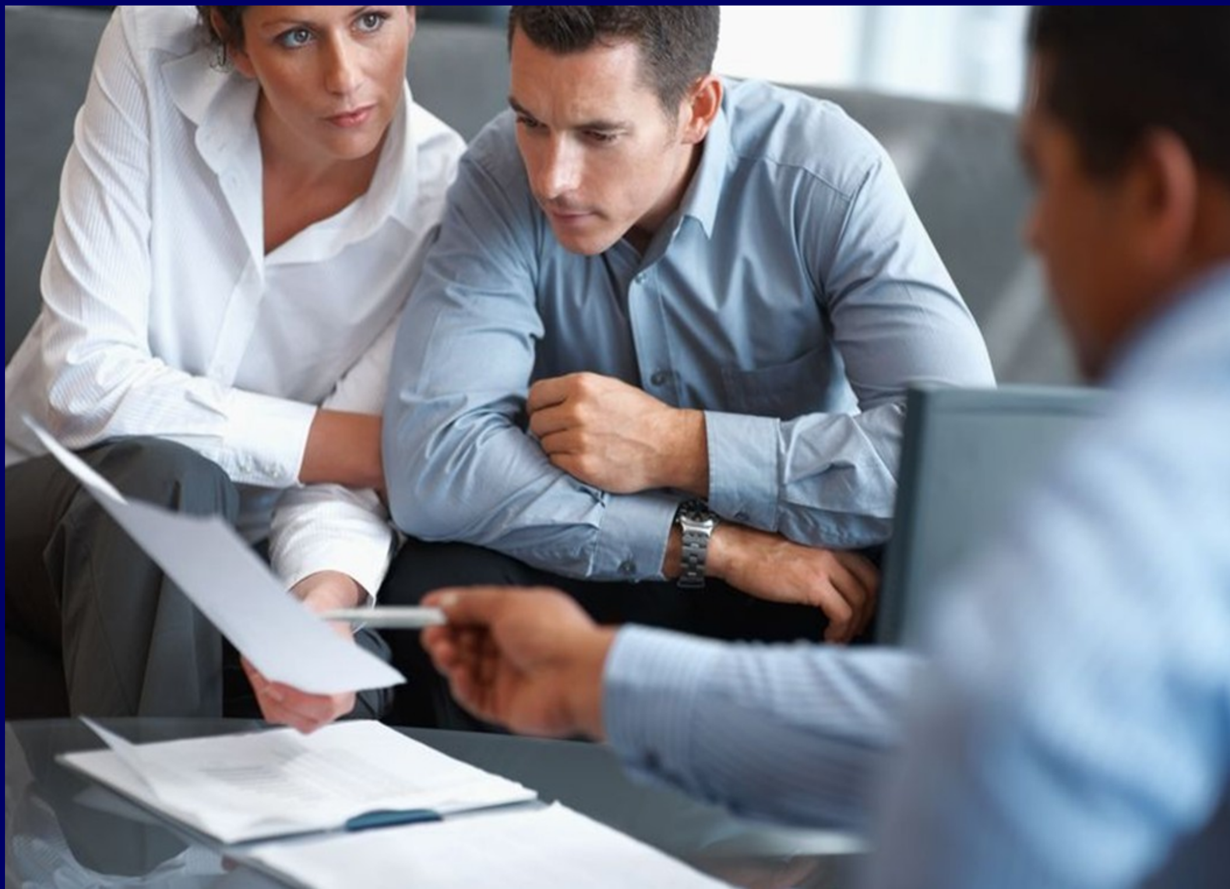
Understanding Investment Expenses



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Introduction

We wish financial service expenses were simple, fully disclosed, and easy to understand. But, it's just the opposite. There are multiple service providers, several layers of expenses, and every advisor has a different fee schedule. It is complex, but you need this information for three important reasons:

- Expenses reduce your net performance
- Every dollar of expense is one less dollar you have for your future use
- Excessive expense undermines the achievement of your goals

Withheld Information

Advisors know excessive expenses will cause you to reject their sales recommendations. They also know higher expenses can increase their compensation. They have an inherent conflict of interest. Too many advisors choose to withhold expense information from you and hope that you don't ask the right questions.

> If you do ask the right questions many advisors will provide verbal responses so there is no written record.

Protect Yourself

How do you protect your financial interests from excessive investment expenses? You have to ask the right questions and you have to require documented responses. Avoid verbal information that is easy to manipulate (omit, misrepresent information) and deny later. Trust what you see, not what you hear, and retain documentation in case there is a future dispute.

Deception

Don't believe advisors when they say: "I don't have access to expense data". They have access or they should not be recommending the product to you. Your solution is to find a higher quality advisor who does not use deceptive sales tactics and is willing to fully disclose investment expenses.

All Expenses

The number of fees, commissions, and other charges that are deducted from your accounts may shock you. All of the following expenses should be documented by your advisor: Planning fees, investment advisory fees, money management fees, custodian fees, commissions, marketing fees (12b-1), transaction charges, insurance fees, administrative fees, penalties for early withdrawal, and any other expense that is deducted or can be deducted from your account.

