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THE BIG GET BIGGER

BY JUDY WARD

THE RETIREMENT PLAN ADVISORY BUSINESS ENTERS A CONSOLIDATION PHASE

FOR DOMINIC CORLETO, A SENIOR INSTITUTIONAL CONSULTANT AT WELLS FARGO ADVISORS, TAKING OVER OTHER ADVISORS' BOOKS OF BUSINESS HAS BECOME A KEY GROWTH STRATEGY. HIS PRACTICE HAS ACQUIRED SIX OTHER ADVISORS' RETIREMENT PLAN CLIENTS AS THEY EXITED THE BUSINESS, AND CURRENTLY HAS FOUR PARTNERSHIPS WITH OTHER WELLS FARGO ADVISORS WHOSE PRACTICES DO NOT FOCUS ON RETIREMENT PLAN WORK.

"From a strategic standpoint, it has accelerated our team's growth tremendously," says Corleto, who is based in Eugene, Oregon. The acquired clients bring new revenue, which has allowed Corleto to add more team members with substantial experience and expertise in different aspects of retirement plan work. The deeper bench, in turn, attracts more new business.

Plan sponsors have realized that they need an advisor who's truly a retirement plan expert, who already has a strong base of plan clients, and who has a substantial organization behind them, Corleto finds. "Corporate buyers are very astute. They will ask things like, 'How many plans do you have?' And that naturally leads to the big getting bigger. If one finalist is an advisor with two plans who isn't a retirement expert, and the other is an advisory team that has 100 plans and really knows what they're doing, which one do you think the buyer will pick?"

The retirement plan advisory business seems to have entered a consolidation phase. "In the wealth management space, that market is more mature and has been consolidating for a while," says Rick Shoff, Doylestown, Pennsylvania-based managing director, advisor group at CAPTRUST. "I think that we are at the beginning of it in the retirement space. If it's a baseball game, a lot of advisory firms feel like they are in the sixth or seventh inning, in their evolution."

THE SQUEEZE

The first nine months of 2018 saw 123 RIA merger or acquisition transactions, according to the third-quarter 2018 "DeVoe & Company RIA Deal Book" report.

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That pace slightly exceeds the 120 deals for 2017's first nine months, and DeVoe expects 2018's final tally to slightly top the previous year. (The data includes wealth management RIAs, plan advisor RIAs, and RIAs that do both, and centers on practices with more than $100 million in assets under management.)

That follows a boom period for deals that mostly centered on wealth management RIAs. Transaction volume at established RIAs grew at an annual pace of 25% between 2013 and 2017, DeVoe & Company says. "This is a hyper-fragmented industry," explains David DeVoe, managing director and founder of the San Francisco-based consulting firm and investment bank focused on RIAs. "There are 10,000 advisory firms, depending on how you define it. And fragmented industries typically consolidate."

It has gotten harder for independent advisors to compete against larger advisory firms for plan sponsors' business, Shoff believes. "The squeeze is in the middle," he says. "On one end, you have large, more-established advisory firms that have a lot of resources to serve clients. On the other end, you have smaller, boutique-y firms that can compete because it's still a 'people' business. But once they grow into the middle, they are no longer boutique-y and unique, and yet they also don't have the resources to compete with the large firms."

These factors help explain the squeeze:

Sponsors' increasing fiduciary awareness. "I think it has gotten harder for independents to compete, and part of that is because of sponsors now going through an RFP (request for proposal) process for an advisor," says Randy Long, founder and managing principal at SageView Advisory Group in Irvine, California. "It's always harder to differentiate your value proposition when you're smaller: It's because of the fiduciary protection, the processes that big firms have in place to help sponsors with their fiduciary responsibilities."

Large advisory firms also have access to scaled lower-cost investments that sponsors increasingly seek, Long says. "The larger firms have the ability to go to asset managers and negotiate for a CIT (collective investment trust) or institutional share class at a lower price," he says. "We're able to significantly lower the asset-management fees, and we pass that savings along to our plans and their participants."

Nick Della Vedova, president of New York-based NFP Corp.'s retirement division, sees low-cost investment access as a growing differentiator for sponsors. "Not having access to rock-bottom-priced CITs — which are not offered to everyone — is going to become a real weakness of independent advisors when they are competing with affiliated advisors," he says. "The differentiated value is just too stark to ignore by a fiduciary."

