The Final Fiduciary Rule: Top Five Takeaways for Plan Sponsors

ADRINE ADJEMIAN, ROBERT R. GOWER, AND BENJAMIN F. SPATER

On April 8, 2016, the Department of Labor ("DOL") published the final fiduciary advice regulatory package (the "Package"). The Package includes regulations introducing a dramatically revised definition of who is considered a "fiduciary" by rendering investment advice for a fee (the "Final Rule"), a Best Interest Contract Exemption from the prohibited transaction for receipt of variable rate compensation when providing investment advice (the "BIC Exemption"), and other related exemptions.

Under the Employment Retirement Income Security Act of 1974, as amended ("ERISA"), a person is a fiduciary with respect to a plan to the extent that he or she renders investment advice for a fee. Fiduciaries are subject to heightened standards of care, must act impartially, and with the exclusive purpose of providing benefits to participants. The DOL first interpreted who can be considered a fiduciary rendering investment advice for a fee in regulations issued more than 40 years ago. According to the DOL, changes in the retirement landscape over the last 40 years have increased the need to expand its interpretation in order to better protect the interests of retirement investors. The retirement world once dominated by defined benefit plans has increasingly been replaced by 401(k)-type defined contribution plans and IRAs where participants make investment decisions and have greater control over their financial future. Combining this changed landscape with increasingly complex and diverse financial products and features (which are often associated with many layers of fees), a new regulatory package and expanded definition of who is an investment advice fiduciary was inevitable.

Although the Package is primarily geared toward advisers, a working knowledge of the Final Rule and BIC Exemption will help plan sponsors understand potential changes in their relationships with advisers, and avoid inadvertently exposing themselves to co-fiduciary liability or engaging in prohibited transactions.

This article provides a brief overview of the Final Rule, and provides five important takeaways for plan sponsors.

Overview of the Final Rule

Section 3(21)(A)(ii) of ERISA provides that a person is a plan fiduciary to the extent he or she 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. In issuing

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the Final Rule, the DOL sought to redefine what is meant by "investment advice for a fee or other compensation."

Under the Final Rule, in order to be treated as a fiduciary providing investment advice, a person, either directly or indirectly, must (1) represent or acknowledge that such person is acting as a fiduciary with respect to rendering investment advice, (2) render investment advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient, or (3) direct investment advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

What Is Investment Advice?

The Final Rule provides that a communication constitutes investment advice if a person provides directly to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner one of the following two types of advice:

- A "recommendation" as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred or distributed from the plan or IRA; or
- A "recommendation" as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), or recommendations with respect to rollovers, transfers or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made.

Only a "Recommendation" Can Be Investment Advice

In order for a communication to constitute fiduciary investment advice, it must be a "recommendation." This means that based on its content, context, and presentation, the communication objectively would be reasonably viewed as a suggestion that such person engage in or refrain from taking a particular course of action. Determining whether a recommendation has been made requires an objective rather than a subjective inquiry. To prevent unintended consequences, the Final Rule provides that certain types of communications, such as general communications, comments at large speaking engagements, marketing of oneself, and providing investment education, may not rise to the level of being a "recommendation" and therefore, under many circumstances will not constitute investment advice.

Investment Advice Must Involve Compensation

Importantly, in order to be considered fiduciary investment advice, the advice must be "for a fee or other compensation, direct or indirect," which includes any fee or compensation received by the advice provider (or an affiliate) from any source in connection with or as a result of the recommended purchase or sale of a security or the provision of investment advice services. This includes a wide range of compensation, including, but not limited to commissions, finder's fees,

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revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, recruitment compensation paid in connection with transfers of accounts to a registered representative's new broker-dealer firm, gifts and gratuities, and expense reimbursements.

Top 5 Things Plan Sponsors Should Know

1. There Are No Changes With Respect to the Existing Responsibilities of Plan Fiduciaries

The Final Rule expanded the breadth of the statutory definition of fiduciary investment advice. It did not in any way lessen the pre-Final Rule responsibilities, duties, obligations or liabilities of plan fiduciaries. Fiduciary plan sponsors already have a duty of loyalty to participants and beneficiaries, including when selecting and monitoring plan service providers. As the DOL explains in the preamble to the Final Rule, the Final Rule does not change such well-established fiduciary obligations.

2. There Is a Seller's Exception Worth Paying Attention To

The Final Rule provides for several exceptions to communications that otherwise would be considered fiduciary investment advice, including a Seller's Exception. The Seller's Exception provides that a person will not be considered to be rendering fiduciary investment advice when such person is providing advice to an independent plan fiduciary involving the investment of securities or other property if the transaction is an arm's length transaction and the person providing the advice reasonably believes that they are dealing with an independent fiduciary who is a "sophisticated investor," including a bank or similar institution, an insurance carrier qualified under the laws of more than one state, a registered investment adviser, a federally registered broker-dealer, and any plan fiduciary independent of the seller with at least $50 million in total assets under management. The purpose of this exception is to avoid imposing fiduciary obligations on sales pitches where neither side assumes that the counterparty to the plan is acting as an impartial or trusted adviser. Because sophisticated investors are involved on both sides of such transactions, there is presumably a level playing field, and neither party expects that recommendations will necessarily be based on the buyer's best interests, or that the buyer will rely on them as such.

The Final Rule requires satisfaction of a number of additional conditions in order to rely on the Seller's Exception. Perhaps most importantly, the seller must know or reasonably believe that the independent fiduciary is capable of evaluating investment risks and may rely on a written representation from the plan or fiduciary regarding such capabilities. This requirement may be difficult for a seller to prove in a transaction with a plan sponsor managing at least $50 million in total assets, as plan sponsors often bring in investment representatives and advisers under the assumption that the representatives and advisers have knowledge the plan sponsor (often acting through its investment committee) does not have. In other words, plan sponsors and investment committees often rely on representatives and advisers in making investment decisions, and thus may not be capable of independently evaluating investment risks. Importantly, a seller may rely on a written representation from a plan fiduciary that the plan fiduciary is capable of completing such an independent evaluation. Therefore, plan fiduciaries should avoid making such representations, whether through existing written agreements with the adviser or otherwise, in order to prevent shifting this fiduciary duty from the seller to themselves.

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Furthermore, the DOL declined to apply the Seller's Exception to plan sponsors with less than $50 million in total assets, noting that although small plan sponsors are typically experts in the day-to-day business of running a company, they are not experts in managing financial investments and applying the Seller's Exception to such small plan sponsors would run the risk of creating a loophole that would result in no improvement in consumer protections.

Because of these conditions, the practical effect of the Seller's Exception is not likely to be great in any transaction with plan sponsors.

3. Investment Education Is Not Investment Advice

The Final Rule sets forth non-exhaustive examples of communications which generally are not "recommendations" and therefore do not constitute fiduciary communications. Perhaps the most significant of these examples is the provision of information and materials that constitute investment education ("Investment Education") or retirement education. The Final Rule describes four broad categories of non-fiduciary educational information and materials, including plan information, general financial, investment, and retirement information, asset allocation models, and interactive investment materials.

Merely providing information to plan and IRA investors about the characteristics of investment products available such as features, terms, and fees and expenses, to the IRA owner or plan investor, without reference to the appropriateness of the investment alternative, falls within the "plan information" category of Investment Education. Additionally, information and materials that do not address specific investment products, specific investment alternatives (offered under the plan or IRA or offered outside the plan or IRA) or distribution options and which inform the plan fiduciary, plan participant or beneficiary, or IRA owner about certain information, such as general financial and investment concepts, effects of fees and expenses on rates of return, and retirement-related risks, fall within the "general financial, investment, and retirement information" category of Investment Education.

The Final Rule also allows educational asset allocation models and interactive investment materials provided to participants and beneficiaries in plans to reference specific investment alternatives if they are presented as hypothetical examples to help participants and beneficiaries understand the educational information and not as investment recommendations. However, the Final Rule differentiates between education provided in the plan and IRA markets. For example, although asset allocation models may identify the plan's designated investment alternatives in participant directed plans, they may not do so under an IRA because in the IRA context, there is no independent plan fiduciary to review and prudently select investment options.

4. Recommendations Regarding Rollovers Are Investment Advice

The Final Rule provides that recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made constitute fiduciary investment advice.

Although it remains to be seen, it would appear some advisers may be less willing to assist participants with the decision of whether or not to roll over their plan assets to an IRA in order to avoid being held to the standard of a fiduciary in advising on such a decision. In particular, such a

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standard may be difficult to satisfy when recommending a rollover in light of the cost benefits plan participants may enjoy, including, for example, access to institutional share classes of mutual funds. A potential impact of this aspect of the Final Rule may be that more departing employees will stay with a plan after leaving the employer, as advisers are less likely to approach participants about considering a rollover. This may result in plan sponsors maintaining relationships with former employees via plan participation for much longer and in greater numbers than they had in the past.

5. The Final Rule Does Not Intend to Make HR Employees Fiduciaries

Employees of a plan sponsor, especially those working in employee benefits and human resources departments, do not want to be inadvertently considered to be rendering fiduciary investment advice in carrying out their job responsibilities. The DOL took note of this concern, and the Final Rule excludes two major forms of communications by employees of plan sponsors from being classified as investment advice.

First, an exclusion applies to employees of a plan sponsor who provide advice to either the plan fiduciary or another employee (other than in the advice recipient's capacity as a plan participant), as long as the employee does not receive compensation in connection with the advice outside of the employee's normal compensation. For example, this would cover a human resources employee relaying investment recommendations or financial information to the plan fiduciary, or an employee charged with preparing financial reports that are ultimately provided to the plan fiduciary (for example, to an investment committee of the plan sponsor).

Second, an exclusion covers employees who are charged with communicating information about the plan to participants, so long as such employee's job is not actually to provide investment recommendations to plan participants (this means the employee must not have job responsibilities that include the provision of investment advice, and must not be licensed to provide investment advice). This exclusion is particularly important because it protects employees who may have accidentally made statements that would otherwise constitute investment advice, and will help avoid a chilling effect on employees providing information about the plan to participants.

In conclusion, the five takeaways from the Final Rule for plan sponsors are that 1) there are no changes with respect to the existing responsibilities of plan fiduciaries, 2) there is a Seller's Exception for arm's length transactions which involve "sophisticated investors," 3) Investment Education is not investment advice, 4) recommendations regarding rollovers are investment advice, and 5) certain communications by employees of plan sponsors will not be investment advice.

Stay tuned for additional analysis, as necessary, of key portions of the Package in advance of its general applicability date of April 10, 2017, and download our recent webinar. If you have any questions, please contact one of the authors or the Trucker Huss attorney with whom you normally work.

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