

## That an ETF is commission-free doesn't make it cheaper, advisers say

Total expense is more of an issue as trading costs fall after Schwab move

By **David Hoffman**  
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Commission-free ETFs are good, but they may not be best.

That's the opinion of a sampling of financial advisers, who generally praised Fidelity Investments' move last week to offer free trading in 25 iShares exchange-traded funds to its retail and registered investment adviser clients.

Advisers said the move toward free ETF trading — ushered in by The Charles Schwab Corp. in November when it launched a proprietary line of exchange-traded funds — may obscure the overall cost of owning ETFs, which can vary widely even when trading costs nothing.

"Many investors will only see the word 'free' and assume it's a good deal," said Armond Dinverno, a financial adviser and co-president of Balasa Dinverno Foltz LLC, which manages more than \$1.5 billion in assets. "Eliminating commissions doesn't guarantee that a commission-free ETF ends up being any cheaper than other ETFs."

Another problem, according to Mr. Dinverno, is the temptation for investors to trade recklessly if they don't have to pay commissions.

"While I'm not saying it's wrong to have commission-free ETFs, free says you can go in and out whenever you want — and I'm not sure that's a good thing for the investor," he said.

"The word 'free' gets everyone excited," said Rand Spero, president of Street Smart Financial LLC, an advisory firm with \$23 million under management. But he said that it can be misleading when it comes to ETFs, because higher expense ratios can offset zero trading costs.

For example, the iShares ETFs that Fidelity is offering commission-free have higher expense ratios than their competitors. The \$40.2 billion iShares Emerging Markets Index ETF (EEM) has a total expense ratio of 0.72%, while expenses at the equivalent \$33.9 billion Vanguard Emerging Markets Stock ETF (VWO), from The Vanguard Group Inc., are 0.27%.

"Vanguard's substantially lower expense ratios will outweigh the transaction cost in most instances, except in the case of small purchases," said Kirk Kinder, owner of Picket Fence Financial LLC, a three-year-old advisory

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firm with \$15 million under management.

"Vanguard products also tend to have a stronger correlation to the index and less drift ... because they hold more positions than the iShares offerings," Mr. Kinder said.

Fidelity, which offers the Nasdaq Composite Index Tracking Stock Fund (ONEQ) as part of its commission-free lineup, believes that its offerings provide superior value.



*Kathleen Murphy: "Fidelity has partnered with the leading ETF provider."*

"Fidelity has partnered with the leading ETF provider in the market to bring investors the best brokerage offering in the industry today," Kathleen A. Murphy, president of personal investing at Fidelity Investments, said in a statement. "Simply put, we're offering the broadest selection of commission-free ETFs from the undisputed ETF leader, and it's only available through Fidelity."

"Just because you can buy something without a commission doesn't mean you are getting the best deal," said George U. "Gus" Sauter, managing director and chief investment officer at Vanguard, who believes that advisers will take all factors into consideration when deciding which ETF to select.

iShares is the largest ETF provider, with \$372.3 billion in assets at the end of 2009, followed by State Street Global Advisors (\$188.4 billion) and Vanguard (\$91.4 billion). Together, the three controlled more than 84% of ETF assets at the end of last year.

Schwab's eight ETFs now have about \$345 million in assets.

Given the momentum of the ETF market leader, the commission-free trading in iShares offered through Fidelity may make it more difficult for other ETF providers to gain traction. And that's not good for investors, according to Lloyd Raines, a financial consultant with RBC Wealth Management.

"I believe in the level playing field," Mr. Raines said. "Based on the totality of circumstances, people should be able to choose from what appears to be best. They shouldn't be influenced by differences in compensation."

Fidelity's decision to use iShares in its program also irked other ETF providers.

"Why not us?" asked Sean O'Hara, president of RevenueShares Investor Services, an ETF provider which had \$314 million in assets in six ETFs at the end of last year.

But having said that, he doesn't think Fidelity's decision will harm his firm.

"The bulk of our business at this point is still done through advisers," Mr. O'Hara said. "I think they are going to pick the ETF that's best for their clients. Not having to pay a \$7 commission won't drive them one way or the other."

As part of its ETF pricing announcement, Fidelity also said it has reduced its online U.S. equity trade commissions to \$7.95 for all of its customers, regardless of trading level. That drops the cost of trading at Fidelity below that of its chief rivals.

Schwab lowered its commission charge to \$8.95 about five weeks ago, TD Ameritrade Holding Corp. currently charges \$9.99, and E\*Trade Financial Corp. charges \$7.99 to \$12.99, depending on a customer's assets and

trading frequency.

Fred Tomczyk, chief executive at discounter TD Ameritrade, said Fidelity's move doesn't necessarily mean that his firm will counter the zero-commission ETF offer — or even lower commissions at all.

Speaking at the Morgan Stanley U.S. Financials Conference in New York last week, Mr. Tomczyk said most of the active traders on whom TD Ameritrade focuses in the retail market care more about service, technology and trading features than about saving a few dollars per trade.

That's why Schwab's offering its ETF to its customers commission-free and lowering trading commissions across the board have not affected TD Ameritrade's business, Mr. Tomczyk said.

"We see no reason to make a move at this point," he said.

Executives from E\*Trade did not immediately return phone calls.

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