The 2018 RIA Market Landscape & HighTower’s Platform Offering

June 2018
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INTRODUCTION

This Aite Group study assesses the HighTower platform business. Aite Group’s analysis focuses on gaining a better understanding of the current market landscape as well as the target market, positioning, and differentiators of the HighTower Platform. For the purpose of this study, Aite Group compared the HighTower Platform with the most relevant platform providers representing all major platform categories.

METHODOLOGY

This study is based on Aite Group’s 2017 and 2016 annual financial advisor surveys and qualitative research from interviews conducted with a broad range of industry participants and financial advisors in February and March 2018. The financial advisor surveys have a margin of error of approximately 5 points at the 95% level of confidence. Statistical tests of significance between or among subsegments of the sample were conducted at the 90% or 95% level of confidence, depending on the segments’ sizes.
TARGET MARKET

This section aims to segment the wealth management market in the United States and to identify the target advisor segments that represent the biggest opportunities for the HighTower Platform.

THE U.S. WEALTH MANAGEMENT MARKET

At the end of 2016, the brokerage and advisory market in the United States represented US$20.4 trillion in assets. Around 33% of these assets are connected to financial advisors within the four large wirehouse firms: Merrill Lynch, Morgan Stanley, Wells Fargo, and UBS (Figure 1).

Figure 1: Distribution of Client Assets Across Industry Segments

<table>
<thead>
<tr>
<th>Market Share of Client Investment Assets Across Industry Segments (2016 client assets=US$20.4 trillion)</th>
<th>'14 to '15 Δ</th>
<th>'15 to '16 Δ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wirehouse</td>
<td>33.5%</td>
<td>(0.8%)</td>
</tr>
<tr>
<td>Self-clearing retail brokerage (non-wirehouses)</td>
<td>17.6%</td>
<td>0.2%</td>
</tr>
<tr>
<td>Clearing and custody</td>
<td>28.6%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Discount and online brokerage</td>
<td>20.4%</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

Components may not add to 100% due to rounding

Source: Aite Group

Financial advisors in the U.S. wealth management market can be divided into two groups: employees of wealth management firms and independent contractors. Around 183,700 advisors exist within the captive employee (nonindependent) market. Approximately 130,500 advisors are part of the independent market, equally split between RIA and independent broker-dealer (IBD) firms.

THE APPEAL OF THE HIGHTOWER PLATFORM

HighTower’s initial focus was on capturing breakaway advisors from wirehouse firms. The key motivation for breakaways is to exit the conflicted wirehouse environment and join the fiduciary movement. These advisors are accustomed to the big-firm support they receive from their employer, and most are seeking a similar level of operational support after breaking away.
HighTower started targeting existing independent RIA firms in 2013. Independent advisors, especially those that experience rapid growth (more than 10% annual growth in client assets), experience an increasing operational burden that initially can be tackled by adding staff. But eventually, they require an infrastructure that has greater scale. They are looking for product platforms that allow them to be more operationally efficient and network with like-minded advisors to keep current on best practices.

Independent advisors are typically not backed by a national brand or supported by an ecosystem of other advisors. As a result, advisors who find HighTower appealing are attracted most to the following tenets of the firm’s value proposition:

- **Platform**: The support required to operate their practice
- **Brand**: The national brand that helps to minimize the inertia in sales and marketing to clients
- **Culture**: The ability to be affiliated with elite advisors and share best practices

Figure 2 illustrates the HighTower business model and how its value proposition aligns with advisors’ motivations, regardless of their origin or stage of business evolution.

**Figure 2: HighTower Business Model**

<table>
<thead>
<tr>
<th>Independent market</th>
<th>Nonindependent market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of advisors and AUM in US$</strong></td>
<td><strong>Number of advisors and AUM in US$</strong></td>
</tr>
<tr>
<td>Schwab: 26,250, $1.3tn</td>
<td>Merrill Lynch: 16,830, $2.1tn</td>
</tr>
<tr>
<td>Fidelity: 10,500, $0.8tn</td>
<td>Morgan Stanley: 15,763, $2.1tn</td>
</tr>
<tr>
<td>TD Ameritrade: 14,000, $0.4tn</td>
<td>Wells Fargo Advisors: 14,882, $1.5tn</td>
</tr>
<tr>
<td>Pershing: 2,000, $0.2tn</td>
<td>UBS: 7,025, $1.1tn</td>
</tr>
<tr>
<td>IBD firms: 66,250, $2.1tn</td>
<td>Regionals: 36,600, $2.8tn</td>
</tr>
<tr>
<td><strong>Total</strong>: 130,500, $4.8tn</td>
<td>Banks and others: 92,600, $1.6tn</td>
</tr>
<tr>
<td><strong>Total</strong>: 183,700, $11.2tn</td>
<td></td>
</tr>
</tbody>
</table>

Motivations:
- National brand
- Elite advisor culture
- Operations support
- Technology choice
- Elimination of conflicts
- Manage risks

Motivations:
- Liquidity needs
- Succession planning
- Inorganic growth
- Operational efficiency
- Business transformation

Source: Aite Group
NONINDEPENDENT MARKET OPPORTUNITY

The four wirehouses—Merrill Lynch, Morgan Stanley, Wells Fargo Advisors, and UBS—make up the largest group of nonindependent advisors (54,500), with the remaining captive advisors being employed by regional broker-dealer firms, banks, and other wealth management entities. Wirehouse advisors are characterized by high productivity and a great degree of breakaway interest.

