

**A CASE FOR STARTING OR
JOINING A REGISTERED INVESTMENT
ADVISORY (RIA) FIRM**

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EXECUTIVE SUMMARY

Based on feedback from hundreds of advisors considering starting or joining Registered Investment Advisory (RIA) firms, financial advisors are asking themselves fundamental questions such as:

- What's the best advisory model for my clients?
- How can I “re-capitalize” personal market-related losses?
- How would I fare without the guidance and infrastructure in my current environment?

This paper explores some of the options available to advisors who may be considering a change from their current broker-dealer environment. It examines:

- “Net” annual compensation in the RIA model as compared to a captive hybrid or bank/brokerage environment
- Accepting a check (forgivable loan) compared to starting an RIA
- The role of the RIA custodian in regards to service, products, technology, practice management and protecting assets
- Recent net new asset flow comparisons between RIA custodians and top brokerages
- Options available to advisors/teams beyond starting their own firms

Find out for yourself what makes a successful move to independence—and learn from those who did.

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INTRODUCTION

The business of providing investment advice has radically changed in recent years. With affluent clients frustrated by real or perceived conflicts of interest and difficult market conditions,¹ an increasing number of financial advisors see a need to re-earn clients' trust.² A move to a different advisory channel can present that opportunity to some.

Those who leave a bank/brokerage firm, wirehouse or independent broker-dealer to become a Registered Investment Advisor (RIA) often want to improve the service provided to clients, expand their advice and product offerings, and increase their earnings potential. Some may be in transition-planning mode trying to determine the best way to maximize the sale of their revenue stream at a later point in their career. Still others may be interested in evolving their fee-based practice to fee-only over time and believe the best channel for this evolution is outside the bank/brokerage channel.

Clients of advisors are often business owners who appreciate doing business with other business owners. Based on feedback from hundreds of advisors who in recent years started their own firms or joined existing firms custodialing their assets with Schwab Advisor Services,³ it's not uncommon for clients to respond "What took you so long?" when learning that their advisor started or joined an independent firm. What's more, an overwhelming 98 percent of independent RIAs say if they had to do it again, they would make the same decision to go independent.⁴

"After 16 years in the wirehouse environment, I wanted transparency. When I was with my prior firm, we used to start every client meeting with an explanation of why we weren't the same as the big-name wirehouse on our business card—we were always trying to differentiate ourselves from the traditional broker. I find it refreshing that today we can talk about our boutique independent model. We can talk about customization. We can talk about the service model and why we went down this path in the first place."

—John Krambeer, President and CEO, Camden Capital Management

Momentum Shift to RIAs

The recent financial crisis and massive firm consolidations have prompted investors to question advisors about the stability of major Wall Street firms that are holding their assets.⁵ While this crisis of confidence led many previously happy advisors to actively research becoming independent advisors, the stage began to be set for this exodus nearly a decade ago. Since the early 2000s, Schwab Advisor Services believes, many traditional wirehouses may have unintentionally created a fertile environment for the next generation of independent advisors.

Team building

To begin with, many wirehouses transitioned from simply accommodating advisors who wanted to team up, to encouraging them to partner in order to better serve clients and ensure continuity when a team member leaves the firm.⁶ In this environment, a fully functional and compatible team that becomes unhappy with its firm wields a significant amount of leverage. Advisors who have branded their team within the construct of the wirehouse have already created a boutique atmosphere similar to independent practices, and are similar in nature to the RIA model.⁷

“Certain individuals and teams have evolved their own boutique business model. They need a more focused solution.”

—George Dunn, Managing Director
Convergent Wealth Advisors
Institutional Group

An emphasis on fee-based business

Traditional wirehouses have also encouraged the growth of fee-based accounts in the past decade in order to annuitize revenue flows and manage shareholder expectations from quarter to quarter. For example, the 2007 *Focus on Growth* bonus program provided Merrill Lynch financial consultants an incentive to grow their fee-based business.⁸ Advisors with 80 percent to 100 percent fee-based client assets under management are increasingly realizing that “haircuts” on these assets by wirehouses can be avoided by going independent. This emphasis on fee-based accounts underscores an increasing awareness of how RIA custodians are compensated (see page 11). Those advisors with a more balanced mix of fee and commission business may often value the oversight and support of an independent broker-dealer on an ongoing basis.

Consolidation

Combinations of major banks and brokerages in 2008 and 2009 haven't inspired a sense of stability for clients or advisors.⁹ Merging cultures, integrating products/platforms and reducing expenses may heighten uncertainty.

Advisors may feel disenfranchised by the retention packages they are offered (or not offered), the treatment of team members in retention package calculations, the changes in leadership, and the rumored or actual compensation plan changes. These advisors may be challenging their firms to work to retain them by actively and sometimes openly pursuing other options like going independent.¹⁰ Ultimately, many advisors are not in control of their or their clients' destinies.

A crisis point

The sub-prime and credit crises continue to be a major source of client and advisor frustration. As such, many advisors and teams have considered a fresh start by accepting a forgivable loan offer from a competing firm.¹¹ Others, who have looked carefully at the math and weighed the multi-year commitment required as part of the loan (see Exhibit 8: Comparing a Forgivable Loan With Starting an RIA Firm on p. 18), have opted to consider monetizing their revenue by starting an RIA instead. With an increase in disgruntled advisors and with more conservative banking cultures increasingly influencing recruiting policy, there is a growing school of thought that forgivable loan amounts will trend down from the heights reached in 2007 and 2008.¹² On the other hand, an emerging emphasis for those seeking independence is building equity in a business without depending on colleagues with different incentives.¹³

“On August 8, 2008, everyone in The Courage Group left the safety net of working for a large, bank-owned, international wealth management firm and moved several blocks down the street to open our doors as Courage Partners, LLC. We left without being able to notify our clients in advance, our new space was not ready, the phones were not working properly, the furniture had not arrived, our former firm was not helpful and, a month later, the equity markets began the historic ‘waterfall event.’ We quickly learned that an 80-hour workweek would be a vacation—and how to survive on energy bars and bottled water. Five months later, our clients appreciate how we came to our decision and understand why our move to independence benefits them. We have been overwhelmed by the incredible affirmations our clients have given us and are even more determined in our dedication to serve them. I am so pleased and thankful to report that nearly all our clients, including all of our major clients, have followed us to Courage Partners, which is even larger than it was when we declared independence.”

—*Ralph Courage, Managing Member
Courage Partners, LLC*

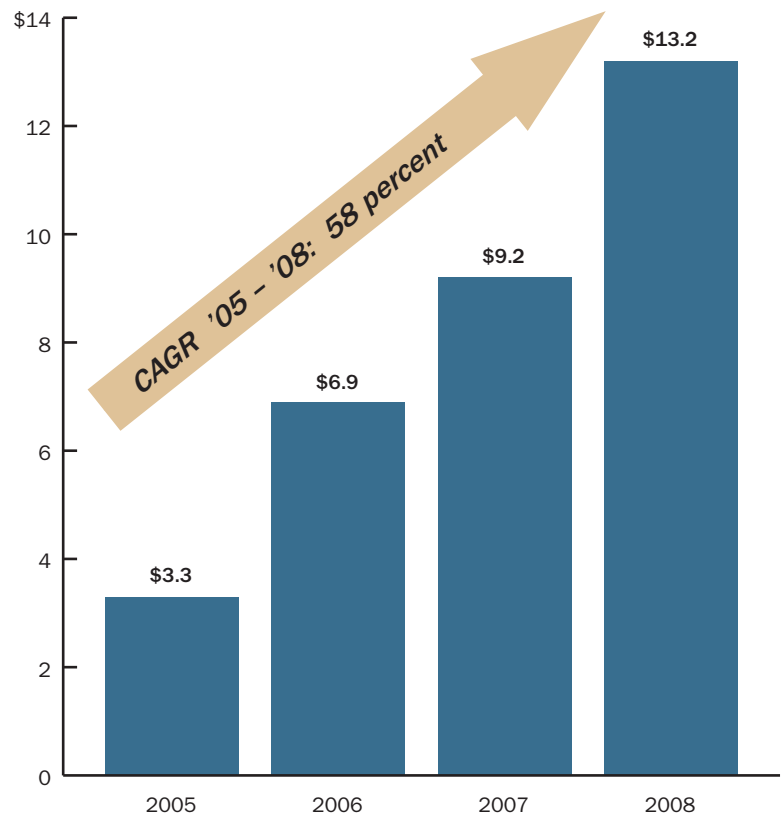
The experience of Ralph Courage and Courage Partners may not be representative of the experience of others and is not a guarantee of future performance or success.

