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Some FAQ News Under ERISA - The DOL Issues Two More Sets of "Investment Advice" Q&As

Authored by Andrew L. Oringer, Susan M. Camillo and Young Eun Lee

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The U.S. Department of Labor (the "DOL") released two additional sets of FAQs on January 13, 2017 regarding the new "investment advice" regulation and related exemptions (the "Rule") under the fiduciary provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). The Rule, adopted in 2016, is currently scheduled to become applicable on April 10, 2017. The Rule would apply to a wide range of retirement investors, including individual retirement accounts ("IRAs") and other plans that may not be subject to ERISA.

Dechert previously published an in-depth discussion of the Rule in a May 2016 OnPoint, and followed that with six additional OnPoints on industry-specific or other particular aspects of the Rule.[1] As we have suggested in our December 2016 OnPoint regarding the Rule, the recent election has drawn into question the survival of the Rule as revised by the DOL. It is clear, however, that the DOL, in preparing and releasing the two sets of January FAQs, is proceeding on the basis that the Rule will become effective as presently scheduled.

This OnPoint summarizes certain aspects of both sets of January 13, 2017 FAQs. The set of FAQs captioned as "Consumer Protections for Retirement Investors - FAQs on Your Rights and Financial Advisers" (the "Consumer Protection FAQs") is less substantive and more directed at general considerations for the ultimate retirement investor. These FAQs include as an exhibit a list of potential questions for the retirement investor to ask his or her provider of financial services. The set of FAQs captioned as "Conflict of Interest FAQs (Part II - Rule)" (the "COI FAQs") supplements the DOL's October 27, 2016 FAQs regarding various exemptions issued in connection with the amended fiduciary regulation.[2] The COI FAQs are more technical than the Consumer Protection FAQs, and address a series of specific interpretive issues arising under the amended regulation.

I. FAQs Relating to Consumer Protection

Certain of the discussion in the Consumer Protection FAQs appears to restate the DOL's justification for adopting the Rule. There are a number of general policy statements, and in some cases the DOL's discussion arguably has

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[1] *See* the following Dechert OnPoints:

- The New DOL Fiduciary Rule: Impact on Mutual Fund Distribution
- Navigating the DOL's New Fiduciary Rules: A Game Plan for Broker-Dealers
- Mutual Fund Sales by Intermediaries – Fall-Out from DOL Fiduciary Rule and FINRA Enforcement
- The DOL Issues "Investment Advice" FAQs – Continues to Try to Find an Ideal Balance for the Brave New Fiduciary World
- DOL "Investment Advice" FAQs: Considerations for Investment Advisers, Broker-Dealers and Insurance Companies
- Has the Fiduciary Worm Turned? Freedom Caucus Targets the New ERISA "Investment Advice" Regulation

[2] The October 27, 2016 FAQs were fashioned as comprising "Part I" of the DOL's FAQ initiative regarding the Rule; thus, the COI FAQs are fashioned as "Part II."

political overtones possibly intended to position the Rule for continued survival in the new administration. For example:

- The very title of the Consumer Protection FAQs refers to "consumer protections."
- The introduction to the Consumer Protection FAQs states -

  > Financial companies often pay advisers more to promote certain products rather than to recommend what is best for their customers. That incentive creates what is known as a *conflict of interest* [emphasis in original]. And conflicts of interests sometimes can cause advisers to give bad advice.

- In Dechert's May 2016 OnPoint, it was noted that the practical effect of the Rule could possibly extend beyond covered retirement accounts, to accounts over which the DOL has no jurisdiction (not even interpretive jurisdiction) whatsoever.[3] Now, in Q&A 19 of the Consumer Protection FAQs, the DOL seems to be positioning the Rule as a basis on which pressure may be placed on providers to follow the principles of the Rule even where the Rule clearly has no application, as follows -

  > [T]he best interest standard and other significant consumer protections offered under the Department of Labor's Rule and exemptions only apply to retirement accounts in ERISA plans (like 401(k) plans) and IRA accounts where you are building up savings for your future retirement. An investor can always ask an adviser whether the adviser will live by the fiduciary "best interest" standard in the Department of Labor Rule and exemptions for all investments – and if they will not, can consider finding one who does.

