The Reality of the DOL Fiduciary Rule

I rarely write opinion pieces. I'm not sure why to be honest, but I prefer to stick to facts, figures, and strategies. Opinion pieces are far more grey, rather than clear cut "dollars and cents" type stuff.

Last month the Department of Labor Fiduciary Rule was supposed to go into effect. I'm both infuriated and ecstatic all at the same time. I suppose I'm somewhat bipolar when it comes to the new fiduciary rule.

Why so emotional? The rule is great for investors, bad for brokers, and neutral to negative forc current fiduciaries. It's a hot bed of "what ifs" and "what could be" when it comes to how financial advisors interact and guide their clients.

What Is A Fiduciary

The term "fiduciary" is at the heart of the matter. Just what is a "fiduciary"?

A fiduciary is someone who holds a special responsibility to act only in the best interests of someone else. Above all else, a fiduciary must put the best interests of the person receiving the advice, guidance, or services *first and foremost no matter what!*

Your doctor is a fiduciary. They must put your interests above their own. Your attorney and your accountant also hold a fiduciary responsibility. They must always act in your best interests regardless of their own personal financial gain or loss.

For example, your doctor must take action to ensure your health is their primary goal. This means they can't recommend a procedure or prescription unless they can honestly say it's the right thing for you. Even if one procedure or prescription pays them more money, they must do what's right for you at all times.

The same goes with your attorney. They have an obligation to act in your best interests at all times. Your accountant is no different. They must provide advice and guidance which is ultimately in your personal best interests.

The underlying - and unwavering - theme here, is a fiduciary must do what's right for you regardless of any compensation, perks, or benefits they receive. If investment product B is better than investment product A, but pays the advisor less, they must recommend the use investment product B.

If you're unfamiliar with the concept of a "fiduciary advisor", I bet this all comes as a shock to you! You've likely always assumed your investment advisor (or financial planner or whatever you want to call them) was providing guidance solely in your best interests. Unfortunately, *this couldn't be farther from the truth.*

The Brokerage World

The reason this is such a hot button topic, is most financial advisors are held only to a "suitability standard". What exactly is a "suitability standard"? It's not much actually.

As industry pioneer Michael Kitces says (my own paraphrasing) "When you go buy a suit, the salesman will sell you one that fits. That's a suitability standard. The fiduciary standard would prompt the salesman to make sure it looks good on you too!"

Do you want your suit to look good? *Or just fit?*

Until now, the financial industry has been held solely to a suitability standard. Any financial advisor or investment manager must have reason to believe an investment or insurance product is simply "suitable". They have no responsibility to make sure it's the best solution for you.

In other words, the investment product must generally be a fit. It doesn't have to be the best fit however.

This allows brokers and financial advisors to sell you products which may be OK, but pay them a lot more money than investments which may be best for your situation.

The scary part about the suitability standard, is anything can be "suitable" if it's spun right. Any reasonably intelligent broker or advisor can make a case for whatever product they're hocking at any moment in time.

The bar is set too low!

All financial advisors are currently held at a minimum to a "suitability standard". The "fiduciary standard" is not a requirement (currently).

A pure fiduciary standard is simply something that elite advisors (like my friend Brian at Landmark Wealth Management) have embraced as "the right way to help clients succeed".

But America's retirement crisis overwhelming. People have to work longer, harder, and then retire with less.

Don't believe me? 48% of married couples receive more than half of their retirement income from Social Security. The average retired worker gets $1,360 per month in 2017.

You can double that for couples. The average couple would get about $2,600 a month then, which is more than half of most retirees income.

For 21% of married couples (and 43% of singles), Social Security payments make up over 90% of their income. The numbers are staggering, and scary.

No matter where your politics lie, the Obama Administration recognized this, and in my opinion was the first Presidency to do anything about the financial industry's apathy towards investor success.

Enter The Fiduciary Rule

Let me start by explaining what the fiduciary rule is. Under the direction of the Obama Administration, the [Department of Labor] set out to provide parameters within which financial advisors could provide financial advice.

Why did they target advisors? Frankly, it's our business to help people plan and prepare for a successful retirement. We hold an important power over the relative financial success our clients enjoy.

The problem is some financial advisors (brokers) are getting rich off other peoples struggles!

The biggest issue is the fees charged to investors. It's far too common to see fees of 2% to 4% per year and more!

