The Daily Dish

Best Interest Regulation

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Eakinomics: Best Interest Regulation

Investment advisors should give their clients advice that is good for the clients. That's a pretty simple notion, but an impressive saga ensued after the Dodd-Frank reforms instructed the Securities and Exchange Commission (SEC) to study the issue and do any rulemaking necessary to ensure it was happening. That made sense, since the SEC has regulated investment advisors since the 1940s. Then regulatory hell broke loose.

First, in a pure regulatory power grab, the Department of Labor (DOL) proposed its "fiduciary rule" — without doing any real investigation into whether there was a real problem to solve and using the thin reed that their oversight of retirement security under the Employee Retirement Income Security Act allowed the new regulation. The resulting rule was a costly disaster, threatened more costs and more limited options for consumers, portended costly litigation bills for wealth managers, and satisfied exactly nobody.

Fortunately, the courts stepped in and the U.S. Court of Appeals for the Fifth Circuit vacated the DOL rule in its entirety, saying on page 31: "The Fiduciary Rule conflicts with the plain text of the 'investment advice fiduciary' provision as interpreted in light of contemporary understandings, and it is inconsistent with the entirety of ERISA's 'fiduciary' definition. DOL therefore lacked statutory authority to promulgate the Rule with its overreaching definition of 'investment advice fiduciary.'"

In other words, DOL had no business doing a fiduciary rule at all.

Now the right thing is happening and (as the plain language of Dodd-Frank directed) the SEC has released its Best Interest Regulation (BIR). Thomas Wade takes a close look at how the SEC navigated the collision between investment advisors (always regulated under the SEC) and brokers who have increasingly moved into the lucrative advisory business (but were not regulated by the SEC). The BIR drops the by-now-toxic "fiduciary" language, but its BIR meets or exceeds that standard. In particular, it requires advisers to mitigate, rather than simply disclose, conflicts of interest.

It simultaneously holds brokers to a higher standard of obligation, but dodges the costly regulatory burden and reduces the threat that investors would no longer have good access to a range of financial advice.

Of course, nothing is perfect, and the BIR includes a fairly onerous set of disclosures. This will doubtless be the topic of many comments on the proposed rule. Regardless, this is a step in the right direction and a lesson in judicious use of the SEC'S regulatory authority.