



*charles*  
SCHWAB

Advisor Services

# Going independent as a hybrid RIA

**Understanding  
the practice model**

*Own your tomorrow.*

# The breakaway movement continues to gain steam

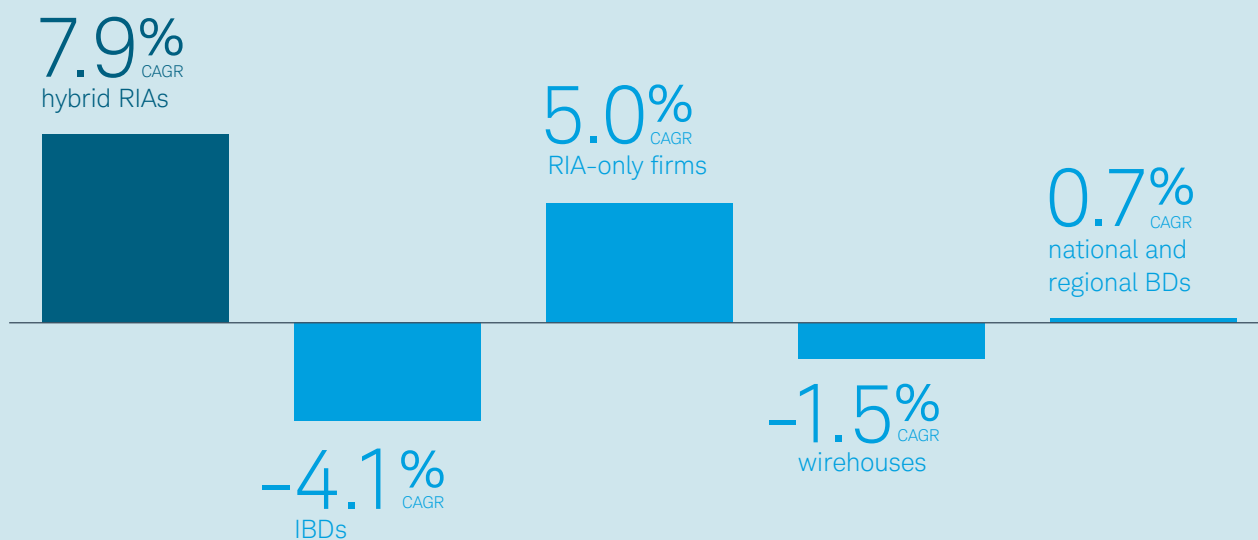
As an independent registered investment advisor (RIA), you have the opportunity to keep your commission-based business. The hybrid RIA model allows you to maintain both brokerage and advisory business—a combination that can help you meet the unique needs of your clients and your business.

That kind of flexibility is one of the reasons why more advisors are seizing the RIA opportunity to create the future they imagine for themselves and their clients.<sup>1</sup> Sophisticated technology and support, increased access to financial products, and an expanded array of business models now make it easier than ever for you to seize the freedom and control of independence.

## The future of financial advising is independent

The outlook for advisors in the hybrid and RIA channels has been positive in recent years, while the captive channel has seen a decline.<sup>2</sup> The number of advisors moving to the RIA space has increased.<sup>3</sup> And advisors within the RIA channel are experiencing asset growth.<sup>4</sup>

### Momentum favors the RIA



Advisor headcount, five-year compound annual growth rate (CAGR)<sup>5</sup>



RIA growth shows no sign of slowing down. In fact, industry expert Cerulli Associates estimates that the independent channel is set to outpace the wirehouse channel over the next five years.<sup>6</sup>

## For RIAs, every critical metric trends up

Firms of all sizes have flourished over the past five years<sup>7</sup>:

5.5%  
CAGR

Net new  
clients

10.9%  
CAGR

AUM growth

9.8%  
CAGR

Firm revenue  
growth

Median compound annual growth rate (CAGR) over the five-year period from 2013 to 2017 for all firms with \$250 million or more in AUM.

