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Via Electronic Filing

December 15, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **File No. 4-606: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers**

Dear Ms. Murphy:

A number of views have been expressed in other comment letters regarding the fiduciary standard of conduct, its application, and possible effects of its application upon the investment advisory activities of broker-dealers, and these views sometimes misrepresent the "reality" of what occurs in the marketplace. This comment letter, derived from a series of several articles authored by the undersigned[1] and published at RIABiz.com in recent weeks, seeks to provide the Section 913 Study Group with added perspectives on the important issues the Study Group is currently considering.

Executive Summary:

- Capitalism runs on opportunism. However, even Adam Smith recognized the necessity of professional standards of conduct as a means of constraining greed.
- Participation in the capital markets falters when consumers deal with financial intermediaries who cannot be trusted. I have seen in my 25 years of practice, as an estate planning attorney and then as an investment adviser, a large number of individual Americans withdraw from the stock and bond markets after discovering the inadequacy of the conflict-ridden "investment advice" they received from many securities firms.
- The fiduciary standard of conduct operates to restrain greed, where other measures of constraint are ineffective.

[1] Ron A. Rhoades, JD, CFP® submits this article personally. This comment letter does not necessarily reflect the views of any organization to whom Ron A. Rhoades belongs. Ron serves as Director of Research and Chief Compliance Officer for Joseph Capital Management, LLC, a fee-only investment advisory firm.

- The world is far more complex for individual investors today than it was just a generation ago. As the sophistication of our capital markets had increased, so has the knowledge gap between individual consumers and financial advisors.
- The SEC's reliance upon disclosures is misplaced, particularly as they relate to disclosures of conflicts of interest by financial intermediaries. Disclosures do not address investors' difficulties in dealing with the psychological issues of risk aversion, overconfidence, and cognitive dissonance.
- Given the inadequacy of other consumer protections, including taking into account the ineffectiveness of disclosures, it is altogether necessary to impose the bona fide fiduciary standard of conduct upon those who provide investment advice.
- Disclosures of conflicts of interest are not enough to adhere to the fiduciary standard of conduct. Individuals possess substantial barriers, resulting from behavioral biases, to the provision of informed consent, even after full disclosure.
- Once a relationship of trust and confidence is accomplished – the "sale" of either the product or the service is then easily accomplished – by taking advantages of consumers' cognitive weaknesses and behavioral biases.
- Far too great of the returns of the capital markets flow to financial intermediaries, and fail to find their way to the individual investors. Much of this is due to "hidden" fees and costs which individual investors fail to understand.
- Individual Americans – unable to discern the difference between those who represent the consumer (registered investment advisers and fiduciaries), and those who represent the product manufacturer (salespersons), have been left with a large market of salespeople to deal with – even though the average American "thought" they could trust their "financial advisor."
- Several advisory business models that are both profitable and successful in serving the needs of "Middle America" are highlighted.
- There are now well over 100 colleges and universities churning out graduates with specialized education in financial planning, qualifying graduates to sit for the Certified Financial Planner™ exam. From my conversations with students in several different programs, it is obvious that nearly all of them desire to work within a fiduciary business model.
- The "new federal fiduciary standard" touted by SIFMA and others is not a true fiduciary standard at all. Do not permit the true fiduciary standard, currently existing under the Advisers Act, to be eroded by further "particular exceptions."
- It is time for the SEC to apply the fiduciary standard of conduct broadly upon all investment advisory activities, with the rigor and vitality of the SEC in its heyday, when the SEC was generally perceived to be the finest of our federal governmental agencies.
- Any fear of heightened liability arising from fiduciary status can be circumscribed by the advisor following the dictates found in another timeless phrase: "Say what you do, and do what you say." Those who aspire to be a fiduciary should be an expert. They should be fully, not partially, committed to the client's interest. They should practice with the highest degree of honesty and candor. As a professional, they should care for their clients.

*It will take **courage** for the Commissioners and SEC staff to toss aside their preconceptions, reject the false rhetoric advanced by so many large broker-dealer firms, embrace a true fiduciary standard, and in so doing stand up for individual Americans, the promotion of capital formation, and – indeed – the economic future of America itself.*

WHAT WOULD ADAM SMITH SAY ABOUT THE FIDUCIARY STANDARD?

In 431 days at the Securities and Exchange Commission, Joseph P. Kennedy reformed America's capital markets. Even though Kennedy had profited handsomely, during the tumultuous 1920s and the early 1930s, from financial manipulation, from 1934 to 1935 Commissioner Kennedy led the effort to adopt rules, nearly all of which were opposed by the securities industry at the time. These rules restored individual Americans' trust in our capital markets, leaving an enduring legacy for Joseph P. Kennedy far beyond that reflected in his accomplishments as a financier, Ambassador to Great Britain, or father to a future U.S. President.

