A Glimpse into the Flat-Fee Model

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ANDY PANKO GAVE the *FPA Next Generation Planner* a glimpse into the flat-fee business model. Check out what he had to say:

On the Rise of Flat Fees

Flat/fixed fees—either per year, month, engagement, etc.—or even hourly fees, are going to be increasingly common as they're the most logical form of charging for professional services. Getting indirectly paid for advice by commissions from selling products has conflicts of interest. And tying fees to asset size by doing a percentage of AUM is illogical and arbitrary as asset size alone is a poor indicator of the time and resources necessary to properly serve clients. Plus, percentage of AUM typically overcharges clients with a lot of assets—and underpays the adviser when clients have a small amount of assets.

On the Drawbacks of Flat Fees

The biggest drawback of charging flat or hourly fees is it essentially prevents people of lower income or asset levels from being able to afford the services. Whereas when working with a product salesperson who only gets paid by commission, the client may not actually have to pay any fee directly as the commission will be baked into the cost of the product. And with percentage of AUM, some advisers may choose to work with clients with small asset sizes and will, therefore, knowingly make less revenue than they should for the relationship. But in doing so, the hope is often that the client's net worth and assets will eventually grow such that the adviser will then start making more revenue over time.

On Common Misconceptions About the Flat-Fee Model

I think many advisers see and understand the merit of charging flat fees. However, especially advisers whose business was already built around percentage of AUM, they are stuck in their fee structure and can't easily transition from percentage of AUM to flat fees—even if they wanted to—because it would mean charging some clients more and charging others less. And there would be a lot of uncomfortable conversations on either end of the spectrum.

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One of the big misconceptions is flat fees aren't scalable. While it's true that it logically won't be as profitable as a percentage of AUM model—especially for advisers who are able to set high AUM minimums like $1,000,000—that doesn't mean you can't scale it well and make it profitable. Honestly, I think a lot of the industry overcharges, particularly because of the percentage of AUM model. And using a flat-fee model means "leaving money on the table." However, for the sake of the industry and the consumer, we can't continue to think about running businesses purely to maximize profit. And we can't get stuck in feeling the need to do things the way they've always been done.

The other big misconception is that asset size is actually a good gauge of the relationship's complexity and the amount of time and resources needed to properly serve the client. Therefore, a flat fee won't properly compensate the adviser. That's just flat out false.

On the Logic of the Method

There is admittedly no "right" fee method. But there are some methods that are more logical and rational than others. I frankly think an hourly fee would be the fairest to advisers and clients alike because then compensation would most closely be tied to actual services performed, resources used, etc. However, a pure hourly structure will never work because clients will be reluctant to actually reach out to the adviser because clients will not want to not rack up a big bill. In doing so, they may wait until it's too late to reach out, and then their financial problems may be worse than they should have been in the first place.

I am of the opinion that product sale commissions is the least logical and most biased way for professionals to get paid for their advice. As for percentage of AUM, how many other professions do you know of where the client is charged based on their ability to pay, or their overall health? Do doctors or accountants means-test clients and charge them more simply because they have more? Think about it from this perspective, and be honest with yourself when answering this: if the financial advice industry never existed and you had no bias or preconceived notion of how fees are supposed to be charged, what type of fee model would you come up with for the giving of financial advice?

Editor's note: *If you have a different type of fee model and would like to give our readers a glimpse into it, please email me at alimon@onefpa.org.*