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# Client Alert

## DOL's New Fiduciary Rule Has Far-Reaching Tentacles

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The Department of Labor Employee Benefits Security Administration (EBSA) recently released the long-awaited regulations finalizing its new "fiduciary" definition, in Definition of the Term "Fiduciary;" Conflict of Interest Rule—Retirement Investment Advice, 81 Federal Register 20946 (April 8, 2016) ("Final Rule"). The Final Rule includes two new prohibited transaction class exemptions (specifically, the Best Interest Contract (BIC) Exemption and Principal Transactions Exemption) and several amendments to existing exemptions to align them with the underlying fiduciary standards in the BIC and Principal Transactions Exemptions. Although the Final Rule contains exceptions, it nonetheless reaches many plan service providers that previously may not have been fiduciaries.

EBSA's desire to create more effective ERISA fiduciary standards and reconcile the standards applicable to IRA and non-ERISA plan providers with those new standards is evident throughout the Final Rule. Section 404 of ERISA sets forth a significant fiduciary duty regime for ERISA investment fiduciaries that prohibits self-dealing and profiting from conflicts of interest in the absence of a specific prohibited transaction exemption that authorizes the fiduciary's compensation (or other remuneration). The Final Rule attempts to provide the same level of protection to IRA and non-ERISA plan investors, "investment advice fiduciaries." It is effective June 7, 2016, and applies to transactions on and after April 10, 2017. During a transition period, between April 7, 2017 and January 1, 2018, investment advice fiduciaries may take advantage of the BIC, Principal Transactions, and other amended exemptions if they satisfy certain conditions. EBSA will require full compliance starting January 1, 2018.

### Clarifying the Applicable Plan Types

The Final Rule casts a wide net with respect to delineating the types of plans with fiduciaries subject to the new standards. Investment fiduciaries of ERISA plans again are bound by ERISA's standards plus the prohibited transaction (and excise tax) rules in the Internal Revenue Code ("Code"). There are, however, many plan types with significant plan assets susceptible to market fluctuations (and, unscrupulous investment advice) that do not fall within ERISA's purview, including IRAs, health savings accounts, Archer medical savings accounts, Coverdell educational savings accounts, and other plans defined in the Code Section 4975(e). Code Section 403(b) tax-deferred annuity and custodial account plans sponsored by tax-exempt organizations that do not satisfy the regulatory ERISA safe harbor exemption also are included as applicable plans for purposes of the Final Rule. ERISA-exempt 403(b) plans, governmental plans, and non-ERISA-electing ("nonelecting") church plans are not covered because they are exempt from ERISA and do not fall within the Code's definition of "plan" for purposes of the prohibited transaction rules. ERISA statutory relief is available for violations involving ERISA plans and contractual relief (with the BIC Exemption) is available for those involving IRAs and non-ERISA plans.

**Defining the Investment Advice Fiduciary**

Selecting ERISA plan service providers is a fiduciary function separate and apart from providing investment advice to the plan. In other words, the individual or entity selecting a plan investment adviser for an ERISA plan is a fiduciary without regard to the tenets established in the Final Rule that address investment advice fiduciaries for ERISA plans, non-ERISA plans, and IRAs. In simplest terms, the Final Rule defines "investment advice fiduciary" as a person who renders investment advice for a fee to a plan, plan fiduciary, participant, beneficiary, or IRA owner in the form of a recommendation concerning:

- Acquiring, holding, or disposing of investments.
- Whether and when to take a plan or IRA rollover, transfer, or distribution (including, communications concerning an appropriate form or amount).
- Investment strategies after initiating a plan or IRA rollover, transfer, or distribution.
- Investment management (e.g., portfolio composition, investment adviser selection).

The person either must (i) represent or acknowledge fiduciary status, (ii) render advice pursuant to a written or verbal agreement (or understanding) that the adviser will base advice on the recipient's investment needs, or (iii) direct advice to a specific recipient concerning investment of plan or IRA assets.

The Final Rule provides an exception for advice to certain "independent fiduciaries," that generally include persons or entities with considerable financial expertise who act on behalf of a plan. There is an important caveat, however, for independent fiduciaries holding or managing less than $50 million in plan assets: advice to independent fiduciaries holding more than this threshold may not constitute investment advice within the meaning of the Final Rule while advice to those holding less than that amount falls within its reach. This is especially important for small businesses because, as the Final Rule highlights, it essentially holds small business plan investment advisers to the same fiduciary standards applicable to investment fiduciaries of larger plans.

**Distinguishing Investment Recommendations from Investment Communications**

Every communication concerning plan investments is not a recommendation that constitutes investment advice and consequently births fiduciary status. The Final Rule governs communications that reasonably can be viewed as a suggestion to take (or refrain from) a particular investment action. An objective standard applies that focuses on whether the advice is tailored to a specific individual, and a series of communications that separately would not be recommendations collectively could constitute one in the aggregate. The Final Rule also is clear that communications initiated by computer software could constitute recommendations and ultimately investment advice.