Convergence in thinking

Thousands of successful fee-based teams and individuals are now in a position to consider starting or joining RIAs. The Broker Protocol created in 2004 by some of the major wirehouses attempts to avoid costly lawsuits and Temporary Restraining Orders (TROs) against departing financial advisors. If an advisor resigns, takes limited client information outlined in the Protocol and joins another member firm, the Protocol may shield them from a lawsuit or TRO. Since its inception, many RIAs have also joined the Protocol, enabling them to take advantage of the protection it originally afforded wirehouses.

EXHIBIT 1: SCHWAB ADVISOR SERVICES NET NEW ASSETS FROM ADVISORS TURNING INDEPENDENT

Assets under management (AUM in billions)



Source: Schwab Advisor Services

Schwab Advisor Services' 58 percent compound annual growth rate (CAGR) in net new assets from advisors who recently became independent is another reflection of the trend of turning independent. Exhibit 1 (above) tracks advisors/teams leaving a bank/brokerage firm or independent broker-dealer to start or join an RIA.

ADVISOR MODELS TO CONSIDER

The Spectrum of Independence

If you want to go independent, you have three basic models from which to choose:

- **Pure RIA:** Start or join a 100 percent fee-based RIA, using independent RIA custodians.
- **Open hybrid model:** Start or join a fee-based RIA while affiliating with an independent broker-dealer for transaction business, including on-going commissions and trailers.
- **Captive hybrid model:** Affiliate with a broker-dealer with a corporate RIA and restrictions on RIA custodian access.

The choice of models typically depends on the type of revenues the independent advisor earns: Fee-only advisors may find the pure RIA model the most attractive. Advisors who choose to retain some or all of their commissions usually affiliate with a broker-dealer in what many describe as a *hybrid* model. Schwab Advisor Services provides custodial services to about 1,500 RIAs that have principals or other personnel who have licenses with independent broker-dealers.

In good company

Some independent broker-dealers require associated broker representatives to use their corporate RIA or otherwise restrict them from accessing independent custody and trading platforms for their fee-based business like those offered by Schwab Advisor Services. Other independent broker-dealers, who work with RIA custodians, have embraced a multi-affiliation model that allows their associated brokers' firms to set up their own RIAs and choose the best platform for their clients.¹⁴

Still, it is becoming more common for individuals and teams to join as employees or forge a strategic alliance with an existing independent RIA rather than start their own. In fact, an increasing number of RIAs are hungry to grow by adding advisors and/or teams, either through recruitment or acquisition.¹⁵

Firms specializing in ownership transactions offer an attractive option as well for those seeking specific transition assistance and various degrees of operational and practice management support. Whether as a boutique or a holding company, a handful of investment consulting companies allow an advisor/team to receive up-front compensation in return for a portion of the future revenue stream.

CALLAN CAPITAL: TAKING CONTROL OF YOUR DESTINY

“Schwab was integral in introducing us to vendors and helping us narrow our search for everything from IT to performance monitoring to financial planning software. The Schwab conversion team was critical in transferring the accounts of clients who followed us. We chose Schwab Advisor Services because of its brand. They’ve been in the business of custodying RIA assets much longer than anyone else.”

—Trevor Callan, CIMA and CEO, Callan Capital, LLC

The experience of Trevor Callan and Callan Capital may not be representative of the experience of others and is not a guarantee of future performance or success.

As Trevor Callan—CIMA and CEO of Callan Capital, LLC in La Jolla, CA—stops for a minute in his office overlooking the Pacific Ocean, he’s reminded of all the hard work it took to get here. He and his brothers, Tim and Ryan, conceived the idea of just such a perch as early as 1994. They manage more than \$150 million in client assets from this chic, state-of-the-art office—part California modern, part fast-paced consulting firm and part yesteryear’s Wall Street bullpen. One can’t help but feel the Callan Brothers are finally where they always wanted to be—in control of their own destiny.

What was once a lofty goal became reality in January 2007, when the Callan team left its former wirehouse firm to start Callan Capital. There were many reasons for this move. For starters, the Callans wanted to provide true open architecture for their clients. “We spent a lot of time at our former firm talking about open architecture, but in reality we were confined to our firm’s platform,” says Trevor. “Schwab doesn’t confine us to its platform. Working with a custodian allows us choices we didn’t have before.”

Trevor’s team members also wanted more control over their compensation, which they felt should be tied to *their* interests rather than the interests of shareholders of the company employing them. The idea of creating wealth by owning the firm themselves appealed to them immensely.

“One of the toughest things in our former environment was staying aligned with the critical firm objectives each year,” Trevor recalls. “For example, we wanted to market ourselves as a team. Yet that wasn’t necessarily what the firm wanted to see happen. We found ourselves stagnating. We’d come up with a great marketing technique, but by the time we got the go-ahead the opportunity had come and gone. So we became resistant to thinking outside the box because we were constantly going through hoops to get our initiatives approved.”

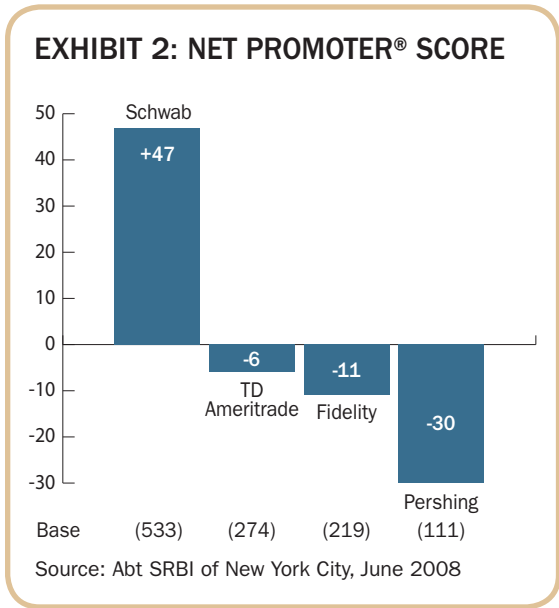
As an elite team focused on high-net-worth clients, the Callans knew their decision to leave the firm wouldn’t go unnoticed. “The legal issues were the scariest part of the whole process,” he explains. “There are many decisions to make when leaving a wirehouse. We opted to be very conservative and walked out, literally, with only our pencils. As it turned out, such an exit drew zero legal implications.”

What Is the Role of the RIA Custodian?

RIA custodians do much more than hold client assets. Schwab Advisor Services, for instance, provides various levels of product, business management, technology and service support to client firms. Unlike some independent broker-dealer models, RIA custodians view advisors as *clients*—rather than supervised agents. As such, advisors can freely move among custodians and use services as they wish.

Service

Though the day-to-day service provided by custodians is usually invisible to the advisor’s clients, the level of service an independent advisory firm provides to its clients is integrally linked to its custodians.



Based on Schwab Advisor Services’ more than 20 years of experience, the opportunity to work closely with a small group of service representatives is often cited as a key advantage of the custodian model.¹⁶

“We have come to know a small group of very capable service representatives. Schwab helped us unlearn our old notion of what a service team means. We have found many friends with Schwab who understand what it means to be best-in-class.”

—Felipe Luna, President, Wealth Management
Concert Global, LLC

The experience of Felipe Luna and Concert Global, LLC may not be representative of the experience of others and is not a guarantee of future performance or success.

Since custodial services are so important to the newly independent RIA, your selection of a custodial team is an important choice. The Net Promoter Score, generated by a study in June 2008 by Abt SRBI of New York City, measures satisfaction with products and services offered by custodians.

The survey results cited in Exhibit 2 involved 1,000 RIAs managing more than \$10 million as reported in ADV filings at the time of the study. Schwab Advisor Services was not identified as the survey sponsor.

Here’s how it worked:

1. The 1,000 RIAs were asked how likely they would be to recommend each custodian

they use to other investment advisors on a scale from 0 to 10, where 0 is “not at all likely” and 10 is “extremely likely.”

2. The Net Promoter Score is the difference between the percentage of “Promoters” (who responded 9 or 10) and “Detractors” (6 or below).¹⁷

Broad product offering

Leading custodians have spent decades developing their investment product offerings based on the needs of their clients. Charles Schwab & Co., for example, is the fifth largest provider of managed accounts in the U.S., with more than 2,300 managers available through its platform.¹⁸ Advisors working with RIA custodians are not constrained by the mandates of a central investment selection committee and thus can more freely select the products they feel are best suited for their clients—which means they can also establish additional custodian relationships to access products their “primary” custodian does not offer.

“I was surprised to find that we have access to just about every broker-dealer’s research, since we have accounts with most of the major firms.”

—Trevor Callan, CIMA, CEO
Callan Capital, LLC

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EXHIBIT 3: TECHNOLOGY RELATIONSHIP

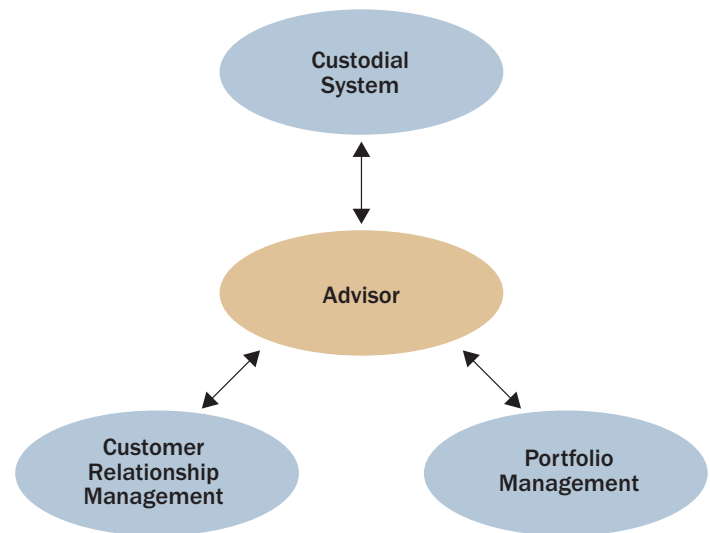
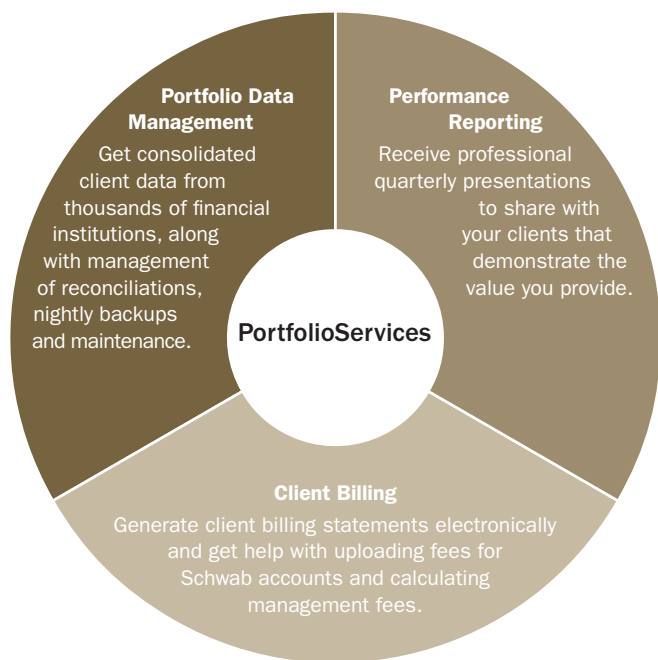


Exhibit 3 shows a common framework from which advisory firms can operate. Similar to product availability, RIA firms have the freedom to select their own technology through an open architecture environment. Advisory firms manage technology needs either internally or through a hosted solution managed by a third party.

Most RIA custodians provide a trading platform and rebalancing functionality through a proprietary portal that integrates with a portfolio management system and a customer relationship management system. Advisors often integrate financial planning, research/newswires and other options as well.

EXHIBIT 4: SCHWAB PERFORMANCE TECHNOLOGIES



In the last few years, RIA custodians have simplified technology for newly independent advisors by offering integrated solutions. Schwab owns Performance Technologies’ PortfolioCenter, one of the two leading providers of portfolio management services—which reinforces the importance of working through an open architecture platform.¹⁹ Schwab PortfolioServices™ is a full-service back-office offering that helps firms manage critical business activities, including generating professional reports and billing clients. Exhibit 4 (above) summarizes the PortfolioServices offering.

PortfolioCenter and PortfolioServices are products of Schwab Performance Technologies (“SPT”), a part of Schwab Advisor Services. Schwab Advisor Services is a business segment of The Charles Schwab Corporation and includes the custody, trading and support services of Charles Schwab and Co., Inc., a registered broker-dealer and member SIPC, as well as the portfolio management and accounting solutions of SPT. CS&Co and SPT are separate subsidiaries of The Charles Schwab Corporation.

For many advisors, technology customization is key. Custodian platforms are often set up to be configurable to any number of outside technology solutions. Independent advisors choose the best solutions based on their unique needs.

Practice management support on the advisors’ terms

An advisor or team that forms or joins an independent RIA firm that custodies assets with an RIA custodian are not employees or representatives of, and don’t work for, the custodian. That means that they don’t receive a “payout” from the custodian.²⁰ So there are no branch managers imposing production and growth demands. But growth is often still a priority for the RIA. As firms grow larger, their needs often become more complex. Some RIA custodians offer dedicated teams to provide business management guidance for client firms, which advisors can choose to access. Schwab’s Business Consulting Services group has significant experience helping firms of all sizes, including most of the 55 firms with more than \$1 billion held on the Schwab custody platform as of December 2008.

“In our opinion, the technology, support and menu of investment choices available for our clients are vastly superior in almost every way to our old brokerage firm platform. But most importantly, we have been impressed daily with the culture and commitment to excellence.”

—Ralph Courage, Managing Member
Courage Partners, LLC

The experience of Ralph Courage and Courage Partners, LLC may not be representative of the experience of others and is not a guarantee of future performance or success.

How does the custodian make money?

So how is a custodian compensated for providing the brokerage, custody, technology and practice management support just described? Generally, the custodian, which is also a broker-dealer, is compensated through brokerage commissions, or asset-based fees in lieu of commissions, and other fees paid by the RIA's clients whose accounts are held by the custodian. As we discuss in the next section, owners of what was previously described as a pure RIA firm set their own fees and their own fee structure.

Schwab Advisor Services' primary revenue sources are transaction revenue (e.g. commissions for trades) from client brokerage accounts, asset-based fees (e.g. fees from mutual fund companies based on fund shares held in customer brokerage accounts) and asset management fees from investment products such as Schwab

proprietary mutual funds and managed accounts. Some custodians provide value-added services to the advisory firm for a fee, typically portfolio accounting systems and certain back-office functions.

Many new RIAs charge their clients asset-based wrap fees—similar to the wirehouse model, in which the client pays a single fee for both investment advice and trade execution. In this model, the RIA typically pays the custodian for its brokerage and other services on an asset-based schedule.²¹ RIA firms that pass transaction costs onto clients keep 100 percent of the revenue earned from client fees.

THE ECONOMICS OF INDEPENDENCE

A Reality Check

To help you evaluate the financial implications of going independent, consider that prior to the creation of Morgan Stanley Smith Barney it was possible, though unlikely, for a wirehouse to reach a payout of 58 percent.²² More commonly, the traditional wirehouse advisor earns 25 percent to 45 percent of the fees paid by clients.²³ Banks, meanwhile, often pay advisors a salary plus 30 percent to 40 percent of the base salary as a bonus.²⁴

Gross Dealer Concession
– Wirehouse Support Costs
<hr/>
Gross Payout
– Out-of-pocket Advisor Expenses
<hr/>
Net Payout

Captive independent broker-dealers may capitalize on the “payout” vernacular by promoting payouts as high as 98 percent²⁵ for top producers, but the term “payout” can be misleading. In practice, a distribution of 88 percent to 90 percent before accounting for overhead expenses is more common, with bonuses sometimes offered as an incentive to grow.²⁶ By combining the bonus incentive and the 88 percent to 90 percent, an advisor/team can theoretically reach the headline distribution of 98 percent of

revenues, again before accounting for administrative fees and overhead expenses.

Yet these additional administrative fees create an even lower effective payout. Tiered administrative fees based on account size can penalize advisors with smaller client accounts, resulting in an *effective payout* between 70 and 90 percent. A typical income statement for an advisor associated with an independent broker-dealer (IBD) breaks down as follows:

Eligible Revenues
– IBD Support Cost
– Administrative Fees
<hr/>
Effective Payout
– Overhead Expenses
<hr/>
IBD Advisor’s Income + Profit (Loss)

After paying the independent broker-dealer for shared support services, the overhead expenses are often higher than in the RIA model, largely due to paying for support services whether they are needed or not.²⁷

Increased Earning Potential as an RIA

Advisors participating in the *Schwab Advisor Services 2007 RIA Benchmarking Study* reported that top firms earn 69 percent to 73 percent *net compensation*, or Owners' Income + Profit, in the RIA model.²⁸ In other words, by managing expenses aggressively, an RIA firm can maintain a 27 percent to 31 percent overhead expense rate, leaving the remainder for principal draws, non-administrative professional salaries and investment in the firm. This compares quite favorably to other compensation models.

