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Protecting American workers' retirement assets

For over a decade, the U.S. Department of Labor (DOL) has tried to modernize the Employee Retirement Income Security Act of 1974 (ERISA), a federal law designed to protect American workers' retirement assets. The release of the new Retirement Security Rule on Oct. 31 is the DOL's latest attempt to improve the protections of this almost 50-year-old regulation. Unfortunately, these efforts are aspirational at best and consistently thwarted by an industry determined to protect its extremely profitable business model.

According to the Employee Benefit Research Institue, 40% of Americans are currently projected to run short of money in retirement, indicating this issue clearly needs more attention.

Having spent the first 20 years of my career in wealth management and the subsequent 20 years in institutional investment consulting, I believe the best answer to safeguarding workers' retirement assets is hiding in plain sight. Improving the odds for American workers achieving their retirement income goals will require a combination of better education and alternatives to the predatory business models that currently dominate the retirement plan investment adviser industry.

Conflicts of interest

The new Retirement Security Rule is designed as a protection against conflicted investment advice. Conflicted advice occurs when the adviser can increase their own compensation with the advice it renders to clients. The cost of conflicted investment advice to retirement plan participants is enormous. In fact, several recent studies performed by independent researchers, including the U.S. government, have estimated that conflicted investment advice costs American workers tens of billions of dollars in unnecessarily high investment management fees each year.

ERISA was originally intended to protect American workers' retirement assets against people in a position of control who would use these large pools of money to enrich themselves. What ERISA failed to anticipate was the evolution of employer-directed pension plans to employee-directed 401(k) plans and that the rules designed to protect retirement plan sponsors from those with conflicts would need to be enhanced to include protections for participants.

Financial services industry: friend or foe?

The role that the financial services industry plays in this story is complicated. On the one hand, the industry's ingenuity and creativity are partially responsible for the explosive growth of 401(k) and IRA assets. On the other hand, its strong desire to maximize profits too often causes it to place its own interests before the interests of the American workers it purports to serve.

From the perspective of the wealth management industry, conflicts of interest are so deeply embedded in its phenomenally profitable customer service model, it cannot imagine another way to deliver investment advice. The industry's primary rebuttal to the new Retirement Security Rule makes this point;

it claims if it isn't allowed to provide conflicted investment advice, then no advice will be provided, especially to the low and moderate-income retirement plan participants.

However, a law degree and 20 years of watching institutionally-hired advisers provide investment advice to tens of thousands of 401(k) participants for an hourly fee make clear how warped by greed this position clearly is. Looking objectively at the situation, it's shocking how the high margin and conflicted compensation arrangements deployed by most investment advisers – schemes that would cause other professional advice givers like accountants or attorneys to lose their professional license – have become universally accepted practice.

Conflicted advice or no advice aren't the only options

Given the hundreds of millions it spends each year marketing the benefits of its conflicted advice, the financial services industry would prefer that consumers spend no time investigating alternative investment advisory solutions.

The Garrett Financial Network of registered advisors, dating back to the '90s, is one of the first good examples of an alternative investment advisory model in which investors pay advisers a flat hourly rate similar to how an accountant or attorney is paid for professional advice. There are also a handful of firms focused on delivering a similar model institutionally to groups of employees.

More recently, the advent of robo-advisers, with an assist from AI, has seen enormous growth. While all robo-advice is not conflict-free, according to Statista, the robo-adviser market is still rapidly growing with the number of users expected to amount to 34 million by 2024.

A way forward

Despite there being options to deliver conflict-free advice to investors, to date, the only group that has made progress improving the odds for the American worker has been the plaintiff's bar. Hundreds of successful lawsuits against plan sponsors, who unwittingly allowed conflicted financial service providers to take advantage of their employees' retirement assets by charging excessive fees, have begun to convince employers they need to pay closer attention to conflicted advice.

Importantly, as seen during the public comment period of the proposed Retirement Security Rule, regulators face significant challenges to their efforts to combat conflicted investment advice. This is evident as the financial services industry once again lobbies to protect its forty-percent profit margins derived from excessive compensation associated with conflicted advice.

Considering this inevitable pressure, the ultimate solution to the problem is likely going to have to come from the free market. The only way forward is for more retirement plan sponsors to understand the detrimental effects of conflicted investment advice on their employees and change their investment adviser hiring decisions accordingly. Then, and only then, will more American workers be in the position to retire.