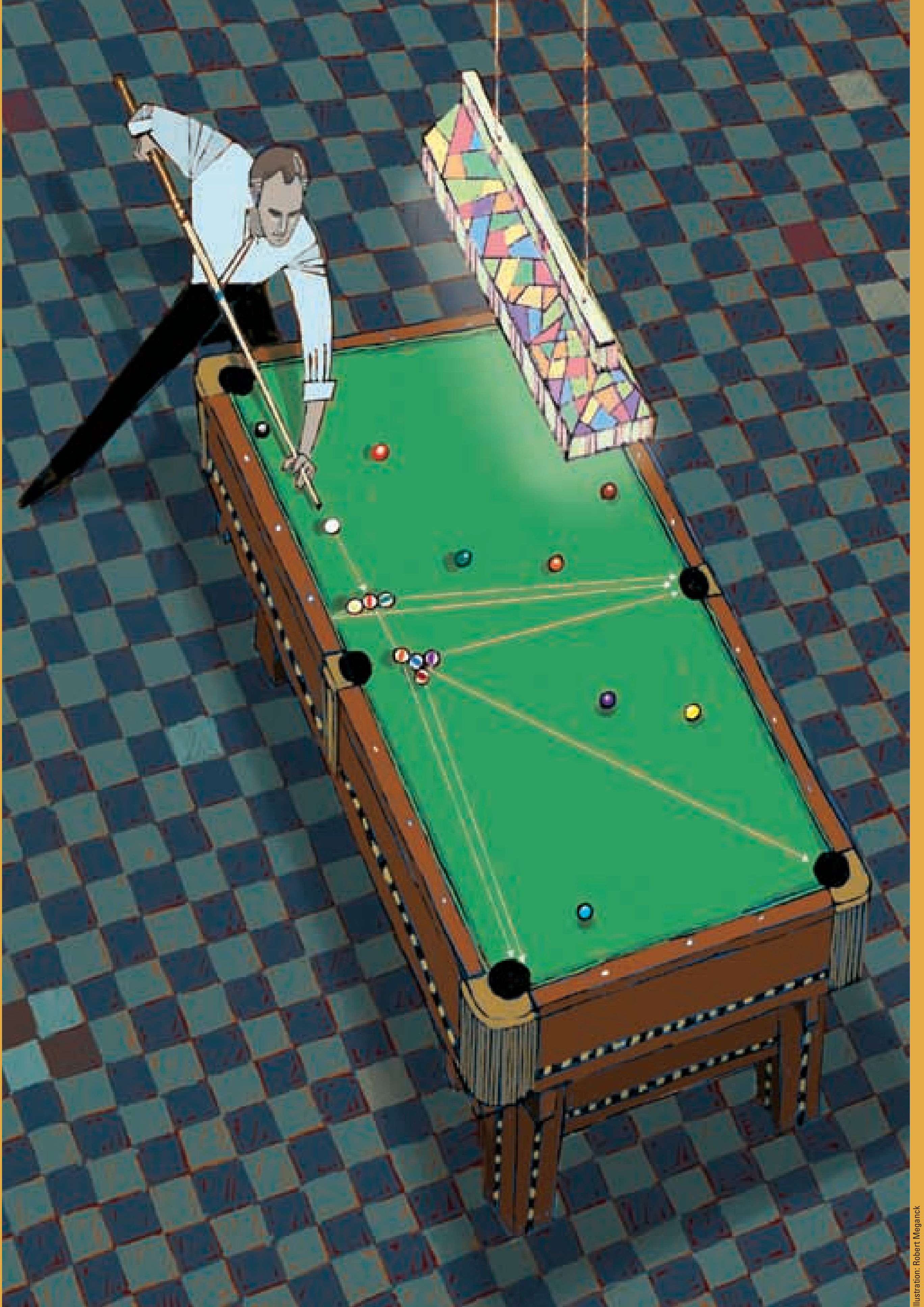

Illustration: Robert Meganck

INDEPENDENT Variables

Think you're ready to join the growing number of advisers starting their own firms? Make sure you consider all the angles

BY ED MCCARTHY

The lure of starting your own firm includes the ability to set your own hours, the freedom to work with the clients you select rather than those assigned to you, an opportunity to manage wealth as you believe it should be managed, and a chance to earn more money and build equity in your own business.

Most of the major custodial firms that serve independent registered investment advisers (RIAs) decline to share specific details about the number of newly minted independents affiliated with their firms. Anecdotally, however, they all agree that the number of advisers making the transition has grown consistently in the last five years and that this growth continues to accelerate.

