

Dually registered advisers in SEC sights

Examinations likely in the next 14 months

By **Mark Schoeff Jr.** InvestmentNews

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Blurring lines between investment advisory and broker-dealer businesses are causing the Securities and Exchange Commission to sharpen its focus on dually registered advisers.

In a recently released document, the commission said firms and advisers registered both as advisers and broker-dealers will be among its targets for examinations.

“They should be prepared to have an SEC examination in the next 14 months,” said Amy Lynch, president of FrontLine Compliance LLC.

The SEC said that it will review how firms and advisers sort clients into advisory or brokerage accounts, the financial incentives attached to that decision and the disclosure of conflicts.

“The SEC has been beating the drum over conflicts of interest for the last 12 to 18 months,” said Kelley Howes, who is of counsel at Morrison & Foerster LLP. “It’s sometimes hard to remember what hat you’re wearing” when an adviser or firm is dually registered. One dually registered adviser said he is confident his firm will pass SEC inspection without a problem.

'POTENTIAL CONFLICTS'

“We work diligently to identify potential conflicts, to address them, to eliminate them where possible and to clearly disclose them when they can’t be eliminated,” said Kenneth Klabunde, a vice president at City Securities Corp.

An SEC exam “enhances our ability to serve our clients and ensure [we follow] best practices,” he added.

Zaim Hajdari, president of Hajdari Group LLC, questions why the SEC is singling out dually registered advisers. He contends that having one foot in each world gives clients the best of each business

model. Mr. Hajdari's adviser and broker-dealer credentials are maintained through Raymond James Financial Services Inc.

“It puts me in a better position to make more investment vehicles and products available to clients as a result of my relationship with Raymond James,” Mr. Hajdari said.

While the SEC has put a premium on reviewing the approximately 2,300 dually registered firms, it also is targeting “distinct broker-dealer and investment advisory businesses that share common financial professionals,” according to the examination priorities document.

“For example, it is not uncommon for a financial professional to conduct brokerage business through a registered broker-dealer that she does not own or control and to conduct investment advisory business through a registered investment adviser that she owns and controls but that is not overseen by the broker-dealer,” the SEC document states.

Although the regulator questions the affiliation of an independent RIA with a broker-dealer, in reality, that setup may reduce conflicts of interest, according to Duane Thompson, a senior policy analyst at fi360 Inc., a fiduciary-duty training firm.

“It affords [advisers] more freedom to select investment products that may not be as readily available on a broker-dealer's platform,” he said. “It's not that easy to pinpoint where the investor protection problem lies.”

One of the compliance challenges for dually registered firms is that they must cope with different standards of care governing investment advisers and brokers. Advisers must act in the best interests of their clients, while brokers meet a less stringent suitability rule.

“The one-size-fits-all compliance program doesn't work well for these firms, because the rules are different under the [Investment] Advisers Act [of 1940] versus broker-dealer requirements,” Ms. Lynch said. “If [advisers] are dual employees, it's hard to know what hat they're wearing at any given time.”

MULLING A RULE

The SEC itself is struggling to sort out the two sides of the investment advice business, mulling whether to propose a rule that would impose a uniform fiduciary standard of care for retail investment advice. Before deciding whether to promulgate a regulation, the SEC will conduct a cost-benefit analysis of the market impact of such a move.

The inspections of the dually registered advisers also could provide insight about a potential rule.

“It gives the staff an opportunity to keep looking at the issues, and that will inform the debate,” said Scott Kimpel, a partner at Hunton & Williams LLP and a former counsel to SEC member Troy Paredes.

Examinations might show what investors are getting out of their relationships with advisers and brokers. “I'm not sure that anyone's done the testing at the individual-investor level,” Mr. Kimpel said.