MCA's Focus on Fiduciary Conference in Washington, DC, on July 18, 2016, featured back-to-back presentations by a strong proponent and equally strong opponent of the Department of Labor's (DOL) conflict of interest rule. Timothy D. Hauser, Deputy Assistant Secretary for Program Operations at the Employee Benefits Security Administration at DOL, and a principal architect of the rule, was the featured keynote speaker opening the day-long conference. David W. Blass, JD, a former senior staff attorney at the Securities and Exchange Commission and general counsel at the Investment Company Institute, which opposed the rule, followed.

The final rule, which generated strong industry opposition, greatly expanded the definition of an investment fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) but also provided several exemptions for commission-based advice. The final rule was released in April with most of its requirements taking effect April 10, 2017. Given the rule's complexity and compliance costs, financial advisors still have numerous questions as they grapple with the impact on their own practices.

Below are excerpts from the transcripts of Hauser's and Blass's remarks featuring some of the highlights from their presentations. Given space limitations, their comments are condensed, organized alphabetically by topic, and do not necessarily reflect all of the specific compliance requirements under the rule's provisions.

### Best Interest Contract Exemption (BICE)

**Hauser:** Probably the most important of [the Rule's] exemptions is the best interest contract exemption. It's an exemption specifically crafted for the retail market for advice, especially to individual retirement account (IRA) customers and to plan participants.

The basic idea is you can make a choice. You can strictly adhere to the statute in its default mode, which means you're a fiduciary as long as you don't engage in conflicted transactions. You're good to go.

Or you can opt to use the contract exemption. In effect what you do in that case is you make a deal with your customer. You tell your customer, “My firm is going to receive some form of compensation that would otherwise be prohibited, but I'm promising you that notwithstanding that conflicted compensation my firm and I are going to give advice that adheres to those same standards; prudent, loyal, reasonable compensation. … Big picture, that's what the best interest contract exemption is.

**Blass:** An ERISA fiduciary cannot receive a commission unless there's an exemption expressly saying that that fiduciary can receive it. That's the best interest contract exemption.

There are policies and procedures required to rely on the exemption that basically say the firm needs to develop a system to ensure that when its representatives are giving advice they are doing it in a way that's not conflicted. So there's no financial incentive to recommend one product over another.

Now that's pretty hard to do if you really step back and think about it. So if you're getting any kind of commission and you're able to recommend different kinds of mutual funds—while all the mutual funds … have different payout structures, they are not standard. They have different 12B-1 fees. That's just within the mutual funds. What if you recommend something completely different or you're thinking about two different products?

Do you have to recommend insurance products or mutual funds and the payout has to be the same? These policies and procedures as the Department has described them seem to call for an equalized payout to the representatives giving the advice, which means you.

**BICE—Disclosure**

**Hauser:** There is also disclosure [under BICE], it's mainly a two-tier kind of disclosure which is, first you can give some spe-
pecific disclosure about the specific fees and costs associated with the account, coupled with the more general sort of description of the firm-level conflicts, the cost associated with the product, and the like. And a note to the customer that on request you’ll give more detailed information, and also directing the customer to a website.

BICE—Contract Execution

Hauser: We made it easier to execute the contract. In fact we eliminated the contract with respect to plan participants, so you do not need to execute a contract with a 401(k) plan participant. You don’t have to execute any contract at all until money is going to change hands, when the transaction’s actually going to occur. You’re welcome to incorporate the contract into existing documents such as account opening agreements, insurance contracts, whatever you use, or to develop a separate document. And we facilitated execution of the contract with existing customers by permitting essentially electronic notice and a negative assent. So you don’t need to get a written [signature].

Carve-Outs from the Fiduciary Definition

Hauser: There’s also a [carve-out from the definition of fiduciary] for general communications. Communications like a speech, articles, books, the kind of mass communications we do not generally treat as fiduciary recommendations on the theory that the customer is not going to think they’re getting the kind of advice we meant to cover when they’re just one of many receiving a mass publication.

This again also was in part responsive to some of this foolishness we were seeing in some of the [lobbyists’] talking points on [Capitol] Hill that said under the Department of Labor rule, Suze Orman [and Jim Cramer from the] Mad Money show were going to be fiduciaries. Again, not true. It was never true, but we literally wrote it into the definition and we even gave a shout-out to Suze Orman and the Mad Money guy in the preamble—which to my mind is unprecedented. I can’t think of another rule where we’ve done anything like that—had a shout-out to celebrities.

Disclosure

Attendee: Can you separate compensation received by the [home office] from third-party managers from an advisor’s level-fee compensation? Can you merely disclose that away and make that a clean transaction? Or is that still problematic?

Blass: I think the rule allows the house, the firm to receive variable compensation. I think the challenge many of the broker-dealers are going to have—they are talking about this and I don’t think it’s settled as far as I can tell—is that after the fact, if it just so happens that dealer A sells more of the funds that pay the most than the funds that pay the least, it doesn’t look right. And will the plaintiffs’ bar use that delta to bring litigation against that dealer, even though the rule actually permits it?

