SEC Staff Recommends Uniform Fiduciary Standard

By Editor Test *Tue, Jan 25, 2011*

All those who give "personalized investment advice about securities to retail customers" should put the clients' interest above their own, the SEC staff recommends.

The Securities and Exchange Commission staff has recommended "establishing a uniform fiduciary standard for investment advisers and broker-dealers when providing investment advice about securities to retail customers that is consistent with the standard that currently applies to investment advisers."

The recommendations, which were said to reflect the views of the SEC staff but not necessarily the commissioners, appeared in the 208-page "Study on Investment Advisors and Broker-Dealers" that the SEC produced as directed by section 913 of the Dodd-Frank Wall Street Reform and Investor Protection Act of 2010. The study was published January 19.

Joan E. Boros, Of Counsel at the Washington law firm of JordenBurt LLP and a former SEC staff attorney, has heard little enthusiasm for the report in either direction.

"I don't assume a uniformed standard will be adopted, nor vice-versa. Mainly, I don't know what might end up being adopted. The study really didn't go very far to give any clue of what any rule or rules would require or excuse," Boros told *RIJ* yesterday.

"While Commissioners Paredes and Casey seem to want to do less and that's why they criticized the study, everyone I have spoken to agrees that the study doesn't really have much substance and [is] a long way from anything that could be adopted," she added.

"One speculation is that the study was an attempt by the others to get Congress to do the work. That in my book is exhibit one for 'Beware of What You Wish For.' As a savvy Hill lawyer has cautioned: It is a lot easier to revise a rule written by a regulatory agency than to amend a statute that Congress enacted."

The debate over the uniform fiduciary standard has frequently focused less on the ethical issue—the reduction of asymmetrical information and hidden conflicts of interest in the retail securities marketplace—and more on the in-house issue of how a new regulatory regime might upset the business models of various distribution channels.

In opposing the recommendations last week, for instance, two of the SEC commissioners cited commercial factors as their primary concern—defining the main impact of the recommended changes in terms of their potential impact on the price and availability of financial advisory services as opposed to their probity.

Last Friday, January 21, SEC commissioners Kathleen Casey and Troy Paredes released their objections to the study's findings. They said that it "fails to justify its recommendation" and "does not adequately recognize the risk that its recommendations could adversely impact investors." They strongly imply that a uniform standard would hurt consumers either by putting brokers and insurance agents out of the advice business or forcing them to charge more for advice.

In the statement, Casey and Paredes write, “The Study unduly discounts the risk that, as a result of the regulatory burdens imposed by the recommendations on financial professionals, investors may have fewer broker-dealers and investment advisers to choose from, may have access to fewer products and services, and may have to pay more for the services and advice they do receive. Any such results are not in the best interests of investors; nor do they serve to protect them.”

Casey and Paredes are the only two Republicans on the commission. Under SEC rules, the five-member commission must have a majority of the party currently in power. The other commissioners are Luis Aguilar, Elisse Walter, and chairperson Mary Schapiro.

Trade groups either praised or condemned the new recommendations, depending on which advisory or distribution channels they represent. The Financial Planning Coalition and the Committee for the Fiduciary Standards, which represent the advisors who are already required to conform to the higher standard, agreed with the SEC staff

Those groups representing registered reps and insurance agents, who are currently held to a standard of conduct that admits a larger element of *caveat emptor* in relations with clients, opposed the recommendation. These groups included the National Association of Insurance and Financial Advisors (NAIFA), and the Association for Advanced Life Underwriting (AALU).

In their statement, Casey and Paredes echoed the concern among brokerage and insurance groups that creating a uniform standard could bring about lots of unintended consequences—such as raising the cost of financial advisory services for middle-class investors.

That concern is based on their belief that advisors might have to pass along the added costs—caused by spending more hours on each client or switching from commission-based to fee-based compensation or increasing their education—that might be associated with meeting the higher standard of conduct.

Brokers—that is, registered representatives of broker-dealers—currently need to meet the “suitability” standard. This rule-based standard requires them not to sell products to customers for whom they aren’t suitable, but tolerates conflicts of interest (such as broker-dealer sales incentives) in the broker-client relationship.

Often overlooked in the debate, it seems, is a subtle distinction between registered reps of broker-dealers and professional advisors. To the extent that registered reps are rule-following employees of large companies, it’s not clear that they have enough discretion or independence to choose to put the clients’ interests first, even if they wanted to. A self-employed financial advisor has both.

If brokers dispense advice, or if they’re viewed as advisors by their clients, it seems reasonable that they should respect a higher standard. They can’t expect to have it both ways. Whether they will have to charge more for switching from rules-based to principles-based conduct is a separate problem—or perhaps merely a red herring.