TD Mutual Funds

The Great Fee Debate

More and more advisors are shifting their practices from a commission-based compensation structure to a fee-based model, with higher income advisors leading the way. The appeal of a fee-based approach is that it provides advisors with more time to focus on enhancing client relationships instead of investing their energies on closing the next big sale. However, there are challenges associated with making the switch, and advisors should carefully consider the makeup of their practices before adopting a fee-based structure.

What to Consider First

Not all financial advisory businesses are suited to a fee-based structure. If you work primarily with clients who engage in a high volume of transactions/sales and enjoy the thrill that comes with successful selling, you're probably better off remaining commission-based. On the other hand, if you're a believer in strategic asset allocation and long-term growth, you may benefit from a fee-based structure.

The advantages of becoming a fee-based advisor include the fact that it makes it much easier to be "client-focused." You can nurture the best relationships in your practice, instead of spending a lot of time monitoring product performance. This way, you are rewarded for the service you provide, rather than the performance of your client's portfolio. Perhaps most importantly, a fee-based practice tends to have more stable income streams, so you won't be as vulnerable to market downturns that make it more challenging to make new sales. And the "annuity" you create will tend to make your practice easier to sell when the time comes for you to retire.

The disadvantage of a fee-based approach is that it may simply not match your advising style. Some advisors also worry that clients will resent paying fees in slower markets – though this situation can be avoided with careful investor education. Others are reluctant to address the question of compensation head-on with clients.

That last point shouldn't worry you. A surprising number of advisors don't take the time to fully explain their compensation to investors, judging by a 2002 Ipsos-Reid poll that found that half of investors with financial advisors believe they "do not pay for financial advice." Yet advisors who do explain their commission and/or fee structure have the opportunity to clearly lay out the value an investor receives from the relationship. This leads to more satisfied clients and an environment of mutual respect.

How to Make the Switch

If you come to the conclusion that becoming a fee-based advisor is the right move for you, you will need to make some other important decisions. First of all, how will you break down the fees that you charge? Your clients will want to know your rates for financial plans, for advice and for asset management. You may also want to build in an annual retainer that covers all the additional services you offer – from annual reviews to seminars. Secondly, will you need to invest in additional staff and office amenities now that you are selling "service" instead of "transactions"?

Finally, how can you ensure that your pricing structure is competitive? To answer this last question, consult with colleagues and centres of influence about their experiences as fee-based advisors – or working with fee-based advisors. Nothing is as valuable as a first-hand account that can help you avoid pitfalls and take full advantage of opportunities.

Investor education will be critical during your transition. The more clients understand the value you bring to their portfolios and the ways fees align to the services they receive, the more they will accept your new cost structure. Emphasize that many clients

end up paying less and receiving more personal attention from their advisor in a fee-based system. Discuss the benefits to clients of a more transparent fee structure. And explain that some fees are tax-deductible – such as those charged to non-RSP accounts.

Many advisors find that a gradual transition works better than a "cold turkey" switch to a fee-based model. This gives you time to educate your clients while you continue to run your business – a process that can be extremely difficult to manage with a client list of several hundred. Consider moving a handful of investors at a time to the fee-based structure. As they become comfortable, move another handful. Pretty soon, your entire client base will have made the switch.

Unveiling Your Fee-Based Practice

Operating within a fee-based structure will require you to fundamentally change the way you do business. Most significantly, instead of selling products, you will need to focus your attention on attracting and maintaining assets. The most efficient way to do this is to deepen relationships with your very best clients. Look for ways to deliver even more to these people – from more frequent face-to-face meetings to more customized reporting.

Whether you decide to transition to a fee-based practice or to remain commission-based, demonstrate the advantages of your approach to investors and make sure they understand how much they will be paying and what they will receive in return. This will lead to more loyal clients and more profitable long-term relationships.

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