

The
Committee
for

THE FIDUCIARY STANDARD

The Outlook for the Fiduciary Standard in Washington

Bullish, Bearish? A Report on the Status of Fiduciary Status

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The Committee for the Fiduciary Standard

www.thefiduciarystandard.org

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A Step Back: Why Dodd-Frank Matters to Investors

- **“The Financial Crisis and the History We now Share.”**

- + Moments in history: Kennedy assassination, Nixon resignation, 9-11, Lehman bankruptcy

- + The Financial Crisis Inquiry Commission Report

- “We conclude there was a systematic breakdown in accountability and ethics.”*

- “.. An erosion of standards of responsibility (resulted in) damage to the trust of investors, businesses and the public in the financial system....”*

What we Will Cover Today

- The Language of the Fiduciary Discussion in Washington
- An Overview of Why Dodd-Frank Matters to Investors
- The ERISA Meaning of *Fiduciary*
- Bullish or Bearish? The Fiduciary Movement and the Birth of a Nation?

The Language of the Fiduciary “Discussion” In Washington

- **The “Don” Running for President**
- **Teenagers**
- **'When I use a word,' Humpty Dumpty said, in rather a scornful tone, 'it means just what I choose it to mean — neither more nor less.'**

A Step Back: Why Dodd-Frank Matters

- **2010, 2011 Dodd – Frank Legislation and rulemaking is historic.**
- **Material differences separate the commercial / suitability and fiduciary standards.**
Core difference: advice that is required to be in the best interest of investors versus advice that is generally permitted to be in the best interest of the advisor.
- **Material Differences Matter.** Products in investors' best interest and to control investment expenses can help improve investor savings. One percentage point in fees over 35 years becomes the difference between a nest egg of \$227,000 versus \$163,000 (Assistant Secretary at the U. S. Department of Labor, Phyllis Borzi. 1)

A Step Back: Why Dodd-Frank Matters

The fiduciary standard can help restore investor trust in Wall Street.

- **The trust deficit.** The Chicago Booth and Kellogg School quarterly Financial Trust Index shows between December 2008 and December 2010, investor trust in the stock market increased just 5 percentage points, from 11% to 16%. “Not trusting” index was reduced just marginally, from 89% to 84%.
- **Former SEC Chairman Arthur Levitt.** “By... taking action on a critical need, the SEC builds the investors’ confidence that someone is looking out for them which, in turn, builds market trust.”

The SEC Staff should be Applauded for Producing a Study Calling for a Uniform Fiduciary Standard “No Less Stringent than Currently Applied to Investment Advisers”

- Study reflects a keen understanding of the differences between the suitability and fiduciary standards.
- Study emphasizes twin fiduciary duties of due care and loyalty.
- Study calls for a best interest standard of conduct “without regard to the financial or other interest” of the advisor.
- Study recommends the Commission could consider prohibiting certain conflicts.
- Study provides analysis questioning the basis for some concerns that harmonizing the standards will increase investor costs or limit product choices.
- Study is a bold blueprint that sets an excellent direction for future rulemaking.

Key Questions Will Only be Answered in Rulemaking

- **Business-model neutral.**

- What does “business-model neutral” mean?

- Dodd-Frank: a commission-based or proprietary product “in and of itself” does not violate the uniform standard, and that the scope of the fiduciary engagement may be appropriately limited such to not require on-going monitoring.

- Whether an accommodation to any business model is permitted should depend on the accommodation’s effect on the client’s best interest. These reasonable limits do not, in and of themselves, place an advisor’s interest ahead of the client’s interest.

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Key Questions Will Only be Answered in Rulemaking

The Advisers Act and conflicts of interest.

Quoting from an SEC report, the Supreme Court noted in *SEC V Capital Gains Research Bureau*:

“The report reflects the attitude – shared by investment advisers and the Commission – that investment advisers could not “completely perform their basic function – furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments – unless all conflicts of interest between the investment counsel and the client were removed. 16”

Key Questions Will Only be Answered in Rulemaking

• Chairman Schapiro on “challenges” in debate, investor “experiences”:

“One of the challenges presented in this debate is how to impose a meaningful uniform fiduciary standard of conduct on BDs and IAs, considering the various business models... In addition, we need to keep in mind the ultimate goal is to enhance retail investor experiences, not deprive them of choice.” * (Emphasis added.)

• Fortune 500 Company on customer “experiences”:

It is the responsibility of employees ... “to help customers enjoy the highest quality experience we can provide.”

Key Questions Will Only be Answered in Rulemaking

- The SEC and conflicts of interest.

