Enumerating the value of financial advice in a competitive market – a dual structure approach and analysis[†]

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Abstract

This paper introduces and examines a composite, dual fee structure (CDFS) for financial planners that helps quantify the value of financial advice. Our structure specifically separates financial planning (advice) fees based on total net worth (NW) from Investment Management (IM) fees based on assets under management (AUM), which are readily observable and pervasive in the marketplace. Doing so facilitates quantifying the value of this financial advice in a competitive market setting. Knowing the financial value of the non-IM component of financial planning services can reduce perceived conflicts of interest by permitting financial planners to generate compensation for non-IM planning activities in a transparent manner, whether or not the client moves investable funds to the planner. © 2021 Academy of Financial Services. All rights reserved.

1. Introduction

The financial services industry continues to be the nexus of ongoing discussions among federal and state regulators, credentialing entities, and financial institutions, concerning

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what constitutes the fiduciary relationship between providers and clients. Underlying this dialogue is the nature of the compensation paid to the agent by the client—commission, flat fee, fee-*only*, fee-*based*, or some combination of approaches (Opiela 2006 and MacKillop 2017). The predominant methodology for many Registered Investment Advisors (RIAs) is fee-*only*, where agents charge a percentage on the level of clients' assets under management (AUM). Many of these RIAs focus primarily on the function of investment management (IM), in which case fees are more directly correlated with AUM, but also include planning services for the broader portfolio. This is an oft used argument suggesting the interests of RIAs are aligned with their clients' as both parties gain or lose value together. This model is certainly not absolute, and a common example of where this model may have a potential conflict is when a planner might recommend a client use AUM to pay off a mortgage. The right recommendation might be to pay off the debt, yet using AUM to do so will reduce advisor compensation in this scenario since the AUM declines by the amount of the mortgage debt paid off. In contrast, many agents working at broker-dealers (BD) are paid on commission, as is also the case with those selling stocks, bonds, or insurance and annuity products. While this latter approach may indeed be a lower-cost approach for some clients, it is not necessarily clear if and whether there is a line between fees associated with completing a transaction and fees paid for financial planning or advice. The further alternative case where professionals are "dual-registered" as both RIAs and BDs certainly does not clarify the situation (Haslem 2010).

No matter the compensation approach, research suggests that advisors do not always act in clients' best interests. Hoechle et al (2018), in a study of financial advisors working for banks, suggest advisors recommend transactions that are most profitable for the bank, and that independent clients performed better than advised clients. Similarly, Egan (2019) reports the incentives of brokers do not align with clients. Perhaps most alarming, Cheng and Kalenkoski (2018) report that more than 20% of clients have no idea how their advisors are paid.

The purpose of this research is not to solve the fiduciary debate. Instead, we seek to examine a potential methodology to determine, or price, the value of financial planning.[1] More specifically, we seek to separate the value of financial advice from the presumed cost of managing an investment portfolio. Knowing the value of this advice in a competitive market is critical to provide greater transparency to clients and help planners understand the value of the expertise and service they provide. In this paper, we introduce and examine a composite, dual-fee structure (CDFS) for financial planners. We hypothesize that pricing standard investment management activities competitively within the market permits the creation of a reasonable pricing strategy for planning services. Our structure specifically separates financial planning (advice) fees from IM fees that are often subsumed in a single AUM fee. This approach may reduce or perhaps limit perceived potential conflicts of interest by providing a mechanism where financial planners can be compensated for planning efforts whether or not the client moves investable funds to the planner for the planner to manage.

2. Previous research

There is limited research that specifically addresses advisor fees outside of the impact of fees on investor returns. It is well documented that higher management fees are associated with lower investor returns (Fama & French, 2010). Fees and investor returns are naturally a zero-sum game: a dollar paid in fees is a dollar less that investors receive in returns (SEC, 2014). However, there is some literature that addresses what clients might be looking for from financial planners, as well as some survey work sampling the various fee structures used by advisors of different types. We review some of the salient literature in each space next.

Bae and Sandager (1997) examine characteristics that consumers sought from financial planners. They find that clients primarily seek advice on retirement funding, investment growth, and reducing taxes. Most simply want a comprehensive review of their situation. Furthermore, they find only 20% of survey respondents preferred a planner be compensated by commissions from sales exclusively. Statman (2000) suggests financial planners are *investor* managers, and they focus too little on the value they contribute as managing investors and too much on clouding the fees they charge for those contributions. Finke, Huston, and Winchester (2011) find that wealth is the strongest predictor in the decision to pay for financial advice. They find those with at least a college degree are more likely to hire an expert; however, those who perceive they have a better understanding of financial issues are less likely to pay for financial advice. Seay et al (2017) suggests clients with different characteristics (e.g. demographic and income levels) may align themselves with different advisor compensation structures. Cheng and Kalenkoski (2018) survey investors to ascertain how their advisors are compensated and find 27% of clients perceive their advisors are compensated by charging a percentage of investable assets, 16% commissions, 18% some combination of fees and commissions, and 15% a flat/hourly fee. Restating their startling result; more than 20% respond they had no idea how their advisors are paid. In summary, investors overwhelmingly do not know how, or how much, they are paying advisors.

