



Conflicting Interests

401(k)/IRA Advice Rule May Go Back to the Drawing Board

By [Robert Powell](#), MarketWatch

Last update: 11:23 a.m. EST Jan. 29, 2009

BOSTON (MarketWatch) -- In the end, lawmakers are likely to rip up the floor boards and start over. But in the meanwhile, the retirement planning world is all a dither about the U.S. Department of Labor finalizing -- in the waning days of President George W. Bush's term -- a rule that allows financial advisers affiliated with mutual funds and brokerage firms to provide investment advice to 401(k) and IRA plan participants.

According to the 74-page final rule, those advisers must use either a computer model or a flat-fee structure when telling 401(k) participants and IRA owners how to invest.

With the computer model, the fiduciary adviser can "make specific investment computer-generated asset allocation models appropriate for an individual participant based on factors such as age, risk tolerance and financial situation," according to SIFMA Foundation for Investor Education's Web site. "The models must be developed using objective information that's generally agreed to have an impact on portfolio performance." And the adviser must provide information about the computer models they use to the 401(k) investors.

And under the flat-fee structure, "an adviser can recommend an appropriate mix of investments from within (a participant's) plan provided the fees he or she charges for all plan participants are the same fee for advice they receive, regardless of the investment choices they make," according to SIFMA's Web site.

The Labor Department noted in its Jan. 16 release that "access to professional investment advice is particularly important now for workers as they manage their 401(k) plans and IRAs in changing and volatile financial markets." [Read the release.](#) [Read the Labor Department's rule.](#)

Not surprisingly, the brokerage and mutual fund industry agree with the Labor Department's assessment.

While many others agree that 401(k) participants need advice now more than ever, it has to be the right kind of advice from the right kind of advisers, say lawmakers and critics. The final regulations "may undermine retirement savings plans of millions of Americans," House Education and Labor Committee Chairman George Miller, D-Calif., said. "It will allow financial services firms to offer potentially conflicted investment advice on workers' retirement accounts."

And Chad Griffeth, co-founder of Michigan-based investment advisory firm Actium, said: "The rule does not prevent potential for conflicted advice."

Miller has promised to revisit the issue and many predict the Obama administration and congressional Democrats will rescind the rule, which some say already sits in limbo for two reasons: White House Chief of Staff Rahm Emanuel signed an executive order that put a temporary moratorium on new federal rules and mutual fund and brokerage firms are not yet ready to provide advice as mandated by the new rule.

For instance, David Glickman, an industry consultant, told MarketWatch's Retirement Weekly newsletter that one element of the rule calls for brokerage firms and mutual fund firms to charge a level amount for the advice they provide. And that's easier said than done. "I know the guys who are working on it on the adviser side at (a large mutual fund) and I know they haven't been able to crack the nut yet."

Rule Does Have Benefits

To be fair, independent advisers who could face stiff competition from the large mutual fund firms, banks and brokerage firms if the Labor Department's final rule goes into effect say the investment advice rule is not without its benefits. Griffith, for instance, noted that more 401(k) participants could -- in theory anyway -- have access to advice.

Aaron Skloff, chief executive officer of Skloff Financial Group, noted that plan sponsors (employers) and participants will likely have a "larger choice of fiduciaries to choose from, as more financial services companies will embrace the protection the Labor Department has provided them."

He said that under the new rule plan providers must disclose all their fees to plan sponsors and participants. "Hopefully, the disclosure will not include double-, triple- or quadruple-dipping in the form of excessive third-party administrator, subtransfer agent, 12b-1, upfront and deferred commission as well as management and advice fees," he said.

And Skloff said the computer models will force participants into measuring their own risk tolerance instead of relying on the conventional target-risk terms used now -- aggressive, moderate and conservative.

But even though the new rules "will accelerate the shift to unbiased advice and true fee-based compensation in retirement plans," Skloff and other independent advisers say the negatives of the new rule outweigh the positives.

Part of problem has to do with the definition of a fiduciary adviser and what's conflicted advice.

"The controversy exists in that the person delivering the advice must adhere to specific fiduciary criteria, but their affiliated firm, whether that's a broker-dealer, mutual fund company, insurance company, or bank, does not," said Griffith. The new rule "opens the door for conflicts of interest to exist on the part of brokerage firms and mutual fund firms at the sake of participants, whom I fear wouldn't know what questions they should ask to ferret out conflicted advice."

Long list of objections

There is great debate over whether the Labor Department has defined adequately the term fiduciary. Don Trone of Fiduciary Ethos told Retirement Weekly: "Unfortunately, our regulators and self-regulatory organizations have failed to define a uniform standard of care applicable to any investment adviser (broker or fiduciary), which leaves us with an uneven playing field and the potential for abuse and conflicts of interest. The logical compromise to the current scenario is for the Labor Department to publish its own adviser standard of care that must be met by anyone providing advice to participants."

In the absence of that standard of care, Griffeth foresees 401(k) advisers turning to their affiliated firm's "resources" for help in delivering the advice, "thus opening the door for the firm to direct them toward investments that suit the firm more so than the 401(k) participants." In essence, he said the broker-dealers, insurance companies, banks, and mutual fund companies could play "puppeteer" with the advisers that are meeting with participants to benefit their own pocketbooks, not the participants.

Other agree. Roger Wohlner of Asset Strategy Consultants noted in a discussion on the Web site LinkedIn that participants might be steered towards the investments offered by the affiliated firms, especially when it comes time for participants to roll their 401(k) plans over to IRAs.

Skloff, meanwhile, has a laundry list of negatives. There's the risk of fee increases because of the mandated fee-disclosure rule. There's the risk that vendors that market proprietary product cannot be truly independent. And there's the risk that a public company cannot truly act in the best of interest of clients over the best interest of shareholders.

And if those negatives weren't enough, Louis Harvey, president of consulting firm Dalbar, told Retirement Weekly that the one aspect about the new rule that's easily overlooked is this: It also affects IRA owners. "This regulation applies to all IRAs and is enforced by the IRS," he said. "The huge impact is that anyone giving advice to IRAs must now comply with the new regulation. This affects every bank, insurance company, broker/dealer and mutual fund that offers IRAs or defined contribution plans."

So as it stands, the need for advice is great but the rule in its current form seems a nonstarter. "The idea of lowering standards for 'making advice more available to 401(k) investors' sounds remarkably similar to 'making it easier for lenders to provide credit to people wanting to buy a home.'" said Griffeth. "Have we learned nothing?" ■

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