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Flashpoint: The New Fiduciary Regs: A Practical Review- Part III

This is the third and final part to our "Practical Review" of the new fiduciary rules issued by the Department of Labor (D OL). This installment will look at how the rules have been accepted by the benefits com m unity and what we hear or think practitioners are doing to prepare for compliance. (Of course, this is not the end of newsletters to you on fiduciary issues and the evolution of this regulation. As new developments occur, we'll keep you posted.)

As with our April 18th FlashPoint (The New Fiduciary Regs: A Practical Review – Part 1) and our June 23rd FlashPoint (The New Fiduciary Regs: A Practical Review – Part II), our concentration in this article is in regard to third party administrators and financial advisors and the clients they service, rather than to the larger financial institutions. If you have questions about an issue not covered here, please give us a call or send an email and we can address your concern.

Significant Unanswered Questions

One of the phenomena we've witnessed since the final DOL regulation was issued is a continuous fluctuation in the level of practitioner or pundit confidence that they have correctly interpreted certain sections of the regulation or the prohibited transaction exemptions. Points that we all thought were clear on first or second glance through the rules don't seem so understandable on our third or fourth look. What one practitioner questions is different from what another sees as problematic. And, the more discussions we have with others in the industry, the more unclear much of the regulation appears.

Here is a selection of the material unanswered questions that we and others are pondering:

- *What constitutes "offering" a platform?* We know that offering a platform is not considered to be giving fiduciary advice, but if a TPA or other consultant directs a client to a platform that is offered by another company (i.e., a TPA directs a client to John Hancock, Transamerica, Voya, etc.) and receives revenue sharing or other compensation from the platform provider, is the person giving the referral engaging in fiduciary advice?
- *Compensation consternation.* What constitutes "payment" in regard to a recommen dation to an investment advisor or manager? Is a "thank you" dinner enough? A cross-recommendation to another client? A tacit understanding that you will cross-refer? An end-of-year gift sent to anyone with whom you have done business during the year?

- *One recommendation – years of liability?* If a TPA or other consultant recommends an investment advisor or manager and is deem ed to receive compensation so that it constitutes fiduciary advice, what is the extent of the potential liability? While the regulation says that the scope of the fiduciary activity is just the advice, it does indicate that ERISA's co-fiduciary rules apply. So, for example, suppose a TPA recommends an investment manager (and gets paid) to a client on Monday, and on W Wednesday learns that the client has not been making salary deferral deposits (potentially a fiduciary breach). Can the TPA be liable as a co-fiduciary if s/he takes no action to remediate? What if the discovery regarding the failed deposits occurs six months later? One year later? Five years later? Doesn't this turn a normal TPA into something of a §3(16) fiduciary because of his or her exposure to information about potential breaches in the course of the TPA work?
- *Distribution services and automatic rollovers.* Does recommending a distribution service or an automatic rollover recipient constitute investment advice?
- *Am I a fiduciary NOW? What about NOW?* If an advisor who is unrelated to a retirement plan makes to a participant regarding a distribution or rollover, and the advisor only gets paid when the advice is taken, is that advisor a fiduciary in relation to the advice, or does s/he not become a fiduciary until after s/he is paid?
- *TPAs and other non-investment practitioners: No BICE for you!* As the Best Interest Contract Exemption ("BICE") and the Level Fee Advisor Exemption ("BIC E Lite") are available only to investment professionals, there is no exemption for a fiduciary who is a TPA or other service provider. Those folks would become fiduciaries in relation to recommendations of investment advisors or managers. After that, they are subject to all the fiduciary-based prohibited transaction rules without any of the new exemptions. Would this mean that taking revenue sharing and not offsetting it against other fees would be prohibited self-dealing? (In other words, do these rules force a TPA into offsetting revenue sharing?
- *How can this be done, really?* Supposedly, the point of the BICE is to perm it financial personnel to receive compensation in manners to which they are accustom ed. But, how can a sales-based financial entity possibly meet the impartial conduct standards and still provide any kind of incentive compensation, including commissions?
- *No more swag at conferences?* If a financial institution sponsors a meeting of an organization of other service providers (such as ASPPA, NIPA, local ABCs or chapters, etc.), and some of the attending m embers either currently refer clients to the financial institution or do so after those meetings:
- Does that constitute "compensation"?
- Is that "self-dealing," a prohibited transaction?

Information From the DOL: Crickets?

As you can see, these are important questions that can change the w ay m any of us in the industry operate. The DOL said in the preamble to the regulation that, "the Department fully intends to support advisors, plan sponsors and fiduciaries, and other affected parties with extensive compliance assistance activities." We all hoped that the DOL would have engaged in these extensive compliance assistance activities by now, providing guidance so that we could start figuring out how our businesses will need to change, but there has been no information coming from the DOL so far.

Pending Lawsuits Against the DOL: Chilling Effect on Guidance?

One of the reasons for this silence from the DOL may be that five lawsuits have been filed against the DOL that claim that the regulation is—at least in some respects—illegal and should be halted. Needless to say, most parties are less likely to speak freely when involved in litigation, and the DOL is probably no exception.

