Final DOL Fiduciary Rule — Key Takeaways

Update

What we Know About the Rule and its Implications for Advisers' Business Models

Significant Changes, but Less than Originally Proposed

The Department of Labor's (DOL) long-awaited final fiduciary rule under the Employee Retirement Income Security Act of 1974 (ERISA) was released on April 6. Along with the final rule, the DOL also released the new Best Interest Contract (BIC) Exemption and several amendments to other exemptions. The DOL also extended the implementation timeline so that compliance with the new rule will be phased in over a longer time frame. More specifically, the revised definition of "fiduciary" and certain provisions relating to the BIC Exemption will apply in April 2017, and the balance of the rule will apply on January 1, 2018.

While the final rule and exemptions will substantially impact the way many broker/dealers and financial advisers conduct business as well as their compensation structures, a number of concerns that were expressed during the comment process with respect to the initial proposal have been addressed.

This article outlines some of the most significant elements of the final DOL fiduciary rule and BIC Exemption, and discusses some of the implications these changes have for broker/dealers and financial advisers. We urge all financial advisers to review their business plans in light of these changes, and to keep abreast of additional guidance the DOL has committed to provide.

Plans Subject to the DOL Rule

The final fiduciary rule applies to investments under plans subject to ERISA, as well as to traditional and Roth IRAs, Coverdell Education Savings Accounts, Archer Medical Savings Accounts, and Health Savings Accounts. According to the DOL, the rule extends to these non-ERISA savings plans since they (together with ERISA plans) are subject to the Internal Revenue Code tax on prohibited transactions.

"Investment Advice"

The final rule significantly expands the activities for which a broker/dealer or financial adviser might be deemed to be providing "investment advice," and thus be engaged in fiduciary activities under ERISA. Pursuant to the final rule, "investment advice" includes: (i) a recommendation as to various transactions in securities or other property, including a recommendation to take a distribution of benefits or as to the investment of "rollovers"; (ii) a recommendation as to the management of securities or other property, including a recommendation as to the management of "rollovers"; or (iii) a recommendation of another person to give any of the advice described above and the person providing the recommendation represents that he or she is a fiduciary in providing the advice; the person provides the advice under a written or verbal agreement, arrangement or understanding that the advice is individualized; or the person directs advice to a specific recipient for consideration in making investment or management decisions. As such, one-time interactions with a client within the purview of the DOL rule are much more likely to be considered "investment advice." This includes distribution and roll-in/roll-over recommendations, which are now considered fiduciary activities.

Carve-Outs Offer Some Measures of Relief

At the same time, the final rule package provides several exclusions and exemptions to permit certain types of advice arrangements that might otherwise be problematic for a fiduciary.

"Hire Me" Communications

The final rule clarifies that merely recommending oneself to provide investment advice or services — i.e., marketing activities — is not, by itself, investment advice as long as it is not coupled with rollover recommendation or other investment recommendations for investing or managing plan or IRA assets.

Expanded "Seller's Exception"

The final rule provides for an expanded "Seller's Exception," under which recommendations to independent fiduciaries of plans and IRAs who have financial expertise or to plan fiduciaries managing at least $50 million in assets (defined broadly to include both plan and non-plan assets), will not be considered fiduciary activities as long as certain conditions are met. At the same time, the earlier proposed exception for plans with 100 or more participants has been eliminated. While on balance the final version of the "Seller's Exception" should be a positive step, there may be plans that have more than 100 participants but fall below the new $50 million threshold.

"Best Interest Contract" (BIC) Exemption

The revised BIC Exemption, which permits an adviser to receive various forms of compensation, is streamlined and more user-friendly than the earlier proposal. For example, it eliminates some of the complicated proposed disclosure requirements (e.g., annual disclosures and projections) and some of the more troubling contract requirements. The revised BIC Exemption also includes specific examples of how proprietary products may be sold. That said, it will still require, among other things, adherence to "impartial conduct standards" in rendering advice — i.e., the adviser must provide advice in the "best interest" of the retirement investor, which means with the care, skill, prudence and

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diligence that a prudent person would exercise in similar circumstances and without regard to financial or other interests of the adviser or various affiliates and related parties. In addition, the compensation an adviser receives from a recommendation must be reasonable. Finally, financial institutions need to adopt policies and procedures to mitigate conflicts of interest and disclose basic information about conflicts and fees.

General Investment Education

The final rule provides relief by excluding general investment education from the definition of "investment advice" in many situations. Consistent with current law, the final rule permits providing plans, participants and IRA owners with plan information; general financial, investment and retirement information; asset allocation models; and interactive investment materials, without these activities being deemed "investment advice." While the original proposal sought to narrow the current relief available for general investment education by prohibiting the mention of any specific investment products, the final rule backed off from this position. It permits interactive materials and asset allocation programs for plans and participants — although not for IRA owners — to mention specific investment products under certain conditions. Most notably, it requires that the product be a "designated investment alternative" under a plan, that the product be subject to oversight by an independent fiduciary, and that all other investment alternatives under the plan with similar risk/return characteristics be identified.

Some Surprises — Restrictions on Annuities

While the DOL sought to make the final rule more flexible than the proposed rule in most respects, in at least one key area the final rule is more onerous — fixed indexed annuities cannot be sold in reliance on Prohibited Transaction Class Exemption (PTCE) 84-24. As a result, distributors will likely have to rely on the BIC Exemption to distribute fixed indexed annuities. Fixed annuities can still be sold in reliance on the PTCE 84-24 exemption, similar to current practices but with some changes (e.g., limitations on the type of compensation that can be paid, and new standards for putting the customer's best interests first).

Implications of the New Rule for Advisers

The expansion of the "investment advice" definition — which results in fiduciary status — is fairly broad and could potentially affect almost any financial professional who gives retirement investment advice. As noted above, advisers providing recommendations on IRA rollovers from retirement plans, regardless of whether the plan is subject to ERISA, may now be deemed "fiduciaries," possibly requiring them to rely on the BIC Exemption to receive certain types of compensation.

In this regard, the final rule adds new hurdles to the IRA rollover advice process and could hinder the process of sales into IRAs. Nonetheless, IRA rollovers will remain an integral part of the retirement saving process; many participants will still need professional advice in managing and consolidating their defined contribution and IRA assets.

While the new fiduciary rule will likely force changes in business models and add regulatory and compliance costs, those institutions with expertise and experience in the retirement field may be better positioned to make the transition. In addition, advisers with fee-for-service business models may face fewer challenges adapting to the new rule.

Additional Guidance

The DOL has committed to providing additional guidance in the coming months on particular issues or questions as the industry starts to adjust to the new rule. Given the importance and reach of the DOL's new fiduciary rule and the related exemptions, Voya Financial will closely follow any new guidance and provide our valued business partners with relevant updates.

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