Chapter 20

Finding and Hiring the Right Advisor

In This Chapter

- Figuring out how financial advisors work and get paid
- Understanding the alphabet soup of credentials
- Knowing when you may need to hire an advisor
- Discovering how to interview and select an advisor

Personal Finance Workbook For Dummies provides you with the tools and information you need to become a savvy personal financial manager. However, you may have occasions when you need to work with financial services people to obtain a mortgage or a business or school loan or to purchase real estate, securities, or insurance products. Obtaining guidance from a professional financial advisor may also be necessary and appropriate at times.

However, any swindler, idiot with a good heart, or Ph.D. in financial planning with decades of practical and professional advisory experience can call themselves a financial advisor. Fortunately, the majority of the people in financial services aren't crooks or idiots. But you need to know about the extreme differences regarding how financial advisors work, get paid, their training, experience, credentials, expertise, and integrity.

The focus of this chapter is to help you recognize when you may need a financial advisor and empower you to make the wisest decisions possible when searching for and selecting financial services professionals.

Identifying How Financial Advisors Work and Get Paid

One initial way to differentiate between financial advisors is by examining how they're paid, which tells you a lot about how they work and what type of work they do (and don't do).

All people in the financial services industry, which include financial planners and advisors, get paid in one of the following four ways:

- **Commission only:** Commissions for selling financial-services products such as investments, real estate, insurance products, or loans. Examples include advisors affiliated with companies like State Farm, American Family, and Edward Jones. Your auto insurance agent, the municipal bond salesman, a mortgage broker, or real estate agent are all examples of financial services professionals who are compensated on a commission-only basis.

- **Commission and fees:** Most personal financial planners are paid this way. A commonly misunderstood term used to describe this compensation method is *fee-based.* Examples include registered representatives of companies like Lincoln Financial Advisors, Ameriprise, AIG Financial Advisors, Wachovia, UBS, and Merrill Lynch. Commission and fee advisors may receive a fee for developing a financial plan for you and then receive commissions when they sell you insurance and investment products recommended in your financial plan.
- **Salary plus bonuses:** Many discount brokerage firms and banks compensate their employees with a base salary plus incentive pay for bringing in new client accounts (money) into the institution. They may receive substantially higher bonuses by recommending or selling certain products and services over other options.
- **Fee only:** Fee-only financial advisors provide advice or ongoing management and aren't registered representatives of any financial services company. They're typically self-employed Registered Investment Advisors (RIA) or employees of this type of firm. All of their compensation is paid directly by you, the client. How much they charge is painfully obvious to the client.

  One benefit often sited regarding fee-only financial advisors is that they have no financial stake in the recommendations they may provide for you. They recommend only what they believe is in your best interest. This compensation method does remove many inherent conflicts of interest regarding how the advisor is paid. However, it does not ensure that the advice is rendered by an ethical or competent financial advisor.

All financial professionals deserve to be compensated fairly for the advice or products they provide, and you can find competent, ethical financial advisors working under each of these compensation methods. The only thing that should matter to you is whether you're receiving what you really need from a competent professional and at a competitive price. How do you know which advisor under which compensation model is most appropriate for your needs?

If you're looking for a house, a mortgage, a municipal bond or auto or homeowner's insurance, you'll likely need to work directly with a person who is compensated on a commission-only basis.

The most popular form of compensation for personal financial advisors and planners is currently a combination of commissions and fees. These financial advisors may be affiliated with a large brokerage firm or insurance company, or they may be registered representatives with an independent broker-dealer. They must maintain licenses to sell securities, life insurance products and annuities. Often, the majority of their compensation comes from the sale of the products they recommend. However, they may also provide financial planning services and advice for a separate hourly fee, flat fee, or retainer fee.

Planners who charge fees-only charge very similarly to attorneys and often make a similar income as well. Attorneys typically get paid in one of three ways:

- **Hourly fee:** You pay for all of the time that the attorney works on your case or spends with you. Multiply the time spent by the attorney's hourly charge, and that's how much you're fee is.
- **Flat fee:** Some attorneys charge flat fees for a package of services, such as drawing up a living trust package.

- **Contingency fee:** You pay only if you win your case. The lawyer may invest hours or months on your case and incur lots of expenses trying to help you win your case — and if you don't, they're out their money and time. Your fee under a contingency arrangement is based on a percentage of the amount you win — commonly a third of your award is paid to the attorney.

Fee-only financial advisors charge

- **Hourly fee:** You pay for all of the time that the financial advisor works on your case or spends with you. Multiply the time spent by the advisor's hourly charge, and that's how much you're fee is. Always find out the expected cost and the maximum cost before you work with an advisor who charges by the hour.

