DOL Seeks Public Comment on Proposal to Protect Consumers from Conflicts of Interest in Retirement Advice

On April 14, 2015, the U.S. Department of Labor has released a proposed rule that they believe will protect 401(k) and IRA investors by mitigating the effect of conflicts of interest in the retirement investment marketplace. A White House Council of Economic Advisers analysis found that these conflicts of interest result in annual losses of about 1 percentage point for affected investors — or about $17 billion per year in total.

Under the proposals, retirement advisers will be required to put their clients' best interests before their own profits. Those who wish to receive payments from companies selling products they recommend and forms of compensation that create conflicts of interest will need to rely on one of several proposed prohibited transaction exemptions.

"This boils down to a very simple concept: if someone is paid to give you retirement investment advice, that person should be working in your best interest," said Secretary of Labor Thomas E. Perez. "As commonsense as this may be, laws to protect consumers and ensure that financial advisers are giving the best advice in a complex market have not kept pace. Our proposed rule would change that. Under the proposed rule, retirement advisers can be paid in various ways, as long as they are willing to put their customers' best interest first."

Today's announcement includes a proposed rule that would update and close loopholes in a nearly 40-year-old regulation. The proposal would expand the number of persons who are subject to fiduciary best interest standards when they provide retirement investment advice. It also includes a package of proposed exemptions allowing advisers to continue to receive payments that could create conflicts of interest if the conditions of the exemption are met. In addition, the announcement includes a comprehensive economic analysis of the proposals' expected gains to investors and costs.

The proposed "best interest contract exemption" represents a new approach to exemptions that is broad, flexible, principles-based and can adapt to evolving business practices. It would be available to advisers who make investment recommendations to individual plan participants, IRA investors and small plans. It would require retirement investment advisers and their firms to formally acknowledge fiduciary status and enter into a contract with their customers in which they commit to fundamental standards of impartial conduct. These include giving advice that is in the customer's best interest and making truthful statements about investments and their compensation.

If fiduciary advisers and their firms enter into and comply with such a contract, clearly explain investment fees and costs, have appropriate policies and procedures to mitigate the harmful effects of conflicts of interest, and retain certain data on their performance, they can receive common types of fees that fiduciary advisers could otherwise not receive under the law. These include commissions, revenue sharing, and 12b-1 fees. If they do not, they generally must refrain from recommending investments for which they receive conflicted compensation, unless the payments fall under the scope of another exemption.

In addition to the new best interest contract exemption, the proposal also includes other new exemptions and updates some exemptions previously available for investment advice to plan sponsors and participants. For example, the proposal includes a new exemption for principal transactions. In addition, the proposal asks for comment on a new "low-fee exemption" that would allow firms to accept conflicted payments when recommending the lowest-fee products in a given product class, with even fewer requirements than the best interest contract exemption.

Finally, the proposal carves out general investment education from fiduciary status. Sales pitches to large plan fiduciaries who are financial experts, and appraisals or valuations of the stock held by employee-stock ownership plans, are also carved out.

Links to the proposed fiduciary rule, prohibited transaction exemptions, economic impact analysis and other materials are available at www.dol.gov/ProtectYourSavings/, and will be published for public comment in an upcoming edition of the Federal Register.

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