BUSINESS SERVICES ALERT

4/21/15

Department of Labor Proposed Fiduciary Rule Revises and Updates the Regulation of Investment Advice to Plans and IRAs

On April 14, 2015, the Department of Labor ("DOL") issued a Notice of Proposed Rulemaking ("Notice") that, if adopted, would have a significant impact on persons who provide "investment advice" to an employee benefit plan ("Plan"), a Plan fiduciary, a participant or beneficiary of a Plan, an individual retirement account ("IRA") or IRA owner. The Notice contains a proposed regulation that would revise and broaden the definition of "fiduciary" for those who provide "investment advice" to Plans under Section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 ("ERISA"). In addition, the proposed regulation would apply to the definition of a "fiduciary" of a Plan, including an IRA, for purposes of the "prohibited transaction rules" under Section 4975 of the Internal Revenue Code of 1986 (the "Code"). Further, this Notice withdraws the prior proposed regulation, which was issued by the DOL in 2010 relating to the same subject matter (the "2010 Proposal"). Lastly, the DOL (in separate, but related notices) proposed new prohibited transaction exemptions, as well as amendments to existing exemptions for currently and newly covered fiduciaries (and certain non-fiduciaries) under ERISA and the Code. If adopted, these new prohibited transaction exemptions (and amendments to existing exemptions) would allow, in part, certain broker-dealers, insurance agents, and other persons that act as investment advice fiduciaries to continue to receive a variety of common forms of compensation, which would otherwise be prohibited due to their conflicts of interest.

> *The terms, conditions, and application of the proposed regulation, new exemptions, and amendments to existing exemptions are extremely detailed and complex. This Alert only provides a high-level summary of the recent action taken by the DOL. This Alert is informational only and should not be construed as legal advice. If ultimately adopted, the application of the proposed regulation, new exemptions, and amendments to existing exemptions will have a different impact on various persons and entities based on their own unique facts and circumstances. Each potentially effected person or entity should seek the assistance of qualified legal counsel for individual advice regarding the application of the aforementioned proposals*.

Our brief summary of the Notice (and certain new exemptions) is as follows:

1. Proposed Definition of Fiduciary Investment Advice.

In 1975, the DOL issued regulations that significantly narrowed the breadth of the statutory definition of an investment advice fiduciary (described in Section 3(21)(A)(ii) of ERISA) by creating a five-part test that must, in each instance, be satisfied before a person would be treated as a fiduciary adviser. Currently, this regulatory definition applies to both ERISA and the Code. The proposed definition would, if adopted, replace this five-part test. For example, it would remove the requirement that advice be provided on a "regular basis." Accordingly, a one-time project could invoke fiduciary status. The proposed definition is, in several aspects, different from the 2010 Proposal.

Under the proposed definition, subject to specific exceptions (or "carve-outs"), a person renders "investment advice" with respect to money or property of a Plan or IRA if (A) such person provides the following types of advice directly to a Plan, Plan fiduciary, participant or beneficiary of a Plan, an IRA or IRA owner in exchange for a fee or other (direct or indirect) compensation: (i) recommendations as to advisability of acquiring, holding, disposing or exchanging securities or other property; (ii) recommendations as to the management of securities or other property; or (iii) appraisals, fairness opinion, or similar statements (whether verbal or written) concerning the value of securities or other property if provided in connection with a specific transaction or transactions that involve the acquisition, disposition, or exchange of securities or property by the Plan or IRA; and (B) such person either (i) represents or acknowledges that it is acting as a fiduciary; or (ii) renders advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized or specifically directed to the advice recipient for consideration in making investment or investment management decisions. In addition, subsections (A)(i) and (A)(ii) of the proposed definition apply to recommendations to take a distribution, and recommendations as to the investment or management of securities or property to be rolled over or otherwise distributed from a Plan or IRA. The proposed definition creates a new approach that evaluates the adviser's role in providing investment advice. The focus is not on titles or the contractual language contained in a service agreement (unless the adviser contractually acknowledges the fiduciary nature of its advice). The fiduciary could be a broker-dealer, registered investment adviser, insurance agent, or other type of adviser regardless of whether such adviser is or is not subject to federal securities laws. As a fiduciary, the adviser must provide impartial advice in their client's best interests and cannot accept any payments that create conflicts of interest unless they qualify for an exemption intended to adequately protect their clients.

2. The Proposed Definition Includes Limited Exceptions.

The proposed definition contains limited exceptions or "carve-outs" from the fiduciary investment advice definition for communications that should not be viewed as fiduciary in nature. These "carve-outs" are subject to various conditions (several of which are not described in detail herein), including that the person does not represent or acknowledge that it is acting as a fiduciary under ERISA regarding the investment advice provided. The exceptions include:

(A) Counterparty Transactions with Plan Fiduciaries with Financial Expertise. Advice provided by a person who is a counterparty ("Counterparty") in connection with a sale, purchase, loan or bilateral contract with (i) an ERISA Plan with 100 or more participants or (ii) an independent Plan fiduciary that has responsibility for managing at least $100 million in plan assets if the counterparty knows or reasonably believes that the independent Plan fiduciary has sufficient expertise to evaluate the transaction, determine whether it is prudent, and determine whether it is in the best interests of the participants. To satisfy this exception, such Counterparty must obtain certain written representations from the independent Plan fiduciary, fairly disclose the existence and nature of the Counterparty's financial interests in the transaction, and not receive a fee or other compensation directly from the Plan or Plan fiduciary for providing investment advice.

(B) Swap and Security-Based Counterparty Transactions. Advice and other communications provided by a Counterparty to a Plan in connection with certain swaps or security-based transactions.

(C) Employees of the Plan Sponsor. Employees of a Plan sponsor that provide investment advice to a Plan fiduciary if such employee receives no fee or other (direct or indirect) compensation, beyond the employee's normal compensation for work performed for the employer.

(D) Platform Providers. Certain persons (e.g. recordkeepers, third-party administrators, and other service providers) that merely market and make available to a Plan, without regard to the individualized needs of the Plan, participants, or beneficiaries, securities or other property through a platform from which the Plan fiduciary may select or monitor investment alternatives (including qualified default investment alternatives) into which participants and beneficiaries may direct the investment of Plan assets held in or contributed to their individual accounts. To qualify for this exception, such Counterparty must disclose in writing to the Plan fiduciary that they are not providing impartial investment advice or giving advice in a fiduciary capacity.

(E) Selection and Monitoring Assistance. In connection with the activities described in paragraph (D) above, such persons merely identifies investment alternatives that meet objective criteria specified by the Plan fiduciary (e.g. stated parameters concerning expense ratios, size of fund, type of asset, and/or credit quality) or merely provides objective financial data and comparisons with independent benchmarks to the Plan fiduciary.

(F) Financial Reports and Valuations. Appraisals, fairness opinions, or statements of value prepared for (i) employee stock ownership plans ("ESOPs"), (ii) investment funds (e.g. collective investment funds and pooled separate accounts), and (iii) Plans, Plan fiduciaries, participants or beneficiaries, IRAs and IRA owners, solely for purposes of compliance with the reporting and disclosure provisions of ERISA, the Code, and the regulations, forms, and schedules thereunder, or any applicable reporting and or disclosure requirements under Federal or state laws, rules, regulations, or rules established by self-regulatory organization rule or regulation.

(G) Investment Education. Investment education, subject to conditions similar to those included in DOL Interpretive Bulletin 96-1, but with new conditions, including that (i) the information and materials (e.g. asset allocation models) shall not include advice, recommendations, or references to specific investment products, specific investment managers, or the value of particular securities or other property, (ii) the distinction between non-fiduciary education and fiduciary advice applies equally to information provided to plan fiduciaries as well as information provided to plan participants and beneficiaries, and IRA owners, and (iii) the distinction between non-fiduciary education and fiduciary advice applies equally to participant-directed plans and other plans.

3. The Proposed "Best Interest Contract Exemption."

ERISA and the Code prohibit fiduciary advisers to Plans and IRAs from receiving compensation that varies based on their investment recommendations. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This new exemption would permit an investment advice fiduciary to receive certain types of "prohibited compensation" if the investment advice fiduciary (A) contractually agrees to be subject to a "best interest" standard (i.e. the adviser or financial institution must act with the care, skill prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs without regard to the financial or other interests of the adviser, financial institution, affiliates, related parties or any other party), (B) warrants that they have adopted policies and procedures designed to mitigate the dangers posed by "material conflicts of interest" (as defined in the new exemption), (C) discloses important information relating to fees, compensation, and material conflicts of interest, and (D) retains documents and data relating to the investment recommendations that relate to plan assets.

This new exemption is limited to advice provided to Plan participants and beneficiaries, IRA owners, and fiduciaries of Plans with less than 100 participants. In addition, this exemption only covers compensation received in connection with investments in certain assets, including bank deposits, mutual fund shares, interests in bank collective funds and insurance company separate accounts, shares of exchange traded REITs and ETFs, publically-offered corporate bonds, certain agency debt securities and Treasuries, certain insurance contracts, and exchanged-traded equity securities. Further, the exemption does not apply to futures and options, and appears to not cover compensation related to hedge funds and other private fund investments. Lastly, this exemption would not cover principal transactions, which are addressed by a separate proposed exemption.

4. The Proposed "Principal Transactions Exemption."

This new exemption would provide relief for principal transactions in certain debt securities under a Plan or IRA, subject to satisfying conditions that are similar to those required by the Best Interest Contract Exemption, as well as other requirements.

5. Comment Period.

The proposal is subject to a 75-day comment period and public discussion after which the DOL will issue a final regulation, new exemptions, and amend existing exemptions. The Obama administration is focused on this initiative. Public opinion is that the administration (through the DOL) will push for final action before the end of the President's second term.

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