MARCH 17, 2016

ERISA Newsletter

SAWTOOTH MOUNTAINS, IDAHO

205 N. 10th Street, Suite 300 · Boise, Idaho 83702
208.342.5522 · 866.ERISALAW
www.erisalawgroup.com

Beyond Wall Street's Myth – The Little Guy Will Be A-OK

ERISA's Near-New Fiduciary Definition

by Jeffery Mandell, Esq.

For an executive summary, albeit losing some color and context, go straight to page 6.

It's Not Pretty. I have limited my legal practice to ERISA for 34 years. I've seen a lot of things, I've been around the block, so to speak. Although my life has been steeped in ERISA, it often is hard to be a big fan of it. ERISA's objectives are spot on, but I believe the implementation of it is more complicated than it needs to be. Law seems plain wrong when it is so complex that no one can comply with it. ERISA also uses and wastes resources that employers and other plan sponsors can better spend elsewhere.

For nuanced reasons beyond the scope of this article, I also am not a fan of ERISA regulations, be they IRS, DOL or PBGC. They can drive one nuts. They drive my clients even more nuts when they receive my bills for services that mostly help them try to comply, or get back into compliance, with ERISA. Plan service and financial providers, employers and other plan sponsors often expend their efforts and dollars not to advance their respective employee benefit and/or business objectives. Instead, they spend their resources to avoid hefty legal fees, other costs and resources to avert potential litigation, horrific tax consequences and/or Department of Labor penalties, and other liabilities arising in large part from pandemic misunderstandings regarding and confusion stemming from ERISA's regulations and this byzantine legal regime.

Yet, notwithstanding the ugly mess ERISA is, with its shackled yolk nearly bringing employee benefits to its knees, it hunkers along, enabling tried and tired employers to

provide valuable retirement, deferred compensation and health benefits to employees.

But ERISA Works. Regardless of popular notions, our United States government does some good. The Employee Retirement Income Security Act of 1974, as amended ("ERISA") does good. It was passed in 1974 because our private retirement system needed comprehensive and consistent rules. Many employees where getting a bad deal. At the same time the Internal Revenue Code ("Code") and existing other law encouraged executives and other highly paid employees to receive generous retirement benefits while providing little (and sometimes no) benefits to rank-and-file employees. ERISA and the Code slightly leveled the playing field as between owners, executives and their workforces.

ERISA built important protections and prescribed reasonable and logical precepts of conduct. An employee lucky enough to be employed by a large or sophisticated company could retire with something amounting to a meaningful nest egg (in contrast to today's 401(k) milieu).

So, you might say that although ERISA often is hard to like, and even harder to swallow, we all essentially need it.

Like a friend, ERISA can be maddening. But you need it.

DOL Disclosure Rules: A Painful but Great Step. The Department of Labor (sometimes "DOL") plan provider/fiduciary level Section 408(b)(2) regulations were painful. So were the participant level Section 404a-5 disclosures. Wall Street fought them hard. Eventually Wall Street realized the regulations were happening with or without it, at which time Wall Street changed its objectives (and still essentially lost).

When the first draft of those regulations floated about many moons ago, I immediately recognized that if they got off the ground, it would be a good thing. They would lead to more transparency, to plan sponsor and employee education about the plan's true fees, services and expenses, and to a higher degree of disclosure from (and also honesty of) financial institutions and their related parties. Most importantly it was evident that in the end it would lead to greater retirement savings. The DOL's initiatives have already paid off, pushing down the investment fees participants and plans pay (but not IRA fees because the regulations do not affect IRAs). The regulations also sowed the ground for a new and robust dialogue about plan expenses and returns, one that Wall Street fought to avoid and that has been long overdue.

It is worth noting that the cause for the above-stated pain of these disclosures was and is <u>not</u> the regulations. For the large part they are very understandable and easy to satisfy. The frustration and costs of employer compliance resulted because the employers are and were exposed to significant liabilities for noncompliance yet it was the financial institutions and their brokers, agents, RIAs, etc. who as a general rule

(with very little exception) failed to provide the disclosures in accordance with the regulations.[1]

Whether the financial industry's widespread noncompliance was and is an attempt to still hide the ball regarding the true costs of plan investments and how those dollars are allocated among the various interested third party (non-employer, non-employee) providers, or is a designed half-hearted attempt to comply, and/or is for some reason beyond me, I don't know. I'm not a member of that club.

The Conflict of Interest Proposal on the Table. The above brings me to today. The DOL, with the President's full support, has for a few years moved to implement its next logical step — let's hold the investment industry, upon whose advice and recommendations we all rely, to some standard of accountability. This step is often referred to as the new conflict of interest or the new definition of fiduciary proposal.

Investment advisors must disclose conflicts of interest. The DOL will prohibit misrepresentations.

Candor from Wall Street. The DOL's proposal provides that financial institutions should no longer be allowed to provide advice regarding retirement and IRA monies when that advice is <u>not</u> in the plans', participants' and IRA owners' best interests. If a different available product (of which the advisor is aware and about which the client is interested) is in their best interests, but generates a smaller return for the institutions, consultants, RIAs, brokers or other financially interested plan providers than the return the advisors will receive from the advisors' recommended investment, the advisors must disclose that conflict of interest.

Let's take the individual, perhaps just like you, who has worked and sacrificed for a lifetime in part to save for retirement. Cutting to the chase, for Wall Street, the Chamber of Commerce, and some in Congress to object to the principle (and/or not put its money where its mouth is) that such saver should not demand <u>and expect</u> honesty and candor from the financial industry is ludicrous.

Wall Street does not want its industry to be held to be "fiduciaries," notwithstanding the reality that plan sponsors and individuals are directly led by Wall Street to rely upon its investment candor, advice, recommendations, and

[1] More than one client employer expressed surprise and severe displeasure that even though the rules require that the financial and other providers provide the requisite information and materials to employers and employees, it is the employers (e.g., discretionary fiduciaries), and in most all cases <u>not</u> the providers, who face the direct liabilities from a failure to correctly provide the disclosures. I believe the Department of Labor is not only mulling over this inequity, but also in general is considering how Wall Street should have some skin in the ERISA financial game. The new proposed fiduciary regulations advance that ball.

increasingly frequently its investment decision-making. If they are not fiduciaries, then I am not an outspoken ERISA lawyer from Boise, Idaho.

IRA Rollover Owners Deserve Better. Let's also consider the plan participant who has had investments in her/his 401(k) plan and perhaps also had the good fortune of being employed by a plan sponsor that, having caught on, negotiated lower plan expense ratios. The participant retires and rolls over her/his plan benefits to an IRA with that same financial institution that services the 401(k) plan (which institution historically skirted on or over the edges of ERISA law to accomplish its desired retention of the 401(k) monies in the IRA).

The regulations require that IRA owners and plans receive candid and honest investment information.

What justification is there that such person, without warning or knowledge, pays considerably higher internal IRA fees than the, often materially, lower fees and expense ratios the participant paid while that money was in the plan for an IRA investment that by design appears to the IRA rollover owner to be the same as or almost identical to the 401(k) plan investment? That's precisely the historical and current norm. The Department of Labor proposal neither argues nor requires that the plan and IRA fees be the same. It just wants the broker or other advisor to tell and not deceive the retiree about it.

Regulations in a Nutshell. The DOL's proposed fiduciary definition/conflict of interest regulations may be summed up as this: persons who provide investment advice to plans, participants and IRA owners must be candid and not lie to or hide the ball with the investor.

For example, if the advisor can either charge W fees to the plan, receive X in compensation and recommend that the plan keep Investment Z, or charge the plan W Plus More, get paid X Plus More, and recommend Investment Z be replaced with Investment Wonderful, then the proposed rules give the advisor ways to be truthful about that inherent conflict of interest. Because the advisor will no longer be permitted to overlook the conflict or misrepresent the investment recommendation to the investor, such education should encourage plans and individuals to make informed wiser investment choices.

If that advisor fails that standard, he/she/it can be liable for the losses (or foregone gains) the unsuspecting plan and individuals sustain. That's not radical. It's not even a high bar. It's merely the right thing to do (and I hate repeating this cliché) for America. Such disclosure is what any person expects from a trusted advisor.

OMG – The Little Guy! Allow me to address Wall Street's (and protesting Congressmen's and business interests') current argument that if the regulations become law, the little guy will be hurt. Wall Street tells Congress, the DOL, big and

small business and President Obama that under the proposed regulations the average citizen with retirement savings will not have access to financial products and will not get the investment advice he or she needs. Retirement and IRA brokers, advisors and consultants will be too terrified to offer advice. America's fees for retirement savings will go up; retirement funds will go down.[2]

Please stop. It's nonsense. First, the regulations make clear that much if not the majority of what these advisors currently do – providing investment education, as one example – they can continue to do without becoming fiduciaries. Second, I am sick and tired of the same old Wall Street ERISA institutional resistance and cries of America's financial ruin to all proposals that might help the little guy just a bit yet cause the slightest of inconvenience or unease to Wall Street and business as usual.

Third, Wall Street's best argument disproves it. Wall Street is fighting this proposal because it is very worried it will cut into its profits and remuneration. This, of course, is the whole point of the DOL proposal – plans, participants and IRA owners should and will pay lower fees once they learn the truth. Moreover, investors very well might not be happy campers when receiving the news.

Wall Street must disclose its own financial interests in an investment if the plan or IRA owner pays higher fees that increase the advisor's fees.

