



To Fee or Not to Fee

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Find your Value Proposition before Transitioning to a Fee-Based Practice

In the UK, the Financial Services Authority (FSA) imposed the following rule starting in June 2005: “Financial advisors wishing to call themselves *independent* must give their clients the option to pay by fee”. Unfortunately, this new rule was a regulatory response to a number of miss-selling scandals and a call for a more transparent way of doing business.

How advisors in the UK responded, though, is certainly food for thought for the financial industry here in Canada, particularly for those advisors contemplating a transition to the fee model.

Some UK advisors who did not want to work on a fee basis merely skewed the explanation of the compensation choices in favour of commissions. Others simply raised the amount of the fee so high that no prospect chose that option.

According to Brett Davidson with FPadvance, a UK company that trains advisors on the transition to fees, the reason for this is that advisors do not fully understand the value they bring to the client-advisor relationship.

One example of this was the template the FSA put out to help advisors explain to prospects the difference between commission and fee options. When adopting the template, many advisors often did not change the dollar amount of the fee in the template, even though it was just meant to be an example. Again, because of a lack of understanding about how they add value.

In a Datamonitor study, UK advisors were asked how much they would charge for various services such as investment advice or selling life insurance. The study found that advisors would charge similar amounts across various products and services despite the different time and administrative demands that are involved¹.

If an advisor doesn't understand his or her own value, then how can clients be expected to pay for it? They can't and they won't. Therefore, communicating a well-defined value proposition is crucial. An effective transition to a fee-based business demands that clients understand the value being delivered, above and beyond the technical aspects of the investment management process².

¹ Fees and the changing financial advisor business Model, Datamonitor, January 2006

² Working with HNW clients, *Advisor Impact*, April 2004

Clients will gladly pay for value. In the absence of value, I can't imagine a client who wants to pay either a fee or a commission³. Advisors who operate a service-based business should find they have a sufficient pool of clients and the quality of proposition to move more easily to a fee-basis⁴. Clients will value different things depending on where they are financially in their stage of life, but you can certainly emphasize your core strengths.

Here are some examples of what clients value from their advisors:

- Advice and Service

Clients need someone to be the "go to" person. They need access to someone who has demonstrated a high degree of knowledge and responsiveness. They need a trusted coach and mentor who will keep them from blowing themselves up with impulsive financial decisions such as buying into get-rich schemes.

A quick reply to simple basic questions will always be appreciated, as will a measured response to those bigger issues that life tends to throw at your clients.

Warren J. Baldwin, CFP, R.F.P., CIM, Regional Vice-President with T.E. Wealth agrees. Several decades ago it was common to take a financial matter to one's "bank manager". Banks have made it their business over the last several decades to educate the consumer to take their business outside of the branch and to interface with the services for their banking needs electronically via the Internet or over a telephone line. Given this dynamic change in the banking establishment, it leaves an opening for a successful adviser to become the one-stop shop for the client's financial needs.

- Choice and Guidance

As advisors, it is our role to provide all the choices available without any compensation bias. Clients want to be educated so they can make their own decisions but, more importantly, they are also looking for expertise and recommendations.

- Depth and Breadth of Service

Clients want the freedom to discuss all topics related to their finances, no matter how remote. Having a clearly defined comprehensive offering of services will certainly go a long way to show your value. Combine that with a smaller client base to ensure you can deliver your services to all of your clients.

³ White noise: the impact of the compensation debate, by Shelley Lee, FPA Journal, May 2001

⁴ Fees and the changing financial advisor business Model, Datamonitor, January 2006

One of the reasons for the appeal of the Family Office model is that it allows the client to experience true one-stop shopping. It is easier for a client to call one person rather than guessing who they should call for a particular question.

- Comprehensive Financial Planning

This is where advisors can add the most value. You become the client's Chief Financial Officer (CFO); someone who is going to pull all the client's resources together into one comprehensive plan. First putting them on a savings plan to achieve their goals, and then keeping them on that plan. As life goes on, plans change, and that is expected. Financial planning is about achieving goals and, as goals change, financial plans need to be updated as well.

Money is a source of stress in people's lives. Clients want and expect a trusted advisor who's going focus on their goals and keep them from making big mistakes. But that can only be provided by a comprehensive financial planning service on top of managing investments and selling life insurance.

- Implementation

If you now work in a commission model, you have been implementing your clients' plans extremely well because that is how you get paid. Believe it or not, clients truly value the implementation process because otherwise they succumb to inertia and procrastination. So, just because you are no longer directly paid for implementation should not deter you from emphasizing this as a benefit.

- Investment Selection, Monitoring, and Reporting

Research conducted by Cerulli Associates in 2002 suggested that clients valued the review and ongoing service that they received from a financial advisor far more than the fund selection and plan preparation that goes on behind the scenes. At the end of the day, clients want to achieve their financial goals, they want to be educated enough along the way to give them peace of mind, and they do not want to be blinded with science⁵. Even though you may enjoy the time doing investment research or reaching a decision to add or discard a manager, the clients actually see little value in these technical endeavors.

That being said, they certainly want good monitoring and reporting. A discussion with your client on how often you eyeball their portfolio will certainly eliminate any misconceptions. Reviewing with a client a good numerical and graphical report that goes beyond the simple monthly broker statement will go a long way. In fact, a study conducted for CapTrust Financial Advisors found that more than 90% of investors who received regular updates said those updates enhanced the advisor's credibility⁶.

⁵ Value is in the eye of the beholder, FT Advisor, November 2004

⁶ Manager or fund? Fee or commission? By Dan Jamieson, Registered Rep, March 2000

- Portfolio Management

If clients care very little about what type of product or which mutual fund of the available thousands you choose, they do care about bias. Essentially they are looking for best in class; good managers at the lowest cost, regardless of affiliation. If you can do that, then you are certainly earning your fees.

Richard Croft of R N Croft Financial Group Inc. believes the advisor 's job is to pull the individual components together and to get the client to focus less on individual security performance and more on the risk/return of the whole portfolio. "This focus on the portfolio will put you on the side of the client who simply wants a decent rate of return without taking on too much risk," he says.

You can further enhance your value by providing regular rebalancing, strategic asset allocation tweaking, year-end tax loss selling, and strategies for asset location (e.g., equities in the open account and fixed income in a tax-sheltered account).

- Deliverables

One management consultant book once suggested that if you are charging value-based fees, you should not promise the client anything in the way of deliverables, or what you and I would call reports (financial or investment). The book claimed that all the client cares about are results.

I disagree. Our clients' results may not happen for ten, twenty, or more years from now. Without deliverables, you may find it difficult to retain clients for an extended period of time. Providing a consistent level of deliverables (financial plan updates, performance statements, etc.) becomes a very important factor in justifying your fee.

Even after all that, it is human nature for a client to focus on investment performance to legitimize your fee. So, your value will need to be reinforced again and again.

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