Do you really know the true cost of your advisor?

By Ric Edelman

4–10%

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Up to 120%

Advisors earn **as much as 120% for variable universal life (VUL) insurance policies.**

Many advisors fail to reveal the total costs to clients.

Diversification. Asset allocation. Portfolio optimization. Sharpe ratios. Modern Portfolio Theory. The efficient frontier. The Fama-French four-factor model.

Many consumers know they are ill-prepared to make good investment decisions. That's why you're smart to turn to a financial advisor for help. But what does it cost to work with an advisor?

As I explained in my book, *The Truth About Money*, you should not merely ask an advisor, "What is your compensation?" Ask instead, "What are the total costs I will incur by working with you?"

You see, you pay not only for your advisor's advice but for the investments your advisor recommends. So it's vital that you receive full disclosure. Otherwise, you might end up paying far more than you should — and far more than you realize.

So let's examine all the costs that might be involved.

First, of course, is the advisor's compensation. Some advisors earn commissions from the sale of products. Commissions vary depending on the product: typically 4 to 10 percent for annuities and as much as 120 percent for variable universal life (VUL) insurance policies. Some products pay salespeople a one-time commission, while others continue to pay brokers and agents small annual commissions for as long as you own the product.

Many advisors choose not to accept commissions for the sale of investment products out of concern that doing so creates a conflict of interest between them and their clients. These professionals (including Edelman Financial Engines) are Registered Investment Advisors,[1] who instead charge an asset-management fee based on the size of your account. In addition to the amount they charge, you need to know when they charge it. Some firms charge their clients in advance, requiring them to prepay the fee, while others (like Edelman Financial Engines) charge the fee in arrears. (This way you don't pay for services until after you receive them and all your money gets invested right away.) Ask your advisor for a copy of Form ADV Part 2, the disclosure document that all Registered Investment Advisors are required to file with federal or state regulators. The advisor's fee schedule should appear in there.

In addition to your advisor's compensation, you will incur costs to own your investments. Nontraded REITs, for example, typically charge 2 percent in annual operating fees, while VUL policies and annuities feature "spreads" — the difference between what the insurance company earns on your money and what it pays you.

Mutual funds and exchange-traded funds also incur annual expenses. First is the annual expense ratio, which covers fixed costs — salaries, marketing, overhead and the like. The annual expense ratio does not appear on statements; it is found only in the fund's prospectus and even "no-load" funds pay it. ("No-load" means only that you pay no commissions to a salesperson; it does not mean "no fee.") **As of Dec. 31, 2018, according to data from Morningstar, annual expense ratios ranged from 0 to 15.17 percent. The average was .97 percent.[2]**

Funds also charge variable costs. The biggest are brokerage commissions and trading expenses, which can amount to tens of millions of dollars per year, charged proportionately to everyone who owns shares in the fund.

To find these and other variable expenses, you must read the fund's Statement of Additional Information. Unlike prospectuses, advisors are not required to give you a fund's SAI. As a result, many investors have never even heard of this document, let alone read one. (I have trained thousands of financial advisors over the years and am surprised by how often I've met advisors who've never heard of the SAI.) You can find SAIs on most fund company websites.

Finally, if you're invested in a taxable account, pay particular attention to the fund's turnover rate, or the degree to which the fund is buying and selling securities.

High turnover not only translates into higher brokerage commissions and trading expenses, but it also causes investors to pay more in annual taxes — including possibly at high ordinary tax rates instead of lower capital gains rates.

So, do you really know the true cost of your advisor?

Be careful when asking an advisor what he or she charges; make sure he or she tells you the total costs you'll pay when working with him or her.

If your advisor can't or won't provide this information for you, contact us. We're happy to provide it to you. And we don't just give investment advice. We can evaluate your spending habits as well as the risks in your portfolio. We also help our clients make important financial decisions like buying a new home, selecting insurance coverage, saving for a child's future education, or creating an effective retirement or estate plan. Ask us about how we can help you!

1. Registration with the SEC does not imply a certain level of skill or training.
2. The average mutual fund expense ratio was derived from Morningstar Direct's database of open-ended mutual funds. The database was filtered to include only the oldest share classes of noninstitutional, U.S. dollar based funds (as of 12/31/18).