

Fiduciary Reference

Analysis of Investment Fiduciary Issues

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Financial Firms' Steps Toward Fiduciary Are Significant; Are They Enough and Will They Stay Intact?

The DOL Rule caused many firms to change and / or reduce their product offerings. The firms now say, in a reversal from prior claims, such shifts are actually good for investors.

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Executive Summary

In 2016 and 2017 the Consumer Federation of America (CFA) reported, in three separate comment letters, that 34 financial firms spanning assets managers, insurance companies, and broker-dealers changed their products and / or product offerings to comply with the DOL rule. The firms are: Advisor Group, AIG, Allianz Life, American Financial Group, American Funds, Ameriprise Financial, American Life Insurance Company, BlackRock, Cetera, Columbia Threadneedle, Edward Jones, Federated Investors, Fidelity, Franklin Templeton, Great American Insurance Group, Jackson National, Janus Capital Group, Jefferson National, J.P. Morgan, Lincoln Financial Group, Lord, Abnett & Co., LPL Financial, Merrill Lynch, MFS, Morgan Stanley, Nationwide, Oppenheimer, Pacific Life, PNC Investments, Raymond James, Symetra, Transamerica, UBS, and Voya Financial.

At first, most of the firms spoke negatively of the DOL Rule in their comment letters and press reports, saying the rule would or likely would *harm* investors due to eliminations or limitations on product choices. Then, some of the same firms changed their minds, stating that they were innovating new products in response to the rule, and commenting these exact changes were actually *beneficial* to investors. Regardless how the firms explain these new product offerings, questions remain whether they will stay intact and to what extent they will translate to brokers rendering real fiduciary advice.

Introduction and Methodology

The CFA authored a September 2017 comment letter to the SEC in response to a request for information on the standard of conduct for investment advisers and broker-dealers.¹ In it, CFA evaluated industry group claims that “condemned the DOL rule as overly complex and burdensome” by extensively surveying what several firms have accomplished in the way of developing innovative, pro-investor plans to implement the rule.²

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¹ Letter from Barbara Roper and Micah Hauptman, CFA, to the SEC, Standard of Conduct for Investment Advisers and Broker-Dealers, September 14, 2017, <https://consumerfed.org/wp-content/uploads/2017/09/cfa-letter-to-sec-on-standard-of-conduct-rfi.pdf>

² *Id.* at 43-4.

The September 2017 comment letter draws on information from two prior CFA comment letters to the DOL.³ The 281 pages of these three letters together form the base of the data we analyze to highlight the steps the financial industry has made towards fiduciary. These steps (1) benefit investors, (2) work to the advantage of financial firms, by their own admission, and (3) exist (largely to date) despite continuous public opposition to the rule by financial firms and industry groups.

Financial Firms and Industry Groups Had criticized the DOL, alleging it “Reduces Access to or Choices within [Retirement] Products”

The Securities Industry and Financial Markets Association (SIFMA) has heavily criticized the DOL rule since its inception. In their August 2017 comment letter to the DOL, SIFMA focuses heavily on the concept of investor “choice,” using the word twenty times.⁴ Two such uses summarize their position:

- The Rule and its exemptions “have caused many financial institutions to change business models, limiting the choices available to retirement savers and their access to advice.”⁵
- “95% of study participants indicated they have reduced access to or choices within the products offered to retirement savers because of efforts to comply with the Rule.”⁶

Financial firms also voiced their opposition to the Rule. A few noteworthy examples:

- Voya Financial claimed “the vague language of the proposed BIC exemption... would lead to a narrowing of investment choices.”⁷
- Ameriprise claimed “[t]here can no longer be any doubt that the Rule has led firms to eliminate commission-based accounts for retirement investors or to discontinue offering common investment products like mutual funds.”⁸
- Morgan Stanley has said a BIC exemption limitation “needlessly restricts consumer investment choice and is unnecessary given the other comprehensive protections contained in the exemption” and that the current Proposal does not permit “many investments that are utilized by consumers.”⁹

These three brokerages did, in fact, trim their funds substantially in preparation for the DOL Rule. However, they then changed their minds and decided this was good for investors, because cutting funds with “poor performance, high fees, or few assets” was “long overdue,” as representatives of the firm have told media and investors.

