

August 14, 2019

Vanessa Countryman, Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Dear Ms. Countryman,

In the spirit of advancing the Securities and Exchange Commission's (SEC) mission to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation that we submit this petition to amend Form ADV, Part 1A, Item 5 ("Information About Your Advisory Services"), Section E ("Compensation Arrangements") by requiring investment advisers to disclose the schedules of fees levied for their services and other compensation in a standardized format.

As the SEC is well aware, investors' understanding of the distribution of fees and costs charged by advisers is a key component of an efficient market for retirement advice. Yet, the current availability of information makes it difficult for investors to know how a particular adviser's fees compare relative to the market and to compare prices for various levels of service. Indeed, a 2017 article in the *Wall Street Journal* noted that "Describing the fee disclosures of my adviser as opaque would be generous."¹ As we discuss below, the proposed change to the form will protect investors from exploitation, instill more efficiency in the selection of an investment adviser, allow lower-cost advisers to better compete on price, and facilitate greater capital formation by steering investors to lower cost—but equivalent quality—investment advisers.

Changes to Form ADV could, in effect, put the information regarding adviser fees on par with that provided for expense ratios associated with various funds. Under the current disclosure landscape, investors in mutual funds and exchange-traded funds (ETFs) can know with limited effort how a particular fund's expenses compares to other similar funds. For example, discount online brokerages often allow investors to search for funds by sorting on various criteria—including the relative prices of investment expenses. In stark contrast, investors cannot know with reasonable effort how a particular adviser's fees compare to others. (We acknowledge the helpful role of the detailed fee schedule provided in ADV Part 2 [the "Brochure"], although the provision of this fee schedule does not facilitate comparison across advisers.)

There is a robust and growing literature showing that comparative pricing information among services reduces the price of those services. The advent of online shopping, facilitated through

¹ Fuller, Andrea. 2017, May 7. "What's My Investing Fee? A Frustrating Quest." *Wall St. Journal*. Retrieved from <https://www.wsj.com/articles/whats-my-investing-fee-a-frustrating-quest-1494209820>.

online search engines, has resulted in decreasing prices for life insurance,² health care,^{3,4,5} low-cost airlines,⁶ and hotel rooms,⁷ among other goods and services. In online retail, price information displayed on price comparison websites results in lower prices, controlling for the quality of those websites.⁸ In other contexts, price transparency provided by third parties has been shown to reduce prices in health care,⁹ and would enable physicians to negotiate lower prices from manufacturers for medical devices.¹⁰

Similar effects can be observed from increased transparency in the financial sector. A series of experiments indicate that transparency in trade information increases trader welfare by reducing bid-ask spreads.¹¹ Another study suggests that the introduction of OpenBook on the New York Stock Exchange generated greater pre-trade transparency, making prices more efficient.¹² When transparency is limited, high search costs have been found to increase the dispersion of fees charged by mutual funds, reducing efficiency and creating opportunities for rent seeking.¹³

Increased transparency, expressed as greater disclosure requirements, directly benefits investors. A recent working paper finds that greater fee disclosure requirements for indirect fees earned by 401(k) service providers resulted in a shift to charging direct fees and a reduction in total fees incurred.¹⁴ The study also showed that increased disclosure of indirect fees led mutual fund providers to increase their offering of fund share classes with lower fees, and retirement plans to offer more low-cost mutual fund investment options to investors. Another recent study finds that

² Brown, Jerry R. and Austan Goolsbee. 2002. "Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry." *Journal of Political Economy* 110(3): 481–507.

³ Brown, Zach Y. Forthcoming. "Equilibrium Effects of Health Care Price Information." *Review of Economics and Statistics* (Accepted 2018).

⁴ Christensen, Hans, Eric Floyd, and Mark G. Maffett. 2013. "The Effects of Price Transparency Regulation on Prices in the Healthcare Industry." *SSRN Electronic Journal* 10.2139/ssrn.2343367.

⁵ Whaley, Christopher. 2015. "Searching for Health: The Effects of Online Price Transparency." *SSRN* <http://dx.doi.org/10.2139/ssrn.2684809> (working paper).

⁶ Moreno-Izquierdo, Luis, Ana B. Ramón-Rodríguez, and Jose Francisco Perles-Ribes. 2015. "The Impact of the Internet on the Pricing Strategies of the European Low Cost Airlines." *European Journal of Operational Research* 246 (2): 651–660.

⁷ Johnson, Eric J., Wendy W. Moe, Peter S. Fader, Steven Bellman, Gerald L. Lohse. 2004. "On the Depth and Dynamics of Online Search Behavior." *Management Science* 50 (3): 299–308.

⁸ Bodur, H. Onur, Noreen M. Klein, and Neeraj Arora. 2015. "Online Price Search: Impact of Price Comparison Sites on Offline Price Evaluations." *Journal of Retailing* 91 (1): 125–139.

