
A Two-Headed Nightmare: The Robos and the DOL

By Kerry Pechter *Thu, May 21, 2015*

The Amazon-ification of financial services will eventually disintermediate tens of thousands of financial salespeople. If you didn't get the memo already, consider the conflict-of-interest proposal a final wake-up call.

The conflict-of-interest proposal from the Department of Labor, posted April 20, won't protect consumers, as the Obama administration hopes and declares. It won't destroy the insurance industry or the broker-dealer industry, as the industries seem to fear.

It will, instead, buy those industries some time as they gradually adjust to a much more serious disruption of their traditional distribution and payment models. I'm talking about the same wave of automation and disintermediation that has already revolutionized the publishing industry, the travel industry and many others.

So-called robo-advice, or "the digital advisory channel," is already here. It has already enabled 401(k) participants and direct investors to manage their own accounts. It has allowed cheap day trading on discount trading platforms. It has allowed advisors to transfer repetitive drudgery to "platforms." It's just the latest expression of the Internet's power to vaporize the middleman.

The robo-advice threat and the DOL conflict-of-interest threat are two parts of the same threat to traditional distribution. Both aim to make the distribution of financial products and services less expensive, more objective and more transparent—i.e., more consumer-friendly. Of the two, you should be more worried about the digital threat. Consider the DOL its messenger.

The 'best interest' compromise

The most labor-intensive parts of the financial services industry—sales and distribution—are the last pockets of resistance to the digital channel. To give them time to adjust to the new reality, the DOL has compromised. Its proposal asks "advisers" (registered reps and insurance agents, not RIAs or CFPs) to pledge to act in the "best interest" of IRA customers. This standard of conduct is more demanding than the "suitability" standard (caveat emptor) now in effect. But it's less stringent than a true fiduciary standard, which requires intermediaries to act in the "sole interest" of their clients (which for several reasons they couldn't possibly meet).

This is not a serious effort to protect the consumer. First, the "best interest" standard won't protect anybody from anything. It's too vague and indefinable. Its ambiguity will only reduce

transparency, and it will do nothing to foster trust in the industry. It dilutes the meaning of a fiduciary. As the *Fiduciary News* columnist Chris Carosa has written, anybody who swears to follow a best interest standard can now claim to be a fiduciary. (Disclosure may increase, but disclosure is a stale joke.)

Second, the DOL uses the word “adviser” as loosely as the industry does. By not drawing a bright line between advice and sales recommendations, it colludes with the deception that it should unmask: that sales recommendations are on a par with advice. The conflict-of-interest proposal’s main accomplishment, if enacted, will be to allow the administration to declare victory and pretend that it accomplished its mission, without causing sudden dislocations, of the type that Retail Distribution Review caused in the UK.

Deep-six the red herring

Still, you’ll be hearing a lot of sound and fury from the industry about the proposal. No public comments have been posted on the dol.gov/ebsa or regulations.gov websites as of May 15. But industry lawyers and trade association chairmen will undoubtedly make at least two arguments: that the costs of complying with the proposal outweigh its benefits and that the proposal, though well-intended, will backfire. That is, if the administration takes away the incentives (like high commissions) that motivate brokers and agents to pursue middle-class clients, no one will bother to advise those investors.

This populist-sounding piece of sophistry is 95% bunk. You might as well argue (and some undoubtedly do) that banning ads for high-sugar breakfast cereals and soft drinks on TV will deprive small children of useful video entertainment. This argument contains just enough truth (people need investments; financial inertia is widespread and harmful) to give it credibility among those who want to believe it. In my opinion, it insults the intelligence of the American public. The faster we deep-six this red herring, the better.

To repeat: the DOL proposal doesn’t ban anything. The DOL has already said that it won’t try to outlaw commissions. Although the new standard would force intermediaries to pledge to act in the best interest of clients, be more fee-transparent, and accept more legal accountability, its edges aren’t sharp enough to shut down the traditional distribution channels overnight.

Instead, it gives the financial industry some breathing room. It will give certain obsolete, labor-intensive parts of the industry time to adapt to the Internet-driven world, if they choose.

The future of financial advice for the middle-market is already here: a self-managed interface supported by an accredited or licensed adviser on a recorded line. To escape becoming a glorified phone rep, an intermediary will need to do something an algorithm can't, and deliver something that can't be delivered via a screen (on a watch, smartphone, tablet, laptop, desktop, ATM or back of an airliner seat) is doomed. (Retirement income planning can't easily be automated; more on that in a future column.)

Amazon-ification

Registered reps and insurance agents, and their trade associations, will find the DOL proposal alarming. They, along with the asset managers and annuity issuers who rely on them for third-party distribution, will undoubtedly fight it. But the manufacturers must recognize that the digital advisory channel will be better for them, and for their customers, in the long run.

For those at the top of the financial industry food chain, the process of distributing products—i.e., gathering liabilities—is a necessary evil. On the one hand, liabilities are indispensable; they fund huge projects and they fuel the fun side of finance, which is buying and trading assets. But the task of selling retail products through human intermediaries to collect those liabilities is an expensive chore.

The DOL didn't create the current situation. Millions of Boomers are unprepared to make sophisticated financial decisions about their IRA savings. The DOL arguably has an obligation to help them find impartial advice about retirement investing at economy-of-scale prices. The industry will fight the regulators in order to maintain unobstructed access to those IRA assets. But even if the DOL proposal goes nowhere, the Amazon-ification of financial services will eventually disintermediate tens of thousands of financial salespeople. Consider the conflict-of-interest proposal a wake-up call.