

“Call to Action” May Create Fiduciary Liability under ERISA

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Traditional investment advisers, as well as broker-dealers, insurance brokers, banks, and employers, are abuzz with questions and concerns relating to the final regulation issued by the Department of Labor (DOL) on April 8, 2016. *For an explanation of the background on the final regulation and a summary of the rule, see either of our previous alerts below:*

- [4/19/2016: Employer Action Required Following Issuance of Final Rule](#)
- [4/19/2016: A Brave New World for Investment Advisors Following Issuance of Final Rule](#)

While the underlying premise of the final rule is relatively straightforward – that is, to broaden the scope of fiduciary status for persons who provide investment advice to employee benefit plans and other tax-advantaged accounts, such as individual retirement accounts and health savings accounts (collectively referred to herein as IRAs), under the Employee Retirement Income Security Act of 1974 (ERISA) or the Internal Revenue Code of 1986, as amended (Code) – its application is conditioned upon satisfaction of four main requirements:

1. There must be a “recommendation”
2. For a fee or other compensation
3. Made under specified circumstances
4. That is not otherwise excepted

This client alert is intended to provide you a general summary of what constitutes a “recommendation” under the final rule. A separate client alert has been prepared and will be distributed to explain which types of advice have been specifically excluded from the scope of this rule. Additional client alerts will be distributed to address each other component of the final rule and applicable exemptions in detail.

What’s a recommendation?

A “recommendation” is 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. The final rule imposes an objective standard that looks at whether there is a “call to action” that a reasonable person would believe was a suggestion to make or hold a particular investment or pursue a particular investment strategy.

The more individually tailored the communication is about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation. For example, a person who provides advice regarding a selective list of securities as appropriate for a plan or IRA is considered a recommendation, even if no recommendation is made with respect to any one security. (However, please refer to our next client alert for an explanation of a specific exception for certain platform providers.) Furthermore, advice that, when viewed individually, does not constitute a recommendation, may nonetheless rise to the level of a recommendation when viewed in the aggregate. It makes no difference whether the communication was initiated by a person or a computer software program, or whether it is provided by a fraternal benefit society and other tax exempt organization to its members.

In defining “recommendation” for purposes of the final rule, the DOL relied on guidance previously issued by the Financial Industry Regulatory Authority (FINRA) and the Securities and Exchange Commission (SEC). Accordingly, there are similar (although not identical) concepts among the various regulators. As a result, communications that require the adviser to comply with “suitability” requirements under applicable securities laws will certainly constitute a recommendation under the final rule. Note, however, a fiduciary investment adviser is not considered to satisfy the fiduciary standards and prohibited transaction rules of ERISA and/or the Code merely by satisfying, for example, the “suitability” requirements under applicable securities laws.

What type of advice must be covered in the recommendation?

All recommendations are not created equally. Rather, a recommendation must cover one of the following topics in order to be covered under the final rule:

- the advisability of acquiring, holding, disposing or exchanging of securities or other investment property of *the plan or IRA*

- 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*
- the *management of securities or other investment property* of the plan or IRA, including investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, and the selection of investment account arrangements (e.g. commission-based brokerage v. fee-based advisory)
- rollovers, transfers, or distributions *from a plan or IRA*, including whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made

Notably, the valuation of securities or investment property is not considered a recommendation under the final rule. Similarly, advice regarding the purchase of health, disability, and term life insurance policies is not considered investment advice if the policies do not have an investment component. However, there is no similar exclusion for bank certificates of deposit and similar products.

Where a transaction is comprised of multiple steps, the determination of whether a recommendation has occurred is determined separately with respect to each step. For example, a rollover of plan assets to an IRA that will purchase an annuity is considered advice regarding two separate steps – that is, advice regarding the rollover and advice regarding the investment after the rollover (i.e. the purchase of the annuity). If the transfer was coming from a taxable account (rather than a plan or IRA), the advice regarding the transfer would not implicate this rule, but the advice regarding the investment of the amounts transferred into the IRA would do so.

While the scope of management activities encompasses recommendations as to proxy voting, the exercise of ownership rights, and similar activities, it does not include the provision of guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy, and which are not directed or presented as a recommended policy for the plan or IRA to adopt. Similarly, a recommendation addressed to all shareholders in an SEC-required proxy statement would not constitute fiduciary investment advice under the rule from the person who creates or distributes the proxy statement.

Importantly, a recommendation can include a referral of other persons who provide investment advice or management services. A general recommendation to hire an advisor, without identifying a particular person or group to engage, would not constitute investment advice. Further, a recommendation of a service provider who would not be considered a fiduciary would not rise to the level of a recommendation.

This rule does not preclude an adviser from marketing himself, or an affiliate, as a potential fiduciary to be selected by a plan fiduciary or IRA owner since touting personal attributes does not implicate the rule. But advisers should proceed with caution in their marketing efforts. If an adviser recommends, for example, that the investor pull money out of a plan or invest in a particular fund, that advice is given in a fiduciary capacity and is evaluated separately from the adviser's self-promotion. Similarly, the adviser could not recommend that a plan participant roll money out of a plan into investments that generate a fee for the advisor, but leave the participant in a worse position than if he had left his money in the plan. In conclusion, there is a fine line that investment advisers must walk in order to avoid fiduciary status under the final rule. While the determination of whether a particular statement (oral or written) constitutes a recommendation is based on an objective standard (i.e. would a reasonable person believe it to be such?), the analysis will be fact-specific with respect to each separate component of the transaction. Cautious advisers should take this opportunity to assess the scope of their business and the marketing strategies utilized in talking with clients.

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