Fee-only compensation aligns the interests of clients and their financial advisors

Category : Payment of Investment Advisors, Financial Planners, and Investment Counselors

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Fee-Only Compensation Aligns the Interests of Clients and their Financial AdvisorsSeveral important considerations favor using fee-only financial advisors over advisors and investment counselors who accept third party commissions and other payments. Fee-only payment arrangements with advisors allow clients to: 1) maintain trust and reduce unethical behavior, 2) separate financial decisions from purchases, and 3) obtain lower cost financial products. Percent of asset fees align client and advisor interests. Hourly fees and fixed fees unrelated to amount of assets can be even better from the standpoint of the client, when the advisor is competent and the advice is focused on the best interests of the client. With hourly and fixed fees that client knows what he or she is paying and keeps the full benefit of the advice.   Fee-only compensation arrangements allow individuals to maintain trust more easily. The client and advisor relationship should be based upon a bedrock of trust. Investors prefer never to feel the need to question the motivations behind any particular financial recommendation made to them. As in any other professional relationship, an investor wants to have absolute confidence in the competence, objectivity, ethics, and goodwill of his financial advisor.   When you engage a doctor for medical services, you do not want to worry continually about whether your doctor is competent and ethical or whether your medical interests will be sold out to the higher bidder? In the practice of medicine, the lines of demarcation regarding ethical behavior and patient’s interests seem much clearer than in investing. Doctors have an ethical tradition dating back at least to Hippocrates that has been honored by each new generation of doctors. (Recently, of course, escalating costs and managed care have intervened to place some ethical stress on the doctor-patient relationship. Interestingly, financial interests are at the heart of this conflict of interest in a doctor/patient relationship.)   As with the doctor-patient relationship, you want your financial advisor to put your interests on top. This often is difficult when money is involved. Except for the comfortably rich, whose means far exceed their desires, everyone else, including financial and investment advisors, feel financial pressures. Their kids need braces... a vacation would be nice... that sportster would be fun to drive...   When you want the best financial plan and personal investment strategy that you can get for you family, do you really want to have to worry about your financial advisor’s ethics? Do you want to wonder whether he is glibly spouting well-crafted sales messages, while he loads up your portfolio with high commission financial products to pay for his car, his vacation, and his kid’s braces and not yours?   Fee-only advisors can better separate financial decision-making from the purchase of financial products. This helps to assure that the decision process is unbiased and that better financial products can be found for the client. Fee-only advisors can more objectively determine which particular financial products will better meet their clients’ needs.   Firms in the financial services industry compete for the business of individuals and their financial advisors using different distribution strategies. All financial services firms face challenges in finding efficient ways to advertise, market, and sell their products to advisors and individual investors. The net cost to an individual to acquire a particular kind of financial product with the same intrinsic value as another can vary dramatically due to these distribution issues.   To earn their compensation, objective and competent fee-only advisors will find better, more cost-effective options for their clients. Often the most advantageous products for individuals are those that do not bear substantial up front and recurring distribution channel costs. There will always be an associated distribution channel cost to pay your commissioned advisor. Investors who use commissioned advisor are far more likely to acquire financial and investment products with higher distribution costs. Commissioned advisors will claim that their products are better, but such claims lack a factual basis. The scientific investment literature consistently has demonstrated that higher distribution costs mean lower returns for investors.   Saving on distribution channel costs is just one way very important way that a fee-only financial advisor can save money for clients. In addition to the high distribution channel cost, commissioned products may not necessarily be the best available from the point-of-view of the client. Fee-only advisors can identify the best products from across the industry. They are not restricted only to those that pay commissions.   Like ancient maps of the unknown seas, navigating the sea of advisor self-interest requires us to put the label "Here There Be Dragons" on some parts of the advisory map. The simplest way for an individual to avoid conflict-of-interest problems is to employ a fee-only advisor, after also assuring that he or she is competent, hard working, and reasonably priced.

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