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# Going Independent: Why Many Successful Financial Advisors Are Starting or Joining Independent Firms

Prepared in partnership with Moss Adams LLP

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## Introduction

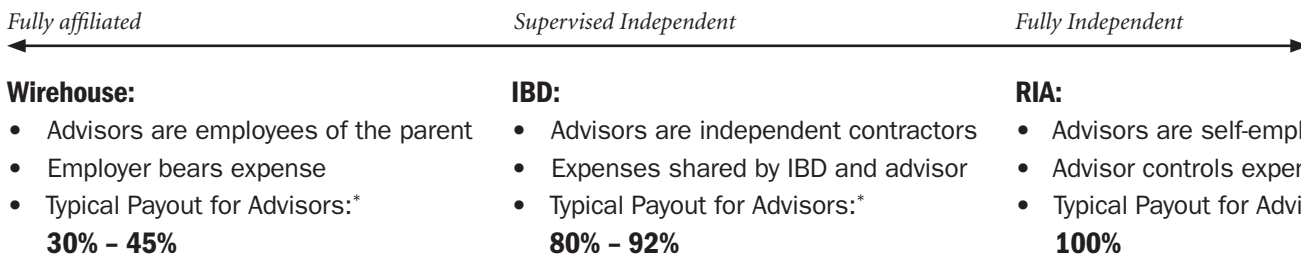
Financial advisors are evaluating their options to maximize the personal, professional and financial rewards of their business. They may think about building true ownership equity in their business and about being rewarded for their own profitability. They may wish to keep more of the revenue they generate and decide how their services are priced. They may want more control over their career path and the opportunity to choose the products they believe to be right for their clients.

This white paper is for advisors who are contemplating independence as an opportunity to achieve greater professional freedom, deeper client relationships and the financial rewards of owning a business. Advisors who believe they have outgrown their firms are considering the change as a way to align their business with their values and build wealth in a way they could not as an employee of a firm.

One factor driving this trend is that high-net-worth clients are increasingly looking to their financial advisors for help with complex needs. Just as these clients are calling for broader, more sophisticated solutions, advisors are often finding themselves constrained by restrictive corporate policies. Frustrated by conflicts (or the perception of conflicts), scandals and a product-centric business model, an increasing number of financial advisors are leaving wirehouses for independence. In the process, they are not only improving service to existing clients but are attracting new clients who prefer to work with advisors under a business model that encourages their advisors to deliver sound advice with a client focus.

Most advisors have a sense for what it means to go independent and know that such a transition can take several forms. The two prevalent models are to affiliate with an independent broker-dealer (IBD) or to become fully independent as a registered investment advisor (RIA).

### THE SPECTRUM OF INDEPENDENCE



\*Percentage of revenue

For illustrative purposes only. Individual results may vary.

Source: *On Wall Street* and Moss Adams

In addition to the benefits of serving clients better and managing the practice more autonomously, the financial rewards of going independent can be significant. The following chart shows the impact of independence on an average advisor’s income and profit at three different revenue levels: \$500,000, \$1 million and \$3 million.<sup>1</sup> Clearly, independence can provide advisors with the opportunity to keep more of what they earn and to build true ownership equity in their businesses — opportunities that are limited or simply not available to employees of many financial services firms.

**AVERAGE NET PAYOUT<sup>2</sup>**

	<i>RIA</i>	<i>IBD</i>	<i>Wirehouse</i>
\$ 500,000 Practice	\$ 291,662	\$240,603	\$186,000
\$ 1,000,000 Practice	\$ 362,572	\$295,793	\$320,080
\$ 3,000,000 Practice	\$1,168,471	\$873,834	\$836,400

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**Key Study Findings:**

- *By going independent, advisors may gain control of many of the variables that drive satisfaction and position their practices to capitalize on the trend.*
  - *Independence may enable advisors to keep a greater share of the revenue they earn and build equity in their business.*
  - *“Independence” is a spectrum, but the increasingly popular RIA model can provide the greatest freedom to look after clients’ best interests.*
  - *The greatest profitability potential is in the RIA model.*
- 

<sup>1</sup>The complete financial analysis and details on the methodology are outlined in the Appendix.

<sup>2</sup>The payout includes owner salary plus firm profitability in the RIA and IBD models. The payout shown is combined for two principals in the \$3,000,000 practice.

# PART I: The Trend Toward Independence

## A Client-Centric Perspective

High-net-worth clients are increasingly looking to their financial advisors for help with complex needs and sophisticated solutions. It should come as no surprise that wealthy Baby Boomers — a group skeptical or downright cynical about Wall Street — are especially likely to seek out independent advisors.<sup>3</sup> With four million Boomers turning 60 each year until 2024, advisors cannot afford to ignore the needs of this demographic.<sup>4</sup>

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*“Boomers will demand a new style of financial planning and preparedness, with their own unique needs and concerns. . .”*

— Ken Dychtwald, Ph.D., President & CEO, Age Wave<sup>5</sup>

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Consider, for example, that about 46 million of the 75 million Boomers born between 1946 and 1964 are expected to retire in the next 10 years, doubling investable household assets to more than \$30 trillion.<sup>6</sup> Yet, according to renowned gerontologist Ken Dychtwald, only one-third of all Boomers currently have a financial advisor.<sup>7</sup>

With affluent clients frustrated by product limitations, incentives out of sync with customer needs, scandals and conflicts of interest, an increasing number of financial advisors see a need to win clients’ trust. In leaving wirehouses, they want to improve service to existing clients and to attract new clients who prefer to consult with advisors who provide unbiased, trustworthy advice.

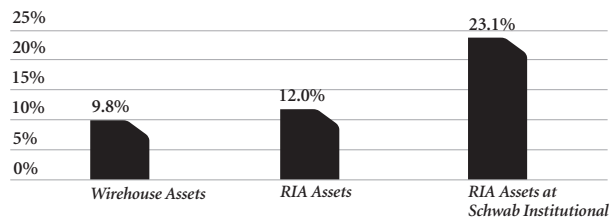
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*“Independent reps and RIAs have picked up market share after major brokerages were tainted by the investment banking and mutual fund scandals. Moreover, Baby Boomers are now at the age when they must focus on their investments, and they are demanding unbiased financial advice.”* — Charles “Chip” Roame, Tiburon Strategic Advisors<sup>8</sup>

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The trend toward independent advisory models is demonstrated by the asset growth experienced by RIAs versus wirehouse advisors.

### CAGR '02 – '05

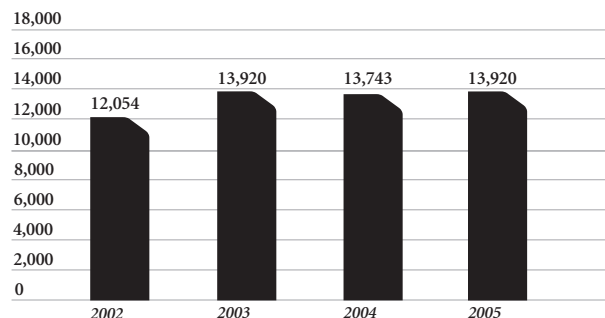


Source: Wirehouse Assets & RIA Assets: Cerulli Associates; RIA Assets at Schwab Institutional: Schwab Strategy Group. CAGR stands for “Compound Annual Growth Rate.” Past performance is no guarantee of future results.

Advisors have also started to position themselves to take advantage of investor preferences. The number of RIA firms has increased at an average of 9.6% from 2002 to 2005 and shows no signs of slowing.<sup>9</sup>

### RIA FIRMS

28.9% 3-Year Growth



Source: Money Market Directories, National Regulatory Services, Cerulli Associates

According to Frank Campanale, chairman and chief executive officer of Campanale Consulting Group LLC in Birmingham, Michigan, “The statistics are pretty clear that the registered investment advisor custodian firms are capturing about \$3 for every \$1 the major houses are bringing in new business today.”<sup>10</sup>

<sup>3</sup>“How Boomers Will Change Your Firm,” *Financial Advisor*, April 2005

<sup>4</sup> www.agewave.com, Ken Dychtwald, November 2006

<sup>5</sup> Ibid.

<sup>6</sup>“How Boomers Will Change Your Firm,” *Financial Advisor*, April 2005

<sup>7</sup> www.agewave.com, Ken Dychtwald, November 2006

<sup>8</sup>“Jumping Ship,” *On Wall Street*, June 1, 2006

<sup>9</sup>“Should I Stay or Should I Go?” *Cerulli Edge* — U.S. Edition, August 2006

<sup>10</sup>“Broker-dealer Roundtable: Wirehouses face challenges in trying to break product focus,” *Investment News*, August 21, 2006

## Financial Advisor Perspective

More than 1,500 financial advisors move from wirehouse firms to independence each year.<sup>11</sup> As more top-producing advisors strike out on their own, independence has gained respect in the industry and among clients.

There is an industry misperception that most advisors who move to independent broker-dealers or RIAs do so because they cannot meet their production targets in the wirehouse environment. This simply isn't true, says Philip Palaveev, Senior Manager with Moss Adams LLP, who explains that it is often "the largest and the best" of the independent registered reps who leave brokerage firms to become fee-based advisors.<sup>12</sup>

Chip Roame of Tiburon Strategic Advisors, while stating that the seven largest national full-service firms push out about 3% of brokers annually due to poor production, estimates that 1% of major-firm advisors choose of their own accord to go independent.<sup>13</sup> According to National Financial Service's annual broker sentiment index, 60% of advisors say they would abandon their "channel," or form of employment.<sup>14</sup> Another 18% would choose to start their own RIA.<sup>15</sup>

Increasingly, many advisors realize that their success flows from their own skills and abilities, not the resources and reputation of the big Wall Street firms. For these advisors, independence brings many intangible benefits. "It's the freedom to control your own world," says Michael Golub, who formed his own firm, the Golub Group, after running the group successfully for years within a regional broker-dealer. "Clients didn't even know who our broker-dealer was," says his partner, Colin Higgins. "We finally had to ask: why are we paying out half our income to a firm that's not helping us?" The simple recognition that they — not the firm — were the reason for their success convinced Golub and Higgins to go fully independent. Not only would they be able to keep more of what they earned, but they also would be building equity in a business that could one day be worth millions of dollars.

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*"Advisors' strong desire for autonomy, the increased sophistication of service agents and advisors' view of the rise of centralized investment committees inside the wirehouses are key drivers of this renewed growth."*  
— Cerulli Associates<sup>16</sup>

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<sup>11</sup>"More advisors jumping into RIA channel," *Investment News*, May 8, 2006

<sup>12</sup>"Many registered representatives would prefer to be fee-only," *Investment News*, November 6, 2006

<sup>13</sup> Ibid.

<sup>14</sup>"Many registered representatives would prefer to be fee-only," *Investment News*, November 6, 2006. The survey included 1,000 advisors and brokers from wirehouses, regional broker-dealers, banks, insurance companies and "independent" firms, which National Financial Services defined as firms with 1,000 or fewer advisors.

<sup>15</sup> Ibid.

<sup>16</sup>"Should I Stay or Should I Go?" *Cerulli Edge* — U.S. Edition, August 2006

## PART II: Why Advisors Go Independent

### Are Clients Losing Trust in Institutions?

Advisors who fear they may lose clients when they move may be surprised to find that clients are not as wedded to the firm as they may think. Clients are increasingly choosing independent firms as their primary advisors because they believe they are more objective. When asked to rate problems in the brokerage industry, the top two problems mentioned by investors were “industry motivated by greed” (mentioned by 69%) and “financial advisors/firms putting their own interests ahead of investors” (64%). At the same time, fully 90% said they were either “very” (50%) or “somewhat” (40%) satisfied with the services they receive from their broker or financial advisor.<sup>17</sup> It may simply be that clients are happy with their advisors but mistrustful of the industry or large brokerage houses as a whole. Indeed, several newly independent advisors say that not having to worry about their firm’s name being associated publicly with a scandal is an important benefit of independence.

