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Management Alert

DOL: Proposed Expanded Definition of "Fiduciary"

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Background

Section 3(21) of the Employee Retirement Income Security Act ("ERISA') includes in the definition of a fiduciary someone who provides investment advice for a fee or other compensation, direct or indirect. Final regulations issued in 1975 by the U.S. Department of Labor ("DOL") adopted a five-part test for determining who was a fiduciary. To be considered a fiduciary, a person had to

- render advice to a plan as to the value of securities or other property or provide recommendations as to the purchase or sale of such securities or other property;
- do so on a regular basis;
- pursuant to a mutual understanding, arrangement or agreement;
- that such advice would serve as a primary basis for plan investment decisions; and
- the advice had to be based on the plan's particular needs.

In October, 2010, the DOL issued proposed regulations that expanded the definition of a fiduciary, resulting in a lot of pushback by various groups against both the expansion and the complexity of the proposed rules. In September, 2011, the DOL withdrew these proposed regulations.

On April 14, 2015 the DOL re-proposed regulations, which provide more of an interpretive framework than did the 2010 proposal for determining who is a fiduciary by reason of providing investment advice for a fee. These re-proposed regulations would apply to those providing investment services to participants in 401(k) and other participant-directed plans, to ERISA-covered plans as well as to non-ERISA (*e.g.*, sole proprietor only) plans and IRAs.

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 Proposed Regulations

The 2015 proposed regulations ("2015 Proposal") sets out a core definition of a fiduciary and then provides several exceptions.

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Core Definitions

The general rule is that a person is a fiduciary if the person provides recommendations or advice ***for a fee*** regarding:

- the advisability of acquiring, holding, disposing or exchanging plan or IRA assets. This includes a recommendation as to taking a distribution from a plan or making a rollover to an IRA;
- the management of such assets, including assets rolled over or otherwise distributed from a plan or IRA to another plan or an IRA; or
- an appraisal, fairness or similar statement, verbal or written, with respect to the value of such assets in regard to a specific transaction(s) involving the acquisition, disposition or exchange of such assets by the plan or 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 "specifically directed" to the "recipient for consideration in making investment or management decisions with respect to Property."

The new definition differs in significant ways 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.

Exceptions to the Fiduciary Definition

The following persons will not be considered fiduciaries under the 2015 Proposal, *unless they have otherwise acknowledged fiduciary status:*

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 this work).

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

   If the 2015 Proposal is finalized in its current form, it is likely that agreements with platform providers will be revised by such providers to incorporate this exception.

3. ***Selection and Monitoring Assistance.*** If, in connection with platform provider-related services described above, a person who 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, that person also will not be considered a fiduciary. Similarly, it is likely that provider agreements will begin to limit their obligations in order to fit within this exception.

4. ***Investment Education.*** Persons who make available investment-related information and materials generally are not considered fiduciaries. To be considered investment education, investment-related information 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.

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(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 all material facts and assumptions on which the models are based are disclosed and the models are accompanied by a statement that 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 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 either reflect other assets or advise as to need for the individual to consider other assets).

These rules are not materially different than what is today considered to be non-fiduciary investment education.

5. ***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 advice to a fiduciary who is independent of such person and who is exercising control with respect to an arm's length transaction or proposed transaction between the plan and the counterparty, will not be considered a fiduciary ***only if*** the counterparty obtains a written representation from the independent plan fiduciary that the plan fiduciary exercises control as to the management of the plan's assets, the plan has 100 or more participants and the plan fiduciary is not relying upon the counterparty to provided impartial advice or to give advice in a fiduciary capacity. The counterparty may not receive a fee for providing this advice and must reasonably believe that: (i) the fiduciary has sufficient expertise to evaluate the transaction and (ii) the plan fiduciary manages at least $100 million of plan assets (the counterparty can rely on the Form 5500 or a representation as to the assets under management). There are similar provisions for swap dealers.

   While counterparty documentation may be changed to incorporate some of these requirements if the 2015 Proposal is finalized, in our experience plan fiduciaries generally are not counting on the counterparty to be a fiduciary (except perhaps in certain principal transactions with an outside service provider to a plan); thus, the relationships essentially should not change.

6. ***Financial Reports and Valuations.*** A person who provides an appraisal, fairness opinion or statement of value to, or with respect to an ESOP, an investment fund (*e.g.,* a collective fund or a pooled separate account) in which more than one unaffiliated plan has an investment, or with respect to compliance with respect to legally required reporting or disclosure will not be considered an advice fiduciary.

7. ***Execution of Securities Transactions.*** A person who executes buy/sell transactions for securities (*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.

   However, 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.

New Class Exemptions and Amendments to Existing Class Exemptions

The DOL also has proposed two new prohibited transaction class exemptions and several amendments to existing class exemptions in connection with the 2015 Proposal.

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- “Best Interest Contract” Exemption: The purpose of this exemption is to permit certain types of fee arrangements, such as brokerage/insurance commissions, 12b-1 fees, and revenue sharing payments, that are common in the retail market and that would otherwise, because of the 2015 Proposal, be prohibited transactions. This exemption only applies to plan participants/beneficiaries, IRA owners and small plan sponsors (those plans which ***are not*** participant-directed and have 100 or fewer participants). The exemption only covers certain transactions, requires the service provider to affirmatively acknowledge that it is a fiduciary and agree to provide advice that is in the “best interest” of the investor, *i.e.,* that satisfies the ERISA prudence requirement and is provided without regard to financial or other interests of the adviser or the financial institution for which the adviser works. There must be a written contract that sets forth these items, as well as other warranties of the adviser and financial institution, there must be disclosures of material conflicts of interest and fees, and the financial institution must notify the DOL of its intent to rely on the exemption. There are also recordkeeping requirements.
- “Principal Transaction” Exemption: The purpose of this exemption is to permit principal transactions in certain debt securities. This exemption applies to plan participants/beneficiaries, IRA owners and plan fiduciaries. This exemption has conditions and requirements similar to those in the “Best Interest Contract” exemption.
- Certain current Prohibited Transaction Class Exemptions are also proposed to be amended to bring them into conformity with the 2015 Proposal.

Impact of 2015 Proposal Upon Plans and Plan Sponsors

While the definition of “fiduciary” has definitely been broadened by the 2015 Proposal, 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, who traditionally have taken the position that they are not fiduciaries. They likely would fall within the definition of a fiduciary under the 2015 Proposal. Otherwise, except for some changes to underlying documentation of 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 need to review is investment education which is provided to participants, ensure that the materials used and topics covered do not go beyond that which is permitted under the regulations, thus inadvertently making an “educator” a fiduciary.

The greater impact of the 2015 Proposal will fall on those persons (*e.g.*, broker-dealers) who provide direct investment advisory services to plan participants and IRA holders; or who try to market to participants who are considering taking distributions from plans and rolling over these distributions to IRAs. These “retail”-oriented service providers, who traditionally have avoided characterization as fiduciaries, would become subject to ERISA fiduciary standards if the 2015 Proposal is finalized, and the DOL announced that such expansion to more broadly address IRAs is completely intentional.

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