Benefit Insights

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A non-technical review of qualified retirement plan legislative and administrative issues
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Fiduciary Rule Round Up

There has been much upheaval in the retirement world as of late and it centers around the new fiduciary rule. The New Fiduciary Rule means that many investment professionals that weren't previously considered fiduciaries will now have to take on that role. So, why is that such a bad thing? Well, it's not per se, but the implications of how this may change the way the investors and their companies function may leave them frustrated and tentative towards some future business. But before we get too bent out of shape, let's break it down and see what we're truly looking at.

In April 2016, the Department of Labor (DOL) laid out its plan to implement the "New Fiduciary Rule" or "Best Interest Rule." At its core, the rule raises the fiduciary standard of investment advisers to match that which already applied to RIA's (registered investment advisers). The central focus of the DOL guidelines is to protect plan participants from conflicts of interest related to investment advice that could threaten their retirement savings. Since its inception, the rule has been met with confusion, controversy, delays, and lawsuits as providers struggle to understand how the new rule will affect the way in which they do business. The rule, originally scheduled to begin phase one in April 2017, was partly implemented in June. After several delays, further phases of the rule meant to be implemented in January 2018 have now been pushed back to July 2019.

Who is subject to the new rule?

The rule expands the "investment advice fiduciary" definition under the Employee Retirement Income Security Act of 1974 (ERISA). As of June 9, 2017, all financial professionals who provide advice on retirement plans are considered fiduciaries and must act in their clients' best interests. Previously, only RIA's who charged a fee for service on retirement plans were considered fiduciaries. While the rule will have an overall impact on the retirement industry, it will heavily impact advisers whose compensation is paid on a commission basis. A fee-based adviser, or RIA, gets paid the same amount regardless of the investment offering or investment selection provided within the plan. A commission-based adviser can be paid in a myriad of ways from different investment companies. These fees are typically volume based and can vary from fund to fund and even share class to share class. This is not to say that a commission-based broker cannot provide good advice for your plan. They did not create the system by which they are paid. But true or not, the DOL views commission based pay as a deterrent to being able to provide objective investment advice to plan sponsors and participants.

Does the new rule only apply to investments in our retirement plan?

No. In addition to qualified retirement plans, the new rule expands the fiduciary standard applied to both traditional and Roth IRA's. So, any advice or investments offered for plan distributions will be subject to the rule. In addition, Health Savings Accounts (HSAs), Medical Savings Accounts (MSAs), SIMPLE IRAs, and SEP IRAs also fall under the new rule's protection. Now, a financial professional who advises on the investments in an HSA is considered a fiduciary. The result is that brokers and advisers will be limited to how they can be compensated for the guidance they provide on these types of accounts.

If this is about protection, what's the downside?

The DOL's new rule has a large impact on the investment industry. Not only have the compensation models that the rule aims to remove been in place for a long time, compliance with the expanded fiduciary rule is not clearly defined at this point. Moreover, the industry will have to implement sweeping changes to contracts with their advisers, compensation models, systemization and compliance oversight, etc. It isn't as though they are unwilling, but the scope of the changes to an already heavily regulated industry shouldn't be minimized. In addition, many wonder if the regulations will even survive the administrative review process. Implementing the change required to handle the increased fiduciary responsibility and proof of compliance may raise the cost of doing business, so plans could see investment fees increase in the future.

Some firms are prohibiting brokers and advisers from giving rollover advice on 401(k) assets and taking up a strictly educational role to avoid liability. Investment professionals that give advice must produce additional documentation on plan fees and services to determine if a rollover is in their best interest, which can prove difficult.

What Plan Sponsors Need to Know

Why do you care about this and what should you be doing? According to a 2017 Personal Capital survey, 46% of Americans thought that their financial adviser was already required to meet this level of fiduciary responsibility. Financial advisers play a pivotal role in retirement planning and their advice can make an enormous difference in retirement savings. While the rule is targeted primarily at providers of retirement plan products and services, it will also affect plan sponsors. Plan sponsors should expect to receive new disclosures and amended contracts from their advisers and need to review and understand the nature of the relationships they have with their advisers. The decision to hire or retain service providers remains a fiduciary decision, and plan sponsors have an ongoing duty to monitor those advisers. Failure to do so could subject plan sponsors to potential ERISA fiduciary violations.

Since rollover or distribution recommendations will be covered by the new conflict of interest rule, some service providers may be less willing to assist participants with the decision of whether, or not, to roll over their plan assets to an IRA. This will effectively allow them to avoid being held to the standard of fiduciary in giving advice on such a decision. It's a notable change to the rules and may result in participants electing to leave assets in the plan following termination.

Plan sponsors should also take a close look at the investment education that is provided to plan participants and beneficiaries to ensure that the investment education qualifies as education rather than advice under the new rules.

Technically Speaking

Back in our June 2017 issue we took time to address the uptick in automated financial advice that is getting a foothold in the investment world in our article "Rise of the Machines". It appears the new rules being issued will give even further cause for advisers to consider the possible value in utilizing the Robo-Adviser platforms as an investment tool for their clients.

