

DEVIL IN THE DETAILS

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There are two types of investment advice available to investors; brokerage accounts and advisory accounts. The unfortunate and painful reality is that not only are investors unacquainted with the significant discrepancies between the two, they are unaware that there is a difference.

In a 2006 Investor Perception Study...

54% of investors held the false belief that both stockbrokers and independent Registered Investment Advisors have a fiduciary responsibility to act in their best interest.

74% were not aware that only independent Registered Investment Advisors have a fiduciary responsibility to their clients.

79% stated that they would rather work with an investment advisor if they knew advisors provided greater investor protection than stockbrokers.

What can be taken from this study is the fact that there is considerable confusion and ignorance with Americans regarding the realities of financial advice and the individuals who provide it.

The federal law that governs investment advisors is the Investment Advisors Act of 1940. The Securities and Exchange Commission enforces and interprets this law. Federally regulated advisors must register with the SEC and operate their business in accordance with Advisor Act rules and regulations. Brokers have been exempted from this act if *"the investment advice is solely incidental to its business and it receives no special compensation for the advice."* Believe it or not, but commissions are not considered special compensation.

In 1999 the SEC widened its interpretation of these rules when it allowed for brokerage firms to provide fee-based accounts without registering as investment advisors. At the same time the SEC issued a controversial *"no-action"* position that allowed for brokerages to take advantage of the proposal even before it was finalized. In 2004, the Financial Planning Association sued the SEC for allowing the *"no-action"* position to continue without taking final action. Despite continued protest from independent financial advisors the SEC bowed to the pressure from the big brokerage firms and adopted a final rule which is almost identical to the 1999 proposal.

Why is this important?

An independent Registered Investment Advisor is a fiduciary. A fiduciary is a person who acts on behalf of and for the benefit of someone else. When fiduciaries are acting in their official capacity, their primary concern must be for the interest of the person for whom they are acting and NEVER their own personal interests. On the other hand broker-dealers and their representatives may be obligated to bring suitable recommendations to their customers, they are generally not fiduciaries and therefore often do not make decisions that are solely based in their customers interests.

For example: Registered Investment Advisors cannot trade with their clients as a principal, brokerage firms earn significant undisclosed profits by trading as a principal with customers. Registered Investment Advisors cannot engage in other business activities such as investment banking or underwriting, whereas brokerage firms do. It is in our opinion which we have chronicled and articulated in the *Markowski Monthly* and on the radio show that broker's interests are not aligned with their customers. Brokerage firms would in fact be setting themselves up for

countless lawsuits if their brokers were to take on the responsibilities of an Registered Investment Advisor since most of their areas of business would disqualify them as a fiduciary because they are self-serving, not client centric.

The bottom line is that advisory firms and Registered Investment Advisors are prohibited from engaging in fraudulent, deceptive, or manipulative conduct in their planning activities. Clients are owed more than honesty, full and fair disclosure and good faith alone. They have an affirmative duty to utmost good faith to act solely in the best interest of the client.

Who do you want looking after you and your family?