

RIA ... To Be or Not to Be

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About the Author: David D. Holland is an independent financial planner in Ormond Beach, Florida. In addition to his professional credentials, he is a licensed insurance agent and owns a Registered Investment Adviser firm. In 2006, David wrote \$18 million in fixed annuities and another \$12 million in RIA accounts. He achieved this success by working exclusively with retirees and by developing a comprehensive marketing and planning system to meet their needs. In 2007, David teamed up with industry veteran, Mike Mastowski, to establish Retiree Adviser Marketing Corporation (RAM) to give independent annuity agents the tools they need to take their businesses to the next level. For more information about RAM's annuity marketing tools (including RAM's proprietary seminar selling system and client acquisition system) or to arrange an individual practice development consultation with David Holland, agents are invited to call **888-422-7007** or visit **www.retireeadviser.com**.

Introduction

Today many independent financial professionals face the question of whether or not they should become a Registered Investment Adviser (RIA). The question has been forced by the issuance of NASD Notice to Members 05-50, increased broker-dealer supervision, heightened regulatory scrutiny of fixed index annuity sales practices, changes in insurance company distribution, poor reporting by the ill-informed media, and the swelling senior/retiree marketplace. In this environment, independent agents should be taking a very hard look at whether their current business structure can adapt to these changes and whether or not their practices are positioned to thrive over the coming years. The RIA question will directly impact the success of independent agents for the next ten years.

The Players and Their Motivation

Before we address the question of whether or not an independent agent should become an RIA, it is very important to understand the "Players" that are involved:

NASD – The National Association of Securities Dealers weighed in heavily on the issue of broker-dealer supervision of fixed index annuities with its Notice to Members 05-50. The Notice has been both praised and condemned because the Notice gave broker-dealers the authority to supervise the sale of fixed index annuities by their representatives. The truth is that broker-dealers already had the authority to supervise the sale of fixed index annuities by *their* representatives. Before 05-50, NASD rules were already in place that gave broker-dealers the authority to supervise anything and everything financial that their representatives did. Even without 05-50, a broker-dealer *could* supervise and take a *haircut* on the sale of life insurance, disability insurance, long-term care, fixed annuities, index annuities, and immediate annuities, if they so choose. 05-50 did not change the ability of a broker-dealer to supervise fixed products; it did, however, make it very clear to the broker-dealers that they are responsible for what many of them had treated as outside business activities. 05-50 provided the solid regulatory authority that many broker-dealers wanted to assert their control over fixed annuity sales. With 05-50 in hand, many broker-dealers have informed their representatives that their fixed index annuity sales must go through the broker-dealer, be supervised,

and of course, be subject to the broker-dealer's grid, payout, or some form of haircut. In some cases, broker-dealers have forbidden their registered representatives from recommending fixed index annuities altogether.

Broker-Dealers – Before 05-50, many broker-dealers allowed their representatives to sell non-variable product as “outside business activities” just as long as the representative notified and received prior approval from the broker-dealer. Prior to 2000 and the explosive growth of fixed index annuities, many broker-dealers didn't care what the representative did with fixed products as long as a representative did a minimum amount of broker-dealer business. Of course, that indifference changed to profound interest when representatives started recommending fixed index annuities in greater quantities. Setting aside their obvious interest in getting their piece of fixed index annuity commissions, broker-dealers do have the responsibility and the right to supervise the sale of fixed index annuities. The truth is that broker-dealers are responsible and should supervise the recommendations that their representatives make, whether that recommendation is an immediate annuity, fixed index annuity, load mutual fund, stock, bond, REIT, or variable annuity. Used incorrectly, or in the wrong situation, the sale of an immediate annuity or a fixed index annuity can do as much damage to a client's finances as variable annuity or stock. Therefore, a broker-dealer should be supervising their representatives to ensure that all sales, whether variable or non-variable, are appropriate for their clients' situation. If a financial adviser does not want their broker-dealer supervising these activities, nor taking a piece of the revenue for that supervision, then a financial adviser or agent should be looking at other ways of doing business.

