DOL DYNAMiQS™

Impact of the **Department of Labor Fiduciary Rule**

On April 6, 2016, the Department of Labor (DOL) issued the final fiduciary rule (Rule). The new Rule is a package of separate rules creating, amending or revoking existing law regarding retirement accounts. It applies to anyone meeting the DOL's criteria without regard to types of licenses or products used. The Rule is the most significant change in the law since the Employee Retirement Income Security Act of 1974 (ERISA) was passed. Whether your clients are ERISA plan sponsors, ERISA plan participants, ERISA account beneficiaries or IRA owners, this Rule will likely have a significant impact on your business—regardless of if you serve them as a registered representative or investment advisor.

The New Rule **At A Glance**

The new Rule contains numerous changes, but we have outlined some of its key highlights. The Rule:

- Creates a new definition of a fiduciary under ERISA
- Creates the Best Interest Contract Exemption (BICE)
- Still permits a digital or "robo" solution
- Provides new rules for IRAs
- Provides for grandfathering requirements for existing accounts
- Impacts how variable and indexed annuities must be sold
- Creates additional liability for fiduciaries and increases potential for litigation

Change in **Definition of a Fiduciary Under ERISA**

The Rule changes the definition of who is considered a fiduciary under ERISA. The new definition will cover a much broader group and include many registered representatives who are not currently considered fiduciaries under ERISA. This change will be effective April 10, 2017.

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The Fiduciary Test Under the New Rule

The test is based on whether you receive compensation (direct or indirect) for making a "recommendation" to an ERISA plan, participant, beneficiary or IRA owner. A recommendation has been broadly defined as a communication that could be viewed as advice to engage in or refrain from a course of action. The chart below will help you determine if you will be considered an ERISA fiduciary:

Initial Test

Have you received compensation (direct or indirect) for making a recommendation to an ERISA plan sponsor, ERISA plan participant, ERISA account beneficiary or IRA owner?

- ☐ Yes. You may be considered an ERISA fiduciary if you also meet one requirement from both Box A and Box B below:
- ☐ No. You are not considered an ERISA fiduciary.

Box A

You made a recommendation:

- ☐ As to whether to buy, hold, sell or exchange a security or other investment property;
- ☐ As to how securities or other investment property should be invested; or
- ☐ As to the management or the selection of other persons to provide investment advice or services (solicitors or TAMPs). This includes whether to maintain assets in an existing plan or to roll over, transfer, or distribute such assets to an IRA.

Box B

You directly or indirectly:

- ☐ Represented or acknowledged that you are acting as a fiduciary;
- ☐ Rendered the advice pursuant to a written or verbal agreement based on the particular needs of the recipient (such as an advisory contract); or
- ☐ Gave advice to a specific recipient regarding a particular investment or management decision.

Exceptions to the Rule

The following activities fall under a **safe harbor** and will not be treated as fiduciary advice:

- **Platform marketing** such as marketing the services of a TPA or providing investment platforms to plans without regard to individual or specific plan needs (does not apply to IRAs)
- **Selection and monitoring assistance** such as completing an RFP (does not apply to IRAs)
- **General marketing communications** such as newsletters or general promotional materials for your business (this is sometimes called the "Hire Me" exception)
- **Investor education** such as general financial, investment and retirement information as well as asset allocation models for plan investment alternatives (does not apply to IRAs).

What It Means to **Be a Fiduciary**

Being a fiduciary fundamentally changes the way you interact with clients and conduct business, especially with respect to brokerage and IRA clients.

- You must act in a client's best interest (without regard to competing financial or other interests);
- You are subject to a private right of action which allows you to be more easily sued in such venues as state court and in turn means more potential liability; and
- There are restrictions on the type or manner of compensation that you can receive.

