

THE INTELLIGENT INVESTOR

MARCH 28, 2009

### **The Fight Over Who Will Guard Your Nest Egg**

By JASON ZWEIG

A power struggle in Washington will shape how investors get the advice they need.

On one side are stockbrokers and other securities salespeople who work for Wall Street firms, banks and insurance companies. On the other are financial planners or investment advisers who often work for themselves or smaller firms.

Brokers are largely regulated by the Financial Industry Regulatory Authority, which is funded by the brokerage business itself and inspects firms every one or two years. Under Finra's rules, brokers must recommend only investments that are "suitable" for clients.

Advisers are regulated by the states or the Securities and Exchange Commission, which examines firms every six to 10 years on average. Advisers act out of "fiduciary duty," or the obligation to put their clients' interests first.

Most investors don't understand this key distinction. A report by Rand Corp. last year found that 63% of investors think brokers are legally required to act in the best interest of the client; 70% believe that brokers must disclose any conflicts of interest. Advisers always have those duties, but brokers often don't. The confusion is understandable, because a lot of stock brokers these days call themselves financial planners.

Brokers can sell you any investment they have "reasonable grounds for believing" is suitable for you. Only since 1990 have they been required to base that suitability judgment on your risk tolerance, investing objectives, tax status and financial position.

A key factor still is missing from Finra's suitability requirements: cost. Let's say you tell your broker that you want to simplify your stock portfolio into an index fund. He then tells you that his firm manages an S&P-500 Index fund that is "suitable" for you. He is under no obligation to tell you that the annual expenses that his firm charges on the fund are 10 times higher than an essentially identical fund from Vanguard. An adviser acting under fiduciary duty would have to disclose the conflict of interest and tell you that cheaper alternatives are available.

If brokers had to take cost and conflicts of interest into account in order to honor a fiduciary duty to their clients, their firms might hesitate before producing the kind of garbage that has blighted the portfolios of investors over the years.

Richard G. Ketchum, chairman of Finra, has begun openly using the F-word: fiduciary. "It's time to get to one standard, a fiduciary standard that works for both broker-dealers and advisers," he told me. "Both should have a fundamental first responsibility to their customers."

When I asked whether Finra should be that single regulator, Mr. Ketchum replied: "Do we have the infrastructure and would we do a good job? We think yes."

Others disagree. "It would be lethal if Finra becomes the only regulator," retorts Tamar Frankel, a professor of securities law at Boston University. "Finra has an inherent conflict of interest, because it's the same people regulating themselves."

In testimony to the Senate in the past week, SEC Chairwoman Mary Schapiro said the agency is considering "whether to recommend legislation to break down the statutory barriers" that impose different regulations on brokers and advisers.

Ms. Schapiro stepped down earlier this year as head of Finra to lead the SEC. In 2005, when she was vice chairwoman of Finra's predecessor, Ms. Schapiro wrote a scathing letter to the SEC calling "this much-vaunted fiduciary duty ... imprecise and indeterminate."

When I asked her now if she still held that view, Ms. Schapiro replied: "I wear a new hat now. I completely get that I work for America's investors, so my perspective has changed. I think investors would rationally say that they prefer fiduciary duty as the standard of care. And they are entitled to have their interests come first, always."

Ms. Schapiro said it is too early to say who should be the lead regulator if brokers and advisers are brought under the same set of rules.

Ms. Schapiro sounds sincere, and they say there is no zeal like that of the convert. Here is hoping she means what she now is saying, and that Congress -- and the investing public -- will hold her to it. It is high time for everyone who says "Trust me" to be held to the highest standard.