Particularly relevant for this research, it is unlikely clients know for *what* they are paying—financial advice or transaction costs? Lahtinen and Shipe (2018) review ADV data from 2009 to 2015 and find virtually all portfolio management investment companies charge a percentage of AUM while financial planning services companies use fixed and hourly fees most often. The authors conclude that fee structures are not homogeneous and vary depending on the services offered by the firms. Kitces (2017) suggests the average percentage of AUM charged may be 1%, but that the median fee for high-net-worth clients is closer to 0.50%. Furthermore, he reports the results of an *Inside Information* survey suggesting that the all-in fee, or the total fee that includes transaction costs as well as the costs of underlying products, is closer to 1.65%. In summary, it is perhaps not surprising that with the complexity of fee structures found across the financial services profession, not only do investors not know how their advisors are compensated, they surely are not likely to understand the value of *financial planning* relative to investment management activities.

3. Methodology and data

We initially outline and describe a basic dual-fee structure before we discuss how such a structure might be utilized or optimized. The purpose of this composite structure is to both value, and potentially allow an advisor to charge for, financial planning advice separately from any IM fees that may be collected for managing AUM (or any commissions earned associated with selling a particular product). The goal is to develop an approach and structure such that the fee schedule adequately compensates the planner for the value provided to the client and separates this advice charge from the broader AUM fee. Under many *fee-only* mechanisms where fees are charged as a percentage of AUM, the assumption is the greater the amount of assets, the greater the scope of planning work. While there is likely some positive correlation between investable wealth and planning requirements, the relationship is not always so straightforward. Two clients with similar levels of total wealth might have very different planning needs. Here we address this challenge by distinguishing between *total* wealth, and *investable* wealth. We use a client's net worth (NW) as a proxy for their *total* wealth, which we posit is a better representation for the financial planning effort associated with the client's financial situation than simply the level of the client's investable assets, captured as AUM.

In our introductory model. we consider the asset universe to include the following asset classes: stocks (S), bonds (B), real estate (RE), and business ownership (proxied here by private equity, PE). The sum of these assets represents a client's NW at time "t" as shown in Eq. (1). For simplicity purposes, we assume a client's investable assets are equal to AUM, modeled here as simply containing stocks and bonds (Eq. 2). The non-AUM portion of NW is modeled by asset classes likely held by high net worth clients. Specifically, this portion of the portfolio includes additional assets, such as a home (Real Estate, RE) and portion of a business (Private Equity, PE). When we substitute Eq. (2) in Eq. (1), we get the final result in Eq. (3).

$$NW_t = S_t + B_t + RE_t + PE_t \qquad \text{Eq. (1)}$$

$$AUM_t = S_t + B_t \qquad \text{Eq. (2)}$$

$$NW_t = AUM_t + RE_t + PE_t \qquad \text{Eq. (3)}$$

Each of the NW and AUM portfolios will increase or decrease based on the respective returns of the underlying asset classes (R_x), where "x" represents the underlying asset class. The value of the portfolios at time "t + 1" is found by Eq. (4) for AUM and Eq. (5) for NW.

$$AUM_{t+1} = S_t(1 + R_{S,t}) + B_t(1 + R_{B,t}) \qquad \text{Eq. (4)}$$

$$NW_{t+1} = AUM_{t+1} + RE_t(1 + R_{RE,t}) + PE_t(1 + R_{PE,t}) \qquad \text{Eq. (5)}$$

The focus of this analysis is on the fees associated with these portfolios. We first model the traditional, single, fee-only approach used by many advisors in Eq. (6):

$$AUM\ Fee_t = \Sigma_j \omega_j AUM_{j,t} \qquad \text{Eq. (6)}$$

where j represents the number of tiers in the (regressive) fee tier structure and ω_j is the fee level in tier j. Advisors using this model charge a single fee, ω_j, which covers services associated with their investment management function as well as some level of financial planning service. Similarly, we can model the CDFS fee in component parts as follows:

$$CDFS\ Fee_t = \Sigma_k \varphi_k IM_{k,t} + \Sigma_l \theta_l NW_{l,t} \qquad \text{Eq. (7)}$$

where k and l are analogous to j, and φ and θ permit differential fee levels for the IM and NW components. It is important to note the value of IM in Eq. (7) is equivalent to the level of AUM in Eq. (6). We change the identifying variable name to highlight that the IM fee, φ_k, in Eq. (7) is different from the single fee, ω_j, in Eq. (6). While both are charged as percentage of AUM, the IM fee, φ_k, used in Eq. (7) represents the *investment management function only*.

Assuming a financial planner provides the same services under either fee structure, in a competitive market it must be true that the fees are equal as depicted in Eq. (8).

$$AUM\ Fee_t = CDFS\ Fee_t \qquad \text{Eq. (8)}$$

$$\Sigma_j \omega_j AUM_{j,t} = \Sigma_j \left(\varphi_j IM_{j,t} + \theta_j NW_{j,t} \right) \qquad \text{Eq. (9)}$$

Substituting Eqs. (6) and (7) into Eq. (8) yields Eq. (9). We can currently approximate ω from what is observed in marketplace by fee-only planners. We can also approximate φ using so-called robo advisor fees, which arguably represent the latest innovation for providing the most basic investment management functions. The resulting question is then the determination of the fee schedule for θ. Doing so represents the mechanism for quantifying the value of financial advice using this approach.