In addition, there are Consumer Protection FAQs that are more specifically directed to particular elements of the Rule. A number of the Q&As clarify that the Rule doesn't affirmatively require providers to stop current practices, and indicate that the decision as to whether to continue existing practices is in the hands of the provider. For example –

- Q&A 11 states that the Rule does not prohibit the receipt of commissions and does not require a shift to an asset-based fee, and Q&A 22 states that the Rule does not require that an IRA be switched from a "non-advisory" account involving commissions for each transaction to an "advisory" account under which the IRA owner would pay an annual fee based on the assets in the IRA. Q&A 18 puts the issue starkly, stating, "Do not believe any adviser who tells you, however, that the Rule prohibits commission-based advice, or that it requires you to enter into an asset-based fee arrangement." In this regard, the DOL may be technically correct that the Rule may allow for current business practices to be continued as outlined in the above-referenced Q&As. However, as a practical matter, the steps that might have to be undertaken by the provider in order to continue current practices may sometimes require changes to the provider's programs that are not feasible or desirable from a business perspective. In situations of that type, the provider may be pushed to abandon current practices or types of clients, raise prices or, possibly, even exit the market.

[3] *See* The Brave New Fiduciary World Has Arrived – The DOL Tries to Find a More Ideal Balance in the Final "Investment Advice" Rules, § V(F)(2).

- Q&A 23 clarifies that the Rule does not “restrict the investments you can hold in your IRA.” However, the DOL does not address the Rule’s unintended consequence of prompting providers to eliminate certain types of product offerings.

- Q&A 24 confirms that the Rule does not prevent a broker from simply following directions to buy or sell a security (or cause a broker to be a fiduciary when doing so). “There is nothing in the Rule . . . that require a change in the commissions the broker charges for just executing an order.”

It is also noted that the Consumer Protection FAQs repeatedly characterize the Rule as setting forth requirements potentially applicable to providers of fiduciary services to retirement accounts, expressly referring in many cases to IRAs. However, in the case of services that are provided to an IRA (or another non-ERISA plan), a provider that proceeds on the basis that it is not a fiduciary will generally not be at risk for being in violation of applicable substantive law by virtue of the Rule, and the IRA owner (or participant in another non-ERISA plan) will not have a fiduciary claim under the Rule that the provider engaged in prohibited self-dealing. The risk under the Rule regarding services to an IRA by a provider taking the position that it is not a fiduciary is generally confined to the possibility that excise taxes might apply. (In particular, there could be an excise-tax risk if, despite the provider's assertion that it was not a fiduciary, the provider was indeed a fiduciary and in a fiduciary capacity engaged in prohibited self-dealing.)[4]

II. FAQs Relating to the Fiduciary Regulation

A. General Structure of the Rule

As indicated above, the COI FAQs are generally more substantive and technically oriented than the Consumer Protection FAQs. The following is a discussion of some of the FAQs included in the COI FAQs.

Q&A 1 helpfully states in stark terms, "As a threshold issue, the communications must be a 'recommendation' to be fiduciary investment advice."[5] If a communication does not rise to the level of being a recommendation, it cannot constitute fiduciary advice under the Rule.

In addition, even if there is a recommendation, the recommendation will not be covered investment advice unless it is for a "fee or other compensation.” Q&A 1 confirms that, for these purposes, the scope of what could constitute a "fee or other compensation" is extremely broad:

> [“Fee or other compensation” for these purposes] includes both any explicit fee or compensation for the advice which is received by the adviser (or by an affiliate) from any source, as well as any other fee or compensation received from any source in connection with or as a result of the recommended transaction or service, including such things as commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to firms in return for shelf space, recruitment compensation, gifts and gratuities, and expense reimbursements.

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[4] Principles like these were also addressed in Section V(F)(1) of our OnPoint, The Brave New Fiduciary World Has Arrived – The DOL Tries to Find a More Ideal Balance in the Final “Investment Advice” Rules.

[5] This point was emphasized in Section IV(B) of our OnPoint, The Brave New Fiduciary World Has Arrived – The DOL Tries to Find a More Ideal Balance in the Final “Investment Advice” Rules, and the DOL has now refocused on this basic principle.

Great care should be taken before a provider proceeds as a non-fiduciary solely on the basis that it is not receiving any fee or other compensation.