With future compliance challenges arising, development of this technology and its application may greatly aid broker-dealers in their efforts to comply with the new regulations. Updated software solutions may alleviate some of the fiscal impact associated with the stiffer compliance rules as well. Automated programs employed to create trading algorithms that are always in compliance with the DOL rules, regardless of market conditions or client circumstances, and devoid of human error continue to make them an attractive tool for investors and advisers alike. Regulator approval may be garnered by the fact that many of these programs already use low-cost index funds for their trading.

Don't Get Ahead of Yourself Quite Yet…

So, what does all of this mean? The back and forth nature of proceedings with regards to the new rule is a bit mysterious to many in the retirement and investment communities but there is hope that some further clarity will be provided when the Dept. of Labor releases its proposal. The 18-month delay would allow for the DOL to coordinate with the Securities and Exchange Commission (which could possibly offer up its own fiduciary rule), broker-dealer regulator FINRA (Financial Industry Regulatory Authority), and state insurance commissioners.

For now, compliance will be pushed back and the question remains whether the delay is to allow for more efficient implementation of the rule as is or to allow time for revisions, making the outcome even more uncertain.

Whatever the coming months hold for the New Fiduciary Rule, the resulting outcome is going to require a level of greater fiduciary responsibility for those directly involved with influencing the retirement plan process. Despite what possible cost and increased responsibility the new rule may bestow upon us, it is time to accept this new level of accountability as a positive next step in the overall picture of retirement planning. Familiarizing yourself with the details of your plan, and your responsibilities to it, is paramount to becoming a successful fiduciary. It's important to utilize all the information available to you and maintain a strong relationship with your adviser and TPA.

Houston, We Have a Problem…

Times can get tough for people. With the onset of Hurricane Harvey having decimated parts of the Gulf Coast and Hurricane Irma following its destructive lead, we are reminded that at any point we may find ourselves in hardship. Companies make layoffs, natural disasters occur, emergencies… well, emerge. With nowhere else to turn, some will look to their 401k for their own disaster relief. A withdrawal in the form of a "hardship distribution" is one of the tools that participants may use in this situation. This year the IRS released new examination guidelines for documenting hardships. Their intent is to clarify the documentation process of proving the existence of a hardship and verifying that the amount withdrawn did not exceed the actual financial need.

Before we go into the regulations surrounding a hardship withdrawal, it is important to define what a hardship is. A hardship distribution is a withdrawal from a participant's retirement account made because of an immediate and heavy financial need. It is limited to the amount necessary to satisfy that financial need but may include amounts required to pay the taxes and penalties. While living conditions and lifestyle choices differ for everyone, the government has created a universal list of events that may cause undue financial strain. The list includes:

- Qualifying medical expenses.
- Costs related to a principal residence (But not mortgage payments).
- Tuition.
- Prevention of eviction.
- Burial or funeral expenses.
- Repair of damages to principal residence (Especially important during hurricane season).

Continued on Next Page

Continued From Previous Page

Does your plan allow for hardship distributions? This is an important question to consider as the plan sponsor and if the answer is yes, there are certain responsibilities you must undertake to justify the withdrawal from your plan's assets. Many 401(k) plans allow for hardship withdrawals since it is generally believed to encourage participation levels. Participants seem more at ease knowing that they could access their accounts in the event of an immediate financial need.

So, how does a participant justify and their employer verify that the withdrawal amount of a hardship requested complies with the regulations? The IRS regulations require that the plan administrator obtain source documents (or a summary of that information), issue the required employee notifications that accompany a hardship withdrawal, and verify they meet the hardship requirements.

So, how have things changed? Historically, to keep employers from being in a position of reviewing the employee's financial situation or judging how critical their hardship need is , the participant was able to demonstrate their hardship through an "attestation." While it was understood that if audited the participant would have to produce the proof, problems producing that proof arose at times, especially when the participant was no longer available. This left the plan in a precarious position with distributions not being justified or not for the proper amount. However, a participant attesting to the fact that they need a hardship distribution isn't enough to move forward anymore. Difficulty in verifying the need and the appropriate distributable amount was simply leading to too many problems.

How does one avoid trouble with a hardship in an audit? Two words… source documents. Auditors will look for documentation supporting the event like receipts, medical bills, tuition expenses, contracts, or a summary of these examples, and they can be provided electronically. The recipient also must agree to keep these documents and be able to produce them upon request if needed (say… for an audit). This documentation is critical and especially helpful in instances where the employee has moved on.

The second key step in the guidelines is disclosure. You must provide the employee who requests a hardship with all pertinent tax and possible withdrawal penalty information. It also needs to be made clear exactly what can be taken as a distribution and from what sources. Depending on the source of the funds, different rules apply to the participant's ability to make a withdrawal and will be outlined in the plan documents.

If you've been going about hardships in this fashion, keep going, you're doing great. If you haven't and your plan offers them, tighten up your procedures moving forward. While hardship withdrawals from retirement savings should be a participant's last resort, they have increased every year over the last five years and that trend is likely to continue. Your familiarity and efficiency in relation to the process will help participants navigate otherwise stormy seas.

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