

BANKING & FINANCE

Conflict of interest rule expected to level playing field in investment sector



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American families lose an estimated \$17 billion a year in retirement savings because of advice tainted by conflicts of interest, according to data released earlier this year by the White House's Council of Economic Advisers. A new federal rule intends to change that.

About 40 years ago, before 401(k) plans existed, Congress created the Employee Retirement Income Security Act, which provided some basic rules for retirement investment advice.



The U.S. Department of Labor finalized a new conflict of interest rule in April that requires all who provide retirement investment advice to plans and IRAs to abide by a "fiduciary" standard. The rule is expected to go into effect in April 2017, with a phase-in or transition period through Jan. 1, 2018. (Photo/File)

Those rules have essentially remained the same for decades, despite a shift from employer-sponsored benefit plans to participant-directed 401(k) plans and growth in IRAs.

In April, the U.S. Department of Labor finalized a new conflict of interest rule in an attempt to protect retirement savings. The rule requires all who provide retirement investment advice to plans and IRAs to abide by a "fiduciary" standard.

That means they must put their clients' best interest before their own profits, the department said.

The rule is expected to go into effect in April 2017, with a phase-in or transition period through Jan. 1, 2018.

Many registered investment advisers, consultants, broker-dealers, insurance agents and other investment advisers have been acting as fiduciaries — in their customers' best interest — before the rule. But not all were legally required to. To make a higher profit, some steer their clients into a particular investment product that may be a "suitable" solution in terms of the customer's financial needs but not the best option.

"A typical worker who receives conflicted advice when rolling over a 401(k) balance to an IRA at age 45 will lose an estimated 17% from her account by age 65," a news release from the White House said. "In other words, if a worker has \$100,000 in retirement savings at age 45, without conflicted advice, it would grow to an estimated \$216,000 by age 65 adjusted for inflation. But if she receives conflicted advice, it would grow to \$179,000 — a loss of \$37,000 or 17%."

Mario Nardone, president of East Bay Financial Services in downtown Charleston, said he doesn't anticipate a great deal of impact to his business since he's a registered investment adviser. RIAs are regulated by the U.S. Securities and Exchange Commission and were already required to follow fiduciary standards, he said.

"My personal practices and preference has always been to be fair and transparent in how I charge fees, which essentially is the client paying for advice, never paying for a product. I'm never getting paid to sell a product," he said. "In my estimation, I think the fear of advisers set up like me to be tremendously impacted is overblown."

The rule will likely "level the playing field," though, among the many different players in the investment industry, Nardone said.

Broker-dealers, as defined by the Financial Industry Regulatory Authority, are those who buy and sell stocks, bonds, mutual funds and investment products for their customers and/or accounts. They are likely to be most impacted by the rule, Nardone said, because they were not required to be fiduciaries, although some may do business that way anyway.

“I hope that it arms the public to be more educated about how to identify the good guys from the shady characters, and I do think that if executed properly, legislation can help do that,” Nardone said.

What do I do now?

Companies that offer retirement plans to their employees should take the new rule as an opportunity to learn more about their plans, according to J. Briggs Huddleston, managing director of (K) Street Advisors in downtown Charleston. The recently formed company focuses exclusively on retirement plans.

He suggested that employers identify the fiduciaries — those who provide investment advice for a fee to an employee benefit plan or its participants — on their retirement plans because the adviser may not be the only one. CEOs, CFOs, HR managers and others within the company who actively make decisions for the retirement plan could legally be fiduciaries, and some may not realize it.

Huddleston said lawsuits over retirement plans are becoming increasingly common, and he expects the new rule to bring on even more.

“These lawsuits can range from a lot of things of a retirement plan, the investments you chose, how you came up with those investments, among other things,” he said. “If you lose a lawsuit, and you’re the fiduciary on the plan, it’s not the business. It’s you as an individual that is responsible for that. A lot of people don’t realize that.”

Companies need to also understand how their broker-dealer or registered investment adviser is paid and if their fees are reasonable. Huddleston suggested asking the adviser to provide third-party data to compare rates.

Additionally, he encouraged fiduciaries to document every decision made about a retirement plan and then document it again to be safe. Decisions made by a fiduciary won't be judged necessarily on the outcome, he said, but the process to get to that decision will be. It's important to show how a decision was made and to be able to prove that it was monitored afterward, Huddleston said.

"I think this is a great opportunity to take a second look underneath the hood with your retirement plan and ask some of the tough questions to whoever is overseeing your retirement plan," he said. "Are you a fiduciary of this plan? How are you getting paid for this plan? How much are you getting paid for this plan? What services am I receiving from this plan? Those are some of the red flags I'd be asking about."

Huddleston said he only expects to see minimal changes to his business since, as a registered investment adviser, he was acting as a fiduciary prior to the rule update. He expects consumers and companies offering retirement plans to be the biggest winners from the rule.

"Anything that's going to make a better product or better solution for the consumer, I'm an advocate for. Anything that's going to give businesses processes to design a retirement plan that's going to allow employees to retire with dignity, I'm an advocate for," he said. "I can't speak for the other people. My position is this is great. At the end of the day, it's designed to help the end user, and it's making large strides to do that."

Representatives from four Lowcountry financial offices that operate as or are affiliated with broker-dealers on retirement accounts were asked for their views on the new fiduciary rule. None of them agreed to talk, either refusing to comment without an attorney present, declining to comment or by not returning messages prior to press time.

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