Find advice you can trust

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By George Mannes @Money July 13, 2011: 12:46 PM ET

PHOTO: NATHANIEL WELCH

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(Money Magazine) -- Who can you trust with your money? You're not sure, clearly, but you would surely like to know.

When Money Magazine asked you to pick the story you would most like to see in this, our Readers' Choice issue, investing like Warren Buffett or fixing your finances the Dave Ramsey way didn't come out on top. What you were most eager to read about was how to find financial advice you can trust.

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Some of you had been burned before:

"A broker turned our $20,000 into $5,000," said one reader.

"A fixed-income adviser assured me that he'd done extensive due diligence on a three-year note that turned out to be a Ponzi scheme," threw in another.

It was also clear that after two horrific stock market crashes in less than 10 years, many of you are

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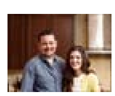
$200,000 income, no emergency fund

The Mendezes know they need to build an emergency fund, but their budget doesn't give them much room to breathe.



Saving for college and retirement on 1 income

Chris and Tina Fleig, ask: How should we save for college and retirement until Tina goes back to work?

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Overnight Avg Rate	Latest	Change	Last Week
30 yr fixed	4.48%	↓	4.59%
15 yr fixed	3.63%	↓	3.74%
5/1 ARM	3.05%	↓	3.15%

simply worried that the next person you entrust with your money -- or the one who helps you now -- will find a way to lose a good chunk of it.

Over the past two years, federal legislators and regulators have been debating about how to make the advice industry more trustworthy.

That could take years to resolve, however, and ultimately neither ethics nor competence can be legislated. (See: Congress, U.S.)

So in this story you'll learn how to determine if a current or prospective adviser has the brainpower, communication skills, and strength of character to do right by you, regardless of whether you have $50,000 or $1 million and no matter whether the pro is with a brand-name brokerage or an independent shop. Scout's honor.

Most qualified badge

Is the adviser or firm qualified to address your needs?

You'll come across a variety of impressive-sounding titles in the advice game: investment consultant, financial analyst, and wealth manager among them.

Such terms tell you little about a person's expertise, however. A "financial planner" may have 20 years' experience in investment, tax, and estate planning -- or may have just started selling insurance two months ago.

Complicating matters, the industry is drowning in credentials; regulatory organization FINRA now lists 109, up from 58 in 2006. And these require varying degrees of training: While a certified financial planner (CFP) must complete 675 hours of study and have three years' experience, a certified asset protection planner (CAPP) merely has to take a three-day course.

How helpful an adviser will be also depends on his employer's business model. Insurance agents, for example, may work with a handful of insurers or only one.

Brokers often have a limited menu of investment offerings. And while mass-market brokerages like Fidelity and Schwab provide individual planning to high-net-worth clients, such firms aren't designed to offer idiosyncratic advice to the majority of customers. More likely, you'll encounter someone trained to guide you through the firm's investment options.

Pick the right acronym: Decide what you want an adviser to do for you. Then check the list of solid credentials at the end of this story to find a match (there could be more than one). To find a new adviser, start with the websites listed, and select at least three to interview. If your current adviser boasts an acronym not listed here, consult finra.org/designations to see what expertise it signifies.

Look for gray hair: Unless your needs are simple, don't work with a newbie, says Linda Hall, Alaska's chief insurance regulator. Instead seek out a pro who's been tested over many market cycles and whose typical client is a lot like you -- ask about average portfolio size and life stage.

Know the limits upfront: When interviewing advisers, ask what services they do and don't provide, what products they put clients in, which they don't or can't, and what brands they favor.

See how each responds to this query: "What resources do you have for problems outside your expertise?" A good adviser won't claim to know it all, but will tell you about pros with whom he or she consults.

The great track record badge

Does the adviser have a history of providing good counsel?

Nearly one in five readers polled by Money Magazine said their biggest concern regarding advisers was that they'd simply get bad advice. Problem is, there's no audited industry measure of quality. And just because an adviser has the license and training required for his job doesn't mean he reliably exercises good judgment.

Open the toolbox: Get prospective advisers chatting about their strategy. You want someone who aims to keep costs low, and doesn't talk returns without mentioning risk. Steer clear of those who brag about big sector bets and market timing; when their luck runs out, so will yours.

