American Bridge

Trump Policy Brief: Fiduciary Rule Review

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DONALD TRUMP'S POTENTIAL FIDUCIARY RULE REVERSAL

Donald Trump signed a presidential memorandum subjecting the so-called "fiduciary rule" to Labor Department review and leaving open the possibility of the rule being revised or rescinded.

The fiduciary rule, set to go into effect in April 2017, would require brokers to act in the best interest of their customers instead of giving advice which would produce themselves higher earnings from fees and commissions.

Trump's action could impact all Americans relying upon a financial advisor for their retirement investments. Over 80 million Americans stood to benefit from the prohibition on conflicted advice, which cost Americans an estimated $17 billion every year.

A retired couple in their 70s, Elaine and Merlin Toffel, received questionable advice that cost them more than $26,000 in annual charges and could have cost over $45,000 if they needed to access the money early, which they did when Merlin needed to move into a nursing facility because of Alzheimer's disease.

President Trump's Signed A Memorandum That Could Reverse The Department Of Labor's "Fiduciary Rule"

DONALD TRUMP SIGNED A PRESIDENTIAL MEMORANDUM PUTTING THE DEPARTMENT OF LABOR'S "FIDUCIARY RULE" AT RISK OF RESCISSION

Trump's Memorandum Directed The Labor Department To Review The Fiduciary Rule, Leaving Open The Possibility That It Be Revised Or Rescinded

Trump's Presidential Memo Directed The Secretary Of Labor To Examine The Fiduciary Rule "To Determine Whether It May Adversely Affect The Ability Of Americans To Gain Access To Retirement Information And Financial Advice." According to the White House's Office of the Press Secretary, "Memorandum For The Secretary Of Labor[:] Department of Labor Review of Fiduciary Duty Rule. (a) You are directed to examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice." [Office of the Press Secretary – White House, 2/3/17]

- **Trump's Memo Called For The Proposal Of A Rule Rescinding Or Revising The Fiduciary Rule Depending On The Result Of The Review.** According to the White House's Office of the Press Secretary, "Memorandum For The Secretary Of Labor[:] If you make an affirmative determination as to any of the considerations identified in subsection (a) or if you conclude for any other reason after appropriate review that the Fiduciary Duty Rule is inconsistent with the priority identified earlier in this memorandum then you shall publish for notice and comment a proposed rule rescinding or revising the Rule, as appropriate and as consistent with law." [Office of the Press Secretary – White House, 2/3/17]

THE FIDUCIARY RULE REQUIRED BROKERS TO PUT THEIR CUSTOMERS' INTERESTS BEFORE THEIR OWN

The Fiduciary Rule Would Require Brokers To Work In The Best Interest Of Their Clients And Generally Avoid Conflicts. According to the Wall Street Journal, "The fiduciary rule, unveiled last spring and set to go into effect in April, would restrict how brokers can provide retirement advice by forcing them to work in the best interest of their clients and generally avoid conflicts, which can come about with commission-based compensation. It stands to affect about $3 trillion of retirement assets in the U.S., according to research firm Morningstar Inc." [Wall Street Journal, 2/3/17]

Existing Law Incentivized The Recommendation Of Products Based On The Commission A Broker Would Receive

The Pre-Fiduciary Rule Requirement Required Brokers To Recommend "Suitable" Investments, But Not That They Put A Customer's Interests Before Their Own. According to the New York Times, "Brokers, like those at the Toffels' bank, are technically known as registered representatives. They are required only to recommend 'suitable' investments based on an investor's personal situation — their age, investment goals, time horizon and appetite for risk, among other things. 'Suitable' may sound like an adequate standard, but there's a hitch: It can mean that a broker isn't required to put a customer's interests before his own." [New York Times, 10/10/14]

- **Under Standing Law, Advisers Were Incentivized With Bonuses And Perks Like Free Vacations To Recommend Products Based On Their Commissions Rather Than Whether A Product Was Best For Clients.** According to the International Business Times, "As the law now stands, advisers who help millions of Americans save for retirement are under no obligation to work in their clients' best interests. Unbeknownst to many savers, advisers are incentivized with bonuses and perks like free vacations to recommend products based on the commissions they bring, rather than whether a product is best for clients." [International Business Times, 4/5/16]

