How an Independent Broker Dealer Rep Can Start an RIA Firm

A STEP BY STEP GUIDE

RIA IN A BOX | JUNE 2016

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THE FLAVORS OF INVESTMENT ADVISER INDEPENDENCE

The pending implementation of the Department of Labor's (DOL) new "fiduciary rule" is poised to dramatically change how retirement investments are managed. With this momentous change, the wealth management industry continues to rapidly shift to a fiduciary, fee-based model. Of course, not every advisor currently affiliated with an independent broker dealer (IBD) should start their own registered investment adviser (RIA) firm, but increasingly it is an option that all advisors with an IBD should evaluate.

Today, an advisor seeking independence in the wealth management industry has three primary business model options:

INVESTMENT ADVISER REPRESENTATIVE & REGISTERED REPRESENTATIVE OF THE INDEPENDENT BROKER DEALER

The most common model present in the independent broker dealer (IBD) industry today is to be an Investment Adviser Representative (IAR) and a Registered Rep at an IBD. In this scenario, the advisor is generally considered an independent contractor and is responsible for paying for general overhead and other platform expenses. However, the popularity of this traditional arrangement continues to steadily decline as more advisors continue to start their own registered investment adviser (RIA) firms.

However, if an advisor is reluctant to operate his or her own RIA firm, most IBD firms will also allow an advisor to be registered to the IBD firm as both an investment adviser and registered representative. This scenario is at times referred to as joining a corporate RIA. In this case, the corporate advisory firm is generally owned and operated by the IBD firm. In other similar scenarios, the financial advisor will join a super office of supervisory jurisdiction (Super OSJ) that may be affiliated with a particular IBD firm. In such arrangements, the corporate RIA or Super OSJ firm will provide additional infrastructure and compliance support, however there may be significant financial trade-offs to the advisor.

Often, under this arrangement, an advisor will operate under a "doing business as" (DBA) name but all investment business is still conducted directly through the corporate RIA and IBD firm. This scenario does usually offer more independence than being affiliated with a traditional broker dealer. However, we continue to see an increasing number of advisors opting out of this traditional IBD arrangement. Instead, many advisors are choosing to operate their own RIA firm once the advisor recognizes that operating an independent RIA firm often offers more independence and flexibility in regards to investment, custodian, technology, and other vendor decisions. In addition, the independent RIA path can also offer more business model options including implementing financial planning and hourly billing which are often disallowed under other arrangements.

INDEPENDENT RIA FIRM & REGISTERED REPRESENTATIVE OF THE INDEPENDENT BROKER DEALER

There are a number of independent broker dealer firms which will allow an advisor to operate his or her own RIA firm while simultaneously operating as a registered representative of the IBD firm as an independent contractor.

While a hybrid setup may allow an advisor to offer both brokerage and advisory services, it should be noted that this arrangement is generally under significant regulatory scrutiny given the potential conflicts of interest and there will be some financial trade-offs to the advisor. One key financial trade-off for an advisor to explore is whether the IBD charges any additional outside business activity supervision or compliance fees as part of allowing the advisor to operate an independent RIA firm. These fees sometimes end up being a significant source of friction to both adviser and end client.

As such, we generally recommend that advisors only consider this option if they have a significant brokerage business outside of traditional retirement accounts. While advisors are often understandably hesitant to fully leave the broker dealer world, operating exclusively as a fiduciary under the RIA model can often best align both client and advisor incentives and allow for much more simplicity. However, there may be scenarios for which it makes sense for an advisor to explore or preserve a hybrid setup.

INDEPENDENT RIA FIRM-ONLY

Under an exclusively RIA-only model, investment advisers are only allowed to charge fees and may not receive any commissions. From a regulatory standpoint, this model often represents the least conflicts of interest for an advisor to manage given that the advisor is operating solely under the RIA model and is no longer charging any commissions to clients via a hybrid relationship with an independent broker dealer. Under this model, an advisor no longer has any affiliation with an independent broker dealer.

An advisor solely operating an RIA firm is also no longer regulated by the Financial Industry Regulatory Authority (FINRA) and is instead exclusively regulated by the relevant state(s) or Securities and Exchange Commission (SEC) depending generally on the total regulatory assets managed by the firm. This model can also provide an opportunity for advisors to take advantage of the DOL best interest contract exemption by potentially qualifying as a "level fee fiduciary." As such a fiduciary, the advisor may have more streamlined and manageable requirements to comply with the new DOL fiduciary rule.

It is important to note the independent RIA firm-only model is not appropriate for all advisors currently affiliated with an independent broker dealer. In particular, advisors that still receive the majority of their income from commission-based products on the brokerage side of the business may at a minimum, wish to retain an affiliation with the independent broker dealer as a registered representative of the broker-dealer in order to still be allowed to receive variable, commission-based compensation.

However, as the wealth management industry continues to evolve towards fee-based, fiduciary investment advice, advisors may want to strongly consider beginning to actively transition from a commission to a fee-based business model. While this transition may not be appropriate for all types of clients, the simplicity and transparency of managing a fee-only investment advisory business cannot be understated. Of course, the macro trends of the industry also connect directly with shifting investor preferences. For many, the move to an independent RIA firm model has a strong 'business case'; prospective advisers pursuing the RIA model tap into the growing investor sentiment to align with an advisor who shares 'pure' incentives without being tethered to commission models that can place advisers at odds with the interests of their clients. Firms that utilize separately managed accounts, no-load mutual funds allocation models, the services of a turnkey asset management platform (TAMP), or provide financial planning are often especially well positioned to migrate to the fully independent RIA model.

THE ECONOMICS OF AN INDEPENDENT RIA FIRM

According to Meridian-IQ, 2,159 new RIA firms were formed in 2014. This compares to 1,959 new RIA firms formed in 2013 which implies a 10.2% year over year increase in the number of new advisory firms being created. Many in the industry assume that firms need a significant amount of assets under management (AUM) in order to prosper. However, the industry stats paint a much different picture. According to Meridian-IQ, of the 2,159 new firms created in 2014, only 635 of those shops had an AUM figure greater than $50 million. Thus, over 70% of new RIA firms which are created start with less than $50 million in AUM. Furthermore, most advisors do not realize that the median AUM of the over 32,000 RIA firms currently registered is only $19.3 million according to the latest Meridian-IQ statistics.

At RIA in a Box®, we continue to see an increasing number of small advisory firms thriving as more advisors seek to act as a fiduciary in every interaction with their clients. This is largely due to the rapid evolution of the ecosystem supporting independent RIA firms. From the registration process and onward, firms like ours along with a number of custodians, technology vendors, and others allow even the smallest of investment advisory firms to operate with incredible efficiency at an affordable cost. Compliance is a serious consideration for any new RIA firm, but again, firms like ours have experience helping thousands of fellow investment advisers implement comprehensive, yet efficient compliance programs with the benefits of the latest technology. The compliance program an independent RIA implements also correlates directly to their specific business and activity as opposed to the broader measures the advisor may need to adhere to under a corporate RIA regime.

For years, many independent broker dealers have stated that advisors need to have over $100 million in AUM in order to profitably operate an independent RIA firm. We respectfully disagree with these assumptions and we believe the economic models below more than support our views. While there is no question that larger RIA firms benefit from increasing scale, even the smallest of investment advisory firms can operate quite profitability in today's world of rapidly declining operational costs. In making any sound business decision, it is prudent to evaluate the numbers and facts as opposed to conforming to the general rhetoric that smaller advisory firms cannot survive or fictitious AUM requirements.

UNDERSTANDING INDEPENDENT BROKER DEALER PAYOUT RATES

Traditionally, independent broker dealers market payout rates in the range of 75-95% of annual advisor revenue production. However, as many independent broker deal representatives understand first-hand, such gross payout rates often do not fully reflect all expenses. Such additional expenses often include:

- Technology: These fees vary widely across the independent broker dealer industry and are often charged as a bundle or a la carte. These fees can be a profit center rather than a simple cost pass through for the broker dealer. In general, technology costs are at least a few hundred dollars per month for the average affiliated advisor.
- Administrative: Some independent broker dealers charge additional basis points in regards to the administration of fee-based accounts or third-party money managers. Others charge additional fees to advisors related to providing errors and omissions insurance or Security and Investor Protection (SIPC) coverage.

- Compliance: Some firms charge advisors additional fees related to compliance especially in regards to the supervision of outside business activity related to the advisor operating their own independent RIA firm. In addition, a number of firms also charge advisor registration and filing fees. Moreover, the complexity of meeting FINRA regulations often adds opportunity cost and cash outlays for advisor reps.
- Ticket charges: Compared to the traditional, self-clearing discount broker dealers that offer traditional custody and brokerage services to RIA firms, the ticket charges at independent broker dealers can be significantly higher. With limited or no ability to select an alternative broker to transact with, this can result in higher cost not just for the advisor, but for the advisor's clients as well.
- Liability Insurance: Errors and omissions insurance provided by independent broker dealers is often marked up through a third-party intermediary. The advisor may also have to subscribe to an insurance policy that has associated underwriting risks built in because the advisor is operating within a heightened risk pool alongside all of the firm's other advisors that conduct various types of securities business.

