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SEC to Decide by Year's End on the Relevancy of Fiduciary Responsibility in Ensuring the Investing Public's Trust

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Every investor wants their investment advisor to provide unconflicted counsel to act in their best interests in addressing and managing the full range of investment and administrative values necessary to fulfill their fiduciary obligations; and every advisor would certainly like to act in their clients' best interests as required by regulatory mandate. Yet, if you are among the vast majority of advisors who (as either an independent contractor or an employee) are supported by a NASD member brokerage firm, it is a violation of your supporting firm's compliance protocol to either acknowledge your fiduciary obligations or that you are providing investment advice as implied in your role as an investment advisor. Even if you wanted to declare your fiduciary status and were, in fact, capable of acting in a fiduciary capacity, your supporting firm would not allow you to do so.

Our industry's best and brightest advisors have petitioned their NASD member supporting firms to create a new advisory firm for advisors who are capable and qualified to declare their fiduciary status. These are advisors who work with clients held to a fiduciary standard, who are capable of acting in a fiduciary capacity, who commonly advise a $1 billion or more in assets and who essentially will lose their business if they cannot declare fiduciary status. Even with facing the prospect of alienating their best-and-brightest and possibly losing the hundreds of billions in assets they advise, these large dominant NASD member brokerage firms, in every case, have made it clear that they will *not* acknowledge the fiduciary status of these top advisors and that their best and brightest advisors are expendable. Clearly, if our industry's leading advisors with the most assets do not have the leverage as employees or independent contractors to move their firms to acknowledge their fiduciary obligations, far greater external authorities must come into play in order to protect the best interests of the investor and advisor. Even when it is clearly in the investing public's best interests, even when our fiduciary responsibilities are clearly delineated in case law, statute and regulatory opinion letters; even when financial advisors are capable of fulfilling their fiduciary responsibilities and have demonstrated they are doing so, our NASD member firms are resolute in not voluntarily acknowledging their advisors are acting in a fiduciary capacity. Their rationale is not illogical. Acknowledging that several hundred of their best and brightest advisors are capable of acting in a fiduciary capacity would, by extension, also mean that the vast majority (10,000 or more) of their advisors are not capable. This raises the unwelcome question of why our largest dominant financial service firms have not developed the resources (processes, technology and support infrastructure) necessary for all advisors to act in a fiduciary capacity. As a consequence, there is no internal motivation that can be brought to bear, no vision or leadership that would cause NASD member firms to voluntarily acknowledge our fiduciary obligations as advisors. Doing the right thing is not in our supporting firms' best interests, as the cultural, structural and technological disruption required to reinvent themselves would be substantial. Only if a higher authority requires the acknowledgment of fiduciary responsibility will our supporting firms be dragged – kicking and screaming – to subordinate their interests to that of the investor and the advisor. The only way to resolve this impassé is for the SEC (whose role and responsibility is to act in the

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best interests of the investing public) to superimpose a solution, and under SEC chairman Donaldson, the protection of the investing public's trust has become a top priority.

To get the attention of the CEO's of our NASD supporting firms to better focus on the issues of public trust, effective November 9, 2004, the SEC will require these CEO's to establish a process to review and modify, if necessary, company procedures and to personally certify they have met with their chief compliance officer to address any significant compliance problems or emerging issue. This sets up our CEO's for being held accountable, which is an important step in making sure firms live by the spirit of the law, and are not hiding behind the letter of the law in a legal construct that minimizes the role and counsel of the advisor. The fact that NASD member firms maintain that "investment advisors do not render investment advice" is counter to common sense, the investor's best interest, the advisor's best interest, legislative intent, the investing public's trust and the well-being of the industry, not to mention the spirit of the case law, statutes and regulatory opinion letters that delineate our fiduciary responsibilities.

