Conflicts of interest in retirement advice

New rules to protect you

By Michael Carlin, AIF, WMS

The financial services world is changing – whether you're ready for it or not. The good and surprising news is that it's changing for the better. In April, the new rule from the Department of Labor addressing conflicts of interest in retirement advice goes into effect. Despite what you are hearing on the news about the doom and gloom surrounding this regulation change, we view the change as a significant upgrade and a necessary one to ultimately help improve the relationship and outcome between clients and their advisors. This rule is hotly contested on Capitol Hill right now and this article addresses what the fuss is all about.

The new rule

The meat behind this rule is that for the first time advisors are now required to put clients' needs before their own needs. I'm sure that's shocking to read and I'm sure people are surprised because they always figured that was the case when they were working with their investments advisors. Unfortunately, the natural conflict of interest that exists within the financial advisor to client relationship has been there forever and we look at this critical new series of laws and rules as a step towards creating a playing field that is more in favor of maintaining clients' best interests.

Changes you'll see

Let me provide an example of how you may see this change. One very popular thing that clients would look to do when they retire is rollover their retirement account, moving their funds from their employer's plan to the care of their favorite investment advisor. It makes sense to take your money out of your corporate plan where you receive no investment advice and rollover into an IRA where you would receive investment advice and increase the number of investments you have access to. A big part of the discussion that was left behind was the simple fact that even though your investment choices were fewer with your existing retirement plan provider, in many cases, if not most cases, the amount you're paying in fees and costs with your corporate plan was often far less expensive than moving your money into your own IRA account.

Fast forward to this rule change. Now your advisor has to have the conversation about the fee structure of where you are with your corporate plan versus moving the money over to an independent account. As a result, advisors are going to face heavily increased scrutiny when they try to move money out of any kind of company retirement plan into an IRA account.

Another example – it used to be popular to take retirement accounts and move them into variable annuities because of the guaranteed features they offer such as guaranteed rates of growth despite market returns and even guaranteed income for life. For years advisors have used those guarantees to lure unsuspecting clients out of their low expense company retirement plans and into highly commissionable investments like variable annuities. These types of transactions will now be under even more scrutiny than even the example mentioned above when you're trying to get money into a regular investment.

The same goes for any type of commissionable based investment. Basically, taking money out of your company plan and moving it into any kind of investment to make a commission is going to be nearly impossible to do under the new rules and regulations.

Long-term perspective

Again, we view these changes as beneficial to the relationship between client and financial advisor. Anything that will help reduce those natural conflicts of interest with regards to fees is a good thing for clients. However, you need to keep in mind that there are big prices to pay for having high cost investments within your portfolio. Remember, retirement accounts are long-term investment vehicles. The difference of earning 1% more because of lesser expenses can mean a lot over the course of a lifetime. In fact, if you're saving $10,000 for 30 years, and you are at a 7% rate of return, you will accumulate $1 ,010,738. But if you earn only 6% because you're paying 1% more in fees, that dollar amount changes to $838,016. This $172,000 difference is a stark reminder of the value in the relative long-term costs of having high expenses inside your retirement accounts. It's no surprise that the focus has turned on expenses and we finally see regulations put in place to benefit clients long-term. (This example is for illustrative purposes only.)

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