Fourth, financial concerns are still going to want to manage the huge monies in IRA and participant accounts. The financial industry and its parties just might not make as much money. And listen, the DOL does not want to snuff out ERISA's financial interests. The DOL gets it. It employs a lot of bright people who are driven to help our citizens' retirement and other employee benefits. Many in the DOL do not think that the rest of us are crooks.

My Guy! I am all for the employer and its employees. They (except sometimes for the largest of employers) truly have been the victims in ERISA's marketplace for the longest of times. I also root for those in the retirement financial industry who want what's best for their clients. They want to inform and educate the employer, employees, and IRA owners because that is how those advisors choose to live their lives. With honesty and I speculate some pride, they build and deserve their clients' trust and loyalty that in turn allows them to succeed.

My Message? What is my message to Wall Street, the Chamber and the increasing number of legislators, in this election year, who are switching sides on the conflict of interest debate? Stop fighting Obama and the DOL on the regulations.

---

[2] Some investors, primarily certain IRA owners, may in the short term incur higher fees. I have little doubt they may be avoided.

Do not lie to us that you are watching out for the average Joe while at the same time you extoll the putative virtues of hollow values.

Stop whining. Make an honest buck.

Qualifying Comments to Put this in Perspective

This Newsletter obviously is not technical. It is, however, accurate. When the regulations become law, which absent a big surprise is within the next few months, we intend to explain the new regulations as we most always do.

If you are in the retirement plan/IRA investment industry, you are advised to now get a head start on the new legal regime.

I have excellent reason to believe the DOL when it says it has and will listen to Wall Street to adjust this initiative to its interests so long as doing so does not compromise the DOL's laudable objective of more transparency and honesty.

I do not indict Wall Street in its entirety. I have great respect for and friendships with individuals and companies in the financial and business sectors who succeed yet not lose sight of what's important in life.

My words are my opinion, my perspective. Use or discard them as you wish.

Executive Summary

Unless the United States legislature finds a way to quash it, the U.S. Department of Labor soon will finalize new regulations. The new rules should profoundly affect an important aspect of how employers, employees, IRA owners and other consumers of ERISA services can expect to receive investment advice.

The DOL initiative requires that providers of investment services not act in their best interests if doing so means that such actions are not in their client plans' and participants' best interests. This law, if finalized, is long overdue.

Arguments against the proposal are self-serving and misleading.

Many plan sponsors at some point are surprised that brokers, consultants, registered investment advisors and many other purveyors of investment advice are held to a very low level of standard of care with respect to their advice. Encouraging reliant employers, employees and IRA owners to invest in XYZ while discouraging the same essential available product in investment ABC that is better and cheaper for the employer and employees, and when XYZ yields greater remuneration, even materially so, than does ABC to the investment advisor, currently is perfectly legal without requiring the nonfiduciary advisor to inform the employer of this conflict.

The employer and employees have a one in a million shot to successfully sue the advisor if XYZ tanks and ABC soars. But the employees have a much greater shot to successfully sue the employer that thought it did its homework and relied upon the advisor who gets off scot-free.

The DOL proposal makes certain advisors in certain conditions "fiduciaries" under ERISA. It also extends that fiduciary definition to advisors, brokers, etc. of IRAs. Fiduciary status means that somebody cannot lie, cheat or clandestinely work against the other party, in a nutshell. The DOL is targeting the advisor who provides advice and gets paid for it, requiring a common sense degree of honesty currently not required.

The little guy and everyone is more likely to increase wealth when the regs become final.

If you are an employer, employee, or IRA owner (see footnote 2), in my opinion you should be thrilled if the regulation becomes law. If you are a financial institution or related party, I suspect you will either be pleased or displeased. If the new legal terrain does not materially change your business model, reinforcing the way you conduct your business with your clients, I suspect you will be pleased. You might be displeased if the required change in your business model, in terms of how you provide investment advice, means you have a bit more work to do and/or your compensation and/or profits are less because your clients are more informed and will be paying you less.

Wall Street has been fighting the Department of Labor with all its might on the proposal. Now big business is fighting it and many in Congress are voicing concerns. Without taking up more space to explain why I say this, you can simply trust me that their arguments are ridiculous.

For more information for your plan, contact Jeff Mandell (jeff@erisalawgroup.com) or John Hughes (john@erisalawgroup.com), or call 208-342-5522 or 1-866-374-7252.

* * *

This *Newsletter* is intended to provide general information only and does not provide legal advice nor create an attorney-client relationship. This *Newsletter* does not discuss potential exceptions to the above rules. The application of ERISA can differ from client to client. For information regarding the impact of these developments under your particular facts and circumstances, you are advised to seek qualified legal counsel. This material may also be considered attorney advertising under court rules of certain jurisdictions.