Threats to broker-dealer model: It’s more than DOL

By Editorial Staff *Thu, Oct 5, 2017*

Even if the DOL conflict of interest rule is ultimately diluted, it has reinforced [the] shift to fee-based advice from commission-based sales, according to Bing Waldert, managing director of research at Cerulli Associates.

The broker/dealer (B/D) model faces several threats from current industry trends, according to the latest research from Cerulli Associates, a global research and consulting firm.

“The shift from commissions to fee-based pricing is one of the most important trends in the wealth management industry,” said Bing Waldert, managing director of U.S. research at Cerulli, in a release. “Even if the DOL conflict of interest rule is ultimately diluted, it has reinforced [this] shift.

“The B/D model faces competitive threats in addition to those imposed by regulation. Chief among these is the growth of the independent RIA (registered investment advisor) model. Advisors are increasingly choosing to strike out on their own, doing business under their own RIA.

“Since the financial crisis, there has been growing consumer awareness of the conflicts of interest inherent in the wealth management industry, creating another competitive threat for B/Ds.

“When Cerulli examines market share shifts, the focus has always been the shift of advisors away from employee-based B/Ds to more independent models. However, some portion of the RIA channel’s growth can be attributed to investors choosing to do business with an independent advisor with fiduciary positioning.

“In order to enhance their credibility with advisors, B/Ds must reconsider their value proposition as an advisor service organization. It is important for B/Ds to help advisors further their career goals, because if advisor recruiting slows, organic growth becomes more important.”

These findings and more are from the October 2017 issue of The Cerulli Edge – U.S. Edition, which explores various metrics that firms use to gauge their success, including data-driven technology, formalized goals, and re-evaluating the role of B/Ds.

In other research published this month, Cerulli found that outsourcing model portfolios is most common among independent broker/dealer (IBD) advisors at 43%.

“The Department of Labor’s Conflict of Interest Rule has raised standards for investment due diligence and documentation; consequently, advisors making their own investment decisions increases potential liability for broker/dealers (B/Ds),” said Kenton Shirk, director of Cerulli’s U.S. Intermediary practice, in a release.

“In response to this growing concern of liability, B/Ds seek to refocus advisors on home-office discretionary programs.” To influence an advisor’s investment decisions, B/Ds and asset managers need to understand drivers behind model portfolio use and outsourcing from the advisor’s perspective.

Cerulli compared the portfolio construction process for advisors affiliated with wirehouses, IBDs, and independent registered investment advisors (RIAs). The advisors were segmented across three portfolio construction process categories: Custom portfolios, practice models and outsourced models.

“Use of model portfolios is prevalent across all three channels with at least 74% of advisors using either practice models or outsourced models,” said Shirk. “Outsourcing model portfolios to a home office or third-party provider is most prevalent among IBD advisors (43%), while RIAs were found to be the least likely to outsource (12%).”

“Outsourcing is most common among IBD advisors, likely due to the advisors’ role as both a financial advisor and a business owner, accompanied by their propensity to be financial-planning-oriented,” said Shirk. “These attributes create time constraints, making it essential for IBD advisors to turn to outsourcing.”

Despite steady advisor productivity levels, IBD advisors who outsource tend to have lower levels of assets under management (AUM) per total practice headcount compared to those who build custom portfolios or practice models.

“This suggests that IBD advisors who outsource tend to struggle more to build operational scale even though they outsource a core function with the intent of increasing capacity,” Shirk explained. “In turn, this implies that they may outsource to sustain a higher volume of lower-balance clients.”