

Anticipating delay to DOL fiduciary rule, broker-dealers and RIAs change course

Brokerage firms, the group most affected by a rule delay, would likely put off big projects around adviser compensation and trimming investment products

By **Greg Iacurci** | August 16, 2017 - 1:10 pm EST

Broker-dealers and registered investment advisers are pivoting in the wake of news that the Department of Labor is likely to get a lengthy delay in the implementation date of its fiduciary rule.

While strategies and mechanisms put in place thus far will largely remain intact, according to analysts and executives, firms are gearing up to halt ones that had been deferred or haven't yet materialized.

"They now get to push [compliance] off into the horizon, and the horizon is kind of beyond vision," said Daniel Bernstein, chief compliance counsel at the consulting firm MarketCounsel.

The first phase of the fiduciary rule, an Obama-era regulation that seeks to eliminate conflicts of interest among brokers when giving investment advice to retirement

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savers, went into effect June 9. The second and final phase, which contains the most stringent and compliance-laden portions of the rule, were set to take effect in January.

However, the DOL has [submitted a proposal](#) that would delay the January date by 18 months, to July 1, 2019. While the federal Office of Management and Budget has yet to sign off on the proposal, most see a lengthy delay as a near certainty.

"Our initial reaction is, everything we were planning on doing in January, we will review all of those things and see if we want to continue to do them in January or just put them off," said one brokerage executive, who requested anonymity due to his firm's policy regarding speaking publicly about the regulation. "I think in most cases we'll put them off."

Broker-dealers are more impacted by the rule than RIAs, and have more to gain from an implementation delay.

For brokerage firms, the most significant compliance steps yet to be made are primarily around broker compensation and which investment products to cut from the so-called product shelf, the inventory of products firms allow their brokers to use with clients.

"I would say compensation and potentially product shelf are two that are most difficult, because you have to coordinate with so many different vendors," said Judson Forner, vice president of planning review at ValMark Financial Group, which houses roughly 300 advisers and brokers. "The more time people have to do it correctly, the more time they'll take."

Many brokerage firms have gone through the exercise of trying to "levelize" commissions, by reducing or eliminating variability in the commissions brokers receive for selling certain investment products in retirement accounts like IRAs. That way, there's no apparent conflict when a broker recommends one investment, like a mutual fund or annuity, over another.

ValMark was one firm that had worked to levelize product compensation in preparation for June 9, when the rule [expanded the definition](#) of who is a fiduciary

and established impartial conduct standards to which firms and their brokers must adhere. But one provision of the rule, the [best-interest contract exemption](#), would have in January apply strict commission requirements that many broker-dealers such as ValMark hadn't yet fully executed.

BICE, for example, would [require commissions paid to advisers to be the same](#) among different categories of investment products without any wiggle room in commission variability as there currently could be. And, those commission levels have to be justified based on "neutral" factors," such as time and complexity, and effort.

The difficulty here, executives said, is especially on the mutual-fund end, where broker-dealers may have to coordinate for the same commission schedules among hundreds of asset managers.

"I think a lot of distributors have already levelized what they could, and I think there will be more of that to come," said the unnamed brokerage executive, whose firm houses several thousand advisers and brokers. If the January date is delayed, whatever levelizing yet to be done will get pushed back, he added.

Any decisions regarding time-consuming technology challenges are also likely to be delayed, the executive said. He pointed to the rule's grandfathering provision as one hurdle — a retirement account could lose the [protection of grandfathered status](#) under the rule as a result of an adviser's subsequent client recommendation. But monitoring when a client may have lost grandfathering status as a result of such a recommendation has proven difficult for his firm and, anecdotally, most others, too, the executive said.

Skip Schweiss, managing director for adviser advocacy and industry affairs at TD Ameritrade Institutional, said RIAs would be less impacted by a delay when compared with broker-dealers.

"The rule elements that the DOL currently seeks to delay include such items as BICE contracts, warranties and disclosures," he said. "The rule's foundational elements, such as extending a fiduciary standard to IRAs and IRA rollover advice and establishing impartial conduct standards, are already in place."

However, rollovers represent one area in which firms, including RIAs, would in many cases have to change policies and procedures ahead of January, observers said.

Normally, RIAs can avoid complying with BICE when giving advice because they, unlike brokers, charge a level fee, often a percentage of assets under management. But RIAs would have to comply with the provision when recommending a client roll over assets from a 401(k) to an IRA, and increasing the adviser's fee in the process.

RIAs are able to side-step some of the more difficult elements of BICE compliance if they receive a "level fee" as defined by the regulation. An adviser charging an asset-based fee of 0.50% for equities and 0.25% for fixed income may not have been considered a level-fee fiduciary under the rule, though, said Mr. Bernstein of MarketCounsel. Assuming the delay occurs, advisers wouldn't have to complete an analysis to determine if they'd qualify as level-fee fiduciaries, and can continue doing business as usual regarding rollovers, he said.

David Edwards, president at Heron Financial Group, which manages \$300 million in client assets, said the fully implemented rule would create additional steps for some rollover transactions. For a new client whose only assets are held in a 401(k) plan, for example, an adviser would have to theoretically analyze a 401(k) plan's fees and services, and document why it's in the client's best interest to move assets to the RIA.

A rule delay may put this new procedure off further, Mr. Edwards said.

"We keep asking our compliance people, 'When do we have to do this?' and they keep saying, 'So far it's uncertain,'" he added.

If there is a delay, most observers believe the provisions of the rule already in place will remain, and don't expect to undo anything they've already been implemented.

"The 18 months is a breathing point to examine options, and to think more clearly or constructively about how best to proceed," said Denise Valentine, senior wealth management analyst at Aite Group. "Nobody's going to go backwards."

In fact, some of the implemented items, such as an update to financial planning systems, have been positive for many firms and "are fundamentally positive for the

client experience," she said.

Aside from levelizing compensation and trimming the investment product lineup, ValMark has, among other actions, also updated disclosures and established a client-review standard reflecting best-interest recommendations for both retirement and non-retirement accounts, Mr. Forner said.

"At this moment, we are comfortable with where we're at," he said. "What we have in place today is not likely to go away."

Compounding the issue for broker-dealers and RIAs, though, is the eventuality that the Trump administration makes changes to the current iteration of the fiduciary rule, creating a conundrum for firms torn between plowing ahead with compliance with the current rule and waiting to see [how the rule may change](#).

If a rule delay does ultimately come about, that 18-month in-between time will ideally be spent preparing for a number of different scenarios.

"You have to be prepared," Mr. Forner said. "We're planners at heart. You hope for the best, but plan for the worst. I think you should have a range [of possibilities], know what you need to do and when to do it."

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