A "Crystal Ball" On Life After The New ERISA Fiduciary Rule

By Ary Rosenbaum, Esq.

The Department of Labor's (DOL) new fiduciary rule that is going to go in effect in April 2017 is going to have a profound change in how financial advisors work with their retirement plan clients. It's unchartered waters, since this is the first time that the rule has been changed since the implementation of ERISA was made effective in 1976. This article's purpose is to serve as a crystal ball to predicting the changes the fiduciary rule will have on the retirement plan business.

Some brokers will leave the business; others will stay

With any change in a way business is conducted, invariably there is going to be those players that will thrive with the change and those that won't. The new fiduciary rule is going to have some major winners but I believe that a lot of brokers and small broker-dealers will leave the retirement plan landscape. Stockbrokers sell stock and requiring them to be a fiduciary when that wasn't something they bargained for isn't in the cards. Some people say the best interest exclusion is just words, but I believe that the rule will put a huge curb to varying layers of compensation, revenue sharing, the alphabet soup of share classes, and less offering of proprietary products. That means that brokers will have more potential liability and make less money. When you compare 401(k) plans to their non-retirement business, brokers make more and don't have to deal with the headache of working with a plan sponsor and dealing with plan participants. Asking them to be a fiduciary with more liability and less pay is not something that many brokers and smaller broker-dealers will want to deal with. Larger broker-dealers will have the resources to pay the legal expenses to comply with the new rule and have the backbench of knowledgeable retirement plan experts among their teams to properly handle retirement plans in a fiduciary capacity. The lone wolf brokers who are attached to a smaller broker-dealer may not have that luxury of being able to work in a fiduciary capacity if their broker-dealer doesn't allow them to. It's inevitable that we will have an exodus of advisors from the retirement plan

space and the reasons will be limited resources of the broker and the broker-dealer, higher compliance costs, more potential liability, and lower fees in a more competitive landscape. People are throwing out numbers like 100,000 to 150,000 brokers are going to leave the business and I think those are pie in the sky numbers. While many brokers are claiming now that they will leave the business due to the fiduciary rule, most brokers are going to stay because there is enough money out there to be made working with retirement plans even if they have to serve in a fiduciary function.

Rollovers are going to stay put

When a financial advisor is a fiduciary, they have the highest duty of care in law and equity. Their financial needs are going to have to be secondary to the financial needs of the plan sponsor. As a fiduciary, a financial advisor can't use plan assets for their own benefit. That's a huge problem if a part of a financial advisor's business is rollovers they get from the retirement plans they work on. Under the finalized fiduciary rule, financial advisors who recommend that a client roll over a 401(k) into an individual retirement account (IRA) are considered fiduciaries. This significant change requires these advisors to follow the DOL's protocol for fiduciaries and avoid conflicts of interest. Advisors can only recommend a rollover to former plan participants of the plans they're working on if it is in the plan participant's best interest. As part of this responsibility, advisors will need to consider fees and expenses associated with both the plan and the IRA, available investments under both, and whether the employer pays some or all expenses. To break it down simply, advisors can't help former plan participants roll over retirement assets from plans they work on if they make more money on rollovers than they do under the plan. Why? They'd be breaching their fiduciary status by using plan assets (belonging to former participants) for their own personal gain when they charge more fees on rollovers than they do on the plan (since they are providing more guidance on rollovers than participants' directed 401(k)). While a financial advisor can work with a former plan participant as long as they work in their best interest, I don't believe that best interest exemption between an advisor and participant can shield an advisor from breaching their duty by using plan assets. So if an advisor could only make the same amount of money on rollovers than they do on plan assets, why would they bother with chasing rollovers from these former participants? They won't because why would anyone work harder to get the same level of compensation? Plus since these advisors know who is a former participant or active, there isn't going to be an outside advisor who's going to really make a mint by soliciting rollovers since plan participants tend to want to align with the incumbent advisor unless they currently work with someone with their other investment assets. So over time, you're going to see a lot more assets of former participants that will stay with the retirement plans they were a part of, rather than rolling over. That's going to be an issue because of access; former plan participants are less involved and educated about a retirement plan of a company they no longer work for.

RIAs Won't Get the Traction They Think They'll Get

Registered Investment Advisors (RIAs) have always been plan fiduciaries because they provide advice to plan sponsors for a fee. While many RIAs think that this fiduciary rule is going to be such a big boon to their business, I don't believe that the opportunity is as big as many think it will be. Brokers are now going to be plan fiduciaries, so the marketplace is going to be evened somewhat. However, there is enough leeway in the best interest contract with the plan sponsor that will still allow brokers to collect commissions and still allow them to sell proprietary products. Despite the gloom and doom predicted by some experts, I think the super majority of brokers will remain in the retirement plan business which means there will be less opportunity for RIAs to pick up new business from these plan sponsors where the broker decided to exit the retirement plan business.

Advisor Fees will decrease

The best interest contract (BIC) exclusion that will require brokers to only push investments that are in the plan sponsor's best interest is certainly going to have an effect on the bottom line that a broker can and will charge. By focusing on the client's best interest, I believe that the trails that brokers receive from mutual funds are going to decrease which means overall plan expenses will decrease. Brokers are certainly going to watch the commissions they collect and proprietary funds they push in light of the BIC and they'll know the old adage that pigs get slaughtered. Bottom line, I believe that brokers will have to make less in light of the BIC and that extra competition is going to have an impact which will lower fees across the board.

The new fiduciary rule will spur litigation

Regulations are usually drafted broadly, so that means there will be lots of interpretation as to what the new fiduciary rule means. What's in the client's best interest? Your guess is as good as mine. There are some experts who think that a broker could work on and charge more on rollovers from former participants of the plans they're working on and I respectfully disagree. The fiduciary rule is unchartered waters; it's the undiscovered country. The rule is open to much interpretation and when interpretations clash, litigation in court is a strong likelihood. I'm sure there are ERISA litigators out there already looking at brokers working on larger retirement plans and seeing what they will do in life after the BIC because there will be a difference of opinion on whether the investments offered under a plan are actually in the best interest of the client. Like I always say, ERISA litigators have to eat too.

The retirement plan business will survive and thrive

Anytime there is a radical change in the regulation of the retirement plan industry, some industry experts will claim that the change will get plan sponsors to terminate their plan because they don't want to deal with the change. They will also claim that providers will leave because there won't be more money to be made in this business as there will be a race to zero when it comes to fees. It's a broken record, because we heard the same gloom and doom when the fee disclosure regulations came out. Plan sponsors didn't terminate the plan and there was no race to zero in fees where the only providers to make any money are the low cost providers. While change will hurt some broker-dealers, registered investment advisors will do well and I'm convinced that plan sponsors are going to do well with the elimination of the conflicts of interest that was hurting them and plan participants.

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