

# Fiduciary Reference

Analysis of Issues in Financial Advice

April 15, 2020

## New SEC and CFP Board Standards Starting June 30<sup>th</sup> Abandon Longstanding Principles that Treat Sales and Advice Differently

*Regulators treated broker-dealer (BD) sales and investment advisers (IA) fiduciary advice differently for years, stressing the harms and risks of conflicts of interest. Avoiding conflicts, if at all possible, was the norm. That was yesterday. Today, new standards reject these ideas, accept conflicts as okay and treat BDs and IAs much alike. The new standards depart from the key principle of the Investment Advisers Act of 1940.*

Knut A. Rostad and Darren M. Fogarty\*

### Forward

*“Rostad and Fogarty tell the story that these standards deserve attention because they abandon decades of established principles. They then offer selected remedies to help investors manage in this new era. The Securities and Exchange Commission’s Regulation Best Interest ignores the brokers’ advisory sales-talk and waters-down significantly brokers’ fiduciary duties. In fact, little remains. Hopefully, this rule will fail to achieve its purpose or is fixed before it brings true disasters on the securities markets. Otherwise, investors and the securities markets may pay the price.”*

**Tamar Frankel, Professor of Law Emerita  
Boston University School of Law**

### Summary

*The SEC and CFP Board pushed new standards in 2018 and 2019. Each will be enforced starting June 30<sup>th</sup>. Each seeks to avoid constraints of the Advisers Act of 1940, legal precedent, and common sense. Each seeks to change advice standards by changing the very meaning of advice and conflicts of interest. Their “success” rebrands conflicts to be acceptable – if not beneficial. This is transformational.*

*Investment advice once meant fiduciary advice. Today, investment advice, while called ‘best interest,’ now often means BD sales practices. The June 2019 SEC standards rulemaking culminates a ten-year effort to replace fiduciary principles with sales practices topped with more disclosure. BD sales practices are now called ‘best interest’ advice and described in confusing and sometimes misleading ways. CFP Board standards introduced in March 2018 also remove lines separating BDs and IAs. “Business model” neutrality is the rallying cry. The standards treat advisers and brokers alike.*

---

\* Knut A Rostad is President and Founder of the Institute for the Fiduciary Standard. Darren M Fogarty is Research Analyst at the Institute. The Institute is a non-profit that exists to advance the fiduciary standard through research, education and advocacy. For more information see [www.thefiduciaryinstitute.org](http://www.thefiduciaryinstitute.org). // Edited May 30, 2020 and August 1, 2022.

*The standards ignore structural, business and legal differences that separate brokers and independent advisers.* Brokers and advisers have different purposes, roles and functions. Brokers, in their commercial roles are incentivized to distribute and sell products for issuers or manufacturers in relationships of three. Advisers are compensated by clients as fiduciaries to clients in relationships of two.

*The standards are an historic setback for investors.* It's not just that they rely on disclosure; their flaw is more fundamental. The standards replace Investment Advisers Act of 1940 (Advisers Act) assumptions and thinking on putting client interests first and obvious broker / adviser differences with *caveat emptor* assumptions and thinking, putting "sales first", and contrived similarities between BDs and IAs.

*The standards' implications for investors have not yet been widely discussed.* While specific holes in SEC and CFP Board standards have been reported for years, the implications of their entire impact have not. The finality of the passing of the Advisers Act thinking in federal regulation on June 30<sup>th</sup> should be.

*The SEC and CFP Board standards start a new era.* Regulators, adviser groups, adviser leaders, and experts should offer guidance and innovative ideas to bolster investor protections as these new standards take hold. Guidance is needed. Here are areas where the standards can still be enhanced.

First, provide concrete guidance to help CFPs mitigate or manage material conflicts. Second, acknowledge and rate broad differences among conflicts based on their magnitude, complexity, and opaqueness. Third, make customer comprehension testing of conflict disclosures the new normal. Fourth, provide consumers a score card to rate brokers and advisers. For CFP Board, redefine the meaning of business model neutrality.

## Introduction

Law professor Tamar Frankel distills the meaning of the fiduciary duty of loyalty to two aspects. The first is acting "for the sole benefit" of the client. The second aspect is a prohibition from "acting in conflict with the interests" of the client. The importance of conflicts could not be more clear.<sup>1</sup>

CFP Board and the SEC will start enforcing new standards June 30<sup>th</sup>. CFP Board's [Codes and Standards](#) and SEC's [Regulation Best Interest](#) (Reg BI) each reject basic fiduciary principles that distinguish advisers and brokers. Consent and conflict management or mitigation take on new importance in delivering a fiduciary / best interest standard. Procedures matter greatly.<sup>2</sup> Both standards fall very short.

The importance of these new standards is hard to overstate. June 30<sup>th</sup> is an historic setback for investors. This paper seeks to explain why. It is also written to remind that remedial fixes can help. How each set of standards is interpreted, applied, and enforced will matter greatly. CFP Board, starting with a cleaner slate, has particularly good opportunities to bolster investor protections with guidance.

---

<sup>1</sup> Frankel, T. (2011) *Fiduciary Law*, New York, NY: Oxford University Press, at p. 108.

<sup>2</sup> U.S. SEC (February 18, 1948) Release No. 4048, *In the Matter of: Arleen W. Hughes*, at <https://www.sec.gov/litigation/opinions/ia-4048.pdf> ("[T]he nature and extent of disclosure with respect to capacity will vary with the particular client involved")

## **Background: Investment advice once meant “fiduciary advice.” Well-established legal and structural differences separate advisers and brokers based on longstanding principles**

The Investment Advisers Act of 1940 (“Advisers Act”) underscored the nature of investment advice, the lethal nature of conflicts, and the differences that distinguish investment advisers from other non-professionals. “Legitimate advisory organizations” differ from conflicted sales of “tipsters and touts”. Leading advisers advocated investment advice should only be compensated by fees and advisers should not be in other businesses. In 1963 the Supreme Court recognized that advisers owed fiduciary duties under the Advisers Act.

These views prevailed for decades. Then, registered reps of broker-dealer firms started advertising themselves as providing “trusted advice,” without changing their legal or business obligations. By June 2009, former SEC Chair Mary Schapiro said the broker-adviser “divide” was overstated and, instead, stated that the “two industries are merging to the point of, in some cases, relative indistinguishability.”

Differences in broker and adviser COIs largely derive from well-established legal obligations and structural differences that define what broker-dealers and independent investment advisers do.

### The Question is for Whom the Financial Rep Works

Frankel identifies the conundrum of the different roles of broker-dealers and investment advisers.<sup>3</sup>

*When broker-dealers serve as brokers as well as advisers and financial planners their legal status is increasingly ambiguous. They hold themselves out to advise clients ... but view themselves as securities salespersons. (p. 48)*

Securities attorney Michael Koffler writes, “Broker-dealers act for their own account or as agents of the issuer, principal underwriter, syndicate members or wholesaler . . . and are contractually obligated . . . to distribute the very securities that they provide advice and recommendations on to investors.”<sup>4</sup>

In contrast, “investment advisers exist solely to provide investment advice to their clients.” In describing the personal nature of the investment advisory relationship, Koffler cites the background of the Advisers Act and a key Supreme Court case: “There is an inherent tension between serving as an agent in the chain of distribution of a security and providing investment advice in a personal relationship.”<sup>5</sup>

The core differences: Brokers are contractually required to represent issuers or other parties while advisers are legally required to represent clients. Brokers exist and are compensated by others to sell and distribute products while advisers exist and are compensated by clients to advise clients as fiduciaries.

