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Retirement Plan Documentation and Prudent Recommendation: Interesting Angles on the DOL's Fiduciary Rule #21

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This is twenty-first article covering interesting observations about the fiduciary rule and exemptions.

While most of the requirements in the new fiduciary rule and exemptions are "old news" for retirement plan advisers, they may require significant changes for advisers to IRAs. For example, ERISA's prudent man rule and the new best interest standard of care both require that fiduciary advisers (which will include virtually all advisers to plans, participants and IRA owners when the rules are applicable on April 10, 2017) engage in a prudent process to develop recommendations. Using variable annuities as an example, here are some of the important steps in a prudent process: evaluating whether the insurance company will be able to satisfy its commitments in the future (based on today's information); a determination of whether the expenses for the variable annuity contract, including expenses of the underlying mutual funds, are reasonable; and determining what portion of an investor's financial assets should be allocated to the annuity. To do that job, fiduciary advisers will need to gather the information necessary to make an appropriate recommendation and then prudently evaluate that information. Stated slightly differently, there is a duty to investigate. The DOL described that responsibility in the preamble to the best interest contract exemption (BICE):

> *This is not to suggest that the ERISA section 404 prudence standard or Best Interest standard, are solely procedural standards. Thus, the prudence standard, as incorporated in the Best Interest standard, is an objective standard of care that requires investment advice fiduciaries to* ***investigate*** *and* ***evaluate*** *investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would.*

Here are two more thoughts on that. First, the DOL has historically taken the position that a prudent process for advice to retirement plans must be documented. That could easily be extended to advice to IRAs as well. In fact, there is a specific documentation retention requirement under BICE. Second, there is an argument that, if a fiduciary adviser cannot obtain – through the investigation – enough information to formulate a prudent recommendation, the adviser needs to abstain from making a recommendation. One obvious example is where an adviser is developing a recommendation to a participant to take a distribution and roll it over into an IRA. In that situation, BICE specifically requires that the adviser consider the investments, expenses and services in the plan, and then compare them to the investments, expenses and services in the proposed IRA. The best interest analysis must be documented by the adviser. If the adviser cannot obtain adequate information about the investments, expenses and/or services in the plan, it would be difficult, if not impossible, to make and document that analysis.

As I said earlier in this article, for a retirement plan perspective, this is not a new requirement. Instead, these are long standing rules. However, for IRAs the fiduciary guidance will, in many cases, require changes in processes and practices. Since IRAs are smaller than plans, and therefore can't afford to pay as much money for services, advisers and their supervisory entities need to develop efficient processes for gathering information and performing the analysis. I suspect this will lead to new programs and computer-based systems.

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

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