CERULLI ASSOCIATES | Commonwealth

Taking Control: Exploring Independence | Part One

Demystifying the Independent Channel

Unpacking independence, the reason advisors seek it, and how they can make a successful transition

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Summary

Independence exists on a spectrum. Advisors looking to leave employee-based firms behind have a variety of independent affiliation options they can pursue. These options, and the ability to move between them, give advisors flexibility to make independence work for their practice, and to evolve their independence over time. Independence may not be right for every advisor, but those who have thoughtfully considered greater economic and operational control of their practice may be best suited to consider a move. Client relationships and the challenges of business ownership are certainly things advisors should consider, but with the right plan and the right partner firm, these obstacles can be overcome.

Methodology

Commonwealth Financial Network® engaged Cerulli Associates to help understand advisor best practices in working with the firms they affiliate with*. In January and February 2022, Cerulli conducted qualitative research interviews with successful financial advisors across employee and independent channels. These interviews addressed a broad range of topics, including consideration or experience with moving to an independent channel, business development, client service models, succession planning, portfolio construction, and their overall relationships with the firms they have chosen to affiliate with. Research participants were required to have a minimum of five years of experience as an advisor and $50 million in client assets under management (AUM).

Independence: Facts and Figures

In the current competitive environment, the independent channels stand out due to a variety of metrics, including:

5.2% headcount marketshare increase during the past decade (compared to a 0.2% decline for the broader industry)

38% of total advisor-managed assets controlled by independent advisors (up from 32% in 2010)

71% of advisors across all channels prefer an independent firm if they were to make a move

COMMONWEALTH VOICES

“At the highest level, independence means you own your business, you are building equity in your own firm, and you are not beholden to a corporate agenda that’s going to tell you how to build your business or service your clients.”

Senior Commonwealth Financial Network® Executive

*This study was paid for by Commonwealth Financial Network®. Commonwealth Financial Network® and Cerulli Associates are separate and unaffiliated entities.

Why Do Advisors Seek Independence?

The factors that motivate advisors to transition from captive, employee-based affiliation to independence can be as varied as the forms that independence can take. Nevertheless, there are certain factors that breakaway advisors identify as motivating them to seek independence with relative consistency: better economics and greater control.

Better Economics

Independent advisors have the potential to experience significantly better economic benefits than their captive, employee peers. The potential economic advantages of independent affiliation are multifold and include the ability to build enterprise value and the potential to maximize income by retaining a larger share of the revenue advisors generate, and by benefiting from better operating leverage.

It is not uncommon for employee-based advisors to send 50%-60% of their gross revenue back to the firm. By eliminating this expense, advisors have the potential to keep more of what they make, assuming they can replicate the resources offered by their broker/dealers (B/Ds) at a lower relative cost. Many advisors do not need everything an employee-based firm gives them, but have little recourse than to pay for it anyway in the form of their reduced payout. Independence allows advisors to "run lean" if they so choose, paying for the resources that they require, and eschewing those that add little value to their practice. If an advisor runs complex portfolios and needs advanced research, they can beef up in that area, while an advisor who outsources portfolio construction can choose to limit the research budget while spending on marketing. An *à la carte* approach to service selection, like the one offered by Commonwealth Financial Network®, can be especially valuable to established advisors who only want to allocate expenses to what they truly need.

Greater Control

Lack of autonomy is a key driver motivating advisors to consider independent affiliation. Many advisors express frustrations with pressure to achieve corporate-level initiatives set by their employers. These home-office initiatives, which often

Commonwealth Advisors Speak

"Instead of paying 65% to my employer, I can pick and choose what I want to pay for."

"At our prior firm, we had a sales associate who wasn't up to par, and it was really a challenge to replace them…that hasn't been an issue since we moved."

"I went independent because I wanted to be able to take care of my clients without being babysat. I understand that large firms have to have very tight controls and everybody has to do the same thing. That's not really the case in the independent world."

"At my prior firm, I felt I couldn't work for my clients because I had to always work for the firm."