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*“I wanted transparency. We used to [with my prior firm] start every meeting with an explanation as to why we weren’t — name a big-name wirehouse. We were always trying to separate or differentiate ourselves from the traditional broker pitching the family. I find it refreshing that today we can talk about our boutique independent model. We can talk about customization. We can talk about the service model and why we went down this path in the first place.” — John Krambeer, President & CEO, Camden Capital Management*

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Increasingly, clients who were once attracted by the name recognition of a major firm are now recoiling at certain conflicts of interest and the negative publicity surrounding some firms. Most advisors who turn independent find that clients understand and support their decision. In fact, advisors who stay with embattled firms may risk losing clients who mistrust the firm: 25% of affluent investors recently surveyed by Spectrem Group moved a portion of their assets out of their financial services firms in the previous two years for lack of trust.<sup>18</sup>

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### Assembling the Right Team

*In August 2005, David Bromelkamp left a major wirehouse to start Allodium Investment Consultants in Minneapolis. Regulatory restrictions and a burning desire to best serve his clients drove the decision. “I had enjoyed a great career at a brokerage firm,” he says, “but eventually I came to the conclusion that in order for me to help our clients and to act in their best interest, I would have to work for an independent RIA firm.” He concluded the best way to do this was to start with a clean slate and build a firm that could provide high-quality, objective advice that lives up to a fiduciary standard of care.*

*It was a team effort from the start. To overcome concerns regarding operational issues, Bromelkamp found a manager to run operational aspects of the firm. “I was looking for someone who would take all of the operational activities like accounting, legal, compliance, technology, human resources and personnel — someone who would manage the business effectively, efficiently and profitably,” he said. This important decision allowed him to continue focusing on helping and advising clients. A Schwab Institutional Business Development Officer assisted in the introduction. “He put two and two together. I was looking to set up an independent firm. He knew of another person who wanted to help set up an independent firm [and] had a good background in operations.”*

*You learn quickly in the transition process about the strength of your team. Bromelkamp had done his homework before choosing a custodian. He asked for feedback from his peers in the industry, especially at RIA firms. That homework paid off. “The transition process was a lot of work,” he says. “I think that in the transition process, whenever there were quirks in the process, the Schwab team bent over backward to make sure that everything got done correctly and met our expectations.”*

*Less than a year into its transition to independence, Allodium already manages more than \$100 million in client assets and is still growing. Regarding his transition and advice for others, Bromelkamp says, “We wouldn’t do anything differently. We executed our strategy exactly how we planned it. The advice I would give any advisor considering moving to an independent advisory firm is to be very clear on the reasons why they want to establish their own firm. In the first months of establishing the business, there are going to be issues that make it look like the transition is going to be difficult. When faced with difficulties, it will be helpful to remind yourself of the underlying motivation to achieve your independence.”*

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<sup>17</sup> SIA Investor Survey, 2004

<sup>18</sup> “Memo to advisors: Don’t lose clients’ trust,” *Investment News*, February 14, 2005

## Conflicts of Interest Gain Visibility

Conflicts of interest have been a part of Wall Street ever since the first trading commission was charged in the late 1800s. Some advisors work to resolve conflicts of interest by switching to a fee-only business with their current employer. Even so, conflicts may remain at the corporate level. Although the pressure to sell proprietary products has abated at some firms, many brokers acknowledge “subtle encouragement” to offer specific products.<sup>19</sup> One advisor recently said he couldn’t offer access to the best separate-accounts managers “because the firm chose not to research managers if they lacked the capacity to make it economical.”<sup>20</sup> Still another advisor spoke of the potential conflict that arises when the firm receives remuneration from mutual fund companies.<sup>21</sup>

Not only are independent advisors not pressured to sell a firm’s products, they have greater freedom to recommend products and strategies that are in the best interests of their clients, such as load-waived funds and money market funds. Following their own ethical standards, advisors can feel confident that they are not recommending a particular product just because it pays more. “Today we can sit down with a client and say we have no conflict of interest,” says Golub. In many cases, this is because the only income the RIA firm receives comes from client fees.

As the effects of the SEC’s reconfirmed broker-dealer exemption rule<sup>22</sup> ripple through the industry, required disclosures may further drive advisors to independence. In April 2005, the SEC ruled that broker-dealers are not considered investment advisors if their advice is “solely incidental” to brokerage services. Under the new disclosure rules, financial professionals must advise clients that brokerage accounts are not advisory accounts and that firms’ interests may not always be aligned with their clients’.

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*“The sentiment is that the Rule forces absurd disclosures on brokers. This is another factor that could encourage brokers to seek alternatives to be free of the increased compliance scrutiny and red tape at wirehouses.”*  
— Cerulli Associates<sup>23</sup>

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Although the independent model is not always conflict-free, access to a greater breadth of products and a fee-based approach can reduce conflicts.

## Are Compliance Restraints Out of Control?

Veteran advisors are finding it harder to do business within the wirehouse environment. In the aftermath of the dot-com bust and conflict-of-interest scandals, many firms have become so conservative that top producers find it increasingly difficult to do anything that isn’t strictly vetted by the firm.<sup>24</sup> Advisors may feel handcuffed when policies limit product offerings and restrict the services they would like to provide.

As more successful advisors find they can do just as well or better for clients without the affiliation of a major firm — and that the firm may actually be holding them back by limiting the way they do business — independence is increasingly attractive.

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*“For me it [going independent] was all about developing an environment where we could act in the best interest of the client using a fiduciary standard of care. Whenever I had a difficult day where I was working on a particularly hard subject or some kind of obstacle, I always went back to that decision and how we didn’t think we had a choice. We felt like we had to do this in order to really take care of our clients and act in their best interests.”* — David Bromelkamp, President & CEO, Allodium Investment Consultants

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<sup>19</sup>“Refugees have less money, clear conscience,” *Investment News*, March 14, 2005

<sup>20</sup>“Smith Barney’s hard line costs it some veterans,” *Investment News*, November 29, 2004

<sup>21</sup> Ibid.

<sup>22</sup> SEC Release No. 34-51523: “Certain Broker-Dealers Deemed Not to be Investment Advisors,” effective April 15, 2005

<sup>23</sup>“Should I Stay or Should I Go?” *Cerulli Edge* — U.S. Edition, August 2006.

<sup>24</sup>“Why More Reps are Getting Their Kicks on Route 66,” *Registered Rep.*, February 1, 2005

## Independence Can Be Lucrative for Advisors

Many advisors are already moving toward a fee-based platform internally. These advisors — who are essentially running their own firm within the payout structure of a larger institution — could be leaving a great deal of money on the table. Optimally, an independent advisory practice will have an overhead expense margin of 35% to 40%, leaving 60% to 65% of the revenue for principal draws, professional salary and investment into the firm.<sup>25</sup> Top-producing wirehouse representatives, on the other hand, typically receive payouts of less than 45%. The highest payout possible at major firms is about 50% for representatives who generate \$5 million in gross revenues.<sup>26</sup> Advisors who transfer their very same business model to an independent platform can, depending on how they manage expenses, have the opportunity to increase their income.

In addition to potentially earning more net income, independent advisors are building equity in the business. A successful independent advisory firm may exceed 20% operating profit margin after fairly compensating the owners and meeting all professional compensation and overhead expenses.<sup>27</sup> The profitability of independent firms creates a transferable cash-flow stream that may appeal to many financial buyers. The industry press reports numerous acquisitions of advisory firms with valuations ranging from 1 to 3 times annual revenues, with many reported in the range of 2 to 2.5 times revenues. Ranges are reported between 6 and 10 times earnings if evaluated on a profit basis. Several factors specific to the business determine the final valuation (see sidebar).

An advisor who generates \$1 million per year in fees could, by taking the business independent, create an asset worth from \$1.5 million to \$3 million. Most important, the sale of a business represents a capital gain, rather than a forgivable loan often offered by wirehouses that one must work to earn over five to seven years and typically taxed as income.

<sup>25</sup>The 2004 FPA Financial Performance Study of Financial Advisory Practices, page 3

<sup>26</sup>On Wall Street, www.onwallstreet.com 2006 Exclusive Payout Grids, November 2006

<sup>27</sup>See Part III: The Economics of Independence; \$3 Million Production Level

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### Factors Impacting the Valuation of an Independent Financial Advisory Practice:

- *Profitability leading to cash flow to the owners*
- *Financial trend of practice growth*
- *Client mix*
- *Service model*
- *Continuity of the business enterprise*
- *Reliability and recurrence of revenues*

Source: Moss Adams LLP

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Some traditional brokerage houses offer continuity plans that allow a retiring advisor to partner with another advisor to share revenues in retirement. The equity is still owned by the firm, but an effort is made in some cases to provide a form of deferred compensation to the retiring advisor. A typical arrangement might include a shared payout based on the revenue generated by the retiring advisor's accounts. There are often limitations, though. The advisor may share in the payout based only on gross commissions, excluding service fees and trailers from money market and mutual funds and these payments may decline. For example, the first year share may be 50% of gross commissions followed by 40% in year two and 30% in year three. Average payout in the final years of production may also affect the formula and may not peak at retirement.

Part III — The Economics of Independence — includes an example comparing the equity in the independent model with a continuity program in the wirehouse model. It shows that independence may be the most lucrative strategy for an advisor's exit plan from the business.

### Independent Firms Are Growing Faster

For many groups, independence could be the ticket to growth: the Golub Group, for example, increased client assets by more than 30%, to \$240 million, in just 15 months after going independent. Three years after the launch, it had surpassed \$500 million in AUM.<sup>28</sup> By adding associates and staff, the principals of a firm can leverage the firm's resources and may generate higher revenues year after year. The principals have substantial equity in a business that may be in a position to carry on without them.

<sup>28</sup>Individual results will vary.

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### Accelerated Growth through Service and Referrals

*The Golub Group was a thriving business even before opening its doors as an independent investment advisory firm in December 2003. With 240 high-net-worth clients, \$180 million in assets under management, and an investment discipline that endeared clients to the firm for its focus on high-quality security selection through market cycles, the group was bringing in more than \$1 million in revenues. But the revenues were going to another firm: the regional broker-dealer that Michael Golub, now 64, had been working for since 1967.*

*Realizing they weren't building equity for themselves, Golub and his partners began to explore independence. After lots of planning and due diligence, they realized that they could take their very same business, establish it as a separate entity outside the broker-dealer — using Schwab Institutional as custodian — and build wealth for themselves while adding value for their clients.*

*Managing the transition process was sensitive. When Golub informed his broker-dealer that his group was leaving, both sides agreed to act in a professional, ethical manner and not pursue client relationships before an agreed-upon date. At the appointed time, letters went to clients informing them of Golub's plans. About a week later, the broker-dealer began an aggressive telephone solicitation campaign to retain Golub's clients. Nonetheless, Golub and his partners retained 96% of client assets at the time of the move. Within 15 months of going independent, the Golub Group increased client assets under management by more than 30%, to \$240 million. "My wish for fellow advisors is to do this earlier than I did," says Golub. "This reward that we're all now reaping is precisely because we cut ourselves loose."*

*Colin Higgins, president of the Golub Group, believes back-office support and technology helped to drive their growth. "I think one of the things that going independent has enabled us to do is to attract new talent and really invest back into our business, to enable us to really take care of our clients in a better way. Schwab's enabled us to do that because of technology investments that we've been able to make through Schwab. We've received great support in terms of the back-office solution."*

*Firm growth has exceeded expectations. The original plan was to grow organically at a rate of about 10%, or about \$25 million a year in new assets. "We've actually accelerated that," says Higgins. Three years after the launch, the Golub Group has \$500 million in assets under management and about 430 client relationships. "And really, we wouldn't have been able to do it without Schwab as a partner," Higgins says.*

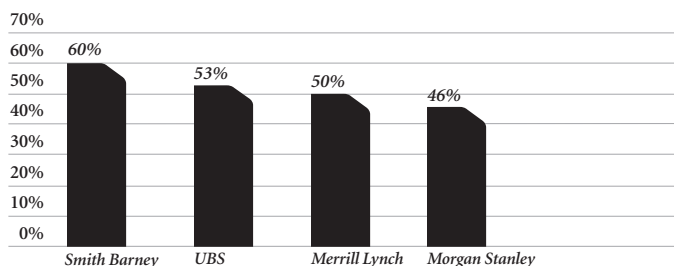
*It is no surprise that referrals have been one key to growth. "We've had great success in terms of getting referrals from our existing client base because we've done a much better job of servicing them," says Higgins. "We've also had good performance, which has helped." He adds that some key outside relationships have been good referral sources as well.*

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### The Industry Is Embracing the Fee-Based Model

Advisors who are employees of wirehouses and other national and regional firms are often constrained by the firm's fee structure. Although many independent advisors continue to earn commissions on product sales, the trend is toward fee-based or fee-only business. When fees are based on assets under management, the advisor has an incentive to increase revenues by growing client assets. This can better align the interests of the advisor and the client.

