DOL's Conflict of Interest Rule: NAPFA responds

On April 6, the U.S. Department of Labor released the final version of its Conflict of Interest Rule for retirement advice under the Employee Retirement Income Security Act of 1974 (ERISA). The new rule amends a 40-year-old statute to reflect realities of retirement saving and to advance consumer protections. Like many in the industry, NAPFA's Public Policy Committee has been monitoring the rulemaking process to understand what's in the final rule and the implications for Fee-Only advisors. The committee asked several NAPFA members for their initial impressions on the DOL rule and its likely impact.

What does the DOL's Conflict of Interest Rule mean for the financial planning profession?

Bob Gerstemeier: It's a game changer for anyone in the securities industry, which almost all FPs are in some way. Almost every IRA rollover or qualified plan recommendation will fall under the new rules. It will take time for all of us to implement the appropriate procedures in our practices. I'm personally hoping for a "super session" on best practices to implement this at the NAPFA 2016 Fall Conference!

Diahann Lassus: It is a major step forward for the financial planning profession, and I couldn't be more excited to see this take place. The elevation of the standard for advice under this rule could be the single biggest event in the profession to date, and it is definitely a tremendous win for professional financial planners. There are many open questions around the impact of the rule, but it will take time to see how it will actually evolve. The next question is: Now that DOL has raised the standard for retirement accounts, what will the SEC do? We are all staying tuned.

Ron Rhoades: It provides the CFP Board with a clear opportunity to revise its Standards of Professional Conduct, and to more tightly embrace the fiduciary standard of conduct for all CFP Certificants. Hopefully, the CFP Board will apply the fiduciary standard at all times for CFP Certificants, and hopefully the CFP Board will lead, rather than follow.

In addition, it will force many brokers to move to the AUM business model. With that comes the impetus to actually do financial planning, seen as a "value added" to an ongoing relationship in which AUM fees are charged. It moves the profession toward a true profession, bound together by a bona fide fiduciary standard of conduct and in service to the public interest, although many steps remain.

Also, for all advisors, it means greater due diligence—as to both investment strategy selection (choice of asset classes utilized in portfolios, SAA or TAA) and choice of investment product (especially due diligence on pooled investment vehicles)—will be required of nearly all advisors to qualified retirement plans and IRAs. And greater documentation of that due diligence will be necessary.

Watch when the final rule comes out—what requirements will be imposed in relation to rollovers of IRAs from qualified retirement plans. There could be a new exemption from the prohibited transaction rules that addresses this. Rolling over a 401(k) to an IRA won't be an "automatic" decision (as if it ever was).

Greater competition in the AUM space will result. Robo-advisors will need to provide some human interaction at the inception of client relationships, in determining strategic asset allocation and the proper use of funds (i.e., whether to pay down debt, etc.). The "pure robo" model, without human interaction with the client, is unlikely to survive in the regulatory environment (see recent FINRA report, and statement by Massachusetts securities regulators). This might challenge the business model of some robos. Also, asset manager fees (i.e., mutual fund and ETF fees) will be lowered in many instances, as asset managers compete on the basis of quality, not the amount paid in revenue-sharing payments. Firms will need to distinguish themselves by offering more points of contact or more in-depth points of contact with clients, data solutions such as online (and secure) data vaults, greater focus on lifetime financial goals establishment and attainment (i.e., life planning), etc.

Some independent broker-dealer firms, especially those that relied on sales of non-publicly traded REITs and other illiquid, high-commission products, will likely disappear or merge. More and more financial advisors in broker-dealer firms will question the benefit of affiliation with a wirehouse or independent broker-dealer, especially given that the technology solutions/support of these firms is often hindered by legacy systems with low functionality.

Look for growth in the number of RIA firms and IARs, and look for more Fee-Only RIAs. NAPFA will benefit, while FSI and SIFMA will bleed members. FINRA will also bleed members, which is why it will push the SEC hard for "third-party exams"—and take over the exams of dual-registrant firms (and possibly RIA firms, depending on how the SEC's anticipated third-party exam rule is written).

Dan Moisand: To the true profession and professionals who comprise it, it means a significant degree of validation for our way of doing things. Professionals behave as fiduciaries and have no fear of being held accountable to such a standard.

Giles Almond: I believe it is too early to tell. It could prove to be an important milestone in the advancement of our nascent

profession. On the other hand, the backlash from the dark side could eventually result in a watered-down, meaningless fiduciary standard. Worst case, perhaps, is that their horribly deceptive end effective marketing clout results in the rule being branded as "Obamacare for retirement plans" and is completely overridden by Congress.

What are the implications of the rule for consumers?

