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Client briefing

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U.S. Department of Labor Proposes New Fiduciary Rules

On April 14, 2015, the U.S. Department of Labor ("DOL") issued a long-awaited notice of proposed rulemaking (the "2015 Proposed Rules") relating to the definition of "investment advice fiduciary" under the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code ("Code"). The 2015 Proposed Rules aim to increase consumer protection by replacing the existing "five-part" test for determining the status of an investment advice fiduciary and imposing the same standards that apply to plans covered by ERISA on individual retirement accounts ("IRAs").

In an effort to respond to concerns from commentators following the issuance of similar proposed regulations published by the DOL in 2010 (the "2010 Proposed Rules"), the 2015 Proposed Rules include specific carve-outs from the definition of fiduciary investment advice, and propose two new prohibited transaction class exemptions (the "Proposed Class Exemptions").

Proposed Rules

Under ERISA and the Code, a person is considered a fiduciary to a plan covered by ERISA or an IRA to the extent such person engages in certain specified plan activities, including providing investment advice for a fee or other compensation. The 2015 Proposed Rules expand the definition of an investment advice fiduciary in significant ways, and apply such fiduciary standards equally to both plans subject to ERISA and IRAs. Under the 2015 Proposed Rules, a person provides investment advice as a fiduciary by (1) providing investment or investment management recommendations or appraisals for a fee or other compensation to an employee benefit plan, a plan fiduciary, participant or beneficiary, or an IRA owner or fiduciary, and (2) such person either (a) acknowledges the fiduciary nature of the advice or (b) acts pursuant to an understanding that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions. Under the 2015 Proposed Rules, fiduciary investment advice generally covers four categories of advice:

- A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from a plan or IRA.

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- A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from a plan or IRA.
- An appraisal, fairness opinion, or similar statement, whether verbal or written, concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by a plan or IRA.
- A recommendation of a person who will receive a fee or other compensation for providing any of the types of advice described above.

The 2015 Proposed Rules differ in several significant respects from the "five-part" definitional test currently used to determine the status of an investment advice fiduciary.[1] Under the 2015 Proposed Rules, investment advice would no longer be required to be provided on a *regular basis* for fiduciary standards to apply and, alternatively, such standards could be imposed with respect to a single transaction. In addition, under the 2015 Proposed Rules the investment advice would no longer be required to serve as a *primary basis* for investment decisions, and would only require that the advice recipient consider the investment advice when making such a decision.

In response to concerns raised with respect to the 2010 Proposed Rules, the 2015 Proposed Rules include the following carve-outs from the definition of investment advice:

- *Plan counterparties.* Recommendations provided with respect to a sale, purchase, loan, or bilateral contract with an ERISA plan with 100 or more participants or at least $100 million in assets by a counterparty acting in an arm's length transaction.
- *Swap and Security-based swap Counterparties.* Offers or recommendations to plan fiduciaries to enter into a swap or security-based swap that is regulated by the Securities Exchange Act or the Commodity Exchange Act.
- *Employees of an employer.* Statements or recommendations given by an employee of a plan sponsor to the plan fiduciary in the course of his or her employment (provided no additional compensation is provided with respect to such recommendation).
- *Platform providers.* Marketing or making available to participant-directed ERISA plans a platform of investment alternatives.
- *Selection and monitoring assistance.* Providing an ERISA plan with investment alternatives that meet objective criteria specified by the plan fiduciary or otherwise providing objective financial data and benchmark comparisons.
- *Financial reports and valuations.* Providing appraisals and valuations to employee stock ownership plans ("ESOPs") regarding employer securities, collective investment funds holding "plan assets," and to ERISA plans and IRAs for purposes of complying with certain reporting and disclosure requirements.
- *Investment Education.* Providing information and materials that constitute "investment education" or "retirement education" (such as asset allocation models). However, asset allocation models that include specific investment products do not qualify for the exclusion from investment advice.

Proposed Prohibited Transaction Exemptions

As part of the 2015 Proposed Rules, the DOL issued two Proposed Class Exemptions.[2] Under the "Best Interest Contract Exemption," fiduciaries are provided relief from the prohibited transaction rules where the fiduciary concludes that the investment

1 Under current regulations, for advice to constitute "investment advice," an adviser who is not a fiduciary under another provision of the statute must (i) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing, purchasing or selling securities or other property, (ii) on a regular basis, (iii) pursuant to a mutual agreement, arrangement or understanding, with the plan or plan fiduciary, (iv) that the advice will serve as a primary basis for investment decisions with respect to plan assets, and (v) that the advice will be individualized based on the particular needs of the plan or IRA.

2 The DOL also issued proposed amendments to six existing prohibited transaction exemptions in order to make these exemptions consistent with changes in the proposed rules.

advice is in the "best interest" of the plan or IRA. The Best Interest Contract Exemption only applies, however, to certain types of investments, and to advice provided to plan participants and beneficiaries, IRA owners, and to plan fiduciaries of ERISA plans with fewer than 100 participants. The "best interest" standard is intended to be consistent with the otherwise applicable fiduciary duties of prudence and loyalty under ERISA, and, as such, the primary impact of the exemption is the application of the exemption to the IRA market. The Best Interest Contract Exemption would permit investment advisers to continue certain existing fee arrangements that would otherwise violate prohibited transaction rules, as long as such advisers conclude that the investment advice is in the best interest of the advice recipient.

To qualify for the Best Interest Contract Exemption, an investment advice fiduciary must (i) contractually acknowledge fiduciary status, (ii) affirmatively agree to comply with impartial conduct standards, (iii) comply with applicable federal and state laws governing investment advice, (iv) warrant that the fiduciary has adopted policies designed to mitigate the impact of conflicts of interest, and (v) disclose information regarding conflicts of interests and costs associated with the investment advice. The exemption specifically prohibits the use of exculpatory provisions that would limit the liability of a fiduciary for violation of any of its contractual obligations. Fiduciaries must also adhere to certain record keeping and disclosure requirements, including advance notification to the DOL of the fiduciary's intention to rely on the exemption.

The DOL proposed a second prohibited transaction class exemption for situations where a broker-dealer or investment adviser sells debt securities from its own inventory to plans, participants and IRA owners (referred to as "principal transactions"). In addition to satisfying the requirements of the Best Interest Contract Exemption described above, the adviser will be required to obtain two price quotes from unaffiliated counterparties, and to sell the securities at a price that is no less favorable than the two quoted prices. The adviser is also required to disclose the amount of compensation and profit it expects to receive in connection with the transaction.

The 2015 Proposed Rules are subject to a 75-day comment period and the DOL plans to hold an administrative hearing within 30 days following the close of such comment period. In the event the 2015 Proposed Rules become final, the final rule would "be effective 60 days after publication in the Federal Register and the requirements of the final rule would generally become applicable eight months after publication of a final rule."

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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