WIREHOUSE SEGMENT

The Aite Group survey of 411 financial advisors conducted in Q2 2017 has revealed that 27% of advisors at wirehouses and other self-clearing firms are more than 50% likely to leave their current employer within the next 18 to 24 months. Forty-seven percent of these financial advisors would likely go independent if they left their current employer; 12% would prefer to join another wirehouse. Eighty-eight percent of the financial advisors who would go independent would opt to set up a new or independent RIA firm or join an existing one rather than join an IBD.

Taking the amounts shown in Figure 2, this means that 14,715 (27%) of the 54,500 advisors at wirehouse firms (Merrill Lynch, UBS, Wells Fargo, and Morgan Stanley) are more than 50% likely to leave their current employers. Of this number, 6,916 (47%) would go independent and 6,051 (88%) would set up or join an independent RIA firm.

THE SEGMENT WITH US$300 MILLION TO US$750 MILLION IN ASSETS UNDER MANAGEMENT (AUM)

According to this same survey in Q2 2017, the desire to break away is particularly dominant among practices with more than US$300 million in client assets: At least 42% of financial advisors at these practices are more likely than not to leave their current employer.

For the population of advisors with US$300 million to US$750 million in assets, 19% of those likely to leave would go independent if they left their current employer. Eighty percent of those who would go independent would opt to set up a new independent RIA firm or join an existing one rather than join an IBD.

Taking the amounts shown in Figure 2, this means that 78,991 (42%) of the 183,700 advisors at nonindependent firms (wirehouses, regionals, and banks) are likely to leave their current employer. Of this amount, 15,008 (19%) would go independent and 12,006 (80%) would set up or join an independent RIA firm.

This survey was conducted before Morgan Stanley, UBS, and Citigroup exited the protocol for broker recruiting. Morgan Stanley, for example, has taken an aggressively litigious stance toward departing advisors and has used this to deter firms such as HighTower from pursuing new advisors. Taking on litigation against these bigger firms represents a commercial risk until the market settles and the courts decide how these cases are handled.
INDEPENDENT MARKET OPPORTUNITY

The independent RIA market has been the sweet spot of the wealth management industry in the United States for over a decade. The industry’s shift toward fee-based, fiduciary business has benefited independent RIAs. But the operational underpinning of a large share of independent RIAs is limiting many firms’ growth potential. Unlike the nonindependent market, acquiring new teams in this segment carries very little commercial litigation risk for firms such as HighTower.

Aite Group’s survey of 315 financial advisors conducted in Q2 2016 has revealed that two-thirds of independent RIA firms work with technology environments that offer basic or no integration. As shown in Figure 3, RIAs with advanced integration spend roughly 17% more time conducting client prospecting and managing their clients. For this purpose, advanced integration is when advisors benefit from automatic data sharing or functional integration between business applications and show an increased level of satisfaction with their setup (i.e., feel that their technology setup is at least two-thirds of the way toward full integration).

Figure 3: Allocation of Independent Advisor Time

Q. Please allocate the percentage of time you spend on each task. (Please have these percentages add to 100%)

<table>
<thead>
<tr>
<th>Task</th>
<th>Basic to no integration</th>
<th>Advanced integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client acquisition and prospecting</td>
<td>131%</td>
<td>4%</td>
</tr>
<tr>
<td>Client management</td>
<td>4%</td>
<td>19%</td>
</tr>
<tr>
<td>Operational processes</td>
<td>16%</td>
<td>58%</td>
</tr>
<tr>
<td>Investment research</td>
<td>16%</td>
<td>69%</td>
</tr>
<tr>
<td>Investment research</td>
<td>21%</td>
<td>-77%</td>
</tr>
</tbody>
</table>

Source: Aite Group survey of 315 financial advisors, April 2016

Independent RIAs that benefit from advanced integration have substantially more clients and more business than do other independent RIAs:

- 57% more clients
- 76% larger book of business

In addition, these financial advisors need to spend far less time on investment research and are able instead to invest that time managing the clients they have and prospecting additional clients. Advisors with advanced integration report allocating almost 20% more time with clients than other advisors and more than twice the amount of time prospecting.
RIAs with advanced integration also have somewhat larger practices by head count, although this is not statistically significant at the 95% level of confidence.

The business benefits resulting from a technology environment with advanced integration features are obviously great for independent RIAs. Many of these advisor firms, however, are reluctant to spend the money required to move to a better setup, as they are simply unwilling to change operational workflows.

At least 21% of these independent practices having basic or no integrations (highest level of operational stress) have assets over US$200 million. Taking the amounts shown in Figure 2, this means that 27,405 (21%) of the 130,500 independent advisors are facing operational stress and would benefit from the support of a platform provider.

