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The Last Word: The Fiduciary Rule Applies on June 9- Interesting Angles on the DOL's Fiduciary Rule #48

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This is a 48th article about interesting observations concerning the Department of Labor's fiduciary rule and exemptions. These articles also cover the DOL's FAQs interpreting the regulation and exemptions and related developments in the securities laws.

The Department of Labor has announced that it will not further delay the application of the fiduciary rule. As a result, the new fiduciary definition and the "transition" exemptions will apply to investment and insurance advice to plans, participants and IRA owners ("Retirement Investors" of "qualified accounts") on June 9.

When the DOL announced its decision, it also issued additional guidance, in the form of FAQs and a non-enforcement policy.

For the most part, the **FAQs** were helpful.

For example, they clarify that certain types of information and conversation are educational, rather than fiduciary. However, FAQ #6 appears to have increased the compliance burden on "Financial Institutions," such as broker-dealers, RIAs, banks and insurance companies. While the general rule for conflicted advice is that the Financial Institution and adviser must adhere to the Impartial Conduct Standards (see below), that Q&A said that Financial Institutions have additional responsibilities to manage conflicts so that variable compensation does not influence advisers to make recommendations that are not in the best interest of Retirement Investors.

The non-enforcement policy (**Field Assistance Bulletin [FAB] 2017-02**) provides that the DOL will not enforce the fiduciary standard or the exemptions during the transition period (from June 9 to December 31), so long as the Financial Institution is making diligent and good faith efforts to comply. However, the failure to make diligent and good faith efforts to comply will result in the loss of the benefit of the non-enforcement policy. Also, the IRS and Treasury will not enforce the fiduciary advice prohibited transactions during the transition period, so long as the requirements of the DOL non-enforcement policy are met.

What does this mean?

It means that, beginning on June 9, recommendations of investment or insurance products or services to qualified accounts must be evaluated two ways.

1. Is the recommendation prudent and loyal?

Recommendations to ERISA-governed retirement plans and participants (including rollover recommendations) are subject to ERISA's prudent man rule and duty of loyalty. ERISA protections apply and claims can be asserted based on breaches of the fiduciary rule.

However, IRAs (other than SEPs and SIMPLEs) are not governed by ERISA and, therefore, the fiduciary standard does not automatically apply (but see the prohibited transactions discussion below).

2. Does the recommendation result in a prohibited transaction and, if so, are the conditions of an exemption

satisfied?

Simply stated, any fiduciary recommendation that results in a payment from a third party (such as a mutual fund or an insurance company) or increases the compensation of the adviser or Financial Institution is a prohibited transaction. As a result, an exemption will be needed. The two most common exemptions are 84-24 (which applies to annuities and insurance products) and BICE (which applies to all types of investments and services, including insurance products). Both require that the adviser adhere to the Impartial Conduct Standards. (However, 84-24 has other requirements, including disclosure compensation and written approval by the Retirement Investor.)

This article focuses on transition BICE, since that exemption will be used in most cases.

As explained above, BICE requires that the Financial Institution and adviser adhere to the Impartial Conduct Standards. There are three such standards:

- The Best Interest standard of care (which is, in its essence, a combination of ERISA's prudent man rule and duty of loyalty).
- The Financial Institution and the adviser can receive no more than reasonable compensation.
- The adviser and Financial Institution cannot make materially misleading statements.

Since one of the conditions of BICE is that the Financial Institution and the adviser adhere to the Best Interest standard of care, the exemption effectively imposes a fiduciary standard of care. In other words, if the Financial Institution and adviser do not satisfy the fiduciary standard, the exemption will be lost and any compensation paid to the Financial Institution and adviser must be restored to the investor's account. As a result, even though IRAs are not subject to ERISA's prudent man rule, the exemption has the same effect as if advice to IRAs were subject to ERISA.

Financial Institutions (including broker-dealers, RIAs, banks and trust companies, and insurance companies) need to institute policies and procedures for compliance with these rules, including training of their representatives about how to satisfy the duties of prudence and loyalty.

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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