#### WIREHOUSE PERCENTAGE OF RETAIL REVENUE FROM NON-COMMISSION SOURCES

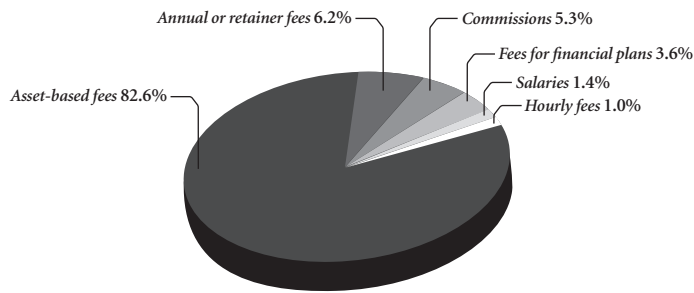


As reported in *Investment News* May 1, 2006, in "Wirehouses' fee-based biz is enjoying torrid growth." Smith Barney and UBS includes net interest income. UBS's percentage is for full-year 2005; others are for Q1, 2006.

A fee-based model can also provide a more predictable revenue stream to the advisor, who continues to serve the account throughout the year and across market cycles.

But the compensation evolution does not stop with asset-based fees. Independent advisors, especially RIAs, enjoy greater pricing flexibility and are free to set their fee schedule with clients, and that helps them become more competitive and manage their practices more effectively. Most retail RIAs use asset-based fees, with almost half using either an hourly or fixed-fee approach, though this component is often limited to specific client situations.<sup>29</sup> In absolute terms, 82.6% of revenues are from asset-based fees versus only 10.8% in retainer, hourly or planning fees.<sup>30</sup>

**REVENUE BY COMPENSATION TYPE**



Source: Cerulli Associates

New RIAs are often concerned with determining the right fee structure for their clients. According to Cerulli Associates, the fee charged during the first year is usually based on the past fees collected and is often too low.<sup>31</sup> In subsequent years many raise fees after tracking time spent by hour and sharing the results with the client.<sup>32</sup>

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**Transitioning to Fee-Based**

*John Krambeer left a major wirehouse after 16 years to start Camden Capital Management in 2004. One motivation driving the decision was pricing. “When we started thinking about this [starting our own firm], we always thought that if we were pitching some type of derivative or collar, it would be nice to be able to price that on the street and to reach out into the open-architecture world in which we live,” says Krambeer. “We were tired of losing business to banks because of price.”*

*The first year, Camden Capital was still affiliated with a broker-dealer. “I had typical old-school brokerage relationships,” says Krambeer. “When I looked back on our first year, I was still focusing on the brokerage side. I tried to do both businesses.” The turning point came in 2005. Clients started encouraging Krambeer to transition to 100% fee-based. He was also discouraged by not being able to access preferred managers through his custodian. Finally, he made the decision to transition to 100% fee-based and, with that decision, forged a custodial relationship with Schwab Institutional.*

*The transition to 100% fee-based removed the final hurdle regarding perceived conflicts of interest with clients. Krambeer recounts what one of his clients told him at the time: “We always thought you were doing a great job for us while you were at [your former firm]. We also thought you were doing what was right for the firm. For the first time in our relationship, we truly believe you are doing [everything] absolutely right for us.” That’s powerful.*

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<sup>29</sup>“Retail Registered Investment Advisors in Transition,” Cerulli Associates, 2005

<sup>30</sup> Ibid.

<sup>31</sup>“Retail Registered Investment Advisors in Transition.” Cerulli Associates, 2005

<sup>32</sup> Ibid.

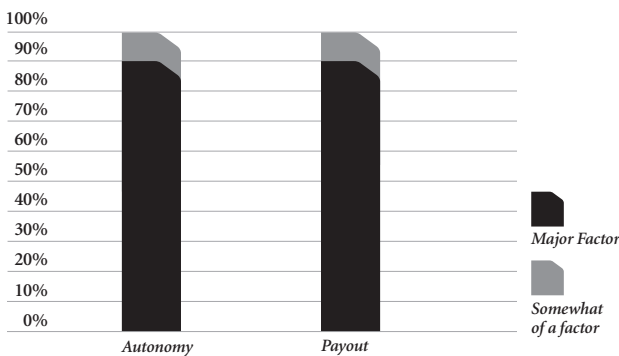
### Advisors Want to Control Their Professional Future

Of all the reasons advisors choose to go independent, autonomy is perhaps the biggest lure because it encompasses all the other benefits. Independent advisors are free to create their own value proposition. “The reward that we’re all now reaping is precisely because we cut ourselves loose, created our own firm, products and destiny,” says Michael Golub.

Sometimes your clients know before you do that your entrepreneurial tendencies will lead you to independence. “I think that people who know me really well have told me for years that I probably should establish my own firm. And now, in hindsight, I realize that I was hearing those people but not really listening to what they said,” says David Bromelkamp.

John Krambeer adds his own twist to the idea of truly working for himself. “In 2004, when we started Camden Capital, it really was just time. I had an entrepreneurial spirit. I wanted to control my destiny. I wanted to create something special. I wanted to really control the service model for my clients who had been with me for many years.”

### REASONS HIGH-END ADVISORS (>\$100 MILLION IN AUM) WENT INDEPENDENT



*Autonomy and payout are overwhelming incentives.*

Source: Cerulli Associates

### Resources to Ease the Transition

Advisors who have made the transition to an independent platform would agree that a great deal of planning is called for before the move. However, advisors do not have to do it alone. Whether an advisor chooses to affiliate with an independent broker-dealer, or go totally independent and partner with a custodian such as Schwab Institutional, help is available. “Organizations like Schwab stand ready to make the process simple. They’re available and more than willing to educate the broker,” says Colin Higgins of the Golub Group. “It’s really a simple process. If you want answers, go to people who have gone through the process.”

The combination or hybrid model offers an appealing transition option for many advisors. There are 5,612 hybrid advisory firms controlling \$716 billion in assets.<sup>33</sup> About 1,700 dually registered advisors custody (fee-based assets) with Schwab.<sup>34</sup> Many successful advisors choose to retain a portion of commission business, either to ease a transition for their clients over a few years or to address a certain product need or approach that best fits their clients.

There is perhaps no greater preparation than understanding the economics of independence as they apply to an advisor’s own situation. The section that follows provides an analysis of independence at three sample practice sizes.

<sup>33</sup>“Schwab ramps up hybrid recruiting strategy,” *Investment News*, March 13, 2006

<sup>34</sup> *Ibid.*

## **PART III: The Economics of Independence**

Whether to affiliate with an independent broker-dealer (IBD) or to become fully independent as a registered investment advisor (RIA) depends in part on the type of revenues the independent advisor earns. Fee-only advisors may choose either the RIA or IBD model; advisors who choose to retain some or all of their commission revenue usually affiliate with a broker-dealer.

The choice also depends on the amount of support the advisor needs. Although going independent often means giving up some of the infrastructure the advisor is used to, it is possible to find substantial support within an independent model by turning to outside consultants or joining an existing firm.

Once the decision is made to operate as an RIA or affiliate with an IBD, the next decision is how to do it. Some advisors start their own independent RIA firm, while others join an existing RIA, sometimes as a principal. Clearly, affiliating with an existing firm involves less risk and lower upfront costs, but it's important to find the right fit from a cultural and business standpoint.

Advisors who choose the IBD route effectively choose “shades” of independence when selecting a broker-dealer. Levels of support can range from nearly everything a wirehouse provides in the way of research, technology and administrative support to minimal involvement by the broker-dealer. Payout levels reflect the amount of support offered and may range from 80% to 92%,<sup>35</sup> although fees may be charged for the services that an IBD provides that lower the “net payout.”

To help advisors evaluate the financial implications of going independent, this white paper analyzes the impact on an advisor's income and the value of the business over time. For three different production levels — \$500,000, \$1,000,000 and \$3,000,000 — this paper compares sample revenues and expenses of the RIA and IBD models with the payout from a wirehouse firm. The results underscore that by going independent, advisors can position themselves to keep more of what they earn and potentially build substantial equity in their business — opportunities that, at best, are limited in a wirehouse-type environment.

<sup>35</sup>“The Independents Raise the Bar,” *On Wall Street*, April 2005

**ECONOMICS OF INDEPENDENCE: SUMMARY OF FINDINGS**

	RIA	IBD	Wirehouse
<b>\$500,000 PRACTICE</b>			
Owner/Advisor/Salaries/ Draws/Commissions	\$ 255,000	\$ 255,000	\$ 186,000
Firm/Advisor Team Pretax Profit	+\$ 36,662	-\$ 14,397	\$ 0
<b>“Net” Income + Profit<sup>1</sup></b>	<b>\$ 291,662</b>	<b>\$ 240,603</b>	<b>\$ 186,000</b>
Additional Cost of Doing Business <sup>2</sup>	+\$ 208,338	\$ 259,397	\$ 314,000
<b>TOTAL REVENUE</b>	<b>\$ 500,000</b>	<b>\$ 500,000</b>	<b>\$ 500,000</b>
<b>\$1,000,000 PRACTICE</b>			
Owner/Advisor/Salaries/ Draws/Commissions	\$ 255,000	\$ 255,000	\$ 320,080
Firm/Advisor Team Pretax Profit	+\$ 107,572	\$ 40,793	\$ 0
<b>“Net” Income + Profit</b>	<b>\$ 362,572</b>	<b>\$ 295,793</b>	<b>\$ 320,080</b>
Additional Cost of Doing Business	+\$ 637,428	\$ 704,207	\$ 679,920
<b>TOTAL REVENUE</b>	<b>\$ 1,000,000</b>	<b>\$ 1,000,000</b>	<b>\$ 1,000,000</b>
<b>\$3,000,000 PRACTICE</b>			
Owner/Advisor/Salaries/ Draws/Commissions	\$ 510,000	\$ 650,000	\$ 836,400
Firm/Advisor Team Pretax Profit	+\$ 658,471	\$ 223,834	\$ 0
<b>“Net” Income + Profit</b>	<b>\$ 1,168,471</b>	<b>\$ 873,834</b>	<b>\$ 836,400</b>
Additional Cost of Doing Business	+\$ 1,831,529	\$ 2,126,166	\$ 2,163,600
<b>TOTAL REVENUE</b>	<b>\$ 3,000,000</b>	<b>\$ 3,000,000</b>	<b>\$ 3,000,000</b>

**Key Findings**

- Advisor keeps 100% of net revenue in RIA model
- Greatest potential for profitability is in RIA model
- The additional cost of doing business is significantly higher in the \$500,000 Wirehouse practice as compared to the independent models

*This study is for educational purposes. It should not be relied upon as an indicator of future performance.*

<sup>1</sup> Total pretax income to principals including compensation for labor and firm profitability. Firm profit for IBD and RIA; Advisor Team profit in Wirehouse

<sup>2</sup> Equals “Additional Expenses” in the RIA and IBD Model; accounts for Firm’s expenses and profit in Wirehouse model

## \$500,000 Production Level

<i>Model</i>	<i>RIA</i>	<i>IBD</i>	<i>Wirehouse</i>
Owner/Advisor/Salaries/ Draws/Commissions	\$255,000	\$255,000	\$186,000
Firm Pretax Profit	\$ 36,662	-\$ 14,397	\$ 0
<b>Total Owner/Advisor Pretax Income</b>	<b>\$291,662</b>	<b>\$240,603</b>	<b>\$186,000</b>

At the \$500,000 production level, a typical wirehouse advisor nets about \$186,000, or 37.2% before taxes and after minimal business expenses. In a practice this size, the IBD payout is 90% on average while in an RIA, the advisor will retain 100% of their revenue. Moving to the RIA or IBD model would naturally increase the payout. At the same time, the advisor would have to assume responsibility for the expenses of an own office. Would the advisor end up with more bottom-line income after paying for rent, utilities, insurance, software, marketing, administrative salaries and other business expenses?

The answer is generally yes.

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*The study shows that a \$500,000 producer can realize a pay raise by going independent.*

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Typical take-home pay for an RIA with \$500,000 in revenues is about 58%, or \$291,662. For an advisor who affiliates with an IBD, average take-home pay is substantially less, at 48%, or \$240,603. The difference between the IBD and RIA model is the broker-dealer portion of revenues. While in theory the added support of an IBD should help lower expenses for the advisor, in practice the IBD offices show slightly higher expenses than RIAs.

