DOL Fiduciary Rule: What Are the Practical Implications?
Webinar Q&A

Tom Clark, Of Counsel, Wagner Law Group has provided answers to additional questions that were raised during the DOL webinar on Thursday July 21, 2016. Please note that these answers are intended for general informational purposes only. Financial advisors and other plan service providers should consult with their own legal counsel to understand the nature and scope of their responsibilities under ERISA and other applicable law.

Question 1 – Discretionary Accounts

- For discretionary accounts, will a bifurcated fee structure, where you may charge less on the fixed income or money markets portion of the portfolio, be considered level or variable compensation?

    - Advisors who provide discretionary or non-discretionary services and who charge less fees on the cash or cash equivalent portions of the portfolio may be seen as having control over their own compensation when they either act or give advice to move assets from the cash to other portions of the portfolio that would result in higher fees to them.

    - Advisors with this practice should consult trusted legal counsel to examine the issues.

- Section IV of the BIC covers proprietary products and third party payments. If a managed account level-fee program includes proprietary funds, can the level-fee BIC be used?

    - Under Section I of the BIC, the BIC exemption does not apply if the advisor "has or exercises discretionary authority or discretionary control with respect to the recommended transaction." Therefore, the advisor cannot rely on the BIC if they are receiving non-level compensation in providing the managed account service. However, the "level-fee" BIC or "streamlined" BIC may be available if the advisor has no discretion over the rollover decision and is instead providing a rollover recommendation that is in the best interest of the client and all other requirements of the exemption are met. The inclusion of proprietary products does not necessarily change the availability of the exemption to the advisor; however, the managed account program must be shown to be in the client's best

interest. The advisor should also be mindful to ensure that it truly is a correct statement that level-fees are received when recommending the proprietary products.

Question 2 – Fee-Only Advisors

- Does the DOL consider rollover advice from an hourly fee-only (non-AUM) adviser to be conflicted? As an hourly adviser I don't gain anything in recommending a rollover versus recommending the money stay put in an employer sponsored plan.

    - If it's advice to a retirement investor and constitutes a recommendation, it's still subject to the DOL rule, even if the compensation is an hourly fee. However, an hourly fee would qualify as a level-fee, so the "full-blown" BIC wouldn't apply, you may be able to rely on the "streamlined" BIC for the rollover decision. The "streamlined" BIC requires the advisor to give a written statement of fiduciary status and to document (internally) the reason for rollover recommendation being in client's best interest; however, it does not require the "full blown" BIC compliance policies or other disclosures.

- How does an hourly fee advisor prove you are acting in the best interest of the client in situations that aren't quantifiable like doing a rollover which results in the loss of creditor and divorce protection?

    - Under the rule, an advisor is required to provide advice that is in the best interest of the client. The best interest standard means that the advice must reflect the "care, skill, prudence, and diligence under the circumstances then prevailing that a *prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims based on the investment objectives, risk tolerance, financial circumstances, and needs of the [client].*"

    - The best interest standard also mandates that any recommendation be made "without regard to the financial or other interests of" the advisor or firm.

    - The advisor must examine factors such as the loss of creditor and divorce protection when making the determination of whether the recommendation is in the client's best interest.

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- If I charge my client, as an individual, a fee based on the total value of all their accounts (IRAs, Taxable, ERISA plans) and if the fee is a level fee and is the same fee regardless of the account values, do I need to consider the implications of the fiduciary rule when

recommending moving between accounts? For example, a rollover from an ERISA plan to an IRA?

- Yes. Providing advice to a client to move assets between accounts may meet the triggering definition under the new rule of a recommendation. If the advice does qualify as a recommendation, then the advisor will need to carefully analyze whether an exemption is needed and which one.

Question 3 – Forced Rollover / Termination

- For plans that forced participant assets rollover into an IRA at termination or separation of service for small asset base at the plan's discretion (i.e. you terminate service and have a $1200.00 balance plan can roll assets to an IRA) how will that be impacted by the change in the rule?

    - The DOL recognized the possible tension between the new rule and the previous safe harbor available to plan sponsors in forcing out participants with small account balances. Assuming the safe harbor is met and the plan document allows it, plan sponsors may continue this practice without implicating the new rule if an exception under the new rule is met for plan sponsors. The exception should be carefully analyzed but generally requires that the plan sponsor employee not receive any additional compensation in carrying out the forceout other than their normal salary. To the extent the advisor is involved in any way with the force out, including any direct communications with the participant, the advisor may trigger fiduciary status under the new rule. The plan sponsor exception is not available to the advisor.

Question 4 – Advice Solely to ERISA Plan

- What effect - if any - will the DOL rule have on providing investment advice for a fee on a client's 401(k) plan without rolling any money out of the plan?

    - If it's advice to a plan or plan participant and constitutes a recommendation, it's subject to the DOL rule. If the advisor receives variable compensation for the advice, the advisor must rely on the "disclosure" BIC, which has requirements mirroring the "full blown" BIC (written statement of fiduciary status and general disclosures on compensation and conflicts), but does not require the advisor to enter into a contract with the client. The DOL believes that since plans and plan participants have legal recourse currently under ERISA, there is no need for a contract. If on the other hand, the advisor truly charges a level fee to a participant regarding their assets held in the plan, while the advisor is a fiduciary under the new rule, no exemption found as part of the new rule may be necessary, but earlier guidance from the DOL may be implicated (e.g. ERISA § 408(g)).

Question 5 – Determining Reasonable Compensation

- As a broker at a regional firm, how do I know if the commission level that my firm sets is reasonable? Will my full-service firm have to compare the commission to that of a discount brokerage?

    - There is no formal DOL definition for what qualifies as reasonable compensation; reasonableness will be determined on the particular facts and circumstances of each case.

    - The standard simply requires that compensation not be excessive, as measured by the market value of the particular services, rights, and benefits the advisor and firm are delivering to the client.

    - Firms and advisors will be required to justify their fees and document how those fees are reasonable.

    - Because advisors also have personal liability under the new rule, it can fairly be assumed that the DOL will expect individual advisors to not blindly rely on their institutions but perform some level of due diligence to ensure that compliance is being done properly.

Question 6 – Client Disregards Advice

- What happens if a client wants to do something against the advisor's advice? For example, if an advisor recommends that the client stay in a 401(k) plan, but a client feels uncomfortable with the company's plan and wants to go against the advice. Does the advisor have to turn this client away?

    - It is plausible that an advisor may expose themselves to liability for receiving compensation from a decision a client has made that goes against the advisor's advice.

    - Advisors with this practice should consult trusted legal counsel to examine the issues.

Question 7 – Complexity of Advice

- If we offer multiple investment strategies of varying complexity, are we allowed to charge a lower fee for the less complex strategies? And what must we document to establish that it a more complex--and expensive--strategy is in a client's best interest?

    - The DOL has provided guidance to advisors "permitting payment of differential compensation based on neutral factors, such as "a reasonable assessment of the time and expertise necessary to provide prudent advice on the product or other reasonable and objective neutral factors."

- Firms should be prepared to justify the reasons for differential payments to advisors, to demonstrate that they are not based on what is more lucrative to the firm.

- Advisors with this practice should consult trusted legal counsel to examine the issues.