  Hourly-based pricing is best for:

  - People who need specific advice about one or a few financial topics.
  - Do-it-yourselfers who want a professional to give them his opinions.
  - People who are comfortable taking on part of the leg-work. They want to do as much as possible to save money, but want some expert analysis and direction.
  - People who recognize a need for a professional advice on occasion, but don't need, or want to pay the price for, a full-time financial advisor.

- **Flat fee:** Some financial advisors offer flat fees for a package of services, such as analyzing whether you're saving enough for retirement and investing in the right places. Flat-fee pricing is best for people who need specific advice or services and are willing to take the gamble that the flat-fee arrangement will cost no more than it would have if they paid by the hour.
- **Retainer fee:** This fee isn't exactly like a contingency fee — you're definitely going to have to pay for this service, unlike in a lawsuit where you could win or lose. However, the retainer fee is often calculated based on a percentage of some sort, such as 1 percent of the assets the advisors manages for you, or some percentage of your net worth or income, or mixture of the two. Retainer fees are also computed by estimating the about of time required to provide the services promised, based on the complexity of the case and the skills required of the advisor, for the time covered under agreement to retain the advisor.

  A retainer fee is best suited for people who need, want, or can afford to transfer the responsibility of managing their personal financial affairs to a financial advisor.

Deciphering What All the Initials, Credentials, and Licenses Mean to You

Before you engage any financial advisor, you want to know a lot more about her, her background and experience, and just exactly what her licenses or credentials mean for you.

Licenses are required by law for any financial services professionals who sell investments, insurance, or financing products. Common licenses you may see financial planners or advisors hold include the following:

- **Securities licenses** are licenses to sell investments and include the following:
  - **Series 6:** Licensed to sell mutual funds, variable annuities, and variable life insurance.
  - **Series 7:** In addition to the items covered under the Series 6, a Series 7 licensed representative may also sell individual stocks, bonds, and option contracts.
- **Insurance licenses** are licenses to sell insurance products and are broken down into the following two categories:
  - **Life and health:** Licensed to sell life, disability, medical, and long-term-care insurance products.
  - **Property and Casualty:** Licensed to sell auto, homeowner's, and liability insurance.

REMEMBER

A *Registered Investment Advisor* (RIA) isn't a license, nor a credential, but a legal requirement of anyone holding themselves out as a financial advisor. The only way around this law is for the advisor to affiliate with a broker-dealer and become a registered representative of that broker (who must themselves be an RIA). The federal or state Securities and Exchange Commissioners regulate RIAs. The advisor's business activities and records may be audited by the regulators at any time.

You may also meet advisors with a lot of initials after their names, but what do these initials tell you about the advisor's educational background and why is it important to you?

You can find no less than 70 different professional designations listed on the National Association of Securities Dealers' (NASD) Investor Education site at `http://apps.nasd.com/DataDirectory/1/prodesignations.aspx`. However, for your benefit, I feel compelled to narrow down the list drastically to the most significant and applicable professional designations held by personal financial planners and advisors, which you can find in Worksheet 20-2.

You should look at professional designations only as a sign of the advisor's initial and ongoing educational and examination requirements. Professional designations in no way insure that an advisor is competent or trustworthy. But, it's a start. In the next section, you can explore some interview questions that can help discover additional information you want to know about any prospective advisor including their core competencies and potential conflicts of interest.

Worksheet 20-2 Primary Professional Designations

Financial Planning:

- Certified Financial Planner (CFP)
- Chartered Financial Consultant (ChFC)
- Certified Public Accountant / Personal Financial Specialist (CPA/PFS)
- NAPFA-Registered Financial Advisor

Investment Management:

- Chartered Financial Analyst (CFA)
- Accredited Investment Fiduciary (AIF)
- Certified Investment Management Analyst (CIMA)

Insurance:

- Chartered Life Underwriter (CLU)

Tax Planning & Preparation:

- Certified Public Accountant (CPA)
- Enrolled Agent (EA)

Other:

- Certified Divorce Financial Analyst (CDFA)

Over the last few years as the financial planning has evolved significantly, a number of colleges and universities now offer bachelor's and master's degrees as well as a few of Ph.D. programs in personal financial planning. A bachelor's degree in personal financial planning provides the student with a good background. However, you should focus more on someone with one of the general personal financial planning designations (refer to Worksheet 20-2), or a master's or Ph.D. degree in personal financial planning.

Interviewing and Selecting Your Personal Financial Advisor

When choosing a financial advisor, I recommend that savvy consumers interview a few different financial advisors to learn more about each one's background, experience, specialties, target clientele, as well as his or her listening skills and communication styles.

