

FOCUSPOINT CASE STUDY #1:

ADVISOR: Fee-only \$50M sole practitioner

GOAL: *Work with 1/3 of clients while creating a more balanced lifestyle and generating the same revenue*

BEFORE

FPS: What was the main factor in your decision to transition to an RIA business model?

WE: Basically, I was unhappy with the IBD model.

For me, it was not an income issue.

The nagging issue of commissions v. fees was just starting to drive me crazy, and the additional supervision and compliance involved with the IBD seemed like overkill. It felt to me that it could put a small office like mine out of business.

For a long time I had felt pretty strongly about the fee side of the business. I didn't want to be serving two masters or confusing clients anymore about how I get paid, how much I get paid, when I get paid, where does it come from. All those potential conflicts of interest that are *inherent* in the IBD model are just not there with the independent model.

FPS: And because of all this, you were feeling burned out. At the time you found us, you were actually considering selling your practice and moving away from financial planning, correct?

WE: Yes. It's an interesting story.

I initially found FocusPoint through FP Transitions, who suggested I contacted you. I was on the phone with them, getting some general information on how to go about listing my practice for sale, and after going through a pretty thorough fact find with me, they said to me, "You know what? It sounds like you don't really want to sell your business. It just sounds to us like there are some parts of the business that you don't enjoy, and maybe if you could outsource them in some way, you would enjoy your business again." And I really respect them for doing that.

So I did, and after doing some research, I began working with FocusPoint in the spring of 2004.

I wanted more balance. And I wanted to remove myself from a lot of the day-to-day operational side of this business—trading, research, all the functions of investment management — which is how I get paid but it certainly isn't where my passion lies.

FPS: I think one of the things that makes your previous situation especially unique is that you weren't really utilizing all the services your IBD could provide, because you wanted a lot of independence.

WE: I think that's true.

In terms of trading and operations, we were doing most of that ourselves and me in particular since I was the only one in the office licensed to process trades. So I was spending a lot of time in front of the computer, doing trades or research on Morningstar—all functions I felt were definitely not the best use of my time and *not* where my competence was.

I knew there was someone out there who could do it better, faster, more efficiently, than I could, thus allowing me more time to spend doing what I felt I was better at: forming and cultivating relationships with clients.

So while I did take advantage of some of the support they offered in the area of research, I was very conscious of doing everything I could to keep myself independent of the IBD.

My situation was probably different than some with an IBD. I did everything I could to keep myself independent from them. On my business cards, for example, I had the IBD's information printed in very small letters, as small as they would allow. My company name stood out prominently. In the past, when I had made the decision to change firms, which didn't happen very often, my clients didn't see anything different.

And at the same time I was moving away from anything proprietary, a lot of stuff at my IBD was moving *toward* that. I wanted to stay away from anything that looked or smelled like it would be proprietary—including software, portfolios, or anything else. And that was one of the other reasons I moved to the independent RIA model.

FPS: Was there anything which prevented you from pursuing it sooner?

WE: Yes.

What prevented me was lack of awareness of available options like FocusPoint.

If I had found you a year earlier I probably would have started a year earlier. And it wasn't that I wasn't searching. I did outsource and transition some parts of my business; for example, I started working with SEI, which was one solution to me which lessened the load of back office functions—and it was an effective one. But I still felt there had to be something even better than that.

I looked really closely at some other turnkey asset management programs and just decided I didn't feel comfortable with any of them.

I just knew there had to be an option better out there which would give me more control.

FPS: What makes FocusPoint different from the other solutions you considered?

WE: Flexibility. In addition to the transparency.

At the time I started working with SEI—and maybe they've changed some of it at this point—I couldn't move existing positions into an account. So if I had clients with low cost basis or investments they owned for sentimental purposes and so forth, my hands were tied. They couldn't try to work a model around them—FocusPoint could, which to me was a huge advantage.

FocusPoint's system also allows me to be able to work with some smaller accounts. I have a good client with a 700k IRA, but his wife has a 5k Roth. I don't want to have to say to them, "I can manage *your* account, but I can't do yours." With SEI there were minimums, so it was not for everyone. With FocusPoint it was nice to have that flexibility of being able to work with small accounts when necessary. It wasn't that I was going to out prospecting for 5k accounts, but when you have clients who have smaller accounts in addition to their larger accounts, you want to be able to accommodate them.

