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Why You Should Only Work With a Fee-Only Financial Advisor

Fee-only financial advisors have some advantages over other types of advisors. Learn what those are and if working with one is right for you.

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Financial advisors can provide valuable advice about money that helps you reach your financial goals. Of course, this advice isn't free. Financial advisors charge for their services in a few ways. Fee-only financial advisors offer a relatively easy-to-understand fee structure that isn't influenced by buying or selling assets they manage on your behalf. Learn more about the pros and cons of working with these advisors and how to find one.

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What is a fee-only advisor?

A financial advisor provides financial advice to clients in areas such as how to invest money, estate planning, tax planning, insurance, retirement planning, wealth management, and comprehensive financial planning. Financial advisors may hold certifications such as the certified financial planner (CFP) designation. Financial advisors vary in terms of their training, certifications, the types of services they offer, and their method of compensation.

The three main forms of financial advisor compensation are fee-only, commission, and fee-based, also known as fee and commission.

What is a fee-only financial advisor? A fee-only financial advisor is an advisor whose only source of compensation from working with their clients are fees paid to the advisor by the client. Fee-only compensation can take several forms depending upon the nature of the advisor-client relationship:

- **Percentage of assets**. The advisor charges a percentage of the investment assets they manage on behalf of their client. For example, if you have $500,000 in assets, you might pay 1% over the course of a year, or $5,000, to a financial advisor to manage those assets. This is sometimes referred to as an assets under management (AUM) fee.
- **Hourly**. These advisors charge their clients for financial advice provided as an hourly fee based on the time they spend providing this advice.
- **Flat fee**. This may come in the form of a flat fee for a one-time project like preparing a financial plan for their client. Or it could be an ongoing charge or retainer for a level of service, such as ongoing investment and financial planning advice.

Fee-only advisors don't collect any compensation from the sale of financial products such as annuities or mutual funds.

Fee-only advisors are often associated with the term "fiduciary." An advisor who acts as a fiduciary puts their client's best interests ahead of their own in any and all recommendations they make.

The National Association of Personal Financial Advisors (NAPFA), the largest professional organization of fee-only advisors, requires that all members sign and reaffirm NAPFA's fiduciary oath each year. The first two sentences of the oath are, "The advisor shall exercise his/her best efforts to act in good faith and in the best interests of the client. The advisor shall provide written disclosure to the client prior to the engagement of the advisor, and thereafter throughout the term of the engagement, of any conflicts of interest, which will or reasonably may compromise the impartiality or independence of the advisor."

Fee-only vs. commission financial advisor

A fee-only financial advisor receives no compensation from the sale of financial or investment products they suggest to their clients.

In contrast, a commission-based financial advisor would receive 100% of their compensation from commissions on the financial products they sell to their clients. This provides a strong incentive to sell financial products; otherwise, they don't get paid. This reliance on the need to sell financial products can lead to conflicts of interest for commission-based advisors in choosing between what is best for their clients and what is most beneficial to their wallets.

If you're looking at fee-only vs. fee-based financial planners, they may sound similar, but they're compensated in different ways. Fee-based, also known as fee and commission, is a hybrid of fee-only and commission-based. This could arise when the advisor charges a fee for an initial financial plan and implements any recommendations made in the plan with financial products that generate a commission for them.

Another version of fee-based would be an advisor who mostly offers their services on a fee-only basis, with the exception of selling life and disability insurance to clients who have a need, or legacy clients for whom they continue to service policies sold in the past.

In the interest of full disclosure, my experience as a financial advisor has been under the fee-only model, and my strong personal and professional bias leans in that direction. That said, I know many advisors under both the commission-only and fee-based models who are outstanding advisors and who put the interests of their client first.

To be clear, there are excellent financial advisors who work under all three compensation models. There are also less-than-stellar advisors working under each model. Their compensation model is important, but it's not the only factor in choosing a financial advisor.

Advantages of a fee-only financial advisor

There are a number of potential advantages of using the services of a fee-only vs. commission financial advisor.

Clear, understandable fees

The fees for a fee-only financial advisor are generally clear, concise, and easy for clients to understand. There are no hidden fees buried inside of financial products. Since there are no financial incentives to earn commissions from the sale of financial products, there are fewer potential conflicts of interest in working with fee-only advisors.

Fiduciaries

In most cases, fee-only advisors have a fiduciary responsibility toward their clients. The cost of the advisor's services is predictable since their fees are fully disclosed upfront. As with any other type of service professional, such as an attorney, physician, or accountant, you are buying a service from the fee-only advisor. They earn money by providing advice, not from selling a product.

Fewer conflicts of interest

Advisors who earn all or most of their compensation from commissions on the sale of financial products have an inherent conflict of interest due to their need to sell products to earn a living. While all financial products are by no means bad, clients should be leery of the motives of advisors whose livelihood depends on selling financial products to you.

Disadvantages of working with a fee-only advisor

There can be disadvantages of working with a fee-only financial advisor as well.

