Coming RIA custody fees and a new recruiting war catch the attention of deal hounds in Manhattan

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The RIA business will likely face two Department of Labor rule-related expenses that will have them applying crowbars to their tightly folded wallets, according to speakers at the **ECHELON Partners** Deals & Deal Makers Summit, hosted this week in New York by its founder, **Dan Seivert**.

For the first time in history, RIAs may find themselves writing checks to custodians as the DOL shifts more oversight burden onto those custodians and revenue sharing and other reservoirs of fees dry up.

"DOL will cause a fundamental change in how business is operating," said Mark Tibergien, CEO of Pershing Advisor Solutions, to the RIAs gathered at the tony New York Athletic Club overlooking Central Park. "RIAs have been getting a free ride for a long time now and that may come to an end."

The comment was elicited in the course of a debate with Dan Seivert where each took a side in a moot court atmosphere.

In a follow-up email exchange with Tibergien, the head of the fourth-largest RIA custodian, based in Jersey City, N.J., said that his comments are intended more as a heads-up than a signal that his BNY Mellon-owned firm has new fees in the pipeline.

"At this point, we are looking at all the permutations of the business and how it might change the economics," he writes. "We will not likely be the market leader in this price change, but each of us needs to think about the markets we serve and the way in which we charge to ensure we can support advisors at the level they demand going forward."

Pay or get paid?

While discount brokerages, robo-advisors and independent RIAs will likely benefit from the DOL rule, the older, incumbent brokerage firms will be hurt in five ways, according to Seivert: Elimination of revenues from disallowed products; movement to lower-revenue products; increased expenses to educate staff; modified processes and upgraded technology along with increased costs for insurance; and supervision and higher penalties for non-compliance.

Given the already thin margins in the broker-dealer industry, these changes, in aggregate, could potentially become a matter of life or death for these firms, heating up the question of whether or not M&A activity will spike or decline in the wake of the rule's implementation – will there be consolidation, or will these impacted businesses appear undesirable and thus will result in a dearth of buyers?

Tibergien added a cautionary note in his email about how the DOL bill may come due hardest on RIA firms that invest primarily using index funds.

"Because our model is organized around larger firms that serve clients, we are experiencing less pressure on our business economics. But RIAs need to understand how everybody in the food chain makes money and be prepared for a shift, especially if they are smaller firms using passive solutions."

Get a move-on

The other exogenous shock underscored at the event was the way that DOL may prompt wirehouses to begin a new round of monetary warfare.

Bill Willis of Willis Consulting, Jeff Bischoff of Old Greenwich Consultants revealed the components of wirehouse recruiting packages and how difficult it is for RIAs to compete with them. "The wirehouses are writing insane checks these days," Willis said.

The other key trend driving advisor movement is the pending DOL implementation. "If you are going after these wirehouse advisors, then you need to also create urgency," Willis said. "Right now we are telling everyone they should move before the DOL deadline because once that goes into effect, who knows what that environment will be for recruiting packages."

Seivert mused as to possible new meanings for the acronym DOL post-rule -- "Dead Ones Left" or "Deals of Love?'" -- as he teased out the probable winners and losers as the rule begins to affect industry revenues, assets.

Unquestionably, he said, the stakes are high. "There are approximately $3.1 trillion of client assets representing $18.5 billion in revenue that will be impacted at broker dealer firms. The prohibited transaction revenue from these segments is estimated to be approximately 10% to 14% of current revenues or roughly $2 to $2.5 billion," says Seivert.

The very good news for the M&A-minded RIA crowd was that, according to the live audience poll, two-thirds of RIA executives believe that deal making will increase as savvy buyers pick up these failing B-Ds on the cheap. Additionally, both Seivert and Tibergien agree that the most impacted firms will be the wirehouses, but due to their size and scale, they will be able to weather the storm.

Independence on the march

Speaking of wirehouses, the crack debate team of Seivert and Tibergien took on the fate of the breakaway movement. Tibergien likes to frame the issue as not so much going independent but rather as choosing a different business model.

"Not all broker-dealer advisors are coin operated. When you want to have a different relationship with your clients, then there is a better way and we are seeing that growth continue across all channels, including broker-dealers. In the last few years, advisory assets at Pershing are up from 5% when I started, to over 53% today."

