DOL Proposed Fiduciary Rule: A Significant Second Take

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After years back at the drawing board following the withdrawal of proposed fiduciary regulations issued in 2010, on April 20, 2015, the United States Department of Labor ("DOL") issued a new proposed rulemaking package that more broadly defines the circumstances in which a person who provides "investment advice" may be considered a "fiduciary" to an employee benefit plan, including an individual retirement account ("IRA"), or its participants or beneficiaries. The proposed rulemaking package would replace the original five-part test from regulations issued in 1975 that must be satisfied before a person can be considered a fiduciary investment adviser with a much broader test, and would provide for new proposed prohibited transaction exemptions ("PTEs") and amendments to existing PTEs applicable to certain conduct of persons treated as fiduciary investment advisers. If adopted as proposed, the rules could have a significant impact on the retirement industry and, thus, will be the subject of intense discussion in the coming months. The proposed package includes the following noteworthy changes:

- Expansion of the fiduciary rules to investment advisers of IRA owners.
- A carve-out from fiduciary status for certain service providers, including those that furnish appraisals, fairness opinions, or statements of value to an employee stock ownership plan ("ESOP"), an investment fund or pooled separate account, a plan, plan fiduciary, plan participant or beneficiary, or IRA or IRA owner, solely to comply with ERISA's reporting requirements.
- A new "Best Interest Contract" PTE, relating to the receipt of variable compensation by fiduciaries who provide investment advice to participants, beneficiaries, IRA holders, and small plans that do not provide participant-direction of investments.

Background — The Internal Revenue Code and 1975 Regulation

Under ERISA, fiduciaries are subject to heightened standards of conduct, including the requirements to act prudently and solely in the interest of participants and beneficiaries and to avoid conflicts of interest. ERISA § 404(a). Fiduciaries who breach this standard of care may be personally liable to the plan, and if so, must restore any losses and return any profits made from the improper use of any plan asset. A person who renders investment advice is considered a "fiduciary" under ERISA to the extent that the person has or exercises any discretionary authority or control over plan administration (for example, an investment manager) or "renders investment advice for a fee or other compensation…with respect to any moneys or other property of [a] plan, or has any authority to do so…" ERISA § 3(21)(A).

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Current 1975 Regulations Regarding Investment Advisers

When the DOL first issued regulations defining a "fiduciary" in 1975, the retirement plan landscape was significantly different — there was no such thing as a participant-directed 401(k) plan, investment products and services were less complex, and participants were not rolling over their fiduciary-protected plan assets into IRAs. The 1975 regulations introduced a narrow five-part test that an investment adviser must satisfy to have "fiduciary" status. Under the current rules, an investment adviser who does not have discretionary authority or control with respect to the purchase or sale of plan securities or other property is nevertheless considered a "fiduciary" if the adviser renders advice:

- as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property;
- on a regular basis;
- pursuant to a mutual agreement, arrangement or understanding with the plan or a plan fiduciary;
- that will serve as a primary basis for investment decisions with respect to plan assets; and
- that will be individualized based on the particular needs of the plan.

The DOL noted in the preamble to the proposed new rule that many advisers, brokers and valuation firms currently operate without any of the accountability required by ERISA of "fiduciaries", and the "specific elements of the [above] five-part test — which are not found in the text of [ERISA] or the Code — now work to frustrate statutory goals and defeat advice recipients legitimate expectations."

2015 Proposed Rulemaking Package

An Updated Definition of Investment Advice

The 2015 proposed rulemaking package includes a broad four-part definition of "investment advice", with seven significant "carve-outs". Under the proposed definition, an individual will be considered a "fiduciary" providing "investment advice" with respect to moneys or other property of a retirement plan (*e.g.,* a defined benefit plan or 401(k) plan) or IRA if such person acknowledges that they are acting as a fiduciary with respect to investment advice, or such person:

- renders investment advice;
- such advice is pursuant to a written or verbal agreement, arrangement or understanding;
- such advice is individualized to, or specifically directed to the recipient of the advice; and
- such advice is for consideration in making investment or management decisions.

The proposed rule also expands on the definition of "investment advice" to include the following recommendations:

- a recommendation as to the advisability of acquiring, holding, disposing or exchanging

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securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed;

- a recommendation as to the management of securities or other property, including securities or other property to be rolled over or otherwise distributed from a retirement plan or IRA;
- an appraisal, fairness opinion, or similar statement (whether verbal or written) concerning the value of securities or other property, if provided in connection with a specific transaction or transactions involving the disposition, or exchange, of such securities or other property by a retirement plan or IRA; and
- a recommendation from a person who is receiving a fee or other compensation for providing such advice.

