Selecting a Financial Advisor

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Executive Summary

The purpose of this module is to discuss key aspects in choosing a financial advisor, including providing relevant information to the advisor, setting expectations with the advisor, understanding the fee structure and dealing with problems that might arise between advisor and client. The module is divided into four segments.

1. A discussion of the need for a financial advisor and the responsibilities of the advisor and the investor
2. Identifying a financial advisor using an online tool and checking the credentials of an advisor with another online tool
3. Preparing to meet with an advisor
4. How financial advisors are compensated, as well as how problems with an advisor may be managed

In particular, the module will address:

- Understanding why you might need a financial advisor
- Preparing a self assessment checklist: What do you want from the advisor and how do you want the relationship to work?
- Preparing an advisor services checklist: What tasks would you like the advisor to perform for you?
- Identifying a qualified advisor in your area
- Preparing an advisor prescreening checklist: Checking references and asking questions
- Describing your current financial situation and financial goals
- Evaluating an advisor's suitability for you
- Understanding advisor fees
- Dealing with financial advisor problems

Educational Motivation

- To understand how a financial advisor can be helpful and to appreciate both advisor and client responsibilities
- To address key factors in selecting a financial advisor
- To appreciate the costs in working with an advisor

Overview of Material

Key Terminology:

Certified Financial Planner (CFP): An advisor with expertise in estate planning and investments who has at least three years of work experience and who has passed a comprehensive examination.

Certified Investment Management Consultant (CIMC): An advisor with three years of consulting experience who is certified by the Institute for Investment Management Consultants.

Certified Public Accountant (CPA): A specialist in accounting and taxes who is licensed to do business by the state and who may represent taxpayers before the Internal Revenue Service; rigorous examinations are required for this certification.

Chartered Financial Analyst (CFA): An investment advisor who has passed a rigorous examination, has at least three years of investment management experience, and is certified by the Association for Investment Management and Research.

Chartered Financial Consultant (ChFC): An advisor who has passed an examination on the major financial planning areas (income tax, insurance, investments and estate planning) and has at least three years of experience.

Chartered Investment Counselor: (CIC): An advisor who is certified by the Investment Counsel Association of America and also holds the CFA designation.

Chartered Life Underwriter (CLU): An advisor who specializes in life insurance and has at least three years of experience.

Commission-Only Planner: An advisor who is compensated through commissions earned on financial products that you purchase. (Compare to fee-only and fee-and-commission planner.)

Enrolled Agents: A tax professional who has passed a rigorous examination and who is enrolled with the US Department of Treasury to represent taxpayers before the Internal Revenue Service.

Fee-and-Commission Planner: An advisor who charges you a fee for service but also receives commissions (sometimes called a "fee-based" planner; compare to fee-only and commission-only planner).

Fee-Only Planner: An advisor who charges a fixed hourly rate, a fixed fee, or a percentage of assets under management. (Compare to commission-only and fee-and-commission planner.)

Personal Financial Specialist (PFS): A designation for accountants who specialize in financial and retirement planning; certification provided by the American Institute of Certified Public Accountants.

Background Information

The facilitator will want to survey key aspects of the financial advisor/client relationship. It is often useful to organize the discussion using webpage forms that can be filled out and printed.

Do I need a financial advisor?

(Based on "Eleven Reasons You May Need a Fee-Only, Comprehensive Financial Advisor" found at www.napfa.org/tips_tools/article.asp?CATEGORY_ID=2&TT_ID=2.)

Individuals decide to work with financial planners for a variety of reasons. They might be overwhelmed and confused about their finances. They might be intimidated by the volume and complexity of financial information they must process in order to handle their finances. Is your financial planning being neglected because you don't know what to do? Are you the type of person who does not enjoy taking care of your affairs, so that no planning will be done without help? Do you have "better" things to do with your life—e.g., leisure or work?

What an advisor can and cannot do for you

(Source: "Working with a Fee-Only Advisor," www.napfa.org/consumer/WorkingwithaFeeOnlyAdvisor.asp.)

