Charles Massimo: Clients need to look out for their own interests and make sure the adviser has no conflicts.

New regulations address conflicts for advisers

By: Claude Solnik April 18, 2016 0

Financial advisers often face a dilemma beyond deciding which is the best investment for their client. Sometimes, the bigger question is, which is best for them?

That comes up frequently, for instance, when there are two identical funds with different amounts of compensation for the financial adviser.

The solution has often been to recommend the fund that benefits the adviser, at the investor's expense. The times and the rules, though, are changing.

New U.S. Department of Labor regulations for financial advisers dealing with retirement accounts seek to require that they place their clients' interest above their own.

The rules, which go into effect in 2018, make investment advisers fiduciaries rather than simply requiring "suitable advice."

It's a big change and possibly an eye opener for people who think their financial adviser already is supposed to be looking out for their interest.

The new rules apply to a wide range of retirement accounts, such as IRA, Roth IRA, 401(k), defined contribution plans and health savings accounts.

"They're asking people to go to a higher standard than you would normally be required to use," Charles Massimo, CEO of CJM Wealth Management in Deer Park, said.

Registered investment advisers like Massimo already must meet this higher requirement, but brokers and others advising investors today only must provide "suitable" advice.

"Usually a fiduciary is someone running a trust fund," said Craig Ferrantino, a financial adviser at Craig James

Financial Services in Melville. “If I do something that a reasonable person would not do, I’d be held responsible for it.”

The new rule affects $12 trillion invested in IRA and 401(k) plans, amounting to a kind of retirement fund Bill of Rights.

On average, those in retirement accounts receive 1 percent less or about $17 billion less a year, due to these practices, according to the White House’s Council of Economic Advisers.

“I can lay out two funds for you, the same funds managed by the same company with the same manager,” Massimo said , adding he would recommend the fund that’s in his cilents’ best interest. “The only difference is one pays me a 4 percent commission and the other pays me a 1 percent commission. And that takes away from you.”

The Department of Labor in its announcement of the rule said it is seeking to reform a “system where firms can benefit from backdoor payments and hidden fees often buried in fine print.”

Critics, like House Speaker Paul Ryan, R-Wisconsin, say the more than 100 pages of rules will add paperwork and expense, which could result in higher costs for advice.

Ryan has said it’s important to “protect the savings of hardworking Americans” from what he views as excessive documentation and regulation, likely to drive advisers away from small investors.

And disclosures could leave loopholes that let advisers look out for their interest more than their clients’.

“If an adviser fully discloses the fees, you still may not know there’s another fund family that’s less expensive,” Massimo said. “They could disclose that you’re paying 4 percent a year. You may say, ‘The return’s good and I don’t know any better.’”

Advisers also might be able to tell clients to check websites regarding other options, rather than disclosing various versions.

“This is where it puts a loophole in,” Massimo continued. “If you fully disclose and let the investor know there’s a site you can go to find the fees, you can get around the rule.”

The new standard could make advising less lucrative, leading some advisers to eschew smaller clients.

“It’s going to be harder for smaller investors to find advice,” Massimo said. “If their overall compensation is lower, they may not want to take on smaller investors. They won’t be able to make money off smaller investors.”

Ferrantino said this is “going to hurt the smaller investor,” since many advisers may not want to provide services with charges, based on volume, that are negligible.

Brokerages also may no longer be able to recommend those saving for retirement use their proprietary funds, including higher fees to their brokers.

“That’s a direct conflict of interest,” Massimo added. “It’s going to get a lot more difficult to have the wealth management arm of a brokerage firm make a significant profit.”

The rules, which have taken nine years to craft amid opposition from brokerages and some advisers, don’t go into effect until 2018, leaving time to modify and overturn.

“Why do you think this has been delayed and kicked down the road for so long?” Massimo added. “The lobbyists on Wall Street have been kicking the can down the road.”

Changes in administration also could lead to changes or the undoing of new regulations.

“They’re going to find ways around it. They’re getting a whole year to figure it out,” Massimo said. “This should be a wakeup call for the investor. The investor needs to understand that your investment adviser is not always acting in your best interest.

Undisclosed fees already led to a number of successful lawsuits related to 401(k) plans, including actions against Merrill Lynch and Ameriprise Financial. Greater awareness could lead to a new wave of litigation.

“It’s happening more and more,” Massimo said. “Lawyers are taking full page ads, saying, ‘Let’s sue your 401(K) provider.’”

Even with new rules, it’s still up to investors to look out for their interest, to find out whether they’re getting the best deal.

“The investor asks one question,” Massimo said. “Is this the least expensive version of a fund you’re offering or is there an alternative?”

The new rules may have an impact before they go into effect, making investors more cautious and conscious of the fact that their adviser may not always have their best interest at heart.

“I’m hoping for guys like us, and there are a lot of them, this is going to be a windfall,” Massimo added. “Investors will realize what we’ve been saying for years: ‘You have to wake up and understand conflicts of interest.’”

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