And I also have much more involvement in the investment process—being able to move positions in and hold them. Yes, I outsourced the investments in the first place to *not* be involved, but I think at some level you want to have some control. I never want to have to tell my clients, "*They* did this" or "*They* did that." I now can honestly tell my clients, "This is what *we* did" when we made a strategic decision to move out of high yield bonds, or trimmed back on real estate, for example.

With typical money managers you don't have that luxury. You can't delay changes to a client's account based on what you think is best. It's whatever they decide to do—even if you don't agree with it. You don't have the choices you have with FocusPoint. I can opt out of or delay recommendations based on what I think is best for my clients.

FPS: What's interesting is that when some FocusPoint partners talk to other advisors about their investment process—and what makes us different from a typical money manager advisors might be used to—often times it appears that the advisors who work with FocusPoint are spending a whole lot of time on

investments simply because they have so much knowledge about it, when in fact they're not spending very much time on investments at all.

How much time would you say you need to spend on the investments piece of your business in order to feel comfortable?

WE: At this point, I do a little of my own due diligence, but no more than 1-2 hours a week—and that might be a lot.

When a change or recommendation is being made, that's when I go into my mode of doing a bit of research on my own. For example, FocusPoint proposes that we sell XYZ fund and use two new large cap positions. Okay, now it's time for me to do a bit of research on my own to help me make that decision for clients ultimately, but I definitely don't do this regularly. I'm not looking for "better" options out there than what is recommended by FocusPoint's investment committee, because I have complete confidence in them, but I do think it's important that when I speak to my clients, I can do so intelligently about why I made those changes.

It's what works for me.

I can run any type of performance or management reports I want, but as far as being actively involved in the investments process, I'm relying on FocusPoint almost totally.

FPS: Ideally that's how it's supposed to work—so that you have some time to step back and consider any recommendations the investment committee might make—which really puts you in a position of being in control and being able to talk to clients very knowledgeably about what's happening.

Definitely.

The agreement my clients have is with *us*, not with FPS.

The discretion on the accounts falls to us, not to FocusPoint. Ultimately it helps me to feel better that I've done everything I could to make sure that these are suitable recommendations for my clients and I'm on top of things.

I know I'm doing what's best for my clients and that's why I continue to stay involved at that level. I'm comfortable with that responsibility.

FPS: Ultimately, you chose not to keep an IBD relationship. Why was that?

WE: At the end of the day, I just wanted some separation.

That was one of the hardest decisions I had to make, and I didn't make it until the tenth hour. It wasn't a decision I made at the beginning. I went back and forth and actually looked at other IBD's that would have been more responsive to allowing me to have my own RIA and a relationship with FocusPoint.

I went through that whole exercise and then realized, "You know what? I don't *want* to do certain things." So it really gave me the opportunity to say to clients, "I *can't* do certain things" that I didn't want to be doing anyway.

529 accounts are a good example. In my state, you can go directly to the plan without going through an advisor and paying a commission; no one can actively manage a 529 account anyway. Ultimately not having an IBD relationship gave me a reason to say no to smaller accounts—and not have any conflicts which relate to compensation. To me, having that IBD relationship promoted that in some way.

For me, it was either all or nothing, and that was my final decision.

Either you're committed to this business model or you're not. Which is it? And if you're just doing it because of the lost revenue, then you need to figure out a way to take care of that. So that's what I chose to do. I sat down and did some modeling and projections about revenues coming from 12b-1's, trails v. the fee side, and so forth, as well as any potential loss of clients. I asked myself, "How many of my clients do I think I can convert to the fee model and how much additional income will that generate?"

And when I sat down and really crunched the numbers, there wasn't going to be any loss in revenue—or whatever loss I experienced would be temporary. I was going to be able to make it up. So I'd be losing the 25 bps trail revenue on a 100k American fund account, but I was going to convert that to a fee-based account and begin earning 125 bps.

The loss of income just wasn't a fear that was worth being concerned about.

FPS: What were your main goals for after your transition was complete? Have you achieved them?

WE: My main goal was to convert everyone I *wanted to* continue to work with from the IBD to this RIA I established.

I can honestly say my goal was never "I want to make more money." But I *did* want to continue the same level of revenue, work with fewer clients, and consolidate everything onto platform.

