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Financial advisers: Making sure you're the winner in the battle for your bucks

The way your planner gets paid may affect his recommendations. Here's why, and what to look for.

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Financial planning services come with different kinds of price tags. The one your planner uses could affect not only how much you pay, but what kind of advice you get.

The National Association of Personal Financial Advisors (NAPFA) promotes the fee-only, no-commission route. As the concept has grown more popular, many advisers—even those who also accept commissions—have worked the word "fee" into descriptions of their payment methods. Making matters more confusing, some advisers use different arrangements for different clients.

Before we consider which arrangement might be best for you, let's sort out what the terms mean.

Fee-only advisers charge an annual percentage of any money you invest with them, a flat or hourly fee for planning and advice, or a combination. They don't get commissions from mutual funds, and they don't sell insurance or other financial products. The money management fee often starts high and declines as the amount of money invested increases, and it may vary by client, depending on how much active management the portfolio entails.

Gary Schatsky, a fee-only planner in New York City and Albany, NY, and chairman of NAPFA, looks at "the size of assets, the complexity of the situation, the client's aggressiveness, and how enjoyable the engagement will be," he says. "Over time, the complexity and the fee tend to go down." His annual fees average around 1 percent of assets invested.

Commission-only advisers don't charge a separate planning fee; their commissions from selling load funds or individual stocks cover their planning work.

With funds, the planner collects most or all of the load the fund charges, as his commission. Loads generally run 4.25 to 5.75 percent, although they can go significantly higher. (The Templeton Capital Accumulator Fund charges 9 percent.) With some fund families, commissions decline as investments

increase. For example, Oppenheimer Funds charges 5.75 percent on investments of up to \$25,000, but if you invest, say, \$100,000 the load drops to 3.75 percent.

Switching to a load fund in another fund family could trigger a new commission and further boost your cost, so you'll spend less in the long run with an adviser who designs and sticks with a diversified portfolio using funds within the same family. Planners often get the entire load charged by a fund.

Fee-based is a catch-all phrase covering a variety of billing arrangements. Like fee-only planners, fee-based ones charge an hourly or flat fee, a percentage of invested assets, or a combination of these. However, they may also receive commissions on life insurance, annuities, or mutual funds. The two main types:

- Fee-plus-commission advisers, probably the most common, generally charge fees for planning and earn commissions from mutual funds or individual stocks in which they invest your money. For other investments, such as real estate, they charge a commission or fee, depending on how they structure the arrangement.
- Fee-offset advisers charge an hourly or flat amount to put together a comprehensive plan, including general investment recommendations, which may earn them commissions. If this type of adviser executes the plan he develops for you, he'll subtract the commissions from his fee for planning.

Other fee-based structures exist, however. For example, Jay Abels, with Family Estate Planning in Papillion, NE, has a declining scale of fees for money management, based on the amount invested as well as the portfolio's complexity. He also earns commissions on insurance policies he sells.

Which arrangement is best? That depends on what you consider most important.

If cost is your biggest concern, you may be better off with an adviser who charges commissions, since one-time loads may eat up less of your money than endless annual fees. But as your stash grows, so will your fee (see [below](#).)

Your investment time frame matters, too. If you'll need your money in less than five years, paying fees rather than commissions may make more sense.

Over longer periods, it's hard to predict which method will leave you the biggest profit, given such variables as expense ratios and sliding fee scales from fee-only planners. Besides, cost isn't the only factor you need to consider: Fee-only planners argue that their pay arrangement is better, because it results in unbiased advice. If a planner who takes commissions

puts you into an inferior investment in order to get a bigger load, your bottom line could suffer enough to make a fee-only planner look inexpensive indeed. For instance, if a commission adviser puts \$10,000 of your money into a mutual fund with a 5.75 percent up-front load, he could earn \$575; putting the same amount into short-term bonds might net him as little as \$38. But what if the bonds make more sense for you?

"With fee-only planners, you're assured of getting impartial advice," says Schatsky. "We don't steer you to a fund because it has higher commissions. We also have more incentive to construct a portfolio that does well, since your portfolio profits determine our compensation."

