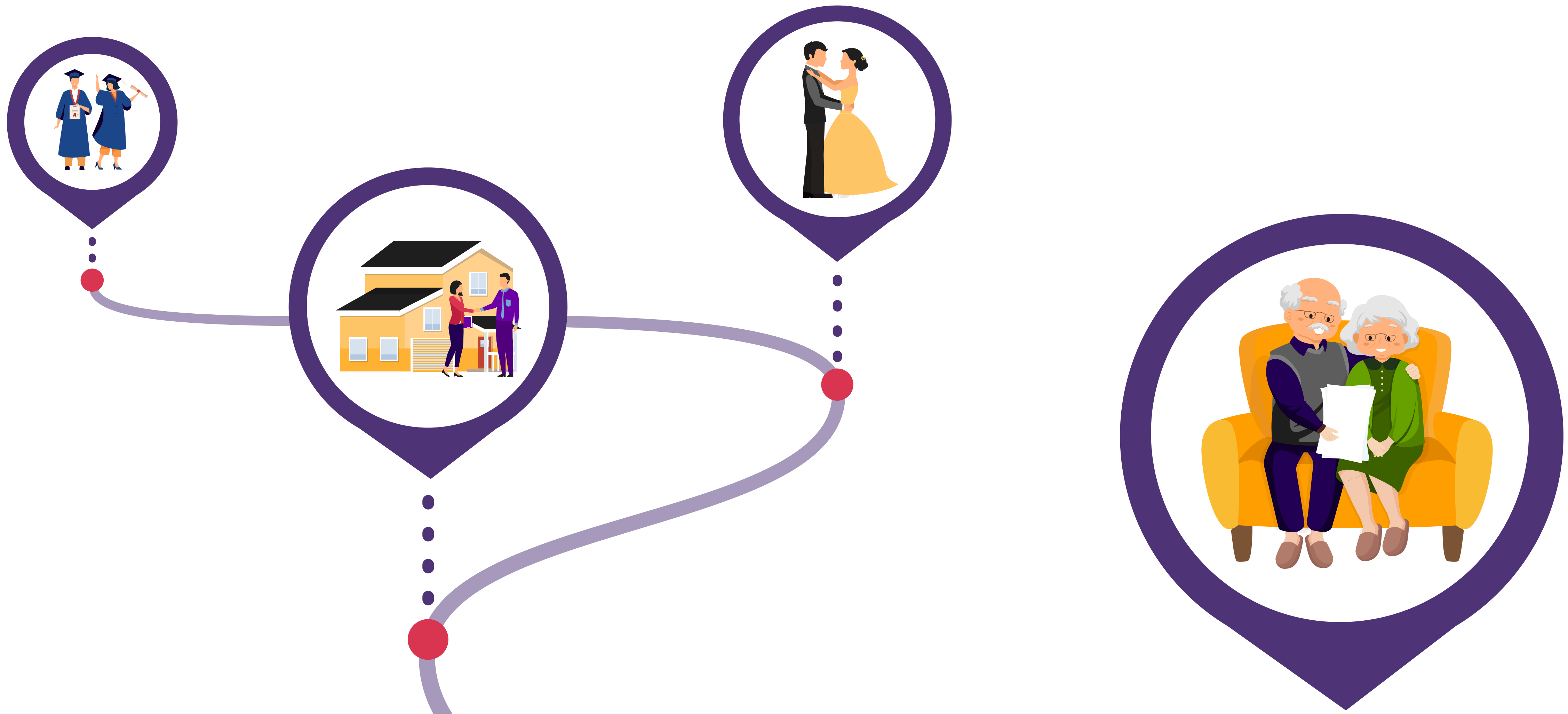
The 2021 MagnifyMoney Guide to Choosing a Financial Advisor

Edited by LendingTree Editorial Team



Putting together your financial plan can feel overwhelming. Not only does your plan need to cover a wide range of financial topics like taxes, insurance and retirement, but you're also making decisions that will impact you years down the road.

A financial advisor can guide you through this process so you have a better chance of reaching your goals. For such an important role, you shouldn't work with just anyone. This guide will walk you through the steps of finding an advisor who suits you.

