

HOW TO CHOOSE THE BEST FINANCIAL ADVISOR

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Choosing a financial advisor is one of the most important career decisions that a doctor will make, but rarely is this approached in an intelligent informative way. Most professionals are too busy to take an active role in their investment planning and leave the majority of such decisions to their financial advisor. It should, therefore, be of great importance that the "best" financial advisor is given the job of caring for one's retirement nest egg. Yet, it continues to amaze me how nonchalantly professionals pass hundreds of thousands of dollars over to an advisor without reviewing their curriculum vitae, to check on such things as educational credentials or past performance records. Even more mind boggling is that 95% of the time there is no formal written job description. Compounding this lack of diligence is the fact that there are many serious problems within the financial advisory industry that can spell disaster for the uninformed or uninterested investor.

This article reviews three essential questions that need to be addressed by all investors if they hope to avail of the best financial advisor:

- 1) *Does this financial advisor have proper qualifications?*
- 2) *Are there any conflicts of interest?*
- 3) *Will there be a written legal contract?*

1) DOES THIS FINANCIAL ADVISOR HAVE THE PROPER QUALIFICATIONS?

There are presently more unqualified than qualified financial advisors in Canada. It is no secret that the financial advisory industry has gone through a remarkable boom over the last decade, so as to meet the needs of the aging wealthy baby boomers. Unfortunately this has led to several problems. Because of deregulation, the four traditional distinct pillars (banks, trusts, insurance companies and brokerage firms) are now all playing on the same field and competing for the same customer. The resulting "turf wars" that have broken out between the different financial companies have led to chaos and confusion for the consumer. In the past, each of these pillars provided their own advisor educational course for their niche market, but now, each is competing against each other claiming that "their course and

designation is best". The result is a plethora of designations and acronyms that has left the consuming public dizzy and an industry which is very poorly regulated. As it presently stands, virtually anybody can take a 3-month course and hang out a shingle calling themselves whatever title they want, e.g. investment specialist, financial advisor, financial planner, wealth specialist, etc., and this has created a dangerous trap for the uninformed investor.

The first step in choosing an advisor is finding sanity in the industry nomenclature madness. The term *financial advisor* is used as a broad reference to anyone who works in the industry. You can divide the financial advisors (and their acronyms) into two groups—the *financial planner* (the generalist) and the *investment advisor* (the specialist). Depending upon your needs, some investors will require the services of one or both. A qualified financial planner is a generalist who has done the appropriate courses that cover the many different areas of overall financial planning, e.g. debt management, estate planning, funding children's education and insurance needs. A financial planner will create and provide you with a written *financial plan* that addresses these issues. When hiring a financial planner, focus your attention on these designations: Certified Financial Planner (CFP), Registered Financial Planner (RFP) or a stockbroker who has completed their Professional Financial Planning (PFP) course. There are many other designations and titles, but these, in my mind, are the best.

An investment advisor is a specialist who deals only with the investment aspect of the financial plan. A good investment advisor will create and provide you with a written *investment plan*. It is my opinion that once your portfolio reaches \$100,000, you need to hold more than mutual funds. Unfortunately, most financial planners sell only mutual funds (and segregated funds) and are unable to offer (or recommend) individual stocks and bonds. Therefore, limit your search for an investment specialist to the stockbroker or investment counselor who can offer all the different investment products. To avail of the investment counselor service, you generally require a minimum of \$300,000 in assets and you must be willing to pass the reins over to this person in a relationship referred to as discretionary investment management. Investment counselor services can be obtained under many roofs. One of the most popular forms is through a brokerage firm as a wrap account, but I am not keen on most wrap accounts because of the high fees. If

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you want discretionary money management, you are best to approach an independent firm directly so as to avoid the middle person cost.

For those with smaller accounts or those not comfortable with passing the reins, the next option is the stockbroker. To many people's surprise, the stockbroker is one of the most closely regulated financial advisors! Ideally, you should be looking at a broker who has either the Canadian Investment Management (CIM) or the Fellow of the Canadian Securities Institute (FCSI) designation (in the near future there will also be a new Financial Management Advisor (FMA) designation).