On the other hand, however, Q&A 10 indicates that a person making a recommendation must receive a fee or other compensation, so that, in the example presented, an employer can recommend that a plan participant increase contributions to maximize an employer match without being treated as providing fiduciary advice where the employer does not receive any compensation. Furthermore, Q&A 12 provides that the mere receipt of fees for providing educational services does not change a communication that is solely educational into a fiduciary investment recommendation. In addition, Q&A 14 makes clear that a person may have two distinct roles, one of which is fiduciary in nature while the other is not. Q&A 29 clarifies that the DOL would not treat a fee paid between financial intermediaries as a direct fee for investment advice for purposes of the independent fiduciary exception unless the fee is paid directly by the plan.

On the topic of what constitutes a recommendation generally, the DOL clarifies in Q&A 6 that an adviser is not responsible or liable for investment decisions made by its client against the adviser's recommendation.

B. Exception for Communications with Independent Fiduciaries with Financial Expertise

A key exception in the fiduciary regulation is the exception for dealing with investors represented by independent fiduciaries with financial expertise. The COI FAQs clarify certain basic applicable provisions.

Q&A 20 restates the rule that the US$50 million threshold for assets under the fiduciary's management or control (where applicable) can be satisfied if the aggregate assets of multiple clients equal or exceed the US$50 million. While this result may have been evident on the face of the regulation, Q&A 20 helpfully goes on to indicate that a company's proprietary money may be taken into account, stating: "The same [favorable] conclusion would apply in the case of chief financial officer of a company that is a plan fiduciary with management or control of a company plan that has US$42 million in total assets and who also is responsible for management of US$10 million in cash and securities held in the company's treasury department."

There are other helpful confirmations. For example, the COI FAQs confirm that a party's reasonable belief regarding a fiduciary's "independent" status can be based on representations from the fiduciary (Q&A 21), the exception applies to communications (including recommendations) with respect to entering into investment advisory or investment management arrangements as well as with respect to transactions that involve investments (Q&A 22), the exception applies to communications with representatives of a registered investment adviser (Q&A 23), and a corporate officer who is a participant in a company's plan and a member of the plan's fiduciary committee may be an "independent plan fiduciary" for these purposes if the officer's job responsibilities include managing the requisite US$50 million in assets (Q&A 27).

Not all of the guidance is favorable from the perspective of providers. For example, Q&A 26 reconfirms that an IRA owner (or relative thereof) cannot be the independent fiduciary for these purposes. The Department repeated its previously expressed view "that merely concluding someone may be wealthy enough to be able to afford to lose money by reason of bad advice should not be a reason for treating advice given to that person as non-fiduciary."

C. Marketing Platforms and Investment Monitoring

The fiduciary regulation has a rule under which a person can market or make available to an independent plan fiduciary a platform or similar mechanism from which the fiduciary may select or monitor plan investment alternatives for an individual account plan, without making a fiduciary recommendation, as long as the marketing is conducted without regard to the individualized needs of the plan and the other applicable conditions are met. Similarly, a person who identifies investment alternatives for such a platform based on objective criteria specified by the plan fiduciary does not make a fiduciary recommendation as long as the person sets forth in writing certain disclosures to the fiduciary.

The DOL has provided some additional clarifications regarding the marketing and monitoring rules. For example, the COI FAQs confirm that a group annuity contract can constitute a “platform or similar mechanism” for these purposes (Q&A 30), a recordkeeper can rely on the provision relating to platform providers to make available to plans a third party’s platform of investment options for which it provides recordkeeping services (Q&A 32), and certain automated cash-sweep services, where the sweep is made pursuant to a client’s standing directions and where the client selects the sweep investment vehicle from a limited list of options, do not involve fiduciary advice (Q&A 34).

