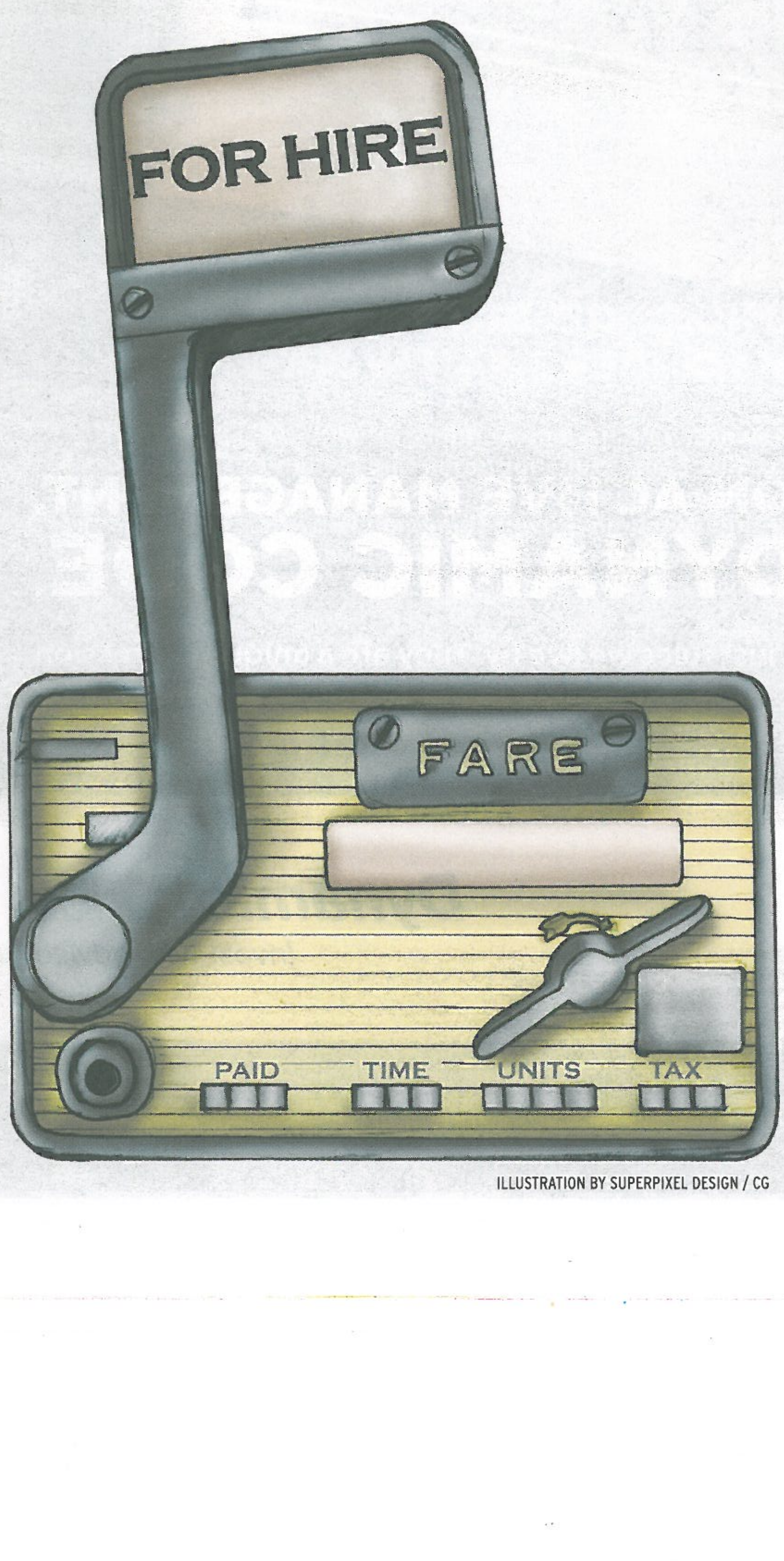
MAKING THE MOVE to a FEE model

As a global trend toward fee-based compensation models gathers steam, there is a strong case for Canadian advisors to make the shift

BY CLARE O'HARA



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WHEN GREGOR McDONALD, A financial planner with **Vision Financial Planning** in St. Catharines, Ont., entered the financial services sector in 1996, he found the deferred sales charge (DSC) left a bad taste in his month.

"Many clients were unaware of how a DSC works and the impact a redemption schedule can have on their funds," McDonald says. "If a client wanted to move funds within the first year, or needed money in an emergency, he or she ended up paying high fees to get at their funds. This problem still exists today with many clients who do not fully understand the fees they have to pay."

Even after finding a firm that offered shorter DSC periods and lower commission payouts, McDonald knew that a commission-based model wasn't for him. (Vision Financial operates under the FundEX Investments Inc. banner.)