ADDRESSABLE MARKET

Given the above, Aite Group recommends focusing HighTower’s platform at both nonindependent advisors breaking away and existing RIAs with a practice size between US$150 million and US$750 million in client assets (Figure 4). Based on the size of the opportunity, the independent market is most attractive.

Nonindependent practices below that asset threshold will find going independent daunting due to their practice size and maturity. They will prefer to join an independent network, such as Raymond James or United Capital. Independent RIA firms below US$150 million will not experience the operational burden that will entice them to leverage an integrated platform.

Practices above US$750 million typically have figured out the operational aspects of their business; otherwise, they would not have reached this size. The motivation to shift to a different operational setup frequently involves monetizing the value of the practice they have built over many years or ensuring succession.

In this category of practices above US$750 million, there are fiduciary-minded advisors who place high value on the leading brand and elite culture of HighTower thus desiring the HighTower Platform. In these cases, HighTower should be opportunistic as it is uniquely positioned to capture market share among these advisors.
BUSINESS MIX OF NONINDEPENDENT ADVISORS

Advisors originating from the nonindependent segment of the market typically have 18% to 20% of their business as commissionable business related to investments. As these advisors become independent, they start to transition this business away from brokerage to advisory (Figure 5).

Figure 5: Business Mix by Advisor Segment

Q. What percentage of revenue/production of the last 12 months was from the following types of business relationships?

<table>
<thead>
<tr>
<th>Fees</th>
<th>Commissions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent RIAs (n=77)</td>
<td>63%</td>
</tr>
<tr>
<td>Wirehouses (n=54)</td>
<td>58%</td>
</tr>
<tr>
<td>Other self-clearing broker-dealers (n=139)</td>
<td>43%</td>
</tr>
<tr>
<td>Fully disclosed broker-dealers (n=136)</td>
<td>34%</td>
</tr>
</tbody>
</table>

Source: Aite Group survey of 323 financial advisors, Q2 2017
REGULATORY LANDSCAPE

Recent enforcement actions by the SEC have made it clear that regulators have increased their scrutiny of advisors who do not serve as fiduciaries acting in the best interest of the clients. These enforcement actions have emphasized certain activities by financial advisors directly impacting retail investors, such as inadequate fee disclosure, dubious sales practices, and inappropriate steering to unsuitable investment strategies and products. The SEC priorities have primarily focused on the following:

- Steering clients to higher-cost products, such as mutual fund share classes charging higher fees and commissions:
  - Ameriprise (2018): Refunded more than US$1.7 million in fees and paid a US$230,000 fine
  - SunTrust (2017): Refunded more than US$1 million in fees and paid a US$1 million SEC fine
- Abuses in wrap-fee accounts (disclosure abuses, trade-away commissions):
  - Raymond James (2016): Paid a US$600,000 fine
- Investment advisor recommendations to buy and hold highly volatile products, such as inverse exchange-traded funds (ETFs):
  - Morgan Stanley (2017): Paid an US$8 million fine for inadequate policies to ensure clients were aware of the risks associated
- Suitability of structured products sales:
  - UBS (2016): Paid a US$15 million fine for failure to adequately train sales force about complex products
- Abusive sales practices, such as churning and excessive trading:
  - Gennity and Roveccio, others (2017): Paid fines of more than US$400,000

In 2018, the SEC OCIE said that examinations this year will focus on firms whose practices and business models create increased risks that investors will pay fees, expenses, or other charges that are inadequately disclosed.
COMPETITIVE LANDSCAPE

A range of strategic options is available to financial advisors seeking to set up an independent advisory firm. On a high level, the options are as follows:

- Leverage an independent platform (e.g., HighTower Platform, Dynasty)
- Sell equity in the practice to a strategic acquirer (e.g., HighTower RIA, Focus Financial)
- Have a direct relationship with a custodian (e.g., Fidelity Institutional, Charles Schwab)
- Join an independent broker-dealer network (e.g., Raymond James)

INDEPENDENT PLATFORM

Independent platforms provide financial advisors with integrated technology and a broad service offering while allowing the financial advisor to retain full control of the practice. Aside from the HighTower Platform, dominant players in this space include Dynasty Financial Partners as well as FinLife Partners offered by United Capital (Figure 6). As FinLife Partners only offers a financial planning process with an associated proprietary TAMP, it does not offer the same breadth of functionality and services as HighTower and Dynasty.

