FIDUCIARY FOCUS

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What exactly is a fiduciary?

Source: Financial Finesse
The term "fiduciary" comes from the Latin word, "fiducia," meaning trust. A fiduciary must act for the benefit of another person in a financial relationship and not for their own personal gain. Fiduciaries must disclose all conflicts of interest, and have a legal obligation to take into account the beneficiary's circumstances, goals, risk tolerance, time horizon and investment experience. In other words, when you hire a fiduciary, he or she is legally and ethically required to act in your best interests.

What evidence demonstrates that financial advisers' conflicts of interest harm savers?

Source: Department of Labor (DOL)
The Department of Labor's regulatory impact analysis suggests that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of one-half to one percentage point per year over the next 20 years. The under-performance associated with conflicts of interest in just one slice of the market — the mutual funds segment alone — could cost IRA investors between $95 billion and $189 billion over the next 10 years and between $202 billion and $404 billion over the next 20 years. While these expected losses are large, they represent only a portion of what retirement investors stand to lose as a result of adviser conflicts, which affect a broader set of investments than mutual funds. These estimates are grounded in a growing body of academic literature that provides empirical evidence of firm conflicts in financial advice.

Is this rule necessary? Aren't my retirement savings already protected by the SEC, Finra and state securities and insurance regulators?

Source: Department of Labor
Retirement savings are supposed to receive special protections under federal retirement and employee benefits law. However, the regulations underlying these laws on retirement advice have not been updated in more than four decades. When the Employee Retirement Income Security Act of 1974 (ERISA) was first passed almost 42 years ago, professional pension managers typically were the ones making complex decisions on retirement investing. Individual Retirement Accounts (IRAs) were created by ERISA, and 401(k) plans would not exist for several more years. But there has been a dramatic shift in our retirement system in the intervening decades: Today, workers are largely responsible for managing their own savings through 401(k)-type plans and IRAs, and so millions of Americans rightfully turn to advisers for recommendations on how much to save and how to invest and manage those savings.

But under these outdated rules, savers cannot count on the retirement investment advice they receive being in their best interest because many advisers are not required to abide by what is called a fiduciary standard. In other words, today's rules allow some financial advisers to put their bottom line ahead of their clients' retirement security. This is especially true for rollovers and IRAs, which almost never receive fiduciary protections under the current ERISA and tax rules. Recent studies show that the vast majority of Americans understandably but mistakenly believe their financial advisers are required to act in their clients' best interest. The reality is very different.

Many advisers do put their clients' best interests first. They are hard working men and women who got into their jobs to help families achieve a secure retirement. But some do not, and the current rules make it harder for all of the financial advisers who are trying to do right to compete — and hard for consumers to know whom to trust. Independent research suggests that conflicts of interest are costing middle class families receiving conflicted advice billions of dollars per year.

The final regulatory package would require retirement investment advisers to put their clients' best interest first.

The SEC has separate related authority to regulate securities markets. And while advice on securities in tax-preferred retirement savings accounts is regulated by both the Labor Department and the SEC, there is much advice involving retirement savings (like advice to purchase some insurance annuity and bank products) over which the SEC has no jurisdiction to protect consumers. The same is true of the Financial Industry Regulatory Authority (Finra). Meanwhile, the states have a patchwork of laws that fill in only some of the gaps.

The new rule uses the Labor Department's authority to ensure that retirement investment advice will be treated as fiduciary advice. Advisers covered by the rule and the related exemptions will be obligated to put the customer's interests first and adhere to fiduciary standards. This will be a change for many advisers in the retirement market today who are not currently required to adhere to these standards. Change is past due. The ERISA regulations on retirement investment advice have not been significantly updated in more than 40 years. The rules need to be modernized to address a changing retirement landscape and the billions of dollars lost to conflicts of interest each year.

Why did the DOL create this new rule?

Source: Franklin Templeton

This is a key part of White House’s “middle-class economics” initiative. The DOL’s motivation for the proposal is to level the playing field and help assure that investors know the investment advice they are receiving is in their best interest and not the interest of the person giving the advice. This is the first major rewrite to the fiduciary definition since ERISA was enacted in 1974.

What does the new definition mean?

Source: American Funds

By broadening the definition of investment advice, the DOL is expanding the fiduciary standard to include retirement investment services that have previously been held to the less restrictive suitability standard. The new rule requires that a recommendation must be not only suitable but in the client’s best interest. It treats broker-dealers and their registered representatives as fiduciary investment advisers whenever they provide investment-related recommendations to retirement plans, plan participants and IRA owners.

Registered investment advisers (RIAs) are already subject to a fiduciary standard of care under the securities laws, but will now have to satisfy the fiduciary standard of care under ERISA, including its rules prohibiting certain transactions unless an exemption applies.

The DOL rule treats as fiduciary advice:

• Recommendations to rollover from a plan to an IRA.

• Recommendations to convert brokerage accounts, such as A and C share mutual fund accounts, to fee-based advisory programs.

What are the consequences for an advisor who breaches fiduciary duty?

Source: National Association of Insurance and Financial Advisors (NAIFA)

The consequences of a claim of breach of fiduciary duty are significant. The financial professional has the burden of proof that he or she has not violated the duty if a complaint is made. If a breach is determined, the financial professional is personally liable for any losses to the plan or participant account, and must return any profits arising from the breach.

What is the DOL's (Department of Labor)"fiduciary" rule?

Source: Principal

Over the years, the DOL has confessed great difficulty in establishing that an adviser acted as a fiduciary in providing investment advice. Under a regulation that the DOL itself issued in 1975, a person was not deemed to be providing investment advice as a fiduciary unless the advice was provided under a five-part test, which included whether the advice was provided under a mutual understanding that the recipient was using the advice as a primary basis for making an investment decision and certain other conditions were satisfied. For example, in one case, a stockbroker who recommended "a few securities" and proposed that the plan trustees "purchase from th[e] select group [of securities]" was not viewed as a fiduciary because there was no "agreement for [the stockbroker] to provide individualized advice upon which the trustees would rely as a primary basis for the [p]lan's investment decisions."

The DOL has now issued a new regulation redefining when a person would be deemed to be providing investment advice as a fiduciary. In proposing the new regulation, the DOL had claimed that advisers were taking advantage of the alleged difficulty in establishing fiduciary status by recommending investments that maximize the advisers' compensation, but were not in the best interest of the plan or plan participants. In making this claim, the DOL asserted that advisers were recommending investments with excessive fees to plan participants.

While the DOL's new fiduciary regulation does not apply to non-investment advice, the regulation has led many advisers to seek more information on how ERISA fiduciary rules apply to a plan sponsor's selection of a new 401(k) plan provider/recordkeeper.