

# Trust that's earned.



©2009 FMR LLC. All rights reserved. Fidelity Investments is a registered trademark of FMR LLC.

## Claiming names

Marc Lamontagne / February 01, 2009



What does it mean when advisors describe themselves, or their services, as fee-only, fee-for-service, or fee-based? It's a question investors are asking, so those of us in the industry need to hurry up and make those distinctions.

The fee-advisor market is both fascinating and confusing. That's in part due to the fact that titles are (for the most part) clearly defined in other countries such as the U.S. and UK, but no regulatory or industry body in Canada has ever attempted to define the terms. In fact, there's no point of reference to even begin with, unless we use a foreign source.

It's also unclear whether the moniker reflects how an advisor is compensated in general or how a client pays for a particular service.

Besides, are we talking about compensation or licensing? As a fee advisor, I frequently get calls from prospective clients who say they're looking for a fee-only financial advisor because they don't want to be sold anything.

There still exists an "us" and "them" myth – the misconception that you're either in one camp or the other. The reality is the majority of financial advisors are neither compensated 100% by fees, nor 100% by commissions. In my own case, I still earn about 1% of revenue in commissions.

### WHY SHOULD WE CARE?

Last year, I conducted a survey of fee advisors across Canada and found just over half felt we should have some industry body define and police the terms around fees – at the same time, many comments stressed the need to keep the regulators out of the debate. Most advisors say they either don't trust them to make the best decisions or feel they will add to already cumbersome compliance requirements. Regulators seem to be treating fee-based accounts merely as another product, and are only concerned with suitability requirements instead of viewing them as part of an advisor's compensation or business model.

Another notable gripe is that under the current unregulated system, certain advisors have seized a marketing advantage by convincing the media that fee advisors are somehow morally superior.

A survey of articles from industry pundits shows they've all taken a stab at defining the model, but have yet to agree whether they're describing a compensation model or a business model. The articles leave the impression that "fee-only" means I'm paid only by an hourly or flat fee, and that I hold no licence. But the former is a compensation model and the latter is part of a business model. A second common area of confusion is whether charging a percentage of assets is fee-only or fee-based. And since trailers are a percentage of assets, should they also be considered fee-based?

The consumer media aren't the most appropriate organization to answer these questions. But, unfortunately for us, they're now setting the agenda because we as an industry can't get our collective act together. To their credit, though, the media have been the best cheerleaders we have on the benefit of the fee model (it aligns the advisor's interests with those of the client) even if it isn't clear what exactly that model should look like.

### WHAT'S ON THE BOOKS?

The main industry professional associations such as Advocis, the Canadian Institute of Financial Planners (CIFP), or even the Institute of Advanced Financial Planners (IAFP) don't define the names nor mention them specifically in any rules or guidelines, except to state that all compensation must be identified and disclosed. That will change in June 2009 for members of the CIFP when they publish new guidelines on the fee model. According to Keith Costello, President and CEO of the CIFP, "We currently have a committee looking at the issue and we plan to conduct a member survey."

The Financial Planners Standards Council (FPSC), on the other hand, does have rule 401 in the Code of Ethics that states "a CFP professional shall not hold out as a fee-for-service practitioner if the CFP professional receives commissions or other forms of economic benefit [trailers] from parties other than the client." However, it does not define what constitutes fee-for-service apart from stating what it is not.

Cary List, president of the FPSC, believes they have gone far enough for now by focusing more on full disclosure and less so on semantics. Also, under Practice Standard 100, the FPSC has provided CFP licencees with suggested terminology. These rules are flexible enough to allow an advisor to have a fee-for-service engagement with one client, but not prevent a commission engagement with another client.

Finally, List states that "we are always looking at revisions in our Code of Ethics and Practice Standards so [we] may address this issue in the future, and if helpful, may adopt the same rules and definitions as the international CFP community."

### U.S. PERSPECTIVE

Down in the States, the National Association of Personal Financial Advisors (NAPFA) is a small but extremely vocal proponent of the fee model. It defines a fee-only planner as one who, in all circumstances, is compensated solely by the client, with neither the advisor nor any related party receiving compensation that is contingent on the purchase or sale of a financial product. A NAPFA member or affiliate may not receive commissions, rebates, awards, finder's fees, bonuses or any form of compensation from others as a result of a client's implementation of the individual's planning recommendations.

According to Diahann Lassus, national chair of NAPFA, the fee can also be deducted directly from a client's investment account "as long as it is unbundled from any other cost and the client receives at minimum a quarterly statement explaining how the fee was calculated." This definition is often used as the benchmark when the financial industry tries to define fee-only.

