

PERSPECTIVE:

It's not what you think.



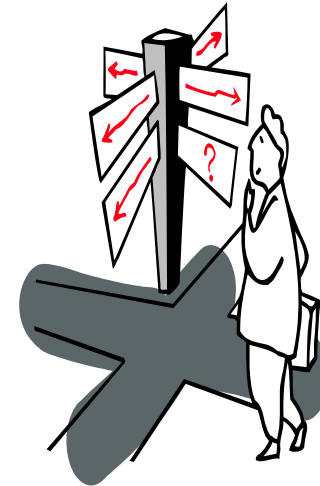
voice

**Operating as an Independent Broker/Dealer CEO:
Three Tough IBD CEO-Level Issues
(Changes We Can See Coming)**

**Chip Roame, Managing Principal
Tiburon Strategic Advisors**

Outline

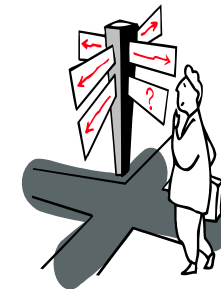
- Three Tough IBD CEO-Level Issues
 - Margin Compression
 - Business Growth
 - Regulatory Environment & Business Model Challenges
- Tiburon Summary Views



Thanks for the Time...

IBD CEO Interviews

- Phil Blancato (Ladenburg & Thalman)
- Tony Batman (1st Global)
- Dale Brown (Financial Services Institute)
- Valerie Brown (Cetera Financial Group)
- Ron Carson (Carson Wealth Management Group)
- Steve Dowden (Invest)
- Ken Ehinger (M Holdings Securities)
- Pat Farrell (Investacorp)
- Matt Lynch (Capital Analysts)
- Joel Marks (First Allied)
- Sanjiv Mirchandani (National Financial Services)
- Jim Nagenast (Securities America)



Source: Tiburon Research & Analysis



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The Overall Mood was One of a Challenging Environment...

Independent Broker/Dealer CEO
Summary Comment



“I worry about the sustainability of the IBD model. It is a perfect storm. Our margins are under attack. Business growth is stagnate. And our basic premises are being challenged”

Source: Tiburon Research & Analysis



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...Overall Challenging Environment

Independent Broker/Dealer CEO
Summary Comment



“For 1% to 2% margins, I might as well run a Safeway store which has far lower risk”

Source: Tiburon Research & Analysis



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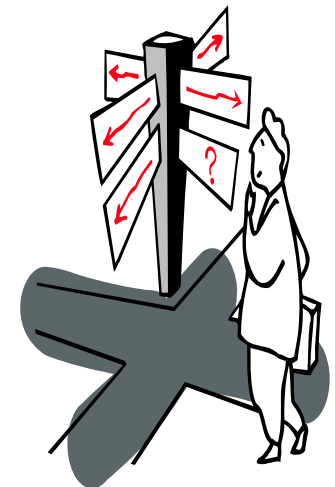
Three Tough IBD CEO-Level issues

Three Tough IBD CEO-Level Issues

- ❑ Margin Compression
 - Revenue Challenges (Revenue Sharing Gone or Down; Asset Levels & Transactions Lower; Hybrid Models)
 - Costs Escalating (Regulatory & Compliance; Product Complexity; Technology; Customization; Upfront Money)

- ❑ Business Growth
 - Rep Recruiting (Less Movement; Wirehouse Reps Increasingly Tied Up; Declining Number of Captive Advisors)
 - Rep Business Building (Sales & Marketing; Rep Recruiting)
 - IBD Acquisitions (Valuations; Unknown Liabilities)

- ❑ Regulatory Environment & Business Model Challenges
 - Fiduciary Standard
 - RIA Only Trend
 - Independent Contractor Status