When I talk with advisors who have an IBD about what I mean by this, and give them the following example, they start shaking their head, nodding, "Yeah, I know what you mean."

Before, when I was with an IBD, five years ago, I'd have a client walk in the office with 100k to invest. And one of the biggest challenges I always had was, "What am I going to do with this money? I can put it in A shares and earn an up-front commission; I can put it in C shares and earn a level commission; I can put it into a brokerage account and purchase a lot of different mutual fund families; I can put it into one of the fee-based accounts; I can use SEI or another third party; I can use a variable annuity," and so on.

It was all just really very confusing—not only to the client, but to me, the advisor. And for me, really, that's where the conflict of interest comes in.

The independent RIA model allows me to never have to have that dilemma.

Now, when I open an account, I know which custodian I'm going to use, I know which model I'm going to construct. That's it, bottom line. Clients either like it or they don't. If a prospect asks, "What about Vanguard?" I can tell that person, "I'm sorry but that's just not what I do. Let me refer you to someone else, or you can go directly to Vanguard if you want to do that," and so forth.

My current situation allows me to really not compromise with clients. Ultimately I can tell those clients that I have found are dangerous to work with, "You know what? I don't think you need me. Let me show you what I do and if you like it let's move to the next step; if you don't then it was nice to meet you."

But it definitely uncomplicated a very complicated process.

FPS: That's a perfect example of what I love seeing from advisors we work with. They can really put it all out there simply for clients: Here's what we do, here's *why* we do it this way, here's the type of client who can benefit from our services, we feel very strongly about how and why we invest this way...we can certainly be flexible to accommodate your needs, but we won't redesign our whole system if it's not a fit.

WE: Exactly.

We've all probably forced relationships in the past because we know we can help most people. Whether you should is another story. I don't worry about that anymore.

I have tremendous peace of mind.

DURING

FPS: What was your biggest challenge as you made the transition?

WE: One challenge was simply explaining the change to clients—especially the ones that had never paid a fee, who had American funds and they'd been a client for ten years.

You've been providing those clients with a certain level of service for years, basically for free, and now you're going to charge them for that. So explaining to some of those clients why and what you're going to get for it was a challenge.

Especially because I'm really making a change of model portfolio, a change of custodian, a change in the back office operations...that's a lot of changes at once. So you'd better really make sure it's the right decision.

I think that the biggest thing was coming up with something that made sense to my clients as to why I was making that decision, and how it was to their benefit. I had that challenge throughout the process.

But as you get further into it, you get better at telling the story.

FPS: How long did your transition take in relation to how long you planned for it to take?

WE: I had 75-80% complete in six months.

And this was most of the clients that were important for me to transition over; I started working on the commission clients afterward.

FPS: How did/do you handle the compliance aspect of your RIA business?

WE: I outsource as much as I can.

I'm still Chief Compliance Officer, of course, but I have a firm that helped me to register and put together my ADV and so forth, file everything. They do ongoing compliance work for me. I had them out here a couple months ago to do a mock audit.

FPS: Did you make any changes in regards to staff?

WE: No, I really didn't.

When I started the process I had two part-time employees; I was here by myself on Fridays. They really worked hard to make this work and get through the process. They were probably seeing applications in their sleep.

Now I have one full-time employee who's here Monday-Thursday 9-3. The changes came after my transition, when I just felt at some point that I needed to have someone here every day. It's too hard to train and follow through when staff isn't here on a consistent basis.

I figured if I was going to go from 350 clients to 125, and outsourcing my back office, I shouldn't need more staff.

Today, my assistant's main function is to prepare me for my reviews. She takes care of that whole process, checklists and forms I complete after I've made the appointments. She knows that this is everything I need her to put together in a binder for me to prepare me for my review.

She also does some day-to-day client service work—withdrawals and deposits, management reports, etc. She helps me with some client communications.

FPS: It sounds like you have very good systems in place.

WE: Oh, absolutely. Systems is the key.

There's no question that you have to have the systems in place. And it's easier when it's done under one model. It needs to be in one place.

That was the other thing about having an IBD. It was pretty common for me to have a client with an American funds account held directly at American funds, a brokerage account at my IBD, a variable annuity account at the Hartford, and a managed account at SEI. Now you've got four different sets of forms, four different websites, four different 800-numbers, four different statements coming in, and so on. So from a staff—and client—standpoint, to become familiar with all of that is just impossible.

