Finding the Right Person to TRUST

8 Strategic Questions
to Ask a Prospective Financial Advisor

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Investing on your own can be daunting. Most studies reflect that the odds are against the individual flying solo missions with the family fortune hanging in the balance. The alternative is to work with a financial advisor. However, finding the right person to trust can seem even more challenging than investing on your own. Conversations with some wealth managers might feel like talking with the charismatic showmanship of The Great and Powerful Oz. So how do you know if a wealth manager is smoke and mirrors or the real deal?

In order to see behind the green curtain, it is all about asking the right questions. Below are the top eight questions to illuminate the type and nature of a future relationship with an advisor. This in-depth exploration covers possible responses and their significance to you.

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1. What fees do I have to pay and how are you compensated?

Without a doubt, this is one of the most important questions to ask a financial advisor. There is always a fee. In order to understand the advisor's response to your question, it helps to be aware of the difference between the suitability standard and the fiduciary standard. The standard under which the advisor operates determines where and how he will receive his fees. The compensation model will directly affect the relationship the advisor will have with you.

Suitability Standard

Under the suitability standard, the advisor makes recommendations that are appropriate for you based only on your risk tolerance, tax bracket, and time horizon. There are drawbacks to this standard as other pertinent factors do not have to be evaluated. For instance, the recommendations do not have to consider costs or comparisons to alternative investments. The litmus test of whether a prudent person would make such an investment is not measured. Consequently, there could be hidden commissions that do not require disclosure, or they are disclosed within a 50-page prospectus. These hidden commissions not only affect your investment returns, but they also affect other important aspects of you reaching your goals such as diversification, liquidity, and rebalancing. Under this standard, there is a greater possibility of being fleeced and you will not know it, see it, or feel it. This is because you are not the center of attention. The product becomes the center point of attention because the product pays the advisor.

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Usually in this environment there are a limited number of products and you may not be able to transfer your portfolio to your next broker with proprietary products. If you change brokers, you might have to liquidate certain investments and thus incur capital gains and transaction costs. The product that you receive is based heavily on the preferred list of products, which usually is based on profitability to the broker. If you are looking for a problem solver, but your broker only makes money if he sells you financial products, this can led to contentious and unproductive meetings.

Fiduciary Standard

Conversely, the fiduciary guidelines are a higher standard. They require the advisor to work in your best interests. An advisor subject to the fiduciary guidelines cannot recommend a given product to you if there is a better one in terms of costs. When the advisor is working in your best interest and costs are considered, then the opportunities for diversification, liquidity, and rebalancing will be apparent in helping you reach your long-term goals. The fees are disclosed to you upfront and there is transparency in seeing the fees distributed to the advisor.

What is your advisor paying attention to?

The difference between **Suitability** and **Fiduciary** Standards of Care determines where and how your advisor receives his fees—and this directly affects his relationship with you

Better →

Suitability Standard of Care

FOCUS *Selling investment products*

Your advisor makes recommendations based only on your risk tolerance, tax bracket and time horizon. Recommendations might not consider costs or comparisons to alternative investments.

Fiduciary Standard of Care

FOCUS *Your complete wealth management*

Your advisor works in your best interests. He cannot recommend a product if there are better alternatives in terms of cost. Fees are disclosed up front with full transparency.

Consider this example of making a new year's resolution to get in better shape. Chris decides to go to a big box store to purchase fitness equipment. A salesman might spend some time asking a few questions. What exercises do you like to do? How much space do you have at home? And, what are your budget and goals? These questions and any education provided are based to sell Chris store products. The salesman's assistance is limited to the available inventory and he receives compensation from the store for the sale of the item. Future communication and support from the employee will revolve around sales. This approach exemplifies the suitability standard.

On the other hand, by hiring a personal trainer, Chris is going to receive a more holistic approach. The information gathering by the personal trainer is going to be more encompassing, going beyond those asked above. The personal trainer will review Chris' goals and objectives, and assess the gap of his current status and his desired outcome. The personal trainer will evaluate Chris' current equipment and offer recommendations according to need. Next will be a plan to provide ongoing education, monitoring, and accountability, as opposed to the ongoing sales calls from the big box store. The personal trainer is truly providing a process, not a product. Because the personal trainer is working for Chris, he receives compensation from Chris. This example is similar to the fiduciary standard.

