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Ethical Standard for Stockbrokers in the United States: An Ethical Analysis of the Suitability and Fiduciary Standards

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By

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Abstract

The everyday investor enters the investment world with an inadequate understanding and knowledge of the market. More often than not, these retail investors turn to the expertise of financial intermediaries, such as stockbrokers or investment advisors. This paper will investigate the relationship between principal and agent as it pertains to the financial service industry. More specifically, the current ethical obligations that dictate stockbrokers' practices will be examined and compared to proposed reforms. In the United States brokers have a legal and ethical requirement to recommend only "suitable" investments to their customers. This standard generates numerous conflicts of interest between brokerage firms and the customers they serve; the products that pay the highest commissions for the broker, may not be the best investment options for the customer. Currently, there are proposals to raise the standard to a fiduciary duty of care, in which recommendations are solely in the best interest of the client.

In part one of this thesis, there will be a focus on the analysis of brokerage firms' revenue streams and apparent conflicts of interest. This section will also look at the historic development of both suitability and fiduciary standard, as well as briefly discuss the current legislative development of ethical standards in the investment industry. In part two of this thesis, focus will be directed to the role of ethics in finance as a whole. Here, an analysis and comparison of various ethical theories and debates will be highlighted; primarily stemming from the neoclassical economic rationale of ethics and variations of agency theory.

Introduction

Business literature has addressed (the ethics of) socially responsible investing and insider trading at great lengths, but there is very little examination of the specific issues surrounding the stockbroker's suitability standards and the coinciding ethical implications. The investment world has received attention in relation to what is or isn't ethical trading or investing – who, when, and how should the client invest – but not on the side of what is ethical of the sellers of financial products. Stockbrokers in the United States currently have a legal requirement to only recommend "suitable" investments to their clients. The suitability standard pales significantly in comparison to the ethical rigidity of the opposing fiduciary standard, and allows room for unethical practices. The ethical obligations of these professionals are currently a matter of political debate. The proposed reform of fiduciary, would require brokers to "act solely in the interest of the customer or client without regard to the financial or other interest the broker, dealer or investment adviser providing the advice." The debate between suitability and fiduciary standards raises questions not only about the relationship between broker and customer, but the role ethics plays in finance as a whole. This paper will examine this issue and the ethical logic behind the proposed reforms.

In simplest terms, a stockbroker is a seller of financial solutions in the form of investment avenues. The role brokers can play range from executing simple tasks to providing customized recommendations. Clients hire brokers to act on their behalf and use their professional expertise to efficiently execute tasks. The relationship relies on the concept of efficiency and dependency; the broker is the expert in this field and the client is paying them for ease and assurance – the demand of one does not effectively exist without the supply of the other. The relationship is complicated by conflicts of interest. Inherent in any agency relationship carries the possibility that the agent will be unfaithful. The financial industry is no exception. The possibility that brokers will serve their own interest at the expense of their clients' is widely recognized by society at large. Since brokers are often compensated from commissions on their transactions, the best solutions for the client may not be the most profitable one for the broker. Herein lies the source of the legal and ethical debate on proposed reform. Would requiring brokers to adhere to a fiduciary standard yield net benefits to clients, or would it hinder the efficiency of the industry?

While the issues of conflicting interest and legal ethical requirements impact the benefit of stockholders the most, it is important to address the lack of common knowledge surrounding the issue. The laws of the investment world and the practitioners within it aren't topics of daily life, nor are they addressed as necessitating active conversations. Therefore, before discussion delves any further, it is important to address these issues as they pertain to the public as well as the industry.

As stated above, the topic of stockbrokers' ethical obligations and regulation debates is simply not common knowledge nor prevailing topical significance. In a survey completed by Infogroup (2010), most Americans found it confusing to determine which financial professionals are required to operate under "fiduciary responsibility." The survey found that 34% of the 1,319 investors surveyed incorrectly think that financial advice is the primary service of stockbrokers, and 66% believe that stockbrokers currently have a fiduciary duty to their clients. There is a clear discrepancy between the way the public believes brokerage firms operate and the way they actually operate. Whether or not a firm adheres to fiduciary or suitability standards is not something that is always explicitly advertised/transparent. As it currently stands, it is the responsibility of the client to do the due diligence to "shop around" and find the firm that provides them the best or most ethical services.

From within the industry, the debate of fiduciary and suitability calls to question a weighted importance on profit or reputation. In his testimony before the House of Telecommunications and Finance Subcommittee, Warren Buffett, the then newly appointed chairman of Salomon Brothers Inc. stated that, "Lose money for the firm, and I will be understanding; lose a shred of reputation for the firm, and I will be ruthless" ("Securities Trading Investigation."). Buffet has been recognized by the financial community for his stance on reputation over profit; he shown a light of honesty and integrity among financial practitioners. Financial economists have generally highlighted trustworthiness and the pursuit of reputation as the agents to steer ethical behavior. Fiduciary responsibility is a source of insurance that financial services are fair and equal opportunity. The current practices in the financial industry are key instigators of the sleazy reputation of financial services. As a result, there is an established disconnect and lack of trust in the profession. History has shown that there is a majority in the field that does not act in the best interest of the client.

The concept of professional ethics and the very term "ethics" insinuates a largely moral component; it suggests professional ethics as an applied branch of moral philosophy. Similar to this notion, ethics are often understood as a moral code for a profession. A superficial application of a moral code, as reflected in legal regulations, sets the bar for ethical divergence in that industry. Currently, the financial industry has set the bar at a suitability standard; allowing room for ethical discrepancies and inequity. In part, the purpose of this paper is to analyze the ethical structures and regulation of the industry. The second purpose of this paper is to suggest ethical and economic rationale for proposed reforms.

This paper is structured as follows. Part I presents the background information required to further analyze this topic. There will be a focus on the analysis of brokerage firms' revenue streams and apparent conflicts of interest imbedded in this system. This section will also look at the historic developments of both suitability and fiduciary standard, as well as briefly discuss the current legislative development of ethical standards in the investment industry. It is important to note, that while this paper discusses and references the current legislation and political atmosphere, focus lies on the ethical implications these laws have on agency relationships and standard reform. Part II focuses on the role of ethics in finance as a whole. Here, an analysis and comparison of various ethical theories and debates will be highlighted; primarily stemming from the neoclassical economic rationale of ethics and variations of agency theory.

Part One: Legality & Financial Economics – Impacts & The Facts

Foundational Information

For many investors, the financial industry is filled with a language of its own. Terms like front-end loads, liquidity, and Sharpe ratio aren't a part of the everyday persons' vernacular, nor does their use by industry insiders lift the veil of confusion and clarify the situation. Naturally, the complexity of the market and the financial services surrounding it necessitates a fitting language. To successfully participate, investors are required to make a review of terminology and verse themselves in the related operations. Because the audience of this paper is aimed at not only financial professionals but the general public, it is essential to break down important terminology and concepts that will be relevant to the greater analysis of and discussion on ethical standards. This includes: Professional titles, firm operations, revenue streams, and regulatory bodies.

The purpose of this section is to not only define and explain what the relevant information/terminology is, but how it specifically relates to unethical behavior in the industry. Detailing why it is important to distinguish between these terms, organizations, and concepts.

Professional Titles

Every investor works with financial institutions in some capacity. This can range from the execution of trades to guidance in investment strategies. One of the most overlooked sources of confusion involves the different categories of institutions and their representatives. In particular, broker-dealers and investment advisors are similar in several regards, but few investors know the significant differences between them. While they do offer similar services and are often compensated in similar ways, they are regulated very differently in the United

States. Some investment advisors are registered directly with the Securities and Exchange Commission (SEC) and are known as Registered Investment Advisers (RIAs). On the other hand, stockbrokers are not registered with the SEC, but are instead registered and under the jurisdiction of the Financial Industry Regulatory Authority (FINRA). To the everyday person, the difference of registering and regulatory bodies holds minimal face value. In reality, this minimal difference is the determinant of ethical obligations in financial services. This section will discuss the aforementioned differences in greater detail and their relevance on ethical standards.

Registered Investment Advisors

Firstly, what is a RIA? While generally described as investment advisors registered with the SEC or state securities administrators, RIAs fall under separate regulation than their broker counterparts. As previously mentioned, the difference in registering and regulatory bodies is the factor affecting the nature of a financial professional's ethical obligations. In general, investment advisors registered with the SEC are held to a fiduciary responsibility; meaning, RIAs have an obligation solely to act in the best interest of their client. This provision has been detailed under the Investment Advisers Act of 1940.

The Investment Advisers Act of 1940 is a United States federal law that was created to monitor and regulate the activities of investment advisers; specifying what qualifies as investment advice and stipulating who must register with state and federal regulators. The Advisers Act addresses the main question of who is and who isn't an adviser by applying three criteria: the nature of the advice offered, method of compensation, and whether or not the majority of the individual's income is generated by their primary professional function (providing investment advice). Section 205 of the Advisers Act, outlines one of the biggest differences between RIAs and brokers; RIAs are prohibited from acting as principals against (the interest of) their clients. Furthermore, the Advisers Act prohibits an investment adviser from entering into, extending, renewing, or generally performing any advisory contract that yields compensation based on the capital gains or losses of their client (*insert subtext citation to the advisors' act).* While they are permitted to collect commission on products sold to customers, many advisers portray themselves as "fee only" to clarify that they do not receive commissions on their recommendations. This pay structure reduces the financial incentive and client concern of biased advice based on personal commission/gain.

Stockbrokers/Broker-Dealers

A stockbroker is a financial professional who executes trades on behalf of clients. As previously mentioned, stockbrokers, unlike RIAs, are registered under FINRA. Therefore, stockbrokers are not held to the same fiduciary duty of care, but rather are obligated to meet the suitability standard. Comparatively, this is a fairly weak standard. As the name indicates, the standard requires stockbrokers to make investment recommendations that are "suitable" to the client and their situation, but not necessarily the best recommendation or solution. This difference of duty of care, ethical standards, and regulatory bodies is one of the base inducements of ethical divergence in financial services.

In the United States, broker-dealers have always acted as both the agent and principal in regards to their clients. The *broker* acts as an agent who executes transactions on behalf of customers. A *dealer* acts as a principal; buying securities from or selling securities to a customer out of its own accounts. United States regulators, after debate over the merits of segregating the two duties, determined that a single individual/role may act in both capacities. Historically, stockbrokers and brokerage firms have provided a number of services. They have executed transactions, arranged for the delivery of securities, maintained custody of funds and securities, and performed accurate recordkeeping (Macey, 969). The specificity of brokerage transactions and operations will be detailed in the later portion of this section. Despite the enactment of securities laws in the 1930s and 1940s, brokers have always provided advice to their clients to some degree. In this instance, brokers have shielded themselves from stringent adviser regulation by taking advantage of their exclusion from the Advisors Act. Under this exclusion, brokers are permitted to give advice, given advice is solely incidental to brokerage services. The normal services provided to brokerage customers are charged by commission on every transaction, while distinct advisory services are a separate fee. Thus, all brokers, including those who provide advisory services, are paid on a primarily commission basis.

The brokerage industry has received significant criticism regarding the financial incentives procured from commission based pay for stockbrokers. Naturally, commission creates a powerful incentive for the inappropriate management and professionalism of duties. The industry has received specific criticism for a practice known as churning – the practice of executing trades for the purpose of generating higher commissions from the account. As a result, the industry responded by introducing "wrap accounts" in which clients paid a flat annual fee for unlimited trading; eliminating the possibility of churning accounts. The SEC had permitted the treatment of wrap accounts as brokerage accounts, rather than under the stricter requirements related to RIAs. However, due to a 2007 court case, this treatment was invalidated and the industry was forced to "unwrap" wrap accounts. If not, they would be required to register as investment advisers and abstain from proprietary trading. Subsequently, the opportunity for unethical practice in regard churning and fortifies financial incentives.

Many brokers call themselves investment planner or investment consultants, despite the fact that they are not registered investment advisors, nor are they held to the same stringent rules. Consequently, consumers are often left confused about what standards apply to various financial intermediaries. In a survey completed by Infogroup (2010), most Americans found it confusing to determine which financial professionals are required to operate under "fiduciary responsibility." The survey found that 34% of the 1,319 investors surveyed incorrectly think that financial advice is the primary service of stockbrokers, and 66% believe that stockbrokers currently have a fiduciary duty to their clients. The similarities between the services provided by RIAs and brokers have led to much of the confusion among clientele, and are one of many reasons for the proposal to extend the ethical requirements of brokers to parallel that of RIAs.

Firm Operations

In order to understand what makes up stockbrokers' ethical and unethical practices, it will be important to first understand how brokerage firms operate. This section will include an explanation and discussion on brokerage firms' mandatory disclosures, as well as the nature of commission based pay systems. While this section is pertinent to the greater discussion of ethical standards and practices in stockbrokers, disclosures and commission based pay systems will be discussed as it pertains to the general financial industry and investor behavior.

Disclosure

The subprime crisis of 2007 and 2008 brought to light many abuses in the financial sectors and as such, substantial financial regulatory overhaul followed in the form of laws such as the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Upon enactment, the Dodd-Frank Act did not impose uniform fiduciary duty upon all professionals giving financial advice, as we have seen in the above mentioned section. Rather, the act required the SEC to create a way for investors to receive clear disclosures from their investment professionals concerning any material conflicts of interest. Given the benefits and effectiveness of mandatory disclosure by issuers, there is no surprise that disclosure has become a default remedy in regards to regulation and consumer protection. In the business world, mandatory disclosure is proclaimed as one of the best "disinfectant" and "antibiotics" for ethical demise. Still, there are grounds for reservations and concern. Antibiotics are a wonderful line of defense, but as infection evolves, so reduces the efficacy of the remedy. Disclosures provide consumers a base line protection against unethical practices, but proves inadequate when the actual foundation of ethics in the industry are unreliable.

In the financial world, there tends to be an overreliance on disclosure. Economists tend to make the assumption that investors are fully rational individuals who make decisions based on optimal resource allocation and wealth maximizing decisions. If this were truly the case, full disclosures are an appropriate remedy for any industry ailment, if not the only remedy needed. If people had both full access to relevant information, and the ability to be fully rational in how they processed information, disclosure would be the solution to numerous situations. However, this is not the case. The problem with sole reliance on disclosure to enable and protect investors is primarily cognitive in nature; deriving from the confusing presentation and complex nature of disclosures.

As mentioned in the previous section and will be further detailed in the later part of this paper, brokers are held to a suitability responsibility. Assuming there are reasonable grounds to believe that a security is suitable for the client, it is permissible to recommend.

However, if multiple options are suitable for the client, the broker may simply choose the stock that generates the highest commission. Even if it is the poorest option for the client. While this would violate a fiduciary duty, a broker does not owe the client such duty, and thus is perfectly fine under the existing regime. Under the Dodd-Frank Act and several other regulations, so long as the recommendation meets suitability and the broker's exclusion from fiduciary responsibility is disclosed, this practice would be appropriate. In this situation, regulation assumes that the mere presentation of disclosure to the investor provides adequate explanation of the broker's responsibility and possibility of undue service. Regulation has adopted the belief that all investors are rational and competent in their evaluation of such disclosure. The economist Herbert Simon once noted that since humans seldom have complete and perfectly accurate information, as well as an inability to perfectly process such information, people are "intendedly rational but only limitedly so" (Prentice, 1069). Therefore, despite the fact that investors are informed that their brokers owe them no fiduciary duty, investors should not bear the responsibility of fully understanding the disclosure.

Additionally, investors tend to remain rationally ignorant. When provided a surplus of information and limited processing time, investors will generally pursue a course of action that satisfies minimum requirements rather than optimizing the information provided. Investors typically do not read disclosure documents, and if they do its not in its entirety. Hence, when an investor receives a disclosure stating that their broker owes them no fiduciary duty of care, they will either (a) not read it and assume fiduciary service, or (b) read it and overlook what it means to not be owed a fiduciary duty. In this instance, investors are simply optimizing their time and the resources provided, and such is rational. At the end of the day, the everyday person cannot be expected to spend hours upon hours gathering information about one of just hundreds of decisions they make throughout their lives. Investors seek out the professional services of brokers for the purpose of optimizing their time and assume a reliance on brokers for accurate and fair information. If investors are forced to bear responsibility to investigate complex and lengthy disclosure documents, this calls to question the complexity of stockbroker's practices and the ethics involved. Furthermore, if no stockbroker owes their clients a fiduciary duty, what should the client do with the information? The disclosure of a lack of fiduciary service does not assist them in choosing a fair and ethical broker. If none of them owes them a fiduciary obligation, why should they seek out their professional advice?

Commission-Based Model

As indicated previously, stockbrokers are primarily paid by commission on products sold. The way in which specific transactions generate income will be further detailed in the next section. In this section, the ever growing ethical dilemma posed by compensation will be discussed.

Financial professionals, like any other product or service provider, deserve to be compensated for their time and expertise. More often than not, compensation is charged in the commission for the financial product purchased. While low-commission is a way brokerage firms differentiate themselves, many investors are willing to pay much higher commissions for firms that provide greater research and information. Suppose a retail situation in which a broker advises a client to purchase a mutual fund with a sales charge, when the client could have bought a similar no-load fund with no shares charge. In this instance, the sales commission is the compensation the broker will receive for sitting down with and designing a financial solution for the client. Is it intrinsically bad advice or unethical of the broker to suggest a higher cost fund when the investor could have purchased a no-load fund with the same expected performance, but at a lower cost? Suitability would determine that this transaction met standards and therefore was ethical and appropriate. Comparatively, fiduciary standard of care would determine that the client's interest wasn't put first and therefore was unethical and inappropriate.

Legal standards aside, arguments for and against the appropriateness of the transaction can be made. It would be a blanketed statement and a significant assumption to conclude that any transaction ingrained with commission conflicts directly implicates unethical behavior, but it is important to acknowledge the opportunity and incentives it creates. This is not to imply that every commission-based broker is corrupt and unethical by nature, but to highlight the negative incentives the model creates and the way suitability standard supports it. In the greater portion of this paper, ethical restraints and implications that surround a commission-based pay system will be reviewed.

Revenue Streams

To fully understand the workings of a brokerage firm and the stockbrokers they house, it will first be important to discuss how firms make money. This section will discuss many of the different ways in which financial service firms generate revenues. Although investment firms offer numerous services, the services that will be detailed are the most prevalent in practice and pertinent to the analysis of brokers' ethical advice under suitability. These services include: Stock commissions, trading profit on stocks, trading profit on bonds, investment banking fees, and mutual fund fees.

Stock Commissions

As it has been mentioned several times in the previous sections, stockbrokers generate a large portion of their revenues in stock commissions. Every time a customer buys or sells a stock, the firm charges a commission. These fees, also known as broker fees, are based on a percentage of the transaction, as a flat fee, or a hybrid of the two. Commission fees vary according to the industry and type of broker. According to the Securities Industry and Financial Markets Association's (SIFMA) study, the average total net revenue for United States financial firms from 2001 through 2008. On average, U.S. firms earned a total of $49 billion in commission revenue, roughly one-fourth of their total net revenue.

Trading Profit on Stocks

When a customer places a 'buy' order on a stock, the firm often fills the order through a process known as internalization. Internalization occurs when a transaction is handled by an entity itself rather than in the open market. Internalized trading refers to when the trade is completed for an investor within their brokerage firm/account. This process is typically less expensive and allows the firm to offer faster execution speed. As well as, allows the firm to avoid paying a fee to a stock exchange or other intermediary for filling an order. Brokerage firms that internalize stock orders can also take advantage of the difference between what they purchased shares for and what they sell them for, known as the spread. For instance, a firm may seek a greater spread by selling its own shares than by selling them on the open market. Furthermore, the firm may well profit by selling the stock to the customer at a higher price than it originally paid.

This process naturally creates a direct conflict of interest between the firm and the client. In general, the firm and the broker has the obligation to provide the client with a "best execution"; a price at least as good as could be obtained elsewhere. However, when the firm is trading with the client from its own account, the firm's economic position is diametrically opposed to that of the client. The better the price is to the firm, the worst to the client and vice versa.

Trading Profit on Bonds

Similar to how many brokerage firms trade against their clients through the internalization of stock orders, many firms also internalize bond orders. It is important to note that the bond market and the stock market are organized very differently. While stocks typically trade through organized stock exchanges, bonds typically trade "over the counter" without a central exchange. Here again lies a direct conflict of interest. With bonds, the broker has a direct incentive to charge the client as much as possible for a bond. Or conversely, pay as little as possible when purchasing bonds. Since the bond market is less transparent than the equity market, it is difficult for clients to determine fair pricing.

Mutual Fund Fees

With stocks, the commission schedule does not usually vary from one stock to another. Mutual funds differ in this regard. Sales charges vary across different mutual funds, and these differences create incentives for brokers to recommend funds that pay higher commissions even if those funds are not the best funds for the client.

Regulatory Bodies

Various federal, state, and independent agencies are set in place to regulate and oversee financial markets and companies in the United States. These agencies each have specific duties and responsibilities that enable them to act independently of each other while working to achieve similar objectives. While opinions vary on the efficiency, effectiveness, and even the need for some of these agencies, they were each designed with specific goals in mind and remain pertinent to this discussion. In this section, various regulatory bodies regarding the financial industry will be discussed and detailed. This includes: Securities and Exchange

Commission (SEC), Financial Industry Regulatory Authority (FINRA), Department of Labor (DOL), and Employee Retirement Income Security Act of 1974 (ERISA).

Securities and Exchange Commission (SEC)

Created in 1934 by Congress, the Securities and Exchange Commission (SEC) is an independent federal government agency responsible for protecting investors, maintaining fair and orderly functioning of the securities markets, and facilitating capital formation. The SEC's primary function is to oversee organizations and individuals in the securities markets, including securities exchanges, brokerage firms, dealers, investment advisors, and investment funds. As previously stated, the SEC is the regulatory body in charge of registry and overseeing for RIAs.

Financial Industry Regulatory Authority (FINRA)

The financial Industry Regulatory Authority (FINRA) is an independent, nongovernmental organization. Although it has regulatory powers, it is important to note that FINRA is not part of the government. It is a not-for-profit entity, and the largest self-regulatory organization in the securities industry in the United States. FINRA writes and enforces the rules governing registered brokers and broker-dealer firms in the U.S.; focusing on the licensing and regulating of broker-dealers. FINRA is also overseen by the SEC.

Department of Labor (DOL)

The Department of Labor (DOL) is the government department responsible for occupational safety, wage and hour standards, unemployment insurance benefits, re-employment services, and some economic statistics. In the scope of this paper, the DOL is the regulatory body in charge of writing the newly proposed fiduciary standard and the related economic analysis.

Employee Retirement Income Security Act of 1974 (ERISA)

The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for most voluntarily established retirement and health plans in private industry to provide protection for individuals in these plans. While not a regulatory body, it will be important to explain ERISA as it is the original definition of the fiduciary standard as it pertains to financial services.

Suitability Standard: Defined and Examined

Codification

As mentioned several times, stockbrokers in the United States currently have a legal and ethical requirement to follow a suitability standard of care. The requirement for stockbrokers defines their recommendations as "suitable". The requirements and definition of what is suitable has evolved over the years, but for the purpose of this paper, suitability standard will be referenced as it is codified by FINRA Conduct Rule 2111:

(a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objective, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose…

(b) A member or an associated person fulfills the customer-specific suitability obligation for an institutional account… The member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, and the institutional customer affirmatively indicates that it is

> exercising independent judgment in evaluating the member's or associated person's recommendations…

This rule applies to all broker dealers that are members of FINRA (aka all licensed broker dealers). There are two major parts that make up the current rule. The first part explains that the broker is required to have a reasonable basis to believe a recommendation is suitable. This basis must be based on relevant information about the customer's "investment profile". The rule imposes an affirmative obligation on the broker to find out the relevant information about a client to be able to make a suitable recommendation. The second part refers to the customer's ability to assess the recommendation. The broker must have a reasonable basis to believe that the client is equip with the adequate information and ability to assess the recommendation and come to an independent conclusion. In short, the broker must first exercise due diligence to acquire information about the client's investment portfolio, and then must make a recommendation that is suitable to those criteria. The broker must also believe that the client is able to make a rational and independent decisions.

FINRA Rule 2111 is further composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability. Reasonable-basis obligation is that aforementioned criteria, that brokers must have a "reasonable-basis" to believe, based on reasonable diligence, that their recommendations are suitable for some investors. This obligation focuses on the brokers understanding of the potential risks and rewards associated with a recommended security or strategy, and their understanding of when it would or would not be appropriate. A lack of understanding here results in a recommendation that violates the suitability rule. The customer-specific obligation is the obligation that requires brokers to align recommendations to a specific client and their investment profile, as delineated in Rule 211 (a). Finally, the quantitative suitability obligation requires the broker to have a reasonable basis to believe that their recommendation, even if suitable in isolation, is not excessive and unsuitable in looking at other aspects of the investment portfolio.

Issues and Implications

Vague & Contestable Language: "Reasonable-Basis"

In looking at FINRA Rule 2111, the common theme-word is reasonable. Determinations and recommendations of the broker must be based on reasonable conclusions. Despite the repetition of the word, there is very little to define what constitutes reasonable. For example, there is no specified range as to what would be considered reasonable in regards to the reasonable diligence a broker must exercise to determine a client's portfolio. There is a list of what makes up an investment profile, but no reference whether the entire list accomplishes reasonable diligence or if only a fraction does. The rule does lend an explanation, stating that what constitutes reasonableness will vary on the complexity of and risks associated with the security or investment strategy and the broker's familiarity with either the security or strategy. Reasonable and reasonability are defined as "being in accordance with reason" or "based on or using good judgment, and therefore fair and practical" (Reasonable, Cambridge). These definitions lend a hand in theological clarifications, but remain ambiguous in practice. What constitutes a normative standard for a "reasonable-basis"?

In the California Law Review, Jeremy Waldron discusses the vagueness in law and language, as seen in the suitability standard. Waldron further specifies the vagueness in terms like "reasonable" as contestability; a phrase or term becomes contestable when it embodies a standard, but the very details of that standard vary with different users. Laws, rules, and regulations generally call for individuals to make value-judgements on the actions of another.

Reasonability invites us to make value judgements on the appropriate levels of justification for action. Herein lies the problem: people tend to disagree about these judgements. One broker's definition of reasonable diligence may vary greatly from another. The way a broker evaluates the suitability of an investment security or strategy is based on their scope of reasonability. With concepts of best interest practice aside, this scope of reasonability could range from aligning with one aspect of a client's investment profile to the entire profile. The probable inconsistences in practice puts clients in a vulnerable position; there is a higher possibility of being given subpar service/recommendations as rationalized by a broker's definition of "reasonable". While there is benefit to legal ambiguity and flexibility, it allows room for unethical behavior as justified by varying judgments.

One way to understand how unethical behavior can emerge from the ambiguous language of the suitability standard is as follows: A customer is looking for a car and goes to a car dealership. They sit down with a car advisor to discuss their automotive needs; the advisor asks various about the customer's transportation and financial situation. At the end of the conversation the advisor recommends a fancy new sports car, which just so happens to provide the advisor with the highest profit. The sports car provides the customer transportation to work, and is within the customer's financial capabilities, albeit some budget scrutiny. While it is not the best car option for the customer, it meets a few of the customer's needs and situational restrictions. Assuming that the car advisor has a reasonable basis to believe that the customer has the capability to make an independent decision, they have acted within the purview of the suitability standard.

Section (b): Clients' Capability

The ethical dilemma surrounding the suitability requirements, as they compare to a far higher fiduciary duty requirement, becomes clearer when the products brokers sell are not seen as simply securities and strategies, but rather as solutions to financial problems. Clients come to brokers with a particular problem, such as saving for retirement, and seek out their professional expertise to help reach a solution or plan of action. It is important to note that while the suitability rule highlights the client's capability to assess the advice and ultimately decide independently to accept or decline, this caveat is tainted by the client's realistic ability to assess professional expertise. In the market, there is always a sense of uncertainty about investment returns. Advice, good or bad, can produce varying returns depending on market conditions. Consequently, clients may not be able to determine the quality of advice. The investors that tend to need advice the most are often the least capable of judging the quality of the advice they receive. Therefore, the FINRA 2111 suitability rule section (b)'s emphasis on verifying the client's ability to independently make a judgement on the broker's advice is counterintuitive; if the client is seeking the advice of a professional, there is already grounds to believe that their ability to successfully assess recommendations is impaired. This is not to say that clients should be preemptively assumed to be incapable of understanding and adequately assessing financial solutions, nor that clients should not independently make decisions on their investments. Rather, that the last barrier to unethical practice should not be dependent on the individual who may not fully understand the situation, and is ultimately the most vulnerable in the transaction. Barriers to possible unethical situations should be put in front of and cleared by the individuals with the most authoritative power, the broker.

The ethical situation here can be compared to the ethical situation in selling any product. It is generally believed that sellers have an ethical obligation (regardless of any legal requirements) to be truthful about their products and to disclose any defects in the products they are selling. The SEC rule 10b-5 makes it a crime "To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." However, it could be argued that, if the defect is visible and the client is given the appropriate opportunity to inspect, there is no duty to disclose nor to further clarify any material facts. Ultimately, caveat emptor – the buyer alone is responsible for checking the quality and suitability of goods before a purchase is made. Again, the FINRA 2111 rule section (b) implies this very principle. It should be noted that while the rule does not explicitly state that it is the client's responsibility to assess the investment recommendations, it was an important clarification and addition made to differ from the previous FINRA 2310 suitability rule. The current rule states that brokers should have, "a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently…" While it is imperative to verify the independence of the client in their investment decisions, it opens room to push blame on the client in the case of an unethical recommendation and related consequences. The argument could be made that, regardless of the ethics and interest of the recommendation, the client was believed to have the autonomous capability to properly evaluate the investment risks and inherently could have decline execution.

Disclosures

While it was discussed at great lengths in the foundational section of this paper, disclosures in relation to the suitability standard plays a role in the susceptibility of unethical behavior and justifies reiteration. Again, ethical situations found in the financial service industry can be found in any service or production industry. In the business world, a reliance on mandatory disclosures have become the remedy to regulation faultiness. It is believed that disclosures provide consumers with adequate information they need to properly evaluate their purchases and protect themselves from unethical practices. Since clients are presented with disclosures detailing the broker's responsibilities and possibilities of undue service, there is no need to reform the ethical requirements. This line of reasoning has two main flaws: it assumes that clients have full access to relevant information and the ability to be fully rational in how they process the information.

Regulation has adopted the belief that all investors are rational and competent in their evaluation of disclosures. The line of ethical behavior becomes blurred in looking at the realities of disclosures, especially in regards to the suitability standard. In theory, they provide a line of protection for consumers. In reality, the effectiveness of such a barrier is based on the foundation of ethics in the industry. Assuming the obligations of the FINRA rule 2111 are met, it is permissible to recommend a security or investment strategy. However, if multiple options are suitable for the client, the broker may simply choose the stock that generates the highest commission without even mentioning other (more suitable) options. Under the suitability rule and the Dodd-Frank Act, so long as the recommendation meets suitability and the broker's exclusion from fiduciary responsibility is disclosed, this practice is appropriate. The belief states the mere presentation of disclosure to the investor is the line of defense to the possibility of undue service; the client was given information regarding the standard of care and responsibility the broker bears, and therefore assumed that risk. If this were truly the case, full disclosures would be an appropriate remedy for any industry ailment, if not the only remedy need. However, this is known not to be the case. Disclosures are more often than not presented with confusing jargon and are complex by nature. Regardless of whether or not clients are presented this information, clients should not bear the responsibility of fully understand a long and complex document to ensure they are not taken advantage of. Ethics in practice ensures explicit and comprehensive understanding; the degree of care a client receives should be explicit in the conversation, not hidden in printed off disclosures.

In addition to the complexity of disclosure documents, it is fair to mention the rational ignorance of the clients. In a transaction of any kind, it isn't uncommon to see a consumer quickly skip past the lengthy disclosure document before accepting terms. When provided a surplus of information and limited processing time, people will generally pursue a course of action that satisfies minimum requirements rather than optimizing the information provided. In short, consumers typically do not read disclosure documents, and if they do it's not in its entirety. Therefore, even when investors receive a disclosure stating that their broker does not owe them a fiduciary duty of care, they will either (a) not read it and assume fiduciary service, or (b) read it over and overlook what it means to not be owed a fiduciary duty. The argument can be made that this oversight and lack of due diligence justifies the possibility of undue service; that the client should have actively reviewed the disclosure and then come to a conclusion. While this argument is true in fact, investors are simply optimizing their time and the resources provided, and such is rational. It is unreasonable to expect that the everyday person can spend hours upon hours gathering information about one of just hundreds of decisions they make throughout the day. While it appears irresponsible to overlook a disclosure, it is rational considering investors seek out the professional services of brokers for the purpose of optimizing their time. Moreover, there is an assumption of reliance on professionals for accurate and fair information. Current regulation and standards calls on investors to bear a higher responsibility and risk than is expected of the professionals in the field. The risk a client should be assuming in a financial transaction is the result of a security or strategy, not the broker.

Compensation Models

As stated in the foundational section of this paper, the ethical implications of stockbrokers' compensation models emphasize the negative incentives within and supported by the suitability standard. This is not to say that stockbrokers' compensation models directly implicate unethical behavior, but rather to acknowledge the opportunity and allurement it creates. The general problem with commission-based pay is that it rewards financial intermediaries for engaging their client in active trading, even if it's not appropriate or necessary. Thus, creating an incentive to engage in unethical practices. Here, two compensation models will be explained and discussed as they pertain to stockbrokers and financial services generally.

An organization's set of procedures for monitoring, directing, evaluating, and compensating employees is its control system. This system, by accident or design, consequently influences employee behavior. The control system regarding compensation can be classified into two general frameworks: outcome-based (commission) and behavior-based (salary). In an outcome-based control system, there is relatively little monitoring and managerial direction, but details straightforward objective measures of results and rewards. Comparatively, in a behavior-based control system, there is considerable monitoring and management direction, and more subjective methods of evaluating compensation are used (Anderson, 76-80). Outcome-based tends to leave employees alone to achieve results in their own way or strategy. There is an emphasized accountability on results (outcomes), but not for how such results are achieved. In this sense, behavior-based control systems are an opposing philosophy. Behavior-based emphasizes specified performance and assumes profitable results will follow. Evaluation and the increase or decrease in salary are based on subjective assessments of employee inputs rather than what they measurably achieve. It should be noted that majority of companies use a mix of approaches, containing elements of both behavior and outcome-based strategies.

Now, how does any of this relate to stockbrokers? While compensation for brokers varies between firms, all stockbrokers receive commission based on the transactions they engage. Therefore, following a more outcome-based system. The inherent lack of direction and emphasis in results can permit behavior that harms the organization in the long run. There tends to be a lack of attention to customer satisfaction, emphasis on profitability, or incline towards easy to sell product lines. Outcome-based models tend to motivate employees to focus on activities with immediate payoff to the detriment of long-term results. In the case of stockbrokers, there is an emphasized focus on recommendations that produce immediate payout, over establishing long-term relationships with clients and their portfolios. This emphasis can be the source of encouragement in unethical behavior and/or loophole practices.

It is worth restating, albeit unethical opportunities, commission does not directly implicate stockbrokers of corruption and unethical behavior. The comparison of compensation models is not intended to say one is innately better or more ethical than the other. Commission models have their place in various industries, including that of the financial service industry. In order to remain competitive and reward individuals on performance, companies commonly adopt compensation models that generally include a base salary with the opportunity to earn bonuses and/or commission; a hybrid of the two. The negative ethical outcomes of commission-based models is not simply the fault of the organization and stockbrokers, but rather the regulation of the overall practices. While commission encourages active trading and unethical practices, it is the overarching regulation that allows it.

Fiduciary Standard: Defined and Examined

In the above sections, fiduciary standard and the relevance it has in various industries has been discussed at great lengths. Finally, in this section, the fiduciary standard itself will be thoroughly defined and examined as it relates to its proposed implementation into the financial service industry and how it compares to the current suitability standard. On February 23, 2015, President Obama proposed a major overhaul to the regulation of the financial industry. He stated, "Today, I'm calling on the Department of Labor to update the rules and requirements that retirement advisors put the best interest of their clients above their own financial interests. It's a very simple principle: You want to give financial advice; you've got to put your client's interests first" (Remarks by the President at the AARP).

In this section we will be looking at the proposed fiduciary standard and precedent then President Obama attempted to enact. The section will look at the pure definition of the standard, its weaknesses and strengths, political timeline, industry reaction, and how it compares to the suitability standard as a whole.

Definition

A fiduciary can be defined at great lengths within the Code of Federal Regulation Title 29, Section 2510.3-21 – Definition of "Fiduciary." While important, the full definition of fiduciary, as defined by the CFR, is far too extensive for the purpose of this paper. *For further exploration of the definition of fiduciary, the link to the CFR section is provided above, but not necessary for the premise of this paper's discussion.* For the purpose of this paper, fiduciaries and fiduciary standard will be referenced as it is currently defined by ERISA and more recently expanded on by the DOL. The core of ERISA's fiduciary duty rules is contained in section 404(a)(1) of ERISA, which provides as follows: (Bintz, 980) (a)(1) [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –

A. For the exclusive purpose of:
    i. *Providing benefits to participants and their beneficiaries; and*
    ii. *Defraying reasonable expenses of administering the plan;*
B. With the care, skill, prudence, and diligence under the circumstances then prevailing hat a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
C. By diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
D. In accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter…

In the later portion of this section, the political timeline and DOL proposal, but first for the purpose of understanding the proposal, we will look at the proposal the DOL made to the definition of a fiduciary. The DOL specifically made a proposal to revise the 1975 Federal Regulation Rule 65263. The proposal attempts to revise the definition of fiduciary investment advice under ERISA, making more advisory activities fiduciary in nature. The new proposal generally covers the following categories of advice, as defined by the Federal Register:

(1) Investment recommendations, including a recommendation to take a distribution of benefits or as to the investment of securities or other property to be rolled over or otherwise distributed from a plan;
(2) Investment management recommendations, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan;
(3) Appraisals, fairness opinions, or similar statements whether verbal or written concerning the value of securities or other property provided in connection with a specific transaction;

(4) Recommendations of persons to provide any advice described in 1-3 above for a fee or other compensation. Persons who provide such advice fall within the general definition of a fiduciary if the either
    a. Represent that they are acting as an ERISA fiduciary with respect to the advice; or
    b. Provide the advice pursuant to an agreement, arrangement, or understanding that the advice is individualized or specifically directed to the advice recipient for consideration in making investment or investment management decisions regarding plan assets. (21928-21930)