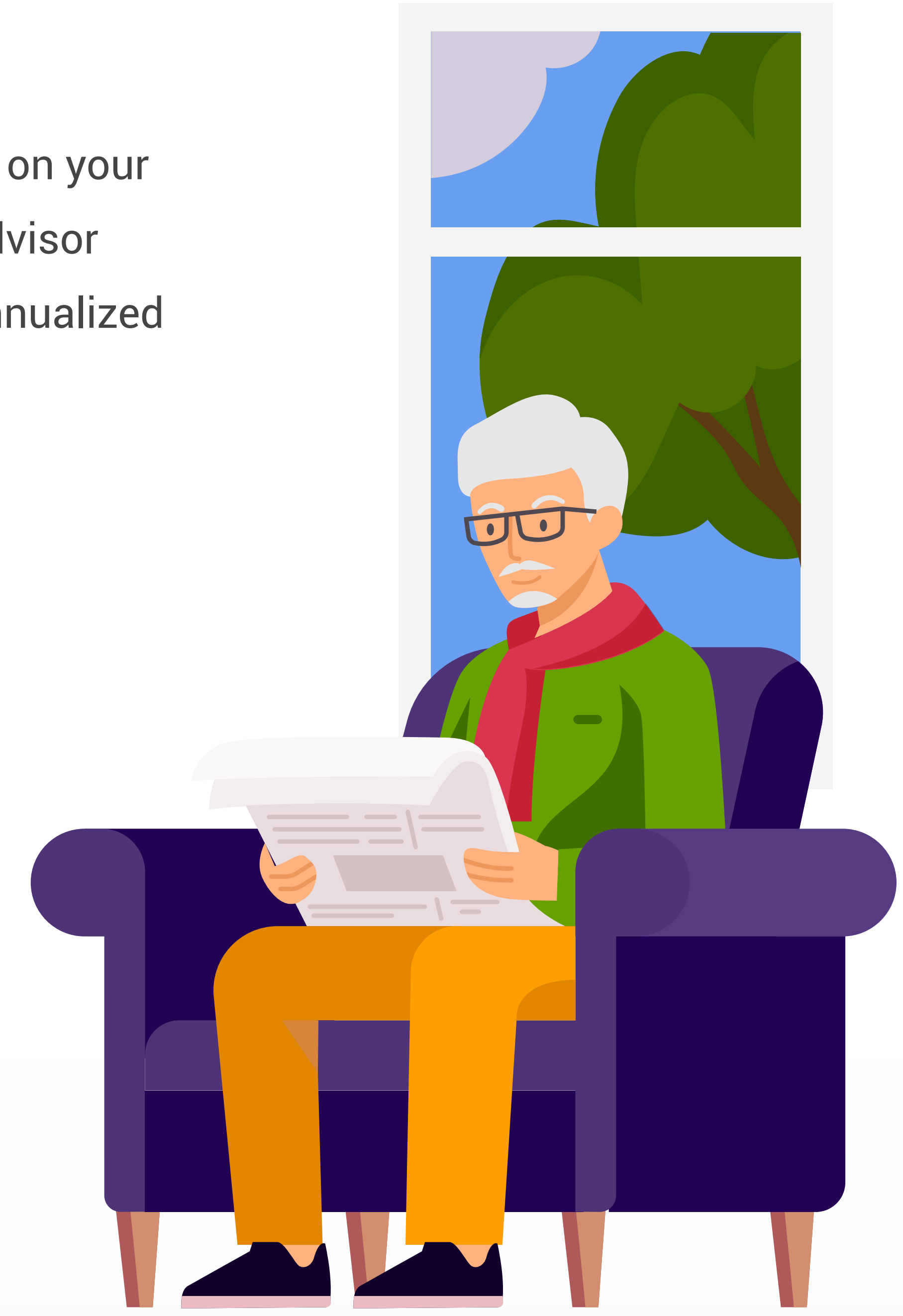
How a financial advisor can help you reach your retirement goals

Working with a financial advisor offers several major benefits over trying to figure out your financial life on your own. Studies[1] from Envestnet[2], Vanguard[3] and Morningstar[4] have found that working with a financial advisor can add from 1.5 to 4 percentage points per year to your investment return. Considering the average annualized return of the S&P 500 is about 10% a year, the advisor boost is considerable.

One reason that an advisor helps your return is because they can keep you from making mistakes. Investing for the long-term can be quite emotional, especially as the stock market sees large gains and losses. The average investor underperforms the stock market substantially because of mistakes like buying high or selling low. An advisor can help you stay calm and on track.

A Rand Corporation report for the Department of Labor5 also found that clients who worked with a financial advisor did a better job of calculating their retirement needs, made better use of the different available retirement accounts, had more retirement confidence and had higher levels of savings in emergency funds.