Factors Attracting Breakaway Advisors, 2021

	Employee Advisors Who Prefer Independent Model	
Factor	**Moderate Factor**	**Major Factor**
Greater autonomy	39%	50%
Higher payout	47%	49%
Ability to build financial value in an independent business	46%	46%
More control of investment decisions and portfolio construction	45%	31%
Desire more personable culture	41%	27%
Ability to select preferred technology systems	53%	27%
Appeal of independent model to clients	46%	24%
Elimination of sales quotas	32%	15%
Lower minimum production/AUM requirements	34%	14%
Reduced exposure to proprietary products	36%	8%

Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute, and the Financial Planning Association® (FPA®) | **Analyst Note:** Data represents wirehouse, national/regional B/D, insurance B/D, and retail bank B/D advisors who indicate that they would prefer to transition to the independent RIA, hybrid RIA, or IBD channels if they leave their current firm. The data exhibited here is a result of Cerulli Associates' surveying of approximately 1,500 advisors each year.

include cross-selling banking products and needing to de-emphasize relationships below a certain AUM threshold can hurt the client-primacy advisors pride themselves on. Moving to independence can help advisors focus on the client and limit the extent to which corporate priorities cloud the primacy of the relationship.

Advisors who have sought independence also express a desire for greater control over key business decisions that meaningfully impact the success of their practice. These decisions include everything from marketing to business development to technology to staffing. However, independent advisors don't have to manage all aspects of their business entirely on their own. They can choose to partner with firms that can support certain areas of their business while choosing to manage other aspects of the business internally, depending upon their skillsets and preferences.

It is important to note that independence is not for everyone. Some advisors are uncomfortable with taking on additional business owner responsibilities, and some like the ability to rely heavily on home-office resources. Advisors who are less compelled to run their own businesses may be better served as employees of a B/D or by joining a larger independent practice that already has established infrastructure.

The move to independence, as related by multiple advisors who have successfully made the switch, must be about more than economics. If the move is just about keeping an additional 30 basis points, then it is not likely the right move. A good partner firm will work with an advisor to ask these questions early in the consideration process, and as a senior executive at Commonwealth Financial Network® relates, "We can tell pretty quickly if independence isn't right. And we'll tell the advisor that too."

How Can Different Affiliation Models Work for Different Advisors?

When advisors consider the broad term "independence," many think of a fully independent RIA hanging a shingle and running the business completely on their own. However, it is important to note that independence has a variety of meanings and there are various affiliation options that can work for different kinds of advisors.

Evaluating Common Concerns Around Independence

In conversations with advisors, two main hesitations emerge around making the move to independence: client retention during the transition, and the management responsibilities associated with operating an independent business. While these are valid concerns, choosing the right firm to partner with and taking several preemptive steps can help to ensure a successful transition.

Independent Affiliation Options

Independent B/D

Can step back from rigid corporate structure of an employee-based firm

Smaller relative payout, but fewer administrative responsibilities

Good affiliation option for advisors who want greater autonomy, but don't need full flexibility

Advisors may have the option for fee-only affiliation if they so choose

Hybrid RIA

Retain access to commission-based products, while garnering a higher percentage of earnings

Commonly preferred affiliation option for larger practices, willing to take on business owner responsibilities, rely less on resources from the home office

Independent RIA

Greatest potential payout as well as potentially the most lucrative valuation upon retirement/sale of the practice

Fully fee-based, no access to commission-based products

Often utilized affiliation option for large, sophisticated, fee-only practices that have complete comfort with running operations

Independence

Least → Most

Source: Cerulli Associates

Client Retention

It is understandable that some advisors are concerned that clients will not follow, and relationships cultivated over the years will wither and die on the vine. As one advisor considering the move relates to Cerulli, "Are my relationships as strong as I think they are?" Another advisor who has successfully transitioned to Commonwealth Financial Network® looks back on the weeks and days leading up to the move and recalls, "I remember worrying that no one would come with me. What would happen then?"

