

*“No thinking man can believe that an economy built upon a business foundation ... can permanently endure without some loyalty to that (fiduciary) principle.”*

Justice Harland Fiske Stone  
Harvard Law Review, 1934

*“Hundreds of thousands of demonstrators gathered in the nation’s capital and cities around the county Saturday to demand action against gun violence”*

Washington Post, on ‘March For Our Lives’,  
March 25, 2018

March 28, 2018

1<sup>st</sup> Quarter Commentary

*Recent regulatory and industry actions on fiduciary have come fast and furiously. Unfortunately, they are mostly not good news for investors. The exception: actions in the states. The takeaway: Investors are on their own to identify real fiduciary advisors, who are also on their own to stand apart in the market place from brokers. The meaning: the Institute’s Best Practices and the Campaign for Investors are more important than ever. Here’s an update on some of these actions and why they matter.*

This past weekend may mark a tipping point for reforms on gun violence. (Never mind your policy view.) Question: Do recent actions on fiduciary put *fiduciary* at a similar tipping point? Here are six conclusions from recent news. Do they suggest underlying changing attitudes will spur investor actions?

- The SEC will proceed with rulemaking; there are risks for investors in doing so.
  - The states are stepping up to fill a gap from federal inaction.
  - CFP Board’s revised standards clearly fall very short for investors.
  - The Fifth Circuit Court decision is tragic; it’s also likely to stand.
  - Industry fiduciary claims are aspirational; they lack credibility as statements of practices.
  - The fiduciary claims also mislead and feed into public distrust of finance.
1. SEC will (finally) proceed with rulemaking. Chairman Clayton speaks concretely and often on improving disclosure, harmonization and titles. On February 23, for example, saying to Financial Advisor, “We have to get to the substance of what these labels (titles that brokers use) mean ... (and) are going to make a big effort to bring clarity and harmony to the investor advisor fiduciary standard of conduct.” On the Fifth Circuit Court ruling, “It hasn’t affected the way I am approaching this (rulemaking)”, according to Investment News.

Skepticism, sure. We’ve heard ‘Rulemaking is coming, rulemaking is coming’ since June 2009 when Chairman Mary Schapiro (2009-2012) championed the Treasury recommendation, and did so for three years. Chairman Mary Jo White also carried the baton (2013-2017), and no rule.

*Bottom line. SEC rulemaking will come with big risks. The chief risk is that enhanced disclosures are branded as fiduciary duties. Investment advice in a confidential and intimate relationship of trust and confidence (see below) will not be presumed. In this case, investors would be better served with no new rulemaking, but by a faithful enforcement of the Advisers Act of 1940. The Institute is pressing our views with the Commission. Our next meetings are on April 5th.*

2. States are stepping up. Three examples show how states are stepping up. First, Nevada passed a fiduciary law last June and other states including Connecticut, Massachusetts, New York, New Jersey are said by the WSJ to be considering such legislation. Second, on the enforcement side, Massachusetts alleged Scottrade violated the DOL Rule, as Investment News reported February 15. ERISA attorney Fred Reish suggested “larger urban states” may follow Massachusetts’ lead.

Third, and unrelated to the DOL Rule, New York’s attorney general announced a settlement Friday with Bank of America Merrill Lynch (BAML). The firm admitted to, “systematically misleading clients about how stock orders were handled; (and) violating New York’s Martin Act.” BAML will pay a \$42 million settlement. The attorney general’s announcement, among other points, took note that BAML “went to astonishing lengths to defraud its own institutional clients about who was seeing and filling their orders, who was trading in its dark pool, and the capabilities of its electronic trading services.” Of particular note, unlike with many recent SEC settlements, BAML was required to affirm its fraudulent and illegal conduct in the settlement.

What did BAML say publically? In an emailed statement to CNBC, Bank of America said, "The settlement primarily relates to conduct that occurred as long as 10 years ago. At all times we met our obligation to deliver the best prices to clients. About five years ago, we addressed the issues concerning communicating to clients about where their trades were executed."

*Bottom line. Key states are stepping up and playing larger roles in securities regulation.*

3. CFP Board’s revised proposed standards fall very short. Final public comments were due February 2<sup>nd</sup>. One issue drawing much criticism was the deletion of the rebuttable presumption that the CFP designation means fiduciary. Deleted, this means an investor should not presume a CFP to be a fiduciary – after many years of CFP Board telling investors the opposite. Ouch!

The Institute expressed concerns with the current, proposed and revised proposed CFP standards. One concern with the proposed standards is that after holding out all CFPs as trusted advisors for ten years, the board has still not provided CFPs guidance in avoiding or mitigating conflicts. A March 8 webinar that included CFP practitioners Cheryl Holland and Rick Kahler discussed the standards and can be found at [www.thefiduciaryinstitute.org](http://www.thefiduciaryinstitute.org). Comment letters to CFP Board from Michael Kitces and the Financial Planning Association merit special attention.

*Bottom line. The CFP Board is likely to announce its final standards in the 2<sup>nd</sup> quarter.*

4. Fifth Circuit Court on DOL rule is tragic for investors. The magnitude of the decision's impact on American savers is mind numbing. Unfortunately, it is likely to stand. (Recall the White House Council of Economic Advisors calculated the price tag savers pay in excess fees at \$17 billion *annually*.) Its' a legal action that defies logic and common sense and will cause severe harms that are predictable, documented and quantifiable. It merits a 'March on Washington.'

