

# Guardrails, Not Straitjackets

---

## *Introducing the DOL's Proposed Fiduciary Rule*

The long awaited and heavily debated Fiduciary Rule Proposal was finally released by the Department of Labor on April 14, 2015. Coined the “Conflict of Interest rule”, the DOL originally proposed a new definition of fiduciary in 2010 which prompted a storm of industry opposition and was later withdrawn. Five years and many opinions later, they believe they have a solution that will appease the masses, but only time will tell.

*To learn more about the current definition of fiduciary and the events leading up to the current proposal, read [The Ever-Looming Fiduciary Rule](#).*

Since the signing of the Employee Retirement Income Security Act (ERISA) more than forty years ago, the pension landscape has changed significantly with a shift to participant-directed accounts. With this shift comes an increased need for impartial, professional investment advice. Understanding which investment advisors are fiduciaries can be tricky. Currently, only some advisors are required by ERISA to act solely in the best interest of their clients as fiduciaries. Conflicts of interest and sales focused strategies have plagued the industry and diminished the retirement accounts of many workers.

### **Redefining Fiduciary**

The proposed fiduciary rule aims to increase consumer protections while taking into consideration the qualms and criticism presented by the industry during the 2010 proposal's comment period.

If adopted, the DOL's proposed definition of fiduciary would classify a person as an ERISA fiduciary if they provide any advice or recommendations regarding investments, investment management, appraisal of investments, or selection of an investment manager/advisor to an employee benefit plan, plan fiduciary, participant, beneficiary, IRA, or IRA owner. This advice is provided for a fee or other form of compensation pursuant to a verbal or written agreement that the advice is personalized to the recipient and to be used in making investment decisions. There are several exceptions or “carve-outs” to the rule which are detailed in the proposal.

A significant difference between this proposal and the current rule, which uses a five-part test to determine fiduciary status, is that the proposed rule does not require that the advice be provided on a regular basis. Additionally, the current rule only includes advice used as the primary basis for investment decision where the proposed rule covers any advice provided for consideration in making investment decisions.

## Redefining Fiduciary

<b>.....&gt; If you provide any advice or recommendations regarding...</b>	Investments Investment Management Appraisal of Investments Selection of a Investment Manager or Adviser						
<b>.....&gt; to any of the these...</b>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">Employee Benefit Plan</td> <td style="width: 50%;">Plan Fiduciary</td> </tr> <tr> <td>Participant</td> <td>Beneficiary</td> </tr> <tr> <td>IRA</td> <td>IRA Owner</td> </tr> </table>	Employee Benefit Plan	Plan Fiduciary	Participant	Beneficiary	IRA	IRA Owner
Employee Benefit Plan	Plan Fiduciary						
Participant	Beneficiary						
IRA	IRA Owner						
<b>.....&gt; for a fee or other type of compensation, whether direct or indirect...</b>							
<b>.....&gt; pursuant to an agreement, arrangement, or understanding that the advice is individualized to the recipient and given for consideration in making investment related decisions...</b>							
<input checked="" type="checkbox"/> <i>You are a Fiduciary</i>							

### Compensation & Prohibited Transactions

Prior to the newest proposal, much of the criticism received conveyed that a stricter fiduciary rule would harm advisors by banning typical forms of compensation integral to their businesses and prohibiting common transactions. In addition to the Fiduciary Rule, the Department has proposed exemptions to the prohibited transaction rules in order to “preserve the ability to engage in common fee arrangements, while protecting plan participants, beneficiaries and IRA owners from abusive practices that may result from conflicts of interest”.<sup>1</sup> The proposed exception would allow advisory firms to continue receiving compensation through common fee arrangements such as commissions and revenue sharing but requires the firm and advisor “to contractually acknowledge fiduciary status, commit to adhere to basic standards of impartial conduct, adopt policies and procedures reasonably designed to minimize the harmful impact of conflicts of interest, and disclose basic information on their conflicts of interest and on the cost of their advice”.<sup>1</sup> As an additional protection for investors/participants, the exemption would be void if the contract contains provisions limiting the liability of the advisor for a breach in contract terms or fiduciary duty. Firms which limit the products their advisors can recommend based on income from a third party or proprietary fund must provide written notice to the

<sup>1</sup> Definition of the Term “Fiduciary”; Conflict of Interest Rule-Retirement Investment Advice. Federal Register. Employee Benefits Security Administration. 20 April 2015.

client of the limitation and disclosure that the limitation will not prevent the advisor from acting solely in the client's best interest.

### **The Bottom Line**

The bottom line is that this proposal provides an extra layer of protection for investors. As Labor Secretary, Thomas Perez explains, "This rule is intended to provide guardrails but not straitjackets, so we know consumers are getting advice that is in their best interest."<sup>2</sup>

Under current law, many advisors are not legally bound to act solely in the best interest of participants and need only to provide advice that is suitable to the client's needs. Many advisors that are not legally bound by fiduciary standards do still act in the best interest of participants. However, others have chosen to profit from their clients and advise in the best interest of their balance sheet instead of the client. Conflicts of interest and sales strategies have been allowed to pollute the industry and diminish the hard earned savings of many participants. This proposal intends to provide a solution by requiring any advisor that provides individualized investment advice for a fee to act solely in the best interest of the person or plan that they are advising. By redefining advisors as fiduciaries, the Department of Labor is redefining the marketplace. Will this change be for the better? Only time will tell.

*The Proposed Rulemaking entitled ["Definition of the Term "Fiduciary": Conflict of Interest Rule-Retirement Investment Advice"](#) was published in the Federal Register by the Employee Benefits Security Administration of the DOL on April 20, 2015. The initial comment period for this proposal ends on July 6, 2015.*

---

<sup>2</sup> Ackerman, Andrew. U.S. Tightens Broker Standards for Retirement Advice. The Wall Street Journal. 14 April 2015.