Of course, an advisor affiliated with an independent broker dealer is also generally responsible for covering all overheard expenses which may include:

- Staff salaries
- Office rent
- Office technology
- Marketing

The key economic differences for an advisor when affiliated with an independent broker dealer versus operating exclusively as an independent registered investment adviser firm are:

- Gross Payout Rate: When an advisor operates under their own RIA firm, the gross payout rate for revenue generated by the advisor is 100% compared to a gross payout rate that varies widely in the independent broker dealer industry.
- Direct technology, compliance, insurance, and other costs: Under a traditional independent broker dealer model, technology, compliance, insurance, and other services are provided directly by the independent broker dealer who then charges the affiliated advisor fees related to those services. As the owner of an independent RIA firm, the advisor makes such purchases directly with the appropriate service providers. While it can vary depending on the advisor's size and business model, these direct purchases are generally comparable under both models. In addition, an advisor often has access to a much larger array of service providers at varying price points once operating an independent RIA.
- Ticket charges: When working with a traditional RIA custodian as an independent RIA firm, the advisor will be able to choose one or multiple custodians which offer the best capabilities to the advisor and their clients. Given the competitive nature of the custody industry, custodians' ticket charges tend to be quite competitive and favorable when compared to the majority of independent broker dealers that frequently mark-up such ticket charges.

MANY RIA FIRMS SUCCEED TODAY WITH LESS THAN $25 MILLION IN ASSETS UNDER MANAGEMENT

There is also a lot of misinformation that has been published in regards to the compliance and regulatory expenses for independent RIA firms. The fact is the vast majority of RIA firms do not have a dedicated Chief Compliance Officer (CCO) on staff. In our experience in providing compliance support to over 1,300 firms on a monthly basis, we generally do not see RIA firms hire a full-time CCO until the firm reaches in excess of $400 million of assets under management. Firms below that asset threshold, generally have a firm principal that wears the CCO hat and delegates some of the firm's compliance responsibilities to other staff members. On other hand, fee-only RIA firms with a single advisor and no staff members, generally have streamlined compliance requirements given that the firm does not have any supervision responsibilities.

Investment advisory firm principals have access to Compliance software and consulting support to help them successfully and competently fulfill their responsibilities as CCO. RIA firms that utilize our MyRIACompliance™ compliance support services generally pay around $400-600 per month and get access to MyRIACompliance™ software which helps automate a firm's monthly, quarterly, and annual compliance and supervision responsibilities. In addition, our team of compliance experts at RIA in a Box can assist with all required registration and regulatory filings and also help review advertising and other client documents.

SAMPLE PROFIT & LOSS STATEMENT COMPARISONS

To illustrate the financial comparisons of operating solely as an independent RIA firm vs. operating as an independent representative, we have broken down to two scenarios below.

Scenario 1:

- Total advisory assets under management: $40 million
- Number of advisors: 1
- Number of support staff members: 1

	Independent RIA		Corporate RIA/IBD	
	Year 1	Year 2	Year 1	Year 2
Total Fee Revenue	$400,000	$400,000	$400,000	$400,000
IBD Revenue Share	$0	$0	($60,000)	($60,000)
Total Net Revenue	$400,000	$400,000	$340,000	$340,000
Overhead Expenses				
Staff Salaries & Benefits	($70,000)	($70,000)	($70,000)	($70,000)
Technology & Other Expenses	($120,000)	($120,000)	($120,000)	($120,000)
Compliance	($5,000)	($5,000)		
	($195,000)	($195,000)	($190,000)	($190,000)
Start-Up Costs	($10,000)	$0	$0	$0
Total Advisor Profit	$195,000	$205,000	$150,000	$150,000
Total Advisor Profit Margin	48.8%	51.3%	44.1%	44.1%

In the scenario above, we also make the following assumptions:

- Average advisory fees charged are 1% of total assets under management
- The gross independent broker dealer payout is 85%
- Technology and other overhead expenses such as office rent, insurance, and marketing equate to 30% of gross revenue
- There is a one-time startup cost of $10,000 in year 1 as a new independent RIA firm.

Scenario 2

- Total advisory assets under management: $80 million
- Number of advisors: 2
- Number of support staff members: 1

	Independent RIA		Corporate RIA/IBD	
	Year 1	Year 2	Year 1	Year 2
Total Fee Revenue	$800,000	$800,000	$800,000	$800,000
IBD Revenue Share	$0	$0	($80,000)	($80,000)
Total Net Revenue	$800,000	$800,000	$720,000	$720,000
Overhead Expenses				
Staff Salaries & Benefits	($70,000)	($70,000)	($70,000)	($70,000)
Technology & Other Expenses	($200,000)	($200,000)	($200,000)	($200,000)
Compliance	($5,000)	($5,000)		
	($275,000)	($275,000)	($270,000)	($270,000)
Start-Up Costs	($12,000)	$0	$0	$0
Total Advisor Profit	$513,000	$525,000	$450,000	$450,000
Total Advisor Profit Margin	64.1%	65.6%	62.5%	62.5%

In the scenario above, we also make the following assumptions:

- Average advisory fees charged are 1% of total assets under management
- The gross independent broker dealer payout is 90%
- Technology and other overhead expenses such as office rent, insurance, and marketing equate to 25% of gross revenue
- There is a one-time startup cost of $12,000 in year 1 as a new independent RIA firm

Scenario 3

- Total advisory assets under management: $200 million
- Number of advisors: 4
- Number of support staff members: 4

	Independent RIA		Corporate RIA/IBD	
	Year 1	Year 2	Year 1	Year 2
Total Fee Revenue	$2,000,000	$2,000,000	$2,000,000	$2,000,000
IBD Revenue Share	$0	$0	($160,000)	($160,000)
Total Net Revenue	$2,000,000	$2,000,000	$1,840,000	$1,840,000
Overhead Expenses				
Staff Salaries & Benefits	($225,000)	($225,000)	($225,000)	($225,000)
Technology & Other Expenses	($300,000)	($300,000)	($300,000)	($300,000)
Compliance	($10,000)	($10,000)		
	($535,000)	($535,000)	($525,000)	($525,000)
Start-Up Costs	($15,000)	$0	$0	$0
Total Advisor Profit	$1,450,000	$1,465,000	$1,315,000	$1,315,000
Total Advisor Profit Margin	72.5%	73.3%	71.5%	71.5%

In the scenario above, we also make the following assumptions:

- Average advisory fees charged are 1% of total assets under management
- The gross independent broker dealer payout is 92%
- Technology and other overhead expenses such as office rent, insurance, and marketing equate to 15% of gross revenue
- There is a one-time startup cost of $15,000 in year 1 as a new independent RIA firm

In all three scenarios, there is a compelling financial reward to start an independent RIA firm. In scenario 1, the solo advisor has increased his or her annual profit by $55,000 (+37.7%) by year 2 and in scenario 2, the two advisors have increased their shared profits by $75,000 (+16.7%) by year 2. In scenario 3, for the larger practice with four advisors and four support staff members, the four advisors have increased their shared profits by $150,000 (+11.4%) by year 2. While these three scenarios are only examples and do not fully reflect the scenario of every advisor currently affiliated with an independent broker dealer, in our observations we generally see advisors improve their take home pay by 10-40% after transitioning advisory business to the independent RIA model.

INITIAL STARTUP COSTS TO CONSIDER

The initial costs to establish a new RIA firm will vary based on the size of the firm measured by the total assets under management, number of clients, and number of advisors or staff members.

In RIA in a Box's company history of helping launch over 2,500 new RIA firms over the years, we generally find that advisors with less than $100 million in assets under management can create a new RIA firm for around $8,000 to $10,000 in upfront costs. However, it is possible for advisors on a tight budget to spend even less if necessary.

The key upfront costs for an independent broker deal representative to consider when launching a new firm include:

1. Entity Formation

Most RIA firms utilize an S-Corporation (S-Corp) or Limited Liability Corporation (LLC) entity structure. We see most new firms take advantage of one of the many online services that assist with entity creation. Other firms will instead utilize the services of a local accountant to assist with this process. An additional $100 to $300 should be budgeted for the state entity registration fee.

- Expert Tip: RIA in a Box research indicates that for RIA firms, the LLC structure is nearly twice as popular when compared to traditional corporate structures.

Total projected cost: $250

2. RIA Registration Assistance

We strongly believe hiring a compliance consultant to help navigate the initial RIA registration process is one of the best investments that an advisor can make. It is a complicated and cumbersome process that varies state by state and it can easily cost an advisor valuable time and future regulatory risk. RIA in a Box's customized RIA registration process costs range from $2,385 to $3,585 per firm in compliance consulting fees. These fees cover the firm and individual representative registration and creation of the required filing and internal compliance documents for a single state.

- Expert Tip: The registration process, even if managed as efficiently as possible, can take up to 2-3 months in some states so it is important to begin the registration process early in the firm's formation process.

