NEW FIDUCIARY INVESTMENT ADVICE RULE

A Significant Change For Investment Advisers To Retirement Plans And IRAs, As Well As Those Who Maintain Retirement Plans and IRAs

On April 6, 2016, the U.S. Department of Labor ("DOL") issued a final regulation (the "New Fiduciary Rule") that redefines and significantly broadens the scope for determining who is treated as a fiduciary as a result of the provision of "investment advice" to plans covered by the Employee Retirement Income Security Act ("ERISA"), and their plan fiduciaries, participants and beneficiaries, and individual retirement accounts ("IRAs"), and IRA owners. The New Fiduciary Rule also includes two new prohibited transaction class exemptions and modifications to other current prohibited transaction class exemptions to reflect this new expanded definition of fiduciary investment advice. This article will focus on the new fiduciary investment advice regulatory rule. A future article will address the new and revised prohibited transaction class exemptions.

The New Fiduciary Rule will become applicable on April 10, 2017. Until such applicability date, the current regulatory rule governing fiduciary investment advice continues to apply. With that said, the regulatory efforts by the DOL to change the rules defining fiduciary investment advice, and the issuance of the New Fiduciary Rule, have been met with significant resistance from the financial services industry as well as in some segments of Congress. Accordingly, it can be expected that future challenges to the New Fiduciary Rule will be made on the legislative, regulatory and litigation fronts. However, until any such efforts are successful, the New Fiduciary Rule is here and is expected to offer some significant challenges as it provides a substantially new landscape for those service providers who offer investment-related advice

with respect to retirement plans and IRAs, and, in turn, for employers, IRA owners, and other plan fiduciaries that maintain and administer such plans and accounts.

Background

Plan fiduciaries under ERISA are required to comply with certain duties of care with respect to the plans that they serve, such as the duty to act prudently and solely in the interests of the plan participants and their beneficiaries. In addition, under both ERISA and the Internal Revenue Code (the "Code"), fiduciaries and IRA owners are required to avoid specified transactions between the plan or IRA and certain persons closely related to the plan or IRA (known as "prohibited transactions") due to the potential impermissible conflicts of interests inherent in such transactions.

Prior to the New Fiduciary Rule, a person would become an investment advice fiduciary if the investment advice is (i) rendered concerning the value of securities or the advisability of purchasing, holding or selling securities for the plan, (ii) provided on a regular basis, (iii) pursuant to a mutual agreement, arrangement or understanding with the plan or plan fiduciary that the advice is, (iv) intended to serve as a primary basis for investment decisions regarding the plan, and (v) intended to be individualized based on the particular needs of the plan.

Under the New Fiduciary Rule, the above five-part fiduciary investment advice definition is eliminated and replaced with a new, much broader definition that is based on the making of investment "recommendations."

Who Is Covered by the New Fiduciary Rule?

Under the New Fiduciary Rule, investment–related communications will give rise to fiduciary status for the investment adviser if the communication constitutes "Covered Advice" and is provided pursuant to a "Covered Relationship."

Covered Advice

Investment-related advice is within the scope of the New Fiduciary Rule if the person provides to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner for a fee or other compensation, direct or indirect, either or both of the following:

(i) a recommendation as to the advisability of acquiring, holding, disposing of, or exchanging securities or other investment property or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA; or

(ii) a recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of persons to provide investment advice or management services, selection of investment account arrangements (e.g., brokerage vs. advisory arrangements), or recommendations regarding rollovers, transfers or distributions from plans or IRAs, including whether, in what amounts, in what form, and to what destination such a rollover, transfer, or distribution should be made.

It is noted that, unlike the provisions of the proposed fiduciary investment advice regulation, the New Fiduciary Rule does not cover appraisals, fairness opinions or similar

statements concerning the value of securities or other property. Thus, until future guidance is issued regarding such matters, those persons who provide appraisals, fairness opinions, or other asset valuations will not be treated as fiduciary investment advisers.

