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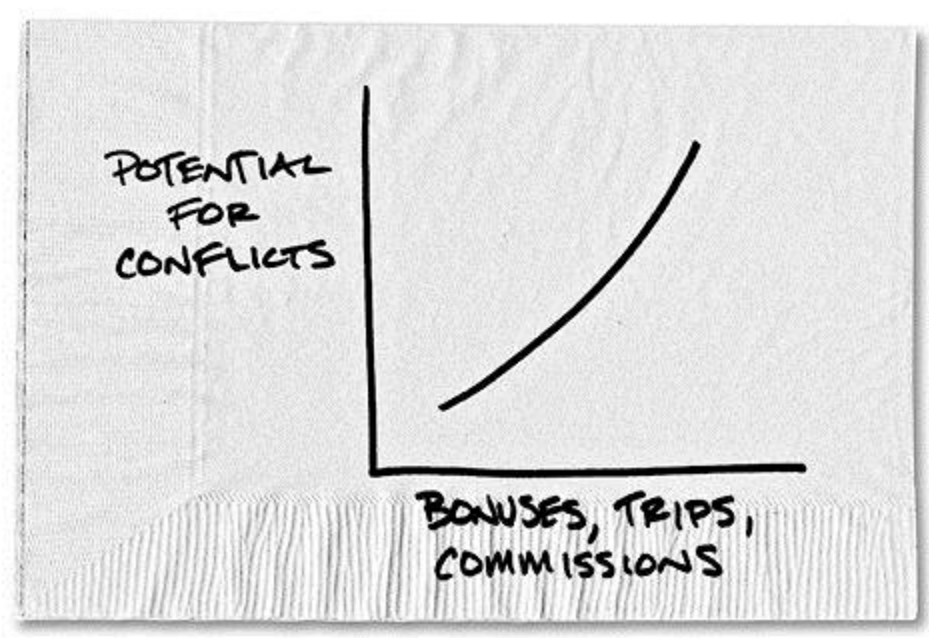
Questions to Ask When Picking a Financial Adviser

By CARL RICHARDS (Carl Richards is a certified financial planner in Park City, Utah, and is the director of investor education at BAM Advisor Services. His book, “The Behavior Gap,” was published this year.)

I’m the first to admit that finding a financial adviser/planner/manager/consultant that fits your needs can be a challenge. All the different titles and abbreviations alone can be confusing. But knowing what questions to ask is crucial to beginning the process of finding someone who will fit your needs.

For today, I want to focus on one of the most important: how advisers are compensated. Often people ask the questions, “How do I pay you?” or “What am I charged as a client?” It’s important to understand that asking advisers how they’re compensated is a different question than those two.



That’s because many financial advisers’ compensation can include bonuses for meeting sales goals, spots on “educational” trips or direct compensation for selling you certain products. So asking how they’re compensated will help you identify potential conflicts of interest.

An even more specific question you shouldn’t be afraid to ask is, “Do you get paid (or win) anything based on the products you recommend to me?” And try this one too: “Do you receive compensation for our relationship from anybody other than me?”

A recent New York Times article by Susanne Craig and Jessica Silver-Greenberg about former brokers at JPMorgan highlights why it’s so important to ask the question:

These financial advisers say they were encouraged, at times, to favor JPMorgan's own products even when competitors had better-performing or cheaper options. With one crucial offering, the bank exaggerated the returns of what it was selling in marketing materials, according to JPMorgan documents reviewed by The New York Times.

To be clear, uncovering a potential conflict doesn't automatically mean it's something bad; it's just very important to know about it.

There are some financial professionals who are only compensated through what you pay them. It's not a catchy name by any means, but they're referred to as a fee-only adviser. (Full disclosure: I work for one.) What that means to you is that this person doesn't receive bonuses, "educational" trips or compensation for selling certain products.

As Josh Brown noted in The Wall Street Journal, this model isn't perfect, but it does reflect an improvement in the financial industry: There will always be conflicts, the world is not a perfect place, but we can say emphatically that the industry has come a long way. The major potential conflicts are washing away as the tide turns from brokerage to advisory but some small flaws still persist. And that's okay, so long as we're moving forward for everyone's benefit.

Obviously the compensation question isn't the only one to ask, and I'll cover others in future posts, but it's certainly one of the most important.

Will You Be My Fiduciary?

By TARA SIEGEL BERNARD

I wrote an article for the paper on Tuesday about the legislative proposals that would require stock and insurance brokers to put their clients' interests ahead of their own.

This is known as **fiduciary duty** — a term so dry that your eyes may be glazing over as you read this.

But it's important. If all of our financial service providers were obliged to put their customers' interests before their own profit motives (think mortgage brokers), fewer consumers would have been steered into risky loans, inappropriate annuities and the many other products and services that got people in trouble in the last few years. At the least, consumers would have been spared the higher costs of some of the products they were sold.

Congress is currently considering proposals, as part of the financial overhaul legislation, that would require brokers to act as fiduciaries (but to varying degrees). As it stands now, brokers only have to recommend investments that are "suitable." And as you might imagine, this can line the pocket of the broker at the investor's expense.

It's unclear whether the fiduciary standard — for brokers, or any other providers — will ever become law.

So in this post, we arm you with what's known as a fiduciary pledge. Craig Evans Carnick, a certified financial planner in Colorado Springs, circulated the pledge in an e-mail last month. As he said in his note, signing the pledge doesn't mean your provider can't make a profit — it just means he can't profit at your expense.

Keep a copy of the pledge in your iPhone, BlackBerry, datebook or whatever. And the next time you're shopping — whether it's for a broker, a mortgage, an annuity or a full-fledged financial plan — ask your provider to sign it.

Here it is:

The Fiduciary Pledge

I, the undersigned, pledge to exercise my best efforts to always act in good faith and in the best interests of my client, _______, and will act as a fiduciary. I will provide written disclosure, in advance, of any conflicts of interest, which could reasonably compromise the impartiality of my advice. Moreover, in advance, I will disclose any and all fees I will receive as a result of this transaction and I will disclose any and all fees I pay to others for referring this client transaction to me. This pledge covers all services provided.

X________________________________

Date______________________________

But will it hold up in court or arbitration?

"Yes, this would help to the extent that it was viewed as a contractual commitment," said Mercer Bullard, an associate professor at the University of Mississippi School of Law who serves on the Securities and Exchange Commission's investment advisory committee. "It also would provide the basis for a regulatory action on the ground that it was materially misleading to make this promise and then violate it."

To beef up the pledge, Mr. Bullard recommended including the actual word "fiduciary," so we added that phrase. He also suggested adding a line that says the pledge covers all services provided.

And since most stock brokers require their clients to sign an arbitration clause, which essentially signs away any right to take brokers to court, Mr. Bullard recommends crossing that out and signing your initials. Then, hold onto the agreement should any problems arise.

Let us know how your financial advisers react to the pledge in the comment section below.

"If they sign, you're good to go," Mr. Carnick said in his note. "If they won't sign it, just go."

Well said.