THE WALL STREET JOURNAL.
WSJ.com

JOURNAL REPORTS | April 4, 2013, 11:19 a.m. ET
FINANCIAL ADVISERS

Questions to Ask Your Adviser About Fees

The way compensation is set up can create conflicts and raise your costs. So know how you're paying.

By CHANA R. SCHOENBERGER

When opening an account with a financial adviser, investors typically receive a stack of documents that explain, among other details, how the adviser gets paid. But it seems few people understand this information.

A recent study by research firm Cerulli Associates found that investors, when asked what pay model their financial adviser uses, rarely knew. One-third of those surveyed said they weren't sure how they paid for the advice they received, and 29% said the services were free, which is rarely the case.

"The adviser doesn't have any incentive to dwell on it much," says Scott Smith, a Cerulli associate director, who wrote the report. He isn't surprised that the individual investors behind the $12 trillion in advisory assets in the U.S. don't know how they're paying for counsel: "It's something that people address and move on from quickly."

The problem for investors is that if you're not aware of how your adviser is compensated or of charges that are often built into products including mutual funds and variable annuities, you can't understand how those fees might affect the advice or the returns you get.

It isn't too late to find out what your arrangements are with your financial adviser. Here are some questions to ask:

1. How are you registered?

Advisers' pay and their obligations to clients are related to whether they are registered with the Financial Industry Regulatory Authority or the federal Securities and Exchange Commission.

Finra-registered advisers—"registered representatives" of securities firms—typically are paid by commissions when investors buy or sell securities. Advisers who charge fees for advice generally are "registered investment advisers," or RIAs, overseen by either the SEC or state securities regulators. Many individuals wear one hat for part of their business and a

Coming in Monday's Journal

Investing in Funds & ETFs

Richard Borge

Today's index funds aren't always what you might expect.

College this fall? Here's a last-minute saving strategy.

Stock-fund stars of the past 12 months

Related Video

Consumer groups and financial industry representatives often tout how well they're protecting consumers' best interests. But sometimes they're not. MarketWatch's Jim Jelter discusses five things financial advisers won't tell you. (Photo: Getty Images)

Some tax problems are much harder to solve than others, but what are the really awful ones? The worst of the worst? Laura Saunders reports. Photo: AP.

Jonnelle Marte discusses the pros and cons of setting up a payment plan, paying by credit card, or just paying off taxes when you can. Photo: Getty Images.

Noah Woods

different hat for the other. If you deal with them in both capacities, you may pay them both an advisory fee and trading commissions.

The distinction in how advisers are paid could affect the advice they give you. Regulations require financial advisers who charge commissions to make sure a product is appropriate for an investor before selling it, but RIAs are held to a higher standard: They are fiduciaries, meaning they have an obligation to think about what investments would *best* serve the client. Also, fee-only advisers are paid only by their clients, which means they have no incentive to sell you particular financial products.

2. What am I paying you and your firm directly?

This can include commissions to trade securities and fees that may be set by the hour or as a percentage of your assets being managed by the adviser.

Knowing exactly what these charges are allows you to factor those costs into your investment behavior. For instance, if you know how big the commission is that you pay every time a trade is made on your behalf, you can decide if there is a point where those fees start to eat up too much of the gains you seek from switching investments. Or if your adviser charges an hourly fee, knowing what that fee is can help you decide how much consultation you really need.

Sometimes there is a free lunch, or at least an appetizer: A financial specialist sometimes will provide some free advice now in hopes of selling you products down the road. Many offer an initial portfolio review for no upfront cost.

3. What payments are built into the products I may buy from you?

You also want to know about compensation that isn't as obvious. There's almost always a cost for advice, even if it's built into the cost of the products you end up buying, says Dan Keady, director of financial planning at financial-services firm TIAA-CREF.

For instance, all mutual funds charge for their expenses, which can include compensation for sellers. But those charges vary widely, and higher charges produce lower returns for investors, so it pays to shop around. Also, a single mutual fund may be available in several share classes with different fees.

Knowing about the fees built into products also can help you spot potential conflicts of interest. A firm benefits if its staffers sell products the firm designs or oversees. Those products aren't necessarily bad for you, but it's worth scrutinizing their charges to see if they compare favorably with those of alternatives.

When investors buy or sell mutual funds through discount brokerage firms' "no transaction fee" marketplaces, part of the funds' expense charges are going to compensate the brokerage firms. If you know what those charges are, you may be able to find a cheaper class of the same fund or a similar fund with lower charges from another provider.

In the case of individual bonds, firms usually collect the difference between the price at which they buy the bonds and the price at which they resell them to investors. This "spread" is also assessed when investors trade foreign currencies through a brokerage firm. Spreads vary, so be aware that you might be able to find a better price from another broker.

Investors may also be charged if their adviser invests part of their account in a hedge fund or private-equity fund. Typically this charge will be obvious. But the investor may not be told about any commission the adviser earns from the funds, a potential conflict of interest, so you should be sure a better deal isn't available elsewhere.

Another potential conflict of interest: Some advisers may get incentives—a trip or a bonus, for instance—if they hit certain sales targets or sell specific products. There's no way for you to know if that's the case, but knowing that it could be is another reason to shop around to make sure you're getting the best possible deal.

Ms. Schoenberger is a writer in New York. Email her at reports@wsj.com.

A version of this article appeared April 7, 2013, on page R6 in the U.S. edition of The Wall Street Journal, with the headline: Questions to Ask Your Adviser About Fees.