



Mr. King Goes to Washington

By Clarence H. (K.C.) King, CFA, CIC, *Managing Director*

Just a month ago, I and twenty-five other representatives of SEC registered investment advisory firms like Emerson converged on Washington, D.C. for the Investment Adviser Association's (IAA) Third Annual Lobbying Day. It was a stunningly beautiful day in Washington, and interspersed among thousands of our nation's eighth graders was our group, there to meet our elected representatives.

The IAA group went to meet with our Congressman and Senators to voice our members' concerns as our representatives wrangled over the Financial Regulatory Reform Act – both the Senate and the House had passed their respective versions and the two bills were undergoing the messy process of “reconciliation” during our visit. This was a miracle of timing that we could not have anticipated when this visit was planned six months ago. Our visit was a crash civics lesson and a window on how Washington works, and as Otto von Bismarck is purported to have said, “If you like laws and sausages, you should never watch either one being made.”

The process began three years ago, when about forty of us visited Washington to discuss Secretary Paulson's Treasury Blueprint – a white paper which came out of nowhere in the last year of the Bush Administration – before Lehman Brothers, before Merrill Lynch, before Bernie Madoff came to light. Time changes everything, and now we are looking at a bill.

The bill, due to be signed by the Senate on July 13, has been the focus of many articles on topics such as “dark pools,” FDIC insurance, “too big to fail,” derivatives regulation, and the Consumer Protection Agency. But we went to Washington to argue something dearer to us and to you our clients – the idea of **fiduciary duty**. We supported the provision requiring Financial Professionals Offering Investment Advice to ***act in the best interests of their clients***.

Does it surprise you that that is a controversial issue? For those of us who are subject to the Securities Act of 1940, as all registered investment advisors are, acting in the best interests of our clients is second nature. Subject to fiduciary duty, we must provide information to our clients about how we are compensated, possible conflicts of interest, and whether we have any record of disciplinary actions against us. Many other “advisors” (such as brokers and insurance agents) are not required to provide the same information. These advisors are only required to know a client's financial situation, understand their financial needs, and recommend “suitable” investments. This is a less stringent standard and is not consistent with best practices such as full disclosure and transparency. “Suitable” may sound fine, and sometimes it may be; often it is not. A broker or an insurance agent making a suitable recommendation could recommend a poor investment option or sell a product sponsored by their firm that has higher fees and/or higher commissions – inducements for them to make such a recommendation. A registered investment advisor, in contrast, operating under a fiduciary duty, must put the client's interest first, above the interests of their firm or themselves. They must also disclose all fees, avoid conflicts of interest, and disclose conflicts of interest where they are not avoidable. They have a duty to consider the total transaction costs of the investments.

So how does one approach this in Washington, D.C.? The IAA had set up appointments for all of us with our Congressman and our Senators – about 90 appointments in all. I met with my Congressman Jim Himes, and senior staffers in his office and those of my Senators, Lieberman and Dodd. We were guided by the comment of Everett Dirksen, long serving Senator from Chicago who observed, “When I feel the heat, I see the light.”

Having done this two years ago, I knew to introduce myself, describe my firm, the number of employees and the profile of a typical client, and to quickly explain why I was there. The fact that we were active members of our firms, not paid lobbyists (who most of these staffers are accustomed to seeing), impressed everyone we met.

I stated clearly that we supported the idea of maintaining the fiduciary duty standard for all people giving investment advice. We also supported the idea of a properly funded SEC so that the agency has the proper resources to examine firms under its jurisdiction. Finally, we wanted a properly funded SEC to remain our regulator. We do not want to be put under the auspices of FINRA, a self regulatory organization (SRO) – read industry funded regulator paying multi-million dollar salaries to its executives who failed, after sixteen years of visiting the Madoff firm, to detect that no trades were being placed.

Arguing the other side are the brokerage industry and the insurance industry – both of whom contribute large amounts of money to our elected officials. I said to my congressman, “I imagine that, representing Connecticut, you have already been visited by some insurance companies...”

Without prompting, my Congressman said, “Yes, I have! And I asked them, ‘When I buy an annuity from you, how much is the commission?’ And you know...they wouldn’t answer the question!” Clearly he understood. My industry colleagues, many of whom represent firms similar to Emerson, had similar meetings and heard similar comments.

How did we do? One overtime, one loss, and a tie! In the bill due to be signed next week the SEC was charged with conducting a six month study of the idea of extending fiduciary duty to brokers that provide investment advice to retail customers. (I call this overtime – some say our representatives punted, or kicked the can a little further down the field). One loss – the SEC will not be allowed to keep the fines they raise (now \$400 million more than what they spend!) but Congress promises to allocate more funding to provide for more regular examinations. And one tie – our legislators were generally not in favor of putting us under the jurisdiction of FINRA, keeping us under the SEC for the time being. We expect that the current senior officials of the SEC, all FINRA alumni, may try to put us under an SRO in the future.

We went to Washington, and our voices were heard. Was this the pro-consumer landmark legislation that was promised? Hardly. But on the bright side, our most pressing issue, the **fiduciary standard** of care for our clients was not watered down. Three years ago, when we were talking about this in an IAA Board Meeting, Blake Moore, the IAA President said, “I’ve heard that if you’re not at the table – you’re on the menu.” So we went to Washington, again, for the third year in a row. Perhaps what we got was sausage – and the process wasn’t pretty, but it was something we all had to do. Had we not gone, the outcome may have been much worse.

K.C. King, a Managing Director of Emerson, has served on the Board of Governors of the Investment Advisor Association since 2004. If you would like to learn more about the IAA, please go directly to their website www.investmentadviser.org or find the link on the Emerson website under the education tab at www.emersonim.com.

