

October 2018—Legislative Intelligence Update | SEC, DOL Say Fiduciary Rules Coming in 2019

Welcome to this edition of the Investments & Wealth Institute *Legislative Intelligence*. This month's update offers an overview of the semi-annual regulatory agendas of the Securities and Exchange Commission (SEC or Commission) and the Department of Labor (DOL or Department), and what it means for the SEC's quasi-fiduciary standard, Regulation Best Interest, and DOL plans for an updated fiduciary rule covering advice to retirement accounts.

SEC, DOL Regulatory Agendas Suggest Coordinated Approach to Fiduciary Rules

In the waning days of October 2018, trade press coverage focused in part on potential action by the DOL to adopt a revised fiduciary rule. This occurred at the same time that the SEC set a date for moving forward with its own quasi-fiduciary standard for brokers, called Regulation Best Interest (Reg BI).

The renewed interest in the DOL fiduciary rule—which many thought was officially buried in June 2018 after a federal appeals court overturned it—comes out of a semi-annual reporting requirement for federal agencies. [These reports](#) are routinely published in the spring and fall, providing a rough timeline for when an agency will proceed with introducing or finalizing a new regulation.

The Department omitted any reference to a fiduciary rulemaking in the spring 2018 agenda. This was likely due to a timing issue, because the Trump administration had long expressed its opposition to the Obama-era rule. Although the regulatory agenda for all 64 federal agencies was published in May 2018, the DOL fiduciary rule was still in effect at the time in late February when federal agencies were required to submit their list of rulemakings to the Office of Management and Budget (OMB). The spring deadline for submission occurred several weeks before the U.S. Court of Appeals for the Fifth Circuit vacated the fiduciary rule, helping to explain the rule's surprise reappearance on OMB's fall 2018 agenda. In the same spring agenda, the SEC noted that it was considering a rule “regarding standards of conduct for investment professionals.” This notice also was submitted in early March, a month before the SEC Reg BI was released for public comment.

Now both rules seem to be synced for adoption next year at the same time—because the latest OMB timelines indicate the fiduciary rules will be adopted by their respective agencies in September 2019. Given the financial services industry's long-stated preference for the SEC to take the lead in lieu of the DOL, the identical dates for action did not escape attention. While not providing any details about its own fiduciary rule in the fall 2018 regulatory agenda, the Department did state that it would propose adoption of its final “fiduciary rule and prohibited transaction exemptions” by September 2019. The SEC, in turn, indicated it is in the final rulemaking stages for Reg BI and a related Form CRS summary disclosure, as well as approval of fiduciary guidance for registered investment advisers to be adopted next September as well.

A fair number of commentators also suggested the timing of the DOL and SEC final rule adoptions is not coincidental, and also consistent with past promises by SEC Chairman Jay Clayton to coordinate its final rulemaking with the DOL.

While heavily criticized in all quarters, Reg BI is not expected to be radically altered as SEC staff combs through the hundreds of comment letters suggesting changes. And notwithstanding some detailed critiques, most Wall Street firms have endorsed the SEC's overall efforts to take the lead in establishing new market conduct standards for retail investment advice.

The two areas where surprises may be in store for the financial services industry are components of the DOL revised fiduciary rule and SEC updated regulatory guidance for investment advisers.

First, the DOL is not likely to start from scratch to create anything like the Obama administration's expansive definition of a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) and related prohibited transaction exemptions (PTEs). Rather, any new DOL fiduciary rule is likely to be de-regulatory in practice. Some observers expect the DOL to simply piggyback on Reg BI in which compliance with the latter would serve as an ERISA safe harbor for conflicted investment advice to 401(k) plans and for individual retirement accounts (IRAs) under the federal tax code.