> Don't buy what the advisor is selling until you have this information and you understand its impact on the achievement of your financial goals.

Your Questions

You want the following types of expense information communicated to you:

1. Is this a one-time expense?
2. What is the first year expense?
3. What is the subsequent year expense amount?
4. Who receives all or part of the expense?
5. What services do you receive for the expense?

Your Expense Requirements

This information will help you understand the expenses that are deducted from your accounts. Use the increased awareness to ask the right questions and compare the proposals of the advisors who want to sell you financial services and products.

Fees

The first type of expense is a fee that is charged by multiple service providers. You want to know all of the fees that are deducted from your assets or billed direct to you.

- **Planning Fees:** The applicable hourly, fixed, or asset-based fees that you pay for planning services
- **Financial Advisory Fees:** Fees charged by advisors or a third party for investment advisory

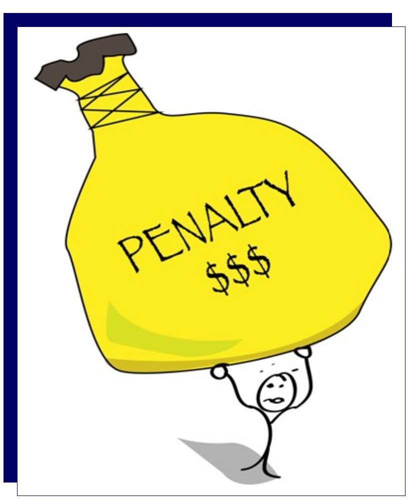
services: Investment Policy, Asset Allocation, Manager Selection, and Performance Measurement Reports

- **Money Management Fees:** Fees charged by money managers, for example a mutual fund, hedge fund, or Separate Account Manager, for making investment decisions for you
- **Custodian Fees:** Fees charged by a third party that takes physical possession of your assets, collect dividends and interest, and process transactions. Brand name custodians include: Schwab, Fidelity, Pershing, and TD Ameritrade
- **Marketing Fees:** Will any marketing fees, for example 12b-1 fees, be deducted from your assets
- **Administrative Fees:** Will any administrative fees be deducted from your assets
- **Wrap Fees:** A wrap fee consolidates several fees (advisory, money management, custodian, transactions) into one fee
- **Additional Fees:** Your advisor should describe any other fees that are deducted from your assets or billed direct to you

Commissions

You should require information for all types of loads (commissions) that are deducted from your accounts or paid by product companies to your advisor.

- **Front-End Load:** The amount of money that is deducted from your assets to pay a commission to your advisor
- **Back-End Load:** The amount of incentive compensation that is paid to your advisor by a product company, for example a mutual fund family. Companies charge higher fees and penalties for early withdrawal to recover commissions that are paid to your advisor
- **Level-Loads:** A recurring commission that is deducted from your assets on a monthly basis



Penalities For Withdrawal

Your advisor should disclose any financial penalties that you will incur if you decide to sell an investment before a certain period of time elapses. The most frequently used penalty period is seven and seven. For example, if you sell the investment the first year you pay a 7% penalty, if you sell it the second year you pay a 6% penalty, and so on until it expires after seven years.

- Penalties go by a number of different names: Contingent Deferred Sales Charges, Penalty for Early Withdrawal, and Surrender Charges.
- What they have in common is a company's ability to withdraw the penalty from your account without your approval in advance.

Do not believe this explanation from advisors: "Penalties do not matter because this is a long-term investment". Penalties do matter. You could have a lot of reasons for selling the product, starting with it is a bad investment. Penalties have the impact of reducing your liquidity.

Transaction Charges

Most transaction expenses are being replaced with fixed fees. However, the fee is still tied to transactions – the purchase and sale of investments. Make sure your advisor discloses all transaction charges that will be deducted from your accounts.

Direct Billing

Advisors do not like to bill you direct. You may not pay them. They prefer to bill your accounts so they do not have to collect from you. Although rare, your advisor should describe any fees for financial advice or services that will be billed direct to you - for example, a retirement planning fee.

Tax Deferred Accounts

You should require full disclosure for all expenses that are deducted from your tax-deferred accounts (pension, IRA, annuity) and whether those expenses could be deducted from a taxable account. You want to maximize the accumulation of assets inside tax-deferred accounts for as long as possible. Why reduce this amount of assets with expense deductions?

Money Market Fund

You should be concerned about paying a fee to a money market fund and a fee to an advisory firm for the same assets. The combined expenses can more than erode the entire return of the mutual fund.

You should be even more concerned if the purpose of the money market fund investment is to pay fees and commissions to your advisor. In other words, rather than bill a portfolio of securities, the advisor bills your money market fund.

Annuity Expenses

You should require the following information if your advisor recommends annuities for the investment of your assets:

- management fees
- advisory fees
- marketing fees
- mortality fees
- administrative fees
- transaction charges
- termination fees
- maintenance fees
- custodial fees,

Annuities are one of the most, if not the most, expensive products that are sold to investors.

and any other fee that is charged to you.

About the Author

Jack Waymire is the founder of PaladinRegistry.com and Investor Watchdog. He spent 28 years in the financial services industry and is the author of *Who's Watching Your Money?*

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