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Investment Management Briefing

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Three Takeaways: DOL Issues RFI; Consider 408(b)(2) Disclosures; and Watch the States

There is a bit of a mixed bag of news for those who interface with retirement fiduciaries and end users. First, the U.S. Department of Labor (DOL) released last night a Request for Information (RFI) seeking suggestions on how the DOL Fiduciary Rule can be improved. We think the RFI, which was previewed last month, provides a golden opportunity to shape President Donald Trump's version of the DOL Fiduciary Rule, and also may reveal how the DOL is seeking to address the President's directive to re-examine the Obama version of the rule. Second, the disclosure requirements under Section 408(b)(2) of the Employee Retirement Income Security Act of 1974, as amended (ERISA) are likely to create an administrative headache for those service providers who become fiduciaries to ERISA plans by virtue of the DOL Fiduciary Rule. Third and finally, some states are starting to enact or may be considering laws that create fiduciary duties and obligations that may conflict with current federal law, thereby creating substantial legal uncertainty.

Take advantage of the opportunity to influence a new version of the DOL Fiduciary Rule by responding to the RFI. As part of the DOL's ongoing re-examination of the DOL Fiduciary Rule (as directed by the President), you are encouraged to submit comments to help the DOL consider three crucial issues:

1. First, would a delay of the Jan. 1, 2018, applicability date of the provisions in the Best Interest Contract Exemption, Principal Transactions Exemption and amendments to Prohibited Transaction Exemption (PTE) 84-24 reduce burdens on financial services providers and benefit retirement investors? Would such a delay carry any risk? Responses to this inquiry are due 15 days following the RFI's publication in the Federal Register (i.e., due approximately the last week of July).
2. Second, under what circumstances can the DOL build upon recent market developments and innovations to create new streamlined (or "mini") exemptions or somehow leverage these developments and innovations to change the DOL Fiduciary Rule so that it is more workable? In other words, how do the developments in technology, advisory and data services affect the DOL Fiduciary Rule and compliance timelines? Responses to this inquiry are due 30 days following the RFI's publication in the Federal Register (i.e., approximately mid-Aug.).

   Consider the following key questions:
   - If the U.S. Securities and Exchange Commission (SEC) or other regulators were to adopt updated standards of conduct applicable to the provision of investment advice to retail investors, could a streamlined exemption or other change be developed for advisers that complies with or is subject to those standards? To what extent does the existing regulatory regime for IRAs by the SEC, self-regulatory bodies or other regulators provide consumer protections that could be incorporated into DOL exemptions? Both SEC Chairman Jay Clayton and DOL Secretary Alex Acosta appear to be coalescing around a harmonized approach by both agencies.
   - Would mutual fund clean shares allow distributors to develop policies and

procedures that avoid compensation incentives to recommend one mutual fund over another? What legal or practical impediments do financial institutions face in adding clean shares to their product offerings? How long is it anticipated to take for mutual fund providers to develop clean shares and for distributors to offer them, including the time required to develop policies and procedures that take clean shares into account? What are the costs associated with developing and distributing clean shares? Have financial institutions encountered any operational difficulties with respect to the distribution of clean shares to the extent they are available?
- Do you anticipate that some mutual fund providers will proceed with T-share offerings instead of, or in addition to, clean shares?
- What market innovations may mitigate or even eliminate conflicts of interest that are associated with recommending financial products? The DOL has acknowledged that clean shares, T-shares and fee-based annuities are important innovations; are there any others? Do you think more time (i.e., a delay of the Jan. 1 applicability date of the deferred exemption conditions) is necessary to build the distribution and compliance structures to account for these innovations?
- Would you be amenable to a streamlined exemption based on a model set of policies and procedures, including policies and procedures suggested by firms to the DOL? Are there ways to structure such a streamlined exemption that would encourage firms to provide input regarding the design of such a model set of policies and procedures?

3. Third, how can the DOL Fiduciary Rule be improved?

   Consider the following key questions:

   - What is the likely impact on compliance incentives if the DOL eliminated or substantially altered the contract requirement (as part of the Best Interest Contract and Principal Transaction exemptions) for IRAs? What should be changed? Does compliance with the Impartial Conduct Standards need to be otherwise incentivized in the absence of the contract requirement and, if so, how? Similarly, what is the effect on compliance if the warranty requirement were to be eliminated?
   - Are there ways to simplify the Best Interest Contract Exemption disclosures or to focus the investor's attention on a few key issues, subject to more complete disclosure upon request? For example, would it be helpful if the DOL were to develop a simple up-front model disclosure that alerts the retirement investor to the fiduciary nature of the relationship, compensation structure, and potential sources of conflicts of interest, and invites the investor to obtain additional information from a designated source at the firm?
   - If the DOL were to provide an exemption for insurance intermediaries to serve as "Financial Institutions" under the Best Interest Contract Exemption, would this facilitate advice regarding all types of annuities? Would it facilitate advice to expand the scope of PTE 84-24 to cover all types of annuities after the end of the transition period on Jan. 1, 2018? To what extent would the ongoing availability of PTE 84-24 for fixed indexed annuities, for example, give these products a competitive advantage vis-à-vis other products covered only by the Best Interest Contract Exemption, such as mutual fund shares?
   - To what extent should the "independent fiduciary exception" be broadened to make it more applicable?

   The complete RFI can be found here (https://www.dol.gov/sites/default/files/ebsa/temporary-postings/definition-of-the-term-fiduciary-request-for-information.pdf). The DOL permits comments to be filed digitally, including through the Federal eRulemaking Portal and via email.

Consider whether to update 408(b)(2) disclosures. To the extent your status as a fiduciary vis-à-vis an ERISA client has changed due to the DOL Fiduciary Rule, then you will need to notify the plan fiduciary within 60 days of the change. If you first made a recommendation (i.e., fiduciary investment advice) starting on June 12, for example, then an updated 408(b)(2) disclosure would technically be due by Aug. 12.

Watch for state legislatures to enact laws broadening fiduciary status. Nevada recently made headlines for passing a law (https://www.leg.state.nv.us/Session/79th2017/Bills/SB/SB383_EN.pdf) that would ensnare broker-dealers and investment advisers under its "financial planner" statute, a rigorous regime mandating fiduciary status and disclosure requirements. This new law goes into effect on July 1, 2017, and is not limited to situations where the recipient of the advice is a retirement client. Whether federal preemption excludes SEC-registered advisers and broker-dealers from Nevada's law is a significant interpretive issue. Other states are considering similar laws.

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