Beyond these potential benefits, here are some of the specific ways that an advisor can help you reach your retirement goals:



1. https://russellinvestments.com/Publications/US/Document/2017_Value_of_Advisor_study.pdf
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1 Assess your current financial health

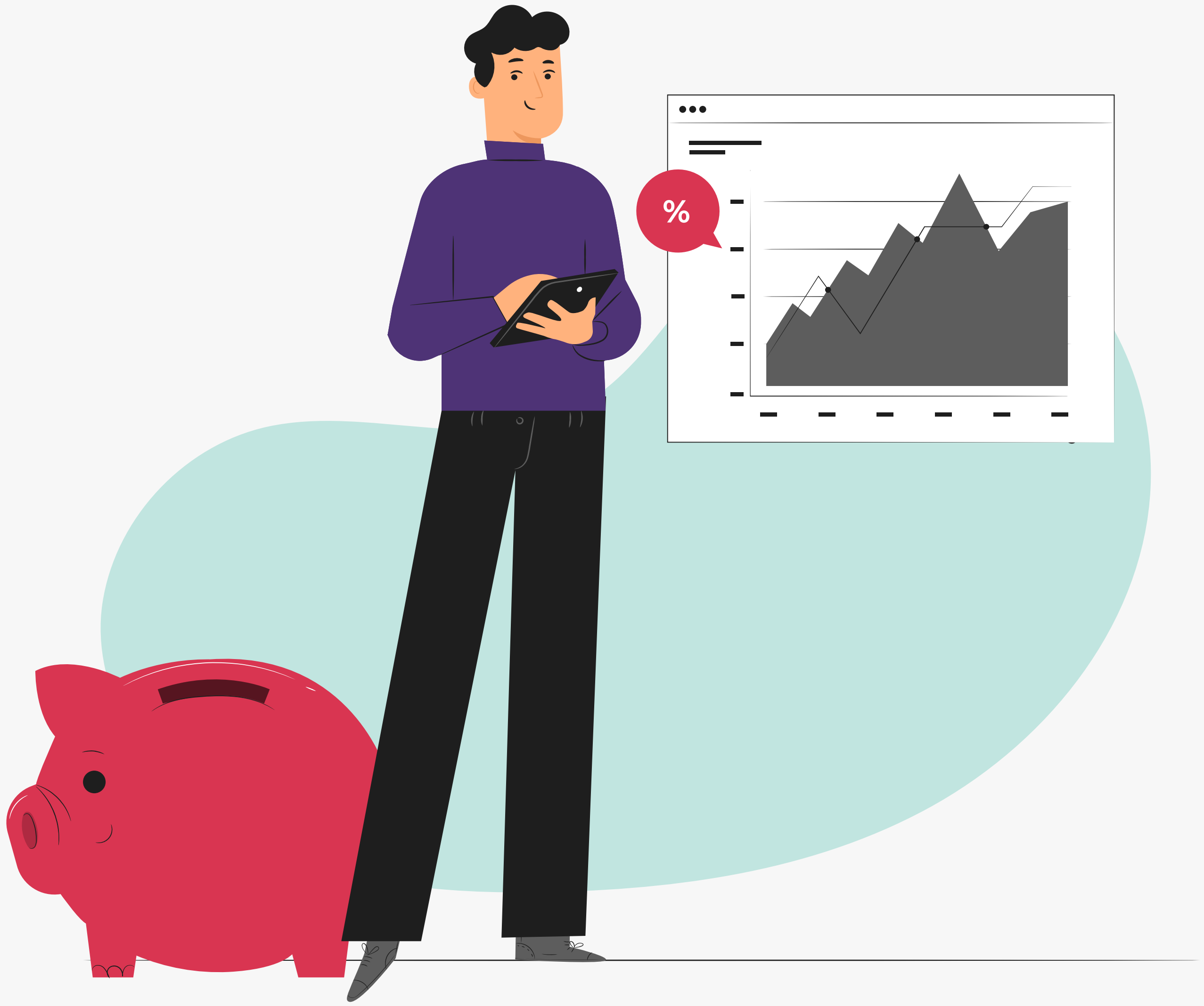
To start, an advisor will get to know your current situation, including how much you've already saved, what types of accounts you're using and your current investment strategy. With this information, they can tell you what you're doing well and where you can improve. They could also determine whether or not you're saving enough to reach your target goals.

2 Offer advice on how to maximize tax-advantaged accounts

Retirement accounts like 401(k) plans and IRAs have several tax advantages to help you save for retirement — but they also have extra rules. For example, depositing money in a traditional IRA gives you an upfront tax deduction and delays taxes on your gains, but if you take money out before you turn 59 ½, you may owe a 10% early withdrawal penalty. An advisor can teach you the rules for the different tax-advantaged accounts and help you decide which are the best for your retirement goals.

3 Create a financial plan to help you stay on track

For goals to be effective, they need to be measurable. Something vague like "have enough money for retirement," is not as useful as *"I want to retire at 65 with enough saved up to generate $50,000 per year in income,"* because with the second goal, you have a clear target and can track your progress. A financial advisor can assist you with defining these retirement goals while helping you figure out how to get there.



