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Congress, regulators strike out on fiduciary titles

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After the financial crisis of 2008, in addition to their primary focus on fixing gaps in systemic risk, Congress also saw the opportunity to address other hotly debated issues that had been festering for years. The fiduciary standard for brokers is an obvious one. The closely related issue of titles associated with fiduciary standards is another that unfortunately remains almost hidden to the public.

When we look at the history of regulation of financial advice, the 111th Congress that passed Dodd-Frank is only the most recent failure in this regard.

Back in 1940, the 76th Congress was perhaps the first to address advisor titles. At the time, the Investment Advisers Act was under consideration, largely in response to a study of stock "tipsters" who charged fees while ripping off the public. Because they fell below the radar and couldn't be studied, the only organized group of advisors called to testify were investment counselors. While they weren't thrilled about regulation, they testified to fully supporting a fiduciary standard and complained that numerous stockbrokers or "customer's men," as they were called then, often misrepresented themselves by using the same title.

In response, Congress wrote into the new law a provision under Section 208 restricting the use of the title "investment counsel" to those registered under the new Advisers Act. Unless his principal business was acting as an investment adviser and rendering investment supervisory services, a person could not use the title.

Unfortunately, as we know, Congress does not have a long-term memory. Indeed, even with the housecleaning undertaken by the 111th in Dodd-Frank, it did little except study the matter. Had it moved aggressively to mandate registration as investment advisers or a fiduciary standard of conduct, there would have been a chorus of howls and protests the like of which would probably have killed the bill.

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Not even the original benefactor of having title protection, the Investment Counsel Association of America, seems to care much about titles these days.

The ICAA changed its own name to Investment Advisers Association several years ago.

We can find the problem growing exponentially in the late 1960s with the growing popularity of financial planning within the industry and the public. The SEC and state regulators initially didn't quite know what to do with financial planners. There was an ongoing debate over the need to have them register as investment advisers, as their advice was not limited to investments.

The argument to regulate them as investment advisers eventually prevailed. Although many of the pioneers in financial planning believed this would legitimize the new profession, in some ways it only added to the confusion. Without realizing it, the SEC had opened a Pandora's Box by making a fatal error of analysis.

While the SEC's guidance went into an extensive discussion of what constituted investment advice, and even noted that "other persons providing financial advisory services, may be investment advisers within the meaning of the Advisers Act, state adviser laws, or both," it stopped short of offering anything more than a functional definition for investment advisers.

By limiting the scope of registration to function, and not extending guidance to misleading titles that implied the offer of advisory services, the SEC largely failed in its mission other than to regulate financial planners as investment advisers. Others wishing to push the envelope on creative titles found the Commission, now overwhelmed by registration of financial planners, unwilling or unable to crack down. Indeed, it found itself so overwhelmed by the new financial planner registrations that, by the mid-1990s, the average exam cycle of advisers by some estimates was once every 40 years.

However, the SEC could have easily expanded its restriction to titles and not just functional regulation, and with little political opposition. At the time, the old customers' men at broker-dealers were still calling themselves stockbrokers or vice presidents of sales. The accounting profession and insurance agents did not stray far from their traditional titles, either.

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Unfortunately, financial services regulation was so fractured by this time that there was little the SEC could do when insurance producers started to use advisor-like titles. Even before the ICAA shed its own title, the National Association of Life Underwriters went the other way in devising a new name, the National Association of Insurance and Financial Advisors. Still, the SEC should have made the effort.

The National Association of Insurance Commissioners, never an energetic group when it came to market conduct, did at one point draft an Unfair Financial Planning Practices Act that prohibited insurance agents from using advisor-like titles. The industry secured a ‘poison pill’ provision, however, that essentially rendered the provision toothless. The provision allowed agents who had “passed a professional course of study” to use advisor-like designations on their business cards.

Even if regulators had acted in concert to decisively tighten up the use of misleading fiduciary titles, it’s not clear whether the advisory profession could have survived a legal challenge. Ironically, in the early 1990s the Florida Board of Accounting sued Silvia Ibanez, a non-practicing CPA and attorney who also held the CFP designation, claiming the latter usage implied that she was state-certified when it was then, and remains, a private sector designation. Representing herself before the U.S. Supreme Court in 1994, Ms. Ibanez won her case on the argument that the state Board’s actions violated her right of commercial free speech.

Today, we find that barely 11 percent of individual investment advisers act as full-time fiduciaries, or about 30,000, with the remaining several hundred thousand operating under securities laws using various titles ranging from, most commonly, financial advisor to wealth manager. None except the financial planner and pension consultant names have received anything more than a cursory review by the SEC. That is, since 1940 when the investment counsel title was fixed into the law.

Thus regulators find themselves today in flux and, for the most part, ignoring the proverbial elephant in the living room. SEC Commissioner Elisse Walter in particular is adamant in public statements that function and what an advisor does is more important than what they call themselves. This is old hat, and for

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all the talk about new approaches to enforcement and regulation, it shows that the SEC still has an old guard mindset.

With the public not only confused over what a fiduciary standard and related titles mean to the client relationship, it is little wonder that many are reluctant to invest in the markets. Absent more energetic efforts by Congress and regulators to clear up this mess, it will be a long time before a clear and unequivocal position of trust of advisors can be established in the marketplace.

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Fi360 offers a comprehensive approach to investment fiduciary education, practice management and support that has established them as the go-to source for investment fiduciary insights. With substantiated Practices as the foundation, fi360 offers world-class fiduciary Training/Education, Tools and Resources that are essential for fiduciaries and those who provide services to fiduciaries to effectively and successfully manage their roles and responsibilities. Fi360 assists those who rely on their fiduciary education programs, professional AIF® and AIFA® designations, Web-based analytical and reporting software and resources to achieve success. For more information about fi360, please visit www.fi360.com or Twitter:@fi360.