Worksheet 20-3 is designed to assist you in interviewing financial advisors of any type. When seeking out a financial advisor, first send this financial advisor interview questionnaire and then visit with several prospective advisors over the telephone. After you've identified those advisors who may be the best fit your needs, ask for a no-obligation, get-acquainted meeting and meet with them in person before you make a commitment or sign any contracts.

TIP

You may obtain an electronic version of this questionnaire at `http://www.garrettplanningnetwork.com/files/Financial%20Advisor%20Interview%20Questionnaire.pdf`. Consider mailing or e-mailing this questionnaire to prospective financial advisors prior to meeting with them for the first time, which save both you and the advisor considerable time.

Worksheet 20-3 Financial Advisor Interview Questionnaire

1. Why did you become a financial planner?

____

____

____

____

____

2. What is your educational and experiential background as it relates to personal financial planning?

____

____

____

____

____

3. What are your financial planning credentials or designations and affiliations?

❑ Certified Financial Planner (CFP)

❑ CPA/Personal Financial Specialist (CPA/PFS)

❑ NAPFA-Registered Financial Advisor

❑ NAPFA-Provisional Member

❑ Chartered Financial Consultant (ChFC)

❑ Certified Public Accountant (CPA)

❑ Chartered Financial Analyst (CFA)

❑ Other (such as MBA, MS, PhD, AIF, CDFA, JD, EA, CLU, RFC): __________

4. What are your areas of specialty?

____

____

____

____

____

5. Please describe your most common engagement or service provided. And what is the type of client or client situation you target?

____

____

____

____

____

6. Are you a registered representative of any broker/dealer? Are you a licensed insurance agent with any company or agency? If so, which one(s)?

7. Are you a registered investment adviser? With the SEC? Or with what State(s)?

8. Are you a fiduciary?

9. How are you compensated?

Fee-Only, please define method of determining fees:

Commissions only:

Fee and Commissions (fee-based), provide typical breakdown:

Other:

10. Do you have minimums for assets, account size, annual fees paid, and so on? And what is your typical fee or charge for an initial engagement?

11. Do you provide a written agreement detailing the total amount of compensation and services that will be provided in advance of an engagement?

12. Do you provide a thorough written analysis of one's financial situation and recommendations?

13. Do you offer assistance with implementation with the plan? Please elaborate.

____

____

____

____

____

14. Will you provide a second opinion or one time review?

____

____

____

Signature of Advisor or Planner: ____________ Date: _____ Firm Name: ____________________

The questions in Worksheet 20-3 are designed to help you get to know a lot more about a prospective financial advisor prior to meeting with them or speaking with them on the telephone. If an advisor refuses to complete this questionnaire, that says a lot about his attitude or his schedule. In that event, continue on with other advisors who will comply with this request.

Here are a few more general guidelines as you go about your search for the right financial advisor:

- Some of the most revealing things you can find out about a financial advisor have to do with why they got into financial planning or advisory services in the first place. An individual that has a sincere and deep passion to serve others may be exactly the type of advisor for which you're looking. Many financial advisors have personally lived through life events that you may be experiencing and their personal insight could be extremely valuable to you, and it's very hard to gain through book knowledge.
- Another key question isn't just *how* an advisor is compensated, but *how much* that advisor will be compensated if you are to work with them. You can't compare advisors' services and prices without getting this kind of detail. And, don't forget about conflicts of interest related to compensation. If an advisor makes $1,000 recommending one strategy or investment and $5,000 recommending another, there is a conflict of interest. You should be fully aware of how this conflict can effect an advisor's recommendations and make sure that the option that would provide the advisor more money is really the best option for you.
- Make sure that any advisor you choose views you as her target client. In other words, she will be proud and honored to have you as a client. If you happen to be someone who just barely makes her minimum requirements, or maybe she made special arrangements or waved her minimums to accommodate you, sooner or later, you may find that you aren't getting the attention and personal service that you need and deserve.

- Many financial advisors, especially independent, veteran advisors, and fee-only advisors, require minimums. Those minimums may be the size of your investment account, your income or net worth, or the annual revenues you generate for the advisor. If you're a do-it-yourselfer or you're looking for a second opinion or one time review, you very likely won't qualify for many of these advisors minimum requirements. It's best to ask that upfront (when you receive their completed interview questionnaire or first speak with them) before you waste any more of your own time or the advisor's.

Be sure to obtain a written contract from the advisor you select, outlining exactly what the financial advisor will provide for you, how much the services will cost in total, what you must provide to get this work completed, and when you will receive the final product.

Always ask a lot of questions. Get a second opinion anytime it feels appropriate. And don't ever turn over control of your financial future to anybody and then just forget about it. You should always review your account statements, and never grant custody over your money. Your advisor could have the right to place trades within your account, or even have their fee withdrawn from your account, however they don't need custody of your money.