Gordon Gecko Meets Adam Smith

> "The point is, ladies and gentleman, that greed, for lack of a better word, is good. Greed is right, greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms; greed for life, for money, for love, knowledge has marked the upward surge of mankind."

So stated Michael Douglas in "Wall Street" (1987) as the infamous Gordon Gekko, a character that has defined Wall Street for a generation. More recently, in "Wall Street 2: Money Never Sleeps" (2010), Michael Douglas reminisces: "Someone reminded me I once said 'greed is good' ... But here's the kicker, now it seems it's legal."

Some observers might opine that Adam Smith, the early champion of capitalism, would surely agree with some of what the character Gordon Gekko espoused. After all, Adam Smith generally held the capitalistic opinion that all people were generally motivated by their own interests.

Adam Smith, however, recognized the difference between self-interest and greed, and he wrote that steps ought to be taken to keep the former from turning into the latter.

Actions based on self-interest lead to positive forces

The undeniable truth is that capitalism runs on opportunism, a fact long known in our country. Long before economics became a science of economic models, in the late 18th Century Adam Smith in his landmark work, THE WEALTH OF NATIONS, posited an economic system based upon self-interest. This system, which later became known as capitalism, is described in this famous passage: "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. "[2]

[2] Smith, p. 14 (Modern Library edition, 1937)

As Adam Smith pointed out, capitalism has its positive effects. Actions based upon self-interest often lead to positive forces that benefit others or society at large. As capital is formed into an enterprise, jobs are created. Innovation is spurred forward, often leading to greater efficiencies in our society and enhancement of standards of living. Indeed, a person in the pursuit of his own interest "frequently promotes that of the society more effectually than when he really intends to promote it."[3]

However, even Adam Smith knew that constraints upon greed were required. While Adam Smith saw virtue in competition, he certainly recognized the dangers of the abuse of economic power in his warnings about combinations of merchants and large mercantilist corporations.

Adam Smith also recognized the necessity of professional standards of conduct, for he suggested qualifications "by instituting some sort of probation, even in the higher and more difficult sciences, to be undergone by every person before he was permitted to exercise any liberal profession, or before he could be received as a candidate for any honourable office or profit."[4] In essence, long before many of the professions became separate, specialized callings, Adam Smith advanced the concepts of high conduct standards for those entrusted with other people's money.

What would Adam Smith, if he were alive 250 years later, observe regarding the modern forces in our economy? He would likely opine, given the economic forces that led to the recent (or current) Great Recession, that unfettered capitalism can have many ill effects. Indeed, he would observe that for all of its virtues, capitalism has not recently been a very pretty sight.

Consumers flee when trust is betrayed

The effects of greed in the financial services industry can be profound and extremely harmful to America and its citizens. Participation in the capital markets fails when consumers deal with financial intermediaries who cannot be trusted. As Tamar Frankel, a leading scholar on U.S. fiduciary law, observed:

> I doubt whether investors will commit their valuable attention and time to judge the difference between honest and dishonest … financial intermediaries. I doubt whether investors will rely on advisors to make the distinction, once investors lose their trust in the market intermediaries. From the investor's point of view, it is more efficient to withdraw their savings from the market.[5]

I can personally confirm the foregoing observation. I have seen in my 25 years of practice, as an estate planning attorney and then as an investment adviser, a large number of individual Americans withdraw from the stock and bond markets after discovering the inadequacy of the

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[3] Smith, p. 423.

[4] Smith, p. 748, see also pp. 734-35. As seen, "Smith embraces both the great society and the judicious hand of the paternalistic state." Shearmur, Jeremy and Klein, Daniel B. B., "Good Conduct in a Great Society: Adam Smith and the Role of Reputation." D.B Klein, Reputation: Studies In The Voluntary Elicitation Of Good Conduct, pp. 29-45, University of Michigan Press, 1997. Available at http://ssrn.com/abstract=464023.

[5] Tamar Frankel, "Regulation and Investors' Trust In The Securities Markets," 68 Brook. L. Rev. 439, 448 (2002).

conflict-ridden "investment advice" they received from many securities firms. These individuals had placed trust in their broker – a trust that was fostered by large marketing campaigns in which the offer of a close relationship with a "financial consultant" or "financial advisor" was promoted. Yet, they found that, in the end, any dream of a beachfront home had disappeared, as much of the returns of the capital markets were diverted into the pockets of the very person who, so often, appeared at their child's soccer game to cheer. Was the cheer for the child, or for the opportunity to undertake more greedy endeavors with the client?

