Insight

Fiduciary Rule Has Already Taken Its Toll: $100 Million in Costs, Fewer Options

SAM BATKINS | FEBRUARY 22, 2017

With the recent presidential memo outlining a call to review the Department of Labor's (DOL) "Fiduciary Rule" for investment advisers, "to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice," it's important to take stock of the rule's impact to date. The White House is also formally reviewing a potential delay of the Fiduciary Rule. When it was issued, it quickly became the most expensive regulation of 2016, a title it kept, with $31.5 billion in total costs and $2 billion in annual burdens. It is the second most expensive non-EPA rule since 2005, according to American Action Forum (AAF) data.

Even though the rule is less than a year old, AAF research has found three major companies have already left part of the brokerage business, an additional six are drawing down their business or switching to a fee-based arrangement, depriving more consumers from investment advice. AAF found reported compliance costs of at least $106 million in 2016, likely representing up-front costs from just four companies. In addition to these impacts, the Fiduciary Rule has affected 92,000 investment advisers, $190 billion in assets, and at least 2.3 million consumers.

The chart below displays the impact of the Fiduciary Rule based on public reports. The chart starts with the three companies who have chosen to leave certain parts of the brokerage business and proceeds to those who also made major changes based on the rule.

Impact of Fiduciary Rule

Company	Impact
Metlife	**Out of market**; sold business; affects 4,000 advisers
AIG	**Out of market**; affects 6,000 employees and $40 million in revenue
Merrill Lynch	**Out of market**; affects 14,000 advisers and $180 billion in assets
State Farm	Drawing down; 12,000 agents and $11.3 billion in assets affected
Morgan Stanley	Drawing down; 16,000 brokers affected

Edward Jones	Drawing down; stopped offering mutual and exchange traded funds
LPL	Switching to fees; 14,000 advisers affected
Raymond James	Switching to fees; $28 million in costs; 7,100 affected advisers
Commonwealth	Switching to fees; stopped offering commission products
Ameriprise	$19 million in compliance costs in 2016
Advisor Group	$11 million in Q4 2016 costs; 9,000 affected advisers
Primerica	$8 million in up-front costs; 10,000 affected advisers

For Metlife, AIG, and Merrill Lynch, the Fiduciary Rule was not just a matter of compliance costs, it concerned legal and future regulatory risk. Rather than try to comply with the complicated new rule, these companies simply left the market, moves that affect billions of dollars in assets, thousands of employees, and countless more consumers.

To estimate the consumer impact to date of the Fiduciary Rule, AAF tallied the number of investment advisers directly affected: at least 92,000 based on public reports. On average, the largest firms have one financial adviser handling up to 500 clients on average. That appears to be the upward bound of potentially affected clients. For smaller firms, 25 to 35 clients per adviser is normal, with a "typical financial adviser" serving 165 clients.

Without data on each firm, it's difficult to assess the total number of affected clients from the Fiduciary Rule. However, a conservative estimate of 25 to 35 for each of the 92,000 affected advisers still yields 2.3 million to 3.2 million consumers with significant changes to their retirement and financial advice. A high-end figure of 160 clients per adviser pushes this figure to more than 14.7 million consumers. The full extent of the law is not yet known, but it's certain that many of these consumers have lost financial counsel they valued because of one federal rule.

To an extent, these impacts have been foreseen. In their previous 10-k reports filed to the Securities and Exchange Commission, company after company highlighted the possible burden. For example, Metlife noted, "Sales to middle income investors would be unlikely to generate sufficient fees to offset the increased cost of providing advice under the rules… Metlife could reduce its risk of exposure." The company did so by leaving the market, directly affecting 4,000 of its advisers, and selling its business to avoid the legal and regulatory hurdles created by DOL's rule. The news reports of Metlife's action proved initial fears over the rule were prescient, "Metlife is shedding the unit as brokerage firms face higher compliance costs tied to the Labor Department's proposed fiduciary rule."

Another company, AIG also has voiced some concerns: "These changes could materially affect our ability to sell or service certain types of annuities and other investment products." These fundamental changes prompted AIG to leave the market, directly affecting 5,200 advisers, as well as 800 full-time employees. In the news surrounding AIG's decision, it was clear the rule prompted the major change in business, "The rule is 'basically going to increase the risk and cost of distributing a number of retirement products, and so therefore it could have a chilling effect on sales and commissions." Curiously, DOL did not extensively discuss the employment implications of the rule and assumed costs from a transition to the new fiduciary regime or use of the "Best Interest Contract Exception" (BICE), an exemption companies seem unwilling to negotiate directly.

Given these impacts, at least $106 million in initial compliance costs and 92,000 affected advisers, the BICE might be unworkable in practice. For background, these exemptions were manifested in three rules published concurrently with the Fiduciary Rule. Even though they don't have compliance costs, they still managed to impose more than three million hours of paperwork. Combined, the three rules also span 232 pages (including the actual rule), serving as a good indicator why many companies have foregone threading the narrow compliance needle DOL concocted. Rather than comply with the tedious prescriptions in the BICE, three companies sold their business, and six more have significantly drawn down their financial advice services.

Conclusion

There is little doubt the Fiduciary Rule has led to an upheaval in the investment community. It's clear the real-world impact of the rule extends far beyond corporate board-rooms. As many predicted, it has led to disruptions for average Americans, at least two to three million, trying to save, invest, and plan their retirement. The administration might not be able to immediately monetize these impacts, but that they exist at all is good reason to scrutinize every aspect of the rule to determine its full effect on average Americans.