HIGHLAND

SPOTLIGHT
JUNE 2016

DOL FIDUCIARY RULE

The Department of Labor (DOL) issued the final version of the long-awaited "Fiduciary Rule" on April 6, 2016. Initial discussions regarding the Fiduciary Rule (the first fiduciary overhaul of the Employee Retirement Income Security Act since 1974) started in 2009. The rule seeks to address the issues surrounding conflicts of interest in investment advice with respect to defined contribution plans. The new rule states that plan advisors must put their client interests first and adhere to a fiduciary standard. Plan sponsors need to be aware of the impact this rule will have on the retirement industry. The anticipated effect will be far reaching, touching many areas not previously covered under the Employee Retirement Income Security Act (ERISA).

WHAT IS THE FIDUCIARY RULE?

The final Fiduciary Rule issued by the DOL expands the definition and scope of what constitutes a fiduciary act under ERISA. Under the new rule, any individual receiving compensation for providing advice to a plan sponsor, participant, or Individual Retirement Account (IRA) will be deemed a fiduciary. This also includes recommendations regarding distributions from a plan or IRA. Fiduciaries will be responsible for providing advice that is in the "best interest" of the client and are prohibited from creating conflicts of interest without a specific prohibited transaction exemption granted by the Secretary of Labor.

One caveat to the rule pertains to a Best Interest Contract Exemption (BICE), which takes effect when certain requirements are met. A BICE would allow advisors to continue receiving most common forms of commissions as long as it is in the "best interest" of the client. This exemption requires a contract between the advisor and investor at the outset of the relationship that discloses any potential fees, charges or commissions. This is important because fees have historically been difficult to discern due to unclear disclosures, and any previous attempts for transparency fell short. The most recent attempt was through ERISA section 404(a), which required plan information and certain investment-related information to be provided to each participant. This change made the information available, but it was not completely transparent who received what form of payment.

The original proposal issued in 2015 limited the types of investment products that would be available for the exemption. However, the DOL allowed for the exemption to extend to all assets in the final rule. Highland believes that transparency is a key component to building trust among plan sponsors and participants. Therefore, the BICE is a step towards transparency as it requires advisors to acknowledge their fiduciary role, and disclose all fees associated with recommendations, while also providing for legal recourse against advisors not acting in good faith.

The Fiduciary Rule will go into effect in April 2017 through a phased-in process. According to the DOL, firms can qualify for the BICE by April 2017 by complying with more limited conditions such as acknowledging their fiduciary status, adhering to the "best interest" standard and making basic disclosures of conflict of interest. Full compliance will be required by January 1, 2018.

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ANTICIPATED IMPACT

The new/revised Fiduciary rule is intended to curb excessive fees and abuses among some players in the industry. It is important to understand how this rule will impact plan sponsors. We expect that this rule may increase employers' compliance obligations and costs, and may also materially alter their relationship with their current advisor. An example of this would include those plan sponsors working with advisors that do not currently act as a fiduciary on the plan. Under the new ruling, many advisors will now be required to recognize their fiduciary role. This acknowledgment in turn changes the roles of each party and may increase advisor costs due to the higher level of care. An additional complication may include plans where the advisor acts as the fiduciary and provides targeted education to participants. According to the DOL, education could consist of general information regarding the mix of assets a participant should hold based on various factors, while avoiding the suggestion of specific investments that constitute that mix. Therefore, plan sponsors will need to fully understand the intent or type of education (i.e. providing investment advice vs. generic retirement information) being provided to participants in order to limit any potential conflicts of interest.

FIGURE 1

"TO" RETIREMENT *- DESIGNING A PLAN FOCUSED ON GETTING PARTICIPANTS "TO" THEIR RETIREMENT DATE*

"THROUGH" RETIREMENT *- DESIGNING A PLAN THAT NOT ONLY GETS A PARTICIPANT "TO" RETIREMENT, BUT ALSO PROVIDES OPTIONS TO HELP PARTICIPANTS INVEST "THROUGH" RETIREMENT*

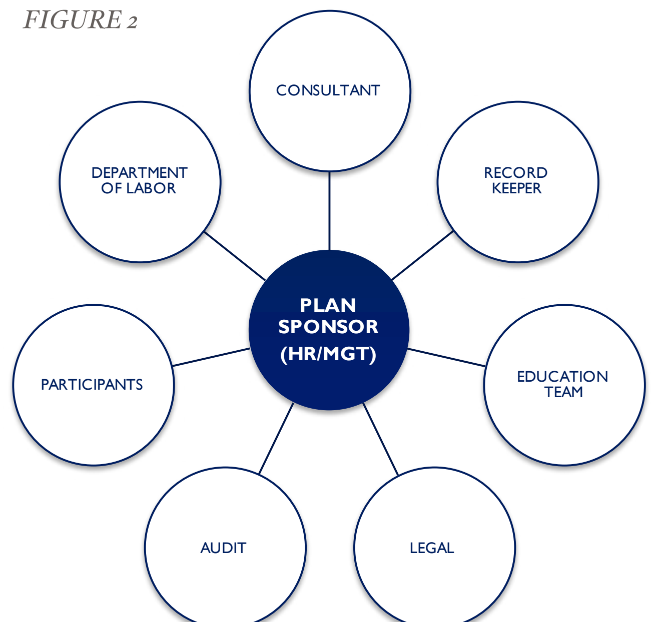
The rule will also impact rollovers from 401(k) plans, making it a fiduciary act to recommend a rollover. Advisors may be less willing to recommend them, which may increase the number of participants staying in the plan after retirement. If this is the case, plan sponsors may need to reevaluate their philosophy by looking to assist participants not only "to" retirement, but "through" retirement (Figure 1). Historically, plan sponsors were mainly concerned about helping participants get "to" retirement with a desired savings level. This theme continues today as many plans have incorporated financial wellness into their plan. Going forward, plans may have more retirees in the plan which may require a shift in philosophy – "through" versus "to". This change may require plan sponsors to seek out alternatives for these participants. Alternatives may include adding additional retirement income products in the plan or just providing targeted education for retirees about the different retirement income options available outside the plan. This change in philosophy should not be taken lightly and may impact the way plans are structured in the future.

HIGHLAND'S VIEW

The final version of the "Fiduciary Rule" expands the DOL's role in protecting retirement participant accounts by expanding fiduciary roles and seeking advice that is in the "best interest" of the participants. The rule will have widespread implications on advisors, plans sponsors, and participants. Highland recommends that plan sponsors better document the roles and obligations of all parties involved under the new rule (Figure 2).

In addition to the changes in roles and responsibilities, the ruling may lead to a re-evaluation of how defined contribution plans are structured and alter the way sponsors care for their employees' needs well after retirement. Highland will continue to monitor the impact of the new ruling and its implications for plan design.

FIGURE 2



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