Source: Tiburon Research & Analysis

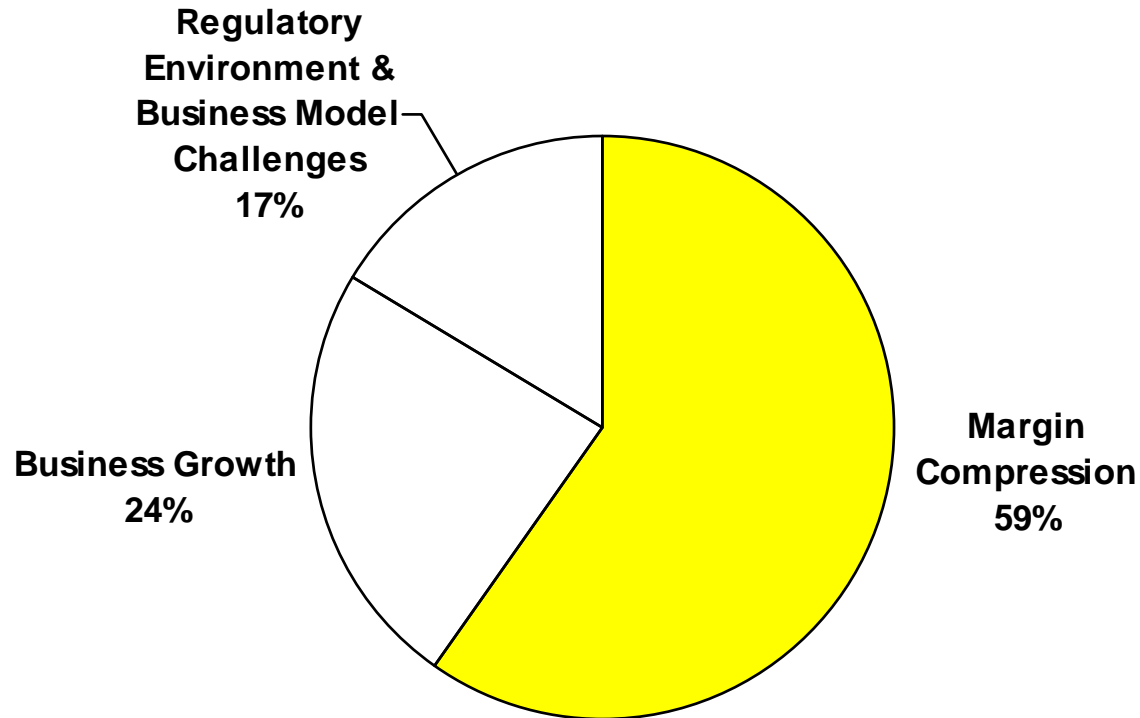


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Almost Three-Quarters of All IBD CEO Comments Related to Margin Compression, with Two Other CEO-Level Issues Accounting for the Remainder

IBD CEO Comments
By CEO-Level Issue



Source: Tiburon Research & Analysis

Outline

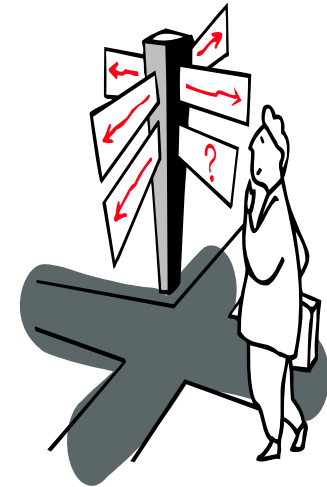
- Three Tough IBD CEO-Level Issues

- **Margin Compression**

- **Business Growth**

- **Regulatory Environment & Business Model Challenges**

- Tiburon Summary Views



#1: Almost All Independent Broker/Dealer CEOs are Worried About Margin Compression...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Everything squeezes my margins – 1) we have to change our technology & hire more compliance people to manage new regulations; 2) reps are seeking up-front money; 3) the hybrid model is a disaster; 4) etc.”

Source: Tiburon Research & Analysis



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Margin Compression Starts with Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Where are we going to get additional revenues?”

Source: Tiburon Research & Analysis



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Margin Compression Starts with Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“The low interest rate environment is killing us”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Revenue deals are down. Money market funds have waived their fees so revenue sharing is gone”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“FDIC insured bank sweep money is not worth much. We used to have long-term contracts for good rates but that is gone; banks are no longer paying for deposits”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Money market funds are not paying 12b1s and this is murdering the IBDs which typically have 10% of their assets in cash at any given time”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“We have \$1.5 billion in money market funds so at 75 basis points, we lost about \$9 million in revenues”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Revenue sharing is down. Old forms of revenues that did not go through the grid, like from mutual fund companies & REITs, are down”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“We need to deepen our partnerships with our business partners, share revenues more widely, and participate further in the value chain”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“My business mix is worse because consumers are not investing for the long-term”

Source: Tiburon Research & Analysis



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... Revenue Challenges...

Independent Broker/Dealer CEO
Comment on Margin Compression



“The hybrid model is not good for independent broker/dealers because all we get is their left over securities business. They want 97%-100% payout on their fee-accounts business and maybe we can charge a compliance oversight fee”

Source: Tiburon Research & Analysis



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... Revenue Challenges

Independent Broker/Dealer CEO
Comment on Margin Compression



“The hybrid model is definitely revenue negative”

Source: Tiburon Research & Analysis



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Plus Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Our regulatory compliance costs are going up dramatically. We just have to deal with it appropriately without breaking the bank”