With respect to persons who might otherwise be considered fiduciaries under the new definition, the proposal carves out the following exceptions:

- **Product or Service Sellers.** A person involved in a sale of products or services with a responsible plan fiduciary to a large ERISA plan (a plan with 100 or more participants or plan assets of at least $100 million) who is not compensated directly by the plan or independent fiduciary, and who obtains or provides certain statements and disclosures regarding the independent fiduciary's sufficient expertise to evaluate whether the transaction is prudent and in the best interest of participants, and that the person is not acting in an impartial or fiduciary capacity in the transaction.
- **Swap Sellers.** A person who is involved with the sale of swaps or security-based swaps to an independent fiduciary of an employee benefit plan who obtains a written representation from the independent fiduciary that the fiduciary will not rely on recommendations provided by that person.
- **Employees.** An employee of a plan sponsor who provides advice to a plan fiduciary in his or her employment capacity, as long as the employee does not receive additional compensation for providing such advice.
- **Platform Providers.** A person who merely markets and makes available an investment platform to a plan (without regard to the individualized needs of the plan) that independent plan fiduciaries can use to select and monitor investment alternatives, and informs the independent plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.
- **Selection and Monitoring Assistance.** A person who merely identifies investment alternatives meeting criteria specified by the plan fiduciary of a participant-directed plan and/or provides objective financial data and comparisons with independent benchmarks to the plan fiduciary.
- **Financial Reports and Valuations.** A person providing an appraisal, fairness opinion, or statement of value to an ESOP, an investment fund (such as a collective investment fund

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or pooled separate account), a plan, plan fiduciary, plan participant or beneficiary, or IRA or IRA owner, solely for compliance with ERISA reporting requirements or other federal or state laws.

- **Investment Education.** A person providing general plan information, asset allocation models, certain interactive investment materials and other general investment information.

Potential Impact of the New Investment Advice Definition

If adopted as proposed, the new definition of investment advice and related carve-outs will have a significant and sweeping impact on fiduciary status for retirement plan service providers. Notably:

- One-time advice may now give rise to fiduciary status. The proposed rule eliminates the requirement in the 1975 regulations that investment advice be provided "on a regular basis".
- Advice must only be a "consideration" in making investment or management decisions, not a "primary basis" for investment decisions, as stated under the 1975 regulations.
- Advice does not have to be "individualized", as provided in the 1975 regulation. Under the proposed rule, advice must only be "specifically directed" toward a recipient to give rise to fiduciary status.
- Acknowledging fiduciary status will automatically give rise to fiduciary status.
- Providing investment advice to individuals (rather than merely plans) will now clearly give rise to fiduciary status. Although this was a generally accepted interpretation of the 1975 regulation, it is now explicitly a part of the new definition.
- Providing investment advice to IRAs will give rise to fiduciary status, as will the provision of advice related to rollovers or distributions to IRAs.

New Proposed Prohibited Transaction Exemptions

Given the existing patchwork of narrowly tailored PTEs available to investment advice fiduciaries to meet specific business practices, and the significant expansion of individuals who will be considered plan fiduciaries under the new definition of investment advice, the 2015 proposed rulemaking package updates a number of PTEs and introduces two new PTEs. Similar to the proposed definition of investment advice, the new proposed PTEs and proposed amended PTEs are broadly written and intended to accommodate today's evolving retirement landscape.

Perhaps the most significant proposed PTE, the "Best Interest Contract PTE" would allow fiduciaries providing investment advice to set their own compensation practices (including receiving commissions and revenue sharing), provided the fiduciary commits to putting the client's best interest first and discloses any conflicts of interest that may prevent them from doing so. Specific requirements include:

- Contractually acknowledging fiduciary status;

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- Warranting that the adviser has adopted policies and procedures reasonably designed to mitigate the harmful impact of conflicts of interest;
- Providing a series of fee-related disclosures;
- Notifying the DOL of reliance on the PTE; and
- Adhering to standards of impartial conduct, including giving advice in the customer's best interest, avoiding misleading statements, and receiving no more than reasonable compensation.

The DOL also proposed a PTE to provide relief for principal transactions in certain debt securities with either an ERISA plan or an IRA. The exemption would permit certain financial institutions and fiduciary advisers to engage in the purchase and sale of certain debt securities where the buyer or seller is a plan, participant account, or IRA and receive a payment for themselves or an affiliate as a result of the fiduciary adviser's and financial institutions advice. Similar to the Best Interest Contract Exemption, the adviser and the financial institution would have to enter into a written agreement under which the adviser contractually acknowledges its fiduciary status and agrees to follow a best interest standard imposing impartial conduct principles.

Finally, the DOL proposed a number of amendments to existing PTEs that are intended to bring those PTEs into conformance with the proposed new rule. In most cases, the amendments impose impartial conduct standards on fiduciaries who intend to rely on the PTEs. The proposed modifications include:

- (PTEs 75-1 and 86-128) Certain transactions involving plans, broker-dealer and banks
- (PTE 77-4) Open-end mutual fund investments
- (PTE 80-83) Securities transactions involving indebtedness
- (PTE 83-1) Mortgage pool acquisitions
- (PTE 84-24) Certain transactions involving insurance agents, insurance companies and other parties

Next Steps

The 2015 proposed rulemaking package promises to be the subject of intense discussion in the retirement industry in the coming months — especially considering the withdrawn 2010 proposed rules elicited more than 300 comments and hearings before Congress. The DOL has requested and will accept comments on its proposal for a period of seventy-five (75) days following publication in the final register (on or before July 6, 2015), followed by a public hearing within thirty (30) days of the close of the comment period. After reviewing comments, the DOL will prepare a final rule, which will become effective sixty (60) days after publication in the Federal Register, though the majority of the requirements will become applicable eight months after publication in the Federal Register. If you have any questions, please contact the author of this article.

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