Use a benchmark: Request the composition and performance of a portfolio the adviser recommended in the past. (Use your current mix if you're working with an adviser.)

Then compare it with an index fund with a similar allocation, like a Vanguard LifeStrategy fund. This will give you a sense of the adviser's success -- assuming he's honest -- and the risks he took to get there, says Westwood, N.J., wealth manager Tom Orecchio.

Enlist other pros: Ask a trusted attorney or CPA what he or his colleagues know about the person's or firm's reputation. "They run in these circles," says Tom Ajamie, a securities attorney and co-author of Financial Serial Killers.

The client is No. 1 badge

Does the adviser have your interests at heart?

It's hard to get good advice from someone whose goals conflict with yours -- so goes the common critique of commission-earning advisers. Indeed, brokers don't have to sell you the best product; they can offer one that pays them more as long as it's "suitable." Only a registered investment adviser, or RIA -- a legal category vs. a credential -- has to put your interests first.

Unless you have $500,000 or more to invest, however, using an independent RIA can be prohibitively expensive. Most are fee-only, meaning they're paid by clients, not commissions.

Typical charge: 1% or more of assets under management, usually with a high minimum. Besides, rules and payment don't determine behavior; there have always been sleazy RIAs and honorable brokers.

And conflicts of interest can be subtle, says Yale behavioral economist Daylian Cain. Most brokers aren't consciously self-interested, he says; they naturally believe that what benefits them is good for you too.

Foresee potential conflicts: Know how your adviser is paid: commissions, fee-only, or fee-based (a combo of the two). Since commissions vary -- mutual fund front-end loads range from 2.5% to 5.75% -- it's fair to ask what the adviser makes on each transaction.

Beware pitches of nontradable REITs, private placements, and structured products, as well as variable and index annuities -- which all have high sales charges and make sense for few people. Willing to pay for fee-only advice? Find it via napfa.org (some advisers will work on an hourly or flat-fee basis). But still perform the due diligence listed here.

Defer decisions: Cain's research has shown that disclosure of conflicts can, perversely, make you more likely to accept conflicted advice, partly because you don't want to insinuate that the giver is corrupt. You're less likely to be swayed if you're not near the adviser when you decide, Cain says. So take 24 hours to cool off.

Assume bias: Usually, Cain says, you assess advice by asking yourself, "How could this be right?" Instead ask, "How could this be wrong?" Seeking evidence to contradict the adviser will help fight your own biases to believe what you've been told.

The upright citizen badge

Does this adviser or firm play by the rules?

In the court of public opinion, investment professionals are guilty until proved innocent: Two-thirds of Americans polled by Harris Interactive in April said they believed most people on Wall Street would turn criminal if they thought they could get away with it. Things aren't quite that bad. New York securities attorney Bill Singer, who has both prosecuted and defended brokers, estimates that 1% to 5% of people in the business are outright crooks -- "people I would not let use my hand towels," as he puts it. And only 716 brokerage representatives (of 630,000) were barred or suspended by FINRA last year for illegal or un-ethical behavior. Still, even one bad apple is too many if it's your apple.

Do a background check: "If an adviser lacks a license, it's likely a fraudulent situation," says John Gannon, head of investor education at FINRA. Fortunately, regulators have made it easier to find license status, records of employment, complaints, and violations online. Short job tenures and violations of the suitability standard are bad omens. Vet advisory firms at adviserinfo.sec.gov; anyone who sells securities should be on finra.org/brokercheck. Insurance agents are tracked by state regulators (via naic.org). Check your state securities regulator's site for disciplinary reports (follow links at nasaa.org), and search Google too.

Watch for red flags: One lesson from the Bernie Madoff scandal: Your investment adviser shouldn't have custody of your securities. That makes it too easy to steal from you. If he or she works for a large brokerage, your money should be held by the home office; assets of independent advisers should be at a third-party firm. Be suspicious, too, of someone who tries to intimidate or rush you into an investment, who guarantees a certain return, or who presents particularly exotic opportunities, adds David Massey, who heads the North American Securities Administrators Association.

Trust a (bad) gut feeling: A good vibe isn't an all clear, since scam artists and crooks are good at bonding with people, says Paul Zak, head of the Center for Neuroeconomics at Claremont Graduate University. On the other hand, if an adviser makes you uneasy, he says, take it as a warning sign.

