

Comments on Fiduciary Standards for Retail Investor Advisers: More effective disclosure should supplement any changes to formal standards

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I was pleased to learn of Chairman Clayton's call for comments on this topic (Clayton (2017)). While I was at the Commission we discussed some of the problems posed by the DOL rule for various advisers' business models. What I learned about "disclosure" in this space did not encourage me to believe that the investors who most needed an expert's financial advice would understand the information being provided.

In fact, determining the cost of financial advice is extremely challenging. (For example, see Fuller (2017)). Even if a retail investor did understand the implications of various disclosures, s/he would have a hard time piecing together all the disclosure formats and the time(s) at which fee and other disclosures were provided. I believe that the SEC's reluctance to specify a strong fiduciary standard for financial advisers harms many retail investors. I also understand that it will be challenging to develop a uniform standard even if that standard is not combined with one produced by the DOL, given the variety of business models underlying the financial advice market.

As a concomitant of any SEC rules regarding fiduciary standards, therefore, I suggest that the SEC require any person offering financial advice to provide a periodic report to his/her clients, describing the fees that were charged and how those fees relate to the size of the portfolio being managed. The attached "Personalized Periodic Adviser's Report" provides an example of what I have in mind. It aims to provide retail investors with two sorts of information:

- a) How much the investor is paying for financial advice.

- b) Signs of potential bias in a financial adviser’s recommendations, toward products that earn him/her or his/her firm relatively large compensation.

The sample report (attached) differentiates fees paid to an adviser, the adviser’s firm, and other service providers. It also separates newly-purchased assets from those purchased in prior periods, and includes a rudimentary separation of fees across different sorts of potential investment assets. The summary of all fees and costs, provided at the bottom of the report, is as follows:

	Paid to Adviser	Paid to Adviser's Firm	Paid to Others	Portfolio Market Value
Sub-totals:	\$ 256	\$ 2,475	\$ 385	\$139,200
Total (dollars)	\$ 3,116			
Total (%)	2.24% of AUM			

I encourage you to look at the complete form, in an attached Excel file. That sheet is reproduced below as a pdf page.

**Cost of Financial Advice**

The sample Report collects all fees and costs associated with assembling or maintaining an investor’s portfolio into a single place. It expresses those fees and costs as a proportion of the investor’s portfolio size, so s/he can get a clear answer to the question “how much did I pay for advice this period?” This same answer will facilitate comparisons of adviser costs across potential suppliers of financial advice. If the adviser was also required to report publicly this “bottom line” fee proportion for classes of portfolio size (or other relevant characteristics), commercial services such as Consumer Reports, AARP, or Morningstar could use those reports to identify relatively cheap or relatively expensive advisers.

This sample Report summarizes the sort of information an adviser should be providing to customers on a regular basis. Mandatory distribution of this Report will encourage conversations

between advisers and clients about the nature and value of an adviser's services – conversations which they should be having already. I would like to see the report produced quarterly, but semi-annually or annually might suffice.

### **Identifying Potential Bias in Financial Advice**

Returning to the summary component of the proposed report (above), note that the investor could also see whether an adviser or his/her employer was unduly benefiting from charges paid. In the sample I have provided, for example -- please, see the full report in the attached Excel sheet or the following page here – the Adviser's Firm charges a wrap fee of 1% on the portfolio's market value. Because some of the portfolio is invested in "Mutual Fund XXX", the investor pays some other financial service provider 1.10% expenses for managing the mutual fund. It is important to include such mutual fund fees in addition to the wrap fee in order to convey the complete cost of financial advice.

### **Recommendation**

Although the attached report is relatively crude and simple, it illustrates my main point: that retail investors would be greatly aided by a regular, clear disclosure of the total costs of financial advice. Such a report would enlist investors' self-interest in disciplining financial advisers, and would encourage advisers to explain the value of their services. Regardless of other policies the Commission might take in this space, I strongly urge you to consider requiring this sort of periodic report for all professionals who hold themselves out as financial advisers, regardless of their technical qualifications or registration.

### **REFERENCES**

Fuller, Andrea, "What's my Investing Fee? A Frustrating Quest", Wall Street Journal (May 7, 2017)

Clayton, Jay, "Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers" (June 1, 2017)

<i>Personalized Periodic Adviser's Report</i>				
	Paid to Adviser	Paid to Adviser's Firm	Paid to Others	Market Value
<b>Annual Fee (% of AUM)</b>	0.00%	1.00%	0%	
<b>Part 1: New Investments purchased THIS period</b>				
<b>1,000 shares of ABC</b>				<b>\$8,200</b>
Commissions and similar (\$)		\$35		
Mutual fund charges and fees (%)				
Principal Markup (%)				
<b>50 XYZ Corp bonds</b>				<b>\$20,000</b>
Commissions and similar (\$)				
Mutual fund charges and fees (%)				
Principal Markup (%)		3.0%		
<b>Mutual Fund XXX</b>				<b>\$35,000</b>
Commissions and similar (\$)		0.70%		
Mutual fund charges and fees (%)	0.40%		1.10%	.
<b>Part 2: Investments purchased during PRIOR periods</b>				
<b>Stocks and bonds</b>				
All charges and fees (\$)				<b>\$47,000</b>
<b>Mutual Fund ZZZ</b>				
All charges and fees (%)	0.40%	0.70%		<b>\$29,000</b>
<b>Investment 8</b>				
All charges and fees (%)				<b>\$0.00</b>
<b>Sub-totals:</b>				
	\$ 256	\$ 2,475	\$ 385	<b>\$139,200</b>
<b>Total (dollars)</b>	<b>\$ 3,116</b>			
<b>Total (%)</b>	<b>2.24% of AUM</b>			