The Weakened Fiduciary Standard in 2013 in Regulatory Rulemaking and the Public Square

How we Got Here, How We Can Reverse Course

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www.thefiduciaryinstitute.org

INSTITUTE FOR THE FIDUCIARY STANDARD

The Weakened Fiduciary Standard in 2013

- Where we started: 2008 – 2009
- Where we arrived: 2010 – 2013
- Why we lost, why we can win
- Challenges and Opportunities

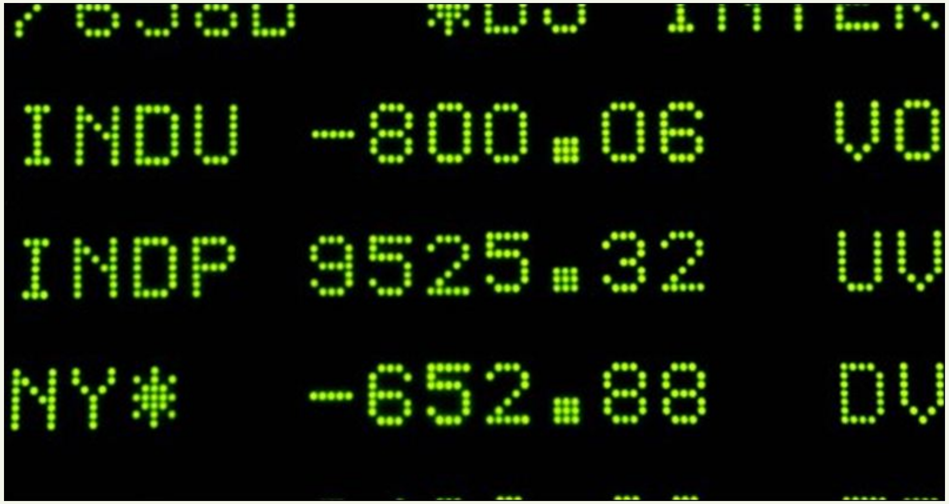
September 2008

- 15 – Lehman Brothers files for bankruptcy; Dow declines 504 points
- 16 – $85 billion AIG bailout
- 17 – Money market funds lost $144 billion; Dow declines 449 points
- 24 – McCain suspends presidential campaign
- 29 – Senate rejects bailout;

  Dow declines 778 points

October 2008

- 6 – 370 point decline to close below 10,000 first time since 2004
- 13% Dow decline for the month
- 240,000 jobs lost



November 4, 2008

- Overwhelming electoral win: 365 to 173
- The historic nature of 2008
- With control of the Whitehouse, the largest margins of Democratic representation in House and Senate since Johnson presidency (except for first two years of Carter Administration.)
- Historic level of Democratic control in Washington

2009

"New legislation should bolster investor protections and bring important consistency to the regulation of these two types of financial professionals by … requiring that broker-dealers who provide investment advice about securities to investors have the same fiduciary obligations as registered investment advisers…

-Financial Regulatory Reform

"A New Foundation: Rebuilding Financial Regulation and Supervision", June 17, 2009

"The Fiduciary Duty Means…"

"The fiduciary duty means that the financial service provider must at all times act in the best interest of customers or clients. In addition, a fiduciary must avoid conflicts of interest that impair its capacity to act for the benefit of its customers or clients. And if such conflicts cannot be avoided, a fiduciary must provide full and fair disclosure of the conflicts and obtain informed consent to the conflict."

-Mary L Schapiro, Chairman, SEC, June 18, 2009

"More Than Mere Honesty and Good Faith"

"A fiduciary owes its customers and clients more than mere honesty and good faith alone. A fiduciary must put its clients' and customers' interests before its own, absent disclosure of, and consent to, conflicts of interest."

