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# Management Alert

## The DOL Fiduciary Definition Regulations are Here . . . Really They are Finally Here

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### Background

Included in the definition of a fiduciary in Section 3(21) of the Employee Retirement Income Security Act ("ERISA") is someone who provides investment advice for a fee. Regulations issued in 1975 by the U.S. Department of Labor ("DOL") included a five-part test for determining whether someone is a fiduciary under this provision of ERISA. However, in response to developments since 1975, *e.g.,* the growth of participant-directed defined contribution plans ("DC Plans") and individual retirement accounts ("IRAs"), the DOL concluded that the 1975 regulations were outdated and did not adequately address conflict of interest considerations.

After many years of back and forth (including two sets of proposed regulations), the DOL issued final regulations on April 6, 2016 that changed the definition of fiduciary by way of the provision of investment advice. These regulations are expected to change key aspects of the retirement benefits landscape, especially for those who advise, provide services or engage in transactions at the retail or institutional level with IRA owners, defined contribution or defined benefit plans or their participants or internal fiduciaries.

The purpose of this Alert is to summarize the newly proposed rules and to discuss the impact of these proposed rules on plans and plan sponsors. Further Alerts in this series will discuss the impact on participants and on service providers.

### Summary of New Definition of Fiduciary

The final regulations (the "Regulations") set out a core definition of an "advice" fiduciary. The regulations then identify a number of situations that are not investment advice for this purpose and include several exceptions.

### Core Definition

The general rule is that a person is a fiduciary if he or she provides recommendations or advice for a fee to a plan, a plan fiduciary, plan participant or IRA owner regarding:

- the advisability of acquiring, holding, disposing or exchanging plan or IRA assets;



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- the investment of assets after those assets are rolled over, transferred or distributed form a plan or IRA;
- the management of such assets, including recommendations on investment policies or strategies, portfolio composition, and the selection of persons providing investment advice or investment management services and investment account arrangements; or
- the management of assets rolled over or otherwise distributed from a plan or IRA to another plan or an IRA.

provided the person, directly or indirectly, represents or acknowledges acting as an ERISA fiduciary in furnishing such advice OR furnishes this advice pursuant to a written or verbal agreement, arrangement or understanding that this advice is "individualized" OR directs the advice to a specific advice recipient.

The new definition differs materially from the DOL's 1975 final regulations. Significantly, it no longer requires that the advice be provided on a ***regular*** basis, or that the advice be provided according to a mutual understanding that it will serve as the ***primary*** basis for decision making.

## Recommendations

Under the Regulations, the threshold question is whether there has been a recommendation. For this purpose, a recommendation is a communication that would reasonably be viewed as a suggestion that the recipient take or refrain from a particular action. The DOL also provided examples of situations that would not constitute a recommendation for this purpose.

1. **Employees.** An employee of a plan sponsor who, while working in an employee capacity and receiving no fee other than normal compensation for work performed as an employee, provides advice to a plan fiduciary is not considered a fiduciary.

   For example, when employees of a plan sponsor provide advice and services to a plan's investment committee, those employees will not be deemed to be fiduciaries (assuming no compensation in excess of their regular compensation was paid for that work).

2. **Platform Provider.** A person who merely markets and makes available to a plan (without regard to the plan's or its participants' individualized needs) a platform that provides a menu of available investment alternatives from which a plan fiduciary can select/monitor investment alternatives made available for participant-directed investments is not considered a fiduciary, if the platform provider discloses to the plan fiduciary in writing that it is not providing impartial investment advice or giving advice in a fiduciary capacity.

3. **Selection and Monitoring Assistance.** A person who,in connection with platform provider-related services, merely: (i) identifies investment alternatives that meet objective criteria set by the plan fiduciary; or (ii) provides the plan fiduciary with objective financial data and comparisons with independent benchmarks for investment alternatives, will not be considered a fiduciary. (It is likely that providers will modify their agreements and disclosures to ensure they fit within this exception.)

4. **Investment Education.** Persons who make available investment education materials generally are not considered fiduciaries. To be considered investment education, the information provided must not be individualized or specific to a participant's needs and situation. Such information falls into four categories:

   a. Plan Information: provides information regarding the plan or IRA operation, rules, distribution options and related advantages and disadvantages, etc. without reference to the appropriateness of any specific investment alternative, or of any distribution option.

   b. General Financial, Investment and Retirement Information: provides general financial/investment education (e.g., asset classes, risk tolerance, etc.) without addressing specific investment products, IRA alternatives or distribution options.

   c. Asset Allocation Models: provides models of asset allocation portfolios of hypothetical individuals with different time horizons and risk profiles based on generally-accepted investment theories; provided that: (i) all material facts and assumptions on which the models are based are disclosed; and (ii) the models are accompanied by a statement that



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application of a particular asset allocation model to an individual situation also needs to take into account the individual's other assets, income and investments.

d. Interactive Investment Materials: materials that provide a means for an individual to estimate retirement needs and retirement income, such as questionnaires, worksheets and software, subject to similar requirements as to asset allocation models (i.e., utilize generally accepted investment theories, objective correlation between asset allocation and projected retirement income stream, disclosure of material facts and assumptions, and materials that either reflect other assets or advise as to need for the individual to consider other assets).

