What to Look for in a Financial Advisor

A financial planner or advisor must be able to provide significant value when helping you achieve your financial goals. Since your understanding of an advisor's process and how it corresponds to serving you is essential to choosing the right advisor, we have created a list of key criteria for you to consider when making that choice. As you interview potential advisors, be sure to ask the following questions to differentiate successful advisors from the rest of the pack.

What professional designation(s) does the advisor have?

The most important distinction to look for when evaluating an advisor is whether or not he or she is a Registered Investment Advisor (RIA). RIAs are legally required to act as fiduciaries, meaning they are obligated to put your interests ahead of their own. For example, imagine there are two similar investments, A and B, that your advisor is considering for your portfolio. Even if A is just slightly better for you, an RIA must recommend it, regardless of any bonus, prize or other compensation he or she might earn by recommending B. In addition, RIAs must disclose all important information to you, including fees charged and conflicts of interest. In short, it is illegal for them to engage in any activity that would serve their interests over yours.

You should also ask if the advisor has an advanced designation such as the Certified Financial Planner™ (CFP®), Certified Investment Management Analyst® (CIMA®) or Certified Financial Consultant® (ChFC®). Having one (or more) of these designations tells you that the advisor has received formal education and training on a wide variety of investment and/or financial planning topics, and has passed an exam that tests their knowledge and skills. Professionals who hold these designations also are required to take continuing education courses to stay current on these issues.

If the advisor does not have one of these certifications, ask how many years he or she has been in the financial services industry, particularly in wealth management or investment management. Even if the advisor *has* earned one of these designations, experience is important. We recommend a minimum of five years experience (and preferably more). If the advisor has not worked through a bear market (the last one was in 2008-2009), you should discuss how he or she would help you to chart a steady course during market downturns.

What is the advisor's compensation structure?

An advisor's compensation structure can tell you a great deal about what your experience working together may be like. There are three basic compensation structures: fee-only, fee-based and commission-based.

- Fee-only advisors are compensated entirely by fees paid to them by their clients, usually structured as a percentage of the assets they manage (often referred to as Assets Under Management, or AUM).
- Fee-based advisors receive the majority of their compensation from client fees, but may also receive commissions on some products (such as life insurance or long-term care policies).
- Commission-based brokers are compensated via commissions generated by buying or selling investment products for their clients.

By working with a fee-only advisor you can feel confident that their interests are aligned with yours, as they are paid for advising you, not for selling you financial products. Fee-only advisors have an incentive to invest your money wisely, since their fees increase as the value of your portfolio increases. Fee-based advisors obtain most of their compensation from fees and thus have similar incentives to a fee-only advisor, but they can earn commissions. This "hybrid" compensation structure can make it difficult to determine when you are being "sold" a product rather than receiving objective investment advice. Commission-based advisors are only compensated when making trades in a client's account, so they have a strong incentive to encourage buying and selling. However, at least you are aware of this and can ask how much commission would be generated if you agree to do the transaction.

Advisors who adopt a clear fiduciary approach to wealth management are typically fee-only. The advice they provide is based on what is in their client's best interest. Their fee is independent of the products they recommend to meet your investing and financial planning needs. With a fee-only (and to an extent, fee-based) structure, you are paying for an advisor's time, knowledge and advice, regardless of how frequently or infrequently transactions take place.

What types of clients does the advisor serve?

Many advisors have a clearly defined clientele. It might be broad-based (for example, "retirees") or highly focused (such as "health care executives"). Having a targeted approach offers two advantages. First, it means the advisor has specific knowledge and expertise in issues common to a certain category of client. Second, it can indicate that you would not be a good fit for that advisor; if so, he or she can probably recommend another advisor better suited to your needs.

Does the advisor have a truly consultative approach?

Perhaps the clearest sign of whether or not an advisor has a consultative approach will occur the first time you meet. A consultative advisor will let you do plenty of talking about what you are looking for, and will ask questions designed to identify what is really important to you and what specific issues you are most concerned about. The best consultative advisors will have a formal process for uncovering those issues.

