Watch Out for Legislation That’s “Too Big to Fail”

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Federal financial services reform may have started with a few core ideas in an attempt to prevent a recurrence of the Great Recession: providing investors and home buyers with more protections, preventing “too big to fail” institutions from posing systemic risk, adjusting bank capital requirements and regulations, and creating more transparency for credit default swaps. But these are inherently complex issues, and the interconnected nature of global financial markets does not easily translate into a simple legislative solution.

Add to the mix that lawmakers are, for the most part, not experts in capital markets and financial services. If the smartest people in finance didn’t fully understand the probabilities of systemic risk, how could we expect Congress, even with the benefit of hindsight, to legislate that risk out of the markets?

Then there is the tendency to legislate by emotion. When the going gets tough, the tough look at polling numbers. If people are angry about bank bailouts, why not create a special tax on big banks, even though they’ve repaid their TARP funds with interest and such punitive measures aren’t good tax policy? If a decade of cheap money added to the problem, why not allow a politically motivated Congress to second-guess decisions by the Federal Reserve, a potentially disastrous move for the economy? If the word “fiduciary” sounds like it’s better for consumers in all circumstances—whether or not it actually is—shouldn’t we just put it in place and worry about the fallout later? The worst possible set of issues to legislate by consumer sentiment is one as complex as those affecting the financial markets.

**THE HOUSE SOLUTION**
There is, however, a certain safety for lawmakers in complexity. H.R. 4173, The Wall Street Reform and Consumer Protection Act, which passed the House on December 11, 2009 is almost 1,300 pages. It establishes a Financial Services Oversight Council; creates financial stability regulations; addresses derivatives, compensation structures and asset-backed securities; creates a Consumer Financial Protection Agency; establishes new investor protections; and more.

In terms of issues directly impacting financial advisors, the House bill’s Consumer Financial Protection Agency excludes advisors regulated by the Financial Industry Regulatory Authority (FINRA) or the Securities and Exchange Commission (SEC), and excludes the business of insurance (with the exception of mortgage and title insurance). The investor protection section of the bill includes a mandate to the SEC to harmonize standards of care at a fiduciary level for brokers, dealers and investment advisors, but it makes special provisions for receipt of commissions and selling a limited set of products. The core language of the standard of care is problematic and potentially unenforceable, but we’ll have to see what emerges from the Senate and, ultimately, the SEC.

There is an ill-conceived amendment in the bill mandating a Government Accountability Office (GAO) study of financial planning regulation, but it falls far short of the push by some advocacy groups to artificially define planning as a profession and create an overlapping regulatory structure for financial planners, adding cost and administrative nightmares to advisors’ practices. This provision may not make it into the final, reconciled bill.

Your profession is counting on your knowledge of these issues and your participation in the debate can make a decided difference in defining our industry for the next generation.
THE SENATE DEBATE

Financial services reform in the Senate Banking Committee has gone back and forth in a tortuous process between a majority-driven effort and a more bipartisan approach. By the date of this magazine’s publication, the revised bill should have moved to Committee mark-up. Where it will end up is anyone’s guess, but Senator Dodd’s announced retirement and the changing political dynamics of the Senate could both play a role. In the final analysis, the Senate will face the same issues the House confronted, and the outcome for advisors is uncertain.

All of the debate around these issues may have informed the Senate in their work. For example, earlier this year Investment News reported that one advocacy group trying to create a byzantine regulatory structure for financial planners “has yet to find a champion even for its more moderate agenda in the Senate.” It could be that legislators are waking up to such voices that are putting their own interests ahead of what consumers want, and that’s an encouraging sign.

WHAT’S THE END GAME?

It’s a long way from where we are now to a new set of workable regulations. Anything could happen in the Senate, in the reconciliation with the House bill and, ultimately, with the agencies who will be implementing some of the changes. The key is to stay informed—on TheWealthChannel.com and through the profession’s advocacy organizations—and stand ready to help legislators understand how the work they do can impact American consumers. Your profession is counting on your knowledge of these issues and your full engagement, now more than ever, and your participation in the debate can make a decided difference in defining our industry for the next generation.

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