Total projected cost: $3,000

3. RIA Firm Regulatory Fees

Each state charges an initial and annual firm filing fee. The average initial registration fee charged by states is approximately $215.

- Expert Tip: California, the state with the largest number of RIA firms in the country, presently charges an annual firm registration fee of $125.

Total projected cost: $250

4. Individual Investment Adviser Representative (IAR) Regulatory Fees

Similarly, nearly every state charges an initial and annual IAR filing fee. The fees charged by most states are less than $100 annually per IAR. In addition, there may be a one-time Financial Industry Regulatory Authority (FINRA) processing fee of $10 per new IAR registered.

- Expert Tip: The states of Louisiana, Minnesota, New York, and Wyoming do not presently charge any annual IAR filing fees.

Total projected cost: $250

5. Individual Adviser Representative (IAR) Exam Fees

An individual associated with an advisory firm, whether in an investment advisory capacity or in an executive, principal or supervisory role is generally required to register as an individual investment adviser representative (IAR). The Series 65 is the qualifying examination set forth in most jurisdictions that an individual must pass before conducting business as an IAR. The Series 65 exam is administered by FINRA and costs $165.

There are certain exemptions available for individuals to meet the competency requirement as an IAR in most jurisdictions. These include a combination of a Series 7 and Series 66 exam, or any of the following professional designations in good standing: Certified Financial Planner (CFP®), Chartered Financial Analyst® (CFA), Certified Insurance Counselor (CIC®), Chartered Financial Consultant (ChFC®), or Personal Financial Specialist (PFS).

Since passing these examinations is a crucial part of starting a RIA and becoming an investment adviser representative, it is important to properly prepare and study accordingly. Several reputable companies provide study material to help prepare for the exams. The average price for the study material including online practice examinations is around $180.

- Expert Tip: Many current independent broker dealer representatives already have passed the required exams or hold a qualifying professional designation which provides for an exemption.

Total projected cost (if necessary): $500

6. Insurance / Surety Bond

Although it is not always required from a regulatory standpoint, we recommend that all new RIA firms always obtain sufficient insurance coverage particularly as it relates to Errors & Omissions (E&O) coverage. E&O insurance, often also referred to as professional liability insurance, can provide liability protection with certain restrictions for mistakes and inadvertent violations of regulatory rules. E&O Insurance can also help protect the firm from liability and the litigation costs associated with allegations related to claims against the firm. The annual premium cost is often tied to the total AUM of the firm. We find that most E&O insurance rates start at around $2,000 per year and increase from there. Such insurance fees will generally be comparable to what an independent broker dealer representative is currently responsible for paying to their current IBD.

In addition, some states require firms to maintain a positive net capital balance or alternatively secure a surety bond. Surety bonds will generally cost around $200 to $400.

- Expert Tip: Be sure to review all insurance policies in great detail. Unfortunately, many professional liability insurance plans include a number of exclusions.

Total projected cost: $2,500

7. Marketing and Advertising

Initially, we find that new RIA firms need to reserve a web domain name, create a logo, order business cards, and create a basic website. However, many independent broker dealer representatives have already gone through this process as part of their current arrangement.

- Expert Tip: While it can be tempting to delay these spends, we believe that a small upfront investment in this category can lead to a very professional image and brand development that will pay future dividends.

Total projected cost: $1,000

8. Technology

There are a wide array and ever increasing number of technology and software solutions available to independent RIA firms at varying price points. Most advisor-specific (client relationship management (CRM), portfolio management, financial planning, etc.) and general small business software applications (e.g. QuickBooks Online, email, etc.) do not require large upfront payments and are billed monthly. However, we believe it is safe to budget an additional $1,500 in upfront setup costs and one-time purchases for software.

- Expert Tip: Be sure to download our complimentary technology infographic on the resources page of RIAinaBox.com that highlights over 100 RIA software systems organized by category.

Total projected cost: $1,500

TOTAL PROJECTED COSTS: $9,250

For more budget-conscious advisors, these start-up costs can be significantly reduced by cutting the upfront marketing, advertising, and technology expenses. Such cost-saving decisions can bring the total upfront costs to below $6,000. However, it is important to remember that there is tremendous value in making the necessary upfront investment to give the new RIA firm the best chance at future success.

THE OPERATIONAL, COMPLIANCE, AND TECHNOLOGY NEEDS OF AN INDEPENDENT RIA FIRM

INITIAL RIA REGISTRATION PROCESS

The RIA firm creation process is generally simplified a bit for advisors currently affiliated with an independent broker dealer since such an advisor is often an independent contractor. As such, the advisor is traditionally not subject to any non-compete or non-solicit employee contract issues that may be present with a more captive broker-dealer employer. Thus, unlike an advisor breaking away from a traditional brokerage or wire house, advisors transitioning away from an independent broker dealer will typically not need to make use of the Protocol for Broker Recruiting (commonly referred to as the “Broker Protocol”). Regardless, we always strongly advise that all advisors consult with proper legal counsel for all matters related to employment law. RIA in a Box is not a law firm and does not provide legal advice.

The RIA registration process is composed of the following steps:

1. The first step a prospective RIA firm must take is to determine whether to register with the Securities and Exchange Commission (SEC) at the federal level or instead at the state level. This is dependent on the anticipated types of clients, the types of services which will be offered, regulatory assets under management, and the states in which the investment advisory firm will conduct business. At this point, the

prospective firm will also want to determine the total number of individual investment adviser representatives the firm will need to register.

Most advisors currently affiliated with an independent broker will initially register with the relevant state(s). Although there are a few exceptions, advisors that start an RIA with less than $100 million in AUM in fee-based assets must generally register with the relevant state(s). An RIA firm subject to state registration must typically register in any state in which it has a physical location, a representative physically located there, has 5 or more clients (or a single client in select states), or is physically soliciting in that state. Each state's registration process is also unique to the individual state. On the other hand, advisors that start an RIA firm with $100 million or greater in fee-based assets under management (AUM) must generally register with the SEC and notice file their firm in state(s) where there is a physical presence or the firm exceeds a de minimus number of clients.

- Pro tip: It is often confusing, but even though FINRA does not have any regulatory authority over RIA firms, it does administer the online application system for the registration of RIAs and their individual investment adviser representatives. Among other things, this means that individuals can use the same FormU4 system, but otherwise have no affiliation or regulatory responsibility to FINRA.

2. The second step is to create a new account with FINRA and the Investment Adviser Registration Depository (IARD). This is done by submitting an entitlement form directly to FINRA. Three to seven business days later, the prospective firm will receive a series of communications from FINRA with further instructions.
3. The third step, and the most complicated, is to construct the RIA firm's Form ADV filings, specifically the Form ADV Part 1, Part 2A and Part 2B. These forms will detail the new advisory firm's business practices and background of individuals associated with the firm. These documents must conform to the specific regulatory standards of the relevant state(s) or the SEC.
4. Once the Form ADV filings have been drafted, reviewed, and are ready for initial submission, the fourth step is to fund the established FINRA account with the appropriate registration filing fees. The total registration fee amount will be dependent on the number of investment adviser representatives, jurisdictions, and branch offices in addition to any required FINRA filing fees.
5. After funding the FINRA account and scheduling any required Series 65 examinations for individual investment adviser representatives, the prospective investment advisory firm must submit the Form ADV documents along with any relevant state specific paperwork. This will trigger a review by the relevant regulatory body. The submitted filings are subject to comment letters and further review if they are found to be insufficient or unsatisfactory to the regulator in any way.
6. The new RIA firm's application will not be complete without the submission of an individual's Form U4, so the sixth step a prospective advisory firm must take is to submit the Form U4 or Form U4s at their discretion. Submission of a Form U4 will notify the independent broker dealer at which the investment adviser representative is currently registered. Once the Form U4 is submitted, the regulator will have the complete application for review.
7. While awaiting final regulatory approval, it is important the prospective RIA firm craft the proper internal compliance documents the firm will need to conduct business in a compliant manner following the firm's registration approval (some states will require these *during* the regulator review period). These key compliance documents include:

    - Investment advisory contracts
    - Privacy policy statements

- Policies and procedures manual
- Code of ethics
- Business continuity plan
- Information security policy

In most cases, if the process is followed correctly and the proper documentation is filed to the regulator's satisfaction, the new RIA firm's initial registration application will ultimately be approved. The length of the entire registration process is subject to many factors including but not limited to the states in which the firm has requested approval, any potential issues with the application content, any proposed business practices that are not deemed acceptable by the relevant regulators, and generally the length of time in which it takes a prospective advisory firm to draft and create the numerous required filings. In general, advisors should budget 2-3 months of time to complete the entire registration process.

COMPLIANCE

The Advisors Act of 1940 (Advisors Act) primarily governs SEC-registered RIA firms while state-registered advisory firms must each follow their applicable state's statutes, rules and regulations. Below is a brief, but not exhaustive list, of some key regulatory requirements that advisors considering starting their own RIA firm should be aware of. While establishing the proper culture of compliance is a key component to building a successful RIA firm, compliance requirements should not be a deterrent to an advisor who is contemplating establishing an independent RIA firm. Compliance needs to be taken seriously but for the majority of firms, it can be managed in a time and cost-efficient manner with the proper help from technology and outside experts.

