Investing Answers

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Ask The Expert: How Much Should I Expect To Pay A Financial Advisor?

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As with most things, cheapest almost never means best when it comes to financial planners. Here's how to make sure that your costs don't get too high...

Question: How much should I expect to pay a financial advisor?

-- Daniel H., Sacramento, Calif.

The Investing Answer: That's a complicated question, Daniel, but a good one. For a little perspective on this, I couldn't help but think about a classic cartoon.

Lucy Van Pelt -- from the beloved "Peanuts" comics and cartoons -- is a notorious antagonist. She's most famous for tripping poor old Charlie Brown over and over again by swiping his football away right before he kicks it, resulting in Charlie Brown's most famous line: "Aaaaargh!"

#-ad_banner-#Lucy's other job, of course, was operating an advice booth from which she dispensed her knowledge about love and other matters. In "A Charlie Brown Christmas," for example, Lucy is willing to advise Charlie Brown, but she asks for up-front payment.

"Boy, what a sound!" she exclaims. "How I love the sound of clinking money! That beautiful sound of cold, hard cash! Nickels, nickels, nickels! That beautiful sound of clinking nickels! Now, what seems to be your trouble?"

As anybody who has ever paid for advice knows, sometimes advice-givers are more excited about getting paid than about solving a problem -- just like Lucy. But you shouldn't have to be left feeling like Charlie Brown, particularly when it comes to financial advisors.

But as I said, exactly how much you should pay is a complicated question. In order to give you the most complete answer, I first want to want to talk about what they are.

In the most general of terms, there are two kinds of financial advisors: brokers and registered investment advisors.

Although brokers often know a lot about the markets, the economy and investments, it's important to realize that they're salespeople. Brokers are required to ensure that what they sell you is "suitable," so when you ask them to buy, say, a bond for your account, they buy you the bond and not a stock or a farm or a car. Brokers earn their money from commissions on their sales.

Registered investment advisors (RIAs, for short) are not brokers. Generally speaking, they don't have to sell things to make money. Rather, they get paid for advice. One of the most important things to know about RIAs is that they are held to a fiduciary standard -- a higher standard than brokers' suitability standard.

To understand the difference, consider our bond example. A broker's suitability obligation means that if you ask for a bond, the broker gets you a bond. A RIA's fiduciary obligation means that if you ask for a bond, the RIA says, "Why do you want a bond? You're overweighted in bonds and they're going to go down in price. You should buy stocks instead. You'll make more money for Junior's college fund." The broker does what you ask; the RIA looks out for you.

There are many ways to pay a registered investment advisor. Here are some of the most common types of RIAs...

Fee-Only Advisors

Fee-only advisors charge a percentage of your account value every year, and in return, you get advice and investment management. If you bring an advisor, say, $100,000 of your savings and the advisor charges a 1.0% fee, you'll pay the advisor $1,000 a year. According to Forbes, these fees run from 0.75% to 1.5% of your account annually, though 2% is not uncommon. The fees vary according to account size, the complexity of your situation and the advisor's experience and credentials.

Different advisors do different things, so be sure to ask whether the fee covers just trading and asset allocation (i.e., investment management) or whether it includes planning (think tax planning, estate planning, college planning, retirement planning, etc.).

Personal finance experts tend to love fee-only advisors because the fee structure ties the advisor's compensation to how much your account grows. They aren't tempted to put you in an investment simply so they can earn a commission.

Some fee-only planners charge a flat annual fee or even an hourly rate instead of a percentage of your assets, though. These rates vary widely, but most hourly rates fall between $100 to $400 an hour, according to the College for Financial Planning.

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You may find this more common when the advisor is doing complicated tax planning, structuring your estate, or some one-time project. You can also have an advisor create a comprehensive financial plan that you execute yourself (sort of like hiring an architect to design a house that you build). According to the College for Financial Planning, you can expect to pay between $100 and $2,000 for this kind of financial plan (though about 15% of advisors charge more than that). About 40% of advisors don't offer that option, though, according to the College for Financial Planning.

Fee-Based Advisors

People often confuse fee-only and fee-based planners. As we mentioned, fee-only planners charge a percentage of your assets, an hourly fee or a flat fee. Fee-based planners also charge fees for their advice, but sometimes they also get payments from companies whose products they sell or recommend. According to the College of Financial Planning, most advisors (60%) are fee-based planners; 17% are fee-only; and the rest are a mixture of retainer, commission only, or a combination.

If you hire a fee-based advisor, be sure to find out if he or she credits those payments toward your fees. Either way, know that receiving those payments may decrease the advisor's ability to put you first.

One final thought: By and large, if you're looking for someone to fetch investments for you, a broker might be the way to go. But if you want someone to act in your best interests, a registered investment advisor is a good bet.

That's not to say that an RIA's interests are perfectly aligned with yours. They do have an incentive to keep you from withdrawing or moving your money away from the firm. After all, the less they manage, the less they make. That could affect the advice you get when you're wondering whether you should withdraw money from the account.

Just like hairstylists, doctors and babysitters, advisors vary widely in what they charge, and "cheapest" almost never equals "best." Interview several advisors before you trust one to manage all that money that you've spent a lifetime saving. For a cheat sheet on the hiring process, check out the National Association of Personal Financial Advisors (NAPFA) Financial Advisor Field Guide, here.