Chapter 6

Fee-Only Advisors

This will be a short and simple chapter (although one that should offend you as much as any of the chapters in this book).

WHAT IS A FEE-ONLY ADVISOR?

I went to the World Wide Web to find a handful of different explanations from the fee-only advisors themselves.

<u>Quote #1</u>

"*Fee-only advisors do <u>not</u> work for commission but rather earn a percentage of assets under management. This assures that your personal interests are served and that your advisor is not potentially swayed by any personal or corporate conflicts of interest.*"

<u>Quote #2</u>

"*A Fee-Only financial advisor is one who is compensated **<u>solely</u>** 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. Fee-only advisors may not receive commissions, rebates, awards, finder's fees, bonuses or other forms of compensation from others as a result of a client's implementation of the advisor's planning recommendations.*"

<u>Quote #3</u> (This is my favorite explanation I found on the Web).

"What is Fee-Only Financial Planning?

Depending on the service you select, the fee is based on hourly fees, flat fees for financial plans, or asset management fees. There are ***no*** *hidden fees or expenses,* ***nor*** *do we receive fees from third parties for the services recommended on behalf of our clients.*

Your account will be customized using index funds, Exchange Traded Funds (ETFs), and "no load" or "load waived" mutual funds which put more of your investment dollars to work.

Why is Choosing a Fee-Only Advisor Important?

Fee-Only advice results in ***objective advice*** *that meets your specific needs. Because we receive* ***no commissions of any kind****, or referral fees from accountants, attorneys, insurance professionals, or anyone else, we have no incentive to recommend a product or service unless it is in your best interest.*

Other Forms of Compensation for Other Advisors

What is a Commission Based Advisor?

A commission based advisor receives commissions from financial companies for selling investment, insurance, and other financial products to their clients. The client may not see the commission, which can be paid in several ways, such as "loads", "12(b)1 fees", or sales incentives, but it is paid.

What is a Fee-Based Advisor?

Fee-based advisors receive ***both commissions*** *from product sales* ***and fees*** *from clients."*

Why do I like Quote #3 as my favorite? Because it's one that has the best marketing pizzazz. Why do I find that interesting? Because my assessment of fee-only advisors is that the concept that they give clients the best advice because they are fee only is an oxymoron (a figure of speech that combines normally-contradictory terms).

Why do I use the term oxymoron? As I'll explain in this chapter, I think it's nearly impossible for a fee-only advisor to give the best unbiased advice to clients.

FEE ONLY IS GREAT MARKETING

When you read that fee-only advisors do not take commissions and because of this are in a position to always make recommendations that are in the client's best interest, it really makes sense, doesn't it?

As I stated in the chapter on "bad BDs and securities licensed advisors," many securities licensed advisors make the majority of their money from commissions (commissions that come from selling stocks and mutual funds).

The higher the turnover in a stock/mutual fund portfolio, the more money an advisor can make.

Additionally, advisors who make their money from selling products, many times will sell "loaded" products—ones that pay front-end and/or back-end commissions.

Therefore, it seems logical that, if consumers work with fee-only advisors, the advisors surely will be able to give less-biased advice, right? The advisor is on the same team as the client because the fee-only advisor makes money from an asset-based fee. The more the assets grow, the larger the annual fee the fee-only advisor makes.

This is great marketing in my opinion. I'm sure that most people reading this chapter have bought into it already and are wondering how I'm going to attack this platform and illustrate what makes a "bad" fee-only advisor.

WHAT ABOUT FEE-BASED ADVISORS?

Let me talk briefly about fee-based advisors vs. fee-only advisors.

As stated earlier in Quote #3 that I pulled off the internet, a "fee-based" advisor can charge fees for advice given and earn money from commissions. If you've bought into the fee-only model as the only one that aligns an advisor's interest with that of his/her clients, then you probably think that a fee-based advisor must give tainted advice because they can earn commissions.

