



DOL Issues Proposed Regulation Amending Definition of Fiduciary

The Department of Labor (DOL) has issued a proposed regulation that would significantly expand the situations in which a person is considered a fiduciary by reason of giving investment advice. Most significantly, the proposed regulation would eliminate the requirements that the advice be given regularly, be given to the plan, and be a primary basis for the plan's, participant's, or beneficiary's decision.

Background

The Employee Retirement Income Security Act (ERISA) imposes requirements on persons who act as plan fiduciaries. A fiduciary must act prudently and solely in the interest of participants and beneficiaries. Fiduciaries are subject to additional "prohibited transaction" restrictions to protect against self-dealing and can be held personally liable for losses sustained due to a violation of ERISA's fiduciary rules.

In the case of investment advice, ERISA Section 3(21)(A)(ii) provides that a person is a fiduciary with respect to a plan to the extent the person "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority to do so." In 1975, the DOL adopted a [regulation](#) that narrowly interpreted the statutory language.

Under the regulation, a person is treated as a fiduciary as a result of giving investment advice only if the person satisfies all elements of the regulation's five-part test:

- Renders investment 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,
- Gives the advice on a regular basis, and
- Gives the advice pursuant to a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary, that
- The advice will serve as a primary basis for investment decisions with respect to plan assets, and that
- The advice will be individualized based on the particular needs of the plan.

In 1996 guidance, the DOL distinguished between providing "investment education," which does not cause a person to be a fiduciary under any circumstances, and providing "investment advice," which may cause a person to be a fiduciary. In 1976 and 2005 advisory opinions, the DOL held that certain actions would not be treated as

providing investment advice – the valuing of closely-held employer securities in an ESOP (1976) and recommendations to plan participants to take otherwise permissible plan distributions even when that advice is combined with a recommendation as to how the distribution should be invested (2005).

Proposed Regulation

The [proposed regulation](#) would revise the current regulation on when a person giving investment advice is a fiduciary by expanding the actions that constitute investment advice and eliminating the five-part test. The proposal is not intended to affect other elements of the definition of “fiduciary,” nor is it intended to affect the distinction between “investment education” and “investment advice.”

The DOL believes that the current regulation inappropriately limits the statutory definition, excluding many actions it believes should be fiduciary actions. The DOL argues that plan investment practices and relationships between plans and service providers have changed considerably since the current regulation was issued in 1975. For example, there has been a move from defined benefit plans to 401(k) plans as well as dramatic changes in financial markets, advice relationships, and the types of financial instruments available. The proposed regulation is aimed at addressing these changes and providing the DOL with legal authority to pursue the problems it has found in its fiduciary investigations (*e.g.*, undisclosed fees, misrepresentation of compensation arrangements, and biased appraisals of plan assets).

Under the proposed regulation, a person would be considered a fiduciary when rendering investment advice if the person:

- Provides advice or makes recommendations relating to plan assets,
- Directly or indirectly meets any of the additional conditions listed in the proposed regulation,
- Does not come within one of the exceptions to fiduciary status in the proposed regulation, or
- Directly or indirectly receives a fee or other compensation for providing the advice or recommendations.

Provides Advice or Recommendations

The proposed regulation provides that the following types of advice or recommendations may result in the provider being a fiduciary under ERISA.

Advice, Appraisal or Fairness Opinions Concerning the Value of Securities or Other Property

The proposed regulation expressly adds appraisals and fairness opinions to the types of advice that could make a person a fiduciary. According to the DOL, this change will align the duties of persons who provide these opinions with those of the plan fiduciaries who rely on them.

BUCK COMMENT. *For example, a person valuing real estate that is being offered to a plan or valuing closely-held employer stock for an ESOP could be considered a fiduciary. The inclusion of valuations as investment advice would be a reversal of the 1976 DOL advisory opinion.*

Recommendations as to the Advisability of Investing in, Purchasing, Holding or Selling Securities or Other Property

The proposed regulations make explicit what the DOL says has always been its position – that recommendations to participants and beneficiaries (as well as to plan fiduciaries) are included in the actions that can make a person a fiduciary. The DOL is asking for comments on whether recommendations to participants related to taking a plan distribution should be considered the provision of investment advice.

BUCK COMMENT. *The inclusion of recommendations to participants and beneficiaries related to distributions would be a reversal of the DOL's 2005 position. The change in position would significantly affect the fiduciary status of those giving advice to individual participants.*

Advice or Recommendations as to the Management of Securities or Other Property

A person providing advice or making recommendations to plan fiduciaries, participants, or beneficiaries with respect to rights tied to shares of stock – e.g., voting proxies – or with respect to other plan assets such as real estate could be a fiduciary, as could a person helping to select persons to manage plan assets.

