PRACTICE MANAGEMENT

THE PRICE OF FINANCIAL ADVICE

Communicating Fee Value Proposition with Clarity

SPDR
STATE STREET GLOBAL ADVISORS
Precise in a world that isn’t.
INTRODUCTION

The financial crisis of 2008 dealt the investment industry a sharp blow. Many consumers grew leery of investing and wondered whether the financial services industry had their best interests in mind. Financial advisors always have made it a priority to earn their clients’ trust, but today, earning that trust is an even more pressing priority as the industry looks to recover lost ground.

The industry is making progress. Tougher industry regulations and a call for increased transparency have given investors back some of their confidence, but the work is far from over. Many financial advisors are still falling short when it comes to helping their clients understand the real value of the services that they provide. This can make investors feel uneasy or even suspicious about whether their financial advisor is promoting their best interests when making investment decisions.

This made us at State Street Global Advisors wonder:

How do today’s investors really think, feel and behave when it comes to the topic of financial advice and do they feel financial advisory services are worth the price?

We made it our mission to find out.
OUR GOAL: To give financial advisors an objective understanding of how investors feel about this important topic and provide them with the tools they need to gain investors’ trust and loyalty by focusing on engagement and integrity.

Going into our study, we already knew one thing—fee discussions make people uncomfortable. So our goal was not only to understand how investors feel about the value of financial advice, but also to uncover new ways to make the complex topic of fees more approachable and easier to understand.

A representative sample of 300 financial advisors and 300 individual investors took our online survey. We used a nearly identical survey for both groups, which allowed us to compare financial advisors’ presumptions about their clients against how investors actually feel. We wanted to learn if financial advisors and investors think, feel and behave similarly on this important topic.

– How well do investors understand financial advisor compensation?
– What role do fees play when an investor is choosing a financial advisor?
– Does understanding fees help or hurt how an investor views a financial advisor?
– Do investors think that the fees financial advisors charge are fair?

We then analyzed the survey findings and developed a few hypotheses. From there we conducted in-depth interviews with a range of leading industry, business and economic experts. To round off our learning, we conducted face-to-face interviews with a sample of investors in their homes.

What we learned is that investors want to have open and honest relationships with their financial advisors, and they want to trust them—but investor confusion about fees is getting in the way. One third of investors don’t understand the fees or commissions they are being charged and this confusion makes them dubious of and less satisfied with their financial advisors. We also learned that investors don’t mind paying for financial advice. They’re not just looking for the lowest price. They just want a clear understanding of what they’re paying and what they’re getting in return.

Armed with our research findings, we now know how critical it is that financial advisors be able to discuss their fee value proposition with confidence and clarity. When they do, they’re more likely to gain their clients’ trust and advocacy. No matter how fees are structured at an advisory firm, this report will provide techniques to create an ongoing dialog about the topic and build stronger bonds with clients in the process.
Communicating Fee Value Proposition With Clarity

**FEE VALUE PROPOSITION.** While you may have mixed emotions about the topic, it’s important that you and your clients are on the same page when it comes to understanding the fees you charge vis-à-vis the services you provide. Blame complex fee models, squeamishness about discussing money, or hesitancy to ask uninformed questions. Whatever the reason, many clients are mystified when it comes to advisory fees.

Investors are seeking greater value from their financial advisors along with a clearer understanding of services provided.

- Is your value proposition as clear as it can be?
- Are you certain that your clients completely understand your fees?
- Could increasing transparency help you retain more clients?

State Street Global Advisors recently commissioned research to explore how financial advisors and individual investors think and feel about the value of financial advice relative to the fees advisors collect. Our research revealed that many investors do not understand how they compensate their financial advisors. It also showed that financial advisors and investors hold other divergent perceptions about the value of financial advice.

