From http://www.marottaonmoney.com/new-sec-advice-rule-abandons-fiduciary-standard-for-brokers/

New SEC Advice Rule Abandons Fiduciary Standard For Brokers

by David John Marotta on April 26, 2018

Securities and Exchange Commission Continues To Ignore Enforcing The Law

The Securities and Exchange Commission (SEC) released another thousand pages of proposed standards which again fail to require a fiduciary standard of care on commission-based brokers posing as investment advisors. For proponents of more government regulation, this is an embarrassingly poor document that will do more harm than good.

We were very critical of the Department of Labor's Fiduciary Rule as an effort to water down a fiduciary label such that it fits universally onto every so-called advisor. We are equally critical of what the SEC has just released which has been described as a watered down version of the Department of Labor's attempt.

For years the SEC had been allowing broker-dealers posing as investment advisors to be exempt from fiduciary requirements. This became known as the "Merrill Lynch rule."

In 2007, the Financial Planning Association sued the SEC for not enforcing the law and won. You would think that losing the lawsuit would mean that the SEC would start enforcing the law and require that everyone register. However, you would be wrong. For the past decade now, the SEC has been delinquent on fulfilling the instructions of that court order. It is difficult to have any respect for a government agency whose sole purpose is to uphold securities and exchange law that fails to uphold the law for 77 years, loses a lawsuit asking them to enforce the law, and still fails to enforce the law for another decade.

And yet the SEC continues to pretend that additional required disclosures will protect consumers. Or perhaps the SEC is so influenced by commission-based agents and brokers that they can't be trusted to do the right thing for consumers. They may simply be another government agency suffering regulatory capture by the industry they are supposed to regulate. Instead of any substantive action, they put additional compliance burdens on smaller fee-only fiduciaries while substituting meaningless disclosures for any real fiduciary duties for broker-dealers.

Disclosures Don't Protect Consumers

The SEC has a long history of allowing Brokers to pretend to be advisors and substituting additional regulatory filings for any real fiduciary standard.

First, the SEC required Form ADV on which registered advisors were required to disclose information about their business and compensation. One check box of this form could have been sufficient for consumers to avoid so-called advisors who also accept compensation in the form of commissions based on the products they sell. Then in 2011, the SEC began requiring Form ADV Part 2. Instead of using a checkbox format, Part 2 requires advisors to write a "plain English" narrative of twenty topic areas. Our firm's ADV Part 2 is currently 25 pages. Among other things, our ADV Part 2 explains the practices we don't engage in and why we believe they are not in the best interest of clients. We also explain some of the mystifying rules of the SEC and why they neither protect consumer nor make sense in the industry. We give our ADV Part 2 to any prospective clients as part of our initial conversation.

Part of my job as Chief Compliance Officer is to strive to understand and then comply with regularly changing requirements. Some requirements are difficult to understand. Others are strange and unique. Even some of the best firms do not comply with all the regulations. These regulations are a burden to smaller firms, and often do not permeate to the advisors of larger firms. The SEC estimates that "the average annual cost and hour burden for investment advisers to complete, amend, and file all parts of Form ADV are $6,051 and 23.77 hours." This estimate must assume paying a consultant for their hundreds of hours of experience. As Chief Compliance Officer in the firm, I believe that delegating compliance to an outside consulting firm results in not understanding the complexities of what is required to comply. As a result, I spend at least 100 hours a year, mostly on understanding what is required as a prerequisite to the hours actually executing the many required reviews, record keeping, form updating, and staff training which actually comprises compliance. I've spent more than 24 hours just writing about inadequate fiduciary rules proposals.

Now the SEC is proposing to add a Form ADV Part 3 to the list of required documents that firms are responsible to complete every year.

According to the SEC, this new Form ADV Part 3 will disclose to investors "a relationship summary, which would provide these investors with information about the relationships and services the firm offers, the standard of conduct and the fees and costs associated with those services, specified conflicts of interest, and whether the firm and its financial professionals currently have reportable legal or disciplinary events."

Disclosures don't work. We currently have massive disclosures and yet consumers still don't understand the difference between "fee-based" and "fee only". According to the SEC "more than two-thirds believed that a fiduciary duty is owed to customers by broker-dealers." Such as duty ought to be required by the Investment Advisers Act of 1940, but the SEC refuses to enforce that legislation.

