INDEPENDENCE FUELS IBD GROWTH BUT DOESN'T HURT WIREHOUSE MARGINS

12/3/2018 Originally Published by Tobias Salinger, Financial Planning

Independent broker-dealers are growing their assets faster than other BDs — but the nearly 27,000 advisors changing firms and the much higher profit margins at the wirehouses present a quandary for the sector.

The stream of advisors going independent makes Cerulli Associates "relatively optimistic about the future" of the IBD space, according to a November report by the research firm. IBD assets have expanded by nearly double the five-year compound annual growth rate of the wirehouses.

Five-year CAGR at IBDs amounts to 11%, compared to 6% at wirehouses and 9% for banks and employee brokerages. IBDs also surpassed wirehouses in 10-year CAGR, at 6% to 3%. IBDs having lower initial assets than wirehouses explains at least part of the disparity, though, points out recruiter Mark Elzweig.

The full picture shows other areas of concern for IBDs. The number of firms has dropped by 28% in the past decade to 847, while higher compliance and technology costs and lower revenue-sharing slashed their margins by 8 percentage points to 3%, consulting firm **ECHELON Partners** reported earlier this year.

Furthermore, the IBDs' industry-leading headcount of 86,779 advisors — or second-highest when limiting the channel to 59,361 representatives on firms' corporate RIA — looks different in light of the breakaways. Cerulli says 8.6% of the industry's more than 310,000 advisors will change firms this year.

IBDs "face great challenges in being able to attract and retain talent," Elzweig says. "Many of those practices are just going to locate themselves somewhere in the RIA world. Even advisors who go independent aren't necessarily going to independent broker-dealers anymore."

Cerulli predicts that IBDs, hybrid RIAs and indie RIAs will add a combined total of about 1,600 advisors this year, while the number at employee branches will go down. About two-thirds of brokers who want to go independent said they would choose indie RIAs, with the remainder opting for IBDs.

Large teams pose retention risks for IBDs "if they don't feel that their home office is necessarily providing the resources and support to justify the cost," says Ed Louis, a senior analyst with Cerulli. "IBDs are investing heavily in resources to improve the advisor experience."

For example, he notes the rising adoption and bulking up of hybrid RIA offerings at the largest IBDs. However, Louis acknowledges that hybrid RIAs are "definitely a work in progress for a number of firms" in terms of profitability, due to the loss of some of the RIA assets to outside custodians.

Wirehouses can also tap into different business lines other than IBDs, since they're much larger firms. Morgan Stanley, Merrill Lynch and Wells Fargo each took in margins of more than 25% last year, versus only 9% at LPL Financial, according to Cerulli.

LPL, Raymond James Financial Services, Ameriprise and 21 major IBDs referred to by the researchers as "institutional IBDs" are driving much of the sector's growth. So-called niche IBDs, such as tax-focused firms like H.D. Vest Financial Services and Cetera Financial Specialists, are also contributing to it.

Institutional firms have 49% of the sector's advisors and 59% of its assets. The 14 niche firms' advisors manage about $50 million in client assets in a sector with a $40-million average. Overall, the IBD channel's assets add up to $3.5 trillion when including the hybrid RIA assets held on their platforms.

Smaller IBDs will have a hard time surviving on their own in an era of consolidation and fee pressures, though, according to Elzweig. M&A activity will reach record levels for the sixth straight year in 2018 across wealth management at more than 180 deals, according to **ECHELON**'s third-quarter report.

Smaller firms "have to be better managed, and they really need to have more substantial producers," Elzweig says. "Part of what we're seeing with firms that have been sold is that the margins are really not there. It's basically a squeeze."