No doubt, independence has its benefits—even firms managing a relatively small amount of assets under management can compensate their owners generously and offer a better work–life balance. But going independent is a major step that requires an examination of one's skills and temperament, adequate financial resources, and a sound business plan. No guarantees of success exist, and the dream of achieving a more balanced life can vanish with 70-hour work weeks in the early years.

Steve O'Neill, senior sales manager with TD Ameritrade Institutional in Jersey City, New Jersey, works with advisers who are moving their business to TD Ameritrade Institutional. He says one of the biggest challenges that he has seen associated with going independent is "making that mental commitment to be an entrepreneur." Advisers who worked as employees are accustomed to having all the services—benefits, technology, performance reporting, research—handled for them. Giving up that degree of support can be a difficult adjustment. "Everyone in the industry talks about payout or financial benefits and some of the other things that are associated with being independent," says O'Neill. "It's really about being your own boss."

First Considerations

Diane MacPhee worked as an independent financial adviser for 16 years before starting DMAC Consulting Services, LLC in Manahawkin, New Jersey, a consulting and coaching firm for financial advisers. She advises others to avoid rushing the decision to go independent and recommends that prospective independents start with some self-examination. "You need to identify what will bring out the best in you if you go out on your own," she says. "Do you want to work in a home office or in a commercial building? Who are the clients that you want to have? You need to lay the foundation first, even though you're under pressure to make money."

As MacPhee notes, money matters. Transitioning advisers need adequate financial reserves to survive the start-up period, which can range from three months to a year or longer. She recommends developing a realistic estimate of how many clients will stay with the adviser, because those clients' fees usually constitute a large part of revenues in the new firm's early years. If an adviser is bound by an agreement

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DIANE MACPHEE

that forbids him or her from taking clients for a period of time after leaving the current employer, that constraint must also be considered. Even if the adviser is free to solicit former clients, however, a risk still exists that those clients will decide against transferring. "People do not react to change very easily anyway," says MacPhee. "You want to make the transition as smooth as possible and have a very well-prepared script where you explain to the client why you're doing this and why their best interests will always be with you. That needs to be very well articulated for [the transition] to go smoothly."

Taking the Plunge

The list of tasks an adviser must complete for a successful launch as an independent is daunting (see "New Adviser Timeline" sidebar on 41) but that didn't dissuade Leslie Beck, CFA, owner of Beck Investment Management in Palo Alto, California. Beck began her career as a stockbroker in 1980. In 1989, she earned the CFA charter and began working as an equity analyst on the institutional side. In time, she was managing more than US$500 million as a portfolio manager at JP Morgan and then took a six-year hiatus to raise her daughter.

Beck returned to financial services in November 2000 and worked on a project with myCFO, based in San Francisco. She did not, however, want to commute from her home in Cupertino, California, so she worked for several local independent wealth management firms. But shortly after her arrival at each firm, her new employer was purchased by a large bank and Beck would find that the new business practices did not mesh well with her approach to wealth management. She still wanted to work with an established independent firm in her area, but she did not want to go through another buyout. "When I was looking at other firms, most of the people were ready to retire," she says. "I could see that I would again be in a situation where I would be working with very nice people, very capable people, but they'd probably sell the firm in a year or two—and again probably to a bank because the banks have the deeper pockets. At that time last year, I was 51, and I didn't want to be caught at 55 looking again for a job and asking where do I want to go."

Beck's experience gave her clear ideas about how she wanted to run a wealth management firm. She had written a five-year business plan for starting her own firm and knew exactly what steps she needed to take. Marketing and attracting clients, in addition to handling the myriad administrative tasks required to run a business, were among the main challenges she knew she would encounter.

Beck asked other local wealth managers for advice, and they strongly recommended that she start her own firm. They offered her outsourcing arrangements to reduce the amount of time she would have to spend on administration, compliance, and other back-office chores. Curt Weil, a principal with Lasecke Weil Wealth Advisory Group, in Palo Alto, CA, offered to serve as Beck's back office. Dave Campbell, owner of Nye Company in Palo Alto, CA, manages Beck's compliance requirements with the state of California. She also received extensive guidance in setting up her firm from her custodian, Charles Schwab Institutional.

Beck opened her firm in June 2007 and uses an executive offices suite to meet with clients, but she still faces the major hurdle of attracting clients. She relies exclusively on referrals, and her marketing efforts received a boost in June 2008 when she was featured in *Forbes* magazine by Goldline Research as one of "The Ten Most Dependable Wealth Managers for Women." Despite the challenges she has encountered, Beck has no regrets about her decision to start her own firm. "I would highly encourage it [for other advisers]," she says. "I wish I had done it earlier."

