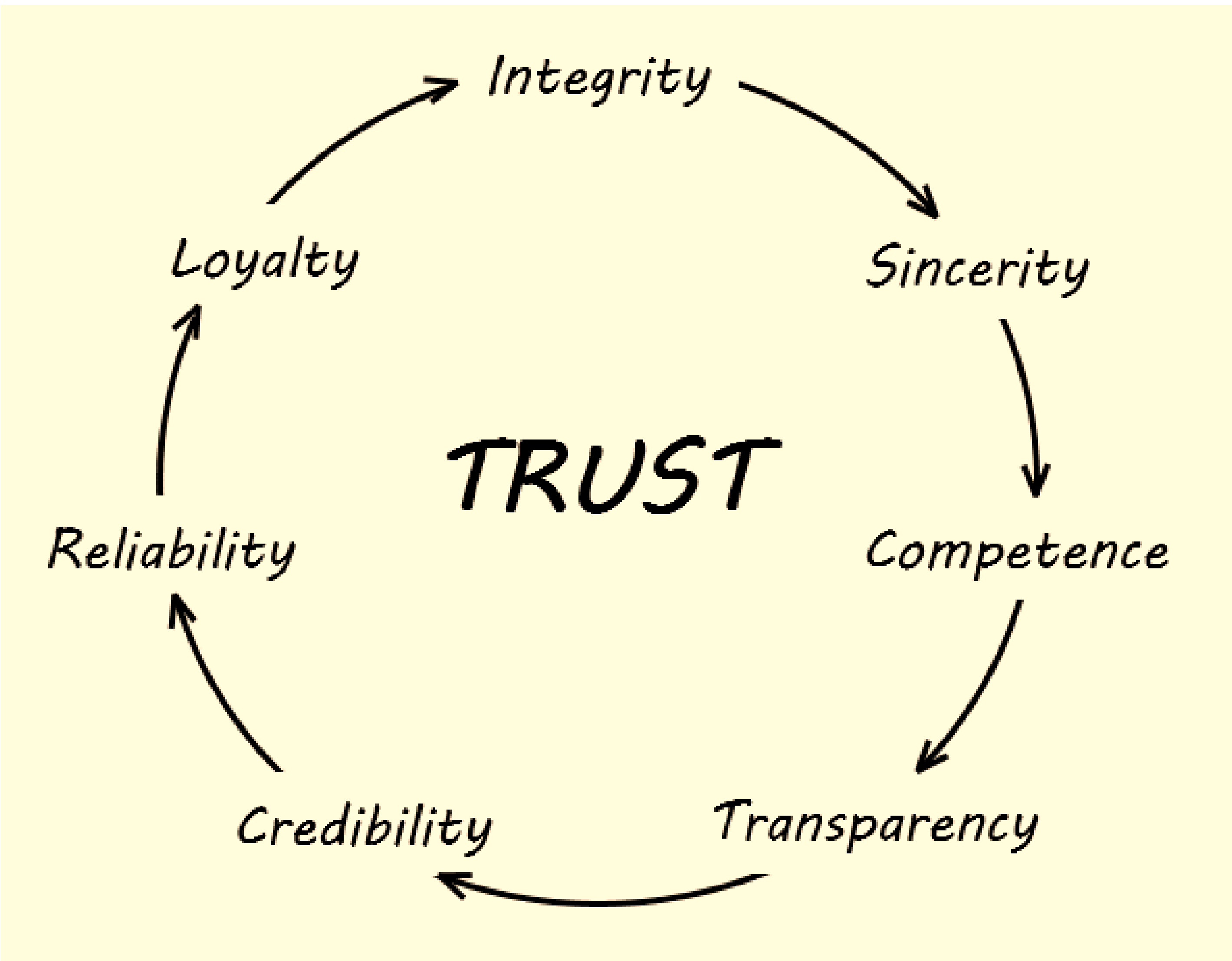
Who do You Trust?

8 Steps to Selecting the Right Financial Advisor

By Nick Naseman, RICP®, CFEd®, CFEI



Congratulations on making the choice to prepare for your future by managing your life savings. Studies have shown that by seeking professional investment support, you will be better prepared than half of the current seniors heading into retirement. Now that you've made the decision to obtain help, how do you decide *where* to get the help you need? There are multitudes of choices available, some good and some not so good at helping you accumulate a nest egg and intelligently withdraw from that nest egg during retirement. Not all investment professionals are created equal, nor do they have the same commitment to your financial well-being. The sad truth is that less than 20% of investors perform any type of due diligence before hiring an advisor. Here are some guidelines to help you make an informed decision:

1. IDENTIFY YOUR NEEDS

Before beginning a search, take time to clearly identify what you want a professional to do for you. Do you want someone to buy and sell investments based solely on your direction? If so, then a stockbroker may be the right fit for you. Do you need help analyzing your life insurance needs and deciding if an annuity is appropriate? Then an insurance agent is what you need (I believe an independent is better than a captive…see question #3). If you need help designing and implementing a financial plan or an income withdrawal strategy, a financial planner should be at the top of your list. Finally, if you need estate and legacy planning, an estate planning attorney or specialist is who you require. Many financial professionals can perform several of these functions, but very few can perform them all. By defining your needs, you can narrow your search and hopefully eliminate some frustration by not hiring the wrong professional. This step is often a major pitfall when it comes to working with financial professionals. Too often the client doesn't articulate what he or she wants and needs from an advisor, and the advisor doesn't do a sufficient job in uncovering these critical factors. In my opinion, this is the one area investors and advisors should spend more time focusing on.

What if you really don't know what you need? A competent advisor can help clarify and prioritize your needs. He or she should press you to answer questions you may be reluctant to talk about: how you plan on taking care of aging parents if you need to, who is going to make decisions for you if you suffer a cognitive disability, or will the surviving spouse be able to maintain his or her lifestyle after the breadwinner passes away?

An adviser can also identify what biases you have. Many of us think we don't have any…which is exactly the point. For example, women tend to be more risk-averse than men. That's neither good nor bad, but can influence investment decisions, given that women as a group tend to earn less and live longer than men. As a result, they could perhaps tolerate a bit more risk.

2. DETERMINE FIDUCIARY STATUS

Knowing your financial advisor's fiduciary status is very important. Not all financial professionals have your best interest in mind. Some are more focused on selling what you can afford, instead of what is best for your unique circumstances. In this instance, recommendations must meet the suitability standard. Basically, that means the advisor has to reasonably believe that any recommendations made are suitable for clients, in terms of the client's financial needs, objectives and situation. On the other hand, if your adviser is a fiduciary, the recommendation must be in your best interest. The difference here is where the advisor's loyalty lies. If he or she is a fiduciary, their loyalty to clients (doing what's best for the client) must be above their loyalty to their firm (making a sale).

There is no clear-cut definition of a financial advisor. One definition from an online legal dictionary is: An individual in whom another has placed the utmost trust and confidence to manage and protect property or money. The relationship wherein one person has an obligation to act for another's benefit (http://legal-dictionary.thefreedictionary.com). In other words, a fiduciary is a trusted individual who is expected to act in the best interest of the client. A fiduciary must place their loyalty to their client above their loyalty to their company or their own interests.

In many states there are no strict regulations regarding the terms "financial advisor" or "financial planner," meaning almost anyone can print up business cards using those terms. Hiring someone with the title "financial advisor" does not mean you are hiring someone who will always make the best recommendation for your unique circumstances.

The term “financial advisor” can be used by numerous professionals. Financial professionals have different specialties and differing levels of client loyalty. The following definitions are from the Financial Industry Regulatory Authority (FINRA) website.

BROKERS

While many people use the word broker generically to describe someone who handles stock transactions, the legal definition is somewhat different—and worth knowing. A broker-dealer is a person or company that is in the business of buying and selling securities—stocks, bonds, mutual funds, and certain other investment products—on behalf of its customers (as broker), for its own account (as dealer), or both. Individuals who work for broker-dealers—the sales personnel whom most people call brokers—are technically known as registered representatives.

INVESTMENT ADVISERS

Investment advisers (purposely with an "e") are individuals or companies that provide advice about securities tailored to the needs of their clients. Common names for this type of professional include asset managers, investment counselors, investment managers, portfolio managers and wealth managers. An investment adviser is an individual or company who is paid for providing advice about securities to their clients. Although the terms sound similar, investment advisers are not the same as financial advisors and should not be confused. The term financial advisor is a generic term that usually refers to a broker (or, to use the technical term, a registered representative). By contrast, the term investment adviser is a legal term that refers to an individual or company that is registered as such with either the Securities and Exchange Commission or a state securities regulator. Investment adviser representatives are individuals who work for and give advice on behalf of registered investment advisers.

FINANCIAL PLANNERS

Financial planners can come from a variety of backgrounds and offer a variety of services. They could be brokers or investment advisers, insurance agents or practicing accountants—or they have no financial credentials at all. Some will examine your entire financial picture and help you develop a detailed plan for achieving your financial goals. Others, however, will recommend only the products they sell, which may give you a limited range of choices.

INSURANCE AGENTS

An insurance agent is a salesperson who can help individuals and companies obtain life, health or property insurance policies and other insurance products including different types of annuities.

ACCOUNTANTS

Accountants are trained to provide professional assistance in areas including tax and financial planning, tax reporting, auditing and management consulting. A CPA can help you consider the tax implications of financial decisions.

