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The Fourth Option

Synopsis: ***This is the story of an advisory firm that wanted scale, wanted to offload back office chores, and wanted total independence on the planning side.***

Takeaways: ***The structure that makes the most sense for a client service firm is a partnership. But few larger entities are offering that option.***

Roughly three years ago, Jennifer Cray, a fee-only planner whose office is located in Menlo Park, CA, faced a situation that other advisors might relate to. "One day, I told my business partner [Julie Schatz], That I was hitting a wall," she says. "I was exhausted and just burnt out. I said, honestly, if somebody told me that I didn't have to go to work tomorrow, I would have been relieved."

The problem wasn't a client overload or working nights and weekends. It wasn't that she was tired of the daily stress of taking on client challenges and keeping up with new tax laws. "My particular pain point was around being our chief compliance officer," says Cray. "The compliance work has just grown and grown, and on the horizon I could see cybersecurity becoming as big as SEC compliance in and of itself. Even with our great compliance consultant, I just hit the wall.

"But," Cray adds, "I didn't want to retire. Julie and I have a great relationship, a great business model where we share responsibility. We're located in Silicon Valley, we love the Bay Area, and business has always been good. We have all the benefits that you have when you're solo, where you work as much as you want to. And we have been very very security-conscious," she adds. "We talk to clients about it every meeting. But when I look out on the horizon and think: I don't like doing compliance now; what is it going to be with this new level of due diligence around vendors?"

There's a long pause in the conversation, and then Cray says: "I just want to focus on my work with clients."

By now, most advisors are familiar with the usual solutions: sell the firm to a larger entity that will take over the compliance and other non-client-facing responsibilities. Or merge with a peer firm that happens to have a staff principal who enjoys compliance.

As it turns out, both options were open. "We have a lot of friends in the business, people we know and love, who are fellow NAPFA members," says Cray. "But we ruled that out pretty quickly, because that wouldn't solve the problem of all the responsibility. Instead of me wearing ten hats, maybe I would only wear seven. And," Cray adds, "I have enough friends who went through mergers to know that, just logistically, merging everything is really really hard."

Being acquired was equally unpalatable, for different reasons. "We talked with several firms," says Cray. "And it was clear that every one of them involved a buyout, where we would get paid for our clients, and we would become W-2 employees. But we are cats who cannot be herded," she adds. "We would be terrible W-2 employees. We want to do things the way we want to do things; all we want is help."

The search for a solution turned up a third option: pay a larger firm to take on the firm's back office tasks, including compliance. Cray and Schatz entered into discussions with two larger entities, and eventually decided that this wasn't what they wanted either. "They charge a percentage of revenue; how much depends on the range of services you want them to provide," Cray explains. "They tuck you under their RIA, and you can keep your own branding. But they wanted to charge us more than we felt comfortable with."

She and Schatz also worried about what might happen if a PE-backed acquirer or a Wall Street firm were to buy their outsource provider while they were tucked in. "We want to keep control of, and responsibility for, everything client-related, everything that touches the client," Cray concludes. "We're very much a comprehensive planning-focused firm, and we want to own that. There are a lot of firms that would tell us how to do that, and we don't want anything to do with somebody else telling us how to do planning."

The frustrating part of this, to Cray, is that many advisory firms are looking for a solution that doesn't even have a name. "There's no established terminology for what we needed," she says. "'Platform' is the closest thing, but that term is used for everything in our industry. We talked with consultants, but never found one who serves successful financial planning-focused RIAs who want to hand off responsibility while keeping control of their practices."

Partnership option

This dilemma might sound familiar to advisors who are receiving weekly offers from PE-backed acquirers while spending more and more dollars and hours on compliance and non-client-facing tasks. If so, they might be surprised to know that Cray and Schatz experienced a happy ending to their story.

Before merging with Forum, Cray was in the last stages of burnout. She was wondering why there weren't solutions for people like her.

Instead of being purchased, they became partners at Forum Financial Management, whose headquarters is based in Lombard, IL, with offices in 36 locations across 12 U.S. states.

