

# To fee or not to fee: Pricing policies in financial counseling

Camilla Mazzoli<sup>a,\*</sup>, Gianni Nicolini<sup>b</sup>

<sup>a</sup>*Department of Economics-Faculty of Economics, University Politecnica delle Marche,  
P.le Martelli n.8, 60121, Ancona, Italy*

<sup>b</sup>*Department of Economics and Quantitative Finance (SEFEMEQ), Faculty of Economics,  
University of Rome "Tor Vergata", Via Columbia 2, 00133, Rome, Italy*

---

## Abstract

Pricing represents a key variable in the financial advisory industry. For this reason we investigate the possibility of identifying the type of advisory provided by making use of the pricing policy that advisors adopt in the United States and Italy. The prevalence of 'opaque' forms of compensation leads us to identify which variables are able to predict the pricing policies (transparent vs. opaque) of a financial advisor. Results suggest that they are related to: the advisor's regulatory status (independent advisor or tied agent), the presence of certifications issued by independent authorities, the involvement in a financial products distribution process and the high or low frequency of the payments that are due for the advisory service. © 2010 Academy of Financial Services. All rights reserved.

*JEL classification:* G20

*Keywords:* Pricing; Financial advisor; Financial counseling

---

## 1. Introduction

Financial advice plays an important role in the decision-making process that an investor develops. Good advice should provide the tools to help an investor identify his or her own specific needs and plan tailored investment strategies. In most cases, the advisor only 'assists' the investor in his or her financial decisions, although the customer could also decide

---

\* Corresponding author. Tel.: +39 0712207254; fax: +39 0712207253.  
*E-mail address:* c.mazzoli@univpm.it (C. Mazzoli).

to give the advisor full control and independence to make investment choices on his or her behalf. In this second scenario, the careful selection of the financial advisor becomes crucial.

The problems faced by an investor in evaluating the quality of the advisor before obtaining first-hand experience of his or her services could result in the investor predominantly relying on indicative aspects such as: reputation of the advisor, brand of the company the advisor works for, education, job titles and certifications, and so on. Together with the above mentioned aspects, the pricing policy that is offered (commission, asset-based fee and flat fee according to Robinson, 2007) is certainly a key point for investors when choosing their financial advisor. For example, Bluethgen (2008) maintains that, despite flat fees have the potential to reduce possible conflicts of interest, investors, on average, seem to prefer advisors that are paid by commissions as they result in a less expensive service. The importance of pricing is also testified by its role of watershed between different regulatory categories.

It is the case of the United States system where, up to April 12, 2005, regulatory differences among financial advisors were based on their compensation (Rickert, 2006; Robinson, 2007). The U.S. advisory market is featured by two main categories: (1) brokers and (2) registered investment advisors.<sup>1</sup>

Registered investment advisors are defined in the Investment Advisors Act (IAA) as, any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. The definition specifically excludes other professionals such as brokers. In fact, the advisory that is offered by brokers is solely incidental to the conduct of his or her business as he or she receives no special compensation therefore.

*Brokers* are defined under the Securities Exchange Act (SEA) as *any person engaged in the business of effecting transactions in securities for the account of others*. The core role of a broker is to execute transactions for customers. Brokers may provide a wide range of services for their clients related to the securities transaction, such as research and advice before effectuating a trade, but for the most part, their function is execution of trades (Rickert, 2006).

For years, the possibility of being specifically paid for giving advice traced the line between brokers and investment advisors. Nevertheless, on April 12, 2005, the SEC adopted Rule 202(a)(11)-1 that eliminates ‘no special compensation’ as a requirement to identify the incidental advisory that is offered by brokers. In this way, the pricing policy used is no longer a tool to set apart brokers from investment advisors. Nevertheless, even after 2005, fiduciary duties are still linked to the compensation policy. In particular, commission-based advisors are held only to a standard of suitability in their recommendations, while fee-based advisors are held to fiduciary standards that require them to place the interests of the client first and hold the advisor personally liable for breaches of fiduciary duty (Robinson, 2007).

Therefore, pricing represents a key variable in the financial advisory. Still, pricing policies that are used across different countries may differ because of the regulations of the country or to the practice. To highlight some of these differences, we compare the United States and Italy. In particular, the results of the studies about pricing in the United States are placed side

by side with the evidence obtained from other studies about the Italian market. The analysis highlights a huge heterogeneity in the pricing structures currently used. The classic fee-based and commission-based structures, already discussed in literature, are paralleled by other far more complex and opaque pricing structures. Through the use of a logistic regression we try to identify the different variables that may explain why advisors choose pricing structures that are transparent or opaque.

In Section 2, we provide a review of the literature on pricing structures. Section 3 presents the regulatory landscape and practice with reference to the pricing of financial advisory both in the United States and Italian contexts. Section 4 illustrates the data and methodology used to carry out the survey and the logistic regression. Section 5 presents the results together with some conclusions and remarks.