Many millions of American citizens left the capital markets not because of disappointing returns – but because the trust which was requested of them by their "financial consultant," and reasonably placed by the citizen in his or her advisor, was subsequently betrayed. It will be many years, before most of these individuals return to the capital markets. Some will never return, choosing instead to maintain their savings in depository accounts earning little interest, or even worse have their savings "stuffed in the mattress" or "hidden in a can."

The counter to greed: the fiduciary standard of conduct

The fiduciary standard counters unfettered capitalism, by operating to restrain greed. This necessity to so restrain opportunism was reflected in a U.S. Supreme Court decision describing the fiduciary standard embraced by the Investment Advisers Act of 1940: "The dangers of fraud, deception, or overreaching … motivated the enactment of the [Advisers Act] ...."[6]

The fiduciary standard of conduct operates to restrain greed, where other measures of constraint are generally believed to be ineffective. Stated differently, fiduciary status operates to constrain the otherwise-permitted actions of the financial advisor, in order to not usurp the opportunities presented to the client due to the information asymmetry present. In essence, the fiduciary standard constrains conduct, where trust reasonably placed by the client in the advisor would be subject to betrayal.

The underlying question before the U.S. Securities and Exchange Commission (SEC) is how to effectuate the Congressional intent that the fiduciary standard of conduct be applied to investment advisory activities. How will the SEC deal with current Congress's current authorization to the SEC, under the Dodd Frank Act provisions, to extend the fiduciary standard to brokers' investment advice to retail customers?

Will the "best interests of the client" – a phrase so often used by Goldman Sachs executives, even as they admitted betting against the success of the very investment products they promoted – become once again synonymous with a true fiduciary standard of conduct, in which the client's ends are adopted as the advisor's own? Or will "acting in the best interests of the client" become forever intertwined with a far lower standard of conduct, one which permits the sale of "sh***y products" to clients.

[6] *Lowe v. SEC*, 472 U.S. 181, 210, 105 S.Ct. 2557, 86 L.Ed.2d 130 (1985)

It has been over 600 days since Chair Mary Schapiro took the helm of the SEC. After serving 16 years at the NASD and FINRA, will Chair Schapiro, like Joseph Kennedy, also be able to set aside her background? Will she be able to restore to Wall Street, through regulation, high standards of ethical conduct?

WITH EVEN GOVERNMENTS ABANDONING PENSION PLANS, INVESTORS ARE BEING TOSSED TO THE FEE-HUNGRY WOLVES

The Ever-More Complex Financial World

We have a problem in America. The world is far more complex for individual investors today than it was just a generation ago. There exist a broader variety of investment products, including many types of pooled and/or hybrid products, employing a broad range of strategies. This explosion of products has hampered the ability of individual investors to sort through the many thousands of investment products to find those very few which best fit within the investor's portfolios. Furthermore, as such investment vehicles have proliferated, individual investors are challenged to discern an investment product's true "total fees and costs," investment characteristics, tax consequences, and risks. Additionally, U.S. tax laws have increasingly become more complex, presenting both opportunities for the wise through proper planning, but also traps for the unwary.

As the sophistication of our capital markets had increased, so has the knowledge gap between individual consumers and financial advisors. Investment theory continues to evolve, with new insights gained from academic research each year. In constructing an investment portfolio today a financial advisor must take into account not only the individual investor's risk tolerance and investment time horizon, but also the investor's tax situation (present and future) and risks to which the investor is exposed in other aspects of his or her life.

The Days of Private Pensions ... Gone

As all investment advisers are aware, very few private employers today provide a monthly check in the mailbox of the retiree, with inflation adjustments, for life. Even some state governments, with budget challenges, desire to phase out pension-based systems in favor of defined contribution plans. The result is a tremendous shifting of the burden for providing for one's financial future – from the trustees of pension systems and squarely upon the ill-prepared shoulders of the average American.

Proper financial planning and investment decision-making are essential to encourage both an increase in household savings and in order to invest those funds more effectively. If people do not make careful, rational decisions about how to provide for their financial security over the course of their lifetimes, then the government will have to step in to save people from the consequences of their poor planning. Not through pensions, but through other means of government support for the elderly in need.

Yet, the reality today is that individual Americans, on their own, can rarely navigate this complex financial world. Hence, it has become ever-more-essential that our fellow citizens turn to others for trusted financial and investment advice.

