The FPA Victory Over The SEC, 10 Years Later

December 29, 2017 • Tracey Longo

The Financial Planning Association has bragging rights few groups in the world possess. The membership organization of some 24,000 planners sued the government and, in 2007, won.

The victory forced the Securities and Exchange Commission to vacate its so-called "Merrill Lynch rule," which since 1999 had given the broker-dealer industry the green light to charge asset-based fees without having to register as investment advisors.

In its lawsuit, the FPA successfully argued that the SEC had exceeded its authority by giving Wall Street a prized exemption from securities law and investor protection. In short, the FPA wanted to overturn the regulation that exempted brokers who charge asset-based fees from SEC oversight and a fiduciary rule that required them to put investors' best interests first.

In defense of its rule, "Certain Broker Dealers Deemed Not To Be Investment Advisers," SEC attorneys asserted that broker-dealers should not be subject to the Investment Advisers Act just because they offer fee-based accounts, if their investment advice is "solely incidental to the conduct of their business as a broker-dealer." In addition, asset-based fees should not be considered "special compensation" for purposes of requiring broker-dealers to register as investment advisors.

The U.S. Court of Appeals for the District of Columbia agreed with the FPA, ruling that the SEC did not have the authority to create such an exemption from advisor law. The judge vacated the Merrill Lynch rule on March 30, 2007.

"It was refreshing to see a court look at the facts and back our position. The little guy could still win in America," says Dan Moisand of Florida-based Moisand Fitzgerald Tamayo. Moisand is a former FPA president and a vocal champion of the lawsuit.

"It was absolutely a victory," he says. "We ran by the mantra, 'They're rich, but we're right.' Frankly, it was sad to see the regulators who are first and foremost supposed to protect the consumer side first with the industry. It was an instance of the shepherd giving the wolf a sheep's costume."

Ten years later, he and other advisory industry advocates contend that the victory has had a lasting impact, creating the path forward for comprehensive fiduciary standards that apply to both advisors and brokers alike offering asset-based accounts—even if the path has been slow and arduous.

Since the Financial Planning Association's victory, the SEC has failed to create a single, inclusive best-interest rule to protect investors. Brokers are still not subject to an SEC-mandated

fiduciary standard when they sell asset-based accounts, despite the industry's move toward asset-based fees.

"Ten years later we still don't have a uniform fiduciary standard across the industry," says Shannon Pike, president of Tanglewood Legacy Advisors in Houston and the 2017 FPA president, "but I think the FPA win set the fiduciary train in motion for us to have this discourse."

Jay Clayton, who took over as SEC chairman in May, has repeatedly told lawmakers and the securities industry that the agency will consider a fiduciary rule in the coming year.

At the heart of the matter is a question: Who is (and who isn't) an investment advisor? The Investment Adviser's Act has an explicit fiduciary rule requiring an investment advisor to always act in a client's best interest, while the law and rules governing brokers allow them to choose an investment that is merely good enough for a client, even if it pays a higher commission and costs more than other investments better suited for the client.

In the vacuum left by the SEC, the U.S. Department of Labor took up the fiduciary gauntlet, albeit for retirement investments only, and created a fiduciary rule, producing more than 1,000 pages of regulation about conflicts of interest. But much of the DOL's enforcement was put on hold until July 2019 because of industry opposition and the Trump administration's call for a review of the DOL's rule. Industry organizations including the American Council of Life Insurers, the Financial Services Institute, SIFMA and the U.S. Chamber of Commerce have sued the DOL to vacate the fiduciary rule in its entirety. A decision is expected soon.

Critics note that non-retirement assets are not blanketed by the rule. Also, they complain that the Employee Retirement Income Security Act (ERISA) forbids the DOL from allowing securities salespeople to accept commissions, which has made the department's rule confusing for the industry and investors. Muddying the water further was a discovery by the Wall Street Journal that many of the comments the DOL had gathered criticizing the rule had been faked.

TD Ameritrade Institutional has been a proponent of "best interest" sales standards for more than a decade and filed an amicus brief in support of the FPA's lawsuit. "I am surprised that 10 years after the lawsuit and seven years after Dodd-Frank we are still in the thick of this debate," said TD Ameritrade Managing Director Skip Schweiss.

Are we going to be here talking about fiduciary standards for brokers 10 years from now? "I hope not," says Schweiss. "I have some level of optimism, even reading the tea leaves, that this is moving forward, after a long period of debate. You've got policy makers talking about this being a priority at the DOL, the SEC and the CFP Board, which says it will finalize its own fiduciary standard by February.

"I've been very closely engaged in these discussions for seven and a half years now and I'm as optimistic as I've ever been," he says.

“We’ve heard statements from Chairman Clayton that this is a priority and we take him at his word, but I don’t know what that means in terms of timing or what proposal,” Schweiss adds.

Without the equal application of fiduciary “best-interest” standards to every type of broker who charges fees for advice and products, it’s “caveat emptor for investors,” Moisand says. “There’s a place for that, just not in an office where someone is holding themselves out as a trusted advisor.”

He says his firm does hear from clients who mention a fiduciary standard from time to time, “but we also still see investors who have worked with brokers and have no idea that their entire retirement portfolio is invested in annuities that cost them as much as 5% annually. Sometimes, to make matters worse, the broker has put the annuities inside an IRA. There is no law against that, and there certainly is a place for guaranteed income in some portfolios, but there is no excuse for additional layers of expenses and fees that don’t have to be there. If you’re a broker today, though, you don’t have to pick the best investment.”

What is his ETA for a comprehensive fiduciary rule that would apply to advisors and brokers alike charging fees for advice? “It was 1940,” quips Moisand, referencing the year the Investment Advisers Act of 1940 was enacted.