Journal of Financial Planning
EXPANDING THE BODY OF KNOWLEDGE IN THE FINANCIAL PLANNING PROFESSION

Forward with Fiduciary

How we got to where we are and why FPA cares

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THE FINANCIAL SERVICES profession is no stranger to regulation. In the wake of the Great Depression that devastated the financial wherewithal of individuals in the U.S., Congress created laws to protect the financial security of its citizens. The Securities Act of 1933 was the first major federal legislation to regulate the offer and sale of securities. This was followed by the Securities Exchange Act of 1934, Trust Indenture Act of 1939, and the Investment Company Act and Investment Advisers Act of 1940.

The collapse of the Studebaker-Packard Corp. in December 1963 created a "focusing event" when employees of the company, along with retired workers, lost all of their pension benefits. Congress set about a major overhaul in federal regulations to specifically address the concerns of workers and retirees and passed the Employee Retirement Income Security Act of 1974 (ERISA).[1]

President Gerald Ford signed ERISA into law on September 2, 1974, Labor Day. The law was straightforward. If you provide advice for a fee or other compensation, direct or indirect, to a plan or to individual retirement accounts (IRAs), you will be considered a fiduciary.[2] Wall Street firms, along with other interested parties, were concerned with the broad nature of fiduciary obligations imposed under the new law and pursued the Department of Labor (DOL) to provide guidance.

In 1975, the DOL issued regulations that significantly narrowed the statutory definition of fiduciary investment advice by creating a five-part test.[3] To be considered a fiduciary, the adviser: (1) must render advice (2) on a regular basis (3) pursuant to a mutual agreement that will (4) serve as the primary basis for investment decisions in an (5) individualized manner. If any one element of the five-part test could be avoided, the adviser would not be held to a fiduciary standard.

Since ERISA, the nature of retirement savings has been upended along with the landscape of financial services. The vast majority of workers today are responsible for their own retirement savings. The very retirement system ERISA was designed to protect—private pensions—has dramatically declined.[4] Instead of receiving a defined benefit from a retirement plan, most workers are now encouraged to make a defined contribution. This shifts the financial burden from professionally managed company plans to self-directed individual accounts. Add in IRAs and a variety of 401 plans, and investors are basically on their own. Caveat emptor.

ERISA 2.0

Similar to the initial passing of ERISA, a confluence of financial challenges and court decisions caused the DOL in October 2010 to propose amendments to the 1975 regulations.[5] The DOL had concerns that conflicts of interest may compromise advice given to retirement plans and IRA investors. After extensive comments and debate, the DOL announced it would withdraw the proposal in September 2011. Given the significance of the rule, the DOL indicated it intended to re-propose the rule after a more thorough and robust regulatory impact analysis.

On February 23, 2015 President Obama took to the stage at AARP in Washington to discuss a matter of national importance. He didn't speak about health care, military security, or foreign policy positions. His concern was that retirees were subjected to conflicted advice. The president referenced studies indicating billions of dollars of financial harm due to conflicted advice. It was during that speech where he said, "We should be able to make sure that folks are treated fairly and given every possible assistance we can so they can retire with security and dignity."[6]

Shortly after Obama's speech, FPA issued a press release stating we "support(s) a fiduciary standard for all who provide investment advice and those who work to secure the financial future of millions of American workers."[7] While FPA supported the initial statement, the re-proposed rule would require a lot of scrutiny, especially given FPA's strong stance on business compensation model neutrality.

On April 20, 2015, the DOL published a notice in the Federal Register that withdrew the 2010 proposal and issued a new one.[8] The final rule that emerged is called the Conflict of Interest Final Rule or simply, the fiduciary rule.

FPA Advocacy

In June 2015, FPA members headed to Capitol Hill for the second annual FPA Advocacy Day. This provided an opportunity to visit with elected officials and policymakers to discuss our support along with sharing our concerns surrounding the re-proposed DOL rule. The day included meetings with White House staff and members of Congress that culminated in FPA leaders meeting with officials from the DOL.

Given this was the first meeting with the leading architects of the DOL rule, uncertainty was at a high level. Both sides delved into an honest, direct, and respectful discussion that was exploratory and explanatory in nature. The business models of FPA members who are compensated by fees and commissions allowed for a robust discussion that covered many facets of the financial services profession. What was very apparent by those of us in attendance was the sincere desire of DOL staff to better understand the potential impact of the fiduciary rule.

Our advocacy efforts continued in earnest with our ongoing participation in the Financial Planning Coalition. The Coalition is comprised of FPA, Certified Financial Planner Board of Standards Inc. (CFP Board), and the National Association of Personal Financial Advisors (NAPFA). The mission of the Coalition is to "educate policymakers about the financial planning profession, to advocate for policy measures that ensure financial planning services are delivered in the best interests of the public, and to enable the public to identify trustworthy financial advisers."

> "While FPA supported the initial statement, the re-proposed rule would require a lot of scrutiny."

The magnitude of the potential effect on the profession through the DOL's re-proposed fiduciary rule could not be understated. FPA, along with its Coalition partners, knew the work that lay ahead.

The Coalition was asked to participate in the first round of DOL public hearings on the fiduciary rule scheduled for August 10, 2015. The very process of hosting public hearings drew criticism from those opposed to the DOL rule in the thinking that the testimony—especially from those criticizing the rule—would not alter the DOL's position. It was determined that past CFP Board chair Ray Ferrara, CFP®, would represent the Coalition along with Marilyn Mohrman-Gillis, managing director of public policy and communications for CFP Board. Testimony included the importance of allowing commission-based and fee-based compensation models along with the Coalition's unwavering support that financial advisers should always hold the best interest, a fiduciary interest, of their clients first.