Prohibited Transactions and Prohibited Transaction Exemptions (PTEs)

ERISA focuses on restricting fiduciaries from engaging in self-dealing or receiving various types of compensation. The general rule is that receipt by a fiduciary of compensation such as loads or 12b-1 fees is a "prohibited transaction" under ERISA. This is often called variable or un-level compensation because compensation varies based on the transaction or investment vehicle. To receive variable compensation, a PTE must be available. BICE is the newest PTE.

Best Interest Contract Exemption (BICE)

With the broad scope of the new fiduciary Rule, BICE will provide the primary exemption whereby the receipt of variable or un-level compensation, such as loads or 12b-1 fees, can be received. The type of disclosure or written agreement will vary depending upon the type of retirement account. For example, BICE will require a written agreement between IRA owners and the financial institution. The final Rule does provide that this documentation can be incorporated into the account opening documents and process of the financial institution. This new requirement will be effective January 1, 2018. BICE requires that:

Advice will be in the best interest of the client.	Advisors will not receive unreasonable compensation.
Certain policies and procedures are in place.	Material conflicts of interest are identified and disclosed.

It is important to note that disclosure is required by the rule but it does not insulate the fiduciary from a private right of action. In addition, there are requirements for a publicly accessible website and transaction disclosures (point of sale) by the financial institution. There is also a six-year record retention period. All of this will be a significant undertaking and expense and it will impact business processes.

For IRAs, a written agreement between the client and financial institution must be signed. For ERISA plans and level-fee programs, many of the BICE requirements are the same, except a separate written agreement signed by the client is not required.

Special **Exemptions Under BICE**

Variable and Indexed Annuities

Currently, variable and indexed annuities are subject to PTE 84-24 which permits the sale of these products, and the receipt of variable compensation, under the requirements of the PTE. However, the new Rule has effectively revoked PTE 84-24 for indexed and variable annuities, which will leave the BICE as the only mechanism that can be used for the sale of, and compensation on, these products.

Level-Fee Fiduciary

Advisors whose compensation is a level fee, a fixed percentage of assets under management, or a set fee that does not vary based on investments selected have also been given a special exemption under BICE. In level-fee fiduciary requirements, financial institutions will be permitted to meet a reduced requirement under BICE, such as providing certain disclosures instead of having to enter into a written contract with the client. There will also be special requirements for IRA rollovers to level-fee programs.

Digital Advice

Digital or robo advice delivers non-discretionary, computer-based allocation models without input from a human financial advisor. Such advice is typically low-cost and requires low account minimums, which may make it a suitable solution for lower-net-worth clients. The requirements for a DOL-compliant digital program remain unchanged under the new Rule.

Grandfathering

The new Rule provides for grandfathering of retirement accounts in existence as of April 10, 2017. An individual advisor and financial institution may continue to receive variable compensation in the account without meeting the requirement of the BICE. If an account is grandfathered it will allow some of the requirement of BICE to be disregarded. However, the following conditions apply to any account attempting to qualify for this grandfathering exemption:

- Accounts must be in existence by April 10, 2017—accounts established after this date must comply with all of the new requirements;
- You can only advise on investments acquired before April 10, 2017;
- None of the existing investments can have triggered a non-exempt prohibited transaction when acquired;
- Any investment advice you provide (including hold recommendations) after April 10, 2017, must be made in accordance with the new fiduciary standard under BICE. That means that any recommendation made must be in the best interest of the client without regard to the compensation received by or the interests of the financial advisor;
- You cannot give advice on any new investments, or investments of additional amounts in the account. This excludes any systematic investment program, such as dollar-cost averaging, established before April 10, 2017; and
- You can only receive "reasonable" compensation.

Additional **Resources**

The new Rule has a significant number of requirements and changes which are still being evaluated by Cetera®, trade groups and other experts. To assist you in preparing your business for the requirements of the new Rule, Cetera has launched a new campaign—DOL DynamIQs™—that provides a clearly defined approach to prepare for the new Rule, from education to implementation.

Major Changes to the Proposal

The Final Rule

Other Related Documents