Can you trust your financial advisor?

Financial advisors now aren't required to put their clients' interests ahead of their own. Although some are fiduciaries, many are little more than salesmen for financial products.

By Kathy M. Kristof Personal Finance, LA Times
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Financial professionals are waging a heated battle over a little-noticed part of the financial reform bill moving through Congress that's all about one word: trust. For individual investors who pay professionals to help them invest or plan for retirement, it may be the most important piece of the legislation.

Two similar versions of financial reform — the one approved by the Senate on Thursday and the one passed by the House in December — must now be reconciled to create a final law. Both bills contain a variety of controversial issues concerning financial regulatory changes, consumer protections, regulation of derivatives and corporate governance issues.

All those thorny issues got far more attention than a provision dealing with the duties of financial advisors to their clients. The House version demands a high standard for all advisors, the Senate version does not.

Now there's a last-ditch battle to determine whether the reform package ultimately will require all financial advisors to be fiduciaries, or trustees for their clients, as the House bill requires. Why does that matter?

This fiduciary provision is simple, says Bob Webster, a spokesman for the North American Securities Administrators Assn. It demands that financial advisors — regardless of whether they call themselves "wealth planners" or "investment specialists" — put their clients' interests ahead of their own.

If they have a conflict of interest, they have to disclose it. If they think an investment you own or a product they're selling isn't good for you, they have to say so.

You thought that was already true? Think again, said Charles Jaffe, author of "Getting Started in Hiring Financial Advisors." Under current law, brokers and insurance agents only need to show that the product they sold you wasn't blatantly wrong for you. That's a far cry from being compelled to show that the product they recommended was right for you.

In fact, these "advisors" can now sell you products that pay them big commissions, without advising you that there might be a far better (and cheaper) alternative for you — it just wouldn't be as good for them.

"I think that if clients knew the difference upfront, they would never choose an advisor who was not a fiduciary," Jaffe said. "The problem is that people think their advisor has their back, when he's looking after his own self-interest, not yours."

When the Senate voted to cut off debate on financial reform Thursday, tough language demanding that all advisors be held to a high standard of trust was sidelined for a provision that would just have securities regulators "study" the issue. That would leave brokers and insurance agents able to continue with business as usual.

The battle over holding all financial advisors to a fiduciary standard has been going on for years, Webster said. Each time, the rule has been derailed by a relentless and well-funded misinformation campaign. The same holds true today, he said. What are you going to hear about the fiduciary proposals, and what's the truth?

Myth: Imposing a fiduciary standard on all financial advisors would deny investors access to valued products and services.

Reality: Investment professionals could sell exactly the same products they sell now, but they would not be able to tell you that they were offering impartial advice when they were simply trying to sell a product that would earn them a commission.

Myth: If this standard was applied, brokers would not be able to sell clients investments that were held in the firm's portfolio, such as initial public stock offerings. Investment advisors also might have to constrain their clients from taking risks that they want to take, such as holding a large portion of their portfolio in one industry, investment class or one company's stock.

Reality: So-called principal trading — trading from the brokerage firm's own account — presents conflicts of interest that would have to be disclosed. (And wouldn't that have been nice for all of those Goldman Sachs clients?) Advisors would also have to warn their clients when they were doing something apparently foolish, such as investing all their assets in their own company's stock. But the client doesn't have to listen. A fiduciary standard does not turn brokers into financial policemen. It simply demands that the broker provide the good advice that they're supposedly being paid to give so that clients can make an informed choice.

Myth: It's not clear that the system is broken. It should be studied, not fixed.

Reality: Brokers and insurance agents take great pains to obscure the difference between advisors who must look out for your best interests and those who don't have to. That leaves investors learning the lesson of who they can trust too late — when they're already stuck with a high-cost, low-value product that enriched the advisor rather than the investor. It's time to stop calling salesmen advisors.

It's also a myth to imagine that you could relax and forget about your investments if Congress passes legislation to hold all advisors to a fiduciary standard.

"Life is not a fairy tale," Jaffe said. People like Bernie Madoff will always exist. No matter how many laws are passed, those who don't pay regular attention to how their money is being managed are flirting with disaster.