

# THE WALL STREET JOURNAL.

MONDAY, DECEMBER 6, 2010

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## What's No. 1 for Brokers?

**Right now, securities firms don't have to put investors' interests first. New regulations may change that—and Wall Street isn't happy.**

BY SUZANNE BARLYN

Putting client interests first may seem like a simple concept, but it's causing an uproar on Wall Street.

The Dodd-Frank Act, the landmark regulatory overhaul passed in July, gives the Securities and Exchange Commission until January to complete a study of a possible single standard of client care for two types of advisers: brokers and registered investment advisers. The agency can then write new rules requiring a uniform standard.

The expectation is that such a standard would be closer to the client-first rule that currently applies to registered investment advisers, rather than the longstanding requirement that brokers recommend only "suitable" investments. (Registered advisers are regulated by the SEC or states, while brokers register with and are regulated by the Financial Industry Regulatory Authority, Wall Street's self-policing organization.) The securities industry supports the change—to a degree—but is worried that it could mean changing certain practices that are critical to its business models.

### PERCEPTION AND REALITY

A study released by the SEC in 2008 found widespread confusion among investors about advisers' titles, responsibilities and legal duties to their clients.

Retail investors often perceive their brokers as professionals whose role extends beyond conducting securities trades on their behalf. Indeed, many brokers at big securities firms—often called wirehouses—now refer to themselves as "advisers" rather than "brokers," even though they may not be registered as such. They typically provide advice about investment strategies and goals, such as college savings and retirement planning, in addition to executing trades.

"There's no question that the average client perceives his broker at a large wirehouse in the same way he perceives his doctor, lawyer or CPA," says Andrew Stoltmann, a Chicago-based securities lawyer who represents investors in disputes against brokerage firms. "People assume their brokers are always looking out for their best interests," says Mr. Stoltmann, who adds he was a broker before becoming a lawyer.

Many brokers may, in fact, look out for their clients' best interests. But if they're not registered as investment advisers in addition to being registered as brokers, they're not legally obligated to meet that standard. Brokers are required to recommend investments that are suitable for each client, taking into account factors such as the client's age, goals and risk tolerance. "Suitable," however, doesn't necessarily mean "best."

Brokers typically are paid through commissions, which can complicate the relationship. Also, brokerage firms may earn fees from investment companies for promoting their products, such as certain mutual funds. "The broker is free to recommend inferior options that compensate the broker more generously, rather than what's best for the investor," says Barbara Roper, investor-protection director for the Consumer Federation of America, a Washington-based advocacy group. They may take their firm's interests into account, as well.

Registered investment advisers, in contrast, are required to act as fiduciaries, or in their clients' best interests. Rather than take commissions, they charge fees, which typically are a percentage of a client's assets overseen by the adviser.

### STRONG OPINIONS

Advocates who say a fiduciary standard should apply across the board contend it's more stringent than the brokerage industry's suitability rule. Brokers not only would have to make recommendations that are best for their clients, says Ms. Roper, but also would be required to disclose any conflicts of interest that could interfere with their ability to act in clients' best interests.

The latest controversy over a uniform standard began during the 2008 Wall Street meltdown, which led to the Dodd-Frank Act. An early version of the legislation would have required, simply, that brokers act in the best interest of clients. Brokers who work for insurance companies, however, lobbied fiercely against the language. The National Association of Insurance and Financial Advisors, a trade group based in Falls Church, Va., argued that a fiduciary duty is a vaguely defined concept that wouldn't protect investors any better than brokers' suitability requirement.

Congress ultimately adopted the provision in the current law requiring the SEC to study the issue and authorizing it to write rules for a new standard, depending on its findings. The agency's request for public comments on the issue attracted more than 3,000 letters.

Brokerage firms should not be allowed to use the term "client" in any communication if they're not willing to serve as fiduciaries, wrote one commentator. "Brokers and dealers should definitely have some legal obligation to their clients by looking out for their interests, not bilking them out of their hard-earned money," wrote a woman identifying herself as a human-resources manager. A broker, however, raised concerns about his compliance responsibilities, which he said increased fourfold in recent years. Brokers, he wrote, were already acting in clients' best interests

and faced innumerable lawsuits if a fiduciary standard were to apply.

#### INDUSTRY CONCERNS

The Securities Industry and Financial Markets Association, or Sifma, a trade group representing many large and midsize brokerage firms, announced its support for a "new federal fiduciary standard" last year, after years of opposing the idea. But it has concerns about how exactly such a standard might be applied.

A fiduciary standard that prohibits brokerage firms from selling securities from their own inventories or branded with the firm's name, for example, could upend current business practices and limit investor choices, says Chet Helck, a Sifma board member and chief operating officer of Raymond James Financial Inc. "If you can't sell your products to your customers, who do you sell them to?" he says.

The Dodd-Frank Act acknowledges some of the brokerage industry's concerns. Charging commissions, for example, couldn't be considered a violation of whatever standard the SEC may develop. (Sifma maintains, however, that the law doesn't guarantee that the SEC will impose a standard that will accommodate commission-based business models.) The new law also wouldn't require a standard to bind brokers indefinitely. That could mean, for example, that brokers wouldn't be obligated to give additional advice about a security years after the purchase is made.

The debate could drag on if the SEC decides to write rules aimed at harmonizing standards, says Knut Rostad, chairman of the Committee for the Fiduciary Standard, an advocacy group based in Falls Church, Va. Rules for some issues, such as defining the types of services that constitute advice, could be adopted quickly. Others aimed at potential changes to the industry's business practices could take years, he says.

The potential impact of a fiduciary standard on brokers' relationships with clients is still unclear. Among other things, it could lead to a marketplace with a range of new products that don't compensate the broker through commissions or other transaction-based fees, says Blaine Aikin, president and chief executive of fi360, a company that trains advisers in fiduciary and other issues.

The brokerage industry will have to embrace a fiduciary standard to remain competitive, says Mr. Aikin. "It is embarrassing to defend that you don't believe the client's interest should be put first," he says.

Ms. Barlyn is a reporter for Dow Jones Newswires in New York. Email her at [suzanne.barlyn@dowjones.com](mailto:suzanne.barlyn@dowjones.com).