A simplified income statement for a pure RIA firm follows. Note that managed account manager fees are netted out of Gross Revenues.

Gross Revenues
– Overhead Expenses
RIA Owners' Income + Profit (Loss)

Monetizing the RIA asset

In addition to potentially earning more net income, independent advisors can build equity and create a transferable asset with significant enterprise value. Buyers typically value RIAs at between 6 and 10 times cash flow,²⁹ or between 1.8 and 3.5 times revenues, with the largest multiples usually applied to teams with \$500 million or more of fee-based assets.³⁰

EXHIBIT 5: SCHWAB 2007 RIA BENCHMARKING STUDY RESULTS—OVERHEAD EXPENSE—TOP FIRMS*

Assets Under Management (\$MM)	25– 100	100– 250	250– 500	500+
Gross Revenues (%)	100%	100%	100%	100%
– Overhead Expense (%)	30.5%	28.8%	29.4%	26.7%
Owners' Income + Profit	69.5%	71.2%	70.6%	73.3%

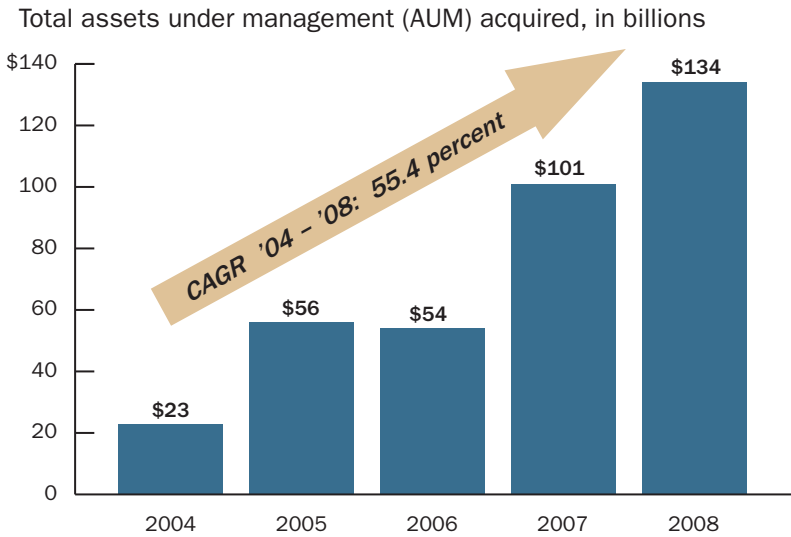
*The top 20th percentile of results are shown for participating firms with the lowest "Overhead Expenses," which consist of all expenses other than principal draws and non-owner professional salaries (also called non-administrative professional salaries). This information is general in nature and limited. It is provided for illustrative purposes only and may not be representative of the experience of others. It is not a guarantee of future performance or success.³¹ The results of the 2009 *RIA Benchmarking Study* were not available at the time of printing.

EXHIBIT 6: SCHWAB 2007 RIA BENCHMARKING STUDY RESULTS—OVERHEAD EXPENSE—MEDIANS*

Assets Under Management (\$MM)	25– 100	100– 250	250– 500	500+
Gross Revenues (%)	100%	100%	100%	100%
– Overhead Expense (%)	39.0%	36.3%	37.0%	34.5%
Owners' Income + Profit	61.0%	63.7%	63.0%	65.5%

*The median results are shown for "Overhead Expenses," which consist of all expenses other than principal draws and non-owner professional salaries (also called non-administrative professional salaries). This information is general in nature and limited. It is provided for illustrative purposes only and may not be representative of the experience of others. It is not a guarantee of future performance or success.³¹ The results of the 2009 *RIA Benchmarking Study* were not available at the time of printing.

EXHIBIT 7: MERGERS & ACQUISITIONS OF RIA FIRMS



Source: Schwab Advisor Services Strategy Group

According to statistics tracked by Schwab Advisor Services, the compound annual growth rate of total assets under management acquired from 2004 - 2008 was 55.4%.

allow an advisor to earn additional income in retirement by passing his book of business on to a teammate in his/her firm.³³ These sunset programs may restrict advisors to sharing clients with a limited pool of other advisors. Further, future revenue streams generated by the retiring advisor may be taxed as ordinary income. Finally, continuity payments are often remitted over five years, diminishing the real returns.³⁴

Potential business-expense advantages

As an independent business owner, you run business expenses through your practice. If you typically pay for seminars, meals or client-appreciation events using after-tax dollars, setting up an independent business may have pre-tax benefits.³⁵

Many factors contribute to valuation modeling, including, but not limited to, assets under management, revenues, growth, book composition, percentage of assets that are fee-based, net operating profits, profit margin and involvement of rainmakers in the future. In 2008, \$134 billion in industry-wide RIA assets changed hands, up from \$101 billion in 2007.³²

Bank/Brokerage Firm Continuity Programs

Wirehouse firms often want to encourage successful advisors to stay with the firm until retirement. For this reason, some have created retirement continuity plans that

FORGIVABLE LOANS FROM WIREHOUSES OR CAPTIVE BROKER-DEALER FIRMS

—By Tom Giachetti and Henry Van Blunk, partners with the legal firm of Stark & Stark

At first blush, a forgivable loan from a wirehouse or independent broker-dealer firm can look attractive. For advisors considering moving to another large financial institution, consider the downside to forgivable loans:

- The transitioning advisor/team often faces penalties in terms of lost deferred compensation and/or option vesting if asset or revenue goals are not reached within strict deadlines. With market volatility being what it is, reaching these goals can sometimes be out of the advisors' control.
- Incentive packages usually include cash and stock, yet as an employee there are limitations to influencing the stock price.
- The loan forgiveness is treated as ordinary income from a tax perspective and taxed at the advisor's income tax rate. The percentage of tax paid on the loan forgiveness is significantly higher than the percentage paid when selling an RIA.
- The new firm and its shareholders share the profit; the transitioning advisor/team takes the risk.

Sale of your RIA practice

Consider that the owner(s) of an independent RIA choosing to sell a business seven to nine years after inception may earn more than if they had accepted a forgivable loan at the beginning of that time period. See the hypothetical case study illustrated in Exhibits 8, 9 and 10 for further potential tax implications. In this example, the earnings are packaged differently in that the advisor/team didn't have to commit to the custodian for seven to nine years to earn them.

The sale of an RIA will either be a Stock/Membership Interest Sale or an Asset Sale. In a Stock/Membership Interest Sale, the shareholders/members are selling their shares/membership interest and pay capital gains tax on the difference between the tax basis of the shares/membership interest and the sale price of the stock. The long-term capital gains tax rate was 15 percent as of June 2009. In an Asset Sale, a large portion of the purchase price is allocated to "Goodwill," which is taxed as a capital gain.

Also consider the possibility that the owner dies during the nine-year period. The owner's family inherits the shares/membership interest and their tax basis is equal to the fair market value of the shares at the date of death. If they immediately sell the shares of the RIA for a lump sum, they pay no capital gains tax. Even if the sale were to require a portion of the purchase price to be paid over time with interest accruing on the unpaid balance, the family would only pay ordinary income tax on the interest portion of the payments.

Holding Companies

Finally, if you feel compelled to monetize your revenue stream in the immediate future rather than after existing as an RIA for a number of years, you might consider speaking with a representative of a holding company—a firm specializing in consolidating RIAs. Holding companies often offer solutions similar to forgivable loans when helping an advisor/team start or join an RIA.

The services and opinions of Stark & Stark and Msrs. Giachetti and Van Blunk are independent of Schwab. Schwab does not provide tax or legal advice. The taxes discussed are federal taxes only, not state taxes, and the reader is advised to consult with a tax professional. This information is general in nature and limited. It is for illustrative purposes only and may not be representative of your circumstances.

An “Unforgiving” Loan

On the following pages, you will find a series of charts: Exhibit 8: Comparing a Forgivable Loan With Starting an RIA Firm; Exhibit 9: Sample Annual Income Simulation; and Exhibit 10: Sale of RIA Firm or Acceptance of Bank/Brokerage Continuity Program Offering. At right you'll find a glossary of terms used in the exhibits.

GLOSSARY

T-12

Trailing 12-month revenue at Bank/Brokerage Firm

RIA Overhead Expenses

Cost of running day-to-day operations. Does not include principal draws or non-administrative professional salaries

Override + Out-of-pocket expenses

Incumbent firm's allocation for profit and overhead

RIA Enterprise Value

Amount firm may be worth if sold

Bank/Brokerage Firm Continuity Program

Allows retiring advisor to transfer his or her book in return for revenue stream

Net Present Value (NPV)

Difference between the present value of cash inflows and cash outflows

Owners' Income + Profit

Includes the salaries and benefits owners pay themselves plus the profit after paying all Non-Owner salaries and Overhead Expenses. Typically, non-owner professional salaries are considered a Direct Expense and therefore are paid in addition to Overhead Expenses. Administrative staff salaries are part of Overhead Expenses.