Carve Outs from the Fiduciary Standard

The DOL proposal includes several categories of "carve-outs" that the Department believes Congress did not intend to have covered under fiduciary investment advice. Rather, these carve-out are intended for communications not ordinarily viewed or characterized by a relationship of trust of impartiality (Milloy). According to the Federal Register definition of the term "Fiduciary", these carve-outs fall into 7 broad categories

(1) Statements or recommendations made to a "large plan investor with financial expertise" by a counterparty acting in an arm's length transaction;
(2) Offers or recommendations to a plan fiduciaries of ERISA plans to enter into a swap or security -based swap that is regulated under the securities Exchange Act or the Commodity Exchange Act;
(3) Statements or recommendations provided to a plan fiduciary of an ERISA plan by an employee of the plan sponsor if the employee receives no fee beyond his or her normal compensation;
(4) Marketing or making available a platform of investment alternatives to be selected by a plan fiduciary for an ERISA participant-directed individual account plan;
(5) The identification of investment alternatives that meet objective criteria specified by a plan fiduciary of an ERISA plan of the provision of objective financial data to such fiduciary;

(6) The provision of an appraisal, fairness opinion, or a statement of value to an ESOP regarding employer securities, to a collective investment vehicle holding plan assets, or a plan for meeting reporting and disclosure requirements; and
(7) Information and materials that constitute "investment education" or "retirement education." (21930)

In the timeline section of this paper, we will see that these carve outs are a step in the right direction for the revised proposal; taking into consideration criticisms of the initial proposal. On the opposite end, the carve-outs also translate into greater need for compliance personnel and internal costs for individual firms and businesses.

Prohibited Transaction Class Exemptions

In ERISA's definition and outline of the fiduciary standard, there are a handful of "prohibited transactions" that are automatically considered to be in breach of a fiduciary duty, along with several exemptions to those prohibitions. The DOL's proposed rule includes two new exemptions from the prohibited transaction provisions of ERISA. The two proposed new exemptions are:

(1) Best Interest Contract Exemption (BIC) – BIC allows an adviser to receive otherwise prohibited forms of compensation in connection with the purchase, sale or holding of certain investment products provided that the adviser "contractually acknowledge fiduciary status, commit to adhere to basic standards of impartial conduct…"
(2) Principal Transaction Exemption – Investment advisers often sell securities out of their own inventory, triggering taxes and other legal sanctions, unless they are exempt. In the DOL's eyes, these principal transactions raise conflict of interest concerns (because the advisor is better able to manipulate the price), and therefore, should be exempt.

Simplifying the Fiduciary Rule

Before going into the implications and effects of the DOL's fiduciary rule, it is important to look at this rule in its simplest form. While it is important to effectively write detailed rules and regulations, the nomenclature of the above text is difficult to understand at face-value. The terminology is useful and pertinent, but extensive. Therefore, here, the DOL's proposal will be simplified as appropriate to the extension of this paper.

In short, the DOL's definition of fiduciary demands that retirement advisors or stockbrokers act in the best interest of their clients and put their clients' interests above their own. This new rule is intended to eliminate any room for advisors to conceal potential conflicts of interest and require clearer disclosures. Previously, only advisors who were charging a fee for service on retirement plans were likely to be fiduciaries; and even then, the only way to be sure was to ask. The DOL's definition expands fiduciaries to include any professional making recommendations or solicitations in this capacity.

As discussed in previous sections, the commission-based model that brokers and advisors lean heavily on creates room for unethical behavior. The DOL's proposed rule aims to alleviate that problem. For advisors that wish to continue working on a commission basis, rules would require them to give their clients a disclosure agreement, known as the Best Interest Contract Exemption. Overall, the proposed regulation attempts to alleviate room for unethical practices in the financial service industry.

Possible Effects & Implications

In addition to the cost analysis the DOL put together for this proposal, several studies have been conducted to assess the potential impacts that the rule would have on the overall market and economy. The two major impacts can be broken down into two categories: (1) Costs to retirement savers and (2) Burden on businesses who provide investment advice.

Costs to Savers

As stated in section 913 of Title IX of Dodd-Frank, the SEC is required to examine the regulatory regimes of broker-dealers and investment advisers. Additionally, the SEC is required to examine the potential impacts on retail customers if those regulatory requirements were to change or be eliminated; the SEC is called on to make appropriate recommendations as to how standards could impact the industry. As a result, the SEC has provided some useful analysis should such a rule be put in place.

The SEC study looked specifically into the impact on investors if the proposed rule resulted in fee-based accounts. Overall, the study found that this change could result in increased costs, as well as greater impact on the gains of individuals' investments. For example, the analysis found "that a 1% increase in annual fees reduces an investor's return by approximately 18% over 20 years" ("Regulation Best Interest: The Broker-Dealer Standard of Conduct"). Additionally, the analysis found that "the shift to a fee-based model would reduce cumulative returns to 'small investors' (with $200,000 or less in assets) by $20,000 over the next 20 years" (Milloy). The study concluded that the DOL fiduciary rule proposal has significant impact on retail investors that could be extremely disruptive to processes within the industry. At a later part of this section, the industry reactions will be discussed; looking at the expert opinions for and against the proposal as they relate to these impacts.

Another study conducted by the Bank Policy Institute (BPI) examined the impact the proposal would have on the US retirement market as a whole. The study was conducted through surveys of 4300 retail investors and 1200 small businesses. It should be noted that the available information on the study does not detail how conclusions were made from the surveys or what was on the survey. That being said, the study concluded that the DOL's proposed rule would likely reduce individual retirement savings. The findings include, but were not limited to:

* 7 million IRAs would fail to qualify for an advisory account due to the balance being too low – this would result in millions of individual investors losing access to retirement advice and support.
* The average costs associated with a fee-based account would increase at an average of 73-196%.
* As many as 360,000 fewer IRAs would be opened each year as a result.

While the DOL conducted a regulatory impact analysis, for the reasons above and more, professionals criticized the quality of the DOL's findings. The DOL's analysis failed to analyze all aspects and kinds of accounts that would be impacted. Consequently, the proposal faced a lot of negative critics – In the political timeline section of this paper, we will see that the proposal is eventually dropped; greatly due to some of the flaws mentioned above. With that in mind, the intention of this paper should be reiterated. This paper has no intention of proving the DOL's proposal of fiduciary standard as appropriate, but rather to use the DOL's proposal as an example of implementation and argue a push for further development and regulation similar to the proposal.

Costs to Businesses

The second category of impact of the DOL's proposal is on businesses and firms that provide investment advice. While the SEC study found that as the rule decreases savings over time for the investor, the cost of services for businesses becomes significantly high. This increase in costs is the result of increased compliance costs, and as a result retail investors may be the ones to face the consequences. The study goes as far as to say that "the increase in costs to broker dealers could cause many to decide to no longer offer certain products and services to retail customer, or would only offer them at increased prices…" ("Regulation Best Interest: The Broker-Dealer Standard of Conduct").); due to risk of litigation under the new regulations or due to restrictions on principal trading.

Deloitte issues a report on the anticipated operational impacts to brokers due to the DOL's proposed rule. This report detailed five themes of operational and financial challenges brokers would face as a result of the implementation of the proposed rule: The five themes are as follows (Deloitte):

1. It will be unfeasible or impossible to operationalize certain requirements.
2. Significant personnel, process and technology changes and investments to operations, business and compliance will be required to comply with the rule.
3. Rule requirements will create disruptions to business operations and customer experience.
4. Rule requirements may conflict with existing regulatory obligations.
5. The rule is ambiguous and broad in certain areas, which challenges the operationalization of the rule's requirements.

In sum, the study concludes that as fiduciary duties are levied on advisers who were accustom to suitability standard, advisers will be faced with significant increases in compliance costs that will eventually be passed on to the investors; limiting their access to investment accounts and retirement savings.

Political Timeline

Now that there is a clear definition of the fiduciary standard in question, it is pertinent to look at the rule as it relates to real life application and regulations. For the purpose of this paper, we will look at fiduciary standard and regulation change from 2010 to 2018.

Fiduciary Rule Under the Obama Administration

2010 Proposal

First mentions of a fiduciary rule or regulation overhaul was started in 2010. The DOL's initial proposal set new definitions for when an adviser was considered to be giving investment advice and when a person was acting as a fiduciary. Specifically, the proposal required that any investment advice, even if it was just a single one-time recommendation, would be held to a fiduciary standard; as opposed to a suitability standard. The DOL's proposal received over 300 comments, which were in large criticisms. Critics found flaws in the costs and effects of the proposal and urged the DOL to seek other means for implementation. By September 2011, the DOL withdrew their proposed rule.

It should be noted that the initial proposal the DOL made in 2010 was very similar to the later 2015 proposal that is focused on in this paper. The primary differences are addressed in the more detailed stipulations and definitions, methods of implementation, and costs analysis.

2015 Proposal

As stated in the beginning of this section the financial industry was once again given notice of a regulatory overhaul. The next major step in the fiduciary timeline was on February 23, 2015 when President Obama called on the DOL to update the rules and regulations dictating financial advisors' practices. While the goal of the two proposals is the same – require more investment advice to be in the clients' best interest – the method is different. The new proposal revised the generalized definition of who is considered a fiduciary to include professionals engaging in any recommendation activities. In short, the new proposal broadens the range of types of advice covered by fiduciary protections. Essentially, any advisor getting paid to provide individualized advice would be considered a fiduciary and would be required to act as such. *See the previous section, "Definition" and "Possible Effects & Implications", for a more detailed explanation of the 2015 proposal.*

2016

On April 8, 2016, the fiduciary rule was published in the Federal Register that made it effective June 7, 2016 but with a delayed applicability dated April 10, 2017. It was taken into consideration that it would take time for financial services companies to prepare for the implementation. On June 1, 2016, eight industry and trade groups (including: the US Chamber of Commerce, the Insured Retirement institute, the Financial Services Institute, the Financial Services Roundtable, and the Securities Industry and Financial Markets Association) filed a lawsuit against the DOL in the northern district of Texas. The collective groups claimed that the DOL did not have the authority to enact the new rules. Finally, seven days later, President Obama vetoed a Congressional attempt to block the rule.

