Broker-dealers will need scale or specialization: Cerulli

By Editorial Staff *Thu, Apr 26, 2018*

'As advisors have adopted passive strategies, ETF structures, and institutional share classes, revenue-sharing to B/Ds has decreased,' a Cerulli analyst writes.

Margin pressures continue to rise for broker/dealers (B/Ds) and firms will need either scale or niche specialization in order to compete successfully, according to a new report from Cerulli Associates, the Boston-based global consulting firm.

“Margins are getting squeezed across every channel,” said Kenton Shirk, director of Cerulli’s intermediary practice, in a release. “B/Ds are challenged by explicit costs related to technology, operations, and compliance, as well as implicit costs causing a reduction in return on assets (ROA).”

ROA is declining for several reasons. “As advisors have adopted passive strategies, ETF structures, and institutional share classes, revenue-sharing to B/Ds has decreased,” the release said. The migration to the [Registered Investment Advisor] model, which has caused the greatest impact for independent B/Ds (IBDs), is another factor.

“Mega teams” have shown a preference for autonomy and economics of the RIA channel, Cerulli said. They either affiliate with a B/D’s RIA platform or move altogether to affiliate directly with an RIA custodian. The loss of these assets, or the shift of assets into less profitable platforms, puts downward pressure on ROA.

In responding to margin pressure, B/Ds have used their access to advisors to renegotiate revenue-sharing agreements with asset managers and promote strategic marketing partnerships and data packages, according to Cerulli.

But the added pressure is causing asset managers to reevaluate strategic partnerships. Nearly 90% of national sales managers say they are evaluating partner firm relationships on the basis of return on investment more than they did five years ago.

“Small B/Ds are ill-equipped to shoulder losses to their already thin profit margins, and consolidation will accelerate,” says Shirk. “The impact of these challenges has been masked by market growth. Still, some boutique B/Ds are joining larger IBDs and becoming large Offices of Supervisory Jurisdiction. The move allows them to lean on the IBD’s scale and infrastructure, but still maintain a reasonable degree of autonomy.”

Wirehouses have also adjusted strategies in response to margin. “While the wirehouses are well positioned with a highly productive advisor-force that boosts profitability, the high cost of recruiting packages has weighed on margins. In the past two years, the wirehouses pulled back recruiting budgets to protect margins, trimming bonuses that skyrocketed in recent years.”

Cerulli’s report, U.S. Broker/Dealer Marketplace 2017: Segments of Strength, provides market sizing and competitive analysis of B/D channels, including wirehouses, national and regional B/Ds, IBDs, insurance B/Ds, and retail bank B/Ds. This report extensively covers recruiting and transition trends, including advisor movement sizing, advisor channel preferences, advisor retention, and transition metrics.