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# The Department of Labor’s Fiduciary Rule: What Plan Sponsors Need to Know

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Philadelphia– Thursday, November 9, 2017

# What "Is" the Fiduciary Rule?

- The "Rule" itself refers to the broadened definition of "fiduciary" investment advice
- The Rule creates more fiduciaries, and expands the scope under which investment-related recommendations may constitute a "fiduciary" activity
- Under ERISA (and the Code), fiduciaries are prohibited from influencing their compensation (and that of their affiliates, etc.) when acting in a fiduciary capacity
- As part of the same regulatory package, the DOL also issued a number of new and amended PT exemptions

# What Plans Are Subject to the Rule?

- Covered:
  - All ERISA plans (but impact on welfare plans limited – recommending health, disability and term life insurance not considered “investment” advice)
  - Most qualified plans
  - Health savings accounts (HSAs)
  - IRAs and certain other tax-advantaged accounts
- Not covered:
  - Governmental plans
  - Non-electing church plans
  - Non-qualified deferred compensation plans, including 457 plans

# Fiduciary Investment Advice – Prior Definition

1. Investment advice given;
2. On a **regular basis;**
3. Pursuant to a **mutual agreement or understanding;**
4. That the advice will be a **primary basis** for investment decisions; and
5. The advice is **individualized for the particular needs** of the plan, participants, etc.

# Fiduciary Investment Advice – New Definition

- “Regular basis” requirement no longer applies
- “Primary basis” requirement no longer applies
- “Mutual understanding” and “particular needs” prongs are not required where advice relates to specific investment decisions
- “Recommendation” is a key concept – very broadly defined…

# Fiduciary Investment Advice – New Definition (cont'd)

*"(R)ecommendation" means a communication that, based on its* ***content, context, and presentation****, would* ***reasonably be viewed as a suggestion*** *that the advice recipient engage in or refrain from taking a particular course of action…*

*…the more individually tailored the communication is to a specific advice recipient or recipients…the more likely the communication will be viewed as a recommendation…"*

# What is “Now” Fiduciary Advice That Wasn’t Before?

- Advice about plan distributions and rollovers
- One-time or sporadic advice
- Advice given to groups of investors
- “Sales” communications, unless an exception applies
- Advice from brokers
  - Many broker-dealers previously took the position that they were not fiduciaries because they were just distributing investments; now, this argument is virtually impossible to make

# Are There Any Exceptions?

- Advice to large plan fiduciaries ($50 million+)
- Certain general (public) communications
- Platform providers
  - Marketing and making available the platform
  - Selection and monitoring assistance (certain disclosures req'd**):
    - Identifying investment alternatives based on objective criteria**
    - RFPs and similar responses**
    - Objective data and comparisons to independent benchmarks
- Investment education (narrower relief than before)

# Why the Changes?

- Overall: Concerns over advisor **conflicts of interest**
  - Shift from professionally-managed defined benefit plans to defined contribution plans and IRAs
  - Baby boomer retirements (estimated **$2.4 trillion** moving from plans to IRAs from 2016 through 2020)
  - GAO report on distributions and rollovers was very embarrassing for DOL, IRS and financial services industry

# Why the Changes? (cont'd)

- Per DOL, firms and individuals could hold themselves out as advisors but escape liability for consequences, due to rigidity of prior five-part test
- Concern that investors do not understand how advisors are compensated, and/or what standards they are held to
- Dodd-Frank study confirmed existence of investor confusion, but SEC not able to agree on uniform fiduciary/best interest standard

# In the DOL's Words…

*"One example of the five-part test's shortcomings is the requirement that advice be furnished on a "regular basis…*

*…As a result of the requirement, if a small plan hires an investment professional on a one-time basis for an investment recommendation on a large, complex investment, the adviser has no fiduciary obligation to the plan under ERISA. The plan could be investing hundreds of millions of dollars in plan assets, and it could be the most critical investment decision the plan ever makes, but the adviser would have no fiduciary responsibility under the 1975 regulation."*

