Department of Labor (DOL) Fiduciary Rule

1. What is the DOL Fiduciary Rule?

The DOL Fiduciary Rule is a regulation issued by the federal government. The regulation is intended to protect retirement investors from conflicts of interest. Once effective, the rule will require anyone who provides investment advice to 401(k), IRA and other retirement account owners to abide by a “fiduciary” standard of care — in other words, the advice must be in the best interest of the retirement investor.

What is a conflict of interest? A conflict of interest is any financial incentive that a reasonable person would believe could influence an advisor’s recommendation.

2. When does the DOL’s Fiduciary Rule go into effect?

Most aspects of the Fiduciary Rule are scheduled to go into effect on April 10, 2017. Some aspects, including the requirement of a Best Interest Contract, will be required beginning on Jan. 1, 2018.

What is a Best Interest Contract? A Best Interest Contract is a contract between the investor and financial institution that binds the financial institution to Impartial Conduct Standards. Under the rule, the Best Interest Contract is required for certain sales (see below)

3. What are Impartial Conduct Standards?

The Impartial Conduct Standards are the core principles of the new rule. Essentially, these core principles specify that any qualifying recommendation must:

1. Be in the best interest of the investor without regard to the advisor or his company’s financial or other interests;
2. Not result in compensation that is in excess of reasonable compensation for the advisor or his company; and
3. Not involve statements that could be considered misleading.

What does reasonable compensation mean? According to the DOL, reasonable compensation is compensation that is not an outlier when compared to other similar products in the marketplace. Compensation can be in many forms, including commissions, revenue shares, surrender charges and operating expenses within the product.

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4. How do the rule’s Impartial Conduct Standards prevent conflicts of interest?
To abide by the “no misleading statements” requirement of the Fiduciary rule, all material conflicts (of the advisor and his/her company) must be disclosed to the investor. A commission, for example, is considered a conflict of interest because the advisor’s compensation will depend on the product that he/she recommends. The standard requires that these conflicts be identified, supervised and mitigated in accordance with the company’s written policies and procedures.

5. Who is a fiduciary under the new rule?
Under the rule, a fiduciary is anyone who gives investment advice for a fee regarding a 401(k), 403(b), IRA or other retirement account, regardless of whether that fee is paid directly by the consumer or the product manufacturer. Further, the investment advice must relate to products that have an investment component.

What is investment advice?
Any of the following recommendations are considered investment advice that is covered by the rule:
• Buy, hold, or sell;
• How to manage investments, including asset allocation or portfolio composition;
• Whether to take distributions or rollover from one account to another; and
• Whether to hire someone to do any of the above.

What insurance products have an investment component?
Variable annuities, indexed annuities, and fixed annuities all have an investment component. While the DOL states that term insurance does not have an investment component, most experts believe that whole life insurance and universal life insurance do have an investment component. Therefore, a recommendation to use distributions from a 401(k) account (even required minimum distributions) to fund whole or universal life premiums would be subject to the requirements of the rule.

What financial, investment or retirement information are not considered investment advice under the rule?
Investment advice that will not trigger fiduciary rule requirements is typically educational or informational in nature. Examples include newsletters; questionnaires; general marketing materials; data on market performance; and general financial and investment concepts such as risk and return, diversification, dollar cost averaging, compounded return and tax deferred investment. However, a suggestion to take an action (or refrain from taking an action) will be considered investment advice under the rule.

EXAMPLES:
Investment advice: “You should roll your old 401(k) over into an IRA and purchase a variable annuity.”
Not investment advice: “One benefit of rolling over an old 401(k) into an IRA is more investment choices.”
6. Does the rule prohibit commissions?

No. Commissions are permitted if the advisor meets all the requirements of a Prohibited Transaction Exemption (PTE). Generally, two PTEs are available for insurance and annuity sales: the Best Interest Contract Exemption (BICE) and PTE 84-24.

What is BICE?

