Waiting for the Fiduciary Train

By Kerry Pechter *Fri, Apr 25, 2014*

Don't hold your breath waiting for the second draft of the Department of Labor's fiduciary proposal. That's one takeaway from a four-hour meeting at the Practicing Law Institute in New York on Tuesday, where securities law experts mulled the history and implications of broker regulation.

Don’t expect the second draft of the Department of Labor’s proposal for a new fiduciary rule to arrive in August of this year, as scheduled. It still needs to be reviewed by the Office of Management and Budget, and it may be the target of a time-consuming lawsuit while it’s there. The final draft may not appear until after November’s mid-term election.

So said David C. Kaleda, a principal in the Fiduciary Responsibility practice of the Groom Law Firm, at a half-day seminar at the Practicing Law Institute in grimy, glistening Manhattan on Tuesday. The seminar’s timely title: “Financial Services Fiduciary Duties: Navigating the Emerging Regulatory Maze.”

Kaleda, a tall young attorney in a light-grey suit and yellow medallion necktie, was one of the expert panelists who appeared before an audience of several dozen compliance lawyers, many of them seeking guidance on how to help their advice-giving clients or companies avoid future trouble with the fiduciary police.

Opponents of the DoL proposal will likely challenge it with a lawsuit during the up-to-90-days review by the OMB, he said. If that happens, the expected line of attack will be that a stronger standard of conduct for advisers will make advice too expensive for middle-class investors. “The lawsuits will likely be based on costs,” Kaleda told *RIJ*.

No one from the Department of Labor spoke at the seminar, which didn’t focused on pension law. The comments of two of the regulators who were at the PLI seminar—Angela Goelzer of FINRA and David Blass of the SEC—were mostly conciliatory.

“We need to be careful not to shut down a whole business line,” Blass, the chief counsel, Division of Trading and Markets at the SEC, said at one point. “We’re not looking to ban commissions,” he later added. Blass stressed that Mary Jo White, the SEC commissioner, has made it a priority to determine *whether to seek* a unified investment adviser–broker/dealer standard of conduct—not *to seek* such a standard, as she was evidently misquoted.

Those were not fighting words. (The regulators did express special concern about “hat-switching,” i.e., about the potential for double-billing when an adviser wearing his registered rep “hat” earns a commission for selling a product and later, acting as a registered investment adviser, charges a fee for managing the same assets.)

The seminar, chaired by Clifford Kirsch of Sutherland Asbill & Brennan, a prominent D.C. law firm, was ornamented by the presence of Arthur Laby, a Rutgers University Law School professor and expert on fiduciary matters, and of Andrew J. "Buddy" Donohue, a former director of the Division of Investment Management at the SEC who is now a managing director at Goldman Sachs. (Let's pause a moment to appreciate the implications of that.)

Equally noteworthy speakers and panelists included, along with those already mentioned, lawyers William Delmage and David Blass of the Securities and Exchange Commission, Melanie Fein, Claudia Marmolejo of Morgan Stanley, James Shorris of LPL Financial and Steven Yadegari of Cramer Rosenthal McGlynn, an asset management firm.

I attended the seminar to absorb as much detail about the never-ending fiduciary issue as a non-lawyer can hope to. I have to admit that, years ago, the fiduciary issue seemed simple to me. What about *honesty* is so hard to understand, I wondered. Of course, it's not that easy, especially in situations where multiple stakeholders with finely divided loyalties are involved.

For an individual, self-employed, fee-only financial adviser, the fiduciary ideal may in fact be achievable. But for financial advice-givers at huge publicly-traded firms like Morgan Stanley, which conduct proprietary trading, which underwrite and distribute new issues, who may represent clients on opposite sides of the same deal and so forth—this is the situation at Morgan Stanley as Marmolejo described it—the opportunities for conflicts of interest are countless and hard to manage. On the contrary, the firm may value the conflicts as synergies.

Judging by comments from Marmolejo, Shorris and Yadegari, many firms are preparing for more intense management of fiduciary risks, regardless of what the DoL's next proposal looks like. Morgan Stanley, LPL Financial and Cramer Rosenthal McGlynn are all are either adding new compliance positions, setting up cross-disciplinary committees, learning to identify conflict-of-interest "triggers," and developing policies designed to reduce or disclose those conflicts.

How expensive, and how dull, that must be. The reality, in my experience, isn't dull at all. Throughout the whole fiduciary debate (whose roots stretch back at least to the 1999 "Merrill Lynch Rule," which muddied the line between compensation for sales and for advice), I have often wished that the discussions included more of the war stories that I routinely hear.

"War" is not an exaggeration in this context. I've heard eyewitness accounts of wirehouse managers slamming their fists on desks and screaming at novice reps: "No matter what you do here, it will never be enough!" Ex-brokers have described former supervisors who characterized client appointments purely as "opportunities" to reach monthly sales targets. I know mutual fund clients who didn't know that their transactions cost them a dime, unless or until they asked.

In private, the sales side of financial services is often a Glengarry Glen Ross [Warning: This video clip is for mature brokers only] world that few investors see, that arbitration conceals, and that industry veterans rarely kiss-and-tell about. Because this world is largely invisible, the DoL's quest for a higher standard of conduct for intermediaries can easily be made to seem like a solution in search of a problem.

But a problem does in fact exist. Millions of Americans don't seek the financial advice they need because they don't know whom to trust. What's the estimated cost of all that lost business, compared with the cost of regulation? We're not likely to hear that question raised, let alone answered, in the months ahead.