Many of those retirement account investments pay brokerage commissions of 3% to 10% as well. Those commissions aren't free, they come out of your pocket somehow. The broker get's rich, while you pay the price!

So the Fiduciary Rule was crafted to reduce the amount of excessive commission and outrageous fee products. Why? Because how a financial advisor gets paid directly leads to conflicts of interest *and* directly impacts your bottom line (negatively).

If they can recommend product A which pays them a 7% commission, or product B which pays them 1% per year, they may likely opt for the 10% commission EVEN if product B is more appropriate and better performing. That's a major conflict of interest!

So the DOL Fiduciary Rule was drafted to remove those conflicts of interest. If the financial advisor still wants to use an investment product which may not be the most appropriate, it must comply with the [BICE carvout].

What is BICE?

BICE is the "Best Interests Contract Exemption. The DOL views any financial advisor as giving advice for a fee as a fiduciary. If the financial advisor's compensation is derived at all from commissions, they're engaging in a prohibited transaction.

Essentially, all retirement accounts (IRA’s 401k’s etc.) must be on a fee arrangement, NOT a commission arrangement. If they’re on a commission arrangement at all, they must follow certain requirements.

First, the advisor must have a contract with the investor. That contract must acknowledge their fiduciary responsibility. This opens the financial advisor - and their employer - to a greater level of litigation.

This is the main reason brokers and their firms hate the DOL Fiduciary Rule. It’s highly likely they’ll get sued much more often than prior. It also means they’ll earn less, while you keep more!

Second, the financial advisor must be able to articulate why a certain product is the best alternative for the investor. Most importantly, the financial advisor must document the various options for the client, and note why their option is the best solution and in the best interests of the investor.

This means when a client leaves an employer, the advisor must be able to clearly articulate why rolling that plan over to an IRA is the best solution.

The Fiduciary Rule Is Watered Down

Simply to get this rule to pass, it had to be so watered down it nearly becomes worthless. First, the rule ONLY applies to retirement accounts. This means your IRA’s and 401k plans etc. fall under the fiduciary rule.

Your regular brokerage accounts, investment accounts, insurance policies, etc. do not fall under the rule. It’s “business as usual” for those investors, and those parts of an investors portfolio.

The BICE exemption is another hang up. It allows for some creativity in explaining why product A is better than product B. It’s a good start, but again, any financial advisor skilled in the art of investment management and financial planning can make a case for one solution over another.

I suspect we’ll see some highly creative arguments as to why an indexed annuity is a better alternative for an investor than leaving the rollover in a 401k plan at lower costs.

Would You Really Want A Financial Advisor FORCED into doing the right thing?

My biggest question for investors is just that. If your financial advisor had to be forced into doing the right thing by you - why would you want to work with them? Wouldn't you prefer someone like Brian at Landmark or myself (I'm a CEFEX certified fee only fiduciary advisor in Las Vegas)? All NAPFA financial advisors agree in writing to a fiduciary standard as well!

We've embraced our fiduciary responsibility for years and years! We weren't forced into doing the right thing by our clients.

I don't know about you, but to me the answer is clear. I'd rather have a firm who has always been a fiduciary versus one who was required to change the way they do business because of a new law.

In the end…

Regardless, the DOL fiduciary rule is a good thing. It's a step in the right direction for investors. It's certainly no silver bullet, and it appears the Trump Administration is going to delay it and water it down even further. Nonetheless, it's a good start.

The irony in this is why aren't financial advisors held to the highest fiduciary standard anyway? Shouldn't the person who helps you manage, grow, and protect your wealth do what's right by you first and foremost?

The brokerage world has fought the fiduciary rule for years now. They hate it! They hate it because it's going to force their financial advisors into doing the right thing:

#1, if your financial advisor is held to a fiduciary standard, their paycheck will likely suffer relative to the commissions they were earning prior.

#2, they're opening themselves up to a much greater level of liability. Lawsuits will start flying, and next thing you know you'll see a lot more brokerage world types on tv as defendants in lawsuits.

Find yourself a quality fiduciary financial advisor from the beginning. Find one who wasn't forced to do the right thing, like my friend Brian! You'll thank yourself down the road!

About The Author

Greg Phelps, CFP®, CLU®, AIF®, AAMS® is the president of Redrock Wealth Management in Las Vegas. He's been in practice 22 years, and has extensive experience with the brokerage world. He's also an author, a speaker, and writes for his financial and investment advice blog RetireWire.