Suze Orman Money Matters in Yahoo Finance

The Five Signs of Bad Financial Advice

by Suze Orman

In a recent survey conducted by Fair Isaac, the company behind the FICO credit score, 79 percent of respondents said that financial professionals were their most trusted source for personal finance and credit information. (Family members came in second at 70 percent.)

That doesn't really surprise me, but it sure concerns me. The fact is that there are plenty of professionals out there who sell clients financial products that put a lot of money in the adviser's pocket regardless of whether they're truly the best choice for the client.

I'm not making a blanket statement that all financial professionals are bad; that's how I got my start as one back in the 1980s, after all. But you really need to do your homework to make sure anyone giving you financial advice is giving you good advice.

Here are five signs that a financial advisor may not have your best interests at heart:

1. You own a mutual fund with the letter "B" in its name.

B-share funds are bad news. While it's true that you pay no sales commission (or load) when you first invest in the fund, you could be hit with a load when you try to leave the fund.

These funds are known as deferred-sales charge funds: If you cash out in the first year you'll pay a commission of, say, 5 percent of the money you pull out; if you leave in the second year , the fee is 4 percent, and so on. After five years or so you typically won't pay a fee when you sell.
But the longer you stay invested in the fund the longer you'll be paying a very steep expense ratio. That's the annual charge all mutual fund investors pay on their investment. The problem with B share funds is that the expense ratio can be 1.5 percent a year or more, because a big portion of that charge goes to pay the advisor who sold you the fund.

When you compare that to index funds or ETFs, which have expense ratios that can be just two-tenths of a percentage point or less (0.20 percent), it's a huge difference. Your advisor is doing well, but the high expense ratio you're paying makes it harder for you to do well.

2. You pay the advisor through commissions rather than a flat rate.

A financial advisor -- which can just be a gussied-up name for broker -- who makes all of his or her money on commissions for the investments you buy and sell obviously has an interest in getting you to do a lot of buying and selling. And it's not unreasonable to see that the advisor has a financial incentive to get you to pay high commissions.

How is that good for you? You and your money deserve a better deal than an advisor who works solely on commission can offer. A better arrangement is to work with an advisor you pay a flat annual fee to rather than per-trade commissions.

A typical advisor fee might be 1 percent to 1.5 percent or so. But again, you need to be careful that your advisor is taking good care of your money. If you're paying an advisor 1 percent or so a year for his fee, and the advisor is then turning around and putting you in mutual funds with annual expense ratios of around 1.5 percent, your total investing costs are way too high.

A financial advisor who charges a flat annual management fee should be focused on individual stocks or very low-cost funds such as index funds or ETFs.

Recommendations from people you trust are obviously a great way to track down a fee-only advisor. You can also search for fee-only advisors at the National Association of Personal Financial Advisors.

3. Your life insurance is a cash-value policy.

If your advisor also happens to be a life insurance agent and has steered you into a cash-value policy, sirens should be blaring in your head. In the vast majority of cases, all you need is a simple-term insurance policy, which is going to cost you about 80 percent less than a cash-value policy such as universal life, whole life, or variable life.

Why would someone recommend an expensive cash-value policy? Well, one strong possibility is that the agent's commission is a percentage of your premium, and the higher cash-value premium translates into a larger commission for the agent.

4. You own a variable annuity inside of an IRA.

Anyone who tells you to buy a variable annuity (VA) for your IRA is clearly not looking out for your best interests. The spin on VAs is that you get tax-deferred growth in mutual funds -- that is, no taxes while the money is invested in the VA. But in truth, everything in your IRA is already tax-deferred anyway!

It's absurd to buy a VA inside your IRA. Why might the advisor recommend this move? Once again, there's a nice commission to be made.

5. You're saving for your kid's college education rather than for your retirement.

One reason many people turn to financial advisors is for help in figuring out how to save money for their children's college educations. While it's logical to want to provide for your kids, a good financial advisor won't blindly set up college funds for you.

Instead, a good financial advisor will assess whether you should be saving for college at all. If you aren't already maxing out on all your own retirement savings options, or you have a big chunk of high-interest credit card debt, you have no business putting your kids' college costs ahead of getting your own finances in good shape.

A financial advisor who has your best interests at heart -- and your kids' for that matter -- will explain that if you retire without sufficient income to live on, or in serious debt, you're going to be a financial burden to your children.

DIY Financial Planning

Finally, allow me to give you some free financial advice: Take the time to become educated about your finances so you can make your own informed choices rather than relying on someone else.

At the end of the day, no one will ever care about your money more than you. You're your own best financial advisor.