# With the Tip of a Hat, a Fund Manager Can Be an ERISA Fiduciary

06.15.17

It's official. The Department of Labor's final conflict of interest regulation became applicable on June 9, 2017. Despite the consternation leading up to the issuance of this rule and the expectations of many that the rule would ultimately be repealed (or, at least, delayed) by President Trump, some advisors may now find themselves unexpectedly wearing a "fiduciary hat" with respect to benefit plan clients (including individual retirement accounts (***IRAs***)). While we expect that the scope of the final regulation has limited effect for fund managers, there are certain marketing and promotional activities that could implicate the final regulation.

Recall, the effect of this regulation is to broaden the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974 (***ERISA***) and the Internal Revenue Code of 1986, as amended (***Code***) to encompass certain persons who provide *nondiscretionary* investment advice to benefit plans and IRAs. Those who possess discretionary management authority over benefit plans and IRAs already were, and will continue to be, fiduciaries of such plans.

Under certain circumstances, funds that allow investments by benefit plans and IRAs (collectively, benefit plan investors) can create fiduciary liability for the fund manager. These investments can also implicate the prohibited transaction rules of ERISA and the Code. Fiduciaries that violate the ERISA standards of care are personally liable for losses to the applicable plan. Furthermore, violations of the prohibited transaction rules under either ERISA or the Code can result in significant excise taxes (of up to 100% of the amount involved) being imposed upon the parties involved in the transaction. To avoid implicating these rules, many funds limit investments by benefit plan investors. As a result, most fund managers will generally not be considered a fiduciary under ERISA or the Code with respect to actual investment activity – even though they possess discretionary management authority over fund assets.

Nonetheless, fund managers can now be considered fiduciaries under the final regulation with respect to activities that occur before the investment takes place and regardless of the limitations placed on investments by benefit plan investors. As you are aware, private funds are required under applicable securities laws to provide certain disclosures to prospective investors and such materials may contain statements that are considered to be investment advice under the final regulation. Furthermore, fund managers may have discussions with prospective investors prior to the actual investment. While the fund manager may have no control over whether the benefit plan investor actually makes the investment in the fund, these communications can rise to the level of a "recommendation" under the final regulation. The result is that the fund manager will be considered a fiduciary with respect to such recommendation. Because of these new restrictions, fund managers should make sure that they do not make an actual recommendation to invest in a fund, and in particular, with respect to participants in self-directed retirement plans or owners of individual retirement accounts, make a recommendation as to whether to invest through such plan or account, on the one hand, or a taxable account on the other.

While certain marketing efforts are specifically exempt from the purview of the final regulation, the determination of whether a communication is exempt will generally be based on the surrounding facts and circumstances, and it will be the fund manager that has the burden of proving that an exception from the final regulation applies. Accordingly, to the extent possible, fund managers should consider relying on a regulatory exemption for advice provided to "sophisticated investors." While this exemption is not available for investments made directly by participants in self-directed retirement plans or owners of individual retirement accounts, it can provide a blanket of protection to the fund manager with respect to communications with other benefit plan investors.

In order to satisfy the exemption for "sophisticated investors," the benefit plan investor must be represented by an independent fiduciary, which itself must be a bank, insurance company, registered investment adviser, registered broker-dealer, or an investment manager with at least $50 million in assets under management. The fund manager is required to inform the independent fiduciary that it is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction. The fund manager must also inform the independent fiduciary of the existence and nature of the manager's financial interests in the transaction. Further, the fund manager is not permitted to receive a fee or other compensation for the provision of advice in connection with the transaction. Finally, the fund manager must know or believe that the independent fiduciary is a fiduciary under ERISA and/or the Code with the responsibility to exercise independent judgment in evaluating the transaction and the capability to evaluate the investment risks. Importantly, the fund manager can rely on the written representations of the fiduciary for these purposes. By satisfying this regulatory exemption, the fund manager may communicate directly with the independent fiduciary of the benefit plan investor without concern that it will be considered a fiduciary with respect to such communications.

While enforcement of certain conditions of the prohibited transaction exemptions that were issued simultaneously with the final regulation has been delayed until January 1, 2018, the final regulation is currently applicable. The DOL has indicated that persons who are now considered fiduciaries under the final regulation are required to act in good faith compliance with respect to the provision of investment advice provided on and after June 9, 2017. Although the DOL is not expected to pursue enforcement activity prior to January 1, 2018, we recommend that fund managers consider taking the following actions immediately to limit their potential liability exposure and to evidence their good faith compliance with the final regulation:

- Revise private placement memorandums and subscription documents to incorporate statements disclaiming the provision of investment advice to benefit plan investors,
- Adopt universal policies regarding permissible marketing and promotional activities, and
- Require written representations of independent fiduciaries to satisfy regulatory exemption.

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