## Why are so many advisors going independent?

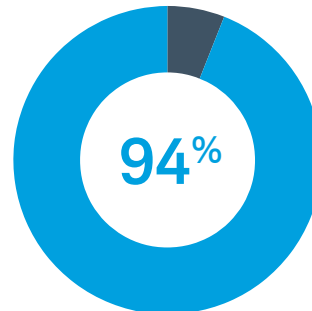
Before we get into the details of the hybrid model, let's review what's attracting advisors to the RIA model. The 2018 Charles Schwab Independent Advisor Sophomore Study revealed motivations that drove recently transitioned advisors toward independence, including:

**Do what's best for clients.** The majority of advisors said they made the move to the RIA model because they wanted to put their clients' interests before anyone else's. They also wanted to provide not just products, but more personalized service.

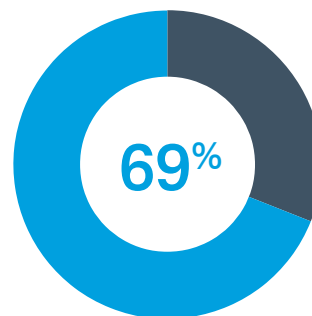
**Run their business—their way.** Advisors said they were motivated by the prospect of calling the shots. They wanted to design their own business and differentiate themselves by building their own brand. Advisors wanted the control that self-employment offers and the ability to choose from an expanded array of products and services.

**Build equity and value.** Economic factors played a major role in decisions. Advisors coveted the opportunity to build long-term enterprise value and to create the potential to monetize their books of business. They wanted to target increasing their income and better plan for the future. RIAs have the potential to keep 100% of the advisory revenue they earn, depending on the model they choose, compared with 50% to 60% in the captive space.

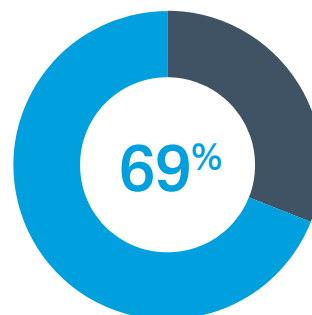
Perhaps most remarkable, the study found that more than 90% of advisors said they would make the decision to become an RIA again and are happier now that they are independent.<sup>8</sup>



Do what's best for clients<sup>9</sup>



Provide more personalized service<sup>10</sup>



Be their own boss<sup>11</sup>

## Find the right fit: Understanding the different advisor models

The RIA model gives you more freedom to explore options that may meet your needs and the needs of your clients. As an RIA, you can be your own boss and have full control to manage your practice the way you want. Choose the level of control, flexibility, and responsibility that's right for you.

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### Fully independent RIA: Maximum control and freedom

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**“How do I conduct business?”** You have total responsibility over and control of your practice. You are an employee of your own firm and a fiduciary, conducting fee-only advisory business through your independent RIA.

**“How am I compensated?”** You receive a full share of the advisory revenue and take on 100% of the business risk.

**“How is compliance handled?”** A single compliance structure is managed by your RIA.

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### Full-affiliation broker-dealer advisor: The security of employee status

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**“How do I conduct business?”** You join an existing firm as an employee of the broker-dealer. You conduct brokerage business as a registered representative of that broker-dealer and act as a fiduciary when conducting advisory business through the broker-dealer's RIA.

**“How am I compensated?”** You receive brokerage and advisory compensation through a share of the broker-dealer's brokerage revenue.

**“How is compliance handled?”** The broker-dealer manages a single compliance structure, which means you're subject to that broker-dealer's rules and regulations.

