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Investors gravitating to fee-based portfolios

Transparency is a key reason for the shift

According to PriceMetrix, investors have been steadily transitioning to a fee-based pricing model for their portfolios. The just-released report aggregated data representing 7 million retail investors, 500 million transactions, and over $3.5 trillion in investment assets. PriceMetrix found that, from 2011 to 2012, fee-based assets increased from 26% to 28% while average household assets increased 13% from $435,000 in 2011 to $491,000 in 2012.

Investors prefer the fee-based model over traditional commission-based accounts for many reasons, but transparency often ranks at the top of the list. Investors in fee-based accounts pay a set percentage typically tied to the size of the account. Since everything is covered in one inclusive fee, investors know precisely what they are paying for. There is no longer any confusion regarding the cost for professional portfolio management, as most firms report these costs directly on monthly account statements.

Fee-based accounts also encourage more efficient portfolio management. By way of their structure, fee-based accounts take commission concerns out of transactions, ultimately encouraging more active management and regular rebalancing. For instance, an advisor may wish to take advantage of a bumpy market by slowly entering a position. This can be costly in a commission-based account though, so an advisor may be less inclined to encourage this for fear that the commissions would outweigh the benefits of the dollar-cost averaging. This is not a concern in fee-based accounts because the trades are included within the fee.

Cost savings are another potential benefit of fee-based accounts. According to data from PriceMetrix, the average equity trade size is $22,240. Therefore an investor with a $500,000 portfolio making 20 trades per year, and charged a commission of 2.50%, would incur total commission costs of $11,120. If that investor were instead in a fee-based account charging 1.50%, they would save $3,620 per year. The investor may also benefit from tax advantages because fees linked with non-registered fee-based accounts are generally tax deductible.

Perhaps one of the biggest advantages with fee-based accounts comes from additional values received. Advisors who provide fee-based services tend to focus holistically on wealth management by providing research and guidance on associated factors such as tax efficiencies, estate planning, education and retirement planning, insurance needs and implementation strategies. Tending to these matters can prove advantageous. According to the Investment Funds Institute of Canada, investors who work with financial advisors have nearly three times more wealth and investable assets on average than those who do not.

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As with any professional service, portfolio management fees are charged for services rendered and there must be value received to justify the cost. An advisor should be prepared to articulate the values clearly, so that the investor can make the right choice.

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