Retirement Income
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Borzi Needs to Appreciate Retail Distribution More

By Kerry Pechter *Tue, Feb 24, 2015*

The argument over whether there should be a fiduciary standard or a suitability standard misses the point. This is about the cost of distribution, not about ethics.

The debate over the Department of Labor's supposedly imminent re-proposal of its "fiduciary" or "conflict of interest" rule has been bothering me, almost tormenting me, since someone leaked the now-famous White House memo a couple of weeks ago. It's a conundrum.

Let's look at it from the DoL's point of view. The regulators are alarmed that financial intermediaries are steering rollover IRA owners into retail products and services that are much more expensive than the ones they received as participants in ERISA-regulated employer-sponsored retirement plans.

Sure, the investments are more expensive. But why? They're often most expensive when the costs of distribution are embedded in the fee structures. In the case of certain variable annuities share classes, for instance, the insurance carrier earns back the one-time commission it pays for distribution by charging the client a big annual mortality and expense risk fee.

The DoL might therefore be misidentifying the problem. It seems to be acting on the presumption that manufacturer incentives are causing intermediaries to steer rollover IRA owners into expensive investments. If that's true, the solution might appear to be to ban the incentives. But it might not be true. Or it might be true for reasons that the DoL doesn't appreciate.

The real problem might simply be that *it is much more expense to distribute financial products and services to individual IRA owners than it is to distribute to participants in retirement plans.* Since individuals are clearly averse to paying the cost of distribution directly, the intermediaries sell them products whose expenses include the distribution costs.

If that's true, a strict new DoL proposal, if it becomes the law of the land, could destroy a system—flawed but functional—that finances the distribution of financial products and services to millions of middle-income Americans, leaving a vacuum in its place. This, in fact, is what the financial services industry seems to argue.

Unfortunately for the industry, it doesn't have a foundation of trust on which to build its case. It has become an over-compensated, entrenched vested interest, and it has pretended that sales and distribution costs are "advice" or "active management" to better justify them. To hide its conflicts of interest, it sacrifices transparency. In some cases, the incentives themselves are high enough to inspire corruption or attract corrupt people.

So the argument over whether there should be a fiduciary standard or a suitability standard misses the point. This is about the cost of distribution, not about ethics. Maybe we should think of ways to make sales and distribution (and advice and asset management) nearly as efficient in the retail rollover world as they are in the wholesale institutional world.

But wait. Using the Internet, that's what Fidelity, Schwab, Vanguard, the 'robo-advisors,' the latest advisor platforms and services like Hueler's Income Solutions are already trying to do. Digital technology will have a much bigger impact than regulation.