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Level Fee Fiduciary: Interesting Angles on DOL's Fiduciary Rule #17

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Much attention has been given to the new fiduciary rules (applicable April 10, 2017) for recommending distributions from retirement plans and rollovers to IRAs. Where the adviser making the recommendation is a "Level Fee Fiduciary," the new requirements are sometimes referred to as "BICE-lite," because only certain of the requirements of the Best Interest Contract Exemption must be satisfied. However, where the adviser will not be a Level Fee Fiduciary, the adviser and his Financial Institution (e.g., broker-dealer or RIA) must comply with all of the BICE conditions.

However, not much attention has been paid to the other BICE-lite recommendations—a recommendation to transfer an IRA from another adviser and a recommendation to change from a transaction-based account to a fee-based account. This article discusses the first of those two . . . a recommendation to transfer an IRA.

The starting point is to know that the fiduciary regulation says that a recommendation to transfer an IRA is a fiduciary act. More specifically, it says that fiduciary acts include:

"...recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made."

The next step is to understand that the recommendation will almost necessarily result in a financial conflict of interest, which the Internal Revenue Code refers to as a prohibited transaction. In other words, a receipt of compensation as a result of the recommendation is prohibited. Fortunately, though, there is an exception, which the Code calls an exemption, that if its conditions are satisfied, allows the adviser to receive compensation on a transferred IRA. The exemption is BICE.

BICE-lite has several requirements, including that the adviser receive only reasonable compensation, that no misleading statements be made, and that the recommendation to transfer the IRA satisfy the best interest standard of care. However, the most demanding requirement is that the adviser document why the recommendation is in the best interest of the investor. (More accurately, BICE-lite requires that the Financial Institution—for example, the broker-dealer or RIA firm—document why the recommendation is in the best interest of the investor.) To quote from the exemption:

"...in the case of a recommendation to rollover from another IRA or to switch from a commission-based account to a level fee arrangement, the Level Fee Fiduciary documents the reasons that the arrangement is considered to be in the Best Interest of the Retirement Investor, including, specifically, the services that will be provided for the fee."

In doing the analysis to determine whether the recommendation is in the IRA owner's best interest, BICE specifically requires that the adviser consider the services offered in the existing IRA and the services that the adviser will offer in the new IRA. In that regard, it would be risky to document the "best interest" recommendation without some specific consideration of the services. However, that is not the end of the story. The rule more generally requires that the adviser act in the best interest of the IRA owner, which could involve other considerations. For example, the general rule for a prudent process is that the fiduciary adviser consider the "relevant" factors. (Those are the factors that a hypothetical knowledgeable person would want to review in

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making the decision.) The best interest standard also requires that the adviser consider the needs, circumstances, objectives and risk tolerance of the IRA owner.

So, what does all of that mean? While there could be a number of ways of satisfying the requirements, I believe that one way—and probably a good way—is to have procedures, forms and services for gathering and evaluating the information and for documenting why the analysis of that information results in a recommendation that the transfer (or not transferring) is in the best interest of the IRA owner.

Also, while BICE does not specifically discuss the analysis that needs to be made if the adviser will not be providing “Level Fee Fiduciary” advice to the IRA, the logical conclusion would be that the requirements are the same (in addition to satisfying the other conditions of BICE that do not apply to Level Fee Fiduciary advice).

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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