# Benefit Insights®

August 2016

PRIMARK BENEFITS
RETIREMENT ♦ PLAN ♦ EXPERTS



# DOL Issues New Fiduciary Rule

On April 8, 2016 the Department of Labor (DOL) issued final guidance that greatly expands the types of retirement investment advice that will be subject to the fiduciary duty rules under the Employee Retirement Income Security Act of 1974 (ERISA). The so-called "conflict of interest" rule for retirement investments will have a significant effect on those who provide investment advice and sell investment products and services to retirement plans and IRAs.

The central focus of the DOL guidance is to protect plan participants from conflicts of interest that could threaten their retirement savings.

The new rule will not apply until April 10, 2017. The rule has proved controversial and numerous lawsuits have been filed by industry groups and the U.S. Chamber of Commerce challenging the new rule. Plaintiffs argue that "The rule and [prohibited transaction exemptions] overstep the Department's authority, create unwarranted burdens and liabilities, undermine the interests of retirement savers, and are contrary to law." President Obama has vetoed a resolution to kill the rule which was approved by the House in April and the Senate in May.

## Background

This new guidance was prompted by the changing landscape of retirement plans over the past 40 years with the shift from employer-sponsored defined benefit plans, with no participant investment responsibility, to participant directed 401(k) plans. When the old fiduciary rules were issued in 1975, 401(k) plans did not exist nor did the now common practice of rolling assets of ERISA plans into IRAs. Under the old rules, a person or institution is considered a fiduciary adviser only if a five-part investment advice test is satisfied.

In today's marketplace, plan sponsors may be surprised to learn that many investment professionals, consultants and advisers have no obligation to adhere to ERISA's fiduciary standards because they do not satisfy the five-part test. Without fiduciary obligation, advisers could potentially give imprudent advice or steer investment decisions towards products that would affect the amount of compensation the adviser would receive for the advice.

The DOL cited this and other factors to justify the expanded definition of investment-advise fiduciary. Fiduciaries are subject to heightened standards of care and must provide impartial advice solely in the best interest of the recipient of the advice and, if found in breach of the fiduciary standards, can be subject to personal liability.

## Activities Considered Investment Advice

Under the regulation, a party is treated as providing "investment advice" if it renders any of the following general categories of recommendations for a fee or other compensation (either directly or indirectly) to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner:

- The advisability of buying, holding, selling or exchanging securities or other investment property;
- The management of securities or other investment property such as advice regarding investment portfolio composition, selection of other persons to provide investment advice or management services or selection of investment account arrangements;
- Rollovers, transfers or distributions from a plan or IRA including whether, in what amount, in what form and to what destination such rollover, transfer or distribution should be made; or
- How to invest securities or other investment property once they are rolled over, transferred or distributed from the plan or IRA.

A "recommendation" is broadly defined by the DOL as any "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."

## Advice Provider Relationship

The regulation describes the following services, communications and materials as generally not involving a "recommendation."

**Providing an Investment Platform for Directed Investment**

Service providers, such as recordkeepers and third-party administrators, often offer a "platform" or selection of investment alternatives from which plan fiduciaries may choose when creating the plan's menu of investment options. Simply marketing or making available the platform of investment alternatives, without regard to the individualized needs of the plan or its participants and beneficiaries, is not a recommendation under the regulation. This exception is subject to two conditions:

- The platform provider must disclose in writing to the plan fiduciary that it is not providing impartial investment advice or giving advice in a fiduciary capacity
- The plan fiduciary selecting the platform must be independent of the platform provider.

**Selection and Monitoring Assistance for Plan Fiduciaries**

Identifying investment options that satisfy the pre-established criteria of the plan fiduciary (e.g., expense ratios, size of fund, type of asset, etc.) is not considered a recommendation. The provider must disclose in writing any financial interest in any of the investment alternatives. Also, providing objective financial data and comparisons with independent benchmarks to the plan fiduciary is not considered a recommendation.

**Investment Education**

Generally the following kinds of investment information and materials will not be treated as recommendations:

- Plan information including benefits or participation, forms of distributions, fee/expense information;
- General financial, investment or retirement information such as retirement-related risks (e.g., longevity, inflation), diversification and risk tolerance;
- Asset allocation models projecting return based on hypothetical fact patterns; and

- Interactive investment materials (questionnaires, worksheets, software) allowing plan participants to calculate retirement needs and income.

**Advice Provided by Employees**
The DOL recognized that the expanded fiduciary definition could potentially cause employees of a plan sponsor to be treated as fiduciaries and that an explicit exception was appropriate. Employees of a plan sponsor, such as those working in employee benefits and human resources departments, may provide advice in connection with certain matters without becoming an investment advice fiduciary if the employee does not receive compensation for the advice beyond the normal compensation for work provided for the employer and other conditions are satisfied.

This exclusion covers employees who routinely develop reports and recommendations for the company and other fiduciaries such as an investment committee member suggesting to others on the committee that they consider adding a specific investment to the plan's portfolio. The exclusion also covers employees who are charged with communicating information about the plan and distribution options to other employees as long as the employee's job responsibility does not involve the provision of investment advice and the employee is not licensed to provide investment advice.

**General Communications**
Providing general investment communications that a reasonable person would not view as investment advice would not be viewed as investment recommendations. Examples given by the DOL of some communications that should meet this exception include general circulation newsletters, public media talk show commentary, remarks at widely attended speeches and conferences, general marketing materials and general market data.

## Best Interest Contract (BIC) Exemption

ERISA and the Code generally prohibit fiduciaries from receiving payments from third parties and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA. Certain types of fees and compensation common in the retail market may fall within these prohibitions when received by fiduciaries. To facilitate continued provision of advice to such retail investors under conditions designed to safeguard the interest of these investors, the BIC exemption was included in the regulation and allows investment advice fiduciaries to receive these various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA and the Code.

As a condition of receiving compensation that would otherwise be prohibited, financial institutions and advisers are required to take several protective steps to mitigate the impact of any conflicts of interest, such as acknowledging their fiduciary status, implementing policies and procedures designed to prevent conflict of interest violations, disclosing information about their conflicts of interest and the cost of their advice and receiving no more than reasonable compensation.

## What Plan Sponsors Need to Know

While the final rule is targeted primarily at providers of retirement plan products and services, it will also affect plan sponsors. Plan sponsