The New Fiduciary Rule: What It Means To Plan Sponsors

By Ary Rosenbaum, Esq.

If you're a retirement plan sponsor and, unless you've been living under a rock, you've probably heard about the Department of Labor's (DOL) attempt to change the definition of fiduciary. What you probably don't know is how that change may affect your retirement plan. Now that the DOL has published a final rule that has redefined what a fiduciary is, it's important to understand how the change could impact your plan. So this article is about the new DOL fiduciary rule and how it can impact your plan.

What is a fiduciary and why does it matter?

A fiduciary duty is the highest standard of care at either equity or law. A fiduciary is expected to be extremely loyal to the person to whom he or she owes the duty of care (the "principal"), The fiduciary must not put his or her personal interests before the duty, and must not profit from their position as a fiduciary, unless the principal consents. As a plan fiduciary, a financial advisor must put the needs of the plan sponsors first and avoid any transactions that may result in a prohibited transaction (which may be as innocuous as soliciting IRS rollover accounts from former participants moving money from the Plan). The current DOL rule imposes a five-part test that must be satisfied in order for a person or an entity to be treated as a fiduciary by reason of rendering investment advice. Advice is considered "investment advice" if an adviser who does not have discretionary authority or control with respect to the purchase or sale of securities or other property for the plan:

1. renders advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property
2. on a regular basis
3. pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that
4. the advice will serve as a primary basis for investment decisions with respect to plan assets, and that
5. the advice will be individualized based on the particular needs of the plan.

The problem with the current rule

There are two types of professionals that can call themselves retirement plan financial advisors: stockbrokers and registered investment advisors (RIAs). Both of these types of retirement plan advisors have the same role. Their role is to work with the employers sponsoring these plans as plan sponsors and fiduciaries in managing the selection of plan investments, whether the investments are plan trustee or participant directed. This process, which is the fiduciary process, involves the development of an investment policy statement (IPS) which details how and why investment options are selected and replaced; the selection and review of investment options based on that IPS, and investment education to participants (if the plan intends to be a participant directed plan). The biggest difference between the two types of advisors is that the RIA is a plan fiduciary and the stockbroker is not. Based on the current rule, stockbrokers have been able to skirt from being considered a fiduciary. Brokers have been able to avoid being labeled a fiduciary by arguing that they only rendered advice from time to time and that their advice wasn't the primary basis for the plan's investments. Since stockbrokers sell financial products and owe no fiduciary duty of care to the plan, they can sell financial products that benefit themselves more than it benefits the plan sponsor. This is not to suggest that brokers are unscrupulous, it is just to note that they currently don't owe the same duty of care that an RIA owes to the plan sponsor. A broker can sell products to plan sponsors that just meet a suitability standard while the RIA has to offer products that are in the best interest of the plan sponsor client. That causes confusion in the marketplace, especially when plan sponsors such as yourselves don't know

what a fiduciary is and whether their advisor is actually a fiduciary.

The New, Final Rule

Under the Labor Department's new rule, any person, whether they are a broker, registered investment adviser, or insurance agent paid to give advice to a retirement plan sponsor is now considered a fiduciary. What does that really mean? It means that when a fiduciary provides advice, it must be in the "best interests" of the client. Being a fiduciary means not benefiting themselves; the client always comes first. It also means that advisors must manage and mitigate their conflicts of interest that may taint the advice they give plan participants. They also must abide by signing a "Best Interests Contract" (BIC) with their plan sponsor client, stipulating that the advisor will provide advice that is in the Best Interests of the client. If the advisor engages in a BIC agreement with the client, and follows its requirements, otherwise-prohibited transactions are now allowed. In addition, a principal transaction exemption will allow advisors serving as fiduciaries to sell their own proprietary products, such as a broker selling a mutual fund managed by their broker-dealer. As with the Best Interest Contract Exemption, this requires, among other things, that plan fiduciaries adhere to certain impartial conduct standards, including obligations to act in the customer's best interest, avoid misleading statements, and seek to obtain the best execution reasonably available under the circumstances for the transaction.

What happens if the advisor doesn't meet the standard

While anyone offering financial advice to a plan sponsor will be a fiduciary, that won't stop an advisor from trying to avoid that role. There will be some unscrupulous advisors who will try to contractually avoid their role as a fiduciary, but the DOL was already one step ahead. If advisers and firms don't adhere to the fiduciary standard, the DOL says that plan sponsors will be able to hold them accountable, either through a breach of contract claim or under the provisions of ERISA.

What will happen to your advisor?

With any change, there are always consequences, and there will be some unintended consequences with the implementation of a new fiduciary rule. If an RIA is currently handling your plan; nothing will change much since the RIA was already serving in a fiduciary role. If you were using a broker or insurance agent, there will be changes if the rule gets implemented. The advisor will have to meet that new fiduciary standard or partner up with an RIA who will serve as a fiduciary while they serve in a non-fiduciary role, or decide that they no longer want to handle retirement plans if they have to meet the fiduciary standard. So if you currently employ a broker or insurance agent to work on your plan, this might be a great time to ask them what they plan on doing with the new fiduciary rule and how they will try to meet that new standard.

What will happen to retirement plans

Many broker trade groups tried to portray that the sky would fall if a fiduciary rule is implemented. Well, that's just fear-mongering. What it really means is that it will cut back on some of the confusion in the marketplace as to the difference between brokers and RIAs because there will be one uniform standard. It will also likely lead to the use of more exchange traded funds and index mutual funds because brokers are less likely to push mutual funds just based in the trail they would receive since they no longer could rely on the less lenient suitability standard. It's also likely that the quality of financial advisors who handle retirement plans will improve as some of the less experienced and smaller players that serve as brokers decide to leave the business. As with retirement plan fee disclosure, it's more than likely that management fees charged by retirement plan advisors will decrease as well since this new fiduciary standard will likely be used to increase competition. Just tell Chicken Little that the sky will fall.

The Effective Date is far off

While you need to be concerned with this new fiduciary rule, you should note that the effective date of the rule is January 1, 2018, over a year and a half away. What does that mean? It means that we have a Presidential election in the interim and a change in the political party controlling the White House and/or Congress could impact whether the rule is changed and/or actually implemented.

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