Key Findings
RIA Marketplace 2013
Complimentary for research participants

CERULLI ASSOCIATES
Global Analytics

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VIEW FINDINGS

1. What types of RIA practices are experiencing the most growth?

Over the course of 2012, the dually registered segment of the registered investment advisor (RIA) market experienced nearly double the asset growth rate (21.5%) of independent RIAs (11.5%). Though the assets of independent RIAs ($1.6 trillion) still far outweigh those of the dually registered ($1.1 trillion), Cerulli believes there are several factors that make the dually registered segment, where advisors establish their own independent RIA while also affiliating with an independent broker/dealer (IBD), more appealing to advisors over the next several years.

The most appealing factor of dual registration is that it presents the least possible disruption to a traditional B/D advisor interested in joining the ranks of the RIA community. An important part of this consideration is ongoing access to the full suite of products and services the advisor may have used to build their practice to the level necessary to consider a move to independence. While there has been growth in the availability of fee-based products for use in the RIA community, many advisors remain loyal to commission-centric mutual funds, REITs, or insurance products, which have served them well over time, making retention of B/D affiliation preferable. Many of these commission products also feature ongoing trail commissions, which can serve as an important part of an advisor's revenue stream, especially during a potentially challenging transition period.

Another important factor in the growth of dual registration is the increased rate of experienced advisor recruiting into existing practices. As seen in the nearby chart, dually registered practices have traditionally accounted for more advisors per practice than independent RIAs. However, over the last five years, this lead has widened substantially. As of 2007, independent RIAs averaged 2.3 advisors per firm while dual registrants averaged 2.6. By year-end 2012, independents had grown to just 2.5 advisors per practices, while dually registered practices averaged 5.4 advisors each. This growth is largely attributable to the recruitment of practicing advisors who were interested in moving into more independent models, but were reluctant to embrace the multitude of responsibilities involved in starting their own stand-alone firm.

In the coming years, Cerulli expects both the independent and dually registered segments will continue to accumulate marketshare as advisors seek greater independence and the potential for higher long-term remuneration. Though IBDs should perceive the growth of dual registration as a positive, they must also keep in mind that the bulk of a typical dual registrant's wealth management assets (AUM) is generally managed under the firm's RIA, which potentially limits revenue for the IBD. In order to stem this tide and generate future revenue, IBDs must seek out additional opportunities to differentiate their product and service offerings in order to help dual registrants solve complex clients' needs, such as retirement income.

EXHIBIT 3.03

Retail-Focused RIA Firms, Assets, and Advisors by Affiliation Model, 2007-2012

Sources: Meridian IQ, Cerulli Associates

Analyst Note: Dually registered assets include those held within their IBD registration.

		2007	2008	2009	2010	2011	2012	1-Year CAGR	5-Year CAGR
Independent	Assets ($ billions)	$1,037.0	$850.6	$1,157.6	$1,243.8	$1,415.8	$1,578.3	11.5%	8.8%
	Firms	9,634	10,439	12,082	12,296	10,357	11,213	8.3%	3.1%
	Advisors	22,495	26,089	27,834	27,931	27,426	27,839	1.5%	4.4%
	Advisors/Firm	2.3	2.5	2.3	2.3	2.6	2.5	-6.2%	1.2%
Dually Registered	Assets ($ billions)	$770.3	$568.5	$629.5	$790.3	$898.0	$1,091.3	21.5%	7.2%
	Firms	5,167	5,069	4,642	4,245	4,659	3,413	-26.7%	-8.0%
	Advisors	13,496	16,119	15,508	17,270	18,266	18,513	1.4%	6.5%
	Advisors/Firm	2.6	3.2	3.3	4.1	3.9	5.4	38.4%	15.7%

2. What factors are affecting investor choices in the financial advice market?

Though investors' perceptions of the financial services industry vary greatly, one area in which investors are unified in their beliefs about financial advice is an expectation that client interests must be at the forefront of their advisor relationships. When asked if it was important that their advisor is "legally obligated to act in your best interest," 76% agreed, 21% were not sure, and just 2% indicated such a requirement was not important to them.

Investors working with advisors in the RIA channel receive care under this fiduciary standard, which aspirationally places client interest above all else. In contrast, those operating on a commission basis within B/D channels are subject to a standard under which an advisor must choose an investment that is suitable, but the interests of the advisor or firm may also be part of the consideration. Cerulli recognizes both that no business model is above malfeasance, and that client satisfaction is the ultimate benchmark of advisor success; however, that does not necessarily mean the standards under which advisors engage clients should vary based on compensation model. Some within the industry argue that clients engaged in commission-based relationships understand these differences, but evidence seems to indicate otherwise.

To best expand their addressable markets, RIAs first must understand the decision criteria facing potential clients. With a growing number of Baby Boomers approaching retirement, there is mounting overall investor interest in paid financial advice relationships; however, several factors limit prospects from actually engaging with advisors. When considering the hardest part of working with financial advisors, investor responses can be classified into three major categories: trust, expense, and communication. As detailed in the nearby exhibit, when offered a list of 10 potential issues, trust and expense issues were the five most frequently mentioned responses. On this basis, investors simply want to find good advisors whom they can trust to recommend the best products at a fair price that they can understand. Advisory practices that can build their brands to address these themes among their target markets should be well positioned to add scale.

EXHIBIT 1.02

Most Difficult Part of Working with Financial Advisors by Age Range, 2013

Sources: Phoenix Marketing International, Cerulli Associates

		Head of Household Age						
Most Difficult Part of Working with Advisors	**Concern Type**	**<30**	**30-39**	**40-49**	**50-59**	**60-69**	**>70**	**All Households**
Finding a good advisor to work with	Trust	15%	24%	38%	21%	21%	19%	23%
Advisors are too expensive	Expense	16%	21%	20%	15%	12%	6%	15%
Costs are not transparent and I don't know how much I pay advisors	Expense	20%	13%	8%	21%	14%	9%	15%
Not sure if the advisors are recommending best products	Trust	12%	16%	15%	14%	17%	12%	15%
I am not sure if I can trust advisors	Trust	13%	20%	14%	15%	13%	6%	14%
Advisors use investment and financial terms I don't understand	Communication	21%	24%	14%	12%	8%	9%	13%
I don't feel like a top priority client for advisors	Trust	11%	16%	11%	13%	10%	5%	11%
Advisors do not communicate frequently enough	Communication	12%	3%	9%	11%	6%	9%	8%
Advisors are hard to reach	Communication	10%	3%	6%	4%	6%	1%	5%
Advisors do not understand my goals and needs	Communication	2%	2%	2%	4%	2%	1%	3%
	Trust total	**51%**	**76%**	**77%**	**63%**	**61%**	**42%**	**63%**
	Expense total	**37%**	**34%**	**28%**	**36%**	**25%**	**15%**	**30%**
	Communication total	**45%**	**32%**	**31%**	**31%**	**22%**	**19%**	**29%**

3. What product are RIAs most interested in adding to their portfolios?

Exchange-traded funds (ETFs) remain an area of high interest among RIAs. Use of the products has grown 26.5% annually among RIAs over the past five years, accounting for $170 billion of the channel's assets by year-end 2012. However, this still accounts for only 7.4% of the channel's overall assets, leaving extensive growth opportunity for providers in the space. This opportunity is further evidenced by the interest RIAs report in increasing their portfolio allocations to the products in the future. As denoted in the nearby chart, 49% of RIA respondents indicated interest in adding ETFs to their portfolio, and just 1% expected reduced allocations.

Although no other product category received such widespread support, equity (30%) and alternative or commodity (29%) funds, and REITs (21%) all sparked substantial interest among respondents. In many cases, this interest is tied to diversification and alpha exploration opportunities. In these cases, advisory practices have pretty much settled on their core portfolio construction staples or manager selection beliefs, but are looking to develop additional relationships outside the expertise of their current providers, in order to improve the potential portfolio outcome of their investors.

The challenge for providers hoping to gain scale in RIA portfolios is to help advisors understand both how the provider's strategy is able to address client needs and how they are best equipped to provide the expertise the RIA practice needs. Unfortunately, education can be an uphill battle for product providers in the RIA space. The RIA community generally exhibits an intellectual curiosity about potential additions to their product portfolios, but can remain unconvinced of the necessity for change unless fully engaged in the product's possibilities. Organizations committed to broadening their distribution within the RIA channel must attempt to create a compelling case on both the intellectual and emotional level. Only by connecting their investment strategy to fulfilling the investor's needs better than other competitors is a manager likely to gain traction within this segment.

EXHIBIT 10.05

RIA-Reported Expected Changes in Product Use, 2013

Sources: Cerulli Associates, in partnership with the Investment Management Consultants Association, WealthManagement.com, Morningstar, FSI, and On Wall Street

Product	Increase by More Than 10%	Increase up to 10%	No Change	Decrease up to 10%	Decrease by More Than 10%	Net % RIAs Expecting Increase
Exchange-traded funds	19%	30%	50%	1%	0%	47%
Alternative/Commodity mutual funds	6%	22%	69%	2%	0%	27%
Equity mutual funds	9%	21%	59%	9%	1%	20%
REITs	2%	19%	73%	6%	0%	15%
Hedge funds or funds of hedge funds	3%	11%	85%	0%	1%	13%
Individual equities	9%	13%	69%	7%	2%	12%
Variable life/VUL/Whole life/Term/LTC	2%	9%	89%	0%	0%	10%
Direct limited partnerships	3%	8%	88%	1%	0%	9%
Separate accounts	7%	4%	85%	4%	1%	6%
Immediate annuities	1%	4%	94%	0%	0%	5%
Balanced/Allocation mutual funds	3%	4%	90%	2%	1%	4%
Structured notes	1%	3%	95%	0%	1%	3%
Fixed annuities	2%	3%	94%	1%	0%	3%
Other	1%	1%	97%	0%	0%	3%
Variable annuities	1%	5%	87%	6%	2%	-2%
Money markets, deposit accounts, cash, etc.	3%	8%	74%	13%	3%	-6%
Individual fixed-income securities	0%	1%	4%	15%	4%	-18%
Fixed-income mutual funds	3%	7%	60%	23%	6%	-19%

4. Which RIAs are experiencing the most success in the high-net-worth (HNW) marketplace?

Much like the trends observed in the overall wealth management industry, the RIA channel's intensifying success among HNW investors ($5 million or greater in investable assets) is largely guided by two main drivers. First, HNW investors are increasingly opting for autonomous, boutique providers at scale to offer the breadth of product sets and services needed to meet their primary (*e.g.*, wealth preservation) and often unique secondary (*e.g.*, philanthropy) goals. In addition, their motivation often involves dissociating themselves from many legacy HNW providers that suffer tarnished brands. Second, as addressed throughout this publication, the channel continues to benefit from advisors and advisory teams in transition.

These HNW investors and high-end advisory teams that favor the independent wealth management model helps to explain why even the smallest RIAs (less than $100 million in AUM) report a relatively high percentage of their clientele being HNW. However, as observed in the exhibit below, approximately one-third of RIAs with AUM of $1 billion or greater identify HNW households as comprising more than 75% of their client bases. Fundamentally, AUM and a firm's ability to offer the services required to address HNW needs, including softer services (*e.g.*, family governance), are highly correlated. The likelihood of a RIA achieving such great scale and proportion of HNW clientele is inherently associated with their capacity to serve the financial and nonfinancial needs of families by way of integrated, customized wealth management, with a specific focus on multigenerational estate planning.

A natural byproduct of grander scale is greater resources, especially technological advances and the ability for many RIAs to ease the transitional process for advisors who are contemplating moving away from employee-driven business models. Many firms provide advisors with an actual framework for doing so. Technology is of particular importance since many HNW investors have the ability to diversify assets across complex product sets and interests that may require potential one-off demands, such as business succession planning. RIAs that possess the technology to deliver all-encompassing and sophisticated services such as performance reporting, in-depth manager searches, tax preparation, and bill pay will increase the likelihood of succeeding in the HNW marketplace. In fact, many of these larger RIAs eventually move further upmarket and spawn into one of the most elite and opaque HNW distribution channels of all—multi-family offices (MFOs). As of year-end 2012, Cerulli estimates that nearly 350 RIAs meet the MFO criteria, which represent a collective asset base of $502 billion. Furthermore, this elite group has posted 1- and 5-year AUM CAGRs of 15%.

EXHIBIT 8.02

RIA High-Net-Worth Clientele by Firm AUM, 2012

Sources: Meridian IQ, Cerulli Associates

	Firm AUM				
Percent of HNW Clientele	**<$100m**	**$100m to $500m**	**$500m to $1b**	**>$1b**	**All RIAs**
Up To 10%	22.5%	10.9%	6.6%	7.0%	13.2%
11%-25%	27.5%	17.5%	12.5%	11.1%	18.7%
26%-50%	25.8%	31.3%	25.0%	24.0%	27.1%
51%-75%	12.0%	22.0%	24.3%	25.5%	19.9%
More than 75%	12.2%	18.2%	31.6%	32.3%	21.1%