

“Before our Very Eyes”*

How Key Wall Street Lobbyists Are Working to Make the Fiduciary Standard A Broker-Sales Standard

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* This is the title of Chapter One, The Financial Crisis Inquiry Report, “Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States,” January 2011. This title reflects the view, as expressed by former SEC Chair Richard Breeden, “Everybody in the whole world knew the mortgage bubble was there.... It wasn’t hidden... You can’t make trillions of dollars worth of mortgages and not have people notice.” (page 4)

Presentation Overview

- Securities Industry Financial Markets Association (SIFMA) Background
- SIFMA “Fiduciary” Framework World View
- Implications of SIFMA’s Framework





“SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers.”

SIFMA Background – Support of Standards

1940 – 2009*: Expressed support for two separate standards

March, 2009: Expressed support for “Universal standard of care... the fundamental principles of fair dealing”

July, 2009: Expressed support for “Federal Fiduciary Standard”

SIFMA Background – “Federal Standard”

“SIFMA’s vision of a harmonized fiduciary standard is even stronger and more pro investor than any other alternative that we have heard advanced.”

-SIFMA Representative John Taft, testifying before the House Financial Services Committee, October 6, 2009

“Put retail customers’ interests first; ... preserve ... customer choice of and access to financial products... and not subject (brokers) to other fiduciary obligations (the Advisers Act fiduciary standard, other statutory stds.)”

-SIFMA Fiduciary “Position”
April, 2012

SIFMA Background – Deciding to Support the “Federal Standard”

“This was a long discussion that had been taking place among the private client group within SIFMA, so principally the retail brokerage part of the industry had been struggling with this issue of is suitability really the standard that should be applied going forward, or should they adopt a fiduciary standard. And they worked at this really for about a three-year period...”



SIFMA CEO Tim Ryan on why SIFMA changed its position and expressed support for a fiduciary standard.

January 31, 2012

John C. Bogle Legacy Forum

Image: Bloomberg

SIFMA Background – Deciding to Support the “Federal Standard” (Cont.)

“The (SIFMA member) CEOs or heads of these distribution arms... embraced, I think, kind of a reality. Reality is that within the marketplace today, the expectation of retail investors is that they will be treated in basically the same way,... whether (at) a Merrill Lynch, a Morgan Stanley or dealing with an independent financial advisor.”



SIFMA CEO Tim Ryan on why SIFMA changed its position and expressed support for a fiduciary standard.

January 31, 2012

John C. Bogle Legacy Forum

Image: Bloomberg

SIFMA “Fiduciary” World View



SIFMA July 14, 2011 SEC Comment Letter*

Five Key Assumptions

- Investment Recommendation Standard
- Conflicts of Interest
- Disclosure
- Scope of Obligation
- Controlling Investment Expenses

*“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>

Investment Recommendation Standard

"The standard of conduct should allow broker-dealers to continue to offer products and services that are available today..." (p. 8,9)

Institute Comment: Permitting products under the suitability standard to presumptively meet SIFMA's uniform standard suggests:

- 1) Eliminating the due care duty
- 2) Permitting the "minimally acceptable" products that FINRA CEO Richard Ketchum has spoken out against

Conflicts of Interest

“Over the years the SEC staff has issued guidance regarding (Section 206)... These statements speak far more in terms of entirely avoiding conflicts, rather than appropriately managing them. Accordingly, these statements could be interpreted and applied in a manner more prescriptive than the “eliminate or disclose conflicts” approach recommended in the Study.” (p. 12)

Conflicts of Interest

"If (avoiding conflicts rather than appropriately managing them) were applied to broker-dealers... it would create legal and compliance uncertainty that would in the worst case prevent, and in the best case disincentivise, BDs from offering many of the beneficial products and services that they currently provide and that retail customers have come to value and rely on." (p. 13)

Conflicts of Interest

Institute Comment: SIFMA's ardent defense of conflicted advice is:

1. A sharp departure from SEC views urging IAs to avoid conflicts
2. A sharp rebuke of the well-established precepts underlying the Advisers Act of 1940 as articulated by the Supreme Court in *SEC v Capital Gains Research Bureau*

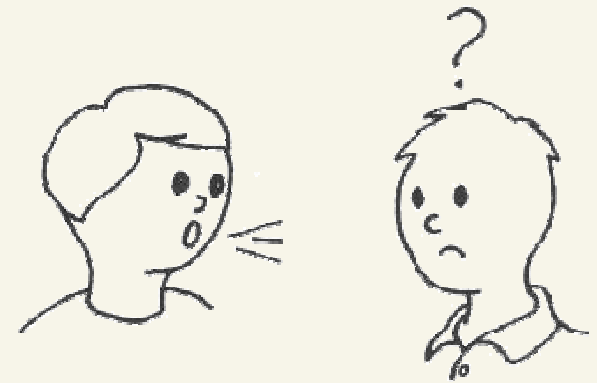
Disclosure

"In general the consent regime should focus particular attention on ensuring that it can be practically implemented and readily integrated into the current broker-dealer operational model." (p.22)

Institute Comment: SIFMA advocates that disclosure be "pragmatic" and "efficient" for the firm, requests detailed SEC guidance on what facts disclosure must include and when disclosure must be provided.