Your financial advisor can do much more for you than simply handle your investments. You might want your advisor to assist with retirement and estate planning, cash flow management and tax planning. It is not too early for you to begin to think about these long-term financial issues. Even though you will likely not retire for 50 years, you can best prepare for retirement by investing early in your working career.

You must also realize that your advisor is not omnipotent. The advisor does not have a magical crystal ball to look into the future. She cannot read your mind. You must tell her explicitly your goals and aspirations. She cannot guarantee the performance of your investments. She is not a trained therapist or psychic.

Identifying an advisor

(Based on www.myfinancialadvice.com/Customer/Default.aspx.)

How will you identify a list of qualified financial advisors? You will want to choose someone who is close geographically to you because you will likely want to meet face-to-face with your advisor on a regular basis. You might want to identify potential advisors who have special expertise that you might need, for example in sophisticated tax planning if you will be dealing with trusts. You might need to identify an advisor willing to work with beginning investors with small account balances.

Checking advisor references and asking questions

(Based on "Checking references, Questions to ask" and "Critical list, Questions for advisor candidates" found at www.gga.ca.)

In selecting an advisor, you will have questions for both the advisor and for client references provided to you by the advisor.

- How long have you been working as an advisor?
- Do you provide just planning or can you also manage my investment portfolio?
- Will you work with other professionals assisting me, such as my accountant and lawyer?
- What are your educational and professional certification qualifications?
- Will you provide me with some client references?

The facilitator may decide to introduce a discussion of the typical professional certifications (see Key Terminology above).

Contact the client references provided by the advisor. Don't be afraid to ask the references hard questions.

- Did the advisor ever disappoint you?
- Is the advisor available and responsive in a timely fashion?
- Has she ever lied to you or been evasive in answers?
- Has she implemented the strategies that you agreed upon?
- How is she to deal with when things go poorly?

Preparing financial information and data for the advisor

(Based on "Financial needs checklist" found at www.gga.ca and "What Are Your Planning Issues?" found at www.napfa.org/tips_tools/article.asp?CATEGORY_ID=2&TT_ID=25.)

It is important that the advisor understand your financial goals and status as completely as possible. It is likely that your advisor will have a set of forms and worksheets that you will use to convey this information to her. The worksheets can be short and of a summary nature, or they might contain many pages requiring very specific financial details. Do not hesitate to tell your advisor which type will be most appropriate for you. The facilitator will want students to fill out a short, sample financial checklist. Typically, the checklist/worksheets will contain questions that are inappropriate for high school students, such as marital status, amount of mortgage debt, etc. Nonetheless, it is a useful exercise for students to see the full breadth of questions and determine why selected questions are not appropriate for them. The facilitator might want to show students a very detailed questionnaire—see www.efmoody.com/planning/questionnaire.html. Please note that the facilitator should emphasize that the hand-out is meant to illustrate the point that questionnaires can be lengthy. The facilitator will want to make clear that a specific commercial product is not being endorsed.

Understanding financial advisor fees

You should not expect your advisor to work for free, but you need to understand how you will pay for her services. Your advisor might work on a fee basis—you will pay a fixed annual fee and/or pay an hourly rate. Under this approach, the advisor has no particular incentive to direct your investments toward a specific investment category or family. Alternatively, your advisor might be compensated based on a percentage of your assets that she manages or via commissions she earns from mutual funds, insurance companies, etc., for investing (using your funds) in their products. The facilitator will want to address the potential conflict here. With well prepared students, the facilitator could productively talk about a wide range of principal/agent issues.

To illustrate the corrosive effect of fees, use the EFFECT OF MANAGEMENT FEES ON RETURN EARNED handout contained herein.

Dealing with problems with your advisor

(Based on www.finra.org/Investors/ProtectYourself/index.htm.)