State Regulators – With swelling retiree populations in many parts of the country, individual state regulators have little choice but to fulfill their mandate to protect the consumer. State regulators are doing their jobs in seeking out and punishing insurance agents who behave badly. Frankly, the financial industry needs to be cleansed of bad advisers, brokers, and agents. The *bad apples* need to go. Most agents and advisers have seen what the wrong product can do to a client's financial situation. Heightened focus on retirees and seniors is very appropriate because most retirees don't have the time to go back into the workforce to “re-create” what has been lost due to bad advice from reckless and indifferent advisers. An increased effort has been made in many states to ensure that agents are providing advice properly. If an agent tells clients to liquidate securities, he or she had better be registered as an investment adviser. Regulators are cracking down, as they should, on agents who provide unregistered investment advice. The consumer should be protected from agents who tell them to liquidate and put all of their life savings into a two-tier fixed index annuity. To help protect the consumer, states must ensure that investment advice is provided by registered investment advisers.

Insurance Companies – Insurance companies manufacture the products and financial advisers distribute them. Some insurance companies (aka “direct writers”) market their fixed index annuities directly to agents. Some still use the career agency system. The majority of insurance companies, however, sell their fixed index annuity product line through three primary distribution channels: banks, broker-dealers, and independent marketing organizations. Regardless of which distribution channels an insurance company utilizes, the focus remains the same: *premium*. Of course, the better insurance companies also focus on ensuring that the products recommended by their agents are appropriate for the clients' situations. With that said, insurance companies are not overly concerned about how agents access their products, as long as they do access them. For the most part, insurance companies are indifferent to whether an agent is a broker-dealer representative, insurance agent only, or a registered investment adviser. So, again, each agent must decide which business

structure and which annuity distribution channel will best serve his or her individual needs and those of his or her clients. The right choice of business structure and distribution channel will enable the agent to efficiently recommend the best fixed index annuities when they are appropriate.

Marketing Organizations – They go by several names that pretty much mean the same thing: Independent Marketing Organization (IMO), National Marketing Organization (NMO), or Field Marketing Organization (FMO). Many insurance companies enter into agreements with marketing companies that, for an override paid to them by the insurance company, will market the insurance companies' products to insurance agents. Marketing organizations come in many shapes and sizes. Some are very big and aim to serve the masses, while some are boutiques catering to the needs of select agents. Some are truly independent and have contracts with a wide array of insurance companies. Some appear to be independent on the surface, but in actuality, have one or two key carriers that they push on their agents. And still others are not independent at all, and are owned outright by an insurance company, so they promote that one company to their agents, even if that company's products are dreadful and/or the company's financial ratings are poor. With many marketing organizations to choose from, independent agents have the luxury, and owe it to themselves, to select the one marketing organization that offers the best array of insurance company choices and products, knowledgeable support staff, innovative client acquisitions systems, seminar selling systems, agent training, and agent production incentives. Also, given the question of whether to become an RIA or not, independent agents would be well served to evaluate potential marketing company relationships based on whether the company can help the agent become an RIA, or offer RIA services.

Seniors and Retirees – They are what this is all about. Do you know what they want and need? Seniors and retirees have needs that are very different than their younger, not-as-far-along counterparts. Seniors and retirees need:

1. To be advised, not sold. To be guided, not pushed.
2. To trust their adviser/agent and to know that their needs are placed above the agent's wants.
3. To know that their adviser/agent understands what their wants and needs are.
4. To be presented with a written plan that is both easy to understand and complete.
5. To receive customized retirement planning recommendations with the proper mix of safety/protection of principal (e.g., a fixed index annuity), growth (e.g., fee-based portfolio of no-load mutual funds), income (e.g., fee-based portfolio of income producing securities), and liquidity (i.e., adequate emergency funds like a CD or money market at the bank) for their individual situations.

Simply stated, the decision to be or not to be an RIA can be reduced down to whether or not being an RIA improves each agent's ability to serve the needs of their clients.

