



Advisor Compensation & Investor Outcomes

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What is the study about?

What the study aims to do

1. Identify whether evidence is conclusive enough to serve as a basis for policy formulation.
2. Assess the weight of the evidence and formulate conclusions about its meaning if there is sufficient evidence.
3. Identify gaps in the research that would improve policy formulation.

It does NOT ...

- Advocate a policy
- Discuss the value of advisors
- Report on papers that are ostensibly research but largely opinion

Three Assumptions

1. There is no such thing as a behaviorally neutral compensation scheme.
2. Identifying a problem with one form of compensation does not automatically imply that one specific alternative is better.
3. Advisors must be compensated and financial institutions must be profitable.



Topics & Content

Summary & Conclusions

Investment
Returns

Advisor
behaviour

Intl.
Regulation

Flow of
funds

Investor
behaviour

Impact
experience



2. Investment Returns

Findings

1. Funds that pay commission underperform
2. Distribution costs raise expenses and lower investment returns.
3. Advisor recommendations are sometimes biased in favour of more compensation for the advisor.

Issues

- No evidence that investors get higher returns with other compensation regimes.
- Behaviour of aggregates versus individuals
- Other forms of compensation besides commission have known biases – question of balance

3. Flow of Funds

Findings

1. Compensation influences the flow of money into mutual funds.
2. Different types of compensation have different influences.
3. Advisors push investors into riskier funds.

Issues

- Affiliation influences flows under many types of compensation.
- Impact of non-commission compensation not well researched
- Motives for pushing riskier products not clear



4. Advisor Compensation in the US

Findings

1. Revenue is seldom pure fee or pure commission.
2. Advisor compensation is correlated with advisor experience and client wealth.
3. Licensure also affects product recommendations.
4. Services and time usage are linked to revenue sources.

Questions that follow

- Who decides on the compensation arrangement: Investor, Advisor or Firm?
- Despite the risk of bias from embedded compensation, why do commissions continue to thrive?
- Why do most advisors have a mix of methods of revenue generation?



5. Investor Behaviour

Findings

1. Investors cannot easily assess compensation.
2. Wealth affects type of compensation available.
3. Investor biases hurt returns and these biases can be confused with compensation impact.
4. Compensation affects advisor effort to overcome bias.
5. Compensation affects investor uptake of advice.

Issues

- Relative impact of investor versus advisor bias unclear
- No studies compare advised people under fee-based versus commission-based regimes.
- Few studies look at impact at the individual level.
- Who should de-bias?
- What will disclosure do?

6. International Regulation

Findings

1. Embedded compensation does lead to biased product advice.
2. More low cost products bought w/o commission, but advisory fees rise. Overall impact unclear
3. Commissions are only one form of influence on sales.
4. Investors still confused about charges.
5. Low income-low wealth segments find it hard to get advice.

Issues

- Total return to investor unclear
- Mis-selling remains an issue
- Still early days. Impact of alternative forms of compensation still not known.

My Observation

- *Low income-low wealth are a disproportionately small part of advisor clients even with commission. Hard to make enough without lending products or insurance to sell.*



7. Conclusions

- All forms of compensation have an impact but the negative effects of commission are well-documented and must be dealt with.
- Several conclusions can be formulated.
 - Investors easily confused about charges
 - Behavioral biases won't be overcome
 - Can't judge outcomes solely by returns
 - People with less wealth will have less access
 - Mis-selling won't be eradicated



7. Identify Gaps

- Investment returns after all costs
- Product advice under other compensation
- Intangible benefits – Non-monetary outcomes
- Impact of non-commission compensation
- Real comparisons of individuals – not just focus on funds – It's a messy real world.



What happens if commissions are banned? *(No one says they will be)*

1. More sales of lower cost products – less biased
 2. Reduced sale of third-party products
 3. More use of technology and piecemeal advice
 4. More client segmentation and tailoring services
 5. Higher fees for full advisory service
 6. More use of bonuses and other incentives
 7. Regulatory arbitrage – products and compensation
 8. Changes in the advisor mix
- ... many other impacts





THANK YOU

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