---

<sup>3</sup> Frankel, T. (2011) *Fiduciary Law*, New York, NY: Oxford University Press.

<sup>4</sup> Koffler, M. (2009) Six Degrees of Separation: Principles to Guide: The Regulation of Broker-Dealers and Investment Advisers. *Securities Regulation & Law Report*, 41 SRLR 776. Available at <https://us.eversheds-sutherland.com/portalresource/lookup/poid/Z1t0I9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEv0JDdu0!/fileUpload.name=/PDFArtic42709.pdf>, at p. 4.

<sup>5</sup> *Ibid*, at p. 4 and 5, citing §205(2) of the Investment Advisers Act of 1940; *SEC v. Capital Gains Research Bureau, Inc.* 375 U.S. 180, 191 (1963).

## Conflicts Are Like a Virus that is a Mortal Threat

Carlo V. di Florio, then Director of the SEC Office of Compliance, Inspections and Examinations, offers a vivid reminder of the potential lethal role of conflicts of interest. He [spoke in October 2012](#), on “A topic of perpetual importance to all aspects of compliance and ethics programs, conflicts of interest.” di Florio looked at history, ethics and securities laws and offered a metaphor for why conflicts are harmful.

*One can think of ethical concepts as the white blood cells that make an organization’s ‘immune system’ . . . effective. Conflicts of interest can be thought of as the viruses that threaten the organization’s wellbeing. As in the microbial world, these viruses . . . if not eliminated or neutralized, even the simplest virus is a mortal threat to the body.*

di Florio continued, “[e]specially when combined with the wrong culture and incentives, conflicts of interest can do great harm.”

### **SEC rulemaking and the CFP Board Standards are a major disruptor of fiduciary advice**

#### Reg BI and Form CRS and Adviser Guidance

The June 5, 2019 rule-makings sought to, “enhance the quality and transparency” of retail investors’ relationships with advisers and brokers, according to the news release.<sup>6</sup> Rules Reg BI and Form CRS are joined with new guidance on the Investment Advisers Act of 1940.

Reg BI. The rule, Reg BI sets out what brokers should do in terms of disclosure, care, conflicts, and compliance.<sup>7</sup> The Reg BI Release discusses whether any conflicts should be eliminated and concludes that they should not be. “We did not mandate the absolute elimination” of any “particular conflicts” as, “[w]e were concerned that the absolute elimination of specified conflicts could mean a broker-dealer may not receive compensation for its services.”<sup>8</sup> The SEC instead chose to only eliminate certain sales contests and the like, and opted to let BDs determine if mitigation is needed, per SEC guidance.

Form CRS. Differing roles and purposes define advisers and brokers. Yet, these differences are virtually never identified by brokers. Reg BI and Form CRS fail to identify or discuss these differences. Instead, advisers and brokers are discussed as being similar, if not indistinguishable. This is evident in the language that advisers and brokers must use to disclose their services within Form CRS:<sup>9</sup>

*When we provide you with a recommendation as your broker-dealer, or act as your investment adviser, we have to act in your best interest and not put our interest ahead of*

<sup>6</sup> U.S. SEC (June 5, 2019) “SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals. *Press Release*, available at <https://www.sec.gov/news/press-release/2019-89>

<sup>7</sup> *Ibid.*

<sup>8</sup> U.S. SEC (June 5, 2019) Regulation Best Interest: The Broker-Dealer Standard of Conduct. *17 CFR Part 240*, available at <https://www.sec.gov/rules/final/2019/34-86031.pdf> at p. 347.

<sup>9</sup> U.S. SEC (2018) *Appendix B: Form CRS*. Available at <https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf>

*yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the recommendations and investment advice we provide you. Here are some examples to help you understand what this means. (p. 14)*

The SEC implies adviser and broker purposes, roles, functions, fees, and commissions are alike.

Adviser Guidance. The SEC's efforts to muddle advisers and brokers differences are also evident in how the SEC re-interpreted the Investment Advisers Act of 1940 in release IA-5248. This release was roundly critiqued by twelve "concerned" law professors.<sup>10</sup> The 'Concerned 12' point out how the SEC's interpretive guidance significantly weakens the fiduciary duty to address conflicts:

*Although Capital Gains insists that fiduciaries have 'An affirmative duty of utmost good faith and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading clients,' Release 5248 largely downsizes these requirements to an obligation to disclose all material facts about conflicts.*

What is missing, according to the law professors, is the well-established principle that "*the investment adviser must seek to avoid conflicts of interest, not merely disclose them.*"

Conclusion. The SEC rejects eliminating conflicts in Reg BI. It then minimizes adviser-broker differences in Form CRS. The SEC then weakens advisers' fiduciary duty by effectively substituting disclosing conflicts for avoiding them in the investment adviser guidance. The historic and legal view that conflicts of interest are inherently harmful is not expressed by the SEC. With the exception for sales contests incentives in some instances, conflicts are not cast as harmful or deserving of avoidance. The SEC is effectively redefining the meaning of conflicts to be minimal and acceptable.

---

<sup>10</sup> Columbia Law School (June 25, 2019) Statement of Concerned Securities Law Professors Regarding Investment Advisers and Fiduciary Obligations. *CLS Blue Sky Blog*, available at <https://clsbluesky.law.columbia.edu/2019/06/25/statement-of-concerned-securities-law-professors-regarding-investment-advisers-and-fiduciary-obligations/>.

## CFP Board

On March 29 2018, Investment News reported the unveiling of the new Certified Financial Planner Board (“CFP Board”) standards, “Under the [new rule](#), all CFPs — including brokers — must act in the best interests of their clients when providing financial advice. The previous rule applied a fiduciary standard to CFPs only when they were involved in financial planning with their clients”<sup>11</sup>

*Raising the advice bar is the most significant new change to the CFP Board’s Code of Ethics and Standards of Conduct. . . . The final standards . . . are designed to strengthen the trust that clients have in advisers who use the mark, according to CFP Board officials.*

*Under the new CFP rules, a mark holder must disclose and manage conflicts of interest and adopt business practices that are ‘reasonably designed to prevent material conflicts of interest from compromising their ability to act in the client’s best interests,’ Leo Ryzewski, CFP Board general counsel, told reporters.*

*‘We’re going to be working diligently to ensure that CFP professionals get all the education and guidance they need on these new standards,’ CFP Board chairman Richard Salmen told reporters. ‘The board’s decision to have an 18-month timetable was because we wanted CFP professionals and the firms they work for to have enough time to live within the standards, truly understanding them and have the time to implement them.’*

“Raising the bar” also refers to language on the duty of care and putting the interests of customers first. This new language is positive and significant. It needs to be interpreted and applied appropriately. Otherwise, this language becomes empty words; the duties merely aspirational. Further, the standards call for CFPs to adopt their own policies (separate from firm policies) to manage conflicts. This is also positive and significant. Yet, guidance has not yet been provided to inform CFPs what they must do.

Unfortunately, where CFP Board has provided guidance on conflicts it’s fallen short in key cases. For example, guidance allows for oral disclosure of conflicts and either oral or inferred customer consent to material conflicts. Oral agreements are well-known for leading to disagreements about ‘who said or meant what.’ Also, CFPs are not urged to avoid conflicts.

The CFP Board standards also treats advisers and brokers and their conflicts alike. It calls fiduciary duty the “Crown jewel” that animates a CFP’s “Commitment to high standards.”<sup>12</sup> Yet, CFP Board views fiduciary duty as “business model neutral.”<sup>13</sup>

CFP Board makes four points regarding conflicts and fee-only compensation and it has issued a paper to discuss concerns regarding fee-only compensation. While CFP Board issued a paper on fee-only CFPs, it has issued no paper to discuss its concerns of brokers, dual registrant, and insurance agents.

---

<sup>11</sup> Schoeff, M. (March 29, 2019) CFP Board Expands Fiduciary Duty for Financial Advisors. *InvestmentNews*, available at <https://www.investmentnews.com/cfp-board-expands-fiduciary-duty-for-financial-advisers-73846>.

<sup>12</sup> CFP Board (November 27, 2018) Commentary to Code of Ethics and Standards of Conduct. Available at [https://www.cfp.net/-/media/files/cfp-board/standards-and-ethics/compliance-resources/commentary\\_coe.pdf](https://www.cfp.net/-/media/files/cfp-board/standards-and-ethics/compliance-resources/commentary_coe.pdf), at p. 3.

<sup>13</sup> This phrase, also comes from p. 7 of a [2010 SIFMA comment letter](#) to the SEC. See footnote 2 for link to CFP Board document.

In fact, since March 2018, CFP Board appears to have been publicly mum on the topic of any concerns specific to brokers, dual registrant and insurance agents. The four points are:

- All compensation presents a material conflict.
- “Business model or compensation neutral” means treating fees and commissions the same.
- Fee-only advisors’ AUM and hourly fee arrangements are “particularly acute” conflicts.
- CFP Board argues that CFPs should not be urged to avoid a conflict instead of disclosing it.

Each point raises questions. Together, by overlooking the historic view that opaque commissions present greater potential harms and risks than do transparent fees, they paint a picture of CFP Board favoring commission compensation over fee compensation. This picture is evident when the new standards were announced in March 2018, in CFP Board commentary on the standards, and when CFP Board issued a paper on fee-only compensation.

When CFP Board announced its new standards, Richard Salmen, then-CFP Board Chair, was also quoted in Investment News as “stressing” the CFP designation is compensation-neutral: “Every method of compensation has some kind of conflict of interest that has to be managed and dealt with.”<sup>14</sup>

In its Commentary to Code, CFP Board writes “Fiduciary duty is business-model neutral.” It applies to all CFPs “regardless of the business model in which they operate.” Further, there is a conflict “when a client pays a CFP pro for providing services, regardless of the compensation method.”<sup>15</sup> No other explanation is offered. Again, this language treats different compensation conflicts the same.

Business model neutrality is referred to (not by name) in a May 14, 2019 CFP Board paper on the standards implications for fee-only planners: “CFP<sup>®</sup> Professionals customarily receive compensation for their services. Therefore, there is no business model or compensation method that eliminates conflicts of interest.” Again, this language treats different compensation conflicts the same. CFP Board then says CFP fee-only planners, “Must disclose and manage their material conflicts of interest. There are some circumstances where the conflicts are particularly acute.” I. E: AUM compensation and hourly fees.<sup>16</sup>

*Comment. CFP Board wrongly treats fee-only and commission compensation alike. This policy defies legal precedent—and common sense.*

First, “Material” conflicts in the past were reserved for the most serious conflicts which may alter the client’s decision to accept the advice or recommendation. CFP Board believes any compensation, per se, is a *material* conflict. Differences between fee-only and commission conflicts are not even mentioned. This notion of ‘conflict equality’ between fees and commissions contravenes common sense and the history and background of modern securities law. The Advisers Act of 1940, affirmed by the Supreme Court in *SEC vs. Capital Gains Research Bureau, Inc.*, is a high mountain to scale (refer to **Footnote 5**).

---

<sup>14</sup> See **Footnote 11**.

<sup>15</sup> See CFP Board’s Commentary to Code (Source in **Footnote 12**), at p. 5 and 6.

<sup>16</sup> CFP Board (2019) CFP Board’s Code of Ethics and Standards of Conduct: Implications for “Fee-Only” CFP<sup>®</sup> Professionals. Available at <https://auth.cfp.net/-/media/files/cfp-board/standards-and-ethics/compliance-resources/cfp-board-guidance-for-fee-only-advisors.pdf> at p. 3.

In *SEC vs. Capital Gains*, the court noted that the investment advisers of the time believed it was vital for an adviser to be impartial. The then-president of the Investment Counsel Association of America offered two guiding principles: 1) Only engage in rendering investment advice and abstain from activities such as “security selling or brokerage,” and 2) Have one’s remuneration “consist solely of definite, professional fees fully disclosed in advance.”<sup>17</sup>

By omitting any mention or reference to this background, CFP Board’s interpretation of “business model neutrality” seems to seek to replace principles set out in developing the Advisers Act, and later affirmed by the Supreme Court, without offering any legal or analytical basis for doing so. In addition, no responsible practitioner or expert says fee compensation is “conflict free”. Negotiating a fee is conflictual by nature. However, it is also a conflict that is different in kind from a conflict associated with an opaque and complex commissioned product recommendation.

This has been an accepted point for decades. Law professor Arthur Laby notes, that broker-dealers, when transacting with their customers as principals, “cannot readily act in their customers’ best interest. Advisers are poles apart. Other than negotiating a fee, advisers are typically not in an adversarial posture with their clients.”<sup>18</sup> After negotiating the fee, a fee-only adviser can generally offer advice without conflicting compensation incentives. Brokers, however, as Laby notes, are in a far more challenging position “as principals [of the firm for which they work].”<sup>19</sup>

*Comment.* CFP Board strains logic and language to describe “business model neutrality” to mean fee and commissions are alike. Saying that unlike things are the same is not neutrality; it shows a bias.

The problem is that brokers’ commissions and advisers’ fees are not alike. They are different by design. Treating them alike strains logic. It requires vague or misleading language to explain. CFP Board *neutrality* does not really mean “neutral.” To be *neutral*, i.e: “Not acting to support either side in a disagreement” or “unbiased” or “impartial” is one thing. Treating complex and opaque commission conflicts like simple and transparent fee conflicts is not being “neutral.”

CFP Board’s comment on avoiding versus disclosing conflicts in its Commentary to Code offers an example of fees versus commissions.<sup>20</sup> CFP Board explains it rejects NAPFA’s recommendation to *encourage* avoidance of conflicts over disclosure of conflicts, “Many conflicts operate at the firm level” outside the control of the individual CFP, so that it might be “misread as a requirement to avoid certain business models entirely,” and this would be incorrect. While many conflicts do operate at a firm level, this has no bearing on whether CFPs should seek to avoid those conflicts they can control. Of course, as the twelve concerned law professors (noted above) point out, the Advisers Act says they must. The strained rationale for rejecting NAPFA’s commonsense recommendation only raises more questions.

---

<sup>17</sup> SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180 (1963) <https://www.sec.gov/divisions/investment/capitalgains1963.pdf>, at p. 7.

<sup>18</sup> Laby, A. B. (2010) “Fiduciary Obligation of Broker-Dealers and Investment Advisers.” *Villanova Law Review*, Vol. 55, No. 3: p. 732. Available at <https://digitalcommons.law.villanova.edu/cgi/viewcontent.cgi?article=1050&context=vlr>, at p. 32.

<sup>19</sup> Ibid.

<sup>20</sup> See CFP Board’s Commentary to Code (Source in **Footnote 12**) at p. 5.



*Comment.* CFP Board can fulfill its “business model neutrality” ideal and act consistently with established legal precedent—and common sense.

CFP Board can fulfill its neutrality pledge. It can revise how it interprets the pledge. It can say that conflicts are different and clients are different and “neutral” means a case by case review as well as an objective determination. It can note legal precedent and the SEC’s excellent decision *In the Matter of Arleen Hughes*.<sup>21</sup> Here, differences in client sophistication and the conflicts’ magnitude, complexity, and opacity are considered. It ought to be a natural part of maintaining “compensation neutrality.” It would reflect true neutrality that comports with legal precedent.

#### Consumer Federation of America

The Consumer Federation of America (“CFA”) also weighs in on broker and adviser conflicts in an April 2019 paper, writing “how the Commission addresses conflicts of interest will largely determine whether investors benefit from the proposed Regulation Best Interest.”<sup>22</sup> In the paper, CFA highlights different types of conflicts. These include “conflicts that are inherent to the business model.” Key points include:

*Conflicts of interest are inherent to both the broker-dealer and investment adviser business models. Brokers and advisers alike have an interest in maximizing their compensation, creating incentives that may not always align with investors’ interests . . . Conflicts of interest that are inherent to the business model are typically fairly simple and straightforward. They boil down to the fact that the firms and financial professionals have an incentive to maximize compensation, whatever their compensation structure, that may not always result in recommendations that are in investors’ best interests. (p. 1-2)*

Conflicts of interest inherent to both the broker-dealer and investment adviser business models are identified: “Commission compensation creates an incentive to maximize transactions” while “AUM fees create an incentive to gather assets” and while some advisers charge “hourly fees” while others charge engagement or monthly fees.” It is explained that “each comes with its own set of conflicts.”

The omissions in this discussion of business model conflicts are clear. There is no mention that conflicts of brokers and advisers differ on the basis of business models. That conflicts of independent advisers tend to be far fewer, more basic, simple, transparent—and more understandable—as compared to broker conflicts is not mentioned. There is no mention of the business models’ different purposes, roles and functions. Instead, interestingly, the discussion of fee compensation conflicts is given great attention, about twice the space, (15 lines) that is given to commission compensation (6.5).

---

<sup>21</sup> U.S. SEC (February 18, 1948) Release No. 4048, *In the Matter of: Arleen W. Hughes*, at <https://www.sec.gov/litigation/opinions/ia-4048.pdf>.

<sup>22</sup> Consumer Federation of America (April 2019). A Framework for Addressing Broker-Dealer and Investment Adviser Conflicts of Interest When Providing Retail Investment Advice. Available at <https://consumerfed.org/wp-content/uploads/2019/04/CFA-Conflict-of-Interest-Framework.pdf>, at p. 1.

Significantly, CFA then devotes a section to describe investment product-related conflicts in detail. Here the conflicts that infest broker-dealers are brought out. This discussion includes these important points:

*“[B]rokers have a strong incentive to recommend the products that pay them the most, regardless of whether they are the best option for the investor. In practice, this means, for example, that a broker-dealer has an incentive to recommend a mutual fund that pays a higher share of the load rather than an available alternative that offers a lower payout . . . . These product-specific conflicts arise because of the stiff competition that exists among product manufacturers, who seek to encourage sales of their products over their competitors’ by offering the most attractive compensation arrangement to the selling brokers. Such conflicts tend to be much more complex than the basic compensation-related conflicts discussed above, making them difficult for even financially sophisticated investors to understand or guard against. (p. 3-4).*

### **Dually registered broker-dealer investment adviser conflicts**

Prior to Reg BI, broker conduct met FINRA’s suitability standard, which only required that a broker-dealer “have a reasonable basis to believe that a recommended transaction or investment strategy . . . is suitable for the customer.”<sup>23</sup> The fact that brokers acted in this sales capacity meant their advice was incidental to the securities transaction.<sup>24</sup> In other words, their legal status precluded them from rendering fiduciary advice to their customers.

Broker-dealers (“BDs”), and brokers, as Koffler notes (See **Footnote 4**), exist and are compensated to distribute and sell products. Their businesses are quite naturally structured to maximize sales. Brokers are provided a plethora of incentives by firms they represent to do just so. These incentives help brokers achieve their business goals. These incentives are, quite naturally, conflicts of interest that, by design, are widely recognized to also hamper brokers from putting their customer’s interests first.

Rhoades: A myriad of compensation sources. Ron A. Rhoades, a fiduciary scholar and professor of finance and financial planning at Western Kentucky University, outlines sources of compensation that a broker-dealer or investment adviser may receive in affiliation with its operations. (See Appendix A).<sup>25</sup> Here Rhoades identifies a myriad of sources his or her firm may be compensated by either a customer or a third-party product manufacturer or other intermediary. Seventeen of these sources are from third parties while four are directly from customers.

---

<sup>23</sup> FINRA (2012) Rule 2111. Suitability. Available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111>, at (a).

<sup>24</sup> As outlined in §202(a)(11)(C) of the Investment Advisers Act of 1940. Available at <https://legcounsel.house.gov/Comps/Investment%20Advisers%20Act%20Op%201940.pdf>.

<sup>25</sup> Rhoades, R. A. (December 6, 2018) SEC Comment Letter RE: Regulation Best Interest and RE: Form CRS Relationship Summary. Available at <https://www.sec.gov/comments/s7-07-18/s70718-4728948-176763.pdf>, at p. 12 and 13.

Ameriprise: Sixteen pages of compensation and revenue. To illustrate BD conflicts on a practical level, the Institute sampled the most recent Client Disclosure Brochure (Form ADV Part 2A) of Ameriprise Financial.<sup>26</sup> The ADV is 64 pages; sixteen pages are devoted to disclosing how “Ameriprise Financial Services and its affiliates receive revenue from several different sources on the products and services you purchase.” In these sixteen pages Ameriprise enumerates all the ways that Ameriprise “and its affiliates” and brokers may receive revenue.<sup>27</sup>

Ameriprise identifies many conflicts. For example, it lists different “cost reimbursement payments,” and mutual fund firms in its “Mutual Fund Program,” as sources of revenue. The cost reimbursement payments “Increase the gross revenues and net earnings of AEIS ... and (some) such payments thus reduce the investor return on their investment.”<sup>28</sup> About the Mutual Fund Program: “Certain aspects . . . create a conflict of interest or incentive.” The list is extensive.

Commonwealth Financial Network: Five pages on fees and costs; other forms of compensation. The ADV Part 2A describes fees and costs when the firm “effects securities transactions.”<sup>29</sup>

In five pages, the firm lists the ways “certain charges” are “in connection with certain investments, transactions and services in your account.” It is not clear what a Commonwealth customer is expected to do with this information. These charges include these descriptions of some of the fees and costs:

*Commonwealth will receive a portion of these fees ... (that are) dependent on the type of the account ... the transaction that occur ... Additional fees and charges ... include but not limited to ... 12b-1 fees, sub transfer agent fees and distributor fees ... management fees and administrative expenses, mutual fund transaction and redemption fees ... deferred sales charges ... transaction charges, service fees ... brokerage fees and charges. (p. 20).*

Then Commonwealth discusses (below) the different pricing of different share classes for the same mutual fund. Again it is not clear how a customer should interpret this information and its impact:

*Commonwealth advisors may select share classes of mutual funds that pay Commonwealth 12b-1, sub transfer agent, distributor, transaction, and/or revenue-sharing fees when lower-cost institutional or advisory share classes of the same mutual fund exist that do not pay Commonwealth or your advisor additional fees. As a matter of policy, Commonwealth credits the mutual fund 12b-1 fees it receives from mutual funds .... back to the client accounts paying such 12b-1 fees. (p. 20)*

---

<sup>26</sup> Ameriprise Financial Services, LLC (September 13, 2019) Ameriprise Financial Planning Service Client Disclosure Brochure, Form ADV – Part 2A. [https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd\\_iapd\\_Brochure.aspx?BRCHR\\_VRSN\\_ID=628487](https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=628487)

<sup>27</sup> Ibid, under section “How we get paid” from p. 19-34.

