



False Fiduciaries

The so-called resolution of the SEC's "Merrill Lynch rule" does nothing to keep brokers from providing financial advice without assuming legal responsibility.

A YEAR AFTER THE SEC'S MODIFICATION of the Merrill Lynch Rule, officially called "Broker-Dealers Deemed Not To Be Investment Advisers," Release 34-51523, is a good time to take a hard look at its actual effect in the marketplace.

Release 34-51523 is a 117-page document acknowledging that brokerages increasingly charge asset-based fees rather than commissions; that they are advertising comprehensive advice rather than brokerage services; and that this is because their traditional bailiwicks—transaction and brokerage services—have been commoditized. Based on exactly these points, the Financial Planning Association and consumer groups have argued that brokers should become Registered Investment Advisers, who are regulated by the SEC and held to legal fiduciary standards.

Somehow, the SEC came to the opposite conclusion. I think this was a realpolitik decision that has more to do with the wirehouses' clout in Congress, and the SEC's fear of 150,000 brokers filing their ADVs and waiting for their next in-office audit, than with the facts of the case. ("You sold these widows and orphans WHAT? What, exactly, is the last tranche of a collateralized mortgage obligation?") But the SEC did try to provide some protections so that a consumer could know whether he was working with an RIA-registered fiduciary or a broker under the NASD's less rigorous suitability rules.

First, the SEC required brokerages that didn't register their reps as RIAs to develop new account forms containing

this explanation: "Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons' compensation, may vary by product and over time."

More significantly, the SEC ruled that if a brokerage or broker provides a financial plan or planning services or holds themselves out as a financial planner, then RIA registration is required. To prevent any weasel wording, the release stipulated that the brokerages "must treat as advisory clients all those customers to whom it delivers a financial plan, regardless of what it chooses to call the plan."

I recently asked my newsletter readers how this was working in the real world and had a chance to talk off-the-record with some brokers who have been functioning as real financial planners within

wirehouses. One who works at Merrill Lynch got a general message from headquarters stating that there would be changes in how he could describe his services. "They aren't going to let me call myself a financial planner anymore," he says. "I've been telling [my clients that] I'm a financial planner for years. Do I have to go back and tell them I'm something else?"

A CFP planner who works at UBS was told essentially the same thing, and then had his discretionary asset management accounts yanked because, he was told, he wasn't trading enough. "I tried to tell them that not trading the accounts was good, and that I was providing services other than shuffling funds around," he says. "But those other services are financial planning."

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Compliance departments are also blocking brokers from offering comprehensive plans by crippling their in-house software. In the first upgrade after the Feb. 1 compliance deadline, the Merrill broker discovered that Merrill's Interactive Financial Foundation software would no longer do many of the estate- and tax-planning functions that he used to offer clients. Brokers with New England Securities found that the version of Financial Profiles that was approved for in-house use would no longer address multiple planning issues at the same time: it will only run a few modules in the same 30-day period.

This seems to be a sort of bizarre, left-handed interpretation of what the SEC intended. Instead of, "let's register brokers who deliver the full complement of planning services," the response is, "let's

make sure they don't function as planners, so we won't have to register."

The SEC was even more concerned that the public might be confused by advisory-related marketing and advertising. But brokerages have hardly scaled back their claims for offering advice. The Winter Olympics and NCAA basketball tournament were rife with powerful images of happy retirees and smiling families, thanks to the care and wisdom of the "financial advisers" or "financial counselors" employed at these brokerages.

This nomenclature didn't happen by chance. When the SEC commissioned a study to find out whether consumers knew the difference between a financial planner, a financial adviser, a financial counselor, a financial analyst, a financial investment counselor or an investment specialist, the result was total confusion. The larger firms clearly co-opted these apparently synonymous terms, figuring that if the public doesn't know the difference, it's not their problem.

Nor are the wirehouses shying away from the term "financial planner" in client communications. Under the "advice and planning" section of Merrill Lynch's website, click on "wealth management process" to find a description that quacks like a financial planning duck: "goals and objectives, asset allocation, implementation from a Merrill Lynch Financial Advisor and reviewing the plan as you go forward." The site says, prominently: "Planning starts with listening," and the company's Financial Foundation Report is described as "a planning service that provides you with a personalized, comprehensive financial analysis that you and your Merrill Lynch Financial Advisor can use as a guide to develop strategies and tactics for managing your wealth effectively...."

Check out Morgan Stanley's site under "planning," a page that talks about the firm's financial advisers and offers a link to "financial planning." We learn that "a good financial, comprehensive, plan shows where you are today and compares it to where you want to be..."

The same kinds of language can be found on Smith Barney's website, ("Your Smith Barney Financial Advisor can pro-

vide you with a detailed and comprehensive financial plan") and UBS: ("...we offer financial planning as part of our wealth management process in our capacity as financial advisers").

STEALTH PLANNERS

Reading through the disclaimers, it's clear these companies have found the same loophole in the SEC's ruling: the broker can't call himself a financial planner without registering as an RIA, but he or she can collect all the client's financial planning information and ship it to a "financial planning department," which is registered as an RIA with the SEC. Paraplanners and other technical people in this RIA-registered division then create a generic financial plan for the broker to deliver to the client.

Get it? The brokerage calls itself a financial planning firm and offers a financial plan through a narrowly defined subsidiary. Consumers think they're getting financial planning services, and the broker can "implement" the plan free of all fiduciary obligations.

I wish I didn't know so many good, ethical wirehouse brokers, because it would be easier to make a black-and-white case. But it does seem that brokerages have built their business model on significant conflicts of interest: "We take companies public and recommend IPO investments to our customers and provide research reports on IPO offerings; we create investment products and recommend investments to our customers; we provide packaged asset management services and our brokers recommend packaged asset management services to our customers." It seems that the brokerages gain an edge in the marketplace when they can masquerade as advisers even though they are really in the business of marketing the products and services where the real money is made.

The SEC has failed to help con-

sumers recognize the difference between brokerage and advisory. The burden thus falls on the RIAs to show how they're different from the guy in the big office with the crippled software.

John Ritter and Jeff Daniher, of Ritter Daniher Financial Advisory in Cincinnati have created a simple tool that could cause some gnashing of teeth in local brokerage offices. They give all prospects a form for the

"financial adviser" to sign and date, after answering some simple questions:

"Are you held to a fiduciary standard in all dealings with me and my financial affairs?"

"Do you disclose all conflicts of interest, both actual and potential, that exist or might exist in our relationship?"

"Do you forego any commission-based compensation to receive all compensation via fees

that are fully disclosed in dollar terms?"

"Do you provide full-service, comprehensive financial planning services as well as investment advisory services?"

"If you provide full-service, comprehensive financial planning services, are these services performed by individuals that have obtained the Certified Financial Planner designation?"

Even if consumers don't understand the implications of the questions, they would see that the wirehouse firm isn't communicating clearly.

The brokerage firms won the first round in their battle to invade the advisory space without having to assume fiduciary obligations. But if we start to see more instruments like this making the rounds, they might find that RIAs are not as easy to push around. **FP**

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