Why the DOL Fiduciary Proposal Would Have a Huge Impact on Advisors and Investors

The Department of Labor has proposed new regulations that will have serious consequences for insurance and financial advisors and their clients planning for retirement. The proposed rule would redefine a retirement investment advice fiduciary under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code.

As a result, many NAIFA members who have operated effectively on behalf of clients under a suitability standard would now be considered fiduciaries and subject to fiduciary-specific restrictions under ERISA and the tax code. As currently written, the proposed rule is unworkable for retirement savers and their advisors. It would fundamentally change the way advisors do business, disrupt long-established client-advisor relationships, increase costs for advisors and consumers and prevent advisors from providing retirement investors with certain types of important advice and services.

The regulations would certainly reduce the availability of services and advice as some advisors would either shift their practices away from the retirement sector or would drop middle- and lower-market clients who would not be able to afford the increased costs. Consumers may find themselves unable to continue working with advisors they know and trust and may be unable to receive advice in a number of common, yet complicated, retirement-investment situations.

INCREASING COSTS

A leading concern for NAIFA, our members and their clients is that the proposed rule would drive up the cost of retirement investment advice and services.

Advisors receiving commissions, revenue-sharing and other third-party compensation would be required to sign a complicated and potentially confusing “best interest contract” with clients. The contract would require advisors to act in the best interest of the retirement investor (as defined by ERISA), adopt written policies to mitigate conflicts of interests (such as a policy creating only level commissions that do not vary based on which products the advisor recommends), and complete increased disclosures and paperwork with each transaction.

The exemption would also require advisors to complete a (potentially lengthy) annual disclosure document for each client detailing all transactions, fees and expenses, and the advisor’s direct and indirect compensation. On top of that, financial institutions would have to maintain and update web sites that show the amount of compensation advisors would receive for each of its product offerings. This would be particularly burdensome for smaller firms with limited resources. They may choose to exit the

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market, resulting in decreased competition and consumer choices.

The increased paperwork, record-keeping requirements and disclosures combined with the need for financial institutions to create and frequently update web sites with data would drive up the cost of advice and services. The best interest contract would increase advisors' liability and potentially expose them to frivolous lawsuits. Advisors could be sued in state courts for alleged contract violations and in federal court for alleged violations of fiduciary duty under ERISA. In these suits, the burden of proof would be on the advisor.

With this huge increase in liability, advisors' costs would inevitably go up. These costs would need to be passed along to consumers. Some advisors and smaller financial institutions would exit the market rather than deal with the new regulatory and liability burdens.

LIMITING ACCESS

But even advisors who continue to serve retirement investors would face restrictions making it difficult or impossible for them to perform some service clients have grown to expect from them.

For example, the proposed rule would prohibit advice on plan distributions, including individual retirement account rollovers.

Any advisor affiliated with a plan service provider, such as an insurance company, would not be allowed to sell a variable annuity from that provider. The advisor would still be allowed to sell fixed-rate annuities, but this would obviously limit the clients' choices.

It is unclear how the advisor would be able to work in the best interest of the client under this situation. What if a variable annuity product would be in the best interest of a client but the rule prohibits the advisor from selling that product? Similarly, would an advisor not licensed to sell securities violate his or her fiduciary duty simply by limiting advice to non-securities solutions? The rule is unclear on this. What is clearer is that the rule would limit consumers' options.

The proposal would ostensibly allow advisors to provide consumers with retirement investing education without triggering fiduciary liability, but the rule's definition of education is extremely narrow. Advisors would not be allowed to give specific product examples. It is unclear whether web sites that include retirement investment calculators would trigger a fiduciary liability.

These are just a few of the problems the proposed rule would present for advisors and their clients.

WHAT IS NAIFA DOING?

NAIFA is uniquely positioned to represent the interests of all insurance and financial advisors, whether they are captive, affiliated or independent, and their middle-market clients. NAIFA's goal is to help regulators create a workable best interest standard that is business-model-neutral and preserves access for middle-income people and small businesses.

NAIFA leaders, including NAIFA President Juli McNeely, have met with DOL officials on multiple occasions to discuss the proposal and the ways it will impact advisors' clients. McNeely also testified at a DOL public hearing on the proposal and at a congressional hearing before the House Financial Services Committee. NAIFA submitted formal comments on the rule to the DOL, outlining proposed changes.

A NAIFA grassroots campaign resulted in more than 18,000 letters to Labor Secretary Perez and members of Congress on the proposal. NAIFA members have also met in person with their legislators to discuss the matter. The DOL proposal was a primary focus at NAIFA's 2015 Congressional Conference, when nearly 800 advisors went to Capitol Hill for meeting with their members of Congress.

NAIFA will continue to work with DOL officials and members of Congress to endure that the final rule is workable and will not place undue burdens on advisors or their clients.

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