Prior Opinion of SEC Staff:

“We do not agree that an investment adviser may have interests in a transaction and that his fiduciary obligation toward his client is discharged so long as the adviser makes complete disclosure of the nature and extent of his interest.... The adviser must have a reasonable belief that the entry of the client into the transaction *is in the clients interest.*” * (Emphasis added.)

* Rocky Mountain Financial Planning Inc., Feb. 28, 1983

Key Questions Will Only be Answered in Rulemaking

- **The SEC study and conflicts of interest.**

The SEC study:

“While the duty of loyalty requires a firm to eliminate or disclose material conflicts of interest, it does not mandate the *absolute elimination* of any particular conflicts, absent another requirement to do so.” (Emphasis added.) Further, “The staff believes that it is the firm’s responsibility – not the customers – to reasonably ensure that any material conflicts of interest are fully, fairly and clearly disclosed *so that investors may fully understand them.*” (Emphasis added.)

Key Questions Will Only be Answered in Rulemaking

. **“Best interest” means “Best interest.”** Established practices require a fiduciary advisor to fully disclose unavoidable conflicts, mitigate the conflict, attain informed consent from the client to proceed with the transaction, then affirm that proceeding with the conflict remains in the client’s best interest.

“Disclosure” alone does not mean “Best interest.” Merely disclosing a conflict and then proceeding with the transaction based on client “affirmation” effectively delegates the fiduciary duty from the advisor to the client. This delegation turns fiduciary duty upside down; it makes the client *responsible* for the advisor's recommendation and the advisor *not* responsible for his/her own recommendation.

Key Questions Will Only be Answered in Rulemaking

• **The heart of fiduciary duty.** In his October 2008 testimony before the Senate Banking Committee former SEC Chairman Arthur Levitt stressed that rigorous enforcement is vital because it “holds people accountable” and is “the most powerful tool a regulator has to keep a market functioning.”

Holding advisors solely responsible – or accountable – for their recommendations is, likewise, at the heart of maintaining a meaningful fiduciary duty.

1. Testimony before Senate committee on Health, Education, Labor and Pensions, October 7, 2010.

2. Testimony before Senate banking Committee, October 15, 2008.

The ERISA Meaning of *Fiduciary* Rule

The ‘Definition of Fiduciary Proposed Rule’ proposed rule, “Would protect beneficiaries of pension plans and individual retirement accounts by more broadly defining the circumstances under which an individual is considered to be a ‘fiduciary’ reason of giving investment advice to an employee benefit plan or a plan’s participants...

The proposed rule takes account of significant changes in both the financial industry and the expectations of plan officials and participants ... (and) is designed to protect participants from conflicts of interest and self-dealing...”.

The ERISA Meaning of *Fiduciary* Rule has Attracted Significant Opposition from the Industry

- + The industry generally expresses concerns about costs and choice, drawing sharp lines between advice and sales and education, DOL not coordinating with the SEC, and in some cases, broadening the reach of the ERISA fiduciary at all
- + The industry generally favors using more disclosure
- + The DOL appears determined to maintain the unique and high standard of ERISA

The Committee Generally Supports the Rule ... Committee Comment letter: *

- History of and purpose for fiduciary status based on information asymmetry -- the fundamental unequal positions of the expert advisor and investor
- Industry concerns of increased costs have not been supported with independent and credible data and analysis
- Sales exemption should only be permitted if client signs a written statement of “informed understanding” of the advisor or broker’s conflicted advice
- Disclosure alone, as advocated by industry reps, negates the very purpose of fiduciary status

The Committee Generally Supports the Rule... Industry Reps advocate That Disclosure Alone Can Fulfill Fiduciary Duty to Handle Conflicts

- “Whether its in the investment or any other part .. of their daily lives.. we have operated our markets very much on the basis of a disclosure regime.” *
- “We live in a world which is full of business relation conflicts, and that in our every day life, we’re engaging in a variety of transactions... And I don’t think this is really all that different, and I actually have faith in the American consumer here... that a consumer can make an informed decision.” **

In Sharp Contrast, Chairman Schapiro has expressed strong support for the Fiduciary Standard

“The standard of conduct that applies to giving professional advice to investors should not be a watered-down, “fair and reasonable” commercial standard. In order to be consistent with the reasonable expectations of investors, the standard that applies to this activity, which is so integral to investors financial security, must be the type of fiduciary standard that applies to a relationship of trust and confidence.” *

Why the Fiduciary Bulls May Reign

- History, from Lexington Green to Cairo
- Technology, from cell phones to blackberries and Skype
- Reputational risk, from a former New York governor to the Oracle of Omaha
- The fiduciary movement grass roots

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Thank you!

Knut A. Rostad, Chairman

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