

Differences Between Brokers and Financial Planners

Sometimes it can be difficult to explain the cultural differences between financial planners and wirehouse brokers. However, at a financial services conference in San Francisco, author Michael Lewis--the celebrated author of 'Liar's Poker,' 'The Big Short' and 'Moneyball'--talked about his own experiences as a broker and as a writer about brokers and their world.

Lewis told the audience that he had written 'Liar's Poker,' which is basically an expose of how Wall Street does business, as a kind of warning to college students entering the workforce. He said that he had always found it ridiculous that the large brokerage firms (in his case, Salomon Brothers, but including also Smith Barney, Merrill Lynch, First Boston and Goldman Sachs) would hire somebody like him, an Art History major out of college who knew nothing about finances, and set him to work giving financial advice to institutions and wealthy people with nothing more than a little sales training. "I had a college roommate who should have been an oceanographer," he said. "He had a passion for it. But he was offered so much money that he ended up working for Bear Stearns."

After he wrote 'Liar's Poker,' Lewis naturally assumed that he had forever burned his bridge with Wall Street, by telling the world how ridiculous (and, often, pernicious) it was in a NY Times best seller. Yet when the credit default crisis swept through Wall Street in 2008, Lewis became interested again. "I had no idea that Wall Street could ever get more absurd than it was when I worked there," he told the audience. "But back then, if a big Wall Street firm designed a zero sum trade, you did NOT want to be on the other side of that trade. But with all the amazing losses from the credit default swaps and CDMOs and everything else, somehow Wall Street had become the dumb money. Incredibly bright people had created doomsday bonds that brought down the finances of the bigger firms."

So Lewis tentatively called up some of the players in Wall Street, and was astonished to find that they were willing--even eager--to talk to him. Then he got what he described as the shock of his life. "They would say to me, the only reason I'm talking to you is because you're the reason I got into this business," he said. "They would tell me, I was in college and didn't know what I wanted to do with my life until I read Liar's Poker."

Somehow, Lewis realized, his intentions had been subverted. "I discovered that my book had a dog whistle effect of calling people into Wall Street," he said, "which was exactly the opposite of what I intended."

Lewis was asked what he believed to be the most important lessons of his book about the credit meltdown. His answers were surprising. He said that Wall Street's incentive structure is (this is the term he used) "badly screwed up." Hundreds of executives and brokers had an inkling that they were creating awful investments, but they managed to tell themselves, 'Just let it last until the end of the year, and I'll get my bonus.' Then they would say, 'Just let it last one more year, so I can get my next bonus.' "If you

incentivize people not to see something, they won't see it," said Lewis. "It is amazing what people won't see if they're paid not to."

By mid-2005, the structured product departments at the Wall Street firms were generating so much money that they had virtually taken over their companies. And Wall Street had taken over the ratings agencies, giving them ever-more-fanciful analyses of the products they were selling, and then paying for the companies to ratify the analyses that they had created. Lewis said that he was particularly disturbed that Goldman Sachs could create securities that were designed to fail, and then sell them to their customers at a profit, and then profit some more by betting against them.

None of those incentives have changed since the meltdown. Unlike financial planners, who owe a duty of loyalty to the people they advise, brokers must profitably work against the interests both of their clients and society. Lewis pointed out that the executives right below top management, who are in the middle of creating profitable securities that eventually fail spectacularly, usually find themselves in a financial sweet spot. Their customers lose everything, their bosses are called on the carpet and sometimes fired (though seldom given jail terms), but these people right below the bosses profit on both ends of the crisis. In the run-up, they pocket millions as the flawed securities are shoveled into customer portfolios. Then, when the securities blow up, they are the indispensable experts who are called on to fix the mess--and earn millions more during the cleanup phase.

Meanwhile, the government has been bailing out Wall Street every ten years or so. "We have a capitalist system except for the highest-paid capitalists, who enjoy the benefits of socialism," said Lewis. "They were massively subsidized, and as soon as they got back on their feet, they started undermining the people who were trying to fix the problem." In describing the lobbying attacks on Congressional efforts to rein in the worst behavior, he said: "It's like a patient in the emergency room who wakes up and immediately attacks the doctor who saved his life."

Meanwhile, brokerage firms are permitted to pose as agents of the customer when in reality they are serving as agents of their firms.

Some of this may be changing. "People are starting to suspect that Goldman doesn't have their best interests at heart," Lewis told the group. "When I did my book tour, the first thing I noticed is that people were angry. They wanted to know who to lynch."

Nevertheless, Lewis said that he fully expects another crisis within ten years, at one point saying "I can see that the next collapse is being built now, though we can't see it yet." In response to a question, he said that individually, there are a lot of really nice people working on Wall Street. But the incentives have to be changed before the crises will end. "When people are rewarded for behavior that is just horrible for society, then the one thing you know is that this will happen again and again and again," Lewis told the audience. "Today, on Wall Street, you can get rich doing creative things that are absolutely disastrous for investors and society."

Is there a solution? Lewis said that if he were made the top regulatory agent of the securities world, the first thing he would do is break up the big firms, and then forbid the industry from making bets for themselves when they are also advising investors on those same securities--basically ending the practice of trading for their own accounts. He would ban credit default swaps and some other derivatives, and absolutely forbid firms from betting against the securities they have sold to their investors. "Today, we allow Goldman to buy insurance on somebody else's house," Lewis said. "That gives them an incentive to throw lighted matches at your house and be rewarded handsomely if it burns." And he would require people who run hedge funds to have their own wealth in the fund, taking the same risks that they were exposing their investors to.

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