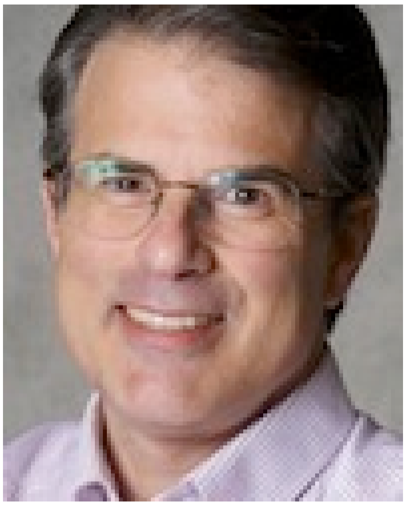
The DOL and the Robo-Advisors

By Kerry Pechter *Thu, Jun 18, 2015*

The DOL proposal will not make investment advice a commodity; it is a commodity. The DOL isn't going to make thousands of financial salespeople obsolete; the digital advisory channel already has.



The Secretary of the Labor Department, Tom Perez, said something remarkable while being grilled by lawmakers during yesterday's live internet broadcast of a hearing of the House subcommittee on Health, Employment, Labor and Pensions on the topic of the DOL's pending conflict-of-interest proposal.

Perez pointed out that, if the proposal and its "best interest" standard of conduct does in fact discourage or stop some brokers from advising IRA owners, those owners will be served—and served more objectively and inexpensively—by the growing army robo-advisors who are entering the advice marketplace. The DOL proposal and robo-advice are convergent trends!

"Technology is a huge ally," said Perez, who exhibited a fair amount of grace under the pressure of House members' rhetorical questions. "A company out of California, Wealthfront, a startup that already has $2 billion in assets under management. They have a platform that enables them to significantly lower fees, and allows them to operate as a fiduciary. They do well by doing good."

In his inoffensive but persistent way, Perez articulated what should be obvious by now. While the DOL conflict-of-interest proposal may threaten the broker-dealers' and IMOs' profitable, labor-intensive grip on the distribution of annuities and mutual funds, the robo-advisors embody the very doom of the old model. The DOL proposal will not make investment advice a commodity; it has become a commodity. The DOL hasn't made thousands of financial salespeople obsolete; the digital advisory channel has. The DOL seems willing to compromise, but the Internet is a Grim Reaper.

Not that any of the legislators, Republican or Democratic, appeared interested what Perez said. Most were busy indicting the DOL proposal as costly, complex and confusing. That is, they tried their best to divert America's attention (actually, fewer than 600 people watched the webcast) from the fact that the existing market for financial advice is too costly, complex and confusing.

And they've done a pretty good job of obfuscation. Opponents of the proposal have succeeded in planting the untruth that the proposal will do more harm than good—to small investors. Commissioned salespeople, they insist, won't agree to sign a binding pledge to act in their clients' best interest (as the current proposal would require). Therefore, the argument goes, they can't or won't try to sell them load mutual funds and fixed indexed annuities.

Small investors, according to this hollow assertion, will have no other source of advice, because their balances aren't big enough to attract fee-based advisors. But that's exactly where robo-advice (a combination of online content and phone support) can and will enter the equation. And it neglects the availability of fee-only advice.

Not that I'm a fan of the current version of the DOL proposal. It's too full of gaps and ambiguities. Most observers have focused on what it says; I've been focusing on what I think are three critical omissions.

First, there's no requirement that a financial intermediary know anything about de-accumulation when advising an IRA owner. There's no requirement for attainment of a retirement income-related designation, like those offered by The American College or the Retirement Income Industry Association. This is a serious flaw, especially if the DOL hopes the IRA money will generate lifelong retirement income. We should make IRAs the special preserve of retirement income specialists.

Second, the DOL doesn't tell its side of the story. If I were the DOL, I would tell the American people that it makes perfect sense to ring-fence IRA money from retail-priced products and services. Otherwise tax-favored 401(k)s serve merely as incubators for future retail IRA accounts. Which means that taxpayers, in effect, subsidize the profits of the financial services industry. The DOL should say, "If you want us out of your hair, get a Roth!" Instead, we bicker about the meaning of "best interest."

Third, the proposal plays along with the fiction that the industry provides advice, pretending that brokers and agents can choose to give objective advice or conflicted advice. This is ridiculous. This is not about "advice." It's about the sale and distribution of securities and insurance products, and whether or not the DOL can or should isolate the $7.4 trillion in IRA money from the retail financial distribution network, or at least demand that IRA money receive special (i.e., impartial, inexpensive) treatment. Both sides seem to enjoy using "advice" as a smokescreen, perhaps to bore the public into turning its eyes away.