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Final Department of Labor Fiduciary Regulations Under ERISA

By Paul Borden and Hillel Cohn

Earlier this week the Department of Labor (DOL) issued its long-anticipated final regulation (the “Regulation”) defining who is a fiduciary as a result of giving investment advice to plans subject to ERISA, to participants or beneficiaries of these plans, or to IRAs.¹ The Regulation significantly expands the categories of persons considered fiduciaries from the regulation it replaced, which was issued in 1975, but generally relaxes many of the requirements contained in the 2015 Proposed Regulation, which immediately preceded the final Regulation. We will describe the Regulation and exemptions, which cover more than 1,000 pages, in a comprehensive fashion in the near future, but wanted to provide you with this summary of the more significant changes between the 2016 Final Regulation, as well as the Best Interest Contract Exemption (BICE) and the 2015 Proposed Regulation and Proposed BICE.

- **Seller Carve-Out Substantially Expanded.**

Under the 2015 Proposed Regulation the seller’s carve-out was limited to plans with 100 or more participants or plans whose fiduciary had at least \$100 million plan assets under management. Under the 2016 Final Regulation the seller’s carve-out is available with respect to plans or IRAs whose independent fiduciary is (i) a bank, (ii) an insurance carrier qualified in more than one state to perform investment management services, (iii) a registered investment adviser, (iv) a broker-dealer registered under the Exchange Act, or (v) an independent fiduciary that has at least \$50 million under management.

- **BICE Not Limited to Certain Assets.**

The 2015 Proposed BICE limited its application to certain assets, such as bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, listed shares, corporate bonds offered under a registration statement under the Securities Act of 1933, and other assets. Specifically, some assets, such as options and other derivatives, were generally excluded from coverage under the exemption. In the 2016 Final BICE, there are no restrictions on what assets the exemption covers. On reflection, the DOL decided that the other safeguards in place in the exemption, such as the impartial conduct standards, were sufficiently protective to allow the exemption to apply more broadly to all securities and other investment property.

¹ <http://www.dol.gov/ebsa/regs/conflictsofinterest.html>.

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- **BICE Revised to Clarify That Proprietary Products Are Covered.**

Under the 2015 Proposed BICE there was some question as to whether a financial institution's proprietary products could be purchased or sold under BICE, and what the DOL considered to be included within the definition of a proprietary product. The 2015 Proposed BICE defined a proprietary product as one "managed" by the financial institution, which begged the question of whether structured or other notes issued by the financial institution were considered proprietary. The 2016 final BICE clarifies that a financial institution can purchase or sell proprietary products under the BICE, and clarifies the definitional issue by providing that "proprietary product" is a product that is managed, *issued or sponsored* by the financial institution or any of its affiliates. Note that the exemption imposes additional disclosure and other requirements if a financial institution sells only proprietary products.

- **Clarification of What Constitutes an Investment Recommendation.**

One of the components for determining whether a person is a fiduciary is whether that person has given a plan fiduciary or IRA owner an investment "recommendation." The 2016 Final Regulation largely tracks the FINRA definition of what constitutes a "recommendation," focusing on whether, in light of its content, context and presentation, a communication could reasonably be viewed as a suggestion that the investor take a certain action or refrain from taking a certain action. A recommendation can be broadly based and need not consist of a suggestion to buy or sell a specific security, and may relate to an "investment strategy" as well as a specific investment. A recommendation may be made by a person or a software program.

- **BICE Available to Small Plans of All Types.**

Under the 2015 Proposed Regulations, BICE was available only in situations where advice was being given to IRAs, plans where participants make investment decisions (e.g. ERISA Section 404(c) plans) and other plans that had fewer than 100 participants. Under the 2016 Final BICE, relief is still available to IRAs and plans where participants make investment decisions, but replacing the old 100-participant prong is any plan or IRA having a "Retail Fiduciary." A Retail Fiduciary is one that is *not* eligible for the seller's exception (see first bullet above), i.e. a fiduciary that is not a bank, insurance carrier, registered investment adviser, broker-dealer or independent fiduciary having at least \$50 million under management.