-Mary L Schapiro, Chairman, SEC, June 18, 2009

July 2010
Dodd Frank Legislation

- "…. To protect consumers from abusive financial services practices…"
- Requires SEC to study BD, IA regulation
- Permits (does not require) SEC to proceed with rulemaking to enact a uniform fiduciary standard for both BDs and IAs
- Such uniform standard must be "No less stringent than the standard applicable to investment advisers under section 206(1) and (2) of this Act"
- Permits commissions and proprietary products

October 2010

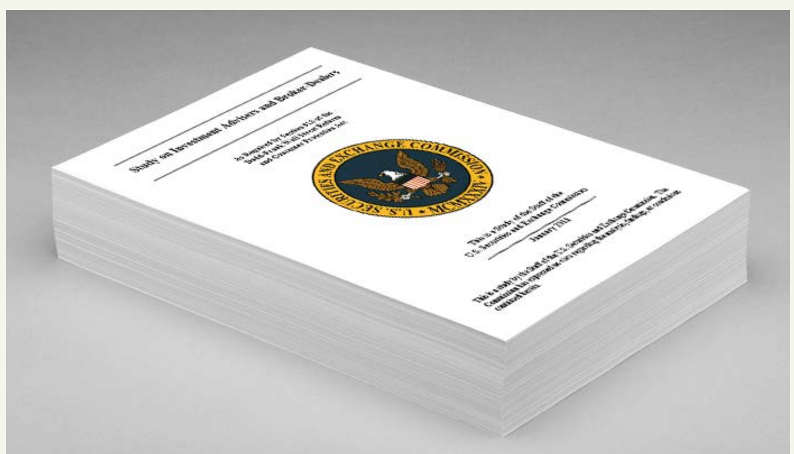
DOL Proposed Fiduciary Redefinition Rule

- To update the definition of “fiduciary” … to mean “a person who provides investment advice to plans for a fee or other compensation”
- The five-part test … advice must be “given on a regular basis” and an understanding that the advice would be “the primary basis for the investment decision.”
- This means infrequent advice “however flawed or conflicted is seldom actionable” by DOL.

January 2011

SEC Staff Study on Investment Advisers and Broker-Dealers

- Written by Staff, not a statement of the Commission
- Sets out background and case for a "uniform fiduciary standard"
- Two Commissioners expressed opposition to uniform fiduciary standard



March 2011

DOL Public Hearing

- DOL staff and industry face off in public hearing
- Industry criticisms aired
- Assertions: DOL has not demonstrated need, Rule will reduce investor "choice," increase costs for firms and force firms to abandon small investors
- Industry candid about its advocacy of commercial sales standard as opposed to the fiduciary standard

March 2011

DOL Public Hearing

"Whether its in the investment or any other part … of their daily lives, of – and you know, we have operated our markets very much on the basis of a disclosure regime and in agreements between two parties."

-Kenneth Bentsen, Acting President and CEO, SIFMA

March 2011

DOL Public Hearing

"We live in a world that is full of business relation conflicts, and that in our every day life, we're engaging in a variety of transactions, whether it's for a product or a service. And I don't think this is really all that different, and I actually have faith in the American consumer here and… that with good disclosure on what their fees might be and contractual arrangements around what their services are being provided, that a consumer can make an informed decision."

-Charles Nelson, President, Great Western Retirement

July 2011
SIFMA SEC Comment Letter*

- Industry argument: Uniform fiduciary standard (UFS) must be “business model neutral.” This means:
  - Investment Recommendation: all products available today should be available under UFS
  - Conflicts: encouraged, can be good for investors
  - Disclosure: must be efficient for firms
  - Scope of Obligation: fiduciary duties can be waived by contract, disclosure
  - Controlling Investment Costs: silence

*“Framework for Rulemaking,” Securities Industry and Financial Markets Association (SIFMA) to the Commission, July 14, 2011 letter. http://www.sifma.org/issues/item.aspx?id=8589934675

August 2011

Wall Street Journal Editorial

THE WALL STREET JOURNAL.

REVIEW & OUTLOOK | August 12, 2011

The Borzi Savings Bomb

An Obama appointee concocts a fictional crisis that will have real costs.

When it comes to new regulation, the Obama Administration has impeccable timing. Just as Americans are worrying about how much is left in their 401(k)s, the Department of Labor has decided it wants to reduce the plethora of options that we have for retirement accounts.

