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What You Need To Know About How Your Financial Advisor Gets Paid

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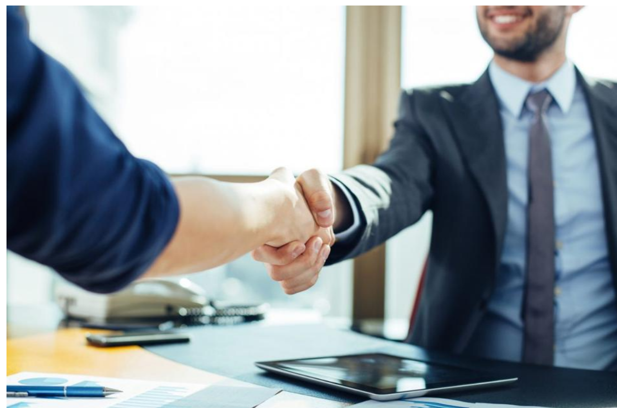
By Lisa Wirthman

A growing number of people are turning to financial advisors to help them manage their wealth.

More than 36 million people are currently using the services of a federally registered investment advisor — a 22 percent increase over 2015, reports the Investment Adviser Association (IAA).



There's a lot to consider when choosing an advisor, including your financial goals, tolerance for risk, communication style, personality and what charges you will incur. But it's just as important to understand how advisors get paid — and how their payment structures can affect your bottom line.

"Knowing how financial advisors are compensated is a key question to ask," said Damon White, chief operating officer and co-founder of Evermay Wealth Management, an independent Registered Investment Advisor (RIA) firm in Arlington, Virginia. "What the financial advisor earns is part of the fees that you pay."

Financial advisors typically earn their income in different ways. Some charge you a flat fee for their services, based on different factors. Others receive commissions for recommending specific investment products or when a stock is bought or sold. Some advisors use a mixed model, incorporating both commissions and fees.

Here are some factors to weigh when hiring a financial advisor:

1. **Hidden Charges**

Start by asking how your advisor structures compensation and for a full disclosure of fees, said White.

Even if your advisor doesn't charge commissions, for example, the custodian of your funds may impose trading fees. In

addition, you may be required to pay management fees or transaction fees for opening and closing an account.

To ensure cost transparency, make sure you review brokerage statements that clearly define the costs associated with your accounts, he said. Also be sure to ask advisors to walk you through the prospectuses of the mutual funds in which you're invested and explain what charges may be passed on to you.

2. **Are Flat Fees For You?**

According to White, a fee-based strategy may work particularly well for clients who want to make long-term investments and trade less frequently.

Evermay, for example, is a fee-based firm that earns income by charging clients a fee based on a percentage of their assets under management. Other fee-based advisors may charge a flat fee for their services or set an hourly rate.

"The structure really reduces the conflicts of interest to properly align incentives," White said. "Our incentive is to grow our clients' accounts because that's how we grow our firm."

3. **The Cost Of Commissions**

Clients who want to do more near-term trading — or who are interested in buying specific stocks — may benefit from a commission-based fee structure. For example, if you exit a mutual fund too soon, some funds charge a redemption fee, something a commission-based broker may not be subject to paying, White explained.

However, a potential downside to a commission-based structure is that frequent trading may eat into a significant amount of your return.

In some cases, a mixed model of commissions and flat fees makes the most sense, especially for investors who are interested in both near-term and long-term trading to meet different financial goals, White said.

4. **Questions Of Philosophy And Communications**

All that said, how your advisor is going to get paid isn't the only important factor to nail down. You should also ask about his or her investment philosophy, to ensure it aligns with your thinking as well as your tolerance for risk, said White. Another key question to ask is whether the advice you receive is customized to your specific needs or whether it reflects a cookie-cutter plan based on a risk profile.

It's also important to ask up front, before you decide to move forward, if your advisor has ever been the subject of regulatory investigations or complaints, and to receive references from clients with similar financial goals, White said. Investors can also do their own research using free online tools such as the Financial Industry Regulatory Authority's Brokercheck.

Communication styles are important, too. An advisor may communicate by phone, email or a client portal — make sure that the type of communication and how frequently you connect meet your expectations for receiving information, said White.

Finally, request a copy of your financial advisor's ethics policy and check that it stipulates a "fiduciary" standard that legally requires them to act in your best interests.

It's natural to think about how an advisor will manage your earnings. But it's equally important to know how your advisor earns income as well. If you understand the entire process, you are more likely to ensure their activity will align with your financial goals.

Lisa Wirthman is a journalist who writes about business, public policy and women's issues.

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