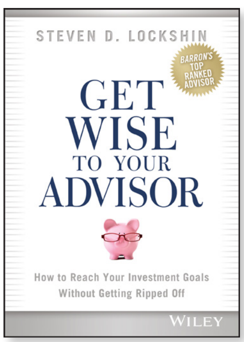
Getting Some Answers

Know What You Don't Know

A self-help guide to choosing the right advisor for you.



From
Get Wise To Your Advisor
by Steven D. Lockshin

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Choosing the right advisor is critical to your financial health... much like choosing the right doctor for life-saving surgery. This answer guide will help you ask the right questions to help identify a truly capable fiduciary to guide you in your financial endeavors.

The questions below are an excerpt from *Get Wise To Your Advisor*.

Instructions:

1. Interview at least three potential brokers or advisors.
2. Have each individual answer the *Get Wise To Your Advisor* questions.
3. Compare the answers to the answers in this guide.
4. Compare the answers from each candidate to one another.
5. Email us if you need help understanding an answer.
   Email can be sent to help@getwisetoyouradvisor.com
6. Choose wisely and unemotionally.

Remember, you are hiring a critical advisor in your life, not shopping for a new friend!

Core Principles

Duty

Your advisor should adhere to the highest level of duty and loyalty to clients, always putting your interests ahead of his or her own.

(Page 193)

Safeguards

Your advisor should make every effort to keep clients' assets safe from fraud and keep client information private.

(Page 198)

Professionalism

Your advisor should operate his or her business according to the highest standards of professionalism in the industry.

(Page 201)

CORE PRINCIPLE

Duty

1. Can you describe your typical client? (p. 194)

A. An advisor should be able to specifically describe the clients they serve. Client demographics matters from a service and staffing standpoint. (You should understand if you are too small or too big to be served well by this practice.) Size also matters when it comes to the investment and financial planning expertise the advisor may offer for various income and wealth levels, risk profiles, savings and liquidity needs, and investment timelines. You—the potential client— should have a clear sense about what you can and cannot expect from your advisor.

B. A difference in the average assets per client and the typical assets per client can indicate a few things: (1) A few large clients skew the numbers, which may mean that the advisor's resources go to serving those large accounts, (2) The advisor does not have a defined client target and is willing to take clients across the income and wealth spectrum, which, as indicated earlier may mean that you may not receive an appropriate level of expertise and service for your needs.

Things to look for or review: Client testimonials and references.

2. Can you describe your service profile? (p. 194)

A. It might appear that all clients should want the highest degree of service and technology possible, but that is not always the case. A tech savvy retiree who likes to keep up with the markets on a daily basis might want a high degree of access to their advisor and high-tech access to view their portfolio. Conversely, a busy young couple with small children might only want a quarterly update. There is no right answer to the service question or the technology question, so long as you are getting the service and access to information that meets your needs.

B. Look for a progressive firm that invests in technology and efficiency.

C. There is no single right answer, although some face-to-face meetings are important. More than anything, advisors should be able to describe the level of service clients receive and that service should be frequent enough to make you feel comfortable.

D. Ensure that you won't get lost in the shuffle and that the firm has the staff to handle the work that needs to be done. Compare the advisor-to-client and the support staff-to-client ratios of this firm with the firms of other advisors you interview.

YOUR CHECKLIST:

- ☐ Request client testimonials and references.
- ☐ Review average account size. *You don't want to be one of the largest or smallest clients.*
- ☐ Comparison shop. Fees should start at 1% and go down from there. If you're only receiving asset allocation and fund/manager selection services, those services should cost 0.25% or less. The value of the advice should make up the difference in cost.
- ☐ Review the service agreement.
- ☐ Interview support staff.
- ☐ Review the firm's ADV.
- ☐ Perform an SEC/FINRA database search to identify any marks on the firm 's or individuals' record.
- ☐ Review regulatory record and third-party audits, if possible.

