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Employee Benefits Innovators Roundtable

Fiduciary Update and the DOL Fiduciary Rule

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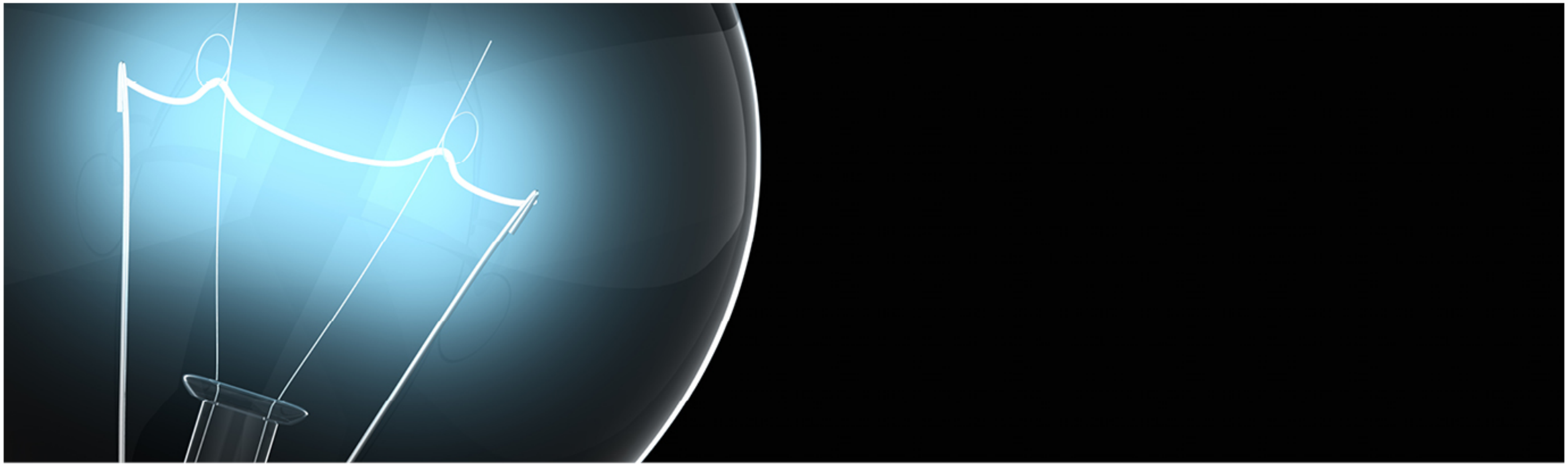

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Tibble and the Duty to Monitor

- *Tibble v. Edison International*, 135 S. Ct. 1823 (2015). Plaintiff plan beneficiaries brought suit in 2007 against the plan's fiduciaries to recover damages for losses suffered by the plan allegedly as a result of the fiduciaries' initial selection of investments in 1999 and 2002. Plaintiffs asserted that the fiduciaries had acted imprudently by offering six higher priced retail-class mutual funds as plan investments when materially identical lower priced institutional-class mutual funds were available
  - **District Court**: Because ERISA Section 413 requires a breach of fiduciary duty complaint to be filed no more than six years after "the date of the last action which constitutes a part of the breach or violation" or "in the case of an omission the latest date on which the fiduciary could have cured the breach or violation," the district court held that the complaint was untimely as to the 1999 funds
  - **Ninth Circuit**: Affirmed, concluding that the plaintiffs had not established a change in circumstances occurring within the six-year period that might have triggered a fiduciary obligation to conduct a full due-diligence review of the 1999 funds

Tibble and the Duty to Monitor

- Supreme Court:
  - Duty of prudence involves a continuing duty to monitor
  - It was error to apply Section 413’s bar to a breach of fiduciary duty claim on account of the timing of the initial selection of the investments without also considering the contours of the alleged breach
  - ERISA's fiduciary duty is derived from the common law of trusts, which provides that a trustee has a continuing duty—separate from the duty to exercise prudence in selecting investments at the outset—***to monitor trust investments and to remove imprudent ones***
  - The Court expressed no view on the scope of the fiduciaries’ duty in this case, *e.g.,* whether a review of the contested mutual funds had been required within the six-year period, and, if so, what kind of review should have been conducted
  - Statute of limitations issue: So long as a claim alleging that a breach of the continuing duty of prudence occurred within six years of the filing of suit, the claim is timely
  - Remanded for the Ninth Circuit to consider the plaintiffs’ claim that the defendant fiduciaries had breached their continuing duty of prudence with respect to the 1999 mutual funds within the six–year limitation period, recognizing the importance of analogous trust law

Tibble and the Duty to Monitor

- Retirement plan fiduciaries have an obligation to prudently select plan investments and authorize the plan to pay only reasonable expenses
- Plan fiduciaries must not only select prudent investments with reasonable fee arrangements at the outset, but also regularly monitor the investments to ensure that their fee structures are reasonable
- While the *Tibble* case addresses fee arrangements, fiduciaries should note that all aspects of investment funds must be monitored on an ongoing basis

New Fiduciary Rule

Statutory Language. ERISA Section 3(21)(A) provides: a person is a fiduciary with respect to a plan to the extent the person:

- 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,
- 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 responsibility to do so, or
- has any discretionary authority or discretionary responsibility in the administration of such plan.

