Fiduciary Commentary

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The DOL New Fiduciary Rule – The Saga Continues

It's been a long road with many false starts, road blocks and fierce debates. After being in the news for nearly 10 years, there is finally an update to the 40-year old fiduciary standard with the release of the final regulations in April 2016. The ruling is arguably the most transformative financial regulation seen in decades, perhaps since ERISA itself.

Since the passage of the new fiduciary standard, numerous events have occurred to cast doubt on its future. In November 2017, the DOL announced an 18-month extension to the start of several key provisions of the new fiduciary standard. The transition period is now extended to July 1, 2019. However, this delay does not impact the parts of the fiduciary rule that were enacted on June 9, 2017, including the set of activities that mandate fiduciary care. In the extension announcement, the DOL specified that advisors still, "have an obligation to give advice that adheres to impartial conduct standards". During this delay the DOL has stated it will coordinate with other regulatory agencies to reexamine the rule.

Background

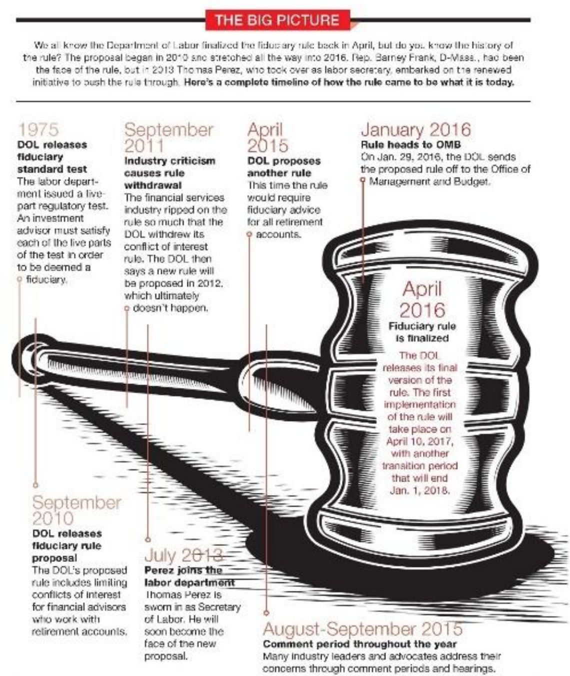
The original fiduciary rule was ratified in 1975, shortly after the passage of ERISA. A fiduciary relationship is viewed as the highest standard of advice available under the law. It requires an advisor to put clients' interests first when making investment recommendations.

This fiduciary standard, along with the incidental advice rule of the Investment Advisors Act of 1940 (where advice is incidental to the transactional nature of the brokerage business) permit different performance standards for brokers and advisors. These discrepancies in investment services are virtually indistinguishable to investors. The motivation for replacing the 1975 regulation was in response to the outdated and divergent standards that permitted practices that subordinated investors' interest.

Chronology of the Fiduciary Rule

The Obama Administration first proposed a revision to the 40-year old fiduciary standard in 2010, requiring brokers and advisers to always put their client's best interests first by providing conflict free advice. The proposal sought to broaden the set of circumstances that would necessitate the elevated standards of a fiduciary when providing services to qualified plans and IRAs. The DOL ultimately withdrew this bold attempt at a rule bowing to fierce pressure from Wall Street. The current restatement of the fiduciary rule was initiated in 2015. Since then, the rule has not had a smooth advancement forward.

After much anticipation, in April of 2016 the rule was finalized and published in the Federal Register on June 7, 2016. To allow financial firms time to comply with the new advice regulations, the effective date of new law was delayed until April 10, 2017.



This delay provided additional time for the affected parties to prepare their challenge to this highly politicized rule. Financial industry trade groups (representing Wall Street brokerages and the insurance industry) filed the first lawsuit against the DOL in *U.S. Chamber of Commerce v. DOL*. The plaintiffs claimed that the DOL overstepped its authority to define a new fiduciary standard. The court threw out the case discrediting each of the plaintiff's key challenges to the fiduciary rule.

