New Fiduciary Rule For Financial Advisors Moves The Needle, But In Which Direction?

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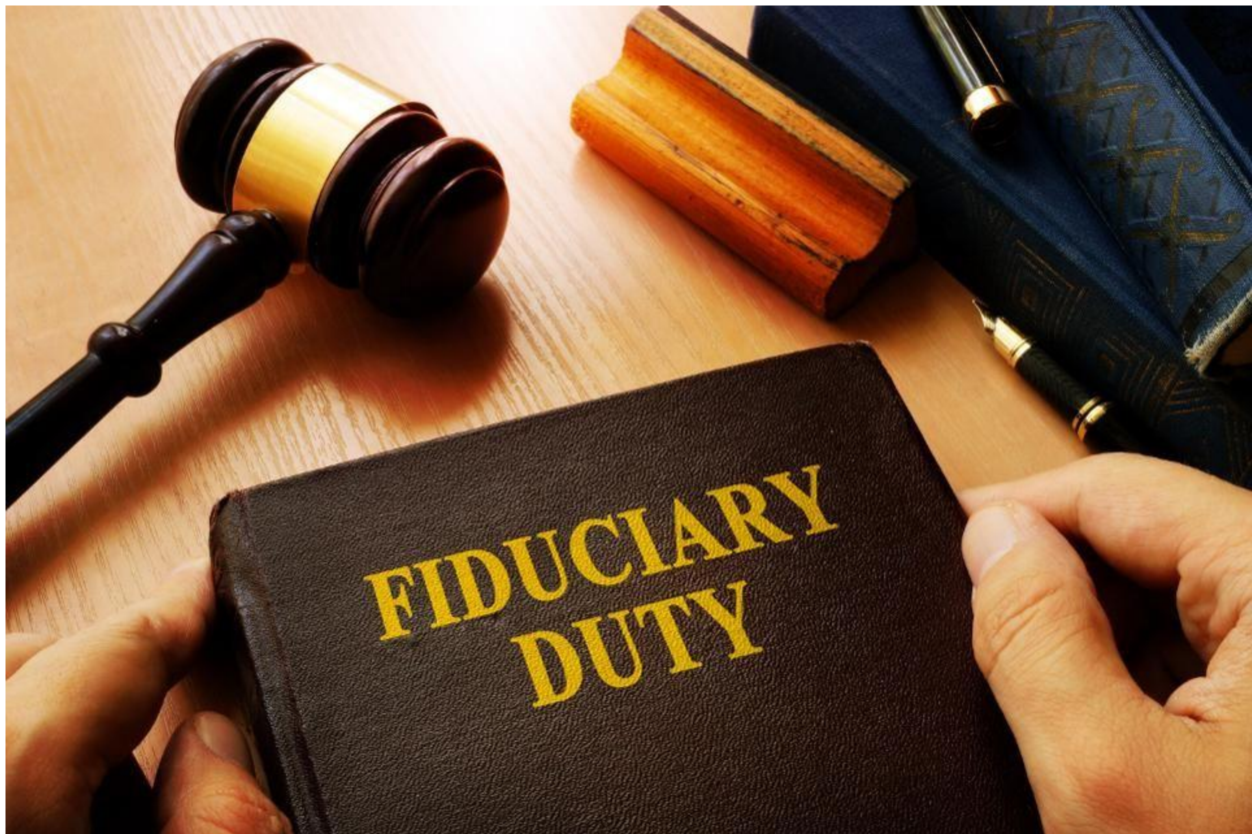

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On June 9, 2017, the financial services world changed forever (maybe), as more financial advisors than ever are now acting under a fiduciary standard of care. This news should have been bigger, but it was not. Part of the reason is that Americans do not fully understand what it means for a financial advisor to act as a fiduciary as defined by the Employee Retirement Income Security Act (ERISA) of 1974. In a recent 2017 survey by The American College of Financial Services, only 52 percent of respondents currently working with a financial advisor were sure whether their advisor was a fiduciary or not. This leaves the remaining 48 percent totally in the dark about the fiduciary status of their advisor. Furthermore, only 31 percent stated they were extremely knowledgeable about what it means for a financial advisor to act as a fiduciary. With this in mind, it is no surprise that June 9 came and went without either the blowback or the fanfare of a rule that many are calling the most influential rule affecting financial services in two decades.

So what does it mean that a financial advisor must now act as a fiduciary under the new Department of Labor rule? From a very basic standpoint, it means that the advisor needs to act in the best interest of the client. The advisor can charge no more than a reasonable fee for his or her services, and must act with the skill, due diligence and knowledge expected of someone familiar with the responsibilities of being an advisor. Conflicts of interest must also be avoided. However, as you can imagine, the details and compliance requirements are far more complicated and nuanced. For example, this rule does not require the financial advisor to provide fiduciary level advice on *all* investments and advice, but only those pertaining to retirement accounts like 401(k)s and IRAs.

What does this new regulation mean for consumers? Well, as a consumer, you might already have received, or you will be receiving, some correspondence from your financial advisor or his or her firm telling you about changes in fees, products, or services. For a start, fees will be changing for consumers. Certain fees for mutual funds, annuities, and other investment options have already been reduced substantially since the rule was announced, and some product fees decreased even more on Friday, June 9. You can likely expect continuing modifications to fee structures throughout the rest of 2017.

Additionally, some companies and financial advisors will be moving away from commission-based fees and compensation, and moving toward a flat fee-based model. A flat-fee model can take many different forms. In some cases, it might be a subscription-like model, or an upfront payment. In other cases, it might be an asset under management (AUM) model, in which the client might be charged one percent each year on all investment assets held with the advisor. For consumers, a move from a commission- or transaction-based brokerage account to an asset-under-management-based fee structure is not always a good or bad thing. Unfortunately, it very much depends on the consumer's specific situation, goals, desires, and planning needs. For a consumer who does not want much additional planning but just wants to keep money invested in a few mutual funds for several years, an asset under management model could be more expensive than his or her current set-up. However, in other cases, it could present a more beneficial structure if what the consumer wants is ongoing advice and planning on a consistent basis from his or her financial advisor.

While product services and fees might go down, the overall cost of getting advice could go up. Opponents of the new DOL rule have consistently attacked the rule with the argument that increased liability, compliance costs, and a higher standard of care will cause the cost of advice to go up. It is almost certain that the new DOL rule will cause the increase of compliance costs and liability expenses for financial services firms. It is likely that some of these costs will be passed directly to the consumer. Advisory fees could rise as a result. Fiduciary advisors cannot charge more than a reasonable fee for their services; however, that does not mean that their advice will be cheap.

While some advisors will expand their offerings and services to comply with the higher standard of care required under the DOL fiduciary rule, other companies and advisors are going to pull back their services, products, and offerings. Some consumers could be severely impacted by a reduction in services available from their current financial services professional. Some consumers might have to start looking for a new financial advisor in order to find all the services and investment options they desire. Some opponents of the rule argue that this reduction in services will most dramatically affect low-wealth and middle-wealth consumers who could be priced out of the market.

Although there is a real risk that some consumers could be priced out of the market, only time will tell. Most low-income individuals do not receive any advice from financial planners today, so the change likely presents a more serious risk for middle-wealth America. Technology may come to the rescue here, as robo-advisors are gearing up to address the needs of that middle market. Betterment, for example, is a retirement-oriented robo-advisor aiming to serve this market and comply with the fiduciary rule. In an interview with Betterment CEO Jon Stein, he said that he was “so excited about this rule because one of the reasons we started Betterment, was to empower clients and give the mass-market good advice about their investments.” While Stein stated he thinks robo-advice is primed for the future with or without the rule, he does think that the fiduciary rule provides unique opportunities for the new technology to serve a large segment of the market with high quality fiduciary advice.

Ultimately, the DOL fiduciary rule will be disruptive to the financial services industry, for better or worse. While most agree with the principles of having a uniform fiduciary standard of care requirement for financial advisors, many are still hesitant about the ultimate impact of the current rule as written. A fiduciary standard, on the one hand, does represent another step forward for greater recognition of financial services as a true profession; however, much still needs to happen. Just because the rule is now in place does not mean that all advisors have the education, process, technology, and services to meet the demands of a fiduciary standard. The fiduciary requirement also is not necessarily complete or permanent yet. The Trump Administration has come out against the rule, and the new DOL secretary is working to review it. Recently, the House of Representatives passed a bill that would terminate the rule. Regardless, it is the law of the land for now, and could be hard to roll back completely. Even if there are subsequent changes to the rule, it is likely that some aspects of the fiduciary standard will stick. After all, once the toothpaste is out of the tube, it is impossible to squeeze it back in.