Conflict of Interest Rules: An Update

New regulations impacting retirement savers and the financial professionals who serve the retirement industry were introduced by the U.S. Department of Labor (DOL) -- the governmental body that oversees pensions and other retirement accounts -- in April 2016. Originally proposed a year ago, the so-called "conflict of interest" rules have been modified to reflect input from consumer advocates, industry stakeholders, and others.

The DOL's final rules make clear its position that education about retirement savings, investing, and other financial topics is beneficial to plan sponsors, plan participants, and IRA owners.

Following are some of the key takeaways from the DOL's regulatory package as they pertain to retirement savers.

Conflict of Interest Addressed

Over the past 40 years, there has been a considerable shift in the retirement savings landscape away from employer-sponsored defined benefit (DB) plans to participant-directed, defined contribution (DC) plans such as 401(k)s. Along with this change, there has been widespread growth in assets in IRAs and annuities.

One consequence of this change, according to the DOL, is the increased need for sound investment advice for workers and their families. The DOL says its conflict of interest rules and its related exemptions are intended to require that all who provide retirement investment advice to employer-sponsored plans and IRAs abide by a "fiduciary" standard -- putting their clients' best interest before their own profits.

Who Is a Fiduciary?

Under the DOL's final rules, "a person is a fiduciary if the person receives compensation for providing advice with the understanding that it is based on a particular need of the person being advised or that it is directed to a specific plan sponsor, plan participant, or IRA owner. Such decisions can include, but are not limited to, what assets to purchase or sell and whether to roll over from an employment-based plan to an IRA." In this capacity, a fiduciary could be a broker, registered investment adviser, or other type of adviser.

Added Protection for Retirement Savings

Under the rule's updated definition of fiduciary investment advice, advisers to plan participants and plan sponsors are expected to provide investment advice in their clients' best interest. Likewise, advisers to IRA savers are expected to put their clients' best interest first when recommending investments.

Firms are expected to have clear written policies and to communicate them to their clients. And when investors believe that advice may not have been in their best interest, written policies can give them a way to seek to hold their advisers accountable.

The Best Interest Contract Exemption

In order to achieve two important goals of the conflict of interest rules -- ensuring retirement savers receive advice that is in their best interest while also allowing advisers to continue receiving commission-based compensation -- the DOL's regulatory package includes a provision called the Best Interest Contract Exemption (BICE). The DOL says this exemption is intended to allow firms to continue to use certain compensation methods provided that they "commit to putting their client's best interest first, adopt anti-conflict policies and procedures, and disclose any conflicts of interest that could affect their best judgment as a fiduciary rendering advice" -- among other conditions. Common forms of compensation, such as commissions, could be permitted under this exemption, provided the conditions of the exemption are satisfied. The BICE is available to financial professionals that advise IRA savers, individual plan participants, and small retirement plans.

How does the BICE affect investors? The contract provisions of BICE are slated to go into effect January 1, 2018. As of that date, IRA clients entering into a new advisory relationship should expect to sign the contract either before or at the time that a new recommended transaction is executed. IRA clients already working with an investment adviser as of January 1, 2018, may receive a notice from their adviser or firm describing their new rights. It should not require the client to take any action unless they object to the terms of the notice.

Clients receiving advice about investments in an employer-sponsored retirement plan, such as a 401(k), should receive the same general protections and disclosure, but should not expect to receive a contract to sign.

Education Versus Advice

The DOL's final rules make clear its position that education about retirement savings, investing, and other financial topics is beneficial to plan sponsors, plan participants, and IRA owners. As such, the DOL said that plan sponsors and service providers can offer investment education without becoming investment advice fiduciaries.

Elaborating on the topic, the DOL stated that this includes the use of asset allocation models and interactive investment materials to identify specific investment alternatives under a plan if certain conditions are met. Such communications from plans that identify specific investment alternatives can be considered "education" and not a "recommendation" because plans have a fiduciary who is responsible for making sure the alternatives in the plan are prudent. There is no such responsible fiduciary in the IRA context, therefore references to specific investment alternatives are treated as fiduciary recommendations and not merely "education."

While the DOL's work may appear to be largely done, the new regulations are not expected to take effect until spring of 2017 (at the earliest) to allow all affected parties to adapt to and incorporate the changes.

To learn more about the new regulations and how they may affect you, visit the Department of Labor website.

United States Department of Labor, "FAQs About Conflicts of Interest Rulemaking."