Perspectives

10 Questions to Ask Before Choosing a Financial Advisor

By Melissa Rudy and Jim Dowd | Posted: 05-25-10 | 09:44 AM | E-mail Article

The recent financial crisis has served as a wake-up call for many consumers, prompting them to learn more about their finances and investments. Whether you need guidance on developing a new investment plan or just want a fresh perspective on your current financial situation, enlisting the services of a professional financial advisor is an important step toward protecting and growing your investment assets.

There are scores of financial planners available to help, but how do you know you are getting quality advice at a reasonable price? And more importantly, how do you know who you can trust with your sensitive information?

Choosing a financial planner is a major decision, and the most important tool in your search is information. The Certified Financial Planner Board of Standards has published a list of 10 questions to ask when evaluating advisors. We have expanded upon them to help you through the interview process. Carefully consider the advisor’s answers to ensure that their approach and offerings are a good match for your short-term needs and long-term goals:

1. What experience do you have in financial planning and investment management?
This may seem like a very basic question, and it is, but it is also one of the most important. By asking wealth management providers to describe their experience--how long they have worked in the field, what companies they have worked for, what kind of financial advice they have provided and to whom--you will learn a great deal about their expertise, style of financial planning, and level of involvement with each account.

Be sure to ask about the type of clients they serve and the average account size, as this will help determine if you fall into their primary category. Also find out how many clients they work with--a high number may be a warning sign that your account will not receive the time and attention it deserves.

2. What are your qualifications and professional credentials?
Degrees and professional certifications do not tell the whole story, but they attest to the amount of time and effort a person has invested in his or her career. You would not take your sick child to see a doctor without a medical degree, so why entrust your assets to someone with only a three-month certificate course in financial planning?

There is a wide range of qualifications available to financial advisors, from a three-month crash course to a full profile of financial and accounting degrees and advanced certifications. Whether your prospective advisor is a FINRA-registered broker-dealer representative or a Registered Investment Advisor who holds the Chartered Financial Analyst designation, you should understand what the certifications mean. Determine what level of education and experience is required, whether continuing education is encouraged or mandated, and whether the organization providing the credential requires members to take an oath or otherwise commit to uphold ethical standards.

For example, the CFA Institute, which confers the Chartered Financial Analyst designation, requires all members to annually certify their compliance with the CFA Code of Ethics and Standards of Professional Conduct, widely regarded as a model for the investment profession. If an advisor is FINRA-registered, there is a good chance that fees and commissions will be embedded in products included in portfolio recommendations.

By understanding the details, you will be better equipped to ascertain that the advisor actually holds the claimed certifications or licenses. Avoid any advisor who exaggerates or fabricates their professional qualifications.

You may also want to ask about a planner's ultimate credentials: their own financial situation. If advisors are put off by questions about their own net worth, it may be a red flag that their own portfolios are not performing well, in which case they are probably not the best candidates to handle your money.

3. What is the full range of services do you offer, and what is your specialty?
This should be an easy question for any professional financial planner to answer, and it is one of the most blatantly obvious in identifying whether a prospective advisor is a good match for your needs. Depending on their credentials and education, a financial professional may (or may not) be licensed to sell investments, offer detailed advice on many or all aspects of financial planning, and/or advise you on tax or estate planning issues.

Are you looking for someone to help you buy and sell securities, provide ongoing management of your investment portfolio, or give general financial advice? If you are seeking guidance on a broad range of economic planning strategies and opportunities, an investment manager probably will not have the required depth and breadth of knowledge. If you need an investment planner who can advise you on real estate opportunities as well as stock and mutual fund investments, you will need to find someone with that specialized skill set. Finally, if an advisor purports to offer services for which he or she is not properly licensed, you should look elsewhere for help.

4. What is your approach to financial planning and investment management?
Every financial advisor will have a unique approach to planning, managing, and investing. Ideally, the professional you choose should be able to adapt to the type and style of investing that fits your comfort level, but many have a preferred method of managing clients' accounts--whether that is via active managers, passive funds, an

approved list, or preferred investment types. If a manager uses individual securities or actively managed funds, ask to see a record of their performance compared to passive index funds, and then use this information to assess their recent investment success.

It is in your best interest to choose an advisor who is willing to learn about your investment goals, your level of risk tolerance, your time horizon, and the liquidity you need from your investments. If a financial planner seems too aggressive or too cautious with your funds, address your concerns immediately; if things do not improve, you may want to change advisors. The same is true if they seem uncomfortable or unwilling to explain their investment strategy. Poor communication is another red flag, as your advisor should be able and willing to clearly explain each step in their process.

5. Who will be working with me?
Many investment and financial planning firms employ a number of professionals, and unless you ask, it is impossible to know whether your account will be managed by one person or several. You should understand how the firm operates and their overall track record, as well as the credentials of the individuals you will be directly working with.