ADDITIONAL NOTES:

Things to look for or review: Review the service agreement you will be asked to sign. Ask to meet support staff members or anyone else you will be interfacing with on a regular basis. And, don't be afraid to ask for contract modifications, if you need them!

ADDITIONAL NOTES:

3. Will you please provide a list all of the licenses you carry? (p. 195)

A. In many cases advisors carry multiple licenses which allow them to "sell" or advise on different products. This can have major implications regarding how your advisors are paid. Cross check the advisor's licenses with their answers below regarding compensation and make sure that they are not getting paid more for certain recommendations than others (e.g., A brokerage license allows someone to charge a commission for trades versus a pure registered investment advisor who is paid a fee for unbiased advice. And, an insurance license is a dead giveaway that they sell insurance.).

Things to look for or review: SEC/FINRA database search (http://www.sec.gov/investor/brokers.htm).

4. How do you ensure that your firm remains in compliance with legal and regulatory statutes? (p. 195)

A. The SEC audits advisors as infrequently as every 10 years. Audits emphasize compliance with laws and regulations but they don't always mean a registered investment advisory firm is upholding the highest levels of professionalism. The SEC requirements are the base level of standards, while top advisors far exceed legal standards.

B. Advisor firms should hire auditors to provide mock audits in the typical-long gaps between SEC audits. Every firm should undergo either an SEC or mock audit at least every three years.

C. The answer you're looking for is "yes." Note that smaller firms often do not use an outside auditor because they lack the resources or initiative to hire one. This is a red flag.

D. You're looking for "yes." An advisor firm should have at least one individual whose job is to ensure that the firm abides by the pertinent rules and regulations.

Things to look for or review: Understand each advisor's and each advisor's firm's regulatory record and audit review process. Ensure that there are qualified and appropriate checks and balances to safeguard your assets.

5. How do you get paid? (p. 196)

A. This set of questions is all about sniffing out conflicts of interest. Don't put much stock in an advisor's attempts to explain away conflicts of interest. Remember, there are plenty of advisors whose businesses involve few conflicts or none at all.

B. If an advisor gets paid for selling insurance, he's got a conflict of interest because insurance cannot be sold through a fee arrangement, only a sales commission arrangement. It's usually acceptable for an advisor to evaluate your insurance coverage, as long as you're not being charged a fee for it. If an advisor does sell insurance, the only way for him to eliminate his conflict of interest is to do a "commission offset," reducing your ongoing advisory fee by exactly the amount of the commission he receives on any insurance sale. Similarly, the advisor may recommend mutual funds but its best to manage them as "noload" under a fee arrangement versus having the advisor receive a commission. When in doubt, the least biased answer is, "No, I get paid a fee for advice not a commission for products."

C. Just like you don't want your doctor to make biased recommendations when prescribing medicine by taking gifts and rewards from pharmaceutical companies, you don't want your advisor to get paid for doing anything other than putting your best interests and financial needs first. Trips, non-cash rewards, or any other real or perceived compensation create biases.

D. Sometimes investment managers will fee share with specific fund companies. Obviously this creates a bias.

E. This is preferable to charging commissions because it eliminates one conflict of interest.

F. A "yes" answer means the advisor has an inherent conflict of interest: Remember, your advisor will be tempted to pay himself a higher fee than is available elsewhere, and he's highly unlikely to fire himself if his performance doesn't stack up.

G. Layers of fees can create conflicts and also make it difficult to understand how your advisor is paid. Avoid opaque fee structures where you can.

H. Advisory clients typically pay a range of fees for services such as investment transactions, asset custody, mutual fund fees, and so on. That being said, you should push for a totally transparent relationship with your advisor, one in which all of the fees, however minor, are on the table.

Things to look for or review: Review the firm's SEC Form ADV (http://www.sec.gov/answers/formadv.htm) and check licenses, particularly insurance and brokerage. Ask about fee-sharing and/or "soft-dollar" arrangements with vendors, mutual fund companies, or money managers. Ask about the fee structure for assets the advisor manages. Ask the advisor to break out all of the embedded costs you will pay. Double check expenses and fees against their ADV.

