
Thoughts on DoL's "Re-Proposal"

By Fred Reish Wed, Nov 30, 2011

Noticeably absent from the DOL's September 19th release, and statements by DOL officials, is any suggestion of a broad revision of the regulation, writes Fred Reish, the well-known ERISA attorney at Drinker, Biddle & Reath.

On September 19th, the Department of Labor announced that, rather than issuing a final regulation on fiduciary investment advice, it would be re-proposing the regulation, which would allow additional comments on the re-proposed version. This is a victory for the private sector, and particularly for insurance companies and broker-dealers, who objected to a number of the provisions in the initial proposal. However, the victory may be limited, in the sense that the DOL will likely provide relief on certain issues, but not on others.

Noticeably absent from the DOL's September 19th release, and statements by DOL officials, is any suggestion of a broad revision of the regulation. In other words, it appears that the basic structure of the proposal will remain in place, but that there will be "adjustments" to deal with specific issues.

While that may be of welcome relief to the financial services industry, it will probably not be helpful to those who are concerned about fiduciary status for ongoing services and recommendations to qualified retirement plans, such as 401(k) plans. In those cases, specific recommendations are made and the services are ongoing. As a result, it is likely that the changes in the re-proposal will continue to be expansive in terms of broadening the definition of fiduciary advice—particularly for small- and mid-sized plans.

My "best guess" is that the DOL will provide relief in the following areas:

- **Individual retirement accounts:** It is likely that the DOL will extend the exemptions of Prohibited Transaction Class Exemption 86-128 to virtually all advice given to the owners of IRAs. In other words, it is likely that both broker-dealers and RIAs will be able to give individualized advice to IRA owners and receive compensation that is not level, that is, the compensation may vary based on the recommendations, which would be more consistent with a broker-dealer business model than with an RIA business model. It will be interesting to see if the DOL imposes any limitations on that exemption, for example, disclosures concerning any variable compensation.

- **Commissions:** Many of the people who criticized the proposed regulation asserted that it precluded commissions as compensation. That is because, where advice is given and compensation is variable, it can result in prohibited transactions. On the other hand, level compensation, regardless of whether it is a fee or a commission, would not result in a prohibited transaction. It seems likely that, in response to the criticism, the DOL will clarify that, commissions are not per se precluded as a form of compensation for fiduciary advice, so long as they are level.

- **Insurance:** In certain cases (for example, insurance agents), the agent represents the provider (i.e., the

insurance company) and not the customer (e.g., the plan). The proposed regulation created an exemption for those cases, so long as, among other things, the agent made it clear to the customer that the agent's interests were "adverse" to the customer's. Needless to say, there were strong objections to the use of the word "adverse," with the argument being that the agent could be looking out for the best interests of the customer and at the same time recommending a product offered by an affiliate. It is likely that the DOL will offer a "softer" version of that exemption that will be more acceptable to the private sector and more consistent with common understandings.

- **Appraisals:** The proposed regulations would have classified appraisers as fiduciaries in a variety of cases. It is likely that the range of cases will be limited, because of objections to the general nature of the rule—and since the primary focus of the change was for appraisers of closely held stock in ESOPs. It is also possible that there will be some clarification of the responsibilities of the appraiser. For example, the preamble or the regulation should specify that the appraiser is a fiduciary for purposes of determining the most accurate valuation and not for the purposes of determining a valuation most favorable to the participants.

- **Commercial transactions:** A number of commercial transactions, such as swaps, could have been covered by the literal wording of the proposed regulation. The DOL has stated that it will clarify those issues and permit the continuation of transactions that are clearly commercial in nature and that are arm's-length.

- **Exemptions and opinions:** The DOL has also stated that the re-proposed guidance will provide for the continuation of existing exemptions, advisory opinions and other guidance related to fiduciary transactions.

- **"Individualized" advice:** Under the proposed regulation, in a number of circumstances the provision of investment recommendations, whether individualized or not, would have resulted in fiduciary status. The DOL has suggested that it will limit the regulation to circumstances in which individualized advice is provided and is directed to specific parties.