I support a fiduciary duty for all people who purport to give financial advice. However, I am perplexed that our current fiduciary standard allows for taking commissions and other kickbacks, selling propriety products, and selling from a limited menu of products (as long as those things are disclosed in the fine print that no one actually reads). I am completely baffled as to how a fiduciary standard can be consistent with any of those things, and my fear is that if we implement a "fiduciary" standard for brokers that not really fiduciary at all, it will only worsen the problem by giving investors false assurances.

Before we talk about extending fiduciary duty, we should fix fiduciary duty to make it really mean something.

Here are the reasons why I do not believe a fiduciary standard is consistent with commissions and other types of kickbacks:

1. **Advisors who take commissions give overwhelmingly bad advice.**

   The Harvard Business School did a study looking at insurance agents who earned commissions. They found that these agents recommended appropriate products only 9% of the time. In the other 91%, they recommended investment-linked products that were dramatically more expensive. http://www.hbs.edu/faculty/Publication%20Files/12-055_f474d8ef-ec12-480f-9a0d-532e9667635e.pdf

   If your advisor takes commissions, chances are almost certain that he will give advice that serves his best interest rather than your own. We can put a fiduciary label on the person, but that won't change the underlying incentives caused by commissions.

   In most cases, investors would be better off if the advisor outright stole money from them and put the remaining money in an appropriate investment. But with commissions, investors get a double whammy: a) the commission itself being extracted from their account, b) the remaining principal being placed in inappropriate investments (since it is generally the inappropriate investments that pay the big commissions).

2. **Behavioral economists have shown unequivocally that incentives influence people's behavior (even when they themselves don't know it), and that disclosure doesn't help the situation.**

   Commissions preclude people from making unbiased recommendations and incentivize them to put their own financial interests above their clients', which is the opposite of what a fiduciary is supposed to do.

   It is true that fiduciaries are required to disclose their conflicts of interest, but this may actually make the situation worse. Daniel Ariely (professor of behavior economics at Duke) found that: *"Disclosure doesn't seem to help. Several studies have shown that when professionals disclose their conflicts of interest, this only makes the problem worse. This is because two things happen after disclosure: first, those hearing the disclosure don't entirely know what to make of it — we're not good at weighing the various factors that influence complex situations — and second,*

the discloser feels morally liberated and free to act even more in his self-interest."
http://danariely.com/2012/07/09/disclosure-not-good-enough/

3. **Taking commissions and other transaction-based compensation is de facto inconsistent with acting in the customer's best interest.**

   It will *never* be in the customer's best interest to take money out of their pocket and put it into your own. The customer would *always* be better off keeping that money, either by choosing an investment that doesn't pay a commission or having the advisor rebate that commission to them.

In short, taking commissions (or loads or transaction-based fees or any of the other names they are called) is mutually exclusive with being a true fiduciary.

Even the head of a large bank (Edward Jewell-Tait, head of private banking at Credit Suisse in Australia) believes that commissions are inconsistent with a fiduciary standard. Here is what he says: *"I think it is simply not possible both to provide advice and sell products at the same time and problems inevitably arise when advisers are incentivised to give particular advice. You simply can't have inducements. You can't have a situation where people are paid commissions on the products they sell at the same time as giving advice."* http://www.smh.com.au/business/credit-suisse-boss-edward-jewelltait-slams-commissions-for-financial-advisers-20140921-10k0s6.html

A better solution to the conflict of interest problem is not to expand an anemic fiduciary standard to more people, but to ban commissions on financial products all together. I am surprised that no one ever talks about this. Other countries have already done this to good effect (e.g., the UK, the Netherlands, Denmark, Norway, Finland, Australia, and India).

Commissions are fine for general consumer products, but financial products are unique from other industries in a few ways which make commissions particularly troublesome:

1. **The cost is hidden.**

   With ordinary consumer products, you know what you're paying. You hand over money, so there's no way to charge more without your knowing and agreeing. However, with financial products, the bank already has your money in their possession, so they can extract loads, commissions, trailing commissions, 12b-1 fees, other direct or indirect fees, etc. – all without telling you. You would be hard pressed to know exactly what you are paying no matter how closely you read the fine print.

2. **Value is opaque.**

   With an ordinary consumer product, you know what value you get (do you enjoy using the product? is it functional? etc.) However, in the financial industry, it is very difficult to determine value. You could look at your return relative to your risk. But in the short term, the return will fluctuate a good deal, and risk is hard to define, and you would need to know a lot of math to figure this out in any case.

Therefore, this is an industry ripe for consumers being taken advantage of.

In a world where we banned commissions, consumers would need to pay to receive financial advice. This may sound bad on its surface (who doesn't like receiving "free" advice?), but the truth is -- consumers are paying right now! They are paying through the teeth in opaque and hidden ways, and that is why the financial industry would like to protect the status quo. In a world of no commissions, these payments would be clear and upfront and consumers could choose to pay them or not, depending on the value.

Here is what has happened in countries that have already banned commissions:

1) As expected, banks have reduced their advice services to middle income customers.

> And this is great. Because here is what is happening:
>
> Previously, a middle income customer may have been paying nothing in advisory fees, but, say $5000/year in loads, trailing commissions, other fees, etc. This was very profitable for the advisor. But now, the advisor can no longer take commissions. The advisor could charge the customer the same amount as he was paying the previous year, but in management fees rather than hidden commissions. So the customer would get the same service for the same price (in fact, a better service, since the advice is no longer conflicted), and all is well.
>
> But say the customer balks at this and refuses to pay $5000 for advice - then this is the market working! It means that the customer was never willing to pay $5000, and he wouldn't have been paying it all along, but for the deceit of hidden fees. Now he can make a free choice, with full information, and he can only be better off by this.
>
> So if some advisors go out of business, it means that the price they are charging is not commensurate with the price consumers are willing to pay for their service -- and so be it. This is the end of consumer deception, and the start of the free market working.

2) New low-cost advice services have emerged to serve lower to middle income customers.

> These include online services, telephone services, etc. And these are serving consumers much better than the high-cost, high-complexity, high-risk investments they were previously being sold by so-called "advisors".

I just don’t understand why we keep talking about expanding fiduciary duty, but we don’t talk about *fixing* fiduciary duty by banning commissions.

As an additional option, we could use big data to solve the conflict of interest problem. We could set up a national database where advisors would be required to submit de-identified information on their clients and the investments sold to those clients. This information would be made publicly available, and programmers could write apps to analyze which advisors were recommending high cost funds that paid big commissions (e.g., IPOs of closed-end funds, funds of funds with layers and layers of fees, complex structured products, variable annuities, and the like) and those advisors' overall returns. In this way, consumers could actually get some real information on which advisors they could trust, and we could let the problem fix itself by exposing the financial crooks for all the public to see. It would be hard for any free market person to object to allowing consumers access to better information.

We already do this in other industries, such as health care. For example, many states have set up all-payor databases, which contain health care claims for all payors in the state. Researchers, public interest groups, and others are able to access this information to analyze for the public good, all while protecting patient privacy under HIPAA. It can be done!

In summary, I support a fiduciary standard for brokers, but do not believe it will accomplish anything meaningful (and may actually be detrimental) unless we fix the fiduciary standard itself by banning the conflicts of interests that we have already banned in other industries. For example, it is a *felony* for a doctor to take a kickback for referring a Medicare or Medicaid patient to a particular specialist or treatment. Let's make kickbacks a felony for financial advisors too.