Your working relationship with your advisor might not always go smoothly. You will want to take measures to protect yourself from unscrupulous advisors and understand how to resolve problems. Protecting yourself is often a matter of applying common sense. Be on the lookout for "too good to be true" recommendations. It is usually a bad idea to invest based on telephone only solicitations. If your advisor touts "inside" information or guaranteed investments, be very wary. You should also be aware of the number of transactions that occur in your account. Lots of transactions can generate huge commissions for your broker, but might not be in your best interest and are a clear warning sign of trouble.

To address serious problems, you will want to contact the appropriate regulating authority. As an illustration, the facilitator may want to use the FINRA website to explore options for dealing with problem brokers.

Web Site Documentation

www.finra.org/Investors/ProtectYourself/index.htm
A useful FINRA website containing registration and licensing information for individual brokers and brokerage firms.

www.finra.org/Investor/Resources/Designations/
A detailed website providing information on many finance professional designations.

www.sec.gov/investor/brokers.htm
A US Securities and Exchange Commission website useful in researching brokers and investment advisors; provides links to key FINRA sites.

www.pueblo.gsa.gov/cic_text/money/financial-planner/10questions.html
Provides a 10-question financial advisor questionnaire.

www.sec.gov/investor/pubs/askquestions.htm
A US Securities and Exchange Commission website that provides questions you should ask about your investments and what to do if you have a problem with a professional advisor.

www.kiplinger.com/personalfinance/features/archives/2004/12/finadvice.html
This website lists several financial advisor networks that can be used to identify and qualify financial advisors by geographic area.

www.myfinancialadvice.com/Customer/Default.aspx
A typical referral service for financial advisors—a good website to use for illustration purposes during the class session.

www.napfa.org
This website for the National Association of Personal Financial Advisors is a gateway to several documents about financial planning, including the two listed next.

www.napfa.org/tips_tools/index.asp
Provides links to several documents that provide a variety of information about selecting, preparing to meet with, and working with a financial advisor.

www.napfa.org/consumer/WorkingwithaFeeOnlyAdvisor.asp
Describes the responsibilities of the financial advisor and the investor.

www.gga.ca
This website contains “Critical list: Questions for advisor candidates” and “Financial needs checklist” prepared by Fidelity Investments.

www.finra.org/Investors/ProtectYourself/index.htm
This FINRA website reviews selecting a broker and avenues for problem resolution with brokers.

www.efmoody.com/planning/questionnaire.html
This website provides an example of a very comprehensive client questionnaire financial worksheet.

www.retireearlyhomepage.com/advise.html
This website has some useful discussion about selecting an advisor and also provides the table on the effect of management fees that is provided as a handout for this module.

Lesson Plan and Relevant Assignments

Materials Needed:

- WEBSITES handout
- EFFECT OF MANAGEMENT FEES ON RETURN EARNED handout

90-minute Lesson Plan:

10 minutes: Segment 1. Discuss the possible need for a financial advisor and the responsibilities of both the advisor and the client.

25 minutes: Segment 2. Distribute the WEBSITES handout. Have students identify and select an advisor that would be appropriate for them using the **Identifying a Financial Advisor** assignment below.

10 minutes: Segment 2 cont'd. Discuss ways to check the background and qualifications of the advisor using the **Checking Advisor References and Asking Questions** assignment below.

25 minutes: Segment 3. Guide students through completion of the **Preparing Financial Information** assignment below.

10 minutes: Segment 4. Discuss how advisors are paid and the impact on your rate of return caused by fees. Distribute the EFFECT OF MANAGEMENT FEES ON RETURN EARNED handout.

10 minutes: Segment 4 cont'd. Discuss how problems with your advisor may be handled.

35-minute Lesson Plan:

In this shorter session, it is recommended that the class not complete the preparation of the financial worksheet (Segment 3), but rather concentrate on the mechanics of choosing an advisor (Segments 1, 2 and 4).

5 minutes: Segment 1. Discuss the possible need for a financial advisor and the responsibilities of both the advisor and the client.

