The new Obama rule that's making stockbrokers swear

Whose interest is a retirement adviser supposed to serve?

By Michael Grunwald : **Politico**: August 11, 2015

In April, two months after President Obama proposed a rule that would require financial advisers to serve the best interests of their clients, a Merrill Lynch executive named John Thiel publicly suggested the industry ought to embrace the new regulatory approach to retirement investments. It would be good business as well as good ethics, Thiel told a Securities Industry and Financial Markets Association conference in Chicago. Merrill's ads already promised "a financial strategy that puts *your* needs and priorities front and center." Why not require all brokers to provide that?

But as soon as Thiel finished his pitch for cooperation, the industry gossip site AdvisorHUB began getting emails from Merrill advisers. "Frankly, most of them are losing their sh**," AdvisorHUB reported. "The emails are apoplectic in nature."

"What the fu** is this guy doing?" one advisor wrote. "It isn't bad enough that we are fighting our own firm to keep compliance and legal out of our sh**--but now this guy says Merrill is open to the discussion somehow?" A branch manager told AdvisorHUB: "What really needs to stop is the constant self-inflicted punches to the face. Is that really so hard?" An adviser from New Jersey put it more bluntly: "Someone needs to step into John's office and tell him to shut the fu** up."

This morning, the Department of Labor will begin four days of hearings about Obama's "fiduciary rule," his effort to stop financial advisers from receiving financial rewards for steering customers into ill-advised investments. It is designed to crack down on stockbrokers and others who provide conflicted advice about IRA's, 401(k)'s and other retirement savings, requiring them to put their customers' interests ahead of their own.

To put it mildly, the industry has not taken Thiel's conciliatory advice. Led by SIFMA, the host of that Chicago conference in April, the brokerage world has launched a fierce campaign to stop the rule before it is finalized, arguing that it would be onerous and unworkable, that it would jack up the cost of investment advice beyond the reach of the middle class, and that it addresses an imaginary epidemic of unscrupulous brokers. SIFMA recently launched a website, keepretirementopen.com, to persuade Americans the rule would make it harder for them to plan and save for retirement.

"It's too complex. It would create higher costs, tremendous disruption in the marketplace, less access to financial advice for people who need it," SIFMA president Ken Bentsen said in an interview. "You'd have to fire some of your clients."

The White House estimates that financial advisers who accept hidden fees and backdoor payments for boosting particular investments cost their clients with pensions and retirement accounts about $17 billion every year. Obama has argued that if his crackdown on conflicts of interest would be as devastating to the advisory business model as Wall Street insists, something is very wrong with that business model. Defenders of the rule add that if advice under a best-interest standard would be unaffordable for ordinary families, the advice that ordinary families can now afford probably isn't serving their best interests. In other words, if your broker is secretly fighting to keep his firm's legal and compliance units out of his, um, activities, it might not be such a disaster if he fires you as a client.

The official position of SIFMA and other trade groups, as well as Merrill and other financial services firms, is that the industry supports a best-interest rule, just not *this* best-interest rule. They say the Labor Department shouldn't be the agency in charge, retirement savings shouldn't get their own standard, and "best interest" shouldn't mean what the administration wants it to mean. They warn that this rule would lead to excess paperwork and frivolous litigation, but they pledge to support a better rule if a different agency—the Securities and Exchange Commission—crafts it. The Wall Street reforms that Congress passed in 2010 actually gave the SEC authority to draft a broader fiduciary rule for brokers, but the SEC has not yet acted.

The rule's defenders say this foot-dragging is exactly why the industry hopes to punt this issue to the SEC—and to the next president, who might be less hostile than Obama. The current system of self-regulation—overseen by a not-exactly-fearsome industry entity known as FINRA—is working well for Wall Street. Disputes are almost automatically directed to arbitration, where brokers only have to demonstrate their advice was "suitable" for their clients, a standard far short of "best interest."

"They're passionately committed to the best interests of their clients, as long as they're not legally required to serve the best interests of their clients," said Barbara Roper, director of investor protection for the Consumer Federation of America. "They say they support a standard to eliminate avoidable conflicts of interests, then they want to define all their conflicts as unavoidable."

In its public comments on the rule, Roper's group catalogued a host of legal disclosures that top brokerages have made about those conflicts, admitting that they benefit when their clients invest in certain funds—usually with high management fees and sales commissions—rather than others. For example, Ameriprise Financial acknowledged "there is an incentive for our financial advisors to sell a fund from a load fund family or a fund that pays a 12b-1 fee over one that does not…which may influence your financial adviser to recommend certain funds or classes over others." A Charles Schwab disclosure neatly summed up the situation: "Schwab may pay a Schwab representative more for selling products or services on which Schwab makes more money."

Meanwhile, a recent report by the Public Investors Arbitration Bar Association documented how firms that emphasize their commitment to their clients on the public airwaves (including Merrill Lynch) have denied any fiduciary duties to their clients in private arbitration cases. According to PIABA, Ameriprise ran ads pledging that "our advisers are ethically obligated to act with your best interests at heart," before arguing in arbitration that "respondent owed no fiduciary duties to Claimants." Wells Fargo's ads say "a healthy relationship with your financial advisor should make you feel that your best interests are the top priority," but the firm argued in another proceeding that "the law establishes that a broker does not owe a fiduciary duty to a customer with respect to a non-discretionary account." UBS made the same legal argument in the same words, despite running an ad that read:

"Until my client knows she comes first. Until I understand what drives her. And what slows her down. Until I know what makes her leap out of bed in the morning. And what keeps her awake at night. Until she understands that I'm always thinking about her investment. (Even if she isn't.) Not just at the office. At the opera. At a barbecue. In a traffic jam. Until her ambitions feel like my ambitions. Until then. We will not rest."

This week, 74 witnesses are scheduled to testify on 25 panels at the Labor Department hearings. The heart of the industry's case will be that the complexity of the 1000-plus-page rule would make it uneconomic for brokers to charge clients commissions for specific trades, shifting the entire sector toward flat management fees that can be exorbitant for families with limited cash to invest. SIMFA general counsel Ira Hammerman said the Obama administration harbors a paternalistic, one-size-fits-all belief that small investors belong in low-cost index funds and exchange-traded funds that rise and fall with the market. The current system gives families the freedom to choose what kind of speculative risks they want to take, who they want to advise them, and how they want to pay—and if they become unhappy with their arrangement, they can easily find a new one.

"Customers vote with their feet every day," Hammerman said.

The Obama administration withdrew an earlier version of the rule in 2011, and industry leaders have been lobbying furiously to try to kill this one before it goes final sometime next spring. They have made inroads in Congress, raising the possibility that Republicans could work with finance-friendly Democrats on language delaying or killing the rule; Senator Claire McCaskill of Missouri recently wrote a letter criticizing the rule. But Obama aides say the president sees the rule as a legacy issue, a key element of his pitch for "middle-class economics." And they're not impressed with industry arguments.

"What, it's too onerous to disclose to your clients how you're getting paid? It's too costly to create a contract where you tell them you'll serve their best interest?" one senior Obama aide asked. "Give me a break."