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DOL Rule Gets (Initially) Warm Reception

By Emile Hallez April 7, 2016

The Department of Labor published the final version of its fiduciary rule yesterday, complete with a host of changes that are arguably quite friendly to the financial services industry.

Based on initial responses, the rule appears to be well received compared to the version the DOL proposed one year ago.

Among the most significant developments in the final version of the rule are provisions allowing "negative consent" for existing client assets and an exemption for "level fees" for advisors recommending clients roll assets from 401(k)s to IRAs. The rule also clarifies that advertising, research reports, commentary and other marketing materials do not amount to advice — a concern that many expressed in comments following the proposed rule.

"Some of the more onerous requirements have been eliminated or significantly ameliorated," says Marcia Wagner, a lawyer whose practice centers on the Employee Retirement Income Security Act.

In revising its regulation, which is designed to put retirement savers' best interest ahead of those of advisors and broker-dealers, the DOL made substantial changes related to its Best Interest Contract Exemption rule, Wagner notes. That exemption allows brokers with IRA and 401(k) clients to continue receiving commissions.

Notably, the final version of the rule contains a provision allowing advisors to continue whatever fee arrangements they have with existing clients, provided they send notices to those clients. Clients would have 30 days to object under the "negative consent" provision, otherwise the fee arrangements — commission-based or otherwise — would remain intact. Similarly, while the final rule requires advisors to rely on the best interest exemption for advice going forward, investments made under prior recommendations could remain unchanged, provided the client is informed and does not request any adjustments.

"It would have been a paper nightmare to get signatures and explain everything. We're talking millions of clients," Wagner says. "This is going to be a workable law now."

However, brokers should be prepared for questions from clients to whom they send those disclosures, says Matthew Sommer, VP of defined contribution and wealth advisory services at Janus Capital. Some clients, particularly those with both brokerage accounts and IRAs, will be confused about why there are different sets of rules governing their accounts, he says.

"It's going to create questions," he says.

Another substantial revision to the proposed rule is that fee-based advisors will be able to make rollover recommendations without having to sign best-interest contracts with clients, as long as the rate those advisors charge for advice stays steady. However, those advisors must pay "special attention" to documentation showing that such rollovers are in the client's best interest, according to the DOL.

"I don't think it will discourage a lot of advisors from pursuing rollover business," Sommer says of the final rule. In many instances, guidelines developed by the Financial Industry Regulatory Authority are similar, he notes. "Advisors who have a process in place and who are able to adjust their tone and tenor to this fiduciary regime are going to be in the best position to capture those opportunities."

The level-compensation exemption for rollover advice is "a big win for 401(k) plan participants, plan sponsors and advisors alike," the American Retirement Association states in a reaction commentary to the final rule's publication.

Another change to the rule allows advisors to continue serving small 401(k) plans on a commission basis and receive 12b-1 fees, under the Best Interest Contract Exemption.

While that modification is welcomed by the industry, fund providers could still see such advisors switch to stripped-down share classes, Sommer says.

"[Advisors] really need to take a step back and see if that's the best thing to do," he says, of continuing to operate on a commission basis with 401(k) plans.

Further, language in the rule's preamble will likely encourage the industry. The DOL notes that cost is only one consideration in the recommendations advisors and brokers make, Sommer says. Relatedly, advisors who recommend that clients switch from a commission arrangement to a fee-based arrangement will have to show that doing so benefits the client, he notes.

"There are going to be scenarios out there where a commission-based structure is in the best interest of the client," he says.

Another big difference between the proposed and final versions of the rule is the removal of an approved list of investments for advisors relying on the best interest contract exemptions. That list had excluded less liquid investments, such as real estate investment trusts.

"That is a very reasonable way to proceed," Wagner says. "The government should not be in the business of picking winners and losers in what people can invest in."

Overall, the final version of the rule appears to be more principles-based than prescriptive, and the DOL appears to be operating under the assumption that most advisors already act in the best interest of their clients, says Jean-David Larson, director of regulatory and strategic initiatives at Russell Investments.

"They've struck a much better balance," Larson says. "They're not trying to disadvantage brokerage models."

Another cut welcomed by the industry is the requirement for firms to include disclosures of one-year, five-year and 10-year projections of investor costs, with assumptions about investment performance. Further, the DOL simplified disclosures that firms have to make on their websites, clarifying that they do not have to provide information about the compensation of individual advisors.

"Then you [would have] information for every client, in every situation, that everyone can second-guess," he says, explaining that such level of disclosure would have a chilling effect on how people advise their clients. "The DOL realized that that litigation threat [to advisors] was excessive."

In a press conference announcing the final rule, Sen. Elizabeth Warren (D-Mass.), pointed to a recent decision by LPL to reduce its wrap fees by as much as 30% for some customers as proof that the rule is already having an effect on the cost of advice.

"That's money that was going to the company and its agents, and now it goes straight into the pockets of consumers," Warren said.

While the DOL received helpful input from many in the financial services industry, there are certain groups that remain opposed to any new regulation, Labor Secretary Thomas Perez said.

In a reaction statement to the final rule, the American Benefits Council states that it remains concerned about "the potential chilling effect of the new standards on employee engagement, if employers are not able to continue working effectively with employees to strengthen their use of retirement programs."

There will likely be attempts by members of Congress, and potentially the next president, to change the rule, said Sen. Brian Schatz (D-Hawaii), speaking at the press conference Wednesday.

The rule would become effective 60 days after publication in the Federal Register, which happened on Wednesday. Firms would have to comply with some of aspects of the rule by April 2017 and all of them by January 2018.

"We are going to have to protect against appropriations riders and other attempts to change this," Schatz said. "There is too much money at stake for those who are benefiting from this $17 billion [in annual fees] to give up so quickly."