Despite fiduciary rule's delay, DOL's measure has spurred changes

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The DOL's measure has put the term "fiduciary" squarely in public view. (Photo: Mike Scarcella/ALM)

More than six years have passed since the U.S. Department of Labor first rolled out its fiduciary rule for the retirement industry, but whether that rule becomes effective in early June, as now planned, still remains uncertain.

Despite the delay, analysts say the mere threat of the federal rule going live — along with a decade of class action litigation — already has wrought changes to an industry more in the public view than ever before. As the attorneys who represent companies parse the fine print to ensure legal compliance should the rule stand, some observers predict many companies will adopt stricter standards for a simpler reason: good business.

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"The cat's out of the bag," said Stephen McCaffrey, board chairman of the Chicago-based Plan Sponsor Council of America. "People, their eyes are open about the things that they have to ask for and look at.

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They recognize that it's their money and they need to ask questions."

It doesn't mean Republicans aren't pushing back. President Donald Trump in February ordered the agency to re-examine the rule, which was due to go into effect in April but was delayed until early June. The regulation was designed to extend fiduciary responsibilities to a wider universe of people providing retirement advice.

Financial firms and their attorneys are scrambling to keep pace with its evolution in Washington, though experts note that the policy fight of the past half dozen years has already had a significant impact on the industry.

Indeed, the landscape for handling retirement accounts has been transformed in recent years — and many analysts expect a number of those changes to stick. A series of class action lawsuits hatched over the past decade are credited with significantly reducing fees associated with 401(k) plans and with ensuring that the interests of employees and retirees come first in the management of those plans.

At the same time, the DOL's measure has put the term "fiduciary" squarely in public view — bringing with it attention from consumers that may spur many companies to broadly comply with the new standard, regardless of its official status.

"There's a higher level of care throughout the industry," said Marcia Wagner of Wagner Law Group in Boston, who specializes in employee benefits law.

Regulatory uncertainty

For those in the retirement industry, the next key date to watch is June 9, when the first components of the DOL rule are now planned to take effect. While there's still considerable uncertainty around its final fate — including whether controversial parts or even the whole rule is reversed — attorneys are advising clients to move forward with compliance, assuming the date will stand.

"Are companies gearing up to comply with June 9? Yes, they are," said Kent Mason, a partner at Davis & Harman in Washington who specializes in retirement savings. "People have to assume, at least for now, that what's in the document is final. Obviously, it can change, but I don't think people can count on that for compliance purposes."

The delay notice hinted that financial advisers and others impacted should take the date seriously, suggesting that it would be "inappropriate" to "broadly delay" implementation of the new definition for fiduciary advice and its best interest standard "in disregard of its previous findings of ongoing injury to retirement investors."

But here are some analysts who doubt that the entire rule will survive intact. "In some ways, this is career staff slow-walking the execution order of a rule they crafted," said Edward Mills, a policy analyst at FBR Capital Markets based in Arlington, Virginia, particularly given that the delay language was finalized without a Trump-appointed labor secretary in place. (At press time, the president's nominee, Alexander Acosta, was approved by a U.S. Senate panel but not by the full Senate.)

"To me, the important thing is, what does the Trump administration and the Republican Congress want to do? They don't want this rule to go into effect," Mills said, predicting that the most likely outcome remains "a series of short-term delays that are ultimately going to lead to a long-term delay, a revoking of the rule or a fundamental rewriting of the rule."

A spokesman for the Department of Labor did not respond to requests for comment on its review of the rule.

Still, while companies scramble to keep pace with the latest developments regarding the regulation, observers said that some advisers and brokers may adopt the stricter fiduciary standard voluntarily in order to differentiate themselves from competitors. With so many firms working for a year or longer to put the fiduciary rule into place, the regulation already has prompted significant changes in the retirement industry.

"There's a lot more focus on compensation arrangements and different fee structures," said Seth Safra, a partner at Proskauer Rose in Washington who focuses on employee benefits and executive compensation. "No matter what happens, the awareness is not going to go away. Just from a competitive perspective, service providers are looking at this and saying, 'Maybe we can use some of this to our advantage to distinguish ourselves in the marketplace.'"

