When You're Serious…

by Bradley R. Newman, CFP®

Should We Have To Regulate Ethics?

The financial services industry has been turned upside-down by the passage of a Department of Labor (DOL) regulation that was intended to assure that investment recommendations to you are completely and unequivocally in your best interests. Coming from a firm who has operated in that fashion since our inception, we can't help but wonder why you need a regulation to tell you that you should treat your clients honestly.

On April 6th the DOL released the final conflict of interest rule (Final Rule), which amends the definition of 'fiduciary investment advice' under the Employee Retirement Income Security Act of 1974 (ERISA). With this, the DOL is attempting to close an over 40 year old loophole that allowed investment advisors to provide investment advice that did not have to be in their clients best interests; i.e., sell highly commissioned products, sell proprietary investment products, etc.

While the amendment sounds good in concept, the reality of its benefit to the end consumer is better in theory than in practice. A few of the issues are:

- The rule doesn't take effect until January of 2018, which means there is over a year and a half of investment advisors not being required to put your interests first.
- The rule will only apply to investment accounts that fall under the ERISA regulations. For example, IRA and 401(k) accounts will be covered, but non-qualified investment accounts will not. Your advisor will have the ability to change the nature of their relationship with you based on which investment account you are discussing.
- By having you sign a Best Interest Contract Exemption (BICE), an advisor will be able to continue selling highly commissioned and proprietary products. In other words, the conflict of interest does not need to go away, as long as you are made aware of its existence and sign the appropriate paperwork.

At the end of the day, the DOL regulation has missed the mark. They have taken a very simple and principled concept, that an investor should presume that their needs and interests will be placed ahead of their advisor's and that they will be given the absolute best investment advice possible for their specific situation, and watered it down to a point that it doesn't provide much real benefit to you as an investor.

As you contemplate your current relationship or the hiring a financial advisor, below are four questions that you should ask:

1. How much do you charge, and what is it based on?

   An advisor who is paid on a completely fee-only basis, and does not receive commissions, revenue sharing or other forms of compensation on investments utilized, is unlikely to have conflicts of interest.

2. What, if any, other products do you sell besides investment advice?

   Advisors can sell products, like insurance and annuities. If you choose to use one of those products, make certain that you understand how the advisor is compensated for selling that product and any potential conflicts of interest that can result.

3. When you make recommendations to me, will they be in my absolute best interest or will they be considered a merely suitable alternative?

   Remember that the DOL regulations do not become effective until January of 2018. Even then, the regulations do not apply to all accounts and the BICE provides advisors a fair amount of latitude. It is always a good practice to know what is driving an advisor's choices.

4. Please provide me with a written estimate of the total investment costs that I will pay to you in my first year, and explain how they are calculated. Additionally, please also estimate for me what your firm will likely earn if I become a client.

   This question offers another way to find out what is driving an advisor's recommendations.

Although the DOL started with the best of intentions, the mighty lobbying efforts of Wall Street have taken the teeth out of the regulation. At the end of the day, you as the consumer will be left to make certain that your interests are being protected. To make matters worse, there are now going to be financial advisors who will have the ability to tout their fiduciary standard, when it may not always exist.

When you evaluate appropriateness of a product or service that is being recommended to you, go back to the basics and ask: How is that advisor compensated? What other options are available that are not being recommended? Who stands to benefit the most from the recommendation?

Bradley R. Newman, CFP® is with Roof Advisory Group Inc., an independent investment management and financial advisory firm based in Harrisburg. The firm is a fee-only registered investment advisor providing portfolio management and financial planning services to individual and institutional clientele. The firm's e-mail address is invest@roofadvisory.com