This said, the rationale for the decision implicitly argues for broker-dealer and investment adviser standards demarcation. Judge Edith Jones explains that Congress understood that incidental brokerage advice is distinct from and inferior to investment advice in a confidential and intimate relationship of trust and confidence. The upshot: harmonizing the standards is not the answer. Demarcation, distinguishing and separating the standards and functions of sales and advice is the way forward. This is discussed here. <http://www.thefiduciaryinstitute.org/2018/03/23/its-time-advisors-and-brokers-go-their-separate-ways/>

*Bottom line. The tragic impact of vacating the rule is clear. It is not mitigated by industry claims of fiduciary hope and change. This said, Judge Jones opens the door for a positive way forward.*

5. Brokerage and insurance industry voices say that ending the DOL rule doesn't matter. The industry says it "will continue down the road to a fiduciary standard," according to Wealth Management. These are aspirational statements that say nothing about current practices.

One consultant says firms have made "huge financial commitment(s) in terms of training and other things to mitigate conflicted advice," and that "the fiduciary mindset is here to stay." Also, to further illustrate industry commitment, one executive states, "You can't un-ring the bell on the fiduciary movement." The Wall Street Journal reports industry leaders say, "The fiduciary rule has been around long enough now that firms recognize it will survive in some form." Another industry publication headline says it all, "Spirit of Fiduciary rule to survive legal setbacks."

There has been progress. Some firms have reported moving retirement accounts to fee accounts, or introduced "clean shares" and T shares, or have reduced their product offerings to better meet the standard, or reduced conflicts in commission accounts. These are good steps forward.

Yet, here's the problem. Brokerage and insurance firms quickly offer fiduciary promises, without offering the proof to back them up. There's no evidence, publically offered, of actions, policies and procedures that are backed by credible compliance or enforcement measures offered. There's no reasonable basis to believe these firms' brokers can or do render real advice in relationships of confidence and trust. Absent evidence, investors are left to trust the industry's honor system.

Further, industry fiduciary claims are made in an explicit context that matters. The context of overwhelming industry opposition to the BICE clearly expressed from 2015 to 2017. For three years, the industry generally castigated the BICE, and the very idea of enforceable regulation. These sharp BICE criticisms came with no meaningful alternative enforcement offered. This backdrop adds an additional burden on firms today who wish to persuade investors they can or do deliver real fiduciary advice.

*Bottom line. The industry “talks” fiduciary advice, it offers no credible evidence that it can or will deliver fiduciary advice.*

6. Brokerage and insurance firms fiduciary spirit or promise is part of a larger problem for finance. The assertion is misleading. It feeds the dark clouds of distrust already dimming finance.

Recent regulatory news important to retail investors includes stories of misleading communications or wrongdoing at discount brokers, and with Scottrade, Well Fargo and, Merrill Lynch. These reports should concern investors and the industry.

WSJ personal finance writer, Jason Zweig writes March 17 about the biggest loss from the meltdown of Bear Stearns, ten years ago, “The public’s lost of trust in markets themselves.” Zweig characterizes, “Main Street views Wall Street as a place where good things happen to bad people and bad things happened to good people.”

Zweig further writes, “If financial executives looked back and sincerely took responsibility for what happened, pledged not to violate the trust of investors again, and expressed a willingness to change their conduct ... (it) would be a welcome step... Research even suggests the stock market prefers companies whose executives sincerely apologize for their mistakes.”

Instead of asserting *fiduciary*, executives should demonstrate *fiduciary*. And speak plainly and candidly. What might an executive say? Here are 84 words that would be a good start, ‘In recent years, we underestimated the meaning and importance of *fiduciary*. Now we know better. Now we know, irrespective of regulation, being a fiduciary is hard. There’re no shortcuts around the time, work and commitment required to nurture a fiduciary culture, and the necessary skills and expertise. We also know we have to show our customers the proof we’ve changed. Our brokers have been paid commissions to sell for decades. That’s changing. In time, some can and will become fiduciaries. Others, frankly, will not’.

*Bottom line. Whole Foods CEO John Mackey talks about building public trust with authenticity, transparency and integrity. Ten years after Bear Stearns, the Circuit Court decision starts a new chapter, and offers an opportunity to, as Zweig suggests, ‘Express a willingness to change’.*

Conclusion. Zweig is pertinent on the opportunity. De facto, the DOL rule is gone. SEC rulemaking risks weakening rules. Industry claims of a fiduciary “spirit”, absent evidence of fiduciary advice, are hollow and cynical. This picture can be changed.

The best regulation today is in the states. The best future regulation is more consumer awareness, assertiveness and action. Action that changes opinions and markets. The future is here.

*This is a quarterly commentary on fiduciary advice from the Institute for the Fiduciary Standard. The Institute is a nonprofit formed in 2011 to advance fiduciary principles and practices in financial planning and investment advice through research, education and analysis. For further information, the Institute website can be found at [www.thefiduciaryinstitute.org](http://www.thefiduciaryinstitute.org).*