ANOTHER VIEW

Vital questions to ask your financial adviser

The financial industry is filled with jargon that can leave the consumer feeling overwhelmed and sometimes even misled. It is important to equip yourself with prudent questions to ask financial advisers to ensure that you understand the advisory relationship you are about to enter. While the questions are geared toward hiring a financial adviser, these questions are applicable to existing financial advisory relationships.

Compensation has the potential to impact the basis of the advice you receive; as such, it is one of the most critical components of a financial advisory relationship; transparency and clear understanding is of the utmost importance. As the saying goes, follow the money trail. For example, has a Chevy dealer ever recommend you buy a Ford? Knowledge is power, understanding the inherent conflicts-of-interest allows you, as the consumer, to make well-informed decisions.

There are three main types of adviser compensation: fee-only, commission-only and fee-based. Fee-only advisers receive their revenue directly from their client strictly as a fee-for-service. Fee-only advisers do not participate in revenue sharing, backdoor compensation, commissions, 12b-1 fees, etc. Commission-only financial advisers receive commissions on the sale of a product, such as a life insurance agent. A fee-based adviser often charges an advisory fee in addition to collecting commissions, revenue sharing, 12b-1 fees, etc.

Ask potential advisers — or your existing adviser — how they are compensated. Advisory fees and commissions are easily outlined, but are they receiving revenue sharing from mutual fund companies? Do certain financial products pay a higher commission than another? Reflect on the answers, are the recommendations in your best interest, or the financial interest of the adviser? If they are not willing to put all their fees in writing, and they are unwilling to disclose their potential conflicts-of-interest in writing, what are they hiding?

Albeit delayed, the Department of Labor Fiduciary Ruling has brought a focus to advisory ethics and standard of care; however, many advisers fail to mention that the Department of Labor ruling would only apply to retirement accounts such as 401(k)s and IRAs. The ruling does not apply to a non-qualified account — or after-tax accounts — such as an individual or joint brokerage account.

A fiduciary is required to place a client's interest first; whereas, the alternative standard of care is a suitability clause, where the recommendation cannot overtly harm the client. It is important to clearly delineate when the adviser is a fiduciary or acting under suitability standards. Few advisers act as a fiduciary in all aspects of your financial life. Again, ask the adviser to provide written confirmation of their regulator standard of care, are they a fiduciary in all aspects of your financial life?

Both the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) provide investors with tools for checking past disciplinary actions of advisers. Prior to meeting with a potential adviser, search the SEC's IAPD and FINRA's Broker Check, to see if any violations or disciplinary actions occurred in the past. These tools are available on their respective websites.

As with any relationship, setting expectations is paramount to the success or failure. Determining how many clients the adviser services will help you understand the level of client service. Typically, an adviser with 1,000 clients will have less frequent communication than an adviser with 200 clients. Ask about communication and meeting frequency to see if that fits your desires.

It's not merely the frequency of meetings, ask who all will be involved in your account. Who is making the investment decisions, the adviser, an investment committee or are decisions being outsourced to a Separately Managed Account/Manager? Are there multiple parties involved in your account, such as a Certified Financial Planner, Chartered Financial Analyst and Accredited Investment Fiduciary?

If interviewing multiple advisers, make certain to asked them the same questions and compare the results. If the answers seem too good to be true, they probably are. If the answers skirts your question or is overly complex, trust your gut. It is perfectly acceptable to go home and reflect upon your conversation. Do not fall victim to high pressure sales.

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