Assumptions

The following assumptions were made to develop the results shown in Exhibits 8, 9 and 10. Associated footnotes, noted with asterisks, can be found on p. 19.

- Gross revenue or trailing 12-month revenue for the hypothetical firm in the illustration is \$1,600,000.
- Ninety percent of the assets and revenue follow the advisor/team after starting the new independent RIA.
- Revenues grow 23.1 percent in the RIA model versus 9.8 percent in the wirehouse or regional firm model.*
- Hypothetical advisor or team is considering accepting a 9-year forgivable loan from a competing wirehouse, with an up-front payment of 125 percent and a back-end payment of 75 percent of trailing 12-month gross revenue.
- Non-owners' salaries + Overhead Expenses are assumed to be 35 percent in the RIA model, while the override (wirehouse or regional firm haircut plus out-of-pocket expenses paid by the advisor/team) is assumed to be 55 percent.
- When it comes to monetizing the asset, a factor of 2.5X revenue has been applied to the projected gross revenue for the RIA firm in year 9. The equivalent comparison point in the bank/brokerage firm model is the firm's continuity program. A payment of 100 percent of gross production for year 9 is factored into the model based on a five-year payment plan.**
- The tax consequences reflected in the Exhibits were reviewed by Tom Giachetti and Henry Van Blunk of Stark & Stark, Attorneys at Law. Their views are independent of Schwab. Schwab does not provide tax or legal advice. The following assumptions were made: a Stock/ Membership Interest Sale in the RIA Model; a capital gains tax rate of 15%; and ordinary income tax rate of 35%.

While Schwab believes the foregoing assumptions are reasonable, it can give no assurance about their accuracy. The assumptions may or may not reflect your circumstances.

No portion of the above discussion should be construed as legal advice and/or appropriate for any specific firm's circumstances. Msrs. Giachetti and Van Blunk are not making any representation and/or recommendation that a Stock/Membership Interest Sale is a preferred sale model. Rather each RIA should consult with professionals to determine what is best for its particular circumstances.

A CASE FOR STARTING OR JOINING A REGISTERED INVESTMENT ADVISORY FIRM

EXHIBIT 8: COMPARING A FORGIVABLE LOAN WITH STARTING AN RIA FIRM

Starting an RIA and selling it in nine years* can be lucrative compared with accepting a forgivable loan and fulfilling a multi-year commitment.

TOTAL CASH COMPENSATION

RIA Model	\$30,531,371
Bank/Brokerage Firm	\$9,729,170

Includes sale of practice/book in the RIA Model and transition of practice/book through a continuity program in the Bank/Brokerage Firm Model

RIA Model

	Year 1	Year 2	Year 8	Year 9	
Gross Revenue	\$1,440,000	\$1,772,640	\$6,168,348	\$7,593,236	
Non-owners' salaries + Overhead	(\$504,000)	(\$620,424)	(\$2,158,922)	(\$2,657,633)	
Owners' Income + Profit	\$936,000	\$1,152,216	\$4,009,426	\$4,935,604	
Start-Up Expenses (sunk costs)	(\$102,606)	\$0	\$0	\$0	
RIA Owners' Income + Profit Adjusted	\$833,394	\$1,152,216	\$4,009,426	\$4,935,604	
Income Taxes	(\$291,688)	(\$403,276)	(\$1,403,299)	(\$1,727,461)	
RIA Owners' Income + Profit After-Tax Net	\$541,706	\$748,940	\$2,606,127	\$3,208,142	A
Monetized Book Value**				\$18,983,091	Years 1 – 9
Capital Gains Tax				(\$2,847,464)	
Net Proceeds After-Tax				\$16,135,627	B

Total Net Proceeds After-Tax	\$30,531,371
-------------------------------------	---------------------

A + B

Bank/Brokerage Firm Model

	Year 1	Year 2	Year 8	Year 9	
Gross Revenue	\$1,440,000	\$1,581,120	\$2,770,632	\$3,042,154	
Override + Out-of-pocket expenses	(\$792,000)	(\$869,616)	(\$1,523,848)	(\$1,673,185)	
Operating Pre-Tax Net (Income + Profit)	\$648,000	\$711,504	\$1,246,784	\$1,368,969	
Forgivable Loan	\$2,000,000	\$0	\$0	\$1,200,000	
Pre-Tax Net (Income + Profit)	\$2,648,000	\$711,504	\$1,246,784	\$2,568,969	
Income Taxes (earnings)	(\$226,800)	(\$249,026)	(\$436,375)	(\$479,139)	
Income Taxes (forgivable loan)	(\$77,778)	(\$77,778)	(\$77,778)	(\$497,778)	
Bank/Brokerage Firm Advisor/Team After-Tax Net	\$2,343,422	\$384,700	\$732,632	\$1,592,052	C
Continuity Program (Monetized Book Value NPV)**				\$3,042,154	Years 1 – 9
Income Tax				(\$1,064,754)	
Net Proceeds After-Tax				\$1,977,400	D

Total Net Proceeds After-Tax	\$9,391,944
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C + D

The defaults on Exhibit 8 are illustrative only and are not meant to be recommendations or endorsements of how terms of an agreement should be negotiated, nor does this Exhibit represent a guarantee of future performance. Actual experience may vary.

EXHIBIT 9: SAMPLE ANNUAL INCOME SIMULATION

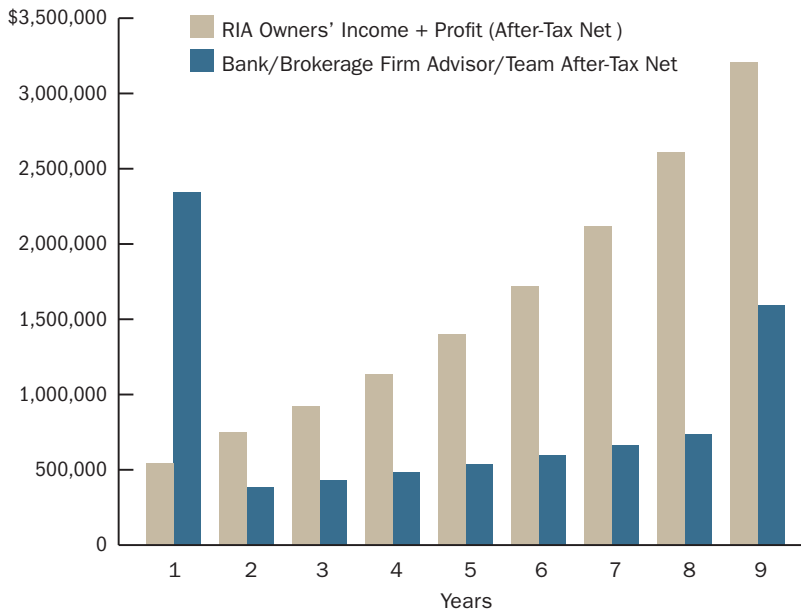
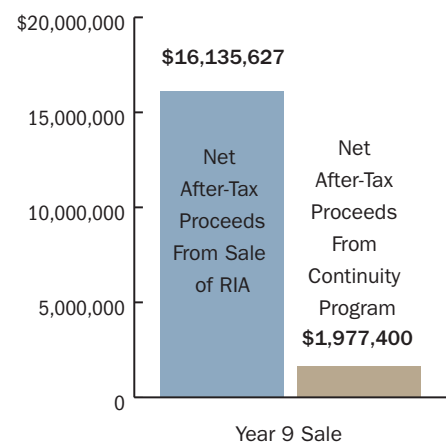


EXHIBIT 10: SALE OF RIA FIRM OR ACCEPTANCE OF BANK/BROKERAGE CONTINUITY PROGRAM OFFERING



*The duration of forgivable loans typically runs from seven to nine years. As a proxy, assets under management compound annual growth rate from 2002 to 2006 was 9.8 percent for wirehouses, 12 percent for RIAs and 23.1 percent for Schwab Advisor Services RIAs. Source: Wirehouse Assets & RIA Assets: Cerulli Associations; RIA Assets at Schwab Advisor Services; Schwab Strategy Group. Past performance is no guarantee of future results. Using a growth rate of 9.8 percent in the RIA model results in a Total Net Proceeds value of \$14,590,440.