Blended Standard

The two standards are straightforward. However, there can be confusion when an advisor belongs both to a broker/dealer and to a registered investment advisor company. You will find many independent financial advisors with this arrangement. This is when additional questions are required. Under this scenario, the first question might be, "What percentage of revenue is derived from advisory fees and what percentage is from commissions?"

You might also ask, "Are you an employee of a larger company?" This question is critical for not only reasons stated above, but in case when the advisor leaves the employer. Generally, an employee has a fiduciary responsibility to his employer, not to the investor. You will also want to know if you are a client of the employer or the advisor. It is important to know ahead of time what future upheaval you might expect – a new advisor or a new broker.

How This Applies to You

This leads us back to the original question at hand, "What fees do I have to pay and how is the advisor compensated?" With the information above, the better question might be, "What standard does the advisor operate under?" Not all commissioned products are poor investments. What is required is an advisor who can help you discern between the good and the bad. You need to know all of the fees and commissions because there is no "free lunch." I spoke with an investor whose brokerage account exceeded $300,000, and he contended he was only paying the advisor $150 annually because that was the only fee he saw. He was working with an advisor who was operating under the suitability standard and all the fees were not fully disclosed.

In contrast, when you work with an advisor under the fiduciary standard, there is transparency in compensation. With this transparency, you are able to assess the costs/benefits of the relationship. Knowing this, the advisor will bring value to the relationship, which will lead to a greater potential for a long-term partnership. Also, the compensation is not tethered to any particular

investment products. As a result, there is a greater opportunity for diversification, liquidity, and rebalancing – all key elements in managing risk. This structure promotes ongoing check-in meetings and discussions about financial issues outside of investments, which may not be addressed or enjoyed under the suitability standard. This support and management makes a difference. According to a 2014 study by Vanguard, one the largest investment companies, advisors can add up to 3% to your net returns. These results are consistent with a 2011 study by Financial Engines and Aon Hewitt.

As a practitioner, I use a blended standard, which affords me the opportunity to operate primarily under the fiduciary standard while still allowing me to offer the commission products when appropriate. I take pleasure in ongoing meetings as they serve to affirm the investment objectives are consistent with the overall wealth management strategy. With this understanding of the standard of care, you will have a greater appreciation for the fees you pay and how your advisor's commissions affect you.

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2. What is your investment philosophy and approach?

This two-part question asks the advisor to describe their core beliefs and their practice.

When asking about the advisor's philosophy, you want to know if the advisor can articulate their viewpoint in a clear, concise manner. Ideally, the discussion will center on the four primary variables of investing. Three of the four variables can be controlled—risks, taxes, and costs. Start with gaining an understanding of how the advisor manages the three controllable variables. The one variable that cannot be controlled is the market. If the advisor launches into an extensive discussion about returns and performance, this is a red flag as he has chosen to focus on the one variable that can't be controlled.

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If you do not get a clear, concise answer, then consider moving on to another advisor. If you are comfortable with the advisor's philosophy, the next step is to ask for it in writing. This document is commonly referred to as the Investment Policy Statement (IPS). If it isn't in writing, then it is in your advisor's head. Just as you are bombarded with investment noise, so is your advisor. If the philosophy is only in the advisor's head, you won't know when he has succumbed to investment noise and changed his strategy or viewpoint. An IPS will help ensure the advisor is not going to chase performance and take unnecessary risks.

When asking about an advisor's approach, you are looking to get an understanding of his practice in terms of implementation and services. How an advisor is compensated is a good indicator as to which of the two common types of practices the advisor

subscribes, transaction methodology or the consultative approach.

The transaction methodology only builds a portfolio based on the current investable assets. This is a standard model for the large banks and wirehouses that offer limited products with undisclosed fees. For the new investor, it is a common place to start. However, the level of service does not grow with the needs of the investor. After the initial transaction, there is very little incentive for the advisor to provide additional services when the advisor's commission is paid up-front. These practitioners spend their energy hunting for new clients in order to have their next payday. Additional education is rarely offered after the initial placement or implementation. You may not receive basic services like rebalancing. The

transaction methodology may well be camouflaged to appear like the second type of practice. Today, because of the misuse of titles such as 'advisor' and 'consultant' over yesterday's titles of 'broker' and 'salesman', a thorough discussion of compensation and standard of care is required to help you determine the difference.

