Investment Advisers and Fee Disclosures

02.12.18

The Massachusetts Securities Division (MSD) recently announced that it is seeking comments on a proposed format to standardize the disclosure of investment advisory fees.[1] This step should be noted by investment advisers across the country.

After all, fee transparency is generally not a controversial objective—especially because fees are publicly disclosed on advisers' Form ADV Part 2. Further, regulators and clients may view the publication of simplified fee tables as a means to recognize efficiencies by disrupting existing business models. Moreover, the focus on fee disclosures lines up with the broader conversation about fiduciary duties in the financial services industry. Finally, the MSD is viewed as a leader amongst securities regulators and has previously led a similar fee disclosure effort for broker-dealers. These realities suggest it may not be long before your state's securities regulator considers a similar approach for registered investment advisers. While the utility of a public, standardized "fee table" is debated, investment advisers should prepare for scrutiny—in the near term—on the form and quality of their fee disclosures.

- **Identifying services that are—and are not— covered by fees:** Investment advisers routinely charge fees tied to the assets under their management (i.e., AUM fees). However, investment advisers differ as to the types of services they incorporate into their AUM fees. For example, Firms A and B both charge an annual AUM fee of 1.5%, but Firm A includes the preparation of a financial plan into that fee, whereas Firm B wishes to charge a seperate hourly fee for such plan preparation.
    - Your firm's fee schedule likely identifies the various types of fees, but you may want to review it to assess how clearly it discloses what is covered by the various fees.
    - If third-party fees and costs are routine and necessary to your services but are not included in your fees, it may be helpful to clearly discuss that such costs will be in addition to your fees. The most common example for asset managers are the brokerage transaction costs.While highlighting the existence of such additional costs may be useful, it does not mean you necessarily need to identify the rates or amounts associated with such third-party costs.
- **Fees in excess of industry norms:** Long-standing guidance from the SEC indicates that an investment adviser's fee must be consistent with the adviser's status as a fiduciary. In a similar vein, regulations specifically require investment advisers to disclose when their fees are in excess of industry norms. For example, investment adviser firms registered with Texas charging an AUM fee of 3% or higher must disclose the fee is in excess of the industry norm and that similar advisory services can be obtained for less. Accordingly, investment advisers should review their fee rates and make adequate disclosures to ensure they are complying with their fiduciary duty and applicable regulations.
- **Format considerations:** It is helpful to remember a central tenant—the format and language used for the best disclosures account for the sophistication of a firm's clients and prospects. Keep this in mind when reviewing the format, terminology, and organization of fee and cost disclosures. By way of example, many investment advisers already utilize a table format when listing their fees on investment management agreements and the Form ADV Part 2. However, any discussion of the fact that brokerage costs are in addition to such fees is typically not included along with the table—if at all. Wise advisers should review how, and where, costs associated with their services are discussed in relevant documents.
- **Solicitor Referral Payments:** We are seeing investment managers increasingly interested in compensating persons for referring clients. The use of "solicitors" is permitted assuming your firm complies with relevant state and federal laws. In addition to other requirements associated with solicitors, there are specific disclosure requirements included in Rule 206(4)-3 under the Investment Advisers Act of 1940. As a result, a simple discussion in the Form ADV Part 2 may not be enough. Firms utilizing paid referral sources must be mindful of the

specific requirements and may want to consider how to bolster their disclosures even if they are not technically subject to certain ones.

- **Website Publication:** Most investment advisers now maintain websites. Accordingly, a firm may be considering the addition of its fee schedule to the website. The fee information is already publicly available on the Part 2, but there are business considerations tied to the accessibility of a firm's website. For example, how many valuable prospects will you lose the opportunity to meet simply because they can't see the value of your fee without meeting you? Conversely, how much efficiency will you realize on business development if you don't have to meet with prospects that don't meet your account minimums or will never see the value you offer?

Wherever your firm lands on the business decision, it is best that any discussion of fees is factual and is not used as an opportunity to "sell" your services. In other words—don't confuse disclosure with marketing. Investment advisers will serve themselves by viewing any discussion of their services and fees, whether on the Form ADV Part 2 or your website, as disclosures only.

[1] http://www.sec.state.ma.us/sct/sctfeetable/feetableidx.htm

Contact:
Ronak V. Patel
512.370.2892
rvpatel@winstead.com