If we allow ω, φ, and θ to be a single weighted fee value representing a multitiered, regressive fee schedule as detailed later, then Eq. (9) leads to the following for any given year t.

$$\theta = \frac{(\omega - \varphi)AUM}{AUM + RE + PE} \qquad \text{Eq. (10)}$$

In portfolios consisting solely of stocks and bonds, Eq. (10) shows the value of financial advice is intuitive, and captured simply as the difference between robo-advisor (IM) fees and the (observable) AUM-only fee, or $\theta = \omega - \varphi$. However, when other assets—such as real estate (RE) or business ownership (PE)—become part of the broader portfolio, NW increases and the value of θ is no longer as static and straightforward. In fact, there are as many unique solutions for θ as there are unique client portfolios. Additionally, as implemented later in this analysis, θ can adjust over time due to the front-loaded nature of the planning function.[2]

While perhaps true, it is not practical to conclude that the value of financial advice varies infinitely with each individual portfolio. An advisor would spend far too much time creating fee schedules if she tailored each one according to individual clients' asset mixes. Instead, it is appropriate to base θ on some characterization of averages or expected outcomes over time. Due to the countless values for the NW fee schedule θ, we conduct a simulation to help us quantify one example of such an acceptable schedule. Doing so in turn helps us calculate the value of financial advice in a competitive marketplace.

The NW and IM fees we introduce in the CDFS both follow a parallel, similar regressive structure. Much like many *fee-only* or *fee-based* charges based on AUM, both fees here are charged at lower marginal rates as the benchmark (i.e., AUM and NW) rises. The rate charged for IM increases at various breakpoints of AUM. For example, the IM fee might be 50 basis points (bps) on the first $250,000 of AUM and decrease as AUM levels rise. This rate is assumed to be charged and collected in perpetuity if AUM is under the advisor's care. Doing so clearly aligns client and planner interests by benefiting both when the portfolio grows, but it also recognizes the decreasing marginal effort for the advisor as the portfolio grows larger. The NW fee is similarly structured, but instead based on the client's *net worth*.

We further suggest that the effort involved in financial planning is not uniform over time. For financial advisors who practice comprehensive financial planning, the initial workload involved with a new client is significantly more demanding in the first year as the planner develops a way forward for a client across all the financial planning areas (e.g., cash flows and debt service, risk and insurance, investment, tax, and estate planning). To account for this non-linear workflow, we assume the full initial financial planning fee is charged the first year at the scheduled rate. Subsequent years are charged at a reduced rate; this analysis uses a rate that is one-half the bps rate used the first year in our initial illustration. This approach allows the client to pay directly for financial planning and to see how much they are paying for that support initially (and over time if they choose to do so) while remaining independent of IM fees. The percentage reduction of the planning fee during subsequent time periods is just one "lever" that can be adjusted by individual planners/firms based on the level and complexity of planning services offered. This decomposition of fees also allows the planner to charge a lower, more market competitive IM-only fee.

Our simulation sets the value of financial planning (the NW fee, or θ_j) as the delta between the "all-in," single, AUM model fee (ω_j), and the emerging robo-advisor IM-only fee (φ_j). We evaluate the impact of these assumptions over time, and as importantly, the analysis here identifies these "levers" that firms and advisors may adjust for their specific practices. In addition to the degree of the reduction of the NW fee in subsequent years, an additional lever is the determination of the level of the individual fees (and breakpoints) charged for each component of the CDFS.

Table 1 shows the NW, IM, and AUM breakpoints and regressive fee structure, respectively, for both the dual fee CDFS (that includes NW and IM) and the single fee-only (AUM) structures analyzed here. The setup is basic and straightforward, yet it provides sufficient insights that generalize to fee structures with more complexity (e.g., breakpoints). The values for the IM component recognize that in a competitive market there is a base cost for advisors to profitably manage investable assets. Fortunately, the advent of so-called robo-advisors have revealed that these costs can be relatively low. A brief survey of multiple

Table 1 Fee breakpoints

Panel A Dual fee structure							
Net worth (NW) component*			Plus	Investment Management (IM) component			
Minimum	Maximum	Fee (bps)	Fee on max	Minimum	Maximum	Fee (bps)	Fee on max
$ —	$ 500,000	60	$ 3,000	$ —	$ 250,000	50	$ 1,250
$ 500,000	$ 2,500,000	50	$ 13,000	$ 250,000	$ 2,000,000	40	$ 8,250
$ 2,500,000	$ —	40		$2,000,000	$ —	30	

Panel B Fee-only (IM-only)			
Minimum	Maximum	bps fee	Fee on max
$ —	$ 250,000	120	$ 3,000
$ 250,000	$ 2,000,000	90	$ 18,750
$ 2,000,000	$ —	60	

*Note the NW Fee is reduced to 50% of the Year 1 NW fee due to upfront planning work. This table depicts the parallel, regressive fee structures used in the simulation. Panel a depicts the two components of the consolidated dual-fee structure (CDFS) and panel B depicts the single, and more widely used asset under management (AUM)-based fee.

robo-advisors shows a range of fees from $0 ("free") to almost 90 bps annually. There are many factors in play when setting these fees. For example, Charles Schwab Inc., which offers free advisory services, mandates its recommended portfolios contain non-trivial cash positions that the firm then uses to generate "fees" from the spread between the rates paid on this cash and what the firm can charge to lend the funds. Brenner and Meyll (2020) suggest robo-advisors are a valid alternative for investment advice. Overall, the non-scientific middle of the range for IM-only fees appears to be approximately 40 bps. We subjectively assess an additional 10 bps on smaller investment portfolios (below $250,000) to recognize the lack of scale for a typical individual planner, which is supported by Uhl and Rohner (2018). Per the regressive approach, we reduce the bps fees by 10 bps as the IM portfolio grows above $2 million and has the lowest marginal IM fee at 30 bps for this example. In all cases the "Fee on max" value is simply the bps fee multiplied by the maximum portfolio value in that row, added to any previous fee on max value. Having generated this IM fee structure based on a rather objective approach in terms of market competition and economies of scale, we can now deductively generate the fee structure for the planning fee (NW component). We use this fee structure to inform us about the market value of providing financial planning and advice to clients. The fee structure shown in Table 1 provides reasonably comparable overall initial fees for clients when controlling for the complexity of the planning activities.

