

DOL's Final Rule on the Definition of "Fiduciary"

On April 6, 2016, the Department of Labor (the "DOL") released the final rule (the "Final Rule") regarding the definition of investment "fiduciaries" for employee benefit plans under the Employee Retirement Income Security Act of 1974 ("ERISA") and for plans (including individual retirement accounts ("IRA")) under section 4975 of the Internal Revenue Code of 1986 (the "Code"). The Final Rule does not directly apply to governmental plans. The Final Rule expands the definition of "fiduciary" to encompass a wider range of persons providing investment advice or recommendations to plans or IRAs for a fee.

POSTED:

Apr 14, 2016

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The Final Rule

The Final Rule states that a person is a fiduciary if the person receives a fee or compensation for providing certain recommendations regarding investments and investment-related activities and policies. Investment professionals who provide such recommendations are fiduciaries if they acknowledge their fiduciary status, provide advice pursuant to an agreement or understanding that the advice is customized for the recipient, or provide advice to a specific recipient regarding particular investments.

The Final Rule clarifies the types of recommendations that fall under the purview of the rule. For example, a recommendation includes communications that suggest that the recipient either act or refrain from acting in a certain way based on a reasonable, objective view of the content, context and presentation of the recommendation. A recommendation may also include a series of actions that, when considered together, may be considered a recommendation.

Under the proposed rule, recommendations as well as appraisals created fiduciary obligations (with exceptions for appraisals for ESOPs and certain other investment funds), but the Final Rule removed appraisals from the list of activities that give rise to fiduciary status. The DOL indicated that it has reserved all appraisal issues for future rulemaking. The Final Rule also clarifies that a financial adviser's recommendation that a customer hire the adviser will not constitute a fiduciary recommendation.

Exceptions

Although the Final Rule broadens the definition of "fiduciary," it also sets forth a

number of exceptions. The following services and arrangements will not cause the provider to be a fiduciary:

Platform Providers. Services provided by platform providers who, without regard to the specific needs of the recipient, market and make platforms available for independent plan fiduciaries to select or monitor investment alternatives available to participants or beneficiaries as long as the platform provider discloses in writing that it is not providing impartial investment advice or advice as a fiduciary. The following selection and monitoring assistance in connection with platform provider services will also not give rise to fiduciary status:

- identifying investment alternatives that meet the plan fiduciary's objective criteria if the financial professional discloses in writing whether it has a financial interest in the investment alternatives as well as the nature of the interest;
- in response to a request for proposal or similar solicitation, identifying a sample of investment alternatives based only on the size of the employer (or plan) or the existing investment alternatives, or both, as long as the financial professional responds in writing and discloses whether it has a financial interest in the investment alternatives as well as the nature of the interest; or
- providing objective financial information and comparisons with independent benchmarks.

General Communications. General communications that a reasonable person would not consider an investment recommendation (e.g., general newsletters, marketing materials or market data).

Investment Education. Investment education provided to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner (regardless of who provides the education), as long as the educational information does not recommend specific investment products or plan or IRA alternatives, and does not recommend investment of a specific security or other investment property. The Final Rule contains a detailed description of the types of permissible education materials and the criteria that must be satisfied to present those materials.

Independent Fiduciaries with Financial Expertise. Advice provided to independent plan or IRA fiduciaries with financial expertise if the financial professional complies with certain requirements and reasonably believes that the independent fiduciary of the plan or IRA is a licensed and regulated financial services provider like a bank, insurance carrier, broker-dealer or registered

investment adviser, or that the independent fiduciary of the plan or IRA has at least \$50 million in assets under management.

Swap Transactions. Advice provided in connection with a swap or security-based swap transactions if certain conditions are met.

Employees. Services provided to a plan fiduciary or to an employee or independent contractor of a plan sponsor, affiliate or employee benefit plan by an employee of the plan sponsor, the plan, an employee organization or a plan fiduciary as long as certain requirements are met and the employee receives no fee or compensation other than his or her normal compensation.

Prohibited Transaction Exemptions

In addition to the exceptions listed above, the DOL is publishing prohibited transaction exemptions that allow investment professionals to receive traditional forms of compensation as long as certain criteria are met. ERISA and the Code provide that investment professionals who provide fiduciary advice to plan sponsors, participants and IRA owners may not receive compensation that creates a conflict of interest unless they are covered by a prohibited transaction exemption. Accordingly, in connection with the Final Rule, the DOL has issued the Best Interest Contract Exemption (the "BICE"). The BICE allows advisers and financial institutions to receive otherwise prohibited compensation for providing investment advice if certain criteria are met. There are a number of specific requirements to meet this exemption, but in general, it is designed to require the financial adviser and its firm to acknowledge in writing their fiduciary status and agree to give advice in the best interest of the advice recipient.

