

# Pushing to Put Investors First

Published in *Arkansas Business* Nov. 11-17, 2019

by Kyle Massey

For Bill Sowell, “fiduciary” is more than a word, even more than a duty.

It’s his business philosophy. As CEO of Sowell Management, a registered investment adviser in North Little Rock, he embraces a legal obligation to put clients’ financial interests first. And he’s frustrated that the requirement doesn’t apply to everyone across the investing industry.

“I felt from the time I go into this business [in 1990] that there was an inherent conflict of interest in the commission sales model of business,” Sowell said. “If I tell you you need to sell Proctor & Gamble, I get paid when the trade is made, and if I suggest that you buy Hewlett Packard in its place, I get paid for that too. Though I’d never recommend something just to get paid, the conflict left the potential for doubt. Am I doing this for you or for me? But our fee-only model completely removes that conflict.”

Financial services companies have been inching closer to a customer-first standard for decades, but the federal Securities & Exchange Commission mandated a “best interest” standard only last June, and it’s already under fire as too vague.

While the value of a new, somewhat squishy standard is up for debate, the rule will apply to broker-dealers as well as RIAs. The SEC is working with the Department of Labor, which promulgated a failed fiduciary requirement rule back in the Obama administration, to coordinate a regulatory approach to apply next year.

“It’s frustrating to me that we would even need a discussion on the need for putting the best interests of a client first. I mean, as opposed to what?” said Sowell, a North Little Rock native celebrating his firm’s 25th year as a fee-based trailblazer.

He’s devoted his entire career to pushing the industry’s evolution away from commission-based compensation.

Sowell Management, which charges clients a flat fee, has about \$2 billion in assets under management (see list of Money Managers on Pages 22-24) and partners with financial advisers nationwide.



“In any business, some people will try to game the system, and that’s why rules are created,” Sowell said, at times deferring to his company president, Chuck Hicks, and CFO Keith Krueger in a group discussion in a conference room of the firm’s new multi-million-dollar headquarters on Northshore Drive.

“The fiduciary standard hasn’t applied in the broker-dealer world, which instead has a suitability standard,” Sowell said. “As long as a product is ‘suitable’ it’s acceptable, even though it might not be the very best choice. Resistance to the fiduciary duty has come from the side of the business where commissions are attached, whether it’s the selling of insurance products or mutual funds where there are upfront charges.”

Other RIAs in central Arkansas agreed with Sowell, but like several broker-dealers contacted for this article, they said they were restrained by company policies from speaking on the record. RIAs typically charge management fees of 0.5% to 2% per year, depending on the size of portfolios. Sowell’s firm has a fee cap of 2.5%, but no adviser has approached that, Sowell said, adding that the average is “probably 1.25% to 1.5%.”

Arkansas’ U.S. senators, Tom Cotton and John Boozman, vigorously objected in 2015 when Obama’s DOL proposed its fiduciary standard, which was opposed by the conservative American Action Forum and the Securities Industry & Financial Markets Association, among others. The senators are now far more open to any DOL-SEC compromise, their representatives told *Arkansas*

*Business.*

### **Commissions Lose Steam**

“Senator Cotton doesn’t have an objection to financial advisers putting their clients’ interests first — they should. However, the Obama-era fiduciary rule didn’t always meet the best interests or desires of investors either,” James Arnold, Cotton’s press secretary, said in an email. “The fiduciary rule limited the choices investors had and made compliance needlessly complicated for brokers. If you look at what’s really helped investors recently, it’s been the market competition that’s driving down investing fees.”

Krueger, the Sowell CFO, whose career includes stints at Merrill Lynch and Stephens, Inc., noted that Charles Schwab, TD Ameritrade and E-Trade last month slashed trading fees for online trades to zero, a move seen as a reaction to competition from apps like Robinhood.

“You’ve got Schwab, TD and E-Trade cutting trading fees to zero. Well, if I’m a customer of Merrill Lynch, do they cut commissions for me?” Krueger said. “And at some point, if you’re cutting commissions, what’re you going to pay to the commissioned salesman? The dynamics of today’s market are moving everyone toward the fee structure. And it’s also the case that broker-dealers are opening their own RIAs in-house.”

Wall Street objections to previous fiduciary standard proposals boiled down to an argument that they would make financial advice less affordable to the middle class, “adversely affecting the ability of millions of Americans to save for retirement.” as the Securities Industry & Financial Markets Association wrote in a letter to the SEC. Another argument was the rule could set off an avalanche of lawsuits.

But as Sowell and others have said, if financial advice is so bad as to invite litigation, perhaps more suits wouldn’t be a bad thing.

Sara Lasure, a spokesman for Sen. Boozman, said her boss hopes the DOL-SEC collaboration results in “rules that are harmonized between the two agencies” that will “protect access to financial advice” for low- to middle-income investors.

In June 2018, the 5th U.S. Circuit Court of Appeals confirmed its earlier decision to vacate the DOL’s fiduciary rule. The rule would have eliminated many commission structures in the industry by

requiring best-interest investment options rather than simply “suitable” investments. The “best interest” rule now mandated by the SEC pulls back from the hard line, allowing some conflicts of interest by brokers as long as they are disclosed to customers.

### **State Oversight**

The SEC, state securities regulators and the Financial Industry Regulatory Authority oversee broker-dealers and their agents, said Ann McDougal, deputy commissioner for the Arkansas Securities Department. FINRA is a private corporation and self-regulator for the broker industry, successor to the National Securities Dealers Inc.

“The SEC regulates investment advisers who have more than \$100 million in assets under management,” McDougal said. “The state securities regulators are responsible for investment advisers who have less” than the threshold. She said that advisers and their representatives have a duty to act “primarily for the benefit of their clients,” while broker-dealers and their agents must offer recommendations “suitable for the customer” based on customers’ expressed needs.

On June 5, 2019, the SEC adopted the Regulation Best Interest (Reg BI) establishing a best-interest standard of conduct for broker-dealers and their agents when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities, including recommendations of types of accounts,” McDougal said. “Firms must comply with Reg BI by June 20, 2020.”

Benjamin Edwards, a law professor at the University of Nevada, Las Vegas, has written about financial industry regulation and believes the SEC rule just pays lip service to protecting investors.

“Stockbrokers have to make money somehow, and they’re pushed to distribute financial products by their employers,” Edwards said in a telephone interview. “The creators of those products have embedded fees or commissions in these products, and the amount the broker is paid depends on the commission sold. Even deeply honest brokers face a bias, because many times they don’t even know about competing products that might be better for their clients.’

He said many customers simply assume their

advisers are acting in their best interest, and he fears that impression will be falsely amplified by the SEC's new "best-interest" standard. He said the "best interest" term is misleading because the rule's "largely rhetorical protections risk luring Americans into misplaced trust and making the SEC complicit" in their new sales pitch.

### **Good People, Questionable Advice**

"The new guidance from the SEC means that with investment advice nearly anything goes as long as Wall Street firms disclose," Edwards wrote in a commentary published by "The Hill," the Washington government and politics website. The disclosures will come in conflicts-and-operations documents, he said, and "undoubtedly appear as largely incomprehensible gibberish to ordinary humans."

The investor sophisticated enough to read and understand such a disclosure document would already know not to trust the firm's advice, he told *Arkansas Business*. "Many stockbrokers are good people who believe they are doing right by clients, but they operate in a system with conflicts so large they can skew what's seen as the best product for a customer," he said.

"They believe in the products they're selling, but they've been educated by the people who created the products and are paid by the same folks to sell them. Other products may be better, but the broker doesn't even know about them because they're pushed by a different company."

Krueger, of Sowell Management, said one worthy goal of a universal fiduciary standard would be clamping down on practices at large broker-dealer institutions known as wirehouses.

These institutions often underwrite initial public offerings and give brokers an "extra kiss" for

selling them as opposed to offerings from a similar company not underwritten by the boss.

"Companies will have an investment bank and then a distribution side of the business," Krueger said. "This isn't necessarily grossly negative, but it's a fact of business. The investment bank and the distribution source go hand in hand in selling the IPO, but we won't do that kind of thing as an RIA. We can't, and we shouldn't."

Both Krueger and Edwards, the Nevada law professor, note that the gray areas in federal oversight have opened a window for states to set their own standards. "In the near future, more states are going to be making their own rules," Edwards said, though Arkansas doesn't seem to be a likely prospect. "Nevada has a fiduciary statute, the only statute in the nation. New Jersey is considering regulations, as is Massachusetts. New York has set regulations on annuities, and more states seem to be willing to step up."

The SEC missed a chance to clear things up in June, Krueger said. Instead, "it really muddied the waters instead of clearing them. It gave some hint that broker-dealers have to take more of a fiduciary mindset, but it only set a best-interest standard. It also didn't really define what 'best interest' is."

Nevertheless, Sowell expects RIAs and broker-dealers to eventually play by similar rules. "It's my personal feeling that at the end of the day there will be one rule for all people in our industry to live by," Sowell said. "As to how long that will take, I don't really know."