AN RIA FIRM'S FIDUCIARY OBLIGATION

The Advisors Act and state laws make it unlawful for a registered investment adviser to engage in practices defined as fraud or deceit. The antifraud provisions of the Advisors Act apply to all RIAs. The most substantial provision in the Advisors Act states that an RIA may not:

- Employ any scheme to defraud clients or prospective clients
- Engage in a practice that operates as a fraud upon any client or prospective client
- While acting as a principal for its own account, knowingly sell any security to, or purchase any security from, a client without disclosing to the client the capacity in which the advisor is acting
- Engage in any practice that is fraudulent, deceptive or manipulative

As a fiduciary, an RIA owes its client an affirmative duty of utmost good faith to act solely in the client's best interest and to make full and balanced disclosure of all material facts, especially with respect to actual or potential conflicts of interest.

The SEC and the states have articulated a number of requirements that flow from an RIA's status as a fiduciary, including a duty to:

- Place the interests of clients ahead of the advisor's business interests
- Refrain from trading on the basis of material, non-public information
- Allocate investment opportunities fairly and not favor client accounts that may benefit the RIA financially (such as proprietary accounts or accounts paying performance fees)

- Use soft dollars only for the benefit of clients and make full disclosure of the use of soft dollar arrangements
- Obtain best execution for client transactions where the advisor directs brokerage transactions
- Resolve trade errors in the client's favor and bear the cost of correcting any errors
- Ensure that investment advice is suitable in light of the client's objectives, needs and circumstances

FORM ADV FILING REQUIREMENTS

The Form ADV includes two parts:

- Part 1 is an online only form and requires information about an RIA's business location, ownership structure, basic operations and past disciplinary events.
- Part 2 is a document that is created locally and then uploaded to the IARD system. It is designed to be a "plain English" document and provide various information about an RIA firm's fees, investment style, potential conflicts of interest, brokerage practices, affiliations with other securities professionals, employees' education and business background, and other information relevant to a client's decision to hire the firm.

The Advisors Act generally requires every RIA to deliver Part 2 of Form ADV (or a brochure containing all the same information) to each client and each prospective client. The Form ADV Part 2 must be provided to clients at the time of entering into an advisory agreement. An RIA also must generally update and deliver a current copy of its Form ADV Part 2 on an annual basis and without charge and can be sent electronically with proper client consent. RIA in a Box's ongoing programs, for instance, includes assistance with the annual update as a standard part of all service. In addition, an RIA firm must completely disclose potential conflicts of interest with its clients on its Form ADV Part 2 and ensure it is in plain English for its clients to understand.

BOOKS & RECORDKEEPING REQUIREMENTS

The SEC and states require RIAs to maintain and preserve specified books and records, making sure they are available for inspection at any time.

The rules of each state or the SEC delineate an extensive list of these books and records, as well as the place and length of time they must be maintained. Also, electronic documents, including emails, must be maintained if they fall into any required record category. It is a general rule that all books and records be properly maintained and preserved in an easily accessible place for five years from the end of the fiscal year during which the record(s) was created. Records less than three years old must generally be readily accessible (usually maintained your office). Articles of incorporation, partnership documents, minute books, stock certificates and other corporate or organizational documents must be maintained continuously in your office in an easily accessible place while your business is in existence. All books and records must be maintained for a period of three years following the date the SEC receives notification that the business is terminated. Books and records are required to be maintained on a "current" basis.

ESTABLISHING INSIDER TRADING POLICIES, PROCEDURES, AND A CODE OF ETHICS

Every RIA firm is required to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by you or any person associated with your business. RIAs often add to these policies and procedures with proactive programs to review and place restrictions on personal trading by employees and other potential conflicts of interest. Common ways RIAs work to protect themselves are with educational programs and the adoption of blackout periods, restricted lists, and pre-approval of certain transactions.

The Advisors Act and similar state regulations make it unlawful for an RIA to provide investment advice unless the advisor has adopted and implemented formal written policies and procedures designed to: (i) prevent violations of the Advisors Act or similar rules by the advisor or its supervised persons; (ii) detect violations that have occurred; and (iii) promptly correct any violations that have occurred.

Fundamentally, the rule requires that each RIA firm:

- Establish and implement written policies and procedures reasonably designed to prevent violation of federal securities laws
- Review the firm's policies and procedures on at least an annual basis
- Designate a Chief Compliance Officer to be responsible for the administration of those policies and procedures

CONTRACTUAL REQUIREMENTS

Section 205(a)(1) of the Advisors Act limits the ability of an RIA to charge performance-based fees unless specific client qualifications and disclosure rules are met. This includes advisory contracts that compensate based on a share of capital gains of a client's funds.

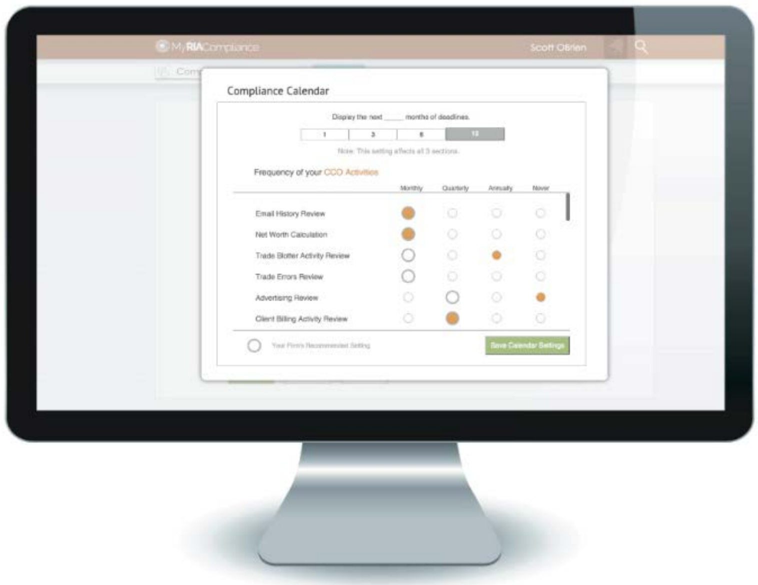
Written contracts between an advisor and clients are not expressly required by the Advisors Act. However, many state regulations do require written agreements, and as a matter of good business practice and for the purpose of enhancing internal controls and mitigating risk, every RIA firm should require that all contracts are in writing whether registered at the federal or state level.

HOW RIA IN A BOX PROVIDES COMPLIANCE SUPPORT TO RIA FIRMS

We provide ongoing compliance support to over 1,300 investment advisory firms. These firms range in size from the recently transitioned solo-advisor to firms with hundreds of advisors scattered across many offices. MyRIACompliance™ support services start at $195 per month for state-registered firms and $345 per month for SEC-registered firms. Our MyRIACompliance™ online software allows an RIA firm to more efficiently and proactively manage compliance and the technology is joined with a team of expert former regulators with SEC and state-level investment adviser regulatory expertise. This combination allows your firm access to leading technology and human expertise to answer compliance questions, review registration or marketing documents, provide Chief Compliance Officer training, or help prepare for an audit. We never charge by the hour and instead offer unlimited consulting time beginning with our professional service level.

In particular, our compliance support services are designed around the fact that many RIA firm principals wear multiple hats at the firm including acting as the Chief Compliance Officer. We also recognize that such principals are juggling a number of priorities and thus MyRIACompliance™ is designed to make the compliance process much more transparent and efficient. In general, we find that most advisors that have been previously affiliated with an independent broker dealer are better prepared than they realize to operate an RIA firm compliantly. Many of the RIA books and record-keeping requirements mirror the requirements that individual advisors previously had to meet while affiliated with an independent broker dealer.

At times, some advisors transitioning from an independent broker dealer have less compliance experience especially as it relates to supervising other staff members. As such, we have specifically designed our MyRIACompliance™ software to help such advisors better meet RIA compliance supervision requirements that generally begin when an advisor starts to build a staff. Our software creates electronic records and provides a real-time dashboard to ensure that all staff members are fulfilling their regulatory requirements in regards to proper disclosures and attestations.



MyRIACompliance™ RIA Compliance Software

HOW TO SELECT THE RIGHT RIA CUSTODIAN

In general, most new RIA firms will need to select a custodian. The custodian is the institution that will custody or maintain the firm's client assets and securities holdings. Under the custody rule of the Investment Adviser Act of 1940, investment advisers must generally use a “qualified custodian” or otherwise be subject to additional regulatory compliance requirements. Traditional investment advisory firms providing portfolio management services will often utilize the custody services provided by banks or broker-dealers that specialize in supporting investment advisers. The custodian selection process is a key step in starting an RIA firm as the custodian will become a vital business partner and may directly interact with the RIA firm's clients as well.

