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BROKER DEALER / FIDUCIARY RULE / NEWS

Small Independent Broker Dealers Stand To Lose A Lot Under DOL Rule

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Small independent broker/dealers (IBDs) want nothing more than to see the Department of Labor's fiduciary rule repealed, and from their perspective it's not hard to see why. IBDs stand to lose an estimated $4 billion in revenue over the next four years because of the rule.

That's according to Peter Chiang, a principal at the consulting firm A.T. Kearney. Chiang is the co-author of an October report on the economic reverberations of the fiduciary rule on different distribution channels.

"For smaller independent broker-dealer folks, they're paralyzed and saying, 'Frankly, I don't know what to do. Where do I even start? I don't have the money to comply,'" Chiang said.

In addition to the loss of $4 billion in revenues, Chiang and his fellow A.T. Kearney researchers estimated that IBDs would lose as much as $350 billion in assets, or about 11 percent, between now and 2020.

That may not sound like much in a $28 trillion asset universe, but with thinning profit margins every dollar in assets that sets sail for another distribution channel is a dollar less on which broker/dealers earn income.

Other distribution channels — RIAs, dually-registered investment advisors, internet-based algorithms, self-directed channels and exchange traded funds — are expected to gain as the DOL rule encourages the adoption of fee-based accounts and away from commission-based transactions.

But for small IBDs with a handful of brokers working out of addresses on Main Street, Orchard Way and Washington Boulevard, their very survival is at stake.

"Many smaller broker/dealers will likely get eliminated," said Kashif A. Ahmed, president of

American Private Wealth, a registered investment advisor in Woburn, Mass.

Factors Working Against Small IBDs

Compared with nationwide and regional broker/dealers, small IBDs have a higher percentage of assets under management in commission-based rather than fee-based accounts. That's according to Michael Wong, a senior analyst who covers the investment services industry at Morningstar.

At small IBDs, accounts typically carry lower balances than at larger firms. In addition, a proportionately higher percentage of assets under management are locked up in retirement accounts as opposed to taxable accounts, Wong said.

All of these factors mean the cost of complying with the fiduciary rule is spread over a smaller asset base and therefore is more expensive.

The Labor Department's rule is slated to go into effect in April with full implementation Jan. 1, 2018. That's unless president-elect Donald Trump or a new appointee to head the department decide to repeal, delay or amend the rule.

For months, Congressional Republicans have been trying to scrap the rule, which pushes distributors to adopt more fee-based models in selling investment products and advice into retirement accounts.

Regulators say investors are better served by fee-based advice as fee-based models are less susceptible to potential conflicts of interest among agents and financial advisors steering clients into products on which agents earn a higher commission.

But agents and advisors want the rule repealed at all costs: A survey of 1,357 advisors by the Financial Services Institute, a IBD trade group, conducted the week after the Nov. 8 election, found that as many as 86 percent of respondents said they wanted the DOL rule abolished.

“We have people who are closing up shop and joining us,” said Larry J. Rybka, president and CEO of Valmark Financial Group in Akron, Ohio. “Anybody with less than $100 million, I don’t see how they make the turn.”

The Challenge of Converting to Fee-Based Models

One way to “make the turn,” is to covert to fee-based models followed by registered investment advisors (RIAs).

Converting to fee-based platforms and shifting assets out of commission-based products — a variable annuity with a surrender charge, for instance — may sound easy on paper.

In practice, converting is a real headache, Rybka said.

“If somebody has only been selling variable annuities or complex products, it’s harder to start charging fees,” Rybka said. “It’s a whole different approach. There’s just a lot of things that don’t fit in the RIA bucket.”

And if converting out of a commission-based model into a fee-based one isn’t in the best interest of a client, then what?

Lincoln National, a big seller of variable annuities, has calculated that a 1 percent annual fee on a $100,000 mutual fund investment, for example, would cost the investor $30,000 over a 30-year life span. Meanwhile, the cost of a $100,000 variable annuity would come to $11,750 over the same period.

“Right now, everybody is kind of holding their breath,” Rose Swanger, a fee- and commission-based financial advisor in Knoxville, Tenn., told InsuranceNewsNet.

“I understand the DOL position, but in some cases, a commission is much better for clients so (fee-based models), that's not in the best interest of the client at all," she said.

For the moment, the industry is planning to continue as if the rule will kick in on April 10, 2017. For some brokers, that means merging with other, larger broker/dealers or joining fee-based RIAs.

Thomas Terhaar, a fee-for-service advisor with the wealth management firm Conrad Siegel Investment Advisors in Harrisburg, Pa., said his firm has fielded inquiries from independent brokers over the past several months to explore possible alliances.

"Folks are looking at the landscape scratching their heads and saying what do I do now?" Terhaar said.

It's a question that even large broker/dealers with deep pockets appear to be struggling with as well.

Merrill Lynch and Commonwealth Financial Network earlier this year announced they would eliminate commission-based products in retirement accounts. However, other broker/dealers such as Cambridge Investment Group, Ameriprise Financial and Wells Fargo Advisors intend to continue offering commission-based products.

Howard Schneider, an industry consultant in Boxford, Mass., said that even if the election of Donald Trump offers something of a reprieve, hard-core commission-only advisors were becoming a smaller group to begin with. This was happening as fee-based business and a move to lower-cost investments slowly squeeze out reliance on commission-only models.

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