<sup>28</sup> Ibid, at p. 18.

<sup>29</sup> Commonwealth Financial Network (March 27, 2020) Commonwealth Financial Network Form ADV Part 2A [https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd\\_iapd\\_Brochure.aspx?BRCHR\\_VRSN\\_ID=629404](https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=629404) at p. 18.

Also, Commonwealth is clear as to the material conflict it has with its customers concerning National Financial Services (“NFS”). It makes plain why there is a conflict. Yet, its obvious relevance to a particular customer is not clear.

*Commonwealth uses National Financial Services LLC (“NFS”) as its clearing and custody firm for substantially all of Commonwealth’s PPS managed accounts. Commonwealth’s business relationship with NFS provides Commonwealth considerable revenue-sharing benefits .... Commonwealth’s revenue-sharing agreement with NFS, and the existence of various fund share classes with lower internal expenses that Commonwealth may not make available for purchase in its managed account programs, present a conflict of interest between client sand Commonwealth or its advisors. A conflict of interest exists because Commonwealth and your advisor have a greater incentive to recommend, or make investment decisions regarding investments, that provide additional compensation to Commonwealth that cost clients more than other available share classes in the same fund that cost you less ... A conflict of interest exists because Commonwealth and your advisor have a financial incentive to recommend or select NTF funds that do not assess transaction charges but cost you more in internal expenses than funds that do assess transaction charges but cost you less in internal expenses. (p. 21)*

The Worst of Both Worlds? Dual Registered Investment Advisers. A recent paper by Nicole M. Boyson, professor of finance at Northeastern University, explores the conflicts of interest of dual registered investment advisers.<sup>30</sup> Boyson finds dual registrants manage more than 80% of RIA assets and “expose fiduciary clients to unique conflicts.” She also finds that since 2003 dual registrants have paid over a half billion in penalties and fines for inadequate disclosure of 12b-1 fees and revenue sharing, and that retail clients of dual registrants pay higher fees than clients of independent advisers.<sup>31</sup>

Boyson gives particular attention to an ongoing SEC initiative, launched in February 2018, and reported as the SEC’s share class disclosure initiative. The SEC has initiated enforcement actions against dual registered RIAs for failing to make required disclosures of 12b-1 fees, “when a lower cost share-class for the same fund was available.” Boyson underscores that while RIAs are named by the SEC in these cases, “Because only brokers and dual registrants can accept 12b-1 commissions, this conflict does not exist for independent RIA firms.” What this means, of course, is that the entirety of the responsibility for the breach falls directly and clearly on the broker or BD that enables the breach.<sup>32</sup>

---

<sup>30</sup> Boyson, N. M. (December 1, 2019) The Worst of Both World? Dual-Registered Investment Advisers. *Northeastern University D’Amore-McKim School of Business Research Paper*, No. 3360537. Available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3360537](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3360537).

<sup>31</sup> Ibid, at p. 3.

<sup>32</sup> Ibid, at p. 1-2.

Discussion of BD Disclosed Conflicts. These ADVs raise many questions. One question is how investors digest and understand the magnitude and nature of the conflicts? The answer is they probably don't. In fact, the reps themselves can't. Ameriprise notes that they leave their own representatives in the dark when it comes to some conflicts arising from such compensation.<sup>33</sup> Separately, so does fee-only advisor, Paul Pagnato, who spent many years with a full-service broker-dealer.<sup>34</sup>

The importance of broker-dealers preventing their own reps from being fully apprised of their own conflicts should not be understated. Ethical implications are obvious. Less clear may be the regulatory implications. One of them being the challenge of attaining "informed consent" and another being managing or mitigating the conflicts absent being fully apprised about them.

The scale and scope of these conflicts are wide. The conflicts of interest are complex and are not transparent. Disclosure, the strategy championed by FINRA and the SEC for dealing with BD conflicts,<sup>35</sup> fails to be adequate in mitigating such conflicts because it is relatively difficult for an investor to gain a meaningful understanding of their implications. And this is *perfectly understandable*.

### Insurance Company Conflicts

Insurance agents and representatives comprise a significant number of CFPs. As such their conflicts matter. Northwestern Mutual Life Insurance Company's ("NM") disclosure of conflicts was recently leaked to a reporter at *Financial Planning*.<sup>36</sup> The disclosure can be found at the bottom of that article.

The document describes in detail how NM's jungle of material conflicts that face a CFP who is a NM representative or insurance agent. Those include, for example, the contractual relationship with NM, the compensations-related conflicts, increasing-payout percentages ... known as a grid, how "I am incentivized to sell more expensive products and services," and that "I have an incentive to recommend an NM variable annuity product for purchases below \$50,000, which is a material conflict of interest..."

This is an extraordinary document. It plainly describes the magnitude of the incentives aimed to make NM a successful product distributor. It describes a rep's relationship of three: NM on one side, customers on another and the agent as the third piece. It openly tells the basic story that reps don't "advise." They are hired, trained and incentivized to sell.

---

<sup>33</sup> Ameriprise Financial, for example, discloses that it "does not share with [its] financial advisors the cost reimbursement payments [they] or affiliates receive" in order to mitigate various compensation conflicts in its Client Disclosure Brochure (cited in **Footnote 26**, at p. 19). But this surely comes at a steep cost in terms of conflict transparency, by definition.

<sup>34</sup> Paul Pagnato discussed his past experience working at a broker-dealer in an October 2018 Institute panel discussion. He said that when the financial crisis of 2008-2009 hit, he was "exposed to conflicts that [he] didn't even know existed."

<sup>35</sup> FINRA (2013) Report on Conflicts of Interest. Available at <http://www.finra.org/sites/default/files/Industry/p359971.pdf>, at 21. ("FINRA is also concerned with how manufacturing firms handle conflicts of interest that may be inherent in a product . . . manufacturing firms [address] those conflicts through disclosure"); For a lengthy analysis of the SEC's views on disclosure as it pertains to COIs, see [https://thefiduciaryinstitute.org/wp-content/uploads/2015/09/IL\\_0915\\_Rostad.pdf](https://thefiduciaryinstitute.org/wp-content/uploads/2015/09/IL_0915_Rostad.pdf).

<sup>36</sup> Salinger, T. (October 31, 2019) Northwestern's CFP Disclosure Put Industry's Fraught Questions in Focus. *FinancialPlanning.com*, available at <https://www.financial-planning.com/news/northwestern-mutual-cfps-disclose-conflicts-of-interest-under-new-standards>.

NM then implies that, notwithstanding these material conflicts, CFPs need not mitigate or manage them. The reason? NM conflicts are designed to be self-mitigated or self-managed. How? The disclosure states, “For more than 160 years, NM has been helping individuals, families and businesses, (so that I know) in the long run I will benefit you most by serving you well.... This in itself helps to mitigate the **material** conflicts .... ” (The emphasis is mine, as is the case in the next paragraph.)