What's the difference between that and being acquired by a PE-backed firm? "We are 100% advisor-owned," says Forum co-managing partner Jonathan Rogers. "We think that's important, because when you have a PE shop, you have a fiduciary duty to your investors, and a fiduciary duty to your clients. That's a conflict. Ultimately," he adds, "we believe that the highest form of organization in our heavily services-centered business is a partnership. If you think of the client relationship as equity, then a partnership model makes a lot more sense than a big corporation owning the equity, with staff that runs the relationships."

How does it work? Advisors become equity partners in Forum based on their total revenue; that is, their revenue as a percentage of the revenue of the firm—and this fluctuates each year. But in fact, they control their own client service activities and business decisions while functioning as a Forum office.

"No money changed hands," Cray explains. "It is an equity swap, where we become partners in the partnership, and owners in direct proportion to our revenue. As the partnership grows, because they're adding partners," she continues, "the pie grows bigger and our piece of the pie grows smaller. But the value of what we own is still our clients. I can choose who I want to transition my clients to when I retire, and do an internal succession just like I could before. We can set our prices. We can run the Menlo office and manage client relationships just as we did before, and we pay our own expenses just as we did before. It's the same as it was with Julie; really no different."

And all those vexing back office functions? "They have a chief compliance officer, who is wonderful," says Cray. "They've built their own back office software, with a workflow engine. We've always used DFA portfolios, and their model portfolios are DFA, they do the trading and their back office and operations people handle all that in-between stuff. Having experts who are responsible for those things makes all the difference in the world."

Back office at cost

What does all this back office support cost the individual offices? "The partner offices plug in and leverage all of our centralized operations, our technology, portfolio management, reporting, billing, compliance, cybersecurity and marketing," says Brian Shapiro, the firm's Advisor Development Officer. "We take a percentage of their revenue, which floats depending on our internal costs, but that is not a profit center for us. We provide those services at cost."

Currently, the cost is 19% of top-line revenue, but that is expected to drop to 17%, where it has been in years past. Beyond that, Shapiro explains, each office runs its own P&L. "With the other 83%, they can hire as many folks as they want, take their profits or reinvest," he says. "They can control their office space, and if they want some technology outside of what we provide, they can go get that with the net."

"We have a zero profit margin target on the services we provide," adds Rogers. "We do make some profit on the advisors who come into the firm as 1099 employees, and also with the TAMP that we've created, and that profit is distributed based on each office's ownership percentage."

Chris Lamia, who merged his Thousand Oaks, CA office into Forum, confirms that he's now paying 17% of his top-line revenue to have the back office chores taken off of his plate. But he sounds like Cray in his before-and-after description of the merger.

"It made me go from being profitable and miserable to a little less profitable and happy," he says.

Lamia has been fee-only since 2008, and says that he was somewhat traumatized about the transition by the propaganda about fee-only compliance that was trumpeted out by his former broker-dealer. "We were all indoctrinated with: *The SEC is coming; you had better stay with your broker-dealer*," he says. "So I hired Stark & Stark, figuring that if I'm going to face the SEC, I am going to put the biggest battleship in the harbor. I wasn't skimping on compliance."

Fast-forward to last year, and the firm had grown from $75 million in AUM to just over $500 million, with four staff advisors and a back office staff to manage. "Suddenly all the back office work and compliance and trade blotter reconciliation and everything was taking up 30% of my time," says Lamia. "I hate that stuff; it's like kryptonite to me. I'm a client person. I want to be in front of clients, helping people. I know those other things are important and even essential, but I don't enjoy doing them."

Forum executives believe the best organizational structure for a high-touch service firm is a partnership.

A second challenge was succession. "I had two other shareholders, but I owned 84% of the equity," says Lamia. "And I was looking at that and saying to myself: *How are my partners going to afford to buy me out? And how are we going to make it fair for everyone?*"

Like Cray, Lamia explored his options. "I reached out to some firms, and the conversation very quickly turned into: they all wanted to acquire me," he says. "I was in my early 50s. I wasn't ready to be put out to pasture. They wanted me to sell my client base, and I wouldn't have any control over how they would service my clients."

The alternative was to

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become an employee of the firm. "But that option means that I would be operating under their control, which is something I don't think any independent advisor is looking for," says Lamia. He adds that the conversations would go off the rails early. "I was meeting with one of the firms, telling them that I want to start taking Fridays off," he says, "And they said, *well, you'd have to check on that with your regional manager.* My response was: *I've been doing this for decades, and now you're telling me I have to check in with someone? As long as my number are good, and my clients are happy, why would you want to control my time?*"

When he told an acquiring firm that his goal was to take Fridays off, Lamia was informed that he would have to clear it through his manager.

