The New York Times

July 6, 2012

A Fancy Financial Adviser Title Does Not Ensure High Standards

By TARA SIEGEL BERNARD

Most investors don't realize that when they walk into a bank or brokerage firm branch, the representatives there are essentially free to emblazon their business cards with whatever titles they please — financial consultants, advisers, wealth managers, to name a few. But if you're looking for someone who is qualified to give smart advice about all aspects of your financial life while keeping costs down, you may not be in the right place.

The issue came up again earlier this week in an article by my colleagues at The New York Times, who quoted former JPMorgan Chase brokers as saying they were encouraged to promote the firm's own funds to customers even when more competitive investments were available. Not only were the funds expensive, but the bank also exaggerated at least one investment portfolio's returns.

This may be one of the more blatant examples of the possible pitfalls when working with a bank or brokerage firm. Investors can't be blamed for failing to recognize the differences between a glorified salesman pushing a particular fund and a true investment adviser who is required to act in your best interest, but there are many.

Let us name a few. If two similar mutual funds are available, brokers can choose to put you in the one that lines their pocket at your expense as long as it's considered "suitable" for your needs (that goes for brokers selling investments or insurance). They aren't always required to disclose conflicts of interest that may influence what they ultimately decide to recommend, experts said. Nor are they always obliged to tell you how they are compensated or who is ultimately paying them. True investment advisers are supposed to do all of those things, by law.

Two years ago, the Dodd-Frank financial overhaul law gave the Securities and Exchange Commission the authority to write rules that would require brokers to adhere to the same standard as advisers — a standard known as "fiduciary duty" — but the law stopped short of requiring that the rules be written. Not surprisingly, the S.E.C. has yet to write the rules. While the insurance and financial industries initially pushed back against the rule, the most recent delay was reportedly tied to the commission's efforts to study the costs and benefits of a rule so that it could withstand a court challenge. So its fate and timing are still uncertain.

Still, some experts might argue that even after a fiduciary rule is passed there will still be reasons to take extra care when working with a broker (in fact, some brokers are already subject to the fiduciary rules because they collect a fee or have discretionary control over their customers' accounts). That's not to say there aren't many capable advisers who work at banks and brokerage firms — they just might be limited in the type of advice they can provide because they're working within the confines of their firm's longtime business model, one with a deep-rooted sales culture that can't entirely change its spots.

Indeed, several former brokers quoted in my colleagues' article echoed a point that I've also heard from former brokers in recent years: As much as their firms would like to recast brokers' images as trusted advisers, it is still hard for them to fully shed the sales mentality.

"A fiduciary duty will help at the margins, raising the amount of due diligence brokers will have to do before recommending a security, but a fiduciary standard will not rewrite the history and culture of the brokerage services industry that has existed since before the Great Depression," said Arthur Laby, a professor at Rutgers School of Law-Camden, and a former assistant general counsel at the S.E.C.

Brokers, for instance, aren't typically paid for advice — that is, they aren't paid for creating a financial plan, and they rarely charge by the hour (though there also aren't enough independent advisers that operate this way). Instead, they make money after they sell you something. "The more they sell, the more they make," said Alois Pirker, research director at the Aite Group, a financial research firm. He says that brokers might take a 45 percent cut of the commission they collect, or, if they collect an annual fee, they will be paid a portion of that (and typically the more business they bring in, the higher the percentage they will collect).

The average fee that brokerage firms charge customers for a managed account — or an account that includes a mix of investments like mutual funds — is 2.02 percent, according to Cerulli Associates, an asset management research firm. That includes a 1.1 percent management fee, while the remainder is for the underlying investments. Accounts with cheaper underlying investments like exchange-traded funds will cost slightly less, though that data wasn't available. (The proprietary JPMorgan portfolio charged an annual fee of as much as 1.6 percent, plus the cost of the investments.)

Independent financial planners typically include an annual charge of 0.85 percent to 1.15 percent of your money, according to Cerulli, plus the investment costs. Alternatively, you can seek out a planner who will charge either a flat fee or by the hour. But the biggest difference between a broker and a financial planner is that the planner's fee, more often than not, will include a holistic financial checkup — a detailed analysis of where your money goes, how to approach paying down debts, how much life insurance to buy and how to set up a saving and investment plan to reach your goals, whether that includes saving for a down payment on a house, college or your retirement. They'll also go over your estate plan, among other things.

Brokers, on the other hand, may work for firms that encourage the kind of training that would allow them to offer similar advice, but you have to ask yourself if they will be willing to spend the time with you if they get paid only after they make a sale, particularly if that portfolio isn't worth millions of dollars. On top of that, many brokers' training is quite limited. (Only about 17 percent of the advisers at brokerage firms are certified financial planners, according to Cerulli.) " 'How much do I need to have to retire?' is the sole focus of the majority of these investment planners," said Scott Smith, an associate director at Cerulli, though he added that many larger firms had professionals on hand with broader experience if you requested that kind of help.

Then, there's the matter of investment costs. If you believe that you are better served investing in a diversified mix of low-cost index funds that are free of hidden charges, then you can look beyond a bank or brokerage firm's offerings. Indeed, a diversified mix of three Vanguard index funds appropriate for retirees, for instance, costs only about 0.21 percent of your assets, or less than 0.10 if you want to invest in the exchange-traded fund shares, according to the firm. "If you were to call up Merrill, can you get them to sell you and put you into a no-load Vanguard fund?" said John C. Coffee Jr., a professor of securities law at Columbia Law School. "My guess is you cannot. But that is where I would tell my mother to put a good portion of her money, and whether it is Vanguard or Fidelity or someone else, I don't care."

Still, the biggest danger right now, experts say, goes back to the fact that most consumers don't know who they are dealing with when they sit down with a broker. "The greatest risk the average investor runs is the risk of being misled into thinking that the broker is acting in the best interest of the client, as opposed to acting in the firm's interest," Professor Laby said.

Imposing a higher standard will go a long way to solving a large part of the problem, experts said, but it won't necessarily eradicate it. "I do not believe a fiduciary standard would be a panacea by any means," Professor Laby added. "It would, however, raise the industry standard, requiring the larger firms with good compliance programs to think very carefully about whether their brokers' recommendations could be defended in court, or before the S.E.C., as consistent with a fiduciary standard."

Mercer E. Bullard, an associate professor at the University of Mississippi School of Law who served on the commission's Investor Advisory Committee, said that a fiduciary duty wouldn't necessarily ensure that investors would always be told about the myriad ways the brokerage firm makes money, including revenue sharing, where mutual fund managers may share a portion of their revenue with the brokerage firm (which may cause the funds to land on its list of preferred funds). Some brokerage firms disclose this information on their Web site now, or at the point of sale, but good luck deciphering all of it.

Regardless of what the law says now or how it may change, you can always ask any adviser you are working with who is paying them. And then, ask the adviser to sign a fiduciary pledge, something you can find in a blog post I wrote in 2010, which is attached to the online version of this column.

Because with or without a stronger law, the burden will always be on the investor to find a conflict-free "financial planner," in the purest sense of the title.