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Stern Advice: How to vet that investment adviser

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WASHINGTON (Reuters) - The Securities and Exchange Commission is taking its own sweet time coming up with a rule that would make all investment advisers put their clients' interest first.

Almost a year and a half after saying it was going to pursue this so-called "fiduciary standard," the agency seems stuck. That's because it is trying to contort the standard in such a way that brokers who are paid commissions to sell products could fit under that definition.

For many individual investors seeking guidance, that defies logic. How can an adviser put my needs first, if he is paid to sell only one shelf-full of products? And paid more to sell some than others?

It's no wonder that the financial services industry remains among the least trusted the United States, according to an annual survey by public relations firm Edelman. Fewer than half of consumers said they trusted financial services firms, and more than half of them said they think financial companies need more government regulation.

In the meantime, the financial advice industry is moving on without the SEC. Traditional brokers are leaving the field and instead becoming independent registered investment advisers who must adhere to a traditional fiduciary standard.

"The wirehouses (big brokerage companies)are losing their grip on high net worth investors," Tom Nally, a senior executive at TD Ameritrade, recently told a meeting of independent advisers. TD Ameritrade is a brokerage company that holds assets and does trades for clients of many independent advisers.

Nally told members of the National Association of Personal Financial Advisers, or NAPFA, meeting in Chicago that his firm has seen an 11 percent increase in the number of 'breakaway brokers' since last year.

But the move by more advisers to a fee-driven model is just one small step forward and hasn't really answered many questions for individual investors. One reason is that a fiduciary is good to have, but it is just one piece of the vetting process.

Another reason is that advisers themselves have clouded the waters, with more than a dozen different designations and several different business models.

"The real challenge is that consumers still don't know the difference between a real fiduciary and a salesman because of the convoluted and deceptive use of titles by many financial services firms," Brightscope's Mike Alfred wrote recently in Forbes. His company publishes data on advisers for consumers to use to compare them.

So, yes, start with a fiduciary adviser, but then take it from there. Here's how to find an investment adviser now.

-- Refuse to play semantics. Many advisers now call themselves "fee-based." That's not the same as fee-only. It may just mean that they charge you fees AND sell products to you that then kick back extra to them. Ask, "Are you making money from anyone but me on my account?" Ask them if they are "fee-only."

Some companies are what's called dually-registered: They have investment advisers registered with the SEC but also do trading that has them registered as a broker with FINRA, the Financial Industry Regulatory Authority.

Sometimes these dual registrants are just in transition from brokers to advisers. But it's better to keep those functions separate. "Don't go to a dually-registered adviser," says John Ritter, a Cincinnati, fee-only adviser and chairman of NAPFA's public policy committee. Use an adviser that is fee-only and a fiduciary.

-- Go for a brand-name custodian. It's fine to have a one-person company giving you investment advice or even making trades for you. But don't let them hold your money directly. That's the mistake that clients of Bernie Madoff (who was nominally a fiduciary) made. Make sure that your account is housed at a brand name SIPC-backed brokerage firm, like an Ameritrade or a Charles Schwab or the like.

-- Don't overpay. Even when they take fees instead of commissions, the big brokerage houses charge more than the independents, says Cerulli Associates, a research firm. On average, the big brokers charge about 1.1 percent of assets to manage an account; the independents charge 0.9 percent, says Tyler Cloherty, a Cerulli analyst.

Even those amounts may be high if you're just getting generic mutual fund-picking advice, and if you're willing to do your own trades. If you have a $1 million portfolio and are paying an adviser 1 percent, that's $10,000 a year for investing advice. "What exactly are you getting for that?" asks Sheryl Garrett, a Shawnee Mission, Kansas, adviser who only bills hourly or by the project. She says she typically gives a year's worth of investment planning for clients for roughly $2,000 or $3,000 a year.

-- Benchmark those returns. You might have an honest and caring and affordable financial adviser, but if she's managing your money, is she doing any better than you could do on your own with a couple of generic mutual funds? That's hard to tell, because there's no standard way in which advisers publish their results.

Next week, Brightscope and Spaulding Group, a performance measurement company, will announce plans to create a uniform performance standard for advisers. Their idea is that they will create a way for advisers to measure and report the performance of the investments they manage in a way that will allow clients and potential customers to compare them. That could take a while, of course.

In the meantime? If you are investing for retirement, find a proxy by which you can measure your adviser. Look at a low-cost target date retirement fund for your age group, or use a web site that allows you to monitor "play" portfolios to create a no-brainer portfolio of low-cost stock and bond funds.

For example, you could check your adviser's performance against that of the Vanguard Target Retirement Fund at h ttps://personal.vanguard.com/us/funds/vanguard/TargetRetirementList.

Or you can create and follow a fake portfolio at Yahoo Finance (h ttp://www.yahoo.com) or Morningstar (ht tp://www.morningstar.com.

Over time, of course, your money manager should provide higher returns, net of fees, than the DIY approach.

(The Stern Advice column appears weekly, and at additional times as warranted. Linda Stern can be reached at linda.stern@thomsonreuters.com; She tweets at http://www.twitter.com/lindastern .; Read more of her work at http://blogs.reuters.com/linda-stern; Editing by Dan Grebler)

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