Disclosure

Institute Comment: SIFMA advocates for “verbal” disclosure in instances, that “consent” from current clients be derived solely from clients’ continuing to use brokerage services.



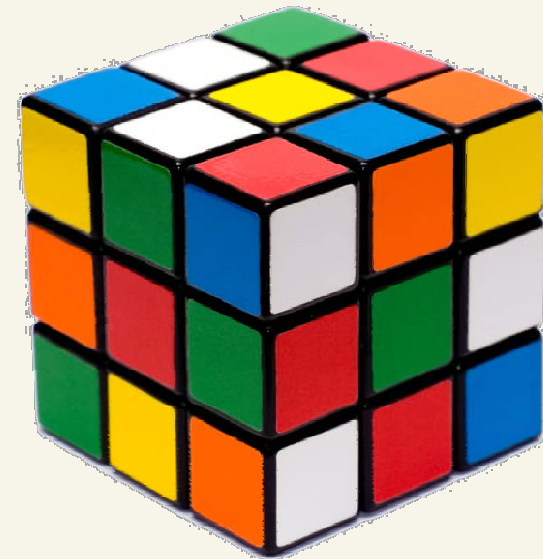
No mention or recommendation of any instance where a conflict is so material that disclosure and consent is insufficient;

No mention or recommendation of any instance where informed consent is required;

Disclosure

No mention, or any questions regarding, as to what constitutes "effective" disclosure.

No acknowledgement (or mention) that the broker is responsible and accountable for showing the disclosure is "effective," consent is "informed" and the transaction remains in the client's best interest, as set out by the SEC in *The Matter of Arlene Hughes* (Release No. 4048).



Scope of Obligation; Defining “Personalized Investment Advice”

“A broker-dealer’s obligation ... should be specified in the customer agreement.... (and) apply on an account by account basis... (p.17) personalized investment advice should include ... communications to a specific customer recommending that the customer purchase or sell a (one or more) security... (or) discretionary decisions regarding securities bought, sold ... (p. 18, 19)”

Scope of Obligation; Defining “Personalized Investment Advice”

Institute Comment: SIFMA believes the standard should only apply as specified by contract for certain topics on an account by account basis.

Personalized investment advice should be explicitly limited to communications or discretionary decisions, or technology that makes recommendations, regarding the sale or purchase of securities.

Controlling Investment Expenses?

“Traditional types of broker-dealer product sales or compensation arrangements should not be viewed to violate the standard of conducts.” (p.17)

Institute Comment: While SIFMA seeks no restrictions on current brokerage sales or compensation arrangements, it is silent on controlling investment expenses.

The SEC: advisory fees are “reasonable in relation to the services provided.”

SIFMA's Uniform Standard Versus The Advisers Act Fiduciary Standard

Issue	SIFMA Standard	Advisers Act
Product Recommendation	<ul style="list-style-type: none">• Recommendation is suitable• No best-interest due care	<ul style="list-style-type: none">• Recommendation is in the client's best interest
Conflicts	<ul style="list-style-type: none">• Need not avoid• May benefit client• Champions conflicted advice	<ul style="list-style-type: none">• Undermines unbiased advice• Must avoid if at all possible
Fees and Expenses	<ul style="list-style-type: none">• Silent	<ul style="list-style-type: none">• Must be controlled

