Why "Fee-Only" Matters

Many of our prospective clients ask us about the *Fee-Only Financial Planning* concept and why it matters. So, here's just one example.

Recently we had lunch with a salesman to discuss an alternative investment involving real estate. It sounded very intriguing and might be a worthy investment for some clients in the future. Unlike a mutual fund or ETF, the internal expenses associated with this type of investment usually aren't clearly spelled out. Much "due diligence" is required, so we probed him about the investment's fee structure. He informed us that our commission on the investment would be 7%. It was at that moment that "fee-only" really mattered to us and our clients.

See, true "fee-only" planners and investment advisors can only be compensated by their clients. This excludes commissions paid by brokers, investment companies, insurance companies, or any other outside agents soliciting their business. Given the desirable financial incentives of commissions, "fee-only" planners are not common. As fee-only planners, we average less than 1% per year in compensation for managing client investments. So for us to earn 7%, it would take about 7 years of management to equal what we could make up front by purchasing this investment with our clients' funds. In dollar terms, if we worked for a few weeks to convince enough clients to buy one million dollars (a small percent of our assets under management) of the product, we would make $70,000. Instead, we will work for our clients for years to earn this amount on the same size assets.

Sadly, most investors give little thought to the hidden costs they pay when an advisor recommends stocks, annuities, or insurance policies. Investors just don't realize they are padding the advisor's wallet with plump, front-loaded commissions. Most investment advisors work for a brokerage firm, an insurance company, a bank, or independently with their primary source of income being commissions (Merrill Lynch, Edward Jones, Goldman Sachs, Ameriprise, etc.). Because these advisors' and their firms generate their incomes by means of commissions, their goal is to maximize and churn trading, which is the unethical practice of excessively buying and selling investments in a client's account.

Due to the obvious conflicts of interest in providing financial and investment advice to people you are selling products; many have migrated to a "fee-based" model. This term often confuses the public into thinking it's free of commissions. In fact, this means they charge fees like a "fee-only" planner, but can also make commissions! For instance, when an advisor sells an "A" share mutual fund to a client or purchases it for their account, a commission is generated. This "front load," often 5%, is rarely mentioned to the client. In the opening example, if we were "fee-based" we could have accepted the commissions <u>and</u> charged our regular fees. Not exactly a great deal for our clients, right? Nope!

While "fee-only" doesn't guarantee honest advice, excellent service, or positive investment returns, it does show a dependency upon these factors for the business to be successful. Over the long-tem, if our clients don't see the value of our service and trust us, they will leave, and our business will fail.

Commission driven firms can prosper even if many of their clients aren't financially successful. They just need new clients to replace the old ones. Since the advisors' income is primarily front-loaded, finding new clients eclipses the need to take care of current clients (unless they can keep the current clients switching products to generate new commissions).

Back to our original story…does this mean our clients can't invest in a good opportunity if there are commissions involved? Of course not. In this example, we can still purchase the investment and simply wave our right to the commission. The result would be our clients getting 7% more of the investment for their hard-earned money. Of course this does raise the question of how much of a cut the salesman would get. And this is why "Fee-Only" matters.

As Fee-Only advisors we are proud to be members of the *National Association of Personal Financial Advisors* (NAPFA). NAPFA members are held to the Fiduciary Standard and must meet arduous requirements to be part of the organization.

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An Independent Fee-Only Financial Advisory Firm