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DOL Rule Means Lots Of Homework This Year

JUNE 1, 2016 • SKIP SCHWEISS

After six years of deliberation, the U.S. Department of Labor last month released its much-anticipated conflict of interest rule for retirement plan advisors. Weighing in at 1,023 pages across seven regulatory releases, it's far from easy reading.

But read it we must, and so we at TD Ameritrade are reviewing and analyzing the rule to determine what it may mean for investors and advisors. Though we've only just begun, we believe the new rule represents the most important, far-reaching and impactful regulatory change to the retirement advice arena in decades.

In its final rule, it appears the DOL recognized that the registered investment advisor business model has fewer conflicts than that of full-service brokers and insurers, thus it imposed a lighter compliance burden in some areas. And the department allows that some retirement investors may be better served by a commissioned broker.

So rather than restricting that channel, the department created a "best interest contract exemption" that lets advisors receiving commissions or third-party compensation continue doing business with retirement plans and IRAs—albeit under strict fiduciary rules.

Now, a column like this cannot in any way substitute for individual compliance guidance, and we are not predicting what the impact of the rule will be on any given advisory firm, because every firm is different. Still, as we are working through the rule and its application, we thought it might be helpful to highlight a few potential questions for RIAs to consider.

1. IRA rollover advice. The new rules apply a "best interest" standard to any advice given to a retirement plan participant considering a rollover into an IRA. In light of their business model, RIAs have been given a lighter compliance burden in this area because they generally are eligible to be level-fee fiduciaries under the best interest contract exemption. But they still need to adapt their business practices to comply with the rule.

RIAs may want to ask themselves: "How might my business practices need to change for me to comply with the rule, and to continue differentiating my firm from competing advice providers?"

2. Various revenue streams. ERISA does not allow for third-party compensation, such as commissions, to be received by fiduciaries from retirement plans. This now extends to IRAs. Does your firm have any revenue streams from third parties —product manufacturers, custodians, etc.—that might need to be modified or even terminated?

3. Reasonable compensation. Under ERISA, any compensation for services must be "reasonable" in relation to the services provided. How will you know if a fee will be considered reasonable under this new rule? Consider how you will justify your fee when recommending an IRA rollover from a retirement plan. The best interest contract exemption mandates that you document this justification, among other things.

4. Advising 401(k) plans. If you are a fee-only RIA, how does the rule impact your ability to advise business owners that sponsor 401(k) plans? Many believe that because RIAs are already accustomed to working under the '40 Act fiduciary standard, they are better-positioned than other advisor channels to manage retirement plan assets. And yet, few do.

We believe the new conflict of interest rule may expand the potential market opportunity for RIAs. You might ask: Are your business processes structured properly to not only comply with the new rules, but to maximize success in this marketplace?

5. ERISA fiduciary standard. So while RIAs indeed are fiduciaries, it is also true that ERISA's fiduciary standard is stricter than the '40 Act standard. The question, then, is: Do you clearly understand the differences between the two standards and how they specifically apply to your business? Consider not just how this review can help you comply with the new rule, but also help you differentiate your approach to providing financial advice.

6. Potential conflicts. Many "fee-only" RIAs may believe they have no conflicts when recommending investments, yet there are some scenarios that might now be interpreted as conflicts. For example:

• You don't charge clients an advisory fee for the cash portion of the portfolio. This may be viewed as a potential conflict. Why? Because an advisory firm could increase its compensation when moving cash into the markets and thus increasing the billable portion of the portfolio.

• You may provide, at no additional cost, asset-allocation guidance for some individual clients on their 401(k) accounts as part of the overall relationship with the retirement investor. If the clients leave their employers and you recommend they roll over their 401(k) balance to an IRA under your management, you would be increasing your own AUM and your own compensation. That, too, may be seen as a potential conflict.

• You recommend third-party managers who share part of their revenue with your firm. Those managers charge different fees and may share part of those differing fees with you, possibly resulting in a conflict.

• You received trailing "12b-1" fees from mutual funds sold to an investor when you were serving as a broker, and those positions are now held in an advisory account with your firm and you are still receiving the fees. You can affect your compensation by recommending a change to the portfolio.

• You charge different fees for the equity and fixed-income portions of your clients' portfolios. You may have a conflict, since you can affect your compensation depending on how you allocate client assets across those asset classes.

7. Best interest contract exemption. You may be thinking you can continue receiving other types of compensation by entering into the best interest contract with clients, but that is not an option if you are a discretionary investment advisor. The DOL believes discretionary RIAs are already covered by ERISA when advising retirement accounts. The good news is that discretionary investment advisors do not need to live under the terms of the exemption; the other news is that some of the flexibility available under the exemption is not available to discretionary investment advice arrangements.

And remember this now includes IRAs and the IRA rollover recommendation. You may want to consider any applicable conflicts of interest you may have with all retirement accounts you advise, including third-party compensation arrangements, to see how those may need to change under this new regulation.

Next Steps

Our overall take is this: More communications with retirement investors will be considered fiduciary in nature. Moreover, ERISA's fiduciary advice protections are being extended, from employer-sponsored 401(k) plans to the many millions of IRAs advised by brokers, advisors, banks and insurers.

The rule has an applicability date of April 10, 2017—the date by which advice to retirement investors must be delivered on a "best interest" basis according to the regulation, and it takes full effect on January 1, 2018—the date by which all contracts must be in place, including with existing clients, as applicable. So while RIAs have some time to understand it better and get into compliance, they should start taking action now.

While we hope this list will get you started in thinking about your business practices under the new rules, you should seek professional advice on your specific business practices and how they may be affected.

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