Straight Talk About Fees

If you have decided the time is right to seek the help of a financial advisor, you may have already realized there is a lot of information to wade through to find the right planner for you. There are a number of factors to investigate when selecting a financial planner, including professional background and experience, regulatory compliance, the services offered and the compensation structure. Of course, all financial advisors are compensated for the services they provide, in one form or another. What you may not realize is the compensation method may impact the objectivity and appropriateness of the products and steps recommended. Having a better understanding of how financial advisors are compensated can help determine which financial advisor may best meet your needs.

MAIN COMPENSATION METHODS

Fee-Only Advisors: Fee-Only advisors do not accept commissions or receive any other third-party compensation for recommending specific products. Just like a CPA or an attorney, 100% of their compensation comes from the client. Fee-Only services can be rendered on an hourly rate, a retainer basis, or as a percent of assets-under-management.

- Hourly rates will be charged on a project basis depending on the amount of hours needed to complete the work. An hourly rate may be $100 - $200 depending on the experience of the advisor and the advisor's location in the country.

- Retainers are a flat fee paid per year to provide financial planning services. Retainers typically run from $2,000 - $10,000 annually for a comprehensive financial planning service.

- Percent-of-assets is a method of charging financial planning fees based on your invest able assets (as described above). The asset management fee can run from 0.7% to 1.25%. As an example, if there were $200,000 of assets to manage, the asset management fee may be up to $2,500 per year.

- The hourly advisor typically requires payment of the fee as work is completed. The retainer advisor and the percent-of-assets advisor typically charge the fee on a quarterly basis. This quarterly fee is usually deducted from the brokerage account that is managed. The Fee-Only financial advisor may or may not be responsible for implementing the recommendations for investments, insurance and estate planning.

Pros

- A Fee-Only advisor acts as a fiduciary for his or her clients. The definition for "fiduciary" according to Webster's Dictionary is a personal "trustee or financial officer." Because Fee-Only advisors work solely for their clients, serving as the client’s advocate and fiduciary, you can be sure they are acting in your best interests.

- For a Fee-Only advisor, almost all conflicts of interest are removed. Because the advisor is not trying to sell a product, the client can feel more comfortable knowing the recommendations are tailored to his or her needs.

- A Fee-Only advisor may offer comprehensive planning, not only looking at investments, but goal setting, income tax planning, insurance planning, retirement planning, college planning and estate planning.

- It is clear how much a Fee-Only advisor is being compensated. There is never any hidden compensation nor is there ever a third-party sales agenda. The client, and only the client, “writes the check”.

Cons

- There are probably only 2,000 pure Fee-Only financial advisors nationwide, and finding one that doesn’t have a high invest able asset minimum can be challenging. The best place to look for a Fee-Only asset manager is via NAPFA (the National Association of Personal Financial Advisors, http://www.napfa.org).

- The advisor’s fee is typically paid out of pocket. At first it can be painful to write the advisors check, but this experience can provide you with a keen incentive to follow through on the advisor’s recommendations. The fees paid may also be used to reduce the client’s income tax by qualifying as a miscellaneous deduction on the 1040 Schedule A.

- If the planner charges on an hourly basis, the client may want to turn off the clock and not get all the advice needed.

- The advisor may or may not help with implementation of the plan recommendations. Do-it-yourselfers and middle-income Americans are typically well-suited for a Fee-Only hourly arrangement because they want to participate in the decision-making process and enjoy doing some of the research and plan implementation themselves. However, more and more “delegators” (people who wish to transfer a portion of responsibility for the management of their financial affairs to a professional) are finding that an hourly ongoing arrangement can work for them too.

- Commission-Only Advisors: Commission-Only advisors receive all compensation from the sale of products. Typically the commission-only adviser will not charge for the advice given and/or planning provided. They may, in fact, tell you that their advice is “free” (it isn’t, of course). What they mean is that if their recommendations aren't implemented, the commission-only advisor isn't paid. Of course, the commission-only advisor will work very hard to convince you that implementing his or her suggestions is the best thing to do

- Initial purchase: For investments, the commission-only adviser receives a portion of the initial investment in the form of a commission. In a mutual fund family, for example, that could be 2% to 5.75% percent of the initial purchase. If investing $200,000 with an advisor who invests in a front-end loaded mutual fund, the fee may be $7,000 if the sales charge is 3.5%. Therefore, of the $200,000 you think you are investing, only $193,000 is actually invested in the recommended funds. It may take many years to recover this fee as compared to just investing in a no-load, low-fee index fund.

- Ongoing 12b-1 fees: These fees are an ongoing, year-after-year charge. They are deducted right from the client's account, thus lowering the return. The fees are used to pay for marketing and distribution; they help compensate the brokers, who are the sales representatives for the investment company. They also help pay for advertising costs. For those funds that have 12b-1 fees, the charge is typically 0.25%, but can run as high as 1.0%. At 1%, for example, the fee paid may be $2,000 per year on a $200,000 account.

Pros

- It is in the commission-only advisor's best interest to complete implementation, so the plan's recommendations will be implemented if given the go-ahead.

- With the commission-only advisor, there is no check to write for the fees. The fees are included in the cost of the products purchased.

