Decumulation Beat

By Editor Test *Wed, Nov 24, 2010*

Only advisors who are self-employed have the autonomy to use the fiduciary standard when working with clients.

A universal fiduciary standard requiring all financial advisors intermediaries to put their clients' interest first sounds like a self-evident improvement over the status quo, but it's hard to see how it could work.

Extending the fiduciary label assumes that all advice-giving intermediaries can act the way doctors and lawyers do. But M.D.s and attorneys usually have the independence to act in a client's interest if they choose. Not all financial intermediaries can act independently.

A person serves the one who signs the checks. While we live in a representative democracy, most of us (i.e., those who aren't self-employed or unionized) work in more or less benevolent dictatorships where our loyalty belongs to the firm or the supervisor who pays our wages, salaries and bonuses and controls our advancement.

As an newsroom colleague of mine used to point out long ago, people should always know "which side their head is battered on."

A fee-only advisor who gets paid by his or her clients can take a fiduciary oath fairly easily. Conflicts of interest will arise, but the conflict takes place in the conscience of the advisor. It's a very different scenario for advisors who are employed by big companies. If they want to advance, they have to be more loyal to the company—to sell or recommend what the company has decided its advisors will sell or recommend, for instance—than to the client.

We could debate the meaning of "advice," "advisor," or "best interest." We could tell ourselves that an advisor can "switch hats" and use the fiduciary standard for one client and the suitability standard for another. We could conjecture that the parallel interests of the company, its shareholders, its employees and its clients eventually converge. But that's only in a non-Euclidean universe, not in the everyday world.

If we created a uniform or harmonized fiduciary standard, we'd be asking some advisors to serve two masters at the same time. That's either an impossibility or a recipe for existential stress. Or a dilution of the standard itself.

I'm not saying that only self-employed fee-only advisors are capable of acting in the client's best interest. They're not necessarily selfless. At a fee-only advisor conference recently, one advisor told me that she doesn't want to see a fiduciary standard for wirehouse advisors because the fiduciary standard represents her competitive advantage over brokers.

"When I first meet clients, I explain that I'm a fiduciary, and that I work for them. And they like that," she said. Sure, she was defending her turf from a new cohort of competitors. But she knows that when she makes a statement like that, she can make it stick. I may be wrong, but I don't think most wirehouse advisors can do the same.

Disclosures aren't the solution. Disclosing conflicts of interest doesn't make them go away. The most vulnerable investors don't read disclosures.

Ironically, Securities and Exchange Commission chairperson Mary Schapiro could determine the outcome of this debate. (The Dodd-Frank financial reform bill left the matter up to the regulators in the executive branch to define the fiduciary rules.)

Why "ironically"? According to reports in credible newspapers, Schapiro accepted a multi-million payout from the financial services industry when she left the top job at FINRA, where she was demonstrably ineffective. In her new, relatively low-paying government job, it must take a superhuman effort not to serve the financial industry first and investors second.