# In the DOL's Words…(cont'd)

*"Because advice on rollovers is usually one-time and not "on a regular basis," it is often not covered by the 1975 standard, even though rollovers commonly involve the most important financial decisions that investors make in their lifetime. 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."*

- Preamble to DOL Fiduciary Rule

# Status of the Rule

- The Rule itself "went live" June 9, 2017
- Reduced requirements under the (in)famous "Best Interest Contract (BIC) Exemption" during transition period
  - Currently scheduled to expire after December 31, 2017
  - Is expected to be extended to July 2019
- DOL has won all the lawsuits (so far)
- But, Rule and exemptions being reviewed in light of Presidential directive
- SEC is getting involved

# Plan Sponsor Employees – Two Categories of Relief

1. Advice from employee to plan fiduciary or other employee (not in capacity as plan participant), if no fee or other compensation other than "normal" pay for services to employer
2. Advice from employee to plan participant, if:
   - Job responsibilities do not include investment advice
   - No securities, etc. licensing (and licensing not required)
   - No fee or compensation other than "normal" pay for services to employer

# Distribution and Rollover Services

- Plan sponsors need to understand what participants are being told by plan vendors
  - Fiduciary advice? (reliance on BIC Exemption)
  - Education on pros and cons of different distribution options?
  - No services?
- Potential concerns about co-fiduciary liability
- Review process, written materials, compensation incentives, etc. for vendor personnel
- (Possibly) consider plan changes to enhance benefits of “staying in” plan??

# Distribution and Rollover Services (cont'd)

- Key factors – plan vs. IRA
  - Level of fees, and who pays?  (IRAs generally more expensive)
  - Services offered
  - Range of investments available
  - Distribution flexibility
  - Penalty-free withdrawals between ages 55 and 59 ½
  - Protection from creditors (state laws differ)
  - RMDs
  - Employer stock (tax treatment vs. diversification needs)

# Large Plan Fiduciaries

- Key carve-out from fiduciary status – note that $50 million test applies across multiple plans and even other assets
- Large plan fiduciaries can expect to receive “disclaimers” from investment providers and recordkeepers
  - Capable of evaluating risks independently
  - No impartial or fiduciary advice intended, and financial interests in transaction explained
  - Fiduciary responsible for independent judgment
  - No direct fee for investment advice as to transaction

# Investment Education

- Similar to distribution and rollover services – advisable to know what vendors are doing (and that they are not "crossing the line" into advice if not intended)
- Overlay requirement: Non-fiduciary education cannot include recommendations of particular investments, etc. either "*standing alone or in combination with other materials*"

# Investment Education (cont'd)

1. Plan information (no "reference to appropriateness" of particular options), such as:
   - Benefits of plan participation and increasing contributions
   - Pros and cons of different distribution options
   - Impact of pre-retirement withdrawals
2. General financial, investment and retirement information (cannot even reference specific investments)
3. Asset allocation models, subject to strict requirements
4. Interactive materials, (again) subject to strict requirements

# 408(b)(2) Disclosures

- New “fiduciary” services may require new 408(b)(2) disclosures, or updates to existing ones
- To avoid PTs, DOL imposes obligations on plan sponsors, as “responsible plan fiduciaries,” not just vendors…

# 408(b)(2) Disclosures (cont'd)

*"The Department does not believe that responsible plan fiduciaries should be entitled to relief provided by the class exemption absent a reasonable belief that disclosures required to be provided to the covered plan are complete. To this end, responsible plan fiduciaries should appropriately review the disclosures made by covered service providers. Fiduciaries should be able to, at a minimum, compare the disclosures they receive from a covered service provider to the requirements of the regulation and form a reasonable belief that the required disclosures have been made."*

- Preamble to DOL 408(b)(2) Regulation

# What Relationships Are Not (Largely) Affected

- Independent, level fee-only investment advisers
  - Generally take on fiduciary status already
  - No conflicts = no reliance on BIC Exemption (or other exemption(s))
  - This assumes no proprietary products
- DOL Rule does not affect “plan assets” status of investment funds
- Attorneys, accountants, auditors, actuaries, third-party administrators, etc.

# Questions?