Gerstemeier: It's another layer of consumer protection. It won't limit access to small mid-range investors. It will limit the sales practices that have been used to prey on these consumers. With technology today, there are ample ways for a fiduciary adviser to be successful serving small and mid-size clients.

Lassus: This can only be a positive for consumers. Think about the elevation of the delivery of advice from suitability to putting the consumer's interests first. How can a consumer lose when a standard is established that requires they receive objective advice about their retirement assets, hopefully leading to a better result at less cost? And it doesn't limit access for the small investors, because there are many advisors out there who are willing to deliver advice under this standard. Once consumers understand what has happened, they'll be ecstatic over the new rule and with working with an advisor who has to put the consumer's interests first.

Rhoades: Many brokerage firms are already rolling out new advisory platforms—with lower minimums and lower fees. While commission-based fees will not be abandoned completely, commission-based compensation will likely be lower, under the Best Interest Contract Exemption, especially for larger transactions. The academic research is clear: lower total fees and costs equal higher returns for investors. Greater retirement security will also result. Consumers will end up receiving more, and better, financial and investment advice, for less total fees and costs. ERISA's prudent man fiduciary standard will apply to IRA accounts, under the BICE contract (when it is utilized). (I'm watching the final rule to see if this provision will be kept in.) This will mean better investment portfolio design.

Moisand: There are so many part-time fiduciaries offering to help the public, I don't see this adding a lot of clarity. None of these smaller investors Wall Street claims they will drop are being serviced for free. Wall Street is concerned that the customers will balk once they see what is going on and what they pay, and they are also concerned about not being able to hide behind the suitability standard, or caveat emptor in the case of insurers. Still, I think it is a huge plus for the consumers, because they're being protected in a way that they need and

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Overview of DOL's Conflict of Interest Rule

By Mary Malgoire

It's hard for people who didn't follow the journey of the DOL's new fiduciary rule closely to understand it. Full implementation of the rule was postponed until Jan. 1, 2018. The goal of the new rule is to clearly establish that any investment advisor who advises ERISA plans and plan participants must act in the client's best interests, as a fiduciary. But the new rule allows conflicted advice/commission income under a "best interest contract exemption" (BICE), which says that "a broker or insurance agent can't sell products and earn commissions unless a contract is signed that obligates the salesman/brokerage firm to work as a fiduciary in advising the client."

This action by the DOL has alerted many millions of investors to the fact and impact of conflicted advice on their retirement savings. This is positive. It sets a higher (but not ideal) bar for the SEC's yet-to-be announced definition of fiduciary. It will be hard to set different fiduciary standards for taxable (SEC's jurisdiction) and retirement (DOL's jurisdiction) accounts.

Of course, there are exemptions. Advisors are permitted to offer variable annuities, non-traded REITs, and proprietary products even if they are inferior to other products that could be better for the client. A requirement that advisors recommend a low-cost alternative if it would be better for the client was eliminated in the final version. This is very disappointing. Look for greater sales of the above products as they give the brokerage and insurance industry greater cover. However, will this hold up in a legal challenge? Hopefully, there will be early and often challenges.

New rules also apply to IRA rollovers, including the *recommendation* to roll assets out of the plan. This is great news. Plan advisors will not be able to recommend an IRA rollover and then stuff the account with high-commission products (unless those products are variable annuities, non-traded REITs, and proprietary products).

All advisors (brokers, planners, etc.) must now advise in the best interests of their client. If the advisor sells a high-commission product, if challenged, she or he would have to show how it's in the best interest of the client. The good news is that we're already seeing pricing changes that favor investors. But the industry will look to see where things settle. My feeling is that fiduciary advisors need to keep the pressure up, acting on behalf of investors. We shouldn't settle for a half a loaf when investors deserve the whole enchilada.

There are disclosure requirements. However, they're watered down from the original proposal. Disclosing that the firm and advisor has to act as a fiduciary can be done on the firm's website only (no need to give it to the client in writing), and there's no requirement to disclose the fees and commissions that a client will pay. This is highly disappointing, especially that actual fees and commissions don't need to be disclosed. Investors won't have the information they need to be an informed consumer.

According to the DOL, retirement accounts lose $17 billion each year due to conflicted (non-fiduciary) advice. Will the brokerage and insurance industries roll over now that they've gotten a few concessions? Probably not. However, changes are already afoot. Personally, I think that we can only achieve the high standards that we expect on behalf of investors if we do this from inside the industry. This is why I'm working so hard for fiduciary best practices. It's the only way.

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receiving protection that many didn't even know they didn't have.

Almond: Nothing could be a more bald-faced lie than the assertion that no one will serve smaller investors under a fiduciary standard. Millions of middle-market consumers are being served quite well by the no-load mutual fund complexes and, increasingly, by the robo-advisors at a very reasonable cost. The brokerage firms, if forced, will find a way. Merrill Edge is one current example. Of course, numerous NAPFA advisors are profitably serving the middle market.

What does the rule's publication mean for the pro-fiduciary movement?

Gerstemeier: It's still not up to NAPFA's standards, but it goes a long way in putting the responsibility on the shoulders of investment advisers. No longer is "buyer beware" an appropriate way to provide investment advice. I'd like to see it stronger, but this is about as good as we can get right now.

Lassus: It's hard to find the right words to describe how significant the publication of the fiduciary rule is to the pro-fiduciary movement. I was trying to think of a visual that demonstrates the real impact and thought about a car that has been stuck for a while with the wheels spinning as we take turns pushing to get it out. Then someone has the bright idea of putting a board under the back tire, and guess what happens? The car becomes unstuck and shoots forward very quickly. This rule is the board under the back tire that has allowed us to once again move forward and to really begin to think about next steps.

Rhoades: There are dozens of organizations, and hundreds of individuals, that have been involved in the pro-fiduciary movement. Assuming the rule is implemented, which is likely, this is a huge win. The SEC is likely to come out with a fiduciary standard, but the change in administrations will likely result in a further delay for any proposal. The SEC might actually be influenced to come out with a stronger fiduciary standard. Despite the express language of Sect. 215 of the Advisers Act, which prohibits waivers of duties, the SEC permits firms to disclaim, and/or seek waivers of, their fiduciary duties of due care and loyalty—in my view, the SEC is incorrect in permitting this. I don't have much hope that the SEC, whose revolving door makes it largely captured by Wall Street, will bring forth a strong fiduciary rule, absent a very strong SEC chair.

Moisand: My hope is that it will encourage the movement to keep up the fight. We hear all the time about lobbying budgets of Wall Street dwarfing those of the financial planning profession, yet here we are.

Almond: I would consider it a victory, but the war is just beginning.

Do you think near-term politics will impact the rule's implementation?

Gerstemeier: I don't believe this issue will be stopped in Congress. There is a lot of talk going on, but not a lot of action. Most people know this is the right thing to do. I believe the opponents in Congress are only pandering to their base. We have received a lot of pushback from the industry lobbyists, but not a lot of traction for stories about this in any place other than our industry press. I routinely ask consumers if they're aware of what's going on with the new DOL rule, and I'm always greeted with a blank stare and no knowledge of the issue.

Lassus: Our current dysfunctional Congress will certainly try to slow it down or stop it as they have tried to stop it along the way. I don't think they'll succeed, but they could make the process much more difficult and drawn out. Hopefully, they'll be too focused on hanging onto their seats to spend much more energy on this one, but it could become a hot election issue quickly. The presidential election is a little different—with the Republicans possibly coming out against it and the Democrats possibly coming out for it—but I'm not sure that will have any impact in the short-term. Given the uncertainty of the election at this stage, I wouldn't hazard a guess on the impact or lack of impact for the implementation process at this point.

Rhoades: Republicans in both the House and Senate will bring up several bills over the next few months to attempt to stop the legislation. But broad support from Democrats is extremely unlikely, in part due to Sen. Elizabeth Warren's influential support of the DOL rule, and in part due to President Obama's very public support for the rule. A presidential veto is very likely in the case of any such bill, and it is highly unlikely that there will be enough support in the U.S. Senate to override a veto. The current administration doesn't "need" anything from Congress for the rest of this year. All of the appropriations bills won't be adopted, and a continuing resolution on the budget nearly always occurs in presidential election years, with the new administration adopting the 2016-'17 budget following negotiations with Congress—in early 2017. Hence, it's highly unlikely that the DOL rule will be "bargained away" this year.

I project the likelihood of implementation of the rule at 90 percent or greater—if the final rule retains an eight-month period for implementation (hence, requiring implementation by early December 2016). However, if a Republican president is elected, and if both the U.S. Senate and U.S. House remain controlled by Republicans, a new Congress could enact legislation that would effectively repeal the DOL's rule. (I don't see a repeal likely, with a Democratic president.) That makes this presidential election very important.

Moisand: It certainly could. I'm no fan of the left, but it pains me to see the Republican party so obsessed with bashing President Obama and so clearly being backed by Wall Street's BS machine. That there is any controversy about the idea that someone holding out as an advisor should give advice solely in the client's interest is mind-boggling to me.

Almond: Yes. Contributions from the dark side will be flowing to its friends in Congress in this election season. The current divided government might be a good outcome for the rule's future. Sad to say, a Republican president and a solidly Republican House and Senate could spell doom for the rule's future.