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Outlook 2014

Fiduciary Rules, Lifetime Income Illustrations, Disclosures Top Practitioners' DOL Concerns

The Department of Labor's re-proposed fiduciary rule is likely to stir up a great deal of practitioner interest in 2014, along with the department's projects on disclosures and lifetime income illustrations, practitioners told Bloomberg BNA.

The much anticipated fiduciary proposal would strengthen financial advice standards for advisers who work with retirement plans and has been postponed several times over the past several years. The DOL now calls the proposed rule the "conflict-of-interest" rule.

The DOL is expecting to release the proposed fiduciary rules in August, according to the agency's fall 2013 regulatory agenda, issued Nov. 26 (231 PBD, 12/3/13; 40 BPR 2801, 12/10/13).

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DOL'S EMPLOYEE BENEFITS SECURITY ADMINISTRATION

Phyllis C. Borzi, DOL assistant secretary for the Employee Benefits Security Administration, said during an exclusive interview Jan. 15 with Bloomberg BNA that although the agency hasn't yet made a decision on how long the comment period will last, it will give a "generous comment period," have public hearings and take meetings on the rule.

Fiduciary Rule Re-Proposal. The DOL's efforts to revise and expand the definition of "fiduciary" under ERISA Section 3(21)(A) has been in the works for more than three years.

The department originally proposed a rule in October 2010, but after the proposal received a great deal of negative reaction, the DOL withdrew it in September 2011, citing the need for more economic analysis (182 PBD, 9/20/11; 38 BPR 1693, 9/20/11).

The proposed conflict-of-interest rule is a "mosaic, or tapestry" of a broad set of themes, Borzi said. The themes include improving accountability, transparency and participant education, she said.

The Securities and Exchange Commission has also been working on a related rule, which would bring investment advisers and broker-dealers under a uniform standard of conduct.

The House on Oct. 29 passed a bill (H.R. 2374) that would prohibit the DOL from amending its rules defining the term "fiduciary" under ERISA until the SEC creates its rules.

President Obama immediately threatened to veto the bill if it reached his desk (210 PBD, 10/30/13; 40 BPR 2553, 11/5/13).

With \$1.4 trillion of defined contribution assets—which Borzi described as "sacred assets," because they are tax favored—having migrated to IRAs over the last five years, and another \$2 trillion expected to move into IRAs over the next five years, it is "critically important" that participants get unbiased financial advice that is in their best interest, Borzi said.

Objective Advice. The world has changed since the days when defined benefit plans were more prevalent, and many people are now ill equipped to make prudent financial decisions, she said.

Borzi offered an example in which she said that after she gave a speech at a brokers' group on the importance of providing objective advice that is in the best interest of the client, a broker approached her and said that he never provided advice on any investment that he didn't fully understand.

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—KENT A. MASON, DAVIS & HARMAN

She asked him, "How do you find out about these investments?" to which he replied, "I go twice a year to an investment training." He then named the financial institution that offered the training. Then he told Borzi, "Therefore, they're the only products I recommend, because I fully understand them."

"And I'm thinking, here's this guy who genuinely thinks that what he's doing is in the best interest of his client, and he almost has blinders on," Borzi said, adding that she asked if it occurred to him that there may

be other products on the market that might be better for his clients.

“I think that brokers are genuinely trying to do what’s in the best interest of their clients. All we’re trying to do in our regulation is hold them up to that standard. If they’re doing that, there shouldn’t be a problem,” Borzi said.

Borzi said it is perfectly fine if people just want to sell, but the intentions need to be clear.

“If you’re selling a product, it ought to be clear to the customer that you’re selling a product. If the impression you give your customer is that you’re not just selling a product, but you’re giving them unbiased advice in their best interest, then you ought to be willing to be accountable for that,” she said.

Little Dispute. The DOL’s conflict-of-interest proposed rules will include a “robust, comprehensive, extensive” economic analysis, Borzi said.

“We’re working with all of our sister agencies and the SEC,” as well as with other people in the administration and the White House, she said. “Most of the information that informs the economic analysis is private sector, and everything we relied on will be cited, so people can go to the original sources. They’ll know who we relied on.”

Borzi said that once the economic analysis is released, “there will be not a whole lot of dispute that there’s a problem.”

Coordination Required. Meanwhile, the DOL and the SEC should coordinate their efforts on these rules both substantively and time-wise, Kent A. Mason, partner at Davis & Harman LLP in Washington, said Jan. 8.

“I think that it is difficult for either agency to do a complete economic analysis without taking into account what the other one is doing, because what the other agency is doing will have a significant effect on the market,” Mason said.

The two agencies also need to coordinate their rules’ effective dates, because the regulations will require some significant restructuring of the industry, he said.

“To force the industry to restructure multiple times at enormous cost, that will ultimately be paid for by investors, which will not be a good way to proceed,” he said.

As a last point on the fiduciary rules, Mason said, “I think it’s best if the SEC and DOL come up with a uniform standard just as Congress said. We want to avoid confusing multiple standards.”

Mason referred not only to H.R. 2374 but also to an Aug. 2 letter sent by 10 senators to Office of Management and Budget Director Sylvia Matthews Burwell expressing concerns that “uncoordinated efforts” by the DOL and the SEC “could work at cross-purposes” (153 PBD, 8/8/13; 40 BPR 1938, 8/13/13).

When to Expect Proposal. Practitioners differed on when to expect the re-proposed fiduciary rules.

Even though the proposed rules have been rescheduled for an August release, Mason said that a combination of factors could result in “a good chance” that they would slip into 2015.

One factor that could lead to a delay is that DOL Secretary Thomas E. Perez has indicated that he wants to address the concerns that have been raised, which could take a while, Mason said.

“I think the other issue is that there will be some hesitation to put something out too close to the election,” Mason said.

But the conflict-of-interest proposed rule may come out this year, Karen Friedman, executive vice president and policy director for the Pension Rights Center, told Bloomberg BNA Jan. 7.

“Our basic feeling right now is that we think there’s going to be a movement from the participant side to ensure that the Labor Department is able to at least re-propose the rule,” she said.

When to expect finalization of the rules is also an open question.

Practitioners and others should probably expect at least a 90-day comment period once the regulation comes out, Judy Miller, director of retirement policy at the American Society of Pension Professionals & Actuaries, told Bloomberg BNA Jan. 6.

If the proposed rules are released in August, the comment period would end in November. Public hearings would probably not be scheduled until 2015, Miller said.

When asked if a finalized rule could be expected in 2015, Borzi said that would depend not only the number of comments the DOL receives, but also the nature of those comments.

Prohibited Transaction Exemptions. One of the factors that led to the re-proposal was that the original lacked guidance on prohibited transaction exemptions that would address the treatment of broker-dealers who work with smaller investors, Borzi said.

The original conflict-of-interest proposed rule failed to include any prohibited transaction exemption proposals, Borzi said.

“The mistake we made was we said we were going to propose prohibited transaction exemptions amending some of the existing ones,” Borzi said. “All we said was we were going to do it. We didn’t say exactly what we were going to do. And that allowed the industry to characterize what we were doing as closing them down. That was never our intention.”

The main problem with the original proposal, Mason said, dealt with the fact that broker-dealers get a significant amount of indirect compensation from mutual funds.

“What happened was that the original proposal essentially made all broker-dealers fiduciaries without revisiting the rules about prohibited transactions,” Mason said. “And so that was the problem: It was not the best interest standard, it was the prohibited transaction issue,” he said.

Borzi said she recognized the problem that merely disclaiming or disclosing the broker-dealer’s conflict doesn’t work under ERISA, because under the statute “it’s flatly prohibited.”

However, she said, “there’s no way, honestly, that we can stick with the absolute letter of ERISA to ban all conflicts. One of the reasons it’s taking so long is that we really want to get this right. It’s a proposal. Certainly, whatever we propose is not written in stone,” she said.