Protection for Consumers Yields Greater Participation in the Capital Markets, Greater Capital Formation, and Greater Economic Growth

In the vast majority of the well-regulated capital markets in the world, it is recognized that the imposition of high standards of conduct upon financial intermediaries is necessary to provide protection to consumers from unfair, improper, and fraudulent practices. Such protection fosters confidence in the capital markets by investors, which in turn promotes increased investor participation in efficient capital markets.

What we all feared: "Better" disclosure yields worse results, per Yale professor's research

Federal securities laws and regulations protect investors largely through requiring the disclosure of information – whether it be of material facts regarding an issuer of a security, or of compensation paid to a financial services intermediaries, or of conflicts of interest which exist as to financial services intermediaries. However, disclosures do not address investors' difficulties in dealing with the psychological issues of risk aversion, overconfidence, and cognitive dissonance.

Moreover, many investors do not enjoy the intended protections of securities laws because disclosures are either inadequate (as to the quality or quantity of information provided), incomprehensible to the individual consumer (in terms of the language or terminology utilized), or deficient in timing (i.e., coming only after the consumer makes a decision). While efforts have been made to formulate disclosures in "plain English," this may have exacerbated a related problem – one in which individual investors receive a large volume of disclosure documents to the point of being overwhelmed.

The summary prospectus, Form ADV Part 2A and Part 2B, and other recent enhancements to disclosure documents are welcome developments. But reliance upon "better disclosure" is largely misplaced. A huge amount of academic research in recent years leads to the inescapable conclusion that, due to various behavioral biases consumers possess, disclosures are largely ineffective (and seldom will be read). Moreover, few consumers possess the resources to hire knowledgeable monitors in order to observe and report on the conduct of the financial advisor.

Fiduciary Duties Overcome the Inherent Ineffectiveness of Disclosures

Law has evolved to provide different layers of consumer protections. For "arms-length relationships" law prohibits false representations (fraud). Other laws (such as the '33 and '34 Securities Acts) provide increased duties of disclosure upon those in superior positions of knowledge. Still other laws prohibit certain terms from finding their way into a contract. At times the law mandates certain contractual terms, forms for contracts, or even the form of a product.

Yet none of the foregoing protections can prevent one in a vastly superior position of knowledge from using that knowledge to reap often-hidden benefits to himself or herself, when that person is entrusted with other people's money.

Given the inadequacy of other consumer protections, it is altogether necessary to impose the fiduciary standard of conduct upon those who provide investment advice. The attachment of fiduciary status provides consumers with the ability to trust their financial advisor to act in the consumer's best interest, not the self-interest of the advisor, as to matters consumers do not fully understand (nor can be expected to understand).

But Should Not Consumers Be "Responsible"?

To accept the premise, advanced by many who oppose the fiduciary standard of conduct, that investors are responsible for understanding what they read and then will act prudently thereafter, it is necessary to conclude that investors are not only armed with timely and adequate disclosure, but also that they possess an ability to understand the disclosures which have been provided to them, both intellectually and unhampered by behavioral biases. However, consumer ability to understand is not only difficult due to the enormous knowledge base required to undertake decisions in dealing with a highly complex financial world, but also due to bounds upon human behavior that limit the extent to which people actually and effectively pursue utility maximization. Individuals possess substantial barriers, resulting from behavioral biases, to the provision of informed consent, even after full disclosure.[7]

Moreover, "not only can marketers who are familiar with behavioral research manipulate consumers by taking advantage of weaknesses in human cognition, but … competitive pressures almost guarantee that they will do so."[8] As evidence of the foregoing, many registered representatives, insurance agents, and even investment advisers have been trained by consultants to first establish a relationship with a prospective client based upon trust and confidence, long before any discussion of fees or products; such training is commonplace in the securities industry. Indeed, I have personally received such training – from multiple different practice management and marketing consultants. These consultants are quick to point out the reality that – once a relationship of trust and confidence is accomplished – the "sale" of either the product or the service is then easily accomplished.

The fact is that we should no more expect the vast majority of individual consumers to be able to successfully navigate today's complex financial world than we would expect them to act as their own attorney or physician.

[7] *See* Prentice, "Whither Securities Regulation? Some Behavioral Observations Regarding Proposals For Its Future," 51 Duke L. J. 1397 (2002).

[8] Prentice, "Contract-Based Defenses In Securities Fraud Litigation: A Behavioral Analysis, 2003 U.Ill.L.Rev. 337, 343-4 (2003).

Who Reaps the Benefits of a Consumer's Savings?

