Private Equity Money Altering the Wealth Management Ecosystem

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The influence of private equity investments on the financial advice industry is creating a full-blown "ecosystem" that will impact even smaller-sized registered investment advisers, according to the latest research from Fidelity Clearing & Custody Solutions.

While much attention is paid to big PE investments, such as the October sale of a $100 million stake in HighTower Advisors, the research looks at the trickledown effect of the more than $3 trillion invested annually in the wealth management industry.

"Private equity capital is flowing toward the upper end of the industry, but it applies to smaller firms as well," said Scott Slater, author of the report and vice president of practice management and consulting at Fidelity's custodian business.

The report found that as larger firms, represented by RIA consolidators and strategic acquirers, take on PE money they fuel the growth of an ecosystem that feels the ripples all the way down to $100 million RIAs.

Mr. Slater identified three main themes of the PE influence on wealth management, including the development of higher-quality consolidator platforms, more larger RIAs, and a trend toward well-developed decentralized institutions, represented by several smaller RIAs.

"Large strategic acquirers with private-equity backers are in position to create M&A infrastructures that enable that strategic acquirer to support smaller partner firms that can also make acquisitions," Mr. Slater said. "The partner firm in turn is executing the deals to build a better business by buying smaller firms and integrating them into the larger business."

This pattern represents a distinct difference from the pre-2008 iterations of consolidators, which were more about rolling up assets and creating scale, Mr. Slater said.

"The old way wasn't as much about incorporating the leaders of those firms being acquired," he said. "Now, the acquirers are much more attentive to the management, because this is often a talent play."

The report breaks down the best practices of partnering with a PE firm as follows: Proactively seek alignment of interest, tap outside expertise to expand options, deliver strong results in return for capital infusion, and mature through accountability and guidance.

According to Fidelity's research, strategic aggregators were responsible for more than two-thirds of M&A activity in the first quarter of 2018, which is up from less than half during the same quarter last year.

One recent example of the indirect impact of PE investors was the announced initial public stock offering by Financial Focus Partners, which is at least 70% owned by PE investors and will represent the first pure-play RIA rollup to go public.

Daniel Seivert, chief executive of **ECHELON Partners**, recognizes the development of the ecosystem being created by PE money, but believes we are still a few years from the money truly impacting smaller firms.

"I don't think the full impact has shown up yet," he said. "PE-backed firms create more competition and that makes it tougher for all the incumbents that don't have the same financial resources. But when the full impact shows up, smaller firms will have to compete with three or four other firms armed with advanced marketing materials, better websites, and who are better at competing for employees."

One of the reasons he believes the full impact hasn't arrived yet is that "there are way too many customers that still need financial help and way too few financial advisers."

"So far, the private-equity money has just been [used] to buy out existing owners and help them make transactions, but they will eventually start to invest that money in better marketing, talent and business models," Mr. Seivert added. "It will take quite a while for all this to play out."