Consumer Federation of America

There They Go Again:

Brokers and Insurance Agents Are Spreading Misinformation About the Akaka-Menendez Fiduciary Duty Amendment

As the Senate moves closer to consideration of financial regulatory reform legislation, Sen. Akaka and Sen. Menendez have announced their intention to offer an amendment to restore the bill's most important provision to protect average, retail investors – the provision holding brokers to a fiduciary duty when they give investment advice. The amendment would replace language added to the bill in committee that would delay indefinitely any SEC action to address a gaping hole in investor protections, that brokers are permitted to offer the same advisory services to investors as investment advisers without having the same obligation to act in investors' best interests.

Based on language in the House-passed reform bill, the amendment would require the Securities and Exchange Commission (SEC) to adopt rules so that brokers who give personalized investment advice to retail investors would have the same obligation as investment advisers to act in the best interest of their clients and to disclose conflicts of interest that could bias their recommendations. That approach has been endorsed by CFA, AARP, Americans for Financial Reform, the Investors Working Group, the North American Securities Administrators Association, the National Association of Secretaries of State, and SEC Chairman Mary Schapiro, among many others.

Unfortunately, the same broker and insurance groups that succeeded in weakening the bill in Committee are back on the attack with a campaign based on misinformation and exaggeration. This campaign is nothing more than an effort to maintain the status quo, in which salespeople are allowed to misrepresent themselves as advisers and offer services that are indistinguishable to investors from those offered by investment advisers without meeting the basic standards that are demanded by this relationship of trust. The Akaka-Menendez amendment would change all that by forcing them to put customer interests ahead of their own bottom line.

Before you vote on this vital amendment, we urge you to get the facts.

Myth: The amendment would deny investors access to valued products and services.

Fact: The Akaka-Menendez amendment would benefit investors by requiring brokers to have a reasonable basis for believing that the securities they recommend are in the best interest of their customers. That would require them to recommend those products that add real value to customer accounts, not just those that benefit their own bottom line. In short, the only products

and services investors risk losing access to under the Akaka-Menendez amendment are those that benefit the broker instead of the investor.

Myth: The amendment would force brokers to increase costs to investors.

Fact: The Akaka-Menendez amendment would reduce investor costs, not increase them. By imposing a fiduciary duty, the amendment would require brokers to consider investor costs in a way that they are not required to do under the suitability standard that currently applies to securities sales. Given a choice between two otherwise comparable investment options, a broker operating under a fiduciary duty would have to recommend the less costly option if that was in the investor's best interests. Operating under the current suitability standard, on the other hand, the broker would be free to recommend the more costly option, and he or she wouldn't even have to tell the investor if the choice was motivated by the chance to earn a bigger commission or more generous revenue sharing payments to the firm.

Myth: The amendment would force brokers to charge fees for advice they now provide for free.

Fact: Nothing in the amendment would require brokers to charge fees or prevent them from charging commissions. On the contrary, financial planners have operated for decades charging a combination of fees and commissions, fees only, and commissions only, and all these compensation models have been deemed acceptable under a fiduciary duty. There is no reason to believe the SEC would apply the standard to brokers with any less flexibility. To eliminate any possible ambiguity, however, the amendment specifically states that being compensated "based on commission or other standard compensation for the sale of securities" does not violate the fiduciary standard.

Myth: The amendment would put small brokers who can only offer limited investment options out of business.

Fact: A fiduciary duty requires only that the adviser recommend the best option for the customer from among the securities he or she has available to sell. Contrary to industry claims, the amendment would not require brokers to consider all possible investment options in order to determine which is best for the customer – an impossible standard to meet, particularly for smaller brokerage firms and insurance agents that offer only a limited menu of investment options. This is how the fiduciary duty has been applied for decades to financial planners who combine advice with product sales. There is no reason to believe the SEC would apply the standard differently to brokers. Even if the SEC were inclined to do so, the amendment's language on sales from a limited menu of products would prevent an overly expansive interpretation. (See below.)

Myth: The amendment would prevent brokers from recommending proprietary products or selling from a limited menu of products.

Fact: Under the Akaka-Menendez amendment, brokers are not prohibited from recommending proprietary products or offering a limited array of investment options. They

simply have to provide clear, up-front disclosure of any such limitations on their recommendations, just as investment advisers and financial planners do today. Brokers would have to disclose, for example, if they only recommended products that make revenue sharing payments or only recommend products from a handful of product sponsors. This would bring practices and conflicts that are poorly understood by investors out into the open. Once those disclosures were made, however, it would be up to investors to choose whether they were interested in receiving investment advice subject to those limitations.

Myth: The Akaka-Menendez amendment will strain already limited SEC resources for investment adviser oversight.

Fact: The Akaka-Menendez amendment will have no effect on SEC resources for investment adviser oversight. It imposes its fiduciary duty under the Securities and Exchange Act, which is the law that governs brokers and is implemented by the SEC, FINRA, and the state securities regulators.

Myth: Because there has been inadequate study, there is no understanding of how a fiduciary duty would interrelate with the requirements imposed on life insurance agents by state insurance and securities regulators.

Fact: Financial planners have been combining investment advice, subject to a fiduciary duty, with life insurance and annuity sales for decades. As a result, state and federal regulators have ample understanding of how these requirements interact. State securities regulators, for example, have concluded that imposing a fiduciary duty on variable annuity recommendations would provide a much needed tool to help clean up abuses in this persistent problem area.

Myth: The issue of imposing a fiduciary duty on broker-dealers has not been adequately studied.

Fact: The SEC has been studying this issue since at least the mid-1980s, when brokers first began offering financial planning services. The Senate Banking Committee and House Energy and Commerce Committee each held their first hearings on the issue at about the same time. Since 1999, the SEC has compiled a voluminous record on the question of how to appropriately regulate advisory services by brokers as part of the agency's consideration of various proposals triggered by the advent of fee-based brokerage accounts. All interested parties have had numerous opportunities to comment. The 2008 RAND Corporation study is simply the most recent addition to this already extensive regulatory record. It was commissioned by the agency to lay the factual groundwork for further policy recommendations after an earlier SEC focus group study concluded that disclosure alone could not adequately convey to investors the differences in legal obligations of brokers and advisers. While the report itself did not (and was not intended to) recommend a legislative solution, the current proposal encompassed in the Akaka-Menendez amendment was developed in response to the report's dual findings: 1) that the lines between brokers and investment advisers had become blurred as members of these two once divergent classes of investment professionals increasingly adopted similar titles and offered a similar set of services; and 2) that investors did not understand the differences between brokers and advisers, including differences in their legal obligations to clients.

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The Akaka-Menendez amendment replaces language in the bill that would require the SEC to conduct yet another study of an issue it has already studied to death. That language, inserted prior to the Senate Banking Committee vote, would require the SEC to initiate a rule-making, but would deny it the authority it needs to raise the standards for brokers when they give investment advice. As a result, it would delay indefinitely any response to a glaring gap in investor protections already identified by the agency. Brokers and insurance agents seeking to maintain the status quo enthusiastically support that study amendment. Investor advocates and securities regulators just as strongly oppose it.

The Senate has a chance to show that it will protect investor interests rather than special interests by voting yes on the Akaka-Menendez amendment. We urge you to do so.