These lawsuits challenge the regulation from any different directions, including such positions as:

- The extension of the DOL's authority under the regulation (particularly in relation to IRAs) is an improper incursion on the purview of the Securities and Exchange Commission.
- The regulation ham pers sales-related nonfiduciary activities.
- The creation of an IRA holder's right to sue financial advisors (i.e., a "private right of action") is unlawful.
- The rule-making process was impermissibly inadequate.
- The rules are unduly vague and violate Constitutional rights to due process.
- The regulation stifles the Free Speech rights of investment advisors by prohibiting truthful commercial speech.

There was a hearing on one of the lawsuit's request that the court enjoin enforcement of the regulation occurred on August 25. One can only assume that additional challenges are waiting in the wings.

Presidential Precedent?

And, of course, one of the factors that we need to consider is that there will be a presidential election before the new regulation is truly effective. As we discussed in this newsletter on several occasions, it is much easier to overturn a regulation before it is effective than after. The DOL made sure that the actual effective date of the regulation was in early June, thereby meaning that the regulation is officially on the books. However, it is still not really operative and won't be until April. Will a new president act to stop the regulation before then?

According to what we have read, it ain't that easy. Overturning an existing regulation requires an act of Congress, an action by the courts, or an initiation of a new regulatory process. Apparently, those who thought up the strategy of finalizing the regulation before the new administration takes office knew whereof they spoke.

The new administration could refuse to enforce the regulation, but one of the key elements of the regulation is the ability of individual participants and IRA -holders to sue. Therefore, action by the DOL once the administration changes may not be sufficient to take the teeth out of the regulation's mouth.

What Will Happen?

That is, of course, the million-dollar question, and no one really knows at this time what the answer is.

We certainly are hearing the beginnings of rumors that the regulation cannot reasonably take effect when planned unless the DOL issues its promised additional guidance soon. Larger organizations, such as financial institutions, need time to develop and establish policies and procedures to comply with the new rules. The word we hear from some representatives of those

organizations is that their IT people are going nuts, as their internal deadline to develop and implement any new program s by April is fast approaching (if not past). If the large organizations cannot comply, how can smaller businesses?

So, one possibility—and at this juncture, it is no more than a pipe dream —is that the D OL will extend the effective date of the new regulation. Closely tied to this possibility is the chance that the courts will, in one action or another in relation to the pending lawsuits, issue an injunction to delay the enforcement of the regulation. Another possibility is that the D OL will act soon to provide guidance on the big questions that currently limit the public's ability to understand the rules, so that the implementation of compliance can go forward. The closer we get to November, the less likely that is.

Will This Issue Die?

Even if the new regulation is put back into the box and not enforced, there is something of a toothpaste-out-of- the-tube effect. The fact is, m any in the general public no longer trust the financial com m unity to act fairly with their money. If this belief is widespread, then it is clear that something will need to change to assure savers that their funds are safe. It is unlikely that this whole concern will evaporate in 2017, even with a Trump presidency.

What Should We Do?

As a result, it is important for everyone who has even an attenuated relationship with plan investments to look at how they operate and where there are potential issues under the new regulation. It is critical for all retirement plan service providers to know where the potential danger areas are if guidance is not issued or if the DOL rules negatively affect their business model. At that point, they can consider how to make their activities "safe," regardless of what the end result of DOL guidance is. If that is unpalatable, they can at least assess the risks and rewards of alternate activities while we await more information.

As always, if you have any questions, please call us. And, we will keep you posted on additional developments as they occur.

Not to Neglect our Friends at the IRS –

The IRS had a busy month in August providing help for those making late rollovers and relief to the Louisiana flood victims.

Revenue Procedure 2016-47 provides a self-certification procedure that would allow certain individuals who have failed to complete a rollover of their retirement assets from either a qualified retirement plan or an individual retirement arrangement ("IRA") within the normally permitted 60-day window to complete the rollover despite the time lapse. The Rev. Proc. allows for eleven different circumstances under which the taxpayer can self-certify and obtain the waiver. A common example is when the distribution check is lost in the mail or misplaced, and as a result is never actually cashed. Prior to this guidance, after 60 days the taxpayer would be out of luck and not entitled to roll the funds to another qualified retirement plan or IRA without requesting an expensive private letter ruling from the IRS. A direct transfer of assets is always recommended, but this guidance will help to preserve those precious retirement dollars.

FBLC's thoughts and prayers go out to all of those families and businesses that have suffered tremendously with the recent flooding in Louisiana. The IRS published Announcement 2016-30

providing relief in the form of relaxed procedural and administrative rules for hardship distributions and participant loans for 401(a), 403(b), and 457(b) plans. The deadline to take advantage of this relief is January 17, 2017, for those participants living in the disaster area or persons living outside of the disaster area with lineal family or dependents living in the disaster area. Both loans and hardship distributions may be made prior to the formal amendment of the plan document. Further, hardship distributions may be approved for the provision of food and shelter, in addition to the usual six reasons, and the usual six-month suspension period for on- going deferrals will not apply. A listing of the affected parishes can be found at https://www.irs.gov/uac/tax-relief-for-victims-of-severe-storms-flooding-in-louisiana.

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