



Selecting a Financial Advisor

Selecting a financial advisor is a critical decision. It starts with an assessment of what a client wants and needs financially, how an advisor can help them accomplish those goals, and what type of relationship a client wants with an advisor.

Regardless of what a client is specifically looking for, however, there are a number of topics every client should investigate when evaluating a financial advisor.

1. **Clients should ascertain whether the advisor is *required* to act in a fiduciary capacity on behalf of their clients.** Certain financial professionals, by the very nature of their organization and regulatory requirements, are held to the highest standard of care as a fiduciary. Fiduciary duty is a *legal obligation* to put the client's interest first and foremost, regardless of the potential consequences for the advisor, at all times. Investment advisors, a legally recognized term, are considered to be fiduciaries and are legally bound to act in the best interests of its clients. Brokers, also a legally recognized term, are not fiduciaries, unless they are also registered investment advisors. Financial Planners is not a legally recognized term, and hence, may or may not be legally bound to the fiduciary standards depending on whether they are organized as an investment advisor or a broker. Selecting a financial advisor with a Fiduciary duty adds another layer of protection to the relationship by giving the client a broader array of legal options should things go south.
2. **Compensation Structure plays an important role in how a financial professional provides advice.** Financial professionals generally charge clients based on one of three models, and in some cases, on a combination of more than one. The models are:
 - a. **Transaction Based Fees / Commissions.** This model is generally attractive for clients who either don't require a significant amount of advice, and/or intend to trade relatively infrequently. However, there is an inherent conflict of interest between a client and a financial professional who charges commissions. The financial professional is compensated only when a client makes a transaction (buy or sell), and hence, is incentivized to recommend an active trading strategy, which may or may not result in the client achieving their goals. Mutual funds with loads are included in this model, since investors indirectly pay the financial professional either up front, when/if the fund is sold within a preset time frame (often as long as 5 or 6 years), or on a combination of the two.
 - b. **Fees, either based on an hourly rate or a flat fee for a service.** This model is generally attractive for clients who wish to maintain an ad hoc relationship with a financial professional, and do not wish to maintain a relationship over time. It is essentially a pay for services rendered infrequently arrangement, and is generally prevalent when working with financial planners (although financial planners often sell products on a commission-based arrangement as well).
 - c. **As a percentage of assets under management.** This model is generally attractive for clients that require a relatively high level of advice, do not wish to invest their financial assets themselves, and wish to maintain an ongoing relationship with a trusted financial professional. When an advisor is compensated based on a percentage of assets under management, the advisor's and the client's interests

are most closely aligned, since a reduction in the value of the client's portfolio results in a direct negative impact on the advisor's fees, and vice versa.

3. **Whether the financial advisor requires binding arbitration.** Many financial institutions require that their clients agree to binding arbitration in the event a client wants to pursue legal action against the advisor and/or firm. While binding arbitration can be a quicker process, it is generally much more expensive and may not be as impartial as other legal avenues. The significantly higher costs associated with binding arbitration mean clients must incur larger losses before it makes sense to pursue redress, and if/when they do, the net amount recovered is likely to be much less. As such, working with a firm that requires binding arbitration includes a higher degree of risk than would otherwise be the case.
4. **The education, certifications, and experience of financial professionals.** Providing financial advice is complicated and yet critical for clients who seek it. There are various organizations that educate, certify, and monitor financial professionals. Many organizations incorporate ethics and regulatory topics in their educational curriculums.
5. **Regulatory / Disciplinary History of advisor and their firm.** Brokers are regulated by FINRA, and clients can obtain regulatory and disciplinary actions against individual brokers and their firms from the FINRA website (see the link below). Investment advisors are regulated by either the SEC or the individual states in which they operate, and clients can obtain regulatory filings and disciplinary actions from those regulatory bodies (please see the links below). Keep in mind that the absence of regulatory issues and/or disciplinary history does not guarantee that a financial professional is honest. However, the presence of regulatory and/or disciplinary actions should serve as a red flag.
6. **What the financial professional's Disaster Recovery Plan entails.** Historically this was not a critical issue. However, events during this decade have highlighted the need for firms to draft, implement, and test procedures that would allow them to recover from a variety of disasters. A firm's ability to get back up and running and handle their clients' affairs in a timely manner should not be underestimated.

In addition to the above questions, we've found the following resources useful when evaluating financial advisors. We hope you will find them useful as well.

Consumer Federation of America - <http://www.consumerfed.org/>

- [Consumer Federation's "Cutting through the Confusion: Where to Turn for Help with Your Investments"](#)

U.S. Securities and Exchange Commission – <http://sec.gov/>

- [U.S. Securities and Exchange Commission "Protect Your Money: Check Out Brokers and Investment Advisors"](#)
- [U.S. Securities and Exchange Commission "Investment Advisors: What You Need to Know Before Choosing One"](#)

Financial Industry Regulatory Authority (FINRA) - <http://www.finra.org/index.htm>

- [FINRA's "Selecting Investment Professionals"](#)

North America Securities Administrators Association (NASAA) - <http://www.nasaa.org>

- [NASAA "Investor Bill of Rights"](#)

CFA Institute - <http://www.cfainstitute.org/>

- [CFA Institute's "How to Select a Financial Advisor"](#)