Actually, fee-based advisors are my favorite kind of advisors. If you want advice on securities products (stocks, mutual funds, variable annuities, etc.), fee-based advisors at least have the opportunity to give clients the "best" advice (I'll explain shortly).

NO-LOAD LIFE INSURANCE AND ANNUITY PRODUCTS

What is a no-load life insurance or annuity product? It's one that doesn't pay a commission.

In theory, you'd think a product that doesn't have a commission must be better than those without, right? If an insurance company doesn't have to pay an agent to sell it, then the product must be priced better (term life insurance should be less expensive, cash value life insurance should have more cash, and annuities should have more cash and no or lower surrender charges).

There are a lot of things in life that sound good in theory but fail in the real world.

Over time, insurance companies have tried to roll out no-load or low-load insurance and annuity products.

Most of them were taken off the market. Why? They must have been better products, right?

No. Most of them were inferior products compared to the ones that paid commissions. How can that be?

Insurance companies put money into research and development of products they know will sell. As you'll find out, fee-only advisors know very little about most insurance products and, therefore, don't recommend or sell many of them.

If few advisors are selling no-load products, how long do you think an insurance company will keep them on the market? Right. Not very long.

You don't have to necessarily agree with what I'm saying, but what I'm saying is the truth.

Most of the good insurance and annuity products (except potentially some variable annuities) are commission-based products because there is a huge national sales force of licensed insurance advisors to sell them.

WHAT MAKES A "BAD" FEE-ONLY ADVISOR?

Let me just get right to the heart of the issue by asking you a few simple questions.

Do fee-only planners have a built-in bias against commission-based products?

Absolutely.

If fee-only advisors can't and won't offer commission-based products, what do you think the odds are of fee-only advisors knowing if any of the commission-based products are any good?

Nearly Zero!

How do I know? Because I've talked to dozens of fee-only advisors over the last several years who have proved their ignorance of commission-based products to me.

Why would I be talking with a fee-only advisor? I have thousands of them who receive the educational e-newsletters I send through The Wealth Preservation Institute. Many of them don't like the fact that I'm a strong advocate of insurance products such as Fixed Indexed Annuities (FIAs) and Equity Indexed Universal Life (EIUL) insurance.

I receive many negative e-mails and calls from fee-only advisors who tell me I'm doing the industry a disservice by touting the virtues of commission-based products.

It's like they are trying to convert me to the cult of fee-only planning.

However, unlike fee-only advisors, my ethical duty is to provide the best advice to my clients and counsel others to do the same no matter what products or concepts are on the table. If I think a commission-based product is the best, I'll recommend it. If I think a no-load product is the best, I'll recommend it.

Fee-only advisors have basically sworn an oath that is contradictory. Their oath is always to do the best for their client by NOT taking commissions. The problem with that as I've stated is that many of the best products in the market are commission-based products.

EXAMPLE PHONE CALL TO EXPLAIN THE PROBLEMS WITH FEE-ONLY ADVISORS

Let me give you an example of the typical phone call I have from a fee-only advisor.

Advisor: Roccy, I read your newsletter the other day where you were bashing securities licensed advisors because you don't think they are doing right by their clients for various reasons.

Roccy: Hi, thanks for the call. Yes, I've done a number of articles indicating why many securities licensed advisors are giving bad advice to their clients.

Advisor: I wanted to call and tell you that I agree with much of what you say but that I also disagree with your insistence that many clients should build wealth with FIAs or cash value life insurance.

Roccy: Really? Why is that?

Advisor: As I'm sure you are aware, the products you talk favorably about in your newsletters are commission-based products.

Roccy: Yes, that's right.

Advisor: Well, as a fee-only advisor, my duty is to my client and to make sure my advice is not tainted by commissions. I am not allowed to sell commission-based products.

Roccy: You don't say.

Advisor: Yes. In fact, I've read your newsletters for several years now; and I usually think they are on point, creative, and very helpful when it comes to several topics. But you seem to have lost your way when it comes to recommending commission-based products.