**Monetized Book Value goes by many names^{29,30} including “Terminal Value” and “Enterprise Value.” This is what your business may be worth. While it is common to use discounted cash flows to determine the value of a practice, we chose to use a multiple of revenues to simplify the model. A firm’s value is ultimately determined based on many factors including the stability of the cash flow and market conditions. It is reasonable to use a factor between 1.8 and 2.6 times revenue for firms with \$100 million and up in assets under management, while firms with \$500 million and up may warrant a multiple between 2.75 and 3.5 times revenue.³⁰ The equivalent in the wirehouse space is a firm’s continuity program offered to retiring advisors. A few of the programs now reach 200 percent of Trailing-12 (equivalent of “2.0” for this Exhibit), usually paid over a 5-year period for the most tenured advisors. We spread the continuity program compensation over a 5-year period using 35 percent times the final year (9), Gross Revenue for Year 1, 25 percent for Year 2, 15 percent for Year 3 and 12.5 percent for Years 4 and 5 (for a total of 100% or one times revenue).

Evaluating the Net Present Value (NPV) of the Total Cash Compensation displayed in Exhibits 8, 9 and 10 may help you evaluate whether to start an RIA firm or to accept a forgivable loan. Using a 15 percent discount rate, the NPV results are as follows: RIA model: \$10,877,100. Bank/Brokerage model: \$4,756,571 (after discounting the 5-year continuity payment at 15 percent as well). At a 9.8% growth rate, the NPV of the Total Cash Compensation in the RIA model is \$5,764,811.

The material in Exhibits 8, 9 and 10 is provided for illustrative purposes only and does not represent an actual case. It does not represent a guarantee of future performance. Actual experience may vary. Exhibits 8, 9 and 10 are not intended to provide specific financial, tax, compliance or legal advice. You should consult professional advisors in these fields.

SOME REASONS WHY ADVISORS CHOOSE THE RIA MODEL

Taking Control of Your Success

Serving clients and increasing net income are two of the key reasons advisors choose the RIA model. In the *Recently Independent Advisor Study* conducted for Schwab by Koski Research (concluded October 3, 2008), 62 percent of the participating advisors stated the desire to provide more personalized service as a determining factor for starting their own independent fee-based firm. Sixty-two percent also cited the opportunity for greater long-term financial success. But there are additional reasons to start or join an RIA. According to the study, 75 percent of advisors cite a preference for working for themselves.

Overcoming discontent

The recent proliferation of bank/brokerage mergers and acquisitions, has created an atmosphere of palpable uncertainty for many advisors. Retention offers from wirehouses may have further exacerbated dissension because the firms making the transition package offers may have determined eligibility by the *individual's* production level rather than the team's. Fueling the fire, at least one major wirehouse has moved to eliminate vertical teams, which previously allowed groups of advisors to earn a higher collective payout.³⁶ Further, team leaders often don't have control over the hiring of staff in the bank/brokerage model. The independent broker-dealer and RIA models afford the owner the option to decide *whether* to hire staff and *whom* to hire.

As more and more successful advisors find that they can do just as well or better for clients without the affiliation of a major firm—and that the firm may actually be holding them back by limiting the way they do business—independence is becoming increasingly attractive.

Managing Conflicts of Interest

Advisors often decide that a great way to offer objective financial advice is to start an independent firm where they charge asset-based fees rather than commissions and define the products and solutions they offer their clients without the proprietary constraints. “For me, [going independent] was all about developing an environment in which we could act in the best interests of the client using a fiduciary standard of care,” says David Bromelkamp, president and CEO of Allodium Investment Consultants. “We felt like we had to do this in order to really take care of our clients and act in their best interests.”

RIAs are required to disclose potential conflicts of interest in their Form ADV, which they must deliver to clients at the start of the relationship.

Pricing flexibility

Independent advisors, especially RIAs, enjoy greater pricing flexibility within regulatory guidelines. They are free to set their fee schedule with clients. They can decide whether or not to charge fees on cash. They can charge hourly for planning. This flexibility allows them to be more competitive and manage their practices more effectively. It's been Schwab Advisor Services' experience that—using a \$1 million client as a standard for comparison—the typical asset-based fee is 100 basis points (bps). Median prices

might decline to 60 bps for a client with \$10 million in assets.³⁷

“One motivation driving the decision was pricing. When we began thinking about [starting our own firm], we thought that if we were pitching some type of derivative or collar it would be nice to be able to price that on the street and to reach out into the open-architecture world in which we live. We were tired of losing business to banks because of price.”

—*John Krambeer, President and CEO
Camden Capital Management*

The experience of John Krambeer and Camden Capital Management may not be representative of the experience of others and is not a guarantee of future performance or success.

EXHIBIT 11: NET NEW ASSETS, 2008
(in billions of dollars)

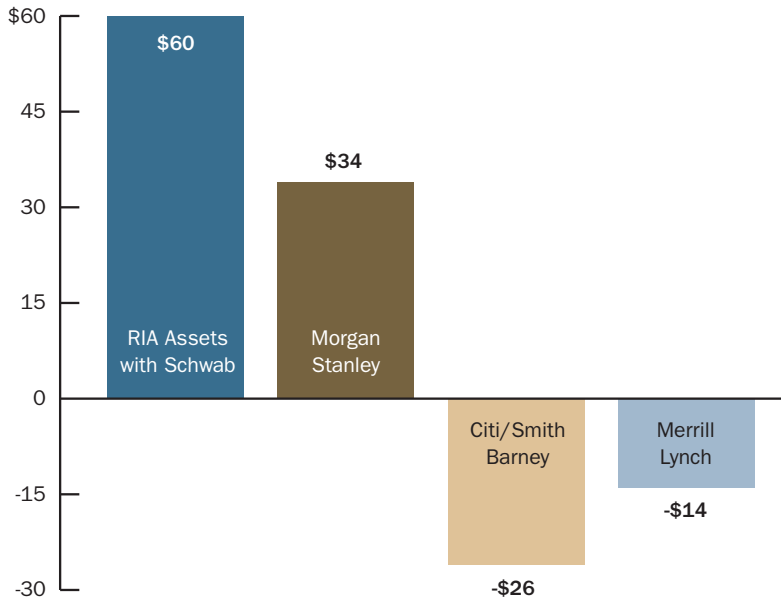


Exhibit 11 compares net new asset flows for three of the major wirehouses (prior to the announced joint venture between Morgan Stanley and Smith Barney) to Schwab Advisor Services, which outperformed the three combined in 2008.

Sources: Morgan Stanley, Citigroup Inc., Merrill Lynch & Co. and Charles Schwab & Co. 2008 Quarterly Earnings. Also “Whole Lotta Love,” Christina Mucciolo, *Registered Rep.*, September 1, 2008.

RIA Firms are Growing Faster

In the six quarters from the start of 2007 through June 2008, the three largest RIA custodians gathered \$215 billion in net new assets, compared to \$168 billion brought in by the top four brokerages.³⁸ For many groups, independence could be the ticket to growth: The Golub Group, for example, launched with \$180 million and increased client assets by more than 30 percent, to \$240 million, in just 15 months. Three years after the launch, it had surpassed \$500 million in AUM.³⁹

“It’s easier to grow as an RIA. You find yourself in a different position in your hometown by being the CEO of a wealth management firm versus being a salesperson in a major organization. Now I’m finding myself on panels and corporate boards. We’re not being viewed as a sponsor as much anymore. Instead, I sit across the table from clients and run a company just like they do.”

—Trevor Callan, CIMA, CEO
Callan Capital, LLC

The experience of Trevor Callan and Callan Capital, LLC may not be representative of the experience of others and is not a guarantee of future performance or success.

MOVING FORWARD WITH INDEPENDENCE

Joining an RIA Firm

Once the decision is made to operate as an RIA, the next decision is how to do it. Joining established RIAs is emerging as a common method for going independent.⁴⁰ For example, Convergent Wealth Advisors, LLC added two former wirehouse teams in 2008, each managing more than \$3 billion in assets at the time of the move. The teams report that they benefited from the operating efficiencies and service culture inherent in their new firm's model. (See "Burns Wealth Management: Sharing Control of Your Destiny," page 24.)

While starting a firm may require re-creating much of the infrastructure the advisor is used to, joining an established RIA may provide a soft landing for advisors seeking a permanent new home or for those wishing to experience the RIA model before fully engaging in starting their own business. Affiliating with an existing firm may involve less risk and lower up-front costs, but also offer less control.

It's possible to find substantial support within some RIA firms. In fact, the choice of starting a firm or joining an existing RIA often depends on the amount of support the advisor needs. Some firms require that investment philosophies align. Most search for advisors who will fit into the firm's culture.

Service with experience

A service team in an existing RIA can augment the custodian's conversion services when a new advisor or team joins. If the existing firm has itself transitioned from the wirehouse or IBD model or has previously added an advisor from one of those models, then multiple resources will have first-hand experience with client transitions. By leveraging existing services, the new advisor or team may be able to scale more efficiently and optimize client-facing service time, not unlike the environment they are leaving.