The key point though is that for a wirehouse, the income is substantially less at \$186,000. Because of the share kept by the average wirehouse — 63% at this production level — this scenario makes working for a major firm an expensive proposition. Recent reductions in payout for lower producers at one major wirehouse to offset the cost of bonuses for administrative support for higher producers may reflect a trend in the wirehouse environment.<sup>36</sup>

But what about the risks of moving from the wirehouse environment, where payout may seem to be more consistent, to an independent model where expense management becomes a top concern? Some of the upfront costs can be minimized by joining an existing RIA. But going independent still involves certain risks. An advisor's outlook on going independent may also be colored by the wirehouse custom of paying sign-on bonuses in the form of forgivable loans.

But focusing on the loan may be shortsighted. With independence, the potential for additional financial rewards comes when advisors are ready to leave their business. Unlike the wirehouse model, where clients are generally considered clients of the firm, both the RIA and IBD models allow advisors to build equity in their businesses. As an advisor's income rises, the value of the business also rises. And when the advisor is ready to retire, the business can be sold for a multiple of revenues. Thus, an advisor who expects to grow revenues would likely be better off receiving a multiple of those higher revenues in the future compared with a lump sum payment based on where his or her business is today.

## \$1,000,000 Production Level

<i>Model</i>	<i>RIA</i>	<i>IBD</i>	<i>Wirehouse</i>
Owner/Advisor/Salaries/ Draws/Commissions	\$255,000	\$255,000	\$320,080
Firm Pretax Profit	\$107,572	\$ 40,793	\$ 0
<b>Total Owner/Advisor Pretax income</b>	<b>\$362,572</b>	<b>\$295,793</b>	<b>\$320,080</b>

At the \$1 million level, the decision to go independent — and whether to choose the RIA or IBD model — involves more than simple number crunching. Here, the question is whether an advisor plans to maintain the practice at current levels or, by hiring staff and leveraging resources, grow the business beyond the \$1 million revenue level. As at the \$500,000 revenue level, an advisor's values and business philosophy also come into play in determining which model offers more personal and professional fulfillment.

The analysis at this production level assumes that an advisor generating \$1 million in revenues needs some help

<sup>36</sup>“Smith Barney to cut rep pay,” *Investment News*, December 7, 2006

to do so. Salaries or commissions paid to junior associates therefore represent a significant portion of expenses. A wirehouse advisor generating \$1 million in production might net \$386,800<sup>37</sup>, but if \$200,000 is generated by a junior advisor, the broker brings home \$320,080, or 32%, after expenses. This same broker, under an IBD payout structure and assisted by two junior advisors, would earn \$295,793, or 39%, after expenses. A portion of the payout will go to the junior advisor's compensation. In an RIA practice with two junior advisors, the principal would earn \$362,572, or 36%, after expenses.

At this revenue level, given the leverage that can be gained by paying associates capable of generating additional revenues, advisors undergo a shift in how they see themselves: they consider themselves business owners, not employees earning a wage.

### **\$3,000,000 Production Level**

<i>Model</i>	<i>RIA</i>	<i>IBD</i>	<i>Wirehouse</i>
Owner/Advisor/Salaries/ Draws/Commissions	\$ 510,000	\$650,000	\$836,400
Firm Pretax Profit	\$ 658,471	\$223,834	\$ 0
<b>Total Owner/Advisor Pretax income</b>	<b>\$1,168,471</b>	<b>\$873,834</b>	<b>\$836,400</b>

At the \$3 million level, economies of scale make the RIA model the most lucrative business model. It should be noted that the evaluation at this level involves a team practice, given one advisor may not have capacity to service all clients at this level. For that reason, the model includes two senior advisors (owners in the IBD and RIA models) and four associates or junior advisors.

The average \$3 million RIA firm will generate \$255,000 in salary and bonus for each of its two principals, plus \$658,471 in profits, for total advisor compensation of \$1,168,471. This compares with a bottom line of \$873,834 for the average advisors in the IBD model and \$836,400 for the average wirehouse advisors. Dividing total compensation by two, we see that the average principal in an RIA firm earns \$584,235, compared with \$436,917 and \$418,200 for the IBD and wirehouse models respectively.

The average \$3 million RIA practice can be rewarding to the principals — offering higher income potential, an asset of significant value and the pleasure of working for themselves and their clients in a manner that supports their values.

Of course, results will vary depending on how advisors manage expenses and which types of clients they serve. Previous studies have shown that firms that serve smaller household accounts tend to be less profitable than their peers. And advisors who are not careful about managing expenses could fail to realize the economic advantages of independence. So, when turning independent, advisors must always remember that, in addition to serving clients, they are running a business.

<sup>37</sup>The senior advisor in the \$1000,000 model is paid out at 39.8% (weighted for differences in payout between transaction and asset-based products — 60% commission and 40% fee).

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## Joining a RIA Firm

*After weighing the risks and rewards of independence, more and more advisors are choosing to join RIA firms. Paul Hynes joined Burns Advisory Group in San Diego after spending 21 years with a major wirehouse. He made the transition to independence in May 2006, along with one associate, to allow himself the freedom and flexibility to serve clients' best interests.*

*With assets under management of over \$100 million, Hynes easily could have started his own business. But the support available from like-minded partners at Burns led him to join a firm instead. As he puts it, "Alone, you're an island. As a group, you can accomplish more." He adds, "By joining an existing RIA firm, we're not all spending the same dollars to duplicate costly infrastructure and personnel." Five months into the transition, 80% of his assets have moved to his new firm. He expects that to be 90% within the first full year.*

*It took a team of people working on behalf of Hynes to manage his move to independence. A personal coach kept him on schedule. A business consultant helped with financial models. He purchased E&O insurance through his broker-dealer, business insurance through a local agent and workers' compensation through his payroll administrator. His banker provided access to capital. Hynes projected that he would require about \$200,000 of investment capital before turning profitable. It is going to be considerably less than that — closer to \$100,000. "We're ramping up to profitability a little faster than we projected," he says.*

*Hynes was prepared to invest "whatever it took" to go on his own. He also recognized that John Burns had already invested time and money making many of the big decisions in creating what Hynes calls an "advisor service hub." Having the back-office support in place would allow Hynes to "hit the ground running," which in turn meant he could spend nearly 100% of his time serving clients.*

*The partners at Burns Advisory Group, including John Burns in Oklahoma, Tom McGuigan in Connecticut and Hynes in California, each have their own practice and share in the service expenses. The firm currently has more than \$300 million in total assets under management.*

*Hynes decided to go fee-only when he joined Burns, although the firm still has a broker-dealer relationship, primarily to retain securities licenses for those who have them. Having a broker-dealer relationship with Cambridge Investment Research is helpful as Hynes transitions clients who have legacy-brokered products to a fee-based model.*

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## Conclusion

The financial advisory business has changed dramatically over the past decade. Many advisors who once were in step with their firms, enjoying strong support and a positive Wall Street reputation, now are considering alternatives in which they do business and serve clients independently. Independence can offer more control over the variables that determine satisfaction among high-net-worth clients — along with the ability to keep a greater share of revenues and build equity in a growing business. While the analysis provided here should prove helpful, advisors contemplating independence must carefully consider their business goals and risk tolerance in the context of their own practices. They must also plan carefully for their transition.

Still, several advisors interviewed for this paper indicated that their only mistake in going independent was not making the transition sooner. The freedom to control their own business practices — from how they serve clients to how they are compensated — carries professional rewards that extend far beyond the bottom line.

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## Your Next Step

If you are considering independence and would like to learn more or talk to an advisor who has made the transition:

- Visit [www.schwabinstitutional.com/public](http://www.schwabinstitutional.com/public)
- Call 877-687-4085

## Appendix: Economic Analysis of Independence<sup>38</sup>

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<sup>38</sup> Forecasts and model results should not be relied upon as an indicator of future performance.

## Introduction and Methodology

This analysis has been prepared by Moss Adams LLP to demonstrate the financial impact of degrees of independence across the affiliation spectrum. It draws from general industry observations as well as specific industry data, such as advisory practice benchmarks, a set of financial documents that estimate the costs and benefits associated with differing degrees of independence. The three affiliation models are as follows:

- **Wirehouses** — Refers to organizations in which advisors are employees of the wirehouses; do not own the client relationships; and receive technology, compliance and strategic direction from the wirehouses. The revenue mix is typically commission heavy, but can include fees.
- **Independent Broker-Dealers** — Refers to organizations in which advisors are typically independent contractors who receive a higher payout for fewer support services, have access to nonproprietary products and services via an open architecture platform, and to a large degree dictate the strategic direction of their individual practices. Advisors in this affiliation model may have commission-based or fee-based practices.
- **Independent Registered Investment Advisors (RIAs)** — Refers to organizations that support fee-based or fee-only advisors in the operational, clearing, custody and compliance requirements and pass through 100% of revenue, with few exceptions, to the advisors. In this affiliation model, advisors have complete independence to create and implement their own strategies, own the client relationships, and staff the practice according to their own organizational designs.

### Test Cases

An effective way to illustrate the financial impact of the differing affiliation models is to create sample income statements based on the affiliation channel and practice size. Models created for this report reflect the following revenue categories:

- \$500,000 revenue size
- \$1,000,000 revenue size
- \$3,000,000 revenue size

It is assumed that practices in the wirehouse and independent broker-dealer models have a revenue mix consisting of 60% commissions and 40% fees. In the RIA model, no commissions are charged and all revenue is generated from fees. The estimated income statements assume that the practices are already established within their affiliation models.

Out of necessity, practices at increasingly higher revenue levels must build and maintain a correspondingly advanced and intricate organizational structure. To consider the human capital expenses at the differing revenue levels, the analysis includes staffing and compensation estimates, based on data from the *2006 Moss Adams Financial Performance Study of Financial Advisory Practices*.

Also considered are transition costs, which are shown in a separate chart illustrating the type and amount of transition expenses advisors can expect to incur when choosing complete independence. These include nonrecurring transition expenses that should be considered in the short-term financial forecast of transitioning to independence.

## Assumptions and Valuation Methodology

Following are model income statements of established practices at differing revenue levels within the three affiliation models. The model uses data from the 2006 Moss Adams Financial Performance Study of Advisory Firms, of 907 firms. Only firms with 95% or more of their revenues coming from fee-based management are included in the analysis as the sample. There were 143 RIA and 83 IBD participants in the final sample. This group was also used to arrive at the percentage of revenue that is allocated to individual overhead expense by categorizing firms with similarly sized peers in the industry. The groupings are within 25% of the target revenue, which means the \$1,000,000 practice includes firms with \$800,000 to \$1,200,000 in revenue.

### Assumptions

The creation of these model income statements required assumptions concerning payouts and staffing. As the revenue for each model increases, staffing requirements grow as well. It is important to note that for comparative purposes, all the models in the same revenue category are staffed in the same manner regardless of affiliation model.

**TABLE 1:  
PROFESSIONAL STAFFING MODELS AT REVENUE LEVELS**

	\$500,000	\$1,000,000	\$3,000,000
Principal:	1	1	2
Professional:	0	2*	4
<b>TOTAL:</b>	<b>1</b>	<b>3</b>	<b>6</b>

For these staffing models, a “Principal” is defined as a revenue-generating owner of the practice, and a “Professional” is a revenue-generating nonowner in the practice.

Payouts within the wirehouse channel were estimated using Morgan Stanley’s publicly available asset-based payout information. Those payouts are:

- Approximately \$500,000 in Gross Dealer Concession (GDC) (i.e., the payout to the advisor per production level): 39.5%
- \$1,000,000 + of GDC: 41%
- \*\$3,000,000 + of GDC: 40% + production bonus of 7.5% = 47.5%

The following production levels for a senior advisor would generate the bonuses of 5% to 7.5% in deferred

compensation if the advisor stays with the firm a minimum of 4.5 years after qualifying:

- \$500,000: 5% bonus
- \$800,000: 6% bonus
- \$1,000,000: 7.5% bonus

This model income statement relies on some assumptions on how the different affiliation models impact the payout to the advisors. Because the revenue streams are deferred, they are not included in the income statement.