Figure 6: Independent Platform Provider Landscape

<table>
<thead>
<tr>
<th>Investment autonomy (Products and access)</th>
<th>Middle-office flexibility (Technology, tools, and brand)</th>
<th>Back-office flexibility (Ops, custody, and clearing)</th>
<th>Practice operations (Majority of work performed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>HighTower Focus Dynasty</td>
<td>HighTower Focus Dynasty</td>
<td>Centralized HighTower United</td>
</tr>
<tr>
<td>Medium</td>
<td>HighTower Dynasty</td>
<td></td>
<td>Hybrid Dynasty</td>
</tr>
<tr>
<td>Low</td>
<td>United Capital</td>
<td>United Capital</td>
<td>Locally controlled Focus</td>
</tr>
</tbody>
</table>

Source: Aite Group

HIGHTOWER ADVISORS

Across all channels of affiliation, HighTower serves 101 firms (including both former wirehouse and bank employee advisors and existing independent RIA firms), making up around US$50 billion in client assets (Table A). The average firm contributes US$487 million to the platform. HighTower maintains a single ADV on behalf of RIA teams, reducing the operational and regulatory burden for these advisors.
Table A: HighTower Advisors

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of teams</td>
<td>101 firms (all affiliations)</td>
</tr>
<tr>
<td>Assets on platform</td>
<td>US$50 billion</td>
</tr>
<tr>
<td>Average assets per firm</td>
<td>US$487 million</td>
</tr>
<tr>
<td>Business model</td>
<td>Advisors are on a single ADV, unified middle and back office, centralized operations of services</td>
</tr>
</tbody>
</table>

Source: HighTower Advisors

HighTower’s core platform includes integrated technology and meets all the essential requirements for operating an RIA firm for a platform fee. To reduce the overall cost of affiliation over time, HighTower passes along the favorable pricing it receives based on its scale.

Core platform services include compliance, marketing, technology, operations, capital markets, investment solutions, client billing, and others. The platform technology is fully integrated and offers choice across various application categories:

- **Customer relationship management (CRM):** Salesforce.com
- **Performance reporting:** Black Diamond, Envestnet Tamarac
- **Portfolio rebalancing:** Envestnet Tamarac, custodians
- **Billing and account opening:** Proprietary software integrated with CRM and performance reporting
- **Advisor dashboard:** Proprietary software, Tableau
- **Financial planning:** MoneyGuidePro, eMoney Advisor, NaviPlan, and two others
- **Investment management:** Relationships with Envestnet at a steep discount to market as well as the HighTower office of the chief investment officer OCIO FSPs

**DYNASTY FINANCIAL PARTNERS**

Dynasty Financial Partners is the closest competitor to the HighTower platform. It currently serves 47 firms (with both breakaway teams and existing independent RIA firms evenly represented), making up greater than US$30 billion in assets (Table B). The average firm contributes US$640 million to the platform. Dynasty requires RIA teams to maintain their own ADV and therefore claims to attract entrepreneurial advisors in their early to mid-40s who have growth ambitions and are not looking for a liquidity event.
Table B: Dynasty Financial Partners

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of teams</td>
<td>47 firms (2015: 28 firms)</td>
</tr>
<tr>
<td>Assets on platform</td>
<td>More than US$30 billion (2015: &gt;US$23 billion), including more than US$11 billion on investment platform</td>
</tr>
<tr>
<td>Average assets per firm</td>
<td>US$640 million</td>
</tr>
<tr>
<td>Business model</td>
<td>Advisors are on their own ADV</td>
</tr>
</tbody>
</table>

Source: Dynasty Financial Partners

Dynasty’s core platform covers technology and all variable-cost elements of an RIA firm for a single bundled fee. The platform includes services such as compliance, reporting, and research and provides technology choice across various application categories.

Dynasty is aiming to generate additional revenue from existing platform clients:

- **Transition and consulting (fee per service):** This includes services such as support with launching the RIA and professionalizing their firm as well as support with client communication strategy and real estate selection.

- **Product platform (fee paid by end client):** In 2016, Dynasty established an OCIO function/a fully functional TAMP and a proprietary proposal generator. The platform offering can range from an all-outsourced OCIO role to providing models only to round out an advisor’s strategies.
DIRECT RELATIONSHIP WITH CUSTODIAN

The RIA custody space is a highly concentrated market with Fidelity Institutional and Charles Schwab the leading players in the space (Figure 7).

Figure 7: Leading RIA Custodians

Custodians are busy developing their own platforms focused on integrating proprietary and third-party applications with services centered around the back office. Independent RIAs that leverage the platforms offered by custodians directly must assume responsibility for key activities, such as compliance and technology setup (e.g., network, phone), as well as collecting revenue on assets custodied away. Custodians do possess pricing power, as any platform fee is in addition to the custody fee earned from independent RIAs. Custodians also make a transition budget available for select breakaways coming on board (commonly referred to as custodian benefit dollars), which might cover the technology and marketing-related costs over the first two years.

Fidelity Institutional launched its Wealthscape strategy in October 2016, developing a web platform that connects all fee-based, commission-based, and hybrid clients to new Fidelity tools and third-party solutions. Key functionality includes the following:

- The platform includes the ability for advisors to white label end-investor portal and marketing materials. End investors also have access to the portal through the eMoney Advisor application.

- It includes the ability for advisors to manage smaller accounts through an automated solution while remaining the investment advisor. Its Automated
Managed Platform (AMP) is also integrated with the eMoney Advisor application and supports hybrid advice. AMP launched in September 2017.

Fidelity is aiming to expand Wealthscape to include a custody-agnostic data consolidation platform (planned for 2018). RIAs are skeptical, though, that this will offer sufficient capabilities for multicustody RIAs.

Fidelity Institutional is targeting RIAs that have at least US$150 million in assets, and its average client size is around US$300 million (Table C).