"We have a sophisticated client base and needed an infrastructure tailored specifically for them. By joining a firm like Convergent Wealth Advisors, the infrastructure was already in place, such as manager research, technology and operations. This allowed us to remain focused on our clients and their investment needs versus organizational and business management issues."

—Lori Van Dusen, Managing Director, Convergent Wealth Advisors, Institutional Group

The experience of Lori Van Dusen and Convergent Wealth Advisors may not be representative of the experience of others and is not a guarantee of future performance or success. Schwab does not recommend or endorse Convergent Wealth Advisors or any other advisory firm for advisors considering joining an existing firm.

There are many options to consider if starting a firm has been ruled out:

1. Join an RIA as an employee with the possibility of buying into or earning ownership in the future.
2. Merge practices, allowing for immediate shared ownership.
3. A company that specializes in purchasing RIAs or shares of practices can aid in the lift out by offering practice management and financial assistance.
4. An advisor/team can form a firm that shares services such as technology and legal/compliance with other firms in return for a portion of the revenue stream, while still building equity in their own independent firm.

Some RIA custodians stand ready to not only help advisors start a firm, but also facilitate introductions to existing RIA firms.

BURNS WEALTH MANAGEMENT: SHARING CONTROL OF YOUR DESTINY

After weighing the risks and rewards of independence, more and more advisors are choosing to join RIA firms. Paul Hynes joined Burns Advisory Group in San Diego after spending 21 years with a major wirehouse. He says that he made the transition, along with one associate, to allow himself the freedom and flexibility to more easily serve clients' best interests.

With assets under management of more than \$100 million, Hynes reasonably could have decided to start his own business. But the support available from like minded partners at Burns led him to join a firm instead. As he puts it, "Alone, you're an island. As a group, you can accomplish more." He adds, "By joining an existing RIA firm, we're not all spending the same dollars to duplicate costly infrastructure and personnel."

It took a team of people working on behalf of Hynes to manage his move to independence. A personal coach kept him on schedule. A business consultant helped with financial models. With his partners, he purchased group Errors & Omissions (E&O) insurance at a significant cost savings compared to individual coverage. He got business insurance through a local agent and workers' compensation through his payroll administrator. His banker provided access to capital.

Hynes was prepared to invest "whatever it took" to go out on his own. He also recognized that John Burns had already invested time and money making many of the big decisions in creating what Hynes calls an "advisor service hub." Having the back-office support in place would allow Hynes to "hit the ground running," which, in turn, meant he could spend nearly 100 percent of his time serving clients. The partners at Burns Advisory Group, including John Burns in Oklahoma, Tom McGuigan in Connecticut and Hynes in California, each have their own practice and share in the service expenses.

The experience of Paul Hynes, John Burns and Tom McGuigan and Burns Advisory Group may not be representative of the experience of others and is not a guarantee of future performance or success. Schwab does not recommend or endorse Burns Advisory Group or any other advisory firm for advisors considering joining an existing firm.

Start-Up Costs

To help advisors evaluate the financial implications of going independent by starting a firm, Schwab Advisor Services projected the start-up costs involved for a firm with \$1,600,000 in client fees (RIA firm revenues), two owners and two administrative staff. See Exhibit 12, on page 26.

Healthcare, rent, supplies and insurance costs are paid year in and year out, so not all the costs shown are incremental costs. Many of the marketing and professional services costs also overlap with any given year's profit and loss statement. Depending on whether you choose to lease or buy, there may or may not be significant technology infrastructure and furniture-related costs involved in opening your doors.

We estimated the key start-up costs by using the *Schwab Advisor Services Profit & Loss Illustrator*⁴¹ (for illustration purposes only). Still other costs were estimated through discussions with and requests for quotations from third-party vendors. Exhibit 12, which does not include any signing bonuses or compensation for owners, professionals or administrative staff, is based on the following assumptions:

Health and other insurance benefits.

Outsourcing of human resources, payroll and benefits administration through a Professional Employment Organization allowing for purchase of group medical, dental and vision plans. The amount shown includes a set-up

fee, a monthly fee, and the first month's payment for medical, dental and vision, and the annual set-up fee for a Schwab 401(k). This is only an example and is not meant to be a quotation for insurance.

Marketing. Includes creation of logo/corporate identity, business cards, welcome letter, folded business announcement and four page website.

Office rent and maintenance. Leasing of 1,400 square feet at \$22/sf. Includes a two-month down payment.

Information technology and utilities.

Purchasing technology infrastructure-related items such as computers, printers and monitors, and outsourcing report reconciliation through a hosted portfolio management system such as Schwab PortfolioServices™ at 432 total accounts. (See page 10 for more information on Schwab Performance Technologies.) Utilities such as Internet, Blackberries and phones (along with their service plans).

Furniture purchases. "U-shaped" executive-style desks, conference tables, articulating keyboards and other office furnishings.

Compliance/legal professional services.

The amount shown typically will cover professional third-party legal counsel regarding, formation of the legal entity (corporation, LLC, etc.) and SEC and/or

state registration, development of compliance procedures, review of employment contracts and client agreement creation. In-person assistance with audits is assumed to be factored into ongoing overhead expenses.

Business insurance. Includes an estimate of annual expenses for Errors & Omissions (E&O) insurance and Property & Casualty (P&C) insurance with aggregate limits of \$1,000,000 each. Many factors are used to determine the rates charged for E&O Insurance, including but not limited to a firm’s mix of business and trading activity.

Additional start-up cost options

From time to time, advisors with assets at various levels decide to work from home in order to manage expenses aggressively. Still others choose to lease space in executive office suites where furniture and basic infrastructure is provided at an affordable, agreed-upon price. Some new firms choose to refrain from initially hiring administrative staff, opting instead to outsource on an as-needed basis.

EXHIBIT 12: SAMPLE RIA START-UP EXPENSES

Health and other insurance benefits	\$10,963
Marketing and business development	\$14,000
Office rent and maintenance	\$5,133
Information technology and utilities	\$48,255
Furniture purchases	\$27,146
Office expenses (supplies, copies, etc.)	\$2,623
Compliance/legal professional services	\$11,500
Business insurance	\$6,940
Total	\$126,560

For illustrative purposes only. Not all expenses are sunk or incremental to Year 1 overhead expenses. A portion will be spent year in and year out.

RESOURCES TO EASE THE TRANSITION

Advisors do not have to go it alone when starting or joining a firm. Whether an advisor chooses to join an existing RIA or go totally independent and work with a custodian such as Schwab Advisor Services, help is available. “Organizations like Schwab stand ready to make the process uncomplicated. They’re available and more than willing to educate the broker,” says Colin Higgins of the Golub Group LLC. “It’s really a simple process. If you want answers, go to people who have gone through the process.”

The experience of Colin Higgins and the Golub Group, LLC may not be representative of the experience of others and is not a guarantee of future performance or success.

Advisor Conversion Services

Advisors and their teams transitioning their clients’ accounts to Schwab Advisor Services work closely with a dedicated team from Advisor Conversion Services (ACS)—a group solely dedicated to handling transitions. ACS team members create custom transition timelines. They often play a key role in the weeks that follow the advisors’ resignation from their former firm. They offer and conduct face-to-face and virtual training to help advisors’ understand new software and/or new systems. Importantly, this is a full-time job for ACS team members—they are not pulled from a service desk temporarily to work on a transition.

Schwab’s Advisor Conversion Services Team assisted more than 500 advisors in transitioning more than 100,000 accounts and \$50 billion in assets from January 2005 through December 2008.⁴² While Schwab Advisor Services has transitioned multiple teams with more than \$1 billion in assets, a typical team usually transitions \$100 million in its first 12 months.

CONCLUSION

The financial advisory business has changed dramatically over the past decade. Many advisors who once were in step with their firms now are considering alternatives. In many ways, bank/brokerages have created a foundation for independence. The shift to teams and fee-based accounts at the major wirehouses set the RIA movement in motion.

Investors are ready for change. For advisors, independence can deliver that change. Not only can independence offer more control over the variables that determine satisfaction among high-net-worth clients, it can also provide the ability to keep a greater share of revenues and build equity in a growing business. Advisors contemplating independence must carefully consider their business goals and risk tolerance in the context of their own practices. They must also plan carefully for their transition.

Most advisors with whom Schwab has spoken report being happy they went independent. They attest that the freedom to control their own business practices—from how to serve clients to how to compensate themselves—carries professional rewards that extend far beyond the bottom line.

Your Next Step

If you are considering independence and would like to use a Profit & Loss Illustrator to estimate start-up costs and annual revenues and expenses, call 877-314-7821.

