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PERSONAL BUSINESS

Broker Or Adviser?

Be forewarned: If yours is employed by a brokerage, your interests come second

Nowadays stockbrokers bill themselves as financial consultants, financial advisers, or even investment advisers. Are they any different than investment advisers who don't work for brokerage firms?

You bet. Broker "advisers" and independent advisers, though both may charge a percentage of your assets for their services, operate under different regulatory regimes. Independent advisers must act as fiduciaries, which means they must put their clients' best interests ahead of their own. So an adviser recommending a Standard & Poor's 500-stock index fund must put your money in a no-load fund with the lowest annual expenses. A broker might recommend an S&P 500 fund, too, but can choose a load fund with higher expenses. A broker has an obligation to serve the client, but the broker's first duty is to the firm.

Organizations such as the Financial Planning Assn. and the Consumer Federation of America want broker-advisers to meet the same fiduciary standards as independent advisers. But this month the Securities & Exchange Commission will likely make a permanent rule that exempts fee-based brokers from advisers' fiduciary obligations. Industry insiders say the SEC figures brokerage oversight and the arbitration system, which is currently handling a record number of complaints against brokers, offer sufficient protection to clients.

Regardless of how the SEC rules, investors should quiz their brokers and advisers to better understand their obligations, compensation, and conflicts.

Do you provide fee-based advice as a registered investment adviser (RIA) or under the broker exemption allowed by the SEC?

If the answer is RIA, then this is the only question you'll need to ask. The law requires RIAs to disclose the information below. If the answer is broker exemption, ask two more questions.

Do you receive incentives or third-party payments for selling certain investments?

Besides the fees disclosed in mutual fund prospectuses and the commissions received from trading, brokers can earn other compensation or qualify for prizes or vacations if they meet specific sales quotas.

Are you encouraged to sell stocks that the firm has in its inventory?

The brokerage firm can sell you a stock from inventory -- at the best price available anywhere. But commissions for those stocks are higher than for stocks not from inventory. So the broker will often earn more for selling the stock of a company with which the firm has done an initial public or secondary offering.

Sure, the SEC has a mandate to protect investors. But in an imperfect world, investors also have an obligation to protect themselves.

By Toddi Gutner