Point / Counterpoint

Broker/dealers who provide investment advice should be held to the same fiduciary standard as other investment advisers.

AGREE

In the asset management world, there are certain matters in which broker/dealers cannot hold to the same fiduciary standards because of the nature of their business (e.g., all transactions performed at a fair market price). But very often broker/dealers are willing to collaborate with investment managers in order to curb or avoid the regulation to benefit the manager instead of the final client. Classic examples of undesired market practices require the participation of a broker/dealer—such as parking, transactions between funds, and soft dollar agreements not directly favoring the investor. These situations could be avoided if a certain degree of fiduciary duty toward the final investor was required of broker/dealers.

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Investment advisers with a fiduciary duty to clients have an obligation to act in the client's best interest and not to engage in any activity that may conflict with this obligation. This includes disclosing all material facts to the client and taking care not to knowingly mislead the client in any way. The intention of this fiduciary standard is to ensure that the investment advice provided will have wealth maximizing consequences for the client subject to the client's risk tolerance and other constraints. While the current standard for a broker/dealer is the suitability standard, for a more level playing field, the higher fiduciary standard should be applied to broker/dealers who provide trading facilities and investment advice. Imposing this rigorous standard is even more relevant in light of the recent global financial crisis and the concomitant lack of confidence exhibited by market participants in financial markets and institutions. While some may argue that applying the fiduciary standard to broker/dealers is, perhaps, overkill, the growing prevalence of discretionary and discretionary-like accounts presents a strong case for this more rigorous standard. In addition, it focuses the attention of broker/dealers (who provide investment advice) on what is of paramount importance—the client's best interest.

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Any investment professional with discretionary authority to manage money for an individual should do what is in the best interest of the individual, period. The idea that better disclosures will solve the problem is flawed. Multiple surveys have indicated that the public makes no distinction between broker/dealers and advisers who are held to a fiduciary standard because of their registrations. The public has spoken and wants to eliminate or minimize conflicts of interest. Rather than trusting that disclosures of conflicts of interest will meet the public's needs, an elimination of the double standard will get all advisers on a level playing field and go a long way toward restoring the trust in our profession that the conflicts of interest have destroyed.

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DISAGREE

While I applaud the industry for making efforts to create better advisers, I do not believe that making all advisers adhere to a fiduciary standard will create a better client–adviser relationship without causing significant harm.

First, current regulations that form the basis for brokers and advisers have been on the books for more than 70 years, yet the regulators have enabled advisers (as defined under the Securities Act of 1933 and the Securities Exchange Act of 1934) to market and promote their services as if they were advisers under the Investment Advisers Act of 1940. Prior to making a wholesale change of the regulatory framework, shouldn't the regulatory agencies be properly enforcing the rules that are already on the books? Should not a broker be a broker and an adviser be an adviser? Is it really necessary to make a broker a fiduciary, or should we let clients determine whom they want to work with? Shouldn't we really be changing the deceptive marketing practices, not the law?

Second, the definition of "fiduciary" would forever become a useless word in the industry. What is a fiduciary? It is a "higher standard of care." If that is the case, how will it remain a higher standard of care if it is the only standard of care? The definition would depend how the courts and arbitration panels define it. Is it possible that one person's advice could be considered reckless yet another adviser would make the same recommendation and deem it practical? Would an adviser now be giving advice based on what a courtroom would say, not based on the financial conditions a client faced? Could contrarian advice to a client eventually be deemed unlawful?

When working with clients, the correct answer to

almost all questions a client asks begins with "it depends." How an adviser interprets the "it" will determine the quality of advice that he gives. If a Securities Act of 1933 broker is obtaining a commission on advice, how will a court decide which component is advice and which is sales? Is it possible to break them out?

Third, what type of information and knowledge about a client would be required to satisfy a fiduciary duty? If a retail client wanted to buy a fund that is very volatile, what due diligence would the adviser have to do to fulfill his fiduciary duty? What if the client didn't want his advice and merely needed the transaction executed? Would it be possible to waive the fiduciary liability? If not, why would an adviser execute the transaction and take on legal liability? Where would the client go to execute the transaction?

I believe that to be a fiduciary for a retail client, you must have a comprehensive view of the client's financial resources. For every financial salesman (and client) to complete this task prior to any transaction would be impractical. Transaction costs—in terms of time, compliance, and insurance—would increase dramatically. As a result, the barriers to entry in this business eventually would rise, lowering the overall standards and quality of advice.

The current rules have all the teeth needed to manage the differing worlds of investment brokers, insurance brokers, investment advisers, and financial planners. The issues revolve around the enforcement of those rules and the cost of enforcement. The most noted examples of financial shenanigans came about not as the result of inadequate rules but because of the fraudulent activity of those perpetrating the acts. Simply because the law said the perpetrators were supposed to be fiduciaries didn't prevent the fraud from occurring.

Regulatory agencies have the difficult task of balancing the acts of promoting commerce yet protecting the integrity of the industry. For better or worse, they have no ability to change behavior through a regulatory framework. They can only change costs and consequences. The cost and consequences of broadening the fiduciary standard would harm the consumer through a false sense of security, in addition to imposing needless extra costs that will be borne by the whole industry. Advisers would not change their behavior but would merely cover their liability. Such a change would not have any positive effect on the investment industry or clients.

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I believe it is unrealistic to require all participants who provide financial services to individual retail clients (e.g., brokers, registered financial service representatives, insurance agents) to abide by a fiduciary duty to those end clients. Such a requirement would likely end up diluting the definition of fiduciary duty as it applies today and would most certainly result in unintended consequences; an established and well-moneyed industry will conjure a creative response to new regulation.

What is needed is a "bright line" definition for consumers on whether their adviser or rep is acting in a fiduciary capacity. As it stands today, many of these financial service reps may sometimes *act* in a fiduciary capacity and at other times simply use suitability guidelines. Cross-selling is a common tactic, but is a part-time fiduciary supposed to exist in the business of giving investment advice?

I have talked to advisers/reps that charge an investment management fee and contract to advise on a fee basis under a registered investment adviser (RIA) and then broker their own deals to the RIA, effectively paying themselves twice for the same service/deal. The client is completely unaware of this dual compensation because it is buried in the bid–ask spread. I view this behavior as highly unethical and probably fraudulent. Thanks to the repeal of the Merril Lynch Rule, however, they can simply create an RIA and have an attorney write up a disclosure full of incomprehensible legalese in their Form ADV. (Incidentally, advisers registered with the SEC are not required to name related personas that are broker/dealers on Form ADV.)

I suggest three steps: (1) Standardize the titles/terminology/roles to make very clear whether an adviser or rep is working as a fiduciary for an end client. For example, a "financial planner" would abide by a fiduciary duty to the end client at all times but a "financial counselor" need not honor such a duty. (2) Require clear enumeration of sources of compensation that an adviser/rep may receive along with a list of all affiliations and registrations. (3) Rigorously enforce such standards to protect consumers. Simply put, typical retail clients are poorly informed on these matters and do not read the fine print—disclosures—heaped upon them. Only strong enforcement will dissuade unethical individual and institutional practices.

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Why can't we let the market for services operate like the market for, say, law services or advertising (or barbers)? If clients want the fiduciary standard, let them negotiate and pay for the contract. If they are willing to accept a lower standard, why can't they have it? For institutional investors, there is no question that the market depends on the client–broker negotiation. The results are lower fees and better services. Retail investors should have the same option. The SEC should require that contracts be clear and precise but should get out of the business of requiring one standard for all.

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