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Brokers Win, Investors Lose Key Reform

By JASON ZWEIG

Over the next week or so, the financial-reform bill that has been oozing its way through the Senate Banking Committee may finally plop onto the Senate floor. Unfortunately, the bill is likely to lack a key provision requiring stockbrokers, insurance agents and others to act solely in the interests of their clients.

That is a shame. The requirement was included in the earlier 1,136-page "discussion draft" of the bill. But it appears to have been horse-traded away in a last-minute push to secure compromise.

Why should you care? As of now, the roughly 630,000 brokers, bankers and insurance agents registered to sell securities must determine whether investments are "suitable"—based on how wealthy you are, what else you have invested in, your tax status and your investment objectives.

Securities salespeople generally aren't obligated to act in your best interest. They needn't tell you that they make extra money pushing one particular investment or that cheaper alternatives might provide you a higher return.

Suppose two mutual funds are "suitable," but one of them pays the broker a fatter fee. You may well end up in that one—without finding out that your broker had an incentive to favor it.

On the other hand, financial advisers—who are regulated as "fiduciaries" under the federal Investment Advisers Act—are obligated to put you first. They must explain their fees, disclose conflicts of interest and disclose past infractions. If they get paid extra to recommend a fund or sell an insurance product, they have to tell you.

If you find these dueling standards confusing, join the club. In 1973, the great financial analyst Benjamin Graham lamented the fact that "most security buyers obtain advice without paying for it specifically."

Almost four decades later, many brokers still don't charge for the advice and guidance they provide. Instead, they get paid mainly when you buy or sell securities. If you get charged for transactions when what you really want is guidance, the result can be too many trades and not enough hand-holding.

Under the fiduciary standard, you would pay primarily to get advice rather than to trade. If the competition for advice increases, then its quality should also go up, helping to clarify how valuable a broker's services actually are (or aren't).

Securities salespeople worry that a fiduciary standard would add regulatory burdens, raising their costs. Many brokers might abandon their least-profitable customers, says Thomas Currey, president of the National Association of Insurance and Financial Advisors.

"The very people who need the hand-holding the most," Mr. Currey warns, "could become the least likely to get it." But these folks, too, deserve to have their own interests put first.

Not surprisingly, brokers and insurance agents have been putting up a fierce fight. Instead of a mandate to expand the fiduciary standard, the Banking Committee's bill will probably call for a study on the costs and benefits of any new standards. The measure will likely be part of the main bill, rather than an amendment—raising the odds that it will sail through Congress.

"We believe that investors deserve to have this issue fully debated," says Denise Voigt Crawford, the Texas state securities commissioner.

It isn't too late to ask your senators and representatives why they disagree.

—Email: intelligentinvestor@wsj.com

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