TD RIAs could face sticker shock in Schwab's referral program

By Ian Wenik for CityWire

Schwab has elected to keep its pre-existing fee structure for Schwab Advisor Network, which could lead some ex-TD RIAs to pay more for referrals of wealthy clients.

Former participants in TD Ameritrade's AdvisorDirect RIA referral program may need to pay more for the clients they receive through Charles Schwab's Schwab Advisor Network.

Schwab has elected to retain its pre-existing tiered basis point fee pricing structure, according to a source familiar with the situation and Schwab presentation materials reviewed by Citywire.

The changes come as Schwab continues its consolidation of the two referral networks under the Schwab Advisor Network brand name. Schwab has invited 175 out of 298 prior participants in Schwab Advisor Network and AdvisorDirect to join the combined program, which sends out clients of Schwab brokerage branches needing complex advice to RIAs in exchange for a fee.

RIAs who participated in TD Ameritrade's AdvisorDirect program paid TD Ameritrade 25 basis points on client accounts up to $2m, 10 basis points on accounts between $2m and $10m, and 5 basis points on accounts above $10m. That pay structure, instituted in 2017, replaced an earlier model which had advisors pay TD Ameritrade 25% of the underlying advisory fee they charged to the client received via referral.

Charles Schwab's basis point fee tier structure takes more graduated steps and combines different fees to generate a final price. Like TD Ameritrade, Charles Schwab charges 25 basis points on the first $2m in assets of a given client obtained by referral. However, Charles Schwab charges 20 basis points on assets between $2m and $5m, 15 basis points on assets between $5m and $10m, and 10 basis points on assets above $10m.

A Schwab spokeswoman said that Schwab Advisor Network charges a 'blended' fee, which combines the basis point fees at different asset levels. An RIA who receives a $5m client through Schwab Advisor Network would pay 25 basis points on $2m in assets and 10 basis points on $3m in assets, for a combined fee of 22 basis points. In contrast, AdvisorDirect charged advisors a single flat fee based on the total number of assets referred, the Schwab spokeswoman said. An RIA who received a $5m client through AdvisorDirect would pay 10 basis points on all $5m in assets.

The new arrangement alters how much money some RIAs would pay for custodial referrals. For example, RIA aggregator Wealth Enhancement Group (WEG) — which is a member of both Schwab Advisor Network and AdvisorDirect — charges a 1% fee for accounts above $2m.

If WEG obtained a $5m client through AdvisorDirect, it would have to pay TD Ameritrade $5k annually. But if it obtains that client through Schwab Advisor Network, it would have to pay Charles Schwab $11k annually based on a blended fee of 22 basis points, a $6,000 increase.

The change is more dramatic for the largest referred clients. For a $50m household, an RIA would have to kick back $58,500 under the Schwab Advisor Network pricing, as opposed to just $25,000 under the AdvisorDirect pricing.

Advisors who join Schwab Advisor Network from AdvisorDirect will not have to retroactively apply Schwab's fee model to their old referrals, as those already-acquired assets are 'grandfathered under the AdvisorDirect fee schedule,' a Schwab spokeswoman said.

RIAs are still processing the impending pricing change.

'I need to review how our book of business looks to validate what impact, if any, this will cause,' said Brian Vendig, president of MJP Wealth Advisors, which is joining Schwab Advisor Network from AdvisorDirect. 'We also need to keep in mind that what branch locations a firm will be assigned balanced against the cost of the program is the other side of the equation.'

A Schwab spokeswoman told Citywire that it plans to reveal a final roster of branch locations to Schwab Advisor Network participants 'by the end of this month.'

One executive at an RIA joining Schwab Advisor Network from AdvisorDirect expressed surprise at the new pricing structure following a briefing with Schwab officials last week. The executive was granted anonymity so as to not jeopardize their new relationship with Charles Schwab.

'I think the fee is just… wow,' said the executive. 'I was blown away by that, because it is a definite money-maker.'

RIAs may be incentivized to raise their fees in response to the pricing changes, explained Mike Papedis, managing partner of RIA consultancy Fusion Financial Partners.

'The higher the referral fee becomes, the more pressure it places on the advisor's profit and loss to stay active in the program and/or be accepting of new referrals,' Papedis said. 'In other words, this may drive higher advisor fees to end clients by the advisor in order to keep desired, and needed, profit margins for their businesses, resulting in increased expenses to the client seeking professional advice.'

The pricing change may also reflect a new reality for RIAs: Charles Schwab's scale gives it the power to set the agenda for the industry.

'The custodians have the leverage in this interaction, so utilizing a "pricing agnostic" structure makes sense,' said Brandon Kawal, a principal at RIA consultancy Advisor Growth Strategies. 'Some will be frustrated with the move, but any RIAs in the program will have to remain diligent in their pricing strategy to ensure margins don't get squeezed.'

Cerulli Associates projected that Charles Schwab would provide custody for a slight majority of all RIA assets (51%) as a result of its 2020 acquisition of TD Ameritrade.
Charles Schwab said it provided custody for $3.2tn in RIA assets as of the end of the first quarter of 2021.

Advisors looking for an alternative source of custodial referrals have few other options. Fidelity's Wealth Advisor Solutions referral program charges RIAs $50k annually to participate, 10 basis points on fixed-income assets held by referred clients, and 25 basis points on all other assets held by referred clients.

'I think you have to swallow hard and decide,' said an executive at an RIA which was formerly part of AdvisorDirect but was not invited to join Schwab Advisor Network. The executive was granted anonymity so they could speak freely without jeopardizing their relationship with Charles Schwab.

Some RIAs may ultimately decide it is no longer worth committing the time and resources necessary to cultivate relationships with financial consultants at Schwab or Fidelity that could eventually produce referrals.

'If I am a smaller firm, do I want to be in that [referral program], do I want to commit the people to it?,' said the executive. 'It's not the cost, per se, of sharing the lead. It's the business model that you have to be staffed for.'