In the end, being acquired wasn't palatable. "What I really wanted was to continue to have local control and sovereignty," says Lamia. "I love what I do. I just didn't love doing some of the activities that you have to do in a planning practice."

After merging with Forum, Lamia dispensed with the things that were making him miserable while holding onto his independence and client relationships. "We run everything locally here," he says. "I do my own hiring. Our staff are W-2 employees of Forum, they get Forum's benefits, and I have discretion over compensation and who I hire and how I design the internal career tracks."

Lamia has been creating an internal sale where his senior advisors buy their clients and revenues proportionately, and he plans to transition them to Forum partners as they grow their part of his business. "We have two associate financial advisors and two full-time client service associates, who have their CFPs," he says. "I continue to be the face of the branch, but any benefits I derive as a partner in terms of lower overhead expenses I pass on to them as partners in my office."

Merger mechanics

The mechanics of becoming partners in a larger firm are not trivial, but Cray says that the process was far less daunting than she would have encountered had she and Schatz tried to consolidate operations with another local firm. "Our portfolios are very similar to Forum's," says Cray. "DFA is very much a part of their DNA, and they are very disciplined." She adds that the clients who have exceptional portfolios with individual preferences have all been accommodated.

Forum has its own tech stack that its advisors use, including a customized CRM and Tamarac. "And we have an internal Monte Carlo that we built that works pretty well for about 60% of the population," says Rogers. "But if an office wants to use MoneyGuidePro or eMoney for the planning, they're going to do that with our blessings. Cray says that her office is still using the CRM built into AdvisorEngine, and Holistiplan for tax planning—and paying for them out of her branch office revenues.

In addition, she convinced Forum to change the process for getting clients onto the client portal. "We wanted it to be easy for our clients to use two-factor identification with an app, because it's more secure than text messaging," she says.

This was an area where having a seat at the table proved to be important; as a partner, Cray was able to make recommendations to the firm as a whole. "They did those things for us and they did them quickly," she says.

There was, initially, some back-and-forth about fees, since Cray and Schatz charge project fees and additional fees for complex clients who need a great deal of up-front planning work before their investments can be managed. Rogers explains that the challenge was that Forum's ADV needs to be normalized for every office of an RIA firm. SEC examiners will question why clients of one office are being charged differently from clients of another one.

"They came up with a solution for accommodating modest planning fees via a minimum fee structure," says Cray. "Their compliance team worked with us to come up with a solution. We're hoping they'll find a solution for later planning fees."

Seat at the Table

Forum's model doesn't require that the new partners grow their revenues and client base. But having more free time does free up capacity for the individual offices to grow their client base.

"For the past two years, I haven't been taking new clients," says Lamia. "When people come in, I do refer to the others. Last year, I transitioned 25 clients internally to the other advisors. But I have to tell you," he adds, "before the merger, I would literally cringe whenever I got a referral, because I didn't have the right infrastructure in place. If you're a drowning man, the last thing you need is more water."

Cray adds that she's been getting referrals from the Forum website, but she is free to decide who to take on and who to refer out—to a Forum office or somebody she thinks would be more appropriate. If an advisor refers clients to another Forum office, there's a residual payment for the referral.

The partnership approach with a shared, centralized back office would seem to check a lot of the boxes that advisors have been looking for—an alternative to the outright sale and loss of control. "There were firms that wanted to write me a big check," says Lamia. "But for me, the key was the sovereignty aspect. I'm not big on people telling me that I have to do this or that. I should be able to hire who I want to hire, create what positions I want to create, serve my clients the way I want to serve them, and those are my expenses, and the back office is paid for appropriately. Here at Forum,' he adds, "I'm not an employee; I'm a partner."

"You don't get a seat at the table unless you're an owner," adds Cray. "If you're an owner, nobody can tell you how many clients you have to have or how you service them. I think there's this gap in the RIA consulting industrial complex that would help people like me not sell ourselves and cash out or outsource this piece or that. People should know that you don't have to sell your firm," she adds, "and take the risk of joining one of these rollups where everybody ends up unhappy."■

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