

## **How Financial Planners Are Paid**

From the *International Association of Registered Financial Consultants*

That old adage "You get what you pay for" still holds true today, especially when it comes to professional advice, including financial advice. If you want objective financial advice, you'll probably have to pay for it. How you pay for it will vary according to the compensation method used by your financial advisor.

It's important to understand, and be comfortable with, the way your financial advisor gets paid - and you need to make sure the advisor's compensation method is suited to your particular needs and situation.

### **Compensation Methods**

Generally, financial advisors are compensated in one of four ways - solely by fees, a combination of fees and commissions, solely by commissions or through a salary paid by an organization that receives fees. In some cases, financial advisors may offer more than one payment option. Here's how these different methods work:

#### **Fee Only**

Many attorneys, accountants, and fee-only financial advisors charge an hourly rate, and your fee will depend on how much time the advisor spends on your situation (including time in research, reviewing the plan with you, and discussing implementation options). Some advisors charge a flat fee for a quoted service (such as a fee for developing a financial plan, preparing your tax return, or drafting a will).

#### **Fee and Asset Management**

Some financial advisors charge a planning fee and then will advise you on investments, insurance and other financial vehicles; most will help you follow through on recommendations using mutual funds and other investments. The fee for helping select and monitor these investments is usually a percentage (typically around one to two percent per year) of the assets, paid quarterly or monthly.

#### **Fee Plus Commission**

Some advisors charge a fee for assessing your financial situation and making recommendations. The fee charged covers the data collection, analysis, recommendations and delivery of the Plan. They may then help you implement their recommendations by offering certain investments or insurance for sale. They typically earn a commission on the sale of those products, and that fact should be disclosed to you at that time.

As with fee-only advisors, fee-plus-commission advisors may charge a flat fee or bill you based on the amount of time they spend on your situation. Others use a fee scale, varying their fees according to the complexity of your financial situation.

The financial advisor will review your situation and financial goals with you and suggest ways you can reach those financial goals. This may include purchasing investments or insurance. You can buy them through this advisor, or - as with many fee-only advisors - you can buy those products elsewhere.

Commissions and other sales charges can vary greatly from product to product (for example, from one mutual fund to another) and from one type of product to another (mutual funds vs. insurance). Don't hesitate to ask your advisor for the amount of the commission on the investments or insurance or to explain how the commission will affect the return over the expected life of the investment.

### **Commission Only**

Some financial advisors, such as stockbrokers and insurance agents, charge no fee but are compensated solely by the commissions earned by selling investments and insurance plus services necessary to implement their recommendations. A commission-only advisor will develop recommendations for your situation and goals, review the recommendations with you and discuss ways to implement these recommendations. The only way the advisor receives any compensation is when you choose to buy the products and/or services the advisor is offering.

### **Salary**

Many banks, credit unions and other organizations offer financial planning services. In most instances, the financial advisors on their staffs are paid by salary, and earn neither fees nor commissions, but may receive bonuses. The organizations are compensated through the sale of investments and/or services.

### **About Fees and Commissions**

You have options for implementing the strategies recommended by your financial advisor through the purchase of investments or insurance. If an advisor helps you select and monitor those purchases, there will be some cost to you and/or payment to the advisor. This could be in the form of a commission, redemption fees, trail fees, "payout" (as with life insurance), or asset management fees.

Additionally, many investments and insurance charge annual management and transaction fees. For example, if you open an Individual Retirement Account (IRA), the company that serves as trustee may charge an annual custodial fee for the service. These costs will be in addition to a fee you pay to the financial advisor for advice.

### **Questions and Answers**

You may read in newspapers or hear on television a lot of conflicting information about the different methods of compensation. Here are answers to some of the most frequently asked questions regarding how financial advisors are paid.

#### **Which is Best for the Consumer - Fees or Commissions?**

The quality of a financial advisor's work is independent of the method of compensation used. In other words, competence and compensation are independent of each other.

No matter what the method of compensation, the possibility of conflict of interest always exists. It's essential that you have a strong sense of trust about the advisor you choose. To establish that trust, you must check out the advisor thoroughly. Find out the advisor's background and credentials, get references (and call them) and ask for a sample of written recommendations provided by that advisor.

An advisor who is honest and straightforward about compensation gives you the information you need to make smart financial decisions. Do not consider hiring a financial advisor who will not disclose how he or she is compensated.

Based on the information you gather, you should consider your overall comfort with an advisor. If you don't feel completely comfortable telling your financial advisor everything about your finances, you can't take full advantage of the planning process.

#### **Isn't a Fee-Only Advisor in a Position to Offer the Most Objective Advice?**

The best advice takes into account all of your needs, goals, resources and desires. Good advisors must be knowledgeable, ethical and trustworthy. No matter how you pay an advisor, the quality of work depends on other factors. An understanding and concern for your best financial interests is most crucial to receiving quality financial advice.

### **Don't Advisors Who Receive Commissions have a Conflict of Interest?**

It's really a question of integrity. Industry research shows that consumers rate "trust" and "ethics" as the most important elements in their relationships with financial advisors. In fact, survey respondents gave this response twice as often as they mentioned good advice and expertise.

If your first choice is a financial advisor who works on a fee- plus-commission basis and you're concerned about possible conflicts of interest, you can implement the advisor's recommendations yourself or through someone else. Simply let the advisor know you don't intend to purchase products directly but would prefer recommendations on a fee basis.

### **Which Advisor is Best for Persons of Modest Income?**

Generally, fee-and-commission or commission-only advisors work with people of modest means. Typically, fees paid working with a fee-only advisor generally make the financial planning process prohibitively expensive for people with modest incomes. However, there are exceptions to this rule, so be sure to interview advisors and ask them about your concern.

### **What Does a Financial Plan Cost?**

A financial plan (one addressing all facets of your financial situation) might range from \$250 for a basic plan to \$4,000 and up for a complex one. Fees vary widely depending on the complexity of your financial situation, the area of the country in which you live, and the financial advisor or firm with whom you work. If you are single, with no dependents, a limited estate and straightforward goals, you will likely pay a lower fee for a plan than someone with a more complex financial situation.

### **What You Need to Know about a Financial Advisor**

Keep in mind that compensation is just one among many important elements that should figure into your decision about hiring a financial advisor.

Foremost, be sure that the advisor you choose uses the financial planning process. It includes addressing the current situation, setting goals, identifying alternatives, selecting and then implementing a course of action, and periodically reviewing.

***This is a client-centered process, with a commitment by the advisor to put the client's interest first.***

Education, credentials, references, trust and rapport, along with compensation method, are what you need to investigate before choosing a financial advisor.

All four compensation methods have their advantages. You must choose the method which, combined with the other qualities of the advisor you select, best meets your needs.

- If you don't understand how your financial advisor is compensated, it's your responsibility and your right to ASK.
- Question your financial advisor in as much detail as necessary until YOU are clear. As a smart consumer, you want to know what you're buying and how much you're paying for it, and you're entitled to that information.