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What's the Immediate Impact of the DOL Fiduciary Rule on 401k Plan Sponsors?

By Christopher Carosa June 6, 2017

The time has come for the DOL's Conflict-of-Interest (a.k.a., "Fiduciary") Rule to transition from theory to practice. Well, sort of. Although implemented, it won't be enforced until early next year. Still, although without the teeth of enforcement, it's formal implementation will have an immediate impact on 401k plan sponsors.

But first, let's take a step back and understand why the Fiduciary Rule will have such a profound effect. "The 401k market has been fertile ground over the past decade for class-action lawsuits brought by plan participants against employers and some service providers, such as record keepers, for breach of fiduciary duty under ERISA," says Nick Sloane, President of Sloane Wealth Management in Warrenville, Illinois. "Such lawsuits have yielded some large monetary settlements, typically from big corporations with massive retirement plans. For example, Lockheed Martin paid a record $62 million in 2015; that same year the Boeing Co. paid $57 million in a separate settlement."

The Rule redefines who is a fiduciary to an ERISA plan. "Effectively, the fiduciary rule expands the 'investment advice fiduciary' definition under the Employee Retirement Income Security Act of 1974 (ERISA)," says Chad Parks, CEO at Ubiquity Retirement + Savings in San Francisco, California. "This legislation will automatically elevate all financial professionals who work with retirement plans or provide retirement planning advice to the level of a fiduciary, bound legally and ethically to meet those standards."

Technically, the legal status of the plan sponsor will not change. "Plan Sponsors typically fall under the definition of a fiduciary under ERISA and are subject to the duties set forth in ERISA section 404," says Charles Field, co-chair of Sanford Heisler Sharp's Financial Services Litigation practice in San Diego, California. "Therefore, the Fiduciary Rule will have no impact on them."

Furthermore, delayed enforcement may give the appearance that things are not changing. Tom Reese, an investment adviser at Conrad Siegel Investment Advisors in Harrisburg, Pennsylvania, says, "While the fiduciary rule will go into partial effect on June 9, full implementation will not take place until Jan 1, 2018. Until full implementation, fiduciaries that receive commission or variable compensation are required in good faith to provide advice that is in the best interest of the investors, charge no more than reasonable compensation for their services and make no misleading statements about plan investments and conflicts of interest."

Yet, that doesn't mean the due diligence work completed by plan sponsors won't intensify. "Plan sponsors need to determine if their service provider intends to change the status of their relationship from 'non-fiduciary' to 'fiduciary'," says Michael Kopec, Director of the Investment Consulting Group for Portfolio Evaluations, Inc. in Warren, New Jersey. "For the former, this will have little to no impact on their plans going forward. However, for the latter, plan sponsors will need to determine what, specifically, will change regarding the services provided and if those changes will affect their plan's fees. Sponsors will then need to review if those changes are appropriate for their participants, and if so, implement procedures for the ongoing monitoring of their provider's adherence to the new rule going forward."

There are specific tasks plan sponsors should undertake immediately and ongoing procedures that should be incorporated. “Plan sponsors should review agreements with their providers and advisors,” says Reese. “With the full implementation delayed, employers will need to continue to make sure their retirement plan is in participants’ best interest. With increased scrutiny and more awareness about conflicts of interest, there is even more pressure on employers to make sure that they are taking a proactive approach to meet their fiduciary responsibility. This would include developing an Investment Policy Statement and regularly reviewing share class, fee benchmarking, and performance of the plan investments.

Again, because enforcement of the Fiduciary Rule doesn’t take place until January of 2018, it doesn’t appear there will be an immediate increase in liability. Reese says, “Plan sponsors’ fiduciary liability is unlikely to immediately be impacted by the fiduciary rule since the Department of Labor’s initial emphasis is not the enforcement of the rule, but rather to require fiduciaries to act in good faith by providing advice in the best interest of their investors.”

