



# The Changing Fiduciary Landscape in Financial Advice

Presented to the Independent Trustee Alliance

By

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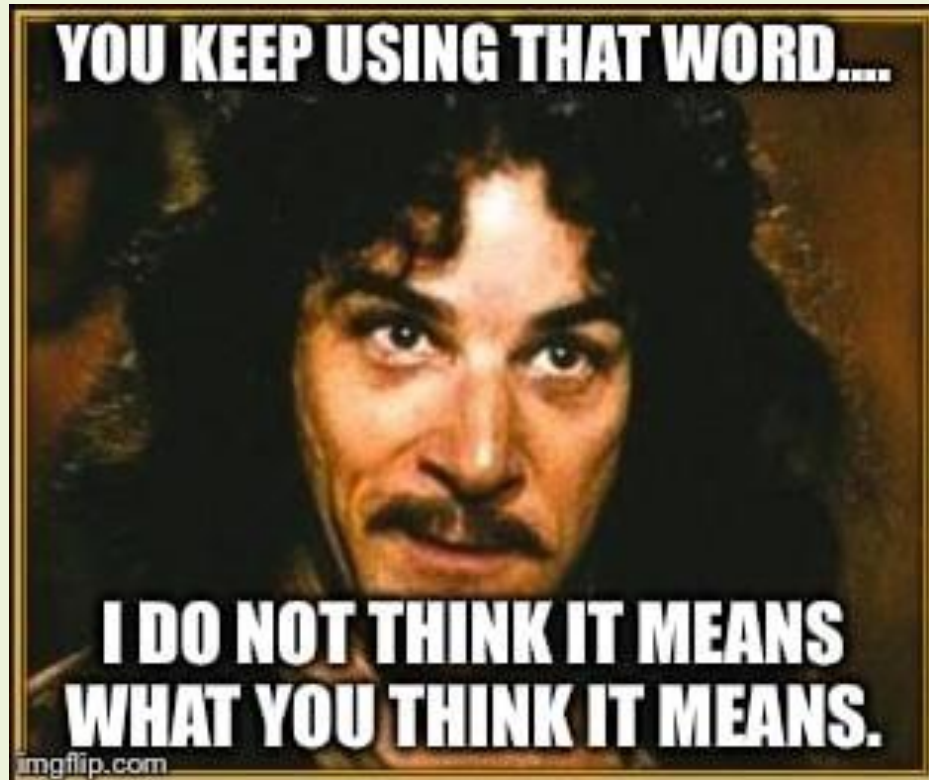
# My Journey

- Started career in financial services in 1992.
- Obtained my CFP in 2003, JD in 2018.
- Have worked with thousands of advisors and hundreds of clients.

**My Aha moment: 2015** - In re Gleeson's Will, 124 N.E.2d 624 (Ill. App. 1955)

This is a practitioner's journey to understand the fiduciary standard.

# You Keep Using That Word



Why are some fiduciaries permitted to have conflicts of interest, while others are not?

Isn't the expectation that consumers make the distinction an unfair shifting of a burden?

## Conflict Avoidance v. Conflict Management

### ITA Code of Ethics

- (a) A member of ITA **must agree to avoid actual conflicts of interest**, and consistent with faithful fiduciary conduct agree not to engage in any activity where there is the reasonable appearance of a conflict of interest.
- (b) An ITA member **shall not engage in any personal, business, or professional interest or relationship** that is or reasonably could be perceived as self-serving or adverse to the best interest of the persons or entity being served.
- (c) The ITA member shall protect the rights of the beneficiaries of the trust against manipulation by third parties.