That's due in part to the widespread publicity the rule has garnered, which extends far beyond the nation's capital.

Plaintiffs' bar action

One of the most contentious fights over the fiduciary rule involves how much potential legal liability those covered under the measure will have to assume under the regulation. Morningstar Inc. analyst Michael Wong estimated in February that class action litigation stemming from the rule could cost the industry $150 million annually — or even more in the early years — among those selling commission-based products under one of the rule's exemptions.

The brokerage industry doesn't have to look far to see the threats that such liability can bring, as a handful of plaintiff's firms has filed dozens of cases against employers for breach of fiduciary duty in recent years with respect to the management of employee 401(k) plans.

"The risk of fiduciary lawsuits is very significant," said Safra. "All of the 401(k) litigation that's going on right now is enough to see why one would be scared about that, even where the fiduciaries have had some success" in defending themselves.

Defined-contribution plans have been replacing traditional pensions since the 1980s, but oversight of the programs and their management failed to garner much attention in those early years. One firm, Schlichter Bogard & Denton, began pursuing cases in the mid-2000s against employers that, it argued, were allowing participants to be charged excessive fees, including cases where those fees presented a conflict of interest or the possibility of self-dealing for the companies involved.

"What existed was a system in a dark closet," said Jerome Schlichter, founding and managing partner of the St. Louis-based firm Schlichter Bogard & Denton, who's been leading the class action fight against 401(k) plan sponsors.

Dozens of cases have since been filed by the firm and others, and Schlichter has been credited with helping to reduce overall 401(k) record keeping fees by an estimated $2.8 billion per year. He's secured a number of high-profile settlements, including a $62 million deal with Lockheed Martin Corp. in 2015, the largest to date. Just two of the cases have gone to trial so far, and both continue to wind their way through the courts after more than a decade. Schlichter called the effort to bring the litigation "an intense battle."

Plan sponsors "know that actions that they may have taken in the past that they thought were responsible are going to be scrutinized much more carefully," said Mark Hess, a partner at Fox Rothschild in Los Angeles, who focuses on employee benefits law.

Still, he noted, the enhanced scrutiny that's come with the threat of lawsuits could motivate plan sponsors to become overly cautious in their management.

"Judgment is going to be impaired somewhat by the fact that they're always looking over their shoulders — how can my actions be interpreted five years from now?" Hess added.

Going forward, it appears that plaintiff's firms may be looking to raise the bar even higher for companies managing a 401(k) plan. Charles Humphrey, an attorney for Fiduciary Plan Governance, a Newbury, Massachusetts-based consultancy, points to a handful of cases filed over the past two years that further probe the actions taken by plan sponsors with respect to their fiduciary duties, digging into the performance and design of certain investments.

Such cases indicate that "the plaintiff's bar is trying to delve into the weaknesses of particular employee benefit plans to see if they can exploit those weaknesses," Humphrey said, though it's unclear at this point whether the new efforts will be successful.

These trends will be crucial to watch for organizations of all kinds. Company executives who take on a fiduciary role are personally liable under the law — breaching those duties willfully can lead to significant fines and even jail time. And yet, experts say, many fiduciaries still don't necessarily understand the extent of the responsibilities involved in managing a firm's 401(k) plan.

"A lot of these people are volunteered into the position," said PSCA's McCaffrey. "Their duty of loyalty is solely to the participants and the beneficiaries — and they need to know, when they walk into a fiduciary meeting, they have to shed their company hat."

The combination of the pending federal fiduciary rule and the heightened risks associated with class action lawsuits have pushed plan managers, advisers and other players to pay closer attention to implementation and oversight of retirement savings accounts. Whether or not the Labor Department ultimately decides to rescind the intensely debated regulation, those broader changes are unlikely to dissipate.

"There was a huge lack of understanding, and I think the entire industry — from plan sponsors to plan vendors — is evolving," said Wagner. "People now understand that this is a serious responsibility."