The securities industry calls marketing and selling - “advising”

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The amount of profit in a transaction is far more important to a securities firm than whether it is the most beneficial alternative for a client. The financial interests of individual investors and the financial services industry firms are fundamentally at odds. Professional “advice” from commissioned securities sales personnel very often has a well-disguised and significant tilt toward the financial self-interest of the organizations that these professionals represent.Real time securities markets create a competitive environment unlike any other industry. There are winners and losers. The more profitable a securities sale is for the industry, the less financially advantageous it is likely to be for the individual. Securities originate from corporations, governments, and other issuing institutions. These products are packaged and resold by financial services intermediaries. In the short run, the securities markets are a high-pressure, zero sum game before transaction costs. Transaction costs are a one-way wealth transfer from investor to the industry. Transaction costs become industry revenues. Certain costs are necessary to enable competitive and efficient markets. However, many individual investors pay unnecessarily high transactions and sales channel costs. “Greater Wall Street” firms are dominated by their sales and marketing functions which generate the revenues. Despite any marketing patina about putting investors’ interests foremost, the welfare of the individual investor is very often secondary. If a financial product is to be purchased in quantity by the individual investor masses, it needs to be packaged and marketed through the industry’s various sales and marketing channels. Relatively simple marketing messages and programs are crafted to “educate” individuals in line with their preexisting beliefs or biases. Individuals are educated just enough to build demand, but not enough to confuse them with optimal tradeoffs, lengthen the sales conversation, and inhibit the efficiency of the sales cycle. Securities professionals are called “producers” by the securities industry. They are highly incentivized to make money for their firms and receive substantial pay and bonuses for themselves. The personality types of securities producers are focused on winning the game rather than serving some altruistic goal of long-term client welfare, despite the investment banks’ ad campaigns. Compensation systems are always one-sided – industry producers are paid whether the client is winning or losing in the markets. While there are many ethical producers in the industry, many others simply do not think or care about the interests of the individual investor. While not “front line producers,” the recent analyst scandals exemplify this problem. Some analysts were publicly pumping up certain securities, while disparaging them privately. Only a fraction of these unscrupulous analysts was detected. Some analysts brazenly and foolishly recorded their duplicity in emails that authorities found during legal investigations. Financial intermediaries like pension funds, mutual funds, broker networks, and insurance companies interface with the markets on one side and their client masses on the other. These firms focus on how to market efficiently to individual investors and how to make a profit on the transaction and/or through fees charged against clients’ assets. Financial planning and investment planning services are not “products” that the industry sells to make money. Instead, they are marketing expenses designed to ease the sale of the securities industry’s real products. Table 1 provides the Securities Industry Association’s 2003 summary income statement for the U.S. securities industry.[1] Table 1 -- U.S. 2003 Securities Industry Revenue

	$ Billions	% of Total
Commissions	$25.7	17.8%
Trading Gain (Loss)	$23.1	16.0%
Underwriting Revenue	$15.1	10.4%
Fees, Asset Management	$11.8	8.1%
Mutual Fund Sale Revenue	$6.1	4.2%
Margin Interest	$4.8	3.3%
Investment Account Gain (Loss)	$2.1	1.5%
Research Revenue	$0.2	0.1%
Commodities Revenue	-$1.9	-1.3%
Other Revenue Related to the Securities Business	$47.9	33.1%
Other Revenue	$9.7	6.7%
Total Revenue	$144.5	100.00%