Source: <https://www.trusteealliance.com/ethics/code-of-ethics/>

### CFP Code of Ethics

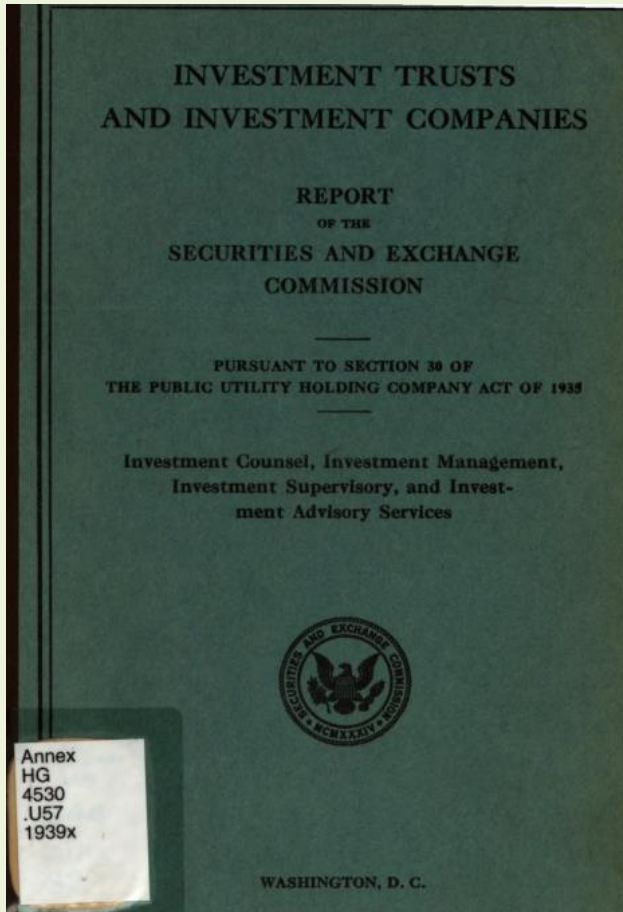
- CFP® professional must act as a fiduciary, and therefore, **act in the best interests** of the Client.
- Duty of Loyalty, ii. Avoid Conflicts of Interest, **or fully disclose *Material* (emphasis mine) Conflicts of Interest to the Client**, obtain the Client's informed consent, and properly manage the conflict;
- Disclose and Manage Conflicts, Section 5, b. **Manage Conflicts**. A CFP® professional **must adopt and follow business practices reasonably designed to prevent Material Conflicts of Interest from compromising** the CFP® professional's ability to act in the Client's best interests.

Source: <https://www.cfp.net/ethics/code-of-ethics-and-standards-of-conduct>

## The Modern Advisory Landscape

- Part I – Foundation
  - *1935 – 1974*
- Part II – Growth and Innovation
  - *1975 - 2018*
- Part III – Reclaiming & Redefining
  - *2018 – present day*

# Foundation: 1935 - 1974



- The report – commissioned in 1935, delivered in 1939
- The foundation of the Investment Advisers Act of 1940
- Excerpt from transmittal letter:

pany Act of 1935. The Commission's survey of investment counsel services was not of the same nature as its study and investigation of investment trusts and investment companies, and this report merely indicates the nature, development, magnitude and some of the more important problems of these investment counsel organizations. The
- The report's primary focus was investment companies and investment trusts, not advisers.
- Source: Letter of Transmittal, authored by Robert E. Healy, Acting Chairman, Securities and Exchange Commission.

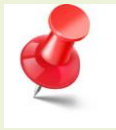


# Report Survey and Findings

TABLE 1.—*Dates of organization of 394 firms replying to the investment counsel questionnaire*

Year of organization	Annual number	Cumulative total	Year of organization	Annual number	Cumulative total
1887.....	1	1	1927.....	8	38
1889.....	1	2	1928.....	9	47
1907.....	1	3	1929.....	20	67
1912.....	1	4	1930.....	23	90
1916.....	2	6	1931.....	44	134
1917.....	2	8	1932.....	55	189
1918.....	1	9	1933.....	41	230
1919.....	2	11	1934.....	44	274
1920.....			1935.....	40	314
1921.....			1936.....	54	368
1922.....			1937.....	13	381
1923.....	3	14	Unknown.....	13	394
1924.....	5	19			
1925.....	6	25			
1926.....	5	30			
			Total.....	394	394

- 394 Investment Counselors surveyed.
- 53 firms, or 13%, were affiliated with brokers or dealers in securities.
- Only 50% of firms had audited financials by an independent 3<sup>rd</sup> party.
- Compensation models included asset-based fees (0.25% - 0.75%), flat retainer fees, profit sharing, and brokerage fees on commissions (soft dollars).





