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Client Alert

Overview of DOL's Final Fiduciary Rule[1]

WASHINGTON, D.C., April 15, 2016. It's out. The thousand-plus pages of the Department of Labor's fiduciary rule is going to take some time for marketplace participants (including us) to digest. Nevertheless, here is **our first take on the rule** and its impact on fi360 clients and the broader advisory community.

The basic framework of the **2015 proposal remains intact with certain concessions** made to improve workability for a number of industry groups and respond to concerns expressed by Congress. We'll get to pragmatic changes made by the DOL in a minute, but first let's look at the central issue of the rule: the definition of an investment fiduciary adviser serving the retirement market.

The **final rule sweeps away the complicated five-part test for determining fiduciary status**. The new definition closes the giant loophole created by the original (1975) requirements for advice to be regular and the primary source of decision-making for fiduciary status to apply. These provisions are gone.

In this respect, the final rule is unchanged from what was proposed at about this time last year. **Virtually everyone who provides investment advice for compensation in the retirement space will be fiduciaries** – a big change for securities-licensed representatives who have escaped fiduciary accountability under the old definition.

April 6, 2016, was without question a transformational day in the history of financial services regulation, perhaps **the biggest change impacting advisors in a generation or longer**.

Opponents and others concerned with the DOL's proposed eight-month deadline for implementing compliance requirements can breathe a little easier. T**he compliance deadline has been extended**. It's now 12 months, or Apr. 10, 2017, for most of the rule's requirements, and 18 months for the Best Interest Contract Exemption (BIC Exemption or BICE), or Jan. 1, 2018. However, BICE comes with a few caveats in which partial compliance starts next April.

At 1,023 pages, the collected documentation released by the DOL for the rule rivals War and Peace in scale (1,225 pages in the original edition of the novel). While the DOL's work product isn't a masterpiece, it certainly is impressive. The heft of the final rule comes from a wealth of commentary that explains and provides context for the rule's provisions and the changes that were made.

[1] The views expressed herein are strictly informational, do not represent an official position of fi360 on regulatory or legislative matters, and should not be relied upon as legal, compliance or investment advice.

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While the definition of fiduciary changed little from the proposal to the final version, the rule now clarifies the kinds of recommendations, or calls to action, that would be considered investment advice, and therefore entail fiduciary accountability. **Two types of investment advice are specified in the rule**. The first involves recommendations regarding the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property. That type also includes recommendations about how to invest after a rollover, transfer, or distribution from a plan or IRA.

The second type of advice involves recommendations pertaining to the management of securities or other investment property. These include recommendations on investment policies or strategies, portfolio composition, the selection of investment managers or advisers, and even types of investment accounts such as selecting between brokerage and advisory accounts. This type also addresses rollovers; whether to rollover, in what amount, in what form, and to what destination.

Exclusions from the definition include most of the carve-outs from the 2015 proposal, which have been renamed non-fiduciary communications. These relate to activities that historically have not been fiduciary in nature and won't be under the final rule. They include **counterparty transactions (sales relationships), platform provider services, swap transactions, recommendations by employees of plan sponsors, and investment education.**

The carve-out for investment education was closely watched since the 2015 proposal prohibited the use of specific plan investment options in asset allocation models or interactive investment materials. The Department has eased that restriction somewhat by allowing their use subject to oversight by a plan fiduciary who is independent of the service provider. However, this exception allowing direct references to specific investment options without incurring fiduciary status is not available for IRAs.

The most closely watched provision in the rule, of course, was the Best Interest Contract Exemption. **Elimination of major disclosures and data disclosures such as 1, 5 and 10-year expense projections for investment products from BICE was a big concession.** In addition, the three-way contract between firm, individual advisor and retirement investor was reduced to the more conventional agreement between firm and client. More interestingly, the **contractual component of BICE was eliminated for advice to plans and plan participants**, who are already covered by a private right of action (to sue for ERISA breaches). The **contract requirement remains for IRAs** and non-ERISA accounts.

Timing of the contract under BICE was also clarified so that recommendations can be suggested prior to execution of the contract. However, transactions can only be executed after the contract is signed.

The ability to sell a limited range of products, generally proprietary, remains available under BICE. Most of the conditions from the 2015 proposal are also in the final rule.

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Of major interest to RIAs is the **streamlined exemption within BICE for level-fee rollover advice**. Retirement advisers who charge a level fee for the advice they provide to plans as well as a level fee for advice to IRA clients have generally been prevented from suggesting an IRA rollover for fear of triggering a prohibited transaction if they charge a higher fee on assets in an IRA than they do for plan assets. This also would apply to a new rollover client with an IRA. Under the proposed rule, BICE could have been used to navigate this situation but fi360 and other organizations suggested a streamlined solution that the DOL now offers. Level-fee advisors (including robos meeting this criterion) can take advantage of a new safe harbor by providing written acknowledgement of fiduciary status, following impartial conduct standards, and documenting why the final recommendation was in the best interest of the client. This is a big improvement that knocks down an existing barrier to client-adviser relationships.

One of the big surprises in the final rule was the inclusion of equity-indexed annuities under BICE. It had appeared that indexed annuities would be included under existing Prohibited Transaction Exemption 84-24 since in the 2015 proposal the DOL only moved variable annuities to BICE. Fixed annuities remain under PTE 84-24, although the DOL also beefed-up investor protections within this existing exemption. The insurance industry isn't happy about these changes.

It was also somewhat surprising that **the DOL completely removed its restricted menu of investment products available under BICE.** Previously only traditional investments such as bank deposits, CDs, mutual funds, exchange-traded REITS and ETFs were eligible, now any product is available. Importantly, **investment selection remains subject to ERISA's tough prudence standard**. This was a smart move by the DOL to add the flexibility of professional judgment and retain strong fiduciary principles with clear recourse available to investors if fiduciary breaches occur.

Finally, the DOL indicated that an adviser's monitoring responsibilities can be specifically limited in a client engagement. However, the DOL also made clear that it would be very difficult for a fiduciary advisor to justify not monitoring a recommended course of action that is risky or volatile.

It's been a long wait between the DOL's comment period on the rule ending Sept. 29 of last year and the bombshell news hitting the industry with the final rule release. **fi360's predictions on what would be in the final rule were mostly on target**, so we will give ourselves a pat on the back for objectively wading through the rhetoric and finding the bottom line reality and significance of regulatory and marketplace changes for our clients. We will continue to monitor and assess the rule in the coming days and weeks to reveal new information about the rule and its impact on the regulated community and investors.

Stay tuned! We'll be back with more information in the coming weeks and months. If you have any questions about this memo or are interested in learning more about fi360's solutions for fiduciary excellence, please contact us at (844) 394-9960 or support@fi360.com.