X. New Department of Labor Final Fiduciary Rule's Impact on the Securities Market

A. Introduction

Planning for retirement is an important decision for Americans and investment professionals play a central role in guiding retirement plans and investments.[1] On April 8, 2016, the U.S. Department of Labor (DOL) promulgated a final regulation: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (Final Regulation).[2] The previous version of the regulation "narrowed the breadth of the statutory definition of fiduciary investment advice."[3] Under the previous regulation many financial advisers and professionals were not obligated to abide by fiduciary standards.[4] The DOL reevaluated its regulation of retirement account advice for many reasons.[5] First, planning for retirement has become increasingly important as the "average American spends roughly 20 years in retirement."[6] Next, promulgation of the Final Regulation was impacted by the sheer size of assets invested in retirement accounts and the potential for large amounts of losses to consumers.[7] According to the Investment Company Institute, at the end of 2015, "[t]otal retirement market assets" in the United States reached $24 trillion.[8] Lastly, there has been a shift in the retirement industry that led to an increase in

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[1] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,945, 20,946 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510 and 2550).
[2] *Id.* at 20,946.
[3] *Id.*
[4] *Id.*
[5] *See* EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LAB., DEFINITION OF THE TERM "FIDUCIARY" (Mar. 30, 2011), https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/fsfiduciary.pdf [https://perma.cc/EVK5-X263].
[6] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LAB., TOP 10 WAYS TO PREPARE FOR RETIREMENT (2015).
[7] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,950.
[8] INV. CO. INST., 2016 INVESTMENT COMPANY FACT BOOK (56th ed. 2016), http://www.icifactbook.org/ [https://perma.cc/4AJV-TVPN].

decision making by individuals regarding retirement accounts[9], and an increase in consumer reliance on investment advice.[10]

The Final Regulation expands the definition of who is a "fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (Code).[11] Under ERISA and the Code, a fiduciary is someone who, among other things, "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so."[12] The Final Regulation expands who is a fiduciary to encompass more situations in which retirement investment "advice" triggers a fiduciary duty.[13] This expansion means that more advisers will be mandated to act in the best interest of their beneficiaries, offer no more than a "reasonable compensation," and make no misleading statements[14] when offering investment advice for retirement accounts, including 401(k) plans and Individual Retirement Accounts (IRAs).[15] Additionally, fiduciaries are required to perform their duties prudently, monitor the benefits and costs of investments, and evaluate the risk and return structure of investments.[16]

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[9] *See* EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LAB., DEPARTMENT OF LABOR FINALIZES RULE TO ADDRESS CONFLICTS OF INTEREST IN RETIREMENT ADVICE, SAVING MIDDLE CLASS FAMILIES BILLIONS OF DOLLARS EVERY YEAR, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/dol-final-rule-to-address-conflicts-of-interest [https://perma.cc/C7NP-ZL4S].

[10] *See id.*

[11] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,946.

[12] Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1002(21)(A) (1974); Internal Revenue Code, 26 U.S.C. § 4975(e)(3) (1974).

[13] *See* Nat'l Ass'n for Fixed Annuities v. Perez, No. CV 16—1035 (RDM), 2016 WL 6573480, at *10 (D.D.C. Nov. 4, 2016).

[14] U.S. DEP'T OF LABOR, CONFLICT OF INTEREST EXEMPTIONS FAQS 2 (2016), https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/ resource-center/faqs/coi-rules-and-exemptions-part-1.pdf [https://perma.cc/6NJT-5SQ3]; Lauren R. Roth, *The Collective Fiduciary*, 94 NEB. L. REV. 511, 519 (2016).

[15] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg., at 20,947.

[16] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LAB., MEETING YOUR FIDUCIARY DUTIES 2 (2012), https://www.dol. gov/sites/default/files/ ebsa/aboutebsa/ouractivities/resourcecenter/publications/meetingyourfiduciaryresponsibilities.pdf [https://perma.cc/8Q52-Z4YX].

Under ERISA and the Code "[q]ualifying as a 'fiduciary,' in turn, triggers the 'prohibited transaction' rules", these rules prohibit conflicted transactions unless a statutory or regulatory exemption applies.[17] A prohibited transaction is one that poses "special dangers to the security of retirement, health and other benefit plans because of fiduciaries' conflicts of interest,"[18] this includes a wide range of compensation practices.[19] The Final Regulation creates an exemption, the Best Interest Contract Exemption (BICE),[20] which "is intended by the Department to serve as the primary exemption for investment advice transactions" pertaining to retail investors.[21] The BICE permits advisers to continue with current compensation practices and fee structures as long as the adviser and firm that retains the adviser "adhere to conditions designed to mitigate the harmful impact of conflicts of interest."[22] The Final Regulation is already impacting the securities market and will continue to do so, even though the Final Regulation will not be applicable to all financial services providers until April 10, 2017.[23]

This article will set out the history of the Final Regulation, describe the future implications the Final Regulation will have on the securities market, and evaluate whether the Final Regulation will actually protect investor's interests or raises investor's cost. First, Section B discusses changes to the retirement investment industry that created the need for the Final Regulation, and the difference between the 1975 regulation and the Final Regulation. Next, Section C discusses the Final Regulation's future impact on investment brokers, roll over accounts, and impact on annuities and real estate investment trusts. Next, Section D discusses the Final Regulation's implementation cost to investment advisers and consumers. Finally, Section E will discuss how recent court cases affect the future of the Final Regulation.

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[17] Nat'l Ass'n for Fixed Annuities v. Perez, No. 16-1035 (RDM), 2016 WL 6573480, at *1 (D.C. Nov. 4, 2016).
[18] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg., at 20,946.
[19] Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,003 (Apr. 8, 2016) (to be codified at 29 C.F.R. 2550).
[20] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg., at 20,991.
[21] U.S. DEP'T OF LABOR *supra* note 14.
[22] *Id.*
[23] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg., at 20,993.

B. Brief History of the DOL "Fiduciary" Rule

The Final Regulation stems from a shift in the retirement investment industry from defined benefit plans to defined contribution plans.[24] When ERISA was enacted, the majority of retirement plans were defined benefit plans,[25] in which employers guarantee a certain benefit amount.[26] Due to provisions of ERISA,[27] the retirement investment industry is comprised of mostly self-directed accounts in defined contribution plans, such as a 401(k)[28] and IRAs. With defined contribution plans, consumers have more responsibility and agency in their retirement investment decisions.[29] In contrast to defined benefit plans, investors with defined contribution plans determine the amount of resources to allocate to the plan, what types of investment devices to invest in, and when and how to withdraw funds.[30] However, the DOL claims that consumers have very little knowledge about how their financial advisers make decisions, how their financial advisers are compensated, and whether there are any conflicts of interest that might affect such investment decisions.[31] The Final Regulation is meant to protect consumers and address the conflict that today consumers have more responsibility in retirement planning but little expertise.[32]

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[24] Fact Sheet: Definition of the Term "Fiduciary," *supra* note 5.

[25] *See id.*; Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 4 (2000).

[26] *How Does a Defined Benefit Pension Plan Differ from a Defined Contribution Plan?,* INVESTOPEDIA (Mar. 2015), http://www.investopedia.com/ask/answers/032415/how-does-defined-benefit-pension-plan-differ-defined-contribution-plan.asp [https://perma.cc/49YM-ST7Z].

[27] *See* Anne Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUS. L. REV. 153, 162–63 (2013) (proposing that the key provisions for ERISA led to the shift to defined contribution accounts including the creation of an IRA, increased regulation on defined benefit plans, less stringent fiduciary standard for self-directed retirement accounts, and changes to stock holding rules for defined contribution accounts).

[28] *See id.* at 163.

[29] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,949.

[30] WILLIAM G. GALE ET AL., THE EVOLVING PENSIONS SYSTEM 53 (William G. Gale et al. eds., 2005).

[31] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,949.

[32] *See id*. at 20,996.

A broader group of financial advisers, who have knowledge of the industry, are now required to make investment decisions that are in the best interest of the investor.[33] Previously, if an investment professional gave advice that did not fall under the categorical definition of a "fiduciary," that professional adviser did not have to adhere to a fiduciary standard.[34] Therefore, a hypothetical investment professional under the 1975 regulation could be deciding between two similar investments to recommend and choose the investment that charged the investor higher fees or that offered a higher commission structure for that investment professional. [35]

Prior to this regulation, some investment "advisers," such as investment-brokers, were not required to claim a fiduciary status and therefore did not.[36] Under the 1975 regulation, fiduciary status was triggered if an investment adviser was designated a fiduciary in a plan document, had "any control over plan assets and discretionary control over certain aspects of the plan" or gave "investment advice" for a fee, defined by a five-part test.[37] Under the 1975 regulation, to be considered "investment advice" an adviser must: (1) give advice as to the value of, or recommend whether to purchase, or sell securities or other property; (2) on a regular basis; (3) with a mutual agreement, arrangement or understanding, written or otherwise; (4) that serves as the primary basis for investment decisions; and (5) is individualized to the investor.[38] The Final Regulation replaces the five-part test with a more inclusive definition.[39] The Final Regulation defines a fiduciary as a person who provides, for compensation, advice to a plan or IRA and makes a "recommendation" towards that plan or investment.[40] The