Risk-mitigation rising. The plan advisor's role has evolved to one that emphasizes helping the employer mitigate its fiduciary and business risks. "For a plan sponsor, we're in the risk-management business," Long says. "When you have more depth and proven processes and more experience, that's what plan sponsors want."

For example, participants' data security has become a big concern for

NICK DELLA VEDOVA
NFP CORP.

sponsors, and that naturally favors larger organizations. "We have significant resources that we've deployed toward 'security architecture.' We've hired very senior people from the federal government's security community, and they have built large teams and the technology to protect our clients' information," says Edward O'Connor, New York-based managing director and head of financial wellness at Morgan Stanley. "It continues to be one of our top priorities."

Pamela Popp, president, retirement services at Kansas City-based Lockton Companies, sees the advisor's role expanding. "Employers are looking for people to help them solve their business problems — not just their retirement problems, and not their benefits problems," she says. "The advisor of the future truly has the business acumen and the financial acumen, and the perspective, to help them solve those challenges. Some of the

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— PAMELA POPP, LOCKTON COMPANIES

solutions will lie in the retirement area, some of them will lie in the benefits area, and some of them will lie elsewhere, in risk management."

Financial wellness becomes crucial. Employers' growing awareness of the need to help employees holistically with their finances represents a big turning point, O'Connor believes. "I see financial wellness as one of those big, revolutionary changes within the employee benefit arena. It may be as big as the shift from DB to DC plans," he says. "I've seen a sea change in the attitudes and the focus of many plan sponsors. The endgame is now financial wellness, not just retirement readiness, and this is broadening what needs to be delivered by financial advisors."

Financial wellness/planning programs now not only encompass retirement savings, but also employees' questions about issues like student debt, HSAs (health savings accounts), which employer health plan to choose, and whether it makes sense to get disability insurance, Della Vedova says. So clients will want broader solutions from advisors. "Going forward, it is going to be very difficult to continue to grow as a siloed, retirement-only practice," he thinks.

What advantage does a large-firm advisor, such as one at Morgan Stanley, have over an independent advisor on financial wellness? "Number one, we have the intellectual property, the content, and the solutions across the whole spectrum of financial needs. And number two, because of our size, we also can bring real buying power, when we need to bolt on other solutions that we've chosen not to do ourselves," O'Connor responds. "As part of a bigger organization, you can bring clients a value and a price that you will never be able to get on your own."

Expanding call for scale. There's a lot of talk currently about the importance of scale in the plan advisory business. "It's very elusive, and it's very relative," Shoff says. "What clients do need, though, is durability. When they say, 'Tell me about how you handle data security,' 'Tell me about your team,' and 'Tell me what other clients you have that look like us,' how you answer speaks to your durability. All these things give clients comfort that when something 'goes bump in the night,' the advisory firm is going to be durable."

There's now also a constant pressure on advisory fees, at the same time as advisors are pressed to deliver more and a broader selection of services, O'Connor says. "For the past couple of years, we've been approached at Morgan Stanley by independent RIAs" about being acquired, he says. These advisors understand that they need scale to compete in today's advisory business, he says.

El Segundo, California-based Cetera Financial Group affiliates with independent advisors who want to focus on work that directly impacts participant outcomes, and get help with other duties, says Jon Anderson, head of retirement plan solutions. Cetera can handle much of the work in areas like data aggregation, investment analytics, provider RFPs, and compliance. "We create an environment that helps advisors to serve their plan clients in a scalable way," he says. With much of the administrative work handled, he says, advisors can concentrate on working with sponsors on plan design and participant outcomes-focused education and advice.

Intensifying practice management pulls. The heightened competition has

THE CONSOLIDATION CONTINUUM

CONSOLIDATION DOESN'T JUST MEAN independent plan advisors' businesses getting acquired by large players, Wise Rhino Group's Dick Darian says. He sees a continuum of consolidation scenarios, based on how much ongoing control an advisor wants to retain:

AFFILIATE. On this first level, an advisor aligns with an integrated platform, but maintains an independently owned and operated business. "That's the first step of 'Hey, I need to scale my business: There are things that I need to do to be more efficient,'" Darian says. With an affiliation, an advisor still faces the basic issues of running a business. "All those things are on the table, except maybe now you're more scaled," he says.

