

Fiduciary Rule Re-Proposal Compliance Costs Outweigh Benefits

On April 14 2015, the Department of Labor (DOL) released its long-awaited fiduciary rule re-proposal. It subjects retirement plan advisers to an ERISA fiduciary best interest standard and the prohibited transaction rules under Section 4975 of the Internal Revenue Code when providing investment advice to retirement plans, plan participants and IRA owners. Under its new and expanded definition of investment advice, recommendations on rollovers and other distribution options from a plan would now be considered a fiduciary act.

Plan advisers should be encouraged to help plan participants with rollovers

Plan fiduciaries are prohibited from gaining from a transaction involving plan assets. Unless compensation between the plan and the rollover IRA is level, advisers will only be allowed to work with participants on the rollover if they comply with a complex and cost-prohibitive exemption. These compliance rules are in addition to being required to adhere to a principles-based best interest standard.

An unworkable exemption is a prohibition

The new proposal includes a “Best Interest Contract” (BIC) exemption that purports to allow advisers to continue to receive all forms of compensation from third parties in connection with transactions involving retirement plans and IRAs. While DOL claims that this exemption is “broad, flexible, principles-based and can adapt to evolving business practices”, the exemption is prescriptive, onerous and unworkable. Financial institutions must notify DOL of the intention to rely on the exemption. After that initial notification, there are no less than **five separate disclosure requirements** embedded in the exemption, many of which are duplicative and unnecessary, including:

- **disclosure of any material conflicts of interest**, proprietary products, and notification of the right of investors to obtain complete fee information in the contract;
- a **“point of sale” disclosure** with an illustration of the total cost of investing in the asset over a 1, 5, and 10 year period (must project earnings to project fees which conflicts with securities laws);
- **an annual fee disclosure** that lists the purchases/sales of each asset and its price, direct/indirect fees retirement investors pays from assets, and the total adviser and financial institution compensation;
- **a public website, updated quarterly**, disclosing institutional and advisor fees *for each asset that has been purchased, held, or sold by any plan or IRA within the last year*; and
- maintenance of extensive data and other records for **six years** to be furnished to DOL upon request.

In **addition**, if investment options provided by the adviser are deemed “limited” the financial institution must disclose to the retirement investor that the “limited” options available might not satisfy the investor’s needs.

The proposed BIC exemption is unworkable. An unworkable exemption is in effect a prohibition. The rule, as proposed, will have a chilling effect on the ability of retirement plan advisers to work with plan participants on rollovers due to these unworkable requirements, ultimately limiting access to financial advice, especially for lower-income savers with smaller account balances.

Damaging consequences of the proposed rule

Example one: The cost prohibitive BIC exemption requirements apply to the plan adviser, *even if the 401(k) plan adviser's IRA is the most competitive product on the market*

Participant X has been working with Plan Adviser A for over 20 years, is about to retire, and the plan does not offer systematic withdrawals. Participant X wants to work with Advisor A on a rollover because he trusts her and the plan does not offer him an effective way to manage his money in retirement.

Plan Adviser A operates as an ERISA fiduciary to the plan and receives a level fee of 30 basis points for those services. Advisor A is proposing to charge Participant X a level fee of 75 basis points on the rollover IRA, because Participant X is going to require more comprehensive financial advisory services. A relative of Participant X has a casual friend who is an adviser – Adviser B. Adviser B wants to charge Participant X a level fee of 100 basis points on the rollover IRA.

Advisers A and B work with different financial institutions. Both Adviser A and B are fiduciary advisers and will comply with a best interest standard when providing advice to Participant X on his rollover IRA. ***Only Adviser A must comply with the cost prohibitive BIC exemption requirements.***

Example two: DOL's bias against transaction-based advice hurts buy and hold investors

Joe Investor is 65 years old and has \$200,000 in an IRA. He wants to buy a portfolio of income-producing stocks with the intention of holding those stocks until the required minimum distribution rules require liquidation. Joe will take distributions of the dividends. There will be no purchases or sales for the first five years. Based on reasonable assumptions, Joe will sell \$5,000 of stock in year six, with that amount increasing by \$200 per year over the next four years.

Adviser A will receive a 5% commission on the purchase and sale of the stock. Because Adviser A receives variable compensation, Adviser A is required to submit a point of sale that shows estimated 1, 5, and 10 year fees. Adviser B will receive a 1% annual advisory fee. Adviser B is not required to submit a point of sale disclosure since Advisor B's compensation does not vary with account activity.

A side-by-side comparison would show Joe Investor pays nearly 40% less in fees with the 5% commission than the 1% level fee after five years. DOL's bias against transaction-based advice could lead to substantially higher costs for this buy and hold investor.

Proposed Rule Limits Investment Education

Under current law, a service provider can name the specific funds available in the plan without becoming a fiduciary. Under the new proposal, mentioning specific fund names in any general communication to plan participants would be considered a fiduciary act. For example, naming a specific fund as an example of a "large cap growth fund" translates practical information to the participants such that they could make decisions. This limitation could make such education less useful for participants.