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Investment Update

In 2010 the Obama administration, through the Department of Labor (DOL), floated a number of proposed updates to the laws governing retirement accounts, with some of the most significant rule changes since Gerald Ford first signed the 1974 Employee Retirement Income Security Act (ERISA). These proposals, as it turned out, did not so much "float" as go down in a flaming ball of molten lead (does lead actually burn?). Lobbying groups tied to the brokerage industry banded together, descended on Washington, and made their objectives quite clear; within months, the proposals were withdrawn.

Fast forward to early 2015, and the DOL was back. This time, the focus was narrower, concentrating on the relationship between "financial advisors" who work for brokerage and insurance companies (what we used to call "stock brokers") and their customers with tax-advantaged retirement investments. More specifically, the DOL wanted to mandate that those who give investment advice to individuals with retirement accounts do so under the understanding that they are acting as a fiduciary to the client. The thinking of the DOL was that as a fiduciary, the advisor must act solely for the benefit of the client when it comes to offering investment advice; as the regulations currently stand, that advice need only be "suitable" for the client, a far lower standard. Even more to the point, the DOL wanted to close the loopholes that allow (in its own words) "brokers and other advisers to recommend products that put their own profits ahead of their clients' best interest, hurting millions of America's workers and their families."

The administration cited a White House Council of Economic Advisors study which showed that conflicts of interest—namely, high-fee, low-return investment products offered by brokers—cost $17 billion in annual losses for individuals saving for retirement. By applying the fiduciary standard, advisors would be required to offer clients the lowest-cost, highest performing investments available.

Last month, after more than a year of public and private meetings with stakeholders—both on the consumer protection side and the brokerage industry side—the DOL issued its new rules, which are scheduled to take effect in April of 2017. The new regulations offer concessions to the industry compared to the 2010 proposals, and will still allow brokers, advisors and insurance agents offering advice for retirement accounts to earn fees, commissions and revenue sharing. But the regs do stipulate more disclosures, including something called a best interest contract exemption (BICE), a document which discloses fees and conflicts of interests that clients will have to agree to and sign. The BICE will also pledge that the advisor will work in the clients' best interest and will only earn "reasonable" fees.

Hardly controversial, right? After all, firms like Agincourt—registered investment advisors—have always been held to a fiduciary standard, since we are under more stringent regulations than those that guide the "registered representatives" of brokerage and insurance firms (even though we are often confused with them by laypeople). But the brokerage and insurance lobbies are once again mounting a furious challenge to the new rules, spearheaded by a man named Scalia—Eugene Scalia, the son of the recently-deceased Supreme Court judge. The younger Mr. Scalia, a prominent anti-regulation attorney (he recently made headlines by successfully representing MetLife against the government's "too big to fail" case), has already filed a lawsuit challenging the new regulations on behalf of five industry trade groups and four trade associations in a Dallas federal court earlier this month. Their main beef is that the new regulations will be expensive to implement, especially for smaller firms, and those costs will therefore be passed through, increasing costs and potentially pricing smaller investors out of the market.

Conspicuously absent from the fray, so far, have been the largest US banks, who appear to have reached a separate agreement with the DOL on their biggest bugaboo, namely, the ability to offer proprietary investment products. The DOL decided that exclusively offering your own firm's investment products was not a conflict of interest for brokers who served clients with retirement funds. Further muddying the waters is the objection by smaller brokerage firms that these very large firms will have an advantage in complying with the regulations, since they have the deep legal and administrative resources to devote to the task, while smaller firms will have many of the same compliance expenses spread over a far smaller revenue

stream. Small firms point out that the liability risk for being sued by a single disgruntled client who claims non-compliance could be sufficient to wipe out a small firm.

On the other side of the aisle, consumer protection groups have complained that the rules have been watered down, and are particularly critical of the leeway given to the mega-banks' proprietary products as well as the lack of explicit disclosures for fees and other charges customers will have to pay (the rule only requires that advisors direct clients to a website with fee information). In addition, these new rules only apply to tax-deferred retirement accounts (those are the only accounts the DOL has rule-making authority over); brokers will not be held to the fiduciary standard for all other customer portfolios they work with. A spokesman for the Institute for the Fiduciary Standard says the new regulations, "Adopted the assumptions of the industry, which is that there are important benefits of conflicted advice." DOL Secretary Thomas Perez is standing by the rules, saying that the final regulations were "streamlined" to make the regulations "workable and doable."

The fact that the industry's lawsuit was filed in Texas and not Washington DC is telling. Industry groups opposed to the regulations believe that the venue will be friendlier to their claims. In defense of the suit, Ken Bentsen, President of the Securities Industry and Financial Markets Association (SIFMA, a lead plaintiff in the lawsuit) said, "The DOL has very much overreached in developing this costly, complex and very prescriptive rule." It's no coincidence that Mr. Bentsen is a former Representative from Texas, a state with more than 27,000 registered brokers.

Agincourt's take on all this? We see both sides of the argument. We believe that everyone who gives investment advice should be held to the fiduciary standard, particularly if they are advising on something as critically important to our society as retirement money. That goes for advisors, brokers, insurance agents—and it should, in a perfect world, extend to all investment advisory services, not just retirement accounts. The federal government has a financial interest in putting in protections for savers, as a failure to do so will place a greater burden on social welfare programs.

There really is no argument that regulations to prevent unscrupulous brokers from selling high priced, low-return "products" are necessary. On the other hand, if these regulations are so burdensome to implement that they put good firms out of business, or force firms to raise their prices and ultimately hurt the people they are designed to protect, then the regulations are clearly counterproductive. As SEC Chair Mary Jo White said to a congressional delegation in 2015, "If we do end up at the end of the day really depriving, particularly, retail investors of reliable, reasonably priced advice, then I would consider [us] to have failed in our purpose there." Only time will tell if these new rules meet the Goldilocks "not too hot, not too cold" test. In any case, modifications to these regulations in the future are a near-certainty.

Speaking of the SEC (and moving this discussion closer to home), we have been busy here at Agincourt in recent months beefing up our own compliance program. The focus of our compliance efforts is two-fold: to protect our clients, and to ensure that we are successful in satisfying rules and guidelines in our continually-evolving regulatory environment (primarily with our main regulator, the Securities and Exchange Commission). Since we established Agincourt in 1999 (and going back to our days at Sovran Capital Management), we have always placed our clients' interests first. But given the current heightened regulatory environment, we had to acknowledge the benefits of taking a hard look at our compliance program in its entirety to ensure we are implementing best practices.

To this end, we started with a clean sheet. We selected a regulatory consultant as well as a cybersecurity consultant to assist us in our efforts. Agincourt's management team performed an operational, compliance and cybersecurity risk assessment across all aspects of our business. Once complete, we developed mitigation strategies to address the vulnerabilities enumerated in the risk assessment. Then we built policies and procedures to address specifics on how we manage these risks, including assigning responsibilities and accountabilities. Further, our updated policies and procedures address the process to be completed when an error, problem, or new risk arises. To complete the loop, we have a continual testing and monitoring process in place, which confirms our success at performing best practices, or identifies areas which need further strengthening.

We have applied these same assessments, procedures and practices to investment management, operations, business practices, and cyber- and information security. Agincourt will remain vigilant in protecting our clients' interests, and will make a concerted effort to continually update, improve, and implement best practices across all aspects of our business.

While these efforts may not get us a lot of attention, they are vital to the health of our company, and something we take very seriously.