- **Written Contract for BICE and Principal Transaction Exemption Not Required for ERISA Plans.**

The 2015 Proposed BICE and Principal Transaction exemption required a written contract between the person seeking to qualify for the exemption and the plan fiduciary or IRA owner. This requirement remains in effect under the 2016 Final BICE and Principal Transaction Exemption only for IRAs and other non-ERISA plans, such as governmental plans, but not plans covered by ERISA, as long as the person seeking coverage under the exemption: (i) provides the ERISA plan investor with a written statement of its fiduciary status, (ii) complies with the impartial conduct standards, (iii) adopts policies and procedures designed to avoid conflicts of interest, (iv) provides certain disclosures and (v) does not in any contract, instrument or communication purport to (a) disclaim any responsibility under ERISA, (b) waive or qualify the right of the retirement investor to bring or participate in a class action against the person or (c) require arbitration or mediation of individual claims in

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locations that are distant or that otherwise unreasonably limit the ability of the ERISA plan investor to assert the claims safeguarded by the exemption.

- **BICE and Principal Transaction Exemption Availability for Existing Clients Can Be Based on Negative Consent.**

As an alternative to executing a written contract as required under BICE and the Principal Transaction exemption with respect to IRA investors and other non-ERISA plans, the financial institution seeking coverage under the exemption may amend contracts existing as of January 1, 2018, by delivering the proposed contract amendment that complies with the BICE or Principal Transaction exemption contract requirements and disclosures to the IRA or other non-ERISA investor prior to January 1, 2018; if the IRA owner does not terminate the amended contract within 30 days, the financial institution can consider such inaction to be consent. If the financial institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, but may not impose any new contractual obligations, restrictions or liabilities on the IRA or other non-ERISA investor by negative consent.

- **BICE and Principal Transaction Exemption Contract Between Broker-Dealer Firm and Client; Don't Need Individual Adviser.**

The DOL was sympathetic to comments questioning the necessity of including individual advisers or registered representatives as parties to the contract entered into between the IRA or other non-ERISA investor and financial institution. Commenters cited logistical issues with having teams of advisers or persons working at call-centers covered under the contract. Based on those objections, the DOL removed the requirement that individual advisers be parties to the contract, as long as the financial institution is a party to the contract and assumes responsibility for advice provided by any of its advisers.

- **BICE Disclosure No Longer Required to Have One-, Five- and 10-Year Projections, Annual Reports, and No Requirement to Adhere to State Laws.**

Under the 2015 Proposed BICE the financial institution was required to provide the plan or IRA investor with a chart providing disclosures, with respect to each asset recommended, regarding the cost (i.e. acquisition, ongoing and disposition costs) to the plan, participant or beneficiary account, or IRA, of investing in the asset for one-, five- and 10-year periods, and certain annual disclosures regarding the assets sold and purchased during the prior year, their price and the fees charged. As a means of facilitating use of the BICE, the DOL eliminated certain requirements that it did not consider critical to its protective purposes. For example, the DOL removed the requirement in the 2015 Proposed BICE and Principal Transaction exemption that the financial institution comply with other state and federal laws relating to advice, and eliminated some BICE disclosure requirements, including the requirement to project the total cost of an investment at the point of sale over one-, five- and 10-year periods, as well as the annual disclosure requirement.

- **Effective Dates of New Rules.**

The effective date for the requirements of the 2016 Final Regulation is April 10, 2017, one year from the date of its publication in the *Federal Register*. The effective date for the BICE and Principal Transaction exemptions is

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generally January 1, 2018, when the full disclosure provisions and contract requirements become effective. From April 10, 2017, until January 1, 2018, prohibited transaction relief is available during which the full disclosure and contract requirements of the exemptions do not have to be met. Instead, during this transition period, prohibited transaction relief under the exemptions is conditioned on the fiduciary's (i) giving advice that is in the best interest of the plan or IRA, (ii) receiving only reasonable compensation from the plan or IRA, (iii) not making any statements to the plan or IRA that are misleading and (v) making certain disclosures to the plan or IRA.

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