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The Subtle 'Tyranny' of Regulatory Overlords

Who really benefits from the 14,000 pages of Dodd-Frank?

If you're a business owner, you quickly learn the pains of regulation and how it impacts your ability to survive and thrive. Author and theologian C.S. Lewis framed the topic best when he said,

> *"Of all tyrannies, a tyranny sincerely exercised for the good of its victims may be the most oppressive. It would be better to live under robber barons than under omnipotent moral busybodies. The robber baron's cruelty may sometimes sleep, his cupidity may at some point be satiated; but those who torment us for our own good will torment us without end for they do so with the approval of their own conscience."*

This description aptly describes the actions of governmental bureaucrats who make up rules with the blessing of their own conscience, believing that what they do constitutes a moral and public good.

As owner of a recruiting firm focused on the financial services broker dealer industry (one of the most regulated U.S. industries) since 2001, I've watched as the do-gooders grinded our industry from 5,100 broker dealers in 1999 to just 3,940 broker dealers in 2017, a 23 percent decline.

Most of the casualties were smaller broker dealers, which is the typical outcome of excessive regulations that favor larger companies and overwhelm the smaller ones. The "one size fits all" rules become increasingly unaffordable for smaller companies to endure.

Dodd-Frank brought 14,000 pages of regulations for our industry to follow, which is on top of the thousands of pages of regulation before the act. Now, we have impending DOL Rules that total 1,023 pages. These new rules will dramatically hinder broker dealer profitability, restricting product choices for consumers. Under the guise of protecting the consumer, the reality of many of these rules is twofold:

1. They create a complex web of rules and procedures that create a rich environment for extorting money from broker dealers through Financial Industry Regulatory Authority (FINRA) fines.
2. The SEC and lawmakers use the complexity of the rules to ensure their future employment at consulting firms or at FINRA.

University of London economist Anthony G. Heyes explains, "It is precisely the complex, opacity and user unfriendliness which underpin the value of the expertise." They end up "selling advice to those they previously regulated." Many of those who drafted Dodd-Frank now work for consulting firms, advising financial services companies and banks on how to navigate the complex Dodd Frank rules.

The Securities and Exchange Commission (SEC) management that makes the rules for broker dealers have high hopes to someday work for the policeman of the rules, FINRA, where they can see a huge pay raise with many upper management posts earning $900,000 or more. The SEC is supposed to police the police (FINRA), but you can understand the conflict of interest they have in not wanting to upset the golden goose of their coveted future employer.

In an article on FINRA done by Investment News in September titled, *"FINRA: Who's Watching the Watchdog?"* the article points out that FINRA is the watchdog that no one is watching. "It is largely

unaccountable to the industry or to the public as quoted by David Burton of the Heritage Foundation. A broker dealer president, Stephen Kohn of the broker dealer Stephen A. Kohn & Assoc., who has a seat on the FINRA board pressed FINRA by asking, "Where do the funds generated by fines go?" He didn't really get a straight answer.

Given FINRA's tight-lipped nature, we are left with few answers. The SEC is under the thumb of the Freedom of Information Act, thus they are forced to be transparent. FINRA, however, is not subject to the Freedom of Information Act.

For advisors set on illegal activity toward their clients, rules and regulations have little effect, yet we are awash in paperwork, policies and procedures that broker dealers must uphold or face stiff fines.

One broker dealer shared a story of a month and a half worth of missing advisor e-mail tracking they discovered after changing tracking vendors. They were forthright with FINRA by quickly reporting the mishap. FINRA was thankful and then responded, "By the way, we are going to fine you $750,000 and restrict your ability to add advisors for one year." After much back and forth haggling, this broker dealer was able to persuade FINRA to lower the fine to $350,000 with no restriction on their ability to add advisors.

Speaking of growth, did I mention that FINRA restricts how many advisors broker dealers can add to their firm in a given year? They have what is called the "Safe Harbor Expansion Provision," which restricts broker dealers from adding more than 30 percent of their size in a 12-month period. If you want to add more than 30 percent in a rolling 12 months, you need to go to FINRA, fill out forms for your request and get permission to add over the allotment. What industry do you know of where regulatory bodies can control how fast a business can grow?

Regulation works out wonderfully for the Bernie Madoffs of the world (whistleblowers repeatedly warned the SEC about Maddoff's investment fraud, but they turned an inept deaf ear). Regulation is also very useful to FINRA, allowing it to generate fine revenue that ends up in places no one quite knows, with FINRA simply saying the money is used for capital projects. The consumer, on the other hand, is left hoping their advisor has their best interest in mind.

By far the most effective regulator of proper behavior is not regulation, but rather reputation. It's the desire to maintain one's reputation that goes the furthest in keeping advisors on the straight and narrow path. In financial services and many other industries, reputation is the primary driver in doing the right thing. The consequence of not doing so is losing customers. A recent example is Wells Fargo and the $3.5 million fake bank and credit card accounts that Wells Fargo management blamed on unrealistic sales goals placed on employees for encouraging the unauthorized bill pay and bank account openings. Besides the aftermath of 5300 employee firings and a $200 million revenue drop from the previous year while competitors JP Morgan and Citibank posted much more robust growth, the real damage will be the bank's potential for future growth as their reputation has been severally damaged.

Advisors work constantly to build their clients' trust, see their clients succeed through their life phases and find the best solutions to their needs. They do this while also increasing their knowledge through designations such as becoming a Certified Financial Planner, with the intent to continuously improve their reputation with their clients and prospective clients, not by fulfilling FINRA Rule 2010.

We do need some regulation, of course. But I share this with you because oftentimes policies implemented with good intentions have many unintentional consequences that are either detrimental (to brokers and clients) or end up having little to no effect in protecting the consumer from rouge financial advisors and brokers. In a more perfect world, we would have far fewer regulations but much smarter, well-thought out regulations that serve the public interest.

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