- **University Of Mississippi Professor Of Law Mercer Bullard: Advisers Could Charge More For Selling One Product Than Another In Circumstances Where There Was No Difference In The Services Offered.** According to the International Business Times, "The monetary incentives that sway the adviser sitting across from them are visible only in the fine print. The problem, said Mercer Bullard, professor of law at the University of Mississippi, is 'getting paid more for selling one product than another in circumstances where there's no difference in the services offered.' An A-share mutual fund, for example, charges an upfront fee that the adviser and firm split. Those sold by Jones carry commissions as high as 5.75 percent for clients of modest wealth. In contrast, an exchange-traded index fund that offers similar exposure may yield a maximum commission of just 1 percent." [International Business Times, 4/5/16]

Aite Group Research Director Of Wealth Management Alois Pirker: The Largest Brokerage Firms Typically Paid Their Brokers And Advisers 45-55% Of Fees And Commissions Generated For Their Companies. According to the New York Times, "At the largest brokerage firms — Merrill, Wells Fargo, UBS and Morgan Stanley — there are incentives to bring in new money. These firms typically pay their brokers and advisers 45 to 55 percent of fees and commissions generated for their companies, explained Alois Pirker, research director of wealth management at the Aite Group, which tracks and advises the financial services industry." [New York Times, 10/10/14]

Rembert Pendleton Jackson Regulatory & Compliance Officer Knut Rostad: Many Brokers Would Push Bad Products At High Prices "Because Their Culture Celebrates Sales." According to the New York Times, "'While many brokers do right by their clients, others push bad products at high prices,' said Knut A. Rostad, the regulatory and compliance officer at Rembert Pendleton Jackson, an investment adviser, and a longtime champion of requiring a uniform fiduciary standard for brokers. 'They do so because their culture celebrates sales. They do so because they can.'" [New York Times, 10/10/14]

Former Edward Jones Financial Advisor Mark Anderson: "The Commission Becomes The Paramount Justification For The Transaction." According to the International Business Times, "What Mark Anderson wanted was simple: to work in the best interest of his clients, free of ethical conflicts. But to do so, the financial adviser eventually found, he would have to leave his job at Edward Jones, a household name in retirement advice. Anderson was a model employee. […] An adviser may offer two similar large-cap growth mutual funds, one of which comes with a substantially higher commission, creating an incentive to sell the higher-paying fund, regardless of whether it performs better than its rival. Or a broker may pile huge amounts of investors' savings into a single mutual fund family due to the bulk discounts afforded by the fund company. 'You end up making decisions that steer people to particular types of products because of commissions,' said Anderson. 'The commission becomes the paramount justification for the transaction.'" [International Business Times, 4/5/16]

- **Former Edward Jones Financial Advisor Michael Kothakota: "They Tell You When You Get There, 'Hey, This Is A Sales Job.' […] You're Basically Trying To Push As Many Clients As You Can Into That Upfront Charge."** According to the International Business Times, "The sales culture at Edward Jones is nurtured from the time training begins, former employees said. 'It's not about how good a money manager or risk manager you are,' the Ohio adviser said. 'It's about how good a salesman you are.' Recruits travel to St. Louis for a high-intensity training program that former employees said focused principally on finding new clients — an expected 25 calls a day, one former adviser said — and selling them company-approved products.' When they train you, they train you to sell specific things,' said Anderson. 'You would have this quiver that has maybe three or four arrows. You want to talk mutual funds? Boom! I have a mutual fund I can sell you.' 'They tell you when you get there, 'Hey, this is a sales job,' ' said Michael Kothakota, who worked at Jones between 2005 and 2008. […] 'You're basically trying to push as many clients as you can into that upfront charge,' Kothakota said." [International Business Times, 4/5/16]

Customers Were Routinely Led To Believe They Were Receiving Advice In Their Best Interest