Source: Tiburon Research & Analysis



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...Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“The costs of complying is going up. We see the SEC, FINRA, & various states. It is multiple regulators all doing the same thing. It is a waste of time and money”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“The costs basis requirements can be cumbersome”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Our SIPC coverage cost is up ten fold”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Managing risk is my first goal. We need to stay in business. The two key risks are product risk and selling away or rogue broker risk”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Product risk includes products exploding. It can also include systematically selling good products but selling them incorrectly and this is increasingly possible with annuities, structured products, & alternative investments”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Product due diligence is greater in the post-Madoff world. We have to have much deeper research. We can not rely on outside firms. We have to invest more. The claim that everyone did it is not going to fly”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“As consumers are searching for yield, we need to do the right due diligence and education on higher yield products. This is a risk management issue”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“The technology of the big firms
becomes the bar for the small firms”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“There are small IBDs with revenues of \$10 million. How will they ever keep up in technology?”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“Keeping up with the technology platforms of Schwab and TD Ameritrade is tough”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“We have to build a better platform to prevent the hybrid trend”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“We have increasing client and financial advisor expectations. You can not compete if you are going to say no to everything”

Source: Tiburon Research & Analysis



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... Escalating Costs...

Independent Broker/Dealer CEO
Comment on Margin Compression



“It used to be that only \$1.0 million +
reps could get up-front money but now
everyone has their hand out”

Source: Tiburon Research & Analysis



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... Escalating Costs

Independent Broker/Dealer CEO
Comment on Margin Compression



“Some of the front money deals make no sense. The wirehouses are paying 100%-200%, sometimes 300%, to stem the tide. The math does not work”

Source: Tiburon Research & Analysis



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#2: Almost All Independent Broker/Dealer CEOs are Focused on Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“There are only three ways to grow business – 1) recruit reps; 2) help reps grow their own businesses; & 3) make acquisitions. We are working on all three. Recruitment is the most predictable per effort”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“2007-2009 were banner recruiting years, even well into 2009 as many reps had made their commitments to move in 2008 and then both AIG and ING were in a state of flux”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“Recruiting came to a halt for smaller B/Ds in 2010. Now is not the time to approach one’s clients about moving”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“Financial advisors seem settled now. They are risk adverse and moving is risky. How do we shake them loose?”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“The wirehouses have locked up many more financial advisors”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“No firm is growing the farm team. Merrill Lynch and Northwestern Mutual are not increasing their numbers of reps. And now Texas Tech graduates want to jump straight to the RIA model”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“All the firms are the same. None have real brand images. The wirehouses differentiate themselves on investment banking products”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“The average age of brokers is getting older. FSI says the average is 53/54 so they are selling their businesses. But there is no younger generation and margins are too thin to start training programs”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“Same store sales is key. Everyone has practice management tools but do they really work. Are they getting a return on investment?”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“We have to help our reps with succession planning or they are going to take the 300% wirehouse deal to cash out”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“We are all chasing scale. It used to be \$50 to \$200 million. Now its \$500 million to \$1.0 billion”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“The buyers include LPL Financial, AIG, Cetera Financial Group, Advanced Equities, Ladenburg Thalman, & Lovell Minnick”

Source: *Tiburon Research & Analysis*



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“IBDs at \$50 million or below are making no profits and have no capital to reinvest”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“There are thousands IBDs that are capital constrained”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“Many smaller IBDs are calling, saying that they have 100 reps and \$20 million revenues but want to go back to being sales guys and no longer fight the fight. They want us to buy them and they become a super OSJ”

Source: Tiburon Research & Analysis



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... Business Growth...

Independent Broker/Dealer CEO
Comment on Business Growth



“The issue with acquisitions is that nobody wants to sell for what their firms are really worth”

Source: Tiburon Research & Analysis



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... Business Growth

Independent Broker/Dealer CEO
Comment on Business Growth



“The problem with IBD acquisitions is that you get a lot of unknown liabilities. The tail coverage on E&O is not real clear. We might just let them go out of business and pick off their best reps”

Source: Tiburon Research & Analysis

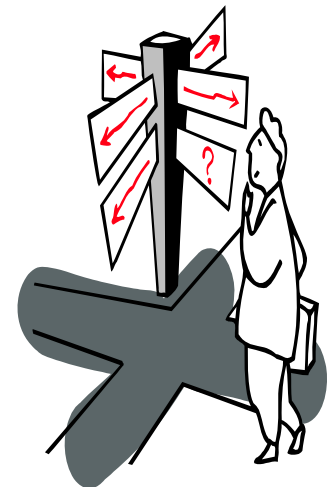


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#3: Some Independent Broker/Dealer CEOs Recognize that the IBD Business Model Faces Several Challenges...

Independent Broker/Dealer CEO Comment on Regulatory Environment & Business Model Challenges



“Nearly everything is in play – the fiduciary issue, 12b1s, the independent contractor status, etc.”

Source: Tiburon Research & Analysis



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...Regulatory Environment & Business Model Challenges...

