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Conflict of Interest Proposed Rule and Exemption Proposals
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I am Ron Rhoades, Chair of the Financial Planning Program at Western Kentucky University. I am also a tax and estate planning attorney, fee-only investment adviser and Certified Financial Planner™.

Thank you for the opportunity to speak today. Like other members of The Committee for the Fiduciary Standard, a group of volunteer leaders of the profession who donate their personal time and treasure to advocate on these issues, I am here on behalf of my fellow Americans – the consumers of investment advice.

For many years we have been dismayed by the huge extraction of rents by Wall Street and the insurance companies. We have seen the harm caused to our friends and neighbors. I am here today to pronounce, for all to hear, that the substantial diversion of the returns of the capital markets, away from individual investors, and into the pockets of many of the broker-dealer firms and insurance companies, must stop.

Please permit me to summarize some of the contents of my comment letter.

Overwhelming academic research demonstrates that high fees and costs result in lower returns for investors.

Despite this, most individual investors, when receiving advice from non-fiduciary advisors, are sold high-cost products.

Economic incentives matter. When a person or a firm providing investment advice has the opportunity to receive much higher compensation from the sale of one product, compared to another, the allure of the higher compensation nearly always wins, to the detriment of the consumer.

As a result of this high extraction of rents, individual investors accumulate far less for their own retirement and other needs.

Hence, I applaud the U.S. Department of Labor's proposed rule, which will substantially reduce the conflicts of interest existing today in financial services.

The huge extraction of rents by Wall Street and the insurance companies must stop. The size of the financial services sector, relative to the overall U.S. economy, has grown from under 3% in 1950 to well over 30%, and perhaps even 40%, today.

Wall Street is no longer the grease that fuels the modern economy; rather, it has become a sludge that cogs the engine of U.S. economic growth.

Not only did Wall Street's conflicts of interest cause in large part the economic crisis of 2008-9, but also the International Monetary Fund now estimates that the excessive financializaton of the U.S. economy reduces growth in U.S. gross domestic product by 2% a year. In essence, Wall Street not only led us into the Great Recession, but it is also responsible for our very slow recovery from it.

The detrimental effect of conflicts of interest, resulting in sales of high-cost products, is likely to compound. The diversion of the returns of the capital markets away from individual investors leads to substantially less accumulated capital. This in turn results in higher costs of capital for firms.

Due to conflicts of interest, many individual investors have not accumulated enough for retirement. As a result, the burden upon federal, state and local governments to provide for our retired citizens increases. This results in higher taxes on all of us.

The fiduciary standard is a much-needed correction to the current unworkable system for the provision of retirement advice. The suitability standard, on the other hand, is not the answer. The suitability doctrine emerged as a way to protect brokers from being sued for brokers' stock and bond recommendations, at a time when brokers' services mainly related to the execution of trades.

The inherently weak suitability standard was erroneously extended by FINRA and the SEC decades ago, so that it applies to the selection of investment managers. As such, suitability has served as a shield to protect brokers and insurance agents from adherence to the duty of care so many other service providers possess.

FINRA's recently proposed "best interests" standard is nonsensical. It is just "suitability" with very minor changes. It falls far short of the fiduciary standard. Worse, by using the term "best interests" to describe its standard, when it is clear from a close examination of FINRA's proposal that brokers possess very little in the way of duties to their customers under it, FINRA has been misleading. As Professors Angel and McCabe observed five years ago: "[T]o give biased advice with the aura of advice in the customer's best interest – is fraud."

Simply put, FINRA's proposal permits brokers to continue to act as supply-side merchandizers, instead of trusted purchaser's representatives. FINRA tries to blur the line between representing the seller and representing the buyer. But, as an eloquent Tennessee jurist wrote 160 years ago, it is an "infallible truth that a man cannot serve two masters." This is a time-honored phrase, repeated often by wise men for millennia.

Into the void created by the SEC and FINRA the Department of Labor has, with courage, ventured. I applaud the DOL's efforts to protect our fellow Americans. I applaud the DOL's leadership on this important issue.

In my comment letter I have set forth that broker-dealer firms, and insurance companies, can easily adhere to the DOL's fiduciary requirements, simply by abandoning the conflicts of interest that differential compensation – to both the firm and the individual broker or insurance agent – create.

I also set forth the inevitable conclusion that commissions on products, if not substantially lowered as larger purchases are made, such as by the use of break-point discounts, can easily amount to unreasonable compensation.

Additionally, I set forth a listing of the characteristics of variable annuities, equity indexed annuities, and fixed annuities, which advisors should fully master, before they recommend these often-complex products. Despite comment letters from insurance agents stating that they have devoted a large amount of training relating to these products, in my many conversations with insurance agents I have discerned that they have been trained to sell these products, not to fully understand them.

The fiduciary standard requires that those who provide investment advice are experts. Extensive due diligence must be undertaken. This expert scrutiny levels the playing fields for all investment products. It is altogether certain that most of the variable annuities and equity-indexed annuities on the market today would not survive the due diligence undertaken by an expert, trusted adviser.

I have heard from opponents of the DOL's proposal that it is difficult to adhere to different standards. Yet, it has long been understood by providers of services under two different standards of conduct that the easiest path to ensure compliance is to simply apply the higher standard to the entirety of the relationship.

I have also heard from opponents of the DOL's proposal that they fear "unlimited" liability under a fiduciary standard. Yet, I have practiced as an attorney, and then as an investment adviser, under a fiduciary standard for nearly 30 years. I have no such fears. Just be the expert. Act as the client's representative, and avoid conflicts of interest. Advise the client with candor and honesty. Do this, and you will look forward to going to work each day, counseling clients as a fiduciary, with no worries about liability.

The DOL, while accommodating to a degree the concerns of the industry, should act to preserve over the long term ERISA's tough "sole interests" standard. The BIC exemption, as Mercer Bullard's previous testimony suggested, because it does not prohibit differential compensation at the firm level, will only possess a modest impact in changing Wall Street's conflict-ridden practices. Hence, I have suggested that the BIC exemption be strengthened, and that it be time-limited – in essence, that the BIC exemption be sunset in several years.

Let us move forward in a manner in which "particular exceptions" to the fiduciary standard, to paraphrase the late Justice Benjamin Cardoza, are not permitted to exist indefinitely. Let us conform the securities industry to the fiduciary standard. Let us not change the fiduciary standard just to preserve the conflict-ridden practices of Wall Street.

The Department of Labor should move forward to quickly implement its proposal. Let us preserve the fiduciary standard – the strongest standard of conduct under the law - and in so doing empower a new era of economic growth and prosperity for all Americans. Thank you.