Study after study has revealed that the average American individual investor today greatly underperforms the indices over the long term. Given the great disparity between the gross returns of the capital markets and the net returns individual investors receive, one must ask – *where does the difference land?*

Far too great of the returns of the capital markets flow to financial intermediaries, and fail to find their way to the individual investors. Much of this is due to "hidden" fees and costs which individual investors fail to understand – such as brokerage commissions (including soft dollar compensation) for trading of securities within pooled investment vehicles, principal mark-ups and mark-downs, bid-ask spreads, and market impact costs. Additionally, most individual investors are unaware of the substantial compensation broker-dealers receive by way of 12b-1 fees, payment for shelf space, and other forms of third-party compensation not reflected in up-front sales charges.

The way to properly assist investors in navigating today's complex financial world is through an embrace of the notion of purchaser's representatives (fiduciaries), who possess the fiduciary duty to keep total fees and costs reasonable for their clients. Financial advisors, armed with knowledge of the "hidden fees and costs" found in many investment products, and bound by a duty to act in the best interests of the client (and not as the representative of the product manufacturer), can and will apply economic pressure on product providers to lower fees and costs.

THE FIDUCIARY STANDARD MAY SINK WALL STREET'S ADVISORS-ON-YACHTS. SHOULD WE CARE?

Central to the broker-dealer community's argument opposing application of the fiduciary standard of conduct is that the fiduciary standard of conduct is somehow "too expensive" for the average American.

Let me reply …......... HOGWASH!

What broker-dealers really mean is, "I can't make the high profits I make now, if you subject our advisory activities to a fiduciary standard."

There are many advisory business models that are both profitable and successful in serving the needs of "Middle America."

Take, for example, Mark Berg of Timothy Financial Counsel Inc., located right in the heart of America in Chicago and Wheaton, Ill. Using a team approach, this firm, founded in 2000, provides hourly-based financial planning and investment advice to hundreds of clients. The firm has neither income nor net worth requirements. For many clients they offer, depending upon the clients' needs, a flat fee for the initial planning, which includes investment recommendations as well as comprehensive financial advice. Thereafter check-ups and follow-up questions are answered typically for hourly fees. So successful is this firm that many investment advisor-only firms outsource the financial planning portion of their client engagements to Timothy Financial. In keeping with its strong fiduciary oath neither the referring firm nor Timothy Financial provide compensation to the other.

A more well-known group of financial planning and hourly-based financial planning firms is that of the Garrett Planning Network. By providing coaching and the opportunity to network with like-minded financial advisors, Sheryl Garrett provides both new entrants to the financial and investment advisory profession, as well as brokers transitioning to a fee-only business model, with a wealth of information, marketing training, practice management skills, and support. The benefits for clients? Access to financial and investment advice for reasonable hourly fees.

How the numbers work

But … the broker-dealer community says … a customer with only $25,000 to invest surely can't be served under an hourly-based model. Yet, if that customer were to purchase a mutual fund and pay a 5.75% commission, the customer would pay over $1,400 – more than the base flat fee plan offered by Timothy Financial Counsel, and more than the hourly-based financial advice of many, if not most, Garrett Planning Network members. And here's the rub … *the client gets FAR MORE for LESS!!!!* They are not just sold an investment product, but rather they receive all-important financial advice. And, since there are no "hidden" means of compensation (ongoing trails from sales of annuities or from 12b-1 "service fees," brokerage commissions (including soft dollar payments) paid back to the broker-dealer firm for trading within the fund, the hard-to-understand-why-it-has-not-been-banned "payment for shelf space" arrangements, and the still-common "sales awards."

Even larger "wealth management" RIA firms often provide services to "middle America." For example, Trovena LLC, a wealth management firm providing services to entertainers, athletes, and other high-net-worth individuals and executives, created an entire division of their firm, OnCubic, to provide services to clients of lesser means. For a low minimum quarterly fee, clients with – effectively – as little as $60,000 to invest can enjoy many of the benefits of Trovena's well-researched and admired investment strategies.

Other large firms provide services through similar programs. This author's firm always provides some financial or investment advice to whoever makes it to our door. Whether the advice be as simple as "pay off that credit card, don't invest," or a referral to a no-load, low-cost mutual fund company, several hours of free consultation, or a referral to a fee-only hourly based financial planning firm, all prospects walk away with the prospect of receiving what they truly need. And, we often take on as clients widows who don't come close to meeting our "minimums" – because as professionals, we believe it is our duty to look after those in need.

But ... are there enough hourly-based investment advisers?

