Choosing a Financial Advisor…What You Need to Know

By Rob Lemmons, CFP®, CPA, AIF®
rlemmons@wealthdimensions.com

From radio and television to print media, it seems that all financial advisors claim to be credible experts who put their client's interests first and offer independent and objective advice. New buzz words - objective, independent, and commitment – litter their sales pitches. A recent radio advertisement for a local bank stated "we put your interests first," while a television ad for a national brokerage firm stated "we offer objective advice". All of these planners claim to be looking out for you, but how do you know that the advice given is always aligned with your best interests?

Most of these financial advisors are affiliated with broker-dealers by the Securities and Exchange Commission (SEC) and are required by federal law to act in the best interest of their employer, not their clients. The large brokerage houses like Merrill Lynch (recently insolvent and purchased by Bank of America), Smith Barney, UBS, JPMorgan Chase, Morgan Stanley, and Edward Jones are not necessarily acting in the best interest of their clients. For this reason, **the SEC requires broker-dealers to add the following disclosure to all client agreements:**

> *"Your account is a brokerage account and not an advisory account. **Our interests may not always be the same as yours**. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. **We are paid both by you and, sometimes, by people who compensate us based on what you buy.** Therefore, our profits, and our salespersons' compensation, may vary by product and over time."*

Is there a better alternative? Under the Investment Act of 1940, a Registered Investment Advisor (RIA) has a fiduciary responsibility to act solely in the best interest of the client at all times. In seeking an advisor, you should avoid anyone who is not willing to take a fiduciary role and acknowledge that role in writing. This will help you guarantee that the advisor you choose is legally bound to act in your best interest.

Now that you have chosen the right type of advisor, you will want to inquire about the planner's experience and educational background as well as the services offered. Look for a financial advisor who has proven experience in financial planning topics such as retirement planning, investments, tax and estate planning, and insurance. Determine what qualifies the planner to offer financial planning advice and whether he/she is recognized as a Certified Financial Planner (CFP®), Certified Public Accountant (CPA), or a Chartered Financial Consultant (ChFC). If the individual holds any professional designations, check on his/her background with the relevant organization and determine what kind of continuing education is required to maintain the designation.

The two biggest causes of retirement planning failure are overly aggressive assumptions and incomplete analysis. Therefore, you will want to make certain that your advisor is thorough and that his/her viewpoint on investing is not too cautious or overly optimistic.

Keep in mind that the type of services offered will often depend on a number of factors including credentials, licenses, areas of expertise, and affiliation with a broker-dealer. For instance, certain advisors may only be able to recommend investments in a limited number of products approved for use by their broker-dealer. Through revenue sharing agreements, mutual fund companies make payments to fund distributors, such as a broker-dealer, for inclusion in the investment platform available to customers. Most brokerage firms limit the funds on their platform to those who will pay revenue sharing, which unfortunately, eliminates client access to many low cost funds.

To judge the value of an advisor's services, it is important to understand how the advisor is compensated and what the total costs are that you're likely to pay. Commission-only advisors earn their income by selling financial products such as certain types of mutual funds, various insurance products, or by executing securities trades. Fee-only advisors earn their income through fees based on an annual percentage of assets. There are some advisors, however, that may receive income from both commissions and fees. These advisors may therefore say their compensation arrangement is "fee-based," not to be confused with "fee-only" arrangements. Other compensation arrangements are more subtle. All mutual funds have expenses, but some expense ratios are much higher than others. Commissions on mutual fund purchases aren't always paid from a visible up-front sales charge: for example, some funds charge a 12(b)-1 fee, which is a commission to brokers. Even if current law requires this sort of incentive to be disclosed, reading through and understanding financial disclosure documents can be tedious. A fee-only advisor's investment recommendations are not influenced by compensation arrangements so there is no incentive to frequently trade securities without just cause or to favor higher cost funds over lower cost funds.

Whatever your needs, taking the necessary steps to find a financial advisor who is legally bound to act in your best interest can be a rewarding experience and a helpful step in securing your retirement.

To make sure your advisor's interests are aligned with yours, ask these four questions. You should be prepared to avoid anyone who cannot answer yes to *each* question.

1. Are you and your firm legally bound as a Fiduciary in all aspects of our relationship and are you a Registered Investment Advisor (RIA) regulated by the SEC?

Federal and state law requires that Registered Investment Advisors are held to a Fiduciary Standard. This law requires that an advisor act solely in the best interest of the client, even if that interest is in conflict with the advisor's financial interest. The Fiduciary Standard is a higher one than the suitability requirement imposed on brokers and other salespeople whose only obligation is to recommend a <u>suitable investment, not the best investment</u>. At Wealth Dimensions Group, we acknowledge our role as a fiduciary in writing.

2. Do you disclose all conflicts of interest, both actual and potential, that exist or might exist in our relationship?

Investment advisors must disclose any conflict, or potential conflict, to the client prior to and throughout a business engagement. You should know if there are any limitations on what investment products your advisor can recommend. These limitations and conflicts can arise from revenue sharing arrangements between mutual fund companies and brokers or the misaligned interests of a commission-based advisor.

3. How do you get paid? Do you receive on-going income from any of the investments that you recommend in the form of "12(b)1" fees, commissions, or other payouts?

As mentioned earlier, some mutual funds and investment product sponsors pay 12(b)-1 and similar fees. Trailing fees may negatively affect you due to the fact that the product sponsor may charge you higher fees and then may pay a portion of that money to the financial advisor on an ongoing basis. Commission-based advisors may receive higher commissions on certain products which may influence their decision to recommend investment products that are not always in your best interest. We at Wealth Dimensions Group receive no compensation other than our clearly stated management fees, thereby eliminating any potential conflict of interest.

4. What are your credentials?

Anyone can call themselves a financial advisor. Titles such as financial planner, financial advisor, financial consultant, vice president, and senior planner are internal titles, none of which are governed by outside entities nor do they require continuing education, experience, or oversight. When looking for financial advice, seek an individual who holds one or more of the following designations:

A **Certified Financial Planner (CFP®)** has met the CFP® Board's education, examination, and experience requirements, and is uniquely qualified to help clients identify their financial objectives and effectively manage their personal finances in order to achieve those objectives. In addition, the CFP® must abide by a code of ethics and meet continuing education requirements.

A **Certified Public Accountant (CPA)** has met certain education and experience requirements and passed a comprehensive uniform CPA exam developed and administered by the American Institute of Certified Public Accountants. A CPA must also abide by a uniform code of ethics and complete 40 hours of continuing education per year.

An **Accredited Investment Fiduciary (AIF®)** designation is granted by the Center of Fiduciary Studies. The AIF® must sign and agree to abide by a code of ethics and complete a continuing education requirement annually.

A **Chartered Financial Consultant (ChFC®)** designation is the property of The American College and may be used by individuals who have successfully completed the initial and ongoing certification requirements for this designation.

Rob Lemmons CFP®, CPA, AIF® possesses expertise in working with high net worth individuals to integrate the concepts of the financial planning process into their daily lives. As an Accredited Investment Fiduciary (AIF®), Rob helps small businesses meet their fiduciary responsibilities by developing and implementing a set of prudent practices to guide the investment related decisions of retirement plans. *You can read more about Rob on the next page.*