2017

In late March 2017, Vanguard and BlackRock, the world's two largest asset managers, requested a more significant delay considering the confusion on final dates and specificities of the rule. After 15 days, the DOL sent for review from the Office of Management and Budget

(OMB), who then decided that an official 60-day delay to the applicability date would be put in place. The announcement of the delay noted that, "…it would be inappropriate to broadly delay the application of the fiduciary definition and Impartial Conduct Standards for an extended period in disregard of its previous findings of ongoing injury to retirement investors" ("Definition of the Term 'Fiduciary'; Conflict of Interest Rule-Retirement Investment Advice"). Responses to the delay and announcement ranged from supportive to accusatory; several accused the delay as being "politically motivated."

The DOL officially reopened the public comment period for the rule an additional 30 days on June 30, 2017. However, in early August 2017, the District of Minnesota proposed an 18-month delay to the rule's compliance deadline; this proposal was filed as a court document as part of a lawsuit in the US District Court. This delay would have changed the final deadline for compliance from January 1, 2018 to July 1, 2019. Within the same document, there were suggestions that in addition to a delay, that changes to the types of transactions that are not allowed under the fiduciary rule be made. In August 2017, the OMB approved the proposed delay and the deadline was once again changed to July 1, 2019.

Fiduciary Rule under the Trump Administration

2017

The fiduciary regulation and proposal was initially created under the Obama administration, as seen in the above sections. On January 20, 2017, Donald Trump was inaugurated into the office of President of the United States. This change in administration was instrumental to the progress of the fiduciary rule. In February 2017, President Trump issued a memorandum that attempted to further delay the rule's implementation by 180 days. In this memorandum, Trump called on the DOL to carry out an economic and legal analysis of the rule's potential impact; instructing the DOL to further consider whether it has harmed or is likely to harm investors, as well as whether it is likely to cause an increase in litigation and prices for retirement services. Finally, Trump's memorandum called on the DOL to publish a proposed rule rescinding or revising the fiduciary rule.

Within 2017, there was several back and forth cases and requests pushing for the implementation date to be delayed. On April 5, 2017, the DOL officially delayed the original April 10th implementation date until June 9th; with opportunity for additional delays. The fiduciary rule was officially kicked into partial effect on June 9, 2017. Full implementation of all elements of the rule remained July 1, 2019.

2018

Before this could happen, a major change in the course of the fiduciary rule occurred. On March 15, 2018, the Fifth Circuit Court of Appeals, based in New Orleans, vacated the fiduciary rule. In a 2-to-1 decision, the court defined the rule as "unreasonableness," and that the DOL's implementation of the rule constitutes "an arbitrary and capricious exercise of administrative power" (Court of Appeals for the Fifth Circuit). Furthermore, on Jun 21, 2018, the Fifth Circuit Court of Appeals confirmed its decision to vacate the ruling, officially killing the DOL fiduciary rule.

Industry Reaction

As seen in the "Possible Effects & Implications" and "Political Timeline" sections of this paper, the DOL's fiduciary rule suffered great scrutiny within the industry and among the political sphere. There is little doubt that a revision to the roughly 40-year-old ERISA rules is overdue for a change. Proceeding the end to the DOL's proposal in 2018, several industry groups have initiated new plans for regulation revamping; these groups including the CFP Board, the Financial Planning Association (FPA), and the National Association of Personal Financial Advisors (NAPFA). While proceeding support and movement is pertinent to revising and improving the regulations within the industry, this section will look at the industry's reactions to the initial DOL proposal. This section will look further at the reactions and rationales against the proposed rule, then follow with the support for the rule within the industry.

Opinions Against

In previous sections, the staunch opposition of the rule from other industry professionals is evident. It is important to note that while the fiduciary rule aimed to strengthen the ethical obligations of financial professionals, the stricter fiduciary standards could have cost the financial service industry an estimated $2.4 billion per year by eliminating conflicts of interest like front-end load commissions and mutual fund 12b-1 fees paid to wealth management and advisory firms (Conflict of Interest Final Rule).

While the rule was still alive and under proposal, several of the industry names made comments on their opinions on the final draft of the DOL's proposal, one of which included Sifma. As one of the fiduciary rule's most vocal opponents, Sifma naturally stated that they remained wary of the final draft. That the rule could force significant changes to current relationship, "…which may leave clients without the help they need to prepare for retirement… saying it was a costly burden on firms and would curtail small-balance retirement savers' access to financial advice ("Reactions to the Labor Department's Fiduciary Rule"). It should be noted that while several large firms had negative opinions of the fiduciary rule, several supported the purpose of the proposal but called for smoother integration. LPL

Financial Holdings Inc., said it was pleased with the Department's changes to the ERISA rule and has generally supported the DOL's efforts. That being said, LPL also stated that the rule's initial requirements were projecting costs too onerous for firms to implement and couldn't fully support it for that reasoning. While there was several of industry firms in opposition of the firm, it does not mean they were fully against the call for regulation change; several believed that the DOL's fiduciary rule was an important first step towards creating a cultural shift in the industry towards greater transparency.

Opinions For

Supporters in favor of the DOL's fiduciary rule applauded the proposal and its goals of increasing and streamlining transparency for investors; making financial conversations easier and, most importantly, preventing abuses on the part of financial advisors. A 2015 report by the White House Council of Economic Advisers found that biased advice drained nearly $17 billion a year from retirement accounts. As stated above, many of the rules supporters lean to the fact that the DOL's proposal was flawed in its economic impact on the industry, but support the backbone goal of the rule; hoping for further revisions and work towards legislative implementation. While admitting to the faulty estimations made by the Department, in the "Economic Consequences of the DOL's Proposed New Fiduciary Standard", Oxford Economics states that the DOL is likely correct in believing that drastic cost is a natural repercussion of large-scale implementation such as this. Additionally, the Oxford Economics admits that action is warranted and necessary to address conflicts of interest in retirement accounts; specifically, the poor requirements and regulations that surround them (*Economic Consequences of the US Department of Labor's Proposed New Fiduciary Standard*). Following suit of other supporters, the text applauds the goal and vision of the DOL's fiduciary rule, but desires greater analysis of economic impact.

Conclusions

The DOL's 2015 fiduciary rule proposal worked to expand the "investment advice fiduciary" definition under the outdated ERISA of 1974. At a total of 1,023 pages, the proposal automatically elevated all financial professionals who work with retirement plans or provide planning advice to a level of fiduciary; binding them to a legal and ethical standard and status. While the new rule was likely to have an impact on all and any financial advisors, it was those who worked on commission that would have been impacted the most. The proposal worked towards a goal of creating an industry culture of transparency and accountability; a goal that was well intentioned and well needed. However, in the end, experts agreed that the DOL's proposal had too many shortcomings for the time being and could not be implemented. There would have been a reduction of choice and limited access for investors, as well as exponentially increased costs for financial service firms. Future calls on the DOL, as well as the SEC (arguably a more appropriate regulatory body for the industry and topic), to revise a more appropriate proposal.

In terms of this paper, the DOL's 2015 fiduciary rule proposal illustrate the current call for regulatory change in the industry. A system that solely supports Wall Street firms with backdoor payments and hidden fees is ultimately bad for the American investor. The conflicts of interest are costing individuals billions of dollars every year. Professionals agree with their concerns of the unethical precedents the industry regulations sets. While the proposal set by the DOL in 2015 did not satisfy the ethical and regulatory renovations, it set a grounds for improvement and development. The argument that rules should stay the same because they have always been that way (i.e. the suitability standard) is no longer available; the DOL's proposal eliminated that reasoning as it proves that there is an ethical demand for it, that is simply waiting on a legal and economical avenue.

Part Two: Role of Ethics in Finance – An Ethical Analysis

Up until this point, this paper has looked at the specific legalities behind the fiduciary standard and suitability standard, as well as the DOL's fiduciary rule proposal. In part two of this paper, the focus will be on the actual ethics of industry regulation; looking into what role ethics has to play in finance and the theories that support and oppose this notion. This discussion will look into two major categories of thought: Neoclassical Economic Rationale, or in other words, the Financial Economic Theory, and Agency Theory. Finally, the section will conclude with a summary of the ethical arguments.

Today, the role of ethics in any field or community is a contentious topic. The role of ethics in finance specifically, has been limited to its role in the context of the financial economic theory (Note: throughout the rest of this paper the financial economic theory and neoclassical economic rationale will be used interchangeable, but refer to the same frame of thought). Contemporary financial economists frame ethics as purely wealth maximization. In this context, ethics is either irrelevant or functions as a constraint on behavior. This portion of the paper will argue how this view is both illogical and ambiguous – Illogical because it allows unethical behavior and manipulation as a means of material gain; Ambiguous because throughout the history of moral philosophy, ethics is perceived as a behavioral motivation, not a constraint.

As the previous portion of this paper examined suitability and fiduciary standards, this portion will examine the neoclassical rationale and variations of agency theory; two competing paradigms of human nature. Is the behavioral assumption that individuals act in their own narrow and selfish-minded interest a valid reason to turn a blind eye to unethical practices? Observation would suggest that while there are people that are unreservedly opportunistic, others do dictate their behavior out of an ethical sensibility or conscience. The opposing theory, agency theory, lends a hand at defining ethical behaviors (e.g. truthfulness, justice in future dealings, voluntary compliance, etc.) as necessary for efficient functioning of the economy.

