The shifting landscape of advisor compensation

As advisors move to asset-based or hourly fees, commissions remain popular

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By Wendy Cuthbert

There are as many ways for financial advisors to get paid, it seems, as there are types of clients: up-front charges, deferred sales commissions, trailers, asset- or fee-based, or fee for service.

More recently, however, as the industry has matured, a growing number of advisors have begun to move away from sales commissions, preferring to charge fees directly to their clients.

“Those advisors who have been in the business for a long time want to move their clients to a fee basis,” says advisor Ron Graham of Edmonton-based **Ron Graham & Associates Ltd.** He charges by the hour for financial planning and tax advice.

But while there has been a movement among some advisors to charge fees rather than collect sales commissions, that doesn’t mean there has been a stampede to the fee platform. In fact, according to fee-only advisor Marc Lamontagne of **Ryan Lamontagne Inc.** in Ottawa, the industry is still dominated by commission-based advisors.

While there is no central body regulating the definition of fees in Canada, there is general agreement that fee-only or fee-for-service advisors charge clients an hourly rate or lump sum; asset- or fee-based advisors charge clients fees that are based on a percentage of assets under management; commission-based advisors receive commissions through the products they sell. The term “fee advisors” refers both to those who work on a fee-for-service basis and those who use a fee-based model.

In fact, many advisors use a combination of these compensation models. Some advisors who formerly relied solely on commissions are including fees in their businesses, according to Lamontagne. “Most advisors are not 100% pure either way,” he says.

That shifting landscape of compensation structure makes it difficult to determine exactly how many advisors today are using each of the payment models.

“It’s really hard to get a handle on how people are actually compensated,” says Larry Colero, executive director of the **Institute of Advanced Financial Planners** in Vancouver. The IAFP, which supports the registered financial planner designation, has made an effort to sort its 417 members by compensation method on its Web site — for the benefit of clients looking for an advisor.

The IAFP’s largest compensation category is “commission and fees,” with 174 advisors; 100 advisors define themselves as “100% fee”; 62 members say they are “100% commission.”

But advisors enter their own information and, Colero admits, too many have chosen the “other” category. “Everybody feels that his or her situation is unique,” he says. “Most consumers that go to the ‘find a planner’ site search are looking for fee-only planners.”

Advocis would not comment on the breakdown of how its members are compensated. But the Advocis Web site indicates that 10% of its 12,000 members offer advice on a fee-only basis. And there could be some overlap between Advocis and IAFP membership.

Investment Executive’s 2007 Advisors’ Report Card, published in September, indicates that there has indeed been a trend toward fees and away from commissions and other transaction-based compensation. The average advisor saw fees more than double, accounting for 30% of his or her revenue in 2007, up from 12.5% in 2006. Transaction fees have dropped correspondingly, accounting for 65% of the average planner’s revenue in 2007, down from 85% in 2006.

Further evidence of the steady movement toward fees lies in the products, says Lamontagne. He points to the increase in sales of mutual fund wraps, high-end wraps, fee-based accounts and separately managed

accounts, which are typically used by fee advisors.

Traditional products, such as back-end-loaded mutual funds, for instance, might make sense for a new advisor. These products appeal to lower net-worth clients and are easier to sell because there are no up-front charges. But for those interested in shaping their business models to serve more affluent clients over the long term, other products may be a better choice.

"You might differentiate between clients with large amounts of money and move those clients into fees or front-end-loaded funds at zero commission for which the trailer fee is larger," Graham says. While this strategy compensates the advisor more fairly for advice rather than sales, you can still use back-end-load funds for smaller clients.

One method of collecting fees is the "commission offset" model. The client pays a fee for a financial plan. That fee is reduced by the amount of any commissions the advisor earns from products sold when the plan is implemented. This was the model Lamontagne used when he started in the industry. But he soon observed an inconsistency between the amount of work he would do for each client and the amount he would be paid.

"Your better clients are subsidizing the work you're doing for your smaller clients," he says. "From a business perspective, it doesn't make sense because every client should be a profitable relationship."

Deciding which method of compensation is best depends on the client sitting in front of you, adds Lamontagne.

Janet Freedman, a fee-only planner at **Finance Matters** in Toronto, charges her clients an hourly fee of $175-$250 for financial planning services. She is happy with her decision not to pursue commissions, even though some clients have requested it.

"Sales is not something I think I'd have been very good at," says Freedman, who works primarily with what she calls "middle-income, ordinary Canadians." She typically makes asset-mix and manager recommendations but makes no money on investments.

A debate heats up now and again over trailer fees. Some "fee purists" — Freedman among them — consider trailers to be commissions and argue that advisors who accept them are not offering true fee-only models but actually blended models. But the **Financial Planners Standards Council**, which confers the certified financial planner designation, defines trailers as "fees."

As long as there is full disclosure with the client, Lamontagne says, there is no conflict in a fee planner including trailer fees in his or her compensation.

Toronto-based **T.E. Financial Consultants Ltd.** , a veteran fee firm, changed to an asset-based structure from an hourly-rate model a number of years ago. T.E. charges, on average, 68 basis points, but that can vary depending on portfolio size, according to Kosta Andrikopoulos, the firm's president and CEO. "The more the client has with us," he says, "the lower that fee rate."

Fees are not always one-dimensional. Lamontagne breaks out his fees into "service" and "investments," for example. He charges a flat annual fee, based on household income, for financial planning and tax advice; an additional percentage fee — higher at the lowest level of assets and then tiered downward, from 1.5% to 75 bps — is added for investment management. Lamontagne sells F-class mutual funds and index products such as ETFs, which have lower management fees.

While fees not tied to the clock are traditionally determined by AUM or household income, not all advisors take that route. When John Amonson of **Amonson Wealth Management Inc.** in Calgary decided to launch a fee-based practice at the end of 1999, he created a fee model based on what he calls a "percentage of adjusted net worth." His net-worth measurement excludes the client's primary residence and basic personal assets but includes non-liquid assets such as business and vacation properties.

Amonson occasionally charges an hourly rate of $275 for new clients who insist upon it, but only over a short term. He prefers to work on his fee-based model, which, he believes, helps cultivate more lasting client relationships.

"Any professional in the business knows you need a long-term relationship to guide clients over time," he

says. “If you do a one-time, hourly-based plan, you don’t have the relationship to guide clients successfully through market cycles. You need a commitment.”

While Andrikopoulos acknowledges fee-based advisors are still in the minority, he expects the movement to become more entrenched as the younger generation of Canadians moves into buying financial products.

This generation’s approach to buying almost anything is to research it at length with online tools. Younger people like to know exactly what they’re paying for ahead of time, Andrikopoulos says. (See story on page B8.)

That more informed clients tend to seek out fee-based planners bodes well for fee-based advisors. But there may be some adaptations required to make the model more palatable for this group.

“In all likelihood, they’re going to be very specific about what they want to know,” Andrikopoulos says.

The solution may be more menu-based or “a la carte” pricing models in the future. **IE**