Advisor Services

The economics of independence

The benefits of starting or joining an independent Registered Investment Advisor (RIA)—the freedom to do what's best for clients, build your own brand, and run your business your way—are clear and compelling. But how do the economics work? Depending on where you are in your career, you may be wondering whether independence is worth the cost or how your earning potential as an independent RIA compares with what you make in a wirehouse or an independent broker-dealer (IBD) model.

To help evaluate how the economics of independence stack up against those of your current practice, you'll want to consider your revenue potential, expenses, and the prospect of business equity in each model.

"Part of the reason you go independent is to grow. Before, the house took 60% of that growth. Now, every new dollar of revenue can impact your cash flow and the value of your firm."

—Brian Power
Gateway Advisory LLC

Keep more revenue

With the RIA model, you're in the best position to maximize your revenue. Because there are no wirehouse or broker fees, you control 100% of the revenue you earn.

Wirehouse	IBD	RIA
Keep 40% of revenue from client fees	Keep 85% of revenue from client fees	Keep 100% of revenue from client fees

Source: *The Cerulli Report: U.S. Advisor Metrics 2018*, Exhibit 2.01.

Think about: The strings attached to that bonus

Have you been offered a retention package or a signing bonus by your firm? These seemingly lucrative offers can be hard to pass up. But understanding the fine print—including the legal, tax, and financial implications of these agreements—is an important piece of the transition puzzle.

Because these signing bonuses often come with extended repayment terms, consider consulting legal counsel before you sign an agreement.

Keep long-term value in mind when evaluating your options. If you have a forgivable loan with an outstanding balance of $1.2 million, you could break even in less than two years based on the incremental income you can generate in the RIA model.[1]

Control costs

You call the shots when operating your RIA firm. With complete control over your expenses, you get to decide how much to spend on technology, compliance, insurance, marketing, and office setup. Unlike wirehouse advisors and, to an extent, IBD advisors, you'll never have to pay for products and services you don't use.

Here's the typical expense breakdown across practice models.

Wirehouse

- Expenses included in the 60% cut that goes to the house
- No monthly invoices or negotiating with vendors

IBD

- Pay an estimated 30% of revenue to cover expenses
- Pay an additional 15% in broker-dealer fees

RIA

- Pay an estimated 30% of revenue to cover expenses
- No wirehouse or broker fees

Source: Schwab estimates.

See how the numbers add up: Schwab RIA Economic Discovery Tool

Schwab's convenient online RIA Economic Discovery Tool can help you estimate the financial benefits you may receive in the independent space. Enter data about your practice for a customized report.

Understand your earning potential at **advisorservices.schwab.com/econ-tools**.

Think about: Startup costs

How much does it take to get started? That number will depend on factors such as whether you're starting your own firm or joining an existing RIA, the number of staff you have or plan to hire, staff compensation, and the technology and trading tools you choose. Startup costs also can vary widely based on the size of your team, the complexity of your offer, and which services you choose to outsource.

If you're transitioning from the IBD channel, most of your infrastructure is likely already in place. Your expenses are limited to technology, rebranding, and legal support. Expect transition costs to range from $15,000 to $30,000.

Based on data from the Schwab RIA Economic Discovery Tool, here's what you can expect to spend to get your firm off the ground:[2]

Single-owner firm, with less than $100 million in assets under management (AUM) and no staff

$15K–$35K

Single-owner firm, with less than $250 million in AUM and two staff members

$50K–$100K

Larger, more complex firm, with multiple owners and staff members

$100K+

Earn more

Because the RIA model gives you greater control over revenue and expenses, your earning potential is higher. And in a recent Cerulli Associates survey of new RIAs, 93% cited higher payout as a key reason for going independent.[3]

Advisor earning potential

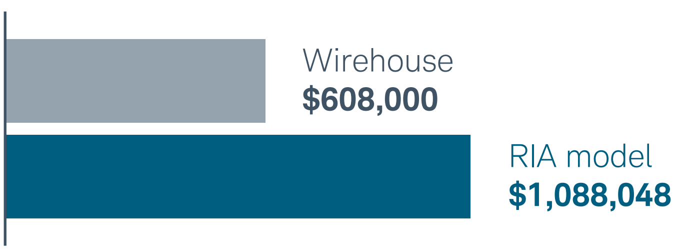
Using $1 million in revenue as an example:

	Wirehouse	IBD	RIA
Revenue	**$1,000,000**	**$1,000,000**	**$1,000,000**
Fees/expenses			
House	($600,000)	—	—
Broker-dealer fee	—	($150,000)	—
Expenses	—	($300,000)	($300,000)
Payout or profit	$400,000	$550,000	**$700,000**

Source: Schwab estimates. Hypothetical example.

The reality behind the numbers: First-year profits

Switching to the RIA channel can potentially translate to twice as much net income as what you may be earning in the captive environment.



Source: Schwab RIA Economic Discovery Tool. Assumptions: $200 million in AUM, two owners, two employees, 100% fee-based. Hypothetical example.

Think about: Practice management support

If your RIA firm is well managed, you can often increase your payout by several percentage points. Custodians like Schwab can provide a number of practice management solutions to help you become more efficient and profitable. In addition, your custodian may also offer consulting services for hands-on support and guidance on how to grow and successfully manage your firm.

Build business equity and create succession planning options

If monetizing your book of business is one of your long-term goals, then the RIA model enables you to lay the groundwork for a potentially lucrative exit strategy. In addition to the prospect of earning a higher income, as an RIA you have plenty of succession planning options. You can sell the business, merge with another firm, or recruit a successor. In each case, you decide the outcome and financial terms that match your goals. Compare that with the wirehouse model, where you can't choose who receives your book of business upon retirement.

The higher value of RIAs

There are several methods for valuing firms, but in general, percentages are typically higher in the RIA model.

Wirehouse

- Advisors tend to receive a negotiated percentage of gross revenue, paid out over three to five years.
- Payout generally ranges from 100% to 180% of gross revenue.

IBD

- Buyers typically value IBD practices somewhere between wirehouse and RIA models because of their mix of fee-based and commission-based assets.

RIA

- Buyers typically value fee-based RIA firms at two to three times that of firms deriving their revenue from commissions or transactions.

Think about: The tradeoffs of sunset programs

Sunset programs are designed to encourage successful advisors like you to join a firm late in their careers or to stay with a firm until retirement. Under this arrangement, you agree to pass along your book of business to a teammate in the same firm in exchange for a share of that business at retirement. While seemingly attractive, sunset programs can restrict your choices.

But with equity in your RIA firm, you have more—and potentially more lucrative—exit options, including selling your business to someone who shares your vision.

Analyze the costs and benefits

You've spent years building your book of business, so economic considerations will naturally play an important role in how you view a move to independence. In an RIA firm, you can maximize your revenue and choose where to focus your business expenses to keep more of what you earn. If building business equity is an important consideration, then the economic advantages of the RIA model become even more compelling. Experienced custodians like Schwab can help you run the numbers and navigate your transition.

As you evaluate your options, you can also use the Schwab RIA Economic Discovery Tool to get a clearer picture of your near-term costs and your long-term value within different advisory models.

You've earned it. Time to claim the rewards of independence.

Ready to speak with a Business Development Officer?

Contact us at **advisorservices.schwab.com** or **877-687-4085**.

1. Schwab RIA Economic Discovery Tool. Assumptions: $200 in AUM, two owners, two employees, 100% fee-based. Hypothetical example.

2. Schwab RIA Economic Discovery Tool. Hypothetical examples.

3. *The Cerulli Report: U.S. RIA Marketplace 2018*, Exhibit 4.05.

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