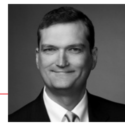
Balancing Act

While the DOL went to great lengths to appease a chorus of industry critics with its finalfiduciary rule, it was resolute in its goal to better protect individual investors.

Scott Cooley



The Department of Labor (DOL) recently published its long-awaited fiduciary rule, officially called "Definition of the Term 'Fiduciary'; Conflict of Interest Rule—Retirement Investment Advice." It should be no surprise that an agency that turns "fiduciary rule" into a 12-word title was similarly verbose when it detailed how advisors should interact with their retirement clients: Where you and I would have said, "Act in your clients' best interests," the DOL generated a manifesto that, runs to more than 1,000 double-spaced pages.

So, while the DOL will not win any awards for brevity, it does deserve a prize for developing a final rule that will advance investor interests without imposing excessive costs on the financial-services industry. With that in mind, despite some much-criticized concessions to the financial-services industry, I believe that the final rule better protects investor interests than the DOL's May 2015 proposal.

The Rule

So, what does the rule do anyway? In essence it imposes a best-interest test on those who provide advice on retirement accounts. An advisor may still recommend an investor roll money from a 401(k) into an IRA, may collect a commission on an IRA, or may even sell an investment product with high fees. But, among the many obligations an advisor has is one to establish documentation showing that a particular investment decision was in the client's best interest.

If they cannot document that they serve investors' interests, broker-dealers, 401(k) plan providers, and other retirement advisors face potential private legal actions, including class-action lawsuits.

The Final Fiduciary Rule

One should approach an evaluation of such a complex and nuanced rule with a fair amount of humility. As one knowledgeable ERISA attorney told me, many of the things we think we know about the rule right now will turn out not to be true. With that caveat in mind,here are a couple of the changes in the final rule that better protect the interests of investors. The theme that runs through these and other improvements to the rule is that they ease the operational burden of the rule (versus the initial proposal) without compromising investor protections.

First, for those investors who are currently in commission-based retirement accounts, there is an improved grandfathering mechanism that should allow them to maintain this relationship if it is in the clients' best interests. The original proposal would have made it difficult to maintain a commission-based relationship, even if doing so would have been the best outcome for an investor.

By providing a streamlined grandfathering provision, the DOL has allowed advisors to keep investors in what, for some of them, will be lower-cost accounts. (If they have already paid the commission on the account, the ongoing trail will likely be much lower than the 1% many fee-based advisors charge.) If advisors wish to move investors from a commission-based to a fee-based account, they must document that it is in the investors' best interests.

Second, in a win for the industry and investors, the DOL's final rule streamlined the documentation associated with the best-interest contract exemption (BIC Exemption), an agreement between an advisor and a client that commits the advisor to acting in a client's best interests, even when paid in a manner that the DOL considers conflicted. Moreover, in the final rule the DOL determined that investors need only sign the BIC Exemption with the firm, not every individual advisor at the firm who provides the client with advice.

An example may illustrate the problem with the initial proposal. Consider a plan provider that operates a call center and serves millions of participants. Let's say an investor called that call center and requested a full, early distribution from her 401(k). Under the original proposal, before the call center representative attempted to dissuade the investor from taking the distribution—perhaps by pointing out that the plan allows for partial distributions to meet a financial emergency, which would save her thousands of dollars in taxes and penalties—the representative would need to receive a signed BIC Exemption. (By its very nature, that advice would be considered conflicted because the provider would receive more revenue if the investor left part of the money in the plan.) If the caller elected to think about it, called back the next day, and spoke to a second person in the call center before engaging in a substantive discussion about her individual circumstances, she would have

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needed to sign another BIC Exemption with the second call center rep.

It is difficult to see how an investor's interests would have been better protected by signing all those additional papers. Moreover, the initial proposal would have produced a costly operational nightmare for advisors and plan providers, which investors would have paid in the end. It is worth noting that the final rule incorporates the investor-protection elements of the original proposal, including the right to participate in a class-action lawsuit.

Thoughts About the Rule

To be sure, that DOL's fiduciary rule isn't perfect. No rule ever is. But the agency did a good job of listening to industry concerns, sifting through them, and responding to those that merited attention. As attorney Marcia Wagner of the Wagner Law Group told *The Wall Street Journal*, the DOL "took a rule which would have been impossible to fully comply with and made a rule that is going to be difficult but not impossible to comply with." And the DOL accomplished these improvements will leaving intact the key investor protections in its original proposal. That is a great outcome for investors.

What does the rule mean for investors? This rule will make it a bit more of a hassle for a broker to handle rollovers, which may lead to some brokers handling fewer rollovers, especially smaller ones.

But the rule provides important protections to investors. In the past, when brokers needed to meet only a suitability requirement, they frequently persuaded investors to roll money out of low-fee 401(k) plans to higher-fee IRAs. That sales-oriented conduct simply imposed unacceptable costs on retirement investors—many of whom, surveys showed, already thought their broker had to work in their best interests.

The Next Steps

Although the revisions to the fiduciary rule are welcome, there is still much that the DOL can do to improve the retirement outcomes of Americans. In particular, it needs to take steps to ensure that money stays in 401(k) plans when participants change jobs, and to address the coverage gap for 401(k)s, which leaves tens of millions of Americans without access to a workplace retirement plan.

First, the DOL could take steps to make it easier for people to move assets from one 401(k) plan to another. The DOL has reportedly considered issuing guidance to plan sponsors that would reduce liability concerns about providing auto plan-to-plan rollovers, as when a participant changes jobs. Plan sponsors could ensure that participant assets follow them to their next job unless the employee makes a different election. This approach would lead to more assets remaining in 401(k) plans, where investors' retirement holdings would benefit from the often-lower fees that these plans feature. The agency should move forward with this initiative.

Second, the DOL should rethink its approach to multiple-employer 401(k) plans, which allow smaller employers to band together to offer a lower-cost 401(k). Making it easier for companies to cooperate to form larger plans should result in greater availability of low-fee 401(k)s at smaller employers.

Late in 2015, the DOL issued guidance making it possible for state governments to offer multiple-employer plans, but it has not yet made it easier for private organizations to offer them. This should be done.

In short, in finalizing a sensible fiduciary rule, the DOL has taken an important step toward protecting Americans' retirement security. But in terms of improving the policy framework around retirement savings, there is still much to do. Here is hoping the DOL seizes the opportunity to score some big wins for retirement investors.

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