

Office Hours

The New DOL Fiduciary Rule and
Your 401(k) Plan: Cutting to the
Chase—What You Need to Know

Guest
Host



Brian Gilmore, ABD Lead Benefits Counsel, VP
Robert Gower, Attorney, Trucker Huss, APC

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[Audio](#)

The New Fiduciary Rule: Big Picture

What is It?

New Department of Labor (DOL) Final Regulations and Prohibited Transaction Exemptions (PTEs) (<https://www.dol.gov/ebsa/regs/conflictsofinterest.html>)

Creates a new test to determine whether investment advice is subject to ERISA or Code fiduciary standards

What are the Main Topics Covered?

- Eliminates prior five-part test in favor of broader fiduciary standard for investment advice
- New three-step analysis to determine whether a communication constitutes investment advice
- Best Interest Contract (BIC) exemption for variable rate compensation paid to fiduciaries (e.g., commissions)

How Does it Affect ERISA Plan Sponsors?

- Not as much as the IRA (including rollover) advice world. But still important!
 - Primarily targets rollover advice and investment advice for IRA owners
 - We cover examples where ERISA plan sponsors need to be aware of new rule

Phased Implementation

Final Regulation Effective Date

- Originally effective **June 7, 2016**

Final Regulation Applicability Date

- Generally will become applicable on **April 10, 2017**

Extended BIC Exemption Compliance Date

- The BIC Exemption is subject to a slower phase-in
 - Full compliance not required until **January 1, 2018**
 - Adviser must comply with the impartial conduct standards, acknowledge fiduciary status in writing, and meet certain other disclosure requirements in the interim

A group of business professionals in a meeting room, with text overlaid on the image. The scene is dimly lit, showing several people seated around a table, engaged in a discussion. The text is prominently displayed in the center-left of the image.

Background:
**ERISA Fiduciary Standard
and The Old Rule**

General ERISA Fiduciary Duties

ERISA governs the conduct of those who have certain authority over the plan's management and assets or provide investment advice for a fee as fiduciaries to the plan. These fiduciary duties are derived from trust law, and they have been described by courts as "the highest known to the law."

Underlying Principles

- ERISA fiduciaries are subject to extremely high standards of conduct
- The ERISA rules are broad and functional, which results in many individuals and entities acting as fiduciaries to a plan
- Every act taken in a fiduciary capacity is subject to the ERISA fiduciary duties
- ERISA fiduciaries who breach their duties may be personally liable to the plan to restore losses or return profits
- Transactions between an ERISA plan and parties in interest related to the plan may be prohibited transactions

The Core Four Fiduciary Duties

- 1) **Exclusive Benefit Rule (Duty of Loyalty):** Must act solely in the interests of participants and beneficiaries
- 2) **Duty of Prudence (Expert Standard):** With the skill, prudence, and diligence of a prudent person acting in a like capacity
- 3) **Duty of Diversification:** By diversifying the plan's investments to minimize the risk of large losses
- 4) **Duty to Follow Plan Terms:** In accordance with the documents and instruments governing the plan

Fiduciary Investment Advice: Who is a Fiduciary?

ERISA §3(21)(A) Categories:

- A person is a fiduciary with respect to the plan to the extent that he or she:
 - (i) Exercises any discretionary authority or discretionary control with respect to the management of such plan or exercises any authority or control with respect to management or disposition of assets
 - (ii) 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) Has any discretionary authority or discretionary responsibility in the administration of such plan

The Old 1975 Fiduciary Investment Advice Rule:

- Narrow five-part test for advisers without discretionary authority or control who render advice to the plan:
 1. 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;
 2. On a **regular basis**;
 3. Pursuant to a mutual agreement, arrangement or understanding with the plan or a plan fiduciary;
 4. That will serve as a **primary basis** for investment decisions with respect to plan assets; and
 5. That will be individualized based on the particular needs of the plan

What's Changed Since 1975?

