Four good reasons to pay dreaded trailer fees

KIRA VERMOND
Special to The Globe and Mail
Published Tuesday, Mar. 31 2015, 5:00 AM EDT

Britain has done it. So has Australia. Other countries are considering banning embedded sales commissions for financial and investing advisers, too.

It's hardly surprising. There's plenty to dislike about the much-maligned sales commission model, despite the fact that the majority of Canadian mutual fund brokers and dealers are paid that way.

To recap: Fund companies pay advisers trailing commissions for as long as advisers' clients stay invested. This payment structure is unclear, confusing and can create a conflict of interest between adviser and client.

The inherent problem comes down to an inefficient and unfair system, says Noel D'Souza, a Toronto certified financial planner and money coach with Money Coaches Canada.

If a client throws $2,500 into an investment one year and the adviser earns 1 per cent, that's only $25 out of pocket. No big deal. But, for the sake of simplicity, say the portfolio grows to $250,000 and pays out 1 per cent in trailing commissions each year – the cost is $2,500.

That's the price of a long weekend winter vacation in Florida. "It's not a sustainable, healthy model," Mr. D'Souza says.

Maybe not, but in some situations, paying a commission, rather than going with an adviser who charges a flat fee or for assets under management, can make sense for the investor. Here are four of them.

It's cheaper to pay the commission.
Just as the number crunching above demonstrates, newbie investors who are just starting to build a nest egg may be better served by an adviser who earns commission through a fund company. These investors will pay less than if they spring for fee-based advice. Advisers who charge a flat-rate fee usually cost $100 to $300 an hour.

For someone who has a $500,000 portfolio and wants targeted advice about specific stocks, that might be cost effective. But not for a beginner with a $5,500 tax-free savings account.

The same goes for advisers who use the assets-under-management model (the more of your money they manage, the bigger price break you get). John De Goey, a portfolio manager at Burgeonvest Bick Securities Ltd. of Toronto and author of *The Professional Financial Advisor III*, charges 1 per cent to manage a $750,000 portfolio, but more than 1 per cent for anything smaller.

Fee-for-service advisers can't always give you what you want.

Even if you like the transparency of paying an hourly rate, not every adviser can handle every transaction.

Although they can walk you through planning, budgeting and paying off debt, and they can offer general investing advice, they may not be licensed to buy or sell financial products and can't give specific advice about specific products. You will have to find a broker who can do that for you.

In the end, you pay broker's commission plus the hundred-dollar adviser fees.

"I just don't think you're going to find your typical, average Canadian is going to pull out their credit card or chequebook and pay a separate fee to that financial adviser in that range," says Greg Pollock, president and chief executive officer of Advocis, a financial adviser industry association in Toronto.

That's one of the reasons Advocis is pushing against commission bans in Canada. Mr. Pollock warns that if commissions are taken off the table, many Canadians will have no choice but to pay more for advice – and that first invoice could scare them off entirely.

According to one 2013 industry study, half of Canadians using a financial adviser would jump ship if the same advice ended up costing more than they paid as an embedded fee.

No one else wants to talk to you.
Even if you're bright, good looking and have a winning personality, if you don't have a lot of cash to invest, many advisers won't touch you, particularly those who charge a percentage of assets-under-management. There's no incentive to.

But commissioned advisers and brokers will likely take you on. "If the choice is between commission and no advice, maybe you just have to hold your nose and get it," Mr. De Goey says.

Luckily, there is a new choice for those with only $5,000 in their pocket: so-called robo-advisers. These online investment advice firms create personalized portfolios, typically made up of ETFs, using the same complicated computer algorithms that higher-end (and human) advisers use.

You don't want to know what you're paying.
As contrarian as it sounds, not knowing what you're paying your adviser could actually be good for you. Ignorance is bliss, or at least it can lead to a willingness to talk at length with an adviser.

"If I'm on the clock as a client, I'm thinking, 'Oh my gosh, this is costing me $200 for every hour I'm sitting here talking. I want to cut this conversation as short as I can,'" Mr. Pollock says.

But because many uninformed clients who are paying embedded fees think they're receiving that advice for free, they're more likely to invest and stick with their plans. In July of 2016, however, the curtain on commissions will be raised. That's when new rules will require mutual-fund and investment dealers to report costs and portfolio performance each year in writing.

Having that information in black and white will only be a good thing for investors who may have outgrown their commissioned advisers, Mr. D'Souza says.

Right now, it's easy to forget how much investors pay their longtime advisers – if they know that number at all. They stay because it's simpler, even if they would save money by moving to a fee-for-service adviser.

"Inertia is a wonderful thing – or a terrible thing. Once you start something and are comfortable with it, chances are you're not necessarily going to want to change," he says.