# U.S. Department of Labor's New Fiduciary Rule Now Applies

## Expands definition of investment advice

*By George J. Kasper, J.D., LL.M., Pullman & Comley; Member, CTCPA Employee Benefit Plans Interest Group*

Last year the U.S. Department of Labor (DOL) released a controversial new fiduciary regulation (the "Fiduciary Rule" or "Rule") and related exemptions that impact investment advisers to certain retirement plans, IRAs, and other similar arrangements. The Rule has garnered much attention due to its broad application not only to financial institutions and their advisers, but others who provide services to plan sponsors, participants, and retirement account owners as well. In the midst of ongoing debate, legal challenges, and a directive from President Trump, the DOL delayed the Fiduciary Rule "applicability date" until June 9, 2017.

Under the Employee Retirement Income Security Act of 1974 (ERISA), the term "fiduciary" includes a person who renders "investment advice" to a plan for a fee or other direct or indirect compensation as to any plan assets (or has any authority or responsibility to do so). The Rule expands the definition of "investment advice" and accordingly, the types of providers who are considered to be ERISA fiduciaries. Prior to the new Rule, a person was considered to render "investment advice" only if the advice was provided as to the value of securities or property, or as to the advisability of investing in, purchasing, or selling securities or other property; on a regular basis to the plan pursuant to a mutual agreement or understanding that the advice would serve as a primary basis for investment decisions with respect to plan assets and individualized based on the needs of the plan or individual.

As of June 9, 2017, the Fiduciary Rule's amended definition of "investment advice" replaces the prior definition[1]. Generally, unless an exemption exists, a person is deemed to render investment advice with respect to money or property of a plan or IRA if the person provides to the plan, plan fiduciary, plan participant, or beneficiary, IRA, or IRA owner certain types of recommendations for a fee or other compensation.

Investment advice is now defined in terms of "recommendations" that include a recommendation as to the advisability of acquiring, holding, disposing of, or exchanging securities or other property, or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from a plan or IRA. Investment advice also includes recommendations as to the management of securities or other investment property including recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice; and recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such rollover, transfer, or distribution should be made.

According to the Rule, "recommendation" means "a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice re- ▶

[1] See the DOL's recently published Fiduciary Rule *Conflict of Interest FAQs (Transition Period)* (the "FAQs).

(continued)

cipient engage in or refrain from taking a particular course of action." Recommendations are treated as investment advice when rendered pursuant to a written or verbal agreement, or understanding that the advice is based on the particular needs of the recipient; or directed to a specific person or persons regarding the advisability of an investment or management decision with respect to securities or other investment property of the plan or IRA.

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Although the Rule is directed primarily toward broker-dealers and their financial institutions, affiliates, and related entities, it applies regardless of an adviser's status as an investment adviser or broker under the federal securities laws. Fiduciary status now applies more broadly to anyone who provides a "recommendation" about plan investments to plan sponsors or participants, and owners of 401(k) and IRA plans for a fee. Such recommendations may include advice as to plan investment fund options, whether to elect a rollover or other distribution from a plan or IRA, and the management of plan or IRA investments.

The DOL regulations also specify scenarios that are not considered to be investment advice for purposes of the Rule. For instance, the issuance of valuations and appraisals for employee benefit plans are not covered by the Rule. Further, investment advice does not include general financial, investment, and retirement information, certain asset allocation models, and interactive investment materials. Also, a person is not an investment advice fiduciary if, in their capacity as an employee, they provide advice to a plan fiduciary, or to an employee or independent contractor of a plan sponsor, so long as the person does not receive a fee or other compensation in connection with the advice beyond the employee's normal employment compensation. The Rule also includes a "hire me" exception, which allows advisers to recommend that a customer hire them to provide advisory or asset management services without becoming a fiduciary.

The Fiduciary Rule applies to ERISA-governed plans, plans that are tax-qualified under Section 401(a) of the Code, and plans covered by Section 4975 of the Code, as well as to the participants in, or owners of, such plans. Thus most 401(k) plans, profit sharing plans, ESOPS, and most money purchase and defined benefit pension plans are covered, unless they fall into an excluded category (see below). 401(k) plans that benefit only self-employed individuals, SEPs, and SIMPLEs are covered plans. Section 403(b) plans that are subject to ERISA are also covered – this includes 403(b) plans sponsored by private tax-exempt entities other than non-electing church plans.

The Rule also covers traditional IRAs and Roth IRAs (including payroll-deduction-only IRAs), as well individual retirement annuities and HSAs. Archer medical savings accounts (MSAs) and Coverdell education savings accounts are also covered.

The Rule does not impact non-ERISA plans such as government plans, payroll-deduction-only 403(b) plans, and non-electing church plans. Other retirement savings vehicles not covered include non-qualified deferred compensation plans and non-qualified equity based compensation arrangements, as well as 457(b) and 457(f) plans (deferred compensation plans that can be sponsored by government and private tax-exempt employers). Traditional Uniform Gifts/Transfers to Minors Accounts and 529 college savings plans are also not impacted by the Rule.

ERISA fiduciary status requires that providers of investment advice act with prudence, solely in the interest of the plan participants, and for the exclusive purpose of providing benefits to the participants and defraying reasonable expenses of administering the Plan. Accordingly, they cannot act for their own benefit or in their own self-interest, such as using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA[2]. Failure to act in accordance with the ERISA standard of conduct or engaging in self-dealing or

[2]This precludes variable compensation arrangements in connection transactions involving plans and IRAs – such as revenue sharing schemes and commissions received by broker-dealers and insurance agents.

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*Considering its significant disruption, opposition within the industry and within Congress, and the ongoing DOL review of the Rule, changes to the Rule may be on the horizon.*

conflicts of interest can expose fiduciaries to claims by plan sponsors, participants, and IRA owners, as well as the DOL for breach of fiduciary duty and liability for losses caused by the breach.

In addition, ERISA prohibits certain transactions ("prohibited transactions") between plans and fiduciaries that jeopardize plans' security due to conflicts of interest. The receipt of compensation from plan assets and from certain third parties can implicate these rules. Briefly, ERISA prohibits among other activities, the "transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan."

To avoid engaging in a prohibited transaction, investment advisers must structure their compensation arrangements in a manner that does not involve a conflict of interest or self-dealing or they must rely on an exemption. In conjunction with its issuance of the Fiduciary Rule, the DOL also issued two new prohibited transaction exemptions[3] for certain insurers, financial institutions, their affiliates and related entities, and modified certain existing exemptions. The requirement to satisfy several conditions for these exemptions has been delayed on a transition period that currently ends on January 1, 2018.

More information about the exemptions can be found on the DOL website at www.dol.gov.[4]

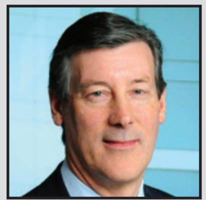
[3]The new exemptions include the Best Interest Contract Exemption (the "BIC Exemption") and the Principal Transactions Exemption

[4]https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2

The Fiduciary Rule has significant impact on providers and recipients of financial/investment advice. Although the most drastic effects of the Rule will be felt by financial institutions, it also impacts other plan advisors and service providers.

Many agree with the DOL's objective of protecting the retirement assets and the best interests of plan participants and account owners. However, implementation of the Rule has caused significant burdens for plan service providers and particularly complex compliance hurdles for financial institutions and broker-dealers.

Considering its significant disruption, opposition within the industry and within Congress, and the ongoing DOL review of the Rule, changes to the Rule may be on the horizon, including a possible extension of the transition period beyond January 1, 2018.



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