Notwithstanding this, the following communications are not recommendations:

- Investment Platforms. Platforms available to plan participants for investment selection (and subsequent investment monitoring, for example, benchmarking) are not recommendations that constitute

investment advice if the platform provider is not otherwise a plan fiduciary and makes certain disclosures in writing to the plan fiduciary.

- General Investment Communications. Investment newsletters, circulars, talk shows, and other similar publicly available, widely distributed information about investment performance, market indices, and trading are not recommendations.
- Investment Education. General investment information concerning the plan or IRA, retirement considerations, asset allocation models, and interactive investment tools that do not refer to specific individuals (or otherwise address the appropriateness of a specific investment alternative or distribution option) is not a recommendation.

Although the Final Rule carves out asset allocation models and interactive investment tools there are unique concerns with these materials because the Final Rule permits methodology that considers both hypothetical individuals (that conceivably could permit a participant to select a profile with a hypothetical participant the same age) and plan-designated investment alternatives. In other words, these tools could permit participants to create hypothetical investment models that mirror their own circumstances, thereby creating an individualized investment recommendation that ordinarily would constitute investment advice. If the plan fiduciary authorizes a provider to make these specific tools available to participants, the Final Rule requires "a plan fiduciary independent from the person who developed or markets the investment alternative" to oversee them. This means that employers (rather than providers) could end up with fiduciary liability attributable to these educational tools.

Communications with plan sponsor employees concerning the plan's investment options also do not constitute investment advice, under the Final Rule, unless those employees (i) receive a fee outside of normal compensation; (ii) have job functions that require them to provide investment advice; or (iii) are registered advisers (or the advice they provide requires licensing or registration). This communications exception is important because it confirms that internal conversations between employees concerning, for example, whether to participate in an early retirement window that provides an enhanced pension benefit, whether to transfer an account balance from another employer's plan, and differences between various forms of benefit will not cause employees to become investment advice fiduciaries.

**Best Interest Contract (BIC) Exemption**

If investment advice fiduciaries give advice in the retirement investor's best interest and implement certain practices that protect against conflicts of interest, the BIC Exemption permits them to receive (or continue receiving) compensation in connection with their recommendations. The Final Rule generally explains that advice in an investor's "best interest" is (i) grounded in care, skill, prudence, and diligence; (ii) based on the investor's investment objectives, risk tolerance, and financial circumstances; and (iii) provided irrespective of the adviser's interests. (Adviser, for purposes of the preceding sentence, includes the financial institution employing the adviser, an affiliate, or related company.) Retirement investors are ERISA plans, non-ERISA plans, IRAs, plan fiduciaries, participants, and IRA owners.

To rely on the BIC Exemption, advisers must adhere to certain Impartial Conduct Standards. The adviser's financial institution, in turn, must adhere to the same standards and acknowledge fiduciary status with respect to the adviser's advice, plus:

- Implement anti-conflict policies and procedures reasonably and prudently designed to prevent violations of the Impartial Conduct Standards.
- Refrain from incentivizing advisers to act contrary to the Impartial Conduct Standards.
- Disclose fees, compensation, and material conflicts of interest associated with the investment recommendations that could affect the adviser's (or financial institution's) best judgment.

**A. BIC Exemption Contracting Requirement**

For IRAs and non-ERISA plans (including health savings accounts), the Final Rule requires institutions relying on the BIC Exemption to enter into written contracts with investors that reflect the Impartial Conduct Standards. Financial institutions may provide the contracts with account opening materials or just before the adviser executes a transaction in connection with rendered advice. The contract may cover multiple transactions, and a negative consent rule applies for existing relationships so that no investor signature is required. There is no contract requirement for ERISA plans, but the financial institution must acknowledge both its own fiduciary status and the fiduciary status of its adviser.

**B. BIC Exemption Disclosure Requirement**

For all plans – ERISA plans, non-ERISA plans, and IRAs (including, health savings accounts) – the financial institution must provide a written disclosure (before or at the same time as executing a recommended transaction) that contains certain regulatory content. Institutions that limit investment advice to their own proprietary products (and other investment products that provide third party payments due to the transaction) may rely on the BIC Exemption if they satisfy certain other conditions and disclosure requirements. Investment advice fiduciaries that receive flat fees or fixed fees based on a percentage of plan assets (generally called "level fee fiduciaries") also may rely on the BIC Exemption if they satisfy specific conditions and make additional disclosures. Level fee fiduciary requirements are important especially for investors concerned about the advantages of IRA rollovers or accumulating savings to cover foreseeable health expenses during retirement.

Financial institutions relying on the BIC Exemption must notify EBSA in advance of facilitating recommended transactions. An exception applies for compensation associated with transactions and systematic purchase programs in place before April 10, 2017, the Final Rule's applicability date.

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*Christina Crockett, contract attorney, also contributed to the content of this alert.*

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