The Fiduciary Rule Delay and Legal Exposure: One Law Firm's Opinion

By Kerry Pechter   *Fri, Mar 17, 2017*

It is possible that the delay to the Department of Labor (DOL) Fiduciary Rule applicability date will not be effective before April 10. If that were to happen, it could cause enormous confusion and noncompliance. In an effort to head off these problems, the DOL has published Field Assistance Bulletin 2017-1 (the FAB), which provides... Read more »

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So, what does this mean for advisers and financial institutions? The FAB recognizes the industry's concerns about having to comply with the Rule during a temporary "gap period," as well as the possibility that it could find out only immediately prior to April 10 that no delay would occur.

The FAB assures advisers and financial institutions that they will not face possible DOL enforcement merely because they elect to "wait and see" what happens. The FAB makes clear that the DOL still intends to issue a final delay regulation before April 10, but it provides at least some breathing room for the industry in light of the uncertainty.

Specifically, the FAB provides that the DOL will not take enforcement action for non-compliance with the Fiduciary Rule, including its related exemptions, in two cases:

1. "Gap" Period: If the DOL decides to delay the Fiduciary Rule but the delaying regulation is not finalized until after April 10, the Fiduciary Rule would briefly become applicable during the resulting "gap period." This would trigger fiduciary status and prohibited transactions for many advisers and financial institutions that waited for the DOL to complete the regulatory process. During the gap period (April 10 until the delay is finalized), the FAB states that DOL will not take enforcement action related to the Rule.

2. No Delay: If DOL decides to let the Fiduciary Rule become applicable on April 10 with no further delay, advisers and financial institutions would have a "reasonable period" after that decision is announced to begin complying with the Rule. Further, the FAB states that the "Transition Period" disclosures required under the Best Interest Contract Exemption (BICE) and the DOL's exemption for principal transactions could be provided during the 30-day "cure period" that these two exemptions recognize where disclosures are inadvertently omitted.

In fact, it appears that the DOL is hoping that advisers and financial institutions relying on BICE (or the principal transaction exemption) will hold off on providing retirement investors with Transition Period disclosures until after the delay (if any) is finalized. In the FAB, the DOL expressed its concern over investor confusion resulting from disclosures that communicate uncertain applicability dates and "conditional" acknowledgements of fiduciary status.

Finally, the FAB states that the DOL will consider additional relief as necessary, including a potential prohibited transaction exemption. As we explain below, we believe additional relief will be needed, because the enforcement policy set forth in the FAB provides relief only from DOL enforcement, not from prohibited transaction excise taxes or private litigation.

Does the FAB provide absolute protection?

No. The FAB provides no protection or assurances against action by other regulators or the private sector. Unless the DOL issues a class exemption providing relief for prohibited transactions occurring during a "gap period" (or a "reasonable period" after the decision not to delay the Rule is published, if this should occur), the enforcement policy alone won't provide relief for "conflicted" advice to IRAs or for excise taxes resulting from prohibited transactions involving ERISA plans.

The DOL has no jurisdiction over the enforcement of the prohibited transaction rules for IRAs, or the assessment of excise taxes, which is handled by the IRS in all cases.

As a statement of the government's intent, however, the FAB is a very important first step. It puts the DOL on record as wanting to avoid negative consequences that would result from a temporary application of the Rule. We applaud this, and hope DOL will build on this foundation, providing an even stronger statement of its intentions to hold harmless those who act in good faith.

What should advisers and financial institutions do now?

Despite the limited relief, advisers and financial institutions may want to proceed with their compliance efforts. While we believe the Rule will probably be delayed, the delay would only be until June 9. During the 60-day delay period, the Rule will be re-reviewed. It may be ultimately modified or revoked, but the final result is far from certain.

Second, it is important to remember that compliance with the current fiduciary and prohibited transaction rules is required in the meantime. The publicity surrounding the Rule has resulted in fiduciary status and "conflicted" recommendations from advice fiduciaries becoming more closely scrutinized.

If no delay occurs (which is unlikely, in our view), compliance with the Rule would be required within a "reasonable period," even with respect to DOL enforcement. For disclosures required during the BICE Transition Period, the 30-day cure period could be regarded as a safe harbor of sorts.

In other cases, the FAB does not explain what the DOL would consider a "reasonable" period, but it could be quite short. The FAB provides some flexibility for institutions to consider whether to wait and see what happens in early April, but the relief is not absolute. Advisers and financial institutions should follow further developments closely, and we intend to provide updates to our financial services clients as they unfold.