“Give them the third degree”

As CPAs, your clients may ask you to make a referral or recommendation for a financial advisor. Now more than ever, it’s important to ensure that this responsibility is balanced by both your personal and professional opinion so that your clients can attain and maintain financial independence.

Below are nine key questions you should ask before referring clients to an advisor.

1. **Do you serve clients in a fiduciary capacity?** Unlike the public accounting professions, where every CPA functions as a fiduciary, in the financial world true fiduciaries are difficult to identify.

Most in the financial industry adhere to the “suitability” standard meaning that they only have to document an explanation of why their investment advice was reasonably justified for a client. That said, an advisor operating under this standard could still win an incentive prize to Hawaii for referring clients to a particular “suitable” investment. Most suitability-based financial advisors work under commission-based sales models, but this is not always the case. The line is often blurred between functioning as a fiduciary capacity.

To be sure, ask the advisor to put in writing whether they uphold the fiduciary standard. Also, ask if they have a client bill of rights.

2. **How are you compensated?** Insist that the advisor disclose all sources of compensation. And don’t become confused by yet another set of tricky terminology used in the industry: advisors who are “fee-only” and “fee-based.” Fee-only means an advisor is paid a flat fee, a percentage of the value of a client’s assets or an hourly fee. The compensation structure eliminated conflicts

of interest because there's no commission. Fee-based means an advisor takes either fees or commissions on products or services they sell.

Some financial advisors are strictly fee-only, some are solely fee-based and others are a combination of both. Ideally, fee-only compensation ensures impartial judgment. However, there are some highly qualified fee-based financial advisors, so evaluate this on a case-by-case basis.

Also, ask the advisor if they accept any "soft-dollar" payments i.e., some benefit for referring products or services. For example, in exchange for referrals, some companies provide advisors with upgraded computer terminals, which cost thousands of dollars. The Securities and Exchange Commission requires that every financial advisor disclose any soft-dollar payments in their Form ADV.

3. **Can you provide professional references?** The SEC forbids advisors from disclosing any client references. Therefore, ask for professional references preferably those who are attorneys or CPAs. Both of these types of professionals can provide insightful references because they have a basis for comparison in working with various financial advisors.
4. **Do you have any disciplinary action against you?** Inquire about disciplinary actions brought by any organization. Any regulatory disciplinary actions or judgments would be present on the advisor's U-4 Form. If there is anything present, have them explain it.
5. **Do you have an independent custodian for client assets?** In the Bernie Madoff world we now live in, it's also important to ask if the client's assets are held by

an independent custodian. In the Madoff situation, all of this client's money was accounted for only by Madoff's firm, which was generating false statement

6. **What is your ratio of clients to investment advisors?** Ideally, the financial planning and investment advisory firm should have, at most, a ratio of 50 clients per investment advisor (50:1). Since financial advising is an ongoing, comprehensive process, the ratio should be low so that your client receives individualized attention.
7. **May I see Part I of your Form ADV?** If the advisor is a registered investment advisor, ask for Form ADV Part I and II. All RIAs are required to show their clients Part II of this document. However, just as important if not more so is Part I. For example, it tells you the number of employees in the firm and how many of them are involved in an investment function. The form also discloses all formal compensation agreements that could potentially serve as conflicts of interest.
8. **How is your portfolio invested?** Ask the advisor if they invest their money the same way that they invest money for clients.
9. **What is the total cost of services?** Ask the financial advisor to provide an estimate of total annual costs as a percentage of the portfolio. The estimate should include a breakdown of visible and less visible costs. Visible costs include commissions and advisor fees. Less visible costs include expense ratios on mutual funds, transaction fees, and whether the financial advisor gets some sort of credit toward that Hawaiian trip.

In addition to these questions, inquire into the advisor's education and other credentials. Furthermore, make sure the financial advisor is someone whom your clients will actually like. Financial advising involves divulging personal information, and if you don’t find the referral source likable, it’s likely that your clients will feel the same.