It continues, “The nature of NM and its insurance products also helps to **manage material conflicts** of interest,” and “My conflicts are further **mitigated** by NM ‘s compensation practices ... specific programs were designed intentionally to minimize compensation that could incent sales behavior that is in material conflict with a client’s best interest. All of these steps help **mitigate** my conflicts” in selling NM products to you.

### **Independent Registered Investment Adviser Conflicts**

Broker, insurance agent and dually registrant advisers’ conflicts have been noted and described. What about advisers? How do their disclosed conflicts compare and contrast?

The Institute looked at the ADV’s Part 2A of three independent investment advisers regarding their fees and compensation, other financial industry activity and client referrals and other compensation. The firms were selected from Investment News largest fee-only firms with AUM of \$5 to \$20 billion.<sup>37</sup>

#### Adviser Investments, \$5 billion in AUM, Newton, Massachusetts

Adviser Investments identifies two main conflicts on two pages.<sup>38</sup> The first conflict entails the firm chairman writing an independent newsletter on Vanguard funds that includes model portfolios that could, potentially, create demand for certain funds or ETFs. (The chief investment officer also writes a newsletter about Fidelity funds.) The model portfolios “may differ substantially from the portfolios managed by Mr. Wiener.” The firm's Form ADV discloses how this conflict is mitigated.

The second conflict concerns advisers receiving differential compensation depending on which program clients are enrolled. The conflict is addressed by having each program recommendation reviewed by an oversight committee to ensure the interests of the clients are put first.

Adviser Investments identifies one conflict, the publishing of two newsletters that does not appear to be material or necessarily undermine the firm’s advisers’ objectivity. The second conflict regarding recommending different programs which carry differential compensation appears to be akin to the conflict inherent in negotiating a fee for service.

---

<sup>37</sup> Ezhu (June 1, 2019) RIA Rundown 2019: Largest Fee-Only RIAs. *InvestmentNews*, available at <https://www.investmentnews.com/ria-rundown-2019-largest-fee-only-riAs-79761>.

<sup>38</sup> Adviser Investments (June 5, 2019) Adviser Investments Client Disclosure Brochure, Form ADV Part 2A, available at [https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd\\_iapd\\_Brochure.aspx?BRCHR\\_VRSN\\_ID=584214](https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=584214), at p. 23-24.

Savant Capital Management, \$5 billion in AUM, Rockford, Illinois

Savant identifies numerous conflicts in four pages of its ADV.<sup>39</sup> These conflicts include a subsidiary, and contractual arrangements with a number of unaffiliated entities that provide related services to Savant clients. These include Foster Group, Carson Wealth Management and the State Bank of Freeport. Regarding State Bank, according to Savant, “Savant has an economic interest to refer clients to State Bank as Savant will receive a percentage of the fee State Bank charges the referred client for the trust or estate services provided.” Further, the individual adviser receives no incentive compensation for referring a client to one of these. In all instances, “The client is not obligated to use” these services.

Separately, Savant also discloses a small interest (1%) in a national trust company, National Advisors Trust Company, that it recommends to clients. Additionally, Savant also identifies a number of conflicts associated with the service of Moneta executives on industry boards and associations.

Moneta Group, \$20 billion in AUM, St Louis, Missouri

In its ADV part 2, “Item 5, Fees and Compensation” Moneta uses two pages to discuss fees and comp the firm receives.<sup>40</sup> “Fees are typically assessed based on assets under advisement or supervision.” Family CFO and family office clients, institutional clients, IRA rollover, and concierge services.

The only fees received from a third-party involve, “Certain partners [who are] state licensed insurance agents.” The firm states that it is “not a licensed insurance agency and does not receive compensation from the sale of insurance products.” Moneta reports that it generally does not allow advisors or partners to sell insurance products but that a few individuals who were partners of the firm before the no-insurance policy was adopted are excluded from that policy. These individuals continue to receive and keep commission payments, and some runoff commissions are directed to charity. After these legacy partners retire or otherwise depart Moneta, no advisors or partners at Moneta will receive insurance commissions; and Moneta itself does not receive any compensation from insurance sales.

In Item 10, “Other Financial and Industry Activities and Affiliations,” Moneta identifies a number of business affiliations that may create conflicts in the context of certain Moneta executives or advisors.<sup>41</sup> Advice regarding, for example, Argent Capital Management, Retirement Plan Services, and Enterprise Bank. Each potential conflict is described plainly in its scope and scale, why it may present a conflict to a client, and that a client may choose to avoid the conflict by rejecting the recommendation.

In addition to providing clear disclosures, Moneta waives and/or rebates advisory and other fees when its advisors recommend Argent Capital. Retirement Plan Services proceeds will terminate in 2020. Overall, through these affiliations, it is significant that no referral fees are paid to any Moneta employees or to the firm for any recommendation from employees to Moneta clients.

---

<sup>39</sup> Savant Capital Management, LLC (March 10, 2020) Savant Capital Client Disclosure Brochure, Form ADV Part 2A, available at [https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd\\_iapd\\_Brochure.aspx?BRCHR\\_VRSN\\_ID=619067](https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=619067), at p. 39-42.

<sup>40</sup> Moneta Group Investment Advisors, LLC (November 1, 2019) Moneta Group Client Disclosure Brochure, Form ADV Part 2A, available at [https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd\\_iapd\\_Brochure.aspx?BRCHR\\_VRSN\\_ID=598357](https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=598357), at p. 10-11.

<sup>41</sup> Ibid, at p. 24-25.

## Differences among conflicts of interest

Conflicts differ on three major dimensions. Their (1) magnitude (scope, scale, frequency), (2) complexity (difficulty in discerning their impact) and 3) opacity (transparency). These dimensions relate to the difficulty to evaluate the conflict and its subsequent potential harm and risk. They reveal how conflicts differences are material and important to assessing a firm, advisor and a recommendation. A low potential harm / risk conflict that is more easily understood should be treated differently from a high harm / risk potential conflict that is far more difficult to understand.

We offer a framework to assist consumers in evaluating different conflicts. Guiding assumptions include: One, if explained in plain language, consumers often can comprehend advice with minimal conflictual incentives. Two, in a market regulatory environment, potential harm and risk is more closely associated with the magnitude, complexity and opacity and subsequent comprehension of a conflict. Three, differences between the least and most potentially harmful and risky conflicts tend to be evident to consumers.

We offer three categories of conflicts from those that are rated the most difficult to evaluate and possess the greatest potential harm and risk, to those that are the least difficult to evaluate, and possess the least potential harm and risk. The conflicts of a firm, rep, or a recommendation are initially placed in a category based on a subjective judgments as to their potential harm and risk.

Greatest magnitude, complexity and opacity and risk. Conflicts of greatest magnitude and complexity and opacity are often associated with broker dealers due, in large part, to the multitude of potential incentives and payments from manufacturers and third parties. These fees and costs are identified by Ron A. Rhoades (see **Appendix A**) and seen in the Northwestern Mutual (insurance and BD) and in the Ameriprise ADV. These conflicts are deemed the most difficult to evaluate and comprehend.

- The magnitude, complexity and opacity of the conflicts make consumer comprehension hard.
- The ability of the broker rep or insurance agent to explain the conflicts is uncertain. Ameriprise states their reps are not informed of all conflicts (See footnote 33).
- Full and complete disclosure and discussion of all-in costs and fees could significantly mitigate the conflicts. Fully disclosing the expected cost to the customer and payments to the rep and the firm would be helpful. Yet, it is very difficult for a commission broker to do so.