A common refrain of financial planning is recognizing that all clients are unique. It is quite possible, and even more likely, that there might be significant variation among clients' relative values of net worth (NW) and investable assets, or AUM. The size and scope of clients' AUM and NW is the focus of further analysis, a third potential "lever." If a client's AUM represents their entire NW, say early in their career when their net worth may consist solely of assets in a 401(k) plan, the breakdown of the planning fee versus IM fee may likely

Table 2   Target versus simulation statistics (10-year horizon)

Asset class	Returns (annual)		Risk (annual)		Correlations (desired/simulated)			
	Desired	Simulated	Desired	Simulated	Bond	Real estate	Private equity
Stock	5.60%	5.52%	14.30%	13.95%	0.000/−0.004	0.53/0.51	0.73/0.71
Bond	3.10%	3.10%	3.42%	3.33%		−0.19/−0.18	−0.23/−0.22
Real estate	5.80%	5.79%	11.07%	10.77%			0.49/0.47
Private equity	8.80%	8.76%	20.17%	19.72%			
Monte Carlo runs	10,000						

This table shows the target and simulated values for risk and return inputs used in the Monte Carlo simulation. Results are shown for all asset classes used in the simulation as well as the correlation of those inputs. Target values come from JP Morgan 2020 long-term capital market forecast.

differ from that of a client where the level of AUM is significantly less than their NW, for instance, as they approach or have entered the retirement phase and own real estate and/or a small business interest. The ratio of NW to AUM will serve as a proxy for the delta in the IM fee versus financial planning fee in this analysis. In other words, as the AUM decreases relative to total NW, a planning fee schedule becomes more relevant than an IM fee schedule, causing the planning fee to increase and the IM fee to decrease. To see these impacts, we investigate the variance of planning and IM fees for *three* clients: a young client in the accumulation phase, a near-retirement client with some remaining work years but planning for the transition to retirement, and a retired client in the spending phase. We then add three levels of the relationship that cover this spectrum of the ratio between AUM and NW: one where NW equals the level of AUM, one where NW is 1.5X the amount of AUM, and finally where NW is 2X the client's AUM.

Our quantitative approach involves simulating the dual fee structure properties over the relevant time period for each of our clients: 40 years for the young client (accumulation phase), 20 years for the client transitioning to retirement (transition phase), and 10 years for the retired client (spending phase). Essentially, we construct our CDFS by first setting the IM fee component comparable to robo-advisors as discussed above. We then consider a first-year planning fee that when added to the IM fee, is equivalent to the typical AUM fee found in the industry. We then run a simulation to examine the behavior of the component fees over various investment periods, recalling that the planning fee is adjusted downward in year two in our initial illustration. Running the simulation over time requires some further assumptions:

- Recall a clients' total wealth is represented by their net worth (NW).
- To recognize the positive relationship between investment horizon and portfolio riskiness, the initial asset allocation of the IM portion of the client's NW is assumed to differ among these three profiles. For the IM component of the portfolio we generate a generic stock/bond allocation of 80/20, 60/40, and 40/60 for our respective clients.
- A client's NW is comprised of AUM assets (modeled with stocks and bonds and denoted by IM) and other assets. These other assets are modeled to be initially split evenly between real estate (RE) and private equity (PE) asset classes (representing home ownership and small business interests, respectively).
- Portfolios are rebalanced annually back to the original weights, but only for stocks and bonds. Because real estate and private equity are less liquid and likely held longer, they are not rebalanced but instead left to "drift" with their associated returns.[3] To calculate fees, we simulate returns of the four asset classes using the J.P Morgan (JPM) 2020 market forecast values for returns, risk, and pairwise correlation between these asset classes.
- To ensure proper return co-movement, we utilize a Cholesky decomposition to generate the respective asset class returns over time. Table 2 shows the target return, risk, and correlation values for the asset classes investigated here over a 10-year period, as well as the distribution of the mean values for these statistical properties over the relevant time periods using 10,000 Monte Carlo runs.[4]

Again, the intent of our analysis is not to generate a debate about the specific fee levels or breakpoints selected; we use what we believe to be within the range of fees generally representative of the industry. Instead, the focus of this investigation is to introduce a framework

and mechanism for truly valuing the financial advising expertise that planners provide to clients, separate from the oft-used single AUM fee that likely subsumes a financial planning effort, and observe the behavior of the component fees over time.