The second type of service is a consultative approach. The consultative approach resembles a coaching program, a wealth management class, and your personal think tank. The advisor with a consultative approach will help you maintain a long-term approach to reaching your goals by disregarding short-term obstacles. The more common obstacles can come in the form of short-term adverse market conditions and investment noise that sounds like solid investment advice. The major emphasis on the consultative approach is education. The purpose of the education is to partner with you in order to make better financial decisions, not to sell you products. In addition, the consultative approach may include an outside team of specialists. The proactive team may include a CPA, an insurance specialist, and an estate attorney. The purpose of the consultative approach is long-term partnership with the intention of improved decision-making. If there is a lack of satisfaction, the relationship can be terminated with minimal costs.

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It is interesting to note there are fewer investor complaints to regulators with the consultative approach to practice. Because there is an inadequate amount of education about compensation, services, and suitability versus fiduciary standards, most investors will unfortunately start with the transaction-based service. The two types of services may not be significantly different when an investor is starting out. However, when an investor accumulates investable assets in of excess of $500,000, the second type would be preferable to an investor.

3. What is your process for helping me with my financial concerns?

The question helps you, as an investor, to understand what you can expect in the advisor/investor relationship. It will be either a consultative process or a transactional methodology.

If it is the latter, you can expect to be sold something with each meeting or you may experience reluctance by the advisor to meet if the probability of a sale is low. Transactional advisors will tend to dive into three possible areas – the products they offer, their investment knowledge, or their past experiences – instead of describing their process. They are trying to impress the investor while attempting to overcome the lack of a documented process. Unfortunately, this mentality is prominent among advisors who "wing it" and hope for the best. This method may be adequate for investors with simple and straightforward concerns.

Documentation of the advisor's entire process may be one of the best indicators of the value he brings.

However, the investor with $1 million in financial assets will benefit the most from the consultative process that addresses his unique circumstances. The process will vary by advisor. During the first meeting, often called "the discovery" meeting, the advisor begins by asking a plethora of questions and building a rapport. The purpose is to give the advisor a sense of who you are, and more importantly, to provide a total view of your financial picture. After the initial assessment, ongoing meetings will provide education, monitoring, and mutual accountability. The ongoing meetings are the essence of the consultative process, providing the opportunity for collaborative, proactive problem solving. Documentation of the advisor's entire process may be one of the best indicators of the value he brings. Consequently, I recommend reviewing the documentation prior to making a commitment. Personally, I enjoy the problem solving and planning aspects of the consultative process that go beyond investment transactions.

4. How will you help minimize my tax burden?

It is important to have an advisor that has a strong tax background or has a person on their team that can make sure financial decisions are consistent with your tax objectives. The advisor should have a 360-degree view of your financial situation. By looking at the past decisions and outcomes, the advisor can best plan to mitigate taxes or the tax drag on your wealth in the future.

With increased tax rates and new taxes on unearned income, an advisor with a strong tax background can help minimize your current tax liability and thereby make the investments more efficient during the accumulation phase. In addition, knowing when various assets should be drawn-on during the distribution phase is equally important. In every economic decision, there is an element or consequence of taxation. Don't let the tax tail wag the economic dog. Likewise, the financial planner should be aware of the various tax strategies of transferring assets to heirs and contributions to charities.

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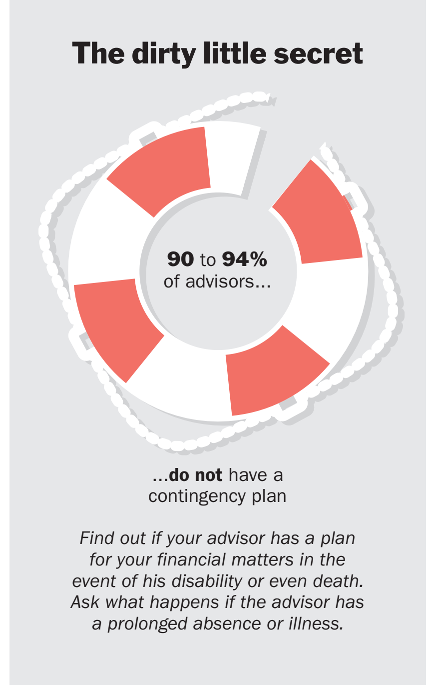
5. What happens to my money if something happens to you?