ATTORNEYS

A lawyer is licensed to give legal advice to clients. Lawyers are trained to tell you about the legal impact one financial planning or investment decision might have on another—such as the tax implications of setting up a certain type of trust for your estate.

3. IDENTIFY WHAT PRODUCTS WILL BE OFFERED

It is also important to know what types of investment vehicles your advisor can recommend. Some advisors are only licensed to offer securities (stocks, bonds, mutual funds, etc). Others are only licensed to offer insurance products (life insurance or annuities). Still others can recommend investment vehicles such as commodities, REITS, Limited Partnerships, real estate, art, etc. Even advisors who are licensed the same may not offer the same products due to the company they work for.

A major determinant on the products an advisor can offer is whether or not they are a captive or independent agent. A captive agent can only offer products of the company he or she represents, while an independent can usually offer solutions from many different companies. Be careful if someone indicates they are independent, though. Oftentimes, even though an advisor will be contractually independent, he may be psychologically captive. What I mean by that is even though the adviser has the option of offering different solutions, he only recommends one. Usually this is due to incentives offered by the company if the adviser steers investors to that particular company.

4. UNDERSTAND HOW YOUR ADVISOR GETS PAID

Know how your advisor gets paid. This area can help identify any potential conflicts of interest your adviser may have.

- Commission – These advisors rely on commission-based products and services to make their living. Brokers selling loaded mutual funds and insurance salesmen fall into this category.
- Fee-Based – These advisors have the option of recommending a combination of commission-based products or getting paid based on the amount you have invested with them (assets under management fee).
- Fee-Only – These advisors only recommend non-commissioned based products. They can charge fees in several ways; an assets-under-management fee, retainer fee (flat fee), hourly fee, or task-based fee.

5. IDENTIFY ANY SPECIALTY YOUR ADVISOR WOKS IN

Along the same line as identifying requirements, make sure to ask if the advisor works in a specialty. Most advisors focus on growing your money during your working years. Once you get near or in retirement, the risks to your portfolio change. For one thing, you don't have as much time to recover from significant losses as you did while you were still working. It's not easy to go back to work after your portfolio experiences a few bad years of returns. Most investors' portfolios ratchet down to a more conservative asset allocation mix in retirement. However, that may not be the best for your particular situation. Being too conservative, coupled with monthly withdrawals, may not give your nest egg the longevity required to maintain your desired lifestyle. Additionally, selecting an efficient withdrawal strategy can help your portfolio last several years longer. Recent studies have shown that conventional wisdom may not be the optimum strategy to get the most lifetime retirement income.

6. KNOW WHAT SERVICES ARE OFFERED

Know what services you can expect. If the adviser can't provide these services, make sure they have a trusted referral and can make the introduction.

- Investment recommendations
- Insurance recommendations
- Tax reduction strategies
- Estate planning
- Retirement income planning
- Budgeting recommendations
- Ongoing education and coaching

7. CONDUCT A BACKGROUND CHECK

Finally, conduct a background check of your potential adviser. There are several places you can go to identify previous complaints against your adviser. For brokers and investment advisers, go to: www.adviserinfo.sec.gov/.
For insurance agents:
www.sircon.com/ComplianceExpress/Inquiry/consumerInquiry.do?nonSscrb=Y .
The adviser may be a member of ethics organizations that conduct their own background checks before accepting members. An example is: www.ethics.net.
Conducting a simple search with your internet browser (Google search) may turn up any complaints. While not all complaints will show up via these methods, keep in mind that not all complaints that are lodged are legitimate. If the adviser does have a complaint lodged against him or her, ask them to explain.

8. ASK QUESTIONS

Below are some questions to ask when you are interviewing an advisor. This is not an exhaustive list, but a few suggestions. A true professional shouldn't hesitate to give you clear answers to any of these questions. Any reluctance may be an indication they are not the right fit for you.

Questions to ask your advisor:

1. **Are you a fiduciary? If so, will you put it in writing?** Often, an adviser will say they act in the client's best interest. However, if they are unwilling to put it in writing, they are not true fiduciaries.

2. **How do you get paid?** Have the adviser explain *every* way they receive compensation from having you as a client. If they are an RIA, this will be explained in the ADV Part 2 (required to be provided to every client and prospective client). However, you should not hesitate to ask. Does your advisor charge for updating your retirement/investment plan? Or is it included in the basic fee structure? How often can you meet face-to-face? Most advisors allow multiple meetings, but a few charge for anything more than the annual review.

3. **Are you a captive agent**? Captive agents are normally only authorized to offer products from one company or are limited to a few companies' products. This limits your selection and may prevent you from obtaining the best solution to satisfy your unique investment needs.