[33] *See id.* at 20,951.
[34] *Id.* at 20,954.
[35] *See* Lisa Kiplinger, *What It Means for Investors: Rules for Financial Advisers Are Changing*, USA TODAY (Apr. 6, 2016), http://www.usatoday.com/story/money/personalfinance/2016/04/05/fiduciary-ruling-investor-adviser-advisor/82655312/ [https://perma.cc/XQC9-FGWP].
[36] *See generally* Thomas V. Powers, Note, *A Uniform Fiduciary Standard for Investment Advisers and Broker-Dealers*, 30 REV. BANKING & FIN. L. 119 (2010).
[37] Patrick C. DiCarlo & Emily Seymour Costin, *'Fiduciary' Defined: DOL's Proposed New Rule Creates More Questions Than Answers*, 28 BENEFITS L.J. 1, 13 (2015).
[38] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,954 n.15.
[39] *See id.* at 20,946.
[40] 29 C.F.R. §§ 2510.3–21(a)(1).

Final Regulation defines a recommendation as "communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action."[41] Additionally, the Final Regulation sets forth a non-exclusive list of examples of what is not considered a recommendation.[42] These examples include, marketing a platform of investments, providing selection and monitoring assistance, providing object data to the plan, and furnishing or making available communications or investment education to a plan or certain persons involved in the plan.[43] ERISA protects consumers by "imposing trust law standards of care and undivided loyalty on plan fiduciaries and by holding fiduciaries accountable when they breach those obligations."[44] Additionally, fiduciaries are not allowed to participate in "prohibited transactions" that are risky to the consumer's retirement investments.[45] The Final Regulation's expansion of the term fiduciary ensures that more investment advisers are held to the standard of putting foremost, the consumers' best interest. [46]

C. The Final Regulation's Effect on the Securities Market

The Final Regulation will have an impact on the securities market because the fiduciary standard has expanded to include investment brokers (brokers) and one-time rollover retirement decisions.[47] A retirement rollover is when an investor withdraws assets from one retirement account and contributes those assets to another retirement plan or IRA.[48] The Final Regulation also ensures that investment advisers are taking into consideration the consumers' best interest, including by disclosing conflicts of interest and weighing fees charged against return on investment.[49] The Final Regulation will

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[41] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,997
[42] *Id.* at 20,948.
[43] *Id.* at 20,997.
[44] *Id.* at 20,946.
[45] *Id.*
[46] *Id.* at 20,947.
[47] *See id.* at 20,946.
[48] *Topic 413—Rollovers from Retirement Plans*, IRS (2016), https:// www.irs.gov/ taxtopics /tc413.html [https://perma.cc/8JRG-UDXA].
[49] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,946.

increase the cost of doing business for financial advisers[50] and could increase the costs to consumers.[51]

1. Impact on Investment Brokers

Brokers are "Registered Representatives of a Broker Dealer."[52] Brokers' compensation is based on commission from investments that they recommend.[53] Prior to the Final Regulation, brokers were held to a suitability standard by regulation of the Financial Industry Regulatory Authority (FINRA).[54] This suitability standard required brokers to recommend products suitable "to clients' needs, objectives, and financial circumstances,"[55] not necessarily the "best" product for the consumer.[56] The Final Regulation includes brokers as fiduciaries, officially requiring brokers to offer advice that

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[50] *See id.* at 20,951.

[51] *See* Bruce Kelly, *DOL Fiduciary Rule's Unintended Consequences: Higher Fees for Investors*, INV. NEWS (Sep. 16, 2016), http://www.investmentnews.com/article/20160916/FREE/160919952/dol-fiduciary-rules-unintended-consequence-higher-fees-for-investors [https://perma.cc/2RFZ-TC46] (citing John Rooney, Managing Principal of Commonwealth Financial Network, noting that "that an industry move to standardize commissions could have a potential harmful impact on investors in mutual funds as well as alternatives. If a firm were to implement a standard commission of 3% on mutual funds, that means the price of short-term bond funds would actually double, from the typical commission of 1.5% today").

[52] Brian Menickella, *A Practical Overview of How the DOL's Fiduciary Rule Will Impact 401(k) Plan Sponsors*, FORBES (May 20, 2016), http://www.forbes.com/sites/brianmenickella/2016/05/20/a-practical-overview-of-how-the-dols-fiduciary-rule-will-impact-401k-plan-sponsors/#17b1cce73e1b [https://perma.cc/6AZH-DRU7].