A clearing firm acting as a custodian for an RIA will generally hold client assets, process securities transactions, deduct advisory fees, and compile and deliver client account statements. When evaluating potential custodian options, an advisor should consider the following:

- Service

One of the primary motivations of operating as an independent advisory firm is the ability to serve clients in a highly customized manner. Much like many advisors view their high level of service as a differentiator, advisors should also carefully review the service aspects of potential custodians. The advisory firm should inquire about who they will be working with, which could be a particular person or a team. During the normal course of business, advisory firms will need to open accounts, reconcile trades, and transfer money to clients in urgent situations. Be sure to question how these types of interactions are handled from a service standpoint.

- Investment Platform

Investment advisers utilize different strategies and allocation models and will need access to different markets and securities to manage their clients' investments. A custodian will provide an investment manager access to an array of investment products including equities, bonds, exchange traded funds, options and other derivatives. For firms implementing an asset allocation or diversification strategy, a custodian can provide access to a wide array of fund families and numerous mutual fund offerings. Firms not specializing in money management can utilize third party institutional money managers through the separate managed account platforms offered by custodians. In addition, some clearing firms may provide access to a range of alternative investment products.

- Technology

In today's financial services marketplace, there is an ever increasing need and reliance on technology. The plethora of technology options available to advisory firms today is leveling the playing field and allowing independent advisory firms to compete with much larger financial institutions that often use outdated systems. RIA firms often need to manage client accounts, communicate with clients, properly bill and invoice accounts, provide performance reporting, and build financial plans while simultaneously managing a myriad of other processes.

A custodian may often offer in-house technology or access to 3rd party providers. An RIA firm should evaluate the technology options within the particular platform they will utilize and evaluate any particular support available in selecting and properly integrating systems. In addition, the advisory firm should review its internal systems to ensure that their clearing firm can support such systems.

- Value Added Business Support

Custodians have a thorough understanding of different types of advisory practices and the challenges that a firm can have in growing and operating their practice. A custody firm may offer guidance on essential business goal planning, strategies to obtaining new clients, access to studies on best practices, and guidance on the proper investment adviser technology to select. By taking advantage of such value added areas of expertise, an advisor can build a more efficient and scalable practice.

- Fit and Focus

There are many different advisory firms, and not all RIA custodians are the right fit for every type of practice. In addition, some traditional investment adviser custodians have minimum asset requirements for new firms. These minimums can range from $0 to over $100 million in AUM. Thus, while some custodians may be very willing to support smaller, emerging firms, other custodians focus on firms with well-established financial practices already operating in the IBD channel that are looking to transition to the independent RIA model. Thus, it is vital that an advisor properly define or categorize the type of firm they are looking to build and look to align with a clearing firm that best caters to them.

FIVE STEPS TO CHOOSING THE RIGHT TECHNOLOGY TO STREAMLINE RIA OPERATIONS

Investment advisory firms are notorious for not properly considering opportunity cost when making the decision to evaluate how and when to use technology in the operations of their firm. Whether you are just starting or seeking to further grow your practice, time is your most precious commodity and time is especially a limited source to the principal of a smaller RIA firm who is constantly wearing multiple hats.

Principals of independent firms typically alternate between Chief Executive Officer (CEO), Chief Investment Officer (CIO) and Chief Compliance Officer (CCO). It generally does not make sense for that same principal to also fill the Chief Technology Officer (CTO) role. Any technology task that takes time away from business development and relationship management responsibilities with prospective and existing clients is very expensive time. Furthermore, regardless of time, it is quite difficult for a principal of an RIA firm to stay on top of the latest industry technology trends and innovations in order to avoid costly mistakes that later need to be rectified.

We generally suggest that advisors leaving an independent broker dealer to establish an independent RIA firm explore the prospective firm's technology needs through a five step process:

1. Review the practice's specific business operations to determine particular needs
2. Establish an initial monthly technology budget
3. Determine the firm's desire to "build" vs. "buy" technology
4. Decide on general small business applications and other infrastructure
5. Select specific RIA technology and software solutions

STEP 1: REVIEW THE PRACTICE'S SPECIFIC BUSINESS OPERATIONS TO DETERMINE PARTICULAR NEEDS

This first step can at times be a bit daunting for many advisors that have never before had complete freedom as it relates to technology decisions. While a bit overwhelming, advisors can streamline the process by allowing for a bit of upfront planning discipline and structure as part of the process.

1. Review a firm's specific business operations to determine particular needs
   We believe it makes sense to review a firm's number of employees including specific functions, type of clients, type of services offered, and regulatory requirements to begin to establish a firm-specific technology road map.
2. Staff / Employees
   a. How many staff members will the firm employ?
   b. What are the job functions of each staff member?
   c. Does the firm have multiple offices?

   Solo-advisor firms have much different technology needs than a firm with dozens of investment adviser representatives scattered across multiple offices. As soon as a 2nd staff member is added to the firm, the needs of the firm now include efficient internal communications between staff members. Similarly, when a second office is opened, it leads to more cross-office communication, supervision, and key decisions about what functions should or should not be centralized at the home office.

   Most new RIA firms start as 1-3 individuals in a single office. As such, cross-office communication may not be an immediate necessity, but we strongly encourage all advisory firms to select technology systems which can scale with additional staff members and offices. There is no better time to install new technology than when a RIA firm is first being formed. Most notably, there will be little if any legacy data to load into the system. This all quickly changes once a firm begins operating. Transitioning from one system that has been outgrown to a new system is an experience that should generally be avoided whenever possible. Thus, it is vital to always look a few years into the future when making the initial technology investment. And yes, technology should be viewed as an investment that will yield dividends in the coming years.

When talking about future scalability, it is hard to overlook the value of web or cloud-based software systems. Virtually all new RIA software is web-based which means that the software is hosted by a 3rd party in the cloud and then accessed by an investment advisory firm or its clients via the internet. With the proper security precautions in place, most professional, cloud-based solutions also offer a more secure way to store sensitive client information. Be very cautious when considering a software solution that is not cloud-based.

3. Types of clients
    a. Will the firm primarily serve individual or institutional clients?
    b. What is the wealth and investment sophistication of the firm's target clients?
    c. Do clients have a strong desire to access real-time information online?

The vast majority of new RIA firms primarily cater to high net worth (HNW) individuals. However, other firms may focus on ultra-high net worth (UHNW) or institutional clients. In general, we see that firms catering to more institutional-like clients may require more advanced and detailed investment performance reporting capabilities. Regardless of wealth levels, there continues to be growing demand by retail clients to access investment information 24/7 via an online platform. However, depending on the size and sophistication level of a firm's clients, the firm may choose to provide different types of investment information to clients.

We generally find that new investment advisory firms that target the HNW individual client segment, do not need advanced portfolio management and reporting systems. This is largely due to the fact that we see many such firms looking to provide simplified reporting. Simplified generally means showing clients a consolidated personal balance sheet along with some other basic information. Today, the 50 page quarterly client meeting paper presentation is being replaced by an online portal that offers clients a single page summary of a client's current vs. target asset allocation, personal balance sheet (including accounts not managed by the advisor), and basic managed portfolio performance information.

4. Types of services offered
    a. Will the firm manage portfolios in-house or via 3rd party money manager(s)?
    b. Will the firm offer financial planning services to clients?
    c. Would the firm like to see a client's full financial picture including accounts the firm does not manage?

While the majority of newly formed investment advisory firms will directly manage client investment portfolios, a growing minority will look to a 3rd party money manager or a turn-key asset management platform (TAMP) to assist with portfolio management. While technology should not be the primary driver of such a key business decision, it is worth noting that firms that do not directly manage client portfolios generally will have fewer technology requirements as it relates to portfolio management and rebalancing software. In addition, such advisory firms are often less dependent on the trading technology and capabilities of the firm's custodian. Firms outsourcing portfolio management are at the forefront of the advisor-client relationship and often rely on a CRM system to ensure the client experience and relationship is being fostered.

On the other hand, many new firms that directly manage client portfolios are seeing the value of implementing a disciplined model portfolio system. While model portfolios can mean many different things depending on the investment style of a particular firm, in general, implementing a model system allows a firm to not only operate much more efficiently, but also offer a more standardized client investment experience. Internally, such a disciplined practice allows a firm to be sufficiently served by simpler, more cost efficient portfolio management solutions. In addition, this also enables an easier installation of standard client reporting packages, update letters, and much more. We'd argue this not only leads to a more efficient and profitable business operation but also a much better client experience.

In RIA in a Box's latest 2015 survey, 59% of RIA firms first registered in 2014 disclosed that they do offer financial planning services. This figure has remained relatively steady in recent years. In addition, our survey revealed that nearly 65% of firms with less than $50 million in assets under management (AUM) that offer financial planning services utilize a financial planning software system. We see adoption by new firms to be slightly lower than this, but in general, advisory firms that offer financial planning services will invest in purchasing one of the popular RIA financial planning software solutions. Firms that do not make such a purchase are often performing basic calculations using Microsoft Excel. However, given the figures noted above, it is important to know that less than 40% of new investment advisory firms are choosing to purchase financial planning software.

