CHAPTER 7

The Importance of Avoiding Bad Investment Professionals

We often say that a majority of bad investment "professionals" suffer more from incompetence than lack of ethics, but the losses caused by incompetence can be just as financially devastating to you as an investor as the losses caused by unethical investment "professionals" or scam artists. *The reality is that many investment "professionals" you should avoid are, or seem to be, nice and confident people.*

As an example, I remember cross-examining an investment "professional" in an arbitration taking place in Virginia. One significant issue was the improper use of margin in our client's investment account. The client was a wonderful lady, and the investment "professional" came across as a decent guy. The problem was that our client's investment account had been hurt by high commission strategies and products recommended by this seemingly nice investment "professional".

When those investment strategies and products didn't turn out so well, a grossly inappropriate margin strategy was implemented to try to amplify the returns in the account. In other words, the investment "professional" had the account borrow money from the investment firm he worked for so that he could use the extra money to attempt to increase the returns and make up for the losses. When my cross-examination of this investment "professional", who was under oath, turned to address the margin activity, the investment "professional's" nice demeanor and charm could not hide his ignorance about margin and how it could destroy a portfolio. It was obvious that the investment "professional" was in over his head. Of course, when I realized this, I wanted to make him look as foolish as possible so that the triers of fact could witness his utter incompetence.

I was on a roll. When there was a break in the proceedings, our team went to a side conference room and I confidently asked with a smile how my cross-examination was going (as it was a big case, we had two experts and co-counsel as well). I was jacked up and ready to go back in and finish destroying the investment advisor, but to my surprise, none of my teammates seemed to share my enthusiasm.

After hesitating and looking at each other for confirmation as to what they were all thinking, the more senior expert said, “We think you should stop your cross-examination.”

I was taken aback. I started, “But I have a lot more I can hit him with that I haven’t even touched.” My astute teammates then explained to me that all the triers of fact were visibly beginning to sympathize with the “nice guy” investment “professional” who I was humiliating under oath. I followed their advice and ended my cross early, without making the investment “professional” look more foolish. We won the case and helped our client move forward on a better financial footing.

The point of this war story is to help you *avoid confusing a kind and charming demeanor with competence in the financial world*. Our goal is to keep you not only from the unethical side, but also the incompetent side of the securities industry.

We recognize that selecting the right financial professional can be extraordinarily difficult because so much marketing money is spent by the securities industry to attract investors. More than 3,000 broker-dealer firms in the United States are members of FINRA (Financial Industry Regulatory Authority). This means there are a whole lot of good and bad investment professionals out there trying to convince you to trust them with your money.

Given the context above, consider the following facts:

1. Investors file more than 3,000 formal claims against brokerage firms yearly, which is the equivalent of each member firm getting a client so upset every year that they sue their brokerage firm; and

2. FINRA, the regulatory body that purportedly regulates the broker-dealer industry, lodges fines and restitution orders of less than $100 million a year against all its collective members combined, which is less than the net income of just one of the largest broker dealers regulated by FINRA (i.e., LPL Financial makes about five times the amount that FINRA fines the entire industry).[8]

Our takeaway from these statistics is that customer complaints and regulatory fines are simply a manageable cost of doing business for many in the securities industry, and regulators are unable or unwilling to step up and stop the practices that lead to these complaints. As a result, it is up to you and me and other consumers to recalibrate how we choose our investment professionals.

To make the task of avoiding the bad investment "professionals" more daunting, keep in mind that the analysis above is only of FINRA member broker-dealers. It does not include thousands of other investment professionals and companies in the United States that are not fully regulated by FINRA, such as trust companies, investment advisors, financial planners, insurance salespeople, as well as unlicensed individuals and entities who are pitching investments to investors like you.

The good news is, that among this massive group of various types of investment professionals, there are plenty of good financial professionals in the marketplace who are both competent and ethical, and who represent a

8 Sadly, this is not surprising given the fact that FINRA is funded by the very same brokerage firms that it is presumably policing (i.e., the salaries of the regulators are paid by the brokerage firms that they are regulating).

viable option to help you invest and manage your portfolio. If this book can help you navigate away from the bad investment "professionals", whether incompetent or unethical (or both), then we have greatly increased the chance that you will safely end up with a good financial professional to help you manage your investments.

The previously discussed history of the securities industry indicates two ends of the spectrum of investment professionals that currently exists in the marketplace: those who are following the new path of professionalism and those who are still focused on the old ways of commission and conflict-driven sales. Our experience is that even savvy investors have a difficult time distinguishing between the two ends of the spectrum, largely because of the deceptive marketing of bad investment "professionals". In the next two chapters, we include detailed steps that you can employ to significantly increase the chances that you will avoid a bad investment "professional" and end up with a competent and ethical professional.