The Fiduciary Standard and Its Impact on Investors

Effective June 9th, the U.S. Department of Labor imposed a fiduciary standard that requires stewards of retirement savings accounts to act in their clients' best interest. Many elements of the 1000+ pages of regulation are currently in force; other provisions will become active in January 2018. There is a chance, however, the rule will be substantially revised or even eliminated by then.

Until then, the rule impacts all financial advisors who provide financial management, advice, investment and oversight of retirement accounts - defined-contribution plans: *four types of 401(k) plans, 403(b) plans, employee stock ownership plans, Simplified Employee Pension (SEP) plans and savings incentive match plans (simple IRA); defined-benefit plans: pension plans or those that promises a certain payment to the participant as defined by the plan document, and Individual Retirement Accounts (IRAs).* It only applies to retirement accounts because this is the extent of the DOL's authority under the Employee Retirement Income Security Act of 1974 (ERISA).

ERISA is a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans. There is an effort underway to have the SEC establish a universal fiduciary standard to cover all investment accounts - but that is still in the future.

Registered Investment Advisors have always been fiduciaries to their clients under the Investment Advisers Act of 1940. While the 1940 law did not define the duties of a fiduciary, over time and legal rulings, the standard evolved to require that an adviser:

- Exercise due care (prudence and reasonableness) when acting on behalf of clients.
- Employ reasonable care to avoid misleading clients.
- Have a reasonable basis for investment advice.
- Seek best execution of clients' trades.
- Act in the best interest of clients.
- Place the interest of clients above its own.

This standard was significantly broader than that which applied to insurance agents and securities representatives and broker/dealers, who were expected to:

- Treat customers in a fair manner characterized by high standards of honesty and integrity.
- Place the interests of the customer first.
- Disclose all material information in connection with an investment recommendation
- Not execute trades in a customer's account unless the customer approved and authorized the trade in advance, or had given the broker discretionary trading authority

- Make investment recommendations consistent with the customer's financial status, investment objectives, level of understanding and risk tolerance.

In developing its fiduciary standards for retirement accounts, the DOL moved beyond broad-based concepts to minutia. The regulations that begin to take effect on June 9th are 1,023 pages in length. The new rule automatically elevates all financial professionals who work with retirement plans or provide retirement planning advice to the level of a fiduciary, bound legally and ethically to meet the standards of that status. While this will have the most effect on securities brokers and insurance agents, who are paid on a commission basis, registered investment advisors will be affected as well by the regulators' attempt to detail the responsibilities of the fiduciary and disclosure requirements.

The new DOL rules are expected to increase compliance costs, particularly for smaller, independent broker dealers and RIA firms without the financial resources to invest in the technology and the compliance expertise to meet all the requirements. Rollovers from 401(k) plans to IRAs are expected to come under increased scrutiny, as will fee arrangements. Many analysts expect the new regulations to drive the growth of robo-investing with less risk of human interaction or conflict in investment decisions. There is also considerable concern that servicing small accounts will become un-economical, resulting in fewer options for smaller accounts.

Retirement investors can expect increased disclosure documents on the RIA's fiduciary duties, impartial conduct standards, fees - including the "Level Fee exemption" and a host of other issues.

While the intent of the DOL fiduciary rule is admirable, investors always need to be aware that those willing to exploit and defraud others are rarely stopped by laws, regulations or disclosure requirements. The investor must always be alert to promises that are too good to be true, the lack of independent third party statements, improper payment arrangements and many other fraudulent actions. Crimes can be detected only after they have taken place and that is typically too late to recover the investor's funds.

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