There is a dirty little secret in the financial services industry—most financial advisors do not have a plan in case of their death or disability. Depending on the survey, 90 to 94% of advisors are without a contingency plan. Moreover, 50% of advisors are within 15 years of retirement. Federal and state regulators alike have expressed concern with this issue.

You want to ask if there is a plan that your financial matters are taken care of in the case of his disability or even death. The goal is to avoid a lapse in management, as various issues can be time sensitive. What will happen with any management fees that may have been paid in advance? An advisor may a have a default plan where the organization (employer or broker/dealer) takes over his business. From an investor's perspective, this is not much of a plan. The new advisor may not have the same philosophy and approach as your former advisor. If this occurs, an exit strategy will have to be considered.



Find out if your advisor has a plan for your financial matters in the event of his disability or even death. Ask what happens if the advisor has a prolonged absence or illness.

Likewise, ask what happens if the advisor has a prolonged absence or illness. The answer could be telling. If he does not have a plan for specific person(s) to take over the day-to-day operations, you may be at risk. It also begs the question, can an advisor help you and your family with wealth management planning if he cannot plan for his business?

Continuity planning is difficult. There are many variables and scenarios just as there are in wealth management. An advisor that has a continuity plan in place has demonstrated the importance of his clients and family by making a set of difficult decisions. This shows his ability to address the challenging variables that you face.

6. Do you address my wealth management questions beyond investments advice?

The answer to this question will differentiate whether the advisor is an investment counselor or a wealth manager. An advisor may have a consultative approach and use the title of wealth manager. However, you want to make sure where the service begins and ends. Elite wealth managers go beyond investment counseling to address the five key concerns of successful investors.

Wealth Preservation

A big picture view of investing. You want your investments to maintain your quality of life throughout retirement. This includes determination of your risk comfort and planning for smoothing out the volatility of the market ups and downs.

Tax Mitigation

Taxes are a part of life, but you have an opportunity, through smart decisions, to ensure that you don't pay more than your fair share. It is important to select an advisor that has a strong handle on tax strategies – from income taxes, capital gain taxes, to estate taxes.

Asset Protection

A too often overlooked area, asset protection is about strategies to protect your wealth from unfriendly third parties. Elite wealth managers can assist in minimizing the exposure of assets to creditors, litigants, and ex-spouses.

Protection of Heirs

The distribution of wealth to heirs in accordance to your vision. This includes the difficult discussions regarding long-term care planning so that your wishes will be honored and your heirs are not left with difficult or unanticipated decisions. For instance, if you don't have a will and you live in the State of Maryland, it is possible for your estate to end up in the hands of the Board of Education in the county where you lived.

Taking Care of Your Heirs/Long-Term Care Planning

For most people, estate planning is not high on the priority list. The same can be said for childless households when it comes to long-term care planning. Less than half of Americans don't have a basic will or long-term care arrangements. By not addressing these issues, decision-making is left to others—possibly strangers or the government.

Charitable Giving

An elite advisor can help you discern between the optimal tax strategies of gifts and bequests along with the coordination of your estate plan.

The five concerns of the affluent noted above are complex. Yet, it is exciting to devise strategies to address them. Knowing what an advisor will do beyond basic investment advice provides critical information for finding someone to trust. Thus, the goal is finding an advisor with a consultative approach to address these five concerns. Conversely, an advisor providing only investment counseling services limits the opportunity to integrate your financial future.

7. Why did you become a financial planner?

This appears to be an unusual question to ask because every answer is going to be different. However, the question gives the advisor the opportunity to reveal his true passion, show the path where he came from, and the unique skills and talents developed along the way. Listen to the personal stories of the advisor, and watch the facial expression, body language, and voice inflections. Do the nonverbal cues match the verbal message? Also, look into the advisor's credentials.

> In addition to the technical skills, you want to find an advisor who can simplify and explain complex issues.

Elite financial planners possess a wide range of technical and interpersonal skills. Credentials can be important in assessing potential client satisfaction. Certain ones, such as CFP®, CFA, and CPA, show the ability of an advisor to comprehend complex financial issues. In addition to the technical skills, you want to find an advisor who can simplify and explain complex issues.

You want to avoid the advisor who has chosen this career based on the "Arby's Criteria," which basically means the career was chosen because it sounded good at the time, and there were no other options available. The investor needs to ascertain if the advisor is going to stay in the industry when financial times get tough. In other words, if the advisor's compensation were to be cut in half due to markets, regulations, etc., would he still be here tomorrow?

