DOL Rule, Not Actually Delayed, Could Survive in Some Form

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By Emile Hallez

Editor's Note: Today Ignites *examines President Trump's Friday actions, which could result in the repeal of the Department of Labor's fiduciary rule and large parts of the 2010 Dodd-Frank Act. This piece addresses what last week's memo says about the DOL rule, and what it does not. Please also see our analysis of what it may mean for broker-dealers' treatment of '40 Act products, and fund companies' plans to introduce 'clean' shares of their funds, as well as a gallery depicting the reactions of trade groups and elected officials.*

President Donald Trump spent just two weeks in office before attempting to dismantle what the Department of Labor has spent more than six years building: A fiduciary rule designed to put the best interests of retirement investors ahead of those of the financial advisors who sell products to them.

Trump signed a memo on Friday directing acting secretary of labor Edward Hugler to examine the rule, which the department was slated to begin enforcing April 10.

Although a widely circulated draft version of Trump's memo cited a 180-day delay in the applicability of the rule, the final version has no mention of any delay. Early on Friday, industry lobbyists praised the phantom delay, and numerous media outlets ran breaking stories citing the 180-day figure, which correlated to earlier leaks of a potential six-month stay.

U.S. House Financial Service Committee member Ann Wagner, who attended the Oval Office ceremony in which the order was signed, also referred to the "delay" in a statement on her website.

Confusion Persists

The roller-coaster-like change has left the financial services industry a bit dumbfounded.

"It looks to me like there is no delay," says Marcia Wagner, head of the Wager Law Group and Employee Retirement Income Security Act specialist. The administration's 180-day figure appears to have "not well thought out, and they're leaving it up in the air for now," Wagner says.

"This puts the financial services community in a difficult position," she says. "These large broker-dealers and wirehouses, they can't turn on a dime. Having clarity in the [applicable date of the] rule is really quite important."

Trump could be handing off authority to the DOL, allowing the regulator to go through the mandated evaluation process to identify what its new leadership could perceive to be problems, she notes.

During its review, the DOL is ordered to evaluate various aspects of the rule, including whether it will reduce individuals' access to advice, disrupt the retirement services industry or spur litigation. If the review reveals that the rule is inconsistent with Trump's stated priorities, it "shall publish for notice and comment a proposed rule rescinding or revising the rule, as appropriate and as consistent with law," the final version of the memo states. It offers no time line for the review or any action.

At the same time, confirmation hearings for Trump's pick for Labor Secretary have been postponed indefinitely.

Acting Secretary Hugler issued a brief statement.

"The Department of Labor will now consider its legal options to delay the applicability of the date as we comply with the President's memorandum."

The Feb. 3 memo, which came in addition to an executive order designed to gut the 2010 Dodd-Frank Act, prompted applause from the financial services industry. The Investment Company Institute and Insured Retirement Institute both issued statements supporting Trump's actions, and several firms provided similar comments.

"In its current form, the rule could have the unintended consequence of limiting valuable help for workers saving for their retirement," Empower Retirement said in a statement attributed to its president, Edmund Murphy, issued on Friday, prior to the final version of the memo being released. "This implementation delay affords the retirement industry an opportunity to seek further enhancements to the rule."

The reaction was starkly different from one Dodd-Frank architect, University of Michigan professor Michael Barr. Barr worked with legislators on the act during 2009 and 2010.

"Frankly, it's quite disturbing. They're reducing transparency in the system. They're reducing guardrails in the system," Barr said during a Bloomberg interview Friday.

At its core, the rule is designed to extend a standard of care to the IRA market, charging brokers with acting in their clients' best interests. That obligation is greater than the current suitability standard, which requires simply that brokers to sell products that are appropriate for clients, with less regard for the commissions that those brokers can receive and other conflicts of interest.

'No Going Back'

The former head of the Employee Benefits Security Administration, the unit that wrote the rule, noted the time and care that went into crafting it. After being proposed and then withdrawn in 2011, the rule went through years of revisions as EBSA staff worked to ensure the final draft responded to issues raised through multiple comment periods, Phyllis Borzi said.

"I think the genie is out of the bottle," she told *The Wall Street Journal.* "The market has spoken," Borzi said adding that investors already expect advisors to work in their best interests.

She also blasted the president for acting inconsistently with his campaign message.

“For a president who was elected by the working class who felt that they were left behind and the system was rigged, this order certainly shows which side he is on, and it isn’t the side of working people,” she said.

Regardless of whether the executive order ultimately delays or derails the rule, the financial services industry can hardly relax — largely because of the ongoing threat of being sued, says Wagner, the Erisa attorney.

Litigation brought against firms and advisors by consumers will help ensure that a fiduciary standard remains in practice and means that the essence of the rule will likely live on in some form, she says.

“There’s no going back. Lessons learned can't be unlearned, especially when it comes to the tort bar,” Wagner says. “The tort bar isn’t done; this is just beginning.”

Further, the Securities and Exchange Commission could work to finally push through its own version of a fiduciary rule, which would apply to all investors, not just assets of investors within qualified retirement accounts, she notes.

“You’re going to see perhaps as a result of this the SEC stepping up and trying to create a more unified and harmonized definition of a fiduciary,” Wagner says.

The massive, years-long process the DOL undertook in developing its rule could be a useful framework for the SEC, if it were to build out its own version, she says.

“I think you will see some form or watered-down version of this rule,” she says.

Regarding the fiduciary rule’s accompanying best interest contract exemption, which is a separate rule in itself, Wagner says that portions could survive. However, an aspect of that rule that would have opened IRA litigation to the tort bar, creating a private right of claim for investors, is less likely to live, she says.

In the immediate future, Wagner says fund families should contact distributors to gauge demand for T shares that several families have begun adding. The products typically have front-end loads of 2.5%. The uniform rate of these so-called transaction shares aimed to address concerns that traditional commission structures created an inherent conflict of interest for advisors, who rely on them for compensation. That conflict stems from the fact that front-end loads for traditional A shares, for example, vary between providers and sometimes even between funds within a family. In addition, traditional front-end loads are far higher, generally between 4% and 5%.

“They should be asking the independent broker-dealers and wirehouses, if, regardless of this rule, they really want or need T shares,” she says. “The industry will have to determine whether they are better than what came before."

First Movers Likely to Turn Action into Marketing

Further, firms have spent considerable time and financial resources preparing to comply with the fiduciary rule, and few appear to be ready to scrap their plans altogether, says Jason Roberts, CEO of the Pension Resource Institute. But companies that waited until virtually the last minute to begin preparing for the enforcement deadline are most likely to ditch their compliance plans, Roberts says.

That distributors and others would continue their compliance plans is common sense, given that Erisa provisions still apply, even if to a smaller percentage of people selling securities, he says.

"Erisa Title I has been on the books since 1974," Roberts says. "The rules are still the rules, and they are very technical."

Broker-dealers on his client list have said they will retain new practices they've adopted, such as using tiered compensation based on neutral factors, he notes.

More than half of about 75 company clients have already put new policies into practice and have indicated that they generally plan to keep them, he says.

"A number have said, 'We intend to train and supervise to the higher standard,'" he says.

Additionally, companies that have gone through the process of complying ahead of time will be able to cite the higher standard as a marketing tactic, even if the rule does not survive, he notes.

"Advisors will be quick to point that out about their competition [that] hasn't done so," he says.

And given the SEC's attention to conflicts of interest, firms that haven't taken steps to get in compliance with the DOL's rule could "begin to look like outliers in the eyes of the regulators."

Grace Jennings-Edquist and Joe Morris contributed reporting.