15 minutes: Segment 2. Distribute the WEBSITES handout. Have students identify and select an advisor that would be appropriate for them using the **Identifying a Financial Advisor** assignment below.

5 minutes: Segment 2 cont'd. Discuss ways to check the background and qualifications of the advisor using the **Checking Advisor References and Asking Questions** assignment below.

10 minutes: Segment 4. Discuss how advisors are paid and the impact on your rate of return caused by fees. Distribute the EFFECT OF MANAGEMENT FEES ON RETURN EARNED handout.

Assignments:

Segment 2 – Identifying a Financial Advisor

While useful for our purposes of identifying an advisor, please note that this is a commercial website that contains advertising and attempts to sell products. It would be a very useful lesson to remind students that commercial sites are often designed as primarily sales and marketing sites.

URL: www.myfinancialadvice.com/Customer/Default.aspx

1. Click on a particular financial topic to find an advisor for that topic.
2. Enter your state of residence to view advisors in the appropriate geographic area. Submit.
3. Move the cursor over the name of any advisor and click to view more detailed information on the

advisor. Explore the information in the advisor profile. Of particular interest would be expertise, credentials and fees. Students will want to compare and contrast profile screens for different advisors.

Segment 2 cont'd – Checking Advisor References and Asking Questions

URL: www.gga.ca/choose7.html

1. Go to www.gga.ca/choose7.html and select "Checking references, Questions to ask."
2. Check each box representing a question that you would like to ask advisor references.
3. If you are unable to save the completed form as an electronic file, be sure to print it out.
4. Go to www.gga.ca/choose7.html and select "Critical list, Questions for advisor candidates."
5. Check each box representing a question that you would like to ask your advisor candidate.
6. If you are unable to save the completed form as an electronic file, be sure to print it out.

Segment 3 – Preparing Financial Information

URL: www.gga.ca/choose7.html

and

URL: www.napfa.org/tips_tools/articles.asp

1. Go to www.gga.ca/choose7.html and select "Financial needs checklist."
2. Click on each blank representing a question that you would like to answer and type your answer.
3. If you are unable to save the completed form as an electronic file, be sure to print it out.
4. Go to www.napfa.org/tips_tools/articles.asp; click on "What is Comprehensive Planning?"; select "What Are Your Planning Issues?" This form does not allow for electronic data entry.
5. Working with either a hard copy of the form or viewing on the screen, compare this version of a worksheet to the worksheet prepared above.
6. To view a more comprehensive worksheet, go to www.efmoody.com/planning/questionnaire.html.

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A detailed website providing information on many finance professional designations.

www.sec.gov/investor/brokers.htm
A US Securities and Exchange Commission website useful in researching brokers and investment advisors; provides links to key FINRA sites.

www.pueblo.gsa.gov/cic_text/money/financial-planner/10questions.html
Provides a 10-question financial advisor questionnaire.

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www.kiplinger.com/personalfinance/features/archives/2004/12/finadvice.html
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EFFECT OF MANAGEMENT FEES ON RETURN EARNED

The Effect of Management Fees on your Earnings. Assumes $2,000 yr. contribution, 10% annual return before management fee.					
IRA Balance after	**5 Years**	**10 Years**	**20 Years**	**30 Years**	**40 Years**
Mgmt. Fee @ 0.02%	$13,423	$35,022	$125,696	$360,454	**$968,249**
Mgmt. Fee @ 0.25%	$13,334	$34,556	$122,204	$344,402	$907,762
Mgmt. Fee @ 0.50%	$13,238	$34,077	$118,528	$327,816	$846,479
Mgmt. Fee @ 1.00%	$13,047	$33,121	$111,529	$297,150	$736,584
Mgmt. Fee @ 2.00%	$12,672	$31,291	$98,846	$244,692	$559,562
Mgmt. Fee @ 3.00%	$12,307	$29,567	$87,730	$202,146	**$427,219**

(SOURCE: www.retireearlyhomepage.com/advise.html)