Roccy: Really. Would you like me to comment on your position?

Advisor: Yes, I'm curious as to why you keep recommending commission-based products.

Roccy: Let me start by confirming that you do not sell products that pay commissions.

Advisor: Yes, that's correct.

Roccy: Would you say you know very much about the commission-based products that are out there?

Advisor: What do you mean?

Roccy: I wonder if you spend X amount of time each week researching commission-based products to make sure they are no good or not better than what you would otherwise offer them.

Advisor: Uh, no, I don't spend time researching commission-based products.

Roccy: Do you know what an FIA is?

Advisor: Sort of. It's some kind of an annuity, right?

Roccy: Yes, it's an annuity that never goes backwards, locks in gains every year, and can be purchased with a rider that guarantees a return of 7%-8% (on an accumulation value) coupled with a guaranteed income for life that a client can never outlive.

Advisor: Oh.

Roccy: Would you agree with me that a financial planner or Registered Investment Advisor (RIA) should know about any/all products that guarantee a return coupled with a lifetime income? Especially if the advisor is giving retirement-planning advice.

Advisor: Yes (very hesitant usually because the advisor knows I'm now going somewhere specific with this discussion).

Roccy: I want to make sure I understand something. You tout yourself as an advisor who always puts the client's interest first because you do not make commissions; but you don't even know what an FIA is and certainly don't know anything about powerful FIAs that can guarantee a return of 7%-8% on an accumulation value that will be used to guarantee insureds an income for life they can't outlive.

Advisor: I suppose that's true.

Roccy: And will you admit that the reason you don't know anything about FIAs is because of your bias against insurance products that have commissions?

Advisor: Well, I'm not sure I'd put it that way. We just believe that clients, if they need to use annuity products, should use no-load products (ones without commissions).

Roccy: I get that. Do you know any no-load annuities that will guarantee a rate of return coupled with guaranteed income for life a client can't outlive?

Advisor: No.

Roccy: Let me ask you this. What kind of investments do you recommend for clients who are 65 or older who are scared of losing money in the stock market and who want to make sure they have a guaranteed income that will never run out before they die?

Advisor: Well, I would typically recommend no-load mutual funds and maybe bonds or whatever else made sense for the client.

Roccy: You mean you are going to recommend a "proper mix of stocks, mutual funds, bonds, etc."?

Advisor: Yes, but ones with no commissions.

Roccy: Right, I get that; however, there is no guarantee with the investments you recommend to clients, and your projected returns are simply a guess as to what you think the investments will do over time. If those projections don't come true, your clients will run out of money in retirement.

Advisor: Well, we have investment models we use to mitigate that risk.

Roccy: Really? Most elderly clients are not interested in mitigating risk if there are options to eliminate it.

Roccy: Let me ask you about the advice you give to your clients who are under the age of 55.

Advisor: Ok.

Roccy: What do you think about using cash value life insurance as an asset class and as a tax-favorable/wealth-building tool for retirement?

Advisor: Life insurance as a wealth-building tool? No. I don't recommend using life insurance as a wealth-building tool.

Roccy: Why (of course, I already know the answer before he answers it because I've heard it from dozens of other fee-only advisors)?

Advisor: Why? Because life insurance is a terrible place to build wealth. There are good-sized commissions that are paid in most products, and then there are the insurance expenses that are a drag on cash growing in the policy.

Roccy: How familiar are you with Equity Indexed Universal Life (EIUL) insurance?

Advisor: I've never heard of it.

Roccy: What are you familiar with?

Advisor: Whole life, variable life, and universal life.

Roccy: Then is it fair to say that you've not run numbers to determine if EIUL policies will work as a tax-favorable and protective wealth-building tool?

Advisor: Yes.

Roccy: Will you agree with me that a properly structured policy allows cash to grow tax free and come out tax free?

Advisor: Yes.

