

summaries



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New Fiduciary Duty Rules for Retirement Accounts

Under ERISA (Employee Retirement Income and Securities Act) the Department of Labor is the regulator which oversees retirement accounts in the United States. Recently, the Department of Labor issued an updated fiduciary standard that governs the responsibilities of professionals providing financial advice to retirement accounts.

Why It Matters:

In managing client portfolios we act in a fiduciary role for our clients. This means client interests must always be placed first. Importantly, client interests take priority over any opportunity in which we, as the advisor, could benefit at the client's expense. This is most relevant with regard to the selection of investment vehicles and the compensation structure for our services.

Until now there have been two sets of standards that applied to advisors of retirement accounts. One set of standards existed for Registered Investment Advisors (RIAs) such as Sigma Investment Counselors. As RIAs, the "standard of care" for clients is that of a fiduciary. It requires that advisors always put client interests above their own in providing advice and transacting investments in client accounts. This has always been the approach at Sigma and our culture reflects this in many ways. Our approach to portfolio management is based on the financial plan we design for each client. This plan is documented in the Investment Policy Statement (IPS). The IPS reflects the client's unique needs and circumstances and is reviewed annually or more often if a client's circumstances change.

In addition to documenting each client's plan in the IPS, we hold each employee of the firm to the highest of ethical standards as required by Sigma's Code of Ethics. Annually, we require all of our employees to sign an acknowledgment that they will abide by the policies and provisions of this Code of which the first paragraph states, "We must accept certain limitations as to our freedom of action with regard to personal financial matters. Our financial interest must at all times be subordinated to those of the firm's clients." Those of us who hold the CFA designation are also required to sign the CFA Code of Ethics and Standards of Professional Conduct as part of our annual renewal of membership. At the heart of this code is putting client interests above those of the firm and/or individual advisors as well.

At Sigma, we believe that being a fiduciary is critical in earning clients' trust and confidence. Our approach has always been to provide clients competent, objective, unbiased and continuous advice on their investments. We have always prioritized client interests above our own. This means being transparent about our fees and all charges that take place within accounts. We have no arrangements to receive compensation from other sources other than fees paid directly by our clients.

All of this may sound intuitive. However, those advising retirement accounts that were not RIAs (primarily brokers and financial consultants with independent brokerage licenses) were held to a standard of care that was not as stringent. The standard for non-RIAs only required the investment advice be "suitable". Further, an investment only had

local independent personal accessible
interactive creative local independent personal
knowledgeable thoughtful ethical experienced

to be deemed suitable at the time the investment was made. If circumstances changed and the investment was no longer appropriate, the provider could still hold the investment in the account, collecting any fees and trailing commissions that a product may provide. Furthermore, the provider was not required to provide a disclosure of imbedded fees being charged on the account. In short, there was a different standard for RIAs and financial advisors that were selling commission based products. This created opportunities for advisors to benefit at the client's expense. Client interests were not always placed first. Because fees did not have to be disclosed, this could lead to hidden (and high) compensation structures along with investment vehicles that were not appropriate for retirement accounts.

Despite controversy and significant pushback from many of the large brokerage firms, in April the DOL enacted a law that requires all advisors to retirement accounts be held to a fiduciary standard. This means providing prudent and impartial advice, disclosing potential conflicts of interest and information about fees, avoiding misleading statements, and receiving no more than "reasonable" compensation. Advisors must be fully transparent and all fees need to be disclosed. The new rule also restricts the use of certain annuities and managed account programs. Such vehicles can now only be used under an exemption that requires the client to sign a Best Interest Contract (BIC).

The new DOL fiduciary ruling represents a huge shift in the way the industry operates with regard to selection of investment vehicles for retirement accounts. The rule advocates for the investor, large or small. We note, however, that this rule applies ONLY to retirement accounts. Taxable accounts (including those that are to be used for retirement) do not fall under this ruling. The fiduciary standard of care for brokers and other non-RIA entities does not apply to taxable accounts. For non-retirement accounts under non-RIA advisors, the standard reverts back to suitability, which is less than ideal. We by no means intend to imply that all non-RIA investment professionals when working with non-retirement account assets will put their own interests ahead of their clients'. However, "buyers beware" remains the operative view in these situations.

At Sigma, we recognize the fiduciary duty and standard of care we have for each and every client and account. It is a privilege to act as fiduciaries for our clients. We greatly appreciate and value the trust and confidence our clients place in us each and every day.

If you have further questions on the implications of the new Department of Labor rules please do not hesitate to contact your portfolio manager or any member of Sigma's staff.

Denise M. Farkas, CFA
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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives