

Department of Labor releases final fiduciary rule

Initial compliance required by April 10, 2017; full compliance required by January 1, 2018



The Department of Labor (DOL) released its final “Conflict of Interest” rule¹ and six prohibited transaction exemptions, which have been reviewed and approved by the White House’s Office of Management and Budget.

The rule, which expands the definition of “fiduciary” under the Employee Retirement Income Security Act (ERISA) by requiring retirement investment advisers—including broker-dealers and insurance agents—to abide by a fiduciary standard, will be published in the *Federal Register* on April 8, 2016 with an effective date of June 7, 2016. The DOL believes this effective date will provide certainty to plans, plan fiduciaries, plan participants and beneficiaries, individual retirement accounts (IRAs), and IRA

owners that the new framework is “now officially part of the law and regulations governing their investment advice providers.”

Below we have highlighted some of the key changes, clarifications and additions to the final rule. However, as Deloitte conducts a more comprehensive review of the final rule text, we are likely to identify additional changes.

Timeline

The final rule clarifies that the timeline for compliance with the rule and exemptions will be phased in over the course of about 20 months, with full compliance required by January 1, 2018. However, **substantial changes will be required**

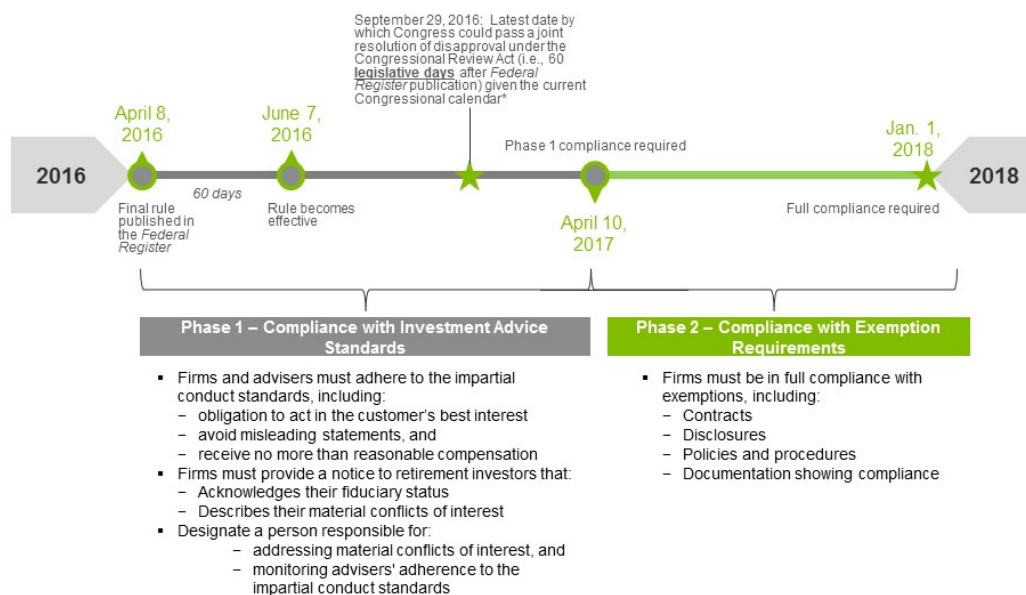
¹ Department of Labor, Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, available at

<https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-07924.pdf>

within 12 months, including delivering advice to retirement investors under a “best interest standard” instead of the traditional “suitability standard”. Organizations will be given until

January 1, 2018 to implement the compliance, operational, technology and process changes to support the exemption requirements and new advice standards.

DOL Conflict of Interest Rule Implementation Timeline



* The rule remains effective during the Congressional review period

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Best Interest Contract (BIC) exemption

Although many of the major components of the rule remain the same as under the proposed version, the DOL made certain key changes in light of the extensive written comments, testimony during four days of DOL-hosted hearings, and other engagement with various stakeholders. Importantly, the rule retains the overall BIC exemption that allows fiduciaries to receive various forms of compensation that would otherwise be considered conflicts of interest and therefore prohibited under ERISA and the code.

However, the exemption contains several changes that may make adoption of the BIC more operationally feasible, including **broadening the list of allowable assets that qualify for the BIC exemption to include all asset classes.**

In addition, the BIC exemption now includes **provisions clarifying how it can be used for the recommendation of proprietary products,** including a requirement that firms determine that any limitations of such products are not so severe

that the adviser will be unable to satisfy the best interest standard.