Covered Relationship

The person providing the covered advice will become a fiduciary under ERISA and the Code if such advice is provided, directly or indirectly (e.g., through or together with an affiliate), in the following manner:

(i) such person represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA or the Code;

(ii) such person renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; or

(iii) such person directs the advice to a specific advice recipient regarding the advisability of a particular investment or management decision with respect to the assets of the plan or IRA.

What is a Covered "Recommendation?"

Under the New Fiduciary Rule, a "recommendation" means a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the advice recipient take or refrain from taking a particular course of action. Whether a particular investment–related communication constitutes a recommendation will be determined based on an

objective, rather than subjective, analysis. The New Fiduciary Rule notes that the more individually tailored the communication is to a specific advice recipient, the more likely the communication will constitute a "recommendation." An adviser that provides a selective list of securities to a specific advice recipient as appropriate for that advice recipient would be making a covered recommendation even if the recommendation does not relate to any one security. Further, it may be possible that a series of actions, made directly or indirectly (e.g., through or with an affiliate of the adviser), may constitute a recommendation when viewed in the aggregate even though any one action individually would not rise to the level of a recommendation. Finally, the determination whether a communication is a recommendation does not depend on whether it is made or initiated by a person or pursuant to a computer software program.

Communications Treated as Not Involving a Covered Recommendation

The New Fiduciary Rule provides a non-exhaustive list of investment related communications that are not treated as a recommendation giving rise to fiduciary investment adviser status. The New Fiduciary Rule provides the following excluded communications.

a. Platform Providers. Service providers, such as third-party administrators (TPAs), recordkeepers and some mutual fund complexes, often offer a "platform" of investment alternatives to plans for the investment of plan assets. Under the New Fiduciary Rule, the making available to a plan fiduciary, without regard to the individualized needs of the plan or its participants or beneficiaries, of a platform or list from which the plan fiduciary can select investment alternatives into which the participants and beneficiaries can direct the investment of the assets held in their accounts will not constitute an investment recommendation if certain conditions are met. These conditions require that the plan fiduciary be independent of the person

making the investment platform available, and such person discloses in writing to the plan fiduciary that such person is not undertaking to provide impartial investment advice or otherwise give advice in a fiduciary capacity.

b. Investment Selection and Monitoring Services.

In connection with the provision of an investment platform, as described above, fiduciary investment advice status will not apply to:

(i) identifying investment alternatives that meet objective criteria specified by the plan fiduciary, provided the person identifying such investment alternatives discloses in writing whether the person has, and the nature of (if applicable), any financial interest in any of such investment alternatives;

(ii) identifying, in response to a "request for proposal" on behalf of a plan, a limited set of investment alternatives based only on the size of the employer or plan, current investment alternatives under the plan, or both, provided the response discloses in writing whether the person identifying such limited set of investment alternatives has a financial interest in, and if so, the nature of, any such alternative; or

(iii) providing objective financial data and comparisons to financial benchmarks to the plan fiduciary.

c. General Investment-Related Communications

The furnishing or making available to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner of general communications that a reasonable person would not view as an investment recommendation will not give rise to an investment recommendation under the New Fiduciary Rule. Examples of such excluded general investment-related communications include general circulation newsletters, comments, remarks and presentations in public broadcasts or widely attended speeches or conferences, and general research and market data (such as market price quotes, performance reports and prospectuses).

d. Investment Education

The New Fiduciary Rule makes an important distinction between investment recommendations and investment education. The former potentially gives rise to fiduciary investment advice, while the latter does not. Under the New Fiduciary Rule, the furnishing or making available to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner of (i) plan information, (ii) general financial, investment and retirement information, (iii) asset allocation models, and (iv) interactive investment materials will, if certain conditions are met, constitute investment education that does not result in fiduciary investment adviser status. The basic thread that runs through nonfiduciary investment education is that the information and materials provided offer general plan and investment/retirement-related information that does not include recommendations as to particular investments or investment management alternatives. However, a limited exception applies that allows specific designated investment alternatives to be identified in connection with an asset allocation model or interactive investment materials

with respect to a plan (not IRAs) if such investment alternative is subject to oversight by a plan fiduciary who is independent of the person offering such asset allocation model or interactive investment materials.