However, it is also possible that the DOL will add at least one other streamlined PTE to its 2019 rulemaking. Under the old fiduciary rule, rollover advice was deemed to be a fiduciary act, sweeping in recordkeepers' call centers and many other brokers and advisors advising 401(k) account holders for the first time when advising rollovers into IRAs. However, the old fiduciary rule also added a streamlined PTE for "level-fee" advisors, i.e., those receiving fees directly from clients and meeting certain conditions of the exemption. The Department held the view that, notwithstanding the reduction in conflicts by charging a level fee for advice, level-fee advisors still had a financial incentive to recommend rollovers that resulted in increasing their own assets under management.

But with the old rule gone, it is very likely that the DOL will refrain from deeming rollover advice to be a fiduciary activity under any new rule. However, level-fee advisors who previously were fiduciaries to pension plans will be stuck without a safe harbor absent a new exemption. DOL [Advisory Opinion 2005-23A](#) made rollover advice by level-fee advisors problematic by essentially stating that a person who is not an ERISA fiduciary can advise on rollovers without committing a prohibited transaction, noting that the safe harbor applies only to someone who is not a plan fiduciary. So it is possible that the Department will address this problem by adding a similar level-fee exemption or withdrawing Advisory Opinion 2005-23A and providing new rollover guidance.

There are still shortcomings to Reg BI because any reliance by the DOL on a new SEC rule governing a broker's retail investment advice would not apply to insurance producers selling annuities, which are sometimes an investment option in qualified plans. If the DOL refrains

from revising the PTEs for annuity transactions, any strengthened market conduct standard will fall to the National Association of Insurance Commissioners (NAIC), which is in the middle of drafting an updated suitability rule in this area. The model rule, when finally adopted by the NAIC, will take years to be approved by the 50 individual state insurance commissioners, and with the exception of New York, are not expected to adopt a “best interest” standard comparable to a fiduciary standard.

The other potential question is whether the SEC will move forward in adopting the proposed regulatory guidance for investment advisers. This may seem surprising because adoption of regulatory guidance is not required in a rulemaking and most of the SEC’s [proposed guidance](#) is a 38-page summary of past SEC regulatory views of fiduciary obligations under the Investment Advisers Act of 1940. On the surface this separate rulemaking would appear to be noncontroversial.

However, industry trade groups have questioned the SEC’s interpretation of an advisor’s fiduciary obligations in their comment letters, and have harshly criticized what they claim are new mitigation requirements that go beyond the standard Form ADV delivery and the letter of the law. Instead, critics note that the SEC has emphasized in the guidance that additional details of a conflict beyond boilerplate disclosure may be necessary so that a client can make an informed decision before hiring an advisor or accepting an investment recommendation. They claim that there is no basis in law for requiring an advisor to go further by seeking to avoid or mitigate a conflict other than through disclosure, asserting that the true roots of advisory conduct arise from the common law of agency, not SEC rules or court opinions that opponents assert do not explicitly affirm these additional fiduciary duties beyond disclosing conflicts. Some go further by questioning whether advisors even have a suitability obligation. Industry critics appear to have an ally in SEC Commissioner Hester Peirce, who in public remarks earlier this year said the duty to seek informed consent from a client after disclosing a conflict doesn’t cite any court decision, but only the written instructions drafted by the agency for filling out Form ADV.

A bellwether here of the Commission’s appetite for reinforcing fundamental fiduciary obligations under the Advisers Act would be a failure to formally adopt the regulatory guidance at the same time it adopts Reg BI and Form CRS, thus signaling a fiduciary retreat on all fronts—at the SEC, DOL, and state insurance commissioners—on the contours of what could be a shrinking fiduciary standard across the board.

About Legislative Intelligence Update

The purpose of this update, prepared by Potomac Strategies for Investments & Wealth Institute, is to give members legislative, regulatory, and other public policy intelligence and analysis. It is strictly informational and should not be relied upon as legal, financial, or compliance advice. Investments & Wealth Institute, as an education and credentialing organization, does not lobby Congress and generally does not advocate for any particular legislative or regulatory position either on its own or through its relationship with Potomac Strategies.

If you have questions after reading this update, please contact Investments & Wealth Institute by replying to this email. We will either respond personally to your inquiry or include a response in an upcoming issue.