These rules are not materially different than the old rules regarding non-fiduciary investment education.

## Exceptions

The following situations are excluded from the definition of fiduciary:

1. **Counterparty or Swap Dealer with respect to a Transaction with a Plan Fiduciary with Financial Expertise.** A person acting as a counterparty to a plan and also providing information or materials that could be considered advice to a fiduciary who is independent of such person and who is exercising control with respect to an arm's length transaction between the plan and the counterparty, will not be considered a fiduciary if certain requirements are satisfied. First, the independent fiduciary must satisfy certain status requirements (e.g., the fiduciary is a bank, insurance company, registered advisor, broker-dealer). Second, the counterparty must reasonably believe that the fiduciary has sufficient expertise to evaluate the transaction. Third, the counterparty reasonably believes that the independent plan fiduciary exercises control as to the management of the plan's assets and is responsible for exercising independent judgement in evaluating the transaction. This requirement can be satisfied by receiving a written representation from the plan or independent fiduciary. Fourth, the counterparty may not receive a fee for providing this advice. There are similar provisions for swap transactions. While counterparty documentation may be changed to incorporate some of these requirements, in our experience sophisticated plan fiduciaries generally are not counting on the counterparty to be a fiduciary. Thus, the relationships essentially will not change.

2. **Execution of Securities Transactions.** A person who executes buy/sell securities transactions (e.g., a broker or dealer, reporting broker or a bank) is not considered a fiduciary solely by reason of executing these transactions in the ordinary course of its business if: (i) the fiduciary providing the instructions is not such broker, dealer or bank; and (ii) the instructions specify the price range for the purchase or sale of the security, the time span (not more than five days) within which the transaction is to be effected, and the minimum or maximum quantity of the security to be purchased or sold.

   A broker, dealer or bank that has discretionary authority is a fiduciary with respect to the assets over which it has the requisite authority or control.

## Valuations and Appraisals

The definition of fiduciary in the 2015 proposed regulations included providers of appraisals, fairness or similar statements of the value of an asset. In response to comments, the DOL decided that issues related to valuations were more appropriately addressed in a separate, future, initiative. The DOL did reiterate in the preamble to the Regulations its position that a proper valuation of "hard-to-value" assets is the "single most important factor in determining the prudence of the transaction."

## New Class Exemptions and Amendments to Existing Class Exemptions

The Regulations will confer fiduciary status on certain persons who previously were not fiduciaries. As a result, the DOL also has also finalized two new prohibited transaction class exemptions and amendments to several existing class exemptions to enable DC plans and IRA owners to receive services without giving rise to a prohibited transaction.



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- "Best Interest Contract" Exemption: The purpose of this exemption is to broadly allow financial institutions, advisers, and their respective affiliates and related parties to receive compensation that would otherwise give rise to prohibited transactions as a result of advice to DC Plan participants, beneficiaries and certain fiduciaries (including small DC Plan sponsors), and IRA owners. The exemption requires that the financial institution and/or adviser undertake certain protective measurements, which include acknowledgement of fiduciary status and compliance with impartial conduct standards. The financial institution must enter into an enforceable written contract with IRA owners providing for the required protective conditions. (With respect to ERISA plans and ERISA fiduciaries, the DOL does not require an enforceable written contract because these parties have a cause of action under ERISA.) Finally, the financial institution must notify the DOL regarding its intention to rely on the exemption.
- "Principal Transaction" Exemption: The purpose of the exemption is to allow principal transactions or riskless principal transactions in debt securities, certificates of deposit or interests in a unit investment trust, between an adviser or financial institution and a plan, participant or beneficiary account, or IRA. Financial institutions and advisers seeking to rely on the exemption must acknowledge fiduciary status; adhere to impartial conduct standards; disclose material conflicts of interest; adopt certain policies and procedures and retain certain records. For principal transactions and riskless principal transactions involving IRAs and plans not covered by Title I of ERISA, a written contract will be required.
- Certain current Prohibited Transaction Class Exemptions were also amended to bring them into conformity with the Regulations.

## Impact of Regulations on Plans and Plan Sponsors

While the definition of "fiduciary" in the Regulations is broader, the impact on plans and plan sponsors may not be as great as might appear at first glance. The key impact will fall on investment consultants, advisers and brokers, some of whom have taken the position that they are not fiduciaries. Except for some changes to the documentation for relationships between plans and their service providers, the current relationships between plans and their service providers will stay essentially the same.

One area that plan sponsors will now need to review in a different light includes investment education materials that are provided to participants, in particular to ensure that the materials continue to constitute education rather than investment advice.

The bigger impact of the Regulations in the DC Plan community will fall on those persons (*e.g.*, brokers) who provide direct investment advisory services to DC Plan participants and IRA owners; or who try to market to participants who are contemplating a distribution from plans. These "retail-oriented" service providers, who traditionally have avoided characterization as fiduciaries, would become ERISA fiduciaries and subject to ERISA's fiduciary standards and prohibited transactions.

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