InvestmentNews
The Leading Information Source for Financial Advisers

Calm before the RIA storm

A strong 2013 won't diminish rising business pressures, particularly for midtier firms

By Mason Braswell | *June 1, 2014 - 12:01 am EST*

Many fee-only registered investment advisory firms are sitting pretty after strong growth in 2013, when rising markets perked performance across the board.

But don't get too comfortable, industry experts warn.

"One of the dangers of a year like last year is that it can cause you to be a little complacent," said Scott Hanson, a founding principal of the Hanson McClain Group, an RIA with about $2 billion in assets. "This may be the quiet before a storm."

RIAs at all asset levels continue to face pressure from mounting competition, margin compression and regulation. But those elements especially strain advisers in the middle tier — about $100 million to $200 million in assets under management — and force them to grow by expanding their client services, adding teams, or merging or partnering with a larger firm.

“Status quo for a lot of these firms is just not going to work,” said **John Furey**, principal and founder of consultancy Advisor Growth Strategies. “It's going to be less profitable, and they'll grow less.”

Showing the benefits of scale, investment advisory firms with over $1 billion in assets are soaking up a greater share of client assets. Those businesses control 54% of the market, up from 42% in 2008, according to research from Cerulli Associates Inc..

Breakaway brokers are taking notice. With more options for affiliation and the increased cost of striking out on their own, more newcomers to the independent channel are going with established firms, said Scott Smith, a director at Cerulli.

“We're seeing growth accumulating for the largest RIAs with more than $1 billion in assets,” Mr. Smith said. “Rather than what we thought of as traditional breakaways starting their own shop, we're seeing a lot more interest in joining existing firms.”

Industry consultants cite fee pressure as a hurdle to growth, as online advice platforms that use algorithms to determine asset allocations offer investment management for clients at a fraction of the price.

“If you're the $100 million firm getting by picking mutual funds in asset allocation, it's probably getting harder and harder to be successful” because of online advice platforms, **Mr. Furey** said.

In response, he said, top players are tackling horizontal expansion with advisers getting new certifications or adding personnel to include trust, insurance and tax-planning specialists. Other firms are hiring certified financial planners to help with crafting plans or networking with estate attorneys.

“That's what we're seeing from some of the bigger firms in the industry,” **Mr. Furey** said. “They're building a wealth management experience that the $100 million RIA cannot compete with.”

Silvercrest Asset Management Group, which ranks No. 4 on this year's InvestmentNews list of fee-only RIAs, has experienced growth in recent years because of efforts to expand its institutional business. In 2008, Silvercrest was still mostly a family office practice with about 2% of assets (or approximately $200 million) in institutional business.

In 2008, veteran adviser and institutional sales consultant Allen Gray joined Silvercrest to build relationships with institutional clients. Its experience with large, ultrawealthy clients helped him demonstrate to consultants that the firm could handle private endowments and institutions. Five years later, about 16% of its $15 billion-plus in assets comes from institutional clients.

THE NEAR FUTURE

“Very soon you're going to see advisers accepting lower profitability and being OK with it, or they're going to transition to a new model,” **Mr. Furey** said. “It doesn't mean that they're going to transition their firm, but they could adopt a new service bureau.”

Another option is to consider a roll-up or partnership giving advisers technology to expand their practice. More players are offering services from compliance to capital markets and clearing, and advisers have a choice to lease those capabilities or provide an ownership stake in their practice.

“Margins are going to come in across the board,” said Clint Sorenson, an adviser who left Wells Fargo Advisors in May to form Emerald Asset Management under the umbrella of Raymond James Financial Services. “It's going to take a well-run business to keep margins at the level they are now.”

Raymond James Financial Services made its own play in the roll-up space last September by providing Steward Partners, an independent founded by former Morgan Stanley managers, with capital to recruit ex-wirehouse advisers. Steward, which signed a 10-year deal with Raymond James, is seeking to grow to 50 or 60 partner advisers. It will also offer consulting services to other breakaway teams wanting to start their own firms. Steward has grown to about $800 million in assets.

In addition, firms such as Focus Financial Partners have come to act as banking intermediaries for independent investment advisers — providing a capital investment in exchange for an equity stake in the partnership. Founded in 2006, Focus Financial has been involved in about 40 acquisitions and now has about $70 billion in assets under management among its partner firms.

Summit Financial, a $600 million investment adviser, joined with Focus earlier this year. At the time, its founder, David Daniel, said Summit made the move because it had been struggling with performing due diligence on potential purchases while overseeing day-to-day operations. Focus Financial helped Summit come up with a list of possible matches, he said.

The consolidation trend likely will continue.

“We're going to see more recruiting growth as opposed to pure breakaway growth,” said Mr. Smith at Cerulli.