

Update: DOL Finalizes Its Conflicts-Of-Interest Fiduciary Rule

Issue: DOL Final Fiduciary Rule

Date: April 7, 2016

Action Taken: The Department of Labor (DOL) has finalized its much anticipated new fiduciary [rule](#) applicable to financial institutions and advisors working with retirement savers. The final version has changed significantly from its proposed form and reflects NAIFA's strong advocacy and input provided to both the DOL and to Members of Congress.

The rule is over 1,000 pages long and will require a careful review and analysis by NAIFA and our counsel. Because NAIFA members are always subject to the rules and requirements of their financial institutions (broker-dealers, insurance companies, etc.), we will await further discussion of the practical applications of the rule until the financial institutions have made determinations on their specific implementation requirements.

DOL has made significant changes to the fiduciary rule it proposed last year. While still defining advice for a fee (or other compensation) as fiduciary in nature, the ability to receive common forms of compensation, including commissions and other third-party compensation (12b-1 fees, marketing fees), has been streamlined and simplified from the proposed rule.

Background: The Department of Labor believes previous rules encourage the sale of high-fee products that pay higher commissions, and that recommendations need a more rigorous standard. The final rules expand the definition of investment advice subject to fiduciary obligations, and impose an Impartial Conduct Standard that can be enforced either through the Courts or through ERISA.

NAIFA's Advocacy Success: NAIFA's [efforts](#) through testimony and meetings with Congress, DOL, OMB and others--in DC and in the district offices, as well as through letters, emails, and phone calls--made a remarkable difference in what was the proposed rule to what was issued as the final product. The differences include:

- BIC contract provisions can be incorporated into New Account forms and signed at point-of-sale
- Improvements to grandfathered provisions under BIC for investments prior to Applicability Date
- Definition of education versus recommendation clarified
- Elimination of a contract requirement for advice to ERISA plan sponsors and participants
- Electronic Notices to existing clients, with "negative consent"
- Advice to small employer plan sponsors and participants covered by BIC
- Advice on rollovers and distributions covered by BIC
- Advisors not signatories to BIC contract, so no private right of action against advisors
- Proprietary products will satisfy Best Interest standard, under certain conditions
- Welfare plans not included, unless there is an investment component
- "Hire me" sales conversations are not investment advice

- BIC contract can waive claims and awards of punitive damages
- Definition of reasonable compensation clarified
- Elimination data retention for financial institutions
- Extension of effective date
- Removal annual disclosures and 1-,5-, and10-year projections

Please note: Although the DOL rule is applicable when working with tax-favored retirement-savings clients, all SEC and FINRA rules, including suitability, are also still applicable. An investment recommendation that is not suitable under securities laws would not meet the Best Interest standard under the DOL final rule.

Following is an initial summary of some (not all!) of the provisions of the final rule. NAIFA is committed to providing on-going information and a more detailed and in-depth commentary as we continue our analysis and review.

The Best Interest Standard: Generally, advisors who provide individualized advice, for a fee or other compensation, are investment advice fiduciaries. As such, advisors and firms need to satisfy a Prohibited Transaction Exemption (PTE) to receive commission-type compensation.

The most significant PTE is the "***best interest contract***" (***BIC***) exemption. It would allow payment by commission or fee sharing (and other common variable compensation) if the firm and the client sign a contract that:

- Commits the firm and advisor to providing advice in the client's best interest, charges only "reasonable" compensation, and avoids misleading statements about fees and conflicts of interest
- Adopts policies and procedures designed to ensure that advisors provide best interest advice, prohibiting financial incentives for advisors to act contrary to the client's best interest
- Discloses conflicts of interest—this requires directing the buyer/saver to a website that discloses the firm's compensation arrangements, and making the client/saver aware of his/her right to complete information on fees charged

The BIC contract can be entered into at the point of sale—when other account-opening documents are being signed – and advice prior to signing of the contract is subject to a best interest standard.

Annuities and PTE 84-24: Advice on, and sale of variable and indexed annuities is permissible only under the authority of the BIC exemption. In proposed form, the rule would have kept indexed annuities in “the insurance PTE” (84-24). The rule contains language acknowledging that additional complexity of variable and indexed annuities supports a unique compensation structure, and specifically states that fees are not the only factor in making investment decisions.

