White Paper

Written by

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# Measuring the Cost of a Financial Advisory Relationship

*Selecting a financial advisor is a lot like choosing a contractor. Cost is just one of the factors. Picking the lowest or the highest bidder won't guarantee you the best value or service for your situation.*

The only compelling reason to work with a financial advisor is the assumption that they will help you to manage your financial outcomes better than you could on your own. They will provide improved results, greater simplicity, or both!

Several factors determine the value of this financial advisory relationship: the skill and expertise of the advisor, the up-front costs of products and services provided, and hidden costs that are not immediately apparent. All of these must be taken into consideration to find the advisor who will bring the greatest worth to your assets in the course of your relationship.

The purpose of this paper is to identify the various levels of cost in a financial advisory relationship so that the consumer can gain a better understanding of the total costs and benefits of working with a financial advisor and financial institutions in general. By understanding these costs, the consumer can ascertain how these expenses relate to the results they may receive from working with an advisor or a financial institution.

First, let us identify the various levels of costs that can be a part of a financial relationship. They include:

- Planning Fees
- Management Fees
- Sub-Manager Fees
- Sales Charges
- Transaction Costs
- Performance Fees
- Mortality Expenses (Annuities)
- 12 B-1 Fees (Mutual Fund Expenses)
- Operational Expenses (Tax & Audit)
- Surrender Fees

**Planning Fees:**

It is not unusual for a financial advisor to charge a planning fee for developing an overall strategic financial plan that will deal with issues such as retirement, wealth transfer, income tax planning, and overall investment strategy. These fees can be charged on an hourly, flat fee or retainer relationship model. There will be a wide range of fees regardless of the model used. It's wise to check with at least three to five planners, gathering information about how their capabilities relate to your needs as well as how their fee schedules compare.

*Hourly Fees.* As with other professional services, hourly fees can range from as low as $50 per hour up to several hundred dollars per hour. Two factors are important in determining how much planning fees will cost: the rate per hour and the number of hours worked. It is very important to understand what is included in the scope of the financial strategy project and the advisor's estimate of the number of hours that will be necessary to complete the project satisfactorily. Unfortunately, it is not unusual for an estimate to be exceeded. Additional work that was not included in the original scope of the agreement can add to the cost of an hourly project. Care must be taken to understand the scope of the project so that it will provide you with the information you need when comparing it to other models and methodologies.

*Flat Fees.* Some advisors charge on a flat fee basis. After initial discussions, the advisor will quote a fee that will be payable either one-half up front and one-half on delivery, or, in some cases, all up front or all on delivery. Clearly, having some paid at the end of the project gives the client more power in the relationship. These flat fees also range from a few hundred dollars to several thousand dollars for a project.

*Quarterly Retainer.* There are still other advisors who charge a quarterly retainer to work in an ongoing financial services relationship. These fees also have a wide range from a few hundred to maybe a few thousand dollars per quarter. These fees often are based on the complexity of the relationship, such as the size of assets involved, income, and planning issues that need to be addressed.

**Management Fees:**

The amount that is charged for managing an investment portfolio is known as the management fee. Most often this fee takes the form of a percentage of the assets under management by the advisory firm. The amount varies as widely as the fees of other relationships, most often ranging from 0.75 percent to as high as 3.0 percent. We have observed that most firms charge between 1.0 and 1.25 percent of the assets they manage. Some firms also have a lower fee schedule for larger amounts of money under management.

It is not unusual to have a minimum fee associated with the relationship as well. This increases the costs for smaller accounts and provides the management firm with a minimum level of revenue for managed accounts.

In some cases, there is also a profit sharing fee in addition to the base flat fee. For example, a manager may have a management fee schedule of one percent for assets under management and receive 20 percent of the profits over a certain level of return such as the 5 Year Treasury Note, or some other specific index or benchmark.

**Sub-Manager Fees:**

Firms rarely discuss the costs of sub-manager fees and most consumers are not aware of these charges. Many advisors make use of mutual funds and separate account managers to implement the advice in their portfolios. These mutual funds and separate account managers also have costs associated with them. As with every example used in this paper, the fees vary widely, from index funds that can be as low as 0.18 percent to actively managed mutual funds that could be in excess of 2.0 percent.

In our experience, we find that prospective clients very seldom know to ask about the sub-manager fees. In fact, when we bring up the topic—as we feel it is important to do—the conversation often gets turned back to what our fee is in the process, rather than considering the total relationship. We have yet to understand why potential clients consider one to be more important than the other.