ADDITIONAL NOTES:

CORE PRINCIPLE

Safeguards

1. *What safeguards does your firm have in place to ensure that my assets are protected from fraud? (p. 199)*

A. Assets should be held with a reputable third-party custodian, rather than being in the advisor's control.

B. Your risk goes up dramatically when your advisor has custody of your money. Serving as a general partner or manager of an LLC is custody. In these cases, it's essential that your advisor use a reputable third-party administrator and a reputable third-party auditor. These outside administrators and auditors play a critical role in providing " checks and balances" that ensure nothing inappropriate is being done with your assets.

C. You don't want your money invested with the next Bernie Madoff. Madoff got away with his crimes for decades because the auditor that provided oversight was not reputable or even truly independent. Your advisor should require that any person or firm investing client money should be overseen by a major auditing firm. The firm's job is to ensure that your money is accounted for and is being handled properly.

D. Administrators are responsible for reporting to investors on matters such as contributions, withdrawals, and account balances. The use of a third-party administrator—that is, a company independent from the hedge fund or other asset management firm—means you're far less likely to receive fictional numbers.

E. In discretionary relationships, an advisor is allowed to execute transactions without your approval—you trust her to make the right moves, and can fire her if they don't work out. Most advisory relationships are discretionary. However, a discretionary relationship underscores the importance of using a separate custodian to act as a shield against fraud.

F. The answer should be that the advisor can only wire money with your written permission—usually backed up by a confirming telephone call—to an account in your name only (typically with the exact same name on the account).

G. All your accounts should be held in your name, not your advisor's or anyone else's. If any account is not in your name, you should make sure you understand why.

H. Liability insurance covers cases in which an advisor screws up—putting

YOUR CHECKLIST:

- ☐ Research the custodian your prospective advisor uses.
- ☐ Look for a name you recognize. If you don't recognize the name of the firm, confirm that they are audited by a well respected (preferably "Big 4") accounting firm.
- ☐ Ask to see third-party fund audits proving the money in funds is where they say it is. Only accept audits form well respected firms.
- ☐ Ask for verification of insurance coverage.
- ☐ Ask to see written policies for managing discretionary relationships.
- ☐ Ask to see written policies and procedures used to guard against fraud.
- ☐ Review advisor's privacy policy.
- ☐ Review advisor's ethics policy.

ADDITIONAL NOTES:

you in an unsuitable investment, selling a stock they were supposed to buy or forgetting to make a trade, for instance. The right amount of coverage is a subjective matter; $100,000 of coverage per incident might be fine for a firm with an average account size of $50,000, but would be far too low for a firm with an average account size of $100,000. The key here is to compare the coverage levels of the advisors you interview. Low coverage may end up contributing to your decision to rule out a particular advisor. Coverage of $5 million seems appropriate for a small to medium size firm.

I. Nearly every industry provides a privacy policy these days, but it doesn't hurt to read the fine print and understand how and when your information will be used. It's worth asking about how and when your data is passed to affiliated vendors and how the advisory firm monitors their use of personal information.

J. Background checks should be mandatory for employees at most levels of the advisor's organization.

K. A "yes" answer may be a yellow flag, but not necessarily. It may show that the advisor is serious about running a tight ship. If multiple firings have been necessary, there may be more cause for concern.

Things to look for or review: Use of a major (public company) custodian, limited use of partnership or LLC products, evidence of insurance coverage.

ADDITIONAL NOTES:

CORE PRINCIPLE

Professionalism

1. What does your firm do to plan for the future? (p. 202)

A. Policies and procedures cannot account for every eventuality but they should demonstrate a thoughtful approach to protecting client's assets and maintaining continuity in times of change or crises.

B. It's important that the company has a succession plan and even insurance to buy out the shares of a major shareholder in the event of an untimely death.

