How to identify a great financial adviser

If you're looking for a relationship with a great financial adviser you need to be able to identify one. This guide will help you to understand the key attributes of a world class financial adviser.

wealth foundations

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INTRODUCTION

Are you looking to appoint a financial adviser, but not sure how to tell a great adviser from an average one, or even a poor one?

Choosing a financial adviser is a very important aspect of having a successful investment experience. The wrong choice of adviser can have a significant negative impact on your long term wealth outcome. The right choice can significantly enhance your wealth and your ability to achieve your desired outcomes.

What key attributes would a financial adviser look for when appointing a financial adviser?

Most people seeking to enter into a relationship with a financial adviser use a fairly arbitrary assessment process. To compound this, their assessment is often based on limited experience and understanding of the financial planning and wealth management industry. For those unfamiliar with the industry it can be a very confusing environment that makes it extremely difficult to make sound, objective decisions.

The aim of this guide is to provide a methodology to help you choose a world class financial adviser. The suggestions are an industry insider's perspective. What key attributes would a financial adviser look for when appointing a financial adviser?

Before we look at these, let's look at some typical ways that people choose a financial adviser:

- The most common approach is via a referral from a friend or colleague. The problem with this approach is that it is often the only assessment made. It presumes that the friend or colleague has made a methodical and objective assessment of their adviser;
- They seek a referral from a trusted professional such as their accountant or solicitor. Again, this is only as good as the due diligence performed on the recommended adviser. In most cases you would expect this to be more in depth than that done via a friend or colleague;
- They search for an adviser via a professional body, such as the Financial Planning Association or the Association of Financial Advisers. This approach assumes that all members are of equal competence. Unfortunately, this is not the case. There can be a wide disparity between members' skill and ability;
- They use the services of an existing relationship. For example, they may use the financial advice services of their bank. While this plays on the strength of the existing relationship, it assumes that the provider is capable of providing specialist service in all areas. This is not always the case. Most businesses see leveraging off existing relationships as a smart business strategy. Unfortunately, it does not always translate into a smart decision for you.

While these methods can produce good professional relationships, it is clear that some independent assessment will aid the decision making process. If you're interested in a more detailed paper on how to find a competent adviser **visit our blog** and download our free guide - **Six Steps to Finding a Competent Financial Adviser in Australia**.

THE 8 ATTRIBUTES OF A WORLD CLASS FINANCIAL ADVISER

So, what key attributes should you look for to make an independent assessment of a financial adviser?

1. A High Degree of Professionalism

Managing other people's financial affairs is a delicate balancing act.

At one extreme is the adviser that we will call the "teller". They see their role as providing advice to clients who are less informed than themselves. Under this approach, the adviser sees themselves as the "expert" whose role is to tell their client what to do.

Unfortunately, few, if any, financial decisions are black and white. They involve a complex assessment of personal circumstances, preferences and risks which rarely lend themselves to an advice model that involves being told what to do. While some clients may prefer this style of advice, it is not considered healthy for a successful long term relationship. A world class adviser-client relationship is one of collaboration.

A true professional puts providing professional advice ahead of their desire to be liked

The other extreme of adviser is the "appeaser" who sees themself as the provider of information and suggestions. When it comes to decision making, however, they defer the responsibility totally to the client. While this approach respects the fact that it is ultimately the client's responsibility to make decisions about their financial future, it often leads to the adviser taking the path of least resistance.

One of the more challenging aspects of providing good advice is to know when to question a client's decision. While many business relationships are maintained on the philosophy that "the customer is always right", when it comes to providing financial advice this is not always the case.

Some advisers allow their clients to proceed with actions that they would not recommend. This is often driven by the desire to appease their client and not unsettle the relationship. While this may be the path of least resistance in the short term it is not the basis for a valued client-adviser relationship.