1. Even though the two systems (IBD and RIA) may compensate their professional staff in different ways, these differences are not reflected in the models. Instead, the average of the two percentages (professional expense as percentage of revenue) was taken to arrive at the dollar amounts. The dollar amount was then averaged, and the same dollar figure is used in both models. This is to demonstrate that even though the percentages are different (based on the inherent difference between 100% revenue flowing to the practice in the RIA, versus 90% after the broker-dealer “haircut” in the IBD), the absolute dollar amount is the same.
2. In the wirehouse model, it is assumed that the junior advisors are paid a commission of 80% after the wirehouse haircut. The difference (override) between the firm payout and the portion that the junior advisor receives is compensation to the senior advisors for providing referrals to the juniors.
3. As business owners, principals of the RIA firms and the IBD-affiliated firms should assign themselves a fair market compensation for their labor in the practice. The salary plus bonus in the RIA and IBD models is assumed to be \$255,000 per principal. Since there is no business ownership in the wirehouse model, such an assumption is not necessary. Ultimately, all three models are compared on the basis of total “Net” (Income + Profit) compensation to owners, regardless of method, so this assumption does not impact the overall appeal of the model.

### Valuation Methodology

Part of this analysis includes valuations for the respective practices. Following is a brief overview of two valuation methods: the discounted cash flow approach and the multiple approach.

- Discounted cash flow — This method determines the value of a practice by estimating future cash flows while taking into account the time value of money, with both a risk factor and an annual growth rate assigned to those cash flows. The cash flow measured in these models is the operating income, or firm profit.
- Multiples — This method determines the value of a practice by selecting a figure from the financial statements, such as revenue or profit margin, and applying a multiple that attempts to reflect the average market rate of practices that have recently been bought and sold.

In order to illustrate the various multiple approaches, we compare the IBD and RIA models using a revenue multiple. We also compare the RIA terminal value to a wirehouse forgivable loan using an earnings multiple. Finally, we compare the terminal value of all three models while accounting for continuity programs offered by wirehouses.

Each modeled income statement per revenue category is accompanied by estimated valuations demonstrating both methods. We made some assumptions based on observations of the industry as well as empirical knowledge regarding the discount rates and multiples in these models.

In the discounted cash-flow model, the discount rate for each independent broker-dealer model is higher than for its RIA counterpart. This tends to occur in practice because of the increased risk inherent in transferability issues in broker-dealer-affiliated firms, among broker-dealers, for instance. Other risk components can include the advisor's employment status with the independent broker-dealer or the financial impact from the level of support provided to client relationships. There is also the risk that a portion of the revenues in the independent broker-dealer model, those derived from commissions generated through transactions, will be nonrecurring.

We have observed that revenue multiples in the marketplace can range from 1.5 to 6. For the purpose of this report, we chose a revenue multiple of 2 for the fee-only model and 1.8 for the broker-dealer model. The revenue multiple for the fee-only firm (RIA model) is higher because of the increased certainty of the revenue, whereas the multiple for the independent broker-dealer is slightly lower because commissions are included in the revenue mix. As with the discounted cash-flow model, commissions might not recur

because they are transactional. The multiple approach can be applied to the different affiliation models; the actual multiple has not been derived from any statistical source.

In the earnings multiple approach, we assumed the advisor or team of advisors would sell the business in 5 years or in 10 years. The lower this number, the higher the discounted value will be since the proceeds will be received sooner. At the same time, the longer this period is, the higher the growth in cash flow. We selected 22% as the growth rate since the projected growth between 2005 and 2006 in the Moss Adams survey was 22.7%. We discounted the future cash flows to their present value in order to compare the amount to a forgivable loan offer from a wirehouse. Typical discount rates range from 20% to 30%. We selected 20% for all three models. The typical multiples observed in the industry have been between 6 and 10 times Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). We selected 7 times EBITDA. The actual multiple will be driven by many factors such as growth, transferability, depth of talent and quality of client base. Finally, we selected a multiple of 1.2X of Gross Revenue to calculate the wirehouse loan.

The danger of the multiple approach, particularly the revenue multiple approach, is that it neglects the profitability, risk, transferability and other unique characteristics of the practice. It lacks the due diligence of reviewing operating and direct expenses to arrive at the gross margin and operating profit margin. And it is based on the movements of the mergers and acquisitions market, which tends to be driven by larger organizations focused on acquisitions as part of a strategic move.

In summary, the models of the two valuation methods rely on either valuation theory (discounted cash flow) or market forces (multiple approach). Certain characteristics can potentially increase a firm's dollar value.

**TABLE 2:  
FACTORS IMPACTING VALUATION**

- Financial trend of practice growth
- Client mix
- Service model: Holistic wealth management firm, fee-based firm, commission and fee firm, etc.
- Continuity of the business enterprise
- Reliability and recurrence of revenues

**\$500,000 REVENUE PRACTICES**

**AFFILIATION MODEL FOR \$500,000 REVENUE PRACTICE**

	RIA		Independent BD		Wirehouse	
Practice Profile						
Principals\Senior Advisors	1		1		1	
Junior Advisors\Reps						
Revenue Generated by Senior Advisors\Principals			\$ 500,000	100.00%	\$ 500,000	100.00%
Revenue Generated by Junior Advisors\Reps			\$ 0	0.00%	\$ 0	0.00%
<b>TOTAL REVENUE FROM CLIENTS</b>	<b>\$ 500,000</b>		<b>\$ 500,000</b>		<b>\$ 500,000</b>	
B-D Share on Senior Advisors\Principals			\$ 50,000		\$ 309,000	
B-D Share on Junior Advisors\Reps			\$ 0		\$ 0	
Broker-Dealer Share of Revenue <sup>1</sup>	\$ 0	0.00%	\$ 50,000	10.00%	\$ 309,000	60.00%
<b>NET REVENUE TO ADVISOR</b>	<b>\$ 500,000</b>	<b>100.00%</b>	<b>\$ 450,000</b>	<b>100.00%</b>	<b>\$ 191,000</b>	<b>100.00%</b>

**PERCENTAGES BELOW ARE BASED ON % OF NET REVENUE TO ADVISOR**

**Direct Expenses**

Professional Salaries or Commissions Paid						
Owners <sup>2</sup>	\$ 185,000	37.00%	\$ 185,000	41.10%	\$ 0	0.00%
Nonowners <sup>3</sup>	\$ 0	0.00%	\$ 0	0.00%	\$ 0	0.00%
Professional Bonuses/Incentive Comp						
Owners <sup>2</sup>	\$ 70,000	14.00%	\$ 70,000	15.60%	\$ 0	0.00%
Nonowners <sup>3</sup>	\$ 0	0.00%	\$ 0	0.00%	\$ 0	0.00%
<b>TOTAL DIRECT EXPENSE</b>	<b>\$ 255,000</b>	<b>51.00%</b>	<b>\$ 255,000</b>	<b>56.70%</b>	<b>\$ 0</b>	<b>0.00%</b>
<b>GROSS PROFIT (8 LESS 13)</b>	<b>\$ 245,000</b>	<b>49.00%</b>	<b>\$ 195,000</b>	<b>43.30%</b>	<b>\$ 191,000</b>	<b>100.00%</b>

**Overhead Expenses<sup>4</sup>**

Auto Expenses	\$ 4,003	0.80%	\$ 8,362	1.90%	\$ 0	0.00%
Business Development and Marketing	\$ 10,653	2.10%	\$ 12,407	2.80%	\$ 0	0.00%
Depreciation/Amortization	\$ 3,901	0.80%	\$ 3,735	0.80%	\$ 0	0.00%
Equipment Leases, Purchases and Maintenance	\$ 4,527	0.90%	\$ 4,449	1.00%	\$ 0	0.00%
Health and Other Employee Insurance Benefits	\$ 10,367	2.10%	\$ 9,923	2.20%	\$ 0	0.00%
Information Technology						
(Hardware, Software & Outsourcing)	\$ 8,787	1.80%	\$ 6,425	1.40%	\$ 0	0.00%
Insurance, Business-Related (P&C, E&O, etc.)	\$ 5,496	1.10%	\$ 4,185	0.90%	\$ 0	0.00%
Office Expenses	\$ 9,874	2.00%	\$ 11,032	2.50%	\$ 0	0.00%
Office Rent, Repairs and Maintenance	\$ 22,673	4.50%	\$ 24,530	5.50%	\$ 0	0.00%
Outsourcing Services Excluding IT	\$ 8,272	1.70%	\$ 2,393	0.50%	\$ 0	0.00%
Payroll Taxes	\$ 13,054	2.60%	\$ 10,391	2.30%	\$ 0	0.00%
Professional Services	\$ 8,172	1.60%	\$ 3,982	0.90%	\$ 0	0.00%
Retirement Benefits	\$ 12,628	2.50%	\$ 8,605	1.90%	\$ 0	0.00%
Salaries Expense <sup>5</sup>	\$ 53,031	10.60%	\$ 57,561	12.80%	\$ 0	0.00%
Taxes and Licenses Excluding Payroll Taxes	\$ 2,259	0.50%	\$ 4,602	1.00%	\$ 0	0.00%
Training, Education, Professional Dues & Licensing	\$ 5,329	1.10%	\$ 4,066	0.90%	\$ 0	0.00%
Travel & Entertainment	\$ 6,205	1.20%	\$ 7,097	1.60%	\$ 0	0.00%
Utilities/Phone/Fax/Online Service	\$ 5,976	1.20%	\$ 6,707	1.50%	\$ 0	0.00%
All Other Expenses	\$ 13,132	2.60%	\$ 18,946	4.20%	\$ 5,000	2.60%
<b>TOTAL OVERHEAD EXPENSES</b>	<b>\$ 208,338</b>	<b>41.70%</b>	<b>\$ 209,397</b>	<b>46.50%</b>	<b>\$ 5,000</b>	<b>2.60%</b>

<b>Operating Income</b>	<b>\$ 36,662</b>	<b>7.30%</b>	<b>\$ -14,397</b>	<b>-3.20%</b>	<b>\$ 186,000</b>	<b>97.40%</b>
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**Principal PreTax Income**

Salaries\Draws\Bonuses	\$ 255,000	51.00%	\$ 255,000	51.00%	\$ 186,000	37.20%
Firm Profit	\$ 36,662	7.30%	\$ -14,397	-2.90%	\$ 0	0.00%
<b>TOTAL</b>	<b>\$ 291,662</b>	<b>58.30%</b>	<b>\$ 240,603</b>	<b>48.10%</b>	<b>\$ 186,000</b>	<b>37.20%</b>

<sup>1</sup>Independent broker-dealers typically allow the firms to aggregate payout, meaning that the entire branch has the same combined payout of 90%. Therefore the independent broker-dealer keeps 10% of the revenue.

<sup>2</sup>As business owners, principals of RIA firms and IBD affiliated firms typically assign themselves a fair market compensation for their “labor” in the practice. The salary in the RIA and IBD models is assumed to be \$185,000 per principal and the bonus is assumed to be \$70,000. Since there is no business ownership in the wirehouse model, such an assumption is not necessary. Ultimately, we compare all three models on a total compensation to owners, regardless of method, so this assumption does not impact the overall appeal of the model.

<sup>3</sup>In an independent firm, the professional compensation is typically a salary plus a bonus. The model assumes any nonowner professionals in the RIA model is paid a salary of \$100,000 and a bonus of \$15,000 each — corresponding to positions in the top quartile of professional compensation in the 2005 FPA Compensation Study, produced by Moss Adams and sponsored by SEI Investments. In an IBD Model, the reps (nonowners) are typically paid on a commission that is negotiated between the principals and the reps. The commission assumed in this model is 70% of the “production” of the reps. Such a commission will be typical for an IBD branch where the reps have no expense responsibilities. In the wirehouse model, we have assumed that the junior advisors are paid a commission of 80% their production after the firm “haircut.” The difference (override) between the firm payout and the portion that the junior advisor receives is compensation for the senior advisors for providing referrals to the juniors.

<sup>4</sup>Overhead expenses are assumed based on data from the 2006 Moss Adams Financial Performance Study and are based on the percentage of revenue that a practice of this size devotes to a certain expense.

<sup>5</sup>Includes salaries expense for Administrative, Support (Technical) and Dedicated Management Staff.

### \$500,000: DISCOUNTED CASH FLOW MODEL

	<i>RIA Model</i>	<i>IBD Model</i>
<b>Base Year Profitability (Year 0)</b>	<b>\$ 36,662</b>	<b>\$ -14,397</b>
Projected Yearly Growth in Profitability	22%	22%
Year 1	\$ 44,727	\$ -17,565
Year 2	\$ 54,567	\$ -21,429
Year 3	\$ 66,572	\$ -26,143
Year 4	\$ 81,218	\$ -31,895
Year 5	\$ 99,086	\$ -38,911
<b>Discounted Values</b>		
Discount Rate	20%	23%
Year 1	\$ 37,273	\$ -14,280
Year 2	\$ 37,894	\$ -14,164
Year 3	\$ 38,525	\$ -14,049
Year 4	\$ 39,168	\$ -13,935
Year 5	\$ 39,820	\$ -13,821
Terminal Period	\$ 278,742	\$ -80,625
<b>TOTAL VALUE</b>	<b>\$ 471,422</b>	<b>\$ -150,874</b>

Discount rate for the IBD model is higher due to transferability issues (cost of changing broker-dealers) and the fact that IBD practices have a higher portion of commission-based income.

