

Adviser Fees And Their Effect On Your Returns



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Choosing the right financial adviser can be fraught with unknowns. From understanding the alphabet soup of credentials to making sense of complicated financial jargon, some of the smartest people I know struggle to choose the right adviser for their needs.

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Mandy is an engineer in her mid-fifties who worked at a small manufacturing company. She has an IRA left over from a corporate job she had in her twenties and thirties, and a portfolio of index funds that has seen positive returns over time. Mandy often thinks her returns could be better, but she isn't sure where to turn to get the help she needs. She's heard horror stories about people getting ripped off by financial

advisers and brokers and doesn't want that to happen to her. As a result, Mandy has done nothing, which she knows isn't a good move.

A smart, capable professional, Mandy is embarrassed about her lack of knowledge about the financial industry. Yet the truth is, the way the industry works is confusing for many people. There are different models and different levels of responsibility to the client, as well as different ways to pay for advice. Even with disclosures, adviser compensation may seem opaque, and what you don't know may negatively impact your investment returns in the long run.

The Ways Advisers Charge Clients

Financial advisers have a variety of methods for charging clients. Some charge a percentage of assets under management, or AUM, which ties the adviser's fees to the success of the client's portfolio. Others charge a flat retainer or an hourly fee for financial advice, and some advisers get paid commissions by the financial companies whose products they sell instead of getting paid directly by their clients.

To make matters even more confusing, advisers refer to how they're paid using terms like "fee-only," or "fee-based." No wonder Mandy, and many like her, don't know where to start! Let's look at three of the most common adviser compensation models and what they mean:

Fee-Only: Fee-only advisers receive payment directly from their clients for advice, implementation of that advice, and may include asset management. They don't sell individual financial products, such as annuities or securities, and they don't receive commissions on those recommendations, but they may recommend certain types of investments, such as low-cost or institutional mutual funds. A fee-only adviser may charge clients by retainer, by the hour, or by the assets they manage for the client. Fee-only advisers provide fiduciary advice on

asset allocation *and* fiduciary advice on selecting investments. Because they don't sell products, they don't receive commissions from product providers.

Fee-Based: Fee-based advisers are like fee-only advisers, but with one major difference: Fee-based advisers *sell* financial products *and* receive a commission from the product provider when they sell a product to you. When providing fiduciary advice or performing duties related to plan implementation, these advisers charge you a fee, which is usually debited from your account. Then, when they recommend an investment product, they sell a product to you that is "suitable" and receive a commission, which is provided to them through the product provider, in essence increasing your overall investment cost.

Commission-Based: Some who call themselves financial advisers include securities brokers and insurance agents, who receive compensation by the commissions they earn from selling financial products, such as stocks, bonds, annuities, or other investments. Often the advice you receive is around which financial product is best for you (suitability standard), rather than the holistic allocation advice you might receive from a fee-only or fee-based adviser.

In addition to the fees you pay your adviser, you may also pay ongoing or transaction fees related to your investments. An example of ongoing fees could include annual fees to maintain your account, while transaction fees might occur every time you buy or sell an investment.

How Fees Impact Your Portfolio

Let's face it: it costs money to invest, and savvy investors keep a close eye on the fees they pay because they know how quickly high fees can erode investment returns. Investopedia shares a simple example: Suppose you have \$80,000 in an investment account and pay 0.50% in annual fees. You keep the investment for 25 years and earn 7% each year. At the end of

the 25 years, your original \$80,000 will have grown to around \$380,000. But what if your annual fee equaled 2% instead of 0.50%? At the end of 25 years, you'd only have about \$260,000 instead of the \$380,000 you could have had with the lower fee. While 2% may sound like a small price to pay, it certainly adds up over time! If you use a fee-based or commission adviser, how much additional cost are you adding to the overall investment costs for products you purchase from them? This cost is not usually so transparent.

Ask Questions to Save Money

When it comes to investing your hard-earned money, don't be shy about asking questions. Advisers expect it, and most would be happy to explain their fee structure as well as the costs related to the investments they recommend. Don't assume, however, that every financial adviser is required to have your best interests at heart when they give advice and recommend products. While they may hold similar titles, such as "Wealth Manager," "Financial Adviser," or "Investment Advisor," financial regulations may not require the same duty of care. Advisers who act as fiduciaries have a regulatory obligation and/or an ethical duty to make recommendations in their clients' best interest. Others, such as insurance or securities brokers, must only ensure their recommendations are suitable for the client. If more than one financial product is suitable, but one pays the adviser a higher commission, he or she might recommend the higher priced product to you.

Finding the right financial adviser for your needs can be daunting, but it's not impossible. Your investments deserve the same level of care and research you might dedicate to buying a new home or car, and understanding the adviser fees you pay could mean the difference between an average nest egg or an exceptional one. Doing nothing, as Mandy did, pretty much guarantees a lower return. Doesn't your future self deserve better?

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