BICE requires, in most cases, the Best Interest Contract (a contract between the advisor’s company and the investor). In that contract, the advisor must agree to follow the Impartial Conduct Standards and make certain disclosures both at the point of sale and on the company’s website. The advisor’s company also has to have written policies and procedures to identify, mitigate and supervise conflicts of interest. BICE is available for sales of any products, but must be used for variable and indexed annuities.

What is PTE 84-24?

PTE 84-24 requires that the advisor follow the Impartial Conduct Standards and make certain disclosures at the point of sale, including specific statement of the percentage or dollar amount of commission. PTE 84-24 does not require the Best Interest Contract. PTE 84-24 is only available for insurance contracts and fixed annuities.

7. Will the rule make it harder to sell indexed annuities? If so, why?

BICE requires that a “financial institution” sign the Best Interest Contract. Banks, broker-dealers, registered investment advisers, and insurance companies are considered financial institutions. Other entities, such as independent marketing organizations (IMOs), must apply to the DOL to seek to obtain financial institution status.

Some insurance-only licensed agents who have been selling indexed annuities may not be affiliated with a financial institution, so they will not be able to continue selling these products in the retirement market, under the rule, if they do not affiliate with a financial institution. Some insurance companies, broker-dealers, and registered investment advisors (RIAs) are assessing whether or not they could be the financial institution for these independent agents, and some IMOs are applying to the DOL for financial institution status.

8. Does the new rule apply to registered investment advisors (RIAs) who are paid a flat fee?

Yes. Under the new rule, a fee-only advisor has a conflict of interest when he or she recommends that an investor add more money to a retirement account that is under the advisor’s management. It is a conflict because the additional funds will increase the advisor’s assets under management and, therefore, increase his or her fees. However, recommendations from RIAs in this case may fall under the rule’s BICE Light conditions.

What is BICE Light?

BICE Light is the phrase given to a special part of the BICE that permits “Level Fee Fiduciaries” — advisors who are only receiving a flat fee — to satisfy BICE without a contract and, generally, with less compliance requirements.
9. How does the rule apply to advisors who sell only a limited menu of proprietary products and limited product offerings (i.e., captive or career agents)?

BICE has additional requirements for sales of proprietary products, including a requirement that the financial institution review its available products and determine that those and other limited offerings will not result in imprudent recommendations or excessive compensation.

10. Can an advisor be sued?

Yes, advisors may be sued, but the financial institution and not the advisor will generally have the direct litigation risk posed by the rule. The Best Interest Contract will provide consumers with potential breach of contract claims against the financial institution. BICE does not require that advisors sign these contracts, but some financial institutions may require that advisors sign them.

11. Do the rule’s requirements extend to wholesalers recommending products to advisors?

A wholesaler’s recommendations to an advisor are not in scope of the rule. However, a wholesaler’s direct interaction with a consumer (401(k), IRA or other retirement account owner) could lead to allegations that the wholesaler made a recommendation, thus triggering the Fiduciary Rule’s requirements.

12. Did Congress pass a law to make the DOL Fiduciary Rule go away?

Both the Senate and the House passed resolutions under the Congressional Review Act to negate the rule. However, President Obama vetoed those resolutions in June, and there is not enough support in the House or Senate to overcome the veto. This approach to overruling regulations, including the rule, is available only in the first 60 days following a regulation’s finalization, so it cannot be used by a new Congress in 2017.

13. Can a new President stop the rule?

A new President cannot, by himself or herself, stop the regulation from being implemented. While a new President could ask the DOL to issue new regulations, that process would take 1-2 years to complete, and the rule will be fully implemented by then. A law passed by Congress and approved by the President (or veto overridden by Congress) could negate the rule, but most experts believe such a scenario is unlikely.

14. Won’t litigation in the federal courts stop the rule?

There are five lawsuits pending in various federal courts. These lawsuits claim that the rule is unconstitutional and unlawful and, therefore, should be stopped. The judges handling those cases will likely not issue rulings until the last quarter of 2016, at the earliest. Because of the rule’s many requirements, waiting for or relying upon a favorable ruling in the litigation is not prudent. Many who market and sell insurance and annuity products in 401(k) accounts or IRAs are preparing for the rule’s implementation in April 2017.