Roccy: What if I told you that various EIUL policies over the last twenty years have averaged anywhere from 7.2% in excess of 9.5% (depending on the policy used)?

Advisor: Really?

Roccy: Would you become more interested in EIUL policies if you knew the money in the policy could never go backwards due to stock market losses?

Advisor: Yes.

Roccy: Would you become more interested if you knew the gains in the policy were locked in at the end of every year and could never be lost due to stock market losses?

Advisor: Yes.

Roccy: Would you become more interested to learn that from 1998-2008 the stock market averaged a negative 1.45% and that many of the EIUL policies in the market returned close to 6%?

Advisor: Yes.

Roccy: If you want to learn more about EIUL policies and why they can be a terrific protective tax-favorable/wealth-building tool, you can pick up a copy of my book, Retiring Without Risk, at **www.retiringwithoutrisk.com**. In my book, I explain how EIUL policies can work out as better or much better wealth-building tools than stocks, mutual funds, and bonds and even tax-deferred 401(k) plans. Also, in the book, I cover FIAs and FIAs with guaranteed income riders. I highly recommend you pick up a copy of the book.

Advisor: I might do that.

Roccy: Right, but just for the record, even if you determined that an EIUL policy or an FIA were the "best" option for a client, you couldn't sell one to a client because you are a fee-only advisor.

Advisor: No. I could counsel the client to buy one; but I just couldn't make any money from the sale because I can't make money from commission products.

Roccy: Right. And there's the rub. You actually have a disincentive to learn about commission-based products because you can't make money selling them. Besides your built-in and inaccurate bias against all commission-based products, you actually have a conflict of interest when taking a stance that you won't make money from commissions.

The conflict being that, if you were to recommend the best product or wealth-building tool for a client that happened to be a commission-based product (which will never happen because you don't know anything about commission-based products), you wouldn't make any money. Do you see the conflict?

Advisor: No.

Roccy: No? You don't see a conflict when providing the best advice puts you in a position to make no money? There is no conflict between what's best for you and what's best for your clients?

Advisor: I see your point, but I always recommend the best investments for my clients. As a fee-only advisor, I am the only type of advisor who can give unbiased advice because I don't make money on the sale of products.

Roccy: Our conversation has already proved the point that you are not capable of providing your clients the best advice because you have a built-in bias against commission-based products. Not only do you have a built-in bias, but you have an admitted ignorance of many of the best commission-based products.

Advisor: I don't agree with that.

Roccy: I'd expect no other stance from you.

I appreciate the call today. I'll chalk it up to yet another bang-my-head-against-the-wall call with a fee-only advisor who is under the false impression that commission-based products are bad or evil and who is not willing to take the time to research and understand commission-based products to make the decision if they really can be of value to clients.

Advisor: Good day.

Roccy: Good day.

SUMMARY OF THE PREVIOUS PHONE CALL

First, let me state the previous phone call is one I have several times a year. Fee-only advisors are very consistent in their point of view and how they conduct their business.

What can be learned from the previous call?

1) That fee-only advisors know very little about most commission-based products (because they can't sell them and make money from them, there is no incentive to spend time learning them).

2) That fee-only advisors have an admitted built-in bias against commission-based products.

3) That most fee-only advisors know nothing or very little about FIAs and EIUL policies (mathematically two of the best wealth-building/retirement-planning tools available).

4) That fee-only advisors have the ability to recommend commission-based products but can't sell them themselves.

5) That fee-only advisors cannot possibly provide the best unbiased advice to their clients. In fact, it's just the opposite for many clients because of their built-in biases and limitations.

ONE MORE EXAMPLE OF THE PROBLEMS WITH FEE-ONLY ADVISORS

Let's assume that a fee-only advisor has a client who is 60 years old and has $500,000 of the money in his IRA. The client is scared of the stock market and has as his number one goal to never run out of money in retirement.

