

Advice: New Guide on Costs Analysis

## How to Cut a Big Portion of Your Wealth Management Cost

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With rather simple measures clients of wealth managers can reduce their costs of wealth management significantly. This is a main result of the new MyPrivateBanking.com guide [“Cut the Costs of Wealth Management”](#).

However, because of lack of knowledge or inattention the majority of clients do not fully explore them. All it needs is an increased awareness of the significance of costs, the various direct and indirect cost drivers and

the levers on how to reduce costs without hurting performance.

Hidden Costs come in many products and transactions

To be able to reduce the cost a client has to understand the costs drivers and pricing models. However the pricing models offered by most wealth managers are normally intransparent and only report the direct costs either as a “flat-fee”, “transaction fee” or “performance fee”. Many clients are not aware of various indirect costs, hidden in many products and as well transactions, easily doubling the direct costs of managing a portfolio.

Widely used vehicles to hide costs are funds and structured products:

- Mutual funds are often recommended inspite Exchange Traded Funds (ETFs) are available for the same investment class, delivering the same or better performance and costing less than a third.

- Hedge funds and even more “funds of hedge funds” do not only give a lot of freedom in investment decisions, but also for calculating costs. They often charge hefty performance fees on top of their annual management fees, pushing the yearly costs to 5% and more per year.
- Structured products such as Multi-Bonus- or Guarantee-Certificates got very popular with wealth managers. However, it is very difficult to the outsider to calculate the costs and even simple structured products have costs in the range of 2%-3% per year.

Extra costs are not only generated by the choice of investment products but also through the process of portfolio management. In a pricing model based on transaction-fees a higher-churn of the portfolio generates extra costs and often not all transactions are required respectively beneficial to the investor.

Kickbacks – the way to pay a wealth manager twice.

Clients pay indirectly for various hidden costs charged by product issuers and banks. However, these actually give back a huge chunk to the wealth managers as a reward for “encouraging” investors to choose their products.

Consequently, besides their role to advise their clients on investment decisions, wealth managers often develop a second, often conflicting role, and source of income: selling bank services and investment products. And for performing these sales functions, wealth managers receive kickbacks.

- Kickbacks by banks are in particular relevant for independent wealth managers who do not work for a bank. Often, they can choose the bank for their client, and banks are willing to provide incentives to the wealth manager through kickbacks on the transaction-fees. Overall, these kickbacks to the wealth manager can make up to 50% of what the client pays to the bank.
- Kickbacks by product issuers: A multitude of financial products are competing for investors. Product issuers depend on the recommendation of wealth managers to their clients and reward them through kickbacks. Normally, 90% to 100% of the front load paid for investing in a mutual fund and up to 50% of the management fee a client pays the wealth manager goes back to the wealth manager.

Over the course of the last few years an increasing number of clients demands more transparency from their wealth managers. Since self-regulation obviously has not

worked, laws and courts have increasingly stepped in to end the practice of kickbacks, or at least make them transparent to the clients.

## Simple steps to reduce the total costs of wealth management

Clients should not pay more than 1% per year of their total assets for wealth management. They can take control over costs by rather simple measures:

- Choosing a strategy and wealth manager best for the respective investment type and amount.
- Pushing the wealth manager for full transparency, the use of cost-effective products, and full disclosure and payback of all kickbacks and commissions.
- Choosing a price-competitive wealth manager by meeting various wealth managers, assessing their competence and requesting an offer.
- Opting out of all services provided by the wealth manager that are not required, or you can be done somewhere else at a cheaper rate.

Finally, and very important: Clients should negotiate. There is plenty of room for fee reductions. Clients should educate themselves about the market and communicate precise and determined their requirements; and within minutes they can save a lot of money.