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September 2011

DOL Pulls Rule

News Release - For Immediate Release: September 19, 2011

US Labor Department's EBSA to re-propose rule on definition of a fiduciary

Additional time ensures strongest possible protections for retirement savers, business owners

"WASHINGTON – The U.S. Department of Labor's Employee Benefits Security Administration will re-propose its rule on the definition of a fiduciary. Consistent with the president's January executive order on regulation…

2012

- March comment letter from friends of fiduciary
- April Comment letter to SEC from Institute for the Fiduciary Standard

2013

March SEC release and call for information

SEC Seeks Information to Assess Standards of Conduct and Other Obligations of Broker-Dealers and Investment Advisers

FOR IMMEDIATE RELEASE, 2013-32

Washington, D.C., March 1, 2013 — The Securities and Exchange Commission today published a request for data and other information to assist the agency in considering whether to make new rules about the standards of conduct and regulatory obligations for broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers.

Institute for the Fiduciary Standard
Analysis of SEC Release

Assumptions regarding a possible uniform fiduciary standard and the duty of loyalty:

1. Restricts what communications are fiduciary advice
2. Allows fiduciary duties be waived
3. Suggests disclosure is optimum to address conflicts
4. Omits more rigorous disclosure requirement
5. Rebrands conflicts
6. Redefines loyalty

Rebrands *Conflicts*

- Seeks to de-stigmatize conflicts of interest
- Questions whether principal trading is always a conflict of interest
- Omits any mention that conflicts of interest are harmful
- Omits stating the benefits of eliminating, avoiding conflicts of interest
- Omits urging brokers to avoid conflicts of interest
- Urges disclosure most efficient for firm and least effective for clients as only mitigation of conflicts

Redefines *Loyalty*

- Minimizing conflicts changes the meaning of loyalty
- Clients "choice" and "access" to all products is more important than only recommending products in client's "best interest"
- Today, loyalty is… "Do the right thing"
- Tomorrow… "Disclose doing the wrong thing"

How We Got Here;
What Went Wrong

Three Overriding Factors

1. Lobbying from insurance and brokerage industries
2. “I am from Wall Street and I am here to help…”
3. Industry’s dubious claims and inaccurate statements

