What to look for in a Financial Advisor

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Select a financial consultant whose service offering corresponds to your goals.

Provided by Justin Dale Young, CFP®

Financial advisors aren't all the same – far from it. As the profession has evolved over the past 40 years, different kinds of advisors have emerged with different practice emphases or specialties. Different compensation methods for those advisors have emerged, too. So it is important to look for a financial advisor with an understanding of these subtle and not-so-subtle differences.

Is saving for retirement your top priority? If so, look for a CERTIFIED FINANCIAL PLANNER™ or other financial advisor that offers comprehensive financial planning – long-range planning designed to help you build and preserve those savings. Comprehensive financial planning is not merely about the return; it is also about tax and risk management and helping you create the future you want for yourself. It is holistic – concerned with the quality of your life.

Are you mostly interested in portfolio performance? You might want an advisor who offers active money management featuring tactical asset allocation (which is the opposite of the passive buy-and-hold strategy). Tactical asset allocation seeks to continually fine-tune portfolios in light of valuation and economic factors with the goal of exploiting the better-performing parts of the market. Active portfolio management may cost an investor more than traditional portfolio management, but it has many advocates.

Are you more of a hands-on type? If you go in for day trading and like to manage your investments from your own "control panel," you might opt for an investment advisor who can consult you about selecting securities and offer you investment options.

Are you just seeking a basic financial strategy? If you are just looking for a one-time financial plan, a wide variety of investment professionals at least claim to provide it, or something similar. True financial planning, however, is best executed by a CERTIFIED FINANCIAL PLANNER™ that can offer not only a "blueprint" but also a hand in implementing and carrying out the plan over time.

Are you concerned about income or estate taxes? You might want an advisor well versed in a) accounting, b) estate planning, c) insurance. There are quite a few financial advisors who have migrated to financial consulting from accountancy or insurance careers; yet others are licensed to practice law. The additional skill sets give them a deep understanding of wealth preservation and/or tax and risk management techniques.

Are you looking for a "quarterback" to help you manage your financial life? A wealth management firm may be just what you are seeking. Typically, this is a firm uniting several specialists in investment management, retirement planning, estate planning and insurance, perhaps with a network of other professionals they can refer to as needed. In a team effort, they can draw on their collective knowledge and ability to design a highly personalized, long-range strategy for a client. Wealth management firms commonly serve a high-end clientele – and some even go so far as to provide “family office” services, handling everything from bill paying to personal portfolio management.

One comment here: remember the phrase “jack of all trades, master of none.” If you meet a lone financial advisor who claims to be able to deliver just about every financial service under the sun, keep in mind that it is indeed a remarkable individual who can “specialize in everything.” It really takes a team or at least multiple minds at work to “cover all the bases” of wealth management with fluency.

Look for professional designations & understand their meaning. The financial services industry has a whole bunch of three- and four-letter designations that (mostly) signify acquired and implemented knowledge. For example, take the CERTIFIED FINANCIAL PLANNER™ designation – when you meet a CFP™, you know the professional has a bachelor’s degree and 3 or more years of full-time experience with personal financial planning.[1]

Most CFP™ professionals have several years of experience (perhaps even decades of experience) in the financial services industry, and have studied 100+ financial subjects (investment classes, taxes, risk management, retirement and estate planning and more). A CFP™ professional must pass a certification exam administered by the Certified Financial Planner Board of Standards Inc., and abide by the CFP Board's code of ethics and standards.[2]

The Chartered Financial Analyst (CFA) and Certified Investment Management Analyst (CIMA) designations are also much-esteemed designations, often held by advisors experienced in portfolio management. The American College at Bryn Mawr has for years issued the Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU) designations to insurance professionals who have completed extensive studies in insurance, investments, taxation, and financial and retirement planning and passed related exams. The Personal Financial Specialist (PFS) designation is conferred to CPAs who have also become CFP™ professionals by the American Institute of Certified Public Accountants (AICPA).[2]

Not all designations are meaningful. Some don’t require much study. In the early 2000s, the Certified Senior Advisor (CSA) designation started popping up. It was easy to obtain – all it took was a 3-day training course and taking one “approved” class among a list of prerequisites. Three days of study and an open-book test are the only requirements needed to become a Chartered Senior Financial Planner (CSFP). There is no coursework at all required to become a Certified Retirement Counselor (CRC). What are these designations worth? Ask the state of Nebraska, which has a statute barring their use (and the use of all such “senior advisory” designations). The curriculum required to obtain such designations pales in comparison to that required for the truly professional ones.[3,4]

Some advisors abide by a fiduciary standard; others don't. All CERTIFIED FINANCIAL PLANNER™ professionals are required to uphold a fiduciary standard – that is, they must act in the best interests of their clients as they perform their work. It is what is right for the client that counts, not what might be profitable for the advisor. Believe it or not, that was not always the case.[5]

For many years, the given in the financial services industry (and insurance industry) was the "suitability" standard. By the terms of this standard, an investment or other financial or insurance product only needed only to be "suitable" for a client or customer to be appropriate. At a glance, the difference between "fiduciary standard" and "suitability standard" may seem like splitting hairs – but the latter standard offers financial or insurance professionals some wiggle room to put their best interests before yours.[5]

A good advisor also upholds the fiduciary standard in an ongoing professional relationship. Financial planning or retirement planning is not treated as an event which is over and done, but a goal-oriented process with an eye on the long run (and correspondingly, a commitment to serving your best interests in the long run).

