

UTAH DIVISION OF SECURITIES
Retainer Fee Standards
9 February 2009

RETAINER FEES

The Division must clarify some issues involving Retainer Fees in general. The Division has come across numerous state-covered investment advisers and federal-covered advisers that offer investment advisory services, financial planning services, and/or other types of services for various types of fees that the adviser refers to as a “retainer fee.” However, the actual structures of these fee arrangements vary widely from adviser to adviser, creating some confusion as to the proper definition of a Retainer Fee and the appropriate standards to apply to Retainer Fees.

The Division finds a common mistake is for an adviser to use the terms “Fixed Fees” and “Retainer Fees” interchangeably.

To clarify, a **Fixed Fee** is a fee based on the set dollar amount for a given service or set of services. The set dollar amount is either predetermined by the adviser or negotiated between the adviser and the client. Moreover, Fixed Fees can be charged in advance or in arrears. From the Division’s review of investment advisers who purport to charge Retainer Fees, most are actually charging a Fixed Fee in advance and mislabeling that fee a “Retainer Fee.”

A **Retainer Fee** is generally an agreement between a professional (in this case, investment adviser) and a client in which the client agrees to pay a sum of money to the professional for the professional’s performance of or promise to be available to perform, at an agreed price, any services that are needed during a specified period.

Retainer Fees can take different forms, but the Division considers most Retainer Fees unreasonable advisory fees.¹ However, one form of Retainer Fee may be charged to Utah clients if established correctly. The different forms are listed below.

NONREFUNDABLE RETAINER FEES

A general category of Retainer Fees is “Nonrefundable” Retainer Fees. A Nonrefundable Retainer Fee is a specific amount of money that is prepaid to a professional for a service that is to be performed in the future, but without any obligation to return the funds even if the professional never provides the retained service. As Nonrefundable Retainer Fees do not include a refund policy, they allow for an advisory fee to be charged without any advisory service being rendered. As such, the Division considers Nonrefundable Retainer Fees an unreasonable advisory fee. Moreover, any other type of Retainer Fee that includes the feature of being nonrefundable would also be deemed unreasonable.

¹ §61-1-6(2)(g) of the Utah Uniform Securities Act (“Act”) allows the Division to sanction any investment adviser that: “has engaged in dishonest or unethical practices in the securities business.” R164-6-1g(E)(10) of the Utah Administrative Code specifies as a dishonest or unethical practice: “Charging a client an unreasonable advisory fee.”

GENERAL OR TRADITIONAL RETAINER FEES

Another form of Retainer Fees is a “General” or “Traditional” Retainer Fee. A General or Traditional Retainer Fee is a specific amount of money paid by a client to a professional to guarantee that professional’s services will be available if needed by the client at some point in the future. Typically, the professional then charges clients on an hourly basis once engaged. Essentially, a General or Traditional Retainer Fee is a fee for an investment adviser’s *availability*, not for any service(s) rendered. As the Division requires that advisory fees correspond to advisory services, a General or Traditional Retainer Fee is considered an unreasonable advisory fee.

SECURITY RETAINER FEES

Another form of Retainer Fees is “Security” Retainer Fees. Security Retainer Fees are used almost exclusively in bankruptcy cases as they allow for cash or other collateral to secure payment of fees for future services. The Division considers Security Retainer Fees to be unreasonable advisory fees for the following reasons. First, advisory clients generally carry no inherent risk of defaulting on payments to the adviser. Second, charging a client who is in risk of bankruptcy an advisory fee may be a violation of the adviser’s fiduciary duty since an advisory client who is nearly insolvent will only exacerbate their insolvency by paying advisory fees. Third, the Division finds a client better served by retaining legal services when filing bankruptcy and does not consider securing future investment advisory services as necessary for a client filing bankruptcy.

SPECIAL OR SPECIFIC RETAINER FEES

Another form of Retainer Fees is “Special” or “Specific” Retainer Fees. A Special or Specific Retainer Fee is a specific amount of money prepaid to the professional, which the professional maintains for the use of rationing payments for services rendered during a given period. Special or Specific Retainer fees are typically held in a separate account that accrues interest for the benefit of a client or other entity mandated by some regulatory body. Typically, the specific amount is determined by the professional based on an estimation of the hours needed to complete the project or service. While the Division generally considers this Retainer Fee unreasonable, the Division will consider its use reasonable if established within certain guidelines outlined below.

HYBRID RETAINER FEES

The last form of Retainer Fees is “Hybrid” Retainer Fees. Hybrid Retainer Fees combine the features of a General or Traditional Retainer and a Special or Specific Retainer. A Hybrid Retainer Fee is a specific amount of money prepaid to the professional to both guarantee that professional’s services will be available if needed in the future and to ration payments for those future services when used during the specified period. As part of a Hybrid Retainer Fee pays for the availability of the adviser and not the services rendered (the feature similar to a General or Traditional Retainer Fee), the Division considers this form of Retainer Fees to be unreasonable as well.

REQUIREMENTS TO ESTABLISH SPECIAL OR SPECIFIC RETAINER FEES

To establish a Special or Specific Retainer Fee correctly, the Division requires all the following requirements be met and maintained:

- 1) Any and all prepaid monies are either:
 - A) Deposited in a trust account under the client's name; or
 - B) Held in escrow;
- 2) The adviser agrees to annually submit independently-audited financial statements to the Division. These financial statements must both:
 - A) Follow the requirements outlined in R164-5-3 of the Utah Administrative Code; and
 - B) Include a specific engagement for a Certified Public Accountant to conduct an audit of compliance and related controls regarding the trust or escrow accounts used for Retainer Fees;
- 3) Any monies paid for a Retainer Fee must be exclusively used for investment advisory services. The adviser may not commingle the prepaid investment advisory fees (i.e. Retainer Fees) with any other prepaid or retainer fees used for services that are not investment advisory in nature;
- 4) The investment adviser discloses in its Schedule F, or disclosure brochure, the use of Retainer Fees and provides adequate information so that clients can reasonably assess what the amount of the Retainer Fee will be. Note: the Division will review this disclosure on its initial review of the Form ADV to ensure the disclosure is adequate and review the general range of Retainer Fees proposed; and
- 5) The specific dollar amount of any Special or Specific Retainer Fee arrangements will be reviewed with the Division to ensure the fee is not an unreasonably excessive amount. For this review, the Division will generally evaluate the amount of time the adviser used to perform the retained services and determine whether the dollar amount meets the Division's standards for hourly fees.