What follows is a condensed summary of the concrete steps that financial firms have taken to move toward fiduciary from the 281 pages of CFA comment letters.

³ Letter from Barbara Roper and Micah Hauptman, CFA, to the DOL, April 17, 2017, at 79-91, 118-136, <https://consumerfed.org/wp-content/uploads/2017/04/CFA-DOL-Fiduciary-Reexam-Comment.pdf>; Letter from Roper and Hauptman, CFA, to the DOL, August 7, 2017, at 3-20, <https://consumerfed.org/wp-content/uploads/2017/08/cfa-response-to-dol-fiduciary-rule-rfi.pdf>

⁴ Letter from SIFMA to the DOL, August 9, 2017, <http://www.sifma.org/wp-content/uploads/2017/08/SIFMA-Submits-Comments-to-the-DOL-on-the-RFI-Regarding-the-Fiduciary-Rule-and-Prohibited-Transaction-Exemptions.pdf>

⁵ *Id.* at 6.

⁶ *Id.* at 12.

⁷ Letter from Voya Financial Inc. to the DOL, July 16, 2015, at 9, <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00336.pdf>

⁸ Letter from Ameriprise Financial to the DOL, July 21, 2017, at 2, <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00246.pdf>

⁹ Letter from Morgan Stanley to the DOL, July 21, 2015, at 23, <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00662.pdf>

Insights from Sept. 2017 CFA Letter To SEC – RFI Regarding Standard of Conduct

The DOL Rule’s “restriction on conflicts of interest has led to a redesign of some investment products where incentives are baked into the products themselves. Among the most promising of these developments is the Commission’s approval earlier this year of mutual fund ‘clean shares,’ which eliminate payment for distribution, leaving the broker’s compensation to be separately negotiated between the broker and the customer.”¹⁰

Examples of Firms Developing Clean Shares¹¹

- “American Funds...became the first fund family to win approval of [clean shares] in January [2017].”
- “Janus [Capital Group] received approval shortly thereafter.”
- Lord Abbett, MFS, Columbia Threadneedle, Fidelity, J.P. Morgan, Oppenheimer, and Federated Investors have “reportedly either adapt[ed] already existing share classes to meet SEC definition of clean shares or are developing new share classes that meet the definition.”
- “Franklin Templeton, BlackRock, and several other fund complexes are planning to offer mutual funds that meet the clean share definition.”
- “At least one brokerage firm, PNC Investments, a brokerage, has adopted a DOL rule implementation plan using clean shares¹² offered by its 17 fund partners...PNC is charging a 3% commission for purchases and a \$75 flat fee for exchanges among funds.” PNC more recently changed to a 1.5% commission on sells.¹³

Non-Clean Share Developments in the Annuity and Mutual Fund Markets¹⁴

- LPL’s novel development, its Mutual Fund Only Platform, “has similar potential [to clean shares] to simultaneously reduce conflicts and reduce investor costs” by “offer[ing] investors access to more than 1,500 mutual funds from 20 fund families while standardizing compensation for financial professionals and thus neutralizing incentives to favor one fund or fund family over another.”
- “In addition, LPL is eliminating certain annual account and trading fees, including annual IRA maintenance fees, confirm fees, and inactive account fees.” This eliminates “the added costs that can sometimes be associated with holding mutual funds at the broker rather than at the fund company itself.”
- A recent survey of retail annuity manufacturers found that 45 percent either have already or will introduce new annuity products in response to the DOL fiduciary rule. Moreover, at least 1 in 4 variable annuity writers said they expect to be more innovative with their product design in 2017.

¹⁰ Clean shares came about because of the DOL Rule. They are a class of mutual fund shares that allow for uniform costs across the board, thereby removing a broker’s incentive to recommend a more expensive fund over a prudent alternative. This increases transparency, leads to fewer conflicts of interest, and also decreases unnecessary costs to investors.