Non-Fiduciary Investment Advice Activities

Under the New Fiduciary Rule, except for transactions in which the investment adviser represents or acknowledges that it is acting as a fiduciary, the following activities will not result in fiduciary investment adviser status.

a. Transactions with Sophisticated Independent Fiduciaries

The provision of investment advice by a person to a fiduciary of a plan or IRA who is independent of the investment adviser will not cause the adviser to become a fiduciary investment adviser if the following requirements are met:

(i) the adviser knows or reasonably believes that the independent fiduciary is a bank, insurance company, registered investment adviser, registered broker-dealer, or holds (or has under management or control) assets of at least $50 million (such independent fiduciary status may be supported by a written representation from the plan or independent fiduciary);

(ii) the advisor knows or reasonably believes that the independent plan or IRA fiduciary is capable of independently evaluating investment risks (such independent fiduciary's capability may be supported by a written representation from the plan or independent fiduciary);

(iii) the adviser fairly informs the independent fiduciary that the adviser is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity with

respect to the transaction in question, and fairly informs the independent fiduciary of the existence and nature of the adviser's financial interests in the transaction;

(iv) the adviser knows or reasonably believes that the independent fiduciary of the plan or IRA is a "fiduciary" under ERISA or the Code (or both) with respect to the transaction and such fiduciary is responsible for exercising independent judgment in evaluating the transaction (the independent fiduciary's status and responsibility as a fiduciary under ERISA and/or the Code may be supported by a written representation from the plan or independent fiduciary); and

(v) the adviser does not receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner for the provision of investment advice with respect to the transaction.

b. Swap and Security-Based Swap Transactions

The provision of advice to an ERISA-covered benefit plan by certain swap dealers, major swap participants or swap clearing firms will not give rise to fiduciary investment advice if, among other things, the plan is represented by a fiduciary under ERISA that is independent of the swap dealer, major swap participant or swap clearing firm, and such dealer, participant or clearing firm does not receive a fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice in connection with the swap transaction.

c. Employee-Provided Advice

An employee of the plan sponsor, an affiliate of the plan sponsor, the employee benefit plan, an employee organization (e.g., an employee of a collectively-bargained union), or a plan

fiduciary will not be treated as a fiduciary investment adviser if he or she, acting pursuant to such employment capacity, provides advice to a plan fiduciary or employee (other than in such employee's capacity as a plan participant or beneficiary) or independent contractor of the plan sponsor, affiliate or plan, provided the person receives no fee or other compensation, direct or indirect, in connection with such advice beyond the employee's normal compensation for work performed for the employer. In addition, if an employee of the plan sponsor or of an affiliate of the plan sponsor, acting in such capacity, provides advice to another employee of the plan sponsor in such employee's capacity as a plan participant or beneficiary, such advice will not constitute fiduciary investment advice provided (i) the advising employee's job responsibilities do not involve the provision of investment advice or recommendations, (ii) such employee is not registered or licensed under federal or state securities or insurance law, (iii) the advice provided does not require the adviser to be so registered or licensed, and (iv) the employee adviser receives no fee or other compensation, direct or indirect, in connection with the advice given beyond the employee's normal compensation for work performed for the employer.

The intent of this "carve-out" for employee-provided advice is to exclude from treatment as fiduciary investment advice the provision of investment-related advice by employees, who work, for instance, in a company's human resources, accounting or finance departments, to investment decision-making plan fiduciaries or those in the upstream chain ultimately reaching such decision-making fiduciaries. The second part of the employee-provided advice carve-out can be expected to reach most employees who work in a company's benefit plan "call center" with respect to the provisions of advice regarding general plan operations.

