So Many Studies Can’t All Be Right Good news and bad news in the aftermath of Dodd-Frank

Keith Hickerson
The American College of Financial Services

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There was a large dose of “wait and see” embedded in the overwhelming Dodd-Frank financial reform legislation in the guise of an extensive number of studies to be conducted by various government agencies. While the purposes of the studies vary, many will constitute the basis for additional regulation or rulemaking. The SEC alone is creating more than 100 rules and completing 20 separate studies required by the law, all in a limited timeframe with no additional resources.

Three hotly anticipated studies have recently been released—two by the SEC and one by the Government Accountability Office (GAO)—that have the potential of changing the way financial advisors work and the way they are regulated. First the good news: the GAO, which had been charged with determining whether regulation of financial planners is adequate, reached a balanced and well-reasoned conclusion. They found that while most, if not all, of the activities planners engage in are already fully regulated, there may be some issues with uneven enforcement and opportunities for increased consumer clarity on roles, titles, and duties.

**GAO STUDY: NEW LAYER OF REGULATION FOR FINANCIAL PLANNERS NOT WARRANTED**

The primary challenge with the Dodd-Frank approach in initially mandating the GAO study is that it was built on a false premise. It assumed that “financial planning” is a separate and distinct profession, which, of course, it isn’t. Instead, “planning” is a discipline that crosses many professions and could be used by accountants, insurance experts, attorneys, investment advisors, and others. How would you begin to define what constitutes a planner for purposes of separate regulation and oversight other than through the wide range of activities they perform? Using that approach, almost any financial services professional could be deemed a “planner.”

Luckily for both advisors and the public, the GAO didn't see the need for duplicative regulation and appeared to see through the private agenda that was behind the study’s inception. A few planner groups want to set up their own self-regulatory organization (SRO) reporting to the SEC to control education, credentialing, and standards for their membership. The GAO didn't buy it.

What the GAO did observe—and it continues to be important—is that consistent enforcement must be in place to protect consumers at both the state and federal level. They also found that some consumer confusion remains as to the titles, duties, and standards of care for various types of financial professionals. Some advocacy groups have concentrated on the use of particular titles, which is arguably the least critical issue for consumers. If, for example, separate regulations were established for anyone calling herself a “financial planner,” advisors could quickly change their titles to “wealth manager” or “financial consultant” instead.

It’s much more relevant to talk about the credentials and qualifications that stand behind any one of a dozen common titles being used with the pub-
lic. The American College continues to carry on the fight for strong credentials. Consumers deserve the expertise of advisors who hold their CLU®, CFP® certification, or ChFC®—along with other quality marks—rather than rogue designations earned in a few days at a seminar.

The GAO ultimately made three recommendations: (1) for the NAIC to review consumers’ understanding of standards of care relevant to the sale of insurance; (2) for the SEC to take up the issue of titles and designations; and (3) for the SEC to collaborate with states to better understand complaint data associated with financial planning activities and which practices might benefit from additional oversight in the future.

As for the SEC, as noted earlier, they have their hands full. It seems unlikely that they would willingly broaden the scope of any of their current studies. It is fitting that the NAIC should look at standards of care for insurance sales, because the various groups yelling “fiduciary” every time there’s an open microphone or editorial page don’t seem to understand how insurance works. To be an agent of the company and a fiduciary for the client at the same time is not really workable, at least not in the true sense of what being a fiduciary means.

What’s a little sad about the whole debate is that the various voices in the standards of care debate all really want the same thing—to serve consumers well with the highest ethical standards—there’s just disagreement on how to achieve that end and assure the continuation of consumer choice, product and service availability, and low-cost distribution models.

That brings us to the SEC studies, including their examination of standards of care for broker/dealers and investment advisors. Broker/dealers have operated effectively for years under a rules-based suitability standard, while investment advisors have worked within the framework of a principles-based fiduciary standard. Some argue that the suitability standard is easier to enforce and that it promotes “before the fact” regulation, while the fiduciary standard is more nebulous with actions more often evaluated “after the fact.” Nevertheless, there has been a long push to harmonize the two standards when advisors are providing investment advice about securities to retail customers. The specific standard would be to act in the “best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.” In addition, the study recommends harmonizing disclosures (making sure they’re in plain English), and addressing disparity in other regulations and consumer protections between the two business models.

On the surface, there’s nothing much there with which to disagree. The trouble lies, as it often does, in the details. Will consumers actually benefit from this fundamental change in regulation? Will their costs go up? Will their investment results be better? Will their choice of and access to products and services be diminished? On the subject of cost impacts alone the study spends almost two dozen pages essentially saying “who knows?”