If the client used one that rolled up a **<u>guaranteed return at 8%</u>** for ten years and then turned on his **<u>guaranteed income for life</u>**, the account value for income purposes at age 70 would be **<u>$1,187,409</u>** and the guaranteed income for life payment (which is not an annuitized payment) would be **<u>$71,245</u>** (this product also had a 10% up-front bonus that helped drive up the values).

Of course, the fee-only advisor can't find any way to guarantee such income from a "properly balanced mix of stocks, mutual funds, and bonds" without using an FIA.

The question is: Is the fee-only advisor really going to recommend that this client use an FIA to grow wealth and guarantee an income for life?

The real-world answer is NO WAY.

Why? Call me a cynic; but, if the advisor recommends an FIA to this client, he will be losing $5,000 a year on average as a fee that he charges on the assets he currently has under management.

Let's expand the example. Assume the fee-only advisor has 20 clients over the age of 60 who have the same fears and goals. Assume the total wealth of these clients is $10,000,000 that could arguably be repositioned into FIAs.

Assume the fee-only advisor charges a 1% fee annually to manage the money for these 20 clients. That means the advisor makes $100,000 in fees on these clients.

Is it reasonable to think that a fee-only advisor who has seen the light when it comes to growing wealth in a protective and guaranteed manner with FIAs is going to counsel his clients to move their money to an FIA? To many the question is laughable. Again, there is no way a fee-only advisor is going to move money to an FIA that he/she doesn't make money on.

Is it possible a fee-only advisor could still charge a fee to manage the FIAs? It's possible, but what's the point? Once the money is growing at 7%-8% a year guaranteed on the accumulation value and since the client already knows from day one what the guaranteed income will be at any age, why would a client pay a fee to an advisor to give advice going forward on these products? They wouldn't.

FEE-BASED PLANNERS

Let me discuss a little more about fee-based planners (vs. fee-only planners).

Fee-based planners are ones who can make commissions on clients but who typically use no-load mutual funds and other low-load investments for clients when dealing with typical brokerage account money.

Why do I like fee-based planners?

Because they too are on the side of their clients when it comes to asset-based fees vs. commissions that are made when buying and selling stocks, mutual funds, and bonds.

However, if the fee-based advisor understands the value of cash value life insurance or fixed indexed annuities, he/she can recommend either product and make money from the advice given.

Fee-based planners have an incentive to learn about commission-based products so the best advice can truly be given to clients (unlike fee-only advisors who have no incentive to learn about commission-based products).

SHOULD YOU NEVER USE A FEE-ONLY ADVISOR?

This is a great question. If it were me, the answer would be that I would never use a fee-only advisor. Is it because I think they are all dishonest or incapable of giving money-management advice?

No. It's because the vast majority of them know nothing or very little about commission-based products; and even if they did know something about them, there is a disincentive to recommend them to clients.

Because of my research on FIAs and EIULs, I know mathematically that for many clients they can be two of the best tools to grow wealth in a protected manner.

It would be very difficult to think that an advisor who knows nothing about these products and, in fact, has taken an oath not to make money from these products (which is equivalent to taking an oath not to recommend these products) can give the "best" advice to me or to anyone else.

QUESTIONS TO ASK A FEE-ONLY ADVISOR TO DETERMINE IF HE/SHE IS A "BAD ADVISOR"

These are questions that you'll already know the answer to before asking them.

1) Are you a fee-only or fee-based advisor?

If the answer is fee only, then you know he/she has the issues discussed in this chapter.

2) Do you know what an FIA is?

3) Do you know what an EIUL policy is?

4) Do you regularly research FIAs and EIUL policies to make sure you are up to date on the best ones in the market at any given time?

4) Have you ever recommended either to your clients?

5) Would you recommend an FIA or EIUL policy to me if you thought it was the best way for me to grow wealth in a protective manner?

Again, you should already know the answers to the previous questions before you ask them; and, if that is the case, you may choose to simply make sure that the advisors you work with are NOT fee-only advisors.