Anticipating problems, the SEC is getting proactive in soliciting input on emerging problems and is taking a different approach than they have in the past. Rather than announcing the problem and levying fines which, in itself, leads to a loss in public trust, the SEC will seek to identify problems and solutions, and simply fix them by utilizing its regulatory powers. Charles A. Fishkin is leading this initiative and has hired industry experts to identify the next big issue and to fix it before it becomes front page news. They will anticipate problems early and will resolve them in the least invasive way possible. Ambiguous rules and dubious practices will be the targets for increased inspections and enforcement. The SEC has challenged compliance officers to conduct soul-searching internal reviews. Stephen M. Cutler, Enforcement Division head, has said, "Just because a certain way of doing things is second nature to you and appears to be standard operating procedure on the street, doesn't mean it is the correct way of doing things." Rather than the SEC examining a limited number of individual firms from top to bottom each year, examiners are fanning out to look at areas of concern. The SEC is very likely to find that the standard operating procedure used to insulate NASD member firms from fiduciary liability is counter to the best interests of the investing public and to mandated public policy. It is inconceivable in today's regulatory environment that SEC examiners will not reason that investment advisors do, in fact, render investment advice and should be held to a fiduciary standard. Our supporting NASD member firms opining that any investment advice rendered is incidental to trade execution is no longer a viable rationale for why advisors should not be held to a fiduciary standard. Clearly some advisors are engaged in commission sales, but there are also advisors who are engaged in fiduciary counsel. It would be a breach of fiduciary responsibility if they didn't render advice. Maintaining status quo is no longer a safe course of action.

> **THE FACT THAT NASD MEMBER FIRMS MAINTAIN THAT "INVESTMENT ADVISORS DO NOT RENDER INVESTMENT ADVICE" IS COUNTER TO COMMON SENSE, THE INVESTOR'S BEST INTEREST, THE ADVISOR'S BEST INTEREST, LEGISLATIVE INTENT, THE INVESTING PUBLIC'S TRUST AND THE WELL-BEING OF THE INDUSTRY, ...**

Most importantly, the SEC has required registered advisors have a code of ethics by October 5 of this year; and before the end of the year, the SEC will decide whether these advisors must declare their fiduciary status. Every indication is that effective January 7, 2005, the SEC will require registered advisors who have $25 million or more under advisement to declare their fiduciary status. This effectively creates a new criterion based on fiduciary principles against which the most discerning investors with the most assets will hold advisors accountable. This "emerging issue" is something chief compliance officers must address with each CEO of NASD member firms and is an area on which SEC examiners will be focusing. The "fix" is likely to be just what our best and brightest advisors have petitioned their firms to do – the establishment of a separate advisory firm in which advisors who have demonstrated ability can declare they are acting in a fiduciary capacity. This makes it possible for advisors within NASD member firms to fulfill their fiduciary obligations and puts NASD firms on the right side of history. It opens the door for NASD member firms to provide the processes, technology and support infrastructure necessary to democratize access for all their advisors to fulfill their fiduciary responsibilities. It unlocks the market forces within the free enterprise system for advisors to compete on the basis of the depth and breadth of the investment and administrative values they address and manage. It aligns the interests of the investor, the advisor and the advisor's supporting NASD member firm.

From the perspective of the SEC, which is interested in preserving and protecting the investing public's trust, the only option is to acknowledge the fiduciary status of advisors. It would not be in the investing public's best interest for the industry's best and brightest advisors, who are the alpha group of advisors around which the industry will grow, to evolve outside of our largest, dominant financial services institutions. Our largest financial services firms would lose the initiative from within to evolve to fiduciary counsel, which would both weaken our leading institutions and cause even more disruption. Make no mistake, the pain and disruption required for today's leading financial services support firms to evolve their culture, structure and technology from trade execution to fiduciary counsel will be quite challenging. Literally the industry must reinvent itself, going from a commission sales/product management organizational structure to a fee-based counsel/

process management organizational structure. The imponderable is whether it is more or less disruptive for a new generation of support firm to emerge and find its legs than for the established dominate firms to evolve. Speed and adaptability clearly go with a new generation of support firms, as does the adoption of technological innovation and a far lower cost structure. If the SEC truly focuses on the investing public's best interest, an extraordinary degree of innovation will be fostered that promises an unprecedented level of investment and administrative counsel to come within the reach of all financial advisors and their clients. The SEC is the invaluable catalyst for the industry to do the right thing, which will trigger a renaissance within the financial services industry and facilitate an unprecedented level of professional investment and administrative counsel.

If the over-arching objective of the SEC is the well-being of the investing public and not maintaining the status quo of NASD member firms, the SEC can be instrumental in greatly elevating the role and counsel of the advisor and the well-being of the investing public. The SEC has promised by years' end to tell us whether our fiduciary responsibilities should be acknowledged and whether the investing public should expect its interests to be put ahead of the advisor's supporting firm. The right thing to do is pretty clear. The SEC is our best hope for the right things being done. ■

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