Proprietary Products: The final rule specifically addresses proprietary products and how they can be recommended and sold under the authority of the BIC PTE. Proprietary product rules require that firms determine that the limitations (on advice restricted to only proprietary product choices) are not so severe that the advisor will generally be unable to satisfy the exemption’s best interest standard and other requirements. We are continuing to review other conditions that must be met in order to satisfy the Best Interest Standard, and whether those conditions are workable.

Education: Educational activity will not be held to fiduciary responsibility. The rule provides that investment advice does not include communications “that a reasonable person would not view as an investment recommendation, including general circulation newsletters, television, radio, and public media talk show commentary, remarks in speeches and widely attended conferences, research reports prepared for general circulation, general marketing materials and general market data.”

Advice to Plan Sponsors: Advisors and firms may rely upon the BIC PTE when advising small-business plan sponsors on 401(k) and other retirement plan options and details. The rule states: “The BIC exemption will be available for advice to small businesses that sponsor 401(k) plans. Additionally, recommendations to plan sponsors with assets of more than \$50 million (vs. \$100 million in the proposed rule) will not be considered investment advice (subject to certain conditions)”.

Approved Asset List eliminated: The rule’s language specifically states that advisors “recommending any asset—not just those on an asset list included in the proposed rule—can take advantage of the BIC exemption to continue receiving most common forms of compensation.”

BIC Contract not required for Advice to ERISA Plan Sponsors: No contract will be required for advice provided to ERISA plans and their participants and beneficiaries under the BIC exemption. However, firms must acknowledge in writing that they, and their advisors, are acting as fiduciaries when providing investment advice to the plan, participant or beneficiary.

Fee/Expense Disclosure and Data Retention: Disclosure requirements generally apply only to the financial institutions, not to the individual advisor (except for the requirement that clients/savers be informed of the website on which fee/expense information is disclosed). The proposed rule’s requirement of disclosure of investment performance projections (at one, five and 10 years) was eliminated, as was the annual disclosure requirement. The rule does require firms and advisors to inform clients/savers that they can request more detailed disclosure on costs and fees. The rule also requires firms to maintain a website that shows fee/cost information. The final rule also eliminates the proposed rule’s requirement that financial-services firms maintain records with detailed data on inflows, outflows, holdings, and returns for retirement investors. Instead, firms’ retained records requirements would be limited to the information required to show that they complied with the law.

Level Fee Exemption: Firms and advisors working on a level fee can rely upon the level fee exemption. Firms must keep records on certain specific recommendations, including a recommendation to roll over assets from an employer plan to an IRA, and show that the level fee is in the customer’s best interest. Level fee fiduciaries are defined as those who receive the same compensation, regardless of the particular investments the client makes (e.g., they may be compensated based on a fixed percentage of assets under management or a fixed dollar fee) and are not compensated based on commissions or transaction fees.

Enforcement/Private Right of Action: In a change from the proposed rule, the final rule only grants a private right of action (right to sue) to IRA holders, but not to ERISA plan sponsors, participants or beneficiaries, in the event of an allegation of breach of fiduciary duty. Also, the

contract can allow a waiver of the right to sue for, or collect punitive damages. ERISA plan sponsors, participants and beneficiaries can seek relief under ERISA procedures.

HSAs and other plans with an investment component: The new best interest standard rules will also be applicable to health savings accounts and other welfare arrangements with an investment component for advice on how to invest those funds.

Effective Date: June, 2016

Applicability Date: April 10, 2017 (for the new definition of investment advice fiduciary, including acknowledgment and recommendations in the best interest of the client)

Applicability Date: January 1, 2018 (for full compliance with BIC and other exemptions)

Next Steps: Most of the final rule's requirements fall on financial-services firms rather than on individual advisors. NAIFA members will need to adjust to their broker-dealers' and investment advisor firms' implementation requirements. NAIFA will work closely with financial-services firms, and will remain deeply engaged in the emerging strategy of how to address remaining issues. Plan to participate in our [April 13 Webinar – DOL Fiduciary Rule: What it means for NAIFA Members and their Practices](#). Also watch for the announcement of our Fiduciary Best Practices Workshop - A new four-hour NAIFA Skill Builders Series workshop developed by subject matter expert Don Trone, GFS®, on fiduciary best practices, scheduled to be released in June 2016. This new NAIFA Skill Builders Series Workshop is designed to be delivered through the state and local associations. Additional details will be announced soon. For more information, contact [Diane Powers](#), Vice President, Professional Development and Education.