Shortly after his inauguration, President Trump ordered the DOL to review the fiduciary rule. The examination would include an economic and legal analysis and the "likely impact" of the regulation on access to retirement information and financial advice. Soon after this directive, the DOL calls for a 60-day delay to the fiduciary rule's April 10, 2017 effective date. With this stay, it opens another window and comment period on the effects of the new law. Although the fiduciary rule officially takes effect in June 2017, enforcement is on hold until the January 1, 2018, the expected full implementation date.

On November 29, 2017 the rule is once again postponed. An additional 18-months extension is granted pushing the full enactment of the DOL rule to July 2019. This delays the requirement to fully comply with exemptions permitting contracts to disclose certain compensation arrangements the class exemption for principal transactions and the prohibited transactions exemption by Jan. 1, 2018). The extension allows more time for the DOL to review lawsuits brought against it, reexamine its effect on both fiduciaries and consumers, and its impact on the economy. This further delay brings more uncertainty with the new rule.

Where to Now?

Despite the postponement in the implementation of the law, the new fiduciary standard is not dead. The real concern with the 18-month push is the possibility for key elements of the law that give it the teeth to be effective may be permanently dismantled.

The DOL's review will include a collaboration with the SEC and the National Association of Insurance Commissioners to further analyze the new regulation and to contribute ideas in developing "alternatives" to the fiduciary rule. The examination will include a study of the potential impact of the new advice regulations on a long-held critique by the rules opponents; access to retirement information and financial advice.

The industry has long cited the adverse effects of the new fiduciary rule on retirement savers. Brokers and insurers have claimed that the regulation would stifle investors' access to affordable financial advice and prevent the development of much needed savings plans. Skeptics are doubtful that any absence of service offerings would last in the hyper-competitive financial service market. Providers willing to comply with new regulations will scramble to fill the void left by firms unwilling or unable to comply with the conflict-free advice regulations.

Serious challenges remain in arriving at a more cohesive approach to the fiduciary rule. Financial advice standards of conduct for brokers and investment advisers need to be unified and myriad state insurance regulations need to be addressed.

Despite these challenges to resolve the conflict between the brokerage and advisor models, there is some indication that the SEC's enforcement maybe moving in the direction of the DOL. Notable class-action suits under ERISA in which plaintiffs have recorded victories in multiple excessive fee cases, support the move in the direction of the DOL's elevated standards for advice givers.

The new SEC Chairman stated that assessment of the regulatory structure, as well as the current condition in the market, play a significant factor in reassessing potential regulatory decisions. It is expected, nonetheless, that given enough time for further reevaluation, DOL and SEC will finally be on the same side.

Conclusion

Despite Wall Street's best efforts, the fiduciary rule is moving forward, albeit slowly. However, the lobbying effort isn't over. Some believe the politicization will continue for years, as interested parties from both sides continue to debate on how to change the rule.

Many experts (North Pier included) believe that all financial advice should be held to a fiduciary standard. Others believe there is simply too much money being made to affect the real change that is needed. Once again, the fear is that this additional transition period will be used by the law's opponents to water down the rule through exemption loopholes that will continue to permit practices that permit harm to investors.

Retirement Provisions Included in Budget Deal

On February 9th, President Trump signed a two-year budget deal with Congress. The agreement includes several policy changes and add-ons to the bill that affect retirement plans, including:

- The removal of the six-month prohibition on contributions to retirement plans after a hardship withdrawal. The revised regulations will apply to plan years beginning after Dec. 31, 2018. Additionally, the legislation permits employers to extend hardship distributions to amounts to permit include QNECs, QMACs and profit-sharing contributions. It would also remove the requirement to take a loan before taking a hardship withdrawal.

- Special disaster-related rules for distributions of retirement funds for individuals impacted by the California wildfires. The legislation provides relief from the 10% early withdrawal penalty for qualified distributions up to $100,000 made on or after Oct. 8, 2017, and before Jan. 1, 2019. Additionally, participants may choose to spread the distributable amount over a three-year period beginning with the year of distribution for tax purposes. The bill also permits savers to repay the distributed amounts to the plan within three years from the date the distribution was made and be treated as a rollover and not includible in income.

Finally, the new law calls for creation of a Joint Select Committee to solve the Multiemployer Pension solvency issues. The committee will be tasked to introduce bipartisan legislation to address the multiemployer pension crisis by December this year.