Welfare Benefit Plans

As noted, fiduciary investment advice under the New Fiduciary Rule generally requires a recommendation concerning an investment in, or management of, securities or investment property. For purposes of the New Fiduciary Rule, "investment property" does not include health insurance policies, disability insurance policies, term life insurance policies, and other property to the extent such policies or property do not have an investment component. Thus, it would be expected that advice concerning an employer's insured group health plan and insured long term disability plan would not give rise to fiduciary investment advice. However, welfare benefit arrangements, such as health savings accounts, Archer medical savings accounts, and Coverdell education savings accounts are covered by the New Fiduciary Rule due to the fact that such accounts can have an investment component.

Execution of Securities Transactions

Under the New Fiduciary Rule, a registered broker-dealer or reporting dealer who makes primary markets in the federal government's (or its agencies') securities and reports daily its positions in such securities to the Federal Reserve Bank of New York, or a bank supervised at the federal or state level, will not be deemed a fiduciary under ERISA or the Code with respect to a plan or IRA solely because it executes purchase and sale securities transactions for the plan or IRA in the ordinary course of its business if the broker-dealer, reporting dealer or bank is neither the fiduciary of the plan or IRA nor an affiliate of such fiduciary, and the instructions of the fiduciary with respect to the securities transaction reflect the security in question, the price

(or price range) for the security, a time span for the transaction (not to exceed five business days), and a minimum or maximum quantity to be purchased or sold.

Employer Considerations

The New Fiduciary Rule represents a significant change in the service relationship between investment-related advisers and the plans and IRAs they serve. Simply stated, this new regulatory rule will treat many more plan and IRA advisers (as well as advisers to the plan participants and their beneficiaries, and IRA owners) as fiduciaries under ERISA and the Code. Thus, such investment advisers will be subject, as applicable, to the demanding fiduciary duty and prohibited transaction rules under ERISA and the parallel prohibited transaction rules under the Code.

Although the New Fiduciary Rule is directed principally toward outside investment advisers to plans and IRAs, it can be expected to also impact employers who sponsor retirement plans for their employees (such as employer-sponsored 401(k) plans). Accordingly, employers/plan sponsors may want to consider the following:

1. What type of investment-related information do plan sponsors provide to their plan participants and their beneficiaries? Does such information constitute nonfiduciary "investment education" or does it cross the line to constitute fiduciary-based "investment advice."

2. Do any employees of the employer/plan sponsor provide investment-related advice to a plan fiduciary or to another employee (other than in such latter employee's capacity as a plan participant) of the employer/plan sponsor (such as a human resources employee who

provides investment advice and analysis to a plan investment fiduciary in support of such fiduciary's investment decision–making authority)? If such investment advice is provided, does the employee receive a fee or other compensation, directly or indirectly, in connection with the investment advice that is beyond the employee's normal compensation for work performed for the employer/plan sponsor (such as an incentive fee or commission tied to the making or performance of the plan's investments based on the employee's investment advice)?

3. Review service and investment adviser agreements regarding the employer/plan sponsor's liability exposure for acts (including breaches of fiduciary duty or prohibited transactions) by the investment adviser should the adviser become a fiduciary investment adviser under the New Fiduciary Rule. This liability exposure can occur through employer/plan sponsor agreements to indemnify and hold harmless an investment adviser from certain liabilities resulting from acts of the adviser.

4. Investment advisers may seek to limit their discretionary investment responsibilities with respect to a plan, IRA and its participants, and in turn, transfer those responsibilities to the employer/plan sponsor or IRA owner. In addition, investment advisers may seek greater fees to offset the additional fiduciary liability risks the adviser is taking under the New Fiduciary Rule.

5. Employers/plan sponsors should also be aware of the potential fiduciary liability exposure due to the ERISA rules governing co-fiduciary liability (i.e., imposing, in certain circumstances, liability on a fiduciary for the breaches of fiduciary responsibility engaged in by another fiduciary).

If you have any questions concerning the New Fiduciary Rule and how it may apply to you, please contact your regular Brach Eichler attorney.