



What Comes Next? – Lessons Learned & Practical Implications of the Fiduciary Rule Under Review

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STATUS OF THE DEPARTMENT OF LABOR'S (DOL'S) REVIEW OF THE FIDUCIARY RULE (THE "RULE")

Status of DOL's Review of The Rule

- ✦ **January 20th: President Trump issued an Executive Order imposing a freeze on new regulations — some confusion over the impact on the Rule**
 - > Issued within hours of the conclusion of the inaugural events
 - > Applied to regulations that had been finalized, *but had not yet taken effect*
 - > This regulatory freeze did not impact the Rule, because it became effective June 7, 2016
 - > The Rule is currently scheduled to become applicable on April 10th, 2017

Status of DOL's Review of The Rule

✦ February 3rd: The Trump administration releases (leaks) a Draft Executive Memorandum

- > Directed the DOL to reconsider the impact of the Rule on investors, retirees, the industry, advice access, pricing and litigation
- > Contained a specific direction calling for an examination of “whether the prohibited transaction exemptions (PTEs) issued in conjunction with the rule, especially the best interest contract exemption, substantially undermine the Rule’s effectiveness at achieving its intended goals.”
- > Also directed the DOL to delay the applicability date for 180 days

Status of DOL's Review of The Rule

- ✦ **Later on February 3rd: The final version of President Trump's Executive Memorandum is Released**
 - > Contains *no reference to the 180-day delay period or the PTE exemptions*, and directs the DOL to:
 - Conduct an updated economic and legal analysis concerning the likely impact of the Rule to determine whether it's likely to cause harm to investors by reducing access to plans or advice
 - Consider whether it has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors/retirees
 - Determine whether the Rule is "likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services."

Status of DOL's Review of The Rule

★ The Final Executive Memorandum also directs the DOL as follows:

- > If the DOL review results in:
 - an “affirmative determination” that the Rule causes the type of harm/adverse impact at issue, or
 - “for any other reason . . . [the DOL determines] that the Fiduciary Duty Rule is inconsistent with the priority identified earlier in this memorandum,”
- > Then the DOL is directed to “publish for notice and comment a proposed rule rescinding or revising the Rule, as appropriate and as consistent with law.”
- > In response, the Acting Secretary of Labor announced that “The [DOL] will now consider its legal options to delay the applicability date as we comply with the President’s memorandum.”

Status of DOL's Review of The Rule

- ✦ **On February 9th: The DOL's Employee Benefit Security Administration (EBSA) sent documents to the Office of Management and Budget (OMB) for approval — details not yet public**
 - > One document is a proposed rulemaking that delays the Rule's April 10th applicability date for 180 days
 - > And, in fact, there is a document filed on February 9th on the OMB website entitled "Definition of the Term 'Fiduciary' — Delay of Applicability Date."
 - > A second document was also filed with OMB, which would start another round of public comment on the Rule

Status of DOL's Review of The Rule

★ On February 9th: EBSA filing with OMB (continued)

- > To become official, any notice to delay would have to include a public notice and public comment period — that period could be very short (some are anticipating as short as 15 days)
- > The DOL would then have to review the comments and prepare a final rule, which would have to go back to OMB for approval. Assuming OMB approval, the DOL would then publish the final rule in the Federal Register, formally adopting the new applicability date
- > In fact, OMB has already held 9 meetings (between 2/14 & 2/22) with interested parties to discuss the DOL's proposal to delay implementation of the Fiduciary Rule
- > The OMB process (at this stage) is now concluded (as of February 27th), so we could hear something this week or early next week

Status of DOL's Review of The Rule

★ How is the Fiduciary Rule faring in litigation?

- > Very well! The DOL is batting 1,000. The attacks have included the following arguments:
 - the Rule exceeds the DOL's statutory authority under ERISA — i.e., it has no authority to define “investment advice” and related terms
 - the BIC Exemption exceeds the DOL's exemptive authority — extends ERISA fiduciary standards to Title II plans, such as IRAs, and the statute doesn't expressly provide for this
 - the written contract requirement for the BIC Exemption and PTE 84-24 impermissibly create a private right of action
 - the rulemaking process violated the Administrative Procedures Act (APA)
 - the BIC Exemption, in particular, is unworkable
 - and even that the Rule violates the First Amendment!
- > These arguments have all been losers, thus far