# Investment Advisers Act of 1940

(11) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, or any

In the business of providing advice about securities, for compensation.  
Often described as the "ABCs":

- Advice
- Business
- Compensation

- Who is NOT included?
  - Banks
  - Lawyers, accountants, engineers, teachers – incidental to practice of profession
  - Broker / Dealers
  - Publishers
  - Advising on US Government obligations only
  - Statistical Rating Organizations
  - Family Offices

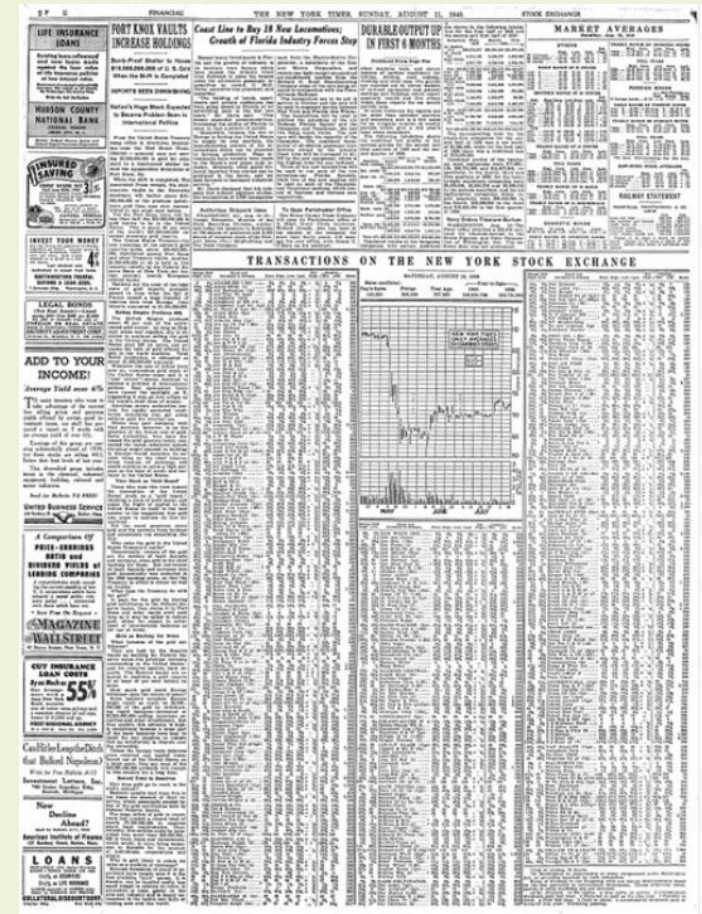




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# Pause and Reflect on 1940

- Social Security is 5 years old.
- 400 stocks on the NYSE
- Who, and how many, owned stocks and bonds?
- Homeownership in 1940: 43.6%