Why be an RIA

Being an RIA does not mean giving up being an insurance agent. To the contrary, the two services are entirely compatible, and actually, are very complementary. Most importantly, being an RIA enables an insurance agent to superbly deliver the five things (outlined above) that seniors and retirees need:

1. As an RIA, an agent can advise. No selling is required. Recommendations are made, and if they are accepted, the client hires the agent to be their adviser. The adviser is then paid an ongoing fee for providing *advice*. To provide this service, the agent must be an investment adviser representative of a Registered Investment Adviser firm. Registration can be done as an individual, but few advisers choose this route due to personal liability concerns. So the question, which will be addressed later, is *how to become registered*.
2. As an RIA, an agent can build tremendous credibility and trust with clients, because the clients recognize the agent's role as an adviser, not simply a salesperson.
3. As part of developing investment recommendations for a client, an RIA interviews and documents the client's needs and wants. When the plan is presented, the RIA reviews those needs and wants with the client, to ensure communication has been clear.
4. As an RIA, an adviser can prepare written financial plans that include recommendations for liquidation of securities, recommendations for the purchase of fixed index annuities and/or other annuities, recommendations for the purchase of bonds, CDs, preferred stocks, income funds, growth funds, and even individuals stocks. An agent who chooses to become an RIA is insulated from accusations of providing "unregistered investment advice." That does not mean the agent/RIA can make reckless, totally self-serving recommendations and then escape repercussions by hiding behind the shield of being an RIA. RIA or not, unethical behavior or irresponsible actions can and should be punished.
5. As an RIA, an agent is free to build a customized plan for each client's unique situation. The plan can include recommendations for a variety of investment and savings vehicles. Part of the plan can be the recommendation of the best fixed index annuity for the client, while another part of the plan can be recommending a portfolio of no-load growth mutual funds and income securities (which the RIA will manage for the client for a percentage of their account). These recommendations can be highly customized to fit each individual client's situation.

What RIAs Can Do

An RIA can provide the following services to clients which an insurance agent alone cannot:

1. Provide recommendations about whether to buy, sell, or keep specific investments.
2. Provide a written financial plan to a client for a fee (by the hour or a flat fee).
3. Manage client assets for a fee (usually a percentage of the value of the account) and recommend individual securities, mutual funds, bonds, preferred stock, and CDs for that portfolio.

How to Become an RIA

Once an agent has decided to become an RIA, the next step is to decide the best platform for accessing RIA services. What this means, is determining the best way to become an investment adviser representative (IAR) of an RIA. The question is now, an IAR of which RIA?

Do-It-Yourself RIA

Although not a viable option for most agents, any agent can setup a separate corporation and then register that corporation with their state's division of securities or with the Securities and Exchange Commission (SEC). Prior to registering, the agent must complete the series 65, 66, and/or possibly

another exam, depending on the requirements in the agent's state. To register, the agent then must submit the appropriate application and disclosures to his or her state and prepare the RIA firm's ADV disclosure brochure. This is a lengthy document the RIA applicant must prepare to describe what services the RIA firm provides, how it provides information about its staff, how it charges fees, and how it manages clients' assets. Most financial professionals who choose to set up their own RIA corporation are wise to retain an RIA consultant to help with the regulatory application process. There are also ongoing state and SEC requirements such as filing annual reports, updating documents maintained by the regulatory body, and, of course, paying fees. A separate errors and omissions (E&O) policy is necessary to cover RIA services, since insurance agent E&O policies usually exclude coverage for these services.

Separate, and in addition to getting setup and maintaining the RIA firm with the regulatory bodies, the RIA firm must build the capacity to provide the services it offers.

