



Financial Reform and the Fiduciary Standard

By Tom Brakke

March 23, 2010

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On March 15, Senator Christopher Dodd released a draft bill addressing the regulation of the financial markets. Three years after the first cracks in the financial system appeared and more than a year after the point of maximum stress, are we finally going to see some real reform?

That's a question that can't be dealt with in a few paragraphs. The issues are complex, from the "big picture" notions of what kinds of regulation make sense to the nitty-gritty details of how provisions should be implemented. Unfortunately, the battle over ideas is being waged by well-financed vested interests within a political process, so it is possible that there may not be very much progress made at all.

One disappointing aspect of the draft bill is the call for more study about whether to adopt the fiduciary standard for every type of financial advisor. I believe that the standard, which applies to registered investment advisors (including me), is the one that should apply to all purveyors of financial advice. That is not the case today.

Some advisors are bound by the **fiduciary** standard. That means that they must put the client's interests ahead of their own and must disclose how they are compensated and whether they have any conflicts of interest. Others are held to a **suitability** standard, meaning that the products and services only must be deemed "suitable" for the client in question, a lower standard of care that does not include the requirements of fiduciary duty. To confuse matters further, there are some advisors who act in both capacities at different times.

I have seen articles from those who favor the fiduciary standard that frame the debate by saying that brokers and agents operating under the suitability standard *don't* put their clients first. That is a misstatement; they *aren't required to do so*. There are fine individuals operating under each standard who do the right things



for their clients. But why perpetuate different standards in the first place? And why would anyone argue for a lower standard of care?

By all accounts, the brokerage and insurance industries, whose salespeople operate under the suitability standard, are fighting the move to the fiduciary standard. The delay of its adoption must be viewed as a political victory for those firms. As is clear from reading this [article](#), the harm that the industry groups feel could come from the new standard is not related to a concern for clients, but in response to their fears of lower profits. (The link includes an inaccurate depiction of fiduciary duty by an industry trade group, a tip-off that it is interested in preserving the status quo rather than doing the right thing.)

In any case, the debate will rage on for now. What should you do in the meantime? You should understand how your advisors work on your behalf. Ask them under which standard they operate. Have them explain in detail what that means. If they are subject to the suitability standard, ask them to disclose completely how they are paid and what other products or services they considered recommending to you, and find out whether they will operate under the fiduciary standard when dealing with you.

The financial crisis taught us that transparency in financial transactions is critically important. If new rules make previously hidden information visible, that's great, but if the regulations don't happen, you owe it to yourself to ask the right questions.

Tom Brakke, CFA, is a registered investment advisor, in addition to providing consulting services to investment organizations and [advisors](#) about how to structure processes for better decision making. He authors a blog, [the research puzzle](#), and writes newsletters like this twice a month; you may subscribe at [tjb advisors](#).

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