"Best Interest", Whatever That Means

In the SEC's latest proposals they propose a "Best Interest" regulation which is never defined and then admit:

An investment adviser is a fiduciary, and as such is held to the highest standard of conduct and must act in the best interest of its client. Its fiduciary obligation, which includes an affirmative duty of utmost good faith and full and fair disclosure of all material facts, is established under federal law and is important to the Commission's investor protection efforts. The Commission also regulates broker-dealers, including the obligations that broker-dealers owe to their customers. …

An investment adviser's fiduciary duty is similar to, but not the same as, the proposed obligations of broker-dealers under Regulation Best Interest.

Financial Advisor Magazine summarized the lack of teeth to the new "Regulation Best Interest" when it quote Commissioner Stein:

One of the most outspoken critics is Democrat Commissioner Kara Stein, who called "Regulation Best Interest" the "Regulation Status Quo" because of its failure to institute a fiduciary standard for B-Ds or even define what "best interest" is.

"One might say the emperor has no clothes," said Stein, who voted against releasing the three SEC proposals. "For at least the last decade, investors have been asking for some type of fiduciary duty. The proposal today squandered the opportunity for us to act in retail investors' best interests."

Stein said the SEC's failure to create a fiduciary standard for brokers was particularly painful after listening week after week to SEC examiners report back on findings of broker fraud.

"Does this regulatory proposal require B-Ds to put their investors interest first? No," Stein said. "Does this proposal require all financial professionals to do so as fiduciaries? No. Does this proposal require brokers to provide retail investors with the best available investment options? No."

Bob Veres writing about the new SEC ruling explains the politics this way:

When it became clear that the SEC was considering a "fiduciary" rule which would resemble the existing suitability standard, fiduciary advocates were forced to abandon their hope of forcing brokers to act as fiduciaries.

The inevitable alternative was too damaging to consider. The brokerage industry was powerful enough to emasculate and co-opt the term "fiduciary," defining it as the suitability standards they currently operate under, and thereby allowing brokers to do an even better job of posing as advisors.

The SEC proposal uses the term "best interest," preserving "fiduciary" as a distinction for fee-only and SEC-registered professionals. This is a victory for real fiduciary planners, who can maintain a meaningful competitive distinction in the marketplace.

Some, like Veres, are touting this SEC proposal as a win for consumers or actual fiduciaries but I don't see how anything has changed for the better. The industry and the legal and regulatory environment is still captured by the approximately 88% to 93% of so-called investment advisors who accept commissions and, despite their obvious conflict of interest, still want to mask as an objective advisor.

Perhaps there is a distinction between "acting in the consumer's best interest" and "fiduciary" but there is no legal nor SEC definition of "best interest." I am certain that such a confusing distinction will be lost on the consumer. I would rather have categories making a distinction between "fiduciary and "non-fiduciary" than between "fiduciary" and "best interest." Given the lack of understanding of what it means to be a fiduciary, I think consumers will choose "best interest."

Consumers don't understand the difference between different types of so-called financial advisors. As [Mark Schoeff Jr. writes for InvestmentNews](#):

Advisers must meet a fiduciary standard that requires them to act in their clients' best interests. Brokers meet a suitability standard that requires them to sell products that meet a client's objectives and risk appetite but also allows them to recommend investments that give the broker the biggest fee or commission.

"No doubt there's a great deal of confusion in the marketplace as to what standard of conduct applies to a particular relationship," Mr. Clayton said.

Consumers also don't understand the harm done by brokers with conflicts of interest. One estimate puts the annual harm at $17 billion.

Barbara Roper, director of investor protection at the Consumer Federation of America said "The $64,000 question — or the $17 billion question — is whether the standard of conduct they propose is sufficient to reform harmful broker-dealer business practices."

The $17 billion to which Ms. Roper referred is the amount of investor harm caused annually by broker conflicts when working with customers in retirement accounts, according to an Obama administration study.

Advisor, Adviser, Manager, Counselor, Consultant, Expert, Director, Guide, Mentor

The SEC understands the confusion of salespeople posing as financial advisors. In one of their documents they wrote:

Specifically, we believe that certain names or titles used by broker-dealers, including "financial advisor," contribute to retail investor confusion about the distinction among different firms and investment professionals, and thus could mislead retail investors into believing that they are engaging with an investment adviser – and are receiving services commonly provided by an investment adviser and subject to an adviser's fiduciary duty, which applies to the retail investors' entire relationship –when they are not. Additionally, broker-dealers and investment advisers, and the financial professionals that are associated with them, currently engage in communications with prospective or existing retail investors without making clear whether they are a broker-dealer or an investment adviser, which can further confuse retail investors if this distinction is not clear from context (whether intentionally or not).

The SEC's solution is to restrict the terms "advisor" and "adviser" and not allow those terms to be used of broker-dealers. This sounds reasonable until you look at the plethora of titles currently being used by financial services professionals. In our firm we use the title "Wealth Manager" to show that we don't simply give advice that clients then have to implement but instead implement the strategies for them. We think the term "Manager" shows that as a fiduciary we can manage a client's investments on their behalf rather than a salesperson who would continually need to come back for permission to buy and sell.

Even if you force the industry to change their vocabulary, it won't change their desire to market whatever term they are forced to choose.

If the ban on brokers using the term "Advisor" is actually implemented, I would expect a new term to arise such as "Relationship Manager" complete with an ad campaign "You deserve your own Relationship Manager, not just an Advisor."

How much of that $17 billion are you being gouged?

This latest set of regulations from the SEC illustrates how government regulation is not the answer. Having failed to enforce the Investment Advisers Act of 1940, and having failed to abide by the court ruling a decade ago, the SEC has little to say in their latest document.

Being able to gouge consumers $17 billion is a large incentive for the commission-based financial services industry to continue confusing consumers and swaying regulatory agencies like the SEC to manufacture spiffy new marketing terms such as "best interest."

The SEC has been swayed to allow salespeople pretending to be financials advisors who:

1. Are allowed to act in their own best interests
2. Are allowed to receive commissions based on the products they recommend you purchase
3. Are not required to have any training
4. Are not dedicated to offering any more than sales advice

While consumers as a rule are fooled, you don't need to be. You are now an informed consumer who can insist on only working with:

1. An advisor who is legally obligated to act as a fiduciary
2. A fee-only advisor who refuses to take any commissions
3. An advisor who holds the CFP® mark
4. An advisor who offers comprehensive financial planning

Members of the National Association of Personal Financial Advisors (NAPFA) satisfy all of these criteria.

From http://www.marottaonmoney.com/sec-isnt-enforcing-the-law/

SEC Isn't Enforcing The Law

by David John Marotta on April 23, 2018

For years the SEC had been allowing broker-dealers posing as investment advisors to be exempt from fiduciary requirements under what came to be known as the "Merrill Lynch rule." However, in 2007, the Financial Planning Association sued the SEC for not enforcing the law and won.

James Watkins reports in "Investors and Pension Plan Participants Deserve Better Protection":

In 2007, the Financial Planning Association won a lawsuit that it filed against the SEC to force them to enforce the registration provisions of the 1940 Investment Advisors Act against Merrill Lynch. In an attempt to resolve the dispute, the SEC had proposed the following disclosure in lieu of registration:

Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits and our salespersons' compensation may vary by product and over time.

Once the court ruled against the SEC, the SEC withdrew the disclosure requirement. Despite subsequent calls for bringing back the disclosure to address current conflict of interest issues plaguing the investment industry, the SEC has not done so. Given the fact that the SEC has already approved the quality of the disclosure, one would think the SEC would simply re-institute the disclosure requirement to at least educate and warn the public, which would clearly be in furtherance of the agency's mission statement. And yet, for some reason, the SEC refuses to take this simple and much-needed step.

You would think that losing the lawsuit would mean that the SEC would start enforcing the law and require that everyone register. However, you would be wrong.

As a 2012 article entitled "On 5th Anniversary of FPA's Win on 'Merrill Rule,' Fight Continues" reports:

Thompson says financial planners and FPA members continue to bring up the suit with him. "There was a lot of frustration" among planners, he recalled, over not getting the SEC to "listen to the financial planner's viewpoint, not just Wall Street's." He says that while the successful suit led to much in the way of positive feelings "at least on the financial planner side, it also exacerbated and polarized feelings" between the broker-dealer and the investment advisor communities.

