



## **SEBI's new RIA norm could increase cost of advice**

**By Ravi Samalad**

Nashik-based RIA Anil (name changed) used to sell LIC policies before becoming a mutual fund distributor and eventually an RIA.

Becoming a SEBI registered Investment Adviser was the only choice for him to practice fee-only advisory. Today, he has more than 300 clients as an RIA. Following the new SEBI circular, he has to prune his clientele to 150 and stop accepting new clients. "I had just started to earn up to Rs 3 lakh per month through one-time, annual retainer and DIY financial training assignments. Now, my revenue would drop by 50% suddenly, a drop of 1.50 lakh per month. I have no choice but to increase the fee," says Anil who spoke on the condition of anonymity. Anil does not have Rs 50 lakh corpus to put in this business to transition to non-individual RIA. He doesn't have a Post Graduate or MBA degree either. "I have been advising clients since 2012. I don't know how an MBA degree would add value to my clients," asks Anil. New business models SEBI's new rule for RIAs has forced RIAs to reconsider their business models. Individual RIAs who do not have the capital and have more than 150 clients could either partner with other RIAs to form a new entity, join a platform or simply downsize their clientele to 150.

**Fee conundrum** From proposing a cap of Rs 75,000 annual fee in its earlier consultation paper, SEBI has increased this upper limit to Rs 1.25 lakh in its latest circular. However, RIAs argue that fees should not be regulated and left to market forces. SEBI has given leeway for RIAs to charge up to 2.5% AUA based fee, way higher than the current market standard of 1% fee. RIAs can charge less than 2.5%. Many RIAs feel that they won't be able to charge a fee as high as 2.5% unless they showcase substantial value or alpha. Assuming one continues as non-individual RIA and charges Rs 1.25 lakh per annum (maximum permitted) to 150 clients, the annual revenue

works out to Rs 1.87 crore with monthly revenue of Rs 15.62 lakh. While this appears lucrative, not all 150 clients would be willing to pay Rs 10,417 fee per month to their adviser. Also, some clients would choose AUA based model while others could choose fixed fee model. Also, clients can switch to either of the two fee model (fixed or AUA based) in 12 months. Not the end of the road Notwithstanding the cap on fee, individual RIAs can still run a profitable practice. "RIAs will now have to keep their focus sharp on which segment they want to cater to. The capping of fee at Rs 1.25 lakh per annum has not made it unviable for individual RIAs to sustain. They can still be profitable by controlling costs and managing the right number of clients and fee structure. The opportunity for RIAs has become larger because investors who need goal based planning and multi-product advisory will have to approach RIAs," observes Vishal Dhawan, founder, Plan Ahead Wealth Advisors. However, it is not as easy as it appears. If the client wishes to terminate the contract, the adviser has to refund the money for the unexpired period of service. Both adviser and the client have to provide a 30-day notice if they wish to terminate the contract. Advisers can retain a maximum one quarter fee if the client wishes to leave the adviser. "Most of the work is done in advance. For instance, collecting data, preparing the asset allocation based on the client's risk profile, goals and time horizon and choosing products. But SEBI has allowed us to collect only two quarter fee in advance. The client may terminate the contract after a few months after the financial plan is prepared," says Anil. Currently, many RIAs charge one-time fee for preparing a financial plan in the initial stage. SEBI's circular is silent on whether RIAs could charge such one-time fee from specific assignments. "So far, we have been charging an initial fixed fee for preparing a plan and subsequently a % of AUA based or fixed retainer fee, depending on the client's choice. Now, we can either charge a fixed fee or AUA based fee right from the beginning. Clients typically come to a planner to find a solution on a variety of areas such as – should they prepay a loan or invest the money, succession planning, etc, and we charge a fixed fee for it. Suppose the client wants to work on an ongoing basis, then you can't charge AUA based fee. The client has to decide in advance which model he/she prefers. However, it is difficult for most clients to decide this at the beginning. If the client chooses AUA based model, what if the client doesn't have enough assets. How do we get compensated for the effort which was put in the planning

stage," says Vishal. RIAs charge anywhere between Rs 10,000 to Rs 25,000 for preparing a financial plan. Since SEBI is silent on whether such clients will be counted for individual RIAs as regular clients under the 150 rule, some RIAs say that they will go by the spirit of the regulation. "I believe that as long as the letter of engagement explicitly mentions it as one-time advice it can be done. The client needs to sign a no further engagement letter to ensure that he/she won't be added to 150 client limit," says Mumbai-based RIA Kavitha Menon who has 38 clients. To comply with the new rules, Kavitha has to get her succession plan in place, make the compliance online with digital signatures. All individual RIAs have to now appoint legal heir, executor, trustee, administrator of estate of the deceased (the "Obligor") as the person-in-charge in the event of investment adviser's death/ disability. Enhanced capital Existing non-individual RIAs have three-year time to raise the net worth from the current Rs 25 lakh to Rs 50 lakh. Individual RIAs who wish to apply for non-individual license have to bring in this capital immediately. Melvin Joseph started practicing as fee-only adviser from 2010 and got his individual RIA license in 2013. Over the years, he has built a clientele of 500. Melvin doesn't want to let go of his clients. He is in the process of taking up a non-individual RIA license. To raise the Rs 50 lakh capital, Melvin is planning to withdraw his savings and retirement corpus to put it in his new partnership firm. His wife will be the partner in the new entity. Although this Rs 50 lakh will be locked in the business, he can invest it in mutual funds under the company name. Meanwhile, his revenue has stopped until he gets a new license as non-individual RIA. What's in a name? In order to differentiate mutual fund distributors from RIAs, SEBI has asked MFDs not to use the nomenclature independent financial adviser, wealth adviser or any such similar name. But RIAs say that even acquiring an RIA license doesn't offer much clarity to investors. Some say that the new RIA rule does not help an investor discern between non-individual entity that can offer distribution and advisory services under an RIA license, an RIA who only gives stock tips and individual RIAs who operate as fee-only adviser offering comprehensive financial planning service. Also, RIAs say that there is no clarity on how they should count their clients. For instance, can a person who had paid fee in the past be counted as a client under the 150 cap for individual RIAs? Some MFDs who call themselves as investment advisers, planners, wealth advisers, independent financial advisers are considering

taking up RIA license just to retain their existing company name and continue to offer distribution services. However, they will have to take into account the compliance costs and renewal fee (Rs 5 lakh every five years) and net worth into account. Cost of advice One unintended consequence of the new norms is that it could increase the cost of advice for clients. The possibilities of costs related to compliance, qualification, audit, maintenance of records, compliance officer, and the cap on revenue due to 150 client rule (for individual RIAs) getting passed on to clients is not ruled out. "The client may be willing to pay a fee up to a certain threshold and not above that. It will be a function of the client's willingness to pay and the structure of an RIA firm for it to be viable and profitable. The cost may go up for clients and the RIA," observes Vishal.

One thing RIAs are happy about is that they now have clarity on most areas which was long-awaited.