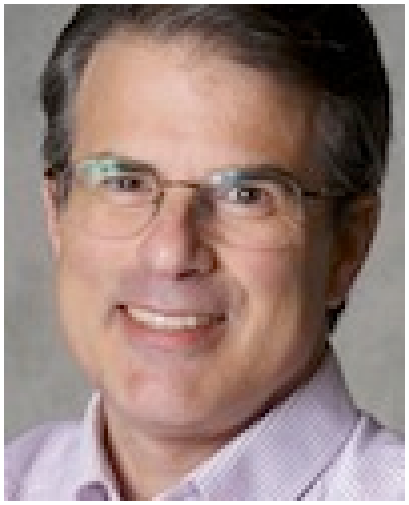
Questions for the DOL's Tim Hauser

By Kerry Pechter *Thu, Oct 1, 2015*

The DOL may believe that, by establishing a blanket "Best Interest" principle, it won't have to pick winners and losers. But it can't avoid picking winners and losers. A one-size solution never fits all.



Hubert A. Ross, a tall, 53-year-old CFP from Destin, Florida who clears his trades through LPL, was almost pleading for a simple answer to what he considered a simple question: Couldn't the combatants in the battle over Department of Labor's fiduciary proposal lock themselves in a room for a day or two, negotiate a settlement, and end the five-year standoff over the DOL's attempt to start regulating rollover IRAs like mini ERISA plans?

"You're all intelligent people," Ross said, to anyone nearby, which included panelists David Blass of the Investment Company Institute, Steve Hall of Better Markets, Bonnie Treichel of the Retirement Law Group, and David Certner of AARP, who had just finished debating the proposal at the National Press Club in Washington, DC. "Shouldn't you all be able to solve this?"

Ross was right: the DOL proposal is simple. It would bar the dodgy "suitability" standard of conduct for sellers of mutual funds and annuities to IRA owners, which allows them to make self-serving recommendations. But, like Nancy Reagan's "Just Say No" anti-drug campaign, it's not just simple—it's simplistic.

Like Ross, I was at the symposium on the proposal hosted by the Investment Management Consultants Association on Tuesday. The luncheon speaker and main drawing card was deputy assistant Labor Secretary Tim Hauser (right), who in mid-August chaired four days

of public hearings on the proposal.

IMCA has a stake in all this. Its members could be affected by the final proposal when it is published in early 2016. If they are "fee-based," like Hubert Ross, and earn both asset-based fees and commissions on the sales of securities, they may no longer be able to sell commission-based products to IRA owners without signing a pledge to act solely in the client's "best interest."

This requirement, known as the Best Interest Contract (BIC) Exemption, rankles broker-dealers. It entails both a legally binding pledge of good faith and a fresh layer of red tape. Broker-dealer trade groups have warned that they will cease selling commissioned products —such as variable annuities and load mutual funds—to IRA owners just to avoid the BIC. Broker-dealers say the BIC will force them to abandon those consumers, since commissions on packaged products are the compensation-model-of-choice for middle-market clients. (Some believe the industry is bluffing.)

I attended the meeting mainly because Hauser was speaking and welcoming questions from members of the audience, which numbered about 150. Handed a wireless microphone, I was able to ask him: "After what you heard at the hearings, do you now think that the DOL was in fact naive to think that broker-dealers could ever accept the terms of the BIC?"

This question was not as unfairly loaded as it sounds, because during the August hearings Hauser twice asked industry attorneys in just those words: Are we naïve to think that this compromise can work? (One lawyer murmured No and one said frankly Yes.)

Watching the webcast of the hearings at home, I nodded *Yes, yes, yes*. For one thing, the DOL had not adequately defined "best," as a legal definition. Also, the agency seemed to offer a paradox: *Advisers can accept conflicted compensation if they pledge to provide unconflicted advice*.

To me, conflicts of interest are not mere temptations, which an intermediary can choose to ignore if he or she is sufficiently self-disciplined. They are dark masses whose gravity curves the ethical space around them. They reduce transparency and limit the available range of options. Even when disclosed, they can work to the disadvantage of consumers. So when I first read the DOL proposal, I thought: This can't work.

Of course, it would have been naïve to believe that Hauser might confess that the DOL had woken up to the impracticability of the BIC exemption, and he didn't. "I didn't ask that question *several* times," he demurred, and went on to explain that most of the witnesses at the hearing had assured him that the DOL wasn't naïve and that the BIC was in fact workable. He politely, and at length, turned my loaded question aside.

After his address, Hauser paused in the adjoining hallway to field a few more questions. Hundreds of portraits of newsmakers, from Eliot Spitzer to Sharon Stone, cover the length of one wall. Hauser, who worked as a Legal Aid attorney in rural Missouri for six years after graduating from Harvard Law School in 1985, is tall and lanky with tousled light brown hair. He wore wire-rimmed glasses, a grey suit and soft black walking shoes—not the glossy cap-toe Oxfords or tasseled loafers popular on Wall Street or K Street.

I asked Hauser if the DOL was targeting variable annuities with its proposal. The proposal would require VA sellers to meet the BIC exemption and pledge to act solely in the IRA client's interest. Under the status quo, advisors can sell VAs for a commission as long as they meet the requirements of so-called PTE 84-24, which does not require such a promise.

Hauser said, "The proposal isn't intended to favor one product over another." He noted that variable annuities are complicated, but that they also offer some beneficial guarantees. No, he said, the DOL is not targeting VAs.

That wasn't a satisfying answer. VAs, about a third of which are sold through independent broker-dealers, have been under attack in the mass media. Journalists often use VAs as an example of sales predation. Jill Schlesinger, the well-known CBS financial reporter, made VAs the butt of a joke at a recent robo-advice conference in New York. Ironically, sales of VAs have already leveled off or dropped. Some broker-dealers now hesitate to sell investment-only VAs to IRA owners because they duplicate the tax deferral that IRA owners already have.

Finally, I asked Hauser if the DOL distinguishes between different types of commissions. After all, not all commissions are equal. Annuity commissions can be especially opaque. The

average purchaser of a B-share VA probably doesn't know how the contingent deferred sales charge regime works. The commissions that purchasers pay on fixed annuities are built into the prices of the contracts. FIAs are sometimes even advertised as "no-fee" products. But he said, "No we treat all commissions the same."

That gave me pause. The agency either doesn't fully understand the many different business models in the financial services industry, or it doesn't care. Hauser and his boss, EBSA chief Phyllis Borzi, may believe that, by establishing a blanket "Best Interest" principle, they can protect the consumer without picking winners and losers in the marketplace. But they can't avoid picking winners and losers. A one-size solution never fits all.

Hauser assured the audience on Tuesday that the DOL staff will read all 2500-plus public comments and tweak the final draft of the proposal accordingly. We'll know more in a few months.