Lesser magnitude, complexity, opacity and risk. These conflicts have a far lesser magnitude, complexity and opacity. Those disclosed by Savant are examples and include recommending a related service offered by an affiliated firms. These conflicts are deemed less potentially harmful and risky.

- The conflict appears to be limited, straight forward and transparent. It is more easily understood.
- The client is not obliged to use the service provider; the adviser is not generally compensated for the referral. Yet, if the adviser is compensated, the amount is disclosed.



Least magnitude, complexity and opacity and risk. Conflicts with the least magnitude, complexity and opacity are generally associated with fee-only or independent advisors. Advisers Investments and Moneta’s conflicts are associated with this group of conflicts. Their conflicts seem to be well defined, simple, straightforward, and transparent. These appear to present the least potential harm and risk:

- Associations and other affiliations are clear, minimal and understandable, and appear to not present material conflicts.
- The fee negotiation on an hourly, fixed or AUM arrangement, (which is not an advice-related conflict incident) is completed at the outset of the engagement when the client is likely to be more on guard. This is done at a time when the adviser/client relationship has not yet formed. It is a one-off, straightforward and transparent conflict.
- Other conflicts of AUM fee-only advisors include decisions that can increase or decrease the AUM, such as whether the client should or should not pay off his/her mortgage.

The magnitude, complexity, and opacity of a conflict can be captured in a rating for a firm, rep or a recommendation. A rating that reflects how difficult conflicts are to evaluate and the potential harm or risk to the customer. Conflicts that are the most difficult to evaluate possess the greatest potential harm and risk, while conflicts least difficult to evaluate generally possess the least potential harm and risk.

The sixteen-page Ameriprise description of compensation and revenue presents conflicts with far greater potential harms and risks than does the conflict associated with evaluating advice from a AUM planner on whether to pay off a mortgage. The conflict on the mortgage is straight forward and transparent.

#### Differences among conflicts and informed consent

Differences among conflicts matter. The greater the potential harms and risks to customers the greater the challenge to obtain informed client consent. Gaining informed consent requires certain conditions be met. These include notice to the client that the fiduciary nature of their relationship is waived for this transaction, that the client is fully informed about the conflict and the client is able to consent to the transaction. This requires reasonably understanding the associated risks and providing clear and specific consent.<sup>42</sup>

This also requires dealing with behavioral biases. As finance professor and attorney, Ron A Rhoades notes, “A disclosure-based regime, must take into account academic research that reveals the substantial ineffectiveness of disclosures as a means of consumer protection.”<sup>43</sup> Still, reasonable understanding of the conflict matters.

Deborah S. Bosley, Ph.D., Founder and Principal, The Plain Language Group, LLC, underscores, “Consumer comprehension is the key measure of disclosures. Differentiating conflicts and their disclosure on the basis of consumer comprehension is common sense and better for investor protection.”

---

<sup>42</sup> Frankel, T. (2011) *Fiduciary Law*, New York, NY: Oxford University Press, at p. 200-205.

<sup>43</sup> Rhoades, R. A. (December 6, 2018) SEC Comment Letter RE: Regulation Best Interest and RE: Form CRS Relationship Summary. Available at <https://www.sec.gov/comments/s7-07-18/s70718-4728948-176763.pdf>, at p. 6.

## Discussion: Advisers Act principles

We argue that the SEC and CFP Board standards are historically important, because they cast aside the jurisprudence, key principles and common sense that shape and emanate from the Advisers Act. Two main tenets that have succumbed in the SEC and CFP standards particularly stand out. One that conflicts are a virus and “mortal threat” and, two, that sales and advice should be regulated separately. The commonsense case against these new standards is overwhelming; the legal case refuting them is compelling.

### Legal Precedent and Analysis

Legal thinking evolves. Fiduciary law, according Frankel, has existed for centuries precisely because, it can “Accommodate new situations and changes in social morals and norms, yet maintain its core values and norms, without which no society can survive.”<sup>44</sup> The rationale for the new standards does not rest on new social morals or norms. Nor does it rest on a new legal case. In fact, no legal arguments appear to be marshalled and applied to justify and explain why the principles of the SEC and CFP standards should replace the principles and tenets embedded in the Advisers Act.

Frankel succinctly describes loyalty. Koffler explains adviser/broker opposing roles, purposes and functions. Boyson suggests these differences are evident as independent advisers are exposed to fewer conflicts and have fewer fines and penalties than dual registrants. Laby takes this scenario one step further and notes that these differences must be addressed—before fiduciary duties are imposed:<sup>45</sup>

*Broker-dealers transact with their customers as principals and, when doing so, cannot readily act in their customers' best interest. Advisers are poles apart. Other than negotiating a fee, advisers typically are not in an adversarial posture with their clients and can adhere more easily to the best interest standard. These differences create a deep tension that must be addressed before imposing a fiduciary duty on brokers that give advice. (p. 32)*

### Abandoning Common Sense

The new standards also reject simple common sense. Here are three examples.

One. The new standards say conflicts are acceptable; common sense says they're not. That conflicts are okay isn't stated explicitly. It is, however, stated implicitly, clearly and loudly – despite common sense saying otherwise. The SEC explains it does not mandate eliminating any particular conflict and also notes benefits of conflicted recommendations. Meanwhile, CFP Board explains it does not encourage CFPs to avoid conflicts. The message: conflicts are very acceptable, sometimes beneficial.

---

<sup>44</sup> Frankel, T. (2011) Fiduciary law in the twenty-first century. *Boston University Law Review*, Vol. 91: 1289-1299, at p.1290.

<sup>45</sup> Laby, A. B. (2010) “Fiduciary Obligation of Broker-Dealers and Investment Advisers.” *Villanova Law Review*, Vol. 55, No. 3: p. 732. Available at <https://digitalcommons.law.villanova.edu/cgi/viewcontent.cgi?article=1050&context=vlr>.

Two. The new standards say that fees and commissions are alike; common sense says they're not. Common sense tells us that a commission is not a fee or even like a fee. In recent years, critics of fees have argued that commissions are better than fees for clients, based on a campaign of dubious claims— not new data and evidence. Instead, incentives designed to undermine objectivity have been recast as being less costly. Religion has been intoned. Fee planners are called “Holier than thou”. The campaign worked. The real and important advantages to consumers of transparent fees over opaque and conflictual commissions has been dismissed and replaced by the unsubstantiated refrain – ‘Fees have conflicts, too’.

Common sense has been bludgeoned by misleading talking points. The fact is negotiating a transparent fee at the start of a relationship and then giving advice absent ongoing commission incentives is one thing. Opaque product incentives, commission schedules and conflicted advice through the relationship is quite another thing. Yet, the new standards plant their flag on the claim that fees and commissions are the same thing.

Three. The new standards say broker and adviser conflicts are alike; common sense says they're not. In addition to Koffler and Laby, common sense tells us that brokers are not advisers. Their own ADV disclosures show just how much. Dual registrants Commonwealth, Northwest Mutual and Ameriprise describe revenue sources in lengthy detail. Meanwhile, independent adviser ADV's describe fees and revenue and business interests from Adviser Investments, Savant Capital Management and the Monet Group. They are far more limited; they are transparent. Their conflicts in business affiliations and related entities and economic impacts, if any, appear to be clear.

#### Abandoning Advisers Act Principles Matters

Abandoning Adviser Act principles matters. It's not just that the new standards rely on disclosure. Their flaw is more fundamental. Starting with that the standards replace Advisers Act thinking on “putting clients first,” transparency, and broker / adviser differences with *caveat emptor* thinking on “putting sales first,” boiler plate or confused disclosure, and contrived broker and adviser similarities.”

