March 5, 2015

From: Bob Clark, editor-at-large, Investment Advisor magazine/ThinkAdvisor.com

To: The Best Practices Committee of the Institute for the Fiduciary Standard

Re: Your request for comments on your "proposed best practices" for fiduciary advisors, released in January 2015.

Gentlemen and Lady,

First, let me thank you for all your time and hard work that went into drafting this proposal. The current debate, launched by the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, over a fiduciary standard for securities brokers is, my view, the most important consumer protection issue in America, today. Originally initiated by the stock market crash of 1929, discussions about a broker fiduciary standard raged over most of the following decade, only to be thwarted in the resulting Investment Adviser Act of 1940, by the inclusion of the so-called "broker exemption."

The debate has continued over the intervening 65 years, with the brokerage industry largely succeeding in defeating repeated attempts to legally require brokers to act as fiduciaries for their clients. Notable exceptions are passage of the Employee Retirement Income Security Act in 1974, and the Financial Planning Association's unlikely victory in federal court, preventing the SEC from extending the "broker exemption" to managed assets, in 2007. Today, this debate, reignited by Dodd-Frank, has largely stonewalled at the SEC by the brokerage industry, but is still alive at the Department of Labor, in the form of extending ERISA protections to IRA investors. Despite staunch backing from White House, including President Obama himself, I have to admit to being skeptical about a favorable outcome.

It seems to me, history shows us that occasionally the courts exhibit enough gumption to stand up to the combined might of the financial

services industry, Congress does once in a blue moon, and regulators almost never: Which doesn't bode will for the DOL initiative. However, Politicians, regulators, and even the securities industry itself are responsive to overwhelming media and public sentiment, such as in the 1990s, when the "fee-only" asset management movement caught the attention of the financial media, and transformed the brokerage business. Granted, the securities industry was prevented from co-opting the asset management business only by the FPA's lawsuit, and still managed to avoid a complete transformation by inventing the "fee-based" status for brokers, enabling them to be "part-time" fiduciaries, without drawing client attention to that fact. Still, the entire episode illustrates that the securities industry can be induced to adopt more client-centered business models (albeit kicking and screaming), and to my mind, represents a major step toward a media/consumer driven transformation of that industry to "fiduciary-only" advice.

Which brings me to the work of the Institute for the Fiduciary Standard and other pro-fiduciary groups, and specifically, to your proposal. It's my belief that these combined efforts represent the beginning of the second step toward this transformation of the retail brokerage business: Increasing public awareness (through the media) of the fact that retail brokers do not have a duty to put the interests of their clients ahead of their own—or those of their firms—at all times: and why that matters. As you wrote in your Proposal: "Today, a wide range of financial professionals serve investors in a dynamic and complex market place. 'Best Practices' are designed to assist investors in evaluating and selecting investment advisers and wealth managers from among these diverse professionals. Investors seek guidance that is objective, transparent, and understandable. Best Practices, crafted to be concrete, verifiable and understandable, exist to assist them in doing so."

The question that needs to be answered, then, is: do these best practices further these objectives? Here are some specific comments about each practice. I completely agree with Practices 2, 3, 8, and 9, and in the interest of brevity, will focus on the other seven:

1. "Affirm that the fiduciary standard under the Advisers Act of 1940 governs the professional Relationship at all times." It's hard to argue with this, in that it closes the loophole allowing "part-time" fiduciaries. However, it seems to leave open the possibility of having some clients

for whom the advisor acts as a fiduciary, and others for whom he/she does not. This raises the question of how these standards will be used, but if the goal is some kind of "fiduciary" accreditation, this would seem to allow a "bait and switch," in which an advisor would market their "fiduciary" seal of approval, while not acting as a fiduciary for some, or possibly most, of their clients.

4. "Provide, at least annually, a written statement of total fees and underlying expenses paid by the client. Include an accounting or good faith estimate of any payments to the advisor or the firm or related parties from any third party resulting from the advisor' s recommendations." This "practice" is essential to fiduciary advice, as it includes the adviser's firm, as well as the adviser herself/himself. I'd like it even better if the adviser was also required to know, and report to their client, all the expenses, fees, loads, mark ups, and any other costs related to every recommended financial product.

5. "Avoid all conflicts and potential conflicts. Disclose all unavoidable potential and actual conflicts. Manage or mitigate material conflicts. Acknowledge that conflicts of interest can corrode objective advice." This is also essential. Will the disclosure documents included a detailed description of how the adviser intends to manage or mitigate all unavoidable conflicts?

6. "Abstain from principal trading unless a client initiates an order to purchase the security on an unsolicited basis." Not sure how one would verify an "unsolicited" purchase.

7. "Avoid significant gifts, third party payments, sales commissions, or compensation in association with client transactions that cannot be directly credited back to the client or managed as a fee offset." Not sure how an adviser acting as a fiduciary "at all times" can, at the same time, be a registered representative, and therefore legally obligated to put the interests of their firm first.

10. Have access to a broad universe of investment vehicles that provide ample options to meet the desired asset allocation and in consideration of widely accepted criteria. No further explanation is offered for this "practice," but I suspect it's mostly covered under the "reasonable basis for investments" in practice. ???

11. Consider peer group rankings in ensuring compensation and expenses are reasonable. What would determine one's "peer group." Would this allow brokers to charge higher AUM fees, as this is the practice in their "industry?"

Conclusion

As you observed in your paper, there are two general criteria for helping investors sort out the various kinds of "financial advisors:" technical and ethical." The practices devoted to technical issues seem sound, subject to the above concerns. The ethical issues are quite good as well, with the rather large exception of your clear intention of creating the possibility of brokerage registered representatives to meet these fiduciary best practices.

While I would agree that some brokers probably do act in the best interests of their clients, I would also observe that they are bucking a very powerful system that offers many financial incentives to put their firms' interests first, including compensation, bonuses, expense accounts, support, perks, careers, promotions, referrals, etc. etc. Consequently, I'm skeptical that their clients can reasonably rely on them to act outside of their firms' interests, or to continue to do so.

I'm also somewhat skeptical that an outside entity such as the Institute would be able to monitor brokers' compliance with some of your proposed standards, such as unsolicited principle trades or a statement of all fees and expenses (both to the broker and their firm). While without verification, your standards would be doing little more than creating yet another way that brokers could claim to meet a fiduciary standard, while not doing so in practice. On the other hand, I can see that at least part of your strategy could be to create standards that most, if not all, employee brokers couldn't live up to (broad access to investment vehicles, peer group compensation, e.g.). Yet, again, I'm not sure how you would monitor claims of having done so.

With that said, I do believe that if you can in fact verify compliance—or lack of same—with these standards, in both the brokerage and the RIA communities, you have a very good chance of attaining your goal of correcting "investor misconceptions about what advisers or brokers do

and how they are compensated, and how much investors themselves pay for these services." Thereby, advancing the cause of increased consumer protections, and brining us another major step toward a fiduciary transformation of the retail financial services industry.

Respectfully submitted,

Bob Clark