



## BoA's Merrill Bid Is Dawn of New Distribution Era

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In one fell swoop, the face of retail distribution has been dramatically transformed.

**Bank of America's** \$50 billion bid for brokerage giant **Merrill Lynch** over the weekend has accelerated the shift toward a new paradigm for how mutual funds, exchange-traded funds and other investments are sold.

With Merrill coming under bank ownership and the large regional broker-dealers having been consumed by bigger banks in recent years, the different distribution channels are converging. "This muddies the water as to where the dividing lines are," says Dennis Gallant, principal and founder of **Gallant Distribution Consulting**. "The channels have to be redefined."

What had been a gradual trend toward astute consolidation in the brokerage industry has now suddenly been throttled ahead with an aggressive move by the largest U.S. commercial bank to buy the nation's No. 1 retail brokerage outfit.

The largest banks have been acquiring brokerage outfits in an attempt to capture a larger portion of customer assets and increase scale. In 2006, **UBS** bought Piper Jaffray. In 2007, **Wachovia** bought **A.G. Edwards**. It is also happening on the independent side of the business, with **LPL** acquiring three Pacific Life broker-dealers last year and Schwab continuing to expand its registered investment advisor network.

"You're looking at a completely different model for the distribution of financial products," says Lisa Cohen, president of **Momentum Partners**. "The wirehouse channel is completely gone." (Morgan Stanley is now the only true stand-alone wirehouse brokerage.)

Still, the BoA deal will create a new powerhouse in financial services, offering an unrivaled breadth of products — including banking, brokerage and insurance offerings — through a captive group of financial advisors. While the trend had previously been for firms to focus more on their core businesses, there is now potential for even the largest brokerages to be swallowed whole.

Under this new distribution model, the U.S. retail market more closely resembles its counterparts across the pond, where most European brokerage firms are operated by banks. "The universal bank model is the dominant model for large financial organizations in the rest of the world," says Robert Ellis, managing director of wealth management at **Celent**.

He argues that a large, well-funded commercial bank with a strong brokerage outfit is "the

winning model” for U.S. firms looking for an enduring foothold in the retail space. By adding brokerage and asset management revenues to the balance sheet in a downturn, BoA is offsetting any negative contribution from proprietary trading and investment banking.

The rub for fund companies is that the Merrill deal further tips the balance of power in favor of the distributors. Due diligence teams tasked with manager selection will wield greater influence over fund sales, making wholesalers less relevant. The largest distributors will have greater pricing power when negotiating selling agreements. And having fewer and bigger firms controlling distribution will prompt more broker defections from these large conglomerates to smaller, independent shops.

This puts pressure on fund firms to dedicate additional resources to the gatekeepers guarding the b-d platforms. Firms may have to hire analysts to conduct technical analysis or even junior portfolio managers to go out into the field to articulate an investment philosophy.

“As you get fewer and bigger home offices — and this deal creates a pretty big one — asset managers are going to have to rethink how they service the home office, which will change wholesaling dynamics somewhat,” says Ben Phillips, director at **Casey Quirk & Associates**.

Money managers will have even less leverage in negotiating selling agreements with the large distribution firms. “The distribution power for captive advisors is being further and further concentrated in a few gatekeepers’ hands,” says Chip Roame, managing principal of **Tiburon Strategic Advisors**.

Bank of America has been building its private banking and asset management capabilities over the last decade through acquisitions of **U.S. Trust**, Fleet Boston and its **Columbia Management** unit, which followed the merger with Nations Bank in 1998. The retail brokerage piece was the one area where it lacked a meaningful presence, analysts say.

The deal enables BoA to tap into a wider audience. “It allows them to serve a broader array of affluence,” Gallant says. “You have a better chance of getting new clients, keeping those clients and getting more of their wallet share.”

Still, there remains some upside for funds. When the dust settles from the Merrill acquisition, there will be winners and losers in the fight for shelf space, analysts say, with some firms gaining an edge from the deal by scoring opportunities previously not available to them. Others, meanwhile, may find themselves being pushed out of the Merrill platform by newcomers with strong BoA ties.

Phillips sees both advantages and drawbacks to the BoA model. “You can move lots of product through it very quickly,” he says. However, there will be stiff competition from products other than funds that have been traditionally sold through banks, he adds, which could cannibalize assets.

With the number of distributors shrinking, RIAs will become more attractive with some managers opting not to pay the higher shelf space payments to be on the big platforms. Similarly, financial advisors frustrated with the captive model and looking for more freedom are going to start their own practices or join an independent advisory firm. "RIA firms will make a play here," Gallant says.

Some observers view the transformation as a positive trend for the investors. "Even more brokers and advisors will be establishing their own firms, providing the retail public with more choice in an already over-served retail marketplace," Ellis says.

Momentum's Cohen sees the increasing number of independent financial advisors leading to a "more democratic process for how funds are sold," with more funds competing based on merit.