My Journey toward a Better, Simpler Fiduciary Rule
April 24, 2017
by Bob Veres

I have no problem whatsoever with the intent of the DOL fiduciary rule (may it rest in peace). But I was dismayed with the rule’s final form. In fact, I believe that the DOL’s voluminous tome can be distilled to a single sentence.

If you include the best-interest contract exemption (BICE) language, the rule ran to over 2,000 pages, and imposed a whole lot of burdens not only on the brokerage firms who have been leeching on retirement assets for a century or more, but also on advisors who have been behaving as fiduciaries all along.

The exercise gave me a disheartening insight into this big unwieldy organization we call the United States government. The DOL took what is fundamentally a simple concept and turned it into a pile of bureaucratic legalese that runs 600 pages longer than Tolstoy’s War & Peace. If this is the way every agency and regulator in Washington handles things (and I strongly suspect it is) then it’s no wonder businesses are up in arms about regulatory overkill.

We need to regulate our capitalist system to make sure everybody plays fair. But do we need thousands of pages for every simple item of fairness?

Is there a better way?

To find out, I embarked on a journey. I started with the belief that the intent of the DOL Rule could have been codified, in its entirety, on the back of a napkin. So I wrote my version of the Rule, and then asked my Inside Information readers to weigh in on whether they would support my scaled-down version or modify it.

Here’s what I started with:

Any individual or organization providing financial or investment advice for compensation in regards to an IRA rollover must adhere to the same standards of care that are required of individuals or
organizations that provide financial or investment advice to qualified plans under the ERISA rules and guidelines.

This would require advisors to create investment policy statements for clients (something many don’t do now, but which would be an excellent best practice), and otherwise do what most of the best advisors normally do: exercise due diligence in the selection of investment options and periodically report on the whys and wherefores of their selections. New best practices in this area are already emerging.

Would we need anything else? Perhaps the DOL was forced to accommodate the business model of the brokerage and independent BD firms who still want to pay commissions to their brokers and reps to sell garbage products. In that case, we might have to hold our noses and add a second sentence:

Any individual or organization that intends to provide financial or investment advice for compensation in regards to an IRA rollover, who does NOT intend to adhere to the ERISA standards of care, must disclose this to the customer, and describe the conflicts of interest inherent in the transaction on a disclosure document no more than one side of one page in length, in 14 point type or larger.

Even with the second sentence, all of that would fit on a (somewhat large) napkin, and my personal preference would be not to include that second sentence.

Among the very first people I heard back from was Kate McBride, of FiduciaryPath, LLC. McBride also happens to be the past chair and co-founder of the Committee for the Fiduciary Standard, one of the strongest and most articulate proponents of the DOL’s fiduciary efforts. Her amended version expands my language to explicitly cover retirement plans and plan participants, and also the decision about whether or not a rollover is recommended. It reads as follows (changes in boldface):

Any individual or organization providing financial or investment advice for compensation in regards to a retirement plan, participant, IRA rollover, and the decision whether or not to roll over must adhere to the same standards of care that are required of individuals or organizations that provide financial or investment advice to qualified plans under the ERISA rules and guidelines.

Her suggestion is to make the same changes to the second paragraph:

Any individual or organization that intends to provide financial or investment advice for compensation in regards to a retirement plan, participant, IRA rollover, and the decision whether or not to roll over who does NOT intend to adhere to the ERISA standards of care, must disclose this to the customer, and describe the conflicts of interest inherent in the transaction on a disclosure document no more than one side of one page in length, in 14 point type or larger.

I next heard from Michael Taxman, who practices in Hanover, NH, who said that my one sentence was unnecessarily long, and didn’t go far enough. “Let’s not allow representatives of broker-dealers and insurance companies to hold themselves out as financial advisors,” he said. “You either are a salesman for your company, or you are an advisor to your client, period. Isn't this already how it is
supposed to work under the old division between investment advisors and broker-dealers?"

His simpler one-sentence fiduciary rule:

If you give investment advice for compensation, you are a fiduciary.

Alas, I have two problems with this version. First, it opens the door for sales reps to offer investment advice, and receive commissions on (sometimes very non-fiduciary) product sales, and still call themselves advisors and pose as fiduciaries. (They will claim that they aren’t giving investment advice for compensation, and if they’re taking commissions, that would be correct.)

And second, it expands the rule into areas where the DOL doesn’t have jurisdiction – namely, the SEC’s territory. But Taxman’s comments got me to thinking that we could extend this exercise in a helpful way for the SEC. Before SEC attorneys come out with their own 2,000+ page “harmonization” rules, the fiduciary community could propose a back-of-the-napkin version similar to whatever we come up with here for the DOL.

At this stage of the journey, I cast my vote for Mr. Taxman’s version.