**HOW CAN CLIENTS DETERMINE IF FINANCIAL ADVICE IS VALUABLE IF THEY DON’T UNDERSTAND WHAT THEY ARE PAYING? THEY CAN’T.**
Our research showed that investors who do not understand what they’re paying, trust financial advisors less, and are less likely to refer them to others—a significant problem in a post-financial crisis world where financial advisors are looking to rebuild trust and regain loyalty. **Straightforward changes, however, can improve an investor’s comprehension and help inspire trust and engender loyalty among current and prospective clients—without reducing fees.**

To explore the topic of financial advisors’ fee value propositions, we conducted an online survey among financial advisors and individual investors, as well as in-depth interviews with industry thought leaders and individual investors. We confirmed what many in the industry believe—**confusion is rampant when it comes to advisory fees.** Evidence suggests this lack of comprehension may be directly related to the complexity of fee structure within the industry and its lack of standardization.

2/3 of investors express no particular loyalty to their primary investment provider.¹

—Center for Applied Research, The Influential Investor
Does Understanding Fees Help Or Hurt How An Investor Views A Financial Advisor?

INVESTORS SEEK PREDICTABILITY AND TRANSPARENCY IN FEE STRUCTURE. When it comes to compensation, financial advisors typically fall into four categories: flat fee, commission-based, fee-based or a hybrid. In our research, 75 percent of financial advisors said they have a primary means of charging for their services, but 25 percent said, “It depends.” However, investors strongly favor flat-fee based or fee-based compensation for its predictability and transparency. Thirty-six percent of investors said this fee structure is most appealing because they know what they’re going to be paying upfront.

FIGURE 1: REASONS WHY INDIVIDUAL INVESTORS PREFER FEES VERSUS COMMISSIONS²

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>I know what I am going to be paying upfront</td>
<td>36%</td>
</tr>
<tr>
<td>I trust that my advisor is not selecting costlier investment products just to drive up commissions</td>
<td>20%</td>
</tr>
<tr>
<td>My advisor is invested in my success</td>
<td>27%</td>
</tr>
<tr>
<td>An actively traded account could result in high commissions, costing more than fees</td>
<td>10%</td>
</tr>
<tr>
<td>I can deduct investment advisor fees on my taxes</td>
<td>7%</td>
</tr>
</tbody>
</table>


This preference has not gone unnoticed in the industry, which has been charting a slow migration toward a fee-based model. “It’s safe to say that the change is a bit glacial,” said one industry leader. “We’ve been talking about it forever. I’ve certainly heard it for the last 10 years.” Some say the process has gone on for even longer, that the trend toward fee-based compensation began about 20 years ago when transparency first became a buzzword. “People talked about it, but talk is cheap and their actions didn’t always follow,” said Mike Stevens, Managing Director, State Street Global Advisors Intermediary Business Group.
Uncertainty About Fees Erodes Trust

The preference for fee-only models among investors isn’t surprising. Investors have historically had trouble understanding, let alone comparing, the fees they are paying their financial advisor. “We just see it over and over again. Investors don’t know how much they’re paying and some people don’t think they’re paying anything,” said Glenn Frank, Director of Investment Tax Strategy at Lexington Wealth Management. Consistent with our research, Cerulli reported in 2013 that one of the most difficult things about working with a financial advisor is that, “costs are not transparent and I don’t know how much I pay advisors.”

**FIGURE 2: MOST DIFFICULT PART OF WORKING WITH FINANCIAL ADVISORS**


Ultimately, the complexity of compensation models leaves investors feeling befuddled with a gnawing uneasiness about the whole process. That uneasiness ultimately will morph into a lack of trust in their advisor. **“If they don’t understand how the financial advisor is paid, that’s a problem, because then they can’t trust that the advisor is acting in their best interest,”** said Michael Arone, Managing Director, Chief Investment Strategist, State Street Global Advisors Intermediary Business Group. Investors are more trusting of their financial advisors when they talk about these conflicts at the outset. **“If you’re up front and disclose your compensation plan, your clients will have a greater level of trust in you,”** said professor of Behavioral Economics at Harvard Kennedy School of Government, Dr. Brigitte Madrian.
Financial Advisors Overestimate How Much Investors Understand About Fees

In addition to highlighting investor confusion, our research also shows a clear divide between what financial advisors are saying and what investors are hearing. Only 33 percent of investors completely understand how they are paying their financial advisor. Yet, 53 percent of financial advisors think their clients completely understand. In addition, 61 percent of financial advisors say they collect performance fees and only 18 percent of investors think they are paying them.