Mark Toledo, CFA, also went the solo route when he started Total Portfolio Management in Evanston, IL, in 2003. He worked for an independent investment advisory firm for 17 years, but in the early 2000s, that firm began narrowing employees' job responsibilities into more specialized tasks. That specialization didn't appeal to Toledo, who enjoyed having a broader set of responsibilities that included new business development and client service in addition to managing a multi-asset-class portfolio.

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LESLIE BECK, CFA

In March 2003, Toledo began to seriously consider launching his own firm. He started the process by determining the overall investment philosophy he wanted to follow and his target market. After resolving those two issues, he considered the strategic alliances he would need to implement the plan. For investment management, he contacted Dimensional Fund Advisors, based in Santa Monica, California, about becoming an approved adviser in their investment advisory network, and he now works with Dimensional in that capacity. To reduce his overhead expenses, Toledo leased office space from a local accounting firm and paid them for administrative support. That arrangement gave him a professional setting in which to meet clients and reduced his initial outlays for phone systems and similar items.

Because Toledo's previous employer imposed a one-year no-solicitation clause, which prevented him from approaching previous clients, he was forced to build his clientele from scratch. Initially, Toledo had planned to focus on two markets: smaller public-sector clients—for example, municipal pension plans—and high-net-worth individuals. He found, however, that his firm's lack of a long-term record made it impossible to secure public-sector accounts, so in 2007 he decided to focus exclusively on individuals. His change of focus has paid off, and as of summer 2008, he works with 21 households and has approximately US$70 million dollars in assets under management.

An Ensemble Approach

Starting a new wealth management firm does not always entail going solo. Darin Pope, CFA, had worked in portfolio management for Key Private Bank and Citizen's Bank and he witnessed a series of corporate changes, both reorganizations and mergers, that had discouraged him. "My concern was, over time, that it was just difficult for me, in that type of environment, to maintain client relationships," he says. "It left me with a situation where I really wasn't able to develop long-term relationships with clients, and that was very important to me."

As Pope considered his career options, he reflected on what he liked and disliked about his work. He concluded that he enjoyed portfolio management and interacting with clients, but he didn't enjoy the administrative and operational tasks required to support the portfolio management process. "I realized that if I was going to do what I loved full time, I needed to partner with people who really wanted to do some of those other things and leave the investment management piece to me. I had to find people with different skill sets, different interests, and different things that they wanted to do."

Finding partners with those complementary skills wasn't easy. As Pope contacted other firms to discuss the prospect of joining them, he found that the advisers were similar to himself. "There were two, three, four, or five other people sitting around the table, and they were all just like me," he says. "They were all portfolio managers, all with the same personality, the same attitude, and the same outlook on things. I said to myself, does this group really need another person like me? And the answer often was: not really. I mean, I'm not sure how much additional value I bring to the table in this group."

As part of his job search, Pope contacted an executive recruiter, who put him in touch with two business partners interested in starting a wealth management firm. Pope met with them, and the trio realized that their experiences and skills would blend well. They were also looking for people with complementary talents to round out their team. "I met the two partners who were looking to start up United Atlantic Advisors, which is now United Advisors," he says. "These were people with more of an entrepreneurial bent. In other words, they were business people who wanted to start a business, and they were looking for people to partner with. They were looking for an investment management person, and they also were looking for an operations person."

Pope joined the new firm at year-end 2004 and is now a principal with United Advisors in Secaucus, New Jersey. The company has acquired several small, independent advisory firms and has more than 15 employees located in five states. Pope advises other CFA charterholders who are considering going independent to determine "what you love to do, find a way to make sure that you are able to do that fulltime, and don't hesitate to partner with individuals who love to do what you don't want to do. I think we're all hesitant of that

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>
> DARIN POPE, CFA

because we want absolute, complete control—of course, that's why we're going independent. But you can have that by simply, at some level, taking a look at what you really love to do and what you don't like to do and then finding people who would be equally freed by doing what they love to do, which complements what you love to do."

Available Resources

The custody firms that work with independent advisers recognize the business opportunity that results from assisting advisers in transition. For example, Fidelity Institutional Wealth Services, Bank of New York Mellon's Pershing Advisor Solutions, Raymond James, and TD Ameritrade Institutional, have dedicated staff and programs to assist with transitions. (The Charles Schwab Corporation declined requests for information.) Some programs are geared toward fee-based RIAs. Others, such as Fidelity's HybridOne, allow a mix of commission-based and fee-based businesses. As a rule, the programs do not charge separate fees for the services they provide during the transition, which usually takes from three months to a year to complete.

The custodians' transition programs provide assistance with a variety of needs, ranging from the search for office space to technology setup. "We help with hardware, software, connectivity, security, networking issues, and all of the things that are needed to get a new office up and running," says Mark Jones, director of transition management for Raymond James in St. Petersburg, Florida. "Traditionally, the adviser probably had an IT department to lean on to do this for them. Now, they have to take an active role and that's why we assign a dedicated technology consultant, just like we do on the operations side."

