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Labor Department Redefines 'Fiduciary' for ERISA and Internal Revenue Code Purposes

On April 6, 2016, the Department of Labor (DOL) issued a widely anticipated final regulation that redefines who is a "fiduciary" of certain employee benefit and other plans for purposes of the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (Code). The regulation greatly expands the scope of fiduciary status. The DOL also issued several new and revised exemptions from the prohibited transaction rules of ERISA and the Code that otherwise would limit the ability of a fiduciary and its affiliates to receive compensation from or otherwise engage in transactions with plans.

The new rules are perhaps of most interest to — and will have the greatest effect on the businesses of — individuals and entities that provide services to individual retirement accounts and individual retirement annuities (IRAs). As explained below, however, because the rules fundamentally change how fiduciaries of all types of plans are identified, all service providers to plans should familiarize themselves with the regulation and determine whether any change to their existing business practices is warranted.

This alert does not attempt to describe the new rules in detail. Instead, it is intended to familiarize readers with the nature of the new rules so that they can begin to evaluate whether there is a need to consider the application of the rules to their particular circumstances.

While the new fiduciary definition does not become effective until April 10, 2017, those providers who will now first be treated as a fiduciary will need considerable time to evaluate the new rules and the extent to which changes in business practices should be made, and those who already are fiduciaries under the existing rules will want to evaluate the effect of the new prohibited transaction exemption relief.

Background

The DOL has authority to issue regulations regarding fiduciary status under employee benefit plans that are subject to ERISA as well as any plan that is subject to Section 4975 of the Code. These include certain types of arrangements that are not subject to ERISA such as IRAs, Archer medical savings accounts, health savings accounts and Coverdell education savings accounts (for simplicity, collectively called "plans" in this alert).

The existing DOL regulation addressing fiduciary status was issued in 1975 and established a five-factor test. Unless the party satisfied each factor, it was not treated as a fiduciary under ERISA or the Code and thus was not subject to the fiduciary duty requirements imposed under ERISA (including its prohibited transaction restrictions) or the generally similar prohibited transaction restrictions under the Code. In enacting its new regulation, the DOL noted that the investment advice marketplace has evolved greatly since 1975, which was before the advent of participant-directed 401(k) plans or the widespread use of IRAs, and that the existing regulation inappropriately shielded too many advisers from fiduciary liability in this new landscape.

New Standard for Fiduciary Status

Making a 'Recommendation'

Under the new regulation, a person generally can become a fiduciary if they provide the following types of "recommendations" to a plan in exchange for a direct or indirect fee or other compensation:

- a recommendation as to the advisability of acquiring, holding, disposing of or exchanging, securities or other investment property, or a recommendation as to 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.
- a recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (*e.g.*, brokerage versus advisory) or recommendations with respect to rollovers, distributions or transfers from a plan (including whether, in what amount, in what form and to what destination such a rollover, transfer or distribution should be made).

Subject to certain exceptions described below, any person who provides such a recommendation will be a fiduciary under the new regulation if they (i) represent or acknowledge that they are acting as a fiduciary, (ii) render the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient, or (iii) direct the recommendation to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of a plan.

What Is 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 regulation goes on to provide a nonexhaustive list of examples of communications that generally will not be treated as recommendations for purposes of the regulation (called "carve-outs" under the regulation as proposed, a term the DOL expressly disavowed in the final regulation). Among these are:

- general communications and commentaries on investment products such as financial newsletters;
- certain activities and communications in connection with marketing;
- making available a platform of investment alternatives that a plan fiduciary could choose from; and
- the provision of information and materials that constitute investment education or retirement education.

With respect to investment education in particular, the final regulation expressly describes in detail four broad categories of nonfiduciary educational information and materials, including (i) plan information, (ii) general financial, investment and retirement information, (iii) asset allocation models, and (iv) interactive investment materials.

Moreover, there are certain activities that will not be treated as recommendations even if they otherwise would be treated as such under the general rule, including communications in arm's length transactions with certain plan fiduciaries who are licensed financial professionals (for instance, broker-dealers, registered investment advisers, banks and insurance companies) or plan fiduciaries who have at least $50 million under management.

Prohibited Transaction Relief

ERISA and the Code each identify transactions between a plan and a fiduciary (among other persons) that are prohibited absent a statutory or administrative exemption. Such nonexempt transactions are subject to potentially substantial penalties. For example, absent an applicable exemption, the receipt of a fee from a plan by a fiduciary or its affiliates, or the sale of products to a plan by a fiduciary or its affiliates, might be prohibited. The expanded scope of the fiduciary definition will cause additional parties to need exemptive relief to enter into transactions with plans — for instance, broker-dealers who may now for the first time be considered a fiduciary with respect to an IRA.

As part of its package of new rules, the DOL made available new and revised administrative exemptions that it said are intended to "broadly permit firms to continue to receive many common types of fees, as long as they are willing to adhere to applicable standards aimed at ensuring that their advice is impartial and in the best interest of their customers." The exemption that has received the most attention, the so-called best interest contract or BIC exemption, is designed to provide conditional relief for common types of compensation, such as commissions and revenue sharing, that an investment adviser might receive in connection with advice to retail retirement investors. Another new exemption, the so-called principal transactions exemption, allows advisers to sell to or purchase from plans certain investments out of their own inventories under certain circumstances (for instance, the sale to an IRA of a proprietary investment fund).

Relief under the new exemptions is subject to many conditions that advisers may find onerous. Moreover, if advice is provided to a non-ERISA plan (such as an IRA), the adviser must agree to adhere to standards of fiduciary conduct and fair dealing in an enforceable contract so as to, in effect, provide the private right of action that already is available to enforce the fiduciary duties imposed under ERISA.

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The new rules are complex and subject to many exceptions and uncertainties. As such, any meaningful advice as to their application will need to be tailored to individual circumstances. Plan service providers who think that they may be affected by the new rules are urged to consult with their legal counsel to determine the impact of the new rules on their obligations and existing business practices.

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