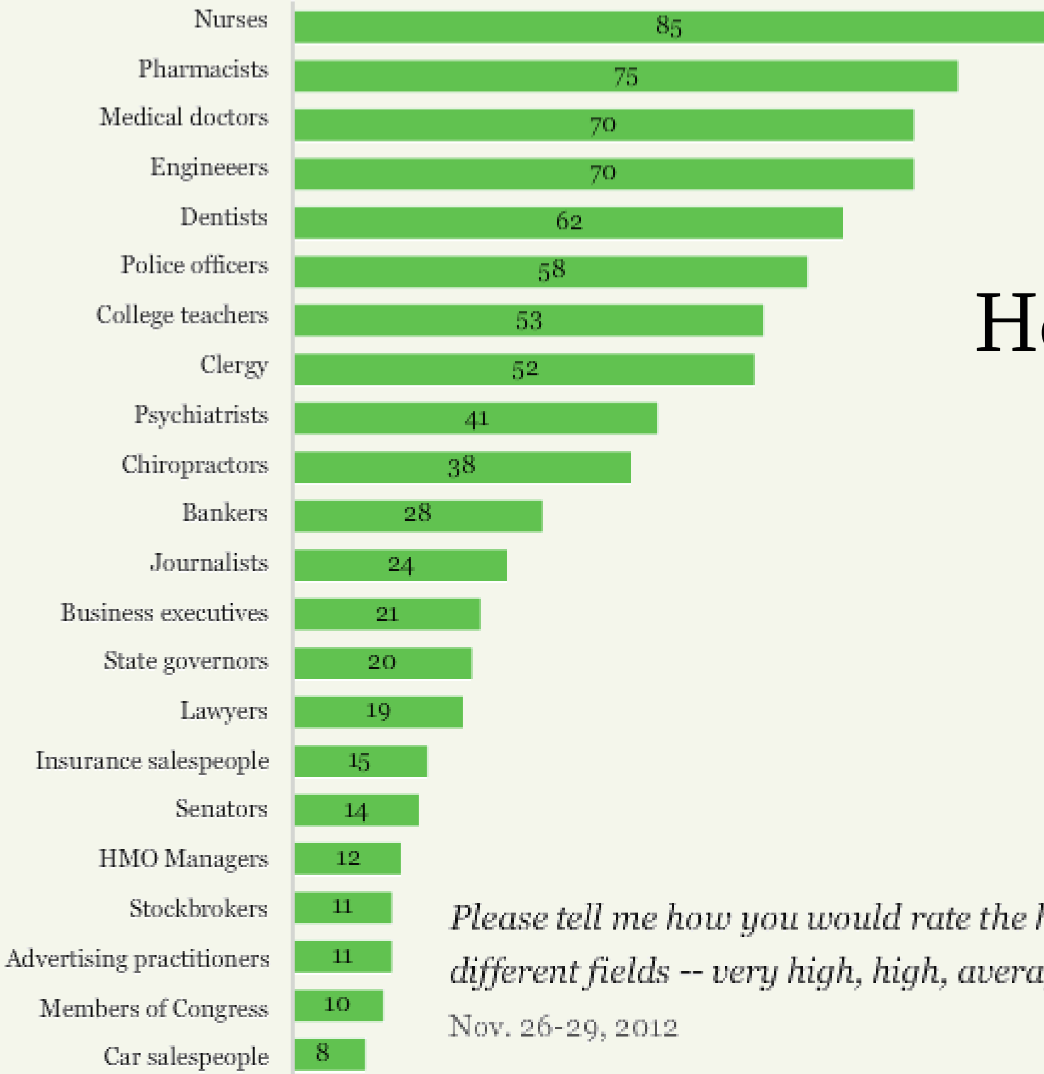
Industry Lobbying

- Important, but not as important as you think
- Case in point: An SRO for investment advisers, when campaign contributions were not aligned with the industry position
- House Financial Services Committee members contributions (2011-2012) from securities industry:
  - Chairman Spencer Bachus (R-AL) -- $ 286,677
  - Member Kevin McCarthy – (R-CA) $271,900
- Lesson: Fiduciary rule versus the Golden rule

"I am from Wall Street and I am here to help…"

- Backdrop: Wall Street and Washington
- Continued public distrust and disgust
- 2013 Harris reputation survey: Wells Fargo, JP Morgan, Citi, BoA, Goldman, AIG hold six of the bottom nine positions of sixty most visible companies
- Congress: 81—11 disapprove / approve
- President: about even disapprove / approve

Honesty / Ethics in Professions



Please tell me how you would rate the honesty and ethical standards of people in these different fields -- very high, high, average, low or very low?

Nov. 26-29, 2012

% Very high/High

GALLUP

"It's not what you say, it's what people hear."

-Frank Luntz

- Luntz: Words that work:
  - "Imagine, inspire, cleaner, healthier, safer, the simple truth, reliable, respect, renew, accountability, results, solutions, …"
- Fiduciary Language: Words that don't work
  - "Best interest" versus "suitability"

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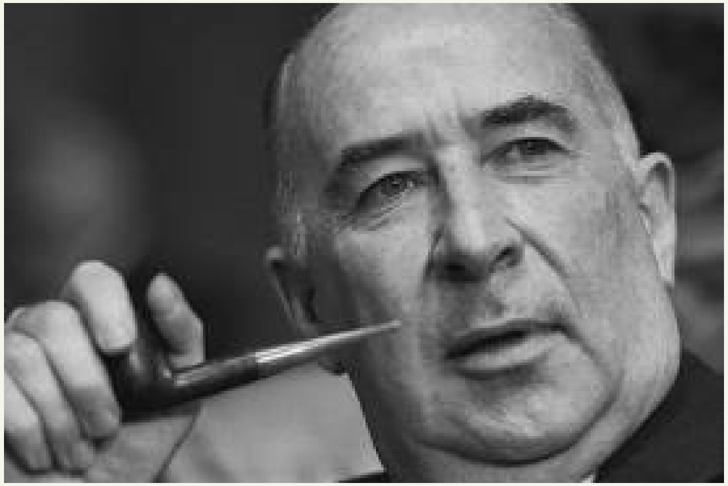
Industry's Inaccurate Statements, Dubious Claims

- SIFMA claims to support a 'uniform fiduciary standard' while it works for a commercial sales standard

"Watch what we do, not what we say."

