As featured in the September 21, 2021 issue of ThinkAdvisor ThinkAdvisor

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How Proprietary Advisory Platforms Conflict With Fiduciary Standards

Broker-dealer corporate RIAs have jumped on the proprietary advisory platform bandwagon at a rapid clip over the last five years. We've been approached by broker-dealers wanting us to recruit advisors to their broker-dealer with a focus on bringing advisors to them, not only with a large percentage of advisory assets but assets that will specifically go into their proprietary advisory platform.

Financial products such as mutual funds can't be pushed with such overt bias, yet there appears to be no issue with advisory platforms being pushed in a similar manner.

Bringing up proprietary advisory bias to the head of advisory at a broker-dealer, his response was that "proprietary advisory is not an issue because they are not products, but rather, platforms."

Granted, broker-dealer standards are different from RIA standards, but a fiduciary standard is supposed to set a higher bar than Regulation Best Interest.

Broker-dealer corporate RIAs are free to set whatever profit level they choose, but the conflicts with proprietary advisory platforms include directly and indirectly controlling client assets to their biggest profit center (proprietary advisory platforms), leaving advisors in the dark regarding new, value-added offerings that compete with their proprietary platforms.

It is uncomfortably common to hear advisors' feedback on broker-dealer management telling them directly that they should put their advisory assets into their proprietary advisory platforms. But it is the more subtle ways the platforms are pushed that remind me of the days when insurance broker-dealers manipulated sales into their insurance products. Here are just a few of the tactics we see employed:

- Company websites giving preferential exposure to proprietary advisory platforms.
- Offices of supervisory jurisdiction receiving bonuses based on proprietary advisory client assets from the advisors they supervise.
- Advisors consulting with advisory departments for guidance being steered to use their proprietary advisory platforms.
- Offering incentives to direct more assets into proprietary advisory platforms, such as free services when you hit a certain asset threshold.

As effective as these tactics are at directing assets to their best profit centers, keeping advisors in the dark is even more effective.

You Don't Know What You Don't Know

Advisors rely on their broker-dealer to keep them apprised of new innovations and pricing values, but when pricing values are more attractive than the broker-dealer's proprietary platforms, it is in the broker-dealer's interest to keep advisors in the dark.

A case in point: Fidelity last year launched its Fidelity Managed Account Xchange (FMAX) for advisors as primary managers. If advisors use National Financial Services for clearing, they can receive Fidelity's entire model portfolio lineup of modeling and rebalancing quarterly changes supplied to them at no charge.

If your broker-dealer's corporate RIA allows access to Fidelity Institutional IWS, you can not only receive the quarterly model allocations at no charge, but quarterly model changes can also be automatically implemented at the advisor's discretion at no charge via Wealthscape. The point is, Fidelity has offered a strong value proposition that can bring advisors' clients substantial cost savings and greatly simplifies running a managed model portfolio.

Translating this to a broker-dealer RIA level, we've been active over the last year with a broker-dealer specialized in advisors with tax practices. Many of these advisors opt for the broker-dealer's proprietary advisory platform that manages models using mutual funds and ETFs at a cost between 20 and 30 basis points.

They also use NFS for clearing, but access to Fidelity IWS is not made available. Fidelity's FMAX offering gives advisors an option to go from 20–30 basis points to zero, and you can opt for a broker-dealer that offers billing and performance reporting for around $50–$75 per account annually (no basis points on assets). The advisor will initially need to set up the models per the Fidelity model structure, but once in place, changes can be made automatically or customized by account if they so choose.

These are some of the best ways to battle fee compression by lowering costs to clients, leaving the advisor with less pressure to lower their management fee. How does such cost savings translate with the broker-dealer RIAs that have proprietary advisory platforms? It doesn't.

Even though this program was introduced last year and as of May 2021 the entire model portfolio lineup has been made available, only 40 broker-dealer corporate RIAs of the approximately 275 broker-dealer RIAs using Fidelity NFS clearing have plugged into this offering. The broker-dealer RIAs we work with that are fiduciary focused—having no proprietary advisory platforms—were quick to make Fidelity's offerings available to their advisors.

NFS-clearing broker-dealer RIAs with proprietary advisory platforms have almost entirely ignored the FMAX offering, preferring instead to keep advisors in the dark on a better pricing option than their proprietary offerings. Proprietary advisory platforms are profit center "sacred cows" that almost always make the most profit for the broker-dealer RIA advisory revenue. Broker-dealer RIAs are often structured to ensure they earn a set amount no matter where you turn.

Advisors Trapped in BD RIA Profit Prison

An advisor shared a conversation with his broker-dealer's management telling them he was going to get his own RIA in order to lower advisory costs. Management replied, "You can go anywhere you want within our advisory boundaries, but we'll still make 25 bps off your advisory assets."

When you move your assets to IWS or Schwab, they charge you a platform fee, hold TAMPs directly and charge you another platform fee. If you manage the assets yourself, they make the same on administrative fees and ticket charges. You're trapped unless you leave.

These profit prisons will be broker-dealers' undoing unless they open up to more fiduciary cost savings options, especially as clearing firms become increasingly obsolete places to custody advisory assets while IWS and Schwab/TD Ameritrade are favored for advisory assets.

RIA purists can be guilty of "best is the enemy of better" as they toss all broker-dealer RIAs aside, perceiving fee-only independent RIAs as the only way to uphold a fiduciary standard. Numerous fiduciary-focused broker-dealer RIAs cultivate an environment where advisors can set a high fiduciary bar.

The president of a fiduciary-focused broker-dealer said this about why they avoid anything that conflicts with their advisor's ability to adhere to a fiduciary standard:

"We favor open architecture to strategically leverage the best of brands in the marketplace. We are advocates of flexibility and choice in a conflict-free environment so our independent financial professionals can serve the best interests of their clients.

"Therefore, we do not mark up or revenue-share with any of our investment management service providers, such as investment advisory custodians or money managers, nor do we private label such investment management service providers to create proprietary platforms.

""This makes the recruiting process a little more difficult, because we have to educate the advisors how they and their clients still come out ahead when some competitors may be attracting them with huge upfront bonuses or higher payouts.

"When we analyze all the hidden fees at proprietary platform firms, we are able to show advisors they can not only make more but simultaneously reduce the fees charged to the clients at other firms. The BD, the RIA and financial professional, and the client all win when they have the freedom of choice to avoid proprietary platforms with high fees and have the flexible options to choose based on our open-architecture environment."

Even though CFPs have been required to adhere to a fiduciary standard since June 30, 2020, many ignore conflicts with the best interests of their clients. Opting for a big upfront check over an advisory structure that will save their clients substantial sums over time, far more than what the advisor makes in forgivable note money, is just one of many conflicts with a fiduciary standard.

To understand how upfront forgivable notes are paid for and how abiding by a conflict-free fiduciary standard will make your clients come out way ahead, read my Michael Kitces-requested article "*Why Broker-Dealer Forgivable Notes Aren't Really Forgiven and Are Instead Ultimately Paid Back by Clients*" by going to **www.kitces.com/blog/category/compensation/** to learn how you can save your clients up to 92% on advisory administrative fees.

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