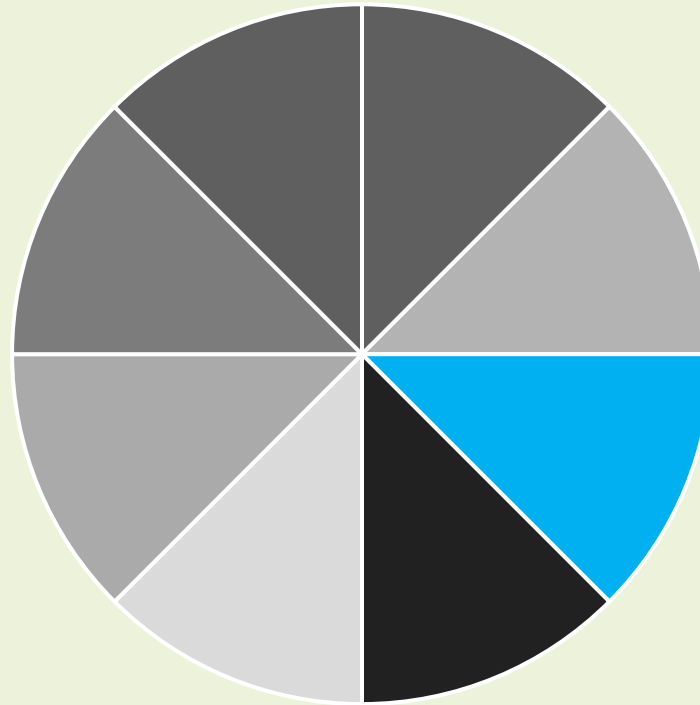
New York Times, Sunday August 11, 1940



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# Areas of Advice - 1940

Financial Planning Areas



■ Retirement ■ Taxes ■ Investments ■ Business Planning ■ College Planning ■ Insurance / Risk Management ■ Debt Management ■ Estate Planning

# The Fiduciary Duty - confirmed

- Supreme Court Decision confirms investment advisers owe a fiduciary duty to clients in ***SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963)***
  - Capital Gains Research Bureau, Inc. (“Respondent”) purchased shares in its own account shortly before recommending the stock in its newsletter. Respondent then sold shares for a gain.
  - Issue before the court: whether this practice “operates as a fraud or deceit upon any client or prospective client” within the meaning of the Investment Advisers Act of 1940?
  - Held – yes, it does.



*“The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested. To insure this, it empowers the courts to require disclosure of material facts. It misconceives the purpose of the statute to confine its application to "dishonest," as opposed to "honest," motives.” – Mr. Justice Goldberg, writing for the majority*

# The lead up to ERISA



- Welfare and Pension Plans Disclosure Act (“WPPDA”) in 1959, involves the U.S. Department of Labor in regulation of employee benefits.
- Teamsters Union’s Central States Pension Fund (“CSPF”), worth \$2.2 billion, founded by Jimmy Hoffa in 1955.
- In 1963, Studebaker defaults on pension plan after closing its South Bend, IN plant.



# 1974 – Employee Retirement Income Security Act (“ERISA”)

Federal law, enforced by the Employee Benefits Security Administration (“EBSA”), a unit of the DOL.

- Standards for participation, vesting, benefits and funding
- Prohibits fiduciaries from misusing funds
- Grants the right to sue for benefits and breaches
- Plan fiduciaries include:

A plan’s fiduciaries will ordinarily include the trustee, investment advisers, all individuals exercising discretion in the administration of the plan, all members of a plan’s administrative committee (if it has such a committee), and those who select committee officials. Attorneys, accountants, and actuaries generally are not fiduciaries when acting solely in their professional capacities. The key to determining whether an individual or an entity is a fiduciary is whether they are exercising discretion or control over the plan.



# ERISA – Defines Investment Advice, 5 Part Test

To be held as a fiduciary, an individual must:

- (1) make recommendations on investing in, purchasing, or selling securities or other property, or give advice as to the value,
- (2) on a regular basis,
- (3) pursuant to a mutual understanding that the advice,
- (4) will serve as a primary basis for investment decisions, and
- (5) will be individualized to the particular needs of the plan.



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# Financial 1935-1974: Foundation

- Summary:
  - 1939 Report – acknowledges potential conflicts of interest.
  - Investment Advisers Act of 1940 – establishes a fiduciary duty for a subset of financial practitioners.
  - Supreme Court affirms the fiduciary duty of investment advisers.
  - Key legislation in 1940 and 1974 arise out of major financial crises.





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# 1975 – 2015: Growth & Innovation

## May 1, 1975

Fixed price commissions abolished –  
deregulation leads to competition, price  
compression, and...innovation?



