IS THE DOL FIDUCIARY RULE THE END OF SOLICITOR ARRANGEMENTS? – PART 2

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In my last blog, I discussed why the solicitor structure has grown in popularity and why it will continue in the future but without the same benefits enjoyed in the past. In this blog post, I review how the DOL's Fiduciary Rule will change the role and structure of the solicitor.
First and foremost, every solicitor will become a fiduciary on April 10, 2017. As a fiduciary, a financial adviser (FA) is subject to an ERISA fiduciary standard. This alone may be sufficient reason for some FAs to exit the industry, but what is more likely to happen is a flood of new fiduciaries will be marketing to retirement investors. Consider that there are approximately 700,000 retirement plans filing a 5500, but this number is dwarfed by the 40+ million homes that hold an IRA. In other words, there are approximately 60 times more IRAs than retirement plans, so it is safe to assume there are more FAs handling IRAs than retirement plans. In short, we will see a drastic increase in the number of fiduciary advisors in the market.

In addition, based on our own internal survey, IRA assets held by a Broker-Dealer (B-D) range between 40 and 80% of B-D total assets. However, many of these FAs know very little about ERISA fiduciary standard of conduct. This lack of knowledge increases B-D litigation risk as tens of thousands of misguided fiduciary missiles seek to secure new engagements or service existing clients. B-Ds will have to establish new training protocols in conjunction with compliance oversight to mitigate this risk. More on training to follow in our next blog.

Keep in mind that many of the FAs that handle IRA assets have historically avoided the retirement plan market place altogether; however, if they want to continue working and building their IRA practice they now have they have no choice but to become familiar with and adopt the ERISA fiduciary standards and obligations into their practice. As a result, we will likely see a drastic increase in FAs and Insurance Agents taking the Series 65, and I would not be surprised to see testing centers unable to accommodate FA's date requests the longer the FA procrastinates. My advice, order the Series 65 study materials now and take the test ASAP.

After the Series 65 is passed, FAs will have to secure Fiduciary Errors & Omissions (E&O) coverage. Trust me, your competitors that live and breathe ERISA will be sure to tell your clients (their prospects) they should not deal with anyone that does not have Fiduciary E&O. Of course, this is an added cost of doing business that has not been necessary in the past for most FAs. Small B-Ds that have prohibited their registered reps from using the "f" word will find this cost difficult to swallow, whereas many of the larger B-Ds have turned this cost area into a profit center due to their bulk buying power. I suspect between this cost and the technology costs necessary to monitor the FAs business subject to the new DOL Fiduciary rule, many small B-Ds will give consideration to a merger or acquisition.

Once the FA has secured the Series 65, consideration should be given to the FA's business model. Whether an FA decides to adopt a fee-based business model or continue exclusively in a commission-based, new agreements, contracts, policies, procedures, and website disclosures will need to be created. The cost for ERISA legal counsel to draft these documents after gathering an understanding of the business model will be a new cost for the FA, their B-D and/ RIA. Small independent RIAs will bear the full brunt of this cost whereas much larger organizations may be able to secure these documents as part of normal overhead. Either way, these new documents and disclosures represent more work and cost.

Regarding the business model, an FA currently in a solicitor arrangement will need to update their contract with the client to reflect their fiduciary status. This represents additional work and client education, but, more importantly, it changes the dynamic of the FA's relationship with the RIA they referred. First, the FA will need to address their responsibility to monitor the RIA. Remember, recommending an RIA to a retirement investor is a fiduciary act. As a fiduciary act you must monitor the RIA to ensure they continue to meet the client's needs and objectives. So, there is more work and risk to the FA for no additional pay. Second, since the FA is a fiduciary, the recommendation to use an RIA could be challenged as a prohibited transaction. You may recall, a fiduciary cannot use its position to increase its compensation. This is found under 29 C.F.R. 2550.408b-2(e)(1) which states:

"Thus, a fiduciary may not use the authority, control, or responsibility which makes such person a fiduciary to ***cause a plan to pay an additional fee to such fiduciary****(or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service. Nor may a fiduciary use such authority, control, or responsibility to* ***cause a plan to enter into a transaction*** *involving plan assets* ***whereby such fiduciary*** *(or a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary)* ***will receive consideration from a third party*** *in connection with such transaction."* [Emphasis added.]
I suspect this is more of a concern for the FA that provides no service other than a referral, than for the FA that was engaged to provide non-fiduciary services. However, every financial institution will need to consult with their legal counsel to determine the extent to which this issue presents a fiduciary risk.

As you can see there are numerous issues that both the Financial Institution and the FA will need to address. I am sure that some FAs will choose to leave the industry, but it seems hard to fathom a smaller number of marketing RIAs in the future. Those that choose to stay engaged will need to change their business model to align with the new DOL Fiduciary Rule. It will cost more, there will be more work, more risk, and no additional pay at this point. FAs that have never provided an investment review to monitor the investments will need to do so in the future to justify their compensation especially on complex products. Of course, there is plenty of opportunity but even the optimistic FA will need to temper their enthusiasm with a large dose of pragmatism.

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