

DoL's New Proposed Fiduciary Definition-Start Preparing Now

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While the new proposed definition of fiduciary from the U.S. Department of Labor ("DoL") is not effective yet, there are indications this rule is moving forward on a track planned by the DoL. The Secretary of Labor, Thomas Perez, has indicated that he does not see any reason for extending the comment period which ends on July 6, 2015 since there has already been a great deal of discussion of the prior proposal issued in 2010, and Assistant Secretary for the Employee Benefit Security Administration, Phyllis Borzi, recently indicated that there will be plenty of time to comment on the proposed regulations and related proposed amendments to the prohibited transaction exemptions (the "Proposal") within the initial comment period. This period will be followed by hearings, publication of a transcript of the hearings and then a period of additional comments. Concerns have been raised both by organizations representing businesses and those championing individual rights. The DoL expected the Proposal to raise disagreements. The Proposal is one of a number of federal agency initiatives to combat perceived conflicts of interest, including other initiatives by FINRA and the SEC.

There are a number of available summaries of the lengthy Proposal, the related carve outs and the prohibited transaction exemption modifications impacting many common plan transactions that will need to be analyzed when the Proposal is finalized. Some of these currently vary by the plan size. However, in order for any potentially regulated party to be able to prepare, one must understand the breadth of Proposal. Under the Proposal, the definition of a fiduciary was expanded by broadening the definition of what actions constitute providing investment advice to an ERISA Plan or an IRA and removing some of the limitations which required the advice to be provided regularly and which had exempted other plan service providers who provide recommendations or guidance on the sale, purchase or maintenance of plan assets only on an intermittent basis (e.g., attorneys or appraisers, with certain appraisals for ESOPs excepted if the requirements were satisfied).

Investment advice includes a person that renders investment advice with respect to moneys or other property of an ERISA plan or an IRA, if such person provides, directly to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner certain types of "investment advice" in exchange for a fee or other compensation, whether direct or indirect. For this purpose an individual provides investment advice if it provides any of the advice described in 1-3 below for a fee or compensation, direct or indirect, provided the individual acknowledges or represents that it is acting as a fiduciary with respect to the advice described below, or it renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to or it is specifically directed to the recipient for consideration in making investment and management decisions, provided that one of the carve outs does not apply. An employer whose plan fiduciary utilizes the investment advice of the employer's own employees with respect to its retirement plan and does not provide any additional compensation to such employees for such advice is not required to treat such investment advice as fiduciary "investment advice" subject to the Proposal.

In order to avoid committing a prohibited transaction once the Proposal is finalized and is applicable (the applicable date is the date specified in the final regulations by which plans and IRAs must comply), many brokers, pension consultant and insurance salespersons will need to meet the new Best Interest Contract exemption requirements. If they wish to continue receiving direct and indirect compensation from the investments sold and the investment advice they provided. (note some requirements vary by the size of the plan.) The Proposal requires parties who provide investment advice to the Plan/IRA and who have a conflict of interest with the plan/IRA to only recommend the contract that is in the "Best Interest" of the Plan/IRA and to disclose the compensation provided to the investment advisor, directly or indirectly, by virtue of the proposed investment. However, the disclosure of the compensation the investment advisor receives in this case does not include revenue sharing. The Proposal expands the definition of Investment advice to include:

1. A recommendation as to the advisability of holding, acquiring, disposing or exchanging securities or other property, including the recommendation to take a distribution of benefits, or a recommendation about the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA (this would reach recommendations of certain advisors to take a distribution from an employer's or government's retirement plan and roll over such funds and invest the funds);
2. 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 the plan or IRA (this could reach the advice regarding managing plan investments and regarding investment of funds by wealth planning individuals who are counseling regarding the investment of rolled over funds in an IRA);
3. 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 by the plan or IRA (e.g., verbal advice to a plan fiduciary regarding the advisability of investing in employer securities in an ESOP account (assuming the ESOP exception does not apply) or regarding investing in alternative investments regarding the value of the particular investment); or
4. A recommendation of a person who is going to receive a fee or other compensation for providing any of the types of advice in 1 to 3 above.

The investment advice captured by the above definition does not include the following categories of carve outs, counterparties to the plan who satisfy a number of requirements; employees of an employer or employee organization sponsoring the plan who provides advice to a plan fiduciary, but received no fee or other compensation, directly or indirectly, with respect to such advice; platform providers that meet certain requirements; selection and monitoring assistance: financial reports and valuations; and investment education as such concept is redefined and provided certain requirements are satisfied.

This alert is not intended to fully explain the extensive Proposal, but instead it suggests what an employer, pension consultant, insurance salesman or investment advisor should consider doing now to prepare for the date the final regulations and prohibited transaction exemptions are issued. The Proposal states the final regulations will be effective 60 days after the final rule is published in the Federal Register and that they will be applicable to plan contracts 8 months after the publication of the final rule. While no one is required to currently comply with the Proposal and potentially regulated parties may choose to wait and see if the Proposal is finalized, there are indications this may be a Proposal that will move to the next stage during this administration.

So both plans and the entities and individuals that work with plans, IRAs, and plan fiduciaries may want to consider starting to review and identify plan relationships, plan vendor services and other relationships to determine if they may potentially involve advice that comes within the expanded definition of investment advice and what changes may need to occur to the various plan relationships. Proactive steps some of the potentially regulated parties may want to consider are listed below by category. These are not intended to be an all-inclusive list because the final regulation may change this list.

