 by Mike Lochmann

Your New, Thousand-Page Definition of a 'Fiduciary'

The Department of Labor has added a new level of complexity to advisors' relationships with their clients.

New Department of Labor regulations to protect individuals from conflicted or misleading investment advice will have major impact on businesses that advise qualified retirement plans and IRA owners. The regulations expand the definition of "fiduciary" to include anyone who provides investment advice or recommendations for a fee with respect to assets of a retirement plan or IRA.

The U.S. Chamber of Commerce and the financial-services industry opposed this controversial regulation. Both the House of Representatives and the Senate have passed resolutions to block the new regulations. President Obama has promised to veto the resolutions. Critics argue that the regulations are far too complex, expensive to implement and will make it more difficult and costly for small businesses and low to moderate income Americans to obtain advice on saving for retirement.

The regulations redefine who is a "fiduciary" (because they provide investment advice) through a complex three-part definition:

COMPENSATION	RECOMMENDATION	RELATION
A person or an affiliate receives a fee or other consideration, directly or indirectly, paid in connection with or as a result of a transaction or service.	Recommends or suggests: • acquiring, holding, disposing, or exchanging assets of a plan or IRA; OR • an investment adviser, a strategy for managing securities, or a portfolio composition for a plan or IRA; OR • a rollover, transfer or distribution of assets of a plan or IRA.	Directly or indirectly by a person who: • represents or acknowledges that it is acting as a fiduciary OR • renders advice pursuant to an agreement that the advice is based upon the particular investment needs of the recipient; OR • directs advice to a specific recipient regarding a particular investment decision for assets of a plan or IRA.

Unless there is an applicable exemption, a fiduciary who accepts a fee from a plan or IRA engages in a prohibited transaction. The fiduciary is subject to a 15 percent excise tax, and must refund the fee. If the fee is not refunded, the fiduciary is subject to a second excise tax of 100 percent.

The regulations create a new "best-interest contract" prohibited transaction exemption that permits advisers, financial institutions and their affiliates to receive compensation for providing investment advice. The exemption is only available to "financial institutions," which include banks, insurance companies, registered investment advisers and registered broker-dealers, and their affiliates and related interests. The financial institution and retirement investor must enter into a written best-interest contract with specific terms, including:

- A statement that the financial institution is a fiduciary.
- That advice provided is in the best interests of the retirement investor.
- That only reasonable compensation will be received for the services rendered.
- That all statements about recommended transactions and fees will not be misleading.
- That the fiduciary will comply with impartial conduct standards.
- That it will follow policies to avoid material conflicts of interest.
- And that it will not create financial incentives to make recommendations that are not in the investor's best interests.

The best-interest contract may not contain any exculpatory provisions limiting the liability of the fiduciary for violating contract terms, or any waiver or qualification of the retirement investor's right to bring or participate in a class action lawsuit against the fiduciary. One of the strongest objections to the DOL regulations is that they affirmatively encourage litigation against advisors.

The financial institution relying upon the exemption must also provide written disclosure of the best-interest standard, disclose material conflicts of interest, maintain a Web page with specific disclosures, maintain and make available certain records for six years, and adopt anti-conflict policies and make additional disclosures if it offers proprietary financial products.

The DOL regulations provide some relief for "level fee fiduciaries" that charge only a flat fee (such as 1 percent of retirement assets under management) for their advisory services. To qualify, the advisor may not charge any commissions or transaction-based fees. A level-fee fiduciary does not have to enter into a best-interest contract, but must provide a statement of fiduciary standards, comply with impartial conduct standards and maintain records explaining why a rollover recommendation was in the best interests of the retirement investor.

On June 1, 2016, the U.S. Chamber of Commerce and seven financial services industry and business groups filed suit in federal court to challenge the new fiduciary regulations. The lawsuit alleges that the regulations exceed the Department of Labor's statutory authority and are arbitrary, capric-ious and contrary to law, including the First Amendment's guarantee of freedom of speech.

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