BUY SMALLER FIRMS. Here, an advisor tries to increase scale by buying another advisory practice's book of business. "Some advisors ask themselves, 'Am I big enough to acquire firms myself?'" Darian says. "I think that most advisory firms view themselves as acquirers, not sellers. Their thinking is, 'I want to continue to be independent, and grow my business.'"

MERGE WITH A PEER. About 75-100 U.S. plan advisory firms fall into the category Darian calls "regional elites," with between $3 million and $15 million in annual revenue. "They want to continue to grow, so they may look at other regional players with similar size, a similar brand, and a similar culture, and try to merge their businesses," he says.

Below the 75-100 regional elites sit about 500 single-practitioner "elite" plan advisory firms, Darian says, and the 75-100 firms also may consider merging with one of them to increase scale. "Many of these regional elites are in the 'dangerous middle': They may have two partners and they've hit their 'capacity wall,' because everything the firm does is wrapped around them," he says. "So they may say to one of the 500 elite single-practitioner firms, 'Hey, why don't you join us?' It's a step in the continuum."

FINANCIAL ACQUISITION. One option to get acquired involves what Darian calls "financial acquirers," citing insurance broker HUB International Ltd. as an example. "They will buy the enterprise, but allow the advisory firm's CEO and team to retain significant independence," he says. "The advisory firm's broker dealer, its branding – all that doesn't change." However, he finds it difficult to imagine that this acquisition model will continue indefinitely. "At some point," he says, "integration and increasing scale will be necessary to build a profitable business."

PRIVATE EQUITY INVESTMENT: In this scenario, the acquired advisory firm keeps more control than if it sells to a branded advisory firm, Darian says. "It's not like the private equity firm is going in and taking over the management of the advisory firm," he says. But it will keep a close watch on the acquired advisory firm's financials.

These deals have only begun, Darian says. "The challenge here is that private equity firms want to write bigger checks to make an investment, usually at a minimum of $50 million," he says. "In our retirement space, there aren't that many advisory firms that could get that price now. So the private equity players are waiting for advisory firms to merge before they get involved."

Also, a significant part of what makes an advisory firm valuable to private equity players is its lucrative wealth management business, Darian says. That helps explain why some very successful plan advisory firms have increasingly put effort into building up a wealth management practice, he adds. "It's going to be more and more of the profitable part of their business," he predicts.

BRANDED ACQUISITION. Another option for acquisition involves selling to a branded acquirer in the advisory business, such as CAPTRUST or SageView. "It's an asset purchase, so the acquired firm's brand goes away," Darian explains. The acquired advisory firm's team members become employees of the acquiring firm.

CAPTRUST's Rick Shoff describes what the advisory firm looks for in an acquisition. "We're only interested in retirement-focused firms that have at least $1 million of revenue per year, which means that they probably have at least $1 billion in assets," he says. "We also want to make sure that we have a similar client philosophy: Our value proposition is focused on the middle market, plans with about $20 million to $400 million in assets. And we want them to be holistic, thinking about not just investments, but plan design and participant education."

RICK SHOFF
CAPTRUST

Crucially, the acquisition has to be a good cultural and interpersonal fit, Shoff says. And it also must be a good economic match. "We're employee-owned, and we believe in shared risk and reward," he says. For example, when it acquires an advisor's practice, the advisor might take half the proceeds in cash, but invest the other half in CAPTRUST's stock.

Like other acquirers interviewed, Shoff says his firm wants advisors who will stick around and grow their practice, not those looking for an exit. "There's a misconception among advisors that somebody's going to give them a big check, and then they can just walk away. And sometimes there's a misconception that somebody will pay them way more than they are worth," he says. "The truth is what they will get paid, on the front end of the deal, it's a pretty tight range: There's not a big difference (among acquirers). For us, we want people who want to buy into what we believe in: We're building a company that matters, and our best days are ahead of us."

– J.W.

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put pressure on independent advisors to run their business very efficiently. "There are a lot of independent advisors who are really great at working with their clients. But oftentimes, they're terrible businesspeople," Long says. "They don't understand their margins, or the profitability of each of their clients. They may have 20 clients, and they're spending 80% of their time on one client, and undercharging that client."