AMENDMENTS TO EXISTING SERVICE AGREEMENTS TO COMPLY WITH THE RULE

Amendments To Existing Service Agreements to Comply with The Rule

- ★ **Background: The new definition of “fiduciary advice” broadens the range of fiduciary activities to include services previously considered educational or otherwise non-fiduciary in nature. As a result:**
 - Compensated investment recommendations to small plan sponsors and participants — including whether and when to take a rollover, and where to roll it — are now *fiduciary advice*, regardless of how often the advice is given or who else might be providing investment advice to the plan and/or its participants
 - A “best interest” standard is required with respect to all fiduciary advice interactions
 - Disclosures are required about fiduciary status, material conflicts, fees, and compensation related to the provision of investment advice

Amendments To Existing Service Agreements to Comply with The Rule

- ✦ As a result, in many instances, the services recordkeepers and others are providing will become fiduciary in nature on and after the Rule's applicability date
- ✦ What's the issue here? Many current service agreements specifically provide that the services being provided are non-fiduciary in nature and, therefore, the service provider is not acting as a fiduciary with respect to the plan and/or its participants
- ✦ What are the options for the recordkeeper or other service provider?

Amendments To Existing Service Agreements to Comply with The Rule

★ At the 30k-foot level, the options are fairly simple:

- > Decline to provide fiduciary services: often not a good option for the recordkeeper, the plan sponsor or the plan participants — and ultimately it could mean the end of the relationship with the plan
- > Seek to maintain the relationship by amending existing service agreements to specifically provide for the provision of fiduciary services
- > We are currently reviewing a number of these proposed amendments for our clients

Amendments To Existing Recordkeeping Service Agreements to Comply with The Rule

- ★ **We typically see the following two approaches to amending the recordkeeping agreement to allow for the provision of fiduciary advice services:**
 - > *The Letter Amendment Approach* — the terms of the Amendment are fairly general and it requires execution
 - > *The Addendum Approach* — the terms of the Amendment are even more general and execution is not required; rather, it is left to the employer to reject the new fiduciary services, otherwise the services agreement is amended in accordance with the addendum
 - > Under both approaches, the new fiduciary services become applicable on and after the Rule becomes applicable (currently, April 10, 2017)

Amendments To Existing Recordkeeping Service Agreements to Comply with The Rule

★ Issues we have encountered under both the letter amendment and addendum approach include:

- > *Vagueness*: in terms of what services are at issue and whether services are being maintained, added (which raises the issue of potential “up selling”) or both
- > *Equivocation*: about ***both*** the services being offered and fiduciary status, by liberal use of the word “may” in connection with services and fiduciary status
- > *Presumptive Drafting*: appear to permit the recordkeeper to initiate interactions with participants, rather than having those contacts take place in response to participant-initiated requests for assistance. This is an issue that needs to be considered by the plan sponsor — how is the provision of fiduciary services to operate? Service provider or participant initiated?

Amendments To Existing Recordkeeping Service Agreements to Comply with The Rule

★ How have we addressed the issues raised by the proposed recordkeeping amendments?

- > We have proposed changes to make amendments much more specific and unequivocal in terms of the services offered, and the standards that apply (we typically prefer the use of “will” over “may”)
- > We typically propose a format that either amends specific sections of the existing agreement or adds a new section to that agreement regarding “Fiduciary Advice Services” or an equivalent title
- > We typically seek to limit the provision of fiduciary services to the circumstance in which a participant initiates the contact with the recordkeeper, and not the other way around
- > And, we have sought to limit the instances of paraphrasing ERISA, in favor of spelling out the applicable fiduciary standard.

HOW THE RULE HAS IMPACTED COMPENSATION PRACTICES

"The Conflict of Interest Rule"

- ★ The official name for the Rule is the "Conflict of Interest Rule"
- ★ In extending the fiduciary standard to more service providers (including broker-dealers, some recordkeepers, and IRA advisers), the DOL intended to address inherent conflicts of interest with certain compensation practices
- ★ The prohibited transaction rules applicable to the fiduciary standard provided the DOL with the necessary tools to address these practices

Identifying Compensation Practices Resulting in Conflicts of Interest



Identifying Compensation Practices Resulting in Conflicts of Interest

- ★ The DOL identified two main compensation practices giving rise to a strong potential for conflict of interest when rendering investment advice:
 - > Variable rate compensation (where the adviser's compensation changes based on the advice given)
 - > Third party compensation (where the adviser receives compensation from a third party for providing certain investment advice)