Advisers need to be open and honest with their clients, even if it means disagreeing with them. A world class adviser understands that their role is a balancing act. On the one hand, they need to respect the fact that the client knows their own circumstances and preferences better than they can and is therefore in a more privileged position for making decisions that apply to their affairs. Yet, on the other hand, the adviser also needs to recognise their role and duty to impart their own experience and expertise to help their client take well-informed action.

A true professional puts providing professional advice ahead of their desire to be liked. They intentionally put their client's interests ahead of their own, at all times. You should recognise the courage and value of advisers who display these characteristics.

Suggested Action:

During your interview, observe and ask questions that will help you to identify where an adviser sits on the spectrum between being a "teller" and an "appeaser". Ask them directly how they deal with situations when their client disagrees with their advice. Above all, avoid being caught committing to someone simply because they're charming and likeable and it's too difficult to say no. This is a long term association and the best client/adviser relationships are those based on an objective assessment of professional capability.

2. Relevant Experience and Qualifications

"Any intelligent fool can make things bigger and more complex - It takes a touch of genius - and a lot of courage to move in the opposite direction."

Albert Einsten

The financial advice industry has barriers to entry that restrict those who can legally provide personal financial advice. Unfortunately, these barriers to entry are quite moderate. You need to recognise that an adviser's legal ability to provide advice is not an endorsement of the quality of their advice.

Ideally, you should look for an adviser who has:

- A sound understanding of economic history and finance theory. Advisers with these foundations are far less likely to get caught up in the short term noise of the financial markets. They generally have a better ability to make objective assessments of financial products and market conditions;

- A level of financial planning education that exceeds the minimum requirements. Ideally, you should seek an adviser who has at least achieved one of the following qualifications:

  CFP - Certified Financial Planner
  DFP - Diploma in Financial Planning
  GdipPlanning - Graduate Diploma in Financial Planning
  DFS - Diploma in Financial Studies
  CPA (FPS) - Certified Practicing Accountant, Financial Planning Specialist

  In addition, complementary tertiary qualifications are highly recommended;

- An ability to clearly explain complex concepts. As Einstein explained, “Any intelligent fool can make things bigger and more complex - It takes a touch of genius - and a lot of courage to move in the opposite direction.” If you find that you are being bamboozled with finance speak and complex concepts, choose another adviser.

Suggested Action:

Do some research about your adviser. Generally, you can find some information about their qualifications on their website or via their Financial Services Guide. You can also get some useful independent information from the following ASIC[1] site - Essential Facts about Financial Advice.

“Structural conflicts of interest can lead even good advisers to believe they are being neutral, when in fact they are giving advice that is biased and self-serving”

3. Objectivity

A critical factor you need to understand when assessing the objectivity of the advice you are likely to receive is the incentives that an adviser can receive when making recommendations. While not all advisers who receive incentives will act in a biased manner, the simplest way to minimise this risk is to employ an adviser that is not exposed to incentives that may bias their advice.

Advisers can be exposed to a number of different incentives. These can include:

- direct incentives from financial product providers. These are generally paid in the form of product commissions;

[1] Australian Securities and Investments Commission

- indirect incentives from financial product providers. These can be in the form of volume bonuses (e.g. holiday incentives) and adviser practice support (e.g. sponsorship of conferences);
- indirect incentives from adviser groups. These may be to promote an in-house financial product. For example, banks may reward advisers for promoting bank products over non-bank products; and
- indirect incentives associated with adviser group ownership structures. For example, if a financial product provider owns an adviser group or adviser group owns a financial product provider, the advice provided is more likely to be subject to some form of bias.

These are a few of the incentives that can skew an adviser's recommendations.

The Sydney Morning Herald article, "Sins of Commission", while a little dated, provides a good commentary on the effect of conflicts of interest as seen by the Australian Consumer Association. The article notes research that demonstrates that "conflicts of interest can unconsciously and unintentionally influence the opinions of experts who are doing their best to be honest and impartial".[2] It observes that "Structural conflicts of interest can lead even good advisers to believe they are being neutral, when in fact they are giving advice that is biased and self-serving".