By contrast, a non-consultative advisor will most likely spend much of your first meeting talking rather than listening. Remember, an advisor's job is to do all he or she can to help you reach your most important goals. If you encounter an advisor who takes little interest in those goals from the start — or asks you just a handful of basic, investment-only questions — chances are that advisor is primarily interested in getting just enough information from you to recommend specific products. He is probably not sufficiently concerned with understanding your personal and financial goals and truly helping you to manage your entire financial future.

Another good indication that an advisor is consultative is that she uses a defined process for meeting with clients on a regular basis. When you interview an advisor, make sure to ask her to spell out her approach for working with clients, including how she schedules regular meetings, then decide if her answers indicate a consultative approach.

Does the advisor "sell" performance?

When interviewing an advisor, pay close attention when he discusses his investment methodology. Does he highlight how he has beaten the market lately, or emphasize his ability to generate huge returns through a "specialized" or "proprietary" approach? If so, be wary. Market-beating returns are usually accompanied by levels of risk that might not be right for you, and the promise of consistent market-beating returns (or suggestions along those lines) is a red flag. Decades of research show that accurately predicting winning and losing investments, asset classes and/or markets year after year is extremely difficult — nearly impossible, really. An advisor who sells performance as the primary reason to work with him is likely to continually buy and sell products in your portfolio, instead of focusing on your overall financial goals.

Over the years, we have often witnessed this "performance-selling" as the markets move up and down or go through periods of heightened volatility. Many advisors today like to talk about the ability to offer "downside protection" and "alternative" techniques that will get clients in and out of the markets at just the right times. We think this is simply market timing disguised as risk management. You may "win" in certain limited periods using these approaches, but the greater likelihood is that over the long-run, you will lose. If you believe (as we do) that the most prudent investment approach is to try to capture market rates of return, it clearly makes sense to work with an advisor who is aligned with your thinking and investment philosophy.

Does the advisor have a clean record?

You can research an advisor's compliance record to see if he or she has ever been censured or has received client complaints via BrokerCheck, available on the Financial Industry Regulatory Authority's website at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck. This site only covers advisors who work with a broker dealer. For independent advisors, see the Investment Adviser Public Disclosure website (IAPD) at http://www.adviserinfo.sec.gov. If an advisor does have any complaints or enforcement actions on his record, ask the advisor for details about the situation to help you decide whether or not you should consider working with him or her.

Does the advisor work with other professionals to solve your biggest concerns?

As we've noted before, the full range of your wealth management concerns are diverse and complex. To effectively address them, an advisor needs to bring various types of expertise and skilled resources to the process. In rare cases, an advisor may possess all of the skills needed to build and maintain a comprehensive wealth management plan. Typically, however, your advisor will need to coordinate the efforts of a team of trusted professionals —including a CPA, an estate-planning attorney and an insurance specialist — to create truly comprehensive solutions.

What tools does the advisor use to maintain your wealth management plan?

Think about all the moving parts of a wealth management plan, not to mention changes that occur in your life. Clearly, such a plan cannot be created once and put in a drawer. It needs to be monitored, reviewed and updated on a regular basis. That's why you need to know what tools and criteria an advisor uses to maintain clients' plans and keep them current. The advisor should be taking advantage of technology such as financial planning software. You will also want to see that the advisor has a systematic, disciplined method for reviewing clients' objectives and risk tolerance, and for rebalancing portfolios according to a targeted asset allocation.

Finally, ask if the advisor creates an Investment Policy Statement (IPS) for each client. An IPS should detail all the key components of your investment plan. Among other things, an IPS should require that you specify your goals and expectations regarding investing, and how you will determine whether or not your portfolio is doing well. Because of its ability to help keep investors on track, we believe an IPS is absolutely crucial for every investor. We also believe a Statement of Investment Selection is important to clarify the types of investments that you, the client, would be comfortable including in your portfolio, and specifying those that you would not want to include.

We hope this has been a useful review of important factors in choosing a financial advisor. We welcome your comments and questions!