Is the Hourly Fee Model Ready for Its Close-Up?

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Relatively few advisors charge by the hour, but the idea is starting to gain appeal.

How much is financial advice worth? Perhaps less than what most advisors charge, according to a small but growing band of financial planners who advocate on behalf of the hourly fee model.

What may sound compelling in theory, however, is a long way from swaying the masses. The business of financial planning and investment management still favors charging clients based on assets under management (AUM) and commissions—a dominance that's unlikely to fade any time soon.

"Most advisors aren't interested in [charging by the hour] because the fees are larger with AUM," says Dan Sondhelm of Sondhelm Partners, an Alexandria, Va. marketing consultancy that's focused on the asset management industry.

Yet there's a growing awareness of alternative compensation models—among advisors and, perhaps more importantly, in the public sphere. You can credit (or blame) the Internet for a greater appreciation of how hourly financial planning and investment advisory services compare with the standard fee schedules.

Allan Roth of Wealth Logic, an hourly fee-only based investment advisory and financial planning consultancy in Colorado Springs, Colo., thinks the growing interest in the fee-for-service model reflects the public's rising skepticism generally. "People are becoming more distrustful."

Perhaps, but AUM remains the clear favorite, and for an obvious reason.

"AUM is a great business model, says Bill Nickles of Yellow Dog Financial in Bolton, Mass. "It's easy to scale and fees rise as the market rises."

But for some advisors, transitioning to a fee-for-service structure has become compelling. "For new clients, [charging by the hour is] all I'll do," Nickles notes. "I have existing clients on the traditional AUM model, but I plan to transition them to a flat fee or monthly retainer by the first quarter of 2020."

Rick Ferry is another financial advisor who's recently jumped on the hourly fee wagon. After a career that began at a brokerage house, followed by a successful launch of an indexing-based advisory shop (which he recently sold), Ferry opened a new consulting service offering financial planning advice exclusively on an hourly basis. From a client's perspective, the hourly fee model offers "the cleanest way to get closest to objective advice," he says.

The advisor's burden

It's unclear if a rising tide of advisors are embracing hourly fees, but anecdotal evidence suggests that the concept is gaining traction. For advocates, the rationale includes bragging rights that there are fewer conflicts of interest with hourly fees versus AUM or commission-based models. Advisors who still use AUM and commissions are quick to disagree, of course, but planners who've made the switch see this as an open-and-shut case in favor of charging by the hour.

For clients, the advantage is obvious: lower costs. Or at least for clients with relatively uncomplicated portfolios and financial-planning issues that are easily resolved.

Whatever the merits, charging by the hour is a burden for advisors in terms of the opportunity cost. "You're going to make way less [as a planner]," says Randy Bruns, founder of Model Wealth in Naperville, Ill. Nonetheless, "our primary business charges for hourly advice." The key reason, he explains, is fewer conflicts. By contrast, the standard AUM arrangement is misguided at best, Bruns opines, contending that charging $30,000 a year on a $3 million portfolio (a 1% AUM fee) is difficult to defend.

As you'd expect, several hourly fee-based advisors who spoke to Horsesmouth are quick to agree. There are many more using an AUM- and/or commission-based template who beg to differ. Measured by where client assets are housed, AUM and commission shops have won the debate, at least for now.

From an intellectual perspective, however, the hourly folks offer a compelling argument and as their views find a wider audience, the movement to "go hourly" may continue to gain traction, albeit from a very low base.

By some accounts, the tide is turning, albeit gradually. Supported by the public's increasing recognition that AUM has a higher price tag over time, a small but dedicated band of hourly fee proponents are keen to suggest that the writing's on the wall.

"I think AUM is dying a slow death," predicts Bruns.

Sheryl Garrett, a former planner who now oversees the Garrett Planning Network, an association advocating and supporting advisors in the hourly fee camp, agrees. "Assets under management is moving out of favor" as a business model for planners, she says, although "I've been saying this for 20 years," she admits.

It's all about incentives

AUM is probably here to stay, notwithstanding the predictions of its demise from some corners. Yet it's striking that a quick Google search turns up a healthy list of advisors charging by the hour. When you talk to these folks and ask why they're willing to adopt a business model that's virtually guaranteed to generate a substantially lesser revenue stream vs. AUM, a common theme emerges: it's the right thing to do.

Many advisors who consult on an hourly basis assert that AUM- and commission-based models create disincentives to analyze client assets that are walled off from a planner—a 401(k) account at a client's employer, for example. With no opportunity to generate revenue from such asset pools, some advisors may be inclined to overlook or even ignore these investments.

"The beauty of our model is that we look at all of a client's assets," says Mark Berg, founder of Timothy Financial Counsel in Wheaton, Ill., one of the largest hourly fee-based financial shops in the country.

Wealth Logic's Roth tells Horsesmouth that there are "far more conflicts in the AUM model" compared with a fee-for-service model that charges only for time spent on a project.

Model Wealth's Bruns relates a story that he says illustrates AUM's conflict. In 2016, he crossed paths with an AT&T retiree, who said he had met with four AUM-based advisors for guidance on a strategic financial decision—accept a sizable lump-sum payment for a pension or let the retirement plan run as is, which would make payments for the rest of his life. All four advisors recommended taking the payment, including one planner who encouraged purchasing an annuity with the proceeds.