If there is a functional division of responsibilities, such as one person who deals with planning and another who handles implementation, it is a good idea to meet each person before you enter into a long-term relationship. You should also should ask about the turnover rate and the tenure of professionals who will be handling your account. High turnover may be indicative of an underlying problem, and is probably reason enough to continue your search.

Small, independent firms may have fewer people with greater experience, but this is not always the case. It is worth asking for professional references (and following up with them) to learn more about the people you will be trusting to manage your financial future.

6. How much do you charge, and how will I pay for your services? Do you receive any form of direct or indirect compensation from the products you offer?
Financial planning services may be paid for through fees, through commissions on transactions in the account, or by some combination of the two. Broker-dealers typically charge an asset-based management fee based on the total value of your investments. They also collect commissions on the products they sell to you, and there are often embedded fees called “trailers” that are rebated to them by the sponsors of the products.

Fee-only registered investment advisors generally charge a planning fee and an asset-based management fee based on the total value of your investments. The planning fee may be fixed or based on an hourly rate-including the time they spend with you in person or on the phone discussing your account--and some advisors will discount or waive it entirely if you agree to keep a certain level of assets with them.

Fee-only services are widely considered a better choice, as commission-based transactions create incentives for brokers to transact more often, but not to perform better. In addition, brokers have an incentive to select investment products that pay higher commissions or have embedded fees. This conflict of interest is inherent in the compensation structure of the brokerage business, and is a source of criticism from investor watchdog groups.

Regulated advisors are required by law to disclose the nature and amount of compensation they receive, and a good advisor will have no difficulty justifying their compensation. Insist that they do so. Plus, it never hurts to ask about available discounts--you may be eligible to receive a better price based on your age, occupation, or membership with a particular organization.

7. What other fees and expenses will I have to pay?
In addition to learning how an advisor charges, you should request a breakdown of other costs that will affect your portfolio returns. Some brokers and planners are more willing or able to talk about costs and expenses. It is important for you to know that your advisor is sensitive to expenses, and having them explained to you in detail is a good way to provide such assurance. Do not hesitate to closely examine the fees charged by underlying mutual fund companies. High costs do not always equate to poor value, but your advisor should be able to articulate clear reasons for selecting particular investments over lower cost alternatives. With investment managers, the old adage "you get what you pay for" does not always hold true.

8. Who, besides me, could benefit from your recommendations?
This question highlights any potential conflicts of interest that may put an advisor in the difficult position of weighing the benefits for your account against his own financial advantage, or the regulations of the company against your instructions and requests. Ask prospective providers if they have an open architecture approach, or if their relationships with insurance firms, securities, or mutual funds could compromise sound management of your account.

In addition to requesting a copy of the firm's code of ethics and conflict of interest policy, it is a good idea to ask whether the advisor would be willing to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct, or some other fiduciary standard. If not, ask them to identify the particular clause that presents a problem. The answer may surprise you, and will surely help in your evaluation.

A fiduciary is legally and ethically obligated to put their clients' interests before their own. If your advisor is not prepared to make such a commitment, you should find out before you enter into a relationship.

9. Have you ever been disciplined by a regulatory agency or professional organization for unlawful or unethical actions in your professional career?

This may be an uncomfortable question to ask, but it can be very revealing in terms of the kinds of problems to watch out for, as well as a financial advisor's honesty and integrity. If you are not reassured by the answer you receive (or even if you are), you can check up on the candidate’s background through FINRA (formerly the NASD), as well as professional organizations like the Certified Financial Planner Board of Standards and CFA Institute.

It is also a good idea to verify that the advisor’s firm is registered with the SEC and/or FINRA before signing on. Fee-only registered investment advisors generally will not be registered with FINRA, which requires membership by broker-dealers but not RIAs. By asking whether a firm is FINRA-registered, you will rule out commission-based advisors; only registered firms are permitted to collect commissions and trailers.

10. Can you put everything in writing?
Last but not least, ensure that everything you have agreed upon in the financial planner's office is included in a written agreement. It is easy for advisors to make sweeping promises, but without a signed corroborating document, there is nothing holding them to their word. A financial planner who is willing to record your expectations in a written agreement is more likely to honor your requests and provide customized service once they are assigned to your account. The document should be comprehensive, covering everything from your investment goals and account management to how often you will receive reports and meet to discuss your portfolio.

Read all of the information that your advisor gives you, especially the disclosure document, sometimes referred to as the Form ADV Part II. This document, along with the Form ADV Part I (which can be accessed online), will tell you a great deal about the advisory firm and help validate the answers to some of your questions. Also request sample client reports, such as a financial plans, portfolio reports, and account statements, and ask to see newsletters or other periodic reports provided to clients.

It is easy to find a dozen financial planners in your local area, but choosing the best advisor for your needs requires patience and persistence. Ultimately, the decision will depend on your financial needs and goals as well as the expertise, personality, and investment strategy of the service provider you are considering. Do not be shy about asking questions--after all, this is a decision that has a large bearing on your money and your future.

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