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THE HISTORY OF ZERO COMMISSIONS

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On October 2nd, 2019 Charles Schwab, Fidelity Investments, TD Ameritrade, Interactive Brokers and E*TRADE finally cast the last straw in the commission race and reached zero fees on trades of stocks and exchange traded funds (ETFs). While this most recent drop by the four largest "discount brokerages" is a milestone, it has been a long time coming. Newer investors often have no idea just how far we have come.

May Day

The first cuts to brokerage commissions began 44 years ago, in what investment professionals now refer to as "May Day", when President Gerald Ford signed the Securities Acts Amendments of 1975 into law. Prior to this, commissions on stock trades were fixed.

As hard as it might be for today's investors to believe, before May Day every brokerage firm charged the same commission for the same transaction, as the law forbade them from charging otherwise. The cost of buying 100 shares of General Electric was the same whether you went to Merrill Lynch or E.F. Hutton.

The "unfixing" of commissions in 1975 also spawned a new kind of brokerage firm: the discount broker. By offering trade executions through salaried staff, Charles Schwab was among the first to charge individual investors less.

The Evolution

At first, traditional brokerage firms dismissed discount brokerage as nonsense. After all, stocks were sold, not bought, and only a few foolish investors would buy and sell stocks on their own without the advice of a Wall Street firm.

Well, over the years the number of "fools" kept growing, and while most investors continued to prefer to buy stocks and mutual funds from someone who would give them advice, the clear price difference between discounters and "full-service" firms eventually eroded what the big firms could charge.

Not only did it cost more to put together a portfolio back in the day, investors tended to have more concentrated portfolios than an investor today. Well-heeled investors were buying a handful of recommended stocks, most likely no more than 10 to 15. Therefore, investors held much riskier portfolios and paid a much higher cost to build them.

That realization, as well as the simple economics of recurrent fees being far more lucrative for securities firms than ever-declining commissions, resulted in brokerage firms embracing fee-based accounts. The advice-driven, fee-based account structure that evolved singlehandedly built the Registered Investment Advisor (RIA) industry into what it is today.

The Final Revolution

In some ways, the eventual race to zero commissions was inevitable, given open competition and more recent technology driven platforms like Betterment and Robinhood being introduced to a rather stale and traditional marketplace.

In actuality, the final leg of the zero fee race began in earnest not all that long ago – in February of 2017 – when Fidelity Investments and Charles Schwab made moves in quick succession to slash equity commissions for the first time in a decade. Fidelity cut equity commissions to $4.95 from $7.95 a trade, rival Charles Schwab swiftly followed by slicing its own fees on standard online trades to $4.95, from $6.95, and TD Ameritrade later followed and reduced its online equity trade commissions to $6.95, from $9.99.

The markets weighed in on October 2nd, 2019 when future commission income was removed from earnings expectations, sending brokerage stocks sharply lower. At the time, Bank of America estimated TD Ameritrade generated 28% of its revenue from commissions, E*TRADE generated about 17% and Schwab only 8%. Fidelity was not listed as it is privately held.

ONLINE BROKERS

CHARLES SCHWAB	38.41	[-8.18%]
INTERACTIVE BROKERS	49.94	[-7.14%]
ETRADE	35.93	[-17.76%]
TD AMERITRADE	36.67	[-21.48%]

Fiduciary Focus

While "free" certainly catches people's attention and makes for a great headline, the move to no-cost commissions was more of an evolution than a revolution.

Today's RIAs, like WT Wealth Management, now focus on building deep and meaningful relationships with clients. The emergence of the Fiduciary Standard firmly places your advisor in your corner for the first time in modern investing history. With the industry-wide adoption of fee-based advisory services, your advisor has no reason to do anything other than what's in your best interest. Exactly the way it should be.

SOURCES

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