The Certified Board of Standards, which issues the U.S. CFP designation, originally said the term fee-only represented the cost of a service offered to the client, rather than how an advisor is compensated in total. A client could hire an advisor on a feeonly basis, but could also hire him or her later for a different service on a commission basis, as long as there was no bait and switch.

However, in January 2002 that rule was changed to be consistent with other organizations. The new rule refers to how an advisor is compensated in total. Now, a fee-only arrangement exists when the advisor is compensated solely by the client for professional services provided. The types of compensation arrangements include the following:

- Hourly, fixed, or flat fees;
- Percentage fees based on some aspect of the client's financial profile, such as assets under management; and
- Performance-based fees that are tied to the profitability of the client's invested assets.

In order for a CFP Board designee to describe his or her compensation as fee-only, all compensation from all clients must be derived solely from fees. Minimal exceptions may be allowed provided the compensation is inconsequential and independent of the purchase of any product or service. The same requirements apply when using terms including, but not limited to, fee-only services and fee-only firm. With the stringent definition of fee-only established, U.S. advisors using the term feebased are by implication saying they will accept commissions, Lassus says.

### WHAT'S NEXT FOR CANADA

In this country, the first task is to reduce the confusion by eliminating two of the three terms, and using the most commonly used term fee-only to describe all advisors compensated by fee.

Then we must establish basic tenets as to what qualifies as a fee and allow room for future innovation. Some examples would include:

- The fee is set by the advisor or firm (not a product provider);
- Client must agree in the form of a signed letter of engagement;
- It must be transparent; and
- It must be reported to the client at the end of an engagement or on a regular basis.

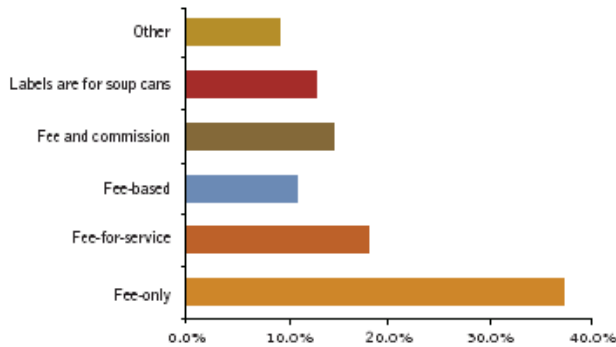
On the point of transparency, UK's main regulator (the Financial Services Authority), which has made huge strides in advancing the fee model, proposes a negotiated trailer as an alternative to paying by fee. The intent, in the case of Independent Financial Advisors, is that all products would be sold on a no-load basis and all compensation, whether charged directly to the client or blended into the product cost, be negotiated with and agreed to by the client.

To make it easier for clients to comparison-shop, advisors should also break out on a standard fee schedule the type of fees charged for particular services. Today, if clients are looking for a financial plan and want to pay a flat fee, they may have to call fee-only advisors to ask if they offer a flat-fee service. The alternative is to have two separate terms that distinguish advice-only advisors from those that also implement. Though this may be a problem for those advisors (myself included) who offer both advice-only services and advice plus implementation services.

An industry body (or bodies) must have the power to enforce the rules on how to use the terms, whether describing a service or an advisor's compensation model. And, finally, we're overdue for a public relations spree to clarify terms and end the confusion.

## DEFINE YOURSELF

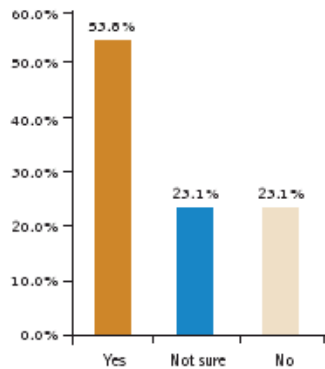
How respondents answered the question:  
 "When speaking to clients, how do you refer to yourself?"



Source: To Fee or Not to Fee, 2008 Fee Advisor (beta) Survey

## NAME CALLING

How respondents answered the question:  
 "Do you feel the terms fee-only, and fee-for-service should be clearly defined by some industry body and their usage regulated?"



Source: To Fee or Not to Fee, 2008 Fee Advisor (beta) Survey

*Marc Lamontagne, CFP, R.F.P., FMA, CSA is a fee-based financial planner with Ryan Lamontagne Inc. in Ottawa.*

**Filed by Marc Lamontagne, editor@advisorsedgereport.com**  
Originally published in Advisor's Edge Report, February 2009

Copyright 2009. Advisor.ca. All Rights Reserved