"I always had a problem with the commission structure. But, at the time, it was the only way mutual funds were sold," says McDonald, who manages more than 130 client households in his hometown of St. Catharines.

It wasn't until McDonald attended a seminar on how to run a practice based on fees rather than commissions that he knew he wanted to make the transition to a fee-based practice. But it took another 10 years before McDonald got the courage to make the jump. He now wishes he had done it sooner.

"It's like quitting smoking," McDonald says. "Once you are in that commission-based model, you just can't get out."

Getting compensated with fees can remove the potential conflict of interest that some commission-based advisors may feel. Being able to align yourself with your clients' interests, without pressure to hit sales targets, can make it easier to provide unbiased advice to your clients.

The recent trend of regulators in other countries banning commissions on some financial products suggests a shift away from commissions may be coming to Canada. (See story on facing page.) Whether that change is made compulsory, many Canadian advisors are making the transition to a fee model to stay ahead of the game.

There are no standards for defining the various non-commission compensation models available to advisors. Terms such as "fee for service," "fee-only," "fee-based" and "asset-based" have different meanings for different advisors. But all these terms refer to compensation models that do not involve sales commissions being paid to the advisor.

The "fee model" (as we will refer to all non-commission models in this article) may refer to a plan under which you: charge your clients an hourly, flat or annual fee (similar to the way lawyers are compensated); charge your clients a percentage of assets under management; or charge your clients a combination of specific and asset-based fees. It should be noted that some advisors use a hybrid model, segmenting their clients into various fee structures free of commissions.

Moving your practice from a commission-based model to one based on fees can seem like an overwhelming and stressful experience, says George Hartman, managing partner with **Accretive Advisor Inc.** in Toronto: "If an advisor does the right amount of preparation, the result can leave clients with overall better service. And the advisor's practice can become much more productive."

How can you make a successful transition to a fee model? The following steps are essential:

WRITE A FORMAL PLAN

As a professional in the financial planning business, you are expected to have a formal business plan in place, says Marc Lamontagne, an advisor and partner with **Ryan Lamontagne Inc.** in Ottawa, who has been running a fee-model practice since 1996. But many advisors have attempted to make the transition without a plan.

In 2010, Lamontagne conducted a study of advisors who had made the transition to a fee model. He found that while most study participants had some type of plan in place prior to entering the transition process, only one-third had a formal plan.

"Those advisors who have a [formal] plan will map out exactly what they need to do," Lamontagne says. "They will know exactly how many clients to [convert] a week, what their fee structure will consist of and how they will communicate that to their clients."

A formal plan also should identify your ideal client base, describe your value proposition, estimate the degree to which you anticipate that revenue will drop during the transition period and the overall time frame for converting your book.

Both Hartman and Lamontagne advise against converting your entire book at once; rather, plan it in stages. Lamontagne recommends converting at a rate of two clients a week, which means the whole process can take up to five years, depending on the size of your book and the compensation structure you choose.

DEVELOP YOUR VALUE PROPOSITION

If you are not providing value to your clients, a mandatory shift to a fee model will put you out of business, says Kevin O'Brien, an investment advisor with **Aligned Capital Partners Inc.** in Burlington, Ont.

If you are going to charge fees for your advice, you must demonstrate to your clients that they will be getting value.

O'Brien suggests that you show your clients the advantages that the fee model can provide. These benefits include: unbiased advice, broader product range, consistent advice under all market conditions, cost savings to clients who have been paying high commission fees, and a potential tax reduction for some clients.

O'Brien started moving his clients to his fee model in 2010. He presented a fee comparison during his client meetings to show his clients the value he brought to the table. He made a point to include dollar figures instead of percentages, so clients could see exactly what was being charged against their overall investment portfolios. He showed his clients how paying fees for his services at an hourly rate would be beneficial to them.

Today, 75% of O'Brien's compensation comes from clients who pay fees for his services.

McDonald is halfway through his five-year transition plan and has converted slightly more than 30% of his client base to his fee model. He spent the first two years of his transition period perfecting his value proposition. Now that he feels more comfortable with his "pitch," he plans to convert the remaining 70% of his book by the end of 2014.

"I had a huge amount of anxiety during those first few meetings, and there are times when you will second-guess your decision," McDonald says. "But now, I realize that the few clients who left [as a result of the transition] were ones that were never a great fit for my business to begin with."

SET YOUR PRICE

Pricing can be determined in various ways, depending on whether your client prefers an hourly or annual rate, a specific annual fee or a fee that is determined based on a percentage of assets.

For example, McDonald uses a fee-for-service model. He charges his clients $100 per month for the first account and $50 per month per subsequent account. He does not charge a fee for a registered education saving plans or trust accounts for children.

"When you factor in the DSC fees these clients were paying," he says, "they can be saving a considerable amount of money on their entire portfolio." IE