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Ask questions before selecting financial adviser

With so many investment options available, many people find it difficult to select a financial adviser.

Over the last year, there have been several high-profile examples in which advisers took advantage of clients. These situations could have been avoided if the client had asked the appropriate questions before selecting an adviser. Below are some questions everyone should ask.

How will my account be invested?

It's useful to know whether individual securities and/or mutual funds will be used as investments for a client's account. Depending on the size of the account, either approach can work well.

If individual stocks and bonds are used, make sure the firm has sufficient resources to thoroughly research and monitor those investments.

If mutual funds are used, it's important to know what fees are involved. Be wary of mutual funds that charge 12b-1 fees, front-end load fees or back-end load fees.

BUSINESS VIEWPOINT

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These types of fees are used to compensate an adviser and may not be fully disclosed to clients. If you see the letter A, B or C at the end of a mutual fund's name, that is often an indication that a load is involved.

How often will investment performance be reported?

In order to hold your adviser accountable, it's important to have access to the investment performance of your account. Not only should total account performance be reported, but performance of the bond and stock portfolios should be broken out separately. The appropriate benchmark indexes' performance should also be listed for comparison.

What is your fee schedule and how will you be compensated?

This is perhaps the most important question you can ask. Unfortunately, how an adviser is compensated can often influence how your account will be managed. If the adviser is compensated based on commissions generated from each stock or bond trade, the broker may have an incentive to actively trade investments in your account.

If an adviser is compensated from mutual fund fees, the broker may select the mutual funds that pay the most fees rather than those that offer the best performance. There are some very good mutual funds that do not pay a 12b-1 fee or a front-end or back-end load fee.

If your adviser is compensated from a monthly fee that is charged to the account, compare that adviser's fee schedule with those of other advisers to ensure that the fees are reasonable given the size of your account.

Are you motivated and/or encouraged to use proprietary products of your firm?

If an adviser works for firm X and uses only firm X mutual funds, this may be an indication that the adviser does not have your best interest in mind. It's unlikely that one firm is the best investment manager available for all sectors of the market. The CFA Institute recently conducted a survey that found that 49 percent of financial industry executives in the U.S. believe that advisers offer products that serve their own best interests, rather than those of their clients.

Who will hold my assets?

Highly regulated firms such as independent trust companies and banks may serve as both adviser and custodian, while other advisory firms often use a third-party custodian. Bernie Madoff's firm did not use a third party, which made it easier for him to defraud his clients.

Does an auditor and regulator review your operations on a regular basis?

This does not guarantee all is well, but a regular and thorough examination of an adviser's firm by a regulator as well as an annual audit should provide some reassurance to a client.

What is the source of the adviser's new business?

Perhaps the biggest compliment a customer can give an adviser is referring friends and family members. You should be impressed if a significant portion of an adviser's new business is generated from client referrals.

People should choose a financial adviser whom they like and trust. As with most things in life, fit and chemistry are important.

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The views expressed here are those of the author and not necessarily the Tulsa World. To inquire about writing a Business Viewpoint column, e-mail a short outline of the article to Business Editor John Stancavage at john.stancavage@tulsaworld.com. The column should focus on a business trend; the outlook for the city, state or an industry; or a topic of interest in an area of the writer's expertise. Articles should not promote a business or be overly political.