I next heard from Professor Ron Rhodes, attorney and assistant professor of finance at Western Kentucky University, who is perhaps our profession’s deepest thinker on fiduciary issues. From his response, I never could figure out if he supported my single-sentence DOL rule, but he did point out some complications in the DOL’s actual rule.

For one thing, Rhodes noted that the impartial conduct standards in the DOL’s rule might be construed as requiring advisors who attend conferences to disclose the subsidized amounts of their registration fees and the costs of meals and entertainment – the percentages that were paid by custodians and exhibitors. (Disclosure: I’ve attended “free” – i.e. sponsor-paid – Jason Mraz and Sheryl Crow concerts in the past six months, and watched sponsored fire dancers twice.)

Rhodes also thinks that under the rules, custodians might also have to start charging for the software platforms and education and practice management advice they now give their affiliated advisors for free.

Another flaw in the original rule is that that BICE permits product sales, even for high commissions – and it can be difficult to determine, legally, if those commissions are “unreasonable.”

Rhodes commented specifically on my second paragraph, saying that he doesn’t believe that disclosures are effective in preventing consumers from getting fleeced, even if the disclosure happens to be printed in my proposed 14 point type. So at this next stop on my journey, I was thinking seriously about eliminating my second proposed paragraph altogether.

After reading Rhodes’ comments, I decided not to amend the revised version of my first sentence.

Then I heard from Skip Schweiss, the tireless managing director of investor advocacy at TD
Ameritrade Institutional, who said that my modified first sentence was overly and unnecessarily verbose, and could be pared down as follows:

ERISA now applies to IRA advice, including advice regarding rolling over a person’s retirement plan balance to an IRA.

With this version, there would be no need for the second paragraph, since every transaction would be subject to a best-interests standard and the prudent investor rule. If a rep sold a non-traded REIT and pocketed a 7% commission, then he or she would have to be prepared to justify the recommendation as acting in the client’s best interests – and I doubt that anybody’s compliance department would be in favor of such an open invitation to the class-action attorneys.

The next commentator was Peter Palion, an advisor who practices on Long Island, NY. Palion pointed out something that I hadn’t considered: that the DOL was never planning to enforce its lengthy rule – at least, not in the same way that it polices the retirement plan marketplace. Instead, the DOL rule, all 2,000 pages of it, was designed to put the entire regulatory burden on the people providing the advice – and it laid the enforcement burden on the community of plaintiff’s attorneys. That’s why you’re required to document everything, including the fact that you intend to act as a fiduciary even if your whole mindset has always been fiduciary.

“I think that with the rule, the government is abdicating its responsibility in favor of trial attorneys,” he wrote, “which explains why the thing is 2,000 pages long.”

This is a fatal flaw of any version of the rule; the fact (and I think it’s true) that it was never intended to be enforced by the DOL using its own resources. Perhaps in the course of drafting my (much) shorter new version of the rule, I can include an admonition to regulatory agencies never to create rules that they don’t, with their own resources, intend to enforce.

In this way, my back-of-the-napkin rewrite of the rule would serve as an example of simple, principles-based regulation for the rest of the government bureaucracy, and this additional principle (enforce your own rules or don’t make them in the first place) would invalidate a few million other pages of regulatory legalspeak.

Finally, I heard from Dan Moisand, of Moisand, Fitzgerald, Tamayo in Melbourne, FL, the former president of the Financial Planning Association. His issue was more general; in the regulatory debates, he argued, we should tell the SEC that it should long ago have abandoned its experiment of opening the door to allowing brokers to call themselves ‘advisors’ without having to register as RIAs (and therefore being without being held to a fiduciary standard).

“We don’t need a new rule,” he wrote; “just an interpretation that holding out is prima facie evidence that advice is not incidental, and the fiduciary duty, as per Capital Gains [the 1963 Supreme Court ruling entitled SEC v. Capital Gains Bureau] would apply to all investment-related activities. If,” he continued, “they backed that with a statement that a title like ‘financial advisor’ or ‘advisor’ was holding out, we’d be off to a good start.”
After reading Moisand’s input, I decided against helping the SEC write a one-sentence “harmonization” rule, and would instead support an effort by fiduciary advisors to get the SEC to enforce the very simple, very clear rules laid down in the Investment Advisers Act of 1940.

So where does that leave us? I would eliminate my second paragraph, and modify Schweiss’ version of the first paragraph, boiling down the DOL fiduciary rule to a simple declarative sentence:

The ERISA statute and fiduciary standards currently governing qualified plans now apply to advice relating to IRA accounts, including advice regarding rolling over a person’s retirement plan balance to an IRA.

One sentence to replace 2,000 pages – and an example for other government regulators to follow in their own spheres of influence.

What do you think? I look forward to an engaging conversation on APViewpoint.