Why Exactly Lovell Minnick Sold First Allied Ahead of Plan

Originally Published By Brooke Southall, RIABiz

Brooke's Note: If you're wondering what's going on with private equity in the financial advisor world, this deal tells much more than you see at first glance. It also tells you something about how much a product company, aware of a "paradigm shift," is willing to pay to get hold of a purveyor of independent advice.

It would be going too far to call RCAP Holdings LLC's purchase of First Allied Holdings Inc. a hostile takeover, but it might be considered the private-equity version of one. See: The 19 ways private equity has juiced up the RIA business and how it's working out.

The realty-oriented owner of a New York-based holding company for a wholesale broker-dealer and two other subsidiaries — only two days past raising nearly $50 million in a (scaled back) IPO — dropped such a large pile of cash onto Lovell Minnick Partners LLC that it coughed up First Allied.

The price paid for First Allied was not disclosed but Nicholas S. Schorsch, chairman and chief executive of RCAP Holdings, told InvestmentNews that the firm is making an initial investment of $200 million in the purchase and upgrade of First Allied.

Blurrier and blurrier

To many, that sounded like harmonization, a term that has come to stand for the thin and fast-fading line between the suitability standard of broker-dealers and the fiduciary standard of RIAs. See: The suitability standard, defined.

In response, an advisor in the audience drew an analogy between commission-based advisors and a car dealership.

"If it's a Ford dealership you expect them to push Ford," he said. "But if the dealer advertises himself as a consumer advocate and just removes the [Ford] signage, that's something else. It's not a matter of harmonization but education — and broker-dealers have blurred the line."

Frank replied: "But what if they don't want to educate investors? That's why we need the rules. If you work for company, you must recommend their best products. As to blurring the line — education and regulation are required so that people do the right thing. If the line is blurred, you have to step in." See: How 5 seriously overworked buzzwords can come between you and your client.

Another attendee, weighed in.

"Wall Street has done a good job blurring what an advisor is. [The fiduciary standard means] first, last and always, in clients' best interest. If we're creating a new definition, how will public understand the difference?"

Kautt cited a study that found that nearly three-quarters of consumers were unclear about the difference between the suitability and fiduciary standards. Of all the outcomes, he said, "harmonization" is the worst — a sentiment with which Schweiss emphatically agreed from the stage.

Frank stuck to his guns: "We can't confuse people who are already confused. Don't blame us for confusion. Law won't lead to confusion because there is confusion. There can be two different standards, and you can explain it case by case."

Inherent conflict

At the morning session, there was some sentiment on the part of advisors that Frank didn't fully understand — or was affecting not to fully understand — the nuances of the RIA fiduciary position in the SRO battle. See: Brian Hamburger answers the questions about an SRO future that has RIA stomachs in turmoil.

"His attitude differs from what's written in the bill," said Ron Butt, senior partner of ARGI Financial Group LLC in Louisville, Ky. "Harmonization suggests that you're trying to come up with [a compromise] between the two [standards]. Frank says there are many different standards. Congress should act to make it more clear that at the end of the day, there is an inherent conflict [between the two]."

Chatting with a reporter before lunch, Schweiss was diplomatic in assessing the depth of Frank's understanding of the RIA model. He noted that the controversy takes up just two subsections of the Dodd-Frank bill — 1% of a 1,000-page piece of legislation.

"Congressman Frank acknowledged there are different business models. He seemed to understand the difference between do-it-yourselfers versus getting professional advice and the need for differing levels of protection [on that level]," Schweiss said.

But he also expressed consternation with the amorphous point at which this years-long debate seems stuck. "The uniform standard could not be a win for advisors — who now have the edge — and could confuse consumers," he says. "And Frank says they are already confused. Are we are going down a path that will further confuse them?"

Unmet burden

To be sure, Frank had his defenders. Patrick Horan, president of Horan Capital Management LLC, an RIA in Hunt Valley, Md., was the first to raise his hand after Frank completed his address and praise the former congressman, Federal Reserve Board Chairman Ben S. Bernanke and former Treasury Secretary Hank Paulson for skillfully guiding the country through the economic meltdown of 2008. "I wanted to say thank you," Horan said after the session. See: Four questions that financial advisors and clients need to ask in a post-Madoff, post-meltdown era.

But Kautt emphatically expressed his displeasure.

"Barney Frank is a consummate political negotiator and a smart guy [but] it is crystal clear to me that Mr. Frank doesn't understand how to protect the consumer as it has to do with the RIA industry — or he chooses not to. ... He didn't clearly show that he understands what's best for the industry. He had no data or statistics to show that any increase in regulation beyond the [Investment Advisers Act of 1940] will enhance the safety of consumers. If we had been in a jury trial, he did not present enough evidence to convict anyone, yet he would move us to a higher [level] of regulation.

