Who Are Breakaway Brokers?

The term breakaway broker refers to an adviser who is making the transition to independence—one who is hanging out a shingle. An estimated 1,500 advisers have been making this transition annually, according to Chip Roame, managing principal of Tiburon Strategic Advisors. Schwab Institutional concluded that these transitioning advisers represent 2 percent of wirehouse brokers. Other sources consider the shift to be 1 percent–1.5 percent in any given year.

A breakaway broker can choose from a number of paths to achieve independence. Such a broker might come from a wirehouse or a national full-service firm and join or start an independent fee-only registered investment advisory firm (RIA). Alternatively, a breakaway broker might join an independent broker-dealer (IBD) as an independent representative (IR). The breakaway broker then may acquire dual advisory and broker registrations to facilitate the transition of his book of business, then finally spring to an RIA.

According to a study of 2004 data, those most likely to make a break for independence were among the 74,000 brokers at wirehouses, the 22,000 brokers at bank-owned brokerages, and the 22,000-plus brokers with regional broker/dealers. Those least apt to convert to the RIA model were the 81,000-plus IRs or the almost 48,000 reps at insurance broker/dealers.

We can debate the magnitude of the breakaway broker movement, but we cannot deny the trend, chosen organizational structures notwithstanding. In this article, I consider the reasons why advisers are opting to move their businesses in this direction and some of the elements that lead to their success. I also review some crucial trends in the advice-distribution business that may help shape the adviser’s decision to go independent.

Why Transition?

One of the reasons brokers cite most frequently for wanting to break from their wirehouse employers is to avoid conflicts of interest, particularly those relating to the sale of proprietary product. Recent structural changes in the investment industry, however, likely have mitigated this concern. About one year ago, wirehouses began selecting their next incarnations as either manufacturers or distributors. Look no further than Citigroup selling its asset management business to Legg Mason and Legg selling its broker network to Citi, which created two pure-play business models. While Merrill Lynch still retains a significant financial interest in its asset management operation, its partner BlackRock now effectively controls the manufacturing business. The bank channel is undergoing a similar transformation, with a number of regional players exiting the mutual fund manufacturing business, focusing on distribution and client relationship management, and employing open architecture.

Other reasons given by full-service brokers for going independent included the following:

- Being your own boss
- Running your own business
- Opportunity to create a business with a “saleable” value
- Dissatisfaction with current environment
- Back-office control
- No proprietary products; panoply of products
- Higher payout
- Freedom to pursue a financial planning business model
- Ability to integrate fee-based advice using mutual funds, individual securities, etc.
- Shedding smaller clients that weigh down the adviser’s “book”
- Desire to manage client relationships holistically
- Insufficient satisfaction in managing client relationships and portfolios

If higher payouts are providing the impetus toward independence, an adviser should look at services from the prospective employer that help grow/support the adviser’s practice. Generally the higher the payout, the fewer the dollars available to provide those vital support services. To balance the litany of reasons for pursuing independence, equal time must be given to the other side. At a wirehouse, the adviser may be supervising one or more assistants but isn’t dealing with
management of the business, hiring, firing, compliance, selection and oversight of clearing platforms, and other responsibilities. Any adviser considering the independent route should be asking questions such as the following:

- Do you want to be entrepreneurial?
- Once you have made the move, you will spend 30–50 percent of your time running the business. Would you be better off joining an existing RIA so you can focus on your clients? Are you prepared to outsource so that you can build a team and grow your business?
- Does your current book of business demand that you park your license in order to continue pre-existing revenue streams? Can you afford to take a short-term hit to your income as you evolve your book? A good next step might be to an IBD rather than an RIA.
- Evaluate your business management acumen, your ability to manage people, your comfort with risk, and your personal definition of success. Did anything give you pause?

Answers to these questions may help the adviser determine the right option, which may be joining an existing RIA, staying at the current distributor, or aligning as an IR with existing RIA, staying at the current option, which may be joining an aggregator.