The previous portion of this paper outlined the real life application of ethical dilemmas in the financial service field; detailing the suitability standard and the ethical implications it poses on industry professionals. This portion of the paper will look deeper into the why deeming a standard, rule, or regulation as unethical is cause for change. It will argue why ethics and ethical behavior (or at least the goal and precedent for) is necessary in finance. This purpose of this portion of the paper is to provide a reminder that there are sound economic rationales as to why, at least some, ethical behavior exists. More specifically, how the agency theory can be used to illustrate the adverse consequences of unethical behavior on the functioning of markets.

Neoclassical Economic Rationale

As with any field or industry, ethics holds a close relationship to the rules that govern practices; ethics is, of course, the principles of human behavior, and therefore regulations must mirror human's ethical capacity. In our society, the neoclassical theory of social responsibility of businesses best articulates the rules of which our economic system exists. The theory of neoclassical economics adopted by theorist and economists, such as Milton Friedman, use the neoclassical rationale as an ethical justification of the economic system. As a result, our society defines and legitimizes businesses that set a purpose of making a profit above all else. We condone unethical practices under the rubric of "that's business." As a result, the financial economic theory has its footing and foundation in our rationale of ethical behavior in professional industries, such as the financial service industry. But when viewed through a philosophical lens, there are paradoxes and disheartening truths if this rationale is genuinely adopted and accepted as fact of human nature.

As stated previously, the purpose of this portion is to provide reason for ethics, and consequentially ethical behavior, in the financial industry. Before that argument is made, it is pertinent to understand the opposing school of thought, that is the neoclassical economic rationale and theory. This section will look to define the rational and its implications on human behavior, its assumptions on industry practices, and the philosophical paradoxes.

Definition & Industry Assumptions

By definition, ethics is the set of moral principles that govern an individual or a group; a theory or system of moral values. Ethics as a concept is concerned with the motivations behind human behavior and the nature of human kind. An individual's morals and ethics are grounded in fundamental motivation, and in theory, cannot be diluted into a constraint on achieving some other objective. The neoclassical view on ethics states that the only reasonable motivation for human behavior is personal wealth maximization; that humans are naturally selfish and will always put their best interest first (Hetzel, 1-2). Many economist and theologist in this regard believe that egoistic behavior, such as this, is a universal feature of human behavior. There is an underlying assumption that everyone always acts in a perceived best interest, whether they are aware of it or not (Bowie, 3). Meaning, that given a conflict of interest, individuals will always put themselves first. Under this notion, it is easy to see the slippery slope when applied to professional practices.

Industry Assumptions

Under the notion of neoclassical economics, it is easy to see how impossible it is for ethical behavior to be upheld in any industry, much less the financial industry. In a world in which material gain is the measure of all things, what role could an altruistic foundation of ethics have? In considering the discussion in the previous section of this paper, fiduciary and suitability standards, ethics is divided in both. Scottish economist Adam Smith wrote that we could not expect "that (managers) should watch over other people's money more than their own" (Bragues, 450). While the notion of fiduciary responsibility is just that, the economist view of human nature does not expect adherence to a level of altruism fiduciary responsibility mandates. The downfalls and ethical loopholes present in suitability standard are exacerbated and justified by the neoclassical rationale. If it is simply human nature to act in your own interest above all else, suitability standard provides the perfect revenue to do just that in the professional world. On the other hand, fiduciary responsibility is the polar opposite of the neoclassical rationale. Fiduciary responsibility assumes and requires individuals to go against their very nature; to act on behalf of someone else's benefit and interest.

If neoclassical economics is accepted as truth, there is no basis to expect a fiduciary duty of care; it goes against human's very ethical capacity and capability. Under that presumption, the entire analysis and creation of the DOL's proposed fiduciary rule is in vain. While people maybe in support of the proposal outwardly, this rationale argues that they are only doing so for their own benefit; whether that be individual or corporate reputation, or political gain. It is easy to see the cynical and pessimistic premise the neoclassical economic rationale sets. This line of thought goes down a spiral of eliminating ethics, or even the attempt of ethics, from any professional practice. This perspective and theory on human behavior stems from ethical position of psychological egoism. In the following section, psychological egoism will be discussed at great lengths; covering what the egotistic assumption is, the implications egoism, and how to dismantle the theory and consequently the neoclassical rationale.

Psychological Egoism

Early in his masterpiece the *Republic*, Plato argued that materialism is the source of human ills. He recounts a story of Gyges the shepherd. Gyges stumbles upon a golden ring that makes him invisible; upon this discovery, Gyges goes to town, kills the king, captures the throne, and weds the queen. He satisfies his every want. The lesson from this story, is that if given the power and opportunity to do everything we want, we will. That as humans, we always seek out our best interest, no matter the harms we cause. While there is no all-powerful ring in the real world, the basic notion of human motivation is argued the same; all we do is to make ourselves as well off as we possibly can be. This is the view of psychological egoism. Similar to the neoclassical economic view, psychological egoism asserts a strict "no-values" mantra over the economics discipline (or all disciplines). The full definition of egoism in this sense is, "there is only one thing that motivates human beings: self-interest" (Shafer-Landau, 89). The egoist thesis focus isn't isolated on the actions of humans, but rather the motivations and intentions behind those actions.

While psychological egoism presents a dark outlook on humanity, it brings to question if it really matters whether or not it's true. If it merely defines humans' underlying intentions and behaviors as self-interested, why does that matter? The world surely goes round without being in complete disarray and embodying a "every man for himself" mentality. In the following, the implications the egoist argument has on ethical obligations will be detailed.

Specific to this paper, if there is no reason to be ethical or have underlying altruism, there is no point in fiduciary regulation. The premises and implications of psychological egoism are as follows:

1. If psychological egoism is true, then we can't be altruistic.
2. If we can't be altruistic, then it can't be our duty to be altruistic.
3. Therefore, if psychological egoism is true, then it can't be our duty to be altruistic.
4. Psychological egoism is true.
5. Therefore, it can't be our duty to be altruistic.

Premise 1 is simply true by definition; if the psychological egoism is true, the notion of egoism makes altruism impossible. Premise 2 is a plausible argument. If we can't be altruistic, there should be no mandate to be altruistic; humanity cannot be required to do the defined impossible. Premise 3 logically follows 1 and 2, if both are true, then it is certain 3 must be true as well. That leaves premise 4 and 5. Premise 4 asserts the truth of psychological egoism; supposing that is true, altruism is futile. There is not duty to be compassionate, considerate, kind, or generous if it does not first benefit the individual. If all the above are true, moral ideals would have to radically changed and ridded of any altruistic elements. While airing on the side of dramatics, if psychological egoism is true, morality is trivial at best. This is the reason why psychological egoism has to be proven untrue; if there is no morality in our actions, there is no point to ethical dilemmas and reform. As premise 2 outlines, humanity cannot be expected to complete what is theoretically impossible. Psychological egoism, and in turn, the neoclassical rationale are truly bleak outlooks on humanity, but are theories and mindsets consistently upheld by theologist and economist a like.

As seen above, the psychological egoist stance on human intentions paints a grim angle on human behavior. Those who prefer a more flattering picture of humanity, one that allows altruistic motives and intentions, have a difficult time accepting this thesis. More moderate positions and weaker versions of psychological egoism have been developed by economists wary of the strict black and white perspective. Three of those positions will be explained here: The first moderate position claims that although people do not always act in their perceived best-interest, they often do. Since there is no compatible and fully-fledged economic model that holds these weaker beliefs, psychological egoism is adopted as substitution. A second possible position is to adopt egoism as an "ethical position." Claiming that people do not always adhere to the stringency of psychological egoism, but believe they ought to. In other words, people *should* act in their best interest. Economists such as Ayn Rand and many libertarians held views very similar to this. This position is called ethical egoism. Finally, a third position is to adopt psychological egoism, but as a heuristic assumption. This position is faulty as it does not require an assumption that psychological egoism is correct as a descriptive theory; that psychological egoism is rather a rule of thumb of human behavior, than a strict guideline (Bowie, 4). It should be noted that many economists do not distinguish these four positions; they move back and forth among the positions as they pertain to the intellectual issue at hand. However, these four positions cannot be held simultaneously as they are incompatible and contradictory. Moreover, under the neoclassical economics, to be a "value-free" discipline – which is the goal of most neoclassical economists – then psychological egoism is unrivaled.

Agency Theory

On the opposite end of the moral philosophy debate surrounding business ethics, and human nature in the greater picture, is agency theory. Thus far, this paper has defined human behavior through the lens of the neoclassical rationale and psychological egoism. Human nature is defined as a derivative of self-interested behavior; meaning, benefit of the individual over anything, even at the expense of others. Under this definition, given a conflict of interest, individuals will always put themselves first. In the previous section, the bleak outlook of this theory is highlighted and explained. In this section, agency theory will be used as a means to dismantle the foundation of the neoclassical rationale, as well as propose a saving grace for morality and ethics.

The agency relationship that this paper is concerned with, in relations to a business (economic) relationship, is modeled after the principal-agent relationship. In a principal-agent relationship, the agent is a person who acts on behalf of another person, the principal. Doctor-patient or lawyer-client relationships are clear examples of agent-principal relationships. These relationships also demonstrate the obligation of the agent to put aside personal interests for the sake of the patient or client. Within this theory, the altruistic nature of the agent is crucial. The notion of agency is one that strongly opposes that of neoclassical economics and psychological egoism; an agent is one who acts for another, even at a cost to *themselves.*

As the first purpose of this paper is to argue fiduciary standard and the necessity it holds, it is important to first note the origin of agency theory before diving into specifics. The original concept of agency came from a legal definition of ethical regulations between agents and principals. The law of agency imposes a specific duty of loyalty on the agent to the principal. This duty of loyalty has been plentiful referred to as fiduciary responsibility. In this sense, if agency theory or the variations of it can be proven, fiduciary responsibility holds a rational argument for implementation; if principal-agent relationships are a matter of human behavior, there should be professional regulations upholding it.

Agency Theory as a Critique of Neoclassical Economics

As mentioned in the previous section, many economists uphold the theory of neoclassical economics and psychological egoism. When considering the concept of agency, these economists run into an anomaly. Inducing an obligation on agents to do the biddings of the principal is a problem because it goes against the central belief of the self-interested rational human. This perspective of humans expects no altruistic behavior, and hence no loyalty. To some extent, the neoclassical view is digestible. It surely must be true that in some cases humans are self-interested and act in their own best interest. Very few economist and ethical philosophers will argue a pure altruism and altruistic intent in human nature. But there are times humans are observed to put aside their own interest on behalf of others. Before delving into the methods in which agency theory destabilizes the foundation of neoclassical economics, we'll look into how economist rationalize the agency relationship to fit their own paradigm of self-interested behavior.

Economist Rationalization of Agency

The very basis of agency theory disrupts, or downright contradicts the neoclassical outlook on human behavior. For hard-nosed economists, appeals to ethical concerns, such as loyalty, is a naïve perspective. According to their framework, human motivation is self-interested and profit-oriented. Therefore, a system and industry that is dependent on the necessity of others-oriented behavior is disruptive. The very core of the agency theory and principal-agent relationship mandates behavior that is inconsistent with the neoclassical ideology.

John Pratt and Richard Zeckhauser describe the agency relationship as, "Whenever one individual depends on the action of another, an agency relationship arises. The individual taking the action is called the agency." (Magee, 781). Hence, the relationship that is created between broker and client implies a sense of dependency on one another; the client depends on the broker to satisfy a transaction of services (to the fullest of their capability and utilizing their professional expertise), while the broker is dependent on the client for paycheck. It should be noted here, that a dependence on a principal for a paycheck does not directly imply profit-driven behavior, but merely a necessary transaction of goods and services – behavior, in this argument, can still be influenced by agency and result in profit. By the framework of neoclassical economics and psychological egoism, this relationship is mutually incompatible. Under the notion of this paradigm, if an agent, like everyone else, is self-interested, why would that same self-interested agent enter a relationship or transaction that requires them to suppress their self-interest for the sake of a principal? On this account, there is no good reason. It is then on the same economist to find a self-interested motivation for individuals to give up their self-interest – in other words, a selfish reason for not being selfish. Herein lies the paradoxical nature of the neoclassical economic rationale when applied to agency theory.

Further confusion of neoclassical economists' rationalization of agency theory, comes into play with the "free rider" problem. First embodied in one of Plato's characters in the *Republic*, Glaucon suggested that if people believe they will get away with something, there is no reason to obey laws. This is the essence of the free rider problem. In short, the free rider problem is an economic and ethical dilemma that emerges from situations involving public good – things that benefit the greater good of society. All members of a group or society can benefit from the efforts of one another, but there are those who will not contribute to the good and still reap the benefit of it; this person(s) is the free rider. The neoclassical economic rationale would seemingly agree with taking on the role of free rider; humans are selfish by nature, and therefore, there is no reason for rules and regulations that hold them to a standard of breaking their own self-interest. Humans are all self-interested and motivated to do what's best for themselves. In this case, not contributing or breaking laws, with the knowledge of getting away with it (becoming the free rider), is the best course of action for their personal gain.

The problem considering this line of thought and agency emerges when considering how businesses, and truly the world, works. If everyone is motivated by self-interest, then what is the point of entering agreements that require the abandonment of one's well-being? Glaucon and the free rider problem argues that if it's in the interest of the individual, and they can get away with it, then break the agreement. In a society in which all humans are engaging in that line of thought, the world would surely be chaotic and inefficient. The very core of business transactions and agreements is the understanding that they are made with the intention of surrendering some personal interest for the well-being of society. In this way, business requires individuals to be bound together by contracts and agreements, only holding them true to avoid collective fatality. The economist would argue that there are no internal ties of loyalty to bind people, rather qualities such as loyalty come at a cost. If this outlook on business and the social system is true, there is no such thing as a loyal agent – loyalty cannot be bought because it is not an economic commodity.

Friedman highlights the essence of the economist perspective on agency and the responsibility of the agent: "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits…" (Friedman, 7). Since business and transactional services is an institution that humans developed, the question of why have they developed it as a self-interested system arises. Friedman and several other neoclassical economists defend self-interested behavior as a means of "driving" the market; arguing that in the end, it is for the benefit of all. In such a system, agency and loyalty become irrelevant and irrational. If the above perspectives are assumed, business would be impossible. If there is no loyalty or agency in a system, business must reduce every obligation to a contractual one motived by monetary incentives or fear; both of which are unsustainable. In summary, the assumption that humans are self-interested, even in a business world, manifests a double standard. The neoclassical economic rationale creates a double standard in real application by claiming that human's only responsibility is the pursuit of self-interested action, but expects a business system which reflects selflessness and loyalty to operate.

The Fault of the Neoclassical View

Ronald F. Duska's writing in *Ethics and Agency Theory,* summarizes perfectly the oversights of the neoclassical economic rationale. Firstly, there is the distinction between "motivating causes" and "justifying reasons" (Duska, 161). In short, the purpose of business cannot be to make a profit; that is a motive. Duska explains the distinction as: "A justifying reason cannot be an individual motive; it must have societal implications." (Duska, 162) Therefore, the purpose of business is an appeal to the societal goods that businesses create. Society allows and encourages business because in the pursuit of profit, more goods and services that benefit the greater good are created. In the absence of goods and services, the motivation of profit cannot be used to justify business – it does not have societal implications. The second distinction Duska outlines is the distinction between motives. While there are monetary goals, such as profit that are motivations for business, there are motivations that do not fit the narrow self-interested category. This would categorize those that engage in business that do not ensure profit, such as artists, musicians, writers, and inventors. Naturally, people that go into these fields do so as a way to make money, but they chose to do it because they enjoy it; there is a greater fulfillment from the activity than the economic satisfaction. While it the neoclassical view could surely be applied to a great portion of the human population, a functioning society would simply be unfeasible – business requires loyalty and selflessness, and not all business sparks motivation from profit-driven intentions.

A New Paradigm of Ethics

Now that agency theory has been used to destabilize the foundation of the neoclassical economic rationale and psychological egoism, how does agency hold up as a model of ethics? In the previous section, it is easy to see how profit motivation can corrupt the principal-agent relationship found in professions such as law, medicine, or financial services. Rather than looking at business as a means to seek profit, business needs to be observed as a means to produce goods and services for the benefit of society; with profit as a possible motivation, but never the purpose of. Duska puts it simply, "To reduce one's life primarily to the making of money is to ape King Midas and to turn an instrument of happiness into happiness itself." (Duska, 163). The mistake of the egoist was confusing the objective of the action with a desirable effect of the action – the objective of business is the beneficial production of goods or services; the desirable side effect is profit.

The agency relationship as a paradigm reflects the human behavior not on an individual level, but at a societal one. No society would permit a business to exist if there were no perceived benefits to society; society can hardly view the purpose of business as exclusively profit making. In that case, the agency paradigm parallels that of the societal view on the purpose of business. Under this paradigm, dedication and loyalty must be goals, not instruments to facilitate those goals. In the neoclassical economic rationale, economist looked at qualities such as loyalty as a boundary to get around, rather than something to strive for. Now it should be noted here that agency theory as a paradigm of ethics in business, like most theories, airs on the side of the way things should and could work in the professional sphere. It is not always the case that professionals do follow an altruistic nature and follow the rules encouraged by the principal-agent relationship. Rather, the take away here should be that agency theory, and more importantly the paradox of neoclassical economic rationale, implores us as a society to set stricter rules and regulations, at the least. Where neoclassical and psychological egoism argued that humans should not be held to a standard they do not ethically have the capacity for, agency argues that these rules and regulations should raise the standard to improve on the ethical capacity humans have; rather than looking at them as restrictions of self-interested behavior, look at them as a goal to achieving a more efficient society and professional system – as is the purpose of business at its core.

Part Three: Personal Reflection & Conclusion

As the author of this thesis, I wanted to include a section in which I was able to speak, not in specific relation to my topic. Over the course of this academic year, I was given the challenge to write a thesis of my choice as a graduation requirement from the Western Oregon University Honors Program. At the end of this thesis and nearing the end of this academic year, I wanted to reflect on the process that it took to get here and what, if I could, change. I truly do believe that this thesis was intended to be a challenge, and it was. It forced time management skills and project development; breaking down a massive end goal into little task, over the course of a long time line. If I could start the year over again, I would utilize and manage that time more wisely. Not to say that I am perfect at it now, but rather see how I could have better improved on it. This is a professional topic that I would like to further research in my future. As I enter the professional world, in the very industry I discuss in this paper, I hope to see if my opinions and stances will change, as well as what legislative changes will happen in the upcoming years.

In specific relation to this topic, I started with a significant interest in the ethical debate surrounding the topic, but by the time I got to that section all I wanted was to further research the legality of it all. If I were to do the thesis again, I would narrow the scope of my topic into the legality, and look more into the DOL's impact analysis (as well as other third-party analysis made on the same proposal). I felt that a lot of the minor topics I covered in this paper were only surface level – an intentional feeling, as I wanted it to be digestible for professionals and everyday people, but it made a lot of it appear to have wholes in theories or weaker arguments than they were intended to have. I believe that after writing this, I have a greater appreciation for all my professors writing dissertations, but also a better understanding of the intentions and motivations I have going into my industry.

I have reiterated several times within this paper, I did not write this with the intention of convincing anyone that one standard is better than the other or one ethical theory is more appropriate than the other (though my bias is fairly evident). I wanted to write this paper more as a means to shine light on an issue that I have seen and struggle with, especially in a field I have been studying for four years to work in. It is something that I hope to look at again in ten years and see positive change. This paper is merely my screenshot of the issue today and my perspective on it. Thank you for getting this far.

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