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The Fight Over Who Will Guard Your Nest Egg



By
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A power struggle in Washington will shape how investors get the advice they need.

On one side are stockbrokers and other securities salespeople who work for Wall Street firms, banks and insurance companies. On the other are financial planners or investment advisers who often work for themselves or smaller firms.



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Brokers are largely regulated by the Financial Industry Regulatory Authority, which is funded by the brokerage business itself and inspects firms every one or two years. Under Finra's rules, brokers must recommend only investments that are "suitable" for clients.

Advisers are regulated by the states or the Securities and Exchange Commission, which examines firms every six to 10 years on average. Advisers act out of "fiduciary duty," or the obligation to put their clients' interests first.

Most investors don't understand this key distinction. A report by Rand Corp. last year found that 63% of investors think brokers are legally required to act in the best interest of the client; 70% believe that brokers must disclose any conflicts of interest. Advisers always have those duties, but brokers often don't. The confusion is understandable, because a lot of stock brokers these days call themselves financial planners.

Brokers can sell you any investment they have "reasonable grounds for believing" is suitable for you. Only since 1990 have they been required to base that suitability judgment on your risk tolerance, investing objectives, tax status and financial position.

A key factor still is missing from Finra's suitability requirements: cost. Let's say you tell your broker that you want to simplify your stock portfolio into an index fund. He then tells you that his firm manages an S&P-500 Index fund that is "suitable" for you. He is under no obligation to tell you that the annual expenses that his firm charges on the fund are 10 times higher than an essentially identical fund from Vanguard. An adviser acting under fiduciary duty would have to disclose the conflict of interest and tell you that cheaper alternatives are available.