How Should You Pick a Financial Advisor?

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Picking the right financial advisor is not easy. The investment management business is notoriously opaque, and advisors' recommendations often come with hidden conflicts of interest. As a result, many people find the whole advisor selection process challenging. For those of you who might soon be looking to engage a financial advisor, here are some guidelines for picking the right advisor for your needs.

Hire a Fiduciary

An advisor operating under a fiduciary standard has to work in the best interests of his or her clients. This means that the advisor must put the clients' interests ahead of their own at all times. Only registered investment advisors (RIAs) have a fiduciary duty, and, hard as it is to believe, most broker-advisors from large brokerage houses are not RIAs. Brokers only are obliged to ensure investments they offer to clients are "suitable," and they can legally place their own interests or the interests of their firm ahead of their clients.

Both Congress and the Securities and Exchange Commission are considering fixing this problem, even though brokerage firms are lobbying hard to maintain their exception to the fiduciary standard. However, until a universal fiduciary standard is in effect, the best course of action is to ask prospective advisors whether they are legally obligated to act as a fiduciary, and to ask for it in writing.

Hire Real Expertise

At its core, much of the financial services industry is still a still a sales business, and the large brokerage firms hire, train and compensate financial advisors based on their sales ability. The vast majority of advisors are well-practiced at this craft, and to the untrained and inexperienced eye, they may sound terrific. The challenge is discerning which advisors are not just good sales people but have real expertise in financial planning and investment management.

While it is relatively easy to ensure is prospective advisor is properly qualified (the CFP® and the CFA are the most rigorous credentials), it is much more difficult to judge a particular advisor's true expertise. But there are things that one can do. The most important thing to look for is an advisor who can articulate a clear investment philosophy and who follows a disciplined investment process. Competent advisors ought to be able to explain their investment strategy in a way that you can comprehend it, and be able to fully describe their process for determining what type of investment strategy is likely to work best for you.

You might also ask the advisor how he or she makes decisions. For instance, you could say, "Take your worst investment and evaluate how you made the investment, monitored it and the decisions you made along the way to stick with it or get out." If you feel the advisor is dodging the question or putting a positive spin on everything, it's a red flag.

The same holds true if you are looking for an advisor who also provides financial planning services. Once again, the advisor should be able to fully describe the process for developing a plan for you and be able to show you samples of his or her work.

Understand the Advisor's Compensation Model

If there is any area in which the financial services industry likes to be opaque, fees and compensation levels are near the top of the list. In the wealth management business, it's confusing in part because advisors use several different types of compensation structures. They may get a commission on the securities they sell and a distribution fee from product manufacturers. Alternatively, they may charge fees, either flat, hourly or as a percentage of the assets they manage for you. Some fee structures incorporate a combination of all of the above.

Ask your prospective advisor to detail exactly how he or she is compensated, as well as the total compensation to be received for managing your portfolio and/or from providing financial planning services. It is also fair to ask how the advisor will manage the inherent conflict of interest of trying to do what is in your best interest while at the same being paid commissions from product providers. Be wary of anyone who shies away from answering these questions in a transparent way or who won't detail all fees, including commission estimates, in writing.

Don't Assume that Bigger Is Better

People are often impressed by numbers. As a result, advisors have a tendency to boast about having significant assets under management and their lofty ranking on various national and state "top advisor" lists. While there are tremendously talented advisors who genuinely hit all of these points, in many cases, big is just big.

Big doesn't necessarily mean great, and it certainly doesn't always equate to high-quality advice and good service. Big can simply be the result of an advisor having good sales skills. Big can also come from inherited relationships from terminated advisors, or from having a corporation's retirement plan as a major client.

The key is to look for the size of advisor that is just right for you —one who is big enough to demonstrate success and expertise, but not so big that you'll get lost in the crowd. To find this happy medium, strive to understand the advisor's business. One of the most important questions to ask is how much experience and success the advisor has with clients like you – people with similar levels of assets, needs and levels of complexity. You might also ask how many clients the advisor serves, as this will give you a good idea how much attention can be devoted to you.

Do Your Homework

Many people say that it is not worth checking references because the advisor is only going to provide references from very satisfied clients. On one level, that's true -- but you can still learn a lot from speaking to these clients. Ask the clients to walk you through how the advisor came to understand their goals and objectives, risk tolerance and return expectations. You might also ask how often the clients hear from their advisor and what they think of the service and reports they receive.

In a similar vein, there is no fool-proof way of ensuring an advisor is honest, but there are number ways of tracking down information that can increase your confidence in the integrity of the advisor you select. For example, if the prospective advisor is an RIA, he or she is required to disclose all disciplinary history in a document called a Form ADV. This document must be made available to all prospective clients before they sign a contract. If the prospective advisor is not an RIA, he or she is most likely a registered representative of a broker/dealer. In this case, you can check for disciplinary history on the FINRA BrokerCheck website (www.finra.org/brokercheck).

Trust Your Gut

At the end of the day, your long-term satisfaction will emerge from your trust and respect for your advisor. You need to be able to communicate back and forth, and you need to be comfortable taking your advisor's recommendations. If you are not completely comfortable with the prospective advisor, then it's not likely that he or she can help you reach your goals.

We believe that those who take the time to conduct proper due diligence and follow these guidelines will have a higher chance of finding truly ethical, high-quality advisors who are dedicated to their clients' financial well-being.

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