Wall Street Has a Unique Way of 'Protecting' Small Investors

By Susan Antilla

What could be better for an investor of modest means than to wake up one morning with a bevy of new friends in high places on Wall Street and in Washington?

Just such a miracle of paternalism has occurred, as financiers and politicians have joined forces to protect the American public from a sinister plan by the U.S. Department of Labor.

Ignore the impending disaster for the low-income, low-balance retirement investor at your peril. This is about "life and death issues," said Georgia congressman David Scott at last week's annual meeting of Wall Street's leading lobbying group, the Securities Industry and Financial Markets Association, or Sifma.

The DOL, as the embattled agency is known, is recklessly seeking to raise the standards required of stockbrokers who give advice about retirement savings, its critics say.

Yes, I meant to say "raise" the standards, not "lower" them. And if you don't understand why rules to improve stockbroker conduct would be a terrible thing for mom and pop investors, it just means you don't have an appreciation for the special way that powerful people think.

I refer to these finance professionals as "stockbrokers" or "salespeople," by the way, because they aren't held to the same regulatory standards expected of real investment advisers. But they give themselves titles like "financial advisers" anyway, and cross their fingers that you don't know the difference.

Earlier this year, a government study concluded that investors lose $17 billion a year as a result of the conflicted advice they're given about their retirement money.

Wall Street has nonetheless made progress pushing the argument that the DOL's more demanding expectations of salespeople will hurt low- and middle-income investors.

Critics of the rule argue with a straight face that securities firms won't be able to afford to do business with low-balance customers if they can't steer those people to high-fee products. So they'll just stop serving them, the threat goes.

Arthur Levitt, Jr., who was chairman of the Securities and Exchange Commission from 1993 to 2001, says the arguments that America's least wealthy investors stand to be cut off from Wall Street's wares are bogus.

"Brokers are among the most resilient, resourceful business people in America," he said in an interview. The notion that the DOL's rule would motivate the industry to dump low-balance customers "is pure fantasy," he said.

As for all that fiery Wall Street concern over the well-being of the little people, watch what Wall Street does, not what it says. Major brokerage firms including Sifma member Merrill Lynch already have moved small accounts -- those with less than $250,000, in Merrill's case -- to online and call center services, in lieu of providing access to dedicated brokers.

So the little people were on Wall Street's second-class list long before the DOL was whipping up its most recent rule proposal. Today, they are props in the industry's fight to avoid higher standards.

Politicians of both parties are frantically at work to help Wall Street foil the DOL's proposal. Their tactics include efforts to delay the rule or to pass legislation that would eliminate the funding DOL needs to implement it.

A popular argument is that the SEC should be setting the standards for brokers, not the DOL. Levitt said that's nothing more than a delaying tactic. Given the philosophical divide among Commission members, the likely split in any vote would leave the issue in limbo and award Wall Street with the status quo, he said.

This is hardly the first time the securities industry has fought to limit responsibilities for its brokers and ease legal liabilities for itself.

For years, Wall Street and investor advocates have scrapped over the dissimilar regulations that apply to two categories of investment professionals whose jobs -- and titles -- increasingly have overlapped.

Investment advisers, who are bound by the rules of the Investment Advisers Act of 1940, are expected to put their clients' interests ahead of their own. This law's so-called fiduciary standard comes into play when conflicts arise, such as the motivation to sell a particular mutual fund: Sell a fund loaded with high fees when there are similar low-fee funds available, and the investment adviser has broken the law.

Stockbrokers, who are subject to the rules of the Securities Exchange Act of 1934 and overseen by the Financial Industry Regulatory Authority, are only expected to sell customers investments that are "suitable" for them. Under suitability standards, a broker can put Granny in a fund that might use an appropriate investment strategy, but is burdened with the highest fees.

The current fight is all about letting stockbrokers continue to conduct the kind of business that advisers do without subjecting themselves to advisers' rules.

Should the DOL lose, there are other options. In the late 1990s, stockbrokers began to abandon the titles that suggested they might be salespeople -- think "account executive" -- in exchange for titles that included the word "adviser."

The public got sucked in to the intended confusion.

But here's a solution: Don't allow brokers to call themselves "advisers" unless they want to come under advisers' regulations. And don't allow brokerage firms to use the word "adviser" in their marketing.

Not that they did much to fix the problem, but in a new rule ten years ago, the SEC conceded that investors were confused about the roles of various investment professionals and that Wall Street's marketing might have played a role in that confusion.

The agency even hired two consulting companies to run focus groups of investors to get an idea of whether the public had a clue that their Wall Street "advisers" weren't regulated as advisers, at all.

Here's what some of those investors said.

From a Baltimore investor: "I don't know the difference. I mean I've got a guy that gives me advice. I don't know what he is."

From an investor in Memphis: "I think there are some credentials that separate the different categories. Don't ask me what they are, but I think there are some credentials that separate some of them."

Another Baltimore guy: "I'm sure we all get postcards or letters daily that they invite you to dinner. You know what? I don't know if they're a financial consultant, financial adviser or financial planners. How would I even know the difference?"

I hate to tell you, Mr. Baltimore investor, but that is exactly how Wall Street was hoping things would turn out.