The difference in commissions on funds may influence an adviser's judgment in ways he's not aware of, according to *Medical Economics* columnist Lew Altfest, a fee-only adviser in New York City. "If you hired a decorator who made different commissions based on which furniture you selected, you'd always wonder if she preferred one sofa because she'd earn a higher commission on it."

An adviser who doesn't take commissions also has a wider choice of funds. The 500 top-performing mutual funds for one-year returns through March include 376 funds with no front-end load; the 1,000 top-performing funds include 736 such funds. A fee-only adviser can pick no-loads, or he can choose load funds and waive the loads. The bigger universe can help if you're going into sector funds or have stringent criteria for a fund.

Of course, a fee-based or fee-plus-commission adviser needn't necessarily invest in load funds; he could charge you a money management fee and stick with no-loads. Nevertheless, some independent observers, such as *Consumer Reports*, agree with those who say fee-only planners are your best bet, because their interests are more closely aligned with your own: If you make more on your investments, so do they.

Not surprisingly, planners who take commissions tell a different story. Some point out, for example, that fee-only advisers may also face their own temptation to ignore your best interests. Say you're switching jobs and must decide whether to keep your funds in your former company's 401(k) plan or roll them into an IRA. If a fee-only adviser suggests that you leave the money where it is, he doesn't profit; if he persuades you to move it to the IRA, he may get to manage it and claim an annual fee.

Others dismiss the bias issue as irrelevant. "This business is based on referrals, and to retain clients and your reputation, you have to recommend investments that do well, and you have to serve people's best interests over an extended time," says Richard A. Alter, an adviser in Boca Raton, FL, who charges fees plus commissions. Adds Mary McGrath, a fee-plus-commission planner with Cozad Asset Management in Champaign, IL: "Good and bad planners exist in both the fee-only and commission realm; experience,

rapport, and the quality of advice are more critical." As for the smaller universe of funds available to commission planners, McGrath says, "There are excellent load and no-load funds; even excluding no-loads, you have plenty of good funds to choose from."

Who's right? Well, there's no question that many fee-plus-commission planners are outstanding; in fact, some of them made our list of "[The 150 best financial advisers for doctors](#)" (Aug. 7, 2000). It's also clear that blanket statements about payment methods have their limits—you should pay at least as much attention to your instincts about a planner's judgment, knowledge, and honesty as you do to how he gets paid. That said, looking first for a fee-only planner is probably wisest. If you can't find one you like in your area, expand your search to other types.

Whatever you do, make sure you understand exactly how your planner will be compensated. What percentage of his income comes from commissions, fees, investment management, and insurance? If a large proportion comes from insurance, the planner is primarily an insurance agent, and there's a good chance you'll be steered toward a policy.

Although many fee-plus-commission advisers voluntarily disclose their commissions, others ignore the issue unless clients insist on the facts. Your retainer agreement or services contract should spell out the compensation arrangement. You can also find out about an adviser's fee structure and professional background by requesting a copy of his Form ADV, which is filed with the SEC.

The bottom line on costs

What payment method costs you the least? Here's how a \$300,000 investment would grow, given a variety of payment methods, returns, and time periods. The table assumes equal expense ratios and 12b-1 fees for mutual funds and disregards potential tax deductions for investment management fees.

Over two years, you'd do better with a fee-only adviser; over five years, you'd do better paying a modest load of, say, 3 percent, rather than a fee; and over 10 years, you'd do better with commission funds. As the accompanying article points out, however, cost isn't the only factor to consider: If a biased adviser puts you into an inferior investment, your return could be low enough to eclipse any cost savings.

	Invested two years, 10% annualized return	Invested five years, 10% annualized return	Invested five years, 15% annualized return	Invested 10 years, 10% annualized return	Invested 10 years, 15% annualized return
No-load, 1% management fee	\$355,776	\$459,474	\$573,834	\$703,720	\$1,097,619
No-load, 1.4% management fee	352,907	450,266	562,335	675,799	1,054,068
3% front load, no management fee	352,110	468,658	585,305	754,779	1,177,257
5.75% front load, no management fee	342,128	455,372	568,711	733,381	1,143,881

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