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The Well-Intentioned Folly of Government Intervention

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For the last year or so, the general public has largely tuned out a story of great significance to our political, financial, legal, and lobbyist classes. When a news story is couched in too much bureaucratic alphabet soup, it will always struggle to gain much traction with readers, and this story certainly fits the bill.

The so-called DOL (Department of Labor) Fiduciary Rule, passed under the Obama administration, resulted from the executive branch's determination that the Securities and Exchange Commission was failing to carry out one of its responsibilities, and from the White House's subsequent, legally dubious decision to usurp that responsibility. So it was that the Department of Labor came to decree that those engaged in the delivery of financial advice as regards retirement-investment accounts (401ks, IRAs, pension funds, etc.) needed to be held to a "fiduciary standard," which is to say, they needed to be legally required to act in their client's best interests, except when they didn't need to.

Confused yet? I thought so. Some explanation is in order.

Brokers v Fiduciaries

I t can be hard for a layman to make heads or tails of the investment products and advice industry in the United States. Brokers are regulated by an independent body called FINRA (Financial Industry Regulatory Authority) and are not required to act in a client's best interests. They work for the firms who employ them and are merely required to provide "suitable" recommendations to the clients they serve. When an investment product they recommend is "suitable," they have done their legal duty, even if a better product was available at a lower price. Conflicts of interest abound in the world of broker-dealers, and they are often not disclosed, let alone avoided. There are bad actors in this space, no doubt, but there are plenty of good actors, too, who, no doubt, act as if they were a fiduciary, even though legally they are not held to the fiduciary standard.

After The Crisis

After the 2008 financial crisis, the SEC was tasked with deciding whether the standard that applied to registered investment advisers (RIAs) should be applied to brokers. RIAs are held to the highest standard of care for clients, treated as legal fiduciaries, meaning that the very best interests of their clients must be their governing consideration, conflicts of interest must be intensely avoided, and those that can't be avoided must be thoroughly disclosed. In fact, disclosure is at the root of most of this controversy, as RIAs have strict requirements to disclose all compensation, whereas broker-dealers do not have to in many cases.

Now you may be thinking what I am thinking right about now: If consumers want to work with someone who does not legally have their best interests in mind, let them — buyer beware and all that. The problem, though, is that the investing public generally has no idea who is wearing what hat when they meet with various financial-services providers. There is, in other words, tremendous confusion over whom each stockbroker or insurance salesman owes his loyalty to.

Addressing this confusion was, in fact, the genesis of the whole DOL Fiduciary Rule mess. In 2009, as the country was still feeling the aftershocks of the financial crisis, the Obama Treasury Department proposed that the SEC establish a fiduciary standard that would bind both broker-dealers and RIAs. But the SEC is not overseen by the Treasury Department and had no mandate to act on the recommendation, so Congress took it upon themselves to "authorize" (but not order) such action in the 2010 Dodd-Frank law. The SEC issued reports, created committees, sought feedback, and held symposiums until 2013, but never acted. Finally, in 2015, shortly after Tom Perez had been named secretary of labor by President Obama, the Labor Department set out to accomplish what the SEC had not, despite its obvious lack of legal authority to do so. By 2016, after extensive negotiations and watering down and altering and opportunities for political theater, the DOL Fiduciary Rule was released.

A Crisis Made Worse

The rule, needless to say, turned out to be a textbook illustration of the folly of government intervention. The original purpose of this effort had been to "protect investors" — a fair and noble goal. But by the time the DOL's final rule was released, it had so many caveats, exceptions, and gray areas that it critics called it a "Swiss-cheese ruling." It claimed to implement a "fiduciary standard," and got many of the same Wall Street brokerage firms that have functioned as non-fiduciaries for decades boast that they were now doing what was best for their clients — but often failed to mention that their best still applied only to a portion of said clients' money, and that they'd only been forced to go even that far by government edict. Meanwhile, the very intelligent, sophisticated financial firms that function outside the fiduciary world did what they do best: They put their creative skills to work to find a clever balance between compliance, and revenue sustenance.

A Turn of Events

Then, a wrench got thrown into the pile: President Trump was elected. All of a sudden the entire ruling was left in doubt, given its dubious legal foundation, and the new administration had new departmental priorities and interpretations of how the rule should be implemented. Lawyers sent out new rounds of suggestions, the media updated all of the headlines on the subject, and questions intensified as to what exactly was going to happen and when. In Senate testimony last week, SEC officials made clear that they remain interested in working with the Department of Labor to make some form of a fiduciary standard a reality. The possibility that trial lawyers become the big beneficiary of this imperfect legislation, rather than investor-clients, cannot be discounted.

The Sad Reality

From the vantage point of yours truly, a registered investment adviser already firmly held to the fiduciary standard both morally and legally, and therefore having no real dog in this fight, the very sad reality is that this battle shouldn't have been fought in the first place — the problem it was intended to solve could have been better addressed by simply redoubling efforts to educate consumers. A free and open marketplace where transparency and choice existed was always the right solution. Instead, we saw the heavy hand of (a no doubt well-intentioned) government intervene, touching off an intragovernmental bureaucratic competition that only served to further muddy the waters. The end

result was a poorly constructed ruling that did not accomplish what it set out to accomplish and may never be implemented.

The Hope Ahead

What now, then? Don't investors still deserve to know whom their "adviser" really works for? Don't they still deserve to know that they're receiving advice that serves their best interests, and to be aware of just how much that advice is costing them? Of course, but governmental regulation is not the best way to make it so. Does anyone believe that a professional practitioner who has to be told by the government not to rip off his clients is going to suddenly become honest just because the government told him to? Fiduciary advisers have a compelling story to tell in the public market, and no doubt they will do just that. Investors can ask exactly how their adviser is paid, and what standard of care he is legally obligated to provide them, and then make their own decision. Honest practitioners will win this fight the way they have been winning it for years now: by providing advice and running an independent-minded business that puts their clients at the top of the totem pole.

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