FIGURE 3. COMPREHENSION OF THE FEES AND/OR COMMISSIONS BEING CHARGED

My clients completely understand the fees/commissions being charged
I completely understand the fees/commissions being charged
I collect performance fees
My advisor collects performance fees


Recognize That Compensation Is An Emotionally Charged Topic

One reason behind this lack of understanding among investors may be the fact that money discussions are culturally taboo and can prompt an emotional response from investors. In our online survey, we asked individual investors and financial advisors to share three adjectives to describe how they feel during fee discussions. We tallied all the words and created the graphs on the opposite page where the size reflects how frequently the word was mentioned. While both used words like fair and reasonable, investors were more likely than financial advisors to use adjectives like nervous, worried, uncomfortable and anxious, while financial advisors were more likely than investors to use words like good, confident, cool and calm.

Truth be told, financial advisors tend to view fee discussions more pragmatically. Hold your nose, take a quick gulp and get the medicine down. “It’s not fun stuff, but obviously you’ve got to do it,” said Frank. How smooth and simple the process is, however, may depend on an individual financial advisor’s fee structure. If an advisor uses a fee-based model or commission-based model he or she may need to explain more carefully than an advisor with a standing fee schedule, which some may perceive as easier to understand.
FIGURE 4: HOW INVESTORS FEEL ABOUT DISCUSSING FEES VERSUS HOW FINANCIAL ADVISORS FEEL ABOUT DISCUSSING FEES

QUESTIONS ASKED OF INVESTORS: What are three adjectives to describe how you feel when it is time to discuss how your advisor charges for his/her services?

QUESTIONS ASKED OF ADVISORS: What are three adjectives to describe how you feel when it is time to discuss with your clients how you charge for your services?

*The size of the words reflects frequency of mention.
Beyond Fees—Your Value Is A Differentiator.

**PRICE IS NOT A TOP-OF-MIND CRITERIA.** Financial advisors need not fear that revealing fees will spook clients, sending them off on a bargain hunt. Finding a financial advisor who charges the lowest fees and commissions is not every investor’s priority, according to our research. While in many industries, price is typically one of the top drivers behind product selection; this is not the case among investors. In fact, when we asked what is important when selecting a financial advisor, “an advisor who charges low fees and/or commissions,” ranked second-to-last among investors. Investors are willing to pay for the valuable partnership financial advisors provide. Investors are far more interested in selecting a financial advisor who is upfront, truthful, empathetic and follows through on goals and promises.

**FIGURE 5. PERCENT OF INVESTORS WHO CONSIDER CRITERIA IMPORTANT WHEN SELECTING A FINANCIAL ADVISOR**

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is upfront with me and represents situations truthfully</td>
<td>97%</td>
</tr>
<tr>
<td>Understands my financial needs and goals</td>
<td>96%</td>
</tr>
<tr>
<td>Acts and performs consistently</td>
<td>95%</td>
</tr>
<tr>
<td>Has a high level of integrity</td>
<td>95%</td>
</tr>
<tr>
<td>Has my best interest at heart</td>
<td>95%</td>
</tr>
<tr>
<td>Welcomes open and honest communication</td>
<td>95%</td>
</tr>
<tr>
<td>Follows through on goals and promises</td>
<td>91%</td>
</tr>
<tr>
<td>Works for a reputable firm</td>
<td>90%</td>
</tr>
<tr>
<td>Keeps me informed on a regular basis</td>
<td>89%</td>
</tr>
<tr>
<td>Knowledgeable about new, innovative investment products</td>
<td>89%</td>
</tr>
<tr>
<td>Is a top performer</td>
<td>84%</td>
</tr>
<tr>
<td>Charges low fees and/or commissions</td>
<td>76%</td>
</tr>
<tr>
<td>Is highly recommended by a family member, friend or colleague</td>
<td>61%</td>
</tr>
</tbody>
</table>


Questions asked How important is each of the following to you when you are selecting an advisor?
Please use a 1-5 point scale where 1 means “not at all important” and 5 means “extremely important.” Reporting top two box scores.