Retirement Plan Sponsor Preparation

- Identify the plan fiduciaries and interview the plan fiduciaries to determine whose advice they use in determining to make, retain, value or dispose of any investment and what compensation such persons may receive directly or indirectly
- Review all disclosures of direct and indirect compensation made to the plan fiduciary under ERISA section 408(b)(2) to identify where such compensation is being paid and to whom
- Review all disclosures to participants regarding investment alternatives and the fees they disclose
- Review all agreements for investment advisory services
- Review all of the retirement plan's service provider agreements
- Review the materials the plan fiduciary receives from the various plan service providers to determine if any contain statements that may constitute "investment advice" that is not excepted out under the Proposal

- Review the plan's list of parties-in-interest that is required for every DoL audit regarding whether it will require updates to include additional persons providing investment advice under the Proposal
- Review the plan fiduciary's or committee's minutes for any other potential sources of investment advice
- Review agreements with any hedge fund investments regarding potential issues
- Review the plan's investment policy regarding whether it requires updates to ensure that the plan fiduciary is guided to ensure it receives all disclosures necessary and required for future investment decisions to avoid prohibited transactions
- Review your plan's fiduciary education program to ensure that your fiduciaries are fully advised of their responsibilities and equipped to fulfill their fiduciary roles under the Proposal
- Review any alternative investment arrangements (including related agreements) regarding fees and valuation advice and how such comply with the Proposal
- Review all current investment advice provided regarding how the Proposal may impact the investment advice arrangement
- Review the current agreements governing the provision of investment advice to participants, professionally managed accounts or brokerage windows regarding how such arrangements and agreements need to change and which new disclosures must be provided to keep such arrangements compliant

Plan Fiduciary Preparation

- Learn the new disclosure and agreement requirements that must be met and which apply to common arrangements with vendors being compensated directly or indirectly for services from the plan
- Review the ERISA 408(b)(2) disclosures the plan currently has received from its existing vendors compensated from the plan
- Identify on whom the plan fiduciary relies for investment recommendations and whether such persons receive compensation directly or indirectly from the plan
- Review all vendor relationships for the plan
- Attend, participate in or study any fiduciary education materials or programs available to you as a plan fiduciary; a prudent fiduciary needs to understand his or her role and the obligations that flow from such role
- Review all investment advisory agreements, professionally managed account agreements and brokerage window agreements to understand the fees and compensation related to such arrangements and to whom such compensation is paid compliant will require.

Plan sponsors should also prepare for the additional work bringing plans into compliance will require. Plan sponsors with collectively bargained workforces may anticipate inquiries from the collective bargaining unit(s) regarding compliance and the fee disclosures since retirement plans and the use of fees generated by participants' contributions may raise the interest of some groups representing employees.

Investment Advisor, Broker, Pension Consultant and Prototype Plan Package Providers Preparation

- Identify all retirement plans or IRAs sold by your company's agents or representatives or maintained by a client of your company and whether you have a current written agreement for services for such plan or IRA
- Identify the size of each retirement plan to determine whether each plan may fit into one of the Proposal's special rules for small or large plans (Review the most recently filed Form 5500 for information on the number of participants and the value of the assets held)
- Educate all of your company's agents or representatives who are the front line client contacts regarding what is required of them under the Best Interest Contract Exemption, the new disclosures required and new agreements necessary in order for such plans' or IRAs' investments to be able to pay commissions or other compensation directly or indirectly
- Educate the client relationship staff at the brokerage firm, pension consultant, insurance company, or investment firm regarding their new obligations, disclosures and agreements that are necessary to avoid committing prohibited transactions and to satisfy any of the carve outs or amended prohibited transaction exemptions

- Establish a process to review and vet potential vendors to satisfy the Best Interest Contract requirements, including periodic updates, a process to communicate those to the sales staff and to prepare the necessary related disclosures on compensation, direct and indirect
- Review your sales staff procedures and techniques for reaching out to individuals who have accounts in retirement plans of their employers regarding the strategies they use and the disclosures they make in encouraging employees and former employees to roll their accounts out of the retirement plan and into an IRA because this has been a particular focus of the regulators with concerns on the fee differential, but not always considering the potential gain from the availability of other investment options. Disclosures in this area will need to be carefully drafted to explain the risks and rewards of making such a transfer
- Review internal policies regarding selling or promoting rollovers and investments
- To the extent you are involved in providing services to retirement plans and plan fiduciaries, you should review the documents plan sponsors and fiduciaries will be reviewing in the sections applicable to them, as described above

The Proposal is not minor and will require many changes in operations of many parties dealing with retirement plans and IRAs. While the DoL has indicated there will be 8 months following the effective date (which will be 60 days post issuance of the final regulation) in which to bring your plan or entity into compliance, even this almost 10 month period may not be sufficient to accomplish full compliance for all regulated parties. In addition, each party's compliance will depend on the compliance of the other parties with which it interacts.

Failure to comply not only indicates potential fiduciary issues, but may mean prohibited transactions if the entity fails to meet the new prohibited transaction exemption requirements. Violation of the prohibited transaction exemption rules may result in excise tax penalties initially of 20% of the amount involved in the prohibited transaction, and if the prohibited transaction is not corrected within 1 year of the initial penalty assessment, the IRS can impose a 100% excise or penalty tax. *This penalty or excise tax is imposed on the parties in interest/ disqualified persons* (these include the plan fiduciary, employer sponsoring the plan, officers and directors of the employer, an employee organization (CUB) any of whose members are covered by the plan, and service providers to the plan among others) *who participated in the prohibited transaction.*

The determination of who provides investment advice under the Proposal to a plan, IRA or plan fiduciary (as defined under the Proposal) is important in order to identify the parties, relationships and those who might potentially be exposed to liability for commission of a prohibited transaction in the event full compliance is not achieved in a timely manner.

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