## 2. Literature review

Some studies about financial counseling have focused on the characteristics of advisors and the products and services that they offer. The different combinations of these aspects have led to the distinction between Independent Financial Advisors (IFA) and non-independent financial advisors (tied agents). IFAs provide advice to investors in the most independent way, which is without having any kind of relationship with the financial firms or suggesting customers to subscribe to their products. For this reason, they are paid by the investors only for giving advice (generally on a fee-based compensation). On the contrary, tied agents are linked to a financial firm whose products they suggest their customers to subscribe. This link may create a potential conflict of interest that could be mirrored in the pricing policy the advisor adopts. In most cases, the advisor debits the investor with both advisory and delivery costs that cannot always be easily differentiated (and that are generally commission-based). Depending on the context one is dealing with, the distinction between IFAs and tied agents can be more or less strong and intermediate situations can complicate this distinction. For example, in the United Kingdom, multitied agents work for a multitude of financial intermediaries that is midway between an independent advisor and a tied agent. Something similar exists in the Australian market also where IFAs are set against franchised financial planners (Bennett, 2000). The latter are comparable to tied agents, but they work on the basis of a relationship with a specific advisory company.

The first point to argue to understand the differences between the two main categories (IFAs and tied agents) is the potential for conflicts of interest that they hold. It is quite easy to understand that tied agents could be more subject to agency problems with their firms and also with their customers (Inderst & Ottaviani, 2009) because of conflicting incentives. In fact, on the one hand they need to sell financial products according to the guidelines of the firm they work for and, on the other, they need to advise customers on what is best for them to do (Hacketal & Jensen, 2008; Jones, Lesseig, & Smythe, 2005). The potential for conflicts of interest is one of the reasons why the selection of the advisor represent an important step of the advisory process. Nevertheless, investors are not always able to perform an accurate selection of the advisor and are sometimes forced to make use of proxies to assess the quality of an advisor. This happens for at least two main reasons: a lack of financial competence or

time constraint. This latter case is depicted by Hacketal, Haliassos, and Jappelli (2009) who maintain that financial advisors tend to be matched with richer, experienced but presumably busy investors. In this way, both the lack of competence and the opportunity cost of time can be reasons why investors could be forced to choose their advisors by making use of proxies of his or her quality. Among the proxies used, Bigel (1998) suggests that investors consider the education and training of the advisor. However, they are also strongly influenced by the quality of the advisor's communication skills (Johnson & Grayson, 2005). Many studies show that when an investor chooses a financial advisor, he or she often places more importance on honesty and discretion than on financial competence and skills (Bae & Sandager, 1997; Martenson, 2008). So far, reputation seems to play a relevant role in the selection of the financial advisor. Moreover, it has been observed that many consumers rely, without much reflection, on the advice of a familiar bank employee in their local bank branch or other known financial institution just because they perceive him or her to be trustworthy (Commission of the European Communities, 2009).

In the previous paragraph we already highlighted the importance of the pricing policy as an additional variable that could drive investors towards the selection of the financial advisor. The relevance of pricing in financial decisions has also been analyzed by Pontari, Stanaland, and Smythe (2009) in the American mutual fund market. The authors highlight how information about pricing is relevant for investors, even if most of the attention is grabbed by performance. The results of the survey suggest that American investors tend to consider pricing only when this information is available, but they ignore it if it is not provided. The authors, in their conclusions, suggest the risk of such behavior to strain the financial shopping decision. Even if the analysis of Pontari, Stanaland, and Smythe (2009) is related to the mutual fund selection problem, a lot of similarities can be found in relation to the selection of the financial advisor.

Barber, Odean, and Zheng (2005) stress the pricing aspect as well. The authors demonstrate that American investors are more sensitive to front-end loads and commissions (called "in-your-face fees") than operating expenses. They confirm the narrow focus of the American investors on past performances, suggesting a more rational behavior that should consider pricing more seriously.

### **3. Regulatory landscape and practice across countries**

An analysis of the regulatory framework in the United States and Italy helps to highlight the differences and similarities of the two financial systems. These elements are useful to check the possibility to generalize the results of the survey that has a narrow focus on the Italian market.

#### *3.1. The financial counseling in the U.S. industry*

The U.S. regulatory landscape about financial counseling sets apart broker-dealers and investment advisors, as already underlined in the introductory section of this paper. With reference to the first category, the SEC 1934 act allows broker-dealers to execute transactions

in securities for their own account or for others. In the following 1940 Act, registered investment advisors are those who receive compensation to provide financial advice to investors. Moreover, broker-dealers must register within the FINRA, while investment advisors are required to register at the SEC or a Government Agency.

The two categories of financial service providers differ in the fiduciary duties they have towards their clients. In particular, registered investment advisors owe fiduciary obligations to their clients. Such obligations require the advisor to act solely for the client's investment goals and interests in mind, free from any direct or indirect conflicts of interest that would tempt the advisor to make recommendations benefiting him or her.

On the contrary, broker-dealers are not compelled to have fiduciary obligations toward clients. The SEC 1940 Act imposes that brokers-dealers can provide financial advisory only if:

- Their advice is 'solely incidental' to their business as a broker-dealer;
- They do not receive any 'special compensation' for rendering such advice.