Things to look for or review: Ask to see succession planning documents, disaster recovery policies, and other relevant policies and procedures.

2. Can you please provide a list of your credentials and background? (p. 202)

YOUR CHECKLIST

- ☐ Review succession planning documents.
- ☐ Review disaster recovery policies.
- ☐ Review advisor and staff resumes.
- ☐ Connect to the advisor's social media accounts (e.g., LinkedIn, Facebook).
- ☐ You should have your advisor on Google Alerts so that you are notified of any news regarding their actions.
- ☐ Review a sample investment policy statement.
- ☐ Review a sample performance report.

ADDITIONAL NOTES:

A. Experience counts, but so do credentials. Don't be afraid to ask challenging questions.

B. Advisors need to "stay sharp" on a range of subjects within their industry. This question can help you ascertain if he or she is making the effort to learn continuously as a way of developing their expertise.

C. You're looking for concrete abilities such as tax or estate planning and/or a sophisticated understanding of areas such as insurance or mortgages. Don't settle for a statement that simply says they offer those services; rather, probe to understand that they truly know what they are talking about.

D. It doesn't matter as much what an advisor's credentials are if less-qualified people will be doing the important work on your account. Know what your team looks like.

E. You want to know that the advisor has invested in being as skilled and capable as possible. You don't just want an advisor selling whatever they can sell. Credentials such as CFA, CFP, CIMA, CPWA, CPA, JD, MBA can help prove that the advisor is serious about his or her professional development.

Things to look for or review: Ask to see advisor and staff resumes. It may even be worth confirming designations such as CFA or CFP with the issuing associations.

3. Can you explain in plain English your investment process? (p. 203)

A. Investment policy statements describe a client's investment goals and objectives, and lays out how the manager will meet these objectives. A formal, written investment policy statement is a must for a serious advisor. Make sure that it highlights what services you can expect, that it affirmatively states there are no economic conflicts of interest, and that the benchmarks against which each manager is compared is clearly defined.

B. Does the report stand on its own? Meaning, are you able to interpret it without a PhD in finance? A performance report should reflect thoughtful analysis but not be mysterious, intimidating, or overly complex.

C. There is no single right answer to this question. Small firms often use outside research providers, and that arrangement can work well. The point of this query is to probe into whether the advisor makes good use of research from a qualified source, rather than choosing investments based on what's hot, or what might benefit him most.

D. The advisor should have a formal evaluation process for hiring and firing investment managers. The absence of such a policy—in writing—means that the advisor may simply sell clients the "hot product" of the moment without putting much thought into its quality.

E. It's key to ask questions about custody, fees, and any other discretionary activities related to assets managed in house. Generally the thing to think about is whether an advisor will be objective in "firing himself" in the event that investments managed in-house are underperforming. How will he ensure that objectivity?

F. A limited number of investment choices raises a big red flag. You should have access to the best investments available, period. Some advisors will tell you that you do have unlimited choices, but the truth may be that their firm has done you a disservice by narrowing the list of choices down to the best options for them, not you. Be skeptical: When firms narrow their investment options, it's usually based on which investment choices are most lucrative to the firm and to its advisors. As you're comparing firms, you should put plenty of weight on whether a firm offers unlimited investment options. This practice is known in the industry as having "open architecture." Many firms claim to have open architecture but in fact have limited open architecture or a sales pitch that includes words like "open architecture with proprietary products." Conflicts are conflicts, so be aware.

G. To properly vet investment managers, advisors should have an in-house research team of at least five people, or they should use a well-resourced outside investment evaluation service, or both.

Things to look for or review: Ask to review a sample investment policy statement. Ask the advisor to walk you through their process for analyzing and recommending investments; understand their process for assessing ongoing performance. Ask to review a sample performance report.

ADDITIONAL NOTES:

Questions?

Please contact help@getwisetoyouradvisor.com

for additional information on finding the best advisor for you.