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### Hybrid advisor: The potential for a balance of both

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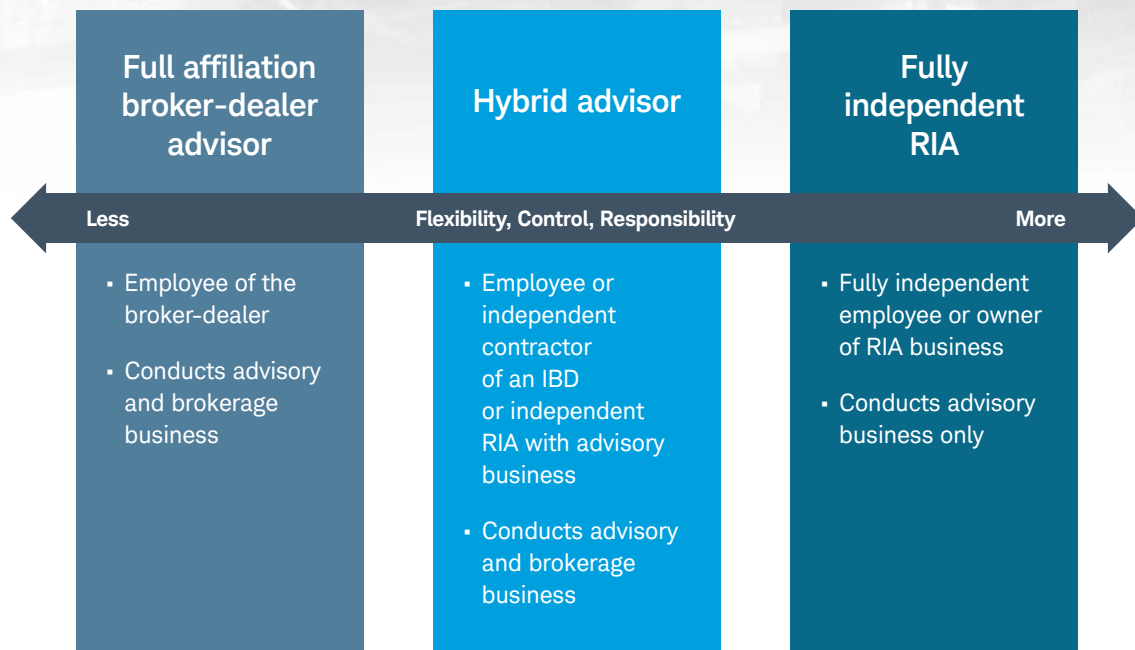
**“How do I conduct business?”** You maintain both advisory and brokerage business. You're an employee or independent contractor of an independent broker-dealer (IBD), conducting brokerage business as a registered representative and advisory business through the IBD's corporate RIA or an independent RIA firm.

**“How am I compensated?”** You receive brokerage compensation through a share of the broker-dealer's brokerage revenue and can receive a full share of advisory revenue through the RIA.

**“How is compliance handled?”** One of the major differences is that you have a dual compliance structure managed by the broker-dealer and the RIA.



## Where do you fall on the spectrum?



### Terms to know



**Advisory business** — the business for which an investment advisor representative charges a fee as a percentage of assets under management



**Brokerage business** — the stream of revenue that comes from the sale of securities or investment products or platforms, or that comes in the form of 12b-1 fees or as commission trails that the broker-dealer receives from mutual fund companies or alternative investment sources

## Two types of hybrids\*

If you are looking to maintain both advisory business and brokerage business, you have options that can help you meet your service model needs and business objectives. You can access the flexibility of the hybrid model in two ways:

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### **Semi-captive hybrid.**

You join the corporate RIA of an independent broker-dealer.

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#### **The semi-captive practice: Fewer management responsibilities, more structure**

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As a semi-captive advisor, you are an employee or independent contractor of an IBD. Advisors who choose this model tend to prefer the structure and support of an IBD and typically don't plan to move to an advisory-only practice. This option may provide a more familiar structure for advisors in transition by allowing them to remain part of the corporate RIA and follow the practices established by that firm.

**“How do I conduct business?”** The IBD provides turnkey infrastructure and support, including customer relationship management and performance monitoring. Unlike the dually registered model, which lets you choose your custodian, the semi-captive model lets the IBD select the custodian. There may be added restrictions—on products, services, and revenue models—which could affect how you would run your practice.