This provision has traditionally meant that broker-dealers receive compensation from their brokerage clients in the form of commissions on specific trades. In essence, the investment advisors' business practice of charging a *general fee*, rather than broker-dealers' practice of charging *transaction-specific fees*, has evolved into one of the distinctions between investment advisors and broker-dealers (Hung, Clancy, Dominitz, Talley, Berrebi, & Suvankulov, 2008).

Nevertheless, in the 1990s, the need of brokers to increase their revenues paved the way for a distinction between *discount brokers* and *full-service brokers*, bringing about some confusion. In particular, the former propose discounted accounts that are attractive to customers who want to trade securities at a lower commission rate without having any advisory assistance from the broker. On the contrary, full-service accounts include advisory assistance from the broker for a higher commission rate (Smith, 2003). In 2005, the SEC issued a notice whose main provision was that broker-dealers had to register as investment advisors if they charged a separate fee for advisory services. Nevertheless, the rule was invalidated on request of the Financial Planning Association. In 2007, the SEC proposed a new temporary rule [Rule 202(a)(11)-1] that somehow allowed full-service accounts by broker stating that:

- A broker-dealer provides investment advice that is not 'solely incidental' if he or she exercises investment discretion with respect to an account or charges a separate fee, or separately contracts, for advisory services;
- A broker-dealer does not receive 'special compensation' solely because he or she charges different rates for his or her full-service brokerage services and discount brokerage services.

As a consequence, the old link between the pricing policy and the independence of the advisor seems to have disappeared, and some confusion is likely to arise among U.S. investors as shown in the survey carried out by Hung, Clancy, Dominitz, Talley, Berrebi, and Suvankulov (2008) and also in the 2010 survey by Infogroup (2010). The authors of the 2008 survey interview a sample of investors about their opinion regarding the U.S. financial

Table 1 Pricing policies in the U.S. financial advisory industry

Compensation type	Broker-dealers	Investment advisor
Asset based	34.5%	81.8%
Transaction based	34.5%	13.6%
Flat fee	31.0%	50.0%

Source: Hung, A. A., Clancy, N., Dominitz, J., Talley, E., Berrebi, C., Suvankulov, F. (2008).

advisory market. The majority of the respondents are persuaded that many brokerage firms are moving away from transaction-based commission towards asset-based fees. This happens because broker-dealers are expanding their form of compensation by offering full-brokerage accounts. They also point out that this overlapping of pricing policies make broker-dealer and investment advisors less distinguishable in the market and this is likely to generate confusion among investors. In this 2010 survey, the 34% of the 1,319 investors surveyed think that the primary business of stockbrokers is giving advice and 66% think that stockbrokers have a fiduciary duty to their clients.

Table 1 shows the different pricing policies that are adopted in the U.S. market. It can be easily traced that no one of the different pricing policies corresponds to a broker or to an investment advisor but both the categories make use of all of the possible forms of compensation thus giving rise to opaque pricing policies.

The main distinction between advisors and broker-dealers comes from duties more than from pricing policies. In particular, they deal with suitability standards and conflict of interest. In terms of suitability, brokers are required to make recommendations that are 'suitable' for their clients under the FINRA rule while investment advisors are required to act in the 'best interest' of their client. An adviser's fiduciary duty requires him or her to evaluate a client's interests against a wider universe of investment alternatives than those that are merely suitable and to make recommendations that are not only suitable for the client but in the client's best interest. For example, a broker may determine that a particular security investment is suitable for a client but an investment adviser may determine that the same investment would not be in the client's best interest because it would result in underdiversification of the client's portfolio or higher fees, or not fit in with the client's asset allocation program (Fein, 2010). About the conflict of interest, brokers are not required to disclose all conflicts of interest when they recommend investment products. For example, a broker is not required to disclose that it receives distribution fees from a mutual fund it recommends to its clients. An investment adviser, on the other hand, is required to disclose such conflicts and to obtain the client's consent to conflicted transactions.

The same confusion characterizes other financial sectors, as well. It is the case of the U.S. insurance market where individuals and small businesses buy insurance through several different mechanisms. Captive agents are agents working for only one insurer and are paid by the insurer by commissions on the products they sell. Next to these, brokers represent more than one company and should provide insurance advice in the interest of the client. Still, they are under contract to insurance companies and they could be influenced by contingent commissions to steer business toward one insurer or another. Moreover, insurers and agents aggressively promote this inaccurate perception in their advertising, often not

making it clear that the agent actually represents the insurer (Cummins & Doherty, 2006; Hunter, 2005).

To reduce the effects of the confusion that arises when identifying a financial operator as broker of investment advisor, the current U.S. administration has recently proposed a new legislation that would adopt higher ethical standards for brokers. In particular they will “act solely in the interest of the customer or client without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice.”<sup>2</sup>

### 3.2. *The financial counseling in the Italian industry*

The evolution of the Italian regulatory landscape of the financial counseling turns around the definition of financial advisory as an investment service (primary) or an ancillary service (secondary). The first regulation concerning financial advisory in Italy dates back to 1991.

