

## New SEC rule marks big change in investment advisory relations

When seeking investment advice, most investors call a trusted financial adviser or stockbroker. If this happens to be the same person, investors should pay special attention to one of the biggest investment advisory decisions from the Securities and Exchange Commission in nearly 35 years.

Since Jan. 31, all United States brokerage firms that offer fee-based financial services have been required to clearly disclose whether an account is a brokerage account or an advisory account. Furthermore, brokers must disclose:

- Whether they are selling or advising a client.
- What their income will be for the service.
- The nature of the relationship on every communication to the client.

This new broker-dealer rule, as it's called in the financial industry, is designed to reduce conflicts of interest between salespeople and advisers. The roles and fees of these two very different professionals must now be clearly identified.

### BROKERS AND ADVISERS

The problem is that many investors don't know the difference between a broker and an investment adviser and believe that both brokers and advisers have a responsibility to serve the investor's best interest. They expect brokers to offer sound advice and behave as fiduciaries (someone with pure objectivity who is ethically responsible for serving the client's best interests).

In fact, with their income directly tied to sales, brokers are in a position to advise clients to purchase investments that are more profitable for the broker, and not necessarily in the best interest of the investor. If enforced, the new rule will reduce this conflict and help better protect consumers from unethical brokers and advisers.

### MISPLACED TRUST

Prior to the Jan. 31 rule, brokers could provide

investment advice that was incidental to their sales role and receive special compensation for the advice. Brokers could wear both hats because the SEC interpretation of its 1940 provision was confusing, especially after a 1999 SEC proposal that allowed brokerage firms to offer fee-based investment services without registering as investment advisers.

For example, many National Football League players learned the hard way that not all financial advisers are trustworthy fiduciaries — some former advisers are now serving prison sentences for defrauding players out of millions of dollars.

The problem was so common in the NFL that in 2002, the NFL Players Association launched a program for approving and monitoring financial advisers for its members. The NFLPA scoured state and federal agencies and trade associations to build its screening criteria, because there is no one agency that holds advisers accountable, nor one set of rules for advisers in the U.S.

### ENFORCING THE NEW RULE

Some brokerage firms complied with the new ruling in advance of the January deadline by issuing statements that define the two roles and their firm's obligation to avoid conflict of interest. One national brokerage firm separated the two roles by requiring all its financial advisers to become independent Registered Investment Advisors who can no longer sell investments.

To define the problem more clearly, a broker-dealer holds its own inventory of securities. A broker buys and sells these securities as an agent for his clients; a dealer trades this same inventory in the market — and it all takes place "under one roof" so to speak.

The SEC is expected to do spot checks of the disclosure statements issued by brokerage firms to customers, thus ensuring that written disclosures are being provided. However, it is really in the hands of financial professionals to comply — and consumers to ask the right questions to protect themselves.

As investors become more concerned about their families' financial security and health, as well as focusing on their investments, they will understand that working with a trusted, objective fiduciary is very important to serving their best interests.

In the future, the SEC could make additional

changes. The Financial Planning Association believes the broker-dealer rule doesn't go far enough in protecting consumers from conflicts of interest and must eventually include bankers, attorneys and CPAs who sometimes provide investment advice but are currently exempt from the new rule.

### QUALIFYING ADVISERS

With so many different titles and professional designations in the financial planning world, it can be confusing for investors to know who provides what services. Regardless of the initials behind the name, here are a few things every investor should know about advisers and brokers:

Advisers have a fiduciary duty to act in a client's best interest. Brokers are salespeople and are not impartial.

Advisers must describe how the adviser conducts business and disclose any potential conflict of interest.

Advisers cannot trade on behalf of their clients from their own brokerage house inventories, because brokers earn significant profits from these trades.

Advisers typically charge fees based on a percentage of managed assets. They cannot accept referral fees or other compensation for a client's business. Brokers earn money from various compensation structures.

Investors should know that brokers are placing an investment order and making money on that order, meaning they cannot provide financial advice at the same time. The cautionary statement "buyer beware" has never been more appropriate.

The government and the American people desire a stable securities market. As technology advances and the financial industry becomes more dependent on electronic trading tools, computerized investment transactions will occur at a faster rate and human beings will continue to make mistakes — intentional and unintentional. Better standards for all financial professionals are essential.

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### BROKER- DEALER RULE

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