The outreach badge

Will the adviser or firm communicate regularly and clearly?

Seventy-three percent of millionaires said they'd fire an adviser for not returning a phone call, according to a recent survey by the Spectrem Group. Those clients may be touchy, but they're onto something: An adviser who isn't communicative doesn't understand that a key part of his job is to minimize your financial stresses which he can't do if he's MIA. How can you trust someone you can't find?

Frequent communication is meaningless, however, if your adviser speaks in jargon. "You want to do business with someone you understand," says

Massey.

Open the dialogue: Talk to the adviser about how she communicates. Does she reach out to clients individually? How often? (Only 24% of clients who speak with their adviser once a year or less say they're very satisfied, vs. 63% of those who are in contact more often, a recent Northstar/Sullivan survey found.) How quickly will the firm respond to inquiries, and to whom will you be speaking ? It may be a colleague or assistant; at a big brokerage, it may not be the person who opened the account.

Get second opinions: As you're vetting advisers, ask to speak with a few clients. References may not weed out criminals (Madoff had lots of happy customers) or help you analyze talent (the adviser probably won't direct you to someone whose investments lost 70%).

Still, clients can tell you about an adviser's communication style, including frequency, substance, and coherence. A good question to ask: In what way did the adviser get in touch during the worst of the financial crisis? After all, you don't want someone who provides guidance only when the path is clear.

WASHINGTON TAKES ON ADVISER TRUST

Can the Feds make financial advisers more trustworthy? A fight over how to do it is being waged on Capitol HIll.

What's at issue: Congress and regulators have been mulling over what's known as fiduciary duty: the idea that a financial professional should put a client's best interests ahead of his or her own. That's the standard to which registered investment advisers have been held; they must pick optimal investments for their clients over ones that benefit themselves more. (If they don't, they can be censured, fined, barred, or taken to court.)

In contrast, brokers work under a less stringent "suitability standard," meaning recommended investments simply must be appropriate for the client. As part of the financial reform legislation enacted last year, the Securities and Exchange Commission was authorized to impose, if it saw fit, a fiduciary standard on anyone who sells securities and provides personalized investment advice.

Where things stand: SEC chair Mary Schapiro is in favor of a universal standard, and she plans to start developing rules this summer. But those won't be in place for at least a year. In the meantime opposition from the brokerage and insurance industries could delay, weaken, or put the kibosh on the whole effort.

Why you should care: At stake are billions of dollars that investors lose to brokers putting them in fee-laden investments that wouldn't pass the fiduciary smell test, say proponents of the fiduciary rule. "This can make a difference of tens or hundreds of thousands of dollars over the life of the investor," says Barbara Roper, director of investor protection for the Consumer Federation of America.

BEST DESIGNATIONS

Not all adviser credentials represent significant amounts of expertise. These are among the best:

CFA

Stands for: Chartered financial analyst

Means the holder is trained in: Investments and investment philosophy

Hours of study: 900 plus four years' experience

cfainstitute.org

CFP

Stands for: Certified financial planner

Means the holder is trained in: Full-service financial planning

Hours of study: 675 plus three years' experience

cfp.net

CLU

Stands for: Chartered life underwriter

Means the holder is trained in: Life insurance products and related financial issues

Hours of study: 400 plus three years' experience

designationcheck.com

ChFC

Stands for: Chartered financial consultant

Means the holder is trained in: Full-service financial planning

Hours of study: 450 plus three years' experience

designationcheck.com

CPA/PFS

Stands for: Certified public accountant/Personal financial specialist

Means the holder is trained in: Full-service financial planning and tax planning

Hours of study: About 2,000 plus two years' experience

http://apps.aicpa.org/credentialsrefweb/PFSCredentialSearchPage.aspx ■

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Nathan Green, Today 02:50 PM

Fee-only financial planner all the way. Your financial planner should follow his own advice, meaning that what they are recommending is how they also invest.

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TechnoPeasan, Yesterday 05:31 PM

After listening patiently as the potential advisor lays out their plan for you, ask them what sort of plan they follow for themselves.

Walk away if they wont tell you.

Walk away if theres a large difference in investment styles such as they want to actively manage individuals stocks for you but are buy&hold indexers themselves.

Walk away if they suggest a variable annuity and they know (because you told them) that you havent maxed... show more

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