Parting Thoughts

The Lobbying 'Tell'

This is the time of year when the various industry magazines come out with their broker-dealer surveys, listing the 'top' BD rankings based on total revenues or the number of 'producing' reps. In the accompanying articles, you will read how the 'top' broker-dealers are not really in the sales business anymore; they are now becoming national advisory firms.

I completely get why they would tell this to credulous writers; the public has increasingly shifted away from any taint of 'sales' in an advisor relationship, and the concept of hiring an advisor who puts their clients' interests first (even if most people don't understand the term 'fiduciary') is an attractant. Anybody who wants to do business with the consuming public will want to move away from the repellants and toward the attractants. Makes sense, right?

There are a few uncomfortable facts about this, however, some of which will appear in the rankings themselves. In the more comprehensive surveys, you will see the percentage or dollar revenues collected by each BD on annuity, life insurance and other product sales, vs. fees (defined by asset management fees, shared between the reps and the broker-dealer). In most cases, with a few exceptions, sales are 40% or more of the total revenues, and are more often over 60%. Sales are important, but the BD executives won't be talking about that.

Another uncomfortable fact is that these BDs have enormous compliance departments which supervise all of the communications put out by the reps and their offices—which is required by FINRA. The affiliation with FINRA, itself, means that these firms are fundamentally living under sales regulations, even as they protest that they are mostly driven by fees related to advice. One way of thinking about this is that their reps cannot, by regulatory fiat, communicate with their clients like adults—the way advisors without a broker-dealer affiliation can. The compliance people have to pre-approve their communications. A national advisory firm presumably wouldn't have those restrictions.

In some of the surveys, you will also see the 'payout range,' which basically says how much of the rep or rep office's compensation (commissions and AUM fees) they get to keep, which gives you a back-door way to estimate how much of their revenues are taken by the BD. These payout ranges are typically far more generous than the wirehouse grids, because the reps are paying their own office expenses. But they are still based on 'production,' which means the more sales and AUM a rep does, the more they get to keep. The numbers are different, but this is exactly like the wirehouse model; that is, the BD collects the revenues and then gives back whatever it determines is the allotted percentage to the reps. National advisory firms collect their own fees directly from clients.

We already have national advisory firms, and none of them are structured this way—for a lot of good reasons, but mainly because they are not organized around product sales. The broker-dealer structure was created to support a sales model. You might argue that it is antiquated (and you would be right), but the fact that the BD firms still embrace it means that they are still, organizationally, sales operations.

Finally, I have to think that if these BD firms are truly moving toward becoming advisory firms, they must be growing increasingly uncomfortable with their membership in the Financial Services Institute. The FSI claims to be a membership organization, but nearly all of its advisor/rep members are 'contributed' by the broker-dealers; that is, the FSI is given the names of the BD's reps, and contact information, and the BD pays for their membership, sometimes collecting that back through the payout arrangement, sometimes not.

The number of reps gives the FSI the appearance of heft in its primary activity, which is lobbying. What is it lobbying for? The most vigorous activities center around protecting independent contractor status for all the rep offices under the BD's RIA, and against any form of a fiduciary standard that would threaten the 'two-hat' arrangement where a rep would give advice (no problem with fiduciary there, as long as it isn't too tightly defined) and then put on the other hat and sell something in a role that is clearly not fiduciary.

You could argue back-and-forth about the former issue, but it should be noted that nobody at the larger independent custodians has to worry about independent contractor status for the independent RIAs that clear through them; they don't have to supervise and direct the activities of advisors who don't sell stuff. Independent broker-dealers, on the other hand, have to walk a very delicate line, telling their supposedly independent contractor reps what they can and cannot do, including what products they can recommend and how they can communicate with their clients. At what point does this regulatory control cross the line to where the rep should be characterized as an employee?

But the latter issue is the really problematic one for firms that claim to be advisory organizations. The FSI organization that they support consistently takes the same lobbying side as SIFMA (the wirehouse trade organization), the American Council of Life Insurers, the American Securities Association, the Association for Advanced Life Underwriting, the Insured Retirement Institute, the National Association for Fixed Annuities and the National Association of Insurance and Financial Advisors. On the other side of the various lobbying efforts are organizations representing actual independent (fiduciary) RIA firms—the very firms that the broker-dealers tell us they are emulating.

Membership in the FSI—at the broker-dealer level—tells us that these firms support lobbying efforts that consistently take the side (and sometimes co-author comment letters) with all of the sales-related associations in the financial services world, against the regulatory and legislative interests of the fiduciary advisor population that they say they aspire to become. It's a 'tell' that belies the quotes that the credulous writers will display in their articles.

The interesting part is that I actually believe that some of the independent broker-dealers do aspire to convert to a business model similar to what we see in the fee-only advisor space. Others, I think, like to pretend that they're moving in that direction while they cling to their comfortable sales culture—maybe because speaking out of both sides of their mouth is good for recruiting.

But as you read those quotes, you might check out the FSI's BD membership (the list is here: *https://financialservices.org/membership/firm-membership/firm-members/*), and ask yourself whether a member of an organization that vigorously lobbies against every meaningful fiduciary proposal embraced by independent advisory firms, that wants that second (sales) hat available to its reps, is really, truly, on the road to becoming a national advisory firm. ■