
Two Definitions of 'Best Interest'

By Kerry Pechter *Thu, Oct 6, 2016*

The gap between what advisors can deliver and what clients feel that the DOL rule promises them is exactly where the plaintiff's attorneys may focus their litigation efforts.



More and more frequently, I catch myself stewing about retirement income—my own. For starters, I plan to work until age 70 if I can and postpone claiming Social Security until then. That's mainly for my family's sake.

My spouse is six years younger than I am, and I want her to qualify for the largest possible widow's benefit. A back-loaded Social Security payment should help ease the pressure she might feel to spend our kids' inheritance.

With three daughters, we have a strong "bequest motive." My wife inherited some money from her parents, and we'd like to pass it through to our children more or less intact. On a per-child basis, the legacy will be modest. My frugal in-laws split their bequest evenly among their three children. So each of our daughters stands to receive one-ninth of the family fortune.

We'll rely on our own savings, most of it in tax-deferred plans, to generate income. Neither of us has a defined benefit pension. So I'm considering the purchase of guaranteed income products. Out of all the products that I write about, immediate variable annuities have always appealed to me. Vanguard used to offer an immediate annuity that was part fixed and part variable. It seemed like the perfect compromise.

On the other hand, the product that would probably best relieve my anxieties about the future is the period certain annuity. I worry most about the years from 75 to 85, when I'm statistically likely to be alive but too old to work. The idea of an extra blanket of guaranteed income during those years, via one or two period certain annuities, just feels safer. (Maybe that's what it feels like to have a pension—as my engineer brother does. But even he frets.)

At present—things could change—I would define that solution as the one in my "best interest." But if the DOL used the same definition, advisors are in trouble. How would an

advisor ever know that such a solution would bring me the most peace of mind, unless I told him or her? If, like most clients, I had no background in annuities, I probably wouldn't be able to communicate my needs.

The DOL fiduciary rule didn't necessarily set the "best interest" bar that high. As I understand the Best Interest Contract exemption, it equated "best interest" with what a "prudent" financial specialist would recommend, without regard to his or her own reward. If the rule stops there, the financial industry—i.e., the world of product distribution—may be able to live with it merely by flattening advisor and broker-dealer compensation. Life as you've known it would go on (albeit with more automation).

But if clients interpret "best interest" to mean a customized solution that's a) tailored to their unique sets of needs, risks and wants; b) encompasses their entire household balance sheets; c) requires their costs to be as low as possible; and d) forces advisors to have virtually every known option or tool at their disposal, then the era of advice-as-product-recommendations may be over.

If that higher definition of best interest dominates, then it's easy to imagine a world where advisors sell only low-cost generic products in computer-generated portfolios. If not replaced entirely by algorithms and call centers, advisors will likely be salaried or charge by the hour, be independent or self-employed, have a 360-degree knowledge of investments, insurance and taxes, and have a balanced understanding of accumulation and distribution strategies. They'll also need a set of interpersonal and consultative skills that many today's sales-driven reps and employee-advisors don't necessarily have.

You could argue that the gap between the narrowest and the broadest definitions of best interest is impossibly wide, and that not even the DOL will expect employees of broker-dealers (or even the robots who replace them) to bridge it.

But that fuzzy gap—between what advisors can deliver and what clients feel that the DOL rule promises them—is exactly where the plaintiff's attorneys may focus their litigation efforts. Despite the disruption it will come with it, advisors and broker-dealers should probably start defining "best interest" in the larger sense.