-John N Mitchell,
US Attorney General under
Richard Nixon



Industry's Inaccurate Statements, Dubious Claims

- Industry claims the fiduciary standard will:
  - Increase costs to firms
  - Reduce investor choice and access to products
  - Cause widespread abandonment of small investors
  - Cause world-wide famine, disease and hunger

Industry's Inaccurate Statements, Dubious Claims

- Each claim backed only by internal company data
- No independent and credible evidence of claims
- The primary "study" asserted to demonstrate cost increases, the Oliver Wyman study, is industry financed and designed, and its underlying data was inaccessible to independent review
- Would not pass a high school debater's scrutiny

Can We Change Course?

Why Fiduciary Proponents Lost Ground in 2009 – 2012 and Why We Can Win Going Forward

Why We Lost Ground

The home field advantage

Battle of Trenton, December 26, 1776

Challenges and Opportunities

- Rebutting dubious claims, inaccurate statements
- Re-framing issue: Wall Street v Main Street
- Broadening support to conservatives, other interests
- Leveraging key advantages of media and message
- Attracting luminary spokespersons
- Expanding to grass roots

Single Greatest Challenge?

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When it comes to new regulation, the Obama Administration has impeccable timing. Just as Americans are worrying about how much is left in their 401(k)s, the Department of Labor has decided it wants to reduce the plethora of options that we have for retirement accounts.

That's essentially the message Assistant Secretary Phyllis Borzi, who runs the Employee Benefits Security Administration, conveyed to a House committee late last month—to bipartisan horror. She is pushing a proposed rule to broaden the definition of "fiduciary" and submit a large swathe of investment advisers, brokers and others to more regulation and legal liability.

For decades the finance industry has provided investors roughly two kinds of services: the "advisory" model, in which an investment professional makes trading decisions, provides specialized advice and charges savers an annual fee; and the "brokerage" model, in which the saver makes the decisions and pays a fee for each trade and occasional advice. The latter model can be cheaper because the broker is often compensated by the company whose products he's offering.

Ms. Borzi says the brokerage model's compensation structure might result in "biased advice." We say "might" because Ms. Borzi and her bureaucratic minions haven't produced a single, serious economic study that shows widespread fraud or malfeasance in the retirement savings industry.

In an email to us, Ms. Borzi cited "widespread" conflicts of interest in the "marketplace for retirement advisory services," adding: "There is a great deal of evidence that these conflicts have resulted in lower returns and higher fees for retirement investors, as reflected in the Department's own investigations and cases, SEC and GAO reports, published securities cases, academic literature and other sources."

But lower returns don't necessarily mean that investors were systematically cheated. Where's the proof?

The rule would have huge consequences for the retirement savings industry. Brokers would have to weigh the cost of higher regulatory compliance against staying in the business. Investors would pay more for trades and advice and have fewer investment choices. Investment educational seminars would likely halt in many cases, lest organizers think they'll be held liable as a fiduciary for giving general investment advice.

Many firms would raise minimum investment amounts to cover their higher costs, cutting off access to lower-income savers. Consultancy Oliver Wyman surveyed about 40% of the investment retirement account market and estimated the proposed rule could "eliminate access to meaningful investment services for over seven million IRAs." Investors could see "direct costs" rise between 75% and 195%.

Democrat Carolyn McCarthy of New York said during the hearing that the rule is "overbearing and has a potential to hurt our national economy." Phil Roe, Tennessee Republican, says it would "curb investment opportunities, raise the cost of investing and reduce the return on those investments for individuals saving for retirement." The Labor Department says it's working on exceptions to the rule to minimize its impact. But why is this rule in the works at all?

Last year's Dodd-Frank law instructed the Securities and Exchange Commission—not the Labor Department—to examine how brokers, dealers, investment advisers and others are regulated, and whether more regulation is needed or not. The SEC is currently conducting that study.

Someone from the White House needs to step in here before Ms. Borzi's savings bomb falls on the heads of American investors.

Thank You

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