Some advisors work on a fee basis; others don't. Today, many financial advisors have fee-based practices, and some only charge fees. This is a real change from the financial services industry status quo of decades past, when advisors were largely or wholly paid by commissions related to financial product sales or trades.

In working for fees only, a financial advisor is telling you that his or her business is built on advice and objectivity, not product sales.

If you're wondering where you can find a fee-only financial advisor, start online at napfa.org. This is the website of the National Association of Personal Financial Advisors. The Financial Planning Association (fpanet.org) is another good route toward a quality financial advisor.[6]

Some advisors charge fees related to investment performance. That is, their portfolio management fee represents a tiny percentage of the invested assets you have assigned them to supervise or manage. So the more your invested assets grow, the more compensation they receive. This arrangement gives them extra incentive to help you grow your wealth, and it encourages a degree of teamwork between advisor and investor. (If your portfolio loses value, the advisor is still going to get paid; he or she will still receive a base fee for the service.)

Some advisors are still largely paid by commission, others through a mix of fees and commissions. In some cases, an advisor may determine that commission-based compensation may actually be cheaper for the client when compared to advisory fees. (When applicable, this tends to be the case for younger and/or middle-income clients rather than wealthier ones.) Still, when you have an advisor earning income primarily from sales commissions or trading commissions, there is a scent of salesperson and customer about the relationship, as opposed to simply advisor and client.

Keep in mind that if you want an advisor who can offer you insurance products, commissions will be poised to enter the client-advisor relationship. Policy and product sales are central to the insurance industry, and that means sales commissions.[6]

Want to check out an advisor's record? You can do this online at the website of the Securities & Exchange Commission (specifically at sec.gov/answers/formadv.htm). That is where you can glean information from a Form ADV. Investment advisors/firms supervising more than $25 million in invested assets must submit this form to the SEC annually. A Form ADV denotes the company's investment management style, the key officers of the advisory practice, and the amount of assets under its management, or AUM in the industry lingo. A Form ADV is about transparency; a clean Form ADV is vital to advisor's career. If the advisor or advisory firm runs afoul of the SEC, it is noted on the Form ADV. You can also visit the Broker Check page of the Financial Industry Regulatory Authority (FINRA) website (finra.org) to find out if an advisor has had any citations, penalties or investigations.[7,8]

What should you ask a prospective advisor? You have done your homework; you have checked out a prospective advisor's background and reputation. Now you are ready for an introductory meeting, which should clearly be offered to you without obligation. What you ask, and what should you consider, during this chat?

Ask who the advisor's typical client is. Hopefully, the description is someone like you. If not, there could be some dissonance. For example, if you are a successful entrepreneur with interrelated business and personal financial concerns, an advisor who is used to consulting middle-class families may not be a good fit. Alternately or in tandem with this question, you could ask, "Who are the types of clients you enjoy working with the most?"

Ask the advisor how long he or she has been doing this. Also, ask what he or she did *before* becoming a financial advisor – the answer may be illuminating. Ask the advisor about his or her professional qualifications, and what kind of study it took to earn them.

Ask about compensation. Is the advisor paid only through fees? Is he or she fee-based or working on a fee-plus-commission basis? Is he or she only compensated by commissions?

Ask how they discuss a client's personal financial matters. Typically, advisors will have a discovery meeting in which they gain insight into a new client's financial life. (Some even have multiple discovery meetings with new clients.) A lot can be revealed in these meetings ... and some very personal money and family issues may be discussed. These can also come out in subsequent meetings as a financial strategy is refined and implemented. Some advisors are very candid when discussing such matters, others approach them gently. Some make suggestions, others are ready with instructions. So, ask the advisor how he or she likes to go about such discussions.

While we are on this subject, beware of a motormouth advisor. You want one who asks you questions, who is clearly interested in what is important to you: what you want retirement to look like, what money means to you and what it should accomplish for you. You do not want a blowhard who seems to dismiss your concerns or opinions.

Ask how they like to play defense. What is the advisor's take on tax and risk management? When it comes to tax-efficient investing or trying to reduce portfolio risk, what tactics is he or she fond of? You might also ask how she or he reacted to the bear market of 2008-09. Assuming the advisor was in the business at that time, what did he or she do to try and help clients hang onto their invested assets during that awful downturn?

Ask to see a multiyear track record. An advisor or advisory firm that is really "up front" with clients and prospective clients will be able to offer you such a report, an independently produced and audited study showing how client accounts performed across X number of years. (It will show either a random sampling of clients or the whole lot.) The report should also note if the performance numbers are gross returns or net-of-fees returns (that is, returns minus management fees).

Lastly, take your time as you search for the right advisor. Many people hire the first financial advisor they meet with, but there is certainly no requirement to do that. Shop around until you find an advisor whose intellect, approach, character and credentials impress you.

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