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Financial Reform and Fiduciary Responsibility

Last July, the most significant change to financial regulations in over 70 years was signed into law. While many provisions are aimed at the large banks and Wall Street firms behind the financial crisis, a number are expected to impact the investment advisory industry.

For example, investment advisors with custody of client assets will have to take new steps to safeguard those assets and also implement new recordkeeping responsibilities. And, in the wake of the Bernie Madoff scandal, anyone knowingly or recklessly aiding and abetting a violation of the law will be subject to civil action by the SEC.

But the most important aspect of the Financial Reform Act surrounds the standard of client care for broker-dealers versus that of investment advisors. Many investors are unaware of the difference between the two professions and of the impact it can have on investment advice. In fact, recent polls indicate that many believe that all professionals in the financial services industry are required to put their clients' interests first.

Investment advisors are fiduciaries. A fiduciary is an individual or entity that is legally obligated always to act in the clients' best interests. Any conflict of interest between the advisor and the client is required to be disclosed in order to meet the fiduciary standard of client care.

Thus, investment advisors are legally obligated to provide investment advice that is in their clients' best interests.

Broker-dealers, insurance companies, and others selling financial products are typically not fiduciaries. Unless they are also investment advisors, they are held to a less-stringent standard of care. Thus, their investment advice and recommendations need only be "suitable", given the client's particular circumstances.

The problem is that some financial products qualifying as "suitable" may in fact deliver poor investment performance, have high costs of ownership or have other risk characteristics that do not represent the best choice for the investor.

Over the coming months, the SEC will be studying whether or not broker-dealers and others need to meet the fiduciary standard of care. With increased disclosure, investors could become more knowledgeable about the hidden fees associated with many financial products. They would be able to make better investment decisions, including whether or not the investment advice makes sense and is worth it -- to them.

As investment advisors, we fully support holding <u>all</u> professionals in our industry to the fiduciary standard of care. After all, it's in our clients' best interests.

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