THE DOL FIDUCIARY RULE: DEAL CATALYST OR DEAL KILLER?

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As the wealth management industry slowly comes to terms with the pending implementation of the Department of Labor's best-interest rule, the industry conversation is now turning to the impact the rule will have on M&A activity.

According to **Echelon Partners'** research and analysis, approximately $3.1 trillion of client assets representing $18.5 billion in revenue will be impacted at national and regional independent and full-service brokerage firms, bank broker-dealers, insurance broker-dealers and dually registered firms. The prohibited transaction revenue from these segments is estimated to be approximately 10% to 14% of current revenues, or roughly $2 billion to $2.5 billion.

While discount brokerages, robo-advisers and independent RIAs likely will benefit from this rule, the older, incumbent brokerage firms will be hurt in five ways:

- Elimination of revenues from disallowed products
- Movement to lower-revenue products within the universe of allowed products
- Increased expenses to educate staff, modify processes and upgrade technology
- Increased costs for insurance and supervision
- Higher penalties for non-compliance

Given the already thin margins in the broker-dealer industry, these changes can potentially become a matter of life or death for these firms, spurring on the question of whether or not M&A activity will spike or decline. Will there be consolidation, or will these impacted businesses appear undesirable, resulting in a dearth of buyers?

Those thinking that deal making will cool as a result of the DOL rule point to the fact that there are very real risks involved in acquiring broker-dealer businesses, given their declining economics and valuations in a post-DOL world. Further, incumbent firms will tend to soldier on rather than want to sell at the bottom, as they are in it for the long run. They will focus on migrating to new business models over time and attempting to manage their way out of their predicament.

On the other hand, there could be a significant opportunity for savvy buyers to pick up these firms on the cheap, with lots of upside. Many of the risks inherent to acquiring these firms can be managed through smart deal structuring. Additionally, by engineering an impacted firm's business model away from commissions and toward fees, a very large increase in valuation can be achieved in a relatively short period of time. Thus, there could be a swarm of large, resource-rich companies looking to gain scale and grow. These resource-rich firms could be supported by a plethora of service firms offering products, technology and other systems readily available to deploy to manage compliance risks, further encouraging legacy firms to become sellers to enhance their competitive positioning.

In the meantime, market signals are indicating that there is dramatic change coming, one way or the other. Various recent adviser surveys show that anywhere from 10% to 25% of advisers are planning on exiting the business over the next few years in response to the DOL rule, which heightens the question of whether they will shut down or sell. On the other hand, there have been some very high-profile deals, such as the recent acquisition of AIG's Advisor Group unit by Lightyear Capital, in which the buyers specifically cited the DOL rule as the reason driving the acquisition.

As a result, the impact of the DOL rule remains uncertain just six short months prior to the deadline to comply.