SNOWDEN
LANE
PARTNERS

September 2015

So You Really Want to Start that RIA? Large Advisors in SEC Crosshairs

Setting up an RIA isn't all roses, and running one is about to get a whole lot harder

This piece originally appeared as an article on WealthManagement.com on September 3, 2015

Despite recent bouts of market volatility, the summer of 2015 brought good news for independent registered investment advisers (RIAs). Several weeks ago, Schwab reported that more than half of 1,007 RIAs they surveyed grew their assets by 75 percent or more in the past five years. And according to ThinkAdvisor, revenue also has doubled since 2009 among 42% of firms.

Many RIAs are growing and, in the last few months, a relatively new phenomenon appears to be gaining momentum – that of large "breakaway" financial advisor teams ($1 billion-plus client assets) leaving big firms to set up independent RIAs. In July and August, eight employees left Barclays to form, "Summit Trail," a reportedly $3 billion-plus RIA with offices in New York, Boston, Chicago and San Francisco. Another group from Deutsche Bank, Alex Brown in Silicon Valley, formed a reportedly $3 billion-plus RIA, "Intellectus," in June. And in May, a group of former Merrill Lynch advisors launched "Quadrant Private Wealth," a reportedly $500 million-plus RIA.

More and more sophisticated advisor teams are appreciating that independent boutiques can provide a superior experience to high-net-worth clients through better technology, un-conflicted products and partnership cultures. It's also not lost on the founders of these firms that they can do better financially – in annual compensation and long-term value creation – than by taking a wirehouse deal. Recently, several high-end independent advisory firms have sold at apparently very solid multiples. Constellation Wealth Advisors' recent sale to First Republic, for a reported $115 million on assets of around $6 billion, is perhaps the latest example. And savvy advisors understand that owning appreciating equity in an advisory firm, taxed at capital gains rates, can be far more lucrative than accepting a wirehouse deal that includes a nine-year lockup and annual loan forgiveness taxed as ordinary income.

Setting up an RIA isn't all roses, however, and running one is about to get a whole lot harder. Advisors thinking about taking the leap need to be wary of specific developments and the aggressive regulatory environment that awaits them. Improvements in technology, efficiency and more resources have increased SEC oversight. Even more threatening are new regulatory developments that would result in more responsibilities, scrutiny and expenses for advisors setting up large RIAs.

Article Written By

Rob Mooney

Managing Partner, Co-Founder & CEO

Rob spent 22 years at Merrill Lynch, in New York, Singapore, Hong Kong, and London. He was General Counsel and Chief Business Risk Officer of Global Wealth Management (GWM) and a member of the GWM Executive and Operating Committees. He previously held senior executive positions in International Private Client and the Asia Pacific Region. Rob started at Merrill Lynch in London (Europe, Middle East and Africa Region) and before that worked at the U.S. Securities and Exchange Commission. He has a BA from Franklin and Marshall College and a JD from George Washington University. He is a Board member and former Board Chairman of the American Red Cross of Central New Jersey and a founding Board member of the Christina Seix Academy, a residential school for underprivileged inner city children. Rob and his wife reside in Princeton, NJ and have four children.

About Snowden Lane Partners

Snowden is a client-focused, financial advisor-owned, and national branded independent wealth advisory firm. Through its open-architecture platform, Snowden delivers wealth advisory services to high net worth individuals, families and foundations. For more information about Snowden, please visit www.snowdenlane.com.

Questions or Comments? Please direct them to:

Snowden Perspectives
540 Madison Avenue, 9th Floor
New York, NY 10022
www.snowdenlane.com

Karly Obermaier
kobermaier@snowdenlane.com

One possible new development involves further reliance on state regulation. Since Dodd-Frank, RIAs with under $100 million in assets have been regulated by the states. That already allows the SEC to focus on larger practices. There is currently talk about raising the threshold for state-regulated RIAs even further, from $100 million to $500 million. This would further fuel SEC focus on large RIAs—a logical move, as larger firms tend to be more complex and present greater risks. For large wirehouse teams with sophisticated clients involved in hedge funds, private equity, structured products, syndicate or brokerage activities, understanding how they will cope with this scrutiny is critical.

Perhaps the most significant (and clearly not yet appreciated) new development is the Treasury Department's Financial Crimes Enforcement Network's (FinCEN) proposed anti-money laundering (AML) rules that will likely apply to RIAs very soon. On August 25, FinCEN proposed closing a loophole that has for years excluded RIAs from, among other things, suspicious transaction reporting (that responsibility resided with broker-dealers). A new rule would designate SEC registered RIAs as "financial institutions" subject to the Bank Secrecy Act, the main U.S. AML law. Going forward, an RIA would have to:

1. Establish and maintain an AML program
2. Adopt internal policies, procedures and controls to address AML issues
3. Conduct independent testing of its AML program
4. Designate an AML compliance officer
5. File so-called Currency Transaction Reports on large cash transactions and keep records relating to the transmittal of funds
6. Provide ongoing AML training for firm personnel

The SEC would be delegated authority to examine RIAs to ensure compliance.

A Complicated Journey

With these potential new developments, breakaway advisor teams can expect a complicated journey when establishing their own compliance programs. The era of inexpensively outsourcing compliance is coming to an end, at least for larger RIAs. Consistent with our firm's experience, large RIAs may anticipate annual costs in the hundreds of thousands of dollars for in-house and external compliance resources, including a chief compliance officer and AML compliance officer, and things like errors and omissions, directors and officers and cyber insurance.

There is also the issue of regulatory harmonization. In response to the SEC's March request for information on the impact of a uniform fiduciary standard, Schwab calculated it would cost an RIA close to $175,000 to implement in the first year and over $100,000 annually after that. For larger RIAs, Schwab estimates over a 100 percent increase in compliance costs. And Schwab's analysis did not include the recent FinCEN proposal.

Additionally, a bill proposed by Rep. Maxine Waters (D-Calif.), ranking member of the House Financial Services Committee, would allow the SEC to charge RIAs user fees to fund exams.

SEC enforcement actions have increased over the past ten years—hitting a record 755 actions in 2014. 205 of those cases were against RIAs, compared with 170 at the start of the financial crisis. In part, this results from the SEC's "broken windows" policy; in a speech on October 9, 2013, SEC Chair Mary

Jo White explained, “The theory is that when a window is broken and someone fixes it—it is a sign that disorder will not be tolerated.” White has made clear that they will look for any “broken window,” even if the violation is small and even if it does not involve fraud.

A number of RIAs have faced heavy penalties for their failure to comply with regulations—and that number is likely to increase.

The SEC’s focus is unlikely to change, as more client assets and advisors move from wirehouses to the independent channel. Recent media coverage of certain large advisors who left wirehouses under a cloud – some of whom have been banned by FINRA from the industry – allegedly setting up RIAs to avoid FINRA regulation will only increase pressure to look at new breakaway firms.

We expect to continue to see a number of large teams break away and form RIAs; however, we will also likely see more consolidation as proprietors of shops come to appreciate the difficulties and expense of running sophisticated product, service and compliance platforms in a complex regulatory environment. Along the way, stay tuned for more headlines as the regulators focus their attention on the operations of large RIAs.