Suggested Action:

To maximise your chance of getting objective and unbiased advice we recommend that you seek an adviser who is remunerated on a fee for service basis. Advisers under this arrangement seek payment for their services directly from you. While this does not eliminate the chance of receiving unbiased advice, you are in a better position to assess the the value of the advice and and whether it is consistent with your best interests.

The other major remuneration alternative for advisers is to receive payments from financial product commissions. Under this arrangement, advisers are paid by the providers of the financial products they recommend. Remuneration that is dependent on product sales may also tend to limit advice to product recommendations, with inadequate attention given to the potentially more valuable personalised strategic advice recommendations.

Some adviser groups get remunerated via a combination of fee for service and commission. While an adviser has an obligation to provide information on their method of remuneration at the time of providing their advice, you should be very clear about how they are remunerated before you make your decision about appointing an adviser.

[2] As demonstrated by George Lowenstein from Carnegie Mellon University in Pittsburgh.

You may also wish to ask to see the adviser's "Soft Dollar Register". This records all benefits of more than $300, in equivalent value, received by advisers from third parties. The register is available to the public on request and it can help to highlight any indirect incentives that may influence advice.

Adviser groups that are independently owned and that have no ownership links with financial product providers are highly recommended. This, however, may limit your search to the domain of the smaller adviser groups.

4. Personalised Advice

You risk being sold an off-the-shelf alternative that suits them rather than a solution tailored for you

Good financial advice costs. You deserve a service that provides value in excess of that cost. Financial advice is provided in many different forms. It varies from the sale of financial products to the provision of comprehensive personalised advice.

We have identified three broad adviser categories, based on the intellectual capital that each is offering their client:

A. At one end of the spectrum is the adviser that has expertise about the array of financial products available in the market. The intellectual capital that they sell to their clients is their **knowledge of the product**;

B. In the middle, you have the adviser that has expertise about the available financial products and about the latest strategies for implementing financial solutions. The intellectual capital they offer is their **product knowledge** and their **solutions to financial problems**; and

C. At the other extreme, you have the adviser who has expertise in product knowledge and providing financial solutions. But, in addition, they also have expertise in knowing the right questions to ask. The intellectual capital they offer? Their **product knowledge,** their **solutions to financial problems** and their **ability to ask the right questions** to ensure the solutions they offer are specifically tailored to the client.

While advisers in all groups can vary from good to bad, knowing what intellectual capital you want to pay for is an important step in choosing the right adviser. If product knowledge is all you want then there is little point paying for a tailored solution. You should, however, be aware that these relatively low cost providers require volume to make a profit. You risk being sold an off-the-shelf alternative that suits them rather than a solution tailored for you.

Recognising which category an adviser falls into can get a little tricky. You see, one of the requirements of providing financial advice in Australia is the 'know the client' rule. You are not supposed to provide advice without knowing a client's circumstances, needs and objectives. This means that all advisers will claim they are category C advisers, yet in reality few have developed the intellectual capital for delivering this.

Suggested Acton:

Avoid choosing an adviser on price alone. It is not a very effective decision making tool. Understand what service you are seeking and look for an adviser that can provide this at a price that offers good value.

Look for signs of an inquisitive adviser who is more interested in you and your circumstances than in promoting their product or services. Advisers that offer solutions in an initial interview are likely to be more interested in selling an available product than taking the time or effort to design advice that is personalised to you and your circumstances and objectives. Even though their services may appear cheaper you are likely to pay dearly for them in the long term.

5. A Consistent Approach

An approach based on enduring principles and processes will be more consistent and more likely to produce better long term outcomes than one based on an "opportunistic" approach. The latter can seem more appealing but is more likely to be driven by the climate of the day. This can work effectively in the short term but can have disastrous results over the long term.

Consistency of approach by an adviser and their firm is a definite advantage, but how do you ascertain this?

