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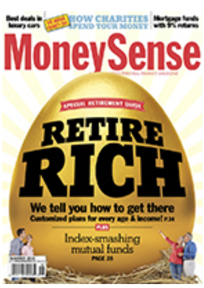
The difference between fee-only and fee-based financial planners

There is a lot of confusion about what fee-only actually means and what such planners can and cannot do for do-it-yourself investors.

By Jonathan Chevreau | Online only, 28/06/13



While *MoneySense* is intended to help empower individual investors, it's a rare person that needs absolutely no financial help or advice. This blog continually makes the point that while self-directed investors can lower costs by buying index funds or ETFs at discount brokerages, that doesn't mean they have to forgo financial planning help, advice or guidance.

Over the last decade or so, there has been a gradual shift from commission-based financial advice to fee-based advice. That is, instead of paying a traditional stockbroker commissions to buy a stock (or ETF these days) and then pay again to sell them, the industry is moving to a fee-based model that imposes an annual fee based on percentage of client assets: typically ranging between 1% and 2%. That is, on a $100,000 portfolio, you might expect to pay between $1,000 and $2,000 a year in fees, often via traditional mutual funds, wrap accounts or investment counsel. Not a bad deal at that level of wealth, if you're getting good advice on asset allocation, security selection, financial planning, insurance and estate planning and the whole gamut of financial advice.

The problem is at greater levels of wealth—and sometimes greater financial sophistication on the part of clients—high fees start to add up: 2% of a million-dollar portfolio is $20,000 a year. Little wonder investors are trying to cut that down in this era of ultra-low interest rates and volatile stock returns. Fortunately, the industry usually starts to taper fees down at such levels of wealth. I'd regard 1% as reasonable but that's still $10,000 a year.

Many *MoneySense* readers are tempted to go it alone by picking their own stocks and bonds, or ETFs, at discount brokerages. Our Feb/March 2013 issue catered to this audience with the first annual feature on the *ETF All-Stars*. Then in the June 2013 issue, we introduced another new feature: *Canada's Best Discount Brokerages*. Both features were written by editor at large Dan Bortolotti, who also writes our popular Index Investor column and his own Canadian Couch Potato blog.

These investors will find Bortolotti's book, the *MoneySense Guide to the Perfect Portfolio*, invaluable. It's a terrific introduction to indexing and discount brokerages. But as even he has discovered, many of these investors may still need some help or guidance in choosing ETFs, settling on an appropriate asset allocation, rebalancing or even with financial issues that go well beyond managing investment portfolios—more holistic challenges like tax-efficient withdrawal strategies, insurance and estate planning, debt management and the like.

Such investors are often told to find a fee-only financial planner and *MoneySense* has catered to this by providing an online directory to fee-only advisers which you can find here. But there is a lot of confusion about what fee-only actually means and what such planners can and cannot do for such investors. In practice, our list of supposedly fee-only planners includes some who appear to be predominantly fee-based or—a term I prefer—asset-based.

Fee-only planners vs. asset-based planners

Here's the difference. Say you have a $500,000 portfolio that you manage with the help of a fee-based (that is, asset-based) adviser charging 1.5% of your portfolio's value each year. In that case, you're paying $7,500 a year for that service. On the other hand, a self-directed investor with the same $500,000 who is buying their own ETFs at a discount brokerage will be paying only small commissions to buy and sell securities (typically $10 per transaction) plus whatever the underlying MERs of their investments are. If mutual funds, they're back around 2%; if ETFs, those MERs will range from 0.08% to 0.55% typically in Canada, with a broader range of fees for ETFs trading on US exchanges.

If this self-directed investor wishes to purchase à la carte financial planning services he or she could go to a true fee-only planner who charges by the project (perhaps a one-time charge of $2,500 for a comprehensive financial plan), or possibly via hourly charges like $250/hour. I'm told the latter are hard to find, as are those who charge monthly or quarterly retainers but they do exist. These fee-only planners are not investment specialists and can't usually recommend specific stocks or ETFs.

What is a money coach?

There's a relatively new term, "money coach," which nicely differentiates true fee-only planners from fee-based (i.e. asset-based) advisers. Regular *MoneySense* readers may know about Money Coaches Canada, which is a network of roughly 21 fee-only money coaches across Canada. Co-founders Karin Mizgala and Sheila Walkington are often quoted in our magazine.

The pair has also published a book called *Unstuck: How to Get Out of Your Money Rut*, which nicely lays out the philosophy. They make the point that financial planners that are fee-based are licensed to sell investments or insurance, while fee-only planners or money coaches do *not* sell financial products. They charge by the hour or by the project: at Money Coaches Canada, a coaching engagement of three or four months will range in cost from $2,000 to $3,500.

Coming soon: Revamping the *MoneySense* fee-only planners directory

To reflect all this, we are planning to revamp the online directory of fee-only financial planners, perhaps recasting it as "Money coaches and fee-only planners." Input from readers and planners at this stage would be welcome, either as comments to this blog or by emailing me at jon.chevreau@moneysense.rogers.com. The first stage will be to develop a short questionnaire that will clarify the nature of services being provided and how compensation works out in practice.

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