The DOL's New Conflict of Interest Rule & Your 401(k) Plan

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Earlier this month, the Department of Labor (DOL) finally released its long-awaited final regulations for the Conflict of Interest Rule. This follows a rather tumultuous, seven year journey to get the rule to the finish line. What the DOL began in 2009 to tackle conflicts of interest in investment advice turned into years of research, two separate proposals and a double public comment round — one in 2010 and the other in 2015. The regulatory project has grabbed the attention and opinion of a variety of groups for and against the proposals, with many financial services companies and financial advisors vehemently opposed to it.

In essence, the DOL's new rule defines who is a fiduciary under the Employee Retirement Income Security Act (ERISA) when investment advice is given to a retirement plan (like a 401(k)), its participants or beneficiaries. The last time the regulations underlying the law on retirement advice were updated was over 40 years ago, and since that time many more workers have begun to participate in retirement investing both through their employers and individually. According to the DOL, individuals are increasingly reliant on investment advisors to assist in managing retirement investments, and treating this advice as a fiduciary function will help protect those individual investors.

While the DOL acknowledges that many advisors do have their clients' best interests at heart, the new rule was created as a way of adding a layer of protection against those advisors who may offer advice driven by personal financial gain.

While the language of the regulations focuses on individual investment advisors doling out advice on individual retirement accounts (IRAs) or other financial plans, the DOL's new rule also affects employers who are plan sponsors for retirement plans for their employees, such as 401(k) plans. In particular, the regulations offer the following relevant clarifications and changes.

WHO IS A FIDUCIARY?

A fiduciary is a person who gives investment advice for a fee, regardless of how or by whom the fee is paid. That fiduciary to a plan and plan participants must act impartially and provide advice that is in his or her clients' best interests rather than his or her own. This type of fiduciary cannot receive payments for their services that will create a conflict of interest unless he or she complies with certain conditions that are designed to minimize the potential conflict. Employers are rightly not in the business of giving investment advice to their employees, but these refinements to the definition of fiduciary may flow down to employers through revised and updated service contracts with plan advisors.

IF AN EMPLOYER PROVIDES A 401(K) PLAN FOR ITS EMPLOYEES, IS IT A FIDUCIARY?

Yes. Once an employer sets up a retirement plan for its employees, ERISA already imposes fiduciary duties on the employer, and it can be held accountable for investment losses when the employer does not discharge its duties of loyalty, care, and others to its employees. The DOL explains that when a 401(k)-type plan is offered by the employer, the plan fiduciary (the employer) must carefully select and monitor the investment options under the plan to those employees who participate in the plan. Just last year, we saw this concept illustrated in the U.S. Supreme Court case of *Tibble v. Edison.* In *Tibble*, the Court reviewed allegations that an employer sponsoring a 401(k) plan had not sufficiently monitored investments for cost.

HOW DOES THE DOL'S RULE CHANGE ANYTHING IF EMPLOYER PLAN SPONSORS ARE ALREADY FIDUCIARIES UNDER ERISA?

The new Conflict of Interest Rule provides additional protection for employee plan participants. The investment advisors, including broker-dealers or mutual fund firm representatives, whom plan sponsors often rely upon to make financial decisions for the employer-sponsored retirement fund, will now follow the same fiduciary standard of conduct under ERISA as the employer itself must. In effect, those third-party advisors will have to disclose any potential conflicts of interest and may only provide financial advice in the best interest of the plan participants, or else risk ERISAviolation penalties or getting sued by the plan participants.

WHAT DOES AN EMPLOYER DO NOW?

Employers should revisit the relationships they currently have with financial services advisors and determine if they might be a fiduciary under their employer-sponsored plan. As plan sponsors, employers should make sure that the fees that their financial advisors are charging are reasonable for the services provided. With the new rule soon in effect, financial advisors are expected to alter compensation arrangements to account for their newly established fiduciary liability. In addition, expect to see revised service agreements, especially the indemnification provisions, and review those carefully (with counsel if needed) to ensure risk remains consistent with the employer's intent and that the plan is properly protected.

WHEN DOES THE CONFLICT OF INTEREST RULE GO INTO EFFECT?

For the most part, the final rule is effective on April 10, 2017, but certain requirements and sections of the rule will not come into play until January 1, 2018.

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