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DOL's Re-Proposed Fiduciary Rule Moves Forward

Yesterday, President Obama announced that the DOL has sent its long-anticipated re-proposal of the fiduciary rule to the Office of Management and Budget. This move means that the re-proposal will be released for comment within 90 days, if not sooner. The content of the re-proposal remains under wraps for now. However, it's widely expected to focus on improving fee disclosures for financial professionals providing asset-related advice to retirement and other ERISA plans. This effort aims to preserve retirement savings by minimizing conflicts of interest. Plan sponsors ultimately may need to change how they communicate investment information to participants, and re-evaluate their rollover advisor and other service offerings.

Background

ERISA requires plan fiduciaries to act prudently and solely in the interest of participants and beneficiaries, and sets forth a series of "prohibited transactions" to restrict fiduciary self-dealing. Fiduciary status is significant, as fiduciaries can be held personally liable for losses in the case of a breach.

A party who "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority to do so" is a plan fiduciary. Specifically, under current regulations, a party giving investment advice is a fiduciary where that party meets all prongs of the following five-point test:

(1) The party advises on the value of securities or other property, or makes recommendations on investing in, purchasing, or selling securities or other property.

(2) The party gives the advice on a regular basis.

(3) The party gives the advice by a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary.

(4) The advice serves as a primary basis for investment decisions for plan assets.

(5) The advice is individualized based on the particular needs of the plan.

In 2010, the DOL proposed to eliminate the five-part test and significantly expand the types of investment advice that would render a party an ERISA fiduciary. The proposed regulation received widespread criticism from broker-dealers, financial advisers, and other stakeholders in the financial services industry. These parties argued that the new proposed standards conflicted with those of the Securities and Exchange Commission (SEC) and would increase consumer costs. (See our November 11, 2010 *For Your Information.*) In September 2011, the DOL withdrew its proposal and announced that it would re-propose changes after reviewing the issues and coordinating with the SEC.

Re-Proposed DOL Rule to be Issued Soon

Yesterday, President Barack Obama — along with Senators Elizabeth Warren (D-MA) and Corey Booker (D-NJ), and Representative John Delaney (D-MD) — announced the much-anticipated re-proposal of the fiduciary rule, also known as the “conflict of interest” rule. Following the announcement, the DOL sent the proposed rule to the Office of Management and Budget (OMB). The specific content of the rule will not be released until OMB publishes the regulation in the Federal Register, which could take up to 90 days — but could happen much sooner.

However, the material issued by the White House (a blog post, fact sheet, Council of Economic Advisers report, and a link to a DOL presentation entitled “Are Your Retirement Savings at Risk”), along with the president’s speech yesterday, address the following themes:

- The current regulation is 40 years old and was written at a time when most retirement plans did not allow for participant-directed investments.
- Due to its outdated nature, the current regulation allows investment advisors to provide conflicted advice, particularly in connection with IRA rollovers.
- This, in turn, inhibits transparency and reduces investment return — thus reducing assets available upon retirement.
- Conflicted investment advice reduces returns by approximately 1%, or $17 billion in annual losses to retirement savings.
- Under the re-proposal, commissions and revenue sharing will still be permitted through exemptions to the prohibited transaction rules.
- In addition to providing a comment period, the DOL will hold a public hearing.

SEC Commissioner Disagrees

As an example of the expected pushback from many quarters, SEC Commissioner Daniel M. Gallagher (one of five current SEC commissioners) has criticized the DOL’s rulemaking process on this issue and questioned the DOL’s findings on investment advisors’ “so-called perverse incentives.” To the contrary, according to Gallagher, SEC “rules expressly prohibit brokers from churning client accounts, and the SEC and SROs [Self-Regulatory Organizations] have sophisticated tools designed to monitor for such activity.” Gallagher, acknowledging the current imperfect system and potential for conflicts, said that “while being a ‘fiduciary’ means acting in the best interest of the client, it does not mean that all models where financial professionals are not fiduciaries are flawed.” He also

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observed that labeling a financial professional as a fiduciary will not necessarily solve the perceived problems, particularly given that, in his view, the DOL has not sufficiently identified these problems.

In Closing

We expect that the re-proposal will face a robust round of debate as the agencies and various stakeholders aim to better define the responsibilities of professionals providing retirement asset-related investment services. In the end, we expect a renewed focus on fee disclosure, in particular. For plan sponsors, whether in response to new regulatory mandates or in an effort to follow best practices for plan participants, a focus on transparency and careful selection of participant referral sources remains imperative. Avoiding conflicts of interest ensures the best outcomes for plan sponsors and participants alike.

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