Rutgers School Of Law Professor Arthur Laby: Brokerage Customers Were Deceived Into Believing They Were Receiving Objective Advice That Was In Their Best Interest When Brokers Called Themselves Advisers And Advertised Advisory Services. According to the New York Times, "Many people think that they are getting that kind of advice when they are not, said Arthur Laby, a professor at the Rutgers School of Law and a former assistant general counsel at the Securities and Exchange Commission. 'Brokerage customers are, in a certain sense, deceived,' he said. 'If brokers continue to call themselves advisers and advertise advisory services, customers believe they are receiving objective advice that is in their best interest. In many cases, however, they are not.'" [New York Times, 10/10/14]

The White House Claimed The Fiduciary Rule Was Bad For Consumers, Comparing It To A Menu Without Unhealthy Options

The White House Claimed Americans Would "Have Better Choices" As A Result Of The Action. According to the Wall Street Journal, "'Americans are going to have better choices and Americans are going to have better products because we're not going to burden the banks with literally hundreds of billions of dollars of regulatory costs every year,' White House National Economic Council Director Gary Cohn said in an interview with The Wall Street Journal. 'The banks are going to be able to price product more efficiently and more effectively to consumers.'" [Wall Street Journal, 2/3/17]

White House National Economic Council Director Gary Cohn: The Fiduciary Rule Was "Like Putting Only Healthy Food On The Menu, Because Unhealthy Food Tastes Good But You Still

Shouldn't Eat It Because You Might Die Younger." According to the Wall Street Journal, "'We think it is a bad rule. It is a bad rule for consumers,' said White House National Economic Council Director Gary Cohn in an interview with The Wall Street Journal on Thursday. 'This is like putting only healthy food on the menu, because unhealthy food tastes good but you still shouldn't eat it because you might die younger.'" [Wall Street Journal, 2/3/17]

- **TIME: A Fast-Food Customer Does Not Assume The Menu Was Health-Focused As Investors Might Assume That A Financial Advisor Was Offering The Best Recommendation For His Or Her Financial Health.** According to TIME, "One problem with Cohn's restaurant analogy has to do with expectations: A visitor to a fast-food restaurant doesn't assume the menu has been put together with his or her health in mind. Ditto when the waiter approaches your table in a white-tablecloth restaurant—whether he recommends the 18-ounce prime rib or the grilled chicken and asparagus over mesclun salad. By contrast, when a financial advisor pitches a corporate retiree to roll his $100,000 401(k) balance into an IRA at the adviser's firm or recommends a particular global-stock mutual fund for another saver's account, those investors might indeed assume that pro is suggesting what he or she believes is best for the investors' financial health." [TIME, 2/3/17]

Trump's Order Could Keep In Place A System In Which Over 80 Million Americans Could Be Receiving Conflicted Financial Advice, To The Tune Of $17 Billion Annually

OVER 80 MILLION AMERICANS STOOD TO BENEFIT FROM THE FIDUCIARY RULE'S IMPLEMENTATION

AARP: "For The 82 Million Households Who Are Counting On Employer-Sponsored Plans Or IRAs For Their Retirement Security, This Loophole Could Mean Losing Nearly A Quarter Of Their Hard-Earned Savings Over Their Lifetimes." According to the AARP, "The rule, proposed in April, requires all retirement plan advisers to provide advice in their clients' best interest. That is the simple goal underlying the new rule. And why not? You've worked hard your entire life. You've put away money for a secure retirement for years. And now, after a lifetime of saving, you are looking forward to a secure retirement — whether it's more time with the grandkids or finally taking the time to travel. But what if one day you discovered that, over the years, 25 percent of your savings had trickled right out of your pocket? Forget a secure retirement — will you even have trouble making ends meet? It sounds like a nightmare scenario, but it's a real concern thanks to loopholes in the law that allow some financial advisers to give investment advice that earns them a higher fee — even if it's not the best advice for you. And for the 82 million households who are counting on employer-sponsored plans or IRAs for their retirement security, this loophole could mean losing nearly a quarter of their hard-earned savings over their lifetimes." [AARP, 7/22/15]

Rebalance IRA Managing Director Scott Puritz: The Fiduciary Rule Was "A Turning Point In Managing Retirement Savings And Making Investing Safer For All Americans." According to the Baltimore Sun, "'I think people are underestimating how historic this is,' said Scott Puritz, managing director of Bethesda-based investment manager Rebalance IRA. 'We believe that 20 years from now, this will be looked back on as a turning point in managing retirement savings and making investing safer for all Americans. At its core, what the rule will do is shine a big spotlight on all of these hidden fees and conflicts of interest.'" [Baltimore Sun, 4/9/16]