Then, adding what is evident in the lengthy disclosures of a myriad of incentives and complex conflicts. Disclosures that apparently will be inferred to allow or mean informed consent. Here, differences matter.

Consumers have a reasonable chance to comprehend limited, less complex and more transparent conflicts. Yet, like financial reps themselves, they cannot readily, if at all, comprehend far more complex and opaque conflicts. The problem is not consumers. The problem is complex conflicts of dual registrants were never intended to be understood by consumers. Commonwealth and Northwest Mutual conflicts are extensive. Their disclosures are fairly well-written. Yet they are also incomprehensible to consumers -- as they are to policymakers or regulators – seeking to know what they mean for them. The opportunity for a serious investor to act reasonably on the basis of these descriptions of conflicts is just about nil.

Finally, claims of fiduciary duty. The standards' chief flaw is their implicit acceptance of a brokerage suitability or sales standard, while holding out a fiduciary / best interest standard.

## Recommendations

The SEC states Reg BI, “Substantially enhances the broker-dealer standards,” so that the legal requirements are in line with “reasonable investor expectations.”

With June 30<sup>th</sup> near, a question is how regulators and adviser groups, adviser leaders and experts can offer guidance and new ways to bolster investor protections at the federal level. Guidance is needed in interpreting, applying and enforcing the standards. Here are five areas where guidance may be helpful.

- *First, mitigate or manage material conflicts.* Disclosures and general principles alone are not enough. Concrete guidance is called for.
- *Second, acknowledge and rate broad differences among conflicts.* Acknowledge that conflicts differ on the basis of their magnitude, complexity and opaqueness. Rate conflicts on the basis of these broad differences and their difficulty to be comprehended, their impact, and their potential harms and risks to customers. This may seem an unnecessarily basic procedure; however, it would contribute to the comprehension of customers, brokers and advisers alike.
- *Third, advance customer comprehension testing of conflict disclosures as the new normal.* Greater transparency in fees and expenses has already helped increase “customer comprehension” of the cost of investment advice and financial planning. Testing comprehension of conflict disclosures should parallel conflict management. Assessing the effectiveness of disclosures should not be left to subjective judgments alone. Firms themselves are uniquely positioned to lead this effort. Firms should commit to testing or affirming customer comprehension of materially conflicted recommendations.
- *Fourth, provide consumers a score card to rate brokers and advisers.* Identify key characteristics consumers should know and can ask about upfront.
- *For CFP Board, re-consider the meaning of business model neutrality.* The term accurately suggests that a fiduciary may accept a commission. However, it has been wrongly interpreted to mean a “one size fits all” approach to addressing all conflicts. This is inaccurate. It defies common sense and reveals the inconsistency of treating unlike conflicts alike. CFP Board should acknowledge that differences among conflicts and customers and clients require different approaches for addressing conflicts.

**Appendix A . Source: Ron A. Rhoades, JD, CFP®**

<b>Your Broker or Adviser should check all those applicable, in the boxes below:</b>	<b>4. WHAT TYPES OF FEES AND OTHER COMPENSATION ARE RECEIVED BY YOUR BROKER-DEALER OR INVESTMENT ADVISER? What forms of compensation might your broker-dealer (or any affiliate thereof) or investment advisor (or any affiliate thereof) receive as a result of their relationship with you?</b>
<b>FEES PAID DIRECTLY BY YOU</b>	
	Investment advisory fees paid directly by you based upon a percentage of the assets upon which advice is provided
	Investment advisory fees paid directly by you of a fixed or flat fee nature, paid either annually, quarterly, or monthly
	Investment advisory fees paid directly by you based upon hourly fees
	Investment advisory fees paid directly by you for discrete projects
<b>FEES PAID BY PRODUCT MANUFACTURERS OR OTHER INTERMEDIARIES</b>	
	Sales commissions (including but not limited to front-end sales loads for mutual fund shares, and including but not limited to front-end commissions for annuities) resulting from sales or purchases of securities, other investments, or annuity/insurance products to you
	Sales commissions in the form of deferred contingent sales charges or back-end loads resulting from selling or purchasing securities, other investments, or annuity/insurance products to or from you
	Mark-ups and mark-downs in connection with principal trading of securities (i.e., where the broker-dealer firm purchases securities directly from you, or sells securities directly to you, from the broker-dealer's own accounts)
	For any securities sold to you, compensation derived from the issuer or stocks, bonds, or other securities relating to the investment underwriting activities of the broker-dealer
	12b-1 fees paid by mutual funds to your brokerage firm, which fees last indefinitely as long as you own the fund, regardless of whether you continue to receive investment advice from us
	12b-1 fees paid by mutual funds to your brokerage firm, which fees will last for only a fixed period of time before they disappear, but which fees may continue during that period of time, regardless of whether you continue to receive investment advice
	Other than 12b-1 fees, any other form of fees or trailing commissions paid to your brokerage firm resulting from the sale of securities, other investments, or annuity/insurance products to you, which fees or trailing commissions last indefinitely as long as you own the security, other investment, or annuity/insurance product, regardless of whether you continue to receive investment advice from us
	Other than 12b-1 fees, any other form of trailing commissions paid to your brokerage firm resulting from the sale of securities, other investments, or annuity/insurance products to you, which fees or trailing commissions last for only a fixed period of time before they disappear, but which fees may continue during that period of time, regardless of whether you continue to receive investment advice from us
	Payment for shelf space received by your broker-dealer. (A shelf-space agreement occurs when a mutual fund pays this additional compensation in exchange for the broker-dealer preferentially marketing the shares of that mutual fund.)

<b>(-cont.) FEES AID BY PRODUCT MANUFACTURERS OR OTHER INTERMEDIARIES</b>	
	Marketing support payments paid by product manufacturers or intermediaries to your broker-dealer or investment adviser arising from the sales of securities or annuity/insurance products to you
	Other revenue sharing payments paid by product manufacturers to your broker-dealer or investment adviser
	Fees and/or commissions resulting from sales of securities for which your broker-dealer acts as underwriter or as part of an underwriting group
	Any other fees and/or commissions received for referrals by your broker-dealer firm of you to any other product or service provider that are not set forth above
	Receipt by your broker-dealer of payments for order flow from other brokerage firms (including but not limited to market makers) (these compensation payments benefit a brokerage firm for directing orders to different parties for trade execution)
	Receipt by your brokerage firm of soft dollar compensation received from managed accounts (including but not limited to mutual funds). Note that Section 28(e) of the (federal) Securities Exchange Act of 1934 discretion with respect to an account shall not be deemed to have acted unlawfully or to have breached a fiduciary duty under state or federal law solely by reason of his having caused an account to pay more than the lowest available commission if that person determines in good faith that the amount of the commission is reasonable in relation to the value of the brokerage and research services provided.
	Other than as previously described, any receipt by your broker or investment adviser of access to software, research, trading software, practice management and/or investment education (though attendance at conference, via webinars, written materials, or otherwise), or other support services from any other brokerage firm, custodian, or product manufacturer.
	Any other forms of revenue sharing or other payments, paid by product manufacturers or intermediaries, to your broker-dealer or investment adviser arising from the sales of securities, other investments, or annuity/insurance products to you, other than as previously described: <i>(Broker-dealer and/or investment adviser: adequately describe such forms of revenue sharing or other payment arrangements, in the space set forth below):</i>