Bloomberg BNA

Pension & Benefits Daily ™

Reproduced with permission from Pension & Benefits Daily, 119 PBD, 6/22/15. Copyright © 2015 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

View From McDermott: DOL Re-Proposes Regulations to Expand ERISA 'Fiduciary' Definition

By Joseph K. Urwitz and Brian J. Tiemann

The U.S. Department of Labor (the "DOL") issued proposed regulations on April 14, 2015 that would expand the types of investment advice covered by fiduciary protections under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and the Internal Revenue Code of 1986, as amended (the "Code").[1] The proposed regulations would require advisers to ERISA-governed retirement plans and individual retirement accounts ("IRAs") to act as "fiduciaries" within the meaning of ERISA and the Code, subject to certain carve-outs identified by the DOL for non-fiduciary adviser services. Advisers that become fiduciaries under the proposed regulations would be subject to ERISA fiduciary duties and prohibited from engaging in certain non-exempt transactions. The proposed regulations are accompanied by two new class prohibited transaction exemptions and amendments to several existing class exemptions, which recognize the expanded scope of ERISA's fiduciary protections under the proposed regulations while allowing advisers to continue certain types of transactions and existing fee arrangements that would otherwise be prohibited for ERISA fiduciaries.[2] While the proposed regulations likely would have the greatest impact on the IRA marketplace, advisers to plan sponsors, and therefore plan sponsors themselves, are likely to be impacted. Comments on the proposed regulations are due by July 21, 2015.

Joseph K. Urwitz (jurwitz@mwe.com) and Brian J. Tiemann (btiemann@mwe.com) are partners in the law firm of McDermott Will & Emery LLP. Both focus their practices on employee benefits and ERISA fiduciary compliance matters for public and private companies and private equity funds. The authors gratefully acknowledge the assistance of their partners, Maureen O'Brien and Todd Solomon.

Existing Regulations and Prior Proposed Regulations

ERISA Section 3(21)(A) provides:

a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsi-

[1] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21928 (Apr. 20, 2015).

[2] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (Apr. 20, 2015); Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21989 (Apr. 20, 2015); Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 80. Fed Reg. 22004 (Apr. 20, 2015); Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters, 80 Fed. Reg. 22010, (Apr. 20, 2015); Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTE 75-1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 80 Fed. Reg. 22021 (Apr. 20, 2015); Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1, 80 Fed. Reg. 22035 (Apr. 20, 2015).

bility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.[3]

The DOL issued regulations in 1975 to define for ERISA fiduciary purposes the circumstances under which ''investment advice'' is provided.[4] The IRS issued virtually identical regulations under the Code.[5] Under the existing DOL regulations, a person engaged to provide investment advice to a benefit plan is considered a fiduciary for ERISA purposes if:

- he or she renders advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property;
- he or she renders the advice on a regular basis;
- the advice is provided pursuant to a mutual agreement;
- the advice serves as a primary basis for investment decisions; and
- the advice is individualized to the needs of the plan, a plan fiduciary or a participant or beneficiary.

[6] If a person does not satisfy all five of these criteria, he or she is not considered a fiduciary for ERISA purposes and is therefore shielded from the potential substantial liability that fiduciary status imposes under the law.

In 2010, the DOL proposed a substantially expanded ''fiduciary'' definition in response to concerns that the five-part test under the existing regulations did not adequately protect ERISA plans, their participants, and beneficiaries because the test allowed investment advisers to avoid being fiduciaries for technical reasons.[7] In addition, the 2010 proposed regulations were intended to address the shift away from traditional defined benefit plans to participant-directed defined contribution plans and IRAs. IRAs are not covered by fiduciary protections of the existing regulations. The proposed regulations would have eliminated requirements that the advice be rendered on a regular basis or pursuant to a mutual agreement. Any advice considered in connection with investment decisions would have been covered, thereby eliminating the ''primary basis'' element of the existing regulations.

The DOL received significant commentary in opposition to the 2010 proposed regulations, much of which emphasized potential unintended consequences of the changes. In response to the commentary, the DOL withdrew the proposed regulations in 2011 and indicated the regulations would be re-proposed. The re-proposed regulations were issued on April 14, 2015.

Re-Proposed Regulations

The proposed regulations would eliminate the five-part test under the existing regulations and provide that an investment adviser is a fiduciary if he or she (i) provides investment or investment management recommendations or appraisals to an employee benefit plan, fiduciary, participant or beneficiary or to an IRA or IRA owner and (ii) either acknowledges the fiduciary nature of his or her acts or provides the advice pursuant to an agreement to provide individualized advice for consideration in making investment or management decisions regarding plan or IRA assets.[8] The new definition applies both for purposes of benefit plans subject to ERISA and to IRAs, which are subject to parallel provisions under the Code.

