YOUR INDEPENDENT INVESTMENT ADVISOR WANTS TO DIE WITH HIS BOOTS ON

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There's a succession crisis in the independent investment advisory business and there's a pretty good chance your adviser is doing nothing about it.

As a group, investment advisers are getting older. A business that boomed following the passage of law that forced people to manage their own retirement has become far more competitive. Younger people are no longer attracted to it.

Even if they were, some of the incentives for independent investment advisers to sell their businesses are poor at best, according to Brooke Southall, managing principal of RIABiz, a website that reports on the registered investment advisory industry. Southall says investment advisers often continue working into their 70s or 80s since by selling they are likely to get what they might earn over the course of a year of two if they kept the business running. "The nature of the business is people don't really want to retire," Southall says. "The rational thing is just to keep it going for another five years and you'll get twice as much as you would have gotten by selling it and you still have a place to go hang your hat during the day."

And then what? The phrase, "die with their boots on," comes up quite a bit in discussions about investment adviser retirement. It sounds heroic when cowboys are concerned, but not so much when it comes to professionals charged with a fiduciary responsibility to their clients. A few private equity-backed firms have sprung up in recent years to try and drive consolidation in the highly fragmented industry, but how much success they will have remains to be seen. "A lot of advisers are just retiring and leaving clients in the lurch," says David Bugen, founding principal of Regent Atlantic, a Morristown, N.J. financial advisory firm.

There are some 300,000 advice-providing professionals registered with the Securities and Exchange Commission and FINRA, the securities industry's self-regulatory authority, according to **Dan Seivert** CEO of **ECHELON Partners**, a Los Angeles-based investment bank that serves the wealth management industry.

The vast majority, an estimated 270,000, work for large brokerage firms such as Bank of America Merrill Lynch (BAC) or Morgan Stanley or mid-sized ones like Raymond James & Associates Inc. (RJF). Some 30,000 are independents, spread out across roughly 12,000 firms, Seivert estimates.

While advisers at larger firms are also reluctant to hand off their business to younger executives in many cases, the fate of the independent firms, often referred to as registered investment advisers, or RIAs, is especially worrisome since most of them don't have a plan for what to do when their founder retires.

RIABiz's Southall appears to be virtually alone in his willingness to say -- publicly, at least -- that advisers have little if anything to gain from selling their businesses. However, he is worth paying special attention to on this point because he is one of the few people who thinks about the question of investment adviser M&A who doesn't appear to have an incentive to espouse the virtues of investment advisers selling their businesses.

Older advisers can't say it isn't worth it to sell their businesses because they will either look stubborn or selfish or, if they are considering a sale, talking down the value of their own merchandise.

Then there are those who acquire or fund investment advisers looking to sell their business, or pass it on to younger employees. Their incentives to convince sellers to sell are obvious enough. They can't do deals if no one wants to sell.

That said, some of those who finance M&A among independent investment advisers argue openly that most of the small independent firms have no enterprise value. Mark Hurley, head of the Fiduciary Network, which provides financing to advisers for acquisitions or to allow younger employees to buy out senior partners, refers to the vast majority of small independent financial advisers as "barber shops."

Hurley translates: "when you're done you sell the chairs and the scissors."

Hurley has an air of calculated brashness that has made him one of the most recognizable people in the independent investment advice industry. He first attracted attention in the 1990s with prophecies of doom for the independent RIA business. He wrote white papers and appeared at conferences telling financial advisers that their numbers would shrink radically in the years to come as they faced increasing competition.

"Just the notion that the same rules that applied to other businesses was beyond inflammatory," Hurley recalls with pride. "I was the spawn of Satan, OK? I would speak at conferences and I'd get to my third slide and people would stand up and start shouting at me."

Backed mainly by Emigrant Bank, one of the largest privately owned banks in the U.S., Hurley has put together 17 investments since founding Fiduciary Network in 2007. The investments consist of providing firms what Hurley calls "permanent capital" in the form of convertible debt that at maturity converts to non-voting common stock. The company also makes personal loans to more would-be successor employees to allow them to buy stock in the investment advisory firms they work for. Fiduciary's investments provide it with annual revenues of between $170 million and $175 million, Hurley says.

Hurley puts the number of independent financial advisory firms at nearly 20,000. He contends roughly 200 of these are sustainable businesses, 1000-1200 are large enough to be sustainable but haven't yet done anything to ensure they will continue to exist once the founders retire, and 18,000 of them will disappear when their founders retire.

The major question for Hurley is what happens to the middle group -- the thousand or so that could sell themselves or obtain financing (from his Fiduciary Network or similar firms) to allow younger employees to buy out older ones.

"If you're an economist you would think most of them would wind up either evolving into sustainable businesses or they would sell to someone who is in a sustainable business. If you're a psychologist and you've dealt with a lot of these guys you'd say they're all just going to do nothing and they're going to go into the ground," Hurley says.

Some of the investment advisers who have obtained financing from Hurley believe it is the only option available for professionals who want to maintain their independence and protect their clients' interests

Brightworth, a $1.2 billion Atlanta-based wealth manager, took a loan from Fiduciary Network in 2007 to allow younger employees to buy partnership interests from the first generation of partners.

"This was the first time we had seen anything like it. I still don't think there's anything like it out there," says Ray Padron, Brightworth's CEO.

Focus Financial Partners LLC chief executive Rudy Adolf would beg to differ. His description of Focus sounds quite similar to Hurley's description of the Fiduciary Network, except that Focus is larger. It has "well north of $370 million in annual revenues," according to Adolf.

Like Hurley, Adolf claims to grant firms it finances total independence to run their businesses as they see fit. Firms in Focus's network, including Buckingham, a $26 billion investment adviser and The Colony Group, a $5.4 billion Boston-based money manager, are unstinting in their praise. Colony CEO Michael Nathanson calls partnering with Focus "the smartest business decision I've ever made in my life."

Still, the firm, along with other so-called rollup firms including United Capital and HighTower Advisors LLC, appear to be magnets for criticism. Hurley and Seivert both say the rollup firms exploit the firms they fund. RIABiz refers to the roll-ups as "very public people who keep many of the details private."

True to that description, Adolf declined to give many specifics on the deals it has struck with the 35 firms that have joined its network. Sellers receive a combination of cash and stock in Focus, Adolf says, though he would go no further.

United Capital CEO Joe Duran says he is not a roll-up because his firm acquires investment advisers outright. He says United pays as much as 10 times EBITDA for acquisitions in some cases if it believes it can increase the profitability of the firm it is acquiring. If not, it would typically pay about five times EBITDA. "Why I'm so violently opposed to rollups is that most of them traffic in the total illiteracy and lack of knowledge of the people who are selling," he says.

No firm appears interested in being referred to as a "roll-up." HighTower also says it rejects the label.

How large a role these firms will play in determining what happens to the thousands of independent RIA firms--or the smaller number of big independents--is anyone's guess.

ECHELON's Seivert believes there is more value in the smaller firms than Hurley and other skeptics give them credit for.

"It they have recurring revenue, someone else can pick them up and add it to their business and make a lot of money," Seivert says.

While he is somewhat dismissive of Hurley and the rollup firms, Seivert believes other private equity-led financing will eventually come along at more favorable terms for investment advisers looking to sell.

Adolf, the Focus Financial CEO, believes banks will try and compete with him, but claims not to be worried as he believes they have "a flawless track record of destroying RIAs."

Whatever ultimately occurs, counting on thousands on independent financial advisers to do the right thing by their clients before the advisers themselves choose to retire sounds very much like wishful thinking.