40 Years of Change

(1) New Landscape:

- Defined benefit plans with no participant investment control was the norm
- Now dominated by 401(k) and other defined contribution plans (and IRAs)
- Financial products marketed directly to plan participants and retail IRA owners
- Little corresponding increase in participant investment expertise (including assessment of expert advice or potential conflicts of interest)

(2) New Products:

Increasingly varied and complex investment vehicles have developed:

- Target date funds,*
- Exchange traded funds (ETFs)*
- Hedge funds*
- Private equity funds*
- Real estate investment trusts (REITs)*
- Structured debt investments*
- Insurance products with limited market exposure for gain/loss (e.g., indexed annuities)*
- Derivatives*

Key Exclusions from Old Rule

ERISA Plans:

- Individuals or entities who gave one-time advice to the plan
 - This was not fiduciary advice because it was not provided on a “regular basis”
- Individuals or entities whose advice was not a primary basis for an investment decision
 - Advice was not subject to fiduciary standard unless used as primary basis for decisions

IRA Owners:

- IRA rollover recommendations
 - Whether, in what amount, in what form, and to what destination a rollover should be made
- IRA investment advice
 - Generally subject to similar fiduciary requirements under the Code as under ERISA
 - However, no direct ability to sue for breach of fiduciary duty as under ERISA



The New Fiduciary Rule **A Broader Approach**

Replacing the Five-Part Test: The New Broader Fiduciary Standard

Determining Whether Someone is Acting as a Fiduciary:

- New rule eliminates the 1975 five-part test
- Introduces a new approach to determine whether an individual or entity is providing investment advice for a fee or other compensation

The New Approach:

- In order to be treated as a fiduciary providing investment advice, a person, either directly or indirectly, (e.g., through or together with any affiliate), must do one of three things:
 1. Represent or acknowledge that such person is acting as a fiduciary within the meaning of ERISA or the Code with respect to rendering investment advice;
 2. Render investment 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**
 3. Direct investment advice to a specific advice 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.

Definition of “investment advice” is key!

Definition of Investment Advice

The Determination as to whether a communication meets the new broader definition of investment advice involves **three steps**:

- 1 Determining whether the communication is in a category that would constitute investment advice;
- 2 Determining whether the communication is a “recommendation”; and
- 3 Determining whether the “recommendation” falls under a safe harbor “exception” to being considered investment advice



Investment Advice? **Three-Step Analysis**

- 1) Is the communication in an investment advice category?
- 2) Is the communication a recommendation?
- 3) Does the communication fall under a safe harbor exception?

Investment Advice Part I:

Categories of Investment Advice

A communication constitutes investment advice if a person provides directly to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner:

- A “recommendation” as to the advisability or acquiring, holding, disposing of, or exchanging, securities or other investment property, or
- A “recommendation” as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA

OR

- A “recommendation” as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice, or investment management services, types of investment account arrangements (brokerage versus advisory), or
- A “recommendation” with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made



Investment Advice? **Three-Step Analysis**

- 1) Is the communication in an investment advice category?
- 2) **Is the communication a recommendation?**
- 3) Does the communication fall under a safe harbor exception?

Investment Advice Part II:

“Recommendations” Constituting Investment Advice

Definition of a “Recommendation”:

- “Recommendation” means a communication that would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action, **based on the communication’s:**
 - **Content,**
 - **Context, and**
 - **Presentation.**

Factors to Consider:

- This is an objective inquiry (not the subjective belief of the advice recipient)
- The more individually tailored the communication is to a specific advice recipient, the more likely it would be viewed as a recommendation
- A series of actions may constitute a recommendation in the aggregate even if they would not when viewed individually
- Does not matter if the communication was initiated by a person or computer software program

Investment Advice Part II:

“Recommendations” Constituting Investment Advice

Non-Recommendations:

- The following categories of communications are not considered to be a “recommendation,” and therefore they do **not** constitute investment advice:

1. Marketing or Making Available a Platform to a Plan Fiduciary

- A platform to select or monitor investment alternatives available to participants is not considered a recommendation as long as:
 - 1) The plan fiduciary is independent of the person who markets or makes available the platform; and
 - 2) The person discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or advice in a fiduciary capacity

2. Selection and Monitoring Assistance

- Identifying investment alternatives that meet objective criteria by the plan fiduciary
 - Person must disclose in writing any financial interest in any of the investment alternatives
- Providing objective financial data and comparisons with independent benchmarks to plan fiduciary

