Hard numbers that show the zero-sum advantages of RIAs over wirehouse brokers as told by fund flows

The hold by the Merrill Lynch and Morgan Stanley crowd over product manufacturers is fast slipping

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0 Comments

Brooke's Note: **Sometimes RIAs get extolled in such loose terms that the critic would be fair to question whether it's all an urban myth. Hard numbers pointing to RIA success are indeed difficult to nail down. See: How many RIAs are there? No, seriously, how many?. These Broadridge asset flow tallies sort of come through the statistical back door of ETFs and mutual funds. What they count is telling nonetheless — as well as the comments about them by a host of sources.**

RIAs are devouring wirehouses by winning investors, the latest flow data for ETFs and mutual funds reveal.

But more than that and more counterintuitively, registered investment advisors are wielding more power than these stockbrokers — on both an absolute and a growth-rate basis — a dominance on the product side that continues to widen, according to the latest data from Broadridge, which has visibility into the flows of $9 trillion of assets.

For example, in the first quarter of 2016, RIAs held $2.1 trillion in mutual fund and ETF assets, up from $2 trillion in the first quarter of 2015, the Lake Success, N.Y.-based firm's data show.

At the same time, wirehouses managed $1.6 trillion in the first quarter of 2016, down from $1.7 trillion in the year-earlier quarter. Altogether, the wirehouses manage, or at least advise on, more assets than RIAs but Broadridge is solely looking at mutual funds and ETFs, so its numbers don't include costly investments such as annuities and derivatives.

Wirehouse channel is now smaller

"We are focused on long-term mutual funds and ETFs. The wirehouse channel is now smaller than RIAs and that happened about three years ago. We saw RIA assets surpass wirehouses and now we've seen it accelerate and the wirehouse channel is flat-lining. Why are they flat-lining? They've embraced managed accounts with direct securities," Frank Polefrone, senior vice president of Broadridge's data and analytics business, said in an interview.

Broadridge's infrastructure underpins proxy voting services for more than 90% of public companies and mutual funds in North America, and processes on average $5 trillion in fixed income and equity trades per day. Broadridge has more than 9,000 full-time employees in 14 countries. It defines its wirehouses as the big four — UBS, Merrill Lynch, Morgan Stanley and Wells Fargo Advisors. Broadridge tracks about 14,000 RIAs that trade through custodians such as Charles Schwab & Co. and TD Ameritrade Institutional. Broadridge also tracks dually registered firms that have an independent RIA and an association with a broker-dealer.

Polefrone added: "But the RIA channel has grown more rapidly for those products we track. It's a combination of the RIA channel managing clients' money more holistically as opposed to the wirehouse that was more focused on products."

The Broadridge report also shows that net new assets of ETFs for retail channels — RIA, independent-broker-dealer, wirehouse and discount B/D — were up by $61.3 billion in the second quarter this year. Meanwhile, at the same time net new assets for institutional channels — private bank, bank and trust — had fallen by $30.4 billion.

"During the first half of 2016, net new assets for passively managed mutual funds increased by $37 billion, or 14%, for the retail distribution channels, while actively managed funds were down by $24 billion, or 0.6%," Polefrone added. "With pending regulatory changes related to appropriate share class usage and the Department of Labor's new fiduciary rule, we expect the growing use of passively managed funds by advisors, along with the increasing popularity of ETFs, to continue to accelerate."

Tom Lydon, editor and publisher of ETF Trends and CEO of Global Trends Investments, says there are a number of factors influencing the increase in ETFs. For instance, he points out, there are 142 new exchange-traded products — which include exchange traded funds and exchange traded notes — compared with 159 launched in the year-earlier period.

The new DOL rules will take some time to cause a massive shift in the ETF arena, Lydon says.

"The new rules will largely affect the way investors pick and choose investments in retirement accounts, and ETFs are not a big part of 401(k)s just yet since most are not set up for intraday trading. However, this new rule could be the impetus to cause a shakeup in the retirement accounts spaces and push more plans to include low-cost ETF options," Lydon writes in an email. See: What to make of yesterday's Wall Street Journal report on Schwab's 401(k) 'bet'.

But massive factors are still impacting the growth in ETFs, he adds. "By shifting out of funds with trailing commissions or other incentives and into ETFs, advisors may diminish conflicts of interest under fiduciary rules. The DOL rule states that an advisor can't just offer one company's products on a platform, so a diversified selection of fund options, including ETFs, may be included to claim fiduciary best practices," he writes.

Lydon adds: "If an advisor shifts away from the commission-based model, many may raise fees to make up the difference and turn to low-cost ETFs in an attempt to maintain their margin levels. Additionally, advisors of smaller accounts will find it harder to justify their fee structure and may be forced to switch into more efficiently priced investment models, such as robo-adviser portfolios, which typically utilize index funds and ETFs."

Bill Butterfield, an analyst with Aite Group, agrees that firms are looking to slash the higher-commission products and as a result moving more to passive funds.

"The move to passive has been a trend for quite some time and I'm not surprised to see it continuing," he says. "Firms are planning and thinking of what it means with the product lineup. They're going away from products with commissions. I wouldn't attribute anything to the DOL right now but we expect passively managed funds to continue."

Net outflows

The bulk of the $35 billion of net outflows from actively managed mutual fund accounts held at IBDs moved to ETFs, which recorded an increase of net new assets of $34.9 billion. The shift to passive ETF products by IBDs increased the overall share of passive products from 19.5% at the end of 2015 to 21% of total fund and ETF assets managed by IBDs.

The wirehouse channel — in a telling breakdown of market share loss — experienced net outflows of $21 billion from actively managed funds, but increased assets of passively managed funds and ETFs by only $5.2 billion. As a result, wirehouses experienced net outflows of long-term funds and ETFs of $13 billion in the first half of 2016, and lost overall market share to other retail channels.

In an email Sharon French, head of beta solutions at Oppenheimer Funds, says her firm, with a brand known largely for active management, is rolling with these advisor preferences.

"This shift is certainly not a surprise," she writes in an emailed response to an RIA query. "It is in part an indication of the changes ahead that the DOL fiduciary rule is bringing about. The other part is the unrelenting macro environment we now live in — with low growth, low rates and high volatility — is putting increased pressure on performance and, as a result, fees. While we remain focused on fundamental active strategies and believe there is merit in smart beta as a complement to those strategies, over the course of the next decade there will be a lot of other strategies that we will develop to meet our clients' needs."

French joined Oppenheimer Funds in April from BNY Mellon, where she was senior strategic advisor to the CEO and president of investment management, with a focus on ETFs. Previously, she was president of F-Squared Capital. Before that, she was head of private client and institutions at BlackRock for its iShares business.

She added in the email: "We've been hearing from our RIA clients for some time that this structure has many benefits for them – from a customization, flexibility, tax, and overall-cost standpoint. They're excited about the prospect of a smart-beta strategy in, for example, ESG, domestic equity or fixed income."

The smart-beta-ETF market is hot, and Broadridge classifies such products as actively managed. Broadridge classifies 94 out of 95 Dimensional Fund Advisors funds as active.

Validates

The flood of outflows from actively managed funds continues apace, the data from Broadridge show. But one of the interesting aspects of the shift toward passive is that IBD reps have begun to forgo active managers, Polefrone added. “For RIAs, it validates what they’ve been doing and that it’s been paying off. Now, other channels like the IBDs are following.

“The RIAs didn’t increase as much from active to passive because they were already there,” he continued. “It felt like what I was looking at is the IBD channel is playing catch-up with passive funds. RIAs are also early adopters to products like ETFs, an approach that is just catching wind with wirehouses.”

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