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MARKETS

Game Over for Broker Commissions

New rule on retirement accounts forces brokerages to rethink per-trade charges

By **MICHAEL WURSTHORN**

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Wall Street’s days of taking commissions appear numbered.

Commission-paying accounts, long a staple of the brokerage industry, are problematic under the Labor Department’s so-called fiduciary rule because a key provision in the rule that permits the use of commission-based retirement accounts continues to be seen as too risky for some in the industry.

The rule, set to take effect in April, doesn’t extend to nonretirement accounts.

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“There will be a natural slow death of commission-based brokerage business where advice is also being given,” said Bharat Sawhney, a managing director focused on wealth and investment management at consulting firm Gartland & Mellina Group. “I think a lot of firms will fall into the camp of trying to make commission accounts unattractive with higher minimums or less products available.”

A shift away from commission-based accounts could be tricky and costly for retirement investors who prefer to buy and hold investments for long periods or favor building portfolios that consist of bonds. It also challenges the Labor Department’s stance that firms will use exemption provisions in its rule to offer retirement savers the option of using a commission-based account when appropriate.

The latest move to limit commission-based accounts came this past week, when Bank of America Corp.'s Merrill Lynch unit said it would do away with individual retirement accounts that charge investors for each transaction. Edward Jones, meanwhile, said in August that investors could still get a commission-based IRA, but they won't be able to use it to invest in mutual funds and exchange-traded funds, making that option less attractive for some retirement savers.

Both firms plan to steer most investors toward accounts that charge a percentage of fees. Clients in those types of accounts are charged a level fee based on a percentage of their assets, minimizing potential conflicts tied to specific investment products, observers have said.



Bank of America's Merrill Lynch unit said it would do away with individual retirement accounts that charge investors for each transaction. *ILLUSTRATION: REUTERS*

The Obama administration has said retirement advice offered by conflicted brokers costs American families \$17 billion a year, and pushes down annual returns on their retirement savings by a percentage point. Financial-industry leaders have said those figures are inflated.

Fee-based accounts also tend to be more lucrative for brokerages. Researcher Morningstar Inc. estimates that fee-based accounts generate 60% more revenue than accounts that charge a commission. But brokerages need to ensure a move to a fee-based account is in the investor's best interest to comply with the rules, experts say. Merrill, for its part, is giving its brokers leeway to discount fees to make such a move easier for investors. However, the firm declined to disclose the extent of those discounts and how long they would last.

Still, some investors say they prefer paying a commission each time they buy or sell a stock, bond or mutual fund because it may be cheaper and gives them access to advice.

Keith Blankenbicker, a 66-year-old retiree in Wilmington, N.C., who used to work in the insurance industry, has to decide what to do with his six-figure commission-based IRA at Edward Jones, where he has a broker he calls regularly each month to review his holdings.

“I’m just looking at a big number that I’ve not considered as part of the deal,” Mr. Blankenbicker said of the thought of being charged a fee.

He said a 1% fee tacked onto his account would cut his annual yield in half, whereas now he currently pays the costs associated with rebalancing his portfolio and for a handful of trades. “The intent of the law is one thing,” Mr. Blankenbicker said, “but the implication for some of us means not getting a fair shake.”

An Edward Jones spokeswoman said the firm will continue to help clients reach their investing goals, but in a way that complies with all rules and regulations. “We still plan to offer a transaction-based account” to clients, the spokeswoman added.

A Merrill spokeswoman said: “We believe this is the right approach and best addresses the DOL’s concerns around conflicted advice.”

Brokerages that want to continue offering a commission IRA option to investors have to use what is known as the best-interest contract provision in the fiduciary rule. It allows brokers to receive variable or commission-based compensation in some circumstances. But it also opens firms up to risks, including class-action lawsuits from investors who feel their interests weren’t served, experts say, forcing firms, such as Merrill, to avoid the provision altogether.

“It’s making the industry very paranoid,” said Marcia Wagner, an expert in employee benefits at the Wagner Law Group. “Brokerages don’t want to become the next place that class-action lawyers go to.”

The Labor Department declined to comment for this article. Timothy Hauser, a deputy assistant secretary at the Labor Department, said in an interview with The Wall Street Journal late August that the “rule is structured in such a way to permit commission-based arrangements to allow third-party payments.”

“For some people, a commission structure is just right,” Mr. Hauser said then.

While the Labor Department didn’t ban commissions, the best-interest contract provision did make “life a lot harder for people who want variable compensation,” said Jamie Hopkins, a professor at American College of Financial Services in Pennsylvania and co-director of its retirement-income program. He says some investors who have less income may be put at a disadvantage if they lose the flexibility of choosing between a transaction system that offers advice and a fee-based structure.

Investors could choose to move their account from a full-service brokerage firm and into a self-directed option, a robo adviser that traditionally charges lower fees or a competing brokerage. Merrill, for instance, will be able to start directing some investors toward its own robo adviser under Bank of America early next year.

Mr. Blankenbicker hasn’t decided what he will do next. “I’m struggling with what I have to do,” he said. “I really liked the way I did business with [Edward] Jones.”

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