The following are additional insights about the pros and cons of moving a practice from a wirehouse:

- How does the cost of establishing and maintaining an independent business (for example, rent, compliance, research, and technology) compare with the so-called broker/dealer arrangement?
- Can the adviser create a firm that is cost-efficient and productive in order to generate higher profitability?
- Is the adviser prepared to build an organizational structure that is independent of any one individual so that the entire organization will be attractive to future buyers?
- Can the adviser build a business that is rooted in profitability rather than revenues?

- Is the adviser’s practice large enough to be independent? Mr. Tibergien writes that he believes that a $1-million book makes a more compelling argument for independence than, for example, a $500,000 practice.

However, rising costs of infrastructure (i.e., compliance and technology) have compressed firm margins, making independence financially more difficult. For example, an adviser may be ready to go independent only to be faced with a prospective employer’s escalating demand for a larger book and greater productivity.

**Breakaway RIAs—Another Type of Transition**

After considering the above issues, perhaps the adviser has concluded that setting up his own business is not appealing. Another trend has emerged where a self-contained, heavily fee-oriented team lifts itself out to form an RIA. These turnkey operations employ a custodian to facilitate the transition. The major RIA custodians understand the worth of capturing these relationships that are moving to wealth management practices, and they are providing online tools and assistance to facilitate the shift.

A potential downside: If the team includes only a small number of members, insufficient depth of business operational experience, transaction-oriented practices, and/or a lack of interest in running a business, the adviser may be better served joining an existing advisory firm or staying put.

**Elements of Success**

No one single model appears to indicate success for an independent rep, according to the three Tiburon studies. Rather, the odds of success were improved through a defined strategy and systematic business processes. Other factors correlated with success included market targets, products/services to support that target, appropriate marketing methodologies, necessary support infrastructure, defined business goals, and written business plans. The Tiburon studies also underscored the need for a service mentality, strong ethics, and determination as crucial personality traits for success in financial planning.

Excellent client service is the *sine qua non*, regardless of which organizational structure the adviser chooses. While Tiburon’s research on client service focused on affluent clients, it nevertheless is informative because advisers are looking to ratchet up the financial worth of their client relationships. Research by the Spectrem Group provided the following additional insights about the elements of success in servicing an affluent clientele:

- Affluent clients overwhelmingly state that they are more loyal to their advisers rather than the firm where the adviser works. Age, gender, or wealth did not change these findings materially. Advisers must perform well and meet client expectations.
- Individuals using financial planners have stronger loyalty to their advisers than individuals who use full-service brokers, investment advisers, or other types of advisers.
- Notwithstanding that apparent loyalty, just more than one-half of the respondents said they would follow their advisers to a new firm.
- The primary driver of loyalty was whether an adviser promptly returned a client’s phone call. Having another individual for the client to contact when the adviser was not available and good investment returns tied for second place.

Tiburon’s research came to the following similar conclusions:

- Nearly all affluent clients who fire their advisers do so based on poor service rather than poor performance.
- Spending time with clients is a key indicator of success. Tiburon found a direct correlation between advisers’ income and time spent with clients.
**Trends Shaping the Independence Decision**

My interviews and research highlighted a number of trends that may shape the financial-advice business. Under the aegis of food for thought, an adviser thinking about the independent route might consider the potential of the following:

- IBDs will continue to consolidate. Economics augur against smaller, nonspecialized IBDs. Most IBDs are very small; only 15 percent have more than 100 reps, and only 2 percent have more than 1,000 reps.
- Aggregation will continue to build momentum as the prevalent IBD business model if only because infrastructure costs such as compliance and technology can be scaled.
- Recruitment from other firms will intensify and all intermediaries will need to develop training, development, business building, and infrastructure support strategies to foster organic growth/retention.
- A shortage of experienced reps will become more pronounced as top advisers retire faster than they can be replaced, leading firms to focus on grooming of less-experienced advisers who can work with and eventually assume the books of retiring reps.
- Over time, there will be some limited consolidation of RIAs.
- IBDs will continue to align with RIAs to broaden their fee-based practices.

