Investments: What Is Fee-Only Financial Planning?

By: Joe the Investor

The world of financial advice is divided into 3 main categories. The traditional financial advisor is what most people are familiar with. This is the most common arrangement where a financial advisor works for an institution and sells product. The financial advice is given “free” and is part of the process of selling these products. The second category of advisor is called a fee-based financial advisor. This type of advisor does the same thing as the traditional advisor, but charges a flat percentage fee based on the assets managed rather than by product. The cost can be less but still can add up over time because the fees are based on a percentage of the assets you have. The advice is still part of the service and is “free”. The last option is a fee-only or fee for service financial planner. This type of planner only gives advice and does not sell product. The charge for the advice is a flat dollar amount based on how much time is spent or how complicated the project is.

What Are the Advantages and Disadvantages of Each Type?

Cost

The traditional advisor tends to be the most expensive. The fees are based on the dollar amount of products you buy. As an example, if you invest $100,000 worth of mutual funds and are paying 2% fees, you are paying $2000 per year as long as you own these funds. The 2% figure is an average MER (Management Expense Ratio) based on a mixture of equities and fixed income (stocks and bonds). There may be other fees like sales loads, account fees, trading fees, trailer or referral fees, administrative fees or penalties for switching or redeeming early. To know the real cost, you would have to add up the costs for your situation.

The fee-based financial advisor may have reduced fees since they are charging a flat percentage instead of an MER plus other costs. Reduced fees are somewhere in the range of 1% to 1.5% for an entire account. The catch is that this option is available to people with larger amounts of assets since the fees charged have to be substantial enough to make it profitable. The minimum asset threshold usually starts at $500,000 in investible assets (assets in a trading account). If you have $1 million invested, this fee can be as high as $10,000 to $15,000 per year.

The fee-only financial planner charges for a plan or project using a flat dollar fee. This means that you would have a plan done once or periodically every 3 or 5 years, and you would pay somewhere between $1,000 and $5,000 per plan.

Note: don’t fixate too much on the names or titles of the person you are dealing with – i.e. financial planner versus financial advisor. These names or titles are used interchangeably in Canada and do not specify a given service or accreditation. There are also additional names like financial consultant, investment advisor, portfolio manager and so on. The key to know what you are dealing with is to ask “what are the fees in dollars?” and have this explained to you. Judging from what you hear, you will know what type of fee structure that is being presented.

Conflict of Interest

The traditional advisor has to serve many masters. There is the client who is paying the bills and must be taken care of. There is the institution and the boss who wants to make the most money possible from client fees. Lastly, there is the regulator / compliance team who ensures that you the advisor is serving the client and not breaking any company, industry or criminal laws. If your company has products that are sub-par, you the advisor are now conflicted. You can sell the client a mediocre product and make your boss happy, or tell the client to go to a competitor and get a better deal which will make the customer happy. Unless you are a very experienced advisor with a substantial book of business or you don’t need the job, it is very difficult to make everyone happy.

The fee-based financial advisor has a similar dilemma if serving the client means that assets should be taken elsewhere. There is also the advice of paying down debt, purchasing real estate, using money to buy a business, starting an art collection, taking money overseas, buying physical metals and so on which are not products sold by the institution and therefore would not generate any fees.

The fee-only planner does not have these conflicts because there is only one master – the client. There are no products and no assets – only the legal system and the ethics body of the association that the advisor belongs to.

Array of Services

In this area, the traditional advisor has the advantage. If you are in a situation that requires a will, an accountant, an estate trustee, a mortgage broker, or insurance products, the traditional financial advisor works for an institution that can provide these services. The administrative aspect of this is also handled for you: Opening accounts, trading, rebalancing the portfolio, automated deposits and withdrawals or filling out forms.

A fee-based financial planner may be able to provide these extra services, but it will depend on the size of the firm. The smaller “boutique” firms may specialize in portfolio management or investments and you may still have to recruit a network of professionals if you have a more complex situation.

The same situation applies for a fee-only or fee for service financial planner. People who do fee-for-service planning tend to be individuals or small companies without the resources to provide a network of professionals.

Minimum Asset Level

If you are selling products or managing assets, the fees that pay for the whole process including the financial planning are a percentage of the amount of money being used to purchase products or assets. If the amount of money being invested is $100,000 at 2% fees, you would be paying $2000 per year. The products would likely come from a preset list. A “know your client” (KYC) survey would be filled out and products are selected rather than having a comprehensive plan done. Asset minimums for a financial plan typically start at $500,000 in product purchases or assets, but some firms may provide a plan with a smaller asset amount. In the age of robo-planning, a plan can be created using software for under

$1,000, but it may not cover all of the scenarios since software is not complete versus talking to a human being.

In the fee-only financial planner case, there is no need for asset minimums because the revenue is not tied to product sales. The revenue generated is tied to time spent and work performed, and whether there is a $1000 trade or a $100 million trade in buying a product, the amount of work in creating a plan and allocating the assets will be the same.

Which type of advisor is right for you? It will depend on what you have, what you need, how much of the work you are doing yourself, and how much knowledge and comfort you have about finances.