EDITORIAL

Let the sunlight shine on fee disclosure

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THERE IS A REASON why the phrase “sunlight is the best disinfectant” has become a cliché. Originally penned by Louis D. Brandeis, the quote has rung true since 1914, when the esteemed justice published it in his book “Other People's Money and How Bankers Use It” (He actually wrote: “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”)

Interestingly, the book, which is a collection of Justice Brandeis' essays, rails against investment bankers' using money deposited in their banks by middle-class citizens to consolidate industries and create monopolies that would then have the power to squeeze out competition and innovation, and pull more money from the pockets of hardworking Americans.

One hundred years later, the investment banking business is vastly different, and the checks and balances in place do a fairly good job of keeping monopoly power in check — though that point could be roundly debated. But the issue of other people's money and how it is handled remains nettlesome, and in the financial advisory business, the difficulty is related mostly to fees and expenses.

The Securities and Exchange Commission's recent investor bulletin that raises a red flag on fees and whether clients understand how their financial adviser is compensated is a welcome reminder that even if strides have been made in this area, there is still a lot of confusion, and much work needs to be done.

KNOWLEDGE DEFICIT

To be sure, the SEC already has regulations in place that spell out what disclosures investment advisers need to provide to clients. But clearly, the SEC is still finding that investors are coming up short in truly understanding not only what they are paying for advice and investment products but the long-term impact of those costs.

The SEC's Form ADV Part 2 requires investment advisers to list information about their fee schedule, and that is important. But when investments are thrown into the mix, costs can quickly become lost in a haze of fee-sharing arrangements, rebates, service charges, markups, surrender charges, custody fees and more.

In its investor alert, the SEC doesn't single out specific products or investment strategies but defines a number of different types of fees of which clients should be aware, including investment advisory fees. In addition, it highlighted the annual fees charged by mutual funds and exchange-traded funds, 401(k) fees, annual variable annuity fees and other charges related to minimum account balances, account transfers, account inactivity, wire transfer fees and others.

TIME COMPOUNDS FEES

Beyond highlighting the importance of the straight facts about fees, the SEC pointedly drew attention to the impact that fees have over time and the need to make sure investors fully understand that, for instance, a fee as simple as 1% can cut a $100,000 investment by nearly $30,000 over 20 years.

Regulation for regulation's sake is not good for anyone in any industry, and fortunately, the SEC's investor alert does not suggest or portend a new raft of rules and documents that advisers will have to meet and fill out. If the agency is able to provide some further guidance, however, that could be helpful.

Still, for advisers, spending more time on fee disclosure would likely cost both time and money, but it would be time and money well spent because it would help level the playing field and raise the level of professionalism in the industry. The debate over fee-only versus commission-based versus a combination thereof potentially no longer would be an issue.

It isn't enough to slap together a table of fees, give it to a client and call it a day. Advisers need to sit down with their clients and go over all of their fees to be sure everything is fully understood, both today and tomorrow.

Justice Brandeis wouldn't have had it any other way.