on the ability to shift furniture freely without the constraint of limited power and computer accessibility.

STEP #9: SELECT SOFTWARE SYSTEMS

The list of software programs that advisors require is long. An advisory practice is fully dependent on its ability to receive, process and generate information. The software a firm uses defines its capacity to be successful in these tasks.

As with all business decisions, approach software strategically by asking the question, "How can I use software to enhance my strategy?" Start by listing all the needs rather than the various software products. Create a list of tasks and reports needed, then find the software that will meet these needs. A computer consultant who is familiar with the advisory business can recommend appropriate solutions.

Ultimately, most advisors' software needs will fall into the following eight categories:

1. **Office applications.** Microsoft Professional with Word, PowerPoint, Excel, Outlook.
2. **CRM (Client Relationship Management).** A database to track and control your client information and contacts. The database also should allow you to segment your client base, scan in important documents and prepare contracts and letters from it.
3. **Portfolio management.** A system that will allow you to download data from your custodian(s) and print reports for your clients. Your portfolio management software will be the backbone of your asset management business, making it essential to select the ideal system for your needs. You will find a detailed list of criteria for evaluating these systems on page 40.
4. **Financial planning.** See page 40 for specific attributes to look for in Financial Planning Software.
5. **Accounting.** Your accounting software should handle accounts payable/ receivable, payroll, cash flow management, general ledger and billing management. QuickBooks and Peachtree are commonly used programs.
6. **Web site.** It is advisable to outsource as much of the Web site design and maintenance as possible. Some custodians offer significant discounts from vendors that provide customized Web design or a lower-cost Web site template, and that host the site. Advisors can decide whether to incorporate account aggregation, allow clients to view statements and decide how to use the site as a marketing and information arm.
7. **Networking.** Even if you only have two workstations, it is imperative to link them together to share information effectively. This requires a network server and the appropriate client software for the network.
8. **Email.** Trying to run an email and Web server is a task for only the largest firms. Most advisors outsource this function to their ISP. Email software typically comes bundled with desktop PCs, but you may want to invest in the full version of Outlook. It is important to note here that email retention is also a compliance issue to contend with. It is required that your firm retains emails for five years with easy access to obtain them.

When evaluating major software systems, consider the following questions:

1. Is it an off-the-shelf system, or do you need customization?
   + If customized:
     —Who will perform quality control on the customization?
     —Will the vendor also maintain it?
     —Will the vendor be there in the long run?
     —Do I own the programming code of the customization?
   + If off-the-shelf, will it fit all your needs?

2. What is the cost of the system?
   + Licensing cost
   + Training and support costs
   + Annual maintenance and updates
   + Add-on modules

3. How reliable is the vendor?
   + Is this a well-established product?
   + Have all bugs and other issues been resolved?
   + Is there a good support system?
   + Is there a user community that you can turn to for advice?

4. How well does this system integrate with other systems that you will need?
   + For example, does the CRM system link with your email system?

5. How long do you estimate it will be before you need to perform a major upgrade or replace the system?

6. What is your training cost?
   + Are you familiar with this system?
   + Who can maintain it in your office?
   + How steep is the learning curve?

Portfolio Management System

Portfolio management software is the core of the reporting system and should therefore have all the capabilities and flexibility that are needed. A superior system will possess the following features and characteristics:

Performance Measurement

+ User-defined performance analysis (by position, class, subclass, account, portfolio, etc.)
+ Compare performance against indices (standard and user-defined)
+ Calculate internal rates of return (dollar-weighted) and time-weighted rates of returns

Accounting

+ Manage a wide range of securities (funds, equities, annuities, etc.)
+ Manage the range of taxable events

Reporting

+ Create reports for any date or time period
+ Prepare consolidated reports (for example, consolidated family accounts)
+ Produce multi-report client packages
+ Comprehensive tax reporting for realized and unrealized gains/losses
+ Export to Excel (in order to further customize reports and use Excel's powerful graphical abilities)
+ Customize (fonts, include/exclude columns, modify details of sub-totals, etc.)