4. Results

In this section we report the results of our dual fee analysis both initially, and over a longer investing period. Table 3 shows the impacts of the fee breakpoints and values we depict in Table 1, as a snapshot at the initial planning point in time. Specifically, based on the simple θ structure proposed, it quantifies the annual fees clients would pay (and planners would receive) under the CDFS (NW and IM) versus the Fee-Only Structure (AUM) in those respective rows per Eqs. (6) and (7). Once again, while client profiles are literally limitless, we present three different profiles for illustration purposes: those in preretirement (accumulation), transition (approaching retirement soon), and spending (in retirement) phases. Within each of those profiles, we further analyze three different ratios of NW to IM for a total of nine potential client scenarios. As one example, Client A is assumed to be in the accumulation phase with a NW of $600,000. We then further delineate this NW as follows, recalling that AUM in the CDFS is designated as IM: NW = IM = $600,000 (column 1), NW ($600,000) = 1.5 × IM ($400,000) (column 2), and NW ($600,000) = 2 × IM ($300,000) (column 3). The portion of the NW portfolio not comprised of IM is an evenly allocated between the real estate (RE) and private equity (PE) asset classes. We contend—with support from practicing planners—that the IM effort is generally the same among all of these client profiles; however, we also contend that of these three client profiles, the planning effort is likely most complex for Clients A3, B3, and C3 as these clients have asset classes not composed of stocks and bonds that the planner must consider when developing a holistic financial plan. Along similar lines, Clients B and C have higher NW, but again we offer the possibility that their net worth can have varied compositions in terms of stocks, bonds, real estate, and private equity analogous to the ratios described for Client A. Within Clients B and C, we again contend that the planning effort increases as the AUM to NW ratio decreases.

What Table 3 demonstrates is that by assessing reasonable (and consistent) IM fee structure or θ, under a dual-fee structure and also for a fee-only (AUM) structure, ω, as in Table 1, it is possible to come up with the financial planning fee component of the CDFS for the NW portion of the portfolio. We posit this financial planning fee serves as a proxy for the value of financial advice. Specifically, the differences among the CDFS are almost negligible in relation to the all nine clients' overall NW (see the penultimate row entitled "As % of NW" for the difference in the CDFS Fee vs. Fee-Only fee). Notably, these percentages monotonically creep upward as the sub client groups' investable assets diminish as a fraction of net worth. That is, as NW held outside of stocks and bonds increases, so do the relative fees, at least initially. We think this is reasonable, as increased non-investment assets (assumed here to be real estate and private business interests) require additional planning efforts, all else equal, which the planner should be compensated for as part of the initial

Table 3   Initial fee example

| | Client A (accumulation) | | | Client B (transition) | | | Client C (spending) | | |
	1	2	3	4	5	6	7	8	9
Net worth	$600k	$600k	$600k	$2,400k	$2,400k	$2,400k	$6,000k	$6,000k	$6,000k
Investable assets	$600k	$400k	$300k	$2,400k	$1,600k	$1,200k	$6,000k	$4,000k	$3,000k
Panel A									
CDFS	6,150	$5,350	$4,950	$21,950	$19,150	$17,550	$47,250	$41,250	$38,250
Panel B									
Single AUM	6,150	$4,350	$3,450	$21,150	$15,150	$11,550	$42,750	$30,750	$24,750
Panel C									
Fee difference, initial	$—	$1,000	$1,500	$800	$4,000	$6,000	$4,500	$10,500	$13,500
As % of NW	0.00%	0.17%	0.25%	0.03%	0.17%	0.25%	0.08%	0.18%	0.23%
Planning effort required	Same	More	Same	Same	More	Same	More

This table depicts the initial fees for three different client profiles (Client A, B, and C) each with three ratios of net worth (NW) to investable assets (IA). Panel a shows the fees for the consolidated dual-fee structure (CDFS) and panel B shows the fees for the single, and more widely used asset under management (AUM)-based fee. Panel C highlights the difference between the two fee structures.

planning effort. We have summarized this position by labeling the relative planning effort required of the client with less investable assets ("Same" – columns 1, 4, and 7) compared with the respective clients with identical net worth but less investable assets ("More" – columns 3, 6, and 9). Nevertheless, these differences are only at most 25 bps of total initial net worth at the beginning of the client-advisor relationship.

Importantly, this decomposition of the overall fee into two components, one of which is comparable in function to the common, single fee-only AUM that is pervasive today, we have deductively determined the value of the planning function that occurs above and beyond the act of solely managing investments. In doing so, we now allow planners and clients more transparency in what they are providing and buying, respectively. Additionally, this approach provides planners a mechanism that can help them separate and distinguish their services such that they might address a larger number of clients' needs. That is, planners can now price and offer more tailored services for a client who might need only IM help or perhaps only broader planning assistance. Under a single fee-only model with one AUM fee structure, clients might think they are overpaying for planning that might not be required (columns 1, 4, and 7 in Table 3). The CDFS allows planners to respond to them with the IM fee schedule in Table 1 that will compete with the so-called robo-advisors. Additionally, if clients need significant financial planning help that is broader than investment management, planners can price it "fairly" in the market using the CDFS methodology. If a client includes an asset or asset class as part of their NW, then the advisor must plan around that asset or asset class and charge for it commensurately. However, planners cannot consider assets that they do not know to exist, so clients should not pay for this effort, nor should the advisor be expected to consider such assets in the overall plan.

As many planners recognize, the financial planning effort for most clients is heavily front loaded. That is, more often than not, formulating the initial comprehensive financial plan involves collecting data about a client's financial position, assessing a client's goals and risk profile, analyzing a client's financial position, and recommending potential actions to meet the client's objectives can involve much more time and effort in the onboarding process than implementing and monitoring the plan in subsequent years. This fact motivates our next analysis, a corollary to the CDFS dual-fee structure, which is a fee feature that recognizes the lesser planning effort required in subsequent years. Specifically, we next evaluate the fee impacts assuming financial planning component fee associated with the NW fee schedule is reduced by 50% after the initial year. In other words, instead the of the 60, 50, and 40 bps fee schedule shown in Table 1, the fee schedule changes to 30, 25, and 20 bps of NW for every year beyond the initial year. The IM fee schedule does not change, which remains consistent and competitive with the robo-advisor approach. Extending this analysis over the investment lifetime of our example clients, we also aggregate the cumulative fees each client pays over their investment lifetime under the different fee approaches.