2) ARE THERE ANY CONFLICTS OF INTEREST?

The next step is making sure both you and your advisor are aware of the many potential conflicts of interest. Because of poor regulations, there are basically no "effective" industry watch dogs, which translates into "buyer beware". Although there are efforts to improve the policing, this will not materialize for quite some time for a number of reasons and so it remains buyer beware. Some areas of frequent consumer abuse include: when the same firm acts as the underwriter and then advisor, the excessive sale of mutual funds over individual stocks and bonds, the sale of rear-load funds over front-load funds, the sale of RRSP-eligible cloned funds over RRSP-eligible index funds, the excessive sale of universal life insurance, the high fees charged by wrap accounts and asset allocation services.

Most of these conflicts stem from the fact that these products are associated with higher commissions for the advisor and their company. The unfortunate part is that most investors are not aware of this abuse because most opt to remain uninformed. This often translates into the advisors interest being placed ahead of yours, resulting in poor portfolio performance!

The best way to minimize conflict of interest is to hire a fee-for-service (FFS) financial advisor. Most advisors are remunerated by commission, being paid a percentage of what they sell you. This percentage varies greatly between different products and companies, and this is where the problems begin. With human nature being what it is, you could get a product that is best for your advisor but not necessarily for you. The likelihood of this happening is enhanced by the fact that most commissions are hidden, so consumers has no idea of what they are paying.

Similarly, some of the best funds (e.g. no-load and index funds) do not pay the annual trailer fee commission, which means that your commissioned advisor is not likely to recommend them. This conflict would not happen with the FFS advisor, resulting in less fees *and* better portfolio performance.

Most financial planners (the generalist) will work on an hourly fee-for-service, but you have to ask. Unfortunately, finding an investment advisor (the specialist) willing to work FFS is more difficult. However, I think this will change in the near future, because of the growing numbers of do-it-yourself investors who will be seeking second opinions on their investment portfolios.

Until then, an alternative is to hire a flat-fee commissioned advisor (similar to the wrap accounts) *but* only if the remuneration is based on performance. Most traditional wrap accounts are too expensive, so you have to shop and compare prices. The performance-based remuneration will guarantee value for your money. Another alternative is to become a do-it-yourself investor and complement this with an hourly FFS second opinion 2-3 times each year. The pay and rewards for the do-it-yourself investor can be tremendous as outlined in *Second Opinion: Hire The Best Financial Advisor or Do It Yourself*.

3) WILL THERE BE A WRITTEN LEGAL CONTRACT?

The written investment contract is your legal document that outlines the advisors job description. My estimate is that 95% of investors do not have this, which is a recipe for disaster. Most advisors know that they should be providing a written investment plan, but they also know that this could lead to occupational suicide. Many investors are paying a very high price for very poor service, but most are not aware of this because of the absent job description. Knowing that the industry is very poorly regulated and that a 3-month course will allow you to hang a financial advisor shingle should sound alarms for most investors, but unfortunately, this is not the case. A written investment plan charts your financial future and without one you are flying by the seat of your pants. In all other professions where money is paid for services, there is a written contract, e.g. new home construction or renovation, leasing a vehicle, expected dental or legal work.

The written contract protects your investments and allows you to keep a score card on how your hired help is performing. There are several things that should be addressed in the written investment plan, but most important for the busy doctor are performance benchmarks to be used and how annual fees are to be reported. At present a written contract is not the industry standard simply because we the consumer have not asked for it. Come on investors—wake up and demand a written investment plan.

CONCLUSION

- 1) Only use a financial advisor with the correct credentials.
- 2) Remember that the industry motto is "buyer beware". You have to get informed!
- 3) Minimize conflict of interest by using a fee-for-service financial planner. When using an investment advisor, request that the annual remuneration be tied to portfolio performance.
- 4) Always get a written contract outlining such things as expected performance, which performance benchmarks will be used and how annual fees will be reported.
- 5) Give serious consideration to becoming a do-it-yourself investor, using one of the many brain-dead investment strategies such as index investing or "Neuro Approach" investing as outlined in *Second Opinion*.