Investor Education Series

How Advisors Are Paid

Individuals who provide financial advice to investors are all paid for their services. How they are paid varies significantly. Financial advisory services require patience, planning, studying and understanding investment products, putting a plan into action and on-going monitoring of the plan, keeping clients informed, and responding to changes in how the plan unfolds due to unforeseen circumstances and the realities of life. No professional works for free. Anyone claiming to do so is not a professional. <u>How a professional financial advisor is paid is critical in understanding the advice, let alone the advisor.</u> Fees Matter!

The vast majority of financial advisors (planners, brokers, salespeople) earn their income from commissions paid by fund companies whose products they sell to clients – this includes sales and trailing commissions. Trailing commissions are paid to advisors by fund companies for on-going advice to investors, after the initial sale. The problem with this is that investors rarely (if ever) receive a statement identifying clearly how much they are paying for this advice, or the total cost of investing. There is little transparency in how fees work in financial services. When advisors are paid at the time of transaction, there is a culture of sales rather than a culture of advice. When advisors are unclear as to who is paying them, how much they are being paid, and when they are paid, there is an ambiguous approach to advice rather than a transparent approach to advice.

What would you rather do?… Pay for the transaction and get your advice for free

OR

Pay for advice and have the cost of the transaction included

Management Expense Ratio (MER): Covers the costs of operating a mutual fund, such as management fees, trading expenses and costs, legal, reporting, and administration costs. It also includes commissions paid to advisors. No-Load funds do not necessarily have lower MER's than Load funds (DSC, S-DSC, or FL). I have yet to meet an investor who knows what they are paying in an MER. Fund companies and investment firms do not easily disclose these costs. Fund companies will send you a prospectus so that you can search out the MER, but no fund company provides the investor with a statement that shows exactly what they are paying.

I have created a table to assist investors to understand how advisors are paid. There is no right or wrong way to pay an advisor. Advisors provide a valuable service. I believe it is vital that disclosure, awareness and transparency are at the forefront of the investor/advisor relationship. Our compensation objective: to align our interests as best as possible with the interests and objectives of our clients.

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John Tabet is a financial advisor licensed as a full-service securities broker. John works with individuals and families to protect and grow wealth. With over 20 years of broad based experience in the financial services industry, John provides clients and investors with a unique perspective on investment management. John has been an independent financial advisor since 2001. The opinions and information shared in this article and series are those of John Tabet alone. They are for information purposes only, and do not construe financial advice.

	Deferred Service Charge (Back End Load)	Shortened Deferred Service Charge (Low Load)	Transaction Fee (Front End Load)	Fee Only	Fee-Based
Highlights	Purchases 0% Redemption Year 1 6% Redemption Year 2 5.5% Redemption Year 3 5% Redemption Year 4 4% Redemption Year 5 3% Redemption Year 6 2% Redemption Year 7 0%	Purchases 0% Redemption Year 1 3% Redemption Year 2 2.5% Redemption Year 3 2%	Purchases 0% - 5% Redemption Usually a flat Fixed Fee ($0 - $50)	Not Applicable	Example: 2% < $250,000 1.5% > $250,000 1.25% > $500,000 1% > 1 Million
Mutual Fund pays Advisor	Sales Commission 5% Annual Trailer Fee 0.5%	Sales Commission 2% Annual Trailer Fee 1%	Annual Trailer Fee 1%	Advisor not compensated by Mutual Fund Co.	Advisor not compensated by Mutual Fund Co.
Investor pays Advisor Directly	Not Applicable	Not Applicable	Up Front Commission	Paid on an hourly basis, directly by the client. Primary focus is on asset allocation and planning aspects.	Asset based fee, payable monthly, quarterly or annually, normally in arrears.
Structure	Advisory services are paid by way of transactions	Advisory services are paid by way of transactions	Transaction compensation is in-line with advisory compensation	No transactional compensation as investor must implement plan on their own	No transactional compensation. Advisor and Investor goals aligned – protect and grow capital
Pro's/Con's	Pro—No Upfront costs Con—No Transparency Con—Advisor paid by a 3rd party Potential for conflict of interest	Pro—No Upfront costs Con—No Transparency Con—Advisor paid by a 3rd party Potential for conflict of interest	Pro—More transparency of costs Con—Advisor paid by a 3rd party Potential for conflict of interest	Pro—Known costs Con—Advisor implements plan on their own No Conflict of interest	Pro—Transparency Pro—Investor & Advisor Alignment • Advisor benefits when investor benefits • Advisor is affected when portfolio value declines