

THE NATIONAL LAW REVIEW

The Fiduciary Rule: What's Next (Part 4)? : Interesting Angles on the DOL's Fiduciary Rule #88

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This is my 88th 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 fourth 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. The first article ([Angles #85](#)) discussed the general legal issues created by the 5th Circuit decision to vacate the Fiduciary Rule. Then, [Angles #86](#) and [Angles #87](#) described fiduciary status for advisors under the "old" 5-part test and the standard of care for fiduciary advisors. This post discusses conflicts of interest for fiduciary advisors under ERISA and the Code—and what the future may hold.

The most difficult of the three issues is how the regulators will deal with conflicts of interest. That is true for two reasons. (This article does not discuss the SEC's new proposed Regulation Best Interest. That will be covered in future articles.)

The first is that the approach taken by the SEC and DOL in the past have been very different and are foundational to their thinking and, most likely, in how they may go forward. For example, the Department of Labor must comply with ERISA and Internal Revenue Code provisions on prohibited transactions for financial conflicts of interest. Generally speaking, fiduciary conflicts of interest are strictly prohibited under both ERISA and the Code. As a result, to permit financial conflicts of interest that result from fiduciary advice, the DOL must issue exceptions (called "exemptions") from the prohibited transaction rules. In order to do that, the DOL must determine that the conditions of the exemption are adequate to protect the interests of retirement investors. On the other hand, the SEC has, by and large, relied on disclosures to mitigate the potentially harmful effects of conflicts of interest. The SEC's expectation appears to be that, if conflicts are disclosed, investors will review those disclosures and make reasoned investment decisions.

The second reason is that, because of the prevalence of 401(k) and 403(b) plans, some relatively unsophisticated retirement investors are accumulating significant amounts of money. That raises the issue of whether disclosures of conflicts of interest, without more, will adequately protect those investors. Unfortunately, disclosure documents can be lengthy and complex, which may make it difficult for less sophisticated investors to appreciate the full significance of the disclosed conflicts.

The DOL may require more than just disclosures in their new prohibited transaction exemptions—which could be released, in proposed form, in the third quarter of this year.

Also, with regard to the SEC, Chairman Clayton has suggested that there should be a shorter (perhaps four pages), more transparent, disclosure document for the conflicts of interest of RIAs and broker-dealers. It remains to be seen whether something that short could adequately cover the material conflicts of interest with sufficient detail to fully inform an investor.

On April 18, 2018, the SEC proposed a new Regulation Best Interest and short disclosure documents. The proposed regulation would impose a best interest standard of care on broker-dealers.

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It is likely—at least in my view—that the DOL will follow suit and issue a proposed regulation re-defining fiduciary advice—perhaps more broadly than the new 5-part test, but less expansive than the Fiduciary Rule.

The DOL will also need to issue prohibited transaction exemptions. (Note: The BIC exemption provided relief for a number of common fiduciary prohibited transactions. However, the 5th Circuit also vacated the BIC exemption.) I suspect that the DOL exemptions will, for the most part, follow the SEC's disclosure requirements, but perhaps adding additional protections for retirement investors.

For both the SEC and DOL proposals, there will be comment periods following the issuance of the proposals. After receiving comments, the SEC and the DOL will develop their final guidance. Then, I suspect that both agencies will delay the applicability of the final rules—perhaps to January 1, 2020—to allow broker-dealers, RIAs and other service providers to make necessary changes.

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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