

At a glance:
Legal and regulatory
considerations for
becoming an RIA

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Tools

As an independent Registered Investment Advisor (RIA), you're in charge of the decisions that drive success. You control everything from the speed of your business's growth to how you serve the complex needs of clients. However, with this freedom come additional responsibilities. Choices you make during your transition will impact your business far into the future. Weighing the legal and regulatory considerations associated with the RIA business model now can help you set up your business for long-term prosperity.

The following is an excerpt from *Legal and Regulatory Considerations: Navigating the Transition to Independence as an RIA*, a white paper.

Evaluate your needs, goals, and objectives

Devote sufficient time and thought to building a strategic plan that charts your vision and puts a timeline in place.

- **Determine your level of independence.** The RIA model offers advisors more options than ever: You can start your own firm, join an existing RIA firm as a partner, or find your place somewhere in between. It all depends on your personal and professional goals. With the hybrid model, you can offer advisory services as an RIA while keeping your commission-based business.
- **Assess your client base.** Pay attention to the products and services your clients require and desire—this can help you define your niche. Gaining clarity around the types of clients that will best fit your business model will help you determine the appropriate mix of services for your firm.
- **Consult legal counsel.** This may be the most important move you make. By discussing your options with trusted legal and financial experts, you can potentially save a significant amount of time and money throughout the transition process.

Assess your employment situation and form an exit strategy

For many advisors, restrictions in the employment agreement with their current firms and the compensation tied to employment may dictate when and how they make the transition. By formulating an exit strategy, you can make the transition more smoothly and avoid or limit the chance of having a drawn-out legal battle with your former employer.

- **Review your employment agreements.** Have your legal counsel review all agreements, including promissory notes or other forgivable loan arrangements, training agreements, non-solicitation and non-compete provisions, and confidentiality restrictions.
- **Determine whether the Protocol for Broker Recruiting is available to you.** Following the protocol can protect your new firm from monetary or other liabilities for soliciting current clients.
- **Set your timing expectations.** While it may only take a month or two to get a firm registered as an RIA, typically advisors take about six months to fully complete the transition. Depending on the complexity of your business model, however, this timetable can be expanded or compressed down to weeks or even days.
- **Keep your plans confidential.** One common way that departure plans are discovered by management is through gossip. Even well-meaning friends, family members, and business associates can inadvertently disclose your plans to leave. Maintaining strict confidentiality can help avoid unnecessary conflict during the transition or premature discovery.

Choose your entity structure

You will need to form a company if you don't already have one. If you already have an existing company, evaluate whether it is the best vehicle for your new independent RIA.

While there are several entity types to choose from, your attorney will likely recommend either a corporation or a limited liability company (LLC). Both entities limit personal liability and allow for proper succession planning.

- **Compare S corporations with LLCs.** Consult your tax advisor to determine the advantages of each structure for your company.
- **Decide where to form your RIA.** This is most often a choice between forming your RIA in the state in which you'll be physically located, or in Delaware or other states with similar favorable statutory and case laws. The advice of your attorney can assist you in an analysis to determine the right location for forming your new entity.
- **Choose a name.** This is a critical part of developing your brand image. From a legal perspective, you will need to ensure that the name you choose is available in the state where you are forming your entity, but you should also consider taking the additional step of running a trademark search to ensure you can use the name you have chosen.
- **Formalize a written agreement with partners.** If you are not going to be the sole owner of your RIA, write a business agreement with each partner.

Protect your business from the unexpected

Obtain insurance to protect your firm against common business risks. While there is no legal requirement to maintain most types of insurance, it is important to protect your company against the financial impact of a claim in today's litigious environment.

- **Evaluate your insurance options.** The types of insurance you might consider include general business, errors and omissions (E&O), life, disability, and buyout.

Determine licensing and registration

Where your firm is based and its assets under management (AUM) are the two most significant factors in determining how to register your investment advisory business.

- **Learn the SEC and state registration requirements.** There are a number of qualifications for determining whether you must register with the SEC or a state authority—the most common of which is your firm's AUM.

- Registration is a complicated issue, so consult with your legal advisor to determine the appropriate registration authority or authorities for your firm. But typically a firm must register with the SEC if it manages \$100 million or more in assets and register with one or more states if it manages less than \$100 million in assets.
- **Register individuals as necessary.** Determine the individuals who need to register with individual states. A firm's federal or state registration determines which individuals need to register as Investment Advisory Representatives and where they need to register. Each state will also have qualification requirements to register as an Investment Advisory Representative. The most common qualification is passing the Series 65 examination. Other examinations and/or designations may also be acceptable.

Prepare and file disclosure documents and forms

To register as an investment advisor, you need to prepare and file certain documents. While filling out the forms is relatively easy, take care to provide proper responses to limit regulatory and civil liability.

- **Complete Parts 1 and 2 of Form ADV.** These are filed electronically through the Investment Adviser Registration Depository (IARD).
- **Register individuals.** Investment Advisory Representatives typically file Form U4 through the IARD/CRD system.
- **Complete additional state filings.** State-registered advisors may have to file additional documents, including a balance sheet, surety bond, client agreements, and marketing materials such as letterhead and business cards.
- **Draft client agreements.** Client agreements should be drafted based on your firm's specific and unique business practices, as described in your disclosure brochure. Although you are not technically required to have an advisory agreement, providing services without one is highly inadvisable.

Learn more

To get a copy of the full *Legal and Regulatory Considerations* white paper or learn more about the RIA model, call a Schwab representative at **877-687-4085** or visit advisorservices.schwab.com/fastforward.

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