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Advisor Fees at a Crossroads: Has AUM Reached a Dead End?

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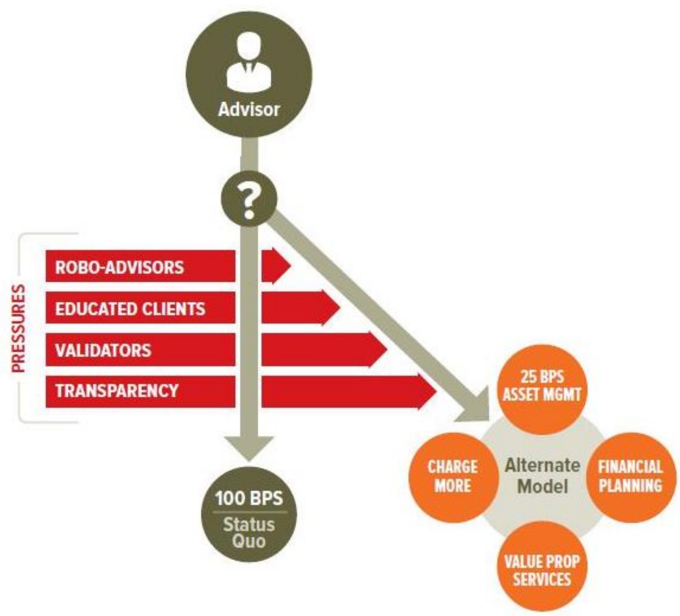
Last year, SEI Advisor Network focused on the new wave of financial planning technologies and practices. Our presentation featured a slide that demonstrates financial planning as a clear value that helps justify an advisor fee.

As we gave our presentation, we quickly saw that our audience wanted to talk about advisor fees. Their key question: is the decline of advisor fees inevitable? This interest intrigued us, and over the last six months, we've worked with our marketing team to fully understand the landscape and to hone our position on how to guide advisors on the topic. You can view the full report [here].

Fork in the Road

We think that the industry is at a fork in the road on advisor fees. The direction that an advisor should take is individually based their unique circumstances.



The status quo is that advisors typically charge a fee based on the AUM that they manage for a client. However, disruptive forces in our industry are driving change. These include:

The original robo-advisors (for this post, we will assume that no advisors are involved), charge about 25 basis points for basic asset management. Some investors perceive, however, that they are receiving "advice" on their investments for that low fee—so why should they pay an advisor more?

- Clients are becoming more investment-savvy, and younger clients are also technology savvy and willing to research investments in a way that previous generations have not. The medical version of this is WebMD. Talk to any doctor these days, and you'll find that many patients go into their surgeries with their own self-diagnosis. The doctor then has to either agree, or spend time breaking down the misdiagnosis before starting on their own. The same is happening in our world. Everyone knows that a financially educated client is a good client, but they can take more time!
- Transparency is another disrupter. A flaw in the AUM charge is that, although it is beautifully simple, it does not tie directly to the value that the advisor is providing. If an advisor's firm is built around financial planning and life advice, there is little correlation. With regulators moving in and pushing for more fee transparency, this disconnect between value and fee becomes very evident.

Advantages of an AUM fee model

There are several advantages to the AUM model; it is no fluke that it has become the dominant way that advisors charge fees.

- Simplicity. The AUM model is so simple. A line item goes on the client statement (which is seldom read) that uses the simplest equation possible to determine what the quarterly advisor fee is.
- Out of mind. The fee comes directly from the client's account; there is no check to write. As such, the fee is out of mind. It is a well-known secret that most advisor clients have little idea of the actual amount, in dollar and cents, that they are paying to their advisor each quarter
- Equality. In this model, everyone is treated equally. It is true that most advisors add a tiering system for their larger clients, but it is typically a consistent model. With one model across a firm's book of business, the client does not have to do comparisons, which may make them second-guess the whole process.
- Built-in increases. Everyone knows that advisor fees must go up, if only to combat inflation. If the assumption is that the market over the long term always goes up, then the advisor has a built-in fee increase. This is not an event that has to be explained to the client.

For whom does the AUM fee model work?

Part of the discussion last year was: is advisor fee compression inevitable? Industry magazines and some industry pundits have certainly implied this and have fueled advisors' fears. Therefore, you may be surprised to see the many different types of advisor for whom the AUM model makes sense.

No advisor fee pushback. If your client base is not pushing you to reduce fees or change your fee model, then this is not the time to be the guinea pig. As part of our research, we surveyed 775 advisors in August of 2015. One of the questions asked, "Are you getting any pressure from your clients to reduce your fees?" Eighty-five percent said no. It is clear that the industry is trying out new fee models, but there is a solid argument that you should let others do the experimentation and feel the inevitable pain. Jump on the fee change band wagon after it's been more fully tested, better known and accepted by more clients.

Legacy AUM advisors. Advisors who have used an AUM model for many years whose clients are used to it. Typically the firm would be monolithic—offering one branded investment service to one segment of clients. This description fits a lot of advisors. This group is often paired with the one above about not feeling pressure from a satisfied client base.

Investment advisors. An AUM fee makes sense for firms that have built their value around investments. There is a more direct link between your clients' assets, their investments and the value that you provide them.

Lifestyle advisors. Lastly, AUM fees are probably right for the lifestyle advisor. This advisor has a good book of clients and a good lifestyle, and is not pushing to grow their client base or make any new, innovative moves with their firm. Often these are older advisors who have decided that a succession plan is not worth it. Once again, this is a large group of advisors.