D. Wrap Fees

There may be some confusion in the market regarding wrap-fee arrangements. Q&A 7 helpfully reconfirms and clarifies that an adviser does not engage in a non-exempt prohibited transaction if it receives an asset-based fee for providing advice regarding mutual funds available on a plan's platform, even if the firm receives revenue sharing or other payments as a result of plan investments in the mutual funds recommended by the adviser, so long as the firm discloses to the plan the extent to which it may receive such fees and expressly provides that any fees received as a result of the plan’s investment in such mutual funds will be used to pay all or a portion of the compensation that the plan is obligated to pay to the adviser.[6] The plan would have to be entitled to any such fees that exceed the plan’s liability. The fees in question can include 12b-1 fees, sub-transfer agency fees and other third-party compensation. The DOL specifically stated that "a prohibited transaction would not arise as a result of the adviser affecting the amount or timing of its compensation to the extent that the adviser appropriately offsets against its [asset-based] advisory fee any fully disclosed 12b-1 fees, sub-transfer agency fees, or other third-party payments."

E. Plan Information and Call Centers

The COI FAQs provide comfort that certain basic information is generally not fiduciary in nature. One example, in Q&A 5, provides comfort that a plan sponsor’s informing a participant that the participant may be subject to an automatic rollover or other cash-out will generally not be a fiduciary act.

There are also a number of Q&As that appear designed to provide comfort to employers that behavior at a call center does not rise to the level of fiduciary activity (and instead would constitute investment education). For example, the DOL expressly clarified that an annuity provider’s call center may generally provide a factual explanation of a guaranteed lifetime-income feature without having the explanation be fiduciary advice (Q&A 8), and the “investment education” provision in the fiduciary regulation may extend to information provided by a call center about the benefits of increasing plan contributions in order to maximize employer matching contributions (Q&A 9).

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[6] *See also* DOL Adv. Opinion. 97-15A (May 21, 1997).

The DOL indicated its view that basic information regarding plans and plan features in the ordinary course generally might not involve the same kinds of conflicts of interest as those that may affect investment advisers. The clarifications regarding basic plan information and call centers arguably seem consistent with the notion that what the DOL has targeted with the Rule is behavior that raises concerns regarding conflicts of interest, rather than behavior in contexts that do not seem to raise the same types of conflict-type concerns as may be present in other situations of more concern to the DOL.

F. General Communications

Q&A 16 gives some comfort on general presentations at speeches and conferences that are widely attended by retirement professionals. However, Q&A 17 may give some providers some pause as to more targeted dinners and similar meetings, as the DOL repeated its previously expressed position that the DOL "does not consider such free-meal seminars to be widely attended speeches or conferences within the meaning of the general communications provision. Moreover, in the Department's view, a reasonable person attending such a seminar could view statements by the investment adviser as investment recommendations even if the statements were made to all the attendees." Thus, the DOL concluded that "[w]hether the particular communications at the seminar could reasonably be viewed as a suggestion that the advice recipients engage in or refrain from taking a particular course of action (i.e., a recommendation) would be a matter of facts and circumstances."

In Q&A 18, the DOL helpfully concluded that a third-party administrator's recommendation regarding a choice of possible recordkeepers is not generally fiduciary in nature. The DOL stated, "The Rule does not treat a recommendation to hire a non-fiduciary recordkeeper as fiduciary advice, although a recommendation to invest in a particular investment alternative or to hire a third party to serve as an asset manager or adviser would constitute fiduciary advice." The DOL also stated, "Whether the [third-party administrator] made a recommendation regarding available investment alternatives would depend on the facts and circumstances."

Q&A 19 offers some comfort about marketing self-directed brokerage services, including so-called "robo-advice." The DOL stated that engaging in such conduct does not run afoul of the Rule because "[t]he Rule covers the recommendations of others to provide investment advice or investment management services and recommendations on the selection of investment account arrangements (e.g., brokerage versus advisory). Here, the financial institution, through the representative, only recommended itself, not another person . . . ." Importantly, however, the DOL cautioned that, "if the financial institution actually recommends a particular account type or service, that would be a fiduciary investment advice recommendation under the Rule."

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It will be interesting to see if the Rule proceeds under the incoming administration towards actual applicability. If you have any questions regarding the possible future of the Rule, or regarding compliance with the Rule in preparation for the Rule's becoming applicable, please contact one of the authors listed below or any Dechert lawyer with whom you regularly work.

This update was authored by:

Andrew L. Oringer
Partner
New York
+1 212 698 3571
andrew.oringer@dechert.com

Susan M. Camillo
Partner
Boston
+1 617 728 7125
susan.camillo@dechert.com

Young Eun Lee
Associate
New York
+1 212 641 5634
youngeun.lee@dechert.com

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