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DOL Re-Proposes Controversial Fiduciary Rule

The DOL released its re-proposal of the regulation defining who is a fiduciary as a result of giving investment advice — also known as the “conflict of interest” rule. In the works since the DOL withdrew its initial proposal on this topic in September 2011, the re-proposed rule broadens the fiduciary definition to include a wider scope of investment advice relationships. However, it also includes a number of key carve-outs. Directed at the financial services industry with a particular focus on rollover-related advice, the re-proposal also addresses plan sponsors’ efforts to provide participants with investment-related information.

Background

ERISA plan fiduciaries must act prudently and solely in the interest of participants and beneficiaries, and the statute sets forth a series of “prohibited transactions” that restrict fiduciary self-dealing. Fiduciary status is significant, as fiduciaries can be held personally liable for losses in the case of a breach of duty.

An ERISA plan fiduciary includes any party that “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.” The current regulation uses a five-point test to determine fiduciary status for a person giving investment advice. The DOL in 2010 sought to replace that test with an expanded list of types of investment advice that would make a person an ERISA fiduciary. Following substantial push-back from the financial services industry, in 2011 the DOL withdrew this proposal and announced that it would re-propose changes after reviewing the issues and coordinating with the Securities and Exchange Commission (SEC). For more background on the fiduciary definition and information on the 2010 proposal, see our November 11, 2010 *For Your Information*.

In February 2015, President Barack Obama announced that the re-proposal of the fiduciary rule was imminent, and suggested that it would focus on improving fee disclosures for financial professionals providing asset-related advice to retirement and other ERISA plans. This announcement expressed particular concern that the current regulation allows investment advisors to provide conflicted advice in connection with IRA rollovers (see our *FYI Alert* from February 24, 2015).

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Expanded Definition

The re-proposed rule, which the DOL issued along with a Fact Sheet and FAQs, defines fiduciary for purposes of providing investment advice as one who receives compensation for advising a plan, fiduciary, participant, beneficiary, IRA, or IRA owner about certain investment matters. These include:

- Investment advice (including rollover and other benefit distribution recommendations)
- Investment management advice
- An appraisal or a fairness opinion on an investment
- A recommendation for a party to give investment advice, investment management advice, or an appraisal/fairness opinion

A person providing the above advice in exchange for compensation is a fiduciary, required to provide impartial advice in the client's best interest, if that person either: (1) represents that he or she is acting as a fiduciary under ERISA or the Code, or (2) provides the advice under an agreement, arrangement, or understanding that the advice is "individualized or specifically directed" for consideration in making plan asset investment or investment management decisions. The DOL defines "compensation" for this purpose as any fee or compensation from any source. This includes, but is not limited to, brokerage fees and mutual fund and insurance sales commissions; it extends to direct compensation as well as compensation to affiliates of the advisor.

In response to criticism of the 2010 proposal, the DOL emphasized its extensive consultation with the SEC and the rigor of its analysis of the re-proposal's anticipated benefits and costs to investors.

Not Just ERISA Plans

By virtue of DOL's jurisdiction over the prohibited transaction rules in Code Section 4975, the re-proposed regulation would also apply to:

- Non-ERISA qualified plans (such as church and governmental plans)
- Individual retirement accounts
- Individual retirement annuities
- Health savings accounts
- Archer MSAs
- Coverdell education savings accounts

Noticeably missing from the Code 4975 list — 403(b) plans. But DOL confirms that 403(b) plans covered by ERISA would be subject to the DOL's fiduciary standards, even though Code Section 4975 does not apply.

The Carve-Outs

Recognizing that its re-proposed fiduciary definition, standing alone, could reach certain relationships that "are not appropriately regarded as fiduciary in nature," the re-proposal includes several important carve-outs. Assuming no affirmative representation or acknowledgement of fiduciary status, the re-proposed regulation provides that the following scenarios do not constitute fiduciary investment advice:

Investment education. This carve-out would allow a plan sponsor, fiduciary, service provider, and others to provide a broad array of investment information to a plan, participant, beneficiary, or IRA owner without stepping into a fiduciary role so long as specific fund recommendations are not included. The investment information could include information about an appropriate mix of stocks and bonds based on age and income, how to estimate future retirement income needs, historic returns of different asset classes, and specific options offered by the plan — including a description of objectives, risk and return characteristics of each of those options, as well as the different

forms of distributions, including rollovers, annuitization, and other forms of lifetime income payment options. The information could also include asset allocation models and use interactive technologies.