Table 4 contrasts the impacts of our two different fee approaches across time for the different client profiles described previously. Specifically, we simulate 10,000 random time series of asset class returns and compare the average overall fees under the CDFS with the AUM fee-only structure for each of our nine profiles.[5] All values are in nominal dollars. Panel A depicts the NW and IM fees for Year 1 and Year 2 for the CDFS. Panel B depicts the same fees for the AUM model. We also aggregate the fees over the respective investment

Table 4 Fee and portfolio results over time

	Client A (accumulation)			Client B (transition)			Client C (spending)		
	1	2	3	4	5	6	7	8	9
Net worth	$600k	$600k	$600k	$2,400k	$2,400k	$2,400k	$6,000k	$6,000k	$6,000k
Investable assets	$600k	$400k	$300k	$2,400k	$1,600k	$1,200k	$6,000k	$4,000k	$3,000k
Stock/bond allocation		80/20			60/40			40/60	
Investment period (years)		40			20			10	
Panel A					Dual-fee structure (CDFS)				
1) Year 1 fee, total	**$6,433**	$5,634	**$5,224**	$22,767	$20,042	$18,410	$49,015	$43,053	$40,063
2) NW fee	$3,657	$3,680	$3,692	$12,977	$13,071	$13,114	$28,009	$28,279	$28,415
3) IM fee	$2,776	$1,934	$1,513	$9,790	$6,952	$5,277	$21,006	$14,754	$11,628
4) Year 2 fee, total	**$4,761**	$3,929	**$3,501**	$16,717	$13,946	$12,264	$36,006	$29,837	$26,743
5) NW fee	$1,888	$1,916	$1,929	$6,664	$6,770	$6,820	$14,402	$14,697	$14,845
6) IM fee	$2,873	$1,993	$1,552	$10,053	$7,157	$5,424	$21,603	$15,120	$11,878
7) Lifetime fees	$424,971	$395,972	$378,350	$450,864	$394,542	$362,293	$417,050	$353,935	$322,280
8) NW fees	$169,219	$226,115	$253,945	$184,024	$206,862	$218,362	$175,223	$186,177	$191,655
9) IM fees	$255,752	$169,061	$123,609	$266,840	$187,282	$143,533	$241,827	$167,559	$130,426
10) Terminal portfolio	$3,331,780	$5,885,393	$7,168,093	$5,190,782	$6,723,209	$7,496,472	$8,443,166	$9,612,364	$10,197,079
11) Terminal IM portfolio	$3,331,780	$1,983,897	$1,315,850	$5,190,782	$3,321,215	$2,393,481	$8,443,166	$5,537,780	$4,085,206
Panel B					AUM fee structure (fee-only)				
12) Year 1 fee, total	**$6,453**	$4,559	**$3,610**	$21,849	$15,849	$12,080	$44,283	$31,779	$25,526
13) Year 2 fee, total	**$6,672**	$4,702	**$3,714**	$22,379	$16,341	$12,471	$45,506	$32,580	$26,117
14) Lifetime fees	$543,514	$380,365	$294,398	$570,621	$415,268	$326,841	$504,220	$358,017	$284,916
15) Terminal portfolio	$3,017,940	$1,969,382	$1,452,884	$5,010,107	$3,286,010	$2,442,828	$8,342,095	$5,535,000	$4,131,453

This table depicts the fees for three different client profiles (Client A, B, and C) each with three ratios of net worth (NW) to investable assets (IA). Panel a shows the fees for the consolidated dual-fee structure (CDFS) and panel B shows the fees for the single, and more widely used asset under management (AUM)-based fee. IM = Investment Management.

period for each client group. Finally, we present the terminal portfolio values for each client group, net of fees, decomposed into the NW and IM components for the dual-fee structure. Notably, for comparison purposes, it is appropriate to compare only the "Terminal IM Portfolio" under the CDFS dual-fee structure with the "Terminal Portfolio Value" under the AUM fee-only structure when NW = IM (columns 1, 4, and 7). This is the case because we assume a client's NW is comprised of IM (modeled with stocks and bonds) and potentially other assets. For clients represented in columns 2, 3, 5, 6, 8, and 9, these additional assets as modeled as evenly split between real estate and private equity asset classes. To the extent a client's NW calculation includes non-appreciating real assets or property (e.g., autos, boats) instead of the real estate and private equity as we depict here, the portion of the NW portfolio not including IM is likely overstated. Accordingly, the level of the planning fee values in subsequent years after the first year are biased in the direction of assumed returns for real estate and private equity. This treatment highlights the importance of determining the appropriate NW for a client and whether (and how) those assets should be modeled to grow. Additionally, in all other client scenarios (columns 2, 3, 5, 6, 8, and 9), the CDFS assesses fees both on NW and IM, whereas the AUM only fee is assessed on only the IM. Put another way, in the AUM model, there are no fees assessed against the real estate or private equity holdings since they are not part of AUM.