In conjunction with the report two SEC commissioners, Kathleen L. Casey and Troy A. Paredes, issued a statement opposing the study as it is currently written. Their main complaint was that the fundamental research wasn’t done on any of the issues above, and that the case wasn’t effectively made to justify such a major overhaul of regulatory structure. Separately, NAIFA surveys also have indicated that implementation of these changes could force some of their members to change business models or move away from middle-market clients to effectively mitigate the added cost and compliance burdens.

Are consumers actually better served if broker/dealers determine—once the new standards and rules are in place—that it’s in their financial and compliance interest to move to a fee-based model? How will the availability of variable and proprietary products be impacted? It’s true that Dodd-Frank has language that says receipt of commissions or selling from a limited product set should not violate a uniform fiduciary standard per se, but that’s not the same as assuring that the implementation rules for the new standards are business model neutral.

And that’s the key question: if the SEC moves ahead with this rulemaking—after any Congressional intervention or the impact of public comment periods—will the resulting interpretive guidance be workable for all business models and avoid significant additional compliance burdens and costs? Will it protect consumer choice and access?

During a recent House Financial Services subcommittee hearing, legislators appeared concerned about where the SEC is headed, both on the fiduciary duty and on the issue of advisor enforcement. Here’s hoping the SEC is more thoughtful about this issue than some of the self-interested advocacy

SEC STUDY: A UNIFORM FIDUCIARY STANDARD FOR BROKER/DEALERS AND INVESTMENT ADVISORS?

An SEC staff study followed that line of thinking and recommended that the SEC pursue rulemaking to move to a uniform fiduciary standard for broker/dealers and investment advisors when providing personalized investment advice about

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years), much of the credit for translating an important planning concept into law can be attributed to the relationships that leading producers built with key legislators and their consistent political engagement.

From client-driven policymaking to political engagement, producers played a leading role in the enactment of reunification. Countless producers poured valuable time and energy into educating and building important relationships with leading legislative policymakers throughout this process. While engaged life insurance producers pursued reunification with the interests of their clients in mind, they consistently report back how much their political engagement and effectiveness have enhanced their reputation with clients and prospects—and by doing so significantly increased their business opportunities. In short, doing the right thing also makes them more successful.

I would be remiss if I did not also recognize how much industry partners, including carriers, producer groups and other associations also greatly helped with critical legislative outreach and education.

The achievement of reunification is proof that successful advocacy is a team sport. And given the fiscal and other challenges we face, whether it be reunification or broader issues that are vital to the 75 million American families and thousands of businesses and their employees who rely on life insurance products, producer engagement and industry unity and strength have never been more essential.

SEC STUDY: WHO SHOULD BE WATCHING INVESTMENT ADVISORS ANYWAY?

Another SEC staff study deals with the core issue of enforcement. Over the years broker/dealers have been examined much more frequently under FINRA’s jurisdiction than investment advisors have been by the SEC’s Office of Compliance Inspections and Examinations (OCIE). It’s a sore point for broker/dealers, who would like to see more balanced enforcement, and it’s clearly in the best interest of consumers to toughen the oversight of investment advisors.

The SEC has an enforcement capacity issue. While the number of investment advisors has grown and the assets under management have grown faster still, OCIE staff has been reduced. The number of examinations of registered investment advisors has dropped 29.8 percent since 2004. Only 9 percent of RIAs were examined in 2010. With the current budget battles front and center in Congress, it’s unlikely the resource issue will be mitigated anytime soon.

Responsibilities for regular oversight is split with state authorities based on assets under management, and Dodd-Frank raises the threshold from $25 million to $100 million. Even given that change, growth in RIAs subject to OCIE examinations will continue to outpace the SEC’s resources.

The SEC study on this subject punts the issue back to Congress with three alternatives to consider: (1) leave enforcement with the SEC but fund increased resources with user fees; (2) set up one or more new SROs to manage RIA enforcement at the federal level; (3) let FINRA handle examinations for dual-registered advisors. While none of these solutions is ideal, the problem clearly needs to be addressed. User fees will overlay additional costs on advisors, and some feel FINRA is not experienced enough in enforcement under a fiduciary standard of care.

The idea of multiple SROs and giving advisors a choice of which to join sets up the possibility of regulatory arbitrage and extraordinary complexity. You can bet some interest groups will be engaged in trying to carve out their own regulatory areas if this path is pursued. While the answer will probably be either user fees or FINRA, we’ll have to wait and see where Congress goes with this issue.

THE BOTTOM LINE: STAY ENGAGED IN THE DEBATE

Regulatory issues too dry for your taste? Too apt to change with the vagaries of political fortunes or too distant in impact? Let’s not kid ourselves. The resolution of these contentious issues can change the way we are able to serve consumers and conduct our practices. Stay informed through your connections with The American College, state your opinions vigorously in the public debate and comment periods, and support industry advocacy groups such as NAIFA, AALU and others. Your involvement in these issues has never been more important to achieve the ultimate result of steering public policy toward the public good.