PIERCE FINANCIAL

RPAG

Fiduciary Hot Topics

SECOND QUARTER 2018

The Future is Looking Cloudy for the DOL’s Fiduciary Rule

In March, the Fifth Circuit of the U.S. Court of Appeals struck down the Department of Labor’s (DOL’s) Fiduciary Rule in its entirety. This follows closely on a decision from the Tenth Circuit just a week prior upholding the Rule. The Fifth Circuit concluded the Rule is arbitrary and capricious; that it is not authorized by ERISA and that the DOL exceeded its regulatory authority in promulgating this rule.

The essence of the Fiduciary Rule is that any person making investment recommendations to plans, their participants or IRA holders, is acting as a fiduciary and may only make recommendations that are in the “best interests of the client.” The rule is complex (the regulation is 176 pages) and has generated much controversy within the financial services industry.

As the result of an executive order issued by President Trump early last year, the Secretary of Labor already placed parts of the Fiduciary Rule on hold until the middle of next year. In view of this delay, now combined with the Fifth Circuit’s decision, it seems the Fiduciary Rule’s future is uncertain. A key question is how vigorously the DOL will defend the Rule. The Trump Administration’s priority is withdrawing, rather than defending regulations. While there is no right of appeal in this case, the DOL could ask the Supreme Court to consider the matter on the basis there is now a split in the Court of Appeals. Under such circumstances, the Supreme Court will often grant a request to hear the case. Spokespersons for the DOL have refused to comment on how the Department intends to proceed.

The Securities & Exchange Commission has been a leader in regulating the financial services industry. It has, on more than one occasion, stated it believes the DOL was stepping on its turf in promulgating the Fiduciary Rule. If the Rule falls by the wayside, it is probable that either the Securities & Exchange Commission or the Financial Services Regulatory Authority (FINRA) will issue a similar fiduciary standard of their own.

Congress Simplifies the Safe Harbor for Hardship Distributions

A provision of the Bipartisan Budget Act of 2018 simplifies the safe harbor for hardship distributions. Most plans follow the safe harbor rules for hardship distributions, although this is not required. Where a plan follows the safe harbor rules, the Internal Revenue Service will not challenge on audit whether a distribution qualifies as a hardship. It is somewhat unusual for Congress to amend a regulatory standard by statute.

To be eligible for a hardship distribution under the safe harbor, a participant must have a pressing financial need and be without the necessary resources to meet this need. The statute eliminates two of the requirements necessary to these facts:

- Participants are no longer required to first take the maximum loan available to them under the plan before requesting a hardship distribution, and

- After a participant takes a hardship distribution, the plan no longer must suspend the participant from making contributions for six months.

This change takes effect January 1, 2019.

Congress Simplifies the Safe Harbor for Hardship Distributions

The Pension Benefit Guaranty Corporation (PBGC) expanded its long standing missing participants program for traditional pension plans to now include terminating defined contribution plans. A plan termination is not complete until all assets are distributed. This can be challenging because frequently there are “missing participants.” In other words, individuals with small account balances that cannot be located. With the elimination of the Social Security Administration and IRS’ letter forwarding programs, no solutions existed at present

Four alternatives were sanctioned by the DOL for dealing with accounts of missing participants:

- For accounts in excess of $5,000, purchase an annuity;
- Roll the account to an IRA established on the participant’s behalf;
- Open an interest bearing account in the participant’s name at a federally insured bank; or
- Transfer such accounts to a state’s lost property fund.

The chief draw backs to all these approaches are costs and the fact it is unlikely the funds will ultimately end up in the hands of participants.

Now plan sponsors have the option of transferring the accounts of lost participants to the PBGC. The program still requires plan sponsors to first make a diligent search for missing participants before transferring accounts to the PBGC. Because the PBGC’s program is publicized and has a searchable database, the program protects the rights of missing participants by making it more likely they will ultimately receive their benefits. In addition to its searchable database, the PBGC conducts periodic searches for missing participants.

Unfortunately, this program applies only to terminating plans and is not available to ongoing plans. While this program is voluntary, it is an all-or-nothing approach. If a plan sponsor elects to transfer accounts to the PBGC, then all accounts of missing participants must be transferred. The PBGC program has no ongoing fees, only a one-time setup fee of $35 per account. There is no fee for accounts of less than $250. This program is open to plans that are terminated after 2017.

LITIGATION UPDATE

Home Depot Lawsuit Challenges Robo Advisory Services Provided by Financial Engines

This suit represents an emerging trend in litigation involving retirement plans. It names multiple plan providers as defendants, rather than just focusing on the plan fiduciaries. In addition to the administrative committee of the Home Depot Future Builder 401(k) Plan and investment committee the named defendants include a number of plan providers, among them Financial Engines and a number of individuals in their company.

The complaint seeks $140 million in damages. Among other allegations, the complaint alleges excessive fees and failure to adequately monitor underperforming investments.

Financial Engines provides online asset allocation tools for individual participants in hundreds of retirement plans. Because these tools are offered online there is no personal interaction between Financial Engines and individual participants.

Plaintiffs contend that Financial Engines, rather than providing genuine personal investment advice, delivered “cookie-cutter portfolios based on minimal participant input.” According to the complaint, Home Depot allowed Financial Engines to charge plan participants advisory fees that were in some cases double the competitive rate. The types of robo advisory services Financial Engines offers are growing within the industry. There is some question as to whether the fees are sometimes excessive given the lack of personal service.

This lawsuit is in its early stages and it remains to be seen how successful the plaintiffs will be in proving their allegations. This suit has not yet been certified as a class action.

Registered Representative - Securities offered through Cambridge Investment Research, Inc., a Broker/Dealer, Member FINRA/SIPC. Investment Advisory Representative – Cambridge Investment Research Advisors, Inc., a Registered Investment Advisor. Cambridge and Pierce Financial are not affiliated. Pierce Financial is located at 2555 Caffey Street, Suite A, Hernando, MS 38632. Cambridge and Pierce Financial do not offer tax advice

ACR#282963 04/18