Recognizing that the proposed regulations would sweep in certain types of adviser activities that are nonfiduciary in nature, the DOL created several carve-outs for advisers that will not become ERISA fiduciaries unless the adviser otherwise acknowledges its fiduciary status. These carve-outs are subject to conditions specified in the proposed regulations which are intended to differentiate between fiduciary and non-fiduciary activities. The carve-outs include the following:

- **Plan or IRA Counterparties:** Statements or recommendations provided to an ERISA fiduciary of a plan with 100 or more participants or an ERISA fiduciary responsible for managing at least $100 million in plan assets with regard to an arm's length transaction with a third party;
- **Swap Transactions:** Advice and communications on certain ''swap'' arrangements that are regulated under the Securities Exchange Act or the Commodity Exchange Act;
- **Employees:** Statements or recommendations provided to a plan fiduciary by an adviser who is an employee of the plan sponsor if the adviser receives no fee beyond his or her normal compensation;
- **Platform Providers:** A platform of investment alternatives provided to a plan fiduciary for a participant-directed individual account plan and determined without regard to the individual needs of the plan or its participants and beneficiaries;
- **Selection and Monitoring Assistance:** Investment alternatives identified based on objective criteria specified by a plan fiduciary or objective financial data provided to such fiduciary;
- **Financial Reports and Valuations:** Appraisals, fairness opinions or statements of value provided with respect to an employee stock ownership plan, a collective investment vehicle holding plan assets or a plan to satisfy reporting and disclosure requirements; and
- **Investment Education:** Information and materials that constitute ''investment education'' or ''retirement education.''

ERISA Fiduciary Duties and Prohibited Transactions

Advisers that become ERISA fiduciaries under the proposed regulations would become subject to the same duties that ERISA imposes on other plan fiduciaries, including duties to act prudently and solely in the interest

[3] 29 U.S.C. § 1002(21)(A).

[4] 29 C.F.R. § 2510.3-21.

[5] Treas. Reg. § 54.4975-9(c).

[6] 29 C.F.R. § 2510.3-21(c)(1)(ii)(B).

[7] Definition of the Term ''Fiduciary'', 75 Fed. Reg. 65263 (Oct. 22, 2010).

[8] Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21928, 21957-21959 (Apr. 20, 2015).

of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them. In addition, ERISA fiduciaries are prohibited from engaging in certain transactions specified under ERISA, unless the fiduciary satisfies the requirements of an applicable statutory, class or individual exemption.

A fiduciary that breaches its duties or engages in a non-exempt prohibited transaction is personally liable for any losses to the plan resulting from the breach and faces disgorgement of any profits the fiduciary obtains through the use of plan assets. The fiduciary likely will incur significant civil penalties and excise taxes, as well as possible criminal consequences.

Because advisers would become subject to the fiduciary duty and prohibited transaction requirements under the proposed regulations, the proposed regulations are accompanied by two new class prohibited transaction exemptions and amendments to several of the existing class exemptions. The new exemptions are as follows:

- **Proposed Best Interest Contract Exemption.**[9] This proposed exemption would apply only to advisers of individual plan participants, IRA owners and small plan ERISA fiduciaries. The exemption would allow such advisers to receive compensation that otherwise would be prohibited under ERISA if the adviser fully discloses the terms of the compensation to the plan and notifies the DOL in advance of its intention to rely on this exemption. To qualify for the exemption, the adviser must enter into a written contract under which the adviser: (i) acknowledges his or her fiduciary status; (ii) agrees to comply with certain standards for impartial conduct, (iii) warrants that it will comply with applicable laws and has adopted written policies and procedures to mitigate any material conflicts of interest, and (iv) discloses material conflicts of interest and advises on the availability of complete information regarding its fees.

- **Proposed Principal Transaction Exemption.**[10] This proposed exemption would allow advisers to recommend certain debt securities to a plan, participant or beneficiary accounts or IRA and sell such securities out of the adviser's inventory. The exemption would require the same contract disclosures required as part of the proposed best interest contract exemption. The transaction must occur at a price that is at least as favorable to the plan or IRA as two quotes obtained from unaffiliated counterparties. In addition, the adviser is required to disclose its expected profits from the transaction.

Relevance to IRA Advisers. IRA advisers often charge clients fees, including revenue-sharing fees and marketing and distribution fees (so-called ''12b-1 fees''), which are permitted for non-fiduciaries but not fiduciaries absent a prohibited transaction exemption. While the proposed best interest contract exemption would allow IRA advisers to continue charging such fees, the IRA adviser would be subject to the onerous disclosure and contracting requirements of the exemption. In addition, the IRA adviser would have to agree in writing that it is subject to the ERISA duties of prudence and loyalty, which would make the IRA adviser vulnerable to breach of contract claims by IRA owners for alleged breaches of these duties.

Relevance to Plan Sponsors. Plan sponsors will need to consider the extent to which information provided to participant or communications with participants is non-fiduciary investment education or whether it constitutes individualized investment advice that would make the adviser an ERISA fiduciary. An investment adviser to an ERISA-governed retirement plan with a private adviser feature might separately become a fiduciary to plan participants under the proposed regulations. A plan adviser who also provides individualized advice to participants likely is not a fiduciary under the existing regulations either because such advice is not provided on a regular basis or is not the primary basis on which investment decisions are made. Under the proposed regulations, such individualized advice likely will render the adviser a fiduciary to participants, potentially resulting in higher fees charged to plans with this feature in order to compensate the adviser for the increased exposure as a fiduciary.

Comment Period and Effective Date. The DOL initially asked for comments on the proposed regulations by July 6, 2015, but later extended the deadline by 15 days to July 21, 2015. The DOL expects to hold a public hearing on the proposed regulations within 30 days after the close of the comment period. The comment period will be reopened for an additional 30 to 45 days after the public hearing.

The proposed regulation will become effective 30 days after the DOL publishes the final regulations in the Federal Register. However, the final regulations will not become applicable for an additional eight months following publication in order to allow current agreements and arrangements to be brought into compliance with the final regulations.

[9] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (Apr. 20, 2015).

[10] Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21989 (Apr. 20, 2015).