1. **Managing Client Assets:** To manage client assets, an RIA must select a custodian to hold client funds, build client portfolios, select funds, monitor client accounts, provide investment performance reporting to clients, execute trades as necessary, deduct quarterly fees from client accounts, organize and retain client documents and correspondence, and develop and test disaster recovery plans.
2. **Building Financial Plans:** To build customized financial and retirement plans, an RIA must first have the *know-how* to do two specific things: how to build an integrated retirement plan with the proper mix of investments and savings vehicles, and how to present it to their client. The two are not the same. Part 1, building an integrated plan, requires financial planning expertise and experience with retirement income planning. For the safe part of the plan, the RIA must be well-versed in principal-protected strategies and, ironically, must be licensed to recommend and sell such products. For the rest of the plan, the RIA must know which investment to recommend in what quantities or percentages. Then the RIA must know how to guide the client on drawing income from these various components of their retirement plan to achieve the desired result. Part 2, presenting the plan, requires skill in presentation software like PowerPoint[®], Excel[®], and Morningstar[®]. And it requires the time and patience to put the plan together.

Agents should not be discouraged from embarking on the *Do-It-Yourself* route if they are prepared financially and mentally for the work required for this approach.

IAR of Broker-Dealer's RIA

For those agents who are already registered representatives of a broker-dealer, a viable approach may be to become an investment adviser representative of their broker-dealer's RIA firm. This may be the same firm or a "sister" firm owned by the same company as the broker-dealer. Either way, an agent can get up to speed rather quickly offering RIA services to their clients if they go this route. The RIA and/or broker-dealer should have already done the work to set up the RIA and have the capabilities to manage client assets. The obvious limitation of this approach is that if an agent isn't already affiliated with a broker-dealer, then it may not make sense to become affiliated with a broker-dealer just to get access to an RIA. Signing-up with an independent RIA may be a much better choice if the agent isn't already affiliated with a broker-dealer. Also, many registered representatives have either left their broker-dealers already or are considering such a move to escape broker-dealer supervision of their fixed index annuity business. Since fixed index annuities

are not securities, any insurance agent that is not affiliated with a broker-dealer isn't subject to *haircuts*, and broker-dealer supervision, just because they recommend such a product. It is the broker-dealer registered representative who is subject to supervision and *haircuts*, not because the fixed index annuity is a security, but because the broker-dealer has the supervisory responsibility for whatever financial products the registered representative recommends. It is the association with a broker-dealer that drives supervision, not the product itself. So, unless an agent is already affiliated with a broker-dealer and wants to stay there, many agents would be wise to consider affiliation with an independent RIA firm.

IAR of Independent RIA

Agents who have never been associated with a broker-dealer or who have terminated their broker-dealer relationship may be well-served by becoming an IAR of an independent RIA. This choice for the agent is in lieu of setting up a corporation and registering it as an RIA firm. Becoming an IAR of an independent RIA firm means just that. The agent becomes a representative of the RIA for the purposes of providing investment advice for a fee and preparing retirement and financial plans. With this approach, the agent who wants to add RIA services is taking advantage of what the independent RIA has already created: selection of the investment custodian, know-how on building investment portfolios, all the administrative details, the know-how to build customized retirement plans and how to present them. The independent RIA firm also guides the agent on their registration, provides E&O for the RIA services, and takes care of billing clients and paying the IAR-agent. The trade-off, naturally, is that the RIA will keep part of the fees generated by the IAR-agent. The RIA firm may also make financial planning support available for a fee so the IAR-agent can choose to use this service when a formal, written retirement plan is needed to present to a client.

Why Not be an RIA?

There are few reasons not to be an RIA. Regulators are going to rightfully seek out and punish agents who provide unregistered investment advice and who make bad recommendations to clients. In increasing numbers, broker-dealers are going to rightfully rein in outside business activities of their registered representatives. Today's retirees and, of course, the upcoming wave of Baby Boomers are going to expect their financial adviser to guide them on their complete financial picture. Agents would be well-served to position themselves to continue to provide fixed index and other non-variable annuities, but they should also take deliberate steps to provide investment advice and to build integrated retirement plans to meet their clients' overall retirement planning needs.

For more information about Retiree Adviser Marketing Corporation,
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