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The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice

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Abstract

Consumers who rely on the financial advice of experts are at an information disadvantage that may be exploited by advisers who are not required to make recommendations that are in the best interest of the customer. Registered representatives of broker-dealers are subject to a suitability standard under the Securities Exchange Act of 1934, while investment advisers are regulated as fiduciaries under the Investment Advisers Act of 1940. An early legislative version of the 2010 Dodd-Frank Act would have eliminated the broker-dealer exception from the definition of investment adviser under the Advisers Act. If enacted, this change would have subjected brokers to a common-law fiduciary standard (like investment advisers), but was postponed to examine the consequences of this policy change. It has been suggested that the imposition of a fiduciary standard on registered representatives would result in significant changes in how broker-dealers conduct business by limiting a representative's ability to recommend commission investments, provide advice to middle-market clients, and offer a broad range of financial products. We take advantage of differences in state broker-dealer common law standards of care to test whether a relatively stricter fiduciary standard of care impacts the ability to provide services to consumers. We find that the number of registered representatives doing business within a state as a percentage of total households does not vary significantly among states with stricter fiduciary standards. A sample of advisers in states that have either a strict fiduciary standard or no fiduciary standard are asked whether they are constrained in their ability to recommend products or serve lower-wealth clients. We find no statistical differences between the two groups in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance.

Keywords: fiduciary regulation, broker dealer exemption, financial advice, household finance, investment advising, brokerage industry

JEL Classification: D18, D12, D78, G24, G28, K23

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