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WHAT TO KNOW ABOUT ADVISOR FEES AND COSTS

Financial advisor fees can be hidden inside different fee structures.

By: Coryanne Hicks - May 13, 2021

You wouldn't get your oil changed or your hair cut without knowing the cost, and yet more than 1 in 5 investors don't know what they pay in investment fees, according to a survey by Personal Capital. Another 10% don't even know if they're paying any fees at all.

If you're working with a financial advisor (whether they be of the human or the robo variety), they're getting paid for the advice they provide, says Kyle Ryan, a certified financial planner and executive vice president of advisory services at Personal Capital. How they're getting paid determines how much that financial advisor costs.

How Much Does a Financial Advisor Cost?

Generally speaking, 1% per year is a reasonable fee to pay for financial guidance, Ryan says. This should include financial advisor fees, plus any fees on the investments you use.

"Unfortunately, we see quite a few that are double that when you add them together," he says. Personal Capital found that a 1% higher fee can cost an investor nearly $250,000 over her lifetime.

Every investor should know how much their financial advisor costs. Otherwise, how can you evaluate whether the service is worth the money?

It would be great if financial advisors wore the fees they charge pinned to their chests like price tags. Unfortunately, this likely won't ever be the case. So it's up to you as the client to ask about a financial advisor's fees. Even fiduciary advisors, who are required to disclose all fees and conflicts of interest, can do so in the fine print.

Here are questions to ask a financial advisor about her compensation:

- How are you getting paid?
- Do you earn commissions?
- How much money are you and/or the company making to put me in this investment?
- What are my total costs for working with you?

An advisor should give you clear, straightforward answers to all of these questions. If she doesn't, go elsewhere.

Of course, a financial advisor's cost will vary based on how you receive guidance. Robo advisors, for instance, are considerably less expensive than human financial advisors. Here are the average fees charged by various types of advisors:

- Human financial advisors: 1% to 2% per year
- Robo advisors: 0.25% to 0.35%
- Hybrid advisors: 0.5% to 1.5%

How Are Financial Advisor Fees Charged?

There are three ways financial advisors get paid:

- Fee-only advisors charge an annual, hourly or flat fee.
- Commission-based advisors are paid through the investments they sell.
- Fee-based advisors earn a combination of a fee, plus commissions.

The most common fee-only financial advisor structure is to charge a percentage of the assets under management, commonly referred to as AUM. In this case, the advisor deducts her fee from your account, usually on a quarterly or monthly basis, based on your account balance. If you have $1 million with an advisor charging 1% of AUM, you'd pay $10,000 per year in fees or just over $833 per month.

"Personally, I prefer this because the better my client does, the better I do," says Lisa Bamburg, co-owner of Insurance Advantage & LMA Financial Services in Jacksonville, Arkansas.

The average financial advisor fee is 1%, but they're often charged on a sliding scale. So the more assets you have under management, the lower your fee percentage will be. While 1% is about the average financial advisor fee for a $1 million account, a $50,000 account may pay closer to 1.2% and a $30 million account might shell out 0.59%.

Robo advisors also use the AUM fee structure. Most robo advisors charge between 0.25% and 0.35% per year for digital-only advice, on top of the fees you pay for the investments they use. When coupled with personalized advice, those fees can rise to 1.5% per year.

AUM financial advisor fees are based on the starting value at the beginning of the year, says Mark Charnet, founder and CEO of American Prosperity Group in Pompton Plains, New Jersey. If your $1 million account is worth only $800,000 at the beginning of your second year, the financial advisor would charge $8,000 for that year rather than $10,000.

Since fees are typically reassessed each month or year based on the account balance, you could pay more one year or less another. "If the account is dropping, the fees will be a lesser total for the year as opposed to the prior year when the account value was stronger," Charnet says.

"Many people aren't comfortable paying fees on losses," Charnet, who uses a commission-based structure, adds. There's also the reverse argument where some investors don't like having to pay more as their account grows.

The Department of Labor would tell you this is a good thing: If the financial advisor's fee grows with your account balance, it's clearly in her best interest to help you make money. Hence why the Department of Labor created the fiduciary rule, which the 5th Circuit Court of Appeals killed in 2018, to try to force all retirement advisors to use a fiduciary's fee-only structure. (Fiduciary advisors must be fee-only.)

But aligning your advisor's incentives with growing your account is only a benefit to you if growth is your primary objective, says Kurt Hemry, president of Ironwood Wealth Consultants in Portland, Oregon. Investors living in retirement are probably more interested in preservation or income than growth.

Other fee-only financial advisors charge hourly, an annual or quarterly retainer that's not based on the size of your account, or a flat fee for each service. For instance, a flat-fee advisor may charge $2,000 to create a comprehensive financial plan. If the advisor isn't licensed to sell investments (and many flat-fee advisors are not), it'll be up to you to implement that plan and manage your investments going forward.

Advisors can also charge a flat annual fee, which ranges from $1,000 to $5,000 per year, or an hourly fee, which ranges from $100 to $400 per hour, Bamburg says.

Since flat-fee advisors have no affiliation with the investments you use, they're often seen as the most unbiased financial advisors, Hemry says.

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Are Financial Advisors Worth the Cost?

Given the impact of fees on investment returns, you have to wonder if financial advisors are worth the cost. The answer comes down to value.

Financial advisors can add value in more ways than achieving higher returns. For instance, the advisor may use tax minimization strategies to reduce your tax bill. Or the advisor may add value by ensuring your portfolio is rebalanced appropriately. Perhaps the biggest benefit of working with a financial advisor is making sure you don't make poor emotional decisions with your money.

"Having a financial advisor might sound expensive, but if you don't have time to manage your portfolio, that can be more costly," Bamburg says. "Statistics show that most of the time, a financial advisor will make your portfolio grow more, even after fees, than an individual can do themselves."

The biggest question when evaluating a financial advisor is if they're giving you greater confidence and clarity that you'll meet your financial goals, Ryan says. He suggests asking the advisor to articulate his or her value for you. The advisor should be able to list all the things that will be done on your behalf to earn the fee. Then you can decide if a financial advisor is worth the cost.

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