As featured in the December 20, 2016
issue of ThinkAdvisor ThinkAdvisor By Jon Henschen

Congress Got Schooled Once by a BD Owner; It Should Again

Jonathan Henschen says that as a recruiter, he knows that broker-dealers are facing a profit squeeze.

I must start this article by confessing that I'm not only a YouTube fan, but also the nerdy type that watches speech footage from the likes of economists Milton Friedman as well as various financial services thought leaders. Recently, I watched a broker-dealer owner give testimony to Congress. Listening to his testimony compelled me to feature his opening comments as the centerpiece of this article for two reasons. First, the content of his testimony was an onion of truth bombs. Second, his testimony reflected many of the thoughts and concerns that broker-dealer owners discuss in private but are afraid to say in public for fear of regulatory backlash.

The speaker, Peter Schiff, is the owner of the BD Euro Pacific, Inc., which is a full service broker-dealer specializing in foreign markets and securities. As we've seen an explosion of Fed money printing since 2008, Schiff has been talking up physical gold and silver as protection from our fiat currency. Back in 2006, Schiff was known for being vocal about his bearish views of the U.S. economy as he warned about an impending crash of real estate and financial markets, which earned him ridicule and mockery by numerous commentators on CNBC.

Peter Schiff's Remarks Before Jobs Committee

Here are excerpts from Peter Schiff's testimony in September 2011 before the House Government Oversight and Reform Committee, specifically the subcommittee on regulatory affairs, stimulus oversight and government spending.

"I guess you can say I'm in the economic and financial doom and gloom business. Thanks to this body, President Obama and the Fed, business is booming. I would rather profit from America's success rather than her failure, which is the reason I'm here today. We have some serious structural problems underlying the U.S. economy and we cannot solve them until we understand them.

"As a nation, we have borrowed and spent our way into a gigantic ditch. We are not going to get out of the ditch by spending more. We have to reverse the mistakes of the past, not repeat them. Government stimulus will never grow this economy, it will never create jobs and it's the equivalent of trying to put out a fire by pouring gasoline on it.

"We have to understand that the housing bubble, the financial crisis of 2008, two events I had predicted and warned about, were the consequence of Government stimulus. We stimulated our way into this problem and we're not going to stimulate our way out. In fact, the stimulus is actually a sedative. The stimulus is preventing the free market from unraveling the problems that years of bad monetary and fiscal policy have created. We don't need more spending, we need the opposite of spending, what we need is under consumption.

"What the economy lacks is savings, investment and production. If we try to preserve the jobs of the bubble economy with more reckless money printing, borrowing and government spending, all we're going to succeed in doing is preventing the restructuring we need and preventing more productive jobs from ever coming into existence.

"I want to talk specifically about jobs. I'm an employer of about 150 people. I would probably employ about 1,000 more if it weren't for government regulations that have inhibited my ability to hire and grow my business and force me to move portions of my business overseas in order to escape the regulatory burdens here. The questions are, why do I hire people and where are these jobs coming from? Jobs in a free market come from two things. They come from profits or the profit motive and they come from capital. You need both to create jobs and in a free market there are going to be plenty of jobs. If there are not enough jobs, Congress has to ask themselves, "What are we doing to inhibit this process?" How are we preventing jobs that would normally be here from coming into existence? Now, in order for me to hire someone, I need to be able to make a profit which means the person I hire needs to deliver to me more value than the cost of employing them. The cost of employing them is not just the wages I pay them but it's all the mandatory benefits, taxes and more importantly, the legal liability that I incur when I hire someone. In fact, one of the riskiest things you can do in America is to hire somebody and because of all the liability from government and from lawsuits that you have put on employers, most small businesses concerns are not how to hire people, but rather, how can I grow my business and hire as few people as possible? That is not something that happens in a free market rather that is something that happens as a consequence of government.

"The other thing you need to create besides profit is capital. People work for me because I have capital. I have the tools that my employees lack. They come to work for me and I give them an office, secretarial support, computers, leads and I give them a brand. But where does capital come from? It comes from savings or it comes from under consumption, so either I have to save it myself or borrow it from somebody else. But there's no money to borrow because it's all going to government or something government guarantees like education or home mortgages. There is no credit available for small businesses.

"It's actually a paradox, but what we need is higher interest rates. Higher interest rates encourage savings. These low interest rates are of no benefit to a typical business."

[As a recruiting firm, we concur that broker-dealers have experienced their largest profitability challenge by making miniscule revenue off money market accounts, which prior to 2008 accounted for as much as half their profits.]

"The low interest rates can benefit government because the government can borrow all this money from the bond market and some of the major corporations have access to cheap money. Wall Street can gamble with it, but small businesses can't sell bonds. They need to borrow money and there's no savings available, there's nothing there so business can't get capital and now there is no incentive to hire because the costs are too high. You're looking at somebody sitting here that has been fined and I'll be happy to talk about my experience. I was fined $15,000 by securities regulators because I hired too many people. Because I hired too many people, I incurred over $500,000 in legal bills defending myself. Because I hired too many people, regulators have me in a hiring freeze ordered for three years. They will not let me hire new people and they will not let me open new offices, despite the fact I was dying to do it. Our firm has plenty of demand, business is growing, but, unfortunately, thanks to what you guys are doing, regulators are preventing me from doing this.

"There are all sorts of ways rules and regulations have inhibited my business, and in fact, it's so expensive having started my securities firm in 1996, that there is no way I could have started that firm today. I have an entire compliance department that costs me millions a year just to stay in business, just to comply with rules and regulations, and they're not doing anything to protect my customers."

Testimony Rings True Four Years Later

Schiff brings up an interesting point regarding restrictions on growth that many advisors are not aware of, that regulators tell broker-dealers what the maximum number of advisors they can recruit in any given year. If a broker-dealer gets into regulatory hot water with FINRA, they will frequently use their growth allotment as a stick of discipline by cutting off their ability to add advisors. As with regulation in general, the little guy is hurt the most. If a broker-dealer is nearing its growth restriction in any given year, management will inform their lower producers that they need to find a new BD, which enables the broker-dealer to make room for larger producers wanting to join the firm. You know you are in an over-regulated industry when regulatory busybodies think they know better as to what your firm can handle in growth than the owners of the broker-dealer themselves.

Schiff's comment on regulation doing nothing to protect his customers also rings true. If regulation truly protected customers, we would have seen a sharp decline in FINRA fines. Instead, those numbers continue to increase. Advisors set on doing ill to their clients never follow rules or procedures; they work around them.

The entire philosophy of regulation is for the sake of bureaucratic employment rather than protection of the investor. Money spent on excessive staffing and FINRA fines could be used more productively for technology, advisor services and expansion but instead is squandered jumping through regulatory hoops.

Schiff's testimony to Congress was five years ago but the context of his speech is even more relevant today. As the new administration contemplates regulatory changes to the legacy they are inheriting, it would be apropos that input from broker-dealer owners will be included in the dialog. Nothing speaks more truth than entrepreneurs who have skin in the game.

PO Box 56, Marine on St. Croix
MN 55047
TEL 888.820.8107 651.433.3501
jon@henschenassoc.com
www.FindABrokerDealer.com