Hold Brokers and Advisors to One Standard, SEC Chief Says

By Editor Test *Tue, Jul 21, 2009*

Mary Schapiro told Congress she favors requiring broker-dealers and investment advisers to act solely in the interests of their clients when providing advice.

In testimony before a House subcommittee July 14, SEC chairman Mary L. Schapiro emerged as a regulatory hawk, displaying much more passion for government oversight of the securities business than she did in her previous job as head of the Financial Industry Regulatory Authority, or FINRA.

Among her themes:

- Registered reps must accept fiduciary responsibility if they give financial advice.
- Target date funds should make their risks more apparent.
- Hedge funds have “flown under the radar too long.”
- The SEC should keep a closer eye on the credit rating agencies.

And, Schapiro pointed out, the SEC won’t be able to enforce those policies without more staff attorneys, more technology, and more funding.

Regarding registered reps, she wants them to put clients first. “We are also closely examining the broker-dealer and investment adviser regulatory regimes and assessing how they can best be harmonized and improved for the benefit of investors,” Schapiro told the House Financial Services Committee’s Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises.

“Many investors do not recognize the differences in standards of conduct or the regulatory protections applicable to broker-dealers and investment advisers. When investors receive similar services from similar financial service providers, the service providers should be subject to the same standard of conduct and regulatory requirements, regardless of the label attached to the providers.

“All financial service providers that provide personalized investment advice about securities should owe a fiduciary duty to their customers or clients and be subject to equivalent regulation. I support the standard contained in the bill Treasury recently put forth, which would require broker-dealers and investment advisers to act solely in the interests of their customers or clients when providing investment advice.

On the issue of regulating hedge funds, she apparently rejects the idea that rich investors don't need the government to watch their backs. "Hedge funds and other unregulated private pools of capital have flown under the radar for far too long," she testified. "I support the recommendation in the Administration's white paper that advisers to hedge funds and other private pools of capital should be required to register with the SEC under the Investment Advisers Act."

Target-date funds, a marketing concept whose flaws were revealed by last fall's equity market crash, also drew Schapiro's belated attention. "Target date funds… have produced some troubling investment results," she told legislators. "The average loss in 2008 among 31 funds with a 2010 retirement date was almost 25%. In addition, varying strategies among these funds produced widely varying results, as returns of 2010 target date funds ranged from minus 3.6% to minus 41%."

Pro forma, Schapiro recommended more disclosure, despite the fact that few investors read disclosures. "I can assure you that our staff is closely reviewing target date funds' disclosure about their asset allocations. …We will consider whether additional disclosure measures are needed to better align target date funds' asset allocations with investor expectations."

On the topic of the ratings agencies (see this week's cover story), she said the SEC is committed to "strengthening the integrity of the ratings process, and more effectively addressing the potential for conflicts of interest inherent in the ratings process for structured finance products."

The Commission, she said, wants to require Nationally Recognized Statistical Rating Organizations (NRSROs) to disclose ratings history information for 100% of all issuer-paid credit ratings and to prohibit an NRSRO from issuing a rating for a structured finance product paid for by the product's issuer, sponsor, or underwriter unless the information about the product provided to the NRSRO is made available to other NRSROs.

Finally, Schapiro described the years leading up to the financial crisis as a period of weakness at the SEC. "Beginning in Fiscal 2005, the SEC faced three consecutive years of flat or declining budgets, the end result being a 10% reduction in its workforce and a cut of more than 50% in its new technology investments," she said.

"This occurred at the same time that the securities markets we regulate were growing significantly in size and complexity," she said. "Since 2005, when these cutbacks began, average daily trading volume has nearly doubled; the investment advisor industry has grown by over 30% in number and over 40% in assets under management; and broker-dealer operations have expanded significantly in size, complexity, and geographic diversity."

"The SEC currently has only about 450 examiners to oversee 11,300 investment advisers and 8,000 mutual funds. If advisers to hedge funds, private equity funds and venture capital funds were required to register with the SEC, as contemplated by the Administration's white paper, our staff roughly estimates that approximately 2,000 additional investment advisers would register… Significant additional resources would be necessary for the Commission to take on additional responsibility in this area," she claimed.