The Coalition continued its strong support of the re-proposed rule stating it was "overdue, needed, and workable" and submitted a 35-page comment letter suggesting that the final rule could be stronger through "modifications, clarifications, and changes."[9]

Certain companies were not going to wait until the DOL published their final rule. These firms were lowering fees and investment minimums in anticipation of the fiduciary rule.[10] Instead of fighting the change, these firms embraced it and were willing to take the lead among their peers.

In the end, the DOL staff read more than 3,000 comment letters along with 300,000 submissions made as part of 30 separate petitions. Submissions from financial service companies, trade and industry publications, academics, and elected government officials included support of, and opposition to, the proposed rule and proposed related exemptions. Despite claims by those opposed to the rule, the DOL stated it had consulted with "staff of the SEC; other securities, banking, and insurance regulators; the U.S. Treasury Department's Federal Insurance Office; and FINRA, the independent regulatory authority of the broker-dealer industry."[11]

The DOL final rule, rebranded as the "Conflict of Interest Rule," was released on April 8, 2016. The release was met with a flurry of statements from both sides of the debate. Some staunch supporters of a strict fiduciary standard commented the DOL watered down the rule, while some in staunch opposition, including FINRA chairman and CEO Richard Ketchum, stated the final version was a big improvement from the original proposal.

In the end, the fiduciary rule supports what many say Congress intended in the 1975 ERISA law; if you provide advice for a fee or other compensation, direct or indirect, to a plan or IRA, you will be considered a fiduciary. Period.

"FPA, along with its partners in the Coalition, has once again championed the rights of individual investors."

Why FPA?

Some of our members have asked why we are supporting the DOL rule. The answer is simple: one of the core values since the organization's founding in 2000 is clients' interests should come first. There is a fundamental belief that the financial planning profession will "do well by doing good." There have been instances when FPA has led on its own and times when we have sought out partners in pursuit of doing what's best when it comes to our clients, the public, and the profession.

Regulations that once drew clear lines and expectations of those servicing clients began to blur as many in the profession abandoned the title of broker or agent and migrated to financial adviser, wealth manager, financial planner, and many other friendlier sounding titles.

This was most apparent in the SEC's 1999 decision, known as the Merrill Rule, that allowed registered representatives (RRs) of a broker-dealer (B-D) to receive fees as compensation without needing to be registered as investment adviser representatives (IARs) under the Investment Advisers Act of 1940. The Merrill Rule permitted RRs and B-Ds to compete directly with IARs and RIAs, yet only be subject to a suitability standard—a standard lower than the fiduciary standard that governed IARs and RIAs.

It took more than three years of litigation for FPA to win its case in October 2007. Many in the financial services industry were surprised by the victory, as it meant a business practice that had been built over the last eight years would need to change. Firms would either have their representatives become fiduciaries or abandon the practice with many firms opting for the latter.

Now nearly a decade later, FPA, along with its partners in the Coalition, has once again championed the rights of individual investors through our unwavering support of a fiduciary standard.

Another practical reason for support of the rule is the theory that it's better to be at the table than outside pounding on the window. Our authentic support of fiduciary coupled with our ability to address various compensation models gave FPA a voice of reason. Whether it was visiting with staff at the DOL or members of Congress, our mission was simple: listen, learn, and share. We listened to concerns, we learned where misalignments existed, and we shared real-world experiences. While the amount of work FPA and the Coalition expended may not have been readily visible to our members, the results of these efforts are very clear.

There can be no doubt that FPA and the profession will face policy issues similar to the DOL fiduciary rule in the future. What we have learned is that honest, direct, and respectful discussion can go a long way to support the mission of FPA, our members, and the profession.

As I write this in June 2016, litigation to halt the implementation of the DOL fiduciary rule is pending. Although some opposed to the rule may desire to be just salespersons, in my opinion, the way of the future of our profession is forward with fiduciary. ■

Endnotes

1. See the 2001 article "The Most Glorious Story of Failure in the Business: The Studebaker-Packard Corporation and the Origins of ERISA," by James A. Wooten, published in *Buffalo Law Review*, Vol. 49.
2. ERISA §3(21)(A) and IRC §4975(e)(3).
3. 29 C.F.R. 2510.3-21(c).
4. See the DOL's "Private Pension Plan Bulletin Historical Tables and Graphs" dates from 1975 to 2013 at www.dol.gov/ebsa/pdf/historicaltables.pdf.
5. See the DOL's "Proposed Definition of the Term 'Fiduciary'," (75 Fed. Reg. 65263 [Oct. 2010]), at webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=24328.
6. Read the full transcript of the speech at www.whitehouse.gov/the-press-office/2015/02/23/remarks-president-aarp.
7. See "Financial Planning Association Responds to President Obama Announcement on DOL Fiduciary Rule" at www.OneFPA.org/about/Press-Room/Pages/Financial-Planning-Association-Responds-to-President-Obama-Announcement-on-DOL-Fiduciary-Rule.aspx.
8. See the DOL's "Definition of the Term 'Fiduciary'; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule," (80 Fed. Reg. 21928 [April 2015]); at webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28201.
9. Access the full comment letter at www.dol.gov/ebsa/pdf/1210-ZA25-00361.pdf.
10. See the March 16, 2016 *InvestmentNews* article by Bruce Kelly "With DOL Fiduciary Rule Looming, LPL Cuts Prices on Model Portfolios," and the March 31, 2016 *Financial Planning* article by Margarida Correia "Third-Party BDs Angle for Position as Fiduciary Rule Draws Near."
11. See www.federalregister.gov/articles/2016/04/08/2016-07924/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice.