DOL REDEFINES AN ERISA "FIDUCIARY"

APRIL 11, 2016

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On April 6, 2016, the U.S. Department of Labor ("DOL") issued the final rule[1] re-defining the term "Fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA") and finalized the Conflict of Interest Rule applicable to retirement investment advice. This final rule made a number of changes and clarifications[2] to the originally proposed rule in April 2015 and is released along with the following:

- the final regulation for the Best Interest Contract Exemption ("BICE") [3],
- an "Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24" ("PTE Amendment")[4], and
- Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1 ("Class Exemptions")[5].

As a part of redefining (thus broadening) the fiduciary definition, the DOL introduced a number of exemptions in order to waive the fiduciary status to a number of groups in order for non-fiduciary service providers to deliver important services to employer sponsored benefit Plans[i] and Individual Retirement Accounts (IRA)[ii] without triggering ERISA prohibitive transaction provisions. As a general theme, the exemptions differentiated a recommendation from general communication where a recommendation is deemed to be investment advice and subjects the advisor to be a fiduciary. Responsibilities are placed on the advisers intending to use an exemption to know or reasonably believe that the counterparty is a fiduciary. Further, the exemptions rely on differentiating general from individualized advice and the use of a number of disclosures. The following is a summary and highlights to the final fiduciary rule. The BICE, PTE Amendment and Class Exemptions are not addressed and summarized in this discussion.

Amendment

DOL is amending parts 2509 and 2510 of subchapters A and B of Chapter XXV of Title 29 of the Code of Federal Regulations

Effective Date

60-days after April 8, 2016 when it is published in the Federal Register[6]

Applicability Date

April 10, 2017

[1] http://www.dol.gov/ebsa/newsroom/fs-conflict-of-interest.html
[2] http://www.dol.gov/ProtectYourSavings/comparison-chart.htm
[3] http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28807&AgencyId=8&DocumentType=2
[4] http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28810&AgencyId=8&DocumentType=2
[5] http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28812&AgencyId=8&DocumentType=2
[6] http://federalregister.gov/a/2016-07924 or www.FDsys.gov

Fiduciary Re-Defined

The current five part rule is replaced by a general rule that a fiduciary is a person who offers client one time or ongoing advice, for compensation, regarding investments and assets in a retirement plan. For the first time, the position of a fiduciary would apply to IRA assets and owners and the inclusion of institutions, affiliates and related entities as fiduciaries when certain conditions are met.

A person offering investment advice[7][iii] to assets of a Plan, Plan Fiduciary[iv], Plan participant or beneficiary, an IRA or IRA owner for "Fee or Other Compensation, direct or indirect," [v] would be deemed a fiduciary if:

1) the recommendation is
   a) to buy, sell, hold or exchange assets or property or how the assets should be invested after the assets are rolled lover, transferred or distributed from the Plan or IRA (collectively "Rollover").
   b) to manage assets such as:
      - investment policies or strategies,
      - portfolio composition,
      - selection of other persons to provide investment advice or investment management services,
      - selection of investment account arrangements (e.g., brokerage versus advisory); or
      - with respect to Rollovers, including whether, in what amount and form, and to what destination such a Rollover should be made.

2) the recommendation listed in section 1 is made directly or indirectly through or together with any Affiliate[vi] by a person who:
   a) Represents or acknowledges that it is acting as a fiduciary.
   b) Renders advice based on the investment needs of the advice recipient; or
   c) Directs the advice to one or more specific advice recipients regarding specific investment or management decision regarding investments in the Plan or IRA.

What is a Recommendation[vii]? – A "Recommendation" is synonymous with fiduciary investment advice.

It is considered a recommendation when an advice recipient reasonably views a communication as a suggestion to engage in or refrain from taking a particular course of action that is individualized or specific to the Plan. Moreover, communication in the aggregate of a series of general individual actions could be deemed a recommendation. Thus, the more tailored the communication is, the more likely it would be considered a recommendation.

[7] As defined under Employee Retirement Income Security Act of 1974 section 3(21)(A)(ii) and Internal Revenue Code Section 4975(e)(3)(B)

Platform Provider Exemption - For the purpose of exempting platform providers who deliver non-individualized or generic plan, services, recordkeeping and investment from being considered ERISA fiduciaries

An investment platform (which is often affiliated with or a part of recordkeeping services and asset managers) can avoid being considered offering recommendations if the communication is not individualized and clearly discloses in writing that the platform is not a fiduciary and should not be deemed as offering impartial investment advice.

(1) A platform or similar arrangement from which a Plan Fiduciary may select or monitor investment alternatives for participants and beneficiaries to direct would not be deemed a recommendation if:
- None-individualized. The platform is made available without regard to the individualized needs of the Plan, its participants, or beneficiaries.
- Not the Same Party. The Plan Fiduciary is independent of the person who markets or makes available the platform.
- Non Fiduciary Advice - The platform discloses in writing that the platform is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

(2) As a platform provider, the following activities would not cause them to be considered recommendations:

a) Selection and monitoring assistance.
- Identify investment alternatives that meet objective criteria specified by the Plan Fiduciary.
- The person identifying the investment alternatives discloses in writing whether the person has, and the nature of, a financial interest in any of the identified investment alternatives.

b) Responding to request for proposals (RFPs)
As a part of a written response to an RFP, identifying a limited or sample set of investment alternatives based on only the size of the employer or Plan, the current investment alternatives designated under the Plan, or both, provided that the person discloses whether the person has, and the nature of, a financial interest in any of the identified investment alternatives.

c) Benchmarking Services
Providing objective financial data and comparisons with independent benchmarks to the Plan Fiduciary.

General Communication & Education Exemption - For the purpose of differentiating general information delivery from recommendation so that individual providing general communication and education would not be considered ERISA fiduciaries.

General communication will not be deemed recommendation if the communication is generic and not individualized. This exemption allows the distribution of information that intend to inform and not advice.

It is not considered a recommendation to make available general communications that a reasonable person would not view as an investment recommendation. For example,

- general circulation newsletters,
- commentary in publicly broadcast talk shows,
- remarks and presentations in widely attended speeches and conferences,
- research or news reports prepared for general distribution,
- general marketing materials,
- general market data, including data on market performance, market indices, or trading volumes, price quotes, performance reports, or prospectuses.

Investment Education Exemption - To differentiate investment education from a recommendation so that individuals providing investment education would not be deemed ERISA fiduciaries.

Investment education such as delivering Plan related information, general information regarding finance, investment and retirement, asset allocation models and interactive investment materials. To not be deemed a recommendation, such investment education must be generic and not individualized with proper disclosures and notices. This exemption allows the distribution of information that intend to inform and not advice.

The following list of information or communication would not be considered a recommendation, if they do not include (standing alone or in combination with other materials) recommendations with respect to specific investment products or specific Plan or IRA alternatives, or recommendations with respect to investment or management of a particular security or securities or other investment property.

1) Plan information

Information and materials that describe the terms or operation of the Plan or IRA as well as general information regarding the types, benefits and impacts of participation, contributions, withdrawals, and distributions. This may also include product features, investor rights and obligations, fee and expense information, applicable trading restrictions, investment objectives and philosophies, risk and return characteristics, historical return information, or related prospectuses of investment alternatives available under the Plan or IRA.

2) General financial, investment, and retirement information

Information that do not address specific investment products, specific Plan or IRA investment alternatives or distribution options available to the Plan or IRA or to Plan participants, beneficiaries, and IRA owners, or specific investment alternatives or services offered outside the Plan or IRA, and inform the Plan Fiduciary, Plan participant or beneficiary, or IRA owner about:

a) General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment;
b) Historic differences in rates of return between different asset classes based on standard market indices;
c) Effects of fees and expenses on rates of return;
d) Effects of inflation;
e) Estimating future retirement income needs;
f) Determining investment time horizons;
g) Assessing risk tolerance;
h) Retirement-related risks (e.g., longevity risks, market/interest rates, inflation, health care and other expenses); and
i) General methods and strategies for managing assets in retirement (e.g., systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the Plan or IRA.

3) Asset Allocation Models **-** For the purpose of excluding asset allocation models from being considered individualized investment advice so that the model provider would not be considered as an ERISA fiduciary.

Based on generally accepted investment theories, a non-individualized model must disclose the underlying assumptions in writing and the incompleteness of data and information model construction. A model may identify Designated Investment Alternatives ("DIA") as long as all other comparable DIAs within the Plan are also disclosed.

Information and materials regarding asset allocation models of portfolio for hypothetical individuals with different investment time horizons and risk profiles, where:

a) The models are based on generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time;
b) All material facts and assumptions on which such models are derived are disclosed;
c) The asset allocation models are accompanied by a statement indicating that, when applying models to their individual situations, they should consider their other assets, income, and investments in addition to their the Plan assets; and

d) The models may identify a specific investment alternative available under the Plan if it is a DIA[8] under the Plan subject to oversight by a Plan Fiduciary independent from the person who developed or markets the investment alternative and the model identifies all the other DIAs under the plan with similar risk and return characteristics; if any and indicating where information on these other DIA may be obtained, including Plan Information and participant fee disclosure under paragraph (d) of the 404a-5 rule[9].

4) Interactive Investment Materials - For the purpose of excluding the availability of interactive investment materials from being considered individualized investment advice so that the provider of such materials would not be considered as an ERISA fiduciary.

Based on generally accepted investment theories, Interactive Investment Materials must disclose objectively the underlying assumptions in writing and the incompleteness of data and information model construction to meet individual circumstances. A DIA may be identified as long as all other comparable DIAs within the Plan are also disclosed.

Questionnaires, worksheets, software and tools related to "Plan information", "General financial, investment, and retirement information", or estimating a retirement income stream that could be generated by an actual or hypothetical account balance, where:

a) Such materials are based on generally accepted investment theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over defined periods of time;
b) There is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the advice recipient
c) There is an objective correlation between the income stream generated by the materials and the information and data supplied by the advice recipients;
d) All material facts and assumptions that may affect the advice recipient's assessment of the different asset allocations or different income streams accompany the materials or are specified by the advice recipients;
e) The materials either take into account other assets, income and investments or are accompanied by a statement indicating that, the advice recipients should consider their other assets, income, and investments in addition to their interests in the Plan or IRA; and
f) The materials do not include or identify any specific investment alternative or distribution option available under the Plan or IRA, unless such an option is specified by the advice recipient or it is a DIA under a Plan and the materials

[8] 29 CFR 2550.404a-5(h)(4) - Designated investment alternative means any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term "designated investment alternative" shall not include "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.
[9] 29 CFR 2550.404a-5

identifie all the other DIAs under the Plan with similar risk and return characteristics; if any, and indicating where information on these other DIAs may be obtained, including Plan Information and participant fee disclosure under paragraph (d) of the 404a-5 rule

Seller's Exemption – For the purpose of exempting people conducting sales functions from being considered ERISA fiduciaries.

The final regulation recognizes that at times the role of a sales person is necessary. As long as the burden is placed on the sales person to know or reasonably believe the counter-party is an ERISA fiduciary who has met certain criteria and disclosure provisions, then the buyer beware (caveat emptor) standard would apply and the sales person would not be deemed a fiduciary.

Any advice by a person to a fiduciary of the Plan or IRA with respect to an arm's length sale, purchase, loan, exchange, or other transaction related to the investment of securities or other investment property, if, prior to entering into the transaction the person providing the advice satisfies the following:

1) The person knows or reasonably believes that the fiduciary is:
   - A bank that is regulated and supervised and subject to periodic examination by a State or Federal agency;
   - An insurance carrier which is qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of assets of a Plan;
   - A state or SEC registered investment adviser;
   - A broker-dealer; or
   - Any independent fiduciary that holds, or has under management or control[viii], total assets of at least $50 million,
2) The person knows or reasonably believes that the fiduciary is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies,
3) The person fairly informs the fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and fairly informs the fiduciary of the existence and nature of the person's financial interests in the transaction;
4) The person knows or reasonably believes that the fiduciary is a fiduciary under ERISA and/or the Code, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction; and
5) The person does not receive a fee or other compensation directly from the Plan, Plan Fiduciary, Plan participant or beneficiary, IRA, or IRA owner for the investment advice (as opposed to other services) in connection with the transaction.

Swap Transactions Exemption – For the purpose of exempting those counterparties to an employee benefit Plan in swap transactions from being considered ERISA fiduciaries.

A swap dealer[10] would not be deemed as a fiduciary when transacting with a Plan if the Plan is represented by an ERISA fiduciary; the swap dealer is not acting as an adviser and receive compensation from the Plan or the Plan Fiduciary for the investment advice; and a written understanding by the Plan Fiduciary that the Plan Fiduciary understands that the dealer is not providing impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and that the Plan Fiduciary is exercising independent judgment in evaluating the recommendation.

Employee Exemption – For the purpose of exempting those employees in the employ of an employee benefit Plan sponsor when they offer advice regarding the Plan and investments from being considered ERISA fiduciaries.

An employee will not be deemed to offer recommendations to a Plan Fiduciary, or to another employee if the employee does not receive additional compensation in connection with the advice and is not licensed or has a job responsibility to deliver investment advice or investment recommendations.

For the purpose of this exemption, an employee is defined as an employee of the Plan sponsor of a Plan, as an employee of an Affiliate of such Plan sponsor, as an employee of an employee benefit Plan, as an employee of an employee organization, or as an employee of a Plan Fiduciary.

Broker-Dealer Exemption – For purpose of executing asset transactions for a Plan or an IRA, a broker-dealer effecting these transactions would be exempt from being a fiduciary the broker-dealer has no discretion over the transaction. The broker-dealer would complete the transaction based on specific and specified set of trading parameters

[10] A swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a) and section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a))

ENDNOTES

[i] **Plan** means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code

[ii] **IRA** means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code.

[iii] **Fiduciary** under ERISA Section 3(21), a person is a fiduciary with respect to a plan to the extent (i) he 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, (ii) he 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 (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Under IRC Section 4975(e), Fiduciary For purposes of this section, the term “fiduciary” means any person who—

(A) 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,

(B) 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

(C) has any discretionary authority or discretionary responsibility in the administration of such plan.

Such term includes any person designated under ERISA section 405(c)(1)(B).

[iv] **Plan Fiduciary** means a person described in section (3)(21)(A) of the Act and 4975(e)(3) of the Code.

[v] “**Fee or Other Compensation, direct or indirect**” means, any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source, and any other fee or compensation received from any source in connection with or as a result of the purchase or sale of a security or the provision of investment advice services, including, though not limited to, commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative’s new broker-dealer firm, gifts and gratuities, and expense reimbursements. A fee or compensation is paid “in connection with or as a result of” such transaction or service if the fee or compensation would not have been paid but for the transaction or service or if eligibility for or the amount of the fee or compensation is based in whole or in part on the transaction or service.

[vi] **Affiliate** means any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person; any officer, director, partner, employee, or relative of such person; and any corporation or partnership of which such person is an officer, director, or partner. A relative as defined in ERISA section 3(15) as means a spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

[vii] **Recommendation** is 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 determination of whether a “recommendation” has been made is an objective rather than subjective inquiry. In addition, the more individually tailored the communication is to a specific advice recipient or recipients about, for example, a security, investment property, or investment strategy, the more likely the communication will be viewed as a recommendation. Providing a selective list of securities to a particular advice recipient as appropriate for that investor would be a recommendation as to the advisability of acquiring securities even if no recommendation is made with respect to any one security. Furthermore, a series of actions, directly or indirectly (e.g., through or together with any affiliate), that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate. It also makes no difference whether the communication was initiated by a person or a computer software program.

[viii] **Control** means the power to exercise a controlling influence over the management or policies of a person other than an individual.