It's interesting that the broker-dealer community argues that there is an insufficient supply of hourly-based financial planning firms, or other "low-cost providers" – so much so that the fiduciary standard can't be applied.

In reply, I would first note that the number of fee-only investment advisory firms continues to grow. The National Association of Personal Financial Advisors (NAPFA), the nation's largest association of fee-only financial planning and investment advisory firms, enjoyed strong growth in its membership over each of the past ten years, despite its high membership standards and the recent recession.

Second, there are now well over 100 colleges and universities churning out graduates with specialized education in financial planning, qualifying graduates to sit for the Certified Financial Planner™ exam. From my conversations with students in several different programs, it is obvious that nearly all of them desire to work within a fiduciary business model.

Third, we must realize that the over-abundance of non-fiduciary "financial counselors" and any shortage of fiduciary investment advisers is the result of the SEC's own past actions. First, the SEC permitted registered representatives to hold themselves out as "financial advisors" and "financial consultants," despite the fact that these titles evoke in the minds of brokerage customers an advisory relationship of trust and confidence. Second, the SEC permitted the large broker-dealer firms to provide much more than "merely incidental" investment advice without being subject to a fiduciary standard. Basic economics dictated the result – a fostering of a higher-expense (for the customer) business model.

Why is this so? The average American was left with the impossible situation of being informed that they could receive "financial advice" and "investment advice" – but with no ability to discern any difference in the quality of that advice. In the classic thesis for which he won a Nobel Prize, George Akerlof explained, "There are many markets in which buyers use some market statistic to judge the quality of prospective purchases. In this case there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual seller. As a result there tends to be a reduction in the average quality of goods and also in the size of the market."

In other words, the SEC created the very consumer confusion which has been confirmed by so many studies (including the Rand study, commissioned by the SEC itself). In essence, the SEC encouraged providers of investment advice to migrate to the lower, non-fiduciary (and more profitable) standard of conduct, and away from the investment advisor-only business model. And, in the process, individual Americans – unable to discern the difference between those who represent the consumer (registered investment advisers and fiduciaries), and those who represent the product manufacturer (salespersons), were left with a large market of salespeople to deal with – even though the average American "thought" they could trust their "financial advisor."

So prevalent is this trust in registered representatives of broker-dealer firms that I have personally observed dozens of my clients, throughout my 25-year legal and then investment advisory career, inform me that their "financial advisor" took them on "for free" and "has never been paid a dime." Of course, that's only because these clients did not understand all of the fees and costs of the products they were sold. Once I informed each client of the vast amounts that were really paid over the years, nearly all expressed outrage. (A few walked out of my office, refusing to believe me, for they had a long-standing relationship with their broker … or rather, "advisor").

The SEC needs to correct the environment. *The market will adjust, if the fiduciary standard is applied to all financial and investment advisory activities.*

"Ron seeks a competitive edge ... he wants to put broker-dealers out of business!"

Another commonly heard argument by broker-dealer firms is that all the advocates of the fiduciary standard desire is a competitive advantage. Nothing could be further from the truth.

If all that I (and so many of my colleagues who are also fiduciary investment advisers) desired was a competitive advantage, I would be arguing against the application of the fiduciary standard of conduct. *Why would I want to create more competition for myself?* Right now, I enjoy a competitive advantage … 99 times out of 100, when I analyze the investment portfolio of the customer of a traditional wirehouse brokerage firm, I discern that the solution our firm offers lowers the prospects' total fees and costs – often by 30% to 70% (even when considering our investment advisory fees), reduces the tax drag on the client's investment returns, and/or reduces various types of investment risks by orders of magnitude. In other words, the customers of broker-dealer firms are my favorite source of new clients – it is "easy pickings."

But the current status quo is not good for Americans. So many pro-fiduciary standard advocates see the substantial harm suffered by their fellow citizens. They have risen in support of the fiduciary standard for this simple reason – *enough is enough!*

"Big Guns" Oppose the True Fiduciary Standard

This is not to say it will be easy. Wall Street has rolled out the "big guns." All of the major firms' executives have already met with Chair Schapiro and the SEC's working group studying the fiduciary issue. (One wonders if any of them shared a private plane for the trip to D.C., or even shared a limo, for that matter.)

In a more disconcerting move, there are those who "endorse" a "new federal fiduciary standard" – which is simply enhancing disclosures. The "new federal fiduciary standard" touted by so many Wall Street firms is not a true fiduciary standard at all. The late Justice Benjamin Cardoza, famous for not permitting an "erosion" of the fiduciary standard in his decisions, would likely roll over in his grave should the SEC permit the fiduciary standard to be eroded through Wall Street's influence.