Just because the focus is on service providers, however, doesn’t mean plan sponsors won’t be effected. “As service providers take on additional responsibility,” says Gary Pallatta, Senior Consultant of the Retirement Plans Consulting Group for Portfolio Evaluations, Inc., located in Warren, New Jersey, “plan sponsors will now be tasked with a need for additional oversight—primarily that of monitoring their vendor is adhering to the new standards. Should their provider fail to sufficiently meet those standards, the plan sponsor, and any named fiduciaries comprising a plan’s committee, could then be perceived as liable for inadequately monitoring the relationship.”

Plan sponsors who currently use service providers targeted by the Fiduciary Rule will find they will suffer from the greatest impact. “Brokers and insurance agents will be impacted the most, demanding that clients’ interests are placed above all else, and leaving no ability for advisors to conceal any potential conflicts of interest,” says Parks. “All fees and commissions must be clearly be disclosed in dollar form to clients. This includes making recommendations or solicitation, not just ongoing advice – if an advisor is charging a fee-for-service, they are considered a fiduciary. Accountability and suitability are the responsibility of the fiduciary, meaning that whatever retirement vehicle a broker, dealer, or provider is delivering, must be in the best interest of the customer (referred to as the Best Interest Contract Exemption).”

The lull in augmented fiduciary liability is unlikely to coincide with a lull in legal actions. “In the past few years,” says Reese, “there have been more class action lawsuits against plan sponsors around conflicts of interest. These lawsuits are likely to continue to happen, so plan sponsors should remain diligent about their fiduciary responsibilities.”

And this trend has not gone unnoticed. Sloane says, “News of lawsuits against larger 401k sponsors have made all plan sponsors more aware of their fiduciary duties and the cost of not paying attention. Many have begun a review of their plans to verify compliance but surprisingly there are quite a few that have really not done anything which may or may not come back to bite them in the future depending on how well their plans were designed and have been managed over the years. They ignore such duties at their peril.”

It’s clear service providers have put this year of preparation to good use. Many wonder if plan sponsors have done the same. “I think for the most part advisors are the ones ‘getting ready’ for the Rule,” says Reese. “Hopefully sponsors and consumers are hearing about the Rule and are at least becoming familiar with what’s going on.”

Others have seen plan sponsors be very proactive. Sherrie Grabot, CEO of GuidedChoice in San Diego, California, says, “As with the advisors, we’ve experienced an increase in plan sponsors looking for 3(38) advice services for both the defined contribution plans as well as the participants. Overall, most plan sponsors are looking to reduce fiduciary liability.”

Sloane agrees with Reese when it comes to plan sponsors taking action. He says, “Every plan sponsor should solicit a “fiduciary review” of their sponsored plans. This review should include plan design review and an overall analysis of all costs and fees associated with the various parts of the plan.”

Tyler Harrison, Managing Member at Efficient Plan in Denton, Texas, echoes this sentiment. He says, “They should and hopefully will be much more diligent in the selection and monitoring of their current and future advisors, making sure the advisor is acting in their best interest and abiding by the rule.”

Grabot suggests that, despite no threat of enforcement, “there has been new light shown on the industry and the issues when it comes to the financial institutions not being fully transparent or acting in the participant’s best interest. As a plan sponsor who has a responsibility to their employee base, they should be asking the right questions to ensure that the partner they decide to move forward with has the good intentions and practices already in place. They should determine whether the provider is acting in the best interests of clients and whether there is full disclosure. Transparency in process and with fees is imperative for the market to operate efficiently, enabling plans to get the best value for their plans. IRA holders should also be doing the same.”

“Hopefully,” says Reese, “this past year gave employers a better understanding of what they need to look out for to act as fiduciaries for their plan participants.”

Delays in implementing the Rule have not dampened the spirit of some supporters. Dan Timotic, Managing Principal at T2 Asset Management, LLC in Oakbrook Terrace, Illinois, says, “I personally feel the fiduciary rule should have been implemented a long time ago. There is absolutely no reason not to hold advisors to a fiduciary standard. Plan sponsors need to make sure the advisor they work with on their company’s retirement plan is a fiduciary.”