Why it's not OK that NAPFA and FPA agree with FSI about relaxed accountability for holders of IRAs

There is no 'suitability' America and 'fiduciary' America

April 1, 2012 — 11:59 PM by Guest Columnist Philip Chao

0 Comments

Susan John responded to this column. See: NAPFA's John responds to critic questioning her group's stance on compensation in light of new DOL rules.

Philip Chao: The fiduciary standard should not be reserved for the affluent America.

When I read the headline in RIABiz, As DOL contemplates stiff fiduciary-related penalties on advisors, NAPFA and FPA find rare concord with FSI, I felt very uncomfortable as a fiduciary investment advisor. The National Association of Personal Financial Advisors' national chairperson, Susan M. John, and the Financial Planning Association are now singing from the same hymnal as the Financial Services Institute Inc. to categorically reject the application of the ERISA fiduciary standard regarding advice given to holders of individual retirement accounts.

In her written statement submitted to the House Committee on Education and the Workforce on March 21, Labor Secretary Hilda L. Solis stated that "Financial professionals who offer advice for a fee should be required to place the interests of those they are advising first and avoid conflicts of interest. That's exactly what the law currently provides. However, there are regulatory loopholes that advisers can use to avoid accountability. This is what her department's effort to update the Employee Retirement Income Security Act of 1974's definition of "fiduciary" is all about — making sure that those who provide investment advice on retirement savings do so in a way that is unbiased and free from conflicts of interest.

David Bellaire: DOL has inserted itself in the process, with reckless disregard for the will of Congress.

In response, David Bellaire, the FSI's general counsel and director of government affairs, stated on the FSI website, "Once again, today's hearing proves that opposition to this rule which would price millions of investors out of the market for advice on their IRAs is bipartisan, and fierce. While the [Securities and Exchange Commission] has been mandated by Dodd-Frank to develop a new fiduciary standard, the DOL has inserted itself in the process, with reckless disregard for the will of Congress. When pressed again today to simply state what the problem is they're trying to fix, or to work with the SEC and issue a joint request for information, they continued to dodge the critical questions. Hard-working American investors deserve to have a government that works with them,

not against them. We should start with the problem that needs to be fixed, not the solution, a solution that would leave millions of IRA investors without access to advice from a financial advisor that is critical to their financial future."

Time to take action

It is universal knowledge that most Americans have overspent, undersaved and poorly invested for their retirement. With the ravages from the Great Recession still being felt and trillions in home equity having been lost, the standard of living during retirement is being curtailed for all. In the meantime, tax revenue is down and national debt is compounding at a rate that threatens our competitiveness and our old-age entitlement programs.

It is under this set of compromising circumstances that we must take action. Retirement assets should never function as a feeding pond for self-serving professionals. We need to apply the same set of regulations to fee-based advisers and commission brokers and hold them equally accountable for the protection of American workers. The best way is to make certain that these advisors are held to the highest standard of care where the interest of the customer always comes first (duty of loyalty); the advice is given with the care, skill, prudence, and diligence that befit an expert (duty of due care); and the process is carried out honestly (duty of good faith). Once the public is properly educated about the fiduciary standard, it is hard to believe anyone would desire or be satisfied with the inferior or lower standard of care from one who renders or claims to deliver financial advice.

The Prudent Man fiduciary standard, as defined under part 4 of title I of ERISA section 404, mirrors the same set of standards. Who would want to seek advice from individuals who places their interests, or those of their employer equally or ahead of the client and to offer advice that is not based on the care, skill, knowledge and diligence of an expert with the possibility of selectively disclosing facts so that the duty of good faith is questionable?

The Prudent Man standard

NAPFA has been the self-appointed standard bearer to what's right and just in the financial advisory and wealth management industry. The members are supposed to distinguish themselves from others by agreeing and practicing the NAPFA Fiduciary Oath, which states right at the beginning that "The advisor shall exercise his/her best efforts to act in good faith and in the best interests of the client…shall provide written disclosure to the client … and … throughout the term of the engagement, of any conflicts of interest, which will or reasonably may compromise the impartiality or independence of the advisor," among other promises that are strictly in line with the

ERISA Prudent Man fiduciary standard or the fiduciary standard promulgated under the Investment Advisers Act of 1940.

In the case of the FPA, its code of ethics points to seven fiduciary elements of integrity, objectivity, competence, fairness, confidentiality, professionalism and diligence. These elements fall squarely in the duty of good faith and duty of due care camps but only infer to the most important duty of loyalty (“Fiduciary Lite”).

FSI’s vision

The FSI’s “vision is that all individuals, regardless of their level of wealth, have access to competent and affordable financial advice, products and services delivered through an independent financial advisor affiliated with an independent financial services firm. And [the FSI’s] strategy supports [its] mission and vision through robust involvement in FINRA governance, vigorous engagement in the electoral and regulatory process and effective influence on the legislative process.”

FSI is a membership lobbying and advocacy organization representing well over 100 broker-dealer members, 62% of all registered representatives who practice as independent advisors, and more than 35,000 individual advisor members. It is FSI’s fiduciary duty to promote, protect and advance the interest of its members only.

NAPFA’s oath

For NAPFA, their Fiduciary Oath unequivocally states that members agree to serve in a fiduciary capacity only when engaging, serving and advising a client. The Fiduciary Oath does not say it is only applicable some of the time and only to certain types of clients. Further, the oath states, “The advisor, or any party in which the advisor has a financial interest, does not receive any compensation or other remuneration that is contingent on any client’s purchase or sale of a financial product.”

This means that either NAPFA members have not found a scalable model to offer advice or services and therefore have, “price[d] out millions of investors out of the market for advice on their IRAs” or otherwise their fee-only arrangement is affordable. Under either circumstance, why would NAPFA, or to a lesser extent the FPA, en masse abandon their Fiduciary Oath or Fiduciary Lite that they hold dear and run into the arms of the FSI, which vehemently rejects the application of any ERISA fiduciary duties?

The conflicted-advice conundrum

This whole notion of embracing the status quo so that affordable advice can remain available to the average (synonymous to less affluent) hardworking Americas has some

real problems. By inference, this kind of affordable advice is given under a non-fiduciary relationship based on the FINRA suitability standard. This is a commercial sales standard of “buyers beware” and relies heavily on disclosures. To put it bluntly, the financial professional can be compensated only if he or she sells something at the end of the advice process.

Assuming most people need to make a living and are not simply giving their professional expertise for the public good, the relationship is conflicted. The FSI and many other “industry” lobbying groups are saying that if the DOL succeeds in applying the fiduciary standard, the cost of providing advice would skyrocket and make it unreachable by the average American. What they fail to say is that the average American is already paying a hefty sum through front loads, back loads, 12(b)-1, bonus, incentives, trips, soft dollars and other direct and indirect compensation for selling products masked as giving advice.

The question is, is conflicted advice an oxymoron? Assume the average commission for selling a front-load mutual fund is 4% and the average IRA account balance is $20,000; the gross commission paid would be $800. If a fee-only planner charges $125 per hour, this would be equivalent to six hours of billable time (probably sufficient time for a simple financial plan for an average American).

If the same mutual fund is implemented on a load-waived basis, the net cost to the client would be the same. However, the fee-based financial professional would be offering the services as a fiduciary and the average American does not need to guess if the adviser is serving with a divided loyalty or offering an oxymoron.

Feet to the fire

This is an election year, so I will bring back the two-Americas discussion. The application and adherence to the fiduciary standard should not be reserved for the affluent America while the average America is served by conflicted product sales professionals who do not have their clients’ best interests in mind. We have two Americas, and the FSI — and all those who support its view plan to keep it that way. They want to maintain the lower commercial-sales standard for the average America. Is cost the smokescreen masking FSI members’ desire to be more freewheeling? Why is disparity acceptable, let alone proudly promoted, by NAPFA, the FPA, the FSI and certain members of Congress who oppose the application of the highest standard that every hardworking American deserves? Why do they continue to divide us as a nation so that the average American has to live with a lesser standard of care while paying comparable fees for the service?

I say there is no “suitability” America and “fiduciary” America. There is only one America, and we should do everything we can to hold the financial services industry’s feet to the fire so that we have a better chance at retirement.

Philip Chao is the principal and founder of Chao & Co. Ltd. providing retirement and fiduciary plan consulting, health and welfare consulting and wealth management services. He is a certified financial planner and holds an accredited investment fiduciary analyst designation from Fi360. He can be reached at pchao@chaoco.com.

https://riabiz.com/a/2012/4/2/why-its-not-ok-that-napfa-and-fpa-agree-with-fsi-about-relaxed-accountability-for-holders-of-iras

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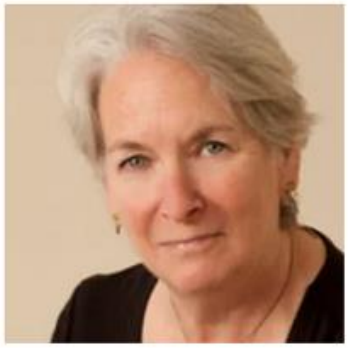
NAPFA's John responds to critic questioning her group's stance on compensation in light of new DOL rules

The national chair says the first objective is not to scare small investors away

April 2, 2012 — 10:55 PM by Susan John

> *Brooke's note: After reading Philip Chao's guest opinion, in response to RIABiz' March 22 article, As DOL contemplates stiff fiduciary-related penalties on advisors, NAPFA and FPA find rare concord with FSI, Susan M. John, national chairwoman of The National Association of Personal Financial Advisors, sent us her response to his comments. We are happy to publish it here.*



Susan John: If no one is willing to advise the consumer of the $25K IRA, that’s a problem.

2 Comments

With all due respect to Philip Chao and his observations on NAPFA and our position on the extension of the ERISA fiduciary standard to IRA account holders, no one has seen any of the details of the re-proposal by the Department of Labor.

The fact is NAPFA led the charge for the strongest fiduciary, fee-only standard in the industry when it was established in 1983. We didn’t wait for a financial debacle to make ethics the No. 1 concern for our members’ clients. NAPFA’s stand on fiduciary rule-making based on the [Investment] Advisers Act of 1940 is unwavering; it defines our dedication to, and relationship with, the public.

Only 2% of advisors would qualify for NAPFA membership. So when we talk about standards, we come first from protecting, and providing true fiduciary advice to, the public. If no one is willing to advise the consumer of the $25K IRA, that’s a problem.

https://riabiz.com/a/2012/4/3/napfas-john-responds-to-critic-questioning-her-groups-stance-on-compensation-in-light-of-new-dol-rules