To fall under the BICE, financial professionals must comply with certain impartial conduct standards and adopt policies to ensure that individual advisers comply with the required standards, disclose important fee information and material conflicts of interest, and maintain records to demonstrate compliance with the BICE. The impartial conduct standards require the financial institution and advisers to provide advice that is in the best interest of the recipient, to refrain from receiving excessive compensation and to avoid making misleading statements regarding fees and conflicts of interest.

For IRAs and plans not covered by Title I of ERISA (such as Keogh plans), financial professionals must sign a written contract stating that their advisers will comply with BICE standards. There is no contract requirement for ERISA plans, but the

financial professional must still adhere to the impartial conduct standards and other requirements of the BICE and provide a written acknowledgement of fiduciary status. The final BICE provides for more flexibility than the proposed BICE regarding when the contract must be executed so that it does not need to be signed immediately. Also a change from the proposed BICE, the final BICE allows fiduciaries that would receive only a level fee for investment services to comply with a more streamlined set of conditions. There are a number of other requirements provided in the final BICE rules.

In addition to the BICE, the DOL has issued the Principal Transactions Exemption, which allows investment professionals to purchase or sell certain investments from their own inventories to plans or IRAs. Similar to the BICE, this exemption requires the financial professional to comply with certain impartial conduct standards and meet other requirements. The DOL has also issued exemptions for purchases and sales, including insurance and annuity contracts and for preexisting transactions. The DOL will amend other prohibited transaction exemptions to include similar requirements.

Potential Effects on Plan Sponsors

In response to the Final Rule, plan sponsors may want to develop procedures for ensuring that their investment fiduciaries comply with the Final Rule. If investment fiduciaries fail to comply with the Final Rule, it is possible that participants could sue the plan sponsors for neglecting to hire an adviser without conflicts of interest. The preamble to the Final Rule notes that plan sponsors continue to have fiduciary obligations in connection with selecting and monitoring service providers. A plan sponsor could have co-fiduciary liability when it hires an investment adviser if the plan sponsor fails to act prudently or in the best interests of participants and beneficiaries or fails to correct a known breach by the investment adviser.

Plan sponsors should also be aware of how the Final Rule may affect participants' need for information. The Final Rule has received a lot of publicity and increased awareness of issues that arise in the context of investments. Plan participants may be aware that investment advisers are subject to new fiduciary standards, and this could lead to increased questions for plan sponsors or litigation. This is a good time for plan sponsors to review their fiduciary practices, such as fiduciary training, as well as investment policy statements and other relevant documents. Plan sponsors that are considering hiring a new investment professional could consider incorporating questions regarding the Final Rule in the request for



proposal and could consider hiring a registered investment adviser.

The Final Rule could also affect the services that financial advisers are willing to offer as advisers may want to avoid providing fiduciary advice in some circumstances. For example, some financial advisers may reduce education services to avoid undertaking a fiduciary role regarding advice for specific investments and distributions. In addition, current financial advisers may seek to amend their existing investment contract as a result of the Final Rule. Accordingly, plan sponsors may want to carefully review existing investment contracts and any proposed amendments to determine if the adviser is a fiduciary or if an exception applies. If the financial adviser intends to comply with the BICE, plan sponsors should consider whether all requirements have been met and documented. Plan sponsors may also want to ask their financial advisers if they are fiduciaries and document the fiduciary status. New contracts with financial advisers should be carefully drafted to ensure compliance with the Final Rule.

Finally, although it remains to be seen how the Final Rule will affect pricing, the Final Rule could increase plan sponsors' access to reasonably priced fiduciary advice and investment products. It is also possible that terminated employees will be more likely to remain in a plan, as investment advisers may be less willing to give advice regarding rollovers if that advice could create fiduciary duties.

Applicability Dates

The Final Rule becomes applicable on April 10, 2017. The DOL provided a transition period for the BICE and Principal Transactions Exemption between April 10, 2017 and January 1, 2018, during which fewer of the conditions apply. The exemptions will apply fully on January 1, 2018.

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