Frank deserves to be cut some slack, according to Brian Hamburger, chief executive of MarketCounsel LLC

"There are so many issues that he has to contend with I wouldn't expect him to be an expert on RIA regulation or, more specifically, the nuances of harmonizing the industry with its broker-dealer counterparts. But he understands the forces at play here and has been a strong consumer advocate."

FINRA speakers wanted

That's a topic that will be taken up today at TD's first Fiduciary Leadership Summit, an event Schweiss hopes will bring opposing voices together for a "civil and constructive debate." He's finding that to be a difficult task: A planned regulatory debate on yesterday's schedule went begging for ideological ballast.

"We hoped we could get an SEC commissioner to attend. Some told us 'policy does not allow us' and others told us they had scheduling conflicts."

Bob Colby, chief legal officer of FINRA, was slotted to appear at today's summit but was stricken with pneumonia and had to bow out. See: New York conference: SIFMA wants members to be like RIAs — minus the same rules of accountability.

"As we speak we're scrambling [for a replacement] Schweiss said. "We want to make sure FINRA's voice is heard."

Schorsch did not respond to a phone call placed to his company. But the New York-based exec, who also runs real estate investment trust sponsor American Realty Capital Properties Inc., made it clear from his comments in a press release issued for the deal that getting into the financial advisory business is something that he's willing to pay up for — to avoid being caught on the wrong side of a paradigm shift.

Just getting started

"Frankly, it was a situation where a buyer found us. The company wasn't for sale … We were really just getting started."

Indeed, Lovell Minnick acquired First Allied less than two years ago. Belke says that his firm contemplated rolling up more IBDs in the way it bought The Legend Group, now part of First Allied.

"It's an outlier," says **Daniel Seivert**, CEO of **ECHELON Partners LP**, a Manhattan Beach, Calif.-based investment bank. "The rule of thumb is five to seven years."

A little distressed

It is fairly clear why Lovell Minnick was willing to sell way ahead of its usual gestation schedule — a very tempting buy-low, sell-high opportunity, according to Seivert. He adds that he has no direct knowledge of Lovell's dealings.

He says that Lovell Minnick "poached" First Allied from Advanced Equities Inc., a Chicago-based company that was under a cloud from an SEC investigation at the time. In other words it got a real bargain. "My sense is that they bought it on the cheap because it was a little bit of a distressed situation," Seivert says.

Other factors that may have depressed the price: there was a minor glut of broker-dealers for sale. Insurance companies were spinning off orphans and many were open to selling after getting their weaknesses exposed by the 2008-09 upheaval in the markets. "

He adds that Lovell Minnick may have another reason for selling earlier than typical. The PE firm may already have reaped the steep part of the revamping curve so that additional years of holding First Allied may not have added proportionally more value.

Belke says that he does not disagree with Seivert's basic analysis and emphasizes that his company didn't simply flip the property. "I would highlight that the business did grow," he says.

First wave

What stands out to Seivert about the Lovell-RCAP deal on a broader scale is what it says about where the advisory M&A market may be in its cycle. Specialized private-equity firms such as Lovell Minnick are typically the ones buying early in the cycle. The arrival of banks and other financial buyers typically marks the frothy peak.

But there are a few levels of buyers in between. RCAP seems to fit the 'tweener' category, according to Seivert. See: Schwab 2013 RIA M&A data show hope but also futility.

"Private equity is the first wave; you have a peak when the banks come barreling in. [RCAP] is a hybrid and a strategic buyer."

Lovell Minnick Partners is a private-equity firm with a rich pedigree in financial services. See: Lovell Minnick jumps into the roll-up game with the purchase of $2-billion wealth manager — and a plan.

Prestigious partners

The Radnor, Pa.- and Los Angeles-based investor owns an interest in H.D. Vest and a number of RIAs, including Mercer Advisors Inc. See: The TD Ameritrade-Orion pairing again proves productive — this time to wrest assets from a $3.6 billion Schwab RIA, Mercer Advisors.

Its investing partners include no less than Goldman Sachs, Aegon and Invesco. First Allied, a San Diego-based broker-dealer, serves more than $32 billion in assets across 300,000 clients, 1,500 independent financial advisors and 500 branches in the United States.

RCAP owns American Realty Securities LLC and the distributor of its REIT products, RCS Capital, which just completed the IPO. RCS Capital trades on the New York Stock Exchange under the ticker RCAP and is now the operating parent, while RCAP Holding Corp. is still legally the overarching parent.

Belke, 43, a chartered financial analyst, received his MBA with honors in finance and accounting from the University of Chicago, and has a bachelor of business administration degree in finance and accounting from the University of Wisconsin.

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