While custodians’ platform strategies will offer an improvement for all independent RIAs, two types of RIAs will work directly with custodians:

- RIAs that are looking for an inexpensive solution and leveraging the discounted and sometimes free applications offered by the custodian (typically RIA firms with less than US$200 million in assets and that are not experiencing rapid growth)
- RIAs that have enough scale to develop their own platform strategy and leverage to negotiate with vendors directly

Neither of the RIA types will be good candidates for the HighTower platform: The first group is not willing to pay a premium for an integrated platform, and the second will aim to recreate the platform at a lower cost.

Table C: Fidelity Institutional Wealth Services

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of RIA firms</td>
<td>2,927 firms</td>
</tr>
<tr>
<td>Client assets</td>
<td>US$882 billion (1.5% growth)</td>
</tr>
<tr>
<td>Average assets per firm</td>
<td>US$301 million</td>
</tr>
<tr>
<td>Business model</td>
<td>Advisors are on their own ADV</td>
</tr>
</tbody>
</table>

Source: Aite Group (2015)

INDEPENDENT BROKER-DEALER NETWORK

There are several large independent networks, and Raymond James is one of the fastest-growing franchises (Figure 8). Recent mergers and acquisitions are catching it up to the wirehouse firms by head count and assets.

Independent broker-dealer networks are particularly successful with smaller breakaway practices. The offering is appealing, as it provides a similar level of support as that which breakaways experienced at their prior employer.

Raymond James has a broad array of affiliation options for financial advisors, from employee advisors to independent contractors. For the independent contractor model, advisors are required to have three years of experience and production of US$300,000 or higher in fee and
commission revenue to join an existing branch and at least US$350,000 to open a new branch. The average advisor has a US$73 million book of business (Table D).

Raymond James allows its independent contractors to start an independent RIA firm away from the firm’s corporate RIA but requires them to custody the assets at Raymond James. The firm does not allow the usage of any TAMP.

Independent contractors are responsible for office IT equipment; office leases; hiring and managing their own support team, branch professionals, and any additional staff; and covering employee benefits. Raymond James allows its employee advisors to become independent contractors, but does not recommend it unless the independent setup will yield at least a 10% net difference.

While Raymond James is an option to move to independence, its brand is one of a regional brokerage and is inherently connected to the world that advisors want to leave behind when aiming to go independent and embrace a fiduciary setup.

**Figure 8: Leading Independent Broker-Dealer Firms**

![Figure 8: Leading Independent Broker-Dealer Firms](image)

<table>
<thead>
<tr>
<th>Client Assets and Number of Financial Advisors at Leading Self-Clearing Brokerage Firms (Non-Wirehouses), 2016 (In US$ billions and number of financial advisors)</th>
<th>Client assets '15 to '16 ∆</th>
</tr>
</thead>
<tbody>
<tr>
<td>Edward Jones</td>
<td>$943, 9.7%</td>
</tr>
<tr>
<td>Raymond James</td>
<td>$586, 23.8%</td>
</tr>
<tr>
<td>LPL Financial</td>
<td>$509, 7.1%</td>
</tr>
<tr>
<td>Ameriprise</td>
<td>$479, 7.2%</td>
</tr>
</tbody>
</table>

Source: Aite Group

**Table D: Raymond James Financial Services**

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of advisors</td>
<td>4,100 financial advisors (3.5% annual growth)</td>
</tr>
<tr>
<td>Client assets</td>
<td>US$300 billion</td>
</tr>
<tr>
<td>Average assets per advisor</td>
<td>US$73 million</td>
</tr>
</tbody>
</table>
### COMPARISON OF PLATFORM VALUE ACROSS COMPETITORS

Advisors are faced with several issues when considering affiliation with a given provider. For some functions such as compliance, advisors first decide how much risk they are willing to take, then decide whether they want to spend the time to do it themselves. Assessing the value of each alternative is complex. The following breaks down the differences in value to advisors across competitors:

- **Adherence to the fiduciary standard:** Advisors wanting to be a true fiduciary to their clients have limited choices in the market outside of HighTower and going directly to a custodian to set up their business. For Raymond James, advisors are restricted in their choice of investment products and accounts while the firm makes money the same way as other broker-dealers (e.g., receives payment for order flow on equities and ETFs).

- **Practice management:** All the competitors in the marketplace provide practice management support; however, as expected, none actively get involved in making daily decisions or do the work on behalf of advisors running their practices. Custodians such as Fidelity, Schwab, and TD Ameritrade also offer practice management consulting. The HighTower network provides the additional benefit of connecting advisors together to enable the regular sharing of best practices.

- **Investment access and oversight:** Advisors at HighTower maintain the widest range of investment choices without conflict and have access to alternative investment platforms and direct alternative investment options. Raymond James restricts advisor investment choices given its captive business model. While teams going directly to their custodians also maintain a wide range of choice, they lose the benefit of ongoing due diligence conducted by a platform provider whose services reduce overall risk.

- **Investment research:** Advisors going directly to custodians and Raymond James must pay for research outside of what is offered for free on those platforms. Advisors choosing Dynasty and HighTower have access to the custodian research and additional investment research included within the base platform fee. In the case of HighTower, teams also benefit from the research provided by trading counterparties, such as Goldman Sachs, through the capital markets function.

- **Revenue management and client billing:** HighTower and Raymond James offer the most turnkey support for advisory fee collection among the options in the marketplace. Both have dedicated operations teams and integrated technologies to support the outsourcing of this entire process. Advisors choosing any of the custodians typically license a third-party technology such as Orion and employ staff to bill and collect advisory fees from clients.
• **Broker-dealer services:** HighTower, along with Raymond James, offers the most complete solutions among the competitors. Dynasty outsources its broker-dealer function completely to PKS, a third-party provider. Advisors going directly to a custodian to offer this service to their clients must properly register as a broker-dealer or choose to outsource this function themselves. The broker-dealer is important to wealth managers, as selling insurance is a byproduct of financial planning, and it is necessary to have a broker-dealer to get paid for placing a client in one of these products.

• **Capital markets and trading:** Only HighTower offers a conflict-free model for trading of fixed income and structured products. Unlike Raymond James, HighTower does not make markets or hold inventory that advisors can sell to clients. Advisors going directly to custodian platforms are subject to markups and pricing that are often no better than what they offer to their own self-directed retail clients.

• **Compliance:** The most rigorous compliance services are offered by HighTower and Raymond James. They do field supervision, full audit support, registrations, regulatory filings, and risk oversight on behalf of teams. HighTower also offers social media support for advisors marketing on LinkedIn or other outlets. Advisors choosing Dynasty or a custodian are on their own ADV, and while they may choose to pay extra for third-party services to perform these functions, they carry the full burden of regulatory risk.

• **Advisor software:** HighTower, Dynasty, and Raymond James are comparable in terms of breadth of advisor software. Raymond James is the most integrated but least flexible for advisors, given advancement of third-party innovations. HighTower and Dynasty use proprietary applications to integrate third-party technologies into a common experience. Custodians offer limited software currently.

• **Computing and networking:** Only advisors at HighTower receive 24/7 IT network support and integrated cybersecurity infrastructure. Advisors must perform these functions on their own in all other competitive options.

**HOW TO UNDERSTAND PRICING ACROSS COMPETITORS**

It’s important to look at pricing in terms of advisor payout. While the top-line pricing of platform services is an important factor in a team’s payout for being independent, it is not the only factor. Below are important elements to consider when understanding pricing differences across competitors:

• **Platform fees:** Platform fees are paid for the core services of a given provider’s platform, such as operations and compliance. There are no explicit platform fees for teams choosing to go directly to a custodian, but advisors would still have to pay fees related to custody and clearing. HighTower and Raymond James charge teams based on gross revenue, while Dynasty charges based on billable advisory AUM. Pricing based on gross revenue is the most transparent of the two, as it is best aligned with how advisors monetize their client relationships.
• **Broker-dealer payout:** In the case of Dynasty and teams going directly to custodians, they may require a broker-dealer to accommodate new client business, collect insurance commissions, support directly held mutual funds, or simply execute nonsolicited securities trades. In each case, the payout on broker-dealer revenue is different across alternatives.

• **Advisory fees:** Advisory fees paid by teams vary across competitive options but also depend on the business practices of the advisor. For example, Raymond James doesn’t charge advisors administrative and program fees for advisory accounts; others eventually lead to custodian advisory pricing. As mentioned previously in this report, it’s important to note that teams pay advisory fees for wrap accounts, and this directly affects their payout. If a client’s account is nonwrap, the client pays the advisory fees, and these fees are transparent to the client.

• **Investment management (third-party managers):** Depending upon the advisor’s reliance on outside investment managers, several alternatives are available across competitors. Advisors can choose to leverage custodian SMA/UMA platforms but are often limited by the number of manager choices. In all cases except HighTower, advisors leveraging third-party managers to offer SMAs and UMAs may not be fully aware they are paying higher manager fees or that those same fees get paid back to the platform provider making the introduction. On top of that, access fees among TAMP alternatives vary. The team bears some cost simply to gain access to managers.

• **Investment management (rep as portfolio manager):** Advisors may choose to leverage custodian capabilities to do their own investment management. However, some advisors not wanting to be locked to one custodian may have to license software to rebalance client accounts across multiple custodians (e.g., Tamarac). In the case of HighTower, advisors have access to a full-time trading desk to avoid conflicts inherent in other models.

• **Compensation and benefits:** There are additional costs of running an independent practice directly with a custodian, including staffing of functions such as compliance, operations, revenue management, and technology. While services from the platform providers vary in these areas, they typically defray or eliminate head count needs. This in turn reduces office rent, utilities, and other costs tied to the number of colleagues in the practice.

• **Sales and marketing expenses:** The entire marketing effort for advisors choosing to go directly to a custodian is borne by the team, whereas platform offerings provide some leverage to the teams in terms of resources and technology.