Conflicts of interest

Fee-only advisors are not immune from conflicts of interest. For example, if your advisor is compensated based on a percentage of your assets under management, they might discourage you from taking money from those investments to meet a financial need as that would reduce their compensation.

Account minimums

Some fee-only advisors may impose minimum account sizes to work with clients on an ongoing basis. They may require $250,000, $500,000, or more in assets to become their client. In the same vein, they may have a minimum fee for ongoing services or a one-time financial planning engagement. These types of fees may be prohibitive for some investors.

High-cost services

Overall, the services of a fee-only advisor may seem more costly than those of commission-based advisors. Additionally, the client may pay these fees out of their assets or checking account versus as a commission, making it seem like a larger expenditure.

Pros and cons of fee-only financial advisors

Pros

- Fees are clear and not based on commission from the sale of a financial product.
- The lack of commission eliminates the potential conflict of interest that can arise when a financial advisor earns their income from selling financial products.
- Many fee-only advisors adhere to a fiduciary standard that requires them to put the interests of their clients first in all aspects of their relationship with them.

Cons

- The cost of a fee-only advisor can be expensive for some investors.
- Fee-only advisors whose fees are based on assets under management might have an inherent conflict of interest against a client withdrawing assets that would reduce their fees.

How to find a fee-only financial advisor

You have several options for how to find a fee-only financial advisor. There are a number of organizations that require their members to adhere to working as a fee-only advisor. Many of these organizations offer listings of member financial advisors on their sites. These include:

- NAPFA
- Garrett Planning Network
- XY Planning Network

If you find a financial advisor on the internet, through a referral, on LinkedIn, or elsewhere, go through their website. Generally, if they are fee-only, they will disclose this on their site as this is a selling point for many financial advisors. If the site references that "securities offered through" or something similar, this likely means that they are part of a broker-dealer platform and probably are not fee-only.

Questions to ask a prospective advisor

When selecting a financial advisor, it's important that you ask them many questions. This is your money and your future. You need to find a financial advisor who is the best possible fit for your situation. If the advisor discourages you from asking questions, this is a big red flag, and you might consider ending the meeting with them on the spot.

Some questions to ask a financial advisor:

- How long have you been a financial advisor?
- Do you work with other clients in similar financial/life situations as mine?
- What services do you provide?
- How are you compensated? Please detail all types of compensation that you would earn from working with me.
- How much do you charge?
- How often would we meet? How often should I expect to hear from you? Am I free to contact you at any time with issues or questions that might arise?
- What training or certifications do you have?
- Have you ever been disciplined by regulatory authorities?
- Where will my investments be held if you provide me with investment management services? (Note: this is crucial. Using his own custodian was a key factor in Bernie Madoff's ability to defraud so many of his clients. A custodian is a financial institution that holds investments for safekeeping, which means the financial advisor doesn't have direct access to your funds. Madoff controlled the company that served as the custodian for his client's accounts, which allowed him to move money at will and fabricate statements.)

A good financial advisor will be receptive to your questions and will want to be sure you are comfortable with their answers. An advisor who tries to rush you through this part of the process may also act this way toward you when providing advice.

FAQs

How much does a fee-only financial advisor cost?

Fee-only advisor costs can vary widely based on the type of service offered and the advisor offering the services.

Advisor fees based on assets under management (AUM) might range from 0.25% of assets up to 1.25% or more of assets. Generally, advisors will charge a lower percentage rate for clients with a larger asset base. Typically this type of arrangement will be comprehensive in that the advisor will not only provide investment management services, but also provide financial planning and related services.

Advisors who work on an hourly basis might charge anywhere from $75 per hour up to $200 per hour or more.

Flat fees might range from $1,000 to $2,500 for a one-time financial planning engagement to $5,000 to $10,000 for ongoing services on an annual basis. These fees might be billed monthly or quarterly.

Is it worth the money to hire a financial advisor?

The definitive answer here is that it depends. It depends on how comfortable you are managing your own finances, including your own investments and financial planning. At first, you might find an advisor to help you review things periodically and to provide recommendations. As your earning power and your wealth grow, it might make sense to engage the services of an advisor on a continual basis.

As with any type of professional service, you should assess the benefits you expect to receive against the cost to determine if hiring this advisor is a good value for you.

What is the difference between a financial planner and a financial advisor?

The services of financial planners and financial advisors often overlap. Someone who describes themselves as a financial planner typically would provide financial planning services and likely not offer investment management. A financial advisor typically offers investment advice and management and may also offer financial planning as well.

Bottom line

It is important to understand how your financial advisor is compensated. Besides giving you an idea of how much their services will cost, their compensation model can also indicate whether or not they bring inherent conflicts of interest to your relationship with them.

Fee-only is the most transparent compensation model and, all else being equal, is probably the most client-friendly advisor compensation model. In all cases, any financial advisor you are considering should fully disclose all sources of compensation that they stand to make from working with you.

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In addition to his bylined articles on sites like TheStreet, ThinkAdvisor, and Investopedia, Roger ghostwrites extensively for financial advisors, investment managers, and financial services companies.

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