Listen for those who speak in terms of the principles and processes that they apply. They are more likely to deliver a consistent approach regardless of the economic cycle.

Listen for the focus of an adviser. An adviser focused predominantly on topical issues will be more inclined towards an "opportunistic" approach. They are likely to focus on the current state of the market, the latest financial products, their knowledge of generic tax structures (e.g. superannuation), etc. While this is comforting, it offers little information about "how" they apply this knowledge. Often their principles and processes are driven by the current state of affairs. Given that situations change, their principles and processes are also likely to change. For example, many adviser groups offer gearing strategies at times when markets are buoyant yet drop them after markets have fallen. This type of inconsistency in approach is not in your long term interests.

An adviser that focuses on "how" they deal with situations is generally one that has invested the time in developing broad principles and processes that work for all situations. The discussion will focus in issues such how they deal with risk in the advice equation, how they help people make decisions, how they choose an appropriate strategy, etc.

The intellectual capital associated with this latter approach is far more valuable to you than the intellectual capital associated with an "opportunistic" approach.

Suggested Acton:

Listen for the structure of the conversation you have with an adviser. If they're more interested in topical issues and give little indication of explaining how they consistently deliver their service, then you're more likely to get an approach suited to the current situation. Listen for those who speak in terms of the principles and processes that they apply. It may not sound as appealing but they are more likely to deliver a consistent approach and the intellectual capital they offer you is of far more value.

6. A Strong Focus on Risk

Financial risk is a poorly understood concept within the general population. This is because it is intangible and difficult to measure. Unfortunately, this lack of understanding also applies to the financial advice industry. Too many advisers focus their attention on the rewards without clearly understanding and explaining the risks they are exposing their clients to.

At the core of a world class investment strategy is a personalised risk policy.

Most of us are familiar with the concept that risk and reward are related, yet we have little idea of how to effectively deal with this relationship. In the risk/reward equation, risk is the cause and the reward is the effect. No discussion on potential rewards should take place without a discussion on related risks. The two are inextricably linked.

Of course, risk is a far more sobering and unappealing topic of discussion than one based on the potential returns you may enjoy. Don't be seduced by these discussions. Always equate the level of potential returns with the level of risk. If someone is promising to deliver above average returns, it is almost always achieved as a result of taking above average risk.

At the core of a world class investment strategy is a personalised risk policy. This policy needs to consider a variety of issues such as your tolerance to risk, your need for risk and your capacity for risk. Your expected lifetime cash flow will also have a major impact on your risk policy.

The level of returns is much more a symptom of the state of the market than they are of the adviser's skill

The development of this risk policy, which forms the driver of your investment strategy, is one of the most important and key roles of a good financial adviser. Many financial advisers do not have the information or processes to adequately meet this obligation (even though they clearly believe they do).

For example, in the midst of a bull market, risks are often ignored. And in the depths of a bear market, risks are often over accentuated. This can lead to advisers and investors increasing their risk exposures during bull markets and decreasing their risk exposures during bear markets. More often than not, their maximum risk exposure is achieved at the top of the bull market and their minimum risk exposure is held at the bottom of a bear market. This is a sub-optimal investment strategy based on trying to manage a variable risk exposure and results in a greater variability in wealth than is necessary.

It is not a smart idea to assess the quality of a financial adviser by the returns they have been delivering to their clients. The level of returns is much more a symptom of the state of the market than they are of the adviser's skill. If you make your assessment based on returns, you are likely to be attracted to an overly aggressive adviser during bull markets and an overly conservative adviser during bear markets.

This is not a smart strategy for choosing a long term partner for managing your wealth. Unless you're willing and able to successfully change advisers to suit market conditions (not advisable), your best choice is an adviser who has a sound risk methodology regardless of market conditions. This will lead to a higher probability of success throughout the entire economic cycle.