However, whether offering financial planning services or not, in tandem with providing simplified performance reporting which includes a personal balance sheet, many new RIA firms are beginning to implement automated account aggregation. Automated account aggregation allows an advisor to view a client's outside checking, savings, investment, credit card, or mortgage accounts with the balances being updated automatically on a daily basis. Such technology has evolved a long way over the last few years and now prevents an advisor from ever having possession of a client's login credentials which is a common, yet major compliance mistake to avoid. Automated account aggregation can greatly improve the client experience by offering a Mint.com-like online experience to clients while also providing an advisor with valuable insight into client assets that are currently held elsewhere.

5. Regulatory Requirements
    a. Will the firm store required books and records electronically?
    b. How will the firm archive all forms of correspondence and advertising?
    c. Is the firm required to send billing invoices to clients?

As RIA compliance consultants, we generally find that the most organized and compliant firms are using technology to assist with investment adviser compliance requirements. We suggest that new RIA firms do not install their own client server in the office. Instead, we strongly encourage all RIA firms to utilize a secure, cloud-based document storage system. A local server in the office is not only often costly, but also a common information security risk as most small advisory firms do not have the internal capabilities or budget to properly manage a server with the required security patches and back-up procedures.

All firms also need to install a system to properly archive all client correspondence. Don't forget that social media posts and website content also need to be reviewed and archived.

Many state-registered RIA firms are required to send separate client billing invoices in addition to the client receiving a custodian statement. Regardless, if required to or not, we always recommend that all state and SEC-registered RIA firms send separate client billing invoices as a best practice. Unfortunately, we often find that the generation and distribution of quarterly billing invoices is one of the more cumbersome operational tasks for any size investment advisory firm. Thus, we strongly encourage advisers to look for a system that helps streamline the automatic creation and electronic distribution of fee billing invoices to clients.

STEP 2: ESTABLISH AN INITIAL MONTHLY TECHNOLOGY BUDGET

We believe an advisor should divide this exercise into two parts:

1. Per firm costs
2. Per user or per advisor costs.

Before we dive a bit more into those two categories, however, we need to make two key assumptions. The first is that the firm will utilize cloud-based technology. Today, we see very few firms, regardless of size, not adopting web-based software and document storage. The vast majority of technology experts believe the cloud is not only more economically attractive to small businesses, but generally also more secure as most firms do not have the knowledge and resources to manage an on-site server and infrastructure. Also, by selecting a cloud-based technology, advisory firms can generally greatly reduce the upfront costs of starting a new RIA firm due to the fact that there are less upfront capital investments into physical infrastructure.

Second, we are making the assumption that this is a new, state-registered RIA firm with $100 million or less in assets under management (AUM). In our experience as RIA technology consultants, we do often see the technology needs of a firm begin to become more complex and costly once a firm reaches around $100 million in AUM.

Per Firm Costs

- General Small Business Needs
    - Office internet: $50-$150/month
    - Website hosting: $25-$75/month
    - Accounting software: $20/month
- RIA Industry-Specific Needs
    - Portfolio Management / Reporting (PMR) software: $200-$2,000/month
    - Automated billing software: $50-500/month
    - Client Portal: $50-200/month

Using the components above, we find that the average per firm-based technology costs for state-registered RIA firms are as follows:

Per Firm-Based Technology Costs Per Month		
Low Estimate	**Average**	**High Estimate**
$400	$600	$2,800

In general, we see most firms spending around $400-800 per month for the bundle of components listed above. However, RIA firms with these characteristics will often experience higher monthly costs:

- Firms with over $50 million in AUM
- Firms that offer complex performance reporting to clients
- Firms that cater to the ultra-high net worth (UHNW) client segment
- Firms that bill clients on a monthly rather than quarterly basis
- Firms extensively utilizing automated outside account aggregation

It is also important to note that the costs of portfolio management, reporting, and billing software along with a client portal are often tied to AUM, number of clients, number of accounts, or a combination of any of those three factors. Thus, as the firm grows, the firm needs to budget for additional costs related to those systems as they are not true fixed, per-firm costs.

Per User/Advisor Costs

One important distinction to highlight when looking at per user/advisor costs is that some systems will treat all users the same, whether the user is an investment adviser representative (an advisor) or a client service representative. On the other hand, some of RIA-industry specific technology solutions will only charge per advisor and not charge extra for client service representatives.

- General Small Business Needs
  - Voice Over IP (VoIP) Phone system: $50/user/month
  - Email hosting: $5/user/month
  - Desktop software: $10/user/month
  - Document storage: $15/user/month
  - Customer relationship management (CRM) software: $30-$150/user/month
  - Email / social media / website archiving: $75/user/month
- RIA Industry-Specific Needs
  - Financial planning software: $100-300/advisor/month

Using the typical components above, we find that the average monthly per user or per advisor-based technology costs for state-registered RIA firms are as follows:

Estimated Total Monthly Per Advisor and Per Client Service Rep User Technology Fees												
	Number of Client Service Reps											
Number of Advisors	0		1		2		3		4		5	
	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High
1	$220	$370	$220	$370								
2	$440	$660	$660	$960	$880	$1,180						
3	$660	$1,110	$880	$1,330	$1,100	$1,550	$1,320	$1,770				
4	$880	$1,480	$1,100	$1,700	$1,320	$1,920	$1,540	$2,140	$1,760	$2,360		
5	$1,100	$1,850	$1,320	$2,070	$1,540	$2,290	$1,760	$2,510	$1,980	$2,200	$2,200	$2,950

The low vs. high cost ranges for each staffing scenario above are primarily driven by whether an advisory firm offers financial planning services and decided to provide financial planning software to its advisors.

The three primary factors that can drive the costs above the estimates listed in the above table are:

- Utilizing more sophisticated CRM software
- Choosing more advanced financial planning software
- Firms with more than 5 advisors and client service representatives

Calculating the Total Monthly Technology Budget for Your RIA Firm

As discussed above, an RIA firm's monthly technology costs are generally driven by per-firm as well per-user/advisor costs. Combined, they equate to a firm's total monthly technology cost. There will be some fixed per firm costs that are generally unavoidable even for the smallest of investment advisory firms. However, as firms grow over time, key drivers of increasing monthly technology expense will be the addition of new staff members, growth in assets under management, and the opening of new offices.

Of course, there will be a wide variance in monthly technology costs for firms depending on a variety of factors. However, we generally find that a solo-advisor RIA firm (1 advisor, 0 client service representatives) should budget around $650-$1,000 in total per month on technology. Depending on circumstances, each additional staff member will cost around $300-$800 per month depending on whether the staff member is an advisor or client service representative and other factors such as the number of clients, the total assets that the advisor is managing, and whether the advisor is located in a new remote office.

STEP 3: DETERMINE THE FIRM'S DESIRE TO "BUILD" VS. "BUY" TECHNOLOGY

To be clear, by "build", we do not mean to literally go out and build and develop a new software application, but rather to build a customized technology suite by integrating a number of different RIA-industry software solutions. By "buy", we mean selecting a pre-built RIA technology platform to utilize as the hub of the firm's client service and internal operational needs.

When making the buy vs. build decision, it is also important to note that when exploring the "build" option not all software "integrations" are created equal. Unfortunately, there is no standard integration.

In general, RIA technology integrations fall into one of these three broad categories:

1. Single sign-on (SSO): The ability for a user to login to multiple software solutions with a single login credential. This is the most simplest of integrations and allows a user to not have to login separately to multiple systems.
2. One-way integration: Data is pushed from one system to another system but only in one direction.
3. Two-way integration: Data is pushed and received from one system to another in both directions.

Thus, when a vendor says that the software is integrated with another solution, it is crucial to probe a bit further and better understand the depth of the integration. However, even if there is a two-way integration in place, it is important to remember that whenever data is being housed by two separate systems with independent data infrastructures, no integration is ever going to be perfect so it is vital to have the proper expectations.

