Commentary

Financial adviser fees: There is still room for improvement

By MARK MEREDITH

Financial advisor fees have commonly been based on a percentage of assets under management. Numerous industry studies have shown that the typical median asset-based fee is about 1 percent annually for accounts under $1 million, and 0.90 percent annually for a $2 million client.


Meredith

Years ago, financial advisors (brokers) were only paid when there was trading activity in the account. There was a direct incentive to recommend more transactions, as it meant more revenue for the brokerage firm. This created a problem, as evidence showed over time that not only did more activity fail to lead to higher investment returns, but it actually detracted from them.

This led to the popularity of the asset-based fee model, where the advisors were not paid for transactions but rather for the advice given. In theory, this model would help remove conflicts of interest from recommending unnecessary transactions or choosing products solely because of the commission paid. The advisor would only recommend a transaction if they thought it was beneficial.

While the asset-based fee model may be an improvement over the commission-based model, there are still issues to point out as to why more improvement is needed. Asset-based fees are highly inequitable, have a detrimental compounding effect, and conflicts of interest are still plentiful under this arrangement.

Generally speaking, there is not more time, services, or overhead involved for a $1 million client versus one with, say, $500,000. But if both clients are charged 1 percent annually, one of them pays $10,000 while the other pays $5,000. Assuming they are both receiving the same service, why should one client be charged twice as much as the other? It may seem equitable as they are both charged the same percentage, but is the fee based on a percentage anyway? Short answer, because it's always been done that way. A flat annual fee can make more sense given that the services rendered are substantially similar.

It's hard to imagine many other services you pay for in the private sector where the sole determinant of your cost is based on how much money you have. Imagine shopping for a financial planner and one of the questions you ask is how much your advisory fee is annually in terms of dollars, and they respond with "how much money do you have?".

This reminds me of a scene from National Lampoon's vacation when the Griswold family is broken down at a remote tire repair shop:

Clark Griswold: "How much will it be?"

Mechanic: "How much ya got?"

How much you have shouldn't be the sole determinant of what you pay for a service.

Conflicts of interest still exist under an asset-based fee model. Imagine you'd like to take $100,000 out of your portfolio to invest into a rental property, and you ask the opinion of your financial advisor. There is now a conflict, as a withdrawal from your account will affect the advisory firm's revenue if they work on an asset-based fee schedule.

Imagine you are 60 years old, preparing for retirement, and your employer has offered a lump sum distribution of your pension benefit. You can collect an annual pension of $35,000 annually or a $500,000 lump sum to rollover into an IRA. Getting objective advice on such a matter would be difficult, if the person giving you advice could get a significant raise by suggesting a rollover.

What we want as investors is for our portfolios to benefit from the wonderful nature of compounding interest, but we'd probably be okay if our costs didn't. Asset-based financial advisor fees compound and can make a significant difference in the long run.

Imagine two $1 million portfolios that earn a gross annual return of 6 percent the next 20 years. One portfolio pays a 1 percent annual fee, while the other pays a flat rate of $5,700. At the end of 20 years, the flat-fee portfolio is ahead by $216,000, not an insignificant sum of money.

Some firms that charge asset-based financial advisor fees would like you to think your interests are more aligned because as you make more money, so will they, and as your accounts decline, their revenue declines. While that sounds great, there are many studies that refute the claim that the advisor can control how your portfolio performs and it is actually driven by a handful of risk factors.

If they truly thought they were the sole determinant of your investment performance outcome, they should only charge a percentage of the profits, not the principal you invested.

Why doesn't every firm go flat fee?

The major wirehouses, broker-dealers, large independent firms, and banks in this country have built their wealth advisory empires on asset-based financial advisor fees, as you can see from the prior chart that it is a lucrative business model. Their comp structures, earnings projections, and much of their overhead is built on the premise of asset-based fees continuing indefinitely. And as their client's portfolios grow with the markets, they will receive automatic revenue increases.

They will not proactively adapt to a flat fee model, as it would drastically disrupt their business revenues and profitability. The current fee structures must be kept in place to pay for incredible overhead they've built up over the years. This is where the small firm has the advantage. Overhead expenditures are not wasted here on research analysts that pretend to know where the market is headed, fancy offices, or season tickets to take clients to Cardinals games. With what the clients will save in long-term costs, they can afford their own tickets.

At the end of the day, a client will only pay a fee if they perceive it to be worth the cost. From my perspective, it is not widely known what the true cost of asset-based fees is over one's investment horizon.