Will the SEC step up?

The fiduciary principle is the paramount answer to the question, "How do we restore trust by Americans in our financial institutions."

The bona fide fiduciary standard of conduct currently found in the Advisers Act is the answer to the question: "How do we ensure that our fellow citizens will receive adequate advice to save and properly invest, in order to provide the necessary capital to our securities markets, which in turn will promote U.S. economic growth?"

Now is the time for the SEC to discharge the great duty with which it has been charged. It is time for the SEC to apply the fiduciary standard of conduct broadly upon all investment advisory activities, with the rigor and vitality of the SEC in its heyday, when the SEC was generally perceived to be the finest of our federal governmental agencies.

Americans need the SEC's application of the fiduciary standard to all investment and financial advisory activities. Our fellow citizens need the help of trusted advisor as they seek to navigate the modern and complex financial world and endeavor to successfully provide for their own future financial needs.

American industry needs the fiduciary standard, as the essential means to restore the trust of individual investors in our securities industry. Greater participation by individual investors in the capital markets will thereby provide capital at reduced costs to the firms in need of such capital for expansion, thereby creating jobs.

America itself needs the fiduciary standard, for the potential failure of individual Americans to save and properly invest, and the potential failure of the capital markets to attract the necessary capital to fuel our country's economic expansion, would impose severe additional strains on both federal and state governments in the future.

Will the SEC, under the leadership of Chair Mary Schapiro, rise to the challenge? Stay tuned for the results of the SEC's study of this issue, due out by late January 2011.

FEARS OF FIDUCIARY LIABILITY: ARE THEY REAL?

Several advisors (including two registered representatives about to leave their wirehouses) contacted me over the past several months, after reading my columns on RIABiz.com, to express to me their great concerns about the increased liability resulting from fiduciary status. I observe that a fiduciary advisor has much less to fear than a registered representative, as long as the fiduciary understands and respects the nature of, and components of, "trust."

In my view, trust has four components.

Component #1: Expert Advice Expected.

First, the client trusts today's RIA as an expert advisor with respect to both financial planning and investments. Education, and a commitment to lifelong learning, is required of every professional.

Attaining CFP(r) certification is a first step to achieving the requisite base set of knowledge a financial planner should possess. I would then encourage advisors to attend NAPFA conferences, which provide a the "NAPFA University" course of study, picking up where the CFP(r) exam study leaves off and enabling the transition from book knowledge to real-world delivery of financial advice.

For the requisite base education (and then some) in investment theory and portfolio management, the conferences put on by Dimensional Funds Advisors are superb. If you choose instead to select actively managed funds, consider fi360's training and tools, and the AIF designation they offer. However, since a fiduciary should possess an investment strategy which withstands academic scutiny, don't overly rely on instruction from just a few sources, regardless of how good the instruction may be. In this regard, I suggest to you the Financial Economics Network at ssrn.com - an excellent resource for academic white papers on investment theories.

In sum, as to this aspect of trust, commit to become an expert. Or, better yet, work within an ensemble firm - surrounding yourself with expert advisors from multiple disciplines.

Component #2: Adopting the Ends of the Client as Your Own

The second component of trust is the client's reasonable expectation that you will advance the client's interest before your own.

This does not mean that you are not entitled to be compensated; in fact, a trusted advisor should, in a rational world, be compensated more than a non-fiduciary registered rep or life insurance agent. What is required is that your compensation be reasonable, given your level of expertise, the value you add, and many other factors. And, as a best practice, your compensation (and that of your firm) should be agreed to at the inception of the fiduciary-client relationship, and your compensation should be level (i.e., not varying depending upon products recommended).

To keep the client's interest paramount, it is best to avoid conflicts of interest. Many wise sages over the millennia, in many different contexts, have conveyed the simple truth that a person cannot serve two masters. Don't try to wear two hats. And NEVER try to take off your fiduciary fedora, once it rests upon your head.

Those conflicts of interest which cannot be avoided must be fully disclosed - and properly managed. Treat the client as if you were a member of your own family. Clients must provide their informed consent - after achieving full understanding of the proposed action, any conflict of interest which may exist, and the ramifications of that conflict. No client would ever consent to a course of action which would be harmful to that client.

To emphasize this point - do not rely on disclosures to "cure" a conflict - because they don't. Disclosures are ineffective for a variety of reasons, including numerous behavioral biases possessed by clients. Biased advice, even with disclosure of the bias, is usually poor advice, even when the advisor intends to be "good." For a greater understanding of the inherent problems of conflicts of interest and the ineffectiveness of disclosures, read Professor Daylian Cain's research on the problems of biased advice, some of which is available at ssrn.com.