Identifying Compensation Practices Resulting in Conflicts of Interest

- ★ The expanded application of the Rule to broker-dealers and some recordkeepers highlights a number of common compensation practices that generate conflicts of interest. Conflicted compensation practices we have seen in 401(k) plans include:
 - > Receipt of Commissions
 - > Revenue Sharing (12b-1 fees)
 - > Personal Ventures (proprietary products)

Identifying Compensation Practices Resulting in Conflicts of Interest

- ★ The expanded application of the Rule to IRA advisers also highlights a number of compensation practices unique to IRA advisers that generate conflicts of interest, including:
 - > Bonuses
 - > Rollovers
 - > Active vs. Passive Management Structures

Addressing the Conflict of Interest

- ★ The receipt of compensation by a fiduciary rendering investment advice is a prohibited transaction under ERISA. Therefore, in order to receive compensation, the fiduciary must satisfy a prohibited transaction exemption
- ★ The rulemaking package introduced a new prohibited transaction exemption, the BIC Exemption

Addressing the Conflict of Interest

- ✦ In order for a fiduciary to continue to receive variable rate or third party compensation, the fiduciary must comply with a number of significant requirements under the BIC Exemption, including:
 - > Disclosing fiduciary status
 - > Adhering to “Impartial Conduct Standards” which requires the adviser to:
 - Give advice that is in the Retirement Investor’s Best Interest;
 - Charge no more than “reasonable compensation”; and
 - Make no misleading statements about investment transactions, compensation, and conflicts of interest

Addressing the Conflict of Interest

- ★ Adopt policies and procedures reasonably and prudently designed to prevent violations of the Impartial Conduct Standards
- ★ Refrain from giving or using incentives for Advisers to act contrary to the customer's best interests; and
- ★ Fairly disclose the fees, compensation, and Material Conflicts of Interest, associated with recommendations
- ★ For advice to IRAs, a written contract is required

Addressing the Conflict of Interest

- ★ In the alternative, the investment advice fiduciary can revise its compensation model to only receive a level fee (a flat dollar fee or basis point fee) and satisfy significantly reduced (“streamlined”) BIC Exemption requirements, including:
 - > Disclosing fiduciary status
 - > Adhering to “Impartial Conduct Standards”

Addressing the Conflict of Interest

- ★ Many providers found the BIC Exemption requirements for variable rate and third party compensation difficult to comply with and have transitioned to a level fee model
- ★ Key reasons for this transition include:
 - > Compliance Burdens
 - > Compliance Cost
 - > Risk associated with warranties

IMPACTS OF THE RULE ON PLAN PARTICIPANT EXPERIENCE

Participant Experience

♦ No Inherent Impact

- > No impact at all to plan participants receiving acknowledged fiduciary advice under the “old rule” (e.g., plan sponsor provided live or computer model)
- > Today, most qualified plan participants have not been receiving advice that would be considered fiduciary advice under the “new rule” most will not be receiving fiduciary advice solely by virtue of the new rule after it becomes effective
 - Unless there is a change in the plan’s service model

Has Your Recordkeeper Been Providing Fiduciary Advice?

- ♦ Is the Information Limited to?:
 - > Non-fiduciary investment information
 - > Non-fiduciary plan-related information
 - Enrollment, balance, processing
 - > Non-fiduciary investment education
 - Saving, budgeting, asset allocation examples



no impact

Has Your Recordkeeper Been Providing Fiduciary Advice?

- ♦ Does the Information Include:
 - > Market volatility information
 - > Asset class information
 - > Distribution advice
 - > Rollover advice





What We Are Seeing...

♦ CHOICE OF:

> Scaled back services

- Could be seen as undesirable participant “take-away”
- Could have other advice resources

> Full freight investment advice

- Distribution/Rollover recommendations
- Buy/Sell recommendations
- Asset modeling
- Retirement planning

Recordkeeper Provided New Rule Investment Advice

- ★ Recordkeeper Must Satisfy the BIC Exemption
 - > Impartial Conduct Standards
- ★ Plan Sponsor Must Monitor Recordkeeper
 - > What are they saying to participants???



WHAT WILL BE THE IMPACT OF A DELAY, REVISION OR RESCISSION OF THE RULE?

Cats, Bags and Bullhorns



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