4. **Do you have any credentials? What do they mean**? Have them explain the letters behind their name and then research them on the internet yourself. Here's a useful link to look up credentials: www.finra.org/Investors/ToolsCalculators/ProfessionalDesignations/DesignationListing/

5. **Do you have any conflicts of interest**? Some advisors are not only compensated with commissions when selling a particular product, but may be compensated if they sell a certain amount of that product (often referred to as soft dollar compensation). Likewise, financial firms may

be compensated more if they steer their clients to particular investments (often referred to as profit sharing).

6. **How do you handle tax and legal questions?** Do they have trusted professionals to refer you to? Be careful about receiving tax or legal advice from someone not licensed in those areas.

7. **How can I, as a client, evaluate your performance? Do you have audited returns?** Ask how long you should wait before you can expect to notice results from the recommendations. Some results will take longer than others to notice (investment performance) while others may be readily apparent (cost savings). Also, be sure to identify what benchmark your portfolio will be measured against. Make sure your adviser is using the same metric when benchmarking your portfolio (comparing apples to apples). Finally, make sure he or she is not selecting time periods of comparison that make the investment look favorable.

8. **How much experience do you have?** Make sure they have experienced bull and bear markets as a professional, or at least have a team member (if part of a team) that has that experience. While experience alone should not be the deciding factor in selecting an adviser (lots of advisors have many years' experience providing bad advice), make sure they are not fresh out of school, unless they are mentored and supervised closely by a seasoned professional.

9. **How will you protect me when the market crashes or has a significant loss?** Make sure you understand your advisor's philosophy when it comes to down markets. Does he or she expect you to hold steady and wait for the market to return? What mitigating strategies or hedging strategies will he or she employ to protect your principal? Has the person managing your money been through both a bull and bear market? How have portfolios performed through a full market cycle? Past performance is not a guarantee of future results, but it may give you an idea of what to expect.

10. **Have you put my portfolio through a stress test?** This question is an extension of the previous one. How is your portfolio expected to

perform when the market loses 20%? How about when it gains 20%? How much of an impact will rising interest rates have on your portfolio? If you have a conservative mix with a significant amount of bonds or bond funds, a rise in interest rates can severely impact your portfolio's value. How much of an impact will taxes have on your withdrawal strategy? A retirement plan can look good on paper, but unless you examine the expected results in various scenarios, you may be in for a big surprise when something out of the ordinary happens.

11. **How will you create income for me in retirement?** What you don't want to hear is that if you take 4% annually, you'll be fine. Without getting into too much detail, the 4% rule is based on a study conducted back in 1994 and indicated that for most retirees, withdrawing 4% a year from their nest egg would allow for 30 years of income. Since the study didn't take into account significant down years like the lost decade (2000-2009) followed shortly thereafter by many years of near-zero interest rates, the 4% rule may or may not be a good rule of thumb to follow. There are several ways of creating income in retirement, including systematic withdrawals, the bucket approach, or the flooring approach, to name a few (all beyond the scope of this report). The best approach for you is an individual decision that should be made only after a thorough discussion with a competent advisor.

12. **How much contact do you have with your clients?** This question should be compared to your communication requirements. If you like fairly regular contact, a once per year meeting will probably not be a good fit. However, if you trust your advisor and don't require frequent communications, weekly emails or market updates can get annoying. Do you like to conduct business via email, phone, or in person? Make sure your style is similar to your advisor's.

13. **What makes you unique?** Finally, the essential question all investors should ask of their advisors. Hopefully, your advisor can clearly articulate a unique service or trait that makes him or her stand out from the crowd. When you get a definitive answer, ensure it lines up with your priorities. What makes your advisor unique should fulfil what you've identified as your critical financial needs.

There you have it. This paper should give you a very good starting point to selecting a financial advisor. Designing and implementing an investment strategy is a collaborative effort. Finding the right financial professional is just the first step. Needs analysis, ongoing communication, and solid recommendations should lead to a plan you are comfortable with and can stick with through the years. Don't be too hasty to switch advisors if you already have one. Use this guide to make sure he or she is a good fit for you, and don't be afraid to get a second opinion. If your current advisor is a true professional and really does have your best interest at heart, they won't shy away from a little competition. Happy hunting and remember, "Don't hope for a good retirement. Plan for a great one!"

IRON MOUNTAIN
FINANCIAL

Nick Naseman is a Colorado retirement advisor and founder of Iron Mountain Financial (a Registered Investment Adviser). He is a Retirement Income Certified Professional®, a Certified Financial Educator®, and a Certified Financial Education Instructor. Nick is a member of the Consumer Advocate Financial Network and Senior Resource Council. Nick is a fiduciary with a focus on designing and implementing retirement income strategies with the goal of making a retirees' nest eggs last as long as possible. You can reach Nick at 719-623-7433, or Nick@Iron-Mountain-Financial.com. Website: Iron-Mountain-Financial.com.

Don't hope for a good retirement.
Plan for a great one!