Parliament law 1/1991 introduces financial advisory as an investment service that can only be offered by investment companies (SIM) and banks. The same law introduces the tied agent (*promotore finanziario*) whose function is to promote the products and services of the SIM or banks he works for and he is also compelled to register at the Italian Security and Exchange Commission (CONSOB). To avoid any possible conflict of interest with the investors, the tied agent is requested to declare his relationship with the bank or investment firm he works for.

Still, the 1993 European Directive n. 22 (whose contents are included in the Italian regulatory framework, first in the EUROSIM law n. 415/1996, and then in the law n. 58/1998) completely changed the landscape by transforming the financial advisory from an investment service (primary service) to an ancillary service. The main consequence of this provision is the possibility for each and every person or firms to provide financial advisory contrary to the previous reserve granted to banks and investment firms. This rule paves the way for the acknowledgment of the IFA in Italy because next to the tied agents, financial advisory can be offered by any person or firm that is linked or not to banks and investment firms. Once again, the law imposes the financial advisor to immediately declare to customers any conflict of interest deriving from a relationship with firms producing financial products and services. The regulatory landscape depicted above is misleading to many customers because of the impossibility of setting apart tied agents and independent advisors which generates conflict of interests and lack of confidence in the Italian financial counseling industry.

Meanwhile, in 2004 the European Parliament passed a law (Market and Financial Instruments Directive; MIFID) whose main aim was to improve financial integration among the countries belonging to the European Union. The MIFID also contains rules<sup>3</sup> to solve the chaotic situation of the financial counseling. The Directive imposes that financial advisory be an investment service (as it was in the 1991 law) that can be offered by a person or firm previously authorized by the CONSOB. Moreover, the MIFID has established that a new register for independent advisor be created at CONSOB next to the already existing register for tied agents. This provision aims at solving the conflict of interest that may arise when a financial advisor promotes the products and services of the firm he works for without taking care of the customers' needs. In the Italian context, the provisions of the Directive have

Table 2 Pricing policies in the Italian financial advisory industry

Compensation type	Tied-agents	Independent financial adviser
Asset based	65.4%	63.2%
Flat fee	7.9%	31.6%
Transaction based	26.6%	5.3%

changed part of the already existing law n. 58/1998, but many rules still need to be transformed into practice. This is the case of the IFA register that is being implemented these days.<sup>4</sup>

The result of this complex legislative path of the financial counseling in Italy is a lack of correspondence between the type of advisory and the pricing policy that is applied. As Table 2 shows, all the categories of advisors mainly make use of pricing policies that are typical of independent financial advisory (asset-based fees and flat fees), thus creating confusion among investors, as in the United States case.

Overall data suggest that even if both Italian and the American financial advisory industries are characterized by different rules and market practices, they should improve their level of transparency towards investors to increase their confidence in the industry.

#### 4. Data and methodology

The lack of correspondence between the type of advisor and the pricing structure together with the opacity of the pricing policies that are adopted leads us to make a deeper insight into the analysis by identifying which variables are able to predict the pricing policies (transparent vs. opaque) of a financial advisor. The survey includes questions on the pricing of investment services (advisory included) and the characteristics of a business and the related consultancy services. Questionnaires were sent to 3,115 advisors and financial intermediaries (banks, investment firms, and consulting firms). Both IFAs and tied agents were surveyed.

The list of authorized investment companies, provided by the CONSOB, were used to sample the investment firms for the analysis. From the public data, provided by the Italian National Association of Independent Consultants (NAFOP) and the Italian branch of the European Financial Planning Association (EFPA-Italia), the individual advisors were selected. In case the single advisors were not IFAs, we referred to the company they work for.

The response rate to the questionnaire was 10.40% that corresponds to 323 questionnaires. The period of the data collection was March through April 2009. This limited time span allows us to exclude the possibility of differences in the responses which could be attributed to changes in market conditions or the regulatory framework. The part of the questionnaire concerning pricing includes questions on the pricing policy adopted (all-inclusive opaque pricing methods or transparent pricing structures), its components (fees and commissions), and the method of quantification (assets under management fee, hourly fees, etc.). Questions on the characteristics of a business (regulatory status of the advisor, number of employees, advisor's level of education, etc.) and on the consultancy services offered (forms of reporting, detailed meetings with clients, etc.) were also included in the questionnaire. The

Table 3 Percentage of financial advisors by regulatory status

Regulatory status	Percentage in the sample
Tied-agents (banks, investment companies, advisory companies)	66.77%
Independent financial advisors (IFAs)	33.23%
Total	100%

breakdown of responses according to the regulatory status of the advisor surveyed is shown in Table 3.