Fees are also rarely an issue when a client leaves a financial advisor. “Typically when an investor leaves a firm, the exit interview reveals problems in communication or trust, but the departure is never about fees,” said Stevens.

**It’s not about lowering your fees. It’s about making sure your clients understand the fees they are paying. They’re willing to pay for the services you provide because, among other things, they don’t have the time or the expertise to navigate the complexities of the financial market.**
A Clear Fee Value Proposition Can Be A Game Changer

Further analysis of our research findings gives financial advisors a strong incentive to ensure that clients understand what they’re paying. Not only can it strengthen bonds with clients, but it may help generate more business. Investors who understand the advisory fees they pay are more likely to think and respond more positively toward their financial advisor than those who don’t understand. They are more likely to believe the fees their financial advisor charges are fair, more likely to agree their financial advisor provides objective advice without regard for the commissions he/she charges, and more likely to refer friends or family to their financial advisor. “Referrals are the lifeblood of our industry,” said Stevens.

FIGURE 6. HOW UNDERSTANDING FEES/COMMISSIONS IMPACT INVESTORS’ THOUGHTS AND BEHAVIORS

But fees are only one side of the equation. It’s not enough to just reveal costs, investors also want to know what they’re getting for their money. According to a recent study conducted by Ipsos, a leading global independent market research company, two-thirds of affluent Americans spend time researching a product or service before purchasing and 74 percent say a good value for the money is more important than price. Whether they’re buying a flat screen TV or an investment portfolio, people want to know that their money is well spent. “There is more pressure than ever for financial advisors to be clear about their own value in order to compete,” said Stevens. “A financial advisor’s value statement and their services have to be crystal clear to their clients and their referral sources.”

Best Practices—Communicating Fees Is About Far More Than Money

PAYING FOR FINANCIAL ADVICE IS A CLIENT’S INVESTMENT IN THEIR ADVISORY RELATIONSHIP.

Effectively communicating the value of your service doesn’t have to be difficult. Adding some simple strategies can not only clarify fee issues, but also help clients better understand the value of the services you provide.

1. **Be Upfront, Consistent and Concise**
   
   Don’t wait for your existing or prospective clients to inquire about fees. Take the lead and address your fee value proposition before he or she even thinks to bring up the topic. “It’s important to be completely upfront and honest with what your client is paying and what they’re getting for their investment,” said Frank. Give the investor the information he or she needs to be confident in your services and their decision. Articulate your services clearly. Keep it simple. It’s not about putting 20 items on the list. It’s about personalizing performance, spelling out the important things that really matter and collaborating with your clients on how you will seek to accomplish those goals.

   We found in our research that 92 percent of financial advisors said that they discussed fees with their clients, but only 67 percent of investors agreed. Most investors said fee discussions happened quarterly or annually, while a small percentage of investors said they actually only talked about fees when their advisor was increasing them. Financial advisors should ensure that the initial fee discussion happens at the start of any new client relationship, but this discussion should not be a one-time event. Fee discussions should be ongoing. Discussing fees regularly improves the likelihood that clients clearly understand what you are charging them and what services they are getting in return.

2. **Ensure Comprehension**

   Paying for financial advice is a client’s investment in their advisory relationship. If an investor doesn’t understand what he or she is paying, it’s difficult for them to determine value. Take the time to explain fee structure and compensation and make sure the investor understands the process clearly. You’ve not only got to communicate clearly, but also be able to assess how much of that information they actually absorbed. After providing an investor with details about fees or compensation, ask them questions so they have to repeat the information back to you. This can allow you to make certain they’re clear about what you’ve told them. Also supplement the information you’ve discussed with written materials that they review later.

3. **Assess your Clients’ Financial Literacy**

   Each investor comes into financial discussions with a different comprehension level. Assessing their financial literacy upfront allows you tailor information to specific clients. Don’t assume that just because someone is highly educated that they are financially savvy. The two don’t always go hand-in-hand. Dr. Madrian points out, “People tend to overestimate their financial literacy.”

