MARKETS

Behind Discount Brokers' Boom: Advisers, Not Day Traders

Charles Schwab and TD Ameritrade rake in client assets, catering to wealth managers and reinvigorating their businesses

TD Ameritrade and Charles Schwab have pulled in about $200 billion combined in net new assets this year, most of which has come from independent advisers. **PHOTO:** CHRISTOPHER DILTS/BLOOMBERG NEWS

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Business is booming for discount brokerages.

But this time the players driving the boom aren't day traders chasing dot-com riches. They are independent financial professionals known as registered investment advisers who manage rosters of typically affluent clients and trade on their behalf with the assets held at the brokerage firms.

By catering to these wealth managers, the brokerages have reinvigorated a business that was racked by the tech-stock bust at the beginning of the century and the financial crisis. Two of the firms leading the way in serving these customers, Charles Schwab & Corp. and TD Ameritrade Holding Corp. , have pulled in about $200 billion combined in net new assets this year, most of which has come from the independent advisers, according to the companies. Smaller rival E*Trade Financial Corp. made a recent acquisition to better tap this business.

While the discount brokers have long served independent advisers, the business has picked up in recent years. "Firms that set up custody businesses for financial advisers are reaping the benefit," said Devin Ryan, managing director at JMP Securities LLC, as independent advisers "have been the fastest-growing area of the wealth-management industry."

The boom underscores two trends that have been upending the wealth-management sector in recent years: The first is a wave of traditional brokers leaving firms like Bank of America Corp.'s Merrill Lynch and Morgan Stanley as they seek to keep more of the fees and commissions they generate, and to maintain greater control over their business and less pressure to market certain types of products, from proprietary funds to credit cards to mortgages. The second is a new federal retirement-saving regulation, known as the fiduciary rule, aimed at curbing conflicted investment advice that has forced traditional brokers to retool their business models.

By 2020, research firm Cerulli Associates predicts that independent advisers will control more assets than Merrill Lynch, Morgan Stanley, UBS Group AG and other major brokerages combined.

Matthew Celenza, an independent financial adviser in Los Angeles, is among the converts. Mr. Celenza this year launched his own wealth-advisory business, Boulevard Family Wealth, with about $1 billion in assets after a six-year run with Merrill Lynch's private banking and investment group. "Going independent gives us better positioning in the business," Mr. Celenza said when he left Merrill in July.

Yet without the infrastructure provided by a traditional brokerage, finding a place to keep clients' money was one of the first things Mr. Celenza had to do upon going independent. He went with Schwab and estimates that his clients save 0.15% to 0.20% in annual fees now that their assets are held at the discount brokerage versus his former firm.

"I know the perception is that Schwab is a discount brokerage," Mr. Celenza said, but "they offer every service a large brokerage service would."

Schwab CEO Walt Bettinger said in October that his firm has logged substantial increases in the number of advisers, up 35%, and assets coming over from broker-dealer firms. At Ameritrade, which ended its fiscal year in October, new client assets on the adviser side surpassed last year's results by more than 50%, CEO Tim Hockey said in October, marking a record year for asset gathering.

Executives and analysts say the trends behind the discount brokerage boom are poised to continue, thanks in part to an increase in consumer awareness about the impact of investment fees and the differences between brokers and advisers. Registered investment advisers have for decades been required to put clients' interests first and typically charge fees, while brokers have operated under a standard in which they could recommend products that would pay them the most in commissions as long as the investment was deemed suitable.

"Fee-based, fiduciary models are the fastest growing areas of the industry," said JMP Securities' Mr. Ryan, and "there's massive market share opportunity" for "firms that set up custodial businesses for [independent advisers] and are reaping the benefit." He said the four big custodians—Schwab, Ameritrade, Fidelity Investments and Pershing, a unit of Bank of New York Mellon Corp. —have about 50% of the market for independent advisers and they continue to make inroads as they invest in their platforms.

Schwab and Ameritrade both attribute their strong net new asset growth largely to independent adviser clients. In the latest quarter, Schwab said core net new assets climbed 72%, or $51.6 billion, from a year earlier, while Ameritrade reported $19.9 billion in net new assets for the period, a 32% year-over-year increase. For Schwab, assets brought in by independent adviser clients rose by more than two-thirds; Ameritrade said such money accounted for about 80% of its net new asset growth.

Meanwhile, E*Trade Chief Executive Officer Karl Roessner said during the company's latest earnings call in October that E-Trade has been losing assets to independent firms, among others, and handles just about 10% of customers' investible wealth. "Accordingly, we have been searching for the optimal way to approach this population," he said on the call in discussing a deal to buy a custodian firm.

Observers say the discount brokerages are poised to gain more share of investor dollars as the independent adviser ranks expand. Dynasty Financial Partners, a firm that supports independent advisers and helps them break away from brokerages, has brought more than $25 billion in assets to firms, including Schwab and Fidelity, said CEO Shirl Penney. "The lifeblood is assets, and they're going one way, to the [independent adviser] space," he said.

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