Independent Broker/Dealer CEO
Comment on Regulatory Environment
& Business Model Challenges



“We may all soon be under a fiduciary standard”

Source: Tiburon Research & Analysis



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...Regulatory Environment & Business Model Challenges...

Independent Broker/Dealer CEO Comment on Regulatory Environment & Business Model Challenges



“There are plenty of articles about going fee-only. The big wirehouse teams are moving to RIA-only models. They are willing to give up their licenses. It looks like the broker/dealer model is losing”

Source: Tiburon Research & Analysis



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...Regulatory Environment & Business Model Challenges

Independent Broker/Dealer CEO Comment on Regulatory Environment & Business Model Challenges



“Many things are easier under the RIA model. There are no audits, no need to review sales literature, etc. IBDs are responsible for all of their reps’ business activities, while custodians are not. IBDs must build up war chests in case of lawsuits; custodians are less vulnerable”

Source: Tiburon Research & Analysis



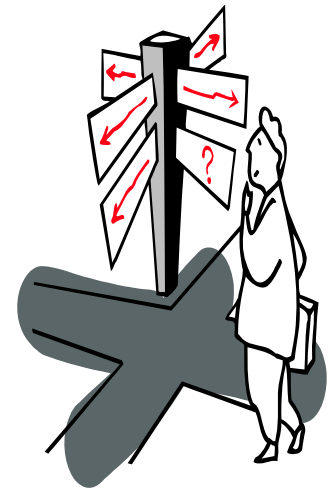
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One IBD CEO Made a Key Point...

Independent Broker/Dealer CEO
Comment on Strategy



“In the mid-2000s, even OK IBDs could succeed. But now you need to be really good”

Source: Tiburon Research & Analysis



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... Another IBD CEO Stated the Obvious...

Independent Broker/Dealer CEO
Comment on Strategy



“IBDs need to find other revenue sources – asset management, prospectus products, fixed insurance, & even fees for compliance”

Source: Tiburon Research & Analysis



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...Many IBD CEOs are Considering Broad Options...

Independent Broker/Dealer CEO
Comment on Strategy



“If the change does not happen quickly enough, we may need to morph into a different business model”

Source: Tiburon Research & Analysis



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...And Yet Another IBD CEO Offered a Key Suggestion

Independent Broker/Dealer CEO
Comment on Strategy



“We need more science regarding our decisions”

Source: *Tiburon Research & Analysis*



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Margin Compression – Likely Developments & Business Advice

Margin Compression

Likely Developments

- Margin compression likely to relax
 - Rates must go up & revenue sharing will return (at some point)
 - Regulatory, compliance, & technology costs will level out in medium term

Business Advice

- Quantify the low margin issues (-4% to +6%)
 - Benchmark (firm level)
 - Segment financial advisor client base
- Pray for money market fund rates to go up quickly
- Seek additional revenue sources
 - Preferred product provider revenue shares (consider moderately closing architecture)
 - Proprietary products (manager of managers, banking spread income, and/or underwriting)
- Find ways to lower costs (best practices profiles as follow up to benchmarking)
- Tread carefully in upfront money wars

Source: Tiburon Research & Analysis



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Business Growth – Likely Developments & Business Advice

Business Growth

Likely Developments

Rep Recruiting

- Recruiting to stagnate over the medium term
 - Wirehouses locking up financial advisors
 - Traditional training grounds stagnating

Acquisitions

- Consolidation likely (scale & niche players survive; middle is challenged)
- Improving valuations lead to increased number of transactions

Business Advice

Rep Recruiting

- Define a differentiator and promote it
- Consider potential rep training programs

Rep Business Building

- Assist with marketing (not sales)
- Develop rep tuck in program

Acquisitions

- Consider scale acquisitions

Source: Tiburon Research & Analysis



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Regulatory Environment & Business Model Challenges – Likely Developments & Business Advice

Regulatory Environment & Business Model Challenges

Likely Developments

- Regulatory results in...
 - Likely fiduciary for most (carve outs coming?)
 - Likely SEC to regulate RIAs (with additional fees) (choice #1 in report)
- Fee-accounts trend accelerates
- Fee-only financial advisor trend accelerates
- 1099 contractor issue headed off due to republican congress

Business Advice

- Remember the independence trend is still your friend
- Support FSI (IBDs' advocate)
- Adapt and innovate
 - Consider financial advisors challenges (e.g., marketing, technology, compliance) and focus value added
 - Understand producer groups model (e.g., M Financial Group)
 - Consider value of role as compliance and/or business development firm

Source: Tiburon Research & Analysis



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And Finally... Several IBD CEOs are Celebrating the LPL Financial IPO

Independent Broker/Dealer CEO
Comment on Strategy



“The LPL IPO was good for the independent broker/dealer business. Its legitimizes the model”

Source: Tiburon Research & Analysis



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