### \$500,000: REVENUE MULTIPLE MODEL

Revenue Multiple	2.0	1.8
<b>MULTIPLE VALUATION</b>	<b>\$ 1,000,000</b>	<b>\$ 810,000</b>

Multiples are not based on any statistic, but rather illustrate the concept. The multiples paid for fee-based firms tend to be higher.

### \$500,000: EBITDA MULTIPLE MODEL

	<i>RIA Model</i>	<i>RIA Model</i>	<i>Wirehouse Model</i>
<b>Years to Sale</b>	<b>5</b>	<b>10</b>	
Annual Growth in EBITDA	22%	22%	
Discount Rate	20%	20%	
EBITDA Multiple <sup>1</sup>	7	7	
Current EBITDA <sup>2</sup>	\$ 40,563	\$ 40,563	
EBITDA at Sale <sup>3</sup>	\$109,629	\$ 296,295	
<b>POSSIBLE VALUE<sup>4</sup></b>	<b>\$767,402</b>	<b>\$2,074,063</b>	
Recruiting Factor <sup>5</sup>			1.2 X
<b>FORGIVABLE LOAN</b>			<b>\$600,000</b>

<sup>1</sup>This is an assumption that drives the value of the business at the time of sale. This assumption should not be taken as a valuation guideline. The typical multiples observed in the industry have been between 6 and 10 times EBITDA. The actual multiple will be driven by many factors such as growth, transferability, depth of talent, quality of client base, etc. which are not reviewed in this illustration. Illustration only.

<sup>2</sup>Earnings Before Interest Taxes Depreciation and Amortization. Taken from the income statement above

<sup>3</sup>Projected EBITDA, using the growth assumption of 22%

<sup>4</sup>A calculation of possible value at the time of sale using the assumptions above

<sup>5</sup>An assumption regarding the typical bonus paid by wirehouse firms when recruiting advisors

**\$1,000,000 REVENUE PRACTICES**

**AFFILIATION MODEL FOR \$1,000,000 REVENUE PRACTICE**

	RIA		Independent BD		Wirehouse	
Practice Profile						
Principals\Senior Advisors	1		1		1	
Junior Advisors\Reps	2		2		1	
Revenue Generated by Senior Advisors\Principals			\$ 600,000	60.0%	\$ 800,000	80.0%
Revenue Generated by Junior Advisors\Reps			\$ 400,000	40.0%	\$ 200,000	20.0%
<b>TOTAL REVENUE FROM CLIENTS</b>	<b>\$ 1,000,000</b>		<b>\$ 1,000,000</b>		<b>\$ 1,000,000</b>	
B-D Share on Senior Advisors\Principals			\$ 60,000		\$ 481,600	
B-D Share on Junior Advisors\Reps			\$ 40,000		\$ 131,600	
Broker-Dealer Share of Revenue <sup>1</sup>	\$ 0	0.0%	\$ 100,000	10.0%	\$ 613,200	60.0%
<b>NET REVENUE TO ADVISOR</b>	<b>\$ 1,000,000</b>	<b>100.0%</b>	<b>\$ 900,000</b>	<b>100.0%</b>	<b>\$ 386,800</b>	<b>100.0%</b>

**PERCENTAGES BELOW ARE BASED ON % OF NET REVENUE TO ADVISOR**

**Direct Expenses**

Professional Salaries or Commissions Paid						
Owners <sup>2</sup>	\$ 185,000	18.5%	\$ 185,000	20.6%	\$ 0	0.0%
Nonowners <sup>3</sup>	\$ 200,000	20.0%	\$ 252,000	28.0%	\$ 54,720	14.1%
Professional Bonuses/Incentive Comp						
Owners <sup>2</sup>	\$ 70,000	7.0%	\$ 70,000	7.8%	\$ 0	0.0%
Nonowners <sup>3</sup>	\$ 30,000	3.0%	\$ 0	0.0%	\$ 0	0.0%
<b>TOTAL DIRECT EXPENSE</b>	<b>\$ 485,000</b>	<b>48.5%</b>	<b>\$ 507,000</b>	<b>56.3%</b>	<b>\$ 54,720</b>	<b>14.1%</b>
<b>GROSS PROFIT (8 LESS 13)</b>	<b>\$ 515,000</b>	<b>51.5%</b>	<b>\$ 393,000</b>	<b>43.7%</b>	<b>\$ 332,080</b>	<b>85.9%</b>

**Overhead Expenses<sup>4</sup>**

Auto Expenses	\$ 5,216	0.5%	\$ 6,393	0.7%	\$ 0	0.0%
Business Development and Marketing	\$ 23,724	2.4%	\$ 18,647	2.1%	\$ 0	0.0%
Depreciation/Amortization	\$ 7,267	0.7%	\$ 9,825	1.1%	\$ 0	0.0%
Equipment Leases, Purchases and Maintenance	\$ 5,015	0.5%	\$ 5,792	0.6%	\$ 0	0.0%
Health and Other Employee Insurance Benefits	\$ 18,432	1.8%	\$ 20,171	2.2%	\$ 0	0.0%
Information Technology						
(Hardware, Software & Outsourcing)	\$ 19,448	1.9%	\$ 13,417	1.5%	\$ 0	0.0%
Insurance, Business-Related (P&C, E&O, etc.)	\$ 10,468	1.0%	\$ 7,112	0.8%	\$ 0	0.0%
Office Expenses	\$ 14,769	1.5%	\$ 14,405	1.6%	\$ 0	0.0%
Office Rent, Repairs and Maintenance	\$ 47,812	4.8%	\$ 35,357	3.9%	\$ 0	0.0%
Outsourcing Services Excluding IT	\$ 9,831	1.0%	\$ 10,058	1.1%	\$ 0	0.0%
Payroll Taxes	\$ 24,175	2.4%	\$ 25,229	2.8%	\$ 0	0.0%
Professional Services	\$ 14,803	1.5%	\$ 7,314	0.8%	\$ 0	0.0%
Retirement Benefits	\$ 27,401	2.7%	\$ 17,674	2.0%	\$ 0	0.0%
Salaries Expense <sup>5</sup>	\$ 106,014	10.6%	\$ 121,352	13.5%	\$ 0	0.0%
Taxes and Licenses Excluding Payroll Taxes	\$ 4,492	0.4%	\$ 4,096	0.5%	\$ 0	0.0%
Training, Education, Professional Dues & Licensing	\$ 8,891	0.9%	\$ 6,336	0.7%	\$ 0	0.0%
Travel & Entertainment	\$ 12,769	1.3%	\$ 7,057	0.8%	\$ 0	0.0%
Utilities/Phone/Fax/Online Service	\$ 8,351	0.8%	\$ 9,039	1.0%	\$ 0	0.0%
All Other Expenses	\$ 38,550	3.9%	\$ 12,935	1.4%	\$ 12,000	3.1%
<b>TOTAL OVERHEAD EXPENSES</b>	<b>\$ 407,428</b>	<b>40.7%</b>	<b>\$ 352,207</b>	<b>39.1%</b>	<b>\$ 12,000</b>	<b>3.1%</b>
<b>Operating Income</b>	<b>\$ 107,572</b>	<b>10.8%</b>	<b>\$ 40,793</b>	<b>4.5%</b>	<b>\$ 320,080</b>	<b>82.8%</b>
<b>Principal PreTax Income</b>						
Salaries\Draws\Bonuses	\$ 255,000	25.5%	\$ 255,000	25.5%	\$ 320,080	32.0%
Firm Profit	\$ 107,572	10.8%	\$ 40,793	4.1%	\$ 0	0.0%
<b>TOTAL</b>	<b>\$ 362,572</b>	<b>36.3%</b>	<b>\$ 295,793</b>	<b>29.6%</b>	<b>\$ 320,080</b>	<b>32.0%</b>

<sup>1</sup>Independent broker-dealers typically allow the firms to aggregate payout, meaning that the entire branch has the same combined payout of 90%. Therefore the independent broker-dealer keeps 10% of the revenue.

<sup>2</sup>As business owners, principals of RIA firms and IBD affiliated firms typically assign themselves a fair market compensation for their “labor” in the practice. The salary in the RIA and IBD models is assumed to be \$185,000 per principal and the bonus is assumed to be \$70,000. Since there is no business ownership in the wirehouse model, such an assumption is not necessary. Ultimately, we compare all three models on a total compensation to owners, regardless of method, so this assumption does not impact the overall appeal of the model.

<sup>3</sup>In an independent firm, the professional compensation is typically a salary plus a bonus. The model assumes any nonowner professionals in the RIA model is paid a salary of \$100,000 and a bonus of \$15,000 each — corresponding to positions in the top quartile of professional compensation in the 2005 FPA Compensation Study, produced by Moss Adams and sponsored by SEI Investments. In an IBD Model, the reps (nonowners) are typically paid on a commission that is negotiated between the principals and the reps. The commission assumed in this model is 70% of the “production” of the reps. Such a commission will be typical for an IBD branch where the reps have no expense responsibilities. In the wirehouse model, we have assumed that the junior advisors are paid a commission of 80% their production after the firm “haircut.” The difference (override) between the firm payout and the portion that the junior advisor receives is compensation for the senior advisors for providing referrals to the juniors.

<sup>4</sup>Overhead expenses are assumed based on data from the 2006 Moss Adams Financial Performance Study and are based on the percentage of revenue that a practice of this size devotes to a certain expense.

<sup>5</sup>Includes salaries expense for Administrative, Support (Technical) and Dedicated Management Staff.

### \$1,000,000: DISCOUNTED CASH FLOW MODEL

	<i>RIA Model</i>	<i>IBD Model</i>
<b>Base Year Profitability (Year 0)</b>	<b>\$ 107,572</b>	<b>\$ 40,793</b>
Projected Yearly Growth in Profitability	22%	22%
Year 1	\$ 131,237	\$ 49,768
Year 2	\$ 160,110	\$ 60,717
Year 3	\$ 195,334	\$ 74,075
Year 4	\$ 238,307	\$ 90,371
Year 5	\$ 290,735	\$ 110,253
<b>Discounted Values</b>		
Discount Rate	20%	23%
Year 1	\$ 109,365	\$ 40,462
Year 2	\$ 111,187	\$ 40,133
Year 3	\$ 113,040	\$ 39,806
Year 4	\$ 114,924	\$ 39,483
Year 5	\$ 116,840	\$ 39,162
Terminal Period	\$ 817,879	\$ 228,444
<b>TOTAL VALUE</b>	<b>\$ 1,383,235</b>	<b>\$ 427,490</b>

Discount rate for the IBD model is higher due to transferability issue (cost of changing broker-dealers) and the fact that IBD practices have a higher portion of commission-based income.

### \$1,000,000: REVENUE MULTIPLE MODEL

Revenue Multiple	2.0	1.8
<b>MULTIPLE VALUATION</b>	<b>\$ 2,000,000</b>	<b>\$ 1,620,000</b>

Multiples are not based on any statistic, but rather illustrate the concept. The multiples paid for fee-based firms tend to be higher.

### \$1,000,000: EBITDA MULTIPLE MODEL

	<i>RIA Model</i>	<i>RIA Model</i>	<i>Wirehouse Model</i>
<b>Years to Sale</b>	<b>5</b>	<b>10</b>	
Annual Growth in EBITDA	22%	22%	
Discount Rate	20%	20%	
EBITDA Multiple <sup>1</sup>	7	7	
Current EBITDA <sup>2</sup>	\$ 114,839	\$ 114,839	
EBITDA at Sale <sup>3</sup>	\$ 310,376	\$ 838,856	
<b>POSSIBLE VALUE<sup>4</sup></b>	<b>\$ 2,172,634</b>	<b>\$ 5,871,994</b>	
Recruiting Factor <sup>5</sup>			1.2 X
<b>FORGIVABLE LOAN</b>			<b>\$ 1,200,000</b>

<sup>1</sup>This is an assumption that drives the value of the business at the time of sale. This assumption should not be taken as a valuation guideline. The typical multiples observed in the industry have been between 6 and 10 times EBITDA. The actual multiple will be driven by many factors such as growth, transferability, depth of talent, quality of client base, etc. which are not reviewed in this illustration. Illustration only.