¹¹ Letter from Barbara Roper and Micah Hauptman, CFA, to the SEC, Standard of Conduct for Investment Advisers and Broker-Dealers, September 14, 2017, at 45, <https://consumerfed.org/wp-content/uploads/2017/09/cfa-letter-to-sec-on-standard-of-conduct-rfi.pdf>

¹² PNC Investments is advertising their clean shares at the following link: <https://www.pnc.com/en/personal-banking/investments-and-retirement/clean-shares.html>

¹³ https://content.pncmc.com/live/pnc/wsp/investmentsAndRetirement/pdfs/PNC_Brokerage_Plus_Fee_Schedule.pdf

¹⁴ *Id.* at 46-7.

Best Interest Standard Compliance Has Encouraged Firms To Review Products; Some Have Reduced Their Offerings As A Result¹⁵

- “Ameriprise was cutting more than 1,500 funds that no longer meet the firm’s due diligence standards” (leaving more than “2,000 different funds from hundreds of firms available for advisers to recommend to clients”). Ameriprise informed Investment News that “[t]he reasons for dumping them range[d] from performance to cost to the amount of assets.”¹⁶
- “Voya announced that it will trim its mutual fund menu by roughly half by end of year, taking it down from 4,000 products to roughly 2,000... Tom Halloran, Voya Financial Advisors’ president, stated, for many firms this culling of funds is long overdue. ‘We have needed to get this done for a bit,’ he reportedly told *Ignites*.” Additionally, other broker-dealers, including Ameriprise, Morgan Stanley and Merrill Lynch, are reportedly trimming “funds with poor performance, high fees, or few assets from their menus.”¹⁷

Insights from April 2017 CFA Letter to DOL – Fiduciary Rule Examination

BIC Requirement Will Not Reduce Investor Access to Advice¹⁸

- “LPL was one of the first firms to announce it would continue to offer commission accounts under the BIC, and it indicated it was working with fund companies to develop new share classes to enable the firm to levelize compensation across fund families and fund types.” Part of that process involved “LPL cut[ting] back dramatically on the number of fund families that would be available to its brokers” in an effort to standardize commissions... Far from hurting investors, however, Casady said the change was beneficial. Some of the reduction reflects the company’s decision to ‘curate the shelf and think about it in context of the DOL and just in general making sure we’re doing the right job by investors.’... ‘We do see the number of relationships narrowing, and we see that creating a better ecosystem for the investor, the end client for the advisor, for the money manager, and, of course, for LPL.’”

New Product Innovations In The Annuity Market¹⁹

- “Voya Financial has created a line of FIAs with lower surrender fees” and more flexibility.
- “Allianz Life has stated that its sales of FIAs could grow with the current version of the BIC and that the firm does not see itself as disadvantaged in the annuity market.”
- American Financial Group believes their products have a simpler product design with shorter surrender charge periods, lower commissions, and trial commission options. Further, they believe their “distribution channels... will be best positioned to comply with the more rigorous compliance requirements.”

¹⁵ *Id.* at 49.

¹⁶ <http://www.investmentnews.com/article/20170606/FREE/170609963/ameriprise-slashes-number-of-funds-available-to-advisers-ahead-of>
http://ignites.com/c/1686543/197773?referrer_module=SearchSubFromIG&highlight=do1%20fiduciary

¹⁷ Letter from Barbara Roper and Micah Hauptman, CFA, to the DOL, April 17, 2017, at 80, <https://consumerfed.org/wp-content/uploads/2017/04/CFA-DOL-Fiduciary-Reexam-Comment.pdf>

¹⁹ *Id.* at 81-3.