About Schwab Advisor Services

Schwab Advisor Services is a leading provider of custodial, operational and trading support for independent investment advisory firms. As of December 31, 2008, client assets custodied with Schwab Advisor Services stood at \$477 billion. These assets, managed by the approximately 5,700 independent advisory firms Schwab Advisor Services served, represented approximately 42% of total client assets custodied with The Charles Schwab Corporation (through its subsidiaries). Brokerage products offered by Schwab Advisor Services are not FDIC insured, are not guaranteed deposits and are subject to investment risk, including the possible loss of principal invested. Schwab Advisor Services is a business segment of The Charles Schwab Corporation and includes the custody, trading and support services of Charles Schwab and Co., Inc., a registered broker-dealer and member SIPC, as well as the portfolio management and accounting solutions of Schwab Performance Technologies (“SPT”). CS&Co and SPT are separate subsidiaries of The Charles Schwab Corporation.

APPENDIX

ENDNOTES

¹ “Ready for a Rebound,” Ellen Uzelac, *Research Magazine*, February 2009.

² “The Trust Factor and High End Customers,” Charles B. Wendel, Financial Institutions Consulting, Inc., May 7, 2008.

³ From 2005 to 2008, 365 advisors or teams of advisors started or joined firms working with Schwab Advisor Services to custody their client assets.

⁴ The *Recently Independent Advisor Study* was conducted for Schwab Advisor Services by independent research firm Koski Research from September 16 through October 3, 2008. Fifty-five advisors who recently started, or went to work for, an independent RIA firm were interviewed via telephone. Koski Research is not affiliated with Charles Schwab & Co.

⁵ “Stability Enhances Loyalty,” Sarah Hansard, *Investment News*, December 7, 2008. Also, “Tumult Could Expand Ranks of RIAs,” *Financial Advisor* (Frontline News), November 2008. Schwab Advisor Services fielded 2,000 inbound calls from interested advisors in Q1 of 2008, up 40 percent from the same period in 2007. From Q3 to Q4 of 2008, online inquiries increased 41 percent.

⁶ See the following for further perspective: “Asset Gathering Machines,” Halah Touryalai, *Registered Rep.*, July 1, 2008.

⁷ “I’ve Got Your Back,” Anne Field, *Registered Rep.*, December 1, 2004.

⁸ “Merrill boosts bonus program,” Darla Mercado, *Investment News*, December 26, 2006.

⁹ “New Era of Retail Brokerage Begins,” *Dow Jones News Wire*, November 21, 2008.

¹⁰ A *FundFire Exchange* conducted by *FundFire* in January 2009 studying the Morgan Stanley joint venture with Smith Barney found that 83 percent of 66 quick-poll respondents believed the brokerage consolidation trend will drive more advisors to the independent channel.

¹¹ “War Breaks Out for Wirehouse Brokers,” Gail Liberman, *Financial Advisor*, November 2008.

¹² “Tide Change for Traditional Retail-Brokerage Firms Expected,” *Investment News Round Table: Wirehouse/Regional Brokerage Firms*, December 8, 2008.

¹³ “Breakaway UBS broker works long hours, couldn’t be happier,” Jed Horowitz, *Investment News*, February 8, 2009. The article is based on a webcast hosted by Schwab Advisor Services.

¹⁴ “Hybrid Heaven,” Halah Touryalai, *Registered Rep.*, November 1, 2008.

¹⁵ “Wall Street Squeezes Small Brokers, Many Go Independent,” Christina Mucciolo, *Registered Rep.*, May 13, 2009.

¹⁶ Levels at which RIA custodians dedicate service teams will vary from one custodian to another.

¹⁷ Example: If there were four respondents who gave a score of 10, 7, 4 and 1, respectively, each score would represent 25 percent of all respondents. The 7 would be removed from the calculation, leaving one Promoter (the 10) and two Detractors (the 4 and 1). The Net Promoter Score is the difference between the two: 25 percent - 50 percent = - 25 percent.

¹⁸ *The Cerulli Edge Advisor*, Q3, 2007, and Schwab Advisor Services Strategy Group. The Cerulli report indicated Charles Schwab & Co. was sixth. However, the creation of the joint venture between Morgan Stanley and Smith Barney moved Charles Schwab & Co. up to fifth place.

¹⁹ "Breaking Gridlock?" Andrew Gluck, *Financial Advisor*, February 2009.

²⁰ "Payout" generally refers to a percentage of commissions or asset-based fee revenue earned by the wirehouse or independent broker-dealer that it pays to its registered representative whose clients' accounts generated that revenue. Since independent advisors are not representatives of Schwab, they do not receive a "payout." Schwab Advisor Services may enter into soft dollar arrangements and provide other benefits to advisors who place their client assets in custody at Schwab.

²¹ Custodians have the flexibility to charge clients separately from the advisor fee and to charge on a transaction basis.

²² "Whole Lotta Love," Christina Mucciolo, *Registered Rep.*, September 1, 2008.

²³ "Low-producers to exit wirehouses," Dan Jamieson, *Investment News*, February 9–13, 2009. Also based on *On Wall Street* compensation guides.

²⁴ "Taming an In-House Rivalry," John Churchill, *Registered Rep.*, December 1, 2008.

²⁵ "LPL to challenge custody biz," Bruce Kelly, *Investment News*, August 6, 2007.

²⁶ "The Mating Game," Christina Mucciolo, *Registered Rep.*, March 1, 2009. Also, "Wachovia stops offering profit-formula deals," Dan Jamieson, *Investment News*, April 12, 2009.

²⁷ This conclusion is based on findings of the 2006 *Moss Adams Financial Performance Study of Financial Advisory Practices*. The study involved 907 firms with 95 percent or more of revenues coming from fee-based management. In the \$500,000 revenue practice, the average overhead expense for independent broker-dealers was 11.51 percent higher than in the RIA model. The \$1,000,000 practice was 3.93 percent lower and the \$3,000,000 practice was 4.48 percent higher.

²⁸ *The Schwab Institutional* (now known as *Schwab Advisor Services*) 2007 *RIA Benchmarking Study* examined firm performance across 647 advisory firms that did business with Schwab Advisor Services at the time. Asset and revenue growth, sources of new clients, staffing, pricing and financial performance were among the topics covered. At the time of the study, the 647 firms managed a total of \$256 billion for more than 140,000 clients. Of these firms,

370 had more than \$100 million in assets and 110 had more than \$500 million in assets. Participants included 380 wealth managers, 43 financial planners and 224 money managers. Results shown are for the wealth manager peer groups from the 2007 study. The top 20th percentile (vs. the median) overhead expense percentage is shown for each of the four categories. So 20 percent of the firms in each peer group came in at equal to or better than (lower than) the overhead percentage shown.

²⁹ Schwab Advisor Services Strategy Group and “M&A Talks Hit Many Roadblocks,” *Financial Advisor* (Frontline News), September 2008.

³⁰ Schwab Advisor Services Strategy Group and “What is your practice worth? — plenty if you’re fee-based,” John Churchill, *Registered Rep.*, August 25, 2008.

³¹ Owners’ Income + Profit is net of overhead expenses, which includes support and administrative staff plus non-staff expenses associated with running a practice. Owners’ net take-home pay is Owners’ Income + Profit less expenses for non-owner professional salaries and any profits reinvested in the business.

³² Schwab Advisor Services Strategy Group.

³³ “Whole Lotta Love,” Christina Mucciolo, *Registered Rep.*, September 1, 2008.

³⁴ “A Seller’s Market,” John Churchill, *Registered Rep.*, September 1, 2008.

³⁵ Consult a tax advisor to explore the potential pre-tax benefits of setting up an independent business.

³⁶ “Morgan Stanley Changes Pay Policies,” Dan Jamieson, *Investment News*, December 3, 2007.

³⁷ *Schwab Institutional* (now known as *Schwab Advisor Services*) 2007 RIA *Benchmarking Study*.

³⁸ “The Five New Realities of Wirehouse Advice,” Timothy D. Welsh and Patrick Butler, *Investment News*, February 22, 2009.

³⁹ The experience of The Golub Group, LLC may not be representative of the experience of others and is not a guarantee of future performance or success. Your experience will vary.

⁴⁰ Based on Schwab Advisor Services internal *Advisors Turning Independent* results reflecting an increase from 2006–2008 of advisors joining firms.

⁴¹ The Schwab Advisor Services Profit & Loss Illustrator uses the *Schwab Advisor Services 2007 RIA Benchmarking Study* (see footnote 28) as a foundation for its assumptions and estimated costs.

⁴² Schwab Advisor Services Activity Metrics, January 2005–December 2008.

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