Component #3: Honesty.

The third element of trust is honesty. Scrupulous honesty. Candor. Because a misrepresentation, or a failure to convey essential material facts the client should know, destroys trust. And once trust is destroyed, it is nearly impossible to restore.

Moreover, once trust is betrayed by any "financial advisor," the client becomes increasingly skeptical of ALL financial advisors. If you operate as a true fiduciary, you'll need to convey how you are different, to overcome the deep skepticism of financial and investment advisors which has built up among the public, and which is often reflected in articles written by well-intentioned, but not always fully informed, journalists.

If the foregoing three elements of trust sound familiar to you, that's good. Because expert advice, in the client's best interest, honestly delivered, combine to roughly translate into the broad fiduciary duties of due care, utmost good faith, and loyalty. These broad and generally non-waivable fiduciary duties must be adhered to by every RIA and financial planner.

Component #4: Compassion.

In my view, however, there is a fourth component of trust. *Compassion.* Clients place trust in their advisors if they believe the advisor will seek to understand the client's concerns and then endeavor to alleviate them. Compassion, and caring for others, although perhaps not legally required of a fiduciary, is an essential aspect of leading a professional life.

Despite its importance, compassion is rarely taught in a financial planning curriculum, or at secular colleges generally. For some self-study in this area, I would recommend 'The Lost Art of Compassion,' a book by Lorne Ladner, Ph.D. It is possible to learn how to become more compassionate, and this will help you in serving your clients and in their perceptions of you. In essence, the more compassionate you become, the greater likelihood that your clients will refer their family and friends to you.

Entering into relationships built upon such an extraordinary level of trust, in which you, the advisor, is engaged as steward of your client's life savings (and of their hopes and dreams), is not an activity to be engaged in lightly. For this reason, not all registered representatives should seek to become fiduciaries. (However, many of them already are, under state common law, which applies fiduciary status upon those in relationships of trust and confidence, regardless of licensure or the terms of any written agreement with the customer. The use of the title "financial consultant" greatly increases the likelihood of finding that fiduciary status exists, de facto.)

Say What You Do …

In summary, any fear of heightened liability arising from fiduciary status can be circumscribed by the advisor following the dictates found in another timeless phrase: "Say what you do, and do what you say." If you aspire to be a fiduciary, be an expert. Be fully, not partially, committed to the client's interest. Practice with the highest degree of honesty and candor. And, as a professional, care for your clients.

Follow these precepts and substantial worries about potential liability fade away. In fact, as reported by one insurance brokerage firm several years ago in a 1995 comment letter to the SEC, fee-only fiduciary advisors have far fewer claims, and less substantial claims (in terms of severity), asserted by their clients, when contrasted with the average registered representative.

Being a Fiduciary is not Easy … But it is Rewarding

I've never said being an RIA and fiduciary advisor was easy. It requires a strong level of commitment. It is a professional calling.

But being a fiduciary advisor, with proper attention to fulfilling the trust reposed in the advisor by the client, will always yield tremendous professional and personal satisfaction for both the advisor and the client. It's a true "win-win" proposition.

Practicing correctly as a fiduciary results in little concern about potential liability. In fact, those who practice under the bona fide high standards of conduct required of true fiduciaries can focus on assisting their clients. They know that simply by doing what is right they can practice with peace of mind, and with little to fear.

<u>In Conclusion</u>

There are major economic forces at work seeking to weaken the fiduciary standard of conduct currently found in the Advisers Act.

The bona fide fiduciary standard of conduct possesses centuries of law underpinning its application. It is a workable standard for all those who provide investment advice.

All that is required now is that the Commissioners, and SEC staff, possess the **<u>courage</u>** to apply the fiduciary standard of conduct. This begins with undertaking an intellectually honest review of the law, and results from understanding the reasons for the application of fiduciary standards.

Americans awaits the results of this important study. What will be the result?

- Will the SEC once again be viewed as the premiere government agency, by the adoption of policies which engender trust and capital formation?
- Will it be seen as the protector of Main Street, or of Wall Street?
- Will the Section 913 Study and its associated Report to the U.S. Congress be intellectually honest, discerning fiduciary law and applying it as Congress intended in 1940, and again in 2010?
- Or will the Section 913 Report instead be filled with the false and unfounded rhetoric, seeking to diminish the fiduciary standard of conduct's application and weakening the "highest standard under the law"?

Respectfully submitted,

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