Recalling some uncertainty at the FPA over the wisdom of suing the SEC, Thompson says "it was a major decision" for FPA's board "to come to grips with the idea." Then as now, the FPA was composed primarily of "small-businesspeople," and among such people, " a lawsuit is the last thing you want to do." By contrast, in the securities industry and among some other associations, filing suits "is a standard tool in the quiver of many associations." …

Thompson argues that filing suit against the SEC, while risky, was also a "perfect forum" for a group like the FPA, which was "always outgunned in terms of lobbying and resources" but in court had, as other advocacy groups have, a "level playing field."

In other words, it took a lot of frustration to even bring the mom-and-pop-shop advocates in the Financial Planning Association to bring suit and the SEC seems to be ignoring the fact they lost.

As you can read in the 2017 "The FPA Victory Over The SEC, 10 Years Later":

Since the Financial Planning Association's victory, the SEC has failed to create a single, inclusive best-interest rule to protect investors. Brokers are still not subject to an SEC-mandated fiduciary standard when they sell asset-based accounts, despite the industry's move toward asset-based fees. …

At the heart of the matter is a question: Who is (and who isn't) an investment advisor? The Investment Adviser's Act has an explicit fiduciary rule requiring an investment advisor to always act in a client's best interest, while the law and rules governing brokers allow them to choose an investment that is merely good enough for a client, even if it pays a higher commission and costs more than other investments better suited for the client. …

Without the equal application of fiduciary "best-interest" standards to every type of broker who charges fees for advice and products, it's "caveat emptor for investors," Moisand says. "There's a place for that, just not in an office where someone is holding themselves out as a trusted advisor."

He says his firm does hear from clients who mention a fiduciary standard from time to time, "but we also still see investors who have worked with brokers and have no idea that their entire retirement portfolio is invested in annuities that cost them as much as 5% annually. Sometimes, to make matters worse, the broker has put the annuities inside an IRA." …

What is his ETA for a comprehensive fiduciary rule that would apply to advisors and brokers alike charging fees for advice? "It was 1940," quips Moisand, referencing the year the Investment Advisers Act of 1940 was enacted.

Whether you think the SEC is ten years delinquent on their enforcement of fulfilling the court order or 77 years late on enforcing the law, you should not look to the SEC to protect you from commission-based sales people. Even the Department of Labor's attempt at a Fiduciary Rule is fraught with exceptions to allow the commission-based world to pretend to offer advice and gouge clients with fees.

The simplest way to ensure that your financial advisor's advice will not be tainted by their own interest to get paid a commission is to work with a financial advisor which refuses to accept any commissions. There is a name for that: "fee-only." And there is an organization whose membership requires them to be fee-only and offer comprehensive financial planning: The National Association of Personal Financial Advisors (NAPFA).

There are, unfortunately, very few comprehensive fee-only financial planners in the country. Currently there are only about 3,000 NAPFA members out of about 77,000 of those with the CFP designation and 275,000 Investment Advisor Representatives registered in various states.

Although it is possible to be fee-only without being a member of NAPFA, it is not likely. My estimate is that at least 93% of the financial services world is comprised of commission-based individuals and that most of the financial services world primarily provides investment advice. Comprehensive financial planning is very difficult and time consuming, but it can also bring a greater value than investment-only advice.

You deserve a fiduciary standard of care. Government legislation has failed to enforce that standard since 1940 despite there being a law requiring it. Even successfully suing the government to enforce their own laws has failed for a decade. It is up to you to choose a fee-only fiduciary offering comprehensive financial planning.

From http://www.marottaonmoney.com/department-of-labors-new-fiduciary-ruling/

Department of Labor's New Fiduciary Ruling

by David John Marotta and Megan Russell on April 17, 2016

The Department of Labor (DOL) announced last week a new fiduciary rule. The DOL's rule would supposedly impose a fiduciary standard on every advisor providing advice about retirement accounts.

A fiduciary is an individual who has a legal obligation to act in a client's best interest, to do what the client would do if they had the professional's time and expertise. It is a very high moral standard.

However, the fiduciary standard is principle-based and cannot be made rules-based.

The fiduciary standard is like the golden rule: do unto others as you would have others do unto you. We cannot define a set of golden-rule-approved behavior and a set of golden-rule-rejected behavior. Each situation calls for a slightly different response and the high moral principle of the standard must guide you.

"Don't push your sister," may work in 99% of cases as an interpretation of the golden rule, but when the TV is falling on your sister, the golden rule would have you push her out of the way. In this manner, you can see how a principle-based standard creates better behavior.

And yet the DOL's final rule consists of 208 pages of rules and regulations where they try to define fiduciary-approved and fiduciary-rejected behavior.

In other words, the DOL's ruling took steps to reduce the high moral fiduciary standard to a lower rules-based standard.

Sadly, a rules-based fiduciary standard has already been what guides the majority of so-called financial advisors, because the financial services industry is divided into two groups.

The first group consists of commission-based agents and brokers of large financial organizations regulated by the Financial Industry Regulatory Authority (FINRA), a private corporation that acts as a self-regulatory organization. This group comprises about 88% of the financial services professionals, and they largely operate under rules-based fiduciary standard interpretations.

The other group consists of fee-only fiduciaries who work as part of independent registered investment advisory (RIA) firms. This group comprises about 12% of financial services professionals, and they largely operate under principles-based fiduciary standard interpretations.

Both groups are ultimately regulated by the Securities and Exchange Commission (SEC).

Sadly for the potentially good intentions of the DOL, any legislation which can include FINRA's commission-based advisors will dilute what it means to be a fiduciary.

What the DOL did to the term fiduciary is the same as what the United States Department of Agriculture (USDA) did with the term "certified organic." The organic rules contain many questionable practices, and the legislation was widely criticized by proponents of organic food. The USDA legislation is rules-based and allows terrible practices to be labeled "organic" without abiding by the principles of what it means to be organic.

We can thank a rules-based interpretation for the fact that something is "certified organic" simply because it complies with the USDA rules that the amount of ingredients with synthetic additives like pesticides, chemical fertilizers, and dyes or that were processed using industrial solvents, irradiation, or genetic engineering is less than 5% and on an approved list worked out with the food lobbyists.

In the same way, any legislation which can include FINRA's commission-based advisors will dilute what it means to be a fiduciary.

The DOL themselves admitted that they compromised the fiduciary standard they hoped to implement by "publishing new exemptions from ERISA's prohibited transaction rules" in order to "provide conditional relief for common compensation, such as commissions and revenue sharing." This specifically relieves commission-based agents and brokers from bans against a practice which is outright illegal in other countries.

The DOL also created a new exemption for "principal transactions" in which advisers sell from their own investments. This practice is known as self-dealing and all true fiduciaries should avoid it.

For the first time, the DOL ruling "explicitly states that proprietary products such as fixed index annuities and variable annuities can be recommended by advisors who won't have to tell clients about similar investment offered by competitors."

None of this is good for consumers.

The fight within the industry is over who gets to use the fiduciary label. Fee-only fiduciaries have tried to make sure that the distinction between brokers and advisors is clear. But most of the industry is not willing to concede the distinction and actively seek to blur the line and cloud the issues.

Most people who call for greater financial regulation and oversight do not understand how much harm that legislation would and does cause. Each regulation passed is used by the commission-based agents and brokers to dilute the definition of what it means to be a fiduciary.

Large financial corporations have large multi-staff compliance departments whose job it is to craft the appropriate paperwork to satisfy the regulators while the front line sales staff lives off commissions.

Small ensemble firms who act like fiduciaries have to take time out of their day of serving clients to fill out the meaningless paperwork which does little to serve or protect client interests.

In the end the DOL's rulemaking is a stack of paperwork which requires financial professionals to produce more paperwork. All that paperwork will be meaningless for those who are fiduciaries and a hypocritical marketing stunt by those who are only "certified fiduciaries."

For this reason, we oppose the efforts to water down a fiduciary label such that it fits universally onto every so-called advisor.

If consumers want a strictly fiduciary advisor, they should seek out a member of the National Association of Personal Financial Advisors (NAPFA) in their area. NAPFA requires a principles-based fiduciary oath which no commission-based agent would be able to sign.