Analyzing Table 4 provides opportunities for planners and clients to better grasp the potential impact of a separate financial planning and IM fee, or what we call θ in our model, against a single AUM, or ω, fee structure. By examining Year 1 fees, one can see the breakout of financial planning fees and an IM fee component compared with the single AUM fee. Recall, this illustration by design will result in the CDFS fee roughly equivalent with the single AUM model fee. This is an appropriate comparison where NW = IM (columns 1, 4, and 7). Not surprisingly, the Year 2 fees for these cases result in lower total fees due to the reduction in our illustration of the financial planning fee in subsequent years. Again, these NW fees for Year 2 and beyond are assessed at 50% of the initial fee schedule shown in Table 2. To the extent our assumptions about the non-linear form of the holistic planning function hold, this would represent a cost savings to the client and perhaps a reduction in revenue for the planner. The timing and scope of the reduction in a planning fee are clearly variable levers included in the overarching θ fee schedule that are at the disposal of planners when thinking about implementing a CDFS. The insight from the visibility of the two fee components could be a catalyst for a valuable conversation between planner and client. This distinction in fees perhaps highlights, and potentially quantifies, what some clients might perceive as the overpayment of advisors in a single AUM model. Alternatively, it could provide an opportunity for advisors to demonstrate their value above and beyond an IM function.

There are some additional observations that emerge upon further examination of Table 4. While the CDFS we illustrate necessarily results in a lower Year 2 fee for the CDFS, this is true only when NW is equal to IM. As expected, line 1 is approximately equal to line 12 in this case, while line 4 is substantially *less than* line 13 for columns 1, 4, and 7. In contrast, the relationship changes when the ratio of NW to IM is greater than one. When NW is greater than IM—that is, the portfolio consists of more than just stocks and bonds (AUM including mutual funds and ETFs)—fees at the end of Year 1 will no longer be

approximately the same due to the fact the planning fee (θ) is based on the client's NW, which includes assets not included in the IM portfolio (where IM and single AUM fees are charged). Consider the nature of the fees across the NW to IM spectrum for each Client A. Now the total fee (revenue) in Year 1 is *greater* under the CDFS than in the single AUM model. Line 1 is greater than line 12 in column 3. These observations hold across each of the other client types.

The behavior of lifetime fees when comparing various clients are another result worth analyzing. Some planners might consider the 50% discount to Year 2 and beyond NW fees as an excessive "penalty" for still having to conduct the implementation, monitoring, and recommendation functions. Again, looking at Client A—as the observations hold for the others as well—we can compare the lifetime fees between the CDFS (line 7) and AUM (line 14). Although the CDFS fee is initially larger than the AUM fee for Year 1 and then smaller for Year 2 as described above, over the 40-year investing lifetime of these particular clients, the overall CDFS fees outpace the AUM fees. Specifically, under the CDFS approach, the NW fees (line 8) increase while IM fees (line 9) decrease as the initial net worth is composed more of non-investable assets and less of stocks/bonds. Additionally, under our construct the annual fees are taken from IM (i.e., stocks/bonds) under the CDFS model, which obviously reduces their compounded value over time, generating even lower IM fees than they would if other asset classes were sold to support the fees. Thus, we find that the value of financial advice, as represented by the NW fee in line 8, increases as the proportion of IM decreases in an otherwise common-sized portfolio. This result is appropriate if one believes that the financial planning demands are higher for portfolios consisting of assets beyond stocks and bonds.

It is also insightful that for these various clients, implementing a CDFS approach in the long-run generates comparable or even increased lifetime (nominal) fees relative to an AUM only approach, despite the fact that the IM are markedly different for the latter two clients in each of our client profile categories A, B, and C. In other words, accounting for all components of NW and conducting holistic financial planning based on these components can jointly generate comparable lifetime fees even when charging market competitive IM-only fees and implementing a planning fee schedule that recognizes the reduced level of effort after creating the initial plan. Thus, despite the almost-countless possibilities for establishing an appropriate θ fee schedule, we demonstrate a simple example that could hold in a competitive market environment.

To make a caveat or limitation abundantly clear, the lifetime fee levels presented in Table 4 are reliant upon the various asset classes' performance, which we simulate 10,000 times using the JPM market assumptions (see Table 2). Under these assumptions, the additional value of a portfolio that includes real estate and private equity becomes apparent. The difference in ending portfolio values (line 10) is stark for Client A1 (stock/bond only) and Client A3 (stock/bond/real estate/private equity). The former generates an ending portfolio worth $3.3 million net of fees versus $7.1 million for the latter. While we did not plan for or anticipate this result in designing this analysis, it is worthwhile noting the value of diversification is substantial under the return forecasts from JPM. Additionally, our simple rebalancing assumptions for stocks and bonds coupled with the no rebalancing approach to real estate and private equity obviate some of the benefits of planning that could occur with more

sophisticated approaches (e.g., see Blanchett and Kaplan, 2013), for examples of these benefits, or gamma).

Clearly planners and firms could, and should, examine adjusting all the "levers" introduced here that are suitable for their practice: different fee levels, breakpoints, and subsequent reduction of planning or NW fee component after Year 1. However, assuming similar regressive fee structures and market competition deterring any significant deviations from relatively comparable advising and IM pricing, the general results from our analysis should hold for more complex fee structures.