We've now simplified *everything*. We have procedures and policies manuals in place, checklists, everything. And all we had to do it for was one custodian, so that was helpful.

This all gives me peace of mind when I'm out of the office as well.

FPS: What was the biggest surprise you encountered during your transition?

WE: I knew what to expect, but I did have one very good surprise.

I had hired FocusPoint primarily to be my back office—for trading, processing transactions, etc. I figured if they also did a decent job on the investments I'd be happy.

As it turns out, the investments side turned out to be a pleasant surprise. I didn't expect FocusPoint to do so well with performance. Other than that it was pretty calculated.

FPS: How did clients react to your discussions with them about your transition?

WE: It was pretty positive. And I made it that way.

A lot of my clients have been with me for a long time, so they've seen me make a lot of changes. That worked in my favor because they all knew that I would never make a change just for the sake of making a change. My clients knew

that if I was doing something different, it was because it's better for you, it's better for me.

I explained to them the whole process of cutting my practice back from several hundred clients to about 100, allowing me to spend more time with them and their accounts, to outsource the back office and investment research to give me even more time.

To me, the investment 'stuff' is becoming commoditized—is already commoditized.

To me, that's the stuff you can outsource. But you can't outsource the relationships. And that's what I want to spend my time doing.

Because 70% of my revenue was already fees, many of my clients were used to it. In fact, I could tell my clients it was going to now cost them less because all those transaction charges at the IBD which may have discouraged me from actively managing your account are now going to go away.

I kept it very positive and really didn't have much resistance.

TODAY

FPS: How has your profitability or revenue been affected by your transition to an independent RIA?

WE: The first year was a little difficult because I went a whole quarter without getting paid, but it wasn't something I didn't anticipate.

If you think about all the things that could or will happen, you can put yourself into savings mode for a few months.

I was pretty liquid, but by 2006 my income was already above where it had been before the transition—with 1/3 of the clients.

FPS Would you consider going back to your previous business model?

WE: Never. I can't even think of a reason that would make me go back.

FPS: What is the best thing about your having made the transition to this model?

WE: There are a lot of things, but working with fewer clients who I really enjoy is definitely the best thing.

In the past, my mentality was that you treat everybody the same, and the reality is that you can't. I was trying to service the clients that had 10k with me that they purchased ten years ago the same way I service the clients who pay me 1% of a million dollars.

You just can't do it. It's not fair to the clients who are paying me 1% of a million dollars. I still have some of those smaller clients, but they're wonderful people and I wouldn't change that.

Now, I spend *more* time with fewer clients, and I have more free time from the operations side.

This model allows about as much free time as you want.

At the beginning of the year my goal was to take six weeks of vacation, which is twice as much as I've ever taken, and I'll be able to fulfill that.

FPS: How is your practice different today than before you became totally independent?

WE: I think the biggest change is not having to make as many decisions about what to do with regard to each account, as I outlined earlier.

I just don't have to think about all of that.

Now, I have one thing to be *very* good at, and one way to get paid.

It's just streamlined and simplified things, but not at the clients' expense, which is a very important element. Clients are even doing better—they're getting better returns and paying less, and I'm more accessible.

That can't be bad.

LOOKING BACK

FPS: What were your biggest fears about going independent and how did you overcome them?

WE: I don't think they were fears as much as issues I saw: New custodian, new back office, new model, tax consequences, etc.

Those aren't fears about going independent, per se, but there are definitely going to be certain clients that, in order to move them over to a model, you have to reposition their whole portfolio. So there's the issue of confronting them about doing that. That was a fear I had. (Would they actually agree to make that move?)

Some of the other stuff was just unknowns. You just can't know everything that's going on in terms of every transfer and every piece of paperwork during a transition.

I have a lot of confidence in FocusPoint. In terms of transition and operations, they always lived up to their end of the bargain.

FPS: Tell us about the level of your independence today vs. prior to your transition.

WE: That's tricky, because even as a registered rep at an IBD, I always thought of myself as an independent business owner.

Whereas some advisors wanted to piggyback on the IBD's name or brand, I was trying to brand *myself*. I had worked really hard to be independent for the last 15 years. So there was a new level of independence because I did not have an IBD to report to, or have to spend any time compliance-wise.

