



Ron Rhoades: Arguably, language in the Johnson Amendment provides the SEC with the authority to craft whatever rules it wants to.

Why the New York Times fiduciary article won't deter the special interests

Consumer-protection regulations rarely get stiffer in the legislative process

by **Ron Rhoades**, Guest Columnist

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Elizabeth's note: I e-mailed Ron Rhoades for his thoughts on the New York Times story, [Trusted Adviser or Stock Pusher? Finance Bill May Not Settle It](#). He sent me this response, which covers a lot of ground. It lays out the depressing reality for advocates of the fiduciary standard in the 1940 Investment Advisers Act. Despite the fact that consumers are waking up to the importance of the fiduciary standard, as evidenced by the Times story, special interests are likely to prevail in Washington, D.C.

After decades of refusal by the SEC to apply the Advisers Act's broker-dealer exemption narrowly, as Congress intended (and their continued inexplicable interpretation of when investment advice is "merely incidental" to a sales transaction), it's no wonder that consumers are worried — as evidenced by the *New York Times* piece. (For RIABiz's post on the story, click [here](#)). Now, it appears to me ...

The Johnson amendment is highly likely to be part of the Dodd Bill

It is highly likely that Dodd's bill, when it finally gets released, will come out with the Johnson amendment included in it. The amendment, put forward by Sen. Tim Johnson, D-S.D., charges the SEC with conducting a study of the regulations governing brokers and advisers within 18 months. The agency would have to issue new regulations within two years. The Johnson amendment, in the eyes of many, leaves the "status quo" as to broker-dealer (BD) and registered investment adviser (RIA) regulation, as it calls for a further study of the issue. But — does the Johnson amendment really leave things status quo?

The "danger" of the Johnson amendment

The Johnson Amendment could be construed to give the SEC authority to "harmonize" and/or undertake another exemption from the definition of Investment Adviser Act. Consider this language from a draft of the amendment released a few weeks ago. The study referred to is the one authorized by the amendment to examine the regulations applying to broker-dealers and investment advisors.

RULEMAKING.—If the study required under subsection (b) identifies any gaps or overlap in the legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to such retail customers, the Commission, not later than 2 years after the date of enactment of this Act, shall commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers, to address such legal and regulatory gaps and overlap that can be addressed by rule, using its authority under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) and the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.).

Does not this language, arguably, provide the SEC with the authority to craft whatever rules it wants to, as to BD/RIA regulation? I, for one, am worried that the SEC will seize upon this language to seek to narrow the application of the Advisers Act even further, and to lower the bona fide fiduciary standard of conduct found in the Advisers Act.

Further amendments – likely?

Even after Dodd's bill is released, anything can still happen in the Senate, as the bill goes through mark-up in the Senate Banking Committee and then is subject to amendments during floor debate. But only rarely do consumer protections get better during the amendment process.

Consider the following factors.

1. *Continued Lobbying.* Even after Senate passage, reconciliation will still take place. Wall Street and insurance firms will continue to lobby extensively on this issue – probably in favor of the Johnson amendment, though it's not clear whether that amendment will trump the House version of reform.

The House bill is viewed by financial planning groups as a failure, and an erosion of consumer protection. But, while the House bill weakens the Investment Advisers Act's fiduciary standard, it also imposes on BD's (and insurance companies, as to VA sales) greater disclosure obligations. And it grants enough authority to the SEC for the Commission to impose even stricter (or weaker) standards. So, chances are, the BD/insurance community does not want the House bill, either, if presented with a choice of the House bill and the Johnson amendment.

2. *The Public Does Not Understand the Issues.* While most Americans definitely possess anti-Wall Street sentiment, as evidenced by the public and media outcry over investment banking compensation practices, the public is not engaged at all on determining standards of conduct for those who provide investment advice. We can't blame the public, however. Deciphering the difference between "suitability" and "fiduciary" standards is not something we would expect the lay person to understand, nor advocate upon.

3. *The Consumer Press is Largely Not Engaged.* There are occasional articles, but they are the exception. The consumer press (NY Times, WSJ, other publications) has largely been on the sidelines during this the debate on the fiduciary standard. But who can blame them, given all of the other issues out there.

4. *Strong Leadership from Administration?* Only if the White House and Dept. of the Treasury were to get behind the fiduciary standard – firmly – would it have much chance. But the issue may be too "nebulous" to resonate, politically. It is far more likely that the Administration will put its political muscle behind the break-up of the large banks, and/or the formation of a consumer financial protection agency, as these issues are more concrete and easier for the public to understand.

The fiduciary standard is a multi-billion dollar issue. Why do BD firms and insurance companies resist the fiduciary standard so greatly?

It's a matter of simple economics. Investment advisers are representatives of the client, and as such possess a duty to ensure that the total fees and costs paid by client, both for the receipt of investment advice and with respect to products purchased, are reasonable. The March 3rd *New York Times* article stated that applying the fiduciary standard would cost one BD firm, in one year, \$300 million. Apply that across an entire industry, and you are looking at billions of dollars a year flowing to BD firms, instead of to consumers.

Apply the implications of the fiduciary standard to insurance product sales and many more billions a year of revenue, and profits, would be affected.

And, in my view, the article underestimates the impact of application of the fiduciary standard, as investment product providers would see increased pressure to lower the fees and costs of their products (including not only annual expense ratios, but also the amount of trading activity within funds, which leads to further fees for BD firms). Indeed, what Wall Street fears most are consumers who are advised upon by knowledgeable investment advisers.

The end game

Nearly a year ago, during a speech to advisers, I was asked to opine on the outcome of "regulatory reform." My response at the time? The fiduciary standard will be weakened through legislation, in all likelihood, or by rule-making authority given to the SEC.

Ten months after giving that speech, I still believe this will be the end result. Why? Follow the money. Consumer groups, the Financial Planning Coalition, the Committee for the Fiduciary Standard, and others are being outspent in terms of lobbying dollars (to pay lobbyists, both those that work within BD and insurance firms, and hired guns – and in terms of political contributions). In D.C., as we all know, special interests rule. Without a consumer outcry, strong leadership from the Administration, and broad media support, initiatives like the CFPA and preserving the fiduciary standard don't have much of a chance against the Wall Street firm and insurance company lobbies.

I hope I am proven wrong in my assessment. I hope that the fiduciary standard not only endures, but becomes properly applied as the wise 1940 Congress that established the Investment Advisers Act intended. But pessimism, or perhaps a realistic look at how things get done in Washington today, compels me to conclude that the fiduciary standard of conduct will remain under attack, and that the Advisers Act's standard will be applied less frequently. Moreover, when applied, the Advisers Act's fiduciary standard will likely be undermined by what the late Justice Benjamin Cardozo, in *Meinhard v. Salmon* (1928), referred to as the "disintegrating erosion of particular exceptions."