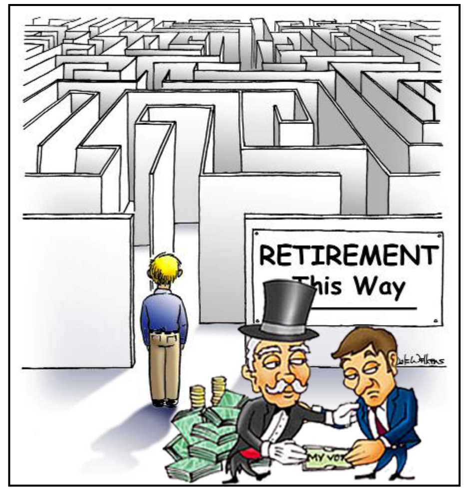
Reprinted from the
Lexington Minuteman

COROMANDEL WEALTH MANAGEMENT

May 2014

Why is the SEC redefining "Fiduciary"?

Navigating the Retirement Maze



At first glance, the title of this month's column looks like a total snoozer. After all, who cares about the Securities and Exchange Commission (SEC), or knows what a fiduciary is? However, if you have an investment advisor or broker who manages your money, then read on, because the SEC appears to be in the process of watering down the standard by which those to whom you entrust your money are measured.

What's a "Fiduciary"?

Legally speaking, a fiduciary is a person to whom property or power is entrusted for the benefit of another. The word has its roots in the Latin "fidere," meaning "to trust." The recognition of a "fiduciary standard of conduct" dates back as far as Confucius (c. 500 BC) and Babylon's Code of Hammurabi (c. 1790 BC). It is a standard against which those entrusted with the property of another are measured.

In the investment world, "fiduciary" has a specific definition. The Investment Company Act of 1940, known in the industry as "40 Act," states that, as a fiduciary, an advisor must always place the interests of the client above their own. (Full disclosure: I am a registered advisor and fiduciary.)

Brokers, on the other hand, are held to a different standard known as "suitability." It stipulates that the investments a broker purchases for a client must be appropriate for that client's particular situation: age, finances, risk tolerance, etc. Suitability is a less stringent metric than the "40 Act" fiduciary requirement, and thus easier to defend in a court of law or arbitration.

From Aristotle to Dodd-Frank

Following the financial crisis of 2008-09, the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed, ostensibly to prevent many of the abuses that led to that particular debacle. One of the stated goals in Dodd-Frank is the establishment of a fiduciary standard that would apply across the entire financial profession, leaving the specifics for a future bill. In 2011, the SEC proposed a uniform standard of conduct: "… for all brokers, dealers, and investment advisers… (that) shall be in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice." It seemed to mirror the intent of Dodd-Frank.

Lobbyists and the "revolving door"

When proposed legislation threatens a business model that has proven lucrative to a particular industry, expect the "K Street" lobbyists and massive amounts of campaign contributions to get unleashed. The Securities Industry and Financial Markets Association (SIFMA) has directed millions of dollars at Congress to ensure that their member companies don't become subject to any meaningful new fiduciary responsibilities.

There is also the issue of the "revolving door." One of the unspoken rules of government employees is: "Thou shall not offend potential future employers." When SEC staffers can leave for positions on Wall Street with an order of magnitude pay increase, it becomes evident that they wouldn't want to appear on any industry "black list."

To date, the issue of a uniform fiduciary standard has been tossed back and forth between the SEC and Congress like the political hot potato that it is. Last October, an SEC advisory group recommended that the SEC proceed with a rule mandating that brokers put the best interests of their clients before their own when providing investment advice. In other words, make brokers follow the same standard of professional conduct that advisors already do, as Dodd-Frank mandates.

So where does the SEC plan to go with this recommendation? A speech by a senior SEC official last month let the cat out of the bag. David Blass, the chief counsel of the SEC's Division of Trading and Markets, told an audience that the fiduciary duty imposed on advisors "should not be considered to be any higher than the suitability standard applied to broker-dealers." In other words, it appears that the SEC intends to dilute the existing "40 Act" fiduciary standard so that brokers would be able to call themselves "fiduciaries" without changing their methods of compensation or allegiance. Translation: Don't raise the bridge (behavior). Lower the river (standards).

What it means for you

In the battle between consumer interests and campaign dollars, expect the dollars to win. By loosening the requirements of the current definition so that Wall Street's retail business practices can be given the blessing of a "fiduciary standard," consumers would only be assured that their advisor or broker is recommending "suitable" investments for them, regardless of how they are being compensated or whose interests come first. "Consumer Protection Act?" Hardly. What appears to be a foregone conclusion within the industry is that legislation for eviscerating the current standard of fiduciary responsibility is in the works, and on Wall Street it will just be business as usual.

George Gagliardi is a fee-only financial advisor with Coromandel Wealth Management in Lexington, where he helps clients develop and implement investment and retirement strategies. He can be reached at (781) 728-9001 or george@CoromandelWM.com. George is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor. *This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should only be given after an individual situation has been reviewed.*