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Choosing a financial adviser

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Sheryl Garrett runs a nationwide network of financial planners catering to an underserved market: middle-income people who want to pay an hourly fee for unbiased, occasional advice on things like college, retirement and tax planning.

Garrett of Shawnee Mission, Kan., was in San Francisco last week promoting her new book, "Personal Finance Workbook for Dummies." I took the opportunity to see what kind of advice she has for average Americans. Excerpts from our interview follow. But first, a little background on how this business works.

Most people calling themselves financial planners or advisers make money one of two ways. They either sell investments or insurance products on which they earn a commission or they manage clients' money for an annual fee, usually based on the size of their portfolio.

The first business model has inherent conflicts of interest. Salespeople have an incentive to sell you whatever will earn them the most commissions. Garrett firmly believes that the higher the commission, the worse the product. "If a product was flying off the shelves, they wouldn't have to pay people to push it," she says.

The second has fewer conflicts but is less accessible to the average American. Most investment managers require you to hand over at least $500,000 in investable assets; many require $1 million or more. If that is all your money, do you really want it with a single manager?

Garrett worked for both types of companies but felt as if they were failing middle-income Americans who can manage their own financial affairs with a little unbiased help now and then.

In 1998, she started her own financial planning practice, providing advice to all comers for an hourly fee. In 2000, she formed the Garrett Planning Network, a group of like-minded planners nationwide.

Planners who join the network work for themselves but pay a fee - $7,500 the first year and $1,200 a year thereafter - to use the Garrett name. They also receive training and marketing advice and can seek help from planners in the network who might have expertise in areas they don't.

There are 290 people in the network, mostly in one-person offices. About 15 are in the Bay Area.

Members must be fee-only planners, meaning they can't earn commissions; and they must be fiduciaries, meaning they are legally obligated to put client interests ahead of their own. Not all planners are fiduciaries.

They must be registered as investment advisers with their state or the Securities and Exchange Commission. They must be certified financial planners or earn that designation within five years.

Garrett planners generally let clients manage their own portfolios. They can't draft estate or other legal documents. They can help with tax issues, but most don't do tax returns.

Garrett says her members' offices are not unlike dental offices, where you schedule an appointment once or twice a year, come in for service and pay on the way out. "There are no long-term contracts," she says.

Her members usually charge $150 to $300 per hour, depending on location and experience.

Garrett admits that providing hourly, fee-only planning "is not the way to get rich." Many planners start out offering hourly advice. Once their client base is big enough, they switch mainly or exclusively to asset management, which can be more lucrative.

Garrett says some of her planners have gone that route but "our retention rate is 70 percent."

Garrett planners must have at least 51 percent of their client engagements on an hourly basis accessible to anyone. They can charge the rest of their clients an annual retainer or asset-based fees, but most do not.

A planner network similar to Garrett's is the Alliance of Cambridge Advisers in Highland, Mich. It has 135 members, including about seven in the Bay Area.

Its members are also fiduciary, fee-only planners, but most charge an annual retainer rather than an hourly fee. The retainer, which entitles the client to unlimited advice, varies widely, but $2,000 to $20,000 for the first year is not uncommon, says Cathy Stegmaier, the alliance's executive director.

Garrett says having a financial planner on retainer is like having a live-in nanny. It's nice, but most Americans can't afford it.

Here are Garrett's answers to some of my questions:

Q: What brings people to a Garrett planner?

A: Most people have one burning issue that brings them in. During their initial get-acquainted meeting (free in most cases) three or four other things pop up.

Q: What is their most common question?

A: Am I saving enough? They won't phrase it that way. They might say, "I want to make sure I am on the right track for retirement."

Q: How do you answer?

A: There are only so many variables: What are your assets? What is your return? How long are you going to work? How much do you need to live on in? When are you going to die?

We try to control the things we can. We can't do much about the stock market. We can control expenses and taxes (in a client's portfolio). We can control what we spend, how long we will work.

Q: Are most people on track?

A: The answer is usually no, but they are heading in the right direction. The folks attracted to us are well above average.

Q: What is the biggest financial mistake people make?

A: In general, Americans are too damned optimistic. We think the economy is going to continue to be fine, the stock market will be fine. I am going to continue working. We have gotten pretty comfortable not having too much strife on our homeland.

We are suckers for a sales pitch.

A broker says, "You qualify for a mortgage." We hear, "You can afford this mortgage." That's how we got into this housing problem.

A healthy does of pessimism, a shaky stock market, is sometimes a good thing.

Q: What kind of rip-offs do you see people falling for?

A: Letting a financial adviser talk you into retiring early and taking a lump-sum distribution from a defined-benefit pension plan and handing it over to them to manage.

Most Americans can't afford to retire before 62 or 65, if then.

For the average citizen, taking the monthly payment (from a pension plan) is almost always better than taking a lump sum.

Q: What are some of your favorite books about money?

A: One of my favorites is "The Richest Man in Babylon" (by George Samuel Clason).

Another one is "Your Money or Your Life" (by Joe Dominguez and Vicki Robin). It's kind of a tree-hugger book (it's been described as the guide to modern frugality) but if people absorb even 10 percent of it, it will change their life.

I haven't read it yet, but a book that might be perfect for the holidays is "The Financial Wisdom of Ebeneezer Scrooge" (by Ted Klontz, Rick Kahler and Brad Klontz).

Q: What Web sites do you recommend?

A: Morningstar.com for mutual funds. Ishares.com for exchange-traded funds.

Finra.org (run by the regulatory organization formerly know as the National Association of Securities Dealers) has some good consumer-protection things, like what's wrong with variable annuities and why they shouldn't be in an individual retirement account.

Q: Can you suggest a financial gift for a young person?

A: If it's their first investment, I might get them shares in an exchange-traded fund. You can go through Sharebuilder.com and pay a commission (as low as) $4.

Q: What is the best way to save for college?

A: In some cases, a 529 plan is a way to save on a tax-efficient basis.

But if the children are young, the parents probably don't have much savings of their own. They should be funding their own retirement and building a nest egg outside of their retirement plans that would cover them for six months if they lost their jobs.

If they have that, then a 529 is OK. But you cannot forsake your retirement to pay for your kids' college.

Q: Any tips for choosing financial advisers?

A: There is an interview in the book and on our Web site (*links.sfgate.com/ZBRL*).

Be sure to ask: Are you a fiduciary? If they don't say yes, don't do business with them.

Net Worth runs Tuesdays, Thursdays and Sundays. E-mail Kathleen Pender at kpender@sfchronicle.com.

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