Bruns argues that the recommendations were likely influenced by the business models behind the advisors. That is, if the client took the proceeds and let one of the advisor's manage the money, there would be a new recurring revenue stream for the planner.

By contrast, "we determined that the retiree should keep his pension," Bruns says.

Ferry cuts to the chase and claims that it's all cut and dried in terms of incentives and the implications for finding impartial advice. "If an advisor is tying his income to your assets and what you buy, he won't be recommending the same stuff I do."

Still waiting for the revolution

Casual observation may suggest that the ranks of hourly advisors are rising, but that's not supported in data from The National Association of Personal Financial Advisors (NAPFA), a professional organization for fee-only advisors. The group's membership in this niche has remained stable recently, says Geoffrey Brown, NAPFA's CEO. Slightly less than 22% of NAPFA advisors (totaling about 3,800) offer some form of hourly planning, he notes, but this percentage has been "pretty consistent" through time.

Meanwhile, AUM remains the "leading" business model for NAPFA advisors, he notes. Nonetheless, Brown says some advisors see themselves in the professional services mold à la lawyers and CPAs, and so they charge by the hour.

The biggest knock on hourly fees among advisors is the uphill battle of earning a living in the niche, which is widely seen as far tougher compared with AUM. But Timothy Financial's Berg counters that his firm, founded in 2000, proves the opposite.

"They say you can't make a living with hourly fees, but it is possible," he explains, citing Timothy Financial as a leading example. "We just hired our ninth employee and we feel like we pay well."

He also reports that Timothy Financial has roughly 600 clients, and the firm is adding 60–80 new clients a year. "We hope to get as many as possible on a recurring basis," although some only need a one-time visit. "We're happy to do that, but the most value [we can offer] is with a recurring relationship."

The one red line for Berg: giving hourly investment advice as a standalone topic. "We need to understand cash flow, taxes" and other aspects of a client's financial profile, which informs asset allocation and investment recommendations and broader financial planning topics.

One of the more intriguing aspects of Timothy Financial's business operations is offering six fee models for clients, ranging from a basic consulting service that's priced at $1,200–$4,300 (a $220 hourly rate) up through the "Level Four" package ($7000–$11,200 or $280 an hour) for moderate-to-high complexity. The most comprehensive advice package is "Level Five," which is reserved for highly complex accounts and starts at $11,000 for 40 or more hours of consulting.

AUM alternatives beyond hourly

The hourly model has its fans, but it's not the only game in town for alternatives to AUM and commissions. A close relative to hourly is the subscription-based model for financial advice, which is also attracting more attention these days. Interest in this twist on fees recently got a boost when Charles Schwab & Co. recently rolled out Schwab Intelligent Portfolios Premium, which charges an initial $300 for a session on planning, followed by a $30 monthly fee for portfolio management through its robo-advisor platform. Subscribers can also tap into Schwab's network of financial planners on an as-needed basis.

"What drove our interest was the increasing prevalence of subscriptions in other industries," Tobin McDaniel, Schwab's senior vice president of digital advice and innovation, recently told *Fortune*. "People like the simpler approach, and feel it's the right way to pay for services."

Advisors generally appear to be responding to this attitude adjustment, notes Michael Kitces, partner and director of wealth management at Pinnacle Advisory Group. Citing research from earlier this year, he reports via email "a huge uptick in retainer-fee-style solutions (e.g., monthly subscription fees, quarterly or annual retainer fees) for financial planning." Hourly planning services, by contrast, are more or less stable among advisors, he adds, which aligns with NAPFA's data.

"Ultimately, 'hourly' is still a transactional business model, and the more comprehensive and holistic advisors become, the more they tend to want to use relationship-based compensation models," Kitces explains. "Monthly subscription or annual retainer-fee models thus are becoming more popular more quickly, because they're still ongoing-relationship recurring-revenue fee models."

Has AUM peaked?

The key takeaway is that the alternatives to AUM, in their various forms, are finding an audience among advisors and the public.

Rick Ferry thinks that the democratization of information is a big part of the reason. "Information is much more readily available," including resources for finding "advice-only" advisors via Harry Sit's consultancy (adviceonlyfinancial.com)—a service that's attracted widespread media attention, including from *Forbes*, *USA Today* and MarketWatch.com.

The do-it-yourself (DIY) investor has become more sophisticated over the past decade or so, thanks to the Internet, Ferry notes. "That makes hourly more attractive," although he says that even DIYers are "still looking for confirmation and validation."

Whatever the reason, Ferry says he regularly hears investors say that they fired their advisor because they no longer want to pay an ongoing fee. They don't see the value and are looking for more simplicity. "Some advisors make portfolios more complex for job security," an observation that's "resonating with the public." It's also the reason "why I have a long waiting list of clients."

Does this mark a turning point? Has AUM peaked? Maybe, but old and successful business model die hard, or at least fade slowly.

In any case, Ferry argues that the case for hourly fees is clear. “It comes the closest to the fiduciary standard…other than *pro bono* counsel.”

Although minds will continue to differ on the merits, advisors in this corner think the time is ripe for disruption, if only on the margins.

“I think more wealthy people will catch on” to the allure of charging by the hourly for financial advice, predicts Bill Nickles.

If he’s right, a quiet revolution may be simmering in the financial planning industry.

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