Spending more of their time on business management issues holds little appeal for many independent advisors, Della Vedova says. "Most advisors who are running their own practice started the practice to have independence and freedom. In the beginning, they spent most of their time selling new business, helping clients, and growing," he says. "But over time, they hire staff and realize that they are no longer in the retirement plan advisory business, but the human capital management business. And that includes all of the functions to run a successful business."

RIAs usually love to focus their time on relationship management with existing clients, and bringing in new clients they can help, DeVoe says. "But independent RIAs end up spending a lot of their time worrying about administrative issues like compliance, technology, and data security," he says. "We are seeing more and more advisory firms sell into a larger organization because they see it as the best way for them to grow the fastest, and to deliver good services to clients. Most importantly, these advisors are asking themselves, 'How do I want to spend my time?' They want to spend their time on what they are really, really good at, and what they really enjoy."

A lack of succession planning. The plan advisory business has gotten tougher just as many advisors near retirement age themselves, often without an internal succession plan. DeVoe has a couple of thoughts on why so many successful advisors lack succession plans. "I have been doing this for 16 years, and for awhile, I thought it's just a psychological slippery slope: When advisors start thinking about putting a succession plan in place, then they start thinking about their retirement, and about their death," he says. "To a degree, people get overwhelmed."

But DeVoe has realized that there's more to the succession issue than he initially thought. "When you start to go on a journey of succession, it seems simple at first: 'Do I sell internally, or externally?'" he says. "Soon, advisors realize that there are a lot of connected issues, such as deal structure, valuation, and governance. Before you know it, there are 30 different items that you need to look at, to put a plan in place." Busy advisors delay that time-consuming process, and by the time they feel the urgency to deal with it, they face their own imminent retirement. At that point, it's too late to groom a successor internally. "Because so many firms don't have a succession plan in place, more and more have to be sold externally," he says.

Of course, it's ironic that these same advisors have many years of experience working with clients to help them plan for their future. Says DeVoe, "It's an old story: 'The cobbler needs to make his own pair of shoes.'"

THE OUTLOOK

Not everyone sees the same pace of consolidation in the plan advisory business. Anderson, for one, doesn't really buy into that idea, or the notion that

"THE ENDGAME IS NOW FINANCIAL WELLNESS, NOT JUST RETIREMENT READINESS, AND THIS IS BROADENING WHAT NEEDS TO BE DELIVERED BY FINANCIAL ADVISORS."

— EDWARD O'CONNOR, MORGAN STANLEY

READER POLL: COULD MORE (CONSOLIDATION) MEAN LESS?

THERE'S A LOT OF TALK THESE DAYS about consolidation in the advisor market — but what have NAPA Net readers seen — and/or experienced?

The majority of respondents to our late November NAPA Net reader poll said that consolidation is occurring, though those responses ranged from 62% who said "yes," 12% who said "among smaller firms, maybe," and another 1 in 10 who responded, "It depends on what you mean by consolidating." The remaining 15%, of course, said "no."

"It's happening at a level I have never seen before," noted one reader, who went on to explain that "fee compression, increased efficiencies, national brand, DOL reg changes, and being at a boutique firm that understands their business are key items. Also, firms working to expand revenue lines are where it is going and they want to be part of it."

Where that consolidation has been seen, we asked readers what they attributed it to, and they indicated (more than one response permitted):

53% - Competition
51% - Desire for greater efficiency
45% - Fee compression
42% - Succession planning
29% - Economics
16% - Potential changes imposed by the fiduciary rule
13% - Technology/robo advisors

"The size of plans has grown, and so has the demands of plan sponsors on advisors," explained one reader. "Some cannot keep up. Also, many advisory firms just cannot grow their revenue, so a sale becomes an option."

"To be a good retirement plan advisor requires so many disparate knowledge and skill sets — investments and funds, plan design and compliance, Recordkeeping, education, etc. — that it's no longer practical for individual advisors to stay fully up to date on all aspects of plans," noted one reader. "That's why affiliating with a larger similarly situated organization makes sense, for both economics and client service."

CONSOLIDATION STATIONS

While consolidation may have been seen, it hadn't come "home" for most of this week's respondents. More than half (59%) said their firm hadn't consolidated during the past two years, though one in five (21%) responded "not yet," 18% said another firm had consolidated with theirs — and the rest, of course, had.