[53] *Id.*

[54] Books and Records Requirement for Broker and Dealers, Exchange Act Release No. 34—44992, 66 Fed. Reg. 55,817, 55,822 (Nov. 2, 2001).

[55] *Hearing on Capital Markets Regulatory Reform: Strengthening Investor Protection, Enhancing Oversight of Private Pools of Capital, and Creating a National Insurance Office Before the H. Comm. on Fin. Services*, 111th Cong. 13–14 (2009) (statement of David G. Tittsworth Executive Director and Executive Vice President Investment Adviser Association).

[56] *See* Self-Regulatory Organizations, Exchange Act Release No. 34—78106, 81 Fed. Reg. 41,364, 41,366 (June 20, 2016) (requiring a member organization to "have a 'reasonable basis' to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer").

is in the best interest of the investor, not one that is merely a suitable alternative.[57]

Some brokers previously recommended that investors purchase investments that pay a higher-commission to the broker,[58] and under the "suitability" standard, such recommendations would have been acceptable.[59] The DOL proposes that this commission-based fee structure incentivizes brokers to make decisions based on higher commissions as opposed to investors' best interests.[60] Such pecuniary interest may be dangerous to the investor.[61] These prior controversial commission compensation arrangements will be prohibited under the ERISA and the Code, unless the BICE[62] or the Principle Transaction Exemption applies.[63] Under the BICE, the financial adviser and the investor enter into an agreement in which the adviser states that he or she is a fiduciary, that the recommendation is in the best interest of the investor, and that the adviser is not earning a fee above "reasonable compensation."[64]

Brokers seem to be the most affected by the Final Regulation.[65] A study shows that brokers stand to lose revenue of up to

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[57] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,946 n.1; Steve Garmhausen, *Why Your Advisor Doesn't Like the Fiduciary Rule*, BARRON'S (Apr. 16, 2016), http://www.barrons.com/articles/why-your-advisor-doesnt-like-the-fiduciary-rule-1460780284 [https://perma.cc/U898-QZVY].

[58] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,992 n.55.

[59] *See* FIN. INDUS. REGULATORY AUTH., RULE 2111 (2014) ("A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile.").

[60] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,992.

[61] *Id.* at 20,992 n.55.

[62] *Id.* at 20,946.

[63] *See id*. at 20,991.

[64] *Id.* at 20,947.

[65] Liz Skinner, *Figuring Out Fiduciary*, INV. NEWS (May 9, 2016), http://www.investmentnews.com/article/20160509/FEATURE/160509939/the-dol-fiduciary-rule-will-forever-change-financial-advice-and-the [https://perma.cc/7255-RTWS] ("Independent broker-dealers, who currently operate under a less stringent standard that only requires that investment advice be "suitable," face the greatest disruption.").

22 percent of their total client assets.[66] The BICE will cause brokers to incur higher cost of compliance,[67] liability in potential lawsuits,[68] and will likely be replaced with fee-only compensation because of the stigma BICE will cast on a transaction.[69] Therefore, brokers will have to alter the manner in which they enter into transactions, receive compensation, and engage in regular business dealings in order to comply with the Final Regulation.[70]

2. Impact on Retirement Roll Over Accounts

When investors retire or change jobs they must decide whether to keep their retirement assets in their current plan, or distribute assets into the new employer's plan or into an IRA.[71] "Retirement roll over advice" is when an adviser makes recommendations about this roll over decision.[72] Under the 1975 regulation, one-time advice or counseling was not considered "investment advice," and therefore a fiduciary duty was not triggered.[73] Consequently, retirement advisers were not required to act as a fiduciary when advising investors as to whether to roll over retirement savings into an IRA because this typically did not fall under the category of advice made "on a regular basis."[74] In contrast, the Final Regulation mandates that financial advisers act as fiduciaries when giving one-time advice.[75] The decision whether to rollover a

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66 Bruce Kelly, *DOL Fiduciary Rule to Cost the Securities Industry $11B by 2020: Study*, INV. NEWS (Sept. 21, 2016), http://www.investmentnews.com/article/20160921/FREE/160929978/dol-fiduciary-rule-to-cost-the-securities-industry-11b-by-2020-study [https://perma.cc/586B-VP7W] (citing a study by A.T. Kearney).

67 Skinner, *supra* note 65.

68 *See* Andrew C. Spacone & Nicole M. Verdi, *Broker-Dealer Liability: Are the Rules Pertaining to Providing Investment Advice to Retail Customers About to Change?,* 64 R.I.B.J. 13, 29 (2016) ("The rule appears to create a new breach of contract cause of action for aggrieved parties.").

69 *See* Skinner, *supra* note 65.

70 *See id.*

71 FIN. INDUS. REGULATORY ADMIN., REPORTS ON CONFLICT OF INTEREST 31 (Oct. 2013).

72 *See id.*

73 Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,949.

74 *See id.* at 20,948–49.

75 *See id.* at 20,961.

retirement account is an integral decision in a consumer's investment future, and the Final Regulation is aimed at protecting that decision by mandating that even one-time decision advisers must offer advice in the consumer's best interests.[76]

The DOL incorporated one-time rollover advice in the fiduciary standard because rollover decisions are crucial to investors.[77] The importance of that advice is due to the significant impact rollovers can have on a consumer's financial future.[78] The DOL claims that consumers can incur significant losses if consumers decide to roll over a defined contribution plan into an IRA pursuant to advice that is the product of an improper conflict of interest.[79] The Final Regulation has received criticism that one-time advice should not be held to a fiduciary standard because investors would have to assume an increased cost of that advice.[80] It appears that the DOL is addressing a problem that was occurring in the industry because investments in IRAs will not continue to increase at the previous rate.[81] This expected decline in rollovers into IRAs may stem from findings that IRAs do not outperform other plans.[82] It is not in the investor's best interest to

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[76] *See id.* at 20,948–49.

[77] *Id.* at 20,949.

[78] *See id.* ("These rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.").

[79] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,949 (citing a 2015 study by Cerulli Associates that concluded an "ERISA plan investor who rolls her retirement savings into an IRA could lose 6 to 12 and possibly as much as 23 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser").

[80] *See* PINAR ÇEBI WILBER, AM. COUNCIL FOR CAPITAL FORMATION CTR. FOR POLICY RESEARCH, DOL'S RETIREMENT ADVICE RULE: HELPING OR HARMING SOUND RETIREMENT PLANNING? 8 (2015) ("Under federal law, those who are considered to be fiduciary under ERISA carry significantly more legal and regulatory liability than those who are not, increasing costs for the fiduciary and his or her customers.").

[81] *See* Liz Skinner, *DOL Fiduciary Rule Could Cause Half of Potential IRA Rollover Assets to Stay Put*: Report, INV. NEWS (Sep. 8, 2016), http://www.investmentnews.com/article/20160908/FREE/160909948/dol-fiduciary-rule-could-cause-half-of-potential-ira-rollover-assets [https://perma.cc/59XJ-HJF4] (citing a Cerulli study showing that 29.4 percent of investors who roll over their accounts rely on financial advisers for that decision).

[82] *See generally* Alicia H. Munnell et al., *Investment Returns: Defined Benefit Vs. Denied Contribution Plans*, CTR. FOR RET. RESEARCH AT BOS. COLL. fig.

roll over his or her account and receive a lower return or to invest in a rollover account that increases fees without an increase in return.[83] Some investors with distinct goals and resources might still find rolling over into an IRA acceptable.[84] This would apply to investors facing frequent job changes, and those who do not want to keep assets in a fund with their previous employer.[85] The Final Regulation's mandate that financial advisers make recommendation in the client's best interest, even for one-time rollover advice, will result in less financial advisers recommending investors to roll over their retirement plans into IRAs, which will lead to a decrease in overall IRA investment.[86]

3. Impact on Annuities and Real Estate Investment Trusts

The fiduciary standard of the Final Regulation applies to variable and indexed annuities.[87] Variable annuities are devices in which investors invests in a portfolio of usually risky assets and are paid in periodic payments starting at a future date.[88] Indexed annuities are complex hybrids investments between fixed and variable annuities, in which investors are "offer[ed] a minimum guaranteed interest rate combined with an interest rate linked to a market index."[89] These

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4 (Dec. 2015), http://crr.bc.edu/wp-content/uploads/2015/12/IB_15-211.pdf [https://perma.cc/S5UQ-6VZP] (finding that the geometric rates of return from 2000 to 2012 was 2.2 percent for IRAs, 3.1 percent for defined contribution plans, and 4.7 percent for defined benefit plans).

[83] *See* Skinner, *supra* note 65.

[84] *See* Wilber *supra* note 80, at 4 ("IRAs play a key role in retirement security. First created in 1974, this retirement vehicle not only provides a tax incentive for savings but also provides a mechanism to preserve the assets accumulated under employer sponsored retirement plans for workers changing jobs through rollover opportunities.").

[85] *Id.* at 12.

[86] *See* Cyril Tuohy, *Report: DOL Rule Could Freeze IRA Rollovers*, INS. NEWS NET (Oct. 3, 2016), http://insurancenewsnet.com/innarticle/nearly-half-future-ira-rollover-assets-risk-staying-put [https://perma.cc/S3PB-5LZA].

[87] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,961.

[88] JEFFREY R. BROWN ET AL., THE ROLE OF ANNUITY MARKETS IN FINANCIAL RETIREMENT 4 (2001).

[89] *See* FIN. INDUS. REGULATORY AUTH., EQUITY-INDEXED ANNUITIES: A COMPLEX CHOICE (2012).

annuities are normally high-commission investment sales.[90] Therefore, with respect to annuity transaction, investment advisers and investors will need to enter a BICE agreement.[91]

Before the enactment of the Final Regulation, the estimated amount of investment in indexed annuities was expected to increase.[92] However, after the Final Regulation was promulgated, indexed annuities sales are predicted to decrease drastically.[93] Additionally, some financial institutions are raising fees for investors due to the Final Regulation.[94] This is due in part to the DOL's findings that variable and indexed annuities are in the category of investments in which advisers are giving conflicted advice, and consumers are losing money on that advice.[95]

The fiduciary standard also applies to non-traded real estate investment trusts (REITs). According to the Securities and Exchange Commission (SEC), a REIT is a corporation, trust, or association that owns real estate that produces income.[96] REITs are usually "comprised of large buildings such as shopping centers, apartment buildings and office buildings, or baskets of nearly identical holdings such as public

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[90] *See* Eve Kaplan, *9 Reasons to Avoid Variable Annuities,* FORBES (July 2, 2012), http://www.forbes.com/sites/f eeonlyplanner/2012/07/02/9-reasons-you-need-to-avoid-variable-annuities/#d5226a44d629 [http://perma.cc/7ACM-GY69] (claiming that fees are at least 2 percent per year and up to 4 percent per year).

[91] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,950.

[92] *See* Greg Iacurci, *Indexed Annuity Sales Projected to Plummet 30% Because of DOL Fiduciary Rule*, INV. NEWS (Aug. 2, 2016), http://www.investmentnews.com/article/20160802/FREE/160809980/indexed-annuity-sales-projected-to-plummet-30-because-of-dol [https://perma.cc/XTJ9-E6NA] (citing a Limra study finding that annual fixed annuities sales were expected to increase 15 percent to 25 percent between 2015 and 2016).

[93] *Id.*

[94] *See, e.g.,* Bruce Kelly, *supra* note 51 (highlighting an example that Carey Watermark Investors 2 Inc., a non-traded REIT managed by W.P. Carey, which has a commission on T-bond of 2 percent which will rise to 3 percent).

[95] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,950.

[96] *See* U.S. SEC. & EXCH. COMM'N, INVESTOR BULLETIN: REAL ESTATE INVESTMENT TRUSTS (REITS) (2011) https://www.sec.gov/investor/alerts/reits.pdf [https://perma.cc/8BCH-D6VX] [hereinafter SEC Investor Bulletin].

storage units."[97] Even though some REIT investments are accompanied by a high-commission fee structure,[98] REITs have a presence in the investment industry[99] because REITs allow for a liquid means to invest in real estate.[100] To continue operating under the current fee structures, REIT transactions will be governed by a BICE, and investment advisers will be unable to charge a fee that is above what is reasonable. [101] The current commission for REITs is 7 to 10 percent,[102] which is likely higher than the "reasonable fee" allowed under the Final Regulation. The DOL issued a FAQ regarding the Final Regulation but still failed to answer what a "reasonable fee" means.[103]

REITs are used in retirement accounts for diversification and for small portions of the total plan.[104] Therefore, investment advisers and brokers will have to change the fee-structure associated with REITS or enter a BICE agreement with customers.[105] It is likely that advisers will decrease their recommendation of REITS, due to the requirement of a BICE because of the conflict of interest, the extra cost and liability associated with a BICE, and the relatively small influence that REITs have on retirement accounts.[106]

D. Cost of implementing the Regulation

The cost to financial industries of complying with this Final Regulation will come from devoting resources to improving technology, designing and implementing new training programs for employees, changing how advisers are paid, and preparing for possible

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[97] Joanne Cleaver, *The Pros and Cons of Investing in Real Estate ETFs*, U.S. NEWS (June 5, 2014), http://money.usnews.com/money/personal-finance/mutual-funds/articles/2014/06/05/the-pros-and-cons-of-investing-in-real-estate-etfs [https://perma.cc/S3PB-5LZA].
[98] *See* SEC Investor Bulletin, *supra* note 96 (showing that non-traded REIT's usually carry a 9 percent to 10 percent commission and upfront fee cost).
[99] *See* Skinner, *supra* note 65.
[100] *See* Cleaver, *supra* note 97 ("The REIT structure injected liquidity (the ability to easily buy and sell) into real estate, a notoriously illiquid category.").
[101] *See* Skinner, *supra* note 65.
[102] *See id.*
[103] *See* U.S. DEP'T OF LABOR, *supra* note 14.
[104] *See* Jon R. Muth, *Investing for a Great Retirement (Part 2)*, 93 MICH. B. J. 42, 45 (2014).
[105] *See* Skinner *supra* note 65.
[106] *See generally id*.

increases in legal fees.[107] The DOL "estimates that the cost to comply with the final rule and exemptions will be between $10.0 billion and $31.5 billion over 10 years . . . ."[108] This estimate is claimed to be composed of mostly initial "start-up" costs and "front-loaded" expenses.[109] These costs could be largely outweighed by the annual $17 billion loss the White House claims investors incur due to conflicted advice and the fees associated with investing.[110] The DOL also estimates that the Final Regulation and Exemptions will save investors more than $40 billion over a ten-year period.[111] However, the financial industry and some lawmakers dispute that the Final Regulation will actually save consumers this amount of money.[112] Some financial institutions are already expecting a conversion to flat fee arrangements that could cost investors more than before the Final Regulation.[113] Merrill Lynch has announced that it will no longer offer new commission-based retirement accounts in order to best comply with Final Regulation.[114] However, other prominent competitors like

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[107] *See id.*

[108] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,951.

[109] *Id.*

[110] *See* Andrew Ackerman, *U.S. Tightens Broker Standards for Retirement Advice*, WALL ST. J. (Apr. 14, 2015), http://www.wsj.com/articles/labor-department-set-to-propose-tighter-broker-standards-1429018259 [https://perma.cc/9XSZ-FGGU].

[111] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LAB., FACT SHEET: DEPARTMENT OF LABOR PROPOSES RULE TO ADDRESS CONFLICTS OF INTEREST IN RETIREMENT ADVICE, SAVING MIDDLE-CLASS FAMILIES BILLIONS OF DOLLARS EVERY YEAR, https://www.dol.gov/sites/default/files/documents/featured/protectyoursavings/factsheetcoi.pdf [https://perma.cc/BGD6-Z6AV].

[112] *See id.* (implying that some financial institutions are reviewing the rule to ensure that it will actually benefit consumers and advisers).

[113] *See* Spacone, *supra* note 68, at 30 ("The Best Interest Exemption appears intended to drive brokerage firms away from third-party compensation arrangements into flat fee arrangements."); Kelly, *supra* note 66 (citing the A.T. Kearny study which predicts "[w]irehouses will accelerate their ongoing transition to fee-based advisory").

[114] Michael Wursthorn, *Merrill Lynch to End Commission-Based Options for Retirement Savers*, WALL ST. J. (Oct. 6, 2016), http://www.wsj.com/articles/merrill-lynch-to-end-commission-based-options-for-retirement-savers-1475784928 [https://perma.cc/EQ3W-J2NR].

Morgan Stanley will likely keep its commission based IRA business structure.[115]

Most financial institutions will need to make a significant investment to comply with the Final Regulation, but consumers will also have an increase in fees because of the regulation.[116] The Final Regulation's effective increase in cost might actually deter some investors from getting investment advice because the cost has now been raised above a standard they can pay.[117] If consumers are charged more and deterred from seeking investment advice,[118] the Final Regulation is not meeting its goals of saving consumer's money.

E. Future of the Final Regulation

Recently, a few different groups have challenged the DOL Final Regulation in court.[119] A U.S. District Court in Kansas has ruled against Market Synergy Group's motion for a preliminary injunction to enjoin "the DOL from taking any action to adopt or enforce the DOL's Amendment and Partial Revocation of Prohibited Transaction Exemption."[120] The U.S. District Court for the District of Columbia granted the DOL's cross-motion for summary judgment in a case in which the National Association for Fixed Annuities challenged the Final Regulation and related Exemption Rules under the

[115] *See* Christine Idzelis, *Morgan Stanley to keep commission-based IRA business despite DOL rule in contrast to Merrill Lynch*, INV. NEWS (Oct. 26, 2016), http://www.investmentnews.com/article/20161026/FREE/ 161029923/ morgan-stanley-to-keep-commission-based-ira-business-despite-dol [https://perma.cc/ZJ5B-88NQ].

[116] *See* Kelly, *supra* note 66 (citing a 2015 Financial Services Institute study which "estimated that the DOL's fiduciary rule would cost firms and clients nearly $3.9 billion in total startup costs to implement the rule").