• **Advisor desktop software:** Some providers include CRM, performance reporting, client portal, and financial planning software within their platform fee, and advisors don’t have to pay separately. In the case of Raymond James, while advisors pay a nominal fee of US$250 per month for use of this software, advisors do not choose applications because many are built and maintained internally. HighTower and the custodians offer the widest range of choices, although the costs are passed to advisors.
• **Technology infrastructure and network support:** In all alternatives, advisors are required to pick up the cost of purchasing PCs, monitors, and networking equipment, such as routers and security devices. However, only HighTower provides the added benefit of managing the advisor desktop (help desk), network, and information security on the advisor’s behalf. For a seven-to-10-person advisory office at HighTower, this amounts to a US$50,000 annual savings in the advisor’s profit and loss statement.

• **Compliance:** Outside of Raymond James and HighTower, teams operating an advisory business under their own ADV will carry all the regulatory risk of compliance oversight, supervision, and audit. While Dynasty offers compliance services and teams going directly to custodians can choose to elicit the help of a third-party provider such as RIA in a Box, teams on their own ADV often incur the cost of adding a compliance person to fulfill these duties.

• **Business insurance:** Depending on the alternative, advisors receive basic business insurance coverage to help defray the risk in running their practice. HighTower provides the most expansive set of coverage (including cyber coverage), followed by Raymond James, which provides basic errors and omissions and fidelity bonding. Advisors choosing another competitor or wanting additional coverage limits beyond what these firms provide must obtain the insurance on their own.

• **Services not offered to independent contractors:** For various reasons, including tax reasons, platform providers do not offer services related to accounting, human resources, facilities (including office space), and legal support. For example, advisors will have to pay for payroll and benefits at market prices and perform the administrative duties themselves or outsource to a third-party provider. They also must do all their own staff recruiting.
ADVISOR BUYING CONSIDERATIONS

Three considerations are important to financial advisors when evaluating platform alternatives available in the marketplace. On a high level, these considerations follow:

- Social dimensions
- Operational support and risk mitigation
- Upfront economics (mostly for nonindependent advisors)

All these considerations directly affect advisors’ ability to successfully set up their new businesses, transition their clients, and grow their businesses over the long run.

SOCIAL DIMENSIONS

According to interviews of advisors who leave the wirehouse, the independent option carries the most risk, and it is most times easier to remain an employee of the same firm or choose to be an employee of another firm. As a result, advisors have three social considerations in their decision to select a platform option (Table E):

- **Independence concerns**: Simply said, advisors don’t want to be alone and on an island. They prefer to be a part of a network of other advisors that they can rely on for emotional and informational support. While independence is the ultimate degree of autonomy, they desire a culture of support that they can easily access when needed.

- **Firm concerns**: Advisors seek alternatives that inherently offer the support of brand and community. For top advisors, they want to be associated with other top advisors and feel like a part of the community. Once there, these advisors want to ensure the value of their community is expanded by adding other like-minded advisors. Similarly, advisors want the support of a powerful brand to help attract and retain clients.

- **Practice/client concerns**: Advisors are looking for the best possible option to help them transition their clients, and in doing so, easily explain why they moved and tell their unique story. It is important to advisors to be able to explain to clients why things will be better for them and be different.

Table E: Advisor Buying Considerations

<table>
<thead>
<tr>
<th>Social considerations</th>
<th>Details</th>
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</thead>
<tbody>
<tr>
<td><strong>Independence concerns</strong></td>
<td>Social isolation</td>
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<td></td>
<td>Independence is the way of low producers</td>
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<td></td>
<td>Operational support</td>
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<td></td>
<td>Short versus long-term economics</td>
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<td>Social considerations</td>
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<tr>
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</tr>
<tr>
<td><strong>Firm concerns</strong></td>
<td>Firm reputation and brand recognition</td>
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<td></td>
<td>Capital infrastructure</td>
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<td></td>
<td>Number of advisors/novelty</td>
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<td></td>
<td>People and community</td>
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<tr>
<td><strong>Practice/client concerns</strong></td>
<td>Transition economics</td>
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<tr>
<td></td>
<td>Clients following</td>
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<tr>
<td></td>
<td>Explaining the move; client story</td>
</tr>
<tr>
<td></td>
<td>Administrative paperwork</td>
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</tbody>
</table>

Source: Aite Group advisor interviews; Reidel Strategy LLC (2015)

**OPERATIONAL SUPPORT AND RISK MITIGATION**

Advisors want to put client interests first. They also want to operate their businesses efficiently to maximize profits and minimize a variety of risks. As a result, they will require expertise across key functions such as client service, operations, compliance, and risk. Independent advisors at a custodian have already organized their businesses, so understanding how their new environment will make them more efficient and ease their operational burden is an important consideration. Below are the upfront considerations offered by competitors in the marketplace:

- **Elimination of conflicts of interest (fiduciary standard):** Independent advisors seek alternatives in the market that allow them to put the client interests first and have the client’s best interests in mind. This includes being able to select from a range of investment products that are not tied to compensation and not restricted to what the company wants them to sell. This concern is considered foundational and table stakes for independent advisors.

