'Don't Expect Action By the SEC'

By Kerry Pechter *Thu, Jun 8, 2017*

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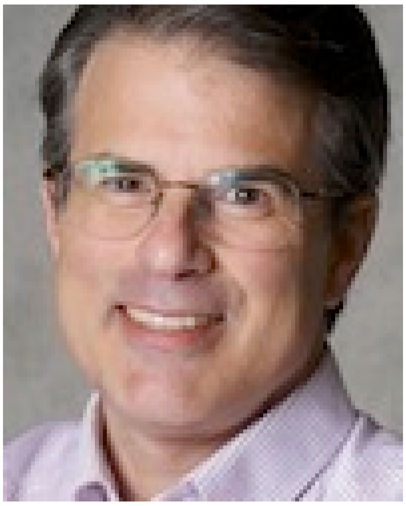

The Security and Exchange Commission called this week for public comments on "standards of conduct" that apply to financial advisors when serving retail investors. But the SEC announcement only "unleashes more uncertainty into an already confused regulatory environment," said an email bulletin this week from a prominent pension law firm.

The firm, Drinker Biddle, warned that "boards of directors, service providers and intermediaries should not expect action in the near future by the SEC with respect to a uniform standard of conduct, as this is not the first time the SEC has called for comments on this issue."

So no one should hold his or her breath waiting for the SEC to push the Department of Labor, and its disruptive fiduciary rule, out of the brokerage space. The retirement industry and its legal teams are receiving about as much useful new information from the SEC about the fiduciary rule as Dorothy Gale got from the Scarecrow when she and Toto stopped to ask for directions to Oz.

A turf conflict between agencies

The SEC's intervention has long been sought by the investment industry, which is accustomed to and familiar with the SEC's rules and their gentle enforcement by the industry's internal watchdog, the Financial Industry Regulatory Authority. It is not accustomed, and resents, additional regulation by the DOL.

The DOL's 2016 fiduciary rule for the first time asserted its authority over advisor behavior not just in the pension arena but also in the retail IRA arena. The rule affected commissioned sales of mutual funds and annuities to individual IRA owners, and was seen by many in the investment industry as an invasion of SEC-regulated and state-regulated territory by Labor.

Some members of the investment industry are concerned that, without an assertion of authority by the SEC, the DOL standards of conduct might eventually apply to all financial advice. It's impractical, some have said, for advisors to have one code of ethics for clients' IRAs and another for their taxable accounts.

The fiduciary rule doesn't affect all advisors. It won't have much impact on the conduct of Registered Investment Advisors, who have always had to act as trusted advisors. And it doesn't affect fee-only planners for the same reason.

But the rule will have, and already has had, far-reaching effect on commission-paid advisors at brokerage firms, and on the product manufacturers who rely on those advisors to distribute their annuities and mutual funds.

Ambiguously, the rule goes into partial effect tomorrow, but now the DOL and the SEC have raised hopes—or fears, depending on your perspective—that the rule might be altered by promising to reopen it for review before January 1, 2018, when the rule is scheduled to take full effect. NAPA Net reported today that the DOL Secretary has sent a Request for Information on the fiduciary rule to the White House Office of Management and Budget as a first step toward reviewing the rule.

What we know now

Drinker Biddle issued an alert on June 6. According to attorneys Diana E. McCarthy and Joshua M. Lindauer:

- The Fiduciary Rule will become effective on June 9, 2017.
- On June 9, providers of investment advice to retirement clients will become fiduciaries and the "impartial conduct standards" will become a requirement of the prohibited transaction exemptions.
- Between June 9 and January 1, 2018, the DOL "will not pursue claims against fiduciaries who are working diligently and in good faith to comply with the Fiduciary Rule and its exemptions."
- On June 1, 2017, the SEC issued a request for public comment on the standards of conduct applicable to investment advisers and broker-dealers when they provide investment advice to retail investors.
- Absent further action by the DOL, intermediaries and advisers utilizing the BICE or PTE must be in full compliance with all of the exemptions' conditions on January 1, 2018.
- Between June 9 and January 1, 2018, financial institutions and advisers must comply with the "impartial conduct standards" when relying on the BICE and PTE. They must give act in accordance with ERISA's standards of "prudence and loyalty" to clients, charge "no more than reasonable compensation," and "make no misleading statements about investment transactions, compensation, and conflicts of interest."

(Some advisors have wondered they can be sued for alleged violations of their fiduciary duty after the rule goes into effect. *RIJ* has been told that the danger of a new wave of class-action suits against brokerages—akin to the wave of suits against 401(k) sponsors and providers in recent years—has been exaggerated by opponents of the rule.)

Given the Trump administration's and the Republican Congress' manifest distaste for federal regulation, they are likely to attack the Obama fiduciary rule. Meanwhile, financial firms are like football fans, waiting nervously while the "zebras" gather around a video booth and watch a replay to either confirm or overturn a ruling on the field—and make a decision that could well determine the outcome of the game.