Investment Advice Part II:

“Recommendations” Constituting Investment Advice

Non-Recommendations:

- The following types of communications are not considered to be a “recommendation,” and therefore they do **not** constitute investment advice:

3. General Communications

- Furnishing or making available general communications that a reasonable person would not view as an investment recommendation, including:
 - General circulation newsletters;
 - Commentary in public 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 Advice Part II:

“Recommendations” Constituting Investment Advice

Non-Recommendations:

- The following types of communications are not considered to be a “recommendation,” and therefore they do **not** constitute investment advice:

4. Investment Education

- Plan Information:
 - The terms or operation of the plan, benefits of participation, effect of preretirement withdrawals, forms of distributions, fee/expense information, etc.
- General Financial, Investment, and Retirement Information:
 - General concepts, historic rates of return for asset classes, effects of fees on rate of return, effects of inflation, retirement income estimates, risk tolerance, etc.
 - No discussion of specific investments or distribution options
- Asset Allocation Models:
 - Based on generally accepted investment theory and historic asset class returns
 - Statement to consider other assets, income, and investments outside the model
- Interactive Materials:
 - Questionnaires, worksheets, etc. for retirement income need estimates that use generally accepted theories and objective correlation between assets and income
 - Material facts and assumptions disclosed and accompany the materials



Investment Advice? **Three-Step Analysis**

- 1) Is the communication in an investment advice category?
- 2) Is the communication a recommendation?
- 3) Does the communication fall under a safe harbor exception?

Investment Advice Part III:

Safe Harbor Exceptions from Investment Advice

- The following activities and communications are exempt under the rule, and therefore they do not constitute investment advice:

1. Seller's Exception

- Applies to advice provided to banks, insurance carriers, registered investment advisers, broker-dealers, and any plan fiduciary independent of the seller with at least \$50 million in total assets under management
- Seller must know or reasonably believe that the independent fiduciary is capable of evaluating investment risk and may rely on written representations
- Seller must also “fairly inform” the independent fiduciary:
 - That the seller is not undertaking to provide impartial investment advice;
 - The existence and nature of the seller’s financial interest in the transaction; and
 - That the seller is not giving advice in a fiduciary capacity
- The seller may not receive a fee from the plan, independent fiduciary, plan participant, beneficiary, IRA, or IRA holder for the provision of investment advice in the transaction
- The seller will generally need to meet these requirements prior to the transaction

2. Swap and Security-Based Transactions

- Specific rules for advice to ERISA plans in connection with swap transactions

Investment Advice Part III:

Safe Harbor Exceptions from Investment Advice

- The following activities and communications are exempt under the rule, and therefore they do not constitute investment advice:

3. Certain Activities by Employees of the Plan Sponsor (Employer)

- Investment advice is exempt to the extent employees of the plan sponsor, acting in their capacity as employees, give advice to a plan fiduciary or to another employee or independent contractor of the plan sponsor
- The employee must not receive any fee or other compensation in connection with the investment advice
 - Other than their normal compensation for work performed for the employer
- Advice given to a fellow employee in that employee's capacity as a plan participant or beneficiary is also exempt as long as:
 - 1) The advice giver's job responsibilities do not involve giving investment advice; and
 - 2) The advice giver is not otherwise registered under securities or insurance laws

Investment Advice Part IV:

Fiduciary Investment Advice Requires Compensation!

In order to be considered fiduciary investment advice, the advice must be “for a fee or other compensation, direct or indirect.”

Fees or Other Compensation

- Any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source
- Any fee or other compensation received from any source in connection with or as a result of the recommended purchase or sale of a security or the provision of investment advice services
- Includes (but not limited to):
 - Commissions, loads, finder’s fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payment to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts, gifts and gratuities, expense reimbursement

The “But For” Test

- A fee or compensation must be paid “in connection with or as a result of” the investment advice provided
- This standard requires that the fee or compensation would not have been paid **but for** the recommended transaction or advisory service
 - Or the fee or compensation is based in whole or in part on the transaction or service

Investment Advice Part V: Real World Examples

- Would the following scenarios confer ERISA fiduciary status?
- 1. Third-Party Administrator/Recordkeeper Recommends that You Hire ABD as the Plan's Investment Adviser**
 - TPA likely not a fiduciary in this case because no fee or compensation for the recommendation
 - 2. ABD Presents Overview of its Services, Including Suggestion that You Considering Hiring ABD**
 - Marketing oneself is not fiduciary investment advice
 - Must be recommendation of another individual to be a "recommendation"
 - 3. ABD Presents Analysis of the Plan's Existing Investment Strategies, Including Suggestion that You Considering Hiring ABD**
 - Depends on the extent of analysis and whether ABD ultimately receives compensation for the recommendations
 - 4. ABD Presents Platform of Investments, Including Suggestion that You Considering Hiring ABD**
 - Likely falls within platform exception from recommendation

A hand holding a pen over a document with a bar chart, overlaid with a red gradient.

The Best Interest Contract **BIC Exemption**

The Best Interest Contract:

BIC Basics

The BIC Exemption allows for receipt by fiduciaries of common forms of variable rate compensation that would typically violate the prohibited transaction rules.

Common Forms of Variable Rate Compensation

- Commissions paid by the plan, participant or beneficiary, or IRA
- Sales loads
- 12b-1 fees
- Revenue sharing
- Other payments/commissions from third-parties that provide investment products

Why is the BIC Exemption Needed?

- Fiduciary advisers must manage plan assets prudently and with undivided loyalty to the plan and its participants and beneficiaries
- Must also refrain from engaging in prohibited transactions
- Prohibited transaction rules generally prohibit fiduciaries from engaging in self-dealing and receiving third-party compensation for plan/IRA transactions

Who Can Rely on the BIC Exemption?:

- BIC Exemption can only be used by “financial institutions” and their employees, contractors, agents, and representatives, affiliates, and related entities
- “Financial institutions” generally include:
 - Registered investment advisers
 - Banks
 - Insurance companies
 - Broker/dealers

To Whom May Advice be Provided Pursuant to the BIC Exemption?

- The BIC Exemption is available with respect to advice rendered to retail “retirement investors”
- “Retirement investors” generally include:
 - Plan participants and beneficiaries
 - IRA owners
 - Certain non-institutional fiduciaries

The Best Interest Contract: BIC Basics

Financial institutions relying on the BIC Exemption must adhere to **impartial conduct standards** and adopt **anti-conflict policies and procedures**.

Impartial Conduct Standards

- Financial institutions relying on the BIC Exemption must:
 - Adhere to a “Best Interest” standard similar to ERISA’s fiduciary duties:
 - Prudent advice that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor
 - Without regard to financial or other interests of the adviser, financial institution, or their affiliates, related entities, or other parties
 - Not recommend transactions that will result in the receipt of unreasonable compensation
 - Not make materially misleading statements

Anti-Conflict Policies and Procedures

- Financial institutions relying on the BIC Exemption must adopt policies and procedures designed to prevent:
 - Material conflicts of interest from causing the adviser to violate the impartial conduct standards (see left column)
 - Using compensation, personnel, or other actions that would incentivize advisers to make recommendations not in the best interest of the retirement investors
- Must be contained in written document readily available to retirement investors free of charge and on the institution's website

The Best Interest Contract:

No Actual Contract Required for ERISA Plans

General Contract Requirements:

- The BIC Exemption generally requires that investment advice be given pursuant to an enforceable written contract
- Copy of the contract must be posted to the adviser's website
- Contract requirement intended for IRA and non-ERISA plans to provide breach of contract remedy to enforce rights
- Advice provided to ERISA plans does not require the written contract because ERISA contains direct right of action against a fiduciary for a prohibited transaction or breach of fiduciary duty (ERISA §502(a)(2) and (3))
- However, financial institutions are **still obligated to adhere to the same standards of fiduciary conduct set forth in the BIC exemption with respect to ERISA plans**

Where Written Contract is Required (IRAs, Non-ERISA Plans):