Among those readers whose firms had consolidated, the reason(s) most commonly cited for doing so was a desire for greater efficiency, followed closely by succession planning, economics, and distantly by fee compression and competition. One reader explained it was about the "potential for referrals with existing business." Or, as another reader noted, "We are bringing on new teams who are looking for efficiencies and a desire for collaboration on a larger scale."

"I think we're getting a constant barrage of marketing from the firms that would like us to consolidate and from the business brokers who want to help," commented one reader. "Those firms have figured out that it's easier to grow through acquisition and they're more visible than in the past. A number of advisors are aging out of the business, so those succession plans shouldn't be considered consolidation. Forcing brokers to roll up their business under one person who meets the 'I know something about retirement plans' also shouldn't count as consolidating, IMHO."

Thanks to everyone who participated in this — and every week's NAPA Net Reader Poll!

— NEA

only expert-level plan advisors can now get retirement business from employers. "I don't think it's happening, and I may be one of the only people in the business saying that," he says. More employers realize that they need retirement plans, and trusted professional help to run those plans, which has led more advisors into this business, he says.

Anderson offers a data point to support his view that there's no consolidation happening, based on Cetera's recent look at the three largest recordkeepers with whom it does business. "Across these vendors alone, the number of advisors they did business with grew 15% over the past three years," he says. Rather than a lot of advisory firms getting acquired, he envisions more potential for independent advisors to affiliate with larger organizations that can give them the support they require to serve plans well.

It's true that after four successive record years of M&A activity among RIAs in 2014-2017, the year-over-year percentage increase slowed down in 2018. "Clearly, 2018 is not a blockbuster year, but I think that's the natural ebb and flow of transactions," DeVoe says. "The core structural dynamics remain: the natural power of scale, and advisor (aging) demographics and lack of succession planning. We still believe that over the next five to seven years, we are going to see a lot of merger and acquisition activity."

"I don't think we'll see massive consolidation, from 10,000 advisory firms to just three or four major players, or even six or seven," DeVoe continues. "But I do think we'll see consolidation at the top: There will probably be 20 or 30 mega-firms that will keep growing bigger."

The world of successful, independent retirement plan-focused advisory practices is already pretty small, Shoff says, so it won't take many deals to have an impact. "We're such a niche, within a niche, within a niche. If you take out the wirehouse teams and the banks, and you focus on independent retirement-focused RIAs that have at least $2 million in annual revenue, there are only about 75 of those advisory firms in the country," he says. "If consolidation means that 10 of those 75 do something, that's significant consolidation. That's not many retirement-focused advisory firms for CAPTRUST to acquire, but we're talking to all of them."

What will prompt more plan advisors to do deals? "If we have a significant correction in the market, we will see some advisors who have been on the fence start to think more clearly about affiliating," Popp predicts.

Morgan Stanley's O'Connor has seen a very slow increase in consolidation the past few years. "But I think we're going to hit an inflection point, and that's going to accelerate," he says. "A couple of elements are going to come together. Number one, there's the raising of the bar from plan sponsors expecting a higher level of service and technology.

"And number two, the regulatory environment continues to challenge plan advisors to maintain a very high standard of care," O'Connor continues. "Every regulatory agency has come to realize that the financial services industry is now responsible for helping Americans achieve a dignified retirement. Both state and federal regulators are putting greater and greater scrutiny on how we service these individuals."

Regardless of the current pace, more deals by retirement plan-focused RIAs are imminent, predicts Dick Darian, Charleston, South Carolina-based partner at Wise Rhino Group, a consulting firm that works with advisory firms to increase their enterprise value. "You are going to start to see 'name' firms with brand recognition do a deal," he says. "Right now it's a seller's market. But there will come a period when that will end, for example when there's a downturn in the broader economy. The cycle will end, and it will become a buyer's market."

JON ANDERSON
CETERA

For the near term, Popp anticipates a pretty quick pace of consolidation. "There are a lot of buyers out there, and they are really pushing valuations up on deals," she says. At some point, she says, valuations will reach a level where buyers start to hesitate, which will lead valuations to level out or decline. "It's already getting expensive again," she says of making acquisitions. "The last thing anybody wants to do is buy high."

» Judy Ward is a freelancer who specializes in writing about retirement plans.