Goldman Sachs Ripped by Critics for History of Putting Profits Over Clients

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By Gil Weinreich, AdvisorOne

Goldman CEO Lloyd Blankfein (right) walking past the New York Stock Exchange. (Photo: AP)

Greg Smith's very public resignation from Goldman Sachs has sparked heated discussions in the financial services industry, not only on the propriety of Smith's *New York Times*op-ed but on the substance of the former Goldman executive's accusations against the firm.

Asked if Goldman Sachs management puts profits over clients, Elliot Weissbluth of HighTower Advisors answered, simply, but emphatically: "Yes." The CEO of the high-net-worth oriented RIA firm said there was an obvious problem not just with Goldman Sachs but with "all the fully integrated bank brokerage businesses" who tout "the 'benefit' — quote-unquote — of using an investment bank along with asset management services, brokerage services and lending services in one firm.

"If the firm…has adjacent [centers] and layers of profit, those are conflicts of interest that make money for the firm at the expense of the client," Chicago-based Weissbluth told AdvisorOne in a phone interview.

As to Smith's lament that he did not like selling his clients "a product that is wrong for them," derivatives expert Janet Tavakoli, author of the just published e-book, "The New Robber Barons," said Goldman's misbehavior in this area was "not new" and well documented.

"Whatever Greg Smith's motives were for coming forward and whatever the propriety of his writing the op-ed, he's offering valuable confirmation for what others have been saying because he's worked there for 12 years," said Tavakoli (left), principal of

Chicago-based Tavakoli Structured Finance, a derivatives and structured finance consulting firm.

In a phone interview with AdvisorOne, Tavakoli said Goldman had a history of “using clients to offload risks that they themselves found unacceptable.

“I’ve documented quite a bit of that in my new e-book,” she said, adding that Goldman was a key architect of “overrated and overpriced” CDO transactions whose “risks were not adequately represented to their clients” and “that should never have come to market.” She added that the firm was a huge beneficiary of the AIG bailout, receiving billions of dollars that should have been “clawed back” for its “fraudulent conveyance” of securities. “They should have been investigated not rewarded,” she says.

Tavakoli also faulted Goldman for its response to the Smith letter.

“Many have been vilifying them as morons who flunked statistics and logic by citing a survey by people who are being paid by the firm,” Tavakoli said. “I believe they are merely being disingenuous by crafting a toss-off response to a serious issue.”

HighTower Advisors’ Weissbluth says Goldman and firms with similar business models claim to offer “synergy” but instead provide “pure conflict” and “layers of profit” at client expense. He cites as an example a broker buying bonds for his client who calls the firm’s fixed-income desk.

“That desk is a profit center for the firm. The advisor has to make margin also. The financial advisor *has* to buy off the desk,” Weissbluth says. “You don’t have competition at work — you have captivity at work.

“HighTower has solved for those conflicts of interest,” he adds. “We force the balance sheets of the big firms to compete. We force the trading desks to compete; we force the asset managers to compete.”

In contrast, the HighTower financial advisor calls the fixed-income desk, “and that desk acts as a market participant." That desk is a servicing desk to that advisor, but not a profit center for Hightower.

Weissbluth says approximately 80 to 90% of the firm’s advisors are former wirehouse brokers. “We’ve replicated the infrastructure, but not the multiple layers of profit,” he says of HighTower’s unbundled services.

“We replicated the good parts of these large integrated models. But we structured out of our economic model any economic conflicts,” Weissbluth adds.

Goldman flap drives home fiduciary issue By Darla Mercado March 18, 2012

When midlevel Goldman Sachs executive Greg Smith blasted his firm publicly last week for what he deems its rapacious behavior toward corporate and institutional clients, many retail advisers whose résumés include wirehouse stints

nodded in recognition. His New York Times Op-Ed piece struck an emotional chord with many of them who recalled relentless sales pressure. "During the last 30 days that I worked at a brokerage firm, I received 25 e-mails from my branch manager on why every one of my clients needed to have [some] new proprietary mutual fund," said Bob Rall, a fee-only adviser at Rall Capital Management and a veteran of Prudential Securities Inc.

"Everything was about the YTB on the product — the yield to the broker — not the yield to the client," he said. Russell G. Thornton, a vice president at Wealthcare Capital Management Inc. and a Merrill Lynch alumnus, agrees. "Within the commission and sales environment of the wirehouse world, the general operating principle is: "How can I sell the most stuff to my clients?'" he said.

Although Mr. Smith's frame of reference reflects the institutional market, some advisers hope that his Op-Ed will be a wake-up call for clients, getting them to demand better quality of service they receive from advisers.

"One thing this ... will certainly do is make the idea of a client-first duty of care harder to ignore," said Michael Branham, an adviser at Cornerstone Wealth Advisors Inc. and 2012 president-elect of the Financial Planning Association.

"Regardless of your legal obligation, it makes business sense to put the client's interests first," he said. "Whether it's [The Goldman Sachs Group Inc.] or a small independent broker-dealer, that's what clients are really asking for." Some of the media coverage declared that advisers' true loyalties are to themselves and their firms, not their clients.

"A blazing resignation at Goldman Sachs shows us once again that financial advisers too often put their own interests first," blared a sub-headline in an article posted last week on Time magazine's website. Some advisers think that they are far enough from Wall Street so that the Op-Ed won't spur clients to question their commitment.

But others said that all the attention the Op-Ed generated only made a stronger case for highlighting the distinction between advice from a fiduciary and product information from a sales representative. If anything, it gives the public a hint of the battle brewing in Washington over from whom a fiduciary standard of care should be required.

"I think clients want to know that whoever is working with them has their interests at heart, and that there's more loyalty to the client than to the firm," said Susan John, chairwoman of the National Association of Personal Financial Advisors.

"In the world of Greg Smith, the affected clients are institutional and presumed sophisticated — they should know and understand the rules of the game," said William L. McCollum, a portfolio manager and chief compliance officer at Eagle Financial Management Services LLC. "To the retail client, the revelation of conflicts of interest may come as a surprise: They have been misled to believe that their interests come first, when in most cases, there exists no fiduciary relationship," he said.

"These firms and their representatives should not pretend to be something they are not," Mr. McCollum said. But other advisers think that the basic tenet of doing what is best for the client transcends business models. In other words, fee-only service arrangements aren't the only way to do right by the customer, because bad apples can turn up among those advisers, as well. "The whole fiduciary thing has been blown out of proportion, and ultimately it boils down to trusting someone," said Mr. Thornton, who describes his fee-only business model as "not better, but different" from his previous commission-based work.

"There were people I didn't like and didn't trust at Merrill, but I also know fee-only people who I don't truly trust or understand. Bernie Madoff should have been a fiduciary, and he was the worst." Mr. Thornton said. "If you do what's best for the client, you still make money — but that's long-term, as opposed to short-term," said Rick Peterbok, chief executive of Interactive Financial Advisors, a dually registered firm. "If you do more to help the client, the rest will be OK."