5. Implications for planners

The analysis of the proposed CDFS in lieu of a single AUM fee structure can prove valuable for financial advisors and clients alike. Advisors only performing IM functions under the single AUM model are getting pressure to compress their fees today with the advent of robo-advisors. This trend has led traditional asset managers to expand their services to include more holistic and customized financial planning services, often to justify their fees. The CDFS provides an avenue for advisors to price the financial planning effort separately from the investment management function, effectively solving the problem of how to structure θ fairly. Such an approach provides greater transparency and could allow clients to hold advisors more accountable for planning support likely obfuscated by the single, fee-only AUM models found at most RIA firms (Mazzoli and Nicolini 2010). Should advisors maintain some reduction of the planning fee component of the CDFS, planners could show that there is indeed a non-linear effort associated with the initial onboarding and financial planning function. Moreover, such a dual fee structure might provide two additional benefits to planners and clients. First, it allows for the planning services to be priced, and more importantly, charged separately from any IM fee allowing for a framework to charge for services—*even when assets are not moved to the advisor for management*, or what Kitces (2013) suggests could be growing the "slice of the pic". Secondly, the CDFS allows for some level of financial planning complexity by more adequately compensating advisors when financial planning efforts are based on NW and not solely AUM.

A further benefit of this framework is that a CDFS could potentially reduce the conflict of interest, or at least can reduce the immediate sense of urgency faced by many advisors, to increase AUM. For example, a prudent recommendation might be for a client to use investments assets to pay down a mortgage. However, a fee-only planner might be disinclined to make such a recommendation as the planner's compensation would be reduced. In contrast, a planner using a form of the CDFS could make the recommendation knowing that any reduction in compensation due to the reduction in AUM would be offset by the presence of a planning fee associated with the client's NW. Thus, the planner is not forced to choose between maintaining compensation (AUM-only) or providing sound financial advice. Again, the CDFS provides a mechanism to be compensated *separately* for financial planning, and that such an effort is based on an essential fundamental characteristic of planning, notably understanding the NW of the client.

Implementation of a CDFS is not without its challenges. First, establishing a client's net worth, or at least the net worth used as a base for fees, is never as straightforward as it might appear. The decision to exclude certain assets, or even to value assets where there is little liquidity, is difficult.[6] However, we suggest the value of these required initial and in-depth conversations with clients will only result in a stronger planner-client relationship as well as a more holistic and effective financial plan. Second, the challenge of θ. Setting the appropriate net worth and asset breakpoint levels for each fee schedule, and the associated fees charged at each level, will need to be determined. Those in this paper, while realistic, are admittedly a basic example for illustration purposes. While challenging to set them perfectly, it is essential for an advisor/firm to analyze what makes sense for their practice. It can only be beneficial for the firm to fully investigate the investment management (or AUM) cost within their own firm. Such an exercise will help them price their investment management operations appropriately, and such an exercise can lead to competitive—yet hopefully profitable—breakpoints and fees. The firm can then in turn move to assessing the scope and magnitude of their broader financial planning services and fees. If, and to what level, a planning fee might be reduced would also need to be accomplished. Here again, this approach, and the accompanying conversation with clients, might make an advisor more attractive to potential clients.

When a client does choose to move assets to the planner, the firm could charge a single, blended fee to ease in operationalizing the concept. The mere discussion of the component aspects will improve client-planner communication. For firms in which financial planning is their comparative advantage over investment management, the CDFS provides a viable option to provide and market those services as a standalone alternative. We also suggest the introduction of a CDFS can lead to new research opportunities. Specifically, researchers can look to better set, and perhaps optimize, both the level and breakpoints of the CDFS schedule. These two variables are just two of the levers available to planners. So, too, more research will be needed to determine what might be the appropriate reduction in the NW component fee after the first year, or initial onboarding of a client. Finally, it will be important to determine whether, and how, a CDFS might change given different client profiles (the ratio of NW to IM) beyond the nine illustrated in this introductory model. We leave these efforts for further research.

There is a myriad of compensation structures available for financial planners, and certainly no one compensation scheme is best for all situations. However, we posit that a composite, dual fee structure like that proposed here is worth investigating by all advisors/firms who perform holistic financial planning services over and above investment management services. Such an examination would provide more transparency to clients, more appropriate pricing for services provided, and perhaps even reduce conflicts of interest. We find that under reasonable return assumptions, such a fee structure can result in comparable fees and portfolio impacts as the pervasive AUM structure. All these outcomes would improve the nature of the fiduciary relationship. Perhaps such an effort can improve on the awareness of the nearly 20% of clients identified by Cheng and Kalenkoski (2018) who have no idea what for what services or advice they are paying. The benefits of pursuing such an approach likely far outweigh the costs, for planners and clients alike.

Notes

1　We use the term *financial planning* in lieu of financial advice to distinguish when advice might be provided incidental to the sale of a product.

2　In this analysis θ reduces to $\theta/2$ for each year after the initial planning activities occur.

3　Annual advisor and trading fees are paid from stock and bond (IA) asset returns. In sum, at the end of each year of analysis, either stocks or bonds are relatively overweight. IM fees are paid from the overweight asset, and then the necessary remainder is sold and used to purchase the underweight asset to bring the stock-bond asset mix back to its original weighting scheme. Transactions or trading fees are assessed at 9.95×2 for a roundtrip buy-sell transaction. The remaining portion of the NW portfolio is assumed to grow at the appropriately weighted rate of private equity and real estate.

4　These mean values become even more aligned between the simulation and target values over our 20- and 40-year time periods discussed later in the study. Based on the numerical similarity between the simulated and target measures (return, risk, and pairwise correlations), we are confident the simulated returns sufficiently represent the potential future returns based on the 2020 JPM Capital Market Assumptions.

5　We depict only mean values for parsimony purposes. All distributional data are available upon request.

6　This analysis assumes planners would assess negative equity assets (e.g., a home that is underwater) as having a zero value for net worth.

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