Trusted Adviser or Stock Pusher? Finance Bill May Not Settle It

By TARA SIEGEL BERNARD, NY TIMES - MARCH 3, 2010

You have probably seen the television commercial, the one where you seem to be watching an intimate conversation between family members. But at the end, you learn that the conversation was actually between a broker and his client.

The advertisement is meant to evoke the idea of financial adviser as confidant, and is part of brokerage firms' broader effort in recent years to recast their image — from mere stock pushers to trustworthy advisers.

But in interviews, former and current brokers said the ad told only part of the story. All said their jobs depended less on giving advice and more on closing sales. The more money they brought in, the more they, and their firms, would earn.

"I learned a lot about being a good salesman at Merrill," said David B. Armstrong, who left Merrill Lynch after 10 years and with partners started an advisory firm in Alexandria, Va. "The amount of training I sat through to properly evaluate investment opportunities was almost nonexistent relative to the training I got on how to sell them."

David B. Armstrong, a former broker at Merrill Lynch, said his training focused on selling rather than evaluating investments. CreditDaniel Rosenbaum for The New York Times

While the issue of broker responsibility is not new, it has resurfaced as Congress has been considering financial overhaul legislation. In his original draft, Senator Christopher J. Dodd, chairman of the Senate Banking Committee, proposed requiring brokers to put their customers' interests first — what is known as fiduciary duty — when providing investment advice. But in recent weeks, the chances of this proposal's making it into the bill began to dim.

Senator Tim Johnson, a South Dakota Democrat on the Banking Committee, has proposed an 18-month study of the brokerage and investment advisory industries, an effort that would replace Senator Dodd's provision.

Imposing a fiduciary requirement could have an impact on investment firms' profits. Guy Moszkowski, a securities industry analyst at Bank of America Merrill Lynch, said that the impact of a fiduciary standard was hard to determine because it would depend on how tightly the rules were interpreted. But he said it could cost a firm like Morgan Stanley, Smith Barney as much as $300 million, or about 6 to 7 percent of this year's expected earnings, if the rules were tightly defined. "It's very nebulous, but I think that is a reasonable estimate," he added.

In a research report about Morgan Stanley last year, Mr. Moszkowski wrote, "Financial advisers will be expected to take into account not just whether a product or investment is suitable for the client, but whether it is priced favorably relative to available alternatives, even though this could compromise the revenue the financial adviser and company could realize."

Technically speaking, most brokers (including those who sell variable annuities or the 529 college savings plans) are now only required to steer their clients to "suitable" products — based on a customer's financial situation, goals and stomach for risk.

But Marcus Harris, a financial planner who left Smith Barney 10 months ago to join an independent firm in Hunt Valley, Md., said the current rules leave room for abuse. "Under suitability, advisers would willy-nilly buy and sell investments that were the flavor of the month and make some infinitesimal case that they were somehow appropriate without worrying," he said.

Kristofer Harrison, who spent a couple of years at Smith Barney before leaving to work as an independent financial planner in Clarks Summit, Pa., said the fact that brokers were paid for investments — but not advice — also fostered the sales mentality.

"The difficulty I had in the brokerage industry" he said, "is that you don't get paid for the delivery of financial advice absent the sale of a financial product. That is not to say the advice I rendered was not of professional quality, but in the end, I always had the sales pitch in the back of my mind."

Mercer Bullard, a law professor and adviser to regulators, said brokers did not have to disclose upfront how they were paid. CreditRobert K. Jodan/University of Mississippi

Mr. Armstrong, Mr. Harris and Mr. Harrison all said they had decided to become independent because they felt constrained by their firms' emphasis on profit-making and their inability to provide comprehensive advice.

A current branch manager of a major brokerage firm, who did not want to be identified because he did not have his employer's permission to speak to the media, confirmed that "you are rewarded for producing more fees and commissions." While he said that "at the end of the day, I think that the clients' interests are placed first and foremost by most advisers," he added that "we are faced with ethical choices all day long."

Brokers are typically paid a percentage of fees and commissions they generate. The more productive advisers at banks and big brokerage firms could collect 50 percent of the fees and commissions they generate, said Douglas Dannemiller, a senior analyst at Aite Group, a financial services research group.

The firms may also make money through other arrangements, including what is known as revenue sharing, where mutual fund managers may, for instance, agree to share a portion of their revenue with the brokerage firm. By doing this, the funds may land on the brokerage firm's list of "preferred" funds. Some brokerage firms, including Merrill Lynch and Morgan Stanley Smith Barney disclose their revenue sharing information on their Web sites, or at the point of sale. Edward Jones discloses it as well, as the result of a settlement of a class-action lawsuit. UBS and Wells Fargo Advisors declined to comment on whether it discloses this information.

Unlike fiduciaries, brokers do not have to disclose how they are paid upfront or whether they have incentives to push one investment over another. “The way the federal securities law regulates brokers, it does not require the delivery of information other than at the time of the transaction,” said Mercer E. Bullard, an associate professor at the University of Mississippi, School of Law who serves on the Securities and Exchange Commission’s investment advisory committee.

The legislative language on fiduciary responsibility was one part of the financial overhaul bill aimed at protecting consumers’ interests. Another part, setting up an independent consumer protection agency, may also be watered down.

The study proposal by Senator Johnson may be included in the actual bill, which means it would not be subject to debate. And consumer advocates contended that the study would stop regulators from making any incremental consumer-friendly changes until the study was completed. The study would also require the S.E.C. to go over territory already covered in a 228-page study, conducted by the RAND Corporation in 2008 at a cost of about $875,000, the advocates said.

“In my opinion, the Johnson study is a stalling tactic that will either substantially delay or totally prevent a strong fiduciary standard from being applied,” said Kristina Fausti, a former S.E.C. lawyer who specialized in broker-dealer regulation.

“The S.E.C. has been studying issues related to investment-adviser and broker-dealer regulation and overall market conditions for over 10 years,” she said. “It’s puzzling to me why you would ask an agency to conduct a study when it is already an expert in the regulatory issues being discussed.”

Even after the study was completed, legislation would still need to be passed to give the S.E.C. authority to create a fiduciary standard for brokers who provide advice. “As we all know, the appetite for doing this in one or two years is certainly not going to be what it is today,” said Knut Rostad, chairman of the Committee for the Fiduciary Standard, a group of investment professionals advocating the standard. His group circulated analysis that tried to illustrate where answers to the study’s questions could be found.

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