

# 7 Questions to Ask Your Next Advisor

This is an excerpt from *Wealth Without Worry*.

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## Is Your Firm Independent?

The word “independent” can have different meanings. Therefore the answer to this question will almost always be “yes,” initially. This is because any advisor knows the value the questioner perceives in an affirmative answer. The definition we are looking for in this context, however, is this: having no association with any entities that adversely affect objectivity. This list of entities could include banks, insurance companies, traditional wire (stockbroker) houses, and broker-dealers (even “independent” ones).

A truly independent firm has no association with these organizations but rather is organized simply as a Registered Investment Advisor (RIA) compensated with fees collected directly from the client. This arrangement gives the independent firm the ability to seek the best solutions for the client while minimizing the chance of a misaligned interest. This eliminates the pressure to push certain products which is often associated with parent company arrangements. The bottom line is that a representative (or, in alphabet soup terms, an IAR) of an independent Registered Investment Advisor can act in a fiduciary manner that eliminates conflicts of interest and applies the highest professional standard available to the client relationship.

## Are You Compensated and By How Much?

Financial advisors can be paid in several different ways: salary, commissions, flat project fees, hourly fees, percentage fees for assets managed, annual retainer, or a combination of any of the above. None of these compensation methods is innately bad or good. However, in being consistent with our overriding consideration, when a client is working with an advisor, a fee-based arrangement has far less chance of producing a conflict of interest. In other words, an advisor who is compensated with fees—directly from the client—is far less likely to be influenced by financial product vendors. Because the advisor is responsible only to the client for remuneration, he or she is likely to act in the best interest of the client. Therefore, make sure the name at the top of the advisor’s paycheck is yours.

Amounts for hourly fees, project fees, and annual retainer arrangements can vary greatly. A comparison of two or three advisors would be a prudent course of action. Concerning the percentage charged for asset management, generally an annual amount of one percent should be the high end of any arrangement, with a reduction in the percentage charged for larger portfolios down to around 0.30 percent.

## What are Your Qualifications?

Vernon Law once said, “Experience is a hard teacher because she gives the test first, the lesson afterward.” With that said, in the important area of money, it is not a good idea to allow someone to learn with your nest egg. The financial services industry is known for being an aggressive recruiter of inexperienced sales representatives. It is a difficult profession in which to become established and most are forced to live paycheck to paycheck early in their careers. The average four-year retention of financial representatives is as low as 11 percent in some areas of the industry. If a newer advisor is going to be considered, make sure the advisor has an established independent firm upon whose experience he or she can draw.

In addition to the minimum requirements discussed, seeking advisors who work specifically with people in your situation is very beneficial. There are many advisors who accept any client who successfully fogs a mirror, particularly when they are getting started in their careers. Ask for demographic data on the clientele of an advisory firm so you can see the firm’s representatives are accustomed to working with individuals with your similar needs, objectives, and problems. (If you need brain surgery, it is not wise to use a heart surgeon to perform the operation—brilliant as the heart surgeon may be.)

## What is Your Approach to Financial Advice?

In the past, the majority of advisors have often offered investment recommendations without having sufficient facts concerning client goals, objectives, and challenges. Any advisor worth his salt will recommend creating a written financial plan before offering any financial or investment advice. To do otherwise is tantamount to malpractice. It is like receiving a prescription from your doctor without having been examined or diagnosed. This written financial plan can initially include a retirement cash flow analysis, an investment policy statement, and a risk management analysis. Often, an estate analysis also is warranted.

Once this written plan is completed and analyzed, the implementation should proceed with recommendations concerning various investment options and risk management tools. Obviously, any investment advice that involves active management techniques, as discussed earlier, should be summarily dismissed along with the advisor. Remember that capitalism creates wealth—not advisors. The advisor’s job is to protect the capital that investors are entitled to.

This is a good subject to broach before the written plan is started. It is not prudent to have a plan created by an advisor who probably cannot implement it properly.

## Does Your Firm Use a Team Approach?

A common misperception is that larger financial firms are better by mere virtue of their size. However, in most cases, large national firms are government-like bureaucracies that actually only lease space to individual representatives in their offices. While a visit to the local branch may give the impression of a team approach, it is likely to be an organization with multiple solo brokers with perhaps a shared personal assistant.

Ironically, smaller independent firms are typically better at building a team that can collectively devote their knowledge and energies to a client’s best interests. We call this fiduciary organizational intelligence. As we know, two heads are better than one.

Working as a true team means that all clients are clients of the firm—not clients of individual advisors within the firm. This also helps with continuity in the event something happens to specific advisors and they are no longer part of the firm. Additionally, in smaller independent firms, the owners/principals are usually involved in the client relationship directly.

## Will You Provide in Writing a Description of Specific Services You will be Recommending?

Whether they are providing financial planning or asset management services, registered advisors should be prepared to provide a written sample agreement for your review in an initial meeting. This should include the delivery of a Form ADV, Part II (a document required by the Securities and Exchange Commission that provides pertinent information concerning the background and detailed operation of the firm and its principals and representatives). These documents will allow a prospective client the opportunity to compare what is said in an initial interview with what is in writing. If there is no willingness to provide such documentation, then simply walk away. This is not an advisor worth your consideration.

## Are You Willing to Act in a Fiduciary Manner in this Relationship?

Most of the other questions in this list have implications concerning fiduciary responsibility. But there is no better way to get to the heart of the matter than by simply asking this question directly. Some representatives may not even completely understand the question or its implications. For reasons cited previously, this question is likely to disturb many of the brokers and representatives who do not fully comprehend it. They are often in no position—either professionally or with their business entity structure—to take on the responsibility that an affirmative answer to this question demands.

No client should accept or expect anything less than the standard that is implied by an advisor being a fiduciary: to act in the best interests of the client and disclose any real or implied conflicts of interest. Once again, if a potential advisor cannot answer this question with a swift and confident “Yes!” then walk away.