- The financial institution must:
 - Acknowledge its fiduciary status in writing
 - Commit to adhere to the “impartial conduct standards”
 - Provide certain warranties regarding conflicts of interest
- Restrictions on provisions that limit liability, require arbitration, impede class action lawsuits

The Best Interest Contract: Required Financial Institution Disclosures

1. Pre-Transaction Disclosures

- Stating best interest standard of care, describing any material conflicts of interest with respect to the transaction, disclosing the recommendation of proprietary products and products that generate third-party payments, informing retirement investors that the investor may receive specific disclosure of the costs, fees, and other compensation associated with the transaction

2. Transaction-Based Disclosures

- A disclosure, on request, describing in detail the costs, fees, and other compensation associated with the transaction

3. Web Disclosure

- Extensive list of required disclosures that must be freely accessible to the public and updated no less than quarterly

4. DOL EBSA Disclosure

- Financial institution generally must provide notice to the DOL of its reliance on the BIC Exemption before receiving compensation based on such reliance
 - Does not need to identify any plan or IRA
- Must be sent by email to: e-BICE@dol.gov

5. Recordkeeping

- Must maintain records to demonstrate compliance for period of six years

The Best Interest Contract: Streamlined Approach for Level Fees

Level Fee Arrangements:

- Applies if the only fee received by the financial institution, the adviser, and any affiliate in connection with advisory or investment management services to the plan or IRA assets is a “level fee”
- **Level fee:** A “level fee” is a fee or other compensation that is provided on the basis of a fixed percentage of the value of the assets, or a set fee that does not vary with the particular investment recommended
- Level fees are generally considered less prone to conflicts of interest

Streamlined Level Fee BIC Requirements:

- The financial institution must:
 - Provide a written statement of fiduciary status to the retirement investor
 - Comply with the BIC Exemption impartial conduct standards
 - For a recommendation to roll over from an ERISA plan to an IRA, roll over from an IRA, or move from a commission based-account to a level fee arrangement, document the reasons why the recommendation meets the BIC Exemption best interest standard
- No requirement to enter into the written contract or make the other required disclosures

The Best Interest Contract: Real World Examples

- 1. Terminated 401(k) plan participant contacts investment adviser to discuss rollover options**
 - Has the participant already decided to make a rollover? Or asking for advice on whether to do so?
 - How would various compensation structures affect the investment adviser's obligations?
 - What if the investment adviser is a fiduciary investment adviser to the plan?
 - What if the adviser makes recommendations regarding investments after the funds are rolled over?
- 2. Plan fiduciaries contact an IRA provider and provide a list of terminated participants with account balances**
 - How would you assess the plan fiduciary's request to have the IRA provider discuss rollover options with the terminated participants?
 - How will the compensation structure be important in this example?
 - What are the plan sponsor's fiduciary obligations in selecting and monitoring the provider, and reviewing any materials provided to participants?



Wrap Up **Key Points**

The New Fiduciary Rule Takeaways

Four Key Points to Remember:

A

There is now a broader fiduciary standard. The new rule eliminates the narrow 1975 five-part test in favor of a more expansive approach to determining fiduciary status. The new approach is primarily focused on whether the person has provided “investment advice” for a fee or other compensation.

B

The key to understanding the new rule is following the three-step analysis to determine whether any given situation involves fiduciary “investment advice.” Look to whether there has been a “recommendation” and whether any exception applies. And don’t forget that fiduciary investment advice requires compensation under the “but for” test.

C

The core ERISA fiduciary responsibilities for plan sponsors remain unchanged by this rule. That means you still have fiduciary duty to act for the exclusive benefit of plan participants, and to exercise prudence when selecting and monitoring plan service providers (including fiduciary investment advisers).

D

The new rule aims to protect investment education from becoming advice, and to prevent your employees from inadvertently becoming fiduciaries. These are wins for plan sponsors.

Content Disclaimer

The New DOL Fiduciary Rule

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Thank you!

Brian Gilmore

Lead Benefits Counsel, VP
ABD Insurance & Financial Services, Inc.
brian.gilmore@theabdteam.com



Robert Gower

Attorney
Trucker Huss, APC
rgower@truckerhuss.com