General

+ Data and reporting security controls
+ Ability to run data queries across the full database (for example, the firm's total holdings in a specific position)
+ Ability to automatically and efficiently interface and download data from Advisors' custodians
+ Ability to automatically and efficiently interface and download pricing data
+ Reconciliation and verification tools
+ Trading and billing capability

Although there are a variety of alternatives available to independent practitioners, TD AMERITRADE offers the following in either a license option or as a fully integrated option:

+ Advent Software's Axys (http://www.advent.com/products/axys/index.asp)

Other systems include:

+ Captools (www.captools.com)
+ E-Z Data (www.ez-data.com)
+ DBCams (www.dbcams.com)
+ StatementOne (www.statementone.com)

There also are innumerable analytical investment tools available to practitioners. The most common among independent advisors is Morningstar's PrincipiaPro for Mutual Funds. Even if you do not plan to use mutual funds in your practice, you'll likely serve new clients who own funds and/or have questions regarding funds – and Morningstar's software is the industry standard for fund analysis. Morningstar also offers similar analytical products for stocks, variable annuities and closed-end funds. The firm recently upgraded its Web-based offering, Morningstar® Advisor WorkStation,℠* to incorporate most of the analytic ability of its machine-based software in addition to extensive additional analytical and graphical tools. TD AMERITRADE has integrated Morningstar Advisor Workstation into its platform to allow advisors easier and more complete access to the information.

One of the most powerful tools available is the "Bloomberg terminal." While access to Bloomberg is common to many advisors at wirehouses, the cost is often prohibitive for newly independent practitioners. If your new practice will focus on actively managing individual securities, it may be appropriate to conserve on other expenditures in order to budget for a Bloomberg terminal. As monetary resources are likely to be tight, however, you must carefully evaluate real need versus the comfort of familiarity in the decision process.

Finally, you might consider individual manager analytical software for separate accounts, which are beginning to play a large role in the implementation strategies of independent advisors.

*Morningstar is not affiliated with TD AMERITRADE. There may be additional fees associated with this service through TD AMERITRADE. For more information about Morningstar, please go to www.morningstar.com.

Financial Planning Software

Advisors performing financial planning need to choose a planning system or a collection of software tools. Although many advisors continue to use Excel for their financial planning, an advanced, high-quality planning program has become a necessity in today's environment. The first decision is whether to use a goals-based or cash-flow-based program (although both may be needed depending on the nature of the practice). Goals-based software typically requires minimal data input while focusing on graphically attractive client reports, and may be most appropriate for long-term goals planning. Cash-flow-based software typically requires detailed and often complex pre- and post-retirement data inputs, and is necessary to conduct short-term cash flow analysis and tax planning.

When selecting financial planning software, look for the ability to enter and modify the following data inputs:

Tax related
+ Marginal federal, state and local income taxes

Allocation to long-term capital gains
+ Early withdrawal penalties for qualified and tax-deferred investments

Multiple goals
+ Year and frequency
+ Cost in real dollars
+ Priority order
+ Inflation (individually)
+ Retirement – varying periods: fixed, variable and terminating
+ Education – cost in real dollars, years

Income
+ Inflation
+ Social security and pensions
+ Annuity – including payment options
+ Alimony – tax consequences
+ Multiple "other" assets
+ By type and by tax status; by asset class
+ Additional contributions – by asset and time

Asset returns – by portfolio

Asset liquidation
+ By goal priority
+ By specific goal
+ By multiple goals

Asset accounts
+ IRAs, Roth IRAs and Educational IRAs
+ Qualified and retirement plans (pensions, 401(k), 403(b), 457, etc.)
+ Annuities and other tax-deferred investments
+ Traditional taxable and tax-free

ESOPs
Many companies offer financial planning software.
Leading products include:
+ PIE Technologies' goals-based MoneyGuide Pro (www.pietech.com)
+ NaviPlan's cash-flow-based Extended (www.naviplan.com)
+ Moneytree (www.moneytree.com)
+ Brentmark's PFP (www.brentmark.com)
+ Unger Software's Methuselah (www.methuselah.com)

STEP #10: SELECT HARDWARE

Only after software needs are identified should hardware be selected. Otherwise, advisors likely will end up with computers that are either too powerful (and too expensive) for the software being used, or that don't have enough power (processor speed, memory, hard disk, etc.) for the software requirements.

