FIELDPOINT PRIVATE®
Summary 2017

LAST MONTH THE U.S. DEPARTMENT OF LABOR ACTIVATED THE "FIDUCIARY RULE," WHICH IS INTENDED TO ELEVATE THE STANDARD OF CARE THAT GOVERNS ADVICE ON INVESTMENT PRODUCTS IN RETIREMENT ACCOUNTS. IT STIPULATES THAT PRODUCT RECOMMENDATIONS MUST BE MADE WITH THE "CLIENT'S BEST INTERESTS" IN MIND, RATHER THAN MEETING A LOWER STANDARD OF SUITABILITY. IT IS THE BIGGEST SINGLE CHANGE IN THE RULES GOVERNING INVESTMENT ADVICE IN MORE THAN A GENERATION, WITH IMPLICATIONS THAT HAVE CAUSED THE GIANT TRADITIONAL FIRMS TO TURN THEMSELVES UPSIDE DOWN IN ORDER TO COMPLY. BUT YOU HAVEN'T HEARD MUCH FROM US ON THE MATTER. THAT IS BECAUSE IT CHANGES NOTHING HERE.

Conflict of disinterest

The Fiduciary Rule becomes reality. Why it's here and what it means.

BY ROBERT MATTHEWS, *President and CEO*

After much drama, delays, fits and starts, the Department of Labor's (DoL) Fiduciary Rule finally took partial effect on June 9, and takes full effect January 1, 2018.

The rule is widely viewed as the most significant change in the regulation of retirement advice since the ERISA (Employee Retirement Income Security) Act of 1974, which established new rules for private pension plans and the federal income tax treatment of benefit plans, supervised by the DoL and other agencies.

The Fiduciary Rule requires investment professionals who advise on retirement assets to put their clients' interests above their own. The industry term for this is acting as a "fiduciary."

While a fiduciary standard had long applied to advice provided for a fee rather than a commission, before the new rule those advising on retirement assets on a commission basis were only required to follow a "suitability" standard. This means their recommendations only needed to be "roughly suitable" for the client. The standard gave firms room to, for instance, recommend a mutual fund that paid a higher commission when a similar fund with a lower commission was available, as long as it was suitable.

If anything it makes firms that compete against us look more like Fieldpoint.

With the suitability standard in place, investment menus ballooned at the traditional firms, evolving into "open architecture" platforms, each with thousands of funds and managers. These were marketed as giving investors greater choice and reducing conflicts of interest. By complete coincidence, they also created tremendous revenue opportunities for the firms. For one, firms could offer multiple versions of virtually identical strategies at different price points, based on the client's willingness to pay. Second, the firms could require managers to pay them in exchange for gaining acceptance to their platforms. The more open the platform, the more rent that could be collected from its occupants.

WHAT CHANGES

The industry has been preoccupied with preparing for the changes for the last couple of years. The most widespread change is to limit the practice of maintaining retirement assets in brokerage accounts, which can charge commissions instead of asset-based advisory fees. There are others; here is a sampling.

According to industry trade publication FundFire, UBS has had to change its compensation system, as it felt it would not satisfy the "client's best interest" standard,[1] While retirement assets may still sit in brokerage accounts, the advisor's compensation will no longer be based on the commissions generated.[2]

Wells Fargo is revamping the mutual funds it uses for retirement accounts. At Wells, different clients were being charged differently for the same mutual fund, which would violate the new rule. It is also disallowing high-yield bonds and a number of other securities categories from retirement accounts.[3]

Why would a firm's investment manager menu carry hundreds and hundreds of managers when – by the laws of statistics – it means most of them are not the best option in their respective asset classes?

JP Morgan had previously announced it was shifting retirement accounts away from clients' advisors to a self-directed (do-it- yourself) platform.[4] In April, as the rollout of the rule was delayed, they told clients this move would be put on hold while they watch to see if the Trump administration rewrites the rule or puts it on hold. The firm has not yet announced whether the June deployment of the rule will ultimately trigger these transfers.

Bank of America's Merrill Lynch unit is moving most of its transaction-priced retirement accounts to a fee-based model. It also informed fund companies in May of last year that it will be cutting the number of mutual funds available on its advisor platform from around 3,500 to 1,800.[5]

In a similar vein, the rule has prompted Morgan Stanley to cut more than 700 funds from its platform[1], and to lower the revenue-sharing fees it charges fund companies in exchange for placement on the firm's platform.

It is notable that the Fiduciary Rule does not go so far as to prohibit these fees. They are not insignificant.

Last June, Morgan Stanley disclosed that 53 fund families (a single fund family may consist of many individual funds) had paid the firm at least $1 million each as part of their placement agreements.

At Edward Jones these fees accounted for 26% of net revenue in 2016, according to a firm disclosure.

If I may editorialize for a minute, how many mutual funds does a firm have to have on its platform to allow for cutting 700, or 1000 or more? If a firm is in fact putting its client's interests first, why would its investment menu carry hundreds and hundreds of managers, when – by the laws of statistics – it means most of them are not the best option in their respective asset class?

THE FIDUCIARY RULE AND FIELDPOINT PRIVATE

So why haven't you heard from us on the new rule? Because it changes nothing here. In fact, if anything it makes firms we compete against start to behave more like us. At least a little, and this is good for clients.

Fieldpoint Private has always taken a fiduciary posture on all retirement accounts – in fact on all investment accounts of any purpose – whether advisory fee-based, or brokerage. And if we were to issue a disclosure stating how much of our revenue comes from fees paid to us by money managers renting space on our investment platform, it would be the shortest disclosure ever written, and the percentage would be zero.

1. *FundFire*, June 8, 2017
2. *FundFire*, June 8, 2017
3. *AdvisorHub*, May 24, 2017; Wells Fargo
4. *Bloomberg*, April 11, 2017
5. *Citywire*, January 20, 2017

One of the central principles established by our Founders was that Fieldpoint Private would set a new standard in the industry for objectivity – that practices that represent conflicts of interest would find no home here. In fact, they saw to it that our unconflicted philosophy would extend even beyond investments. For example, when we design a loan for one of our clients, the loan stays with us. We will not sell it to another institution, because doing so would require us to manipulate the loan's structure to match the requirements of the institution that would eventually acquire it, and that would mean putting our interests ahead of our clients'.

And so, while firms around the country have spent the last two years scrambling to change their business practices to comply with the new rule, or lobbying the DoL and the White House to abandon the effort, we carried on with our clients' business, only pausing briefly to ask the question, "Why would an advisor ever not act as a fiduciary?"■

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