<sup>2</sup>Earnings Before Interest Taxes Depreciation and Amortization. Taken from the income statement above

<sup>3</sup>Projected EBITDA, using the growth assumption of 22%

<sup>4</sup>A calculation of possible value at the time of sale using the assumptions above

<sup>5</sup>An assumption regarding the typical bonus paid by wirehouse firms when recruiting advisors

### \$3,000,000 REVENUE PRACTICES

#### AFFILIATION MODEL FOR \$3,000,000 REVENUE PRACTICE

	RIA		Independent BD		Wirehouse	
Practice Profile						
Principals\Senior Advisors	2		2		2	
Junior Advisors\Reps	4		4		4	
Revenue Generated by Senior Advisors\Principals			\$ 2,000,000	66.7%	\$ 2,000,000	66.7%
Revenue Generated by Junior Advisors\Reps			\$ 1,000,000	33.3%	\$ 1,000,000	33.3%
<b>TOTAL REVENUE FROM CLIENTS</b>	<b>\$ 3,000,000</b>		<b>\$ 3,000,000</b>		<b>\$ 3,000,000</b>	
B-D Share on Senior Advisors\Principals			\$ 200,000		\$ 1,184,000	
B-D Share on Junior Advisors\Reps			\$ 100,000		\$ 648,000	
Broker-Dealer Share of Revenue <sup>1</sup>	\$ 0	0.0%	\$ 300,000	10.0%	\$ 1,832,000	60.0%
<b>NET REVENUE TO ADVISOR</b>	<b>\$ 3,000,000</b>	<b>100.0%</b>	<b>\$ 2,700,000</b>	<b>100.0%</b>	<b>\$ 1,168,000</b>	<b>100.0%</b>

#### PERCENTAGES BELOW ARE BASED ON % OF NET REVENUE TO ADVISOR

#### Direct Expenses

Professional Salaries or Commissions Paid						
Owners <sup>2</sup>	\$ 370,000	12.3%	\$ 370,000	13.7%	\$ 0	0.0%
Nonowners <sup>3</sup>	\$ 400,000	13.3%	\$ 630,000	23.3%	\$ 281,600	24.1%
Professional Bonuses/Incentive Comp						
Owners <sup>2</sup>	\$ 140,000	4.7%	\$ 280,000	10.4%	\$ 0	0.0%
Nonowners <sup>3</sup>	\$ 160,000	5.3%	\$ 0	0.0%	\$ 0	0.0%
<b>TOTAL DIRECT EXPENSE</b>	<b>\$ 1,070,000</b>	<b>35.7%</b>	<b>\$ 1,280,000</b>	<b>47.4%</b>	<b>\$ 281,600</b>	<b>24.1%</b>
<b>GROSS PROFIT (8 LESS 13)</b>	<b>\$ 1,930,000</b>	<b>64.3%</b>	<b>\$ 1,420,000</b>	<b>52.6%</b>	<b>\$ 886,400</b>	<b>75.9%</b>

#### Overhead Expenses<sup>4</sup>

Auto Expenses	\$ 10,078	0.3%	\$ 10,812	0.4%	\$ 0	0.0%
Business Development and Marketing	\$ 47,606	1.6%	\$ 99,718	3.7%	\$ 0	0.0%
Depreciation/Amortization	\$ 22,923	0.8%	\$ 27,788	1.0%	\$ 0	0.0%
Equipment Leases, Purchases and Maintenance	\$ 14,800	0.5%	\$ 22,787	0.8%	\$ 0	0.0%
Health and Other Employee Insurance Benefits	\$ 75,513	2.5%	\$ 37,966	1.4%	\$ 0	0.0%
Information Technology						
(Hardware, Software & Outsourcing)	\$ 45,586	1.5%	\$ 56,306	2.1%	\$ 0	0.0%
Insurance, Business-Related (P&C, E&O, etc.)	\$ 26,785	0.9%	\$ 16,750	0.6%	\$ 0	0.0%
Office Expenses	\$ 40,500	1.4%	\$ 64,653	2.4%	\$ 0	0.0%
Office Rent, Repairs and Maintenance	\$ 105,981	3.5%	\$ 121,825	4.5%	\$ 0	0.0%
Outsourcing Services Excluding IT	\$ 39,826	1.3%	\$ 19,765	0.7%	\$ 0	0.0%
Payroll Taxes	\$ 93,364	3.1%	\$ 54,014	2.0%	\$ 0	0.0%
Professional Services	\$ 49,711	1.7%	\$ 29,788	1.1%	\$ 0	0.0%
Retirement Benefits	\$ 70,194	2.3%	\$ 54,289	2.0%	\$ 0	0.0%
Salaries Expense <sup>5</sup>	\$ 356,314	11.9%	\$ 411,815	15.3%	\$ 0	0.0%
Taxes and Licenses Excluding Payroll Taxes	\$ 7,663	0.3%	\$ 22,282	0.8%	\$ 0	0.0%
Training, Education, Professional Dues & Licensing	\$ 21,250	0.7%	\$ 6,075	0.2%	\$ 0	0.0%
Travel & Entertainment	\$ 29,639	1.0%	\$ 20,223	0.7%	\$ 0	0.0%
Utilities/Phone/Fax/Online Service	\$ 18,955	0.6%	\$ 11,848	0.4%	\$ 0	0.0%
All Other Expenses	\$ 194,843	6.5%	\$ 107,463	4.0%	\$ 50,000	4.3%
<b>TOTAL OVERHEAD EXPENSES</b>	<b>\$ 1,271,529</b>	<b>42.4%</b>	<b>\$ 1,196,166</b>	<b>44.3%</b>	<b>\$ 50,000</b>	<b>4.3%</b>
<b>Operating Income</b>	<b>\$ 658,471</b>	<b>21.9%</b>	<b>\$ 223,834</b>	<b>8.3%</b>	<b>\$ 836,400</b>	<b>71.6%</b>
<b>Principal PreTax Income</b>						
Salaries\Draws\Bonuses	\$ 510,000	17.0%	\$ 650,000	21.7%	\$ 836,400	27.9%
Firm Profit	\$ 658,471	21.9%	\$ 223,834	7.5%	\$ 0	0.0%
<b>TOTAL</b>	<b>\$1,168,471</b>	<b>38.9%</b>	<b>\$ 873,834</b>	<b>29.1%</b>	<b>\$ 836,400</b>	<b>27.9%</b>

<sup>1</sup>Independent broker-dealers typically allow the firms to aggregate payout, meaning that the entire branch has the same combined payout of 90%. Therefore the independent broker-dealer keeps 10% of the revenue.

<sup>2</sup>As business owners, principals of RIA firms and IBD affiliated firms typically assign themselves a fair market compensation for their “labor” in the practice. The salary in the RIA and IBD models is assumed to be \$185,000 per principal and the bonus is assumed to be \$70,000. Since there is no business ownership in the wirehouse model, such an assumption is not necessary. Ultimately, we compare all three models on a total compensation to owners, regardless of method, so this assumption does not impact the overall appeal of the model.

<sup>3</sup>In an independent firm, the professional compensation is typically a salary plus a bonus. The model assumes any nonowner professionals in the RIA model is paid a salary of \$100,000 and a bonus of \$40,000 each — corresponding to positions in the top quartile of professional compensation in the 2005 FPA Compensation Study, produced by Moss Adams and sponsored by SEI Investments. In an IBD Model, the reps (nonowners) are typically paid on a commission that is negotiated between the principals and the reps. The commission assumed in this model is 70% of the “production” of the reps. Such a commission will be typical for an IBD branch where the reps have no expense responsibilities. In the wirehouse model, we have assumed that the junior advisors are paid a commission of 80% their production after the firm “haircut.” The difference (override) between the firm payout and the portion that the junior advisor receives is compensation for the senior advisors for providing referrals to the juniors.

<sup>4</sup>Overhead expenses are assumed based on data from the 2006 Moss Adams Financial Performance Study and are based on the percentage of revenue that a practice of this size devotes to a certain expense.

<sup>5</sup>Includes salaries expense for Administrative, Support (Technical) and Dedicated Management Staff.

### \$3,000,000: DISCOUNTED CASH FLOW MODEL

	<i>RIA Model</i>	<i>IBD Model</i>
<b>Base Year Profitability (Year 0)</b>	<b>\$ 658,471</b>	<b>\$ 223,834</b>
Projected Yearly Growth in Profitability	22%	22%
Year 1	\$ 803,335	\$ 273,077
Year 2	\$ 980,068	\$ 333,154
Year 3	\$ 1,195,683	\$ 406,448
Year 4	\$ 1,458,733	\$ 495,867
Year 5	\$ 1,779,655	\$ 604,957
<b>Discounted Values</b>		
Discount Rate	20%	23%
Year 1	\$ 669,445	\$ 222,014
Year 2	\$ 680,603	\$ 220,209
Year 3	\$ 691,946	\$ 218,419
Year 4	\$ 703,479	\$ 216,643
Year 5	\$ 715,203	\$ 214,882
Terminal Period	\$ 5,006,423	\$ 1,253,476
<b>TOTAL VALUE</b>	<b>\$ 8,467,100</b>	<b>\$ 2,345,642</b>

Discount rate for the IBD model is higher due to transferability issue (cost of changing broker-dealers) and the fact that IBD practices have a higher portion of commission-based income.

### \$3,000,000: REVENUE MULTIPLE MODEL

Revenue Multiple	2.0	1.8
<b>MULTIPLE VALUATION</b>	<b>\$ 6,000,000</b>	<b>\$ 4,860,000</b>

Multiples are not based on any statistic but rather illustrate the concept. The multiples paid for fee-based firms tend to be higher.

### \$3,000,000: EBITDA MULTIPLE MODEL

	<i>RIA Model</i>	<i>RIA Model</i>	<i>Wirehouse Model</i>
<b>Years to Sale</b>	<b>5</b>		<b>10</b>
Annual Growth in EBITDA	22%		22%
Discount Rate	20%		20%
EBITDA Multiple <sup>1</sup>	7		7
Current EBITDA <sup>2</sup>	\$ 681,394	\$ 681,394	
EBITDA at Sale <sup>3</sup>	\$ 1,841,608	\$ 4,977,330	
<b>POSSIBLE VALUE<sup>4</sup></b>	<b>\$12,891,259</b>	<b>\$34,841,311</b>	
Recruiting Factor <sup>5</sup>			1.2 X
<b>FORGIVABLE LOAN</b>			<b>\$3,600,000</b>

<sup>1</sup>This is an assumption that drives the value of the business at the time of sale. This assumption should not be taken as a valuation guideline. The typical multiples observed in the industry have been between 6 and 10 times EBITDA. The actual multiple will be driven by many factors such as growth, transferability, depth of talent, quality of client base, etc. which are not reviewed in this illustration. Illustration only.

<sup>2</sup>Earnings Before Interest Taxes Depreciation and Amortization. Taken from the income statement above

<sup>3</sup>Projected EBITDA, using the growth assumption of 22%

<sup>4</sup>A calculation of possible value at the time of sale using the assumptions above

<sup>5</sup>An assumption regarding the typical bonus paid by wirehouse firms when recruiting advisors

## Your Next Step

If you are considering independence and would like to learn more or talk to an advisor who has made the transition:

- Visit [www.schwabinstitutional.com/public](http://www.schwabinstitutional.com/public)
- Call 877-687-4085

## Wirehouse Continuity Programs vs. Enterprise Value

Another important consideration when comparing the three models is continuity programs offered by some wirehouses. The following analysis compares the equity inherent to the independent models with a typical continuity program at a wirehouse. Since the wirehouse owns the clients, it's not possible to complete an equity-only comparison.

In the example, an advisor with a \$500,000 practice growing at a rate of 22%<sup>39</sup> annually is eligible to participate in the firm's continuity program offered to retiring advisors. We include the deferred compensation the advisor will receive in retirement as well as a factor adjusting for additional retirement benefits to complete the side-by-side comparison.