Meets One of the Additional Conditions

Even if a person provides investment advice, the person is not a fiduciary unless the person also meets at least one of the following conditions:

- The person represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA when providing advice or making recommendations.

BUCK COMMENT. *This change would eliminate the situation where a person acknowledges being a fiduciary and later argues that functionally he or she is not a fiduciary and thus has no fiduciary liability. Under the proposed regulation, the plan fiduciary or participant or beneficiary receiving the advice would be able to act based on what the adviser acknowledges without fear that later facts might result in the adviser from whom the plan is receiving investment advice not being treated as a fiduciary.*

- The person is already a fiduciary because of the exercise of discretionary authority or discretionary control with respect to plan management or the exercise of any authority or control with respect to management or disposition of assets, or because the person has authority or responsibility in the administration of the plan.

BUCK COMMENT. *Under the proposed regulation, a person who is a plan fiduciary for any purpose is also treated as a fiduciary with respect to any investment advice such person might provide the plan. Under the existing regulation, such a person would only be a fiduciary with respect to the investment advice the person provides if the five-part test were satisfied.*

- The person is an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940. The Investment Advisers Act generally treats as an “investment adviser” any person who is in the business of advising others as to the value of securities or the advisability of investing in, purchasing, or selling securities, or who issues analyses or reports concerning securities and is not included in a broad list of exclusions.
- The person provides individualized investment advice or recommendations pursuant to an agreement or understanding that the fiduciary receiving the advice will consider it in making investment or management decisions. This last condition follows the current regulation’s five-part test except it does not require the advice to be both regular and a primary basis for the fiduciary’s decision.

BUCK COMMENT. *With the removal of the “regular” and “a primary basis” components of the five-part test, arguably even the smallest amount of advice (e.g., one-time advice that is weighted and discarded on a narrow issue) would make the person giving the advice a fiduciary. It is not clear that the DOL intended for the proposed regulation to be so broad.*

Exceptions to Fiduciary Status

Under the proposed regulation, even if a person who provides investment advice meets one or more of the above conditions, the person will not be considered a fiduciary in any of the following circumstances:

- **Adverse Interest.** Unless the person providing the advice claims to be a fiduciary, the person is not a fiduciary if the recipient of the advice knows, or reasonably should know, that the person providing the advice or making the recommendation has interests that are adverse to the plan or participant or beneficiary.

BUCK COMMENT. *Only time will tell whether admitting to having adverse interests will be a plus or minus. On the one hand, such an admission may become a standard clause in investment advice contracts as it seems to protect the person from being treated as a fiduciary. On the other hand, how comfortable will plans be in hiring someone who expressly claims to have adverse interests when they can hire someone who does not have a conflict? The market is likely to answer the question over time as there is a weighting of quality, price, what competitors are doing, and the risk of litigation.*

- **Individual Account Plans – General.** A person is not treated as a fiduciary if the information that the person provides is investment education information and materials. The person is also not treated as a fiduciary merely because the person provides advice, appraisals or fairness opinions that are general reports or statements that merely reflect the value of an investment of a plan or a participant or beneficiary

and that are prepared to comply with the reporting and disclosure requirements of ERISA and other laws. However, the exception for advice, appraisals, and fairness options required to comply with ERISA's disclosure requirements does not apply with respect to reports on assets for which there is no generally recognized market and that serve as the basis on which the plan may make distributions to plan participants and beneficiaries.

- **Individual Account Plans – Written Disclosure (Not Impartial).** If the person providing advice discloses in writing to the plan fiduciary that the investment advice is not impartial, the adviser is not treated as a fiduciary merely because the adviser provides a menu of investments from which a plan fiduciary may select investments or provides general financial information and data to assist a plan fiduciary's selection or monitoring of plan investment alternatives. However, the adviser could be a fiduciary for other reasons, e.g., control of plan assets.

Fees and Other Compensation

The proposed regulation treats as a "fee" any fee or compensation, direct or indirect, for advice received by the person if it is related to the transaction in which the investment advice has been rendered. Fees paid to an affiliate would be considered an indirect payment.

Conclusion

The proposed regulation would dramatically expand the definition of who is a fiduciary on account of providing investment advice. Comments on the proposed regulation are due by January 20, 2011. Commenters are likely to focus on the appropriateness of changing a 35-year old regulation in the absence of any new legislation and questions about whether the DOL intended to capture all the situations the proposed regulation would arguably cover.

Buck's consultants are available to assist you in drafting comments to the proposed regulation or in better understanding how the proposed regulation may impact your retirement plans.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.