CLIENT ALERT: DOL'S FINAL RULE ON FIDUCIARY INVESTMENT ADVICE—OVERVIEW AND CONSIDERATIONS FOR PLAN SPONSORS

Employee Benefits Alert
April 4, 2017

On April 8, 2016, the Department of Labor (DOL) published a final rule replacing its 1975 regulation defining fiduciary investment advice. The final rule, titled "Definition of the Term 'Fiduciary'; Conflict of Interest Rule—Retirement Investment Advice," is part of a larger regulatory package that includes new prohibited transaction exemptions (PTEs) and amendments to existing PTEs. The rule and related PTEs ("regulatory package") became effective June 7, 2016 but were not scheduled to become applicable until April 10th of this year. On February 3rd, however, President Trump issued a memorandum to the Secretary of Labor directing DOL to re-examine the rule, assessing "whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice." If DOL concludes that the rule may negatively impact investors' retirement savings, the President's memo directs DOL to publish a proposed rule rescinding or revising it.

To facilitate its review, DOL issued a proposal to delay the regulatory package's applicability date to June 9, 2017. That delay has not yet become final, however, raising concerns about a "gap period" where the regulatory package could be applicable for a period of time before the delay is implemented. To alleviate those concerns, DOL published Field Assistance Bulletin 2017-01 on March 10th, indicating that, while it intends to decide on the delay before the April 10th applicability date, if a final rule implementing the delay is not issued until after April 10th, DOL will not enforce the regulatory package for the resulting gap period. If the delay is ultimately not issued at all, DOL will allow for a reasonable period to begin complying once the decision not to delay the regulatory package is published. On March 28th, DOL issued Announcement 2017-4, stating that it will not impose excise taxes or related reporting requirements with respect to any transactions or agreements covered by its temporary enforcement policy. It should be noted that neither the FAB nor the Announcement foreclose a private cause of action for violations related to the new rule should a gap period occur.

While the future of the regulatory package is uncertain, investment advisers have already been ramping up for its implementation, so plan sponsors should develop an understanding of it and begin reviewing investment adviser relationships. To that end, below is an overview of the regulatory package, followed by some specific considerations for plan sponsors.

Brief summary of what the regulatory package, if implemented, would do:

1. Re-define fiduciary investment advice, from the technical, five-part test in the 1975 rule to a facts and circumstances approach, expanding the universe of fiduciary investment advisers.
2. Provide examples of activities that would not be investment advice under the expanded rule and outline specific exemptions from the rule.

3. Establish two new broad prohibited transaction exemptions intended to allow flexibility in fee and compensation arrangements for advisers, while establishing safeguards for investors' best interests.

Plans that would be affected by the regulatory package. The new rule would affect employee benefit plans governed by the Employee Retirement Security Act of 1974 ("ERISA") and IRAs (*i.e.*, IRAs, Individual Retirement Annuities, health savings accounts, Archer medical savings accounts, and Coverdell education savings accounts).

Re-defining fiduciary investment advice. As noted above, the 1975 rule requires application of a technical, five-part test which requires, among other things, that investment advice be provided on a "regular basis" and with a "mutual" understanding that the advice would serve as a "primary basis" for the recipient's investment decisions. DOL's new rule would replace the technical test with broader guidance for analyzing whether fiduciary obligations attach to an investment-related communication.

Under the new rule, to be fiduciary investment advice, a communication would need to be:

1. A "recommendation" regarding specific investment transactions or investment management, including advice related to roll-overs;
2. Directed to a plan, plan participant, beneficiary, IRA, or IRA owner;
3. For a fee or other compensation, direct or indirect;
4. Made directly or indirectly by a person who acknowledges fiduciary status, has an agreement or understanding with a recipient that the advice is tailored to him/her, or otherwise tailors specific advice to a specific recipient or recipients.

A "recommendation" would be defined as "a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action."

A few key points specified in the rule:

- No exact test would apply. An objective inquiry would be required, requiring an evaluation of how a reasonable person would view the communication.
- The more individually-tailored a communication is, the more likely it would be a recommendation.
- A series of communications considered together could amount to a recommendation, even if individually each communication would not.
- Communications initiated by computer software programs would count.

Communications that would generally not be fiduciary investment advice under the new rule. While the above criteria would generally be used to determine if an investment-related communication is or is not fiduciary investment advice, the rule lists four categories of communications that generally would not constitute recommendations under the rule:

1. Marketing investment platforms to a plan fiduciary, if certain criteria are met.

2. In conjunction with providing a platform, providing selection and monitoring assistance to a plan fiduciary, if certain criteria are met.
3. Communications to a plan, plan fiduciary, plan participant, beneficiary, IRA, or IRA owner that a reasonable person would not view as an investment recommendation (*e.g.*, general newsletters, general marketing materials, performance reports, remarks and presentations in widely attended speeches and conferences, etc.).
4. Investment education activities and materials, so long as they do not include recommendations for specific investment options or management decisions and certain other criteria are met.

With regard to investment education, it would not matter who supplies the investment education materials or activities (*e.g.*, plan sponsor, fiduciary, or service provider); how often the information is supplied; the form it is supplied in; or whether it is provided with other types of information and material. The rule discusses investment education at length, breaking it down into four categories of materials or activities that would not be considered fiduciary investment advice if specific criteria for each category are met:

1. Plan information such as descriptions of the terms or operation of the plan or IRA, the benefits of plan or IRA participation, fee and expense information, etc.
2. General financial, investment, and retirement information where specific investment products, alternatives, or distribution options are not addressed.
3. Asset allocation models.
4. Interactive investment materials.

Specific exceptions to the new rule. The rule sets out three specific exclusions for communications and transactions that would otherwise be fiduciary in nature under the new rule:

1. Transactions between an adviser and an independent plan fiduciary that is either a licensed/regulated financial services provider (such as a bank or insurance company) or manages at least $50 million in total assets (could capture larger employers/plans), if certain criteria are met.
2. Swap and security-based swap transactions, if certain criteria are met.
3. Plan sponsor employees providing advice to the plan sponsor or other employees, if certain criteria are met.

The third exclusion was prompted by public concerns that the final rule could capture routine communications by payroll, accounting, human resources, and financial department employees. The rule describes two specific situations in which this exception would apply:

1. Employees (such as payroll, accounting, and human resources employees) providing advice to the company and other named fiduciaries, as long as they do not receive any fee or compensation for that advice other than their normal pay.
2. Employees providing advice to other employees (such as human resources employees communicating with other employees participating in a plan) if the employee providing advice:

i. Is not responsible for providing investment advice or recommendations as part of his or her duties;

ii. Is not a registered or licensed adviser;

iii. Does not provide advice requiring registration or licensing; and

iv. Receives no fee or other compensation, direct or indirect, in connection with the advice other than his or her normal pay.

Prohibited transaction exemptions. Because more investment advisers would become fiduciaries under the broad new rule, those advisers would become subject to the prohibited transaction rules under ERISA and the Internal Revenue Code that seek to curtail conflicts of interest between fiduciaries and the plans they serve. Under the prohibited transaction rules, some common practices in the investment advice industry, particularly related to certain common forms of compensation (*e.g.*, 12 b-1 fees and revenue sharing) could result in a conflict of interest. Accordingly, as part of the regulatory package, the DOL created two new PTEs—the Best Interest Contract Exemption ("BIC Exemption") and the Class Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (the "Principal Transactions Exemption").

The BIC Exemption specifically sets out to preserve certain common fee structures that would create conflicts of interest while implementing various safeguards to ensure that the best interests of investors are put before advisers' profit goals. Briefly, in order to take advantage of this exemption, advisers would need to acknowledge fiduciary status, follow basic standards of impartial conduct, adopt certain policies and procedures, and meet various disclosure requirements. The exemption sets out more streamlined conditions that would apply to fiduciaries who receive level fees for their advice. The Principal Transactions Exemption is the other new exemption. It would allow fiduciary investment advisers to recommend and sell to plans certain debt securities and other investments from their own inventory, if certain criteria are met. The overall goal of both exemptions is to ensure that investors would be protected by impartial conduct standards. To that end, certain existing PTEs would also be amended and revoked to harmonize the available exemptions with the newly created ones.

It should be noted that the BIC Exemption and Principle Transactions Exemptions, if they become applicable, would have a transition period through January 1, 2018, so that the exemptions could be utilized with applicable conditions being phased in over the transition period.

Some considerations for plan sponsors. While the fate of the regulatory package is uncertain and its most immediate effects would be on investment advisers, there are various things plan sponsors should be thinking about. Here are a few:

- Assess the policies, procedures, and practices already in place for ensuring your fiduciary obligations are being met and to reduce the possibility of co-fiduciary liability. While not mandated, fiduciary training programs, administrative and investment committees, and investment policy statements, are all tools that can help plan sponsors ensure fiduciary obligations are properly carried out and decrease liability risks. If you are not already utilizing these tools, now is a good time to consider implementing them

- Examine your investment adviser relationships, keeping in mind that plan sponsors have the fiduciary obligations of prudently selecting and monitoring all service providers, including investment advisers. What services are being provided and do they result in fiduciary status? If so, has the adviser acknowledged fiduciary status? Do changes need to be made to the services agreement to clarify the scope of services, fiduciary status, or to provide plan sponsor protections (*e.*, indemnification language)?
- Pay close attention to services in the following areas that would be especially impacted by the new rule:

    o Rollover and distribution advice: If your investment adviser is providing rollover and distribution advice, the new rule would specifically treat it as fiduciary investment advice. If such advice is being provided, determine whether the investment adviser acknowledges fiduciary status.

    o Investment education materials and activities: Evaluate services and materials to determine if your adviser may be crossing the line from non-fiduciary "education" to fiduciary advice, and if so, determine whether fiduciary status is acknowledged.

Please feel free to contact a member of our Employee Benefits Practice Group if you have any questions about the subject matter covered in this alert.