**“How am I compensated?”** As a semi-captive advisor, your compensation model is based on your business breakdown, and your IBD fee schedule typically applies to both the brokerage and the advisory sides of your business. Some IBDs may offer you phantom stock or other equity substitutes. However, your book of business could be less portable and more difficult to value under the semi-captive model.<sup>12</sup>

**“How does compliance affect me?”** Your IBD manages all functions, including advisory and brokerage business.

**“How flexible is product choice?”** The IBD manages all functions of advisory and brokerage business. The IBD manages and sometimes restricts investment options, which means you may not be able to fully leverage open architecture in a semi-captive model.

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### **Dually registered hybrid.**

You start or join an RIA firm and become an independent contractor of an IBD.

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#### **The dually registered practice: Flexibility to customize and respond to client and business needs**

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As a dually registered advisor, you start or join an RIA firm and act as an independent contractor of an IBD. The approach is ideal for advisors who want to form their own practice, who plan to conduct mostly advisory business, or who intend to transition to the fee-only fully independent RIA model.

**“How does ownership affect me?”** The most important difference here is that, as a principal of the RIA firm, you own direct equity in your business. The way you build and grow your firm may increase the value and wealth of your business—not of the IBD firm with which you are affiliated as an employee or independent contractor. Even if you choose to join an existing RIA firm, you have the power to negotiate for an equity percentage as part of your compensation.

**“Where do I have more control?”** While the IBD fee schedule applies to your brokerage business, you set the fee schedule for your advisory firm. You're also able to choose the custodian, products, and technology solutions that best align with your practice and your clients' needs.

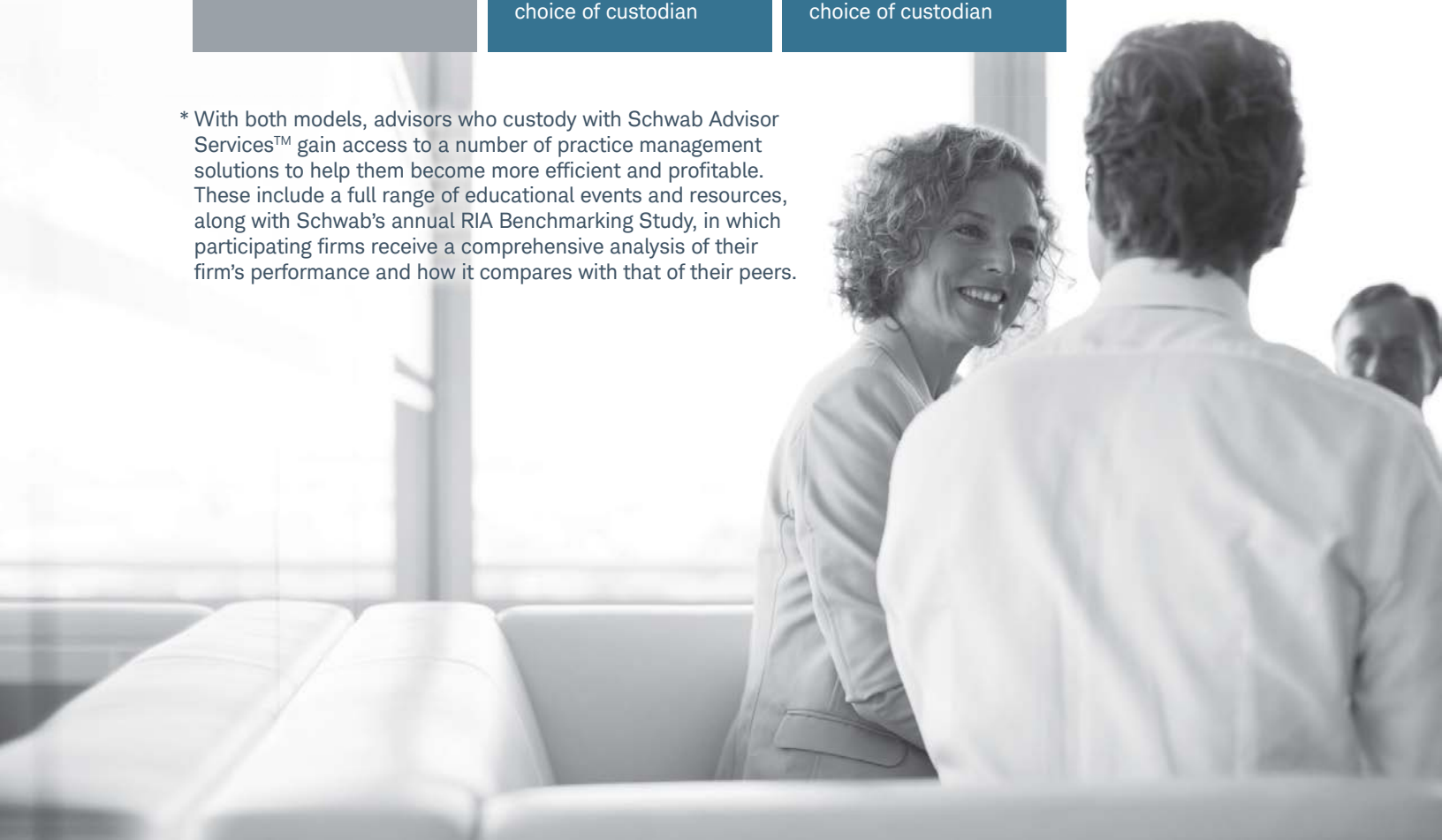
**“Who will support me?”** You can leverage the turnkey infrastructure of the IBD or use third-party vendors to build a customized technology platform. Schwab technology consultants and business development officers can help you determine options that are right for your business and connect you to a network of world-class vendors to help you streamline operations and grow your practice.