- **Operational support:** For HighTower, Dynasty, and Raymond James, this support is delivered through the “platform” of services provided. Advisors also want these services and technologies fully integrated to achieve maximum efficiency. For those advisors choosing to go direct to a custodian, operational support is derived by hiring resources as well as procuring and integrating third-party technologies.

- **Risk mitigation:** Those advisors choosing to go directly to a custodian are responsible for managing all the risks of their business on their own. For example, they must perform investment product due diligence, reduce errors within operational processes, be HR-compliant, and manage all regulatory risks. Some of the platform alternatives reduce this risk.
UPFRONT ECONOMICS

Those leaving a wirehouse or nonindependent firm are required to set up a new business and will require initial working capital to start their new company. While this is a factor in the decision process, it is often secondary to the social and operational concerns. Advisors who are already independent have already set up their businesses, so upfront economics become even less of a concern. Below are the upfront considerations offered by competitors in the marketplace:

- **Revenue participation notes**: Under this option, advisors give up anywhere between 5% and 10% of their revenue (which can be bought back at a fixed interest rate) in return for cash to operate their business. The team is subject to certain restrictive covenants and limitations on outside business activities. There are also put and call provisions.

- **Employee forgivable loans**: In this case, advisors will receive an upfront payout based on production at their current firm, which is forgiven gradually over a period (typically 10 years). This also places restrictive covenants on the advisors. Raymond James is the only competitor in this study that currently offers this option.

- **Working capital loans**: This is a regular term loan provided to the advisor from either the competitor or a third party. If offered by the firm, it is subject to restrictive covenants until the loan is repaid. Dynasty and Raymond James are the only competitors in this study that publicly offer working capital loans.

- **Custodian benefit dollars**: These are payments made by the custodians to help defray the costs of technology, marketing, and transitions-related expenses. The amount of the benefit given is based on prior production, typically limited to two years, and is adjusted thereafter based on AUM. Raymond James is the only competitor in this study that does not offer this option.
CONCLUSIONS

The following section contains conclusions as a result of this research effort.

TARGET MARKET

The target market for the HighTower platform business is the following:

- **Size of team**: AUM from US$150 million to US$750 million
- **Primary addressable market**: Existing RIA firms
- **Secondary addressable market**: Breakaway advisors from protocol firms

Through our interviews, we’ve found that HighTower can service teams with over US$750 million in AUM very well—including teams offering family-office services. In this segment, the HighTower value proposition resonates with fiduciary-minded advisors who value its leading brand and elite culture of advisors. While that size advisor practice is not the target market for new teams, the HighTower service offering scales well to support all teams as they grow.

COMPETITIVE LANDSCAPE

While advisors have many options, HighTower only needs to focus on a select group of competitors in the market:

- **Dynasty** is the closest competitor aiming for a similar advisor demographic. Dynasty does not have its own RIA and cannot offer the option to sell equity to the aggregator. Dynasty does allow RIAs to have their own ADV and might have a leg up with winning young, fast-growing advisors.

- **Raymond James** is another key competitor. With over 7,000 advisors (of which 4,200 are independent contractors), the firm has a tremendous amount of scale. However, its brokerage heritage will not convince advisors that look for a fully conflict-free, pure fiduciary environment.

- **Schwab and Fidelity** are becoming competitors as the largest RIA firms that have sufficient scale to assemble their own platform and tackle topics such as technology, office management, compliance, and other key business concerns independently.
HIGHTOWER VALUE PROPOSITION

HighTower has a premium offering over competitors in the market. HighTower offers the following benefits to advisors (not exhaustive):

- **Brand**
  - National brand awareness for the benefit of all advisors
  - Champion of advisors’ fiduciary duty to always act in the best interests of clients
  - Privileged access to major media outlets, allowing advisors to broaden their reach

- **Culture**
  - Access to elite advisors (16 of Barron’s top 1,200, 25 on Forbes’ Top Advisors list)
  - Best-practice sharing among like-minded advisors, including those with different practice approaches
  - Access to a wide range of sponsored events, such as national, regional, and investment-specific events
  - Inclusive culture that can eliminate advisors’ feelings of isolation while being independent
  - A spirit of community and partnership for advisors, including encouragement of niche practices

- **Platform services (flexibility and choice)**
  - Completely conflict-free service platform that aligns advisor and client interests, including choice among industry-leading providers
  - Wide range of third-party managers, alternative investment products on platform, and retirement solutions
  - Access to institutional-grade investment research
  - Access to capital markets trading desk
  - Choice of multiple custodians

- **Platform services (operational support and risk management)**
  - Fully integrated technology platform comprising leading vendors, such as Salesforce.com, Envestnet, and Black Diamond, offered at greatly discounted pricing
  - Instead of replicating critical operational functions within an individual practice, advisors gain leverage from experienced specialists within a larger firm
  - Reduced regulatory risks through the shared ADV model
• Access to a full-time compliance team, which handles functions such as field supervision, registrations, and SEC/Financial Industry Regulatory Authority (FINRA) audit responsibilities
• Comprehensive IT network support and cybersecurity prevention
• Elimination of financial risks through centralized revenue-collection processes
• Business insurance
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