MAM 184: Tim & Tom Talk DOL Fiduciary Rule

Tom: Welcome to the Mullooly Asset Management podcast. This is Tom Mullooly, and I'm joined by Tim Mullooly.

Tim: Hey everybody.

Tom: This is episode 184.

Tim: 184.

Tom: I almost said 185.

Tim: Yeah.

Tom: We're going to talk about a topic that we covered a few episodes back in December, but apparently ...

Tim: It's back.

Tom: It's back. We need to revisit the Department of Labor changes that are coming now on June 9th.

Tim: That's right. Yeah. Does everyone remember that DOL rule that people were talking about a lot last year? Well, like Tom said, it's coming back, June 9th, so next week, it'll go into partial effect, not full effect.

It was scheduled originally to go into this partial effect back in March or April, I think, but it got delayed, but it's finally going into somewhat of effect, so we figured we would give everybody a refresher as to what this rule is, who it affects, and the ins and outs.

Tom: A couple of things that, I think, are important. Tim's right in the sense that this was originally supposed to be in place April 10th and with the full effect of January 1st of next year, 2018, and that full implementation date ...

Tim: That's still the case. That's still set. Yup.

Tom: Yeah. The major change ... I sat on a panel at NASDAQ at the end of November discussing the Department of Labor changes. At that time, we didn't know it was going to get pushed back like it has, but I remember speaking with a reporter afterwards and I said, "For one of the few times in my career, I can remember being the after picture, not the before picture," because it sounds like, on the surface, that they would prefer to see advisors gravitate more towards the business model that we've got here at Mullooly Asset Management.

Tim: Right. Yeah. For us here, as a firm, not going to have too many big changes to put into effect with this rule. It's more going to affect people in the broker/dealer side of things, but it's just going into partial effect on June 9th, so what exactly does that mean?

Tom: June 9th happens to be a Friday, so I think everyone's going to be good over the weekend.

Tim: Right.

Tom: They're not going to really enforce any of the rules on the very first day that this is in place, and it's kind of ... What was the analogy that you saw in a magazine?

Tim: I think one article in Forbes said there is a "no bite" during this partial effect period, meaning, the rules are there and they want you to abide by them, but there's not going to be any real enforcement of them until the January 1st full effect.

Tom: They're kind of making a trial run.

Tim: Right. Just a dry run to ... You could call it a "soft open", when you open a restaurant, I think, was the quote from the Forbes article. Even though you know you have to act in the best interest of your investors, there's no one really enforcing it.

Tom: It's pretty amazing to think that between basically now and January 1st, we're going to force people in the industry to act in the best interest of investors. Are you kidding me?

Tim: Shouldn't that have always been the case?

Tom: Right. I just want to read some things that were in the Department of Labor frequently asked questions. If you want to read the entire rules that they put out, go right ahead, but they put out a couple of these frequently asked question guides and they're excellent.

Tim: They're much easier to read for everyday people.

Tom: What they talked about was during this transition period, which we're going to be entering now, advisors in financial institutions must give advice in the client's best interest.

Tim: Duh.

Tom: Yeah, I'm shocked. They said that the client's best interest has to have two components. It has to involve prudence and loyalty. Very hard to prove in the court of law, but I still can't believe that everyone is not subject to that level.

Just spending a moment talking about fiduciary obligation, we're investment advisors. We have a fee-only practice. We assume the mantle of a full fiduciary obligation when we're managing our clients' investments, but even a broker has to have some modicum of fiduciary obligation. They can't be reckless.

Tim: Right.

Tom: First of all, they're not going to be in business very long and secondly, they're just going to get one complaint after the other until they're out of business, so there always is some measure of fiduciary obligation, but now, what they're trying to do is drive home the point that if you're going to be giving advice, you are going to have a fiduciary obligation for your clients, and that has never been the case for brokers.

Tim: Surprisingly. Yeah.

Tom: It's amazing. TD Ameritrade puts out surveys and year after year after year, they would publish data where they would pull clients, investors and they had no idea that brokers did not have a fiduciary obligation to their clients.

Tim: I feel like it's a question that would never get asked because it's something that you just assume people are always going to act and just have a good nature about them and do the right thing for people, but obviously, not the case.

Tom: Yeah. Going back to those frequently asked questions, one of the other things that they said during the transition period is that advisors in financial institutions, in addition to giving investors advice in their best interest, they can't charge no more than reasonable compensation. This one gets me all the time. They can't make misleading statements about transactions or about compensation or about any potential conflicts of interest.

Again, you can't see me because it's a podcast, but I'm shaking my head, like, "Really?" That's amazing, but yet before we turned the microphone on, Tim and I were talking about specific instances where a new client would come in to our office, they would show us the statements, and what would they tell us?

Tim: They would say their old broker advisor would say, "Oh, well, there was no commission in there."

Tom: Right. Yeah, no commission, but ...

Tim: There might not be any commission, but they got paid on some sort of fee that was baked into the product that was sold.

Tom: Baked into the cake.

Tim: Technically, commission, there was none, but they still get paid.

Tom: Yeah. One of the things that never really gets discussed very much is where this whole idea about the fiduciary obligation and this whole Department of Labor change came from, and it really sprouted from story after story, where investors had a 401k account at work and then they were talked into rolling their account over, once they leave the company, into an IRA. What are some of the potential problems in that scenario?

Tim: There are a number of problems that could arise from that. First off, no one is forcing you to roll your money out of your 401k, and a lot of the funds, most of the time, in a 401k have greatly discounted fees.

Tom: Hey Tim, I want to just hit the pause button for a second because I think that's a misunderstanding that a lot of people have. I think many people have been conditioned to the idea that "Okay, I had this 401k at work and now I'm retiring, so I have to do something with it," right?

Tim: No.

Tom: They don't.

Tim: People might think that, but that's not the case. You can leave that money in your 401k even if you're not working at that company for as long as you want.

Tom: Right. Even when you get to the point where you're, say, 70 years of age or beyond and you need to begin taking required minimum distributions, the 401k plan administrators will calculate that for you and work with you to take that distribution. You're under no obligation to roll that money from a 401k plan into an IRA, but then what happens, when they go from a 401k plan into an IRA?

Tim: Well, it opens up the door for them to be sold a number of different products that potentially have much higher fees than what they were paying inside the 401k plan, so it, most of the time, ends up costing these people more money and fees and they most likely don't realize that that's happening.

Tom: Right. There is all kinds of different plans out there. Now if you work in a small business and you've got a 401k plan that's being administered by the owner's financial advisor down the street, it's probably not going to be a very cheap plan, but suppose you worked for a big Fortune 500 company, I've got to believe that they've negotiated some pretty cheap fees for the investments in their plan.

Tim: Right.

Tom: It may wind up costing you money to go into some of these products, then the whole other question becomes "Am I doing the right thing with these investments?" We've all read horror stories about clients retiring and they're putting all their money into the .com mutual funds in the late '90s, and it was great for a few months until it wasn't great for a few months.

Tim: Yeah.

Tom: You can run into all kinds of problems. I think that's really a big issue is that this whole Department of Labor business really kind of emanated from these horror stories that we've heard from people who rolled their money out of their 401k plan, when they didn't need to do that, and then went into an IRA, were sold a lot of crappy products, great fees for the broker or advisor, and these investments, they started circling the drain, which is really bad, and this is money that people have to live on for the rest of their lives.

Tim: Yeah.

Tom: That whole 401k transition business really became the starting point for these Department of Labor changes, but they're still under review.

Tim: Yeah. Under the new administration, there's been a mandate for the Department of Labor to conduct a review of the rule.

Tom: In essence, it could still change or there's still the possibility that before January, this thing could be scrapped.

Tim: Right.

Tom: Which is ...

Tim: It's definitely not a finished deal that it's going to 100% go into full effect on January 1st. It's still up in the air, depending on this review. There had been talks about a delay or pushing it back even further than just the June 9th, but the DOL released their official 60-day delay to the rule, so here we are ready for it to go into this transition period on June 9th.

Tom: Yeah. I don't know how many people are actually really ready for this.

Tim: Right.

Tom: We'll see what's going on. I know that in March, right before the initial implementation date, Vanguard and BlackRock, two of the biggest asset managers out there, called for a much more significant delay, considering all the confusion that the rules have caused, so they did open a period of time about two weeks for a public comment, which is really not a long time, but they got-

Tim: Right. It says, according to an Investopedia article, they got 193,000 comment letters, yeah, which is a lot.

Tom: I think almost all of them were opposing a delay.

Tim: Right.

Tom: I thought that was pretty amazing to see those kind of numbers. The legislation itself is over a thousand pages in length and I'm sure, like all legislation coming out of Washington these days, it's going to increase exponentially before it's a final deal.

If it's not stopped, it's going to automatically elevate all professionals in the investment business who work with retirement plans or provide retirement planning advice to the level of becoming a fiduciary. If you're an advisor who has retirement accounts, you're going to be bound ethically and legally to meet the standards of the fiduciary practice.

Tim: That means all advisors or professionals in the business would have to act in their clients' best interest above his or her own interest.

Tom: Right.

Tim: You can't put yourself first in front of your clients. It's got to be the other way around.

Tom: Right. That's really the whole idea behind being a fiduciary is you got to treat your clients' money better than you would take of your own.

Tim: Right.

Tom: It's more than just being suitable. The recommendations to clients now have to be suitable and they have to be prudent. They have to be in the client's best interest. If you want to buy a stock, XYZ, if you're a client, and it's doubled in the last couple of months and it's really speculative, it might be better to wait for this thing to pull back or look for another opportunity. I think the thing that really kind of surprised me with all of these exemptions that came out is that advisors can still work on a commission basis with the clients.

Tim: Right. Surprising enough, there are a number of different exemptions out there, one called the Best Interest Contract Exemption.

Tom: The BIC.

Tim: The BIC, B-I-C, people have been shortening it to. It allows advisors to continue to work on a commission, but they must provide clients with a lot of disclosures beforehand. Just reading the frequently asked questions, it seems like it's a lot of hoops to jump through if you want to continue to work under the commission-based world.

Tom: Yeah. I think if you're a brokerage client, you should prepare to buy a bigger mailbox or just prepare to get flooded with a lot more paperwork because as they begin this transition period now, June 9th, and through the start of this actual implementation on January 1st of next year, financial institutions have to notify their clients of their fiduciary status and any material conflicts of interest.

We provide all of that when we get started with a client, but suppose you're a big brokerage firm, you got retail clients, you do investment banking for other clients, that their stock or their bonds are going to show up in the mutual funds and the ETFs and all the different products that they own, they're going to have to send out phonebook-sized updates to clients. The printers are going to make a lot of money.

Tim: Yeah.

Tom: I don't know who else is.

Tim: Yeah.

Tom: It's a good thing, this Department of Labor fiduciary rule. It really is a good thing because it's going to help level the playing field in terms of hopefully beginning to take away the conflict of interest that brokers have in working with individual investors.

Tim: Yeah, and then hopefully, we'll give investors who may be skittish about working with people in the industry, because they think, "They're just trying to scam me out of money," hopefully, we'll give people peace of mind to know that the person they're working with is putting their best interest in mind when they're getting recommendations.

Tom: That's a good point to end on. Thanks for tuning in to episode 184 of the Mullooly Asset Management podcast and look for us again on the next one, 185. Thanks again.