### WIREHOUSE CONTINUITY PROGRAM + DEFERRED COMPENSATION<sup>1</sup>

<i>(in 1000s)</i>	Year 1	Year 2	Year 3	Year 4	Year 5
Gross Revenue	\$500	\$610	\$744	\$908	\$1,108
Deferred Compensation Payout %	5.0%	5.0%	5.0%	5.0%	5.0%
<b>CUMULATIVE DEFERRED COMPENSATION</b>	<b>\$ 25</b>	<b>\$ 56</b>	<b>\$ 93</b>	<b>\$138</b>	<b>\$ 193</b>
Net Revenue (Income Only)				\$412	
Program Payout Factor <sup>2</sup>				100%	
<b>CONTINUITY PROGRAM PAYOUT</b>					<b>\$ 412</b>
Lost Retirement Benefits Factor <sup>3</sup>					10%
<b>LOST RETIREMENT BENEFITS</b>					<b>\$ 41</b>
<b>OPPORTUNITY COST — LOST NET RETIREMENT<sup>4</sup></b>					<b>\$ 647</b>

The factor of 100% applied to the Net Revenue equates to a revenue multiple of 1.0 when compared to the IBD and RIA multiples. Using the revenue multiple approach, the three models compare as follows:

### ENTERPRISE VALUE MODEL COMPARISON

	<i>RIA Model</i>				
<i>(in 1000s)</i>	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	\$ 500	\$ 610	\$ 744	\$ 908	\$1,108
Factor	2.0	2.0	2.0	2.0	2.0
Enterprise Value <sup>1</sup>	\$1,000	\$1,220	\$1,488	\$1,816	<b>\$2,215*</b>
	<i>IBD Model</i>				
<i>(in 1000s)</i>	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	\$ 500	\$ 610	\$ 744	\$ 908	\$1,108
Factor	1.8	1.8	1.8	1.8	1.8
Enterprise Value <sup>2</sup>	\$ 900	\$1,098	\$1,340	\$1,634	\$1,994
	<i>Wirehouse Model</i>				
<i>(in 1000s)</i>	Year 1	Year 2	Year 3	Year 4	Year 5
Continuity Program + Deferred Compensation <sup>3</sup>	\$ 230	\$ 305	\$ 397	\$ 510	<b>\$ 647*</b>

\*The Enterprise Value of the RIA Model is significantly more than that of the Wirehouse Model.

<sup>1</sup> Uses the revenue multiple approach. The value is an estimate of the amount the business would be worth were it to be sold on the open market.

<sup>2</sup> Ibid.

<sup>3</sup> Although Enterprise Value doesn't technically exist once the firm owns the customers, we have included it in the comparison. It assumes a continuity program exists within the Firm allowing for a transfer of an advisor's business.

<sup>1</sup> Assumes advisor stays with current wirehouse and doesn't break away to another firm.

<sup>2</sup> Assumes amount paid in one lump sum even though payout usually occurs over a 2 to 3 year period.

<sup>3</sup> Includes Pension, 401k and other retirement benefits. Factor is an estimate of additional benefits the advisor would lose by leaving the firm. Factor is applied to Net Revenue.

<sup>4</sup> Assumes Advisor retires at the end of Year 5.

<sup>39</sup> Though it's unlikely a retiring advisor would be growing so rapidly, the comparison is more useful for advisors currently growing at a rapid pace considering independence. Twenty-two percent was selected to maintain consistency with the other valuation models described.

In the example, the RIA enterprise value is \$2,215,000 versus \$743,000 for the wirehouse's continuity program before accounting for taxes. Here's a summary of the value for each practice using the same methodology as in the example:

**PRETAX ENTERPRISE VALUE SUMMARY<sup>1</sup>**

(in 1000s)	RIA	IBD	Wirehouse
\$ 500,000 Practice <sup>2</sup>	\$ 2,215	\$ 1,994	\$ 647
\$1,000,000 Practice <sup>3</sup>	\$ 4,431	\$ 3,988	\$1,360
\$3,000,000 Practice <sup>4</sup>	\$13,292	\$11,963	\$3,780

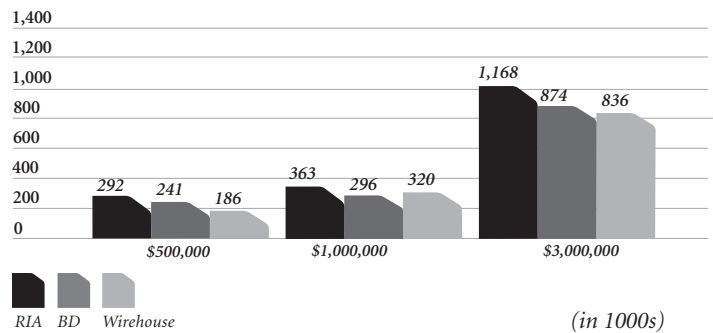
<sup>1</sup>Assumes the business is sold or the advisor retires from their wirehouse after 5 more years of working.  
<sup>2</sup>Assumes Deferred Compensation Payout % of 5% of annual Gross Revenues  
<sup>3</sup>Assumes Deferred Compensation Payout % of 7.5% of annual Gross Revenues  
<sup>4</sup>Assumes Deferred Compensation Payout % of 7.5% of annual Gross Revenues

The gap widens further between the wirehouse and the independent models when considering taxes. The sale of the business is taxed as a capital gain, whereas the continuity program payment is taxed as income. Clearly, the data show that the value of continuity programs can be misleading when compared with the enterprise value the independent models offer.

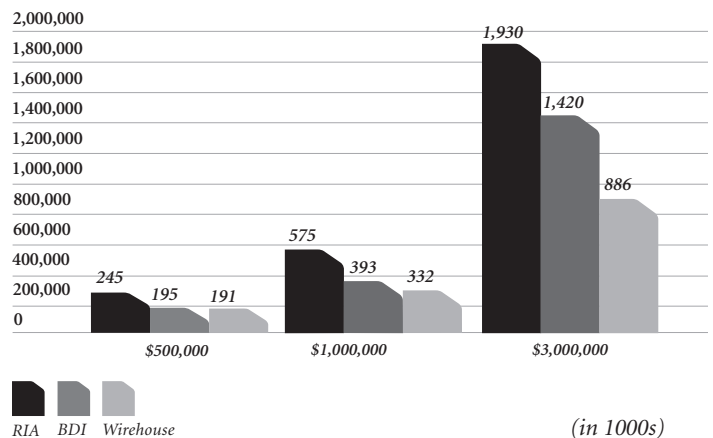
**Cash Flow & Enterprise Value**

Cash flow (profitability) is a key driver in enterprise value. The chart below indicates that as revenue grows the potential for greater profitability is most likely in the custodial/RIA affiliation model. Illustrated here is the principal advisor income growth in the different affiliation models, as well as the gross profitability of the practices.

**FIGURE 1: PRINCIPAL PRETAX INCOME ACROSS REVENUE STAGES**



**FIGURE 2: GROSS PROFIT MARGIN ACROSS REVENUE STAGES**



## Period of Transition

It typically takes from six months to a year for a practice to become fully established. To illustrate expenses during this transitional period, Moss Adams compiled an abridged income statement illustrating the typical first-year transition costs for three practices of differing revenue sizes.

Moving toward complete independence exerts short-term stress not only on the practice but on its clients as well. However, practices that can reasonably contemplate complete independence typically have great depth in existing client relationships. Figures in the table below assume that

85% of total revenue (both commission and fees) will successfully transition into fee revenue.

The Nonrecurring Overhead Expenses refer to those one-time substantial costs that are required to physically and legally build a financial advisory practice. These costs are derived from and on top of the expenses incurred starting the day the business launches. Looking only at transition expenses, the smaller the practice, the higher the percentage of first-year revenue to launch the firm.

**TABLE 3:  
NONRECURRING OVERHEAD EXPENSES AT REVENUE LEVELS<sup>40</sup>**

Total Revenue	\$ 500,000	\$ 1,000,000	\$1,500,000	\$2,000,000	\$2,500,000	\$ 3,000,000
Fee Revenue	\$ 425,000	\$ 850,000	–	–	–	\$ 2,550,000
Other Revenue	\$ 75,000	\$ 150,000	–	–	–	\$450,000
<b>TOTAL REVENUE</b>	<b>\$ 500,000</b>	<b>\$ 1,000,000</b>				<b>\$ 3,000,000</b>
<b>Nonrecurring overhead expenses</b>						
Training and Education	\$ 2,208	\$ 2,702	–	–	–	\$ 5,831
*Rent	\$ 6,046	\$ 7,742	–	–	–	\$ 18,603
Furniture @ 20% down payment	\$ 2,116	\$ 1,935	–	–	–	\$ 3,721
Office Supplies	\$ 1,287	\$ 1,015	–	–	–	\$ 3,202
Phone/Fax/Copy/ISP Set-Up	\$ 1,669	\$ 2,376	–	–	–	\$ 8,132
Legal, Accounting & Non-I.T. Consulting	\$ 3,024	\$ 4,010	–	–	–	\$ 10,049
Compliance Consulting & Registration Fees	\$ 8,640	\$ 8,020	–	–	–	\$ 17,586
*Outsourcing Services Excluding IT <sup>1</sup>	\$ 908	\$ 1,321	–	–	–	\$ 3,303
Software <sup>2</sup>	\$ 5,778	\$ 8,226	–	–	–	\$ 13,554
Hardware <sup>3</sup>	\$ 7,062	\$ 10,054	–	–	–	\$ 18,975
Dues – Clubs	\$ 212	\$ 670	–	–	–	\$ 1,490
Dues – Professional	\$ 354	\$ 287	–	–	–	\$ 331
Equipment	\$ 277	\$ 473	–	–	–	\$ 1,059
*Health and Other Employee Benefits	\$ 2,355	\$ 3,401	–	–	–	\$ 10,222
*E & O Insurance	\$ 553	\$ 1,261	–	–	–	\$ 3,178
*P & C Insurance	\$ 922	\$ 946	–	–	–	\$ 3,178
*Other Insurance	\$ 277	\$ 473	–	–	–	\$ 1,059
Professional Licenses	\$ 645	\$ 1,576	–	–	–	\$ 4,238
Business Development and Marketing <sup>4</sup>	\$ 10,341	\$ 16,188	–	–	–	\$ 61,033
Travel and Entertainment	\$ 1,351	\$ 2,061	–	–	–	\$ 4,753
Miscellaneous Operating Expenses	\$ 7,697	\$ 9,688	–	–	–	\$ 20,048
<b>TOTAL NONRECURRING OVERHEAD EXPENSES</b>	<b>\$ 63,722</b>	<b>\$ 84,425</b>				<b>\$ 213,545</b>
As Percent of Revenue	12.7%	8.4%				7.1%

\* = 2-Month Down Payment

<sup>1</sup>Down payment/upfront costs (2 months) unrelated to software costs (see "Software" line item) associated with portfolio reporting, account processing and rebalancing, asset allocation, financial planning, investment policy and proposal generation, client relationship management, data storage and document management, compliance, trade confirmation processing, license and registration management, accounts payable/accounts receivable management, alternative investment planning models (ability to integrate hedge funds, private equity, etc.) and account aggregation.

<sup>2</sup>Contact management software, accounting software, portfolio management software, quotation and market research software or licensing agreement, financial planning software, general computer operating system software.

<sup>3</sup>Computers (desktops, laptops), single or dual monitors. See above for line items for phones, fax, copy machine licensing agreement and printer purchase

<sup>4</sup>Includes Web site development. The \$3,000,000 practice includes client-level reporting on the Web site.

<sup>40</sup>Forecasts and model results should not be relied upon as an indicator of future performance.

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#### About Schwab Institutional

*Schwab Institutional, a division of Charles Schwab & Co., Inc., is a leading provider of custodial, operational and trading support for independent fee-based investment advisors. More than 20% of RIA assets are custodied with Schwab Institutional, twice those of the next nearest competitor.*

*Client assets custodied with Schwab Institutional increased 24% to \$495 billion between November 30, 2005, and November 30, 2006. These assets, managed by more than 5,000 independent advisor firms Schwab Institutional serves, represent approximately one-third of total customer assets custodied with The Charles Schwab Corporation as of November 2006.*

#### About Moss Adams LLP

*Moss Adams LLP provides accounting and management consulting services to advisory firms throughout the United States, Canada and Australia. With a particular expertise in the financial services industry, Moss Adams has provided consulting services to more than 1,200 investment management firms, broker-dealers and financial advisors on matters related to compensation, organizational design, valuation, mergers and acquisitions, financial management, strategic planning and leadership development. Moss Adams is the eleventh-largest accounting and consulting firm in the United States, with a staff of 1,100, including 180 partners. For more information on Moss Adams, visit [www.mossadams.com/industries/sin](http://www.mossadams.com/industries/sin).*

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