⁹ Lieber, Ethan M.J. 2017. "Does It Pay to Know Prices in Health Care?" *American Economic Journal: Economic Policy* 9 (1): 154–179.

¹⁰ Pauly, Mark V. and Lawton R. Burns. 2008. "Price Transparency for Medical Devices." *Health Affairs* 27 (6).

¹¹ Bloomfield, Robert and Maureen O'Hara. 1999. "Market Transparency: Who Wins and Who Loses?" *Review of Financial Studies* 12 (1): 5–35.

¹² Boehmer, Ekkehart, Gideon Saar, and Lei Yu. 2005. "Lifting the Veil: An Analysis of Pre-trade Transparency at the NYSE." *Journal of Finance* 60 (2): 783–815.

¹³ Iannotta, Giuliano and Marco Navone. 2012. "The Cross-section of Mutual Fund Fee Dispersion." *Journal of Banking and Finance* 36 (3): 846–856.

¹⁴ Badoer, Dominique C., Charlie Costello, and Christopher M. James. 2019. "I Can See Clearly Now: The Impact of Disclosure Requirements on 401(k) Fees." *SSRN* <https://ssrn.com/abstract=3093073> (working paper).

increased disclosure requirements for hedge funds resulted in more accurate financial reporting, thereby aiding investors searching for the best investment allocation.¹⁵

It is in the vein of increasing transparency and improving net returns for investors that we propose the following changes to the Compensation Arrangements section of Item 5, in Form ADV Part 1A:

- Under Section E.1 (required if investment advisers indicate that they are compensated based on a percentage of assets under management), add “Indicate the median (typical) fee and range (25th percentile to 75th percentile) of fees charged as a share of assets under management: _____.”
 - If this charge varies based on the quantity of assets or some other criteria, the adviser must disclose how it varies and what the criteria are for variance.
- Under Section E.2 (required if investment advisers indicate they are compensated based on hourly charges), add “What is the median (typical) hourly rate billed to clients last year? _____.”
- Under Section E.3 (required if investment advisers indicate they are compensated based on subscription fees), add “What is the typical billable rate for subscriptions? _____.”
- Under Section E.4 (required if investment advisers indicate they are compensated based on fixed fees), add “Provide the fixed fee schedule and describe the conditions under which the schedule changes: _____.”
- Under Section E.5 (required if investment advisers indicate they are compensated based on Commissions), add “Indicate the fee schedule for commissions: _____.”
- Under Section E.6 (required if investment advisers indicate they are compensated based on performance-based fees), add “Indicate the fee schedule and criteria for performance-based fees: _____.”

By providing detailed, comparative information about how they are compensated for their services, investment advisers will empower consumers to make more informed decisions about the value of the services and advice they receive. This added transparency may well increase trust between investment advisers and their clients, and trust—more so than the risk and return characteristics of particular investments—appears to matter much more in investors’ portfolio allocation decisions.¹⁶

¹⁵ Honigsberg, Colleen. 2019. “Hedge Fund Regulation and Fund Governance: Evidence on the Effects of Mandatory Disclosure Rules.” *Journal of Accounting Research* <https://doi.org/10.1111/1475-679X.12270> (early view).

¹⁶ For example, one study noted that “Portfolio decisions appear to depend more on investors’ perceptions about the investor–adviser relationship than on the risk and return characteristics of investments comprising the portfolio choice set.” Monti, Marco, Vittorio Pelligra, Laura Martignon, and Nathan Berg. 2014. “Retail investors and Financial Advisors: New Evidence on Trust and Advice Taking Heuristics.” *Journal of Business Research* 67 (8): 1749–1757.

Such information will also aid advisers with more competitive pricing to better-compete with more expensive advisers, as these lower-cost advisers can describe with precision how their fees compare relative to their counterparts.

Finally, it should be acknowledged that this petition builds upon Amendment 84 FR 33630.¹⁷ As you are aware, this amendment considered adopting a new requirement for more specific disclosure of fees by investment advisers in Form ADV in the comments process. Ultimately, out of fear of overwhelming consumers with information and to allow investment advisers more customization in their reporting, rulemakers instead recommended instructions that left the discussion of fees vague. As outlined in the review above, more customization reduces comparability, and since fees incurred represent a major factor—if not the principal factor—in investors' choice set, the benefits of disclosing fees levied for investment services far outweigh the costs.

Thank you for your consideration of this petition to amend Form ADV Part 1A. If you have any questions or comments, please contact Benjamin Harris at the email address provided below.

Sincerely,



Dr. Benjamin H. Harris
Executive Director, Kellogg Public-Private Interface at Northwestern University
benjamin.harris@kellogg.northwestern.edu



Greg Nantz
Research Assistant, Kellogg Public-Private Interface at Northwestern University

¹⁷ “Form CRS Relationship Summary; Amendments to Form ADV” 84 *Federal Register* 33492 (12 July 2019): 33492–33669.