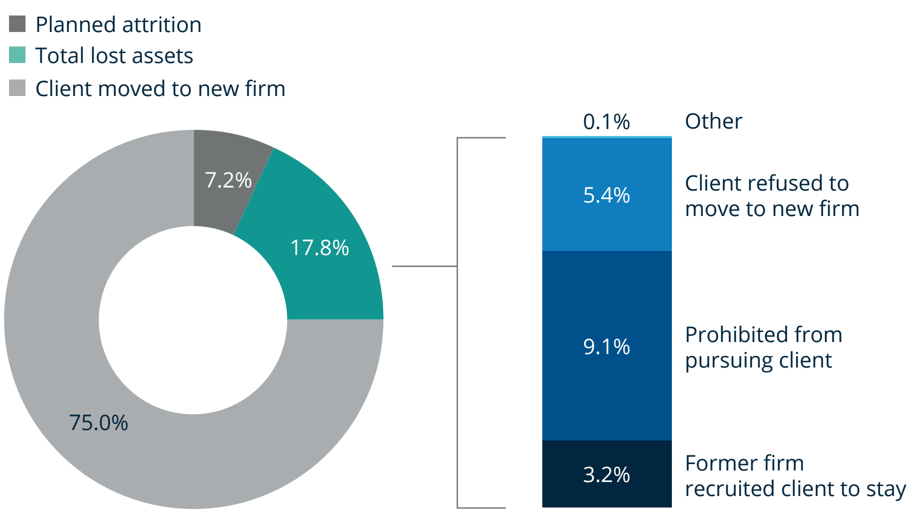
Cerulli's research has consistently shown that clients are more loyal to their advisor than the firm that their advisor works for. Clients see the advisor, and not the firm, as the face of their relationship, and are often more than willing to move with an advisor to a new firm.

Becoming a Business Owner

Many of the crucial decisions around business ownership—things like office space, payroll management, health insurance, and staffing—are made up front. Once these initial decisions are made, business ownership can become more manageable, and a partner firm can help to make these decisions well in advance of the actual transition. Additionally, teaming up with a partner who has already chosen independence can be an effective option for advisors looking to share ownership responsibilities and gain economies of scale.

In addition to helping to make these decisions, operational aids are crucial for advisors. As one independent advisor states, "I only do this once or twice in my career. It's nice to have someone to guide me in the process." This guidance can encompass everything from picking a firm name to helping with ACATS transfers of assets from the old firm to new. A dedicated transition team, like the one offered at Commonwealth Financial Network® and other firms at scale, can help to ease these operational burdens and give advisors peace of mind.

All Advisors: Asset Retention When Switching Firms, 2021



Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute and the Financial Planning Association® (FPA®) | **Analyst Note:** Advisor movement data is based on employee advisors who transitioned to independent affilation in the past three years. Planned attrition represents assets that the advisor chose to leave client behind at former firm. The data exhibited here is a result of Cerulli Associates' surveying of approximately 1,500 advisors each year.

Keys to a Successful Transition

Communicate

Minimizing client disruption does not mean failing to communicate the reasons and benefits of transition.

Plan

Consider scenarios around which clients will come. Make sure the practice remains viable under all scenarios.

Partner

Choose a partner firm with the right affiliation options and resources to support you during and after the transition. Partnering with an advisor who has already chosen independence is an option as well.

Strategize

Many business ownership decisions can be made up front. Planning ahead and making these decisions in advance can lessen the burden when transition time comes.

Consult

Work with legal council to ensure that the transition is in compliance with any existing legal restrictions.

Source: Cerulli Associates

About Cerulli Associates

For over 30 years, Cerulli has provided global asset and wealth management firms with unmatched, actionable insights. Headquartered in Boston with offices in London and Singapore, Cerulli Associates is a global research and consulting firm that provides financial institutions with guidance in strategic positioning and new business development. Our analysts blend industry knowledge, original research, and data analysis to bring perspective to current market conditions and forecasts for future developments. Learn more about Cerulli Associates by visiting www.cerulli.com.

About Commonwealth Financial Network®

Commonwealth Financial Network, Member FINRA/SIPC, a Registered Investment Adviser, provides a suite of business solutions that empowers more than 2,000 independent financial advisors nationwide. Privately held since 1979, the firm has headquarters in Waltham, Massachusetts, and San Diego, California. Learn more about Commonwealth by visiting www.commonwealth.com.

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