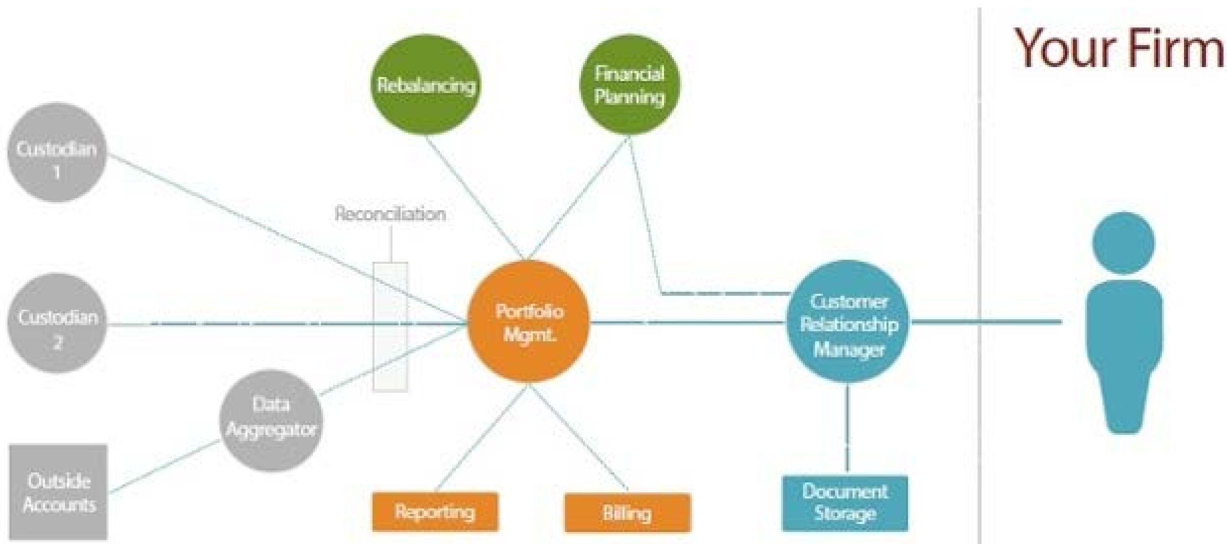
Regardless of whether a firm makes the buy or build decision, we cannot emphasize enough how important it is for any size RIA firm to view technology as an investment rather than as a cost. Every year, RIA in a Box's annual investment adviser technology survey illustrates that investment advisory firms that are aggressively adopting technology continue to grow at a faster pace than their peers that have not made a technology investment. We consider aggressive adopters of technology to be any firm that is utilizing three or more key RIA technology components (customer relationship management (CRM) software, portfolio management and reporting (PMR) software, financial planning software, etc.).

According to our survey, RIA firms that are aggressive adopters of technology grew assets under management (AUM) by 12.71% in 2014 compared to an average AUM growth of 3.25% for firms that do not utilize any industry technology. In addition, only 11.69% of aggressive technology adopters had a decline in AUM in 2014 compared to 23.98% of firms that do not adopt any investment adviser technology.

As shown in the table below, we believe that most investment advisory firms should not attempt to build their own integrated RIA technology suite until they reach close to $100 million in AUM:

	Pros (+)	Cons (–)	Costs ($)	Best For
Do Nothing	No immediate financial cost	ER is more expensive than preventative care	Larger long-term cost and risks	No one
Do It Yourself	Become an RIA technology expert	Lack of expertise and not best use of time	High opportunity cost + technology costs	Generally firms with $100 million or more in AUM
Utilize a Platform	More affordable, constant improvement, and expertise	May not offer complex reporting	For RIA in a Box client, starts at $325 per month	Most firms with less then $100 million in AUM

As discussed in our RIA Systems and Operational Best Practices white paper and as depicted in the sample diagram below, we strongly encourage all advisory firms to focus on making the CRM system the hub of a firm's technology platform:



More so than ever before, there is a lot of great technology available to RIA firms. However, the lines between different categories have become a bit blurred and sorting through all the different options can be bit overwhelming. As such, we are seeing an increasing number of RIA firms choose a platform as an attractive alternative to piecing together their own integrated technology system. In addition to often gaining access to better technology at a more affordable price, some of the other benefits of utilizing a single platform solution include:

1. There are tremendous efficiency gains when all data is stored in one system. No more data uploads or manual entries are needed. Real-time reports are always instantly available.
2. Better technology adoption since there is only one system to be trained on and less confusion as to where to find what information in which system.
3. Ability to have a more proactive compliance monitoring system to help prevent potential registration and filing issues.

STEP 4: DECIDE ON GENERAL SMALL BUSINESS APPLICATIONS AND OTHER INFRASTRUCTURE

We generally define small business software applications as technology that was not designed for the investment adviser industry, but can complement RIA industry-specific technology to complete an investment advisory firm's full technology suite.

While RIA firms have many unique technology needs, they also share many generic technology needs with many other similar small businesses. Some of these general software and infrastructure needs include:

Per Firm Costs

- Office internet

The options will vary based on a firm's geographic location. While much more expensive and robust solutions exist, we generally see small firms (3 or less employees) spending around $100 per month on an office internet connection. When considering options, be sure that the connection has enough upload speed especially if the firm is utilizing cloud software applications and a voice over internet protocol (VOIP) phone system.

- Website hosting

We see many firms consider Smarsh Sites or other RIA-industry specific providers. Most firms will spend around $50 per month on website hosting. It is also important to remember that an RIA firm's website content needs to be archived.

- Accounting software

We see many firms utilize QuickBooks Online. Most RIA firms will pay less than $20 per month. Keeping accurate and up to date financials is one of the key investment adviser compliance books and records requirements.

Per User Costs

- Phone system

Most firms now utilize voice over internet protocol (VOIP) providers. There are a number of different providers out there. Costs and the quality of service will greatly vary but we see many firms paying around $40-50 per month per phone user.

- Email hosting

Microsoft Office 365 charges $5 per month per user ($12.50/month/user when combined Microsoft Office applications). Office 365 is a cloud-based solution and allows users to access email via an application such as Microsoft Outlook or via the web. Google Apps is a solution also growing in popularity and begins at $5 per month per user.

- Desktop software

Microsoft Office desktop applications are still the mostly widely utilized in the investment adviser industry. Firms can choose to pay one-time license fees or pay monthly at a cost of $8.25 per month per user ($12.50/month/user when combined with Office 365 email). This package includes the Word, Excel, PowerPoint, Outlook, Publisher, and OneNote applications.

- Document storage

Most RIA firms today are utilizing cloud storage solutions. There are a number of solutions in the marketplace including Box. Costs will greatly vary from free to upwards of $25 per user per month. When considering such solutions, be sure that the solution has the proper cybersecurity safeguards and user audits and controls.

In addition to the above more common general needs, some RIA firms will also explore these types of technology:

- Electronic signature

There are a number of providers, but the most popular solution in the investment adviser industry appears to be DocuSign. Pricing starts at around $20 per user per month. However, it is important to note that there has not been any clear guidance issued by the SEC or the states as it relates to an RIA firm's use of electronic signatures from a regulatory standpoint although industry adoption continues to rise.

- Online meeting software

Solutions range from free solutions such as Join.me to a more traditional provider such as GoToMeeting that starts at around $40 per month and includes more advanced features.

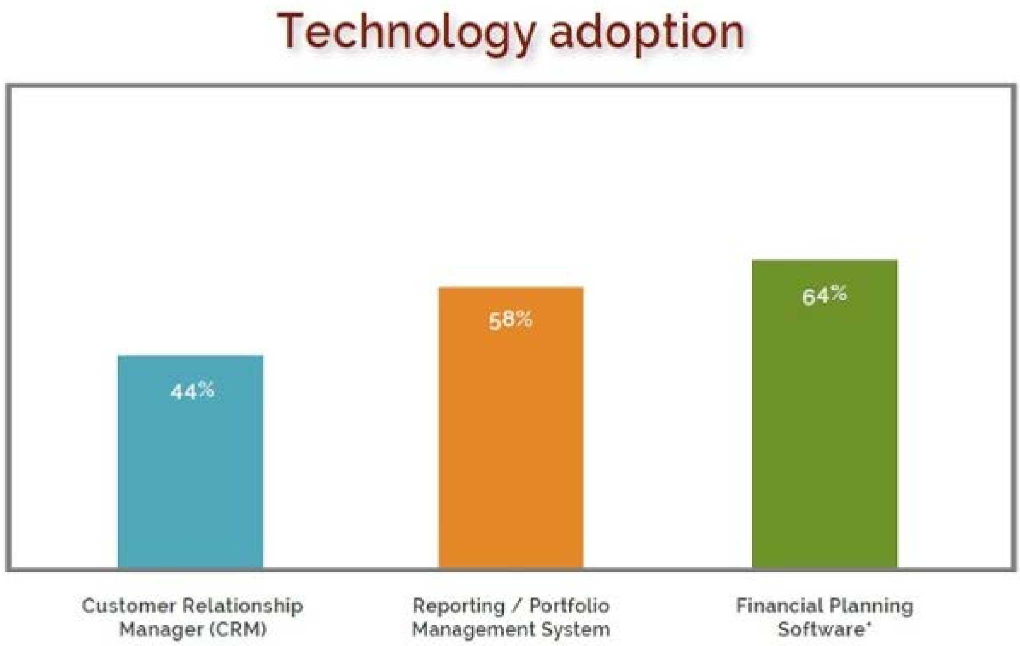
STEP 5: SELECT SPECIFIC RIA TECHNOLOGY AND SOFTWARE SOLUTIONS

We generally define investment adviser industry software as technology that was designed for use exclusively for the investment adviser or broader financial advisor industry. Whereas most small businesses may need a website, firms in the investment advisory industry have unique technology needs specific to managing, reporting on, billing on, and communicating about their clients' investment portfolios and financial goals.

