

The Awful Optics of Fighting Fiduciary Rules

By Kerry Pechter Fri, Apr 19, 2019

Broker trade groups are fighting proposed fiduciary rules in New Jersey and Maryland, but brokers' opposition to consumer protections isn't likely to improve their image.



Last Monday, the state of New Jersey invited public comment on a proposal by the N.J. Bureau of Securities to “establish by regulation (N.J.A.C. 13:47A-6.4), the common law fiduciary duty and apply it to broker-dealers and agents, and to codify it for investment advisers and investment adviser representatives.”

Two financial services trade groups, the Insured Retirement Institute (IRI) and the Financial Services Institute (FSI), promptly responded with press releases denouncing the regulatory move. A month ago, they issued press releases opposing a similar effort in Maryland.

Despite the terrible optics of their war on investor protections, members of the brokerage industry seem determined to keep fighting. Flush with their victory over the Obama DOL fiduciary rule (with help from a sympathetic federal appellate judge in Texas), they may underestimate the cost to their reputations and overestimate the value of the conflicted business model that they’re trying to preserve.

In its release, the IRI warned that independent efforts by the states to regulate advisors would create inconsistent rules across the country, resulting in “fewer advisors, higher compliance costs that imperil smaller broker-dealer or financial advice firms, advisors less likely to take clients with moderate investment funds, and less product innovation and reduced availability of lifetime income products.”

The IRI’s members include many advisers who accept compensation (commissions) from life insurance companies when selling annuities to investors. The industry knows that this form of vendor-financing facilitates a lot of sales that otherwise might not occur, but regulators fret that the practice is not transparent and that it incentivizes inappropriate transactions.

For its part, the Financial Services Institute, which represents more than 100,000 broker-dealer reps, said, “states should refrain from issuing their own fiduciary duty rules. FSI has

long supported a federal uniform standard of care for all investment advice, and we believe the SEC is the appropriate authority to develop such a standard.”

What would the New Jersey rule do? Here’s an excerpt from the [proposal](#):

Proposed new N.J.A.C. 13:47A-6.4(a)1 specifies that for a broker-dealer, or its agent, failing to act in accordance with a fiduciary duty to a customer when making a recommendation or providing investment advice is a dishonest or unethical business practice.

As set forth in subsection (a), a recommendation includes one for an investment strategy, the opening of or transfer of assets to any type of account, or the purchase, sale, or exchange of any security. Subparagraph (a)1i states that when making a recommendation, the fiduciary duty obligation extends through the execution of the recommendation and shall not be deemed an ongoing obligation.

To address the concerns over dual registrants “switching hats” when dealing with the same customer and the resulting investor confusion, the Bureau proposes subparagraph (a)1ii, to state that if a broker-dealer or agent also provides, in any capacity, investment advice to the customer, the fiduciary duty obligation is an ongoing obligation to that customer.

The fiduciary duty will be applicable to the entire relationship with the customer, regardless of the security account type. Paragraph (a)2 provides that it is a dishonest or unethical business practice if an adviser, or a broker-dealer or its agent who has discretionary authority over the customer’s account or a contractual fiduciary duty, or who is acting as an adviser, fails to act in accordance with a fiduciary duty to a customer when providing investment advice.

New Jersey is geographically small, but demographically and financially large. With about 9 million residents, it’s the eleventh most populous state. The median household income is close to \$80,000, or about 33% higher than the US household median. In 2014, New Jersey ranked sixth in the US in sales of variable annuities, at \$6.1 billion.

Other Eastern blue states that are contemplating fiduciary rules—Maryland (which includes professionals and government officials who work in Washington, DC) and New York—are rich too. Along with Nevada, which has a fiduciary rule initiative, those states represent about 13% of Americans likely to buy annuities, according to [Information Asset Partners](#).

The registered-reps and advisers who are represented by IRI and FSI say they want a national standard of care. The Obama DOL offered them a nationwide standard of care, but it was a “fiduciary” standard, and any “fiduciary” rule worthy of the name will disrupt the brokerage distribution model, which, as noted above, relies in part on manufacturers to help finance its sales and marketing functions.

In truth, the brokerage industry doesn’t want any new regulation that might interfere with that model—not state or federal, patchwork or uniform. If there has to be regulation, the industry, as the FSI said, would prefer that the Securities & Exchange Commission (SEC) regulate it. The SEC knows the brokers best and—judging by that agency’s vague new “best interest” proposal—would probably regulate them least.

© 2019 RIJ Publishing LLC. All rights reserved.