Volume 6, No. 2

SENIOR CONSULTANT
The Voice of the Investment Management Consultant

Remaking the Market: My Investors, My Responsibility

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Over the last two years, America's capital markets have been turned upside-down by revelations of corporate malfeasance, accounting fraud and conflicted advice. Stock recommendations by the most reputable firms in the world have been shown to be more about smoothing the relationship between investment bankers and CEOs than about providing sound information to ordinary investors.

As a result, investors don't know what to believe, so they've taken an understandable course of action: *Don't believe anything.* In my four decades working with individual investors, I've never seen such a profound crisis of trust.

The President, the Congress and the Securities and Exchange Commission have all recognized that reforms were long overdue. The passage of the Sarbanes-Oxley Act was an important first step. The on-going efforts by the SEC and the securities exchanges to implement new disclosures for Wall Street analysts have also been significant, and the work by New York State Attorney General Eliot Spitzer and other states have helped shine much-needed light into the darkest corners of the industry. I commend them all for their dedication to the public interest and for bringing these issues forward.

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But I believe there is more that must be done to win back the trust of individual investors, particularly when it comes to conflicted recommendations. The conflicts that plague Wall Street are systemic. They result from the inherent impossibility of divided duties – simultaneously trying to serve corporate, institutional and individual clients. For decades, Wall Street has insisted that its system of "Chinese walls" is adequate to manage those conflicts, but it's clear those walls have been easily breached, and managing those conflicts has been difficult if not impossible.

News of a proposed solution in the form of a global settlement surfaced in recent days. Firms and individuals charged with violations need to work out the appropriate resolution with regulators, of course, but if a global settlement is intended to send a message about the standards that will be expected going forward, then I wonder whether a private settlement agreement is the best way to accomplish that.

In my view any resolution must abide by three principles. First, transparency – any solutions or rule-making must be done in the light of day with input from the public: the investors and the many institutions that serve them. Investors have been left in the dark for too long about the problems of Wall Street. To trust the outcome, they must be involved in the solutions.

Second, we need better and more disclosure – disclosure about relationships within a firm that might create conflicts of interest between one set of clients and another. Investors deserve a clearer picture of the biases and conflicts built into the advice they receive, so that they can make their own informed choices. Disclose all financial incentives that might skew advice. Make that information easily accessible to investors. The compensation of brokers should be clearly disclosed as well. Does a broker receive more for selling stock in Company A over Company B? All commission payments should be clearly disclosed and agreed-to in writing by the client.

Disclosure of this sort will drive change for the better. Some have suggested that we need total separation of research and investment banking, a severing of all ties, so that no firm offers both. In a recent poll we conducted, an astonishing 71% of the respondents thought that was a good idea. If firms can't clearly explain how they manage conflict to investors' satisfaction, then the market will drive the right structural change.

Third and most important, I believe we should build upon the regulations and ethical obligations already in place by requiring more accountability at the senior-most executive level within financial service firms, who serve the general public.

I recently proposed to President Bush and SEC Chairman Harvey Pitt, the establishment of a "Code of Conduct," which would require the CEO and chief compliance officer of every financial services firm to certify that controls are in place to protect investors from conflicts of interest. For example, top executives would certify that employees who provide research and employees who provide advice are in no way compromised by the other business of the firm. Further, this certification would describe what those controls are and how they work.

They would certify that controls are in place to ensure that senior executives of a client company do not receive favorable treatment because of reciprocal business. They would certify that controls are in place to prevent inflated commissions being used as a kickback and ensure that the interests of individual clients come before corporate interests in selling particular products or services. In short, I propose a code of conduct certifying that investment advice has not been compromised.

Last August, I formally certified to the SEC that the financial reports of my company were accurate. Putting my name to those pages made a profound difference in how I thought about our financial reporting process. Requiring the kinds of additional certifications I have proposed would have a similar affect on the way we look at conflicts within our industry. Personal certification is a powerful means of fixing responsibility on the most senior levels of management.

These are not complex steps. They are the most basic principles of ethical conduct. Requiring them would do much to restore investor confidence. ■

About the Author

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