Hiring an advisor? Ask these 6 important questions first

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If you're in the market for a financial advisor, you probably got a referral or two from friends or family. Yet even if advisors come highly recommended, you'll still want to do your own research and find out who they are and how they work.

Don't feel sheepish about scheduling an appointment to get your questions answered before deciding whether or not you want to work with a particular financial advisor.

You can find a checklist of questions at the Plannersearch.org website, maintained by the Financial Planning Association, a professional association for financial planners. Below, we drill down into some of the most important questions to keep in mind before signing.

1. How do you get paid?

It can be hard to know how—and how much—you're paying your advisor. Advisors should be forthright about how they make money off you. Here are three possible ways:

Fee only. The advisor only gets paid by you, not through commissions for selling particular products. He or she can be paid hourly, as a percentage of assets or through a retainer. Advisors who bill a percentage of assets under management typically charge 1 percent, though they may reduce fees for higher account balances, since it's not much more work to manage a $2 million portfolio as it is to run a $500,000 one.

Some advisors are flexible about the exact arrangement. "For clients who don't have much to invest, we will just do it on an hourly basis," said certified financial planner Daniel Lash of VLP Financial Advisors. "Then we'll stay in touch periodically if they need our help."

Commissions. The advisor is paid to trade stocks or funds.

Fee-based. That's where things get murky. Some advisors use a combination of the two methods; they're paid a fee by the client for advice and then commissions on some of the products they sell.

"Fee-based can mean so many different things," said certified financial planner John Litscher, a partner with the Capital Group. "You can still offer investments with commissions, but it's hard for consumers to really understand the terminology and what they're getting."

2. What is your standard of care?

In the wake of the financial crisis, more consumers are interested in knowing whether their financial advisor is a fiduciary. The fiduciary standard says that an investment advisor must always put the client's interests above his or her own, even if that means passing up a juicy commission. Any advisor who provides personalized financial planning must act as a fiduciary.

Brokers who give general investment advice are subject only to a suitability standard, which means they need only recommend investments that meet their clients' general time horizon, risk tolerance and experience. And they need not disclose any conflicts of interest, even if they receive a financial incentive to sell a particular financial product.

Here's an example of how the two standards play out: Say an advisor determines that a client would best be served by owning a Standard & Poor's 500 index fund. The advisor's firm sells such an offering, but it slaps on a 5 percent commission.

The advisor knows that it's possible to find an identical fund that's sold commission-free. With the suitability standard, it's perfectly acceptable to buy the first fund, even though the client would do better by owning the less expensive version.

It's hard to argue against the fiduciary standard, said Bridget Handke, a certified financial planner and a principal of Birchwood Financial Partners. "As fiduciaries, we have to put the client's interests above those of our firm," she said. "That's better for the client."

3. How do you invest?

Most clients come to advisors for their investment expertise. Even if an advisor does not personally manage money but picks the managers who do, he or she still has a way of looking at markets that should be articulated.

Linda Lubitz Boone, president of Lubitz Financial Group, suggests that clients seek out advisors who go a step further and create an investment policy statement, essentially a road map to how investments will be managed.

"You want to work with someone who has a process when markets go up, when markets go down and when markets go sideways," said Lubitz Boone, co-author of "Creating an Investment Policy Statement: Guidelines and Templates" with her husband, Norman Boone.

Lubitz Boone recalled one of her first clients when she began managing money in the early 1990s. The man, who was in his 70s at the time, had insisted against any investments in Japan. Lubitz Boone was surprised, given how well that market had performed in the years before. It turned out that client had been held in a Japanese prison camp during World War II and his resentment toward his former captors ran deep.

"That's why the IPS is so important—because it's clear communication, and the agreements are documented," Lubitz Boone explained.

4. What's your succession plan?

By many accounts, fewer than 1 in 5 financial planners have a succession plan in place, and this in an industry where the average age—now 50, according to consulting firm Accenture—creeps up each year. About 20 percent of advisors are over 60 years old.

Besides being older, financial advisors are also likely to work as sole proprietors. The combination of no succession plan, advanced years and one-person shops can leave clients vulnerable.

Ask any potential advisor what the plan for you is should he or she choose to retire or the some catastrophe strikes. Seek out firms that have given this issue thought and have a plan.

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"The senior advisor in our firm is 57, I'm 40, and we have junior advisors in their 20s," said Lash of VLP Financial Advisors. "We want our clients to know that if something happens to one of us, there are advisors here who can manage their money and who have a similar investment process."

5. Have you had any disciplinary actions against you?

You would hope that the person you're entrusting to help you save for retirement, a college education for your kids and other milestones is trustworthy. But the only way to know for sure is to ask—and then verify on your own. "If you don't ask the question, you might be told of it on page 400 of a 500-page document" that the advisor gives you, said Litscher.

Registered investment advisors must file a Form ADV with either their state or the Securities and Exchange Commission. It details a lot of interesting tidbits about them. You can ask your advisor, who's required to give his or her ADV to you, for a copy or look it up online atwww.adviserinfo.sec.gov.

Part 2 of Form ADV is where you can find out about any disciplinary actions.

To check up on brokers, use the BrokerCheck tool through the Financial Industry Regulatory Authority, the self-regulatory organization for that industry. It lists any criminal felonies, investment-related misdemeanors and current bankruptcy proceedings, among others.

6. What types of clients do you normally work with?

Every advisor has a sweet spot, gravitating toward a particular client profile for which they know they can do good work. For example, Lubitz Boone of Lubitz Financial Group likes working with clients with investable assets of at least $1 million going through a life transition—and they should be nice, too.

"If you're the type of person who is never satisfied, we won't extend an offer to work with you," she said.

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