Cons

- Sometimes the client is unaware of the "load" (or sales commission) and/or other fees that will be deducted from his or her investment. This is a mistake. Consumers should be aware of all fees and expenses before they invest or engage any services. A good commission-only advisor will clearly disclose all fees and expenses and discuss them with you so that you can make an informed decision.

- The commission-only advisor's recommendations may not be in the best interest or best suited to the client's needs due to the inherent conflict of interest when selling a product.

- The commission-only advisor may not be looking at the client's overall picture and may not be tying everything together. The commission-only advisor may only look at investments or one aspect of insurance needs when making recommendations. The advisor will seek to understand your needs and problems, and try to fill your needs with the products and solutions available to him. Much like a handyman you hire for household repairs, the craftsman is only as good as the tools in his tool belt and his knowledge of how to either fix the problem or realize the goal.

- When using a commission-only advisor, the client may pay more (and sometimes a lot more) for the products recommended. Many times, these same products and investments can be obtained at lower cost through a discount brokerage house or service provider. Typically a commission-only advisor will not tell the client about alternative solutions and products; instead, he will offer the client the solutions and products he has in his "tool belt."

VARIATIONS ON TWO MAIN COMPENSATION METHODS

While Fee-Only and Commission-Only are the two main methods of compensating a financial advisor, there are a number of variations on these two main themes. I will describe them briefly here, but when interviewing any prospective advisor, ask detailed questions about how the advisor is compensated. Always request a copy of his or her ADV Part II.

- *Fee-Based Advisors:* Fee-Based advisers typically charge a fee for the financial planning provided. In addition, they also earn commissions on the investments recommended.

- *Fee-Offset Advisors:* This method of compensation is based on paying a minimum price for the work that is done. The amount paid out of pocket is reduced by the amount of commission income generated by the investments implemented. For example, a fee of $5,000 may be charged for the financial planning service. If the commission earned is equal or greater than the $5,000, the client pays nothing additional out of pocket to compensate the advisor.

- *Wrap or Managed Account Advisors:* In general terms, this is a method of having a private money manager at your service. Brokers will manage the client's account by purchasing individual stocks, bonds and other assets. The fees are around 2% of assets, which includes paying the broker, the money manager and the company. The service the broker will provide may include a newsletter, conference calls and his views on money managers. The fee is all-inclusive; it includes the advisor's counsel, money management costs and commissions on trades.

CASE STUDY ON ADVISOR COMPENSATION

For this example, I will use my firm, Resource Management LLC, which I am very familiar. When interviewing prospective advisors, this example can be used for comparison purposes to ensure you are getting a good value. At Resource Management, a Fee-Only financial planning firm, we charge a fee that is an estimate of hours needed to complete the work that needs to be done. During the first, complimentary meeting, a review of your goals and financial situation is conducted. At the end of the meeting, a firm fee quote is provided.
The firm helps identify and communicate the issues that should be looked at, but ultimately it is the client's decision as to the scope of the project and the analysis to be completed. Clients are not required to sign any long term contracts.

More details of our fees are listed under "Our Services" on this web site.

CONCLUDING REMARKS

Now that you know about the different types of compensation methods, what's the best way to determine how the financial advisor you are interviewing is compensated? The first thing to do is to ask. The National Association of Personal Financial Advisors has an excellent questionnaire "How to Choose a Financial Planner: Tough Questions to Ask" that can be used to find out how the firm is compensated, as well as other qualitative questions to ask (you can download it at no cost by visiting www.napfa.org). We will send you Resource Managements answers to those tough questions upon request. Ask to see the firm's ADV Part II, which describes in detail how the firm operates and how it is compensated. The ADV Part II is a document required of all Registered Investment Advisors; they are required to provide this information to you as part of the firm's state and/or Securities and Exchange Commission (SEC) registration. We will make our ADV available to you – just ask. Another important consideration related to compensation is to determine what financial planning services are received for the fees paid. Is the advisor providing just investment advice or providing more comprehensive financial planning advice? It is important to determine if the financial planning advice is custom-tailored to your situation or if it is a boilerplate plan (not customized to your individual situation). When interviewing prospective financial planners, advisor compensation is a key component in determining which advisor to choose. Spend time to understand:

- How the advisor is compensated (initially and in subsequent years)
- What conflicts of interest may exist
- If the advisor is acting as a consumer advocate and client fiduciary or a sales representative for a financial firm.
- What services will be provided and at what intervals

- . The advisor's background and credentials (read their ADV Part II and confirm credentials stated) Thoroughly understanding the compensation issue will help you determine which financial planner is right for you. Making sure your family's financial well-being is intact is one of the biggest responsibilities you have. It is important to become knowledgeable so that prudent decisions can be made regarding this responsibility

Definition of the term "assets-under-management."

Simply put, assets-under-management is the amount the client has available to invest outside of his or her rental property, home equity, 401(k)s and certain other investments. "Investable assets" (meaning assets that the advisor can "manage" or guide on your behalf) can include money in savings accounts, brokerage accounts and IRAs. In traditional wealth management and financial planning firms, your total assets-under-management is typically used to determine the fee for financial planning services and advice.