Over 90% of the RIA executive audience live polled at the conference agreed that the movement to independence would continue to accelerate.

Other topics canvassed included impact of the current business cycle, aging advisors and the significance of scale.

"We now have 1,400 fewer broker dealers and 40,000 fewer advisors when compared to 2007," Tibergien noted. "Additionally, there will be an increase in millionaires, creating an over supply of clients and an under supply of advisors."

These factors all point to a consolidation in the industry spurred by exiting and retiring advisors, which will in turn goose deal making as firms use an acquisition strategy to get to size and scale in order to dramatically increase capacity.

Dangerous when desperate

Another effect of the advisor shortage is increased recruiting as an extension of firms' M&A activities. Accordingly, the DDM Summit featured a popular panel discussion featuring recruiters and consultants specializing in lifting out breakaways, including Matt Sonnen of PFI Advisors, Bill Willis of Willis Consulting, Jeff Bischoff of Old Greenwich Consultants, and Mark Albers of Albers & Associates Consulting.

The panel session revealed methods recruiters and consultants use to entice would-be breakaways to join existing RIAs. "There are three reasons wirehouse advisors leave – money, love and money," Willis said with a smile. "You have to speak to their emotions as well as offer a lot of money in a compensation package similar to what they can get if they simply join the wirehouse down the street."

But these days, the wirehouse down the street is willing to pay big money to keep its best men and women in-house.

"The wirehouses are writing insane checks these days," Willis said. "For $750,000-plus producers, the deals are very attractive. They start at 150% of trailing 12-months production up front in the form of a 10-year forgivable loan. Additionally, if there is a successful early asset transfer (80% of assets come over within six months) 50% more is paid, along with 5% to 20% to 25% bonuses over time-based on performance. All in, these deals can reach more than 300% of their current production."

Pounce!

To combat these lofty pay packages, firms must paint a bigger picture for advisors. "We are now seeing the wirehouse advisors slowly lose the brainwashing they have received to recognize that there are more and more billion-dollar plus RIAs that have significant enterprise value," said Sonnen.

Sonnen should know: he led one of the largest breakaways in the industry with Luminous Capital a few years ago.

"Back then, a billion-dollar RIA was a unicorn, but now there are over 500 of them," Sonnen said. "The trend we are seeing now is more of a 'pull' approach as wirehouse advisors are starting to see the many benefits of independent RIAs and they are starting to understand, despite the brainwashing, that they will make more money over the long-term via creating enterprise value as compared to a short-term view via a cash bonus."

The other key trend driving advisor movement is -- you guessed it -- the pending implementation of the DOL rule. "If you are going after these wirehouse advisors, then you need to also create urgency," Willis said. "Right now we are telling everyone they should move before the DOL deadline as once that goes into effect, who knows what that environment will be for recruiting packages."

RIAs behind the eight-ball

The good news for RIAs interested in inorganic growth is the availability of many more options, resources, tools and advice to participate in what looks like a very opportunistic time in the industry.

Other well received workshops at the DDM Summit were on financing options for acquisitions, technology disruption and its impact on M&A in the advisor technology space, and one on negotiating tactics.

The Summit included multiple networking opportunities via receptions, dinners and lunches. Taking advantage of the historic New York Athletic Club's ambience and killer views, conference organizers hosted "deal-making dinners" sponsored by Vanguard, Pershing, Vestorly and Discovery Database. Attendees dined in fine style, then finished the night off in the club's famous pool room for competitive eight-ball.

The event also was intentionally built as more of a CEO Summit than an RIA seminar, Seivert said in a post-conference chat.

"This years' roster of attendees was noticeably more institutional," he says. "While past years consisted mostly of RIAs, this year we expanded the content to attract a broader set of participants and executives, including more investment management firms, services providers, and wealthTECH companies that are sending their CEOs, CFOs, heads of strategy and heads of practice management to obtain high powered training on deal making that can be put to use right away for not only with the advisors they work with but the firms themselves."

To learn more about what went on at the Deals and Deal Makers Summit, check out the many tweets on Twitter at #DDMSummit2016.