Reprinted from:
THE NATION'S OLDEST WEEKLY BUSINESS JOURNAL
DENVER BUSINESS JOURNAL
VOL. 59 NO. 36 February 22, 2008-February 28, 2008 46 PAGES $2.00

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RAND Report shows confusion about advisers, brokers

RICHARD TODD
PERSONAL FINANCE

The Securities and Exchange Commission's RAND Report offers clear insight as to what many have believed for years.

Investors are confused about the differences between investment advisers and brokers. The problem begins with the many common titles they share, such as consultant, financial consultant, investment consultant, financial adviser and financial planner.

Investment advisers are registered with the SEC, pursuant to the Investment Advisers Act of 1940, and are fiduciaries with respect to their clients. Brokers, who often use labels similar to "investment adviser," aren't bound to the same fiduciary standards.

Investment advisers provide advice; brokers sell products.

The SEC commissioned the RAND Corp. to conduct a survey of more than 650 households; two-thirds of the respondents were classified as "experienced" investors who "held investments outside of retirement accounts, had formal training in finance or investing, or held investments only within retirement accounts, but answered positively to questions gauging their financial understanding."

RAND also collected data from business and economic publications, previous studies and regulatory filings. The result was a 219-page report made public Dec. 31. RAND says its "analysis confirmed findings from previous studies and from personal interviews with stakeholders: Investors have difficulty distinguishing among industry professionals and perceiving the web of relationships among service providers."

The primary concern is the lack of understanding about differences in fiduciary standards between registered investment advisers and broker/dealers.

The industry has become "extremely heterogeneous," offering a range of services not clearly defined. "Investors do not operate with a clear understanding of the different functions and fiduciary responsibilities of the financial professionals," according to the report.

A broker or broker/dealer offers securities and/or investment products for sale, for which they receive a commission. The broker has a responsibility only to find that the investment is suitable for the client. In other words, is the investment suitable for the investor based on their objectives and risk tolerance?

A broker has a securities license, typically a Series 7 for all securities except commodities, and a Series 63 state securities license. Some brokers have only a Series 6 allowing security product sales, typically mutual funds and annuities.

In order to receive a securities license and subsequent commissions, the broker is sponsored by a firm and has passed an examination. The broker is not a fiduciary with respect to his clients.

An investment adviser's firm is registered with the SEC (and possibly the state, for smaller firms) and the adviser passes a Series 65 exam. The adviser offers advice about which investments to buy and sell.

The fiduciary standard is significantly different from the broker -- the adviser's duty is to the client, and the client's best interest is always first. Registered investment advisers are fiduciaries with respect to their clients, and they must disclose all conflicts of interest to the client.

But as RAND notes, investors fail to distinguish the difference, and the lines are blurred between who's advising and who's selling.

Today brokers, including most Wall Street firms, often charge a fee for service, but go back and forth between fee-based services and commission compensation. While disclosure is made in a client agreement or a product prospectus, as RAND notes, it's often unclear to the investor.

Further, some registered investment advisers will charge a fee for their management, and also will collect commissions from the products they're positioning for the client.

Expect some clarification and new regulations regarding the blurry lines of distinction. Although the industry is already highly regulated, better disclosure about commissions, conflicts of interest and fiduciary standards are warranted.

Ask this: "Do you have a securities license?" A "yes" answer means they have the ability to collect commissions for transactions and product sales. A commission compensation structure is a conflict of interest that potentially affects the independence and objectivity of the broker's advice.

Innovest Portfolio Solutions LLC provides investment consulting services to retirement plans, foundations, endowments and wealthy individuals. We can be reached at (303) 694-1900.
Rich Todd can be emailed at richt@innovestinc.com