MONEY TALKS: ADVICE AND THE ADVISOR

# How to Steer Clear of the Crooks

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If you want to avoid falling prey to the Ponzi scheme of someone like Bernie Madoff, the first and most surprising rule you should adopt: Don't trust referrals from your neighbors or friends.

At least, don't rely on the referral to make your decision. Though many advisors have their clients' best interests at heart, there are fraudsters who take advantage of the ready access to their clients' money.

Their chief tool: what the experts call **affinity fraud**—preying on our tendency to trust referrals from people in our social circles, ethnic or religious groups.

Many of these folks suck in their victims by telling them what they want to hear, when it comes to delivering a return on their investment, according to Tony Fiorillo, a fee-only advisor who is president of **Asset Management Strategies** in Fishers, Ind., and works closely with a law firm that has sued stockbrokers for allegedly victimizing clients. It usually takes a while for the investors to discover that the fraudster can't deliver. Meanwhile, the predators take advantage of word-of-mouth referrals to move from one victim to the next.

"This is a very, very sleazy business in a very expensive suit," Fiorillo said.

Affinity fraud is one of the most common ways to victimize investors, according to the **FBI**. A recent global survey by Nielsen of 28,000 people found 92 percent believed word-of-mouth referrals and recommendations from friends and family more than any other form of advertising.

Madoff found his victims among members of Palm Beach Country Club and in Jewish organizations where he was trusted. Fraudsters have preyed upon many other groups. **Marcus Schrenker**—the Indiana financial advisor who tried to fake his own death in a staged 2009 plane crash in Florida and was later convicted of securities fraud—reportedly got enthusiastic word-of-mouth referrals from retired airline pilots. **Roy Fluker Jr.**, who was sentenced in Chicago to 15 years in prison in 2011 after defrauding 2,000 people of $10.7 million, preyed upon African-American church congregants, according to the FBI.

Some cases don't rise to the criminal level and are settled in civil court. In 2012, there were 4,299 arbitration claims filed with **FINRA** against investment advisors for allegedly breaching their fiduciary duty, misrepresenting information, omitting facts and other infractions, compared with 4,729 in 2011.

No matter how trustworthy someone seems—or how much faith you have in the person recommending him—don't go by first impressions, experts warn.

When considering an advisor, set aside a couple of hours to do some background checks, using free online tools available from the **Securities and Exchange Commission** and **FINRA**, Fiorillo advises. Securities violations would be an obvious red flag, but also look out for other possible warning signals, like changing firms frequently.

Look for membership in professional groups such as the **Financial Planning Association** and **National Association of Personal Financial Planners**. "Both of these organizations have rigorous standards," said Kathleen Burns Kingsbury, a wealth psychology consultant at KBK Wealth Connection of Easton, Mass., and author of "How to Give Financial Advice to Women."

It may also be worthwhile to have your attorney do a public record search on an advisor, to make sure you haven't missed anything.

Do a Google check for other potential signs of trouble, such as pending lawsuits. Several years ago, Kingsbury belonged to a business networking group that helped members get referrals. When a very aggressive financial advisor wanted to pitch the group—and gain access to its referral network—a member Googled his name and discovered there were criminal charges against him.

"We were shocked," she said. (Needless to say, they turned him down.)

If an advisor passes muster, meet in person at his or her office, said Scott Cramer, president of **Cramer & Rauchegger**, a retirement and estate planning firm in the Orlando, Fla., area. He is also a member of the National Ethics Bureau, a group that does background checks on financial professionals who have agreed to it voluntarily.

"You want to deal with the kind of professional you would with a doctor, lawyer and dentist—they have an office, they have staff, have regular hours," Cramer said. "You would be surprised how many people who come and see us are dealing with someone working out of the trunk of their car. They talk to them on the phone."

Don't accept the proverbial free lunch. Older people, in particular, often get lured in by unscrupulous advisors at mealtime "seminars" that are really high-pressure sales pitches, according to a 2012 survey by the **Certified Financial Planner Board of Standards**. Among planners surveyed, 56 percent had personally worked with an older client who had been subject to unfair, deceptive or abusive practices in the delivery of financial advice or the sale of financial products.

Make sure the advisor will be placing your money in a custodial account with a third-party such as a reputable brokerage firm that will provide you with quarterly reports on your account, Cramer said. "Never make a check out directly to the financial professional," he added.

Even if you're not well-versed in finance, listen to your gut instincts about a financial advisor during the interview.

"If someone tells you something that just doesn't sound right to you, even though you may not know the difference between an **exchange-traded mutual fund** and **open-ended mutual fund**, pay attention to that," Fiorillo said.

You're better off spending time at the beginning to find a trustworthy advisor than discovering that you helped pay for your advisor's lavish house and fancy sports car—with your life savings.