The limited presence of advisors in the sample offering IFAs reflects the Italian market situation that shows a predominance of tied agents, as reported by the statistics for 2009<sup>5</sup> provided by the main Italian associations of the advisory industry. The €FPA reports a total of 1,897 Italian financial advisors, while the NAFOP reports a total of 239 IFAs. The geographical breakdown of where the subjects operate within Italy is shown in Table 4.

The fact that almost 60% of advisors works in a restricted part of the country shows that the Italian consultancy market is not very developed on a national scale compared to other markets. The prevalence of responses from advisors who work in the north is consistent with the structure of the Italian financial market that is more developed in the central and northern regions compared to that in southern Italy and the islands of Sardinia and Sicily.<sup>6</sup> Thus, it can be argued that the composition of the sample is consistent with the Italian market structure.

After analyzing the questionnaires, a short set of variables has been included in the regression model. A brief description of the variables will follow. The dependent variable *Padv* is a binary variable equal to 0 if the advisor uses a transparent pricing method and 1 if the pricing is opaque. The variable is the yes or no answer of the survey question “Do you price counseling separately or do you prefer a comprehensive pricing structure that includes products prices also?”

The variable *Categ* concerns the regulatory status of the advisors surveyed. It is a dummy variable equal to 1 if the advisor is an IFA and 0 otherwise (banks, investment company, advisory company, etc.).

*Dim* is the number of agencies or offices that the advisor uses for his business. This variable has been used as a proxy for the advisor’s size.

To investigate the case of an advisor that is involved in the distribution process of products or services, the variable *Sel* has been included. This is a binary variable equal to 1 if the advisor declares to be not only an advisor but also a seller of investment products (acting as

Table 4 Geographical breakdown of the sample

Geographical division	Percentage in the sample
Nationally distributed	41%
North-East	20%
North-West	14%
Central	15%
South	6%
Islands (Sardinia and Sicily)	2%
Missing data	4%

a broker). This variable will be equal to 0 for those advisors who narrowly focus on advisory services.

The *Adv* variable has been included to evaluate the importance of investment advisory in the business of the surveyed as a whole. In particular, the variable *Sel* is meant to understand whether the advisor is an investment broker also (namely a “seller” of investment product); the variable *Adv* highlights the possibility that the investment advisory business may be placed side by side with other activities such as credit counseling, real estate counseling, tax-planning, and so forth, that are not able to create conflicts of interest in anyway. The variable *Adv* is equal to 0 if the advisor is focused on counseling and 1 if other services are also provided.

The frequency of payments imposed on investors by the advisor has also been investigated by the variable *PayFreq*. This variable depends on the time-frequency declared by the advisor. If the frequency is under the median value of the sample distribution (low-frequency), the variable will be equal to 1 (or 0 otherwise).

A binary variable *Direct* has been included to take account of the organizational model of the advisor. If the advisor provides his services directly from a single company involved in different business, the variable will be equal to 0. It will be equal to 1 if the advisory company is a captive company with a narrow focus on advisory.

The last variable of the model is *Cert*. This variable is equal to 1 if the advisor is recognized as a certified agent by an independent quality supervision authority and 0 otherwise. Descriptive statistics of all the variables are reported in Table 5.

The equitable distribution of the sample into advisors who declare transparent pricing and those who adopt an opaque structure highlights the heterogeneity of the Italian market. At the same time, it also provides the data for performing robust analyses while avoiding the risk that the different subsample sizes cause distortion to the estimation of the model parameters.

The strong presence of intermediaries involved in the distribution of financial products and services (66.77%) points to a strong overlap between consultancy services and product delivery in the Italian market which in turn provides information on the low incidence of independent consultants in the Italian market.

It is interesting to note that there is high prevalence of individuals who operate exclusively or primarily in the counseling sector, as witnessed by the high value of the *Direct* variable. A strong involvement in the distribution process of investment products can also be noted, as shown by the *Sel* variable. Before proceeding with the regression model, data on the correlations between variables are considered to check the presence of multicollinearity (Table 6).

Although the correlation values are not insignificant, the data do not seem to support the hypothesis concerning the presence of correlations between variables that would raise problems of multicollinearity. The reliability of the results of the logistic regression model is therefore assured.

A logistic regression has been applied to the survey data to highlight the variables which are able to explain the choice of the advisors for ‘transparent’ or ‘opaque’ pricing. The term ‘transparent’ will be used to identify a pricing method that allows the investor to clearly recognize the cost of advisory services from the pricing of investment products or other services. On the other hand, a pricing method will be labeled as ‘opaque’ if the counseling

Table 5 Descriptive statistics

Descriptive statistics: Discrete variable	
Variable	Percentage (number of observations)
<i>Padv</i>	
Transparent (0)	52.60% (162)
Hidden (1)	47.40% (146)
<i>Categ</i>	
Tied-agents (0)	66.77% (15)
IFA (1)	33.23% (104)
<i>Sel</i>	
Yes (1)	78.78% (245)
No (0)	21.22% (66)
<i>Adv</i>	
Yes (1)	22.22%
No (0)	77.78%
<i>Direct</i>	
Yes (0)	81.94% (245)
No (1)	18.06 (56)
<i>Cert</i>	
Yes (1)	76.38% (235)
No (0)	23.62% (73)
<i>PayFreq</i>	
Hi-frequency payments (0)	68.27% (235)
Low-frequency payments (1)	31.73% (73)
<i>Descriptive statistics: Continuous variable</i>	
Variable	Mean
<i>Dim</i>	18.38

compensation (fees and commissions) is merged with other intermediary costs, thus avoiding the possibility for the investor to separate the advisory costs from the price of the products. In this paper we do not consider a pricing policy to be ‘good’ or ‘bad’ on the basis of the degree of transparency it shows. The matter is more related to the possibility of predicting a pricing policy that an investor will be offered by looking at the main characteristics of the advisor.