The message is – it's not just about the potential rewards. It's about achieving the best risk adjusted return. Risk is the driver in this relationship so choose an adviser who focuses and understands how to manage the driver of returns (i.e. risk).

Suggested Action:

Look for advisers that discuss financial risks and who see their role as developing and managing your exposure to risk. An adviser who focuses on the risk side of the equation is more likely to deliver you an appropriate level of risk. If an adviser spends most of their time wooing you with the expectation of high returns without a corresponding discussion of risk, walk away immediately. There is far more to achieving your long term objectives than simply focusing on investment returns.

7. A Good Reputation and Record

Don't forget that investment performance is only one part of the value add

You may wish to seek references or testimonials from existing clients of an adviser. This will give you a good idea of the relationship and value add of the adviser.

In addition, it is reasonable to ask an adviser what sort of returns they have provided to their clients. Again, remember that this question relates to risk adjusted return. Any adviser who doesn't qualify the returns they have provided with a reference to the level of risk is either incompetent or misleading you.

Suggested Action: Ask the adviser what benchmarks they use to measure portfolio performance? If they don't use relative benchmarks or a risk-adjusted measure of performance, then you have a right to question how you will know they are consistently adding value in this area.

Don't forget that investment performance is only one part of the value add. Meeting the above criteria is essential but not comprehensive. Cashflow, Tax and Risk management are equally essential elements of the advice value add.

8. A Supportive Dealer with Quality Culture

For those looking for a long term relationship, the relationship between the adviser, their adviser group and the dealer is also something worth understanding.

The provision of financial advice involves three layers of advice providers. These are:

1) The Licensed Dealer – the entity or individual that is licensed by ASIC to provide advice;
2) The Adviser Group – the entity or practice that is appointed by the Licensee to provide advice. This advice must be provided under the terms of the Dealer's licence and within the policies and terms set out by the Dealer; and
3) The Adviser – the individual that works for the Adviser Group and must comply with the terms and conditions set out by the Adviser Group.

In some cases, these three can be one and the same. An individual, for example, can be the licensee, the owner and manager of the adviser practice and also be the sole adviser. More commonly, however, the three are all different.

Variation in the values and objectives of each can lead to friction which can result in the movement of advisers to new adviser groups and/or adviser groups to new licensed dealers. While this is not an intended outcome for any of the parties it is inevitable unless all three work together to develop a common culture. Unfortunately, any change is likely to have an impact on the quality of service you receive (for better or worse).

Suggested Action:

Asking questions about ownership structures and the relationship between the three layers of advice providers is quite appropriate. The Financial Services Guide will include this information. However, you may want to explore this a little deeper. Most industry participants would want to understand the long term intentions of an adviser and their adviser group before appointing an adviser. Perhaps you should be just as interested.

SUMMARY

The aim of this guide is to give you an insider's view of what is considered important in appointing a financial adviser. We understand that some of the above attributes may have more importance for you than others.

Great adviser firms have a culture that is driven by their intention to effectively deliver their intellectual capital to their clients. These firms are conscious of the attributes that best deliver this to their clients and invest the time to ensure that it flows through in all interactions. Look out for these signs when you meet. What you experience will give you a good indication of the service you will receive. World class advisers are always aligned in terms of what they say and what they do.

World class advisers are aligned in terms of what they say and what they do.

The following additional resources may also assist with your appointment of a great financial adviser:

- ASIC Guide – 'Getting Advice'.
- Independent Consumer Organisation, Choice article - Independent financial advice elusive
- Alan Kohler's Eureka Report Comments - Choosing A Financial Adviser
- Wealth Foundations Free Report - Six Steps to Finding a Competent Financial Adviser in Australia

Good luck. We hope this provides you with some useful pointers to help you make an objective decision with respect to your financial affairs.

Please feel free to forward this eBook to friends and colleagues.

For our views on typical financial planning issues sign up for our "Smart Decisions" blog at www.wealthfoundations.com.au/blog.