The BIC exemption also includes a **grandfathering provision that allows for additional compensation from previously acquired assets.** Specifically, the provision includes compensation from recommendations to hold, as well as systematic purchase agreements, but requires that, after April 10, 2017, additional advice must satisfy basic best interest and reasonable compensation requirements.

Other key changes from the rule proposal

Disclosures

Under the proposed rule, the disclosure framework under the BIC exemption would have required 1-, 5-, and 10-year projections, which firms believe would be difficult and costly. In response to this view, the final rule streamlines the disclosure framework under the BIC exemption by **eliminating these projections,** as well as the annual disclosure requirement.

Insurance

The rule **limits the so-called “insurance exemption” to recommendations of fixed rate annuity contracts.** In order to sell other insurance products—including variable and indexed annuities—insurance companies can use the BIC exemption.

Advice and recommendations

Importantly, the final rule **includes examples of communication that would not rise to the level of a recommendation** and, accordingly, would not be considered advice. Specifically, education is not included in the definition of retirement investment advice so advisers and plan sponsors can continue to provide general education without triggering fiduciary duties. Additionally, under rule general circulation letters, television or newspaper commentary, general research reports, and general marketing materials would not constitute investment advice.

Notably, the DOL specified that in determining whether a communication constitutes a recommendation that it would make “no difference whether the communication was initiated by a person or a computer software program.”

Additional Considerations

Congressional action

Congress may pass a “joint resolution of disapproval” within 60 legislative days following the rule’s publication in the *Federal Register*.² Given the current Congressional calendar, Congress would be required to pass this resolution by September 29, 2016.³ If the President signs the resolution—or, if Congress overrides the President’s veto—the rule will not take effect. This avenue of stopping the rule seems unlikely to prevail given that President Obama would likely veto the measure,⁴ and

Congress may not have the requisite two-thirds majority to override a veto on this issue.⁵

Potential litigation

In addition to the legislative activity, it is likely that the rule will be subject to litigation once it is finalized, including under the Administrative Procedure Act. However, it remains unknown whether litigation would be successful in stopping or delaying the full or partial implementation of the rule.

SEC developments

In a February 19, 2016 speech on 2016 priorities, SEC Chair Mary Jo White pledged to “continue to work to develop support from [her] fellow Commissioners for a uniform fiduciary duty for investment advisers and broker-dealers, and to bring a workable program for third party reviews to enhance the compliance of registered investment advisers.”⁶ Although Chair White previously said the SEC is moving “expeditiously” on a proposal, she declined to estimate when the proposal might be ready for a full Commission vote.

Next steps

Institutions that will be affected by the final rule may contact Deloitte with questions about the rule and activities to support planning, preparation, implementation and compliance.

Deloitte continues to analyze the final rule and will release a more detailed summary and point of view on the immediate steps that organizations should be taking to mobilize and implement the substantial changes that will be required by April 10, 2017.

² Pub. L. 104-121, available at <https://www.gpo.gov/fdsys/pkg/PLAW-104publ121/pdf/PLAW-104publ121.pdf>

³ House Calendar, 114th Congress, Second Session, available at <http://www.majorityleader.gov/wp-content/uploads/2011/07/2016-ANNUAL-CALENDAR.pdf>

⁴ The White House previously issued a Statement of Administration Policy threatening to veto a separate piece of legislation that would prohibit the DOL from finalizing its proposed rule until the Securities and Exchange Commission issues a final rule setting forth a fiduciary standard for broker-dealers. Given that the White House and DOL have repeatedly emphasized the importance of finalizing the rule, legislation that would affect this process faces opposition from the Administration. See

Statement of Administration Policy, H.R. 1090 – Retail Investor Protection Act, available at

https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr1090r_20151026.pdf

⁵ Since the Congressional Review Act was enacted in 1996, only one rule has been disapproved by Congress under the law. See Congressional Review Act FAQs, available at <http://www.gao.gov/legal/congressional-review-act-faq/about>

⁶ Chair Mary Jo White, “Chairman’s Address at SEC Speaks – ‘Beyond Disclosure at the SEC in 2016,’” available at <https://www.sec.gov/news/speech/white-speech-beyond-disclosure-at-the-sec-in-2016-021916.html>

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