The multidelivery model under a single organizational umbrella will gain further traction and will help blur the distinction between IBDs and wirehouses.

Relationships win. The emphasis will continue to shift from per se investments to investment processes and additional investment services.

Wirehouses and IBDs will place even greater emphasis on wealth management and will continue to centralize the related services/support teams. (The equivalent in the RIA world is the custodians’ role as solution providers.)

Wirehouses continue to evolve to fee-based (not fee-only) structures.

It is unlikely that IRs will go back to the wirehouse environment, and it is uncertain how many would be welcomed back. A fee-only adviser would not contemplate such a transition.

The multi-affiliation model will serve to blur further those rigid distribution lines. The adviser can look forward to choosing products he/she wishes to offer, the platforms, the compensation structure (fee-based, commission), and the affiliation structure with the firm.

---

**The Evolution of Choice**

One of the critical items in the preceding list is the blurring between wirehouses and IBDs. As these distribution channels converge, some key trends are likely to include even greater emphasis on financial planning, fee-based pricing, adviser segmentation, and autonomy. Clients will find it more difficult to differentiate based on channels or services.

The multi-affiliation model will serve to blur further those rigid distribution lines. The adviser can look forward to choosing products he/she wishes to offer, the platforms, the compensation structure (fee-based, commission), and the affiliation structure with the firm. The adviser also will have the flexibility to change that affiliation structure at will to satisfy lifecycle needs. Other advantages may include assistance with an exit strategy, greater business support, and legal support in the transition process.

Specific examples of this multi-affiliation model are the structures offered by Wachovia, Ameriprise, and Raymond James. The common underpinning is the recognition that the adviser controls the client relationship. The distributors create different organizational structures and payment formulas to satisfy their advisers’ needs at various points in time. In my research, I found the term “enlightened” used to describe a firm that employed full-service employee brokers, bank brokers, and IRs through its various distribution channels and provided the ability to transition between those channels.

For example, a firm such as Wachovia has multiple distribution channels and employs full-service brokers for one channel, bank brokers for a second, and independent reps for a third, and a broker can transition between channels depending on career and other needs. This sort of enlightened distribution may mitigate the need of many advisers to break away in the future.

Judith K Benson is a principal of Benson Associates LLC, where she provides product development, operations, compliance, and distribution consulting to financial services firms. She earned a B.A. in business administration and economics at Simmons College. Contact her at judith_k_benson@yahoo.com.

The author thanks three industry experts for the generosity of their time and their research in developing this article: Chip Roame, managing principal of Tiburon Strategic Advisors LLC; Catherine S. McBreen, managing director of Spectrem Group; and Dennis Gallant, principal of Gallant Distribution Services.

---

Endnotes

2. From “Recruiting Advisors Transitioning to Independence,” by Moss

© 2007 Investment Management Consultants Association, Inc. Reprint with permission only.

3. Roame, personal communication (September 2006); Catherine S. McBreen, personal communication (September 2006); Dennis Gallant, personal communication (September 2006).


5. See, for example, “A Synopsis of the Independent Rep & Independent Broker/Dealer Markets,” Tiburon Strategic Advisors (September 2005). This reasoning is one of the most recurring themes in my research and interviews for this article. This conflict generally does not exist at an IBD, which usually offers nonproprietary products.


8. Tiburon estimates that there are only 12 households with more than $1 million in investible assets per adviser, which suggests that most advisers will have diversity in their client assets under management.


10. For Spectrem’s telephone survey of more 500 affluent individuals, affluent was defined as those households with more than $500,000 in investible assets. The 30 percent of respondents who did not use advisers were questioned regarding loyalty to their primary financial providers, i.e., the company holding the largest portion of their assets.