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The Fiduciary Rule and Exemptions: How Long Will Our Transition Be?: Interesting Angles on the DOL's Fiduciary Rule #52

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This is 52nd 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 fiduciary regulation that dramatically expanded the definition of fiduciary investment advice went into effect on June 9. As a result, virtually all advisers to plans, participants and IRAs are now fiduciaries, or will be as soon as they make the next investment recommendation to one of those qualified accounts. At the same time—June 9, the "transition" transaction exemptions were effective.

If viewed out of context, the fiduciary regulation, as currently written, will continue in effect for years to come. However, the transition exemptions will only apply until December 31, when the full exemptions will apply, with their many and demanding requirements. But, that's out of context.

When viewed in context, the situation looks much different. For example, the Department of Labor will be publishing the Request for Information asking, among other things, about the potential impact of the fiduciary rule and changes that may be needed. Not to be outdone, the SEC has asked a series of questions about a possible fiduciary standard for all investment advice within its purview. The SEC and DOL have indicated that they will be working together to develop their respective fiduciary definitions (and, in the case of the SEC, a fiduciary standard of care) or, perhaps, they will develop an identical definition of fiduciary advice.

In addition, the DOL has asked for input concerning the structure and requirements of the prohibited transaction exemptions, including the two exemptions that impact most advisers . . . the Best Interest Contract Exemption (BICE) and Prohibited Transaction Exemption 84-24. Those exemptions are exceptions from the prohibited transaction rules, but come with strings attached. On the other hand, the SEC does not have a statutory basis for adopting similar prohibited transactions or, for that matter, exemptions from prohibited transactions. Because of those differences, it is likely that, even if the two regulatory bodies adopt a common definition of fiduciary advice (and a common standard of care), their treatment of conflicts of interest will vary.

As mentioned earlier, the transition period for the DOL's exemptions is only until December 31. And, if I haven't made clear, there isn't any transition period for the fiduciary regulation; it is in full force and effect.

What does this mean in terms of timing? My view is that it will be virtually impossible for the DOL and SEC to collaborate on the development of a common, or at least compatible, definition of fiduciary advice and standard of care before December 31. Because of the Administrative Procedures Act, the final regulation would need to be published in early November, which means a proposed regulation would probably need to be published in early to mid-September. To hit those deadlines, the two regulatory bodies would need to develop a proposed regulation within that time frame. That seems almost impossible —partially because of the need for coordination and partially because the SEC hasn't previously proposed guidance on these issues. In other words, even though the DOL has a basis for revising its regulation and exemptions, the SEC doesn't.

As a result, my view is that the DOL will extend the transition period, perhaps for as much as a year. That would allow time for the two agencies to work together in a thoughtful manner and at a reasonable pace.

That is both good news and bad news to the regulated community, that is, for financial services companies. It is good news because it allows more time to fully adapt to the new rules and because the compliance requirements for the transition exemptions are not that difficult or burdensome. It is bad news—at least for those firms that strenuously object to the fiduciary rule, because, by a year from now, financial services companies will be in compliance with the fiduciary standard and fiduciary advice will have become the standard course of business. The training will have been done, products will have been developed, solutions will have been implemented, and so on. In other words, the fiduciary standard will have become the norm. As a result, it may be more difficult to change the fiduciary definition and standard of care. On the other hand, there will still be significant changes to the exemptions and, particularly, to the Best Interest Contract Exemption.

One way or another, I expect that we will hear, in August or September, that the transition period is being extended.

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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