SIFMA's Uniform Standard Versus The Advisers Act Fiduciary Standard

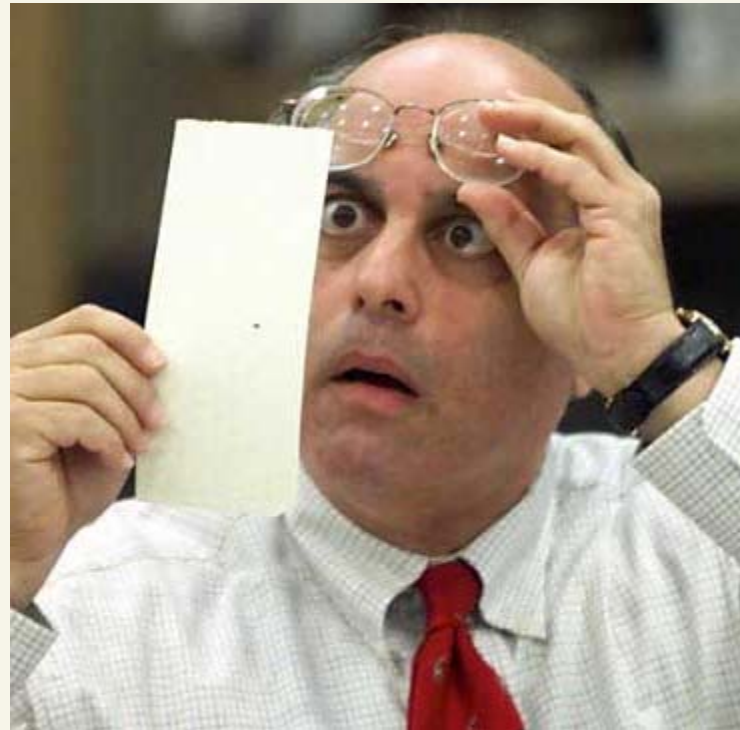
Issue	SIFMA Standard	Advisers Act
Scope of Obligation	<ul style="list-style-type: none">• Limited to recommendations about the purchase or sale of a security, or discretion decision.• Sporadic, based on account, discussion topic, or contract.	<ul style="list-style-type: none">• At all times when providing investment advice.• Continuous, based on relationship of trust and confidence.
Disclosure of Conflicted Advice	<ul style="list-style-type: none">• Efficiency for BD• Investor is responsible to understand disclosure	<ul style="list-style-type: none">• Effectiveness for Investor• Adviser is responsible to ensure:<ul style="list-style-type: none">-Investor understands disclosure-transaction meets best interest standard

SIFMA's Uniform Standard Versus The Advisers Act Fiduciary Standard

Issue	SIFMA Standard	Advisers Act
Overall Big Ideas	<ul style="list-style-type: none">• Business neutral• Choice	<ul style="list-style-type: none">• Duties of loyalty• Due care



Implications of SIFMA's Framework



SIFMA's Uniform Standard Versus The Advisers Act Fiduciary Standard

1. What's best for SIFMA members is best for investors.

SIFMA's "Framework" assumptions are contrary to established fiduciary principles, that depart fundamentally from the Advisers Act of 1940. Instead, SIFMA's assumptions suggest that what's best for its members is also best for investors.

SIFMA's Uniform Standard Versus The Advisers Act Fiduciary Standard

2. SIFMA falls short of Dodd Frank.

SIFMA's uniform standard does not meet the fiduciary standard under the Advisers Act of 1940; and does not comport with the requirements of Dodd Frank, which calls for a uniform standard that: "Shall be no less stringent than the standard applicable to investment advisers under section 206 (1) and (2)."

SIFMA's Framework: What it is *Not*

- It is not about disagreeing on nuanced differences of degree among like-minded market participants
- It is not about “too much regulation”
- It is not about too little “investor choice”

SIFMA's Framework: What it does

- As outlined in the July 14, 2011 letter, fundamentally rejects key precepts underlying the Advisers Act of 1940 as articulated by the Supreme Court in SEC v Capital Gains Research Bureau:

" 'It requires but little appreciation... of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every cacti of the securities industry...

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 were removed....

375 U. S. 180 (1963)

The report incorporated the Code of Ethics and Standards of Practice of one of the leading investment counsel associations... '(an investment adviser) should continuously occupy an impartial and disinterested position, as free as humanly possible from the subtle influence of prejudice...'

The president of the ICA of America ... testified: 'two fundamental principles ... were, first, that they would limit their efforts and activities to the study of investment problems from the investors standpoint, not engaging in any other activity, such as security selling and brokerage, which might directly or indirectly bias their investment judgment; and, second, that their remuneration for this work would consist solely of definite, professional fees, fully disclosed in advance...'

In describing their profession leading investment advisers emphasized their relationship of 'trust and confidence' with their clients, and the importance of 'strict limitation of [their right] to buy and sell securities in the normal way if there is any chance at all that to do so might seem to operate against the interest of clients and the public...'

375 U. S. 180 (1963)

SIFMA's Framework: What it does

- Rejects a centuries-old branch of the law in a vital arena that exists to infuse “trust and confidence” in the capital markets by remedying the information asymmetry between expert and lay person in the delivery of socially important professional advice
- Removes the fiduciary standard for the retail clients of broker-dealers (“removes”, not “waters down”)
- Equates SIFMA members’ interests with the best interests of investors, and promotes distrust and lack of confidence in intermediaries and the markets

The Meaning of SIFMA's Framework: Why It's Important

- Helps upend centuries-old principles governing the essential relationships between financial experts and their clients
- Helps rewrite lessons from the 1920s and 1930s
- Inspires rethinking as to whether “conflicted” advice is inherently “bad” advice
- Helps create a fundamentally different regulatory mission for industry participants and retail investors

SIFMA's Framework and Fiduciary Duties

When it comes to the fiduciary principles of loyalty, due care, and investor best interest...

“Where’s the Beef?”



Thank You

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