Lawsuits

Blass: The Department has turned over most enforcement of this fiduciary rule to the plaintiffs’ bar—the lawyers for investors. Why is that an issue? Congress didn’t give the Department of Labor enforcement authority for the rule as it’s applied to IRAs. The Department can’t go and inspect what you’re doing and be sure that you’re complying with the rule. They instead turned it over to the plaintiffs’ bar by creating the best interest contract that Tim [Hauser] talked about.

Future Guidance

Hauser: There are still issues and questions people have about how to operationalize the various requirements and we very much encourage people to come in and talk to us and to raise issues. I do expect we’ll be starting to push out guidance documents shortly.

I sometimes hear from people that their clients aren’t coming in to talk to us because they’re afraid of what answer they might get on some of these issues. I have to say I think that’s a very short-sighted and foolish attitude. You should not be spending enormous amounts of money building compliance systems if you have questions about how to comply. You shouldn’t be afraid to ask the questions and get the answer. Better you get the answer than you spend that money only to find out that we’re not happy with it and we don’t think it complies.

Grandfathering

Attendee: Do you know if there’s going to be any kind of grandfathering?

Blass: There’s a grandfathering provision, specifically written for the scenario that allows the firm to give continued hold recommendations where the firm’s compensation doesn’t change. So for that A share client you can continue to tell the client, stay tight. Don’t sell, stay invested. But there are some complications. What if they send in a check to the mutual fund and buy something new? Is that part of a continued hold? Should we think of it as reinvested dividend or something like that? It’s very complicated. So while there is a grandfathering provision, ultimately it may not be the silver bullet that we would have hoped.

Investment Advice under the New Rule

Hauser: Generally speaking, if you get a fee and you make a recommendation that’s individualized or specifically directed to a retirement investor—an IRA or a plan participant—you’re going to be a fiduciary unless you’re subject to a carve-out.

[The DOL’s new definition] applies not just to decisions to purchase or sell a particular asset but also to advice to somebody to roll their money out of a plan, to take a distribution from a retirement plan.

Blass: The key to understanding the whole rule is a combination of two things. One, are you making a recommendation. And two, do you get paid in a way that could, after the fact, be viewed as conflicted.

Hauser: During the run-up to the final rule we saw in talking points on [Capitol] Hill and in all kinds of PowerPoints that all of the [lobbyists] in this town prepare, that would suggest that you can’t even talk to somebody about their investment product...
without it being a recommendation or without being treated as fiduciary. Not true.

**Investment Education vs. Investment Advice**

**Hauser:** It’s not just a description of the attributes of an investment or its historical performance or how it compares to other things, [investment advice] really is the sort of communication that a reasonable investor would view as a suggestion to take a particular action, pursue a particular investment strategy, and invest in a particular asset or from a particular menu of assets. It’s an objective test. It’s what would that reasonable person think.

You can describe to your heart’s content all the objective traits of a particular investment. You can describe its historical performance, its fees, what’s going to happen if you try to pull your money out, how it compares historically with other investments.

Similarly, we specifically contemplate that you can give certain examples of hypothetical asset allocation guidance where you, for example, describe the sorts of asset allocations that people in a certain age range, with a certain risk profile, et cetera, invest in over time as long as you’re not tying that to a particular product recommendation. Even then we make an exception for plans. We let people give the asset allocation guidance and use the plan investment lineup as illustrations of what falls in the different asset allocation requirements as long as you let the customer know all of the things on the plan lineup that fall within that [asset class].

**Level-Fee Advisors**

**Hauser:** There’s also a special, more streamlined provision for people who have a very big conflict on the initial transaction with the customer, but then on a going-forward basis really don’t have a conflict of the sort that causes our prohibited transaction rules to kick in. That mainly occurs in the rollover context, when somebody is looking at a customer, say, who has $1 million to roll over, [the advisor is] going to get an advisory fee on an ongoing basis if the advisor talks the person into rolling that money over to them. They’re getting nothing if they don’t talk to them.

**Blass:** If you get a fee, and your compensation purely comes from that fee, meaning an asset-based fee, or a financial planner, one-time-a-year type fee, you don’t have much of a problem under this rule.

**Reasonable Compensation**

**Blass:** There’s a [requirement] within the best interest contract exemption that the compensation provided has to be reasonable. What’s reasonable compensation? It’s quite possible the plaintiffs’ bar will latch onto that [issue] at some future time.

**Rollover Advice**

**Attendee:** Can I still do a financial plan that tells a customer it would be in your best interest to roll over your 401(k) to an IRA, but I don’t recommend particular investments?

**Hauser:** If you recommend to somebody that they roll their money out of a plan, that’s going to count as fiduciary advice. You do need to be prudent in making that recommendation and you need to be attentive to whether or not that’s a recommendation that’s in the customer’s interest.

**Timeline**

**Blass:** So where are things right now? We have a rule adopted by the Department that is set to go into effect on April 10, 2017. [The rest of the rule] goes into compliance on January 1, 2018.

[And] we have litigation. At least three different groups have sued the Department of Labor over this rule, basically asking the courts to vacate the rule or to send it back to the Department to start over. … What does that mean? It means we’re going to see some court decisions between now and April that are going to tell us if [the rule] is going to be effective or not.

As industry analysts navigate nuances of the DOL conflict of interest rule, IMCA is focused on delivering relevant content and expert analysis. To access this content, visit http://www.imca.org/pages/Focus-Fiduciary.

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