4 Determine an asset allocation that aligns with your goals

Your asset allocation is how you spread your money across different types of investments, as each category has a different balance of risk and return. For example, stocks have a high long-term potential return but are also more likely to lose money in the short-run compared to a certificate of deposit (CD) offered by a bank. An advisor would help you decide on an asset allocation that aligns with your goals and risk tolerance.

5 Provide financial monitoring and make course corrections as needed

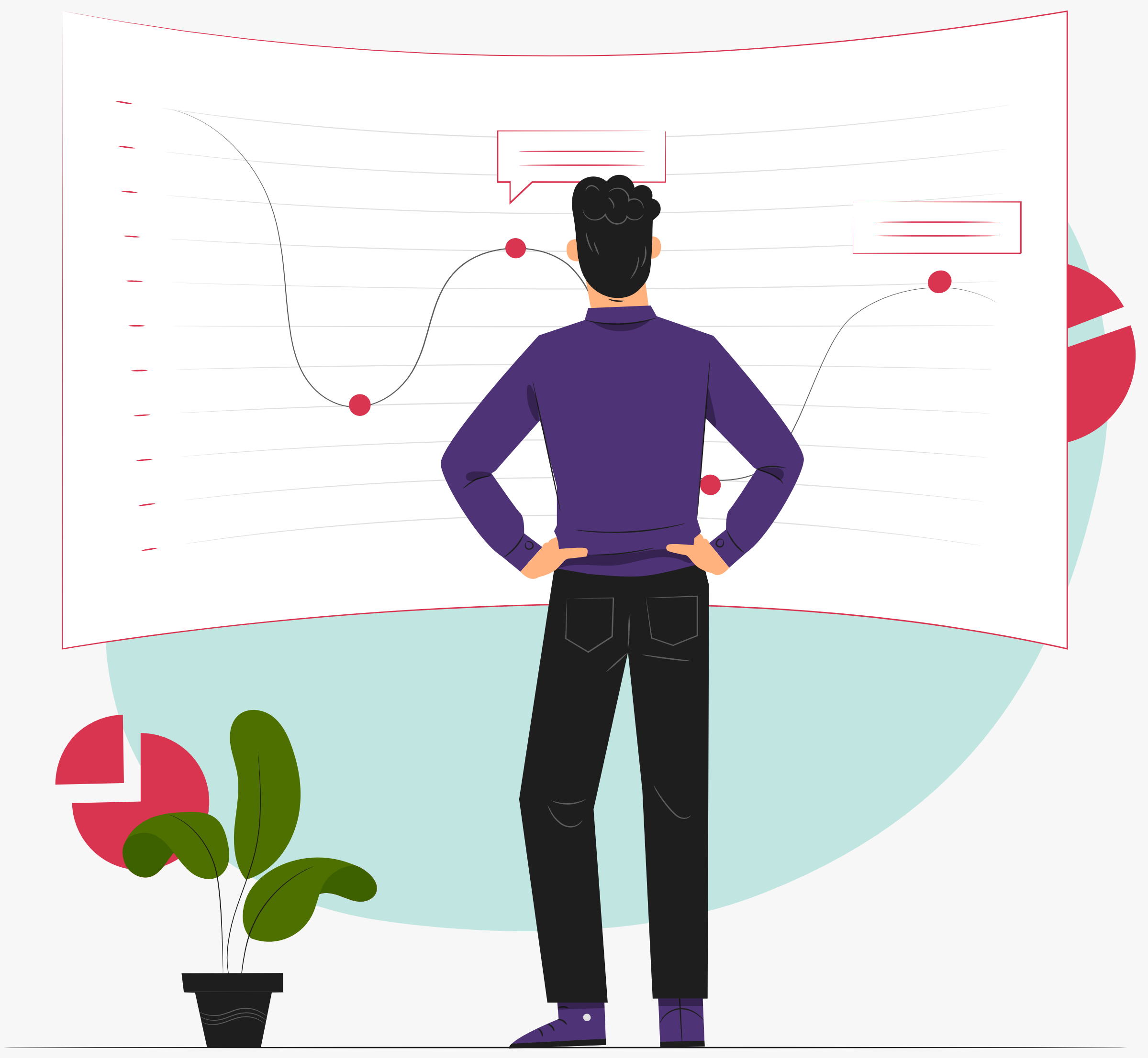
After your advisor has designed your financial plan and portfolio, you could continue working with them to provide financial monitoring. They would track your portfolio and make changes as needed, like if the investment landscape were to change and your stocks needed an update. They would also meet with you regularly — typically at least once a year — to see whether your goals have changed and if your plan needs to be updated to account for that as well.