Conflicted Advice Cost Americans An Estimated $17 Billion In Annual Losses

Americans Lost An Estimated $17 Billion A Year To Conflicted Advice Every Year. According to the ThinkProgress, "The rule would expand the fiduciary duty standard to cover brokers advising people seeking advice about retirement investments, which currently allows them to steer clients toward the products that make themselves more money at the expense of their clients' needs. Americans lose an estimated $17 billion a year to this conflicted advice every year." [ThinkProgress, 3/31/16]

ELDERLY CONSUMERS COULD HAVE THEIR LIVES UPENDED WHEN STEERED TOWARD INVESTMENTS WITH HIGH FEES

A Retired Couple In Their 70s Invested More Than $650,000 Without Knowing The Hefty Annual Charge Of About 4% Of The Amount— More Than $26,000 Annually, Enough To Buy A New Honda Sedan Every Year. According to the New York Times, "After discussions and an evaluation, the bank sold [Elaine and Merlin Toffel, a retired couple in their 70s] variable annuities, in which they invested more than $650,000. The annuities promised to generate lifetime income payments. "We wanted to make the most amount of interest we could so if we needed it to live on, we could use it," said Ms. Toffel, 74, of Lindenhurst, Ill. What she says they didn't fully understand was that the variable annuities came with a hefty annual charge: about 4 percent of the amount invested. That's more than $26,000, annually — enough to buy a new Honda sedan every year. What's more, if they needed to tap the money right away, there would be a 7 percent surrender charge, or more than $45,000. […] Like many consumers, they say they didn't realize that their broker wasn't required to follow the most stringent requirement for financial professionals, known as the fiduciary standard." [New York Times, 10/10/14]

- **The Couple's Life Situation Changed Due To Age, With One Needing To Move To A Nursing Facility Because Of Alzheimer's Disease.** According to the New York Times, "While the couple followed the bank's suggestion and held more than $200,000 in money market funds, they found that they were short of cash because their life situation had changed: Mr. Toffel, 78, received a diagnosis of Alzheimer's and needed to move into a skilled nursing facility, while Ms. Toffel wanted to buy an apartment in the same senior community. But much of their money was locked inside those very costly annuities, which carried the 7 percent surrender charge." [New York Times, 10/10/14]

- **The Toffels Were Short Of Cash After Following The Bank's Advice And Holding Over $200,000 In Money Market Funds, With Much Of Their Money Was Locked Inside Very Costly Annuities Carrying A 7% Surrender Charge.** According to the New York Times, "When the couple initially went to the bank for investment help, they had a portfolio of low-cost Vanguard funds, with an allocation in the stock market that was probably too high, according to the Toffels' son-in-law, Christopher Lombardo. But following the bank's advice, instead of merely adjusting that portfolio, they sold it and paid taxes on the capital gains. They put most of their money in the annuities, which were invested in mutual funds and paid 5 percent each year. But the illiquidity of the annuities caused serious problems last year, Ms. Toffel said. While the couple followed the bank's suggestion and held more than $200,000 in money market funds, they found that they were short of cash because their life situation had changed: Mr. Toffel, 78, received a diagnosis of Alzheimer's and needed to move into a skilled nursing facility, while Ms. Toffel wanted to buy an apartment in the same senior community. But much of their money was locked inside those very costly annuities, which carried the 7 percent surrender charge." [New York Times, 10/10/14]

- **The Toffels Did Not Fully Understand There Would Be A 7% Surrender Charge, Totaling More Than $45,000.** According to the New York Times, "What she says they didn't fully understand was that the variable annuities came with a hefty annual charge: about 4 percent of the amount invested. That's more than $26,000, annually — enough to buy a new Honda sedan every year. What's more, if they needed to tap the money right away, there would be a 7 percent surrender charge, or more than $45,000. […] Like many consumers, they say they didn't realize that their broker wasn't required to follow the most stringent requirement for financial professionals, known as the fiduciary standard." [New York Times, 10/10/14]