The new proposal will include proposals on prohibited transaction exemptions and amendments, Borzi said. DOL will probably issue a new prohibited transaction exemption to deal with revenue sharing, she said.

“The goal of that is to make sure that some of these compensation practices that would literally be prohib-

ited because they could involve conflicts, if we can make the finding that keeping them going is protective of participants and beneficiaries, and in some instances we think we can do that, then we will be putting out exemptions,” Borzi said.

Educating Participants. The shift from defined benefit plans to defined contribution plans, and from there to individual retirement accounts, has spurred the DOL’s interest in providing plan participants with greater financial education.

One education initiative is the DOL’s lifetime income illustrations project, Borzi said.

The DOL released an advanced notice of proposed rulemaking on lifetime income illustrations in May, and included two safe harbor models—one based on a snapshot of a participant’s present savings and one based on a participant’s projected savings.

Plan sponsors who take advantage of a regulatory safe harbor are less likely to open themselves up to enforcement or other liabilities.

While commenters generally agreed that lifetime income illustrations are important, they differed on what approach to take, Borzi said. She was unsure when the proposal will be released.

The project is especially important in light of the “massive movement” from defined contribution plans to IRAs, Borzi said. In fact, she said that \$1.4 trillion moved out of defined contribution plans in the last five years, and over the next five years another \$2 trillion is expected to shift over.

Defined contribution assets are “sacred assets,” Borzi said, because they are tax-favored, while the lifetime income illustrations project “is our field of dreams project,” Borzi said.

“Unlike the Kevin Costner movie, I’m not entirely convinced—in fact, the literature suggests that it isn’t the case—that if you build a lifetime income option into your plan, that people will come,” she said.

“What the literature suggests is that if given the option between cash and a lifetime income opportunity—people take cash,” Borzi said. The DOL’s project is an opportunity to provide plan participants with education about the importance of lifetime income, she said.

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Craig P. Hoffman, general counsel and director of regulatory affairs at ASPPA, told Bloomberg BNA Jan.

6 that ASPPA and its sister organization, the ASPPA College of Pension Actuaries, said they were generally supportive of the idea of providing a safe harbor, but also said that it should be voluntary, not mandatory.

Friedman of the Pension Rights Center said that if a lifetime income illustration is provided, “people should know exactly what today’s monthly income would buy them.”

“If there were projections, we would say that should be an option. But we feel very strongly that there needs to be a true translation of what people have today and what it would buy them in an annuity,” she said.

Other Disclosure Concerns. As part of the DOL’s participant fee disclosure initiative, the DOL indicated that it expected to revisit the issues of participant notices under ERISA, including electronic disclosures, Miller said.

The agency released a request for information April 7, 2011, on electronic disclosure by employee benefit plans (67 PBD, 4/7/11).

Miller said the disclosure requirements need to be updated. “We are strong believers that the rules need to be brought up to date for the 21st century, and would greatly assist participants today.”

The DOL’s current regulation, at 29 C.F.R. § 2520.104b-1(c), requires that disclosures under ERISA be made electronically only to those plan participants who work on computers in their day-to-day employment or those participants who consent to such a delivery method.

The DOL said in Technical Release 2011-03R, that with regard to the ERISA § 404 participant-level disclosure rules, disclosures in the pension benefit statement may be provided electronically (236 PBD, 12/9/11; 38 BPR 2293, 12/13/11).

“There are the oddball exception rules floating around these days that DOL has crafted in conjunction with benefits statements and the [ERISA §] 404(a)(5) disclosures, and there’s a different set of rules that the [Internal Revenue Service] administers for the qualification required notices. So it’s really an area that is desperately in need of modernization,” Hoffman said.

“We really believe that electronic forms of communication should be available as a regular method of informing participants; albeit always, always giving participants the right to elect a paper notice if that’s what they really want,” Hoffman said.

Voluntary Correction Program. One “wildcard” for 2014 is whether the DOL will be coming out with a self-correction program for the late deposit of elective deferrals, Miller said.

“We’re trying to improve our voluntary correction program,” Borzi said. “I think we’re fairly close to putting something out on that.”

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