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Reconnect with your employees and get more along the way

By BARBI HENRY

What does Illinois have in common with Kentucky, West Virginia, Virginia, Pennsylvania, North Carolina, Ohio, Indiana, and Utah? Having traveled to all these states, I can tell you it is "Help Wanted" signs in every town.


Henry

While some feel this is a political issue, that discussion does no good for the small business or even larger business that are needing staff to get their products out the door today.

Take a moment and think of all the help wanted signs you have seen in the last two weeks? Now, think about how many people you know who are ACTIVELY looking for work? See the imbalance? As an employer, what options do you have to attract strong talent to your business? You must come an employer of choice, and that means getting creative. I would like to give you some of the creative tips I came up with during a brainstorming session with some HR friends, if you are interested.

Recruiting ... you must get them in the door to hire and then you must be able to hang onto the person once they are on board. It is not as easy as it sounds right now. You could have a job fair, run radio ads, post on Craigslist, LinkedIn, and other websites. You also could contact schools (high schools, colleges, and tech schools), IDES (state unemployment office), put signage outside your building, put up billboards, church bulletins, and on and on. You may get a handful of applicants if you did ALL these things but probably still not fill all your open positions, at least till after September right now.

What is the secret then to getting those applicants in the door? Allow me to suggest employee referrals, and yes, I am talking about those who already work for you and know what a great organization you have. You do have those people, correct? Well, it is time to get to work making your employees feel valued if you haven't done that before. This means getting to know your employees, what their needs are and what they value as an employee.

Do you offer things like:

Job security and fair pay.

Full-time job with at least 30 hours per week and benefits they can afford.

Work life balance with those family responsibilities they have.

Understanding and willingness to listen to your employees beyond your open-door policy.

If you are doing all the above, then you are well on your way to being that "employer of choice" that I was talking about. You have a head start in the recruiting arena and need to get moving today. The rest of you, hang on, you will need this information, too.

Have you thought about an employee referral bonus? It may not have to be a huge amount, start small, like $100 for recommending someone that you hire and stays past 90 days. You may want to offer new hire retention bonus, maybe $250 or $500 if they stay on for 6 months or longer. (This will get you past the September hump.)

Retention … Now, if you know there are things that you need to do to improve your relationship with your employees, here are some suggestions for doing that as well:

Training, training, training. Be it a 10-minute toolbox talk on safety, how to use their health insurance more effectively, financial planning lunch and learns, or even paying for a class that applies to their job if they get a passing grade.

Monitoring workloads, working side by side your staff to understand their concerns and talking about issues with the process and how they feel corrections could be made to improve the outcomes.

Offering flexible scheduling, remember day cares are generally not a 24-hour business. The kids and home school have been a big Covid issue and hard for any parent, especially the working ones.

Recognizing birthdays and company anniversaries with a card signed by you and the rest of your team. This needs to be done on or prior to the date, otherwise do not make them feel like an afterthought.

$10 gift cards for on-the-spot rewards for doing above and beyond what the daily requirement is. These are not given every day, but if someone does something that gets product out your door quicker, pay attention to that and acknowledge the effort accordingly.

Town Halls, these are meeting that are designed to improve communication for all staff. It can be a 20-minute meeting (socially distanced, of course) once a month or every other month to talk about company goals, achievements, safety, and recognition. If you are not comfortable sharing actual data with employees, talk about the percentage: gain over last year in number of widgets going out the door, reduction in overtime, defective product improvement, and safety issue improvements.

Do you see a theme here, communication with employees? Let them know that they affect the bottom line, and you realize without them, you wouldn't be where you are today and may not be here tomorrow if you don't find more people just like them. Then circle back to the referral bonus and start asking employees to help you fill their shift so that everyone benefits, including them.

Once you are doing all the above, consider doing other assorted employee friendly things, such as:

Thank you, cards

Summer party or another event

Bingo for safety or attendance

Supervisor car wash for the employee cars in the lot

Tshirts, water bottles, anything with a company logo that they can use at work and at home

Donuts, Lunch, or ice cream once a month to let them know you care

With summer coming, if the job has no A/C or is outside, providing Gatorade or other drink to prevent dehydration

Once your employees are convinced that you do want them to be happy, they will be glad to share that information with their friends, families, and others. Then you will see some of the rewards of your recruiting bonus in the way of new faces on your shop floor. Just remember to keep the employee engagement up even if you are fully staffed. You do want your staff to be happy, right?

Barbi Henry is a longtime area human resources professional and has written previously for the Illinois Business Journal.