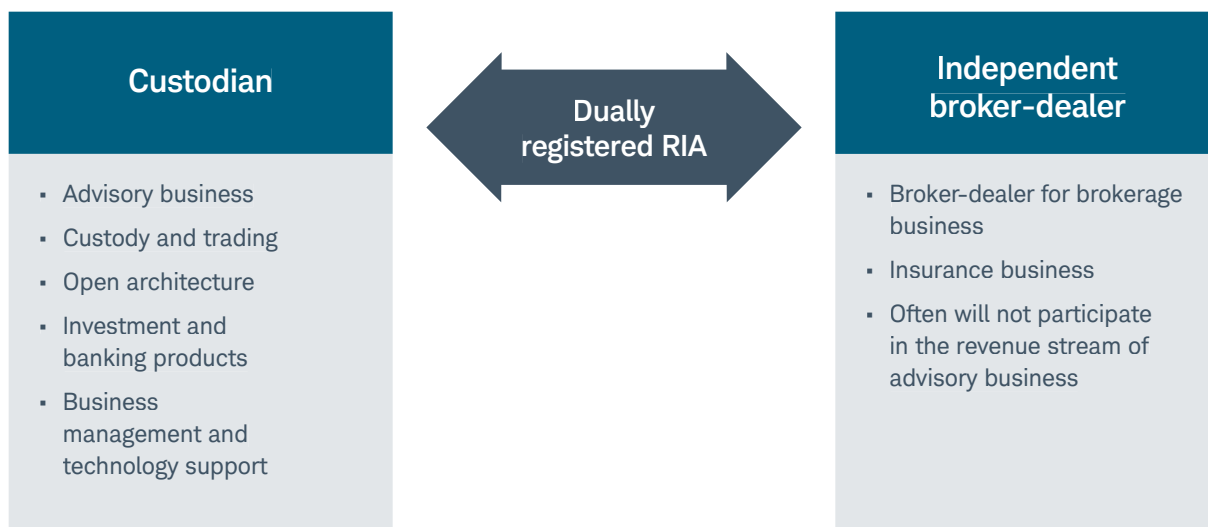
## Different practice hybrid models

	Semi-captive	Dually registered
Profile	Does not want (or is not ready to run) an advisory-only practice	Primarily conducts advisory business
Employment	Employee or independent contractor of an IBD	Starts or joins an RIA firm and is an independent contractor of the IBD
Fees and compensation	IBD fee schedule typically applies to brokerage and advisory assets	IBD fee schedule typically applies to brokerage business only
Control	Less control over technology, compliance, products, service, and choice of custodian	More control over technology, compliance, products, service, and choice of custodian

