September 26, 2011

Proposed ERISA Regulations Defining Fiduciary to Be Withdrawn and Modified

By Paul Borden

In a prior client alert, we reported that the Department of Labor (the "DOL") had issued proposed regulations that would have significantly expanded the categories of persons considered fiduciaries to plans that are subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

Amid an outcry from the public and members of Congress over the scope and substance of the proposed regulations, the DOL announced on September 19, 2011 that it would withdraw the current proposed regulations and propose a modified version of the regulations in early 2012. Among the concerns expressed were those of broker-dealers, financial advisers and other financial industry professionals who worried that the new fiduciary standards issued by the DOL conflicted with those issued by the Securities and Exchange Commission ("SEC") under Dodd-Frank, and would reduce choices and increase costs to consumers and plan participants seeking investment advice.[1]

The proposed regulations were issued under ERISA, which subjects fiduciaries to standards of prudence and loyalty to the plans for which they are fiduciaries as well as to conflict of interest rules, referred to as the "prohibited transaction" rules. The proposed regulations would have replaced the current regulations, which define "fiduciary" and which have been in effect for over 35 years. Under the proposed regulations, a person rendering advice to an ERISA plan would have been treated as a fiduciary if (i) the advice was considered investment advice, (ii) the arrangement was one in which the person was considered to be rendering the investment advice to a plan, and (iii) the person received a fee for such advice.

As noted in our prior client alert, some of the more significant changes the proposed regulations would have made were additions to what would be considered "investment advice" for the purpose of establishing fiduciary status, such as (i) real estate appraisals and valuations, (ii) advice given on a one-time or irregular basis, and (iii) advice that *may be* considered in making an investment decision but that does not necessarily serve as the *primary basis* for an investment decision.

The DOL's September 19 announcement provides that the DOL anticipates revising the current proposed regulations, including (i) clarifying that fiduciary advice is limited to individualized advice directed to specific parties, (ii) responding to concerns about the application of the regulations to routine appraisals, and (iii) clarifying the limits of the rule's application to arm's-length commercial transactions, such as swap transactions.

In addition, the DOL said in its announcement that it anticipated that the re-proposed regulations would address the impact of the regulations on current fee practices of brokers and advisers and would clarify the continued applicability of

[1] In a similar vein, Barney Frank, the ranking member of the House Committee on Financial Services wrote to the DOL, asking it to withdraw and re-propose the regulations in coordination with the SEC and the Commodity Futures Trading Commission. In addition, Mr. Frank urged the DOL to modify the regulations to avoid the potentially adverse effects on the choices available to consumers, municipalities and pension plans that he felt could result under the original proposed regulations.

prohibited transaction exemptions which have long been in effect allow brokers to receive commissions in connection with mutual funds, stocks and insurance products.

CONCLUSION

Although the modified regulations are likely to contain many of the provisions that exist in the withdrawn proposed regulations, we are hopeful that a number of concerns expressed by financial institutions and service providers will be addressed. Based on unofficial comments made by representatives of the DOL, we also expect a clarification and expansion of the "seller's exception" to fiduciary status that applies when an adviser communicates to the plan that it is not providing impartial investment advice to the plan, but rather is providing information to the plan in its capacity as a seller or purchaser to or from the plan.

When those regulations are re-issued, financial institutions and service providers, such as broker-dealers, investment managers, consultants, and appraisers should consider evaluating their relationships with employee benefit plans to establish whether they would be considered ERISA fiduciaries under the modified regulations, and, if so, either take steps to ensure their compliance with the requirements of ERISA, or restructure the relationship to avoid such status.

If you have any questions, contact your Morrison & Foerster attorney or any member of the Employee Benefits and Executive Compensation Group.

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