FINANCIAL ROAD WORK

BY KEN BELLAVANCE

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THE 2ND QUESTION YOU HAVE ALWAYS WANTED TO ASK.

HOW IS A FINANCIAL ADVISOR COMPENSATED?

If you haven't already, one day you will find yourself in an office filled with colorful graphs, charts, file organizers, and plaques of personal accolades. The financial advisor; equipped with a notepad, pen, and calculator, will join you in this cozy environment to begin your introductory meeting. You will immediately think of two questions: How can this financial advisor help me? And how is the advisor compensated for his time and advice?

As the financial advisor gets to know you better, the answer to the first question should be slowly revealed. After all, if the advisor immediately suggests a particular investment, he is either a genius or so overtly sales driven that he just suggested a one-size-fits-all approach. Ideally, the advisor should generate conversations that allow for both parties to express who they are, and how they feel about investments. What would stop you from having a great opening meeting? Not knowing the answer to the second question.

It is the financial advisor's responsibility to help the investor understand how compensation is structured in the financial services industry. Not understanding how advisors are compensated can lead to uncertainty and a lack of trust. Most of the time, the first meeting is complimentary and you should not be charged for the advisor's time. Before attending the meeting, check with the advisor or his staff to make sure the first meeting is free.

In case your financial advisor didn't go into detail on this part, I'm going to break down the different ways advisors can be compensated. Keep in mind, advisors should only be paid in one of the following ways; not a combination of the options. The two subcategories are *Fee Based* compensation and *Commission Based* compensation. Let's begin with Commission based.

COMMISSION BASED COMPENSATION

- **Transactional Services** - For a single transaction, like the purchase or sale of a corporations stock or bond, a commission can be charged – as a flat fee or percentage of the investment value. This is what you are probably most familiar with in the financial services industry. You have probably seen the commercials advertising trades for $7.99. This form of compensation to the financial advisor is very straight forward.

- **Investment Products with a Sales Charge** – There are a variety of investment products manufactured in the investment community. Mutual Funds, Unit Investment Trusts (UIT's), and Real Estate Investment Trusts (REIT's) are a few common investment products you may have heard of. Each product pays a commission to the financial advisor in one of two ways. A one-time *front-end sales charge* that will be applied by purchasing the investment, or a lower ongoing sales charge where the advisor will be paid an annual fee.

- **Insurance Products** – Most insurance company products have a commission already priced into their premiums. For Life Insurance, a percentage of the first year's premium will be paid to the insurance agent as compensation. You do not have to pay the insurance agent out of pocket. Simply pay your premium for the insurance and the agent will be compensated. Each company's products have different features and benefits, and may have a different commission rate for the representative.

FEE BASED COMPENSATION

- **Asset Based Agreement** – Commonly referred to as a fee-based arrangement. You may retain a financial advisor to provide financial consulting services, where the fee for such services will be a percentage of assets being managed for your household or account. In other words, if the financial advisor manages your account(s), he/she may charge a percentage fee that is tied to the overall account balance. The fee can be debited from the investment account or paid to the advisor out-of-pocket.

    - For Example: Chip Jones would like his financial advisor to manage his $100,000 IRA for him. Chip's financial advisor charges a 1% annual fee for managing investment accounts. Chip's advisor is paid 1% of the account balance (which started at $100,000) per year. The fee can be calculated on a monthly, quarterly, semi-annual, or annual basis. If monthly, 1/12 of 1% is debited from the account to be paid to the advisor for managing the account per month.

The asset-based arrangement is attractive for investors who would like to tie the advisor's compensation to the performance of the account. If the account loses significant value, the financial advisor still gets paid, but the compensation is reduced by the same decline as the account value. The opposite is also true. The financial advisor is incentivized to create stable growth in order to simultaneously grow the account balance and increase his own earnings.

This fee-only agreement will most often be a *wrap fee,* which means the fee includes all other fees and ticket charges for transactions. You may also qualify for *breakpoint discounts* for larger investments. Think of a breakpoint like a wholesale discount. The percentage fee may be reduced for large accounts.

- **Hourly Financial Consulting** – A financial advisor can provide financial consulting services, at an hourly rate. For example: If an investor structures his own retirement accounts, but would like a second opinion, an hourly consulting arrangement may be a good option. With this option, the advisor will review your accounts and charge an hourly rate for the length of time necessary. You may consider this type of compensation to be out-of-pocket.

- **Flat Fee Services** – Instead of hourly rates, there is a fixed fee option. This option is very similar to hourly financial consulting but applies to the financial planning world. If an investor wants to have a complete financial plan structured by the financial advisor, a fixed fee can be charged for services. The financial plan will specifically show the investor how to use their income and assets to reach their financial goals. The cost of the plan may vary depending on the scope of services provided, complexity of the process undertaken, the types of issues addressed and the frequency with which services are rendered.

Any questions, whether they be situationally specific, hypothetical, or completely off the wall, can be directed to my email at ken@investplanadvise.com or call me 770-205-4394. When emailing, please include appropriate contact information.

MEET THE AUTHOR
Ken Bellavance

Ken Bellavance studied Finance at the University of North Georgia as a student/athlete. Ken graduated at the top of his class from the Mike Cottrell School of Business and received the Excellence in Finance award for his academic efforts within his field. After four years of college baseball, Ken ended his playing days as an Academic All-American.

As a professional, Ken worked at Provident Funding Associates as a Credit Analyst in the wholesale mortgage industry. He was able to develop a unique skill-set by participating in the mortgage lending process.

Ken and his wife Danielle live in Cumming, GA. They take full advantage of the beautiful North Georgia mountains by kayaking, hiking, and fishing. Being from Stone Mountain, GA, Ken is a Georgia Bulldawg, Atlanta Braves, and Atlanta Falcons fan. He also enjoys losing less than 10 golf balls when he plays a round of golf.

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