Table 6 Correlation analysis

	<i>Categ</i>	<i>Dim</i>	<i>Sel</i>	<i>Adv</i>	<i>PayFreq</i>	<i>Direct</i>	<i>Cert</i>
<i>Categ</i>	1.000						
<i>Dim</i>	-0.254	1.000					
<i>Sel</i>	-0.330	0.266	1.000				
<i>Adv</i>	0.081	0.079	0.028	1.000			
<i>PayFreq</i>	-0.157	0.198	0.198	0.130	1.000		
<i>Direct</i>	-0.110	0.026	0.102	-0.072	-0.043	1.000	
<i>Cert</i>	-0.045	0.033	-0.070	0.036	-0.047	-0.005	1.000

Table 7 Description of the dependent and independent variables and expected sign of parameters.

Variable	Description	Expected sign of parameters
<b>Dependent variable</b>		
<i>Padv</i>	Is a binary variable equal to 0 if the advisor uses a transparent pricing method and 1 if the pricing is opaque.	
<b>Independent variables</b>		
<i>Categ</i>	The variable is a dummy variable equal to 1 if the advisor is an IFA and 0 otherwise (banks, Investment companies, advisory company).	–
<i>Dim</i>	Number of advisor agencies (offices) used to conduct its business; used as a measure of advisor's size.	+
<i>Sel</i>	A binary variable equal to 1 if the advisor is involved in the placement process and 0 otherwise.	+
<i>Adv</i>	The main service provided by the intermediary. The variable is equal to 0 if the agent is focused on investment advisory services and 1 if other services are provided too.	+
<i>PayFreq</i>	The frequency with which the advisor is paid for services rendered. The variable is binary and it's equal to 0 for an high-frequency of payments and equal to 1 in case of low-frequency payments.	+
<i>Direct</i>	A binary variable equal to 1 if the advice is provided directly and 2 if a captive firm is present.	+
<i>Cert</i>	A binary variable equal to 1 if the advisor is recognized as a certified agent by an independent quality supervisor and 0 otherwise.	–

(–) A negative effect between the independent and the dependent variable is predicted.

(+) A positive effect between the independent and the dependent variable is predicted.

The regression model is as follows:

$$Padv = \alpha + \beta_1 Categ + \beta_2 PayFreq + \beta_3 Dim + \beta_4 Sel + \beta_5 Direct + \beta_6 Adv + \beta_7 Cert + \varepsilon \quad (1)$$

Table 7 contains a brief description of the independent variables used together with the expected sign of its parameters. In the table below, the table we provide the reasons behind our expectations.

The variable *Categ* has been included under the hypothesis that the advisor's regulatory status (IFA or tied agent) is likely to be related to a specific pricing policy. A higher value of *Categ* is associated with advisors who are more independent and, as a consequence, adopt a more transparent pricing ( $Padv = 0$ ); for this reason the predicted sign of the parameter is negative.

This hypothesis has already been tested by Hung, Clancy, Dominitz, Talley, Berrebi, and

Suvankulov (2008) on the U.S. market where a relationship within the regulatory status of the advisor (Broker-Dealers, Investment advisors, etc.) and its pricing policy was found. The authors highlight that almost all investment advisors charge asset-based fees for their services, while very few charge commission for advisory services. At the same time, while broker-dealers typically charge commissions for brokerage services, there was a tremendous growth in fee-based brokerage services before the 2005 rule was vacated.

The effect of dimension is addressed by the variable *Dim* ('dimension' or 'size' of the advisory firm). The hypothesis is that subjects that are not only involved in providing advice, such as banks and investment firms, require a widespread distribution network which corresponds to a greater number of branches. The variable coefficient is expected to be positive.

The variable *Sel* (Seller) is included to verify that those who are involved in both the placement processes and in the advisory activity tend to make use of comprehensive (that is more opaque) pricing policies. This way, for those who only offer advice (*Sel* = 0), the pricing is predicted to be explicit (*Padv* = 0) and the predicted sign of the variable is positive. A relationship between pricing opacity and the diversification of advisor activities was first suggested by Black, Ciccotello, and Skipper (2002). The authors compared a model of a financial planner where the advisor is required to manage various aspects of financial planning (trading, financial planning, tax planning, etc.) with a model in which the investor turns to a distinct set of professionals who have a set targeted and are paid separately. They concluded that the former 'comprehensive model' runs a strong risk of opacity in its pricing such that the cost of the advice is hidden in the total price presented to the investor.

