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How DOL Fiduciary Rule Will Affect Rollover IRAs, Annuities and Other Products

The final fiduciary rule announced Wednesday does not go as far as many critics had feared, but it will have an impact

The final fiduciary rule announced by the Department of Labor on Wednesday does not go as far as many critics of the proposed rule had feared, but it will have an impact on financial advisors and the products they offer to clients. It's also expected to accelerate the move from a commission-based business to fee-only model, which has been an ongoing and growing development in the evolution of the industry.

Advisors, however, will still be able to offer commission products, including annuities and proprietary services, but not necessarily in the way they have until now. Moreover, the changes won't take effect in their entirely until Jan. 1, 2018, months later than had been expected.

"Advisors need to think about the product set they currently offer clients," says Matt Sommer, director of defined contribution and Wealth Advisor Services at Janus Capital. They need to consider the fees for those products, but there is flexibility. For example, says Sommer, the rule says that "fees are not the only criteria to use when making investments … and that moving from a commission-based client to fee-based one is prohibited if it's not in the client's best interest….It's all about the client."

"Whatever the investment vehicle involved (such as stocks, annuities, mutual funds, SMAs or commission products), the advisor must be acting as a fiduciary," says Jim Pasztor, of the advisory firm Pasztor & Associates and vice president of academic affairs at the College for Financial Planning.

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The rule is "focused much more on disclosure than outright elimination of differential compensation," says Natalie Wolfsen, chief commercialization officer of AssetMark, a turnkey asset management program provider for 7,000 advisors.

(Related: How the DOL Fiduciary Rule Will (and Won't) Affect RIAs)

Here's how the rule is expected to affect some of products that advisors offer for retirement accounts, which are the only client accounts that are covered by the DOL's fiduciary standard.

Rollover IRAs

While the rule does require that advisors working with clients on rolling over their 401(k) accounts into an IRA act in the best interest of those clients it does not regard the information or education they provide about retirement products as investment advice, as had been feared. "Advisers and plan sponsors can continue to provide general education on retirement saving without triggering fiduciary duties," according to the DOL Fact Sheet.

Advisors will also be able to continue to sell commissioned products if a Best Interest Contract Exemption (BICE) is signed by the client and the advisor's firm. The form, which can be signed at the point of sale not earlier, commits the advisor to put their client's best interest first so long as they

- disclose conflicts of interest
- charge "only reasonable compensation"
- avoid misleading statements about fees and conflicts of interest
- prohibit financial incentives for advisors that act contrary to a client's best interest

What is "reasonable compensation," however is open to interpretation.

Advisors will need to be much more aware of the fee structure of the rollover IRA compared to that of the 401(k) plan, says Terry Dunne, managing director of rollover solutions group for the Millennium Trust Co. Fees in 401(k) plans are often lower than

fees in rollover IRAs.

Fee-only advisors, whether they charge a fee based on a percentage of AUM or a flat fee, will not be required to file a BICE for recommending that a client roll over assets from an employer plan to an IRA. That's because they receive the same compensation no matter what investments are included in the rollover IRA, according to the DOL.

However, "even RIAs who are fee-only will need to shore up their processes on their discussions with clients about rollovers," says Sommer, noting that they will need to document why assets were moved from a lower priced institutional 401(k) plan to a higher priced retail rollover IRA. That case can be made, but the documentation has to include the reasons why, such as advice also given on Social Security or beneficiaries, says Sommer.

Commission Products & Proprietary Products, Including Annuities

In the "protect your savings" FAQ section about the new fiduciary rule on its website, the DOL states clearly that the BICE can "flexibly accommodate a wide range of compensation practices, *including commission-based accounts*, while minimizing the harmful impact of conflicts of interest on the quality of advice."

The DOL rule also doesn't ban proprietary products but notes that firms offering only a limited number of such products for retirement accounts will have to "disclose the associated conflicts of interest … [and] adopt measures to protect investors from those conflicts."

Moreover, advisors who recommend a limited set of products "must consider what is in the retirement investor's best interest." If it's a product they don't offer, say a stock index fund, those advisors "*cannot recommend a product from their limited menu*."

Advisors will still be able to sell commission-based variable and index annuities, but they will have to justify that with a BICE. Eventually the market for those products could change. Larry Greenberg, president of Jefferson National, which offers advisors a platform for tax-deferred investment-only variable annuities in nonqualified (non-retirement) accounts,expects the rule will put pressure on insurers who sell front-loaded insurance products like variable annuities "to reassess their product lines and compensation" in order to meet the standards of the BICE.

Mutual Funds

It's expected that the more expensive classes of mutual funds will come under pressure from the DOL fiduciary rule. "You'll see adjustments in those products and in advisors' use of those products," says Wolfsen of AssetMark.

She expects that fund companies will lower the expense ratios of shares sold to retail investors to match those charged by the institutional version of the same fund and that advisors will move away from funds charging 12b-1 fees, which compensate them.

“Advisors will need to make sure that the class being recommended is the best available for the client, and that it has reasonable fees,” says Pasztor. “Look for 12b-1 marketing fees and trailers to be reduced and/or disappear over time.”

The Investment Company Institute, the trade group for the mutual fund industry, released a statement Wednesday noting that because “the rule is lengthy and complex” it needs “to carefully review and analyze its details to understand fully how it will affect mutual funds.” It will hold a meeting of industry leaders on May 10 in Washington to discuss the implications of the new rule.

--- Check out How the DOL Fiduciary Rule Will (and Won’t) Affect RIAs on ThinkAdvisor.

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