New Fiduciary Rule

Prior regulations. The DOL issued regulations in 1975 to define for ERISA fiduciary purposes the circumstances under which ‘‘investment advice’’ is provided. Under the 1975 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.

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.

New Fiduciary Rule

Prior Administrative Ruling. The DOL had previously interpreted the 1975 regulation as providing that a recommendation to a plan participant on how to invest the proceeds of a contemplated plan distribution was ***not*** fiduciary investment advice. Advisory. DOL Advisory Opinion 2005–23A (Dec. 7, 2005).

New Fiduciary Rule

- In 2010, the DOL proposed a substantially expanded definition of fiduciary 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
- 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
- In addition, the 2010 proposed regulations were intended to apply to IRAs
  - IRAs were not covered by fiduciary protections of the 1975 regulations
- The DOL received *significant* commentary in opposition to the 2010 proposed regulations; the DOL withdrew the proposed regulations in 2011 and indicated the regulations would be re-proposed
- The re-proposed guidance was issued on April 14, 2015, and finalized this April

New Fiduciary Rule

- 2016 fiduciary rule revised effective April 10, 2017, with transition period until January 1, 2018
  - Aimed at financial advisors, including brokers, who provide retirement plan services
  - Will also impact compliance obligations and potentially costs for plan sponsors
- Subsequent actions
  - Congressional action
  - Presidential veto
  - Multiple lawsuits

New Fiduciary Rule

- The new fiduciary rule replaces the 5-part fiduciary test
- The new rule describes
  - **relationships** in which those communications would give rise to fiduciary investment advice responsibilities
    - Who is a fiduciary investment adviser?
    - What standard applies to a fiduciary investment adviser?
  - **communications** that would constitute investment advice
    - When has a recommendation been made?

New Fiduciary Rule

- Relationships
  - An individual or entity is a fiduciary if they
    - Represent or acknowledge that they are acting as a fiduciary within the meaning of ERISA or the Internal Revenue Code (Code);
    - Render advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; or
    - Direct the advice to a specific recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA

New Fiduciary Rule

- Under the new rule, if a fiduciary is providing covered investment advice, the fiduciary must either
  - avoid payments that create conflicts of interest or
  - comply with the protective terms of an exemption issued by the DOL
- Best interest standard versus suitability standard
  - Significant change for many investment advisors

New Fiduciary Rule

- **Communications** that constitute “covered investment advice”
  - a ***recommendation*** to a plan, plan fiduciary, plan participant and beneficiary and IRA owner
  - for a fee or other compensation, direct or indirect,
  - as to the advisability of buying, holding, selling or exchanging securities or other investment property, including recommendations as to the investment of securities or other property after the securities or other property are rolled over or distributed from a plan or IRA

New Fiduciary Rule

- Rollover Recommendations
  - Will be a fiduciary act; DOL supersedes its 2005 Advisory Opinion
  - According to DOL, rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020, and DOL suggested that an ERISA plan investor who rolls her retirement savings into an IRA could lose 6 to 12 and possibly as much as 23 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser
  - DOL provided an example of an ERISA plan investor who rolls $200,000 into an IRA, earns a 6 percent nominal rate of return with 2.3 percent inflation, and aims to spend down her savings in 30 years, would be able to consume $11,034 per year for the 30-year period. A similar investor whose assets underperform by 0.5, 1, or 2 percentage points per year would only be able to consume $10,359, $9,705, or $8,466, respectively, in each of those 30 years.
- ***Key takeaway for plan sponsors*** – what does our recordkeeper tell participants about rollovers (or annuity purchases)?

New Fiduciary Rule

- Other potential “recommendations”
  - Offering platform of investments?
    - Can be exempt if not tailored and if other requirements are met.
  - Investment education?
    - Final rule incorporates and expands existing guidance
    - Describes information that constitutes non-fiduciary education, and also allows interactive investment materials to identify specific investment alternatives under ERISA-covered plans if certain conditions are met
    - But plan sponsors may want to verify compensation model used by their existing record-keeper in light of recent litigation
  - Participant call centers – no blanket carve-out

New Fiduciary Rule

- BICE allows existing potentially conflicted compensation models if:
  - A firm acknowledges fiduciary status for itself and its advisers
  - Basic standards of impartial conduct must be adhered to in giving advice
  - Compensation is "reasonable" (not fully defined in the final guidance)
  - Procedures and policies are in place to mitigate investor harm due to conflicts of interest
  - Potential conflicts and compensation arrangements are disclosed
  - EBSA must be notified by email if a BIC exemption is being used in an advising relationship
- Grandfathering provision that allows for additional compensation based on investments that were made prior to the applicability date of April 10, 2017