   The experts at the Center for Applied Research recently developed a financial literacy assessment tool that can tell you quickly and accurately how much investors understand when it comes to financial services and investments. The tool measures understanding of financial concepts and tests for awareness of financial products. For someone with a reasonable knowledge of investment concepts, the test should not be challenging. However, according to
Suzanne Duncan, head of research for the Center for Applied Research, investors around the globe score just 61% on average. Knowing how financially literate your clients and prospects are can allow you to fill in knowledge gaps with additional information to ensure effective communication about both fees and value. When a client comprehends the specifics of their own financial plan well enough to communicate them to someone else, the plan becomes their plan—and they begin to take ownership of it.

**4. Demonstrate Your Value by Protecting Theirs**

“Financial advisors help their clients make better decisions” said Ingrid Maltrud, investment management strategy consultant. “They’re trying to ensure that you maintain and grow your wealth.” Many investors are highly susceptible to emotional factors that cloud their judgment and can have long-term consequences. An experienced financial advisor protects investors from making emotional decisions that can erode their long-term security, or helps them emerge from a down market unscathed.

According to Cerulli Associates, individual investors place value on financial advisors who lead with their financial planning value proposition. As the lead wealth management advisor, it is your business to know your client better than any other financial professional. Frame your value around being a coach. It is the services you provide to your clients that will differentiate you from other professionals.

**5. Critique the Relationship**

Financial advisors are more than twice as likely to say that they’re reaching out to clients for feedback than investors report that they’ve been asked for feedback from their own financial advisor.

**FIGURE 7. REACHING OUT TO CLIENTS FOR FEEDBACK**

Check in regularly with your clients to find out what’s working and what’s not. This not only gives you valuable information to improve your practice, but also lets clients know you’re responsive to their needs. Don’t be afraid to conduct your own marketing research. Advisors who survey their clients regularly, have a clear understanding of what their clients are looking for and how well they are delivering on those desires.
Why addressing both sides of the value equation is critical.

In the end, our research suggests that communicating fees clearly is about far more than money. It’s about building trust and demonstrating value, and proving to your client that your partnership is the wisest of all their investments. Today’s post-crisis investment market is changing. Investors are wary and pushing for more price transparency, making it more important than ever to promote the value of your own services to clients, said Sterling Shea, the managing director of the Advisor and Wealth Management Program at Barron’s. Financial advisors who have the ability and skill to provide more authentic advice are going to be able to charge more for it and flourish. “More volatile markets also will expose the mediocrity in the industry. There will be huge pressure on those who provide less comprehensive advice with more variable fees,” said Shea. Ultimately, investors are willing to pay when they know they are getting a worthwhile service in exchange.

To clearly communicate your value you’ve got to sweep away the layers of fog and confusion around fees, communicate your value proposition clearly and truly allow your clients to see your worth.
Acknowledgements

We would like to express our deep appreciation to the industry experts, financial advisors and investors who participated in our survey as well as our in-depth interviews. Your insights guided our thinking and inspired our tactical recommendations.

We also thank a2b planning for their invaluable contribution.
Methodology Overview

**ONLINE SURVEY:** A total of 600 individuals completed the State Street Global Advisors Financial Advisors’ Value Proposition and Compensation Survey. It was fielded August 8-20, 2014. All of the 300 financial advisors had an average account under management of at least $500,000. All of the 300 investors had a household portfolio of at least $150,000. Quotations were established to ensure the sample reflected financial advisors across different retail advisory channels and investors across a range of investable assets.

**EXPERT INTERVIEWS:** Fourteen industry experts were interviewed via phone for this project.

**IN-HOME INTERVIEWS:** Seven in-home interviews with investors were conducted for this project. All investors have a household portfolio of at least $150,000. If investment decisions were shared with a spouse, the spouse was included in the interview.

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**STATE STREET GLOBAL ADVISORS**

State Street Financial Center  
One Lincoln Street  
Boston, MA 02111

866.787.2257  
spdrs.com

1 State Street Center for Applied Research, The Influential Investor 2012 survey analysis.


4 Ipsos Affluent Survey U.S.A. – November 2013. Affluent Americans defined as household income of $100K+.

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