6 Help maximize Social Security benefits

The amount you earn from Social Security depends on several factors, such as your total career earnings and the age you start collecting payments. An advisor can help you figure out how to maximize your monthly **Social Security benefits**, a decision that will help you for the rest of your life.

7 Plan for tax implications

As part of your financial plan, your advisor can help you manage your retirement accounts, investments and income in a tax-efficient way to reduce the amount you owe to the IRS. They could also help you find deductions and other tax breaks that you aren't currently using.



8 Take into consideration healthcare costs and long-term care needs

Even when you're on Medicare, you still could face sizable health care costs for things like Medicare premiums, out-of-pocket costs like deductibles and your prescriptions. You also will need to plan for long-term care needs, such as staying in a nursing home, which generally are not covered by Medicare. An advisor can help you budget for these costs, both now and in retirement, while helping you decide whether you need additional insurance.

What a financial advisor can — and can't — do

A financial advisor can...

- Develop steps you could take to reach your financial goals
- Create an investment portfolio that aims for decent long-term returns
- Reduce risk in your investment strategy and financial plan
- Keep you calm and focused on your long-term goals during market swings
- Adjust your investment portfolio and financial plan as necessary
- Prepare you for the financial impact of major life events like receiving an inheritance, getting a divorce or sending your child to college
- Give general advice on taxes, law, real estate and other areas
- Explain insurance products from other companies
- Help you set up a brokerage account for investment trades
- Refer you to specialists in other fields

A financial advisor can't...

- Guarantee high investment returns
- Promise you won't lose money by investing
- Draft legal documents or represent you in court
- Give you a mortgage or other loan
- Process a real estate transaction for you
- Process trades for your investment portfolio
- Sell insurance (unless they are also an insurance agent)

In general, an advisor will look at how your investments, insurance, taxes, debt and current financial situation come together for your financial goals. Advisors are focused on giving advice, like telling you which mutual funds and insurance to consider, versus being salespeople for the products themselves. With that being said, there are financial advisors who also sell products for a commission, which is why you should ask an advisor how they are compensated during your initial meeting.

A quality advisor should have a network of other professionals that can handle the work they cannot, such as an accountant for specialized tax work, a stockbroker to process trades, an insurance agent to sell insurance, lawyers to handle legal issues and a realtor to see to your housing needs.

Financial advisor is a broad term though, and you might see professionals who work across a few different areas. For example, a life insurance agent may also give investment advice in addition to selling insurance and call themselves a financial advisor. You may also come across financial planners in your search, which are a specific type of financial advisor that focus more on the big picture covering all financial topics while an advisor is more likely to specialize in a specific area, like handling your investments.

It's important to make sure that your advisor has the experience and the credentials to offer all the work they claim they can handle. Something that no financial advisor can do is promise you an exceptional return or guarantee that you won't lose money investing with them. Markets are unpredictable and while an advisor can take steps to potentially improve your return and minimize risk, there are no guarantees. An advisor making these promises is a serious red flag.

How to compare advisors

Your financial advisor is one of your most important professional relationships. You're counting on them to help you reach your goals, and potentially setting up a relationship that will last for years to come.

That's why you shouldn't just hire the first person you speak with. Instead, take the time to compare a few advisors so you can find someone who offers the right combination of skills and experience and is a personality match. Following the steps outlined below can help ensure you effectively compare advisors during your search to find one who is truly the right fit for you.

01 Turn to trusted sources to narrow down your options

To get started, you first need to create a list of potential candidates. While doing a Google search or checking local ads is a possibility, there are other alternatives that can get you more information.

First, you could ask friends and family members if they have an advisor they work with who they would recommend. That way, you could learn about their experience before signing up. Prioritize recommendations from people of a similar age and in a similar financial situation. If you're just starting to save for retirement, your siblings and peers might have better references than your parents and grandparents, who are past this stage so their advisor might not be a good fit.

