



## How the Rise of Mega-Banks Will Change Distribution

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The race is on.

With an emergency consolidation of Wall Street firms still in the early stages, it is already clear that having clout with the largest intermediaries will be the key to success for fund managers seeking global distribution.

The big banks will control a bulk of mutual fund distribution once **Merrill Lynch** and **Wachovia** are integrated with **Bank of America** and **Wells Fargo**, respectively. This wirehouse upheaval will stiffen competition for shelf space among fund managers as fewer platforms means less elbow room at the table for fund managers.

A number of industry experts say that the creation of fewer, larger distribution powerhouses will result in lost relationships, margin compression, fluctuations in market share, a rationalization of overlapping managers and a more rigorous manager selection process. In the new distribution landscape, fund managers will have to go to even greater lengths to prove the merits of their funds.

"It's going to cause some managers to be more aggressive in pursuing a vote of confidence from the home offices," says Chris Brown, principal of **Sway Research**. "There will be winners and losers." Essentially, mutual fund companies will have to beef up their analyst teams that pitch the broker-dealer consultants or gatekeepers in order to maintain market share.

Some managers are bound to get bumped off platforms where they've traditionally had success. "At some point, those selling agreements have to be re-papered," says Lisa Cohen, president of consulting firm **Momentum Partners**. "There will have to be a rationalization of platforms because there is going to be tremendous redundancy."

This comes at a time when wholesalers have become less effective in their ability to influence sales but more useful in providing consultative support and practice management tips. "The ability to impact the sale through wholesaling is waning," says Neil Bathon, founder of **Fuse Research Network**, a research firm in Boston. It levels the playing field for firms that lack the relationships but have strong performance, he says.

The current market downdraft has also served as a lesson for a lot of broker-dealers who are now beginning to rethink their asset allocation strategies. This creates opportunities for niche strategies and boutique shops to displace some of the industry heavyweights. "Everyone has to look at their strategy. They would be remiss if they don't consider any changes," says Dennis Gallant, principal and founder of **Gallant Distribution Consulting**.

With respect to the **Bank of America-Merrill** deal, Merrill's financial advisors will be the driving force behind the bank's success in intermediary sales. And the due diligence research department tasked with manager selection will likely be driven by Merrill personnel, analysts say. "The screening at banks wasn't all that good," Bathon says.

While the firm that takes over usually takes over the manager selection process, this is one instance where Merrill's research team is head and shoulders above Bank of America, experts agree. However, there may be an opportunity for funds on the BoA platform to migrate over to the Merrill platform, Momentum's Cohen says.

**Columbia Funds** would appear to be a winner in this equation, with the ability to tap into Merrill's legion of advisors. This would generate more revenue from fees for the bank than it would typically get from advisors using a non-proprietary offering. But all that depends on whether or not the funds pass through the screens. "It will create a new distribution opportunity for Columbia's great products, but a roadblock for their poor-performing products," Cohen says.

Some observers argue that Merrill reps would be reluctant to sell anything proprietary due to the stigma attached to in-house funds. Proprietary fund sales have suffered in recent years as enforcement actions have exposed a conflict of interest for the broker and fund performance has been mediocre at best. All else being equal, most reps would choose to sell a non-proprietary product to eliminate the mere perception of a conflict.

Further, Merrill has shown an aversion to proprietary products, as evidenced by its decision to spin off Merrill Lynch Investment Management, according to **Cerulli** senior analyst Scott Smith.

In cases where two money managers are focused on the same investment discipline, it is likely that Bank of America and Merrill would give the nod to one or the other rather than have duplicative offerings on their shelves. This is where there might be some friction between Merrill and BoA, in that Bank of America wouldn't want to burn a relationship just to appease Merrill leadership. A spokesman for Bank of America says that it is too soon to comment on what the Merrill acquisition will portend for its proprietary fund business.

One idea that has been bandied about is possibly folding the Columbia brand under the **BlackRock** family of funds, of which Merrill owns a 49.8% stake. That would alleviate concerns over proprietary products among advisors and create an even bigger asset management powerhouse. But most analysts say this is a long shot since there would be too many redundancies and that the large minority stake Merrill has in BlackRock would not be enough to make that happen.