[117] Wilber, *supra* note 80.

[117] *See* Idzelis, *supra* note 115.

[118] *See* Garmhausen *supra* note 57.

[119] *See* Mkt. Synergy Group, Inc. v. Dep't of Labor, No. 16-CV-4083-DDC-KGS, 2016 WL 6948061 (D. Kan. Nov. 28, 2016); Nat'l Ass'n for Fixed Annuities v. Perez, No. 16-1035 (RDM), 2016 WL 6573480 (D.C. Nov. 4, 2016).

[120] *Mkt. Synergy Group, Inc.*, 2016 WL 6948061, at *2 (denying plaintiff's motion for preliminary injunction after concluding that "the plaintiff is not likely to succeed on the merits of this claim").

Administrative Procedure Act and Regulatory Flexibility Act.[121] These cases seem to indicate that the Final Regulation will withstand.[122] However, opponents of the Final Regulation were given hope when a judge in The U.S. District Court for the Northern District of Texas made comments about the possibility of a circuit split on this issue.[123] However, the Texas ruling has not been issued.[124] On November 30, 2016, the National Association for Fixed Annuities filed an appeal seeking an emergency injunction.[125] Additionally, there are pending cases in which plaintiffs challenge the Final Regulation.[126] However, the two Federal District Courts that have ruled have done so in favor of the Final Regulation.[127]

F. Conclusion

The DOL Final Regulation's purpose is to expand the definition of "fiduciary," directing more financial advisers to make recommendations in the investor's best interest.[128] This Final Regulation will impact the securities industry by altering the standards of conduct brokers are held to and changing their compensation structure or requiring a BICE, decreasing current high investment

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[121] *Nat'l Ass'n for Fixed Annuities*, 2016 WL 6573480, at *30 (holding in part that the "decision to include fixed indexed annuities under exemptions from prohibited transaction rules for variable and fixed indexed annuities that permitted financial institutions and advisers to receive compensation was not arbitrary and capricious" and the "Department of Labor made reasonable, good-faith effort to comply with requirements of RFA").

[122] *See generally Mkt. Synergy Group, Inc.*, 2016 WL 6948061; *Nat'l Ass'n for Fixed Annuities*, 2016 WL 6573480.

[123] Erin Sweeney, *Dallas judge indicates possibility of vacating DOL fiduciary rule*, INV. NEWS (Nov. 17, 2016), http://www.investmentnews.com/article/20161117/BLOG09/161119933/dallas-judge-indicates-possibility-of-vacating-dol-fiduciary-rule [https://perma.cc/QX6P-64FS].

[124] *See id.*

[125] Mark Schoeff Jr., *NAFA Seeks Stay of DOL Fiduciary Rule During Appeals Process,* INV. NEWS (Nov. 30, 2016), http://www.investmentnews.com/article/20161130/FREE/161139996/nafa-seeks-stay-of-dol-fiduciary-rule-during-appeals-process [https://perma.cc/HZU5-H6LV].

[126] *See* Schoeff, *supra* note 125.

[127] *See generally Mkt. Synergy Group, Inc*., 2016 WL 6948061; *Nat'l Ass'n for Fixed Annuities*, 2016 WL 6573480.

[128] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,946.

industries, and costing the financial industry significantly.[129] By the applicability date, it is possible that the industry will see a large decrease in the amount of IRA rollovers and investments in annuities and REITs.[130] The Final Regulation will affect both consumers and investors financially.[131] Consumers will likely pay higher-fees than they would have before the regulation, and financial institutions will need to invest significantly in procedures and technology in order to comply with the Final Regulation.[132] Recently, the Final Regulation has been challenged in court and while some cases are still pending[133] two Federal District Courts have ruled against the challengers.[134] Therefore, it is likely that the DOL Final Regulation will still become applicable on April 10, 2017, and will continue to alter the retirement investment industry.

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[129] *See* Daisy Maxey, *Ruling Near on Fiduciary Duty for Brokers*, WALL ST. J., fig.1 (Apr. 13, 2014), http://www.wsj.com/articles/SB10001424052702304679404579459831342132534 [https://perma.cc/CGJ2-HVEA].

[130] *See* Skinner, *supra* note 65.

[131] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. at 20,951; Garmhausen *supra* note 57.

[132] *See* Spacone, *supra* note 68.

[133] *See* Schoeff, *supra* note 125

[134] *See generally Mkt. Synergy Group, Inc.*, 2016 WL 6948061; *Nat'l Ass'n for Fixed Annuities*, 2016 WL 6573480.

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