

Best Interest Contract Exemption: Interesting Angles on the DOL's Fiduciary Rule #15

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This is fifteenth article about interesting observations “hidden” in the fiduciary regulation and the exemptions.

In my last post, I said that the prudent process requirement would apply to many, but not all, advisers. This article explains that statement.

ERISA does not apply to individual IRAs (but does apply to SEP and SIMPLE IRAs). As a result, ERISA's prudent man rule does not govern the conduct of advisers when providing investment advice to individual IRAs.

However, when the Best Interest Contract Exemption (BICE) applies to “conflicted” advice on April 10, 2017, those advisers will need to, among other things, satisfy the Best Interest standard of care (which is, in its essence, a combination of ERISA's prudent man rule and duty of loyalty). In effect, conflicted advisers will be bootstrapped into a prudent process requirement. (As background, a “conflicted” fiduciary adviser is one with a conflict of interest, e.g., the advice can result in higher compensation or payments from third parties – such as 12b-1 fees or where proprietary investments are used.)

However, a pure level fee adviser does not have any financial conflicts and therefore will not need to use BICE. (A “pure level fee adviser” is one who charges a level fee, e.g., one percent per year, and neither the adviser, his supervisory entity nor any

affiliated or related party receives any money or financial benefit on top of that fee.) Since a pure level fee, or non-conflicted, adviser won't commit a prohibited transaction and therefore won't need an exemption, that adviser will not be bound by the best interest standard for investment advice to individual IRAs. Instead, the adviser will only be subject to the conduct standards in the securities laws.

As a result, pure level fee advisers for IRAs won't be affected by the new fiduciary rules . . . with a couple of notable exceptions. The biggest of those exceptions is a recommendation to a plan participant to take a distribution and roll over to an IRA with the adviser. But that is a subject for a future article.

For the moment, though, let me leave you with a positive thought. If you are a pure level fee adviser, your existing IRA clients, and your services to those clients, will not be affected by the new rules.

The views expressed in this article are the views of Fred Reish, and do not necessarily reflect the views of Drinker Biddle & Reath.

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