

The Ever-Looming Fiduciary Rule

It's been five years - Is a new definition of Fiduciary on the horizon?

In 1974, President Ford signed into law the Employee Retirement Income Security Act, ERISA, with a goal of protecting the best interest of retirement plan participants and beneficiaries. This landmark legislation set minimum standards of conduct for voluntary retirement plans and imposed stringent duties for the fiduciaries of these plans. Under Section 3(21)(A) of ERISA, a person is deemed a fiduciary to a plan if he/she¹:

- a) exercises discretionary authority or control with respect to the management of the plan or disposition of assets;
- b) renders investment advice with respect to plan assets in exchange for monetary compensation, direct or indirect, or has the authority to do so;
- c) has discretionary authority or responsibility over the administration of the plan.

The following year, the Department of Labor (DOL) issued a regulation which narrowed the definition of a fiduciary and introduced a 5-part test for determining if a person assumes fiduciary responsibilities by providing investment advice. An adviser who does not have discretionary control over the plan is still considered a fiduciary if he/she provides investment advice (1) as to the value of securities or makes recommendations regarding investment alternatives (i.e. the buying and selling of securities) (2) on a regular basis (3) pursuant to a mutual agreement or understanding. As part of this agreement, it must be understood that the provided advice (4) serves as the primary basis for plan investment decisions and (5) is personalized to the individual needs of the plan.¹

Redefining “Fiduciary”

Since the signing of ERISA, the pension landscape has changed drastically with a shift to participant-directed, defined contribution plans and the introduction of more complex investment alternatives. With these changes, adviser/client relationships have adapted. In October of 2010, the Employee Benefits Security Administration (EBSA) of the DOL decided that the law must adapt as well. Aimed at better protecting plans, participants, and beneficiaries, Phyllis Borzi, the Assistant Secretary of Labor who heads EBSA, issued a proposed amendment to

¹ Definition of the Term “Fiduciary”. Federal Register. 22 October 2010. Volume 75. Number 204. Proposed Rules. Page 65263-65278.

update the 35 year old fiduciary definition. The proposed rule expanded the definition of fiduciary to include those who provide investment advisory services for compensation, but are not classified as investment advisors, and deleted the second and fourth parts of the 5-part test which required that the advice be on a regular basis and serve as the primary basis for plan investment decisions. The scope of this proposed rule was broadened to include broker dealers and financial advisers. Nearly five years and many opinions later, the law remains unchanged.

Five Years of Controversy

Looking back over the past five years, the pending change in the fiduciary definition has been constantly looming over the industry as an imminent disruption. When EBSA released the original proposal, they received a storm of response from industry professionals, as well as other affected groups. With such an intense response, the initial proposal was withdrawn in 2011 to give EBSA a chance to evaluate the industry's response and revise the proposal. Since the introduction of the proposed rulemaking, commonly referred to as the "conflict of interest rule" or the "no advice rule", the DOL has delayed re-proposal several times. Most recently, the proposal was delayed to allow Labor Secretary, Thomas Perez, an opportunity to meet with industry representatives.²

Proponents

Supporters of the proposal as written cite conflicts of interest and sales motivation as contributing factors to poor investment advice which depletes participants' retirement savings. They believe that all advisers should be required to act as fiduciaries so plan sponsors and participants need not decipher whether or not an adviser is providing advice as a fiduciary. A website entitled "Save Our Retirement" compares the yearly losses that participants' experience due to poor investment advice to "a colony of termites quietly eat(ing) away an entire house".³ This imagery, although criticized as sensationalism, vividly depicts how small losses can significantly diminish savings overtime.

Opponents

While many admit the need for a change, opponents feel that the proposed rule is too broad and assumes the position that all advisers are unscrupulous and immoral. They believe the proposed rule would make it harder for advisers to provide advice by overregulating them, which in turn, harms participants. Citing

² Schoeff Jr., Mark. Borzi taking back seat on fiduciary. Investment News. 21 October 2014.

³ Save Our Retirement. <http://saveourretirement.com/>. This website was created by AARP, AFL-CIO, AFSCME, Americans for Financial Reform, Better Markets, Consumer Federation of American and Pension Rights Center.

2011 economic analysis from the DOL, they believe the true issue is that many participants in retirement plans are not receiving any advice at all and would benefit from sound advice to assist them in making better investment decisions.⁴ Opponents believe that the proposed rule would make it harder for participants to receive advice from someone they are familiar with, such as the plan provider, due to intensified conflict of interest rules.

Ekon Explains

In March 2015, we released an article entitled [“Rethinking Participant Education”](#) which focused on turning participants into educated, independent investors. This applies to the ongoing fiduciary definition debacle as well.

It is true - not all advisers act in the best interest of the participant. Some sell ancillary products in order to line their own pockets and provide advice that is likely to result in diminished savings for the participant. This is reality but it is not the case for every adviser. There are good advisers in the industry, as well. These advisers truly care about their clients’ plans and participants and put their needs first every time. The entire basis for updating the fiduciary definition is to better protect participants and beneficiaries, as was the intent of ERISA, but what is the best way to do this? This is where participant education comes in. Participants should be able to seek advice they can trust and even more importantly, they should be empowered to be confident, independent investors. This happens when participants are given unbiased education, information, and tools that they can utilize to build their personal savings strategy and plan for retirement.

Is a decision on the horizon?

On February 25th, 2015, the Department of Labor released the latest proposal for changing the fiduciary definition to the Office of Management and Budget. After OMB approval, the proposal will be released to the public for another comment period. Improving retirement success for hard working Americans has taken a primary spot on President Obama’s legacy agenda and the DOL understands that. DOL Secretary Perez stated, at the Consumer Federation of America Conference, “Our aim is to make sure that we have a final rule in place in this administration that will be effective”.⁵

⁴ Cornfield, Jill. Two Sides Start Duking It Out on Fiduciary Rule. PlanAdviser. 29 January 2015.

⁵ Schoeff Jr., Mark. DOL head says fiduciary standard will happen. Investment News. 13 March 2015.