

Dire results seen for 'fiduciary' tweak

Plan service providers rail against DOL rule

By Darla Mercado

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Record-keeping companies such as Fidelity Investments and J.P. Morgan Retirement Plan Services may find themselves having to raise costs on retirement plan clients and limit the guidance that they provide if a proposed rule change that redefines “fiduciary” goes through, according to industry groups.

The Labor Department's proposed rule under the Employee Retirement Income Security Act of 1974 would broaden the term, turning companies providing services to retirement plans into fiduciaries.

As a result, those service providers would curtail investment guidance to retirement plans and charge plans more for participant investment education, critics said. Adoption of the rule could also complicate the rollover process for participants upon exiting plans, they contend.

Costs would also rise for plan sponsors as providers passed on the cost of compliance or as the plan sponsors looked to an independent party to give them investment guidance, industry groups said in their comment letters on the rule.

'LOWERS THE THRESHOLD'

Last Thursday was the deadline for comments to the Labor Department, and a hearing has been scheduled for March 1.

“The proposed fiduciary redefinition lowers the threshold so that normal things that a provider does, such as giving the plan sponsor a sample list of funds, could potentially make them a fiduciary,” said Larry H. Goldbrum, general counsel of The SPARK Institute Inc. The group, which represents retirement plan service providers, filed a comment letter.

The proposed DOL rule was floated in October amid a series of regulatory initiatives aimed at increasing transparency for plan sponsors and participants. It redefines when an investment adviser is acting as a fiduciary to a retirement plan, changing a five-part test that regulators say allowed advisers to skirt fiduciary responsibility while providing advice.

The expanded definition would not only make brokers working with plans fiduciaries but could also apply to firms such as Fidelity Investments and The Vanguard Group Inc., which provide investments, product platforms and record-keeping services to retirement plans.

That prospect alarmed the Investment Company Institute, which in its comment letter called for the Labor Department to clarify an exception in its proposal to allow service providers to help plan fiduciaries pick out funds for their own investment menus.

“Were record keepers to withdraw from providing assistance because of uncertainty about the rule, plans would have to forgo this information or hire an independent fiduciary at considerable cost,” the ICI wrote.

The rule likely would shake up other aspects of the service providers' business.

For instance, companies that provide platforms for plan sponsor clients collect fees for making fund options available. The rule would fundamentally change the way those platform providers charged other fund companies for shelf space.

If the rule became a reality, service providers not giving impartial advice, including those providing platforms, would have to state that in writing to plan sponsors. However, if a company that supplied plans with a platform decided to act as a fiduciary, it would have to change the way it collected fees from the investments it featured on the platform.

“The entire vendor platform gets a significant portion of revenue from variable fees in different investment options that they themselves recommend,” said Marcia S. Wagner, managing director of The Wagner Law Group. “You're forcing the variable-compensation section of the market into a flat-fee arrangement, and it won't be an easy transition.”

Not all industry participants are against the proposal to expand the definition of “fiduciary.” The Certified Financial Planner Board of Standards Inc. supports the expansion and is pushing the Labor Department to limit the scope of an exception that would require advisers and service providers to disclose in writing when they were not providing impartial advice.

“While a fiduciary may obtain disclosure and consent for potential conflicts from plans and participants, the department should not allow disclosure of an adverse interest to negate fiduciary status,” the CFP Board's letter said.

Although the Labor Department isn't taking a hard stance on rollover activity in the rule proposal, it did ask for comments on whether the final version of its fiduciary rule should deem as advice rollover recommendations made as participants exit a plan.

The CFP Board also supports labeling plan distribution recommendations as investment advice. “Some of the greatest abuses we have seen began with bad and self-interested advice that a plan beneficiary take a lump-sum distribution from a benefit plan,” the board wrote in its letter.

Broadening the scope of “fiduciary” to include service providers also would limit education to participants and individual retirement account holders, the Securities Industry and Financial Markets Association wrote in its comment letter.

SIFMA, which represents broker-dealers, is concerned that the investment education that service providers give participants and IRA holders could play a material role in those individuals' investment decisions, thus turning the investment education into fiduciary advice.

“The same information that is given to a plan participant on the day before he rolls his account balance into an IRA becomes fiduciary advice on the day after the rollover,” SIFMA wrote. If the education placed fiduciary liability on the service provider sharing the information, costs likely would go up and the plans would shoulder that cost, the association added.

BOILER ROOM FEARS

A service provider that provides record-keeping services to a plan is ideally positioned to capture rollover dollars as participants exit, and can provide assistance to employees as they search for options.

But if distribution counseling fell under investment advice, it could cut the service provider out of the equation and open the door to advice from others.

“In most situations, the existing provider has a closer relationship with participants, but the way the rules are set up would make it harder for them to provide distribution counseling and easier for a boiler room broker to make cold calls to plan participants,” Mr. Goldbrum said. “This sets up a situation where you push participants to advisers with no affiliation to the plan and a clear interest in getting that money distributed.”

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