
President Trump and the DOL Fiduciary Rule

By Kerry Pechter *Wed, Feb 1, 2017*

If the DOL rule is removed or neutered, then financial services firms may have more autonomy in choosing how to use the savings that digital automation brings: To raise shareholder profits or lower customer fees. It will depend on their particular business models.



From my distant roost here in Costa Rica, I've been following news about the Trump administration's first two weeks and wondering how his recent and future executive orders will change the fate of the DOL's fiduciary (or conflict of interest) rule, originally scheduled to take effect in April.

If you believe, as I do, that the DOL rule was a trailing indicator of the larger technology-driven trend toward lower costs and disintermediation of human advisors—the Amazonification of financial services—then you may agree that no matter what the thinking-fast-and-not-slow President Trump does, he can't stop the tide any more than Canute could.

You have only to look at massive net mutual fund flows to Vanguard at the expense of actively managed fund companies over the past few years (as reported each month by Morningstar) to see that many Americans prefer low-cost, transparent, web-mediated financial services, including advice.

But Trump (or his Labor Secretary) can take the teeth out of the DOL rule by removing investors' right to file class action suits against providers who display a pattern of un-fiduciary conduct toward rollover IRA clients. Financial services companies won't feel as much pressure to meet a true fiduciary standard, with respect to any account. Such a move might ease the downward pressure that the fiduciary rule was bound to—was designed to—exert on the costs (i.e., industry profits) associated with retirement accounts (and, by contagion, with all accounts).

To me, the fiduciary rule was always about putting price controls on the fees associated with rollover IRA accounts, and giving IRA owners the same protections from unreasonable fees that ERISA intended for 401(k) participants. It was always about the money. Calling the rule an "extension of the definition of the fiduciary standard to a much broader range of professionals" was mainly a way for some opponents of the rule to fog its purpose: Helping

savers keep more of their money and ensuring that service providers keep less.

The DOL was right to extend ERISA protections—low, transparent fees—to rollover IRA accounts. Whether the savings was in 401(k)s, 403(b)s or rollover IRAs, it was still tax-deferred; that is, subsidized by the nation. As long as the DOL continued to allow providers to charge whatever the market would bear, the providers would ipso facto consume the subsidy. Unrestricted pricing in a publicly subsidized market isn't kosher.

Maintaining the subsidy under these circumstances would have been unfair to the average taxpayer. But few people in the private financial services industry, particularly those in publicly held companies, seemed to understand that the fiduciary rule, in the long run, might help protect the tax expenditure for retirement savings. They simply saw a threat to their turf and naturally defended it.

(Despite the subsidy, many providers felt no obligation to serve middle-class customers unless they were sufficiently compensated. They reserved the right to decide what reasonable compensation should be. If middle-class customers lost services for lack of adequate incentives, it wouldn't be their fault; it would be the fault of misguided do-gooders who defied market forces.)

In short, they wanted it both ways: A tax subsidy for their products and the right to charge what the market would bear. But, thanks, to technology, that can't last. They will eventually lose market share, I believe, not because of a DOL rule but because of competition from digitally-driven direct marketers, both old school (Vanguard) and new school (Betterment).

Still, stopping the DOL rule matters. If the DOL rule is removed or neutered, then each financial services company will have more breathing-room to decide how it plans to use the savings that digital automation brings. The management of each firm, depending on its business model, will decide how much of those savings to share with the end customer and how much to keep as profit. A cooperative like Vanguard will continue to pass much of its savings onto its customers (while still making boatloads of money), as it has for decades. Other types of firms, however, are likely to behave differently.

Publicly traded firms, like the wirehouses, are likely to want to keep as much as the savings as they can for their primary constituency: their shareholders (including senior executives). One indicator: These firms appear to be opting to use digital technology internally to make advisors more efficient (and eventually, I think, employ fewer advisors). If they can serve more customers with fewer advisors while maintaining traditional fees, profits should soar.

Maintaining traditional fees should be easier if Phyllis Borzi (or someone like her) isn't monitoring them or trying to define "reasonable fees." The Trump administration, which looms as the closest thing to a dictatorship that the U.S. has yet seen, and is likely to usher in the most reactionary period in American history since the McCarthy Era, will probably, by action or inaction, relieve downward pricing pressures from those publicly traded companies while they decide how to proceed.

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