The hypothesis for the *Adv* variable (equal to 0 if the subject in the sample claims that he provides just investment advisory services, a value of 1 is attributed to advisors who are also included in other businesses such as credit counseling, tax planning, etc.) is that the bigger the number of services provided, the higher the probability of merging different pricing components (*Padv* = 1). A positive value of the parameter is predicted. With the aim to consider the situation of advisors engaged in the investment products distribution process (variable *Sell*) together with the advisors who provide different kinds of advisory services (variable *Adv*), we included both the variables in the model.

The variable *PayFreq* (Frequency of payment) is included under the assumption that a payment based on a trading commission is very likely to occur simultaneously with a negotiation, which indicates a fragmentation in pricing and an increase in the frequency of payment of fees. In the case of consultancy services only, logic suggests that a lower frequency would be expected. The expected sign for the variable is positive.

For the *Direct* variable (equal to 0 if counseling is provided directly by a single company involved in different businesses and equal to 1 if the advisory company is a captive company with a narrow focus on advisory) a positive sign is expected. The underlying hypothesis is that choosing to provide advice through a captive company reduces the need to manage other businesses, which also reduces the risk of an opaque price (*Direct* = 1).

The expected negative effect for the *Cert* (Presence of certification) variable is based upon the hypothesis that IFAs, as users of explicit pricing, put more emphasis on their education and quality of certification. This hypothesis is supported by a previous study by Bae and

Table 8 Logistic regression results

Variable	Coefficient	p-value
<i>Cat</i>	−0.9145194	<0.001**
<i>Dim</i>	−0.003033	0.936
<i>Sel</i>	0.9610396	<0.001**
<i>Adv</i>	0.4478231	0.944
<i>PayFreq</i>	0.4478231	0.007*
<i>Direct</i>	0.4096193	0.188
<i>Cert</i>	−0.5642173	0.048*
(Constant)	−0.5090053	0.305

\*p-value <5%; \*\*p-value<1%

Sandager (1997) where a positive link between quality of advisor and degree of customer satisfaction was also identified.

## 5. Results

Results from the logistic regression analysis are reported in Table 8. Results largely confirm the hypotheses regarding the relationships between the independent variables and the dependent variable *Padv*. The *Categ* variable is linked to *Padv* by a negative sign, as expected. This may suggest that opaque pricing policies are frequently applied to advisory services provided by tied agents (banks, investment companies and advisory companies) that combine advisory services with other activities such as the placement of products and services. On the other hand, IFAs prefer a kind of pricing where the remuneration for financial advice is explicit. The variable *Sel* has a positive relationship with *Padv*, as expected. This evidence suggests a strong influence of the organizational model of the advisor on the pricing policy that is adopted. The data on the frequency of payments (*PayFreq*) has a positive value. The hypothesis that a high frequency of payments is more used by tied agents that charge the trading commissions on a day-by-day approach, while the advisory costs are billed with a lower time frequency, is confirmed. The negative value of the *Cert* variable suggests that advisors who receive certifications tend to prefer transparent pricing for their services. The predicted sign for variables *Dim* and *Adv* are compliant with the regression results, but no statistical significance is present for them.

## 6. Conclusions

The binary distinction between IFAs and tied agents is not always reflected in the pricing policies adopted by financial advisors in both the United States and Italy. The different combinations of fees and commissions determine a wide range of pricing structures that may lead to confusion among investors who wish to buy financial advisory services.

The relevance of a pricing structure adopted by investors in their process of selecting an advisor suggests to investigate the possibility to predict the pricing policy adopted by an advisor looking at few observable variables.

Results show that from an investor's perspective the probability of receiving a transparent pricing (where advisory costs are separated from investment product prices) is higher if (1) the advisor is an IFA, if (2) the advisor is not also involved in a distribution process of investment products, and if (3) he has received a certification of quality from independent authorities. These results provide new evidence about the pricing of the advisory industry and, from an investor's perspective, they may be useful during their process of selecting an advisor.

If previous researches on the American market highlight how the information provided to the investors could avoid the pricing and how this lack of information may affect the final investor's decisions, the results of this study may be used to provide some proxy variables to fill this information gap. At the same time investors that are looking for a specific pricing structure in the advisory industry may be supported by our results if they prefer a separate pricing for different services (to evaluate the single product or service pricing elements) or if they like an all-inclusive price that may be easier to use and to understand.

