You Don’t Know What You Don’t Know About Your Financial Adviser

The person you turn to for investing advice may have some skeletons in the closet. Finding out about client disputes can be harder than you may think.

ILLUSTRATION: ALEX NABAUM

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Stocks and bonds crumbled again this week, and inflation seems unstoppable. Maybe it’s time to hire a financial adviser.

After all, for years people like me have been telling you that advisers have to disclose much more about themselves than stockbrokers do, so you can make better-informed decisions about their services and integrity.

As I’ve learned to my shock in recent weeks, however, that isn’t always true. In some ways, financial advisers have to disclose less than brokers do—and what they don’t tell you could hurt you.

That’s truer than ever given how the advisory business has boomed. More than 14,800 SEC-registered advisers managed over $128 trillion for 65 million clients at the end of last year. That’s up from 10,500 advisers running $55 trillion for under 20 million clients in 2012, according to ComplySci, a regulatory-compliance firm, and the Investment Adviser Association. (These dollar amounts include some double-counting across firms.)

What’s the potential problem? Consider Vantage Consulting Group, an investment adviser in Virginia Beach, Va., that manages more than $2 billion in assets, mostly for pension and profit-sharing plans but also for at least one wealthy individual, according to a regulatory filing.

Like all financial advisers registered with the Securities and Exchange Commission, Vantage is required to provide clients with a standardized disclosure form called an ADV brochure.

Vantage's latest brochure, filed on March 31, says the firm must "disclose any legal or disciplinary events that are material to a client's or prospective client's evaluation of our advisory business or the integrity of our management."

The document adds, reassuringly, that Vantage and its management "have no reportable disciplinary events to disclose."

Nowhere does the brochure tell you Vantage was sued for $4 million in U.S. district court in April 2021 over civil claims of fraud and misrepresentation after private funds it recommended to clients allegedly lost millions of dollars.

According to a court filing, some money in those funds had been run "for a period of time" by an outside portfolio manager who has since been sentenced to nine years in prison for running a $100 million Ponzi scheme.

In court, Vantage said no losses occurred from that former manager's transactions, although investors haven't been able to withdraw any money from the funds since March 2020 and two years of one fund's financial statements can't be relied upon.

Vantage didn't respond to requests for comment. Its court filings deny any misconduct in the case, which is still before the court, with a possible settlement pending.

If Vantage were a brokerage firm, it would be required to disclose that lawsuit on BrokerCheck, a website run by the Financial Industry Regulatory Authority, Wall Street's self-regulator.

Because it is a registered investment adviser, Vantage doesn't have to disclose anything about the lawsuit in its ADV brochure. The SEC doesn't compel advisers to disclose all civil lawsuits.

Recent regulatory reforms have blurred the traditional lines between brokers and advisers. What's more, some advisers register with Finra and are required to make disclosures on BrokerCheck.

Many aren't Finra-registered, though—and, therefore, are on the honor system.

When it comes to ADV disclosures, according to the SEC, it's up to advisers themselves to determine whether such events as civil lawsuits, customer complaints and arbitration claims are "material" information for clients to know about.

"I find it a little bit perverse that advisers who are supposedly held to a higher standard of due care and diligence have less disciplinary disclosure requirements than a brokerage firm," says Courtney Werning, an attorney at Meyer Wilson in Columbus, Ohio. "That surprised the hell out of me when I found it out not that long ago."

Me too. In 30 years of writing about the financial-advice industry, I never learned that advisers can provide less-comprehensive disclosures than stockbrokers.

Listen to Maria Fernbach, a 69-year-old retiree. She claims her advisers at Pinnacle Associates Ltd., a New York-based firm, pursued an inappropriate stock-options strategy against her wishes—forcing her to sell part of a decades-old position in Apple Inc. stock to fund more than $400,000 in losses on the options.

In August, a FINRA arbitration panel ordered Pinnacle to pay her $825,000 in damages and reimbursed fees.

Good luck learning that in Pinnacle's official brochure: The document says the firm "has not been the subject of any legal or disciplinary events that require disclosure in this item."

Ms. Fernbach, who used to work in the brokerage industry, thinks that's wrong.

“These registered advisers get to say, ‘We have nothing to disclose,’ when they have plenty to disclose,” she says. “If your customers have losses but nobody knows about it because it’s all kept quiet, then a lot of people will have no clue and more accounts will get butchered.”

In a statement, Pinnacle said this arbitration award, which didn’t include punitive damages, was the first against the firm in its nearly 40-year history and that “Pinnacle has disclosed the matter in compliance with applicable regulations.”

In September, on another regulatory disclosure called Form CRS, the firm responded “Yes” to the question “Do you or your financial professionals have legal or disciplinary history?” It hasn’t similarly amended its ADV brochure.

How did advisory disclosures end up so spotty?

Regulators traditionally regarded stockbrokers as salespeople, whereas the relationship between advisers and their clients was built on trust. That created a presumption advisers would do the right thing.

But, because advisers don’t have to disclose customer complaints, civil lawsuits or arbitrations, it’s impossible to know how accurate that presumption is.

I asked consulting firm Aite-Novarica Group for the largest independent firms whose advisers primarily serve individual investors. Out of the top 25 firms by assets, 20 say in their disclosures that they have no legal or disciplinary events to report. That’s an amazingly clean record for firms that altogether employ almost 4,100 people in advisory functions and manage roughly $900 billion.

Maybe not a single one of these firms’ 318,000 individual clients has ever complained about, sued or filed arbitration claims against them.

Maybe hundreds of clients have.

Given the gaping loopholes in existing regulation, it’s impossible to tell.

“These guys all look like angels on paper,” says Nicole Boyson, a finance professor at Northeastern University who studies the brokerage and advisory business. “But if I’m hiring a financial adviser, do I need to spend a few thousand dollars to hire a private investigator to find out if the adviser is shady? And even then, that might not be sufficient,” because most arbitration results aren’t public record.

Where is the SEC? The agency has said it intends to study the use of arbitration clauses in the contracts between advisers and their clients to “help identify any problematic issues impacting retail advisory clients.” A spokesperson says the

SEC continually reviews disclosure requirements like Form ADV to ensure they provide adequate information.

What I've learned convinces me that you need to add these questions to your list when interviewing a financial adviser: Have clients filed written complaints or arbitration claims against you or your firm? Have you or your firm been sued by clients?

I also hope financial advisers whose clients have never filed a written complaint, an arbitration claim or a civil lawsuit against them will begin to disclose exactly that, in language anyone can understand.

That way, the public would be able to distinguish between advisers with a pristine record and those hiding behind weasel words like "nothing material to disclose."

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