
Why the Borzi Proposal is So Scary

By Kerry Pechter *Thu, Feb 5, 2015*

The "conflict of interest" or "fiduciary" rule could stop the manufacturers of retirement products from distributing to one of their target markets: the owners of \$6 trillion in rollover IRA assets.

Who knew that the modest little rollover IRA would create so much opportunity and, simultaneously, cause so much trouble?

Forty years ago, when ERISA was enacted, no one foresaw that a temporary tax haven between qualified plans and required minimum distributions—a mini-pension set adrift in the sea of retail distribution—would eventually harbor more than \$6 trillion in invested assets, with more to come.

Or that it would someday lead to the looming showdown between Labor Department official Phyllis Borzi and a host of trade associations and law firms representing hundreds of broker-dealers and thousands of registered reps.

Anxiety ran high within those trade associations this week, on fears that the DoL would soon re-propose a rule that could make the money in traditional IRAs off-limits to commission-paid financial intermediaries such as registered reps.

Both sides have legitimate arguments. Do IRA owners deserve unconflicted advice? Of course. Is financial advice ever free? No. Is conflicted advice better than no advice? That's a harder question to answer.

The DoL doesn't want rollover IRA money to be treated as cavalierly as other retail money; it wants it to be treated like pension money and continue to receive products and services at low institutional prices. It doesn't trust brokers, even those who can sell a broad range of products, to provide the unbiased advice that IRA owners need.

But the financial world objects that it can't possibly render those products and services to individual IRA owners on a retail basis as cheaply as it could render them within the wholesale, institutional world of ERISA plans.

In a worst-case scenario, Wall Street fears, the DoL's action will create chaos throughout the third-party retail distribution system by banning the incentives that fuel and the lubricate the machine. Both manufacturers and distributors will suffer the loss of a

significant market. Borzi *doesn't get it*, the Street says.

Advisors, for instance, might stop sell 401(k) plans to thousands of small companies if they lose the possibility of someday managing the six-figure IRAs that roll out of the 401(k)s. And small-town independent broker-dealer reps won't even be able to talk to IRA owners, let alone aggregate all their assets.

So we're at an impasse, all because the humble rollover IRA falls into a legal and regulatory grey zone between the institutional and retail worlds. The stewardship of trillions of dollars in IRA assets, and billions of dollars in potential transaction fees, is at stake.

What happens next? If the DoL proposes a new version of the regs soon (and doesn't provide exemptions-from-prohibited-transactions that will allow the current retail distribution system to continue to serve IRAs), we'll get the Office of Management and Budget's cost-benefit analysis of the new rules. (It will probably satisfy no one.) Then we'll hear the anguished cries of the trade associations. If the DoL refuses to go soft, Wall Street will probably seek redress through political means or the courts.

All because no one anticipated the impact of the little rollover IRA.

I have a strange feeling that these issues will eventually be decided not by courts, bureaucrats, legislators, or lobbyists but by advancing technology. (See today's cover story.) Fee-based robo-advice, digital interfaces and tablets are likely to squeeze a lot of the costs and conflicts out of the financial distribution system before too long. If so, the financial trade groups are defending turf that's already vanishing under their feet.

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