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Ch-Ch-Changes: The Conflict of Interest Rule is Delayed But Newly-Minted Fiduciaries Must Comply with Impartial Conduct Standards

In some ways, financial services advisors can breathe a collective sigh of relief as the applicability date of certain portions of the Conflict of Interest Rule has been put off until July 1, 2019.[1] But the delay is only that and not a complete pass. The new Fiduciary Rule component has been applicable since June 9, 2017, as have been the Impartial Conduct Standards, and the Department of Labor has announced that fiduciaries who fail to comply with those standards in good faith could be subject to enforcement actions for violating their duties of prudence and loyalty under ERISA.[2]

The Conflict of Interest Rule and the Delays

April 8, 2016, was a red letter day for the Department of Labor (Department). On that date, the Department upended a 1975 regulation and replaced it with a new regulation defining investment advice fiduciary. Under the new Fiduciary Rule, a person is a fiduciary under ERISA if the person provided investment recommendations for a fee or other compensation to an ERISA plan, its participants or beneficiaries, or an individual retirement account (IRA). On the same day, the Department published two new administrative class exemptions, Prohibited Transaction Exemption (PTE) 2016-01 or the Best Interest Contract (BIC) Exemption, and PTE 2016-02, the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Principal Transaction Exemption). Also on that day, the Department amended several long-standing administrative exemptions, including PTE 84-24, which concerns transactions involving insurance and annuity contracts. The Fiduciary Rule, BIC Exemption, Principal Transaction Exemption, and the PTE amendments are all bound up in what is commonly referred to as the Conflict of Interest Rule.

The Conflict of Interest Rule was slated to become applicable on April 10, 2017. Before we got there, a presidential election intervened, followed by a Presidential Memorandum. On February 3, 2017, the new president instructed the Department to update the analysis of the Fiduciary Rule's likely impact on access to retirement information and financial advice.[3] Needing time to comply, the Department extended the applicability date of the Fiduciary Rule and those portions of the Conflict of Interest Rule that became

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effective on April 10 by 60 days to June 9, 2017.[4] In addition, the extension provided that investment advice fiduciaries were required to comply with the Impartial Conduct Standards of the BIC and Principal Transaction Exemptions during a transition period from June 9, 2017 through January 1, 2018.[5] Compliance with other requirements, such as mandatory disclosures and written fiduciary compliance representations, was delayed until January 1, 2018, by which time the Department hoped to have completed the analysis required by the Presidential Memorandum.

Following the initial 60-day extension, the Department, after notice and comment, published, on November 29, 2017, a notice of a further delay which extended the transition period for 18 months, from January 1, 2018 to July 1, 2019. The stated reasons for the extended delay were manifold. The Department needed additional time to consider public comments under the parameters stated in the Presidential Memorandum and to consider possible changes to the BIC and Principal Transaction Exemptions and the amendments to the other PTEs. Coordination with the Securities and Exchange Commission (SEC) and state insurance commissioners was another cause for the delay. In a nod to the industry and another indication that changes are afoot for the rule, the Department cited undue expenses that the regulated community may incur to comply with requirements that may ultimately be changed or eliminated.

Significantly, the extension did not delay the applicability date of the Fiduciary Rule.

The Fiduciary Rule and Impartial Conduct Standards

While attention was focused on the delays and the BIC exemption, the Fiduciary Rule quietly came on the scene and became applicable on June 9, 2017. Since then, any person who provides "investment advice—that is, a recommendation or a suggestion that the plan participant or IRA investor make a particular investment decision, such as hiring a specific investment manager or choosing investments from a selected list of securities—for a "fee or other compensation, direct or indirect" is a fiduciary. Receiving the fee would be a prohibited transaction, unless subject to an exemption. With the delays in place on the applicability dates for the BIC and Principal Transaction Exemptions, a fiduciary understandably could have concerns.

According to the Department, fiduciaries should not have cause to worry as long as they follow the Impartial Conduct Standards. During the period of the extensions—first from April 10 to June 9, 2017, and now continuing to July 1, 2019, the so-called transition period—investment advice fiduciaries will not run afoul of ERISA's prohibited transaction sections as long as they satisfy the Impartial Conduct Standards under the BIC or Principal Transaction Exemption standards: (1) act in the best interest of customers; (2) charge no more than reasonable compensation (for the BIC Exemption) or seek to obtain the best execution reasonably available (for the Principal Transaction Exemption); and (3) avoid making misleading statements.[6]

Further, the Department has issued non-enforcement relief for investment advice fiduciaries who "diligently and in good faith" seek to comply with the Conflict of Interest Rule.[7] In publishing the most recent extension, the Department stated that "its general approach to implementation will be marked by an emphasis on assisting (rather than citing violations and imposing penalties on) plans, plan fiduciaries, financial institutions, and others who are working diligently and in good faith to understand and come into compliance with" the Conflict of Interest Rule and will not pursue claims against fiduciaries who do so.[8] By the same token, however, the Department warned that investment advice fiduciaries are subject to the "duties of prudence and loyalty," which are "embedded in the Impartial Conduct Standards" and that it expects fiduciaries to adopt "prudent supervisory mechanisms to prevent violations of the Impartial Conduct

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Standards."[9] In addition, the Department takes the position that, during the transition period, fiduciaries should exercise care in communicating with investors and fairly and accurately describe recommended transactions and compensation practices.[10]

Accordingly, while the 18-month delay provides a further reprieve for some portions of the BIC and Principal Transaction Exemptions and portends some changes, those in the financial services industry should remain mindful of the Fiduciary Rule. Those who find themselves collared as investment advice fiduciaries under the new regulation should be taking heed of the Impartial Conduct Standards and the Department's enforcement and non-enforcement positions.

NOTES

1. 18-Month Extension of Transition Period and Delay of Applicability Dates, 82 Fed. Reg. 56545 (Nov. 29, 2017).
2. The Employee Retirement Income Security Act of 1974, as amended.
3. 82 Fed. Reg. 9675 (Feb. 7, 2017).
4. 82 Fed. Reg. 16902 (Apr. 7, 2017).
5. *See* 82 Fed. Reg. 56545 at 56546 (Nov. 29, 2017).
6. 82 Fed. Reg. at 56547, 56554.
7. *Id.* at 56554; *See* Dep't of Labor, Field Assistance Bulletin 2017-02 (May 22, 2017).
8. 82 Fed. Reg. at 56554.
9. *Id.* at 56550.
10. *Id.*

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