\* With both models, advisors who custody with Schwab Advisor Services™ gain access to a number of practice management solutions to help them become more efficient and profitable. These include a full range of educational events and resources, along with Schwab's annual RIA Benchmarking Study, in which participating firms receive a comprehensive analysis of their firm's performance and how it compares with that of their peers.



## How the custodian and broker-dealer support a dually registered RIA's business



### Choosing your partners

As a hybrid advisor, you have the freedom to select a fee-based institutional custodian for your advisory business, along with a broker-dealer for your commission-based business. Whether semi-captive or dually registered, you must affiliate with an IBD that facilitates the brokerage portion of your business.

#### Independent broker-dealers

When choosing an IBD, consider their business model. Do they impose “haircuts” on your fee-based business, or do they strictly focus on the commissionable side of a dually registered advisor’s business? In your search, you may encounter broker-dealers that specialize in serving dually registered practices and others that are purely accommodative.

#### Custodians

RIA custodians do much more than simply hold client assets. They can be your biggest resource and advocate, whether they’re providing a range of investment and banking products or support for business management, technology, and service.

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#### Schwab Advisor Services™

Schwab pioneered the RIA industry when we launched our custody service more than 30 years ago. With more than \$1.6 trillion in client assets, Schwab Advisor Services is the market leader.<sup>13</sup> In fact, more independent investment advisors work with and entrust more assets to Schwab than any other custodian in the industry.<sup>14</sup> Schwab’s full menu of services for RIA firms can help advisors transition smoothly and accelerate growth as RIAs.

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## What's best for you—and your clients?

The decision to transition to the hybrid model hinges on what's right for you and your clients. Some advisors prefer to sidestep the hybrid model altogether in favor of the fully independent RIA model. If you plan to pursue a hybrid practice, investigate the cost and administrative impact before you decide. Keep in mind that compliance management, economics, and revenue structures look different for each option.

The RIA model can provide you with the freedom and flexibility to serve your clients your way and the ability to build long-term enterprise value. If parting with brokerage business is a concern, remember that you can keep it and still enjoy the benefits of independence as an RIA. Schwab Business Development Officers are consultants who can help make the best decision for you and your clients.

You can also learn more about the benefits of the hybrid RIA model by contacting a Schwab Business Development Officer at **877-687-4085**.

1. *The Cerulli Report: U.S. Intermediary Distribution 2017*, Exhibit 2.05.
2. Ibid.
3. Ibid.
4. *The Cerulli Report: U.S. Intermediary Distribution 2017*, Exhibit 2.07.
5. See note 1 above.
6. *The Cerulli Report: U.S. Intermediary Distribution 2017*, Exhibit 2.13.
7. 2018 RIA Benchmarking Study from Charles Schwab, January–March 2018. Median results for all firms with \$250 million or more in assets under management (AUM). Study contains self-reported data from 1,261 firms and was not independently verified. Participant firms represent various sizes and business models categorized into 12 peer groups—7 wealth manager groups and 5 money manager groups—by AUM size. Past performance is not an indicator of future results.
8. Charles Schwab Independent Advisor Sophomore Study, 2018.
9. Ibid.
10. Ibid.
11. Ibid.
12. The potential difficulty in value is due to the unpredictable nature of the revenue generated by non-fee-based assets, as well as discounts for a mix of commissionable and non-commissionable assets.
13. Charles Schwab quarterly report, June 2018.
14. Charles Schwab Strategy.

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