My new master is SEC but my observation is you're in more control than you are with an IBD.

FPS: What advice would you give advisors considering making a transition to an independent RIA model?

WE: I think what really helped me was having a plan.

And before I had a plan I had a vision. I knew what I wanted it to look like, and I'm not sure a lot of advisors do. They're successful despite that. There's not an organized plan of how they got to where they are...all of a sudden they wake up one day and go, "Wow. Things are looking pretty good!"

But that's where it stops sometimes. I looked at myself and said, "Hey, you're doing pretty good—BUT—are you *happy*? If you had to start over and do it from scratch, what would you do and how would you do it differently?"

That's when I came up with my vision and my plan. It can be as simple as saying, "ideally, I'd like to have 100 clients who are paying me 3k a piece in advisory fees." And then you sit down and decide, "How much revenue do I want?" Well, again, if you wanted gross revenues of 300k and you wanted to work with 100 clients, they'd have to pay you 3k in gross revenue fees.

So you start there, and then you say, "How many clients do I have that are paying me 3k a year? 15? Okay, well, I need 85 more!"

But revenue isn't everything, of course, not by a long shot.

I had the opportunity to really say, "What do I want my ideal client to look like?" in terms of demographics and so on, carve those clients out of my existing client base, and then look for *more* clients that fit that target.

So you have a vision and you have a plan to put that vision in place, but constantly remembering what it's all going to look like. And then you do some modeling and get to work.

I think that's really important and I don't think enough advisors spend as much time on the business side of what we do as they should. We *are* running a business — we really are. And some are better than others at it.

But if you forget that—that this truly is a business, in addition to a practice—then you may be a very good financial planner, but you're not going to be profitable, you're not going to have the right clients, you're not going to be charging the right fee, and you're going to be paying too much for stuff you're not using.

All of that is going to drag you down and burn you out enough to where you're ready to sell your business, which is where I was four years ago before I found FocusPoint.

FPS: Can you walk us through a typical client meeting during your transition?

WE: Well, I'm the type of person who needs a track to run on—not just to refer to but also to jump right back onto each time a client pulled me off that track.

I'm an okay seat-of-your-pants guy but I'm not really comfortable with it. So what really helped me is I developed a presentation and I showed it to every client.

And before I created that presentation, I had to first convince *myself* that this was the right decision. And so I thought, "What's going to help you feel this is the right decision? What is that client going to want to know? What's different? What's it going to cost?"

So I went through a presentation in a binder with every client.

Advisors take longer to make a transition because they almost let their clients determine when and how the transition happens. I wasn't going to let that happen. I said to my clients, "Here it is, I've got the paperwork ready to sign." I *assumed* that everyone was going to do it. Why *wouldn't* you do it?

But you've got to give clients a reason. And even when you have a presentation, you've got to practice it.

One of the best lessons that I had was with one of the first clients that I tried this presentation on. And he truly is one of my best clients. I wasn't going to practice on my not-so-great clients—the whole point of my transition was that I wasn't going to give them the presentation at all! I wasn't going to practice on someone I didn't want to work with.

So I get through this whole presentation with this client: I would now be working with fewer clients, I've outsourced my back office, doing the things I really want—and ought—to be doing. At the end, my client told me, "Sure, this sounds wonderful—for you, but what about for me?" And I thought, "You're right!" I realized my mistake: I was sharing with him the benefits for *me*!

I called him the next day and thanked him. I told him, "I don't know whether you realize it, but you really helped me yesterday. I think you understand that I wouldn't make this change unless it was to your benefit. But my presentation was just horrible!" And he understood.

Then I was able to rework that presentation to discuss why this was good for my *clients*.

FPS: **And what did that presentation end up looking like?**

WE: I went through everything that was a benefit to the client.

Things like active management (that was key for me)—before I only *thought* I was able to actively manage your account, but I didn't have enough time to and it cost too much.

And active management means the potential for higher returns—I can now do that for the same price or less, plus less red tape and cost from the IBD side, simplification, consolidation, full flexibility—I decide, not the IBD, who the investment managers are going to be, how much to charge, what to charge, etc.

The IBD was just the middle man. Now I've been able to eliminate that middle man.

Each client has a different level of understanding what I do and how I do it. But I wanted to be consistent with the message.

If you plan it properly and spend the time, it works.