ADVISER FEE SCHEDULES CREATE OPERATIONAL HEADACHE

Investment companies explore automated tech to manage fee billing

By Danielle Kane

Highly varied adviser fee schedules have put back-office personnel in the middle of a logistical maze as they try to document and report an assortment of fee arrangements. Without regulatory guidance on this issue, advisers are free to be as creative as they want in structuring billing arrangements, industry experts told *Fund Operations*. This variation is forcing transition away from manual oversight to technology to streamline fee data for operations teams.

"Managing fees has always been one of those hidden factories that creates both operational and compliance problems for registered investment adviser firms," said Al Leary, SVP at Trust Company of America. "Fees are often managed by Excel spreadsheets and operational muscle. It can be both difficult to manage and difficult to assess for consistency, unless the firms focus on the fee billing process."

Enter the fee billing dilemma. How advisers charge fees can run the gamut from billing in arrears or billing in advance, to flat-fee rates, linear fees, tiered fees, billing based on account value, and billing on a client's average daily balance, according to Eric Clarke, CEO at Orion Advisor Services. Billing in arrears means invoices reflect fees and activities from a prior and pre-established time period, i.e. charging for services already used.

"Without exception, there is one absolute best practice with billing, and that is billing on average daily account balance in arrears," Clarke told *FO*. The method considers all daily cash flows and market value fluctuations. "This way, you don't have to pray for the market value to be high on four specific days of the year [if you were doing it quarterly]," Clarke said.

As fee billing arrangements can vary across the industry, regulators give advisers some latitude, according to Clarke. "Regulators have not come out and said everyone needs to invoice a certain way. And because of that, many firms have created a ton of arrangements, which are properly disclosed, but there are just so many arrangements to deal with," Clarke said.

Moving away from manual processes

Due to the heavy operational lift managing adviser and retirement plan fee schedules takes, Bob Ward, chief revenue officer at Vertical Management Systems, advocates for both asset management advisers and recordkeepers to look to technology to help.

VMS is partnering with Alerus Retirement and Benefits to develop a billing system for recordkeepers to track this information, which will be in production during the first half of 2018.

"The wealth management industry is in desperate need of a retirement billing application to handle the varied adviser fee schedules, store contractual fee arrangements, calculate fee payments, and generate fee invoices to complete workflow needs to ensure compliance with the plan in a cost-effective manner for recordkeepers," Ward told *FO*.

He continued, "In the retirement world, a recordkeeper deals with hundreds of advisers, so the recordkeeper issue is a significant multiple more than one individual adviser's [fee schedules] because they need to track if for all of the advisers they deal with."

TCA offers a fee management tool for the advisers themselves. TCA's tool consolidates portfolio management, fees, reporting and analytics in one database. The platform aims to ease manual operations by eliminating the need to interact with multiple systems, according to TCA's Leary.

"As the fee environment is under more and more pressure, advisers are changing how they actually charge their fees," Leary said. "The management of assets is rapidly commoditizing. The highest value that advisers bring to their clients is themselves. Any fee engine needs to enable advisers to assess fees that best capture the value they provide clients."

A new perspective

While fee billing schedules continue to heighten in variation, so are fee structures themselves. Some market participants are changing how they determine fees. Advisers have typically charged fees based on clients' assets under management, but The Planning Center, a financial planner in Moline, Illinois, decided to charge based on net worth instead.

"From 2003 to 2008 we developed this new model, and the notion was that we would charge a certain percentage based on someone's core net worth and a certain percentage based on their income," said Matt Sivertsen, senior financial planner at The Planning Center. "As financial planners, we would then provide cash flow management, goals planning, tax projections and more."

Sivertsen explained that for advisers, when fees are based on AUM, it can sometimes cloud advisers' ability to plan adequately for the end client. For example, if a client got a $100,000 bonus at the end of the year, a financial adviser charging on AUM makes more money on fees when the client invests the bonus. Since The Planning Center charges a flat fee based on net worth, it doesn't matter how much of that bonus the client invests because it doesn't change compensation.

This method is particularly appropriate in today's regulatory landscape, given the push from both the US Securities and Exchange Commission and the Department of Labor to provide increased transparency to investors and ensure advisers are always acting in the investor's best interest, according to both Sivertsen and Clarke.

"Whether the DOL fiduciary rule survives or is modified, the extended time of uncertainty, coupled with the natural attractiveness of a more transparent fee relationship, has moved the industry to be more open, less complex and more consistent," Leary added.

The Planning Center's flat-rate fee allows it to eliminate billing fluctuations typically seen with quarterly assessments, which can be based on the capital the client puts in or takes out, as well as market movements.

"Logistically speaking, we do have to manually create a flat-fee billing schedule within our system," Sivertsen said. "On the back end, it does create more work from a client relationship management [system] or Salesforce tracking perspective."

For example, if a client's retainer fee is $6,000 (the retainer can be based off client's annual income and/or net worth), then that number needs to be input into the system if that retainer did not already exist. After it is put in once, then operations teams can use that fee schedule to bill other clients that may come in at that retainer. But new numbers always need to be uploaded manually.

> "The industry is in desperate need of a retirement billing application to handle the varied adviser fee schedules"

There are other financial planning firms that use different variations and calculations of a retainer fee based on income and net worth, Sivertsen noted.

Sivertsen's example highlights the underlying industry issue, which is that many advisers still operate within manual processes when it comes to fee structures and billing schedules.

For this reason, Orion's Clarke emphasized the importance of having an updated and robust portfolio accounting system in the back office, among other tools, that can help with fee management.

"The system should have a mechanism that allows firms to check a box and say which way they want to go – whether they're charging on average daily balance in arrears or not – and plug in the fee schedule, then go on auto pilot from there." Orion offers a portfolio accounting system with this capability.

VMS' upcoming program takes it one step further by providing recordkeepers, who also must deal with the operational headaches of fee billing, a system to track multiple fee schedules from multiple advisers, according to Ward.

"The increased number of adviser fee schedules was becoming too costly to manage efficiently," Brian Overby, president of Alerus said on why the firm chose VMS. "We knew we needed a solution specific to the wealth management space that could track fee minimums, bill fees to participant accounts and support multiple invoice frequencies."