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Take Two: DOL Reproposes Changes to Definition of Fiduciary for ERISA Plans and IRAs

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This is the first in a series of client advisories regarding the Department of Labor's re-proposed regulation on the definition of "fiduciary" under ERISA Section 3(21) and related proposed new and amended prohibited transaction class exemptions (the Proposed Rule). If finalized, the Proposed Rule would expand the definition of who is considered a "fiduciary" to an ERISA-covered plan or IRA as a result of giving investment advice for a fee to the plan or its participants or beneficiaries. This client advisory summarizes the Proposed Rule's new definition of fiduciary by reason of providing investment advice to an ERISA-covered plan or an IRA.

(For further details regarding the proposed new "best interest contract" class exemption, please see our Client Advisory on "DOL's Proposed Prohibited Transaction Exemption: Best Interest Contracts" published concurrently with this one. Proposed amendments to existing class exemptions and discussions highlighting the specific impacts of the Proposed Rule on various parties will be addressed in future client advisories.)

On April 14, 2015, the Department of Labor (DOL) proposed a new regulation defining who is a "fiduciary" of an employee benefit plan covered by ERISA or an IRA by reason of providing investment advice and, concurrently, withdrew its prior proposed regulation that was published in 2010. The Proposed Rule contains several components, including, a proposed regulation regarding the applicable definition of "fiduciary", new prohibited transaction class exemptions and amendments to certain existing prohibited transaction class exemptions. As a general matter, the Proposed Rule will significantly expand the types of activities that would result in fiduciary status and provide a principles-based approach to determining

investment advice fiduciaries, subject to specific carve-outs. Of particular note, the Proposed Rule will apply to individuals and entities providing applicable investment advice not only to ERISA-covered employee benefit plans (and their participants and beneficiaries) but also to Individual Retirement Accounts (IRAs). (Note that the Proposed Rule takes an inclusive approach to the defined term "IRA" such that it includes any trust, account or annuity described in Code Section 4975(e)(1)(B) through (F), which includes individual retirement accounts described in Code Section 408(a) as well as health savings accounts described in Code Section 223(d).) As a result, if the Proposed Rule is finalized, certain activities, advice and communications will now be subject to the fiduciary rules.

Existing Definition of Fiduciary Investment Advice

In 1975, the DOL issued a five-part test under ERISA Section 3(21) for determining under what circumstances a person or entity is treated as providing fiduciary investment advice to an ERISA-covered benefit plan. (The Department of Treasury issued a virtually identical rule for purposes of plans, such as IRAs, subject to Code Section 4975.) At the time this test was established, the vast majority of employer-sponsored retirement benefits were provided under defined benefit pension plans, most defined contribution plans were professionally managed and not participant-directed, and IRAs had just been authorized. The current five-part test provides that for advice to constitute investment advice subject to the fiduciary rules, the adviser must (1) provide advice as to the value of securities or other property, (2) on a regular basis, (3) pursuant to a mutual agreement or understanding with the plan or plan fiduciary that (4) the advice will serve as a primary basis for investment decisions and (5) the advice is individualized to the particular needs of the plan or IRA.

As the DOL noted in its summary of the Proposed Rule, given the changing landscape of retirement benefits from employer-managed defined benefit pension plans to individual account plans (such as 401(k) plans and IRAs) where participants are required to make investment decisions for their own accounts, individuals have become "major consumers of investment advice that is paid for directly or indirectly." Accordingly, the DOL's view is that the five-part test no longer provides adequate fiduciary protections to these consumers who are looking for expertise and information from advisers.

New Definition of Fiduciary Investment Advice under the Proposed Rule

In order to address this shift to individual account plans, the DOL's approach under the Proposed Rule is to broaden the definition of fiduciary investment advice to cover certain categories of advice and then provide certain exceptions, or "carve-outs," for certain conduct that the DOL believes should not give rise to a fiduciary relationship. Specifically, the Proposed Rule provides that an adviser will be subject to ERISA fiduciary standards if the adviser provides directly to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner (1) any of the following types of advice described in the first column below (Covered Advice) in exchange for a fee or other direct or indirect compensation *and* (2) the adviser takes one of the actions described in the second column below:

"Covered Advice" provided in exchange for a fee or direct or indirect compensation:	**Adviser, directly or indirectly (e.g., through or together with any affiliate) does one of the following:**
A. Recommendations as to the advisability of acquiring, holding, disposing or exchanging securities or other property (including recommendations concerning investment of securities or property to be rolled over or otherwise distributed from a plan or IRA);	A. Represents or acknowledges that it is acting as an ERISA-covered fiduciary with respect to the provision of the "Covered Advice"; or
B. Recommendations as to the management of securities or other property (including recommendations on the management of securities or other property to be rolled over or otherwise distributed from a plan or IRA);	B. Provides the "Covered Advice" pursuant to a written or verbal agreement, arrangement or understanding that such advice is individualized or specifically directed to the recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.
C. Appraisals, fairness opinions, or similar statements concerning the value of securities or other property if provided in connection with a specific transaction involving an acquisition, disposition or exchange of securities or other property; or	
D. Recommendations of a person who will also receive a fee or other direct or indirect compensation for providing any of the types of "covered advice" described above.	

Most notably, this new definition would remove the requirements from the five-part test that the applicable advice be made "on a regular basis" and as the "primary basis for investment decisions." As described above, the Proposed Rule could cover a single instance of advice provided that it is Covered Advice and meets the other requirements and the adviser only needs to acknowledge that its advice will be considered by the recipient in connection with investment decisions related to assets of an ERISA-covered plan or IRA.

Carve-Outs

The Proposed Rule also contains several "carve-outs" or exceptions to the general rule described above. Provided that the adviser or entity does not otherwise represent that it is acting as an ERISA fiduciary, the following actions will not cause the adviser to be deemed an investment advice fiduciary under the Proposed Rule:

Carve-Out	General Description of Carve-Out
Advice to Plan Fiduciary with Financial Expertise	Carves out incidental advice from a counter party made to a plan fiduciary in connection with an arm's length sale, purchase, loan or bilateral contract between an "expert plan investor" and the adviser. Subject to other requirements, the applicable plan must have 100 or more participants (and the plan fiduciary represents in writing his or her fiduciary status) or at least $100 million in plan assets.
Swaps Offers or Recommendations	Carves out advice or other communications from a counterparty in connection with certain swap or security-based swap transactions under the Commodity Exchange Act or the Securities Exchange Act, provided that the plan fiduciary makes a written statement that it is not relying on the recommendation.
Advice from an Employee of a Plan Sponsor	Carves out advice to a plan fiduciary from an employee of the plan sponsor, provided that the employee does not receive compensation for such advice other than his or her normal compensation as an employee of the plan sponsor.
Marketing Investment Platforms	Carves out certain service providers (e.g., recordkeepers and third-party administrators) in the marketing or offering of a "platform" or selection of investment vehicles to an ERISA-covered participant-directed individual account plan where the plan fiduciary selects the particular investment options or menu that will be made available to participants.
ESOP Appraisals	Valuations or certain related financial reports provided to ESOPs are not subject to fiduciary treatment. (The DOL intends to return to ESOP issues in the future.)
Identification of Investment Alternatives to Match Objective Criteria	Carves out service providers who identify offered investment alternatives that meet objective criteria specified by the plan fiduciary.
Valuations for Reporting or Disclosure Obligations	Carves out appraisals, fairness opinions or statements of value prepared ERISA-covered plans and IRA in connection with certain legally required reporting and disclosure obligations when provided to Investment Funds in which one or more unaffiliated plans invest and to Funds that hold assets of one or more unaffiliated plans.
Investment or Retirement Education	Subject to certain specified requirements, carves out general investment or retirement education that do not address specific investment products or specific plan or IRA alternatives or distribution options.

The exceptions described above are subject to certain rules and requirements as specified in the Proposed Rule.

Prohibited Transaction Class Exemptions

As previously mentioned, the Proposed Rule includes two new prohibited transaction class exemptions—the "Best Interest Contract Exemption" and a new exemption for "principal transactions" as well as amendments to various existing class exemptions. These changes are intended to "allow, subject to appropriate safeguards, certain broker-dealers, insurance agents and others that act as investment advice fiduciaries to nevertheless continue to receive a variety of forms of compensation that would otherwise violate prohibited transaction rules and trigger excise taxes" under the Proposed Rule. The details of the changes to the prohibited transaction class exemptions will be described in further detail in subsequent client alerts.

Next Steps

The DOL is accepting written comments on the Proposed Rule until July 6, 2015. If finalized, the Proposed Rule would become effective 60 days after the final rule is published in the Federal Register and the requirements of the final rule (including any of the proposed new or amendment prohibited transaction class exemptions that are finalized) would generally become applicable eight months after the final rule is published. The DOL's attempt in 2010 to change the fiduciary standards was met with significant comment and criticism, and we anticipate that the DOL will receive many comments from this new Proposed Rule. Accordingly, changes could be made to both the proposed regulation and proposed changes to the prohibited transaction class exemptions before these rules become effective.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or one of the following members of the Executive Compensation & Benefits practice section.

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