

## Switching to a fee-based practice

**Author argues that advisors who want respect for their advice should ask clients to pay for it**

By George Hartman

Advisor marc lamontagne of Ottawa has tackled the issue of generating revenue from fees vs commissions in his self-published book, *To Fee or Not to Fee: How to design a fee financial advisory practice*.

*The good news is this thin paperback of only 135 pages deals with the subject of charging fees rather than being paid commissions in a succinct yet ample manner. It poses all the right questions and offers a solid framework for making the transition and establishing a fee-based practice.*

I think the author was able to keep it so concise because, for the most part, he isn't too righteous about his position in the commission vs fee debate. Clearly, Lamontagne favours the latter — his bias shows. But his arguments are reasoned and rational. If financial advisors want to be respected for rendering advice rather than be regarded as "product purveyors," he says, the traditional commission model is backward in that the advice is free and the products have a price. Wouldn't it be more appropriate, he adds, to charge for the advice and make the products free?

In addition to that question, advisors contemplating a switch to fees from commissions also have to ask themselves what their real motivation is. A July 2001 *Investment Executive* survey of advisors who have made the switch found that when asked why they made the switch, 48% gave "elimination of conflict of interest" as the No. 1 reason. Surprisingly, only 4% cited "client demand" as a factor that drove their decisions.

Is there an error in logic at work here? Advisors worry about potential client backlash, yet few clients see a fee arrangement as important in reducing conflict of interest. The discrepancy can be explained by thinking more about prospective clients than existing ones. The alleged absence of conflict of interest is probably more important to those who are seeking a new advisor than those who have already entrusted an advisor with their affairs. Clients don't focus on fees; they focus on the value they are receiving for those fees.

There are pros and cons to a fee-based business. The pros include:

- > compensation can be more closely tied to the amount of work performed. Unless your fees are based strictly on assets under management, high-maintenance clients will pay more than those who take up less time;
- > building a recurring revenue stream smooths income flow and creates higher value for the practice when you retire and it comes time to sell;
- > you gain the ability to increase fees if expenses go up, such as when the **Mutual Fund Dealers Association**, the **Investment Dealers Association of Canada** or your dealer or firm impose new charges;
- > there is greater flexibility in product recommendations as deferred sales charge limitations disappear and products without built-in compensation become part of the mix.

There are others. One of the most important in my view is the ability to tier the level of service — and fee — by client segment. "A" clients, for example, get the "platinum" service offer; the "B" get the "gold" offer.

On the flip side, some of the drawbacks are:

- n increased administrative load. You now are in the service business and will need people and systems to manage the fee calculations, invoicing, collection, etc., with resulting higher operational costs;
- > clients tend to be more demanding and some may make you work to justify the fees they are paying;
- > commission-earning advisors typically do not have discretionary control over clients' affairs, but fee-based

advisors have a greater duty of care. As a consequence, some errors-and-omissions insurers will increase your premiums if you provide advice for a fee;

> many dealers and firms do not have a mechanism to allow advisors to charge fees and share them with the firm to compensate for the former's compliance, processing and other responsibilities.

Self-published books written by financial advisors can trigger skepticism in the hearts of book reviewers. When *To Fee or Not to Fee* landed on my desk, I reacted with my usual skepticism. But Lamontagne's book meets its two objectives nicely. It outlines the essential elements of a fee-based practice and provides a structure for making the transition. It is not all-encompassing, but it is a good place to start. To order, go to [www.tofeornottofee.com](http://www.tofeornottofee.com). **IE**

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