Compliance Outsourcing Demand Drives OSJ Mergers

By Murray Coleman March 27, 2017

The ongoing shakeout in broker-dealer ranks isn't going unnoticed in a growing marketplace for offices of supervisory jurisdiction, or OSJs.

Consolidation is likely to spread in the U.S. marketplace for outsourcers of compliance and regulatory work, say industry experts. Indeed, one of this year's biggest mergers is creating a new super-OSJ in broker-dealer **Royal Alliance's** network of 1,800-plus advisors.

The recent acquisition by Los Angeles-based **NWF Advisory Group** of another California-based firm, **WHJR Associates**, is **expected to represent** a $2.5 billion combined firm.

"The days of just receiving an override fee and doing some basic compliance work are over — you've got to really add value as a more diversified OSJ and wealth management firm," says **Shehab Mohammad**, NWF Advisory Group's chief executive.

While succession planning was its chief driver, the new deal was also spurred by a desire by WHJR's **Wolfgang Remkes** to expand from more of a "traditional OSJ line of business," according to Mohammad.

The combined firm is positioning itself to expand from a regional player to a national competitor in coming years. "We're in a marketplace that's in the process of consolidating up," Mohammad says. "That means smaller OSJs are increasingly finding that partnering with bigger and more diversified wealth management firms is a good way to strategically grow their businesses."

The march to larger OSJ networks is also seen as a natural evolution for a service industry that used to be organized mainly through broker-dealers. But those networks are fading in terms of raw numbers. Investment platform provider **Assetmark** estimated last year that those **ranks had thinned** by almost 25% in the past 15 years.

As a result, several independent firm leaders say they're looking to ratchet up their own internal OSJ service capabilities. One of those is Chicago-based **IHT Wealth Management**, which is in the process of a buyout of **U.S. Wealth Management**.

Steven Dudash

The combined entity manages more than $2 billion and includes a total headcount of 65 advisors, more than 60% of whom are now employed by IHT, according to **Steven Dudash**, the acquirer's founder.

"This is about succession planning," he says, noting that **John Napolitano**, U.S. Wealth's head, will keep practicing as an advisor within the merged companies. "John is in his early 60s and wants to return to what he loves to do the most — work with clients," Dudash says. "So this is a natural way to evolve both of our businesses."

He adds that combining the two firms offers advantages in scale. "With all of the competition in the OSJ market now, it's getting very inefficient to try to operate as a smaller standalone shop," Dudash says. "It just makes so much more sense in a highly competitive environment to partner with other experienced players to create a more comprehensive and uniform set of marketing, technology, legal and compliance platforms."

Another incentive he sees for big OSJs like his own to pick up M&A activities over the next several years is an aging population of firm owners. "Right now, this industry is in the sweet spot of baby boomer owners looking to find next-generation leadership," Dudash says.

But he predicts such a succession planning wave among RIAs and OSJs will peak over the next three to five years. "So we see this as a prime time for diversified firms to grow their in-house OSJ resources," Dudash says. "The math just makes too much sense — we're really moving into a golden era of consolidation in the OSJ and RIA space."

Demand for outsourced compliance-related duties is going up, agrees **Dan Catone**, president of **Golden State Wealth Management**. At the same time, though, he cautions profit margins are "razor" thin for OSJs of all sizes.

The longtime advisor moved into OSJ work about four years ago. His firm now manages nearly $1 billion — more than double its assets a year ago, according to Catone. "A vast majority of that growth has come from our expansion into offering OSJ services," he says.

Simply put, Catone adds, being able to offer "in-house compliance and consulting capabilities is turning into a great tool to attract top talent."

But to expand his indie RIA's recruiting game, he's also considering more than just tuck-ins to bring aboard new advisors. Catone says his firm is also entertaining discussions with smaller OSJs to merge operations.

To stay competitive, he's making sure to assemble a complete service menu — including OSJ responsibilities and a host of other investing, consulting, marketing and technology packages — that won't dent advisor payouts below 90%.

"This isn't a business for hobbyists anymore," says Catone. "You've got to be able to manage your costs and maximize an organization's economies of scale just to survive over the longer-term. And the competition is going to become even more fierce in coming years."