Notice to Financial Advisers: State Regulators Are Enforcing the DOL Fiduciary Rule

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Financial institutions and advisers that manage retirement plan assets and are subject to the regulations of the Department of Labor ("DOL") under the Employee Retirement Income Security Act of 1974, as amended, ("ERISA") regarding fiduciary duties (the "Fiduciary Rule") may also be subject to state law violations for failure to comply with the Fiduciary Rule. The Enforcement Section of the Massachusetts Division of the Office of the Secretary of the Commonwealth (the "Massachusetts Enforcement Section") filed an administrative complaint (the "Complaint") on February 15, 2018 against Scottrade, Inc. ("Scottrade") claiming violations of a Massachusetts statute due to alleged violations of the Fiduciary Rule. Given the relief requested in the Complaint and the potential precedent for other states, this action has the potential to be significant, not only for Scottrade, but for other advisers and financial institutions.

Current Status of the Fiduciary Rule
In November 2017, the DOL announced an extension of the applicability date of certain prohibited transaction exemptions under the Fiduciary Rule from January 1, 2018 to July 1, 2019. However, the extension did not apply to the Fiduciary Rule’s “impartial conduct standards” in dealing with retirement investors. The impartial conduct standards require advisers and financial institutions to give advice that is in the “best interest” of the retirement investor, charge no more than reasonable compensation, and refrain from making misleading statements.

The DOL’s November 2017 announcement also addressed the extension of its temporary enforcement policy through July 1, 2019. Pursuant to the temporary enforcement policy, the DOL will not to pursue claims against fiduciaries who are working diligently and in good faith to comply with the Fiduciary Rule and related exemptions or treat those fiduciaries as being in violation of the Fiduciary Rule and related exemptions.

Contents of the Complaint and Relief Requested

The Complaint alleges that, although Scottrade added new policies to comply with the impartial conduct standards, Scottrade expanded the scale and scope of the sales practices that the new policies were designed to curtail. The new policies stated that “the firm does not use or rely upon . . . contests . . . or other actions or incentives that are intended or reasonably expected to cause associates to make recommendations that are not in the best interests of Retirement Account clients or prospective Retirement Account clients.” Nevertheless, Scottrade launched two sales contests that ran in violation of these new policies that were designed to ensure compliance with the Fiduciary Rule. One of the contests placed explicit emphasis on generating retirement assets, which are covered by the Fiduciary Rule. The Complaint notes that Scottrade “failed to take any meaningful steps to remove retirement assets from the scope of the contests or ensure compliance with the Fiduciary Rule.”

Accordingly, the Complaint charges that Scottrade, by “knowingly violating its own internal policies related to the Fiduciary Rule” and failing to act in good faith to comply with the Fiduciary Rule, violated Section 204(a)(2)(G) of the Massachusetts Uniform Securities Act and the regulations thereunder (the “Act”). The section of the Act authorizes the imposition of an administrative fine, the suspension or revocation of registration or any other appropriate action if an investment adviser has “engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.” The Complaint further alleges that Scottrade violated Section 204(a)(2)(J) of the Act because Scottrade “failed reasonably to supervise . . . investment adviser representatives . . . to assure compliance with this chapter [of the Act].”

The relief requested in the Complaint is extensive. The Massachusetts Enforcement Section requests that an order be entered that, among other things, requires Scottrade to cease and desist from further conduct in violation of the Act, censures Scottrade, compels Scottrade to disgorge all profits and other remuneration from the alleged violation, and imposes an administrative fine on Scottrade.

Takeaways from the Complaint
The Complaint puts Massachusetts advisers and financial institutions that manage retirement plan assets on notice that state regulators are monitoring compliance with the impartial conduct standards and that the regulators will take action under Massachusetts law to stop conduct that they view as non-compliant. The Complaint should also serve as a warning to all advisers and financial institutions, as regulators in other states may begin to take actions under state law similar to that taken by the Massachusetts Enforcement Section. Any such actions will be pursuant to state law because the DOL, and not the states, has the authority to enforce ERISA.

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