It's typically best to hire a computer consultant who can map out a firm's expected usage, networking needs, storage needs and so on. For example, even practices with one advisor and an assistant will want to network the office in order to share files and optimally manage workflow and communication. Office buildings with built-in wireless LAN networking can save time and money here. Backup data storage also has become an increasingly important issue due to new compliance regulations.

At a minimum, you will need:

+ Well-equipped, Web-linked workstations for each employee. Consider laptops for maximum flexibility.
+ A reasonably fast, networked color printer for client reports.
+ A basic, reasonably fast scanner.
+ A fax machine or fax software that will allow you to send and receive from your workstations.
+ A photocopier. If you are leasing space in an office park, a copier often is available in the building. If you are purchasing a copier, consider one that can be attached to your network system so that you can print and copy directly from your workstations.

You also may want to consider a personal digital assistant, such as a BlackBerry, to respond quickly to emails from any location. This device can be particularly important to a firm's primary client relationship manager.

STEP #11: ADDRESS SUPPLY AND PRINTING NEEDS

New offices typically need everything from paper clips to Post-It notes. List crucial items used on a daily basis, then place one order for delivery upon moving in. Items that need to be customized and printed should be prepared, reviewed and approved before completion, including:

+ Stationery
+ Brochures
+ Memo cards
+ Various-sized envelopes, including return envelopes
+ Presentation folders
+ Business cards

That said, don't go overboard. Success will not depend on having an expensive, glossy, 12-page brochure. And keep in mind, by working with TD AMERITRADE, you can get access to printing and office supply vendors at reduced costs.

STEP #12: FORMALIZE RECRUITING AND HUMAN RESOURCE POLICIES

All advisors – even those who currently have only one employee – need to establish policies for recruiting, compensation and benefits. These policies will serve as a road map as firms grow and add employees. The 2005 FPA Compensation and Staffing Study (produced by the Financial Planning Association and Moss Adams LLP) provides compensation structures (salaries, bonuses, incentives and other benefits) for various job descriptions. The study can be obtained through the Financial Planning Association's Web site (www.fpanet.org).

Recruiting

As an independent enterprise, you are likely to make your first hire within the first two years. While not an exhaustive list, consider the following recruiting questions:

+ Who will do the recruiting (you, an outside recruiter, another option)?
+ Who will set the total rewards package (compensation, benefits, perquisites, other) for the position?
+ How will you decide if a candidate has the necessary competencies/skill sets (interviews, testing/attitude tools, etc.)?
+ What are the must-do items in the hiring process (such as background and reference checks, using a fair and open recruitment process, etc.)?
+ Who will handle the interviews? (Do they know which questions should always be asked during an interview – and which should never be asked? Are they trained to ensure fair, legally defensible hiring practices?)

Benefits

Employee benefits require a number of careful considerations. For example, do you have to offer benefits and, if so, at what level? You'll also want to consider sourcing options – contracting for each benefit offering from different firms, or using one provider. Costs also must be reviewed. While some advisors pay for all benefits, others share the costs with employees or provide free benefits for employees but not their families. BenefitsLink (www.benefitslink.com) is an excellent resource for information on various types of benefits, providers and legal aspects.

CONCLUSION

Advisors who become independent have enormous opportunities to achieve great success and provide superior solutions to investors' most important financial goals, thanks to the control, freedom and choices that independence offers. What's more, independence provides many advisors with a level of personal fulfillment that they lacked working for wirehouses.

That said, the path to independence is full of pitfalls and hurdles that can prevent advisors from making the most of these opportunities. In order to successfully navigate the path, you first must confront the realities associated with going independent and decide if you are up to the task. Then you must take the appropriate steps at all stages of the process to ensure a smooth and successful transition, including:

+ Addressing the numerous legal issues involved with going independent.
+ Designing an effective business strategy that differentiates your firm from the competition, attracts ideal clients, provides the right products and services profitably, and effectively rewards and motivates all principals and employees.
+ Building and streamlining operations to ensure maximum internal efficiency and a consistent, superior client service experience.

In the end, the key to transitioning to independence is to fully leverage the many tools at your disposal – from the best practices of successful independent advisors to the support and resources offered by custodians, consultants and others. By getting the help you need and not "going it alone," you'll maximize your chances of building a world-class independent investment advisory practice that thrives in the years and decades ahead.

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TDAI 4185 B 11/07