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The Fiduciary Rule: What's Next (Part 2)?: Interesting Angles on the DOL's Fiduciary Rule #86

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Drinker Biddle

Article By Drinker Biddle & Reath LLP
Fred ReishFredReish.com

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This is my 86th article about interesting observations concerning the Department of Labor's (DOL) fiduciary rule and exemptions. These articles also cover the DOL's FAQs interpreting the regulation and exemptions and related developments in the securities laws.

This is the second of my four-part series on the critical questions raised by the 5th Circuit Court of Appeals decision to "vacate," or throw out, the Fiduciary Rule. My last post, Angles #85, introduced the questions:

- *Who is a fiduciary?*
- *What is the fiduciary standard of care?*
- *How will conflicts of interest be treated under the new rules?*

This post discusses the first question: "Who is a fiduciary?"

Assuming that the 5th Circuit Court of Appeals decision is the final word, the old 5-part fiduciary test will automatically be reinstated. That means that, in order for an advisor to be a fiduciary, all 5 requirements in the regulation must be satisfied. (Keep in mind, though, that this only applies to non-discretionary investment advice. Where an advisor has discretion, the advisor is a fiduciary under a different rule.) The 5-part test is that the advisor must:

- Make investment or insurance recommendations for compensation;
- Provide the advice on a regular basis;
- Have a mutual understanding with the retirement investor that:
  - The advice will serve as a primary basis for investment decisions; and
  - The advice will be individualized and based on the particular needs of the retirement investor.

The definition covers investment and insurance advice to "retirement investors," in other words, to plans, participants and IRA owners.

Let's look at each of the 5 parts of the definition.

With regard to the first requirement—recommendations for compensation, it appears that virtually all recommendations to retirement investors would satisfy that requirement, if the advisor (or his supervisory entity, *e.g.*, broker-dealer or RIA) will receive compensation, directly or indirectly, when the recommendation is accepted.

The second requirement—that the advice be given on a regular basis—is a more interesting issue and will vary from case to case. Let me explain. Where an advisor regularly meets with a retirement investor and updates the advice (*e.g.*, asset allocation or investments), it is likely that the requirement is satisfied. That would apply, for example, to an advisor for a 401(k) plan who meets with a plan sponsor on a quarterly or annual basis. Similarly, it might apply where an advisor recommends an individual variable annuity or individual fixed indexed annuity to an IRA owner, with the contemplation that they will meet periodically to review the investments, indexes, etc. However, it would not apply to a one-time sale, where the advisor sells an investment or insurance product and does not provide any ongoing advice.

The third requirement is that there be a mutual understanding, arrangement or agreement, between the

retirement investor and the advisor that the advice satisfies the 4th and 5th requirements (below). While some people believe that refers to a subjective understanding in the minds of the advisor and the investor, the DOL will probably use the standard of what a reasonable third party would conclude based on the communications between the advisor and the investor.

The fourth requirement is that the recommendations be understood to be a primary basis for making investment or insurance decisions. It is frequently described incorrectly as "the" primary basis. However, if you look at the wording of the regulation (and if you look back into the history of the regulation), the recommendation simply has to be one of the primary bases. In other words, it doesn't have to be the sole, or even the predominant, basis for making decisions. As a result, it seems like this condition would usually be satisfied, because recommendations are typically made for the purpose of being seriously considered by an investor.

The last requirement is that there is a mutual understanding that the advice is individualized and based on the particular needs of the retirement investor. While the expectation, and perhaps the understanding in most cases, is that investment recommendation is designed for the particular investor, there are cases where communications about investments may not be fiduciary advice. For example, if a broker-dealer has a list of preferred mutual funds or stocks, the list would likely be viewed as generic and, therefore, as not being intended for any particular investor. However, if that list was narrowed by an advisor and then presented to an investor, that would probably tip the scales in the other direction.

The moral to this story is that, even if the 5th Circuit decision becomes the final word on the fiduciary rule, many—if not most—advisors to retirement plans will still be fiduciaries.

On the other hand, it may make a difference for IRAs. For example, RIAs may generally be fiduciaries, even in the IRA world, because they provide investment services on a regular—or ongoing—basis and there is usually an understanding that the advice is individualized. In addition, many RIAs provide discretionary investment management services for IRAs, which is automatically fiduciary advice.

However, insurance agents and representatives of broker-dealers may, in some cases, make recommendations on an isolated basis, and there may be an understanding that it is a sale, where the advisor will not be providing continuous services. But, where an insurance agent or a representative of a broker-dealer satisfies the 5-part test, the agent/advisor will be a fiduciary.

The fiduciary standard of care will be discussed in the next article, Angles #87.

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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