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Marcia Wagner Explains the DOL Rule

By Kerry Pechter Thu, May 26, 2016



Now hiring: BICE Officer. Requirements: Command of the Best Interest Contract Exemption provision of the Department of Labor's Conflict-of-Interest Rule, and its effect on broker-dealer and registered investment advisor compensation schemes. Starting date: ASAP. Salary potential: Unlimited.

That's a purely hypothetical job posting, but according to Boston-based ERISA attorney Marcia Wagner, it may not be hypothetical for long. "BIC officers' are going to become a cottage industry unto themselves. You heard it here first, folks," she said during a webinar yesterday.

Wagner, a popular speaker who combines an authentic Boston accent with the authority of a Harvard Law degree, held forth about the impact the DOL's new conflict of interest rule or "fiduciary rule" for 90 minutes in the webcast, the latest in a series of four events on the same topic hosted by advisor software maker MoneyGuidePro.

Each webcast has attracted hundreds of attendees, demonstrating the appetite for information about the 1,030-page DOL rule—and insights in how to adapt to it. Between now and next April, when the DOL rule goes into effect, broker-dealers will be scrambling to figure out how to align their current compensation practices with the terms of the Best Interest Contract Exemption, a key element of rule.

Under the DOL rule, the sale of a financial product for variable compensation (such as a third-party commission) to an IRA account owner will be a "prohibited transaction" unless the seller—a registered rep, insurance agent, and sometimes a registered investment advisor—signs a contract pledging to act in the client's "best interest." Here are highlights from the [webinar](#):

One-off sales will be suspect; financial plans show good faith. Wagner stressed that financial plans "by their nature" can help demonstrate prudence of advice, and can ensure that recommendations are in best interest of client. Sales proposals should be made within the context of a holistic financial plan.

Similar commissions for similar products. Differential compensation paid by a broker-dealer to a registered rep must be based on neutral factors that are directly tied to the services provided, such as a requirement for extra time or expertise. "Payouts to the rep DOL may vary for different investment, but not for similar investments in the same category, such as variable annuities," Wagner said.

Deadlines for compliance. Under "transition" BIC, firms must have disclosures ready and must appoint a BICE officer by April 17, 2017. "Full-blown" BIC means having contracts (negative consent is permissible) ready by January 1, 2018.

No need to wait for DOL to acknowledge your filing. "Thousands of firms will have to notify DOL when instituting BIC. DOL won't respond, but it will compile this information for future investigation and enforcement purposes," she said.

Registered Investment Advisors (RIAs) aren't immune to the BIC. "RIAs have assumed incorrectly that they don't need BIC at all," Wagner said. "If they are offering rollover advice to participants, or to an off-the-street participant, where the rollover will mean higher fees than were in the plan, they will need to sign a BIC. They will also need a BIC when recommending a transition from a commission-based to a fee-based arrangement."

Fee levelization is a *de facto* exemption. "There's been a lot of buzz about it lately," she said. "Fee levelizing is a way to comply with the prohibited transaction rule. Instead of using the BIC or Prohibited Transaction Exemption 84-24, a firm can levelize its compensation. Levelizing is not an official exemption. I think of it as a *de facto* exemption. It prevents a

prohibited transaction.”

How to levelize fees. “The first step is to identify all forms of variable compensation in your firm, such as commissions and ticket charges and revenue sharing from mutual fund families and annuity providers—that’s compensation to either firms or their financial advisors that varies with sales volume, but not the custodial fees or fees for sweep vehicles that the firm may charge—and restructure them to make sure that the amount of compensation doesn’t vary depending on which product is sold.”

‘Hire them’ is fiduciary advice. “Some advisors thought recommending investment managers wasn’t fiduciary, but now investment management recommendations are ‘covered’ advice under the rule.”

‘Hire me’ isn’t fiduciary advice. While recommendations to hire third parties are fiduciary, self-promotion is not. In other words, an advisor may make a ‘hire me’ recommendation without being viewed as offering fiduciary advice.

Robo-advice. “Many firms are considering ‘robo’ for small IRA accounts. This is of particular interest because there’s an exemption for robos from the prohibited transaction rules,” Wagner said. Government rulings since 1997 have protected recommendations, including recommendations of proprietary products, that are generated by an independent expert or a computer program. “The computer program can’t favor proprietary products if they generate higher income for the advisor, however,” she added.

This won’t necessarily be easy. Firms can expect conflicts to occur between the need to incentivize advisors and the need to act in the client’s best interest, she said. “It will be hard to design a compensation program that eliminates all incentives to provide improper advice.”

The final DOL rule is ‘full strength.’ “It’s not watered down,” Wagner said in response to a listener’s suggestion to that effect. “It’s been made workable and practicable, but I wouldn’t call it watered-down. The enforcement will be done by DOL with respect to ERISA plans. For non-ERISA plans and IRA, owners themselves and the tort or plaintiff bar will do the enforcement. While the IRS has oversight of IRAs, it’s not interested in enforcement. But that could change. There’s also FINRA and the SEC. They might get involved in this.”

Could the presidential election eliminate the rule? “A president Clinton would likely expand the rule. She has said she is in favor of it and that it addresses abuses that need to be curtailed. Trump hasn’t said much about issues related to retirement so it’s hard to know what his positions are. But it’s true that these rules are a creature of the executive branch and whoever is the head of executive branch will have a big say in how they work in the future.”

Can the rule be overturned by Congress or the courts? Wagner didn’t think so. “I think this is a done deal,” she said. “There’s nothing that Congress can do legislatively, because of the president’s veto. With respect to the courts, yes, the financial industry will bring it to court, but I don’t think it will succeed. In the past, the Supreme Court has bent over backwards not to reverse executive branch actions like this, and I doubt that they will want to change a six-year-long regulatory initiative.”

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