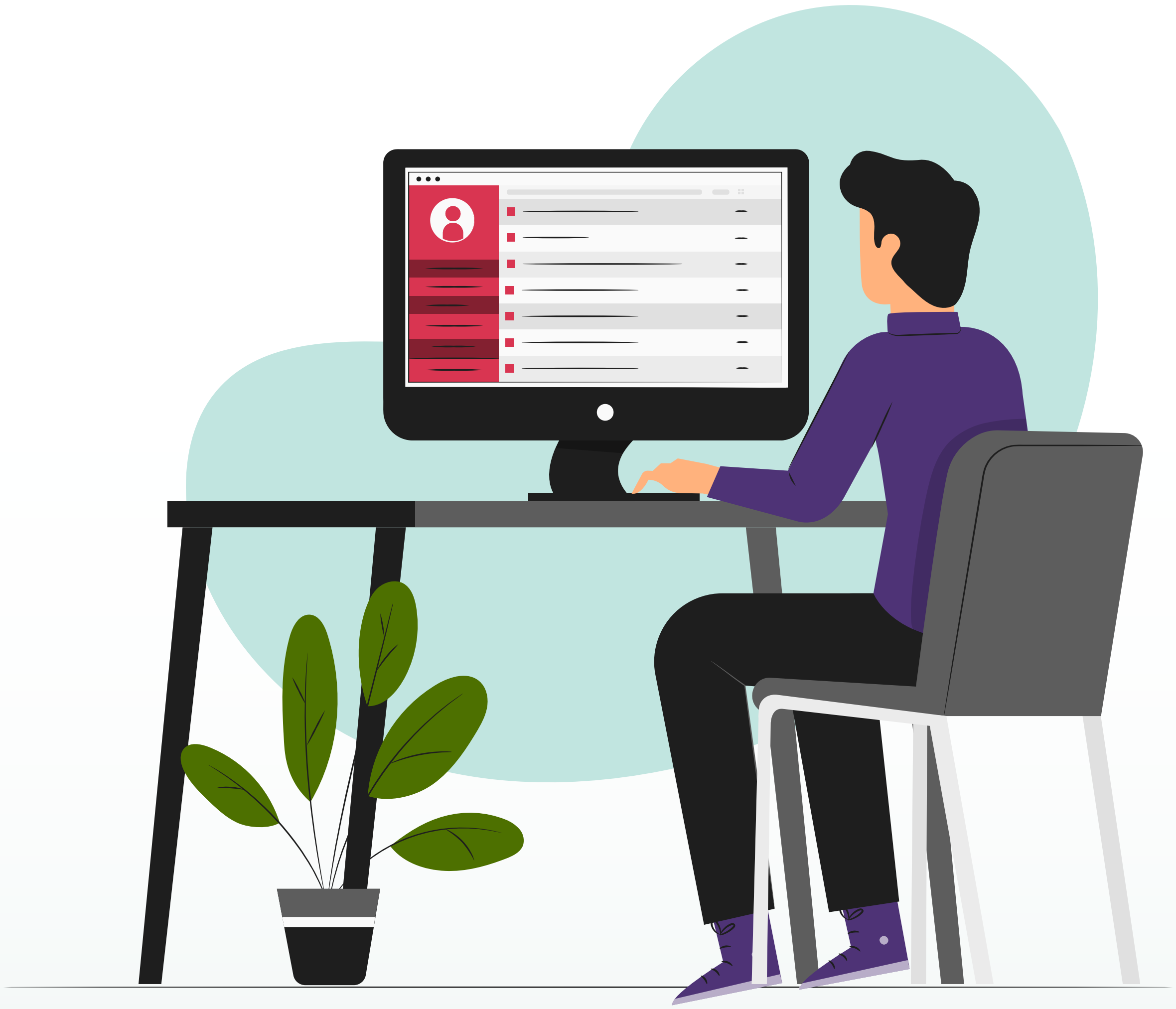
Another option is to use a database run by professional organizations like the Financial Planners Association (FPA)6 or the CFP Board7. Advisors listed on these databases must have the certified financial planner (CFP) certification, often considered the gold standard of financial planning because it involves rigorous training and a difficult exam. This standard helps narrow down your search to quality advisors.

You could also check the MagnifyMoney advisor reviews for an in-depth look at different firms. In addition, MagnifyMoney offers a financial advisor tool that allows you to enter your information, like your portfolio size and needs, and then receive suggestions for advisors.

02 Make sure the advisor can meet your needs

Before scheduling a meeting, check the advisor's website and brochure to see their requirements, services and specialties. First, check whether they have a minimum account size requirement and if so, that you have a large enough investment portfolio to qualify. You should also check whether they offer the services you're looking for. One advisor might only offer investment management while another may focus on more holistic financial planning.

Finally, see whether the advisor regularly works with clients with backgrounds similar to yours. This will make it more likely that the advisor will better understand your financial situation and needs. For instance, a doctor may want to work with an advisor who specializes in working with health care professionals



6. https://www.plannersearch.org/
7. https://www.letsmakeaplan.org/

03 See how their costs stack up

You should also see how an advisor's fee schedule compares to the industry average rates as well as to other advisors you're considering. An advisor's official brochure should list a fee schedule, explaining both how the advisor is compensated and what rates they charge for their services.

It's common for advisors to charge a fee based on a percentage of assets under management, which is a percentage of your total portfolio. Typically, the larger your portfolio, the lower the rate. The typical rate ranges from 0.50% to 1.25%, to give you a ballpark. Advisors may also charge by the hour or by the project.