**Sales Charges:**

The front-end sales charge mutual fund has all but disappeared, but a few still exist in the marketplace. Thirty years ago it was not unusual to have a front-end sales charge in a mutual fund as high as 8.75 percent. Better educated consumers and increased transparency through the financial press have driven these costs down to a much lower level, and many mutual fund groups now operate on a low-load or no-load basis. Today consumers can choose from an abundance of no-load mutual funds. True no-load funds without 12 B-1 fees and/or a surrender charge can be found with great performance. We see little reason for anyone to pay a front-end sales charge in today's environment, yet these funds still exist. Consumers should be cautious and examine all sales materials and prospectuses for relevant information on the costs of purchase.

**Transaction Costs:**

Mutual fund transaction costs are also not widely disclosed to consumers. These costs vary widely and do affect performance. In a typical mutual fund these costs will vary from 0.15 percent to as high as 0.5 percent. Of course these costs are a necessary evil in effecting the work that a mutual fund or separate account manager needs to undertake. What is difficult to ascertain is whether these transaction costs can be lowered effectively for the benefit of the consumer. The financial press has written a lot about 'soft dollars.' Soft dollars consist of research, software, trips, and other costs that the advisory firm may have. Brokerage firms pay soft dollars to the management firms of mutual funds and separate account managers in order to attract their business. There are requirements by the SEC to disclose these soft dollars, however they are not disclosed in mutual fund prospectuses and or annual reports.

If you want to find out if a firm receives soft dollars, you can get a copy of the firm's Form ADV which is filed with the SEC on an annual basis.

**Performance Fees:**

See Management Fees above.

**Mortality Expenses:**

Mortality and insurance expenses are another level of fees commonly associated with variable annuities. This fee pays for the costs associated with providing monthly annuity payouts for the variable annuity contract. It also provides funding for the death benefit associated in the variable annuity contract. This fee can be as high as 2.0 percent of the contract value. It is in addition to the management fee, sub manager fee, transaction fees, and any other marketing costs. These costs combined give variable annuities the high cost reputation that they often deserve. To be fair, there are some very low-cost annuity products on the market today. Investigation is required to ascertain whether a low cost contract is actually being used.

**12 B-1 Fees:**

These fees were instituted several years ago to allow mutual fund companies to charge an additional level of expense over and above their management fees for marketing costs. This would allow previously marketed front-end load funds to be marketed in a manner which would allow consumers to purchase shares at net asset value, deducting the marketing costs from the ongoing operations of the fund.

In order to be able to pay the salespeople or brokers their commissions, a surrender fee was also made part of the agreement. This was to assure that customers who had not stayed long enough to pay their fair share of the commission would compensate the fund for doing so. Most 12 B-1 fees range from 0.25 percent to as high as 1.0 percent of the value of the fund. Again, this is in addition to the other fees associated with the fund.

Another variation of this is a no-load fund that is marketed as a "no transaction fee" or "NTF" fund. Discount brokerage firms often tout these funds to avoid a transaction cost to purchase a fund and hold it in their brokerage account. In reality, the "NTF" collects 12 B-1 Fees and is more expensive for most consumers than the transaction fee fund.

**Operational Expenses:**

Of course to run an organization, there are other expenses that need to be paid. These include the costs for prospectus printing, tax return preparation and 1099 distribution, and an annual audit. These expenses are also part of the expenses of running a mutual fund and are not disclosed or part of the management fee. These fees, depending in the size of the fund, can range from a very small amount up to as high as 0.20 percent.

**Surrender Fees:**

Surrender fees have been dealt with in the 12 B-1 section of this paper. They are very common in the 'B' share environment and in variable annuities. Surrender fees can last as long as 10 years, providing a significant disincentive to switch from an underperforming asset to better performing assets. Surrender fees can range from as high as 10 percent of the value of a fund to as low as 1.0 percent.

**Summary:**

The phrase "you get what you pay for" should be a consideration when evaluating potential financial advisory relationships. You shouldn't choose the lowest or highest fees without considering the value of the services provided. Always make sure that you are selecting from advisory firms with the background and skills to give advice on the issues that are relevant to your situation, then compare the fees charged by the these firms.

Only after a thorough process of evaluation, including checking with client references, asking for and reviewing cost information, and becoming reasonably satisfied that the expected outcomes will meet your specific needs, should an individual begin an advisory relationship.

*If you would like to learn more about the financial services provided by Robert J. Klosterman and White Oaks Wealth Advisors, Inc., call us at 800-596-3579, or visit [www.whiteoakswealth.com.](http://www.whiteoakswealth.com)*

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