



You Are How You Are Paid

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Investment advisors come in many varieties; some provide financial counseling, some manage investment portfolios and others are transaction based. Yet all advisors fill out the same Form ADV and are lumped in the same database. There needs to be a change in the system. The SEC should separate firms based on what each firm actually does so that the public can make a more informed decision when choosing an Investment Advisor.

According to Form ADV, an "Investment Advisor" is anyone who:

- (1) Provides investment supervisory services;
- (2) Manages investment advisory accounts not involving supervisory services;
- (3) Furnishes investment advice through consultations not included in investment advisory services;
- (4) Issues periodicals about securities by subscription;
- (5) Issues special reports about securities not included in a periodical;
- (6) Issues, not as part of any service described above, any charts, graphs, formulas, or other devices which clients may use to evaluate securities;
- (7) Furnishes advice to clients on matters not involving securities;
- (8) Provides a timing service;
- (9) Furnishes advice about securities in any manner not described above.

There are many different ways an investment advisor can be paid. Here is the list provided by SEC Form ADV:

- (1) Percentage of assets under management (AUM)
- (2) Hourly charges
- (3) Subscription fees (for a newsletter or periodical)
- (4) Fixed fees (other than subscription fees)
- (5) Commissions
- (6) Performance-based fees

These categories of services and payments cover a lot of landscape. As such, the term Investment Advisor is vague and confusing, especially for the general public. To simplify matters, I believe the SEC should start referring to Advisors in a different way.



One of the clearest ways to define an Advisor is how they earn revenue. The way a firm earns money accurately describes the primary business they are in. There are three ways advisors are paid; fees for consultation, asset management fees, and sales commission.

“Consultants” provide the purest form of ‘advice’ because they earn a fee for consulting. The advice provider is paid whether or not a client does what is recommended. Payment types include hourly charges, annual retainers, subscription fees, and pay as you go. Falling under this category are hourly fee-only financial planners, subscription research firms, pay-as-you-go research firms, and newsletters.

“Asset Managers” manage assets. Advisors that are asset managers typically charge a fee based on the amount of money they manage. The irony of asset management is that the managers generally do not ‘advise’ investors on what they are doing in a portfolio, rather they just do it. In my opinion, calling an asset manager an “Advisor” misrepresents what they do because it is not how they are paid. They are paid as managers of money, and any advice is ancillary to asset management services.

“Brokers” earn commissions from transactions. A broker may advise a client on which securities to buy or sell, but if the client takes no action the broker does not get paid. As such, Brokers have the most difficult time justifying being called an Advisor. They are paid by transaction even though they may give ancillary advice that leads up to a transaction.

There are many benefits to switching from an all encompassing Advisor title to Consultants, Asset Managers and Brokers. For example, the current contention is that it is not possible for a person who is paid commissions to offer unbiased advice. Therefore, many non-brokers argue that a Broker should not be called an Advisor. Under the new classification method, the word Advisor goes away, so the issue goes away.

Let’s go a step further. A growing number of Advisors call themselves “Fee-only financial planners.” However, a look at revenues reveals that many of these people are not in the primary business of offering financial planning advice. They are in the business of gathering assets and charging asset management fees. Under the new classification methodology, fee-only financial planners who are primarily paid to manage assets will be required to promote themselves as Asset Managers. The change would clearly articulate to the public what these Advisors do rather than what want they want the public to think they do.



The time has come for change in the ADV structure. How a firm earns a majority of its revenue best describes what that firm does. The SEC should create a system where Advisors are required to advertise their practices based on their main source of revenue rather than how a firm wishes to be perceived. If the SEC makes Advisor revenue disclosure a required item and then classifies firms by their dominant revenue stream, the general public will be better served.

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