Fiduciary Rule: What If I Do Nothing, Again?

The Department of Labor is expected to impose new regulations that require financial advisors to enter into a written contract with each client ("Fiduciary Rule"). This contract requires that the financial advisor act in the client's best interest as well as a number of additional provisions and warranties.

There has been an unprecedented level of resistance to the Fiduciary Rule that is scheduled to take effect in the fall of 2016. Opponents argue that these regulations pose a threat to the financial services industry and its clients and that the upheaval will cause more damage than any benefit that could be derived.

There have been a series of threats to the status quo of financial advisors in last 10 years. These have had little effect on the way business is done. In spite of the potential for massive changes, financial advisors and institutions have had to do little more than make minor adjustments and add more disclosures.

Some examples of these threats to the status quo that occurred in the last decade were:

- The pension protection act of 2006 threatened to neutralize incentives by limiting advisors to computer models or level fees. Thwarted by favorable rulemaking by regulators.
- Dodd/Frank threatened universal fiduciary standards. Still awaiting regulatory action.
- Fee Disclosure promised radical changes in pricing by disclosing what clients were paying and what they were getting in return. Poor compliance and weak enforcement turned this tidal wave into a ripple.
- 12b-1 repeal would prohibit the largest compensation source for financial advisors. These efforts have died on the vine.
- Government sponsored retirement plans have been proposed to replace private sector plans. Moving at a snail's pace, the automatic IRA is being adopted in only a few states.
- Repeal of tax advantages threaten to undermine a key benefit of retirement plans, annuities, IRAs, etc.

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- Overhaul of tax laws threaten to change the tax treatment of all investments. No overhaul has made it through the Congress.

The lesson from this past decade of threats may well be that the best bet is to sit back and do nothing, for this too shall pass.

Is the Department of Labor Fiduciary Rule any different?

While the Fiduciary Rule may suffer the same fate as previous initiatives, it may be instructive to understand how this differs from previous attempts at major changes. Here are 10 ways in which the Fiduciary Rule differs from previous proposals/changes.

- Populace issue with a winning message… Opponents must win the argument that acting in a client's best interest is too disruptive, too expensive, too risky and exclusionary to be a prerequisite for financial advisors.
- High visibility… Repeated demands of the President and active involvement of Congressional Leaders with associated media coverage continues to make consumers aware of the planned regulation.
- High awareness of how previous changes failed to materialize… The administration and regulators are keenly aware of the ways that previous attempts to change have been thwarted and have implemented tactics to overcome them.
- No fear of reprisal from disapproving Congress… Unlike any time in recent history, the current administration has shown disdain for the Congress after suffering no reprisals for standing against Congress in the past.
- No action required from Congress for adoption… The Fiduciary Rule is a regulatory change that requires no action from Congress to take effect. While Congress could vote to stop the Fiduciary Rule, there is little chance such an action would survive a certain presidential veto.
- Low interest in campaign support from the financial sector (AKA Wall Street)… The current administration appears to have little interest in support from the financial sector and has been unwilling to negotiate.
- Enforcement not dependent on regulatory inspection… The Fiduciary Rule is embodied in a written contract that permits any client to take action against financial advisor or institution, needing only to prove a breach of contract.
- Explicit agreement required of each client… Clients play an active role since each will be required to sign a best interest contract, thus opening the door for clients to review the arrangement with their attorneys.
- Risk of non-compliance… Clients may have to be reimbursed for market losses. The exposure exists for losses if the protection of the contract is not in place.
- Liability for failure to comply increases over time… The likelihood of a loss occurring increases with the time of the exposure since the period over which the loss is calculated could be any period.

Is it really different this time? "What if I do nothing?"

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