## Notes

1. Although the National Association of Securities Dealers (NASD) lists many designations used to describe investment professionals (Financial Analyst, Financial Advisor, Financial Consultant, Financial Planner, Investment Consultant, or Wealth Manager are generic terms or job titles, and may be used by investment professionals who may not hold any specific designation), there are two main categories as illustrated above.
2. <http://www.treas.gov/press/releases/docs/tg205071009.pdf>. This proposal was incorporated in Section 7103 of the original House version of the Dodd-Frank Wall Street Reform and Consumer Protection Act, HR4193. Section 913 of the bill as passed (PL 111–203) requires an SEC study of the issue and gives the SEC the rulemaking authority to impose fiduciary standards on broker dealers.
3. That single European countries are compelled to introduce into their country laws.
4. Our survey was carried out at the beginning of 2009 when many of the MIFID provisions were not in use yet. This is the reason why we refer to the categories of advisor as they were before the MIFID only setting apart the independent advisor (those already belonging to the NAFOP).
5. Data presented in this paragraph and related to the Italian market are the results of the analysis that has been done by the authors on EFPA and NAFOP data provided on their website ([www.efpa-italia.it](http://www.efpa-italia.it) [www.nafop.it](http://www.nafop.it)).
6. An analysis made by the authors on data from the official statistics of the Italian Security and Exchange Commission (CONSOB) reports for 2009 the geographical distribution of tied-agents: the 55.22% of them works in the North of Italy, the 25.05% in the Center and 19.95% in the South. The raw data are available on the CONSOB Website ([www.consob.it](http://www.consob.it)).

## References

- Bae, S., & Sandager, J.P. (1997). What consumers look for in financial planners. *Financial Counseling and Planning*, 8, 9–16.
- Barber, B., & Odean, T., & Zheng, L. (2005). Out of eyes, out of mind: The effect of expenses on mutual fund flows. *Journal of Business*, 78, 2095–2120.
- Bennett, J. (2000). Financial planning down under. *Journal of Financial Planning*, 13, 114–123.
- Bigel, K. (1998). The correlations of professionalization an compensation sources with the ethical development of personal investment planners. *Financial Services review*, 7, 223–236.
- Black, K., Ciccotello, C. S., & Skipper, H. D. (2002). Issues in comprehensive personal financial planning. *Financial Services Review*, 11, 1–9.
- Bluethgen, R., Gintschel, A., Hackethal, A., & Mueller, A. (2008). *Financial advice and individual investors' portfolios*. Available at SSRN: <http://ssrn.com/abstract=968197>.
- Commission of the European Communities. (2009). *On the follow up in the retail financial services to the consumer markets scoreboard*. The second pillar: advice. Brussels (Belgium).
- Cummins, J. D., & Doherty, N. A. (2006). The economics of insurance intermediaries. *Journal of Risk & Insurance*, 73, 359–396.
- Fein, M. (2010). *Brokers and investment advisers standards of conduct: Suitability vs. fiduciary duty*. Available at SSRN: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1682089](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1682089).
- Hackethal, A., Haliassos, M., & Jappelli, T. (2010). *Financial advisors: A case of babysitters?* Available at SSRN: <http://ssrn.com/abstract=1360440>.
- Hackethal, A., & Jansen, C. (2008). *How to meet private investors' needs*. Available at SSRN: <http://ssrn.com/abstract=1009194>.
- Hung, A. A., Clancy, N., Dominitz, J., Talley, E., Berrebi, C., & Suvankulov, F. (2008). *Investor and industry perspectives on investment advisors and broker-dealers*. LRN-RAND Center for Corporate Ethics, Law, and Governance within the RAND Institute for Civil Justice and commissioned by the U.S. Securities and Exchange Commission (SEC).
- Hunter, J. R. (2005). *Contingent insurance commissions: Implications for consumers*. Washington, DC: Consumer Federation of America.
- Inderst, R., & Ottaviani, M. (2009). Misselling through agents. *American Economic Review*, 99, 883–908.
- Infogroup. (2010). *U.S. investors & the fiduciary standard: A national opinion survey*. Available at [http://www.cfp.net/downloads/US\\_Investors\\_Opinion\\_Survey\\_2010-09-16.pdf](http://www.cfp.net/downloads/US_Investors_Opinion_Survey_2010-09-16.pdf).
- Johnson, D., & Grayson, K. (2005). Cognitive and affective trust in service relationships. *Journal of Business Research*, 58, 500–507.
- Jones, M. A., Lesseig, V. P., & Smythe, T. I. (2005). Financial advisors and multiple share class mutual funds. *Financial Services Review*, 14, 1–20.
- Martenson, R. (2008). How financial advisors affect behavioral loyalty. *International Journal of Bank Marketing*, 26, 119–147.
- Pontari, B., Stanaland, A., & Smythe, T. (2009). Regulating information disclosure in mutual fund advertising in the United States: Will consumers utilize cost information? *Journal of Consumer Policy*, 32, 333–351.
- Rickert, B. (2006). The different tax treatment of investment advisory fees and brokerage fees: The lower the fiduciary duty, the better the tax consequences. Available at SSRN: <http://ssrn.com/abstract=886443>.
- Robinson, J. H. (2007). Who's the fairest of them all?: A comparative analysis of financial advisor compensation models. *Journal of Financial Planning*, 5, 1–8.
- Smith, E. R. (2003). Investment: An assortment of advice, but at what price? *New York Times*, July 20.