

Does Your Stockbroker Place Your Best Interests First?

By Ric Edelman
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When seeking investment advice, do you prefer to take advice from someone whose legal obligation is to focus on your best interests, or the best interests of his employer?

You probably think that's a silly question. After all, who would want to work with an advisor who's more concerned about his company than he is about you?

Well, if your investment accounts are held with a brokerage firm, get ready for some surprising news. According to the SEC, only Investment Advisors (and their Representatives) have the fiduciary obligation of putting first their clients' best interests. When dealing with brokerage firms, your stockbroker, account executive, vice president (or whatever he calls himself) is primarily focused on meeting the interests and needs of his broker/dealer, not yours. This is true even if your broker calls himself an "investment advisor." No wonder *Business Week* wrote on April 11, 2005, "If your broker is employed by a brokerage firm, your interests come second."

Indeed, there is a big difference between advisors who hold NASD licenses to sell securities and advisors who are registered with the SEC or a state securities regulator. But many investors don't know the difference — or even that there is a difference. The SEC realizes this, saying, "We share the concern that there is confusion about the differences between broker-dealers and investment advisors, and we believe that some of that confusion may be a result of broker-dealer marketing (including the titles broker-dealers use) when describing their reps."

The agency goes on to say, "Although most financial planners are registered under the Advisers Act or similar state statutes, financial planners today belong to a distinct profession, and financial planning is a separate discipline from, for example, portfolio management. This development has occurred only relatively recently, well after the enactment of the Investment Advisers Act in 1940."

So, to clarify the situation, the SEC has published, “Broker-Dealers Deemed Not to be Investment Advisers,” Release No. 34-51523; new rule 202(a)(11)-1 under the Investment Advisers Act of 1940. The release is (ready for this?) one hundred seventeen pages long.

The SEC’s message is clear: stockbrokers are salespeople who make a living by selling investments; they are not paid to provide investment advice. Instead, providing advice is “merely incidental” to the sale — much like a car salesman’s advice is merely incidental to getting you to buy a car.

The release says that brokers are deemed to be “investment advisors” if they hold themselves out to the public as financial planners or providers of financial planning services, or if they deliver a financial plan in the course of offering advisory services. If your broker is not registered, he’s telling you that he’s *not* an investment advisor, but instead is merely a product-pushing salesperson.

It’s important to note that the release says that merely charging a fee for services rendered does not mean that employees of brokerage firms are acting as advisors. So don’t let brokers trick you into thinking they are advisors merely because they earn fees instead of commissions.

Beginning July 22, to make sure consumers understand the difference between brokers and advisors, brokers must state in their advertisements and contracts that their accounts are brokerage accounts and not advisory accounts, and that the broker’s interests (and those of his or her firm) may not always be the same as their customers’. Every new client of a brokerage firm will be required to sign a form that states, “Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you, and, sometimes, by people who compensate us based on what you buy from us. Therefore, our profits, and our salespersons’ compensations, may vary by product and over time.”

The SEC says, “Customers should be encouraged to ask questions about their rights and the broker-dealer’s obligations to them, including the extent of the broker-dealer’s obligations to disclose conflicts of interest and to act in their best interest. This would include information about sales incentives and how a broker-dealer’s employees are compensated. In addition, the broker-dealer must identify an appropriate person at the firm with whom the customer can discuss the differences between brokerage and advisory accounts.”

If you want to distinguish between fiduciaries (who are responsible for investing someone else’s assets) and non-fiduciaries, between Registered Investment Advisors and those who masquerade as RIAs, between those who provide advice and those who merely try to sell products, simply ask the broker if he is registered as an investment advisor. If he is not registered, he is not a fiduciary, which means his first priority is satisfying the needs of his employer (such as meeting sales quotas or selling certain types of products). It also means he is not a financial planner. If he says he provides financial planning services, he must be registered — or he and his firm are in violation of federal regulations.

Unfortunately, the Release does not prohibit brokerage firms from calling their brokers “financial advisors,” or “financial consultants,” or similar terms that give the impression that they are Investment Advisor Representatives.

Although the SEC’s release is a good step — it states bluntly what brokers are and are not — the SEC should take the next step and require brokers to register. This will force brokers and their firms to act as fiduciaries, placing their clients’ best interests ahead of their own. Until this happens, consumers must be aware that brokers are not subject to the same standard as Registered Investment Advisors.

Editor’s Note: Edelman Financial Services LLC is a Registered Investment Advisor and all of the financial planners at EFS are Investment Advisor Representatives.