You should also check whether the advisor is fee-only, meaning they only earn money through the fees they charge their clients for advice, or fee-based, meaning they could also make money from commissions. With a fee-only financial advisor, you avoid potential conflicts of interest that may arise related to the advice they provide because the advisor doesn't have a financial incentive to recommend one product or professional over another.

04 Check their Form ADV

All SEC-registered investment advisors need to file a Form ADV with the SEC (Securities and Exchange Commission), which you can search for through the Investment Adviser Public Disclosure website8. On the Form ADV, the advisor should list if they have any potential conflicts of interest, like if they make money from promoting certain funds, as well as if they have any disciplinary issues to disclose, because they or their firm have faced a criminal charge, a regulatory fine or a civil lawsuit. You could also use the FINRA BrokerCheck website9 to check an advisor's disciplinary history.

05 Interview the advisor and their current (and former) clients

Once you've found a few advisors who seem like a good match, you should schedule an interview, both to get more information about how they operate and to see whether they are a personality fit. You'll be counting on them to help you through some tough decisions and emotional moments, like stock market downturns, so make sure you feel comfortable with them.

As part of your research, also ask whether they can give you referrals to speak with their existing clients, so you can hear from a third party about what it's like to work with the advisor. See whether you could speak with a former client as well and ask why they left. That way you could also learn when an advisor isn't a good fit as even the best professionals are not a match for everyone.

8. https://adviserinfo.sec.gov/
9. https://brokercheck.finra.org/

10 key questions to ask a potential advisor

When you first meet with a potential advisor, these questions can help you determine if they're a good fit and also detect any possible red flags.

1. Are you a fiduciary?

If an advisor works as a fiduciary, they are legally required to put their client's best interest above their own. Alternatively, an advisor may follow a suitability standard, which means they only need to recommend investments that meet a client's needs, even if they aren't necessarily the very best for the client.

For example, let's say an advisor could potentially recommend two investments. While both options are appropriate for the client's goals, one is a little better but the other earns the advisor a higher commission. A fiduciary would need to recommend the best investment for the client while an advisor following the suitability standard would not and could end up recommending the option that better benefits their own earnings.

Advisors who hold certain credentials, like a CFP, must pledge to follow the fiduciary standard. Additionally, registered investment advisors (RIAs), which are registered with state authorities or the SEC, are bound by fiduciary duty.

2. What certifications do you have?

To sell investment or insurance products and give investment advice, advisors must apply for basic licenses from the state government. Beyond these licenses, advisors also have the option to apply for additional credentials from financial organizations. Before they can earn these credentials, an advisor typically must take additional courses, pass an exam and/or meet a minimum number of years of experience.

There are numerous certifications for different specialties in the financial advisor industry. Some common certifications include:

- **Certified financial planner (CFP):**
  One of the top advisor credentials, CFPs must study and pass an exam covering a range of financial topics including investing, taxes, insurance and retirement planning.

- **Chartered financial consultant (ChFC):**
  Similar to the CFP designation, the ChFC also covers a broad range of topics. It is run by a different organization though: the American College of Financial Services versus the CFP Board. The ChFC designation is slightly easier to get because advisors don't need to pass a difficult final exam or have a college degree to qualify.

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- **Chartered financial analyst (CFA):**
  A specialty designation for investments and securities.

- **Chartered life underwriter (CLU):**
  This designation denotes a specialization in life insurance and estate planning.
- **Certified public accountant (CPA):**
  A specialty designation for accounting and tax preparation.

Note that not all certifications are equal as some have tougher requirements than others, so double check what actually is required for an advisor to earn the credential. You should also verify with the certification boards that the advisor is actually accredited.

An advisor can have more than one credential if they work in multiple fields. Look for one who offers the credentials that match your needs. For example, if you need a financial plan that covers a variety of topics like taxes, insurance and investing, a CFP could be a good fit since they are general experts. On the other hand, if you have a large investment portfolio and want someone who can help you with complicated market research and sophisticated trades, a CFA could be a better choice.

3. What types of clients do you specialize in serving?

Because different advisors can have different client specialties, it is important to make sure your advisor's fit your profile. First, check that your portfolio is large enough to meet the advisor's account minimum requirement and also aligns with the type of portfolio the advisor usually manages. If your account is much larger or smaller than what they typically manage, the strategies they recommend may not be a good fit.

Advisors also can concentrate on different backgrounds: young professionals, retirees, business owners, professional athletes, etc. If you can find someone who regularly works with clients with your background, they'll be more familiar with your specific financial issues.

4. What services do you typically provide clients?

Advisors could offer a broad range of services: investment management, financial planning, retirement planning, insurance, tax management, charitable planning and estate planning, to name a few. It's possible for a firm to offer all services or to specialize in just a few.