The line items in Table 1 represent the securities industry’s real “products.” None of these major securities industry revenue line items relate directly to the sale of financial of “advice” or “plans” to clients. That is not how “producers” are compensated or how the industry tracks its revenues. The closest line item is "Fees, Asset Management". The securities industry has been pushing to convert transaction bases accounts to asset fee-based accounts. However, fees are charged to clients against assets and not for the production of customized plans. The securities industry's asset based fee compensation structure drives producers to bring in more assets and more clients. The greater the total assets under management, the higher the percentage compensation payout to the producers.[2] In 2005, a survey by Prince and Associates indicated that the average producer at the largest investment bank's retail divisions had 320 clients with $74 million in client assets under management with about 42% of those assets in fee-based accounts. The average large firm producer produced for their firms about $680,000 annually from these client's assets. These producers personally received a payout of about 40% or roughly $275,000 per year each on average. The average producter's assets per client were about $230,000, and average client fees were about .9%/year or about $2,900 per year.[3] (Note that these fees only included direct account related revenues to the firm and not other visible and hidden asset management charges.) If each rep worked six days a week and had nothing else to do, they would have about a day a year available for each client. Unfortunately, they can't spend a day a week with each client, because they spend a significant amount of time trying to find new clients to get more compensation. The only way a system like this can "work" is for richer clients with more assets to get more personal attention and for clients with fewer assets to be managed through commodity client investment management programs run by the investment banks. The industry will argue that they are producing and implementing highly customized financial plans for their clients and some producers certainly are. However, the numbers just don't add up. There isn't sufficient time available to provide comprehensive and customized plans for investors. Instead, the average client is paying about $2,900 every year for a largely commoditized planning process. Securities firm advisory activities performed for clients are incidental to and facilitate the production of revenues made through commissions, trading, margin interest, product sales, asset management fees, etc. There is no reason to believe that this advice is either objective or necessarily in the best interests of clients. It might or might not be. This is not a moral judgment. It is simply a description of a highly competitive and highly profitable sales oriented industry. The capital markets are the essence of capitalism. Individual investors should understand the situation and act accordingly to protect their interests. They should not expect the securities industry to be “on their side.” It simply is not.

In fact, recently a regulatory struggle has been concluded related to securities brokers who manage client funds in these fee-based accounts. In 1999, the Securities Exchange Commission first instituted a temporary rule, generally known as the "Merrill Lynch" rule. This rule exempted broker-dealers from regulation under the Investment Advisors Act of 1940, which imposes a fiduciary responsibility upon those who are regulated as investment advisors at the state and federal level. In these fee based broker-dealer accounts the advice given is "solely incidental" to the brokerage sales relationship, and brokers have no fiduciary obligation to those clients. Instead, broker dealer regulatory standards would apply, such as "suitability" of the investment, etc. In 2005, the SEC approved this rule and as of October 2005 implementation was currently scheduled for January 31, 2006.4 Broker dealers now seem to be faced with the choice either of: 1) making additional disclosures indicating that a firm's interests could be placed above the client's or 2) converting these fee-based accounts to true advisory accounts subject the Investment Advisors Act of 1940 and adopting a fiduciary standard related to their clients' interests.

See these related articles on advisor compensation: ->Does it matter how financial planners and investment advisors are paid? ->Financial planner and investment advisor compensation paid by third parties ->Financial planner and investment advisor compensation paid by clients ->Fee-only compensation aligns the interests of clients and their financial advisors ->Fee-only financial planner and investment advisory groups ->Many investors are not fooled by an ethically challenged securities industry 1) “Securities Industry Financial Results,” Securities Industry Association (http://www.sia.com/research, May 25, 2004 2) "Compensation 2005" Registered Rep., June 2005, p. 35-42, http://registeredrep.com 3) ibid, p. 42 4) Proposed Rule: Certain Broker-Dealers Deemed Not To Be Investment Advisers, Federal Register, January 14, 2005, p. 2716-2741 http://www.sec.gov/rules/proposed/34-50980.pdf Certain Broker-Dealers Deemed Not To Be Investment Advisers, April 12, 2005, http://www.sec.gov/rules/final/34-51523.pdf and Certain Broker-Dealers Deemed Not To Be Investment Advisers, Extension of Compliance Date, September 12, 2005 http://www.sec.gov/rules/final/34-52407.pdf