

Financial Planning

Can IBD Advisors Be Fiduciaries?



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MAR 10, 2015

7:35am ET

Traditional broker-dealer representatives are not fiduciaries -- but what about advisors with independent broker-dealers?

That's a question that fiduciary advocates are grappling with as part of a larger discussion initiated by the Institute for the Fiduciary Standard.

While registered representatives -- whose business is conducted through brokerage accounts to increase product sales -- cannot be fiduciaries, some dual registrants "run their businesses very differently," said Knut Rostad, president of the institute.

Is that enough to make them fiduciaries?

DUAL REGISTRANTS

"Dual registrants, for example, whose individual revenue is overwhelmingly derived from fee advice through the RIA" may exercise fiduciary principles and meet their requirements, said Rostad during the institute's conference call Monday on how the standard applies to advisors who work through an RIA as well as a B-D.

But it's a thorny issue given that IBD advisors wear both hats. Many consider themselves fiduciaries and do most of their business through RIAs, yet are still registered representatives of a B-D.

"Then it comes down to what happens when they switch over and work through the B-D?," Rostad said in an interview. "What are the circumstances there?"

'800-POUND GORILLA'

If IBD advisors are to be considered fiduciaries -- even though part of their business is not technically held to a fiduciary standard -- investors will need to be better educated, said panel members. Dual registrants must take the time to explain the differences between the

fiduciary principles they follow on the one hand and the suitability standard held by B-Ds.

"Wall Street is the 800-pound gorilla in this process because it deliberately obscures advisors who are fiduciaries and salesmen who are following the suitability standard," said Jack Waymire, a fiduciary advocate and the founder of Paladin Research & Registry, an advisor screening company, and InvestorWatchdog.com.

"Most investors don't even know this issue exists and even if they did, they do not know how the different ethical standards actually impact them."

THE 'RIGHT' BUSINESS MODEL

Whether or not dually-registered advisors are fiduciaries can depend on how these advisors structure their business models, said Bryan Beatty, a financial planner and partner at Egan, Berger and Weiner, a Vienna, Va.-based IBD.

"The idea of acting as an advisor in a fiduciary capacity is one that any broker could choose as a path to build their business model around," as his firm has done, he said.

Though an IBD advisor serves two masters -- doing business through both a B-D and an RIA -- panelists argued that there are instances where these advisors can be fiduciaries.

"You can construct your business model to allow you to do what's in the client's best interest and to disclose," Beatty said in an interview. "You can't necessarily do that if you're the employee of a large institution."

But according to Beatty, new fiduciary rules would not be enough to exact change. It may be up to advisors themselves: "If enough people choose the right business model, I think it will go a long way towards changing the ground, if you will."

DISCLOSURE IS NOT ENOUGH

And though disclosure is critical for advisors doing work on both sides, the panelists agreed that a disclosure-based fiduciary rule from the SEC would be insufficient.

"I think there is a mountain of data and research that suggests that disclosure generally doesn't work at all and sometimes can be generally harmful," said Rostad. "The broker industry is advocating openly and aggressively that disclosure alone prevents conflicts."

Rostad argues that the SEC has already incorrectly adopted that logic in three recent cases and tends to focus instead on "disclos[ing] and mov[ing] ahead," rather than examining the underlying practices.

And just because information is disclosed, doesn't mean investors will read it, said Waymire, adding that advisors who are concerned about disclosure should attempt to make the information as accessible as possible.

"To an extent, the investor is their own worst enemy if the information is provided to them, but they don't provide the time to read it," he said. "At the same time, the disclosure doesn't have much value if people aren't allowed to see it."

Waymire also said that making disclosure accessible means not necessarily forcing the client to find a paragraph in a long document, adding that "service agreements don't get the job done."

BEST PRACTICES

Earlier this year the group released a set of fiduciary best practices for advisors with the aim of eventually establishing an industry designation to help investors better understand how their advisors are required to act on their behalf. The institute collected comments from advisors on the proposal through today. Following the comment period's close, a council of experts will review the feedback prior to releasing a finalized version of the best practices this summer.