HOLD FOR RELEASE: 7:00 p.m., April 15, 1975

ZERO MINUS SIXTEEN AND COUNTING

Address by

John R. Evans  
Commissioner  
Securities and Exchange Commission  
Washington, D.C.

Security Traders Association  
of Connecticut  
Hartford, Connecticut  
April 15, 1975

In just sixteen days, the countdown to competitive commission rates will be completed and the fixed rate barrier removed so that market forces will begin to influence public commission rates charged for securities transactions on exchanges. This step represents a fundamental change in the traditional exchange rate mechanism, and it can be expected to have significant effects on competition for business among participants in the securities industry.

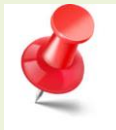




# Brava Financial In the wake of May Day

- Discount brokerages
- Schwab, founded in 1971
- Vanguard, Sept. 1974
- Increasing focus on retail investors
- Blurring between “merchant” and “adviser”

In 1975, EF Hutton creates the wrap account, called “consulting services accounts”, charging 3%.



**Your Own Account/Mary Rowland**  
**Are 'Wrap Arounds' Overpriced?**  
 For small investors, the fees may outweigh the benefits.

**A Growing Trend**  
 Total assets in wrap-around accounts rose 15% in 1990 from \$10 billion through May.

**Top Savings Rates**  
 SMALL SAVINGS RATES  
 MONEY MARKET ACCOUNTS 5.26%  
 6 MONTH C.D.'s 5.80%  
 1 YEAR C.D.'s 6.24%  
 2 YEAR C.D.'s 6.72%  
 3 YEAR C.D.'s 7.22%

**Consumer Interest Rates**  
 Auto Loans  
 20-Year Mortgage  
 30-Year Mortgage

**Lower Fees, Less Service?**  
 BREADCRUMB wrap accounts are a good business for Wall Street, those who provide them are looking for more.

Source, New York Times, Sunday, May 19, 1991

# 1980 – The First 401(k) Plan

Ted Benna, an employee of Johnson, Kendall & Johnson, creates a 401(k)-plan based on provisions in The Revenue Act of 1978.

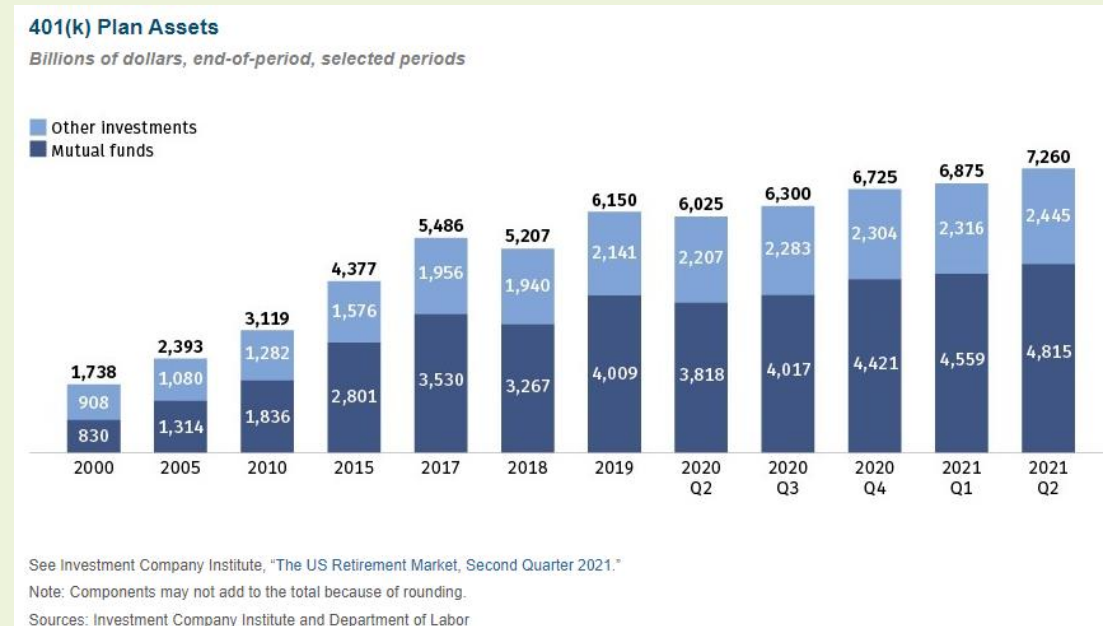
## 401(k) Assets:

1974 - \$0

1985 - \$144 Billion

1995 - \$864 Billion

Sources: Investment Company Institute, US Department of Labor, Form 550 Annual Reports; and Cerulli Associates





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# Pause and Reflect: 1975-1985

- In 1975, the oldest Baby Boomers turned 29.
- April 4, 1975 – Bill Gates and Paul Allen found Microsoft.
- 1976 – Apple releases its first computer.
- January 1, 1983 – considered the official birthday of the Internet.



# Other Notable Milestones

- 1985 – 2008
  - Savings and Loan Crisis, 1980-1995
  - HYB / LBOs, Mike Milken, Ivan Boesky – 1980's
  - Great Bond Massacre, 1994
  - Repeal of Glass-Steagall Act, 1999
  - Dot-Com bubble, 2000
  - Global Financial Crisis, 2008



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# In the wake of the GFC

- **2010** – Dodd Frank passed, DOL proposes expansion of fiduciary definition.
  - September 2011 – DOL withdraws proposed rule.
- **2015** – DOL repropose fiduciary definition expansion.
  - Critically, the rule expands to include IRA recommendations / rollovers.
  - Best Interest Contract (“BIC”) exemption – B/Ds can continue to earn commissions, with rigorous and ongoing disclosure.
- **2018** – 2016 DOL Fiduciary Rule struck down on grounds of unreasonableness, and an arbitrary and capricious exercise of administrative power.

Chamber of Commerce v. U.S. Department of Labor, No. 17-10238 (5<sup>th</sup> Cir. 2018)



# Fiduciary Landscape, 1975-2018

## Summary:

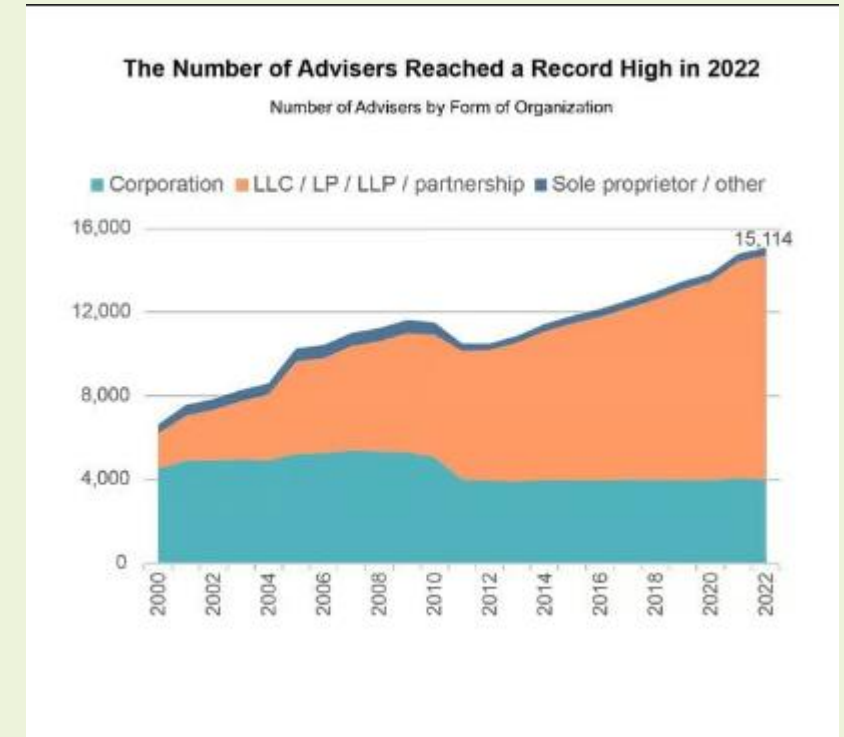
- ERISA – clear fiduciary standard and liability, explosive growth in ERISA plans.
- Deregulation, computing power, and product innovation contribute to capital markets growth – but who exactly is a fiduciary?
- Can an investor expect a best interest standard, or a suitability standard?