If you are looking for a specific type of service, naturally you'll need to find an advisor who offers it. If you believe you have a more complicated need, you may want to target an advisor who specializes in that area. For example, a client with a very large net worth looking for inheritance planning may want to find an advisor who mostly concentrates on estate planning, rather than someone who does estate planning along with a dozen other services.

5. How do you earn money?

Ask the advisor to walk you through their fees. Do they charge an hourly fee, a fixed fee per project or a percentage of your portfolio through an asset-based fee? If it's an asset-based fee, see whether their rates change depending on your portfolio size. It's also possible that the advisor charges a combination of these fees. Whatever their system, make sure you understand how you'll be paying for their services and what your estimated cost is.

You should also check whether the advisor is fee-only or fee-based. A fee-only advisor does not earn money from sources outside of the fees their clients pay while a fee-based advisor does. If an advisor charges commissions, ask them what safeguards they have in place to avoid potential conflicts of interest.

6. What will my total costs be?

When the advisor explains their fees, ask them what services are included and whether you will need to pay extra for additional needs. For example, if you hire an advisor to manage your investments, some will include financial planning as part of the deal while others will charge extra if you want this service as well.

In addition, you may also need to pay third-party investment costs like brokerage costs, fund fees and custodial fees. These don't go to the advisor but you still need to pay them as part of your agreement. Have the advisor estimate how much you'll owe in total per year as a client. A quality advisor should be upfront about their costs, not try to hide them.

7. What is your investment philosophy?

There are countless investment strategies with different strengths and weaknesses. What does the advisor believe? Do they use fundamental analysis to try and find investment opportunities based on financial data? Do they try to time the market based on trends and news? Do they use a passive approach to minimize costs? Make sure that your advisor's investment philosophy aligns with your own, as this will be the person managing your portfolio, after all.

Besides their overall investment philosophy, you should see what other strategies the advisor uses to manage portfolios. Some other questions to consider are:

- Will they customize the portfolio to your unique situation or will you be buying into a pre-designed portfolio?
- Do they take tax efficiency into consideration, making investments that keep your taxable income low while still earning a decent return?
- Do they offer values-based investing, meaning they invest in companies that also advance social and moral causes, like protecting the environment?

8. How do you measure investment performance?

Investing is a trade-off between risk and return. A strong portfolio gain could mean an advisor has done a good job of selecting investments but it could also mean they've taken a lot of extra risk with your money.

How will they measure their performance so you can properly assess whether they are doing a good job? One option is to measure against a common benchmark, like comparing a stock portfolio against the overall S&P 500. Advisors could also use the Global Investment Performance Standards (GIPS) to measure their performance.

Also ask how often the advisor will check in on your portfolio and whether they will rebalance, meaning that if the portfolio asset mix strays from your target, they will readjust to get it right. Ideally, your advisor should do this at least once a year and more frequently for larger portfolios.

9. Do you have any disclosures?

The SEC requires registered investment advisors to report disciplinary issues as a disclosure on their Form ADV filing. This includes criminal charges, regulatory fines and civil lawsuits taken against the firm or the firm's employees or affiliates. Ask whether the advisor has any disclosures, and if so, what the nature of those disclosures is.

If they do, ask what steps they have taken to make sure the problem will not happen again. If an advisor faced a small fine for a paperwork mistake nine years ago and has avoided trouble ever since, that's much better than an advisor who faced repeated issues or a more recent, serious charge like fraud, for example.

Advisors who hold certain credentials, like a CFP, must pledge to follow the fiduciary standard. Additionally, registered investment advisors (RIAs), which are registered with state authorities or the SEC, are bound by fiduciary duty.

10. How do you prefer to communicate with your clients?

You'll also want to make sure that the advisor's communication preferences line up with your own. Does the advisor prefer face-to-face meetings, video conferencing or talking over the phone? Do they use email, text or regular mail to send materials to their clients?

You should also see how often advisors stay in touch with their clients. Do they regularly schedule meetings, like a set annual appointment? Or is it up to you to reach out when you have questions? Decide how hands-on you want your advisor to be when it comes to following up with you.

By working through these questions and conducting a thorough search, you can find the right professional to help you reach your goals. Ready to find a financial advisor near you?

Check out our new advisor tool to get started.

About LendingTree

LendingTree (NASDAQ: TREE) is the nation's leading online marketplace that connects consumers with the choices they need to be confident in their financial decisions. LendingTree empowers consumers to shop for financial services the same way they would shop for airline tickets or hotel stays, comparing multiple offers from a nationwide network of over 500 partners in one simple search and choosing the option that best fits their financial needs. Services include mortgage loans, refinances, auto loans, personal loans, business loans, student refinances, credit cards and more. Visit LendingTree.com for more information.

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