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TOP ADVISER QUESTIONS ON DOL FIDUCIARY RULE ANSWERED

Here are the main points of confusion among Fidelity's many adviser clients, and some insights that might help guide their strategy

By Tom Corra

If advisers have questions about the Department of Labor's investment advice rule, they are not alone.

Among the more than 3,000 third-party financial advisory firms we work with, many are waiting for more clarity on the fiduciary rule — which requires advisers to act in the best interests of clients when handling retirement accounts — before committing to a compliance strategy.

Here are the top questions we hear from firms, as well as some answers that might help guide their strategy. An adviser firm should consult its legal and compliance teams for specific guidance on how the rule will apply.

Can I use the best-interest contract exemption, also known as BICE, to keep doing business as usual under the fiduciary rule?

The BICE can be used to support a number of existing business models, including broker-dealers who operate under a commission-based model, but the BICE generally requires advisers to make changes to their existing business models. Under the BICE, the investor and the financial institution must generally enter into an agreement wherein the adviser agrees to act in the investor's best interest and the investor has enforceable contractual rights. The financial institution is only required to enter into such a contract with IRA and non-Employee Retirement Income Security Act plan clients. The contract may not contain provisions that limit the adviser's liability for breach of contract, prohibit participation in class actions or provide liquidated damages. Additionally, compensation under the BICE must be reasonable, and the firm must adopt "impartial conduct standards" to help ensure advisers act in the best interest of clients. Many other requirements apply as well.

For advisers who qualify as "level-fee fiduciaries," the streamlined BICE may be used for recommendations to rollover assets from an ERISA plan to an IRA, from one IRA to another or to switch from a commission-based to a level-fee arrangement.

Does switching my practice to a level- or flat-fee model take care of all my fiduciary issues?

Advisers who operate under a level-fee arrangement are likely to be less affected by the new rule. However, certain types of recommendations regarding rollovers and account selection do present the potential for conflicts of interest.

Advisers who qualify as level-fee fiduciaries may address these conflicts under the streamlined BICE exemption. Generally, under the rule, a financial institution, the adviser and any affiliates are considered to be level-fee fiduciaries if the only compensation they receive for advisory or investment management services is a level fee. Level fee is defined narrowly for purposes of the streamlined BICE. Level-fee fiduciaries opting to go this route should have a detailed and documented process in place to demonstrate and justify that any recommendations are in the clients' best interest. This process should include a cost and benefit analysis and documentation of the rationale for the recommendation.

Rollovers are a big part of my business. What do I need to be concerned about?

The DOL now considers any recommendations for a fee or other compensation, direct or indirect, relating to rollovers, distributions or transfer of assets from a retirement plan or IRA account to be investment advice. This includes suggestions about whether to process such a transaction, the amount, in what form and the destination for the assets.

Advisers generally should make certain that any rollover recommendations are in the client's best interest and that they have established a detailed process for conducting any such discussions in compliance with the BICE or another applicable exemption. Should one of the adviser's suggestions relating to a rollover or distribution result in any compensation, direct or indirect, to the adviser, the financial institution or any of its affiliates, it could be considered a prohibited transaction. For example, the DOL has indicated that even level-fee fiduciaries may have a conflict when suggesting that a new client take a rollover distribution. In the case of such conflict, the adviser would have to employ the level-fee BICE or another prohibited transaction exemption.

If I'm an investment adviser, are all of my client communications considered investment advice?

Not necessarily. Certain investment communications by platform providers to independent plan fiduciaries about the platform and certain limited selection and monitoring assistance to plan fiduciaries is not considered investment advice. The same is true for certain investment education materials and general communications. To avoid being considered investment advice, such communications must meet a number of requirements.

All advisers, including those who are fee-only, should work with their compliance and legal teams to determine the potential impact based on their registration type, business model and activities. At a minimum, level-fee advisers should pay close attention to how they conduct discussions with new clients in two specific areas: rollover transactions and conversions to a fee-based arrangement.

The industry hopes to receive some much-needed clarity on the rule from DOL in advance of April 2017.

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