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# Today's Financial Landscape

- DOL releases a New Proposal on October 31, 2023.
- As of 2022, 3378 brokerage firms and 15,114 Registered Investment Advisers, many advisers are dually-registered.
- Different definitions of fiduciary duty are emerging.



Source, [Thinkadvisor.com What the RIA Industry Looks Like Now, June 23 2023](https://www.thinkadvisor.com/2023/06/23/what-the-ria-industry-looks-like-now-june-23-2023)



# Brava Financial Newest DOL Fiduciary Rule

2023 Proposed Rule replaces the 5-part test:

*A person is an Investment Advice Fiduciary when that person makes an investment transaction or strategy recommendation involving securities or other investment property to a Retirement Investor; the advice or recommendation is provided for a fee or other compensation (direct or indirect); and the person meets **one** of the following requirements:*

- (1)** The person has any discretionary authority or control, *whether or not* pursuant to a mutual understanding with respect to the purchasing or selling of securities or other investment property of the investor;
- (2)** The person (*or any affiliate of such person*) is in the business of providing investment recommendations to investors, and the investment advice is individualized to the Retirement Investor based on the particular needs of the Retirement Investor and may be relied on by the Retirement Investor in making investment decisions that are in the Retirement Investor's best interest; *or*
- (3)** The person has acknowledged that they are a fiduciary in providing the investment recommendations.

Source: [Mayer Brown, DOL Releases New Proposed Regulation Regarding Investment Advice Fiduciaries, November 16, 2023](#)





# Newest DOL Fiduciary Rule

Final Rule issued on April 25, 2024

- Takes effect September 23, 2024.
- The document is 137 pages.
- Legal challenges are expected.



# Fiduciary Landscape – 2018 to today

- Summary:
- DOL highly motivated to require fiduciary guidance – a fiercely contested position.
- Modern financial planning is complex and multifaceted.
- Clients want an objective, unconflicted adviser.



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# How are advisors paid?

- **Fee-based:** receive compensation from clients, and from product sales and commissions.
- **Fee-Only:** receive compensation from clients only, but this includes, in some cases, percentage-based AUM.
- **Advice-Only:** receive compensation from clients only, often flat fee, negotiated with the client. No product sales, no investment management.



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# Areas of Advice - 2024

Financial Planning Areas



■ Retirement ■ Taxes ■ Investments ■ Business Planning ■ College Planning ■ Insurance / Risk Management ■ Debt Management ■ Estate Planning

# Pause and Reflect: Today

## That was then...

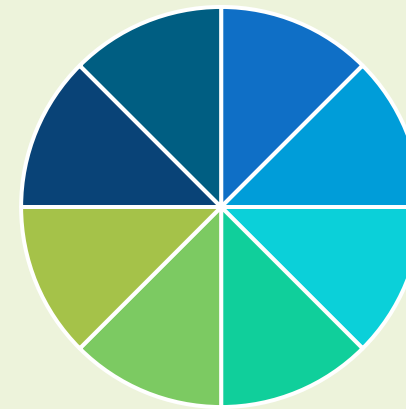
Advice Areas



- Retirement
- Investments
- College Planning
- Debt Management
- Taxes
- Business Planning
- Insurance / Risk Management
- Estate Planning

## This is now...

Advice Areas



- Retirement
- Investments
- College Planning
- Debt Management
- Taxes
- Business Planning
- Insurance / Risk Management
- Estate Planning



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What do you think?

A financial adviser is a fiduciary when \_\_\_\_\_.



# Thank you!

Kelly Nilsson, CFP®, CDFA®, JD

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