TD Ameritrade Institutional's O'Neill says his department's "solutions consultants" act as concierges to transitioning advisers. The consultant serves as the primary contact between the adviser and TD Ameritrade and, in that role, can help guide the adviser to the appropriate resources in the company. "We have resources in place that can walk you through a timeline of legal assistance, finding office space, looking at technology solutions, looking at health care, benefits, 401(k)—basically, how to build the business."

Outsourcing

Keeping costs under control is critical for a new firm, especially in the early months when client revenues are lowest. Outsourcing can reduce staffing and other expenses while still giving a new firm access to experienced vendors. Dave Drucker, a financial adviser in Albuquerque, New Mexico and editor of *Virtual Office News*, a technology newsletter for independent advisers, chose the outsourcing approach when he started his firm. Drucker had been a principal in a successful East Coast advisory firm and decided to move to New Mexico. At the East Coast firm he had access to in-house staff, but he wanted to take a different route at the new location. "I was creating a new company and wanted to fast-track it. I didn't want to have to hire a bunch of people, go through the hiring process and through the training process, which could take years."

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DAVE DRUCKER

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MARK TOLEDO, CFA

Drucker searched for outsourcing partners that provided the services he needed and found that he could hire vendors around the country that met his requirements and eliminated his need to hire staff. Other advisers wanted to learn about his experiences, and that demand for information led to the newsletter and the annual "Technology Tools for Today" conference (details about the conference are available at www.virtualoffice.com). He remains a strong advocate of outsourcing's benefits to advisers: "It's everything from hiring a virtual assistant to having somebody create or run your portfolio accounting for you and create quarterly statements and invoices for clients. I think the bottom line is you can outsource everything but the client relationship. You can't bypass the process of earning your client's trust and establishing a solid foundation to the relationship. That's critical, and whatever it takes to maintain that you've got to do as well."

Outsourcing isn't a panacea, of course. The vendor still requires guidance from the adviser, and failing to provide that guidance can lead to disappointment. Drucker says that because the vendor is an expert in some business function, advisers might assume the vendor knows exactly what the adviser wants. For example, he points out that "even though the outsource partner may be an expert at portfolio accounting and managing that whole process for you, there are still certain guidelines that you need to give them because everybody does it a little bit differently."

Staying Connected

After the new firm is in business, advisers can easily overlook the potential problems of isolation and the loss of networking opportunities. To reduce the isolation, Diane MacPhee urges her clients to create support networks to maintain contact. Additionally, she believes that attending professional conferences is vital. "If you can afford to, try to go to conferences," she says. "People say they can't afford it if they go out on their own, but I tell them that's very short-sighted. You want to take a look at going to the conferences and getting your name out there, so I would say to reach out for peer support."

Mark Toledo took a proactive approach to stay connected. During his first few years, when he wasn't managing portfolios or trying to develop new business, he used the downtime to pursue other, albeit related, interests. He accepted expert witness assignments and became an adjunct faculty member at DePaul University, where he teaches portfolio management. He also took on committee work with his local CFA society. "I became more involved with the CFA Society of Chicago to have the opportunity to interact with others," he says. "That gave me the opportunity to grow as a result of those interactions and the involvement with others."

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New Adviser Timeline

10–12 MONTHS (before starting your own firm)

- Commit to leaving your current position to become an independent registered investment adviser.

8–10 MONTHS

- Determine what steps are necessary to be compliant with your current position's requirements for leaving.
- Select and consult with counsel to devise a legal exit strategy from your current position.
- Review any bonus programs or forgivable loans in effect from your current employer.

6–8 MONTHS

- Ensure compliance and check any client or employment agreements as you depart your current position.
- Check for compliance with regulations.
- Begin searching for potential office locations.
- Identify your business model.
- Establish the value proposition of your firm.

4–6 MONTHS

- Choose your office location.
- Produce marketing materials, such as business cards.
- Structure your technology processes—client relationship management system, internal accounting and billing, etc. —and evaluate vendors.
- Begin recruiting for any additions to your firm.
- Select the risk management and insurance programs needed.
- Establish internal compliance procedures.

2–4 MONTHS

- Refine your technology processes and select systems.
- Build and launch your firm's website.
- Train staff on your firm's client service offerings and technology.
- Ensure smooth flow of operations and other back-office functions.
- Set up financial management systems, such as the annual budget and key performance ratios, and track firm revenue and growth.
- Establish relationships with centers of influence.
- Promote your firm.

DAY 1

- Welcome your clients.

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