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SUNDAY FOCUS ON LOCAL INDUSTRY & DEVELOPMENT

Brokers' standard could be raised

SEC to study issue under new finance law.

Investment advisers already must focus more on clients' best interest.

By **Kyle Waller** and **Casey Smith**
For the AJC

Casey Smith (left) and Kyle Waller hope the fiduciary standard for brokers will be raised.

Now that the president has signed the Frank-Dodd financial reform bill, regulators are about to engage in a historic number of studies commissioned by the legislation. One of the more overlooked aspects of the bill is likely to have the most direct impact on investors in Atlanta and across the country.

The Securities Exchange Commission is mandated to determine whether brokerage houses should adopt more accountable fiduciary standards when giving investment advice. (Brokers are currently held to "suitability" standards.) The SEC must study the issue for six months before issuing a ruling on it.

Why is fiduciary reform so important to the individual investor and how will it impact the current financial services landscape?

One of the inherent conflicts facing broker-dealers is that they get paid when a client buys (or sells) something from them. While brokers are required to make sure that the products sold to a client are suitable, they have no obligation to ensure that the client is actually making a sound investment decision. The distinction is crucial.

Suitability means that a client must simply "qualify" for an investment. In practice, this lets a broker sell clients into higher cost, less client-friendly products; the actual outcome of the investment is secondary to generating a transaction.

The industry word "fiduciary" means all the difference here. Doctors, lawyers and even real estate agents have this same standard. Fiduciary requires an adviser to act in a person's best interest. In the investment services industry, only registered investment advisers are legally held to this standard. In addition, registered investment advisers do not get paid commissions but, usually a percentage based on the fees they manage. Thus, they are highly incentivized to help clients protect and/or grow their investments.

The general public and many politicians often see brokers and registered investment advisers as the same. For years, brokers have used "financial adviser" on business cards and in their titles.

These misleading titles and the commercials brokerage houses run to advertise their services frequently blur the lines between the two. Sadly, many people are not even aware that there is anything else.

All this may change, as the SEC has been authorized to conduct the study and establish rules holding brokers to the same fiduciary standards as registered investment advisers. The SEC will review several issues including how effective the existing standards are at protecting investors as well as how well investors understand the differences between brokers and investment advisers.

Right now, it is difficult for investors to know the true cost of their brokerage relationships, as client fees are not very transparent.

Despite the tremendous lobbying power on behalf of Wall Street's biggest brokerage houses, brokers may finally have to be regulated the same way as fee-only registered investment advisers: with a fiduciary standard of care. However, if the past is any indication of the future, the process could still take years to take effect.

The overall cost of paying for independent advice will most certainly cost less than the expensive products being sold to you. Right now, it is difficult for investors to know the true cost of their brokerage relationships, as client fees are not very transparent.

Hopefully, the SEC will impose the much-needed fiduciary standards, restoring the trust lost between clients and the brokers that have served them during the financial crisis.

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