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Fees vs. Commissions: Rules and Opinions

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When CPAs sell financial products such as securities or mutual funds to their clients, there often is a misunderstanding about the CPA's continuing obligation. Many CPAs think their obligation is over after they receive their commission; however, many clients expect to receive ongoing advice. This is one good reason to extend your services to include investment advice—investment advisers have an ongoing responsibility to their clients and charge annual fees.

James E. Grant, CPA, registered investment adviser of Evergreen Asset Management, Inc., in Carbondale, Colorado, once asked, "What will happen to independence and objectivity when you are paid by a third party for selling investment products? Is there a way of being an investment adviser-without selling your soul or losing your objectivity-while remaining a trusted financial adviser to your clients? How will you cope with the real or perceived conflicts of interest?"

You can avoid conflicts of interest, get paid by your clients and compete with financial giants like Merrill Lynch or American Express if you offer investment-related services. One way to do this is to become a fee-only registered investment adviser (RIA)—you don't have to be a broker-dealer's registered representative. And, although there is a common perception that registered representatives always make more than RIAs, that is not always the case.

For example, a registered representative may invest a client's \$10,000,000 in mutual funds with a 4% sales charge. He or she receives 80% of the commission from the broker-dealer—a quick \$320,000 of income that can't be split with any non-licensed individual. In the same situation, an RIA could charge a flat 1% annual investment advisory fee and make the same amount in a little over three years. RIAs can set up an ongoing "annuity" for many years to come as long as they apply themselves to being good advisers.

Although CPAs can accept disclosed commissions and contingent fees under certain circumstances, they should always be cautious about accepting

commissions—NASD rules prohibit fee-splitting. CPAs also have to disclose conflicts of interest and the source of their compensation from third parties. According to Grant, "This is a difficult disclosure to make without feeling guilty. Why not just eliminate as much as possible the conflicts of interest in the first place?" He makes a good point.

Establishing compensation arrangements is one of the most troublesome issues facing CPAs who provide PFP services. Some of the more typical compensation arrangements follow:

Fees. You are compensated solely by the client for services provided and not as a result of the purchase or sale of any financial product. Fees are hourly, fixed or flat or based on a percentage or some aspect of the client's financial profile, such as assets under management or earned income.

Third-party compensation. There are a variety of compensation arrangements under which you might be paid directly or indirectly by someone other than the client for recommending or referring a product or service. Common third-party compensation methods include

- *Commissions*, generated from the purchase or sale of a financial product or service, including 12(b)1 fees, "trailing" commissions, surrender charges and back-end fees.
- *Fee-offset arrangements*, under which compensation is initially derived from fees that are subsequently reduced by commissions generated from the purchase or sale of a product or service.
- *Referral fees*, compensating the adviser for recommending or referring a product or service provided by another person or entity.
- *Other indirect compensation*, which may include rewards, purchase points, travel credits or other benefits received from a third party for recommending a product or service to the client. This also includes eligibility for sales prizes and "soft-dollar" benefits.

Be Sure You Are Legal

It is extremely important to be aware that proper licensing is needed to receive commissions for selling investment products. Also, do not forget that the NASD rules governing broker-dealers prohibit registered representatives from sharing commissions with nonlicensed partners.

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