8. What safeguards are present to prevent frauds like those perpetuated by Bernie Madoff?

Bernie Madoff was able to do what he did because he controlled every aspect of the investment process. He was the broker-dealer, the custodian, and the investment manager. Furthermore, his independent auditor looked the other way and never performed any meaningful auditing procedures.

Generally, checks are not written to your advisor or broker/dealer with the possible exception of fees. If you are dealing with an independent financial advisor, checks will be written to a custodian, like Fidelity or Charles Schwab. In fact, there are several separate functions that are going on with the management of an account. First, there is the advisor who knows your personal situation best. Next, there is the broker/dealer or registered investment company and finally there are the custodian and the investment

manager. Each investment function includes due diligence of another investment function.

Before I offered wealth management services, one of my tax clients asked me to go check out a broker who had most of her extended family's money invested with him. During the due diligence, which took about an hour, the broker was truthful. He shared with me that he was not licensed and he guaranteed a return of 15%, but the investor's statements did not reflect ownership of anything. He also offered investment advice, even though he wasn't licensed. He tried to gain my trust by name-dropping that his biggest investor was a famous author.

My client took my advice and did not invest with this broker. Several years later, the client shared with me a news article that stated that the advisor had been arrested, his business was shut down, and his investors were out of luck. That famous author—he lost the most amount of money.

The common thread in both instances of fraud was that the fraudulent investment manager controlled everything. The important thing to remember is to make sure the investment functions are segregated by company and never write a check to the advisor when making an investment.

Conclusion

When interviewing potential advisors, you will encounter practitioners using various titles, such as advisor, wealth manager, or financial planner. Unfortunately, the titles are not an indicator of the type of service they provide. It is through asking detailed questions that you will know if this person is the right fit for you. You will know if the advisor operates within the suitability standard of care or the more rigorous fiduciary standard of care. It will be clear what the advisor's philosophy is and if he has a consultative approach. These questions will also illuminate the advisor's process in reaching your goals. You will understand how the advisor integrates your unique tax circumstances with your wealth management strategy. How the advisor will address your key concerns will provide you with confidence in his problem solving ability. Understanding why he became a financial planner will provide insight into his passion and resolve. Finally, you will have a clear understanding of the segregated investment functions in order to avoid a Bernie Madoff situation.

Generally, it is not prudent to make a commitment at the conclusion of the first meeting. The important thing is to get your questions answered before you make any type of commitment. You want to take time and reflect on the information provided. Actually, the wealth manager will also take time to reflect on the information you provide to see if the relationship is a good fit.

If you seek referrals from family, friends, and business affiliations such as attorneys and bankers, be careful. The referrals may not be based on personal experiences. Always ask about their familiarity with the person whom they have referred. You want to grasp the depth of the recommendation. Once you have a few names, contact each advisor

Spending the time now to find a good fit will help establish a long-term and successful partnership.

and ask for a second opinion service.

I strongly believe the consultative approach is preferable. When you get a second opinion from someone that uses this approach, they will review your investment plan, as well as your tax strategy and insurance arrangements, making sure they are appropriately integrated with your goals, objectives, and values. This is an opportunity to understand the gaps between where you are now financially and where you want to be. You will want to confirm upfront that there is no cost or obligation for the second opinion service.

Prepared with these suggested questions, you are ready to search for a trusted advisor. This reduces the possibility of unpleasant surprises down the road. Spending the time now to find a good fit will help establish a long-term and successful partnership. •

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With more than two decades of experience in public accounting and wealth management, Kevin is committed to providing and implementing prudent, personalized, and integrated solutions. Kevin earned his undergraduate degree in Finance and MBA from Oklahoma State University. He has been granted the CERTIFIED FINANCIAL PLANNER™ designation by the International Board of Certified Financial Planners (IBCFP). He has also earned the Personal Financial Specialist designation by the American institute of Certified Public Accountants (AICPA). With more than 25 years of being a CPA, Kevin is a member of the AICPA and the Maryland Association of Certified Public Accountants (MACPA).

Kevin enjoys the outdoor activities of running, golfing, and kayaking. He also likes reading about behavioral management and American History, especially the Civil War. Rich in beautiful landscapes, history, and culture opportunities, Kevin, his wife, and three sons enjoy living near Annapolis, MD.

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