- Jefferson National offers a fee-based annuity, “Monument Advisor VA”, that is “popular among RIAs,” “does not charge any M&E charge or surrender charges,” and whose subaccounts use “low-cost funds ranging from 0.10% to 0.35%.”
- “In February [2017], AIG announced its Polaris Advisory Income Variable Annuity, its first fee-only annuity designed specifically for advisory platforms. The new offering ‘features lower-cost investment options without 12b-1 fees’ according to AIG’s senior vice president for individual retirement products.”
- Jackson National “announced it was developing its first-ever-fee-based variable annuity back in June 2016, an annuity that has “low contract charges (30 basis points for mortality, expense, and administration costs as opposed to the typical 1.15-1.25%), a range of optional living and death benefit riders, and a relatively short surrender-charge period (three years).
- “In January [2017], Jackson launched the Elite Access Advisory, the company’s first fee-based investment only variable annuity specifically to support compliance with the DOL fiduciary Rule. [It] has a contract charge of only \$10 per month, no mortality, expense, and administration charge, and a three-year surrender charge schedule of 2% in the first and second year, 1% in the third, and 0% thereafter.”
- “In January [2017], Transamerica announced its new no-commission annuity, Variable Annuity I-share.”
- “In February [2017], Lincoln announced it was broadening its suite of annuities with new fee-based variable and fixed annuities with no surrender charges, which would ‘provide greater choice and flexibility for advisors and their clients.’ . . . The following week, Lincoln announced the launch of the industry’s first ETF-only variable annuity, built with iShares, further lowering investors’ costs. The product has no surrender charge, all in costs of 1.9% or less, and a guaranteed lifetime income equal to 4% of the initial deposit that increases annually by a 2% cost of living adjustment.”
- “In February [2017], Allianz announced its first fee-based fixed-indexed annuity called Retirement Foundation ADV Annuity. [It] has a seven-year withdrawal charge period, and also uses a simplified design, with one crediting method and four index allocation options or a fixed interest allocation option.”
- “[In August 2016], Great American Life Insurance Company expanded its product offerings to include its first fee-based fixed-indexed annuity, the Index Protector. It has a seven-year declining early withdrawal charge starting at seven percent. The annuity will also be available through several independent broker-dealers, including Raymond James and Commonwealth Financial Network, according to the company.”

Mutual Fund T Shares

- “A number of fund companies either have issued or are preparing to offer a new fund share class, known as T shares, which create level compensation across fund categories and fund families. The T shares in question charge a 2.5% front-end load and an ongoing 12b-1 fee of 25 basis points. According to Morningstar, two fund families had issued a total of 50 T-shares conforming to this description as of the end of March [2017], with another nine firms expected to issue a total of 235 additional T shares by the end of May [2017]. A further 871 T shares from 74 firms are reportedly in the pipeline.”²⁰

²⁰ *Id.* at 84.

Insights from August 2017 CFA Letter to DOL – RFI Regarding the Fiduciary Rule

Continued Positive Developments In The Market Prove That The Rule Provides Sufficient Flexibility to Accommodate A Range Of Approaches To Compliance²¹

- UBS “will reportedly continue to charge commissions on its retirement accounts, but its advisers will not be paid based on commission. Rather, under this approach to complying with the BIC, UBS advisers’ monthly pay will be based on the value and return of the last year’s retirement assets under management...Accordingly, adviser pay will not be driven by ‘the volume of transactions or the products they recommend for retirement accounts.’”^{22,23}
- “Raymond James has announced it will implement the rule by adopting a new product-neutral pay grid for its independent brokers that more closely resembles its payment structure for its employee brokers.”²⁴
- Edward Jones’ reversed their originally cynical position on the impact of the DOL rule and now believes it ‘can structure a new account that will allow for mutual funds in a transaction-based IRA as the industry works to develop and implement long-term solutions.’
- “In January [2017] Advisor Group, which is comprised of four independent broker-dealers, unveiled platform enhancements to help its advisers comply with the rule and ‘create competitive advantages for advisors in [the] ‘Fiduciary Era.’” Furthermore, “[Advisor Group] announced in July [2017] further enhancements to its advisory platform that will allow advisers to seamlessly onboard new clients and open new accounts through an entirely digital process, thereby eliminating most paperwork.”
- “Cetera, a network of seven broker-dealers with more than \$218 billion in client assets, is among the many firms that plan to continue to offer commission-based retirement accounts. The company also recently announced that it was making broad upgrades to its technology platform. As part of these upgrades, Cetera developed a digital advice platform with Envestnet, with an account minimum of just \$1,000, that will be available for use by Cetera’s more than 8,000 advisers by the end of this year.”
- “In July [2017], Nationwide launched its first fee-based FIA. This product, known as New Heights, offers uncapped earning potential, a rarity in the fixed indexed annuity industry.”
- “Another annuity producer, Symetra, recently introduced two new fee-based fixed indexed annuities.”
- “Pacific Life launched a new fee-based FIA, which according to the company, ‘offers even more straightforward, easy-to-understand ways to earn interest, and shorter withdrawal charge periods.’” Christine Tucker, vice president of marketing for Pacific Life’s Retirement Solutions Division added, “clients can be sure rates and caps will not change throughout the entire withdrawal charge period, a longer guarantee than a typical fixed indexed annuity provides...Pacific Index Foundation also offers a

