As featured in the June 2, 2018 issue of ThinkAdvisor ThinkAdvisor

By Jon Henschen

Advisors Have Much to Gain With Broker-Dealer Arbitrage

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The expression, "Out of sight out of mind" applies to the topic of advisory administration fees, as does "I don't know what I don't know."

When I interview advisors regarding the expenses they currently pay, the answers tend to fall into two categories: they are either not aware of what they pay, or they know but have no idea of what pricing competition offers them in the marketplace.

Certainly, advisors are aware of what they are paying for errors and omissions insurance, monthly expenses and miscellaneous expenses such as SIPC & FINRA assessment fees.

However, when asked about what advisory administration fees they pay or how much markup on third-party money managers is being imposed on them or their clients, a pregnant pause of bewilderment is more common than not.

Applying the concept of broker-dealer arbitrage, advisors can change their broker dealer to take advantage of pricing and payout inefficiencies in the marketplace that are profitable enough to make a change worth the effort.

With the advisory space getting crowded as others flood into the same investment style, price compression is an increasing reality, making advisory cost savings increasingly important.

Cutting back dramatically on advisory expenses can make you much more competitive in a crowded space. Here are several ways advisors can net more to benefit themselves and/or their clients.

Advisor Managed Advisory Platforms

There are two types of platforms in this category.

First is the unbundled platform, where advisors pay an administration fee for billing and client statements, with ticket charges paid separately. Second is the all-inclusive fee account, where both administration fees and ticket charges are covered by a single administration fee.

Here are common pricing structures, we see for each platform and alternative pricing that can net advisors much more.

Unbundled Platforms: Typical pricing on this platform is between 10–30 bps on assets. The marketplace can offer you as low as 2½ bps on assets with $125 cap or flat annual payments that run between $25–$55 per account annually.

Performance reporting with these lower cost options offer billing and performance reporting through Orion or Black Diamond. When you do the math, going from 20 bps on assets annually to $25 annually per account, the cost savings are immense.

These lower administrative fees are available to assets held at Schwab, TD Ameritrade, Pershing, National Financial and other clearing and custody firms.

Giving you ultimate flexibility and choice, you can work with these outside advisory custodians under the broker dealer's corporate RIA or under your own RIA—you choose. Ticket charges with some organizations working with RIAs may also be lower than with some traditional broker-dealer clearing firms.

All-Inclusive Platforms: Pricing on this platform typically runs between 25–45 bps on assets (covers administration fees and ticket charges).

The marketplace can offer you as low as 9 bps with a 150-trade cap on this model. The additional expenses with the all-inclusive platform require an advisor to be making around 40–50 plus trades annually per account for the additional expense to pay off.

This platform is intended for the active trader but surprisingly, we find many advisors having their clients on this platform even though they may make only 10–20 trades in an account annually. If you make fewer than 40 trades annually, the math makes the unbundled account more appropriate.

Institutionally Managed Platforms

If you are a fan of others managing your client's assets, there are two ways to achieve substantial savings:

1. Avoid markup on third-party managers
2. Value-priced Separately Managed Accounts (SMAs)

Markups on Third-Party Money Managers: Typical pricing for markups on management fees runs 10–25 bps. The marketplace can offer you zero markup on third-party money managers.

Many small and mid-sized firms as well as a few larger broker-dealers are not imposing this profit center, which is rationalized for doing ongoing due diligence on money managers. Call me crazy, but shouldn't broker-dealer product due diligence be covered by payout grid?

If you're not sure whether you are paying a markup on your third-party manager, ask your broker-dealer. If your BD is not willing to disclose the information, you can call outside advisory companies and ask them what the management fee is for your particular third-party manager.

Value SMAs: Typical pricing for programs where the advisor chooses an investment model and the assets are managed by others range from 30 bps to 100 bps (which reflects a combination of management and administration fees).

The marketplace can offer you a tactically managed platform using very low cost mutual funds and ETFs, with the advisor choosing the model and institutionally managed for 20 bps. total expenses.

Who Benefits Most?

The greatest benefits from these cost savings are achieved by higher-end producers and producer groups because their scale often will bring them payout advantages their current firm doesn't offer, such as payouts up to 96% on all investments for advisors doing $1 million or more in year fees and commissions.

With a combination of higher payout and lower advisory costs, we've consulted with numerous $1 million producers and groups that discovered cost savings of $150,000 to $200,000.

These savings may come primarily to the advisor in the form of payout increases, or go to the client or advisor depending on who is paying the administration fees and ticket charges. Either way, it's a win-win scenario.

Finally, we all have the inner skeptic that hears about great cost savings but thinks, "What am I giving up?"

The cost saving options discussed here are primarily with broker-dealers that have over $100 million of revenue annually, are consistently profitable and/or have deep pocket parent companies.

At these broker-dealers, staffing levels are in the 4:1 to 6:1 range, so service is not sacrificed. If an advisor is coming from a large broker-dealer, they frequently experience a noticeable improvement in service.

For those who need practice management and marketing assistance, you will typically have access to external practice management and marketing resources because outsourced sources are high quality and save the broker-dealer a great deal of expense, with those savings passed on to you, the advisor.

When the storybook candidate contacts us wanting to net more, we hear this recurring narrative: "We've built our practice to the current level ($1 million $2 million of production) and we're at a point where we don't need a lot of broker-dealer bells and whistles. Going forward, it's more about maintaining what we have and growing through referrals. What we need now is to cut expenses and focus on netting more."

When a million-dollar producer nets an extra $150,000 annually through a broker-dealer switch, the inclination might be to buy a new car or purchase some other self-indulgence.

However, that is rarely the case. Hiring additional staff or expanding marketing to grow their client base is usually where the new money is funneled.

The sad side of this picture is advisors making the inquiry, getting excited about the cost savings and dreaming about what they will do with the additional revenue, but never making a move because they don't want to repaper or simply because they don't want to step out of their comfort zone.

Delaying a $150,000 savings for four years puts you at a $600,000 deficit, and that's not taking into account the growth your practice could have experience by investing that savings back into the business.

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HENSCHEN & ASSOCIATES, LLC.
Your Fast Track to a Better Independent BD
PO Box 56, Marine on St. Croix
MN 55047
TEL 888.820.8107 651.433.3501
jon@henschenassoc.com
www.FindABrokerDealer.com