As demonstrated in our recently published RIA technology landscape infographic, investment adviser technology offerings continue to rapidly evolve. We generally define the industry technology categories as:

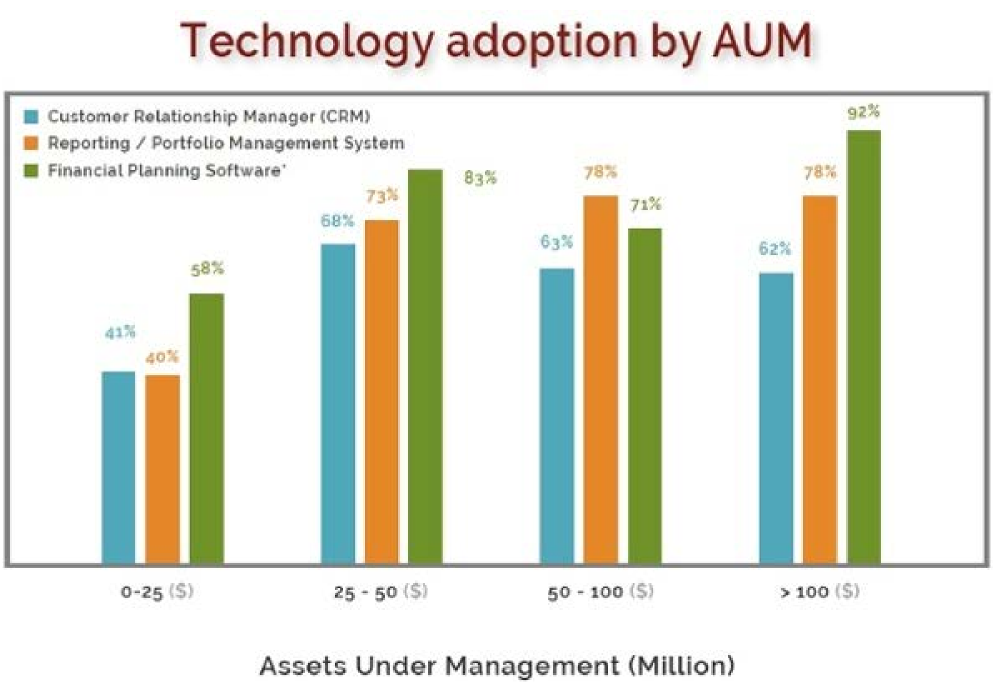
- Customer relationship management (CRM)
- Portfolio management / reporting (PMR)
- Financial planning
- Document management / storage
- Archiving
- Data aggregation
- Rebalancing
- Portfolio risk
- Billing
- Marketing / lead generation

The three investment adviser industry software categories that we see most commonly adopted by RIA firms are CRM, PMR, and financial planning. The results of our 2015 RIA Technology and Investment Operations Survey of over 850 RIA firms reveal the following:



* Only includes firms that offer financial planning services

As to be expected, adoption of these key software components does trend upward as the assets under management (AUM) for a firm increases. In particular, we see a significant increase in RIA firms purchasing customer relationship management and portfolio management software once the firm reaches around $10-15 million in AUM:



* Only includes firms that offer financial planning services

However, along with the rapid evolution of technology in the investment advisory space, the lines between traditional "categories" are becoming more blurred. Some systems fall into multiple categories as they may function for example as a combined portfolio management / reporting, data aggregation, and billing tool. On the other hand, many systems are exclusively focused on a specific task such as CRM, rebalancing or archiving.

Given this overlap between different software solutions, we instead often advise the principal of an investment advisory firm to begin the RIA technology selection process by first defining the key business tasks that the integrated system or platform will need to be able to perform. This process allows the principal to approach the technology diligence and purchasing process in a more efficient manner. Rather than blindly demoing a number of potential solutions, the principal can first ask vendors specific questions to see if the system(s) will meet the firm's critical needs.

CREATING LONG-TERM BUSINESS ENTERPRISE VALUE BY BECOMING FEE-ONLY

How businesses are valued in the wealth management industry is no different than how small businesses in any industry are valued. Generally, a potential buyer is more willing to pay a premium to acquire a business when these characteristics are present:

- Contracted, recurring revenue rather than one-time, product-driven revenue
- Clients can easily be transitioned to the acquirer
- Low client concentration with no client being a significant percentage of revenue
- High profitability margins
- An expanding market with long-term revenue growth potential

Advisors in general, regardless of their current affiliation, are fortunate to benefit from attractive profit margins and a demand for investment advice that continues to grow. While transitioning to the independent RIA model is unlikely to have much impact on an advisor’s current client concentration, such a transition can allow an advisor to:

- Shift from a one-time, commission revenue model to a recurring, fee-based revenue model
- Establish a separate, registered entity that is much easier logistically for a potential buyer to acquire

Furthermore, by transitioning to a new business entity that is fully owned by the principal or group of principals, this may create an opportunity for the owners of the RIA to realize capital gains tax treatment rather than ordinary income tax treatment upon the future sale of the business. This opportunity alone can create significant after-tax value. As such, we strongly advise all advisors to always seek proper tax and accounting guidance when first establishing an independent RIA firm.

VALUE CREATION WHEN TRANSITIONING TO THE INDEPENDENT RIA MODEL

To quantify the value creation an advisor could experience when transitioning to an RIA, it is important to note that in general, the majority of RIA firms, or any other wealth management book of business, will traditionally be valued as a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA). EBITDA serves as a benchmark for a business’s level of profitability. While revenue matters, two firms with $100 million of assets under management each generating $1 million in annual revenue may be worth vastly different values depending on the level of profitability.

Transitioning to the RIA model allows an advisor to fully manage his or her firm's profit and loss statement and determine how to best optimize for growth and profitability. As depicted above in both transition scenarios on pages 7 and 8, transitioning to an RIA model can allow an advisor to immediately improve profitability. Assuming a state-registered RIA firm with $100 million or less in AUM may be valued at around a four times (4x) EBITDA valuation multiple, a $75k increase in annual profitability as depicted in scenario 2 on page can lead to a $300k increase in total firm enterprise value. Thus, not only can an advisor generate increased profits whole operating the RIA firm, but the advisor can also receive a much higher valuation when looking to one day sell the firm.

VALUE CREATION WHEN TRANSITIONING FROM COMMISSION TO ADVISORY FEE REVENUE

The ultimate enterprise value creation opportunity for an advisor is to use the transition to the RIA model as an opportunity to fully transition his or her business from a commission to fee model. Commission-focused advisor practices tend to sell for much lower valuation multiples compared to fee-based advisory businesses. At times, commission-driven practices may only sell for two times (2x) EBITDA valuation multiples compared to 4x EBITDA multiples for fee-based practices. The reason for such a sharp valuation discount is that commissions are much more difficult to predict in the future due to their infrequency and lack of contracted, recurring revenue.

To quantify this a bit further, consider an advisor affiliated with an independent broker dealer today that does around $400k in annual production split evenly between commissions ($200k) and advisory fees ($200k). Today, the practice may be valued as such:

	Revenue	Profit Margin	Profits	Valuation Multiple (x)	Total Enterprise Value
Commissions	$200,000	40%	$80,000	2	$160,000
Advisory Fees	$200,000	40%	$80,000	4	$320,000
Total	**$400,000**	**40%**	**$160,000**	**3**	**$480,000**

However, if the advisor was to transition the $200k of commission production to instead $200k of advisory fee revenue, the practice may instead be valued at a significant premium as depicted here:

	Revenue	Profit Margin	Profits	Valuation Multiple (x)	Total Enterprise Value
Commissions	$0	40%	$0	2	$0
Advisory Fees	$400,000	40%	$160,000	4	$640,000
Total	**$400,000**	**40%**	**$160,000**	**4**	**$640,000**

Thus, by an advisor with $400k of annual production split evenly between commissions and advisory fees that transitions to a 100% fee-based advisory practice may be able to generate $160k in increased enterprise value. Now, if the advisor affiliated with an independent broker dealer transitions those fee-based advisory assets to an independent RIA model and further improves his or her overall profitability, even further enhancements in enterprise value creation can be achieved.

WHY MAKE THE TRANSITION NOW?

With the continued movement towards fiduciary advice, we strongly believe that the RIA model offers advisors the opportunity to best serve clients by placing client interests first. As the general investor population continues to become more educated on the various financial advisor business and compensation models, advisors should expect investors to more frequently desire to work with true fiduciaries. Rarely is there a business model that properly and uniformly aligns both the client and service provider's interests. While the investment adviser model may not be perfect, it does provide advisors with a platform to deliver exceptional fiduciary advice for years to come.

To schedule a complimentary consultation on how to best transition from the independent broker dealer to RIA business model, please visit www.riainabox.com or call us at (866) 611-7638.

About RIA in a Box®

RIA in a Box® is a fast-growing, entrepreneurial financial services firm that is a leading provider of registration, compliance, and operations support services to registered investment adviser (RIA) firms throughout the United States. Since 2005, our mission has been to enable fellow entrepreneurs to create their own registered investment advisory firms and receive the ongoing support they need to successfully operate while maintaining constant regulatory compliance.

Our MyRIARegistration™ solution guides prospective RIA firms through the entire registration and business planning process. Once a firm is established, our MyRIACompliance™ investment adviser compliance programs pair our award-winning online software platform with compliance consulting expertise provided by our team of former regulators. In addition, our MyRIAOperations™ solution supports RIA firms with an integrated technology platform that helps to automate and more efficiently manage client communication, billing, and reporting.

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