²¹ Letter from Roper and Hauptman, CFA, to the DOL, August 7, 2017, at 13-17, <https://consumerfed.org/wp-content/uploads/2017/08/cfa-response-to-dol-fiduciary-rule-rfi.pdf>

²² <https://www.planadviser.com/ubs-signals-commitment-to-asset-based-compensation/>

²³ A June 1, 2017 [AdvisorHub article](#) elaborates on UBS’s changes, saying that the firm “will allow its almost 7,000 brokers to maintain commission-based retirement accounts but will temporarily suspend its grid-based payout formula, which pays brokers a share of the revenue they generate, for retirement accounts... To reduce the appearance of a conflict, UBS will pay its brokers a flat fee based on the overall retirement assets that they manage in both fee and commission accounts. That payout rate will be pegged to the broker’s 2016 production but may be adjusted up or down incrementally as assets in the account rise or fall.”

²⁴ Information on the “product-neutral pay grid” for its brokers is available at the following: <https://advisorhub.com/rayjay-implement-product-neutral-grid-indie-brokers/>

choice of two optional benefits for an additional cost: one for guaranteed lifetime income, and the other for enhancing the financial legacy they leave to beneficiaries.”²⁵

- “Great American is also offering a fee-based product, Index Protector 7, which has been available through advisors affiliated with the Commonwealth Financial Network since March. A comparison of this no-commission product with similar products that do have commissions clearly shows that, when commissions are stripped out, these products can offer much better terms for customers, including shorter surrender periods, lower surrender charges, and significant increases in upside potential.”

The Industry Changes Its’ Mind

These 34 examples of firms culling underperforming, inefficient, and costly investment options and/or innovating new product offerings are important. Some of the firms have changed their minds, publicly stating that these new product offerings do, in fact, benefit their customers. A key question is whether or not these firms will continue to offer such products in the aftermath of the DOL Rule.

Earlier, Voya Financial, Ameriprise, and Morgan Stanley each published statements in their comment letters to the DOL that criticized the Rule for limiting investor choice. Afterwards, changing their minds, the firms then spoke of trimming funds with poor performance, high fees, or few assets from their menus. These two views are simply incompatible, and are hardly reconcilable. It is simply disingenuous to believe the firms could legitimately have held such a strong perspective at the start, and then turned around to cull such underperforming funds.

It is not only individual firms that decried the DOL Rule’s effect. SIFMA failed to acknowledge any of the DOL Rule’s benefits, instead focusing on research initiated by SIFMA itself (surveying firms invited by SIFMA as well), that concluded “53% of [firm] study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and \$900 billion AUM” as part of their intense criticism of the DOL Rule.²⁶

Incidental “Advice” vs. Advice from a Position of Trust and Confidence

SIFMA bemoans that the DOL Rule will limit “brokerage advice.” The implication being that the elimination of brokerage advice is akin to the elimination of investment advice. This is not the case, as not all advice from financial professionals is created equal.²⁷ There is a discernible line in law between advice that flows from brokerage product sales, and that advice which comes from an investment adviser. This line is not apparent to investors and ignored by the financial firms. The 5th circuit decision reminds us of the legal distinction between broker-dealers issuing advice incidental to their product sales and RIAs rendering advice from a position of trust and confidence.^{28,29} As is highlighted in this website, www.noincidentalinvestors.org.

²⁵ http://www.pacificlife.com/about_pacific_life/newsroom/2017_press_releases/pacific-life_s-new-fixed-indexed-annuity-with-simple-interest-cr.html

²⁶ Letter from SIFMA to the DOL, August 9, 2017, at 12, <http://www.sifma.org/wp-content/uploads/2017/08/SIFMA-Submits-Comments-to-the-DOL-on-the-RFI-Regarding-the-Fiduciary-Rule-and-Prohibited-Transaction-Exemptions.pdf>

²⁷ For a thorough breakdown of what constitutes good advice from financial professionals and a characterization of the differences between broker advice and advisor advice, refer to a May 23, 2016 white paper written by the Institute, <http://www.thefiduciaryinstitute.org/wp-content/uploads/2016/05/WhatIsGoodAdvice.pdf>

²⁸ Fifth Circuit Court of Appeals decision regarding DOL Fiduciary Rule, <http://www.investmentnews.com/assets/docs/CI114691315.PDF>

²⁹ For an analysis of the Fifth Circuit’s decision and why it sharpens the distinction between brokers and advisors, <https://www.financial-planning.com/opinion/its-time-advisors-and-brokers-go-their-separate-ways>

Financial Firms Have Made Progress. Is it Enough?

The many steps that financial firms have made to comply with the DOL Rule are notable and positive. The reductions in harmful products and innovations of new funds are moves towards a higher standard of conduct that are important and can benefit investors. These steps forward, in and of themselves, raise the question of whether they constitute *fiduciary* advice. The answer, of course, is “it depends.”

Two points particularly stand out. First, products, by themselves, neither meet, nor fail to meet, fiduciary conduct standards. It is only advice or product recommendations that are judged. Certainly, reducing costs and increasing transparency makes product recommendations more likely to be deemed fiduciary in many facts and circumstances. Still, it is the recommendation or advice that matters.

The second point regards incremental progress or specific steps forward in the broader facts and circumstances context to determine whether conduct is fiduciary conduct. We speak here of incremental progress. Progress which may be significant but, absent a clear benchmark, says little about meeting the demands of fiduciary conduct. High professional standards mean meeting criteria of minimum competence and experience and ethics; it does not mean *making progress towards* doing so, as is evident in other fields. It means meeting a minimum threshold. This is not like, for example, measuring incremental gains in federal fuel-efficiency standards where incremental gains are, in and of themselves, arguably beneficial. Rather, it is like meeting a minimum threshold for practicing law by passing the bar exam. Making incremental gains that fall short of passing the bar fall short in terms of making the grade.

Former SEC Commissioner Luis Aguilar spoke of this in 2010 when Dodd-Frank was under construction in Congress. He expresses his views on the pass/fail nature of fulfilling a fiduciary obligation: “While the scope of service may vary between clients, the standards of loyalty and care in providing that service should not. **You simply cannot be three-quarters of a fiduciary.**”³⁰

Will These New Products Survive the Demise of the DOL Rule?

The innovations spurred by the DOL Rule clearly demonstrate that firms can adapt to a strong fiduciary rule that benefits investors and curbs costly and uncompetitive products. Continued product improvement requires products and professionals to compete on cost and quality rather than on commission grids.³¹ Continued improvement will also require greater transparency of all costs and fees. On this point the SEC is well-positioned to continue to help increase transparency.

Will these product improvements survive the demise of the DOL Rule? The answer may be unclear until SEC rulemaking is finalized. Stay tuned.

³⁰ <https://www.sec.gov/news/speech/2010/spch032610laa.htm>

³¹ From Micah Hauptman’s commentary, personal communication, May 22, 2018.