However, breaking away from current rules under Interpretive Bulletin 96-1, this carve-out would not cover asset allocation models that refer to specific investment products under the plan or IRA, even when accompanied by a statement of other investment alternatives. According to the DOL, model investment allocations that identify specific investment alternatives constitute tailored, individualized investment recommendations that are subject to a fiduciary standard.

> **Comment.** Thus, it appears possible to avoid fiduciary status when providing participants with (1) the list of plan options, and (2) tools for identifying the type and amount of assets that should achieve desired goals, respectively — but not when furnishing these two types of material in tandem. The need to separate this information may reduce its value to participants. Recognizing that this distinction is a meaningful departure from current guidance, the DOL specifically asks for comments on the change.

Advice provided by an employee of the plan sponsor to a plan fiduciary, where the employee does not receive compensation for the advice beyond his or her normal compensation. This scenario includes members of a company's human resources department who develop reports for and recommendations to the plan's investment committee, without acting as paid fiduciary advisors.

> **Comment.** Plan sponsors will welcome this carve-out, which appears to insulate from fiduciary status administrative and other employees who support the investment committee.

Recordkeepers and third-party administrators (TPAs) marketing and/or offering a "platform of investment vehicles" to ERISA plans, where plan fiduciaries choose the specific investment alternatives to make available to participants. This includes a platform provider that identifies investment alternatives using objective criteria like expense ratios or fund size to assist in the selection and monitoring of investment alternatives. The carve-out is available only if the recordkeeper or TPA discloses in writing to the plan fiduciary that that impartial investment advice or advice in a fiduciary capacity is not intended.

> **Comment.** This carve-out may be considered favorable to plan sponsors, since expanded fiduciary status for recordkeepers and TPAs would, in turn, increase the fees those service providers charge plan sponsors.

Clarifying Who's a Fiduciary

The re-proposal also clarifies that attorneys, accountants, and actuaries are not fiduciaries simply by providing professional assistance with a given investment transaction. However, acting outside their normal roles by recommending specific investments or providing valuation opinions for investment transactions would bring these professionals within the re-proposal's fiduciary definition.

Appraisals, fairness opinions, or statements of value to an ESOP, to a collective investment vehicle holding plan assets, or to a plan for meeting reporting and disclosure requirements. This would include providing an appraisal to an ESOP of the value of employer securities, as well as providing routine participant statements.

Additionally, the re-proposal carves out from the fiduciary definition (1) arm's-length sales pitches to large plan fiduciaries with financial expertise, and (2) offers or recommendations by swap dealers or security-based swap dealers acting as a counterparty to a swap or security-based swap transaction with a plan.

Class Exemptions

The re-proposal package also sets forth new class exemptions to the prohibited transaction rules. Notably, it would create the "best interest contract" exemption, described as a principles-based approach that can adapt to changing business practices. Specifically, this exemption allows investment firms and individual investment advisors to continue setting their own compensation structures (for example, via revenue sharing) so long as they "commit to putting their clients' best interests first and disclosing any conflicts that may prevent them from doing so." This exemption would require a contractual acknowledgment of fiduciary status, commitment to basic standards of impartial conduct, and clear and prominent disclosure of conflicts of interest.

Effective Date

The DOL invites comments on the re-proposal until 75 days from publication in the federal register, which runs through July 6, 2015. A public hearing will be held by August 5, 2015.

Further, the DOL proposes that the final regulation be effective 60 days after publication in the Federal Register, with its requirements generally applicable eight months after publication to allow sufficient time for transitioning contracts, recordkeeping, communication materials and other arrangements. DOL invites comments on this timing, particularly for implementing the proposed best interest contract exemption.

In Closing

Significant push-back from financial services industry stakeholders is expected during the comment period, particularly on the effects of applying the fiduciary standard to IRAs. For their part, plan sponsors should evaluate how the proposed changes will affect plan operations and investment education efforts, and inform DOL of any refinements needed to ensure adequate information for participants without imposing expanded fiduciary liability and its associated costs.

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Authors
Julia Zuckerman, JD
Marjorie Martin, EA, MAAA, FSPA

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