Case Study

# Meeting the Challenge of Regulatory Change

## The Situation

With Individual Retirement Accounts and defined contribution plans becoming the primary source for retirement funding, the financial services industry has become the "standard bearer" of retirement security. So it's understandable that regulators in most major economies are increasingly focused on the servicing and guardianship of these assets. For example, the historic standard-setting investor protections, such as "suitability," are being replaced by a "best-interest" — that is, a fiduciary standard of care.

In the US, the most significant regulations to address this issue are the SEC's Best Interest Regulation (Reg BI), various state fiduciary rules, and the Department of Labor's recently proposed new fiduciary regulation (awaiting finalization).

The conventional response to new regulations by financial services companies is to overlay additional policies and procedures to comply, backed up by a ramping-up of compliance resources. In other words, there are more procedures to follow and more staff to hire.

At Princeton Financial Consultants, we think it's time to turn this conventional thinking on its head — for the benefit of both financial services companies and their clients.

## Defining the Strategy

Central to Princeton Financial Consultants' approach to significant regulatory change is helping our clients answer key questions and addressing core business issues:

- What is the intent of the regulation/regulatory trend?
- Do your current business strategy and the regulatory intent need to be in competition?
- Is your organization willing to fully embrace what the regulation aims to do for investors by adapting it within your current business strategy?

In our experience, companies best positioned to thrive in the current regulatory environment are those who are willing to move beyond merely mitigating the regulatory risk and instead adapting their business models.

Adapting business models in response to regulatory change benefits companies in three ways:

1. Compliance does not become a drag on efficiency;
2. The change could present an opportunity to capture additional market share; and,
3. Regulators could view companies' efforts constructively and look to them as thought leaders.

This is the approach chosen by one of our clients, a major financial services company.

Reg BI requires that financial advisors and their companies demonstrate a best-interest-standard for brokerage investors for all recommendations.

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PRINCETON Financial Consultants

The inherent challenge with brokerage pricing is the fact that product pricing varies and most revenues derive from executing recommended transactions. This can present a perceived conflict that is difficult to "un-prove."

Merely looking to mitigate the regulatory risk would result in one of these undesirable outcomes:

- Significant re-pricing, which naturally leads to a "race to the bottom;"
- A heavier supervision model; or,
- An outright limitation of brokerage services.

For our client, any one of these outcomes would be significantly disruptive to their client relationships, their financial advisors, and their profitability.

A close look at our client's business showed financial advisors' clients generally value their relationship and the services provided. However, with the complexity of products, their company's clients lacked a clear understanding of their costs. And, in many cases, there wasn't a formal articulation of goals for brokerage portfolios.

This led to our strategic response: Double down on the resources and the financial advisor incentives to deliver a goals-based plan for each client's portfolio and track the progress toward that goal. And, at the same time, provide user-friendly tools and reporting that aligns all the direct and indirect fees clients pay with the services provided.

## The Results

In effect, this approach created a new paradigm for clients: achieving their financial goal is in their best interest. And by tracking all advisor recommendations against the progress toward client goals, there's no need to heavily supervise and back test each and every transaction. This approach also helps avoid the "cheaper is always better" paradigm.

There were additional benefits, as well. First, financial advisors came to realize that the sharpened focus on the value they provide will benefit their practices over the long term – including capturing more assets.

In addition, imbedding the intent of the regulation within the company's business strategy led to more constructive dialogue with regulators. This includes helping the Department of Labor shape the final version of their newly proposed fiduciary regulation as well as obtaining representation in the OECD's international committee on retirement policy.

Finally, our client now perceives any regulation driven by a standard-of-care model as a potential growth opportunity for their clients, as well as for their bottom line.

## About Princeton Financial Consultants

At Princeton Financial Consultants, we drive transformation for wealth management, banking, and insurance companies. Learn how we can help you by contacting us today at info@princetonfinancialconsultants.com.

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