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New fiduciary rule calls for higher standard of care

401(k) ADVISER
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Recently, the U.S. Department of Labor announced the most sweeping regulatory reform to the financial services industry in over 40 years. Scheduled to take effect next April, the new fiduciary rule requires financial advisers working with retirement accounts, such as 401(k)s and individual retirement accounts, adhere to a meaningfully higher standard of care than current law requires.

From the more than $13 trillion currently invested in self-directed retirement accounts, regulators estimate that investment advisers are charging investors $17 billion more in annual investment management fees than they should be. This is occurring because most Americans have little knowledge of what they're doing when it comes to investing and are relying upon financial advisers whose desire for personal profit is allowed to come before their client's best interest.

Any rule change that promises to take $17 billion in annual revenue away from Wall Street and give it back to investors is going to generate some pushback, and not surprisingly, a six-year battle has raged between regulators and much of the financial services industry regarding the need for the new fiduciary rule.

Higher Standard Of Care

While far from a panacea, the fiduciary rule attaches new legal duties to any investment professional paid to make investment recommendations to retirement account investors. The rule borrows from existing pension law that requires pension consultants act with the duty of loyalty and the duty of prudence. Accordingly, under the new fiduciary rule, any investment recommendation made to an individual retirement account holder will be required to pass two basic tests: 1) did the adviser earn excessive compensation due to the investment recommendation? and 2) would an expert have made a similar recommendation under similar circumstances? Failing either one of these tests will put the adviser at risk of being held liable for damages. This is a significantly higher standard of care for your retirement assets than is currently required by law.

Fiduciary Rule In Action

Here's how the fiduciary rule will work. First, it requires any financial adviser who wants to make recommendations regarding your retirement assets provide a written promise to act as a fiduciary and put your best interest first. Second, it requires the adviser to disclose their fee, and if their fee is variable, disclose all the possible types of compensation they can earn so you can understand the conflicts that exist in the adviser's compensation scheme. Finally, the adviser must provide a warranty that their firm has adopted compliance policies to mitigate any potential conflicts.

Importantly, the fiduciary rule also requires that financial services firms remove all mandatory arbitration language from their new account forms thereby providing you a new cause of action to sue if your investment adviser fails to live up to their promise to act as a fiduciary. This may be the most important element of the fiduciary rule because it creates a powerful enforcement tool, the plaintiff's bar, if any member of the financial services industry breaches its fiduciary duties.

Conflicted Advice

One of the most common conflicts that the fiduciary rule is designed to mitigate is the "sales pitch posing as investment advice" that many 401(k) plan participants receive after leaving their employer. The decision whether to roll your assets into a self-directed IRA, your next employer's plan or leave them in your former employer's plan is very important with potentially life-changing implications. You should not have to make such an important decision based on the advice of an adviser who doesn't have to put your interests first.

Other typical conflicts of interest that exist in relationships between a financial adviser and his or her client include some that are obvious, such as an adviser recommending their own firm's products, and some that aren't so obvious, such as advice about whether it is a good idea to invest or pay down debt.

What To Do Now

I predict the new fiduciary rule will improve your chances of receiving better advice about your retirement assets, which should lower costs and improve account performance. But you're going to have to be willing to do a little work to take full advantage of the protections it offers.

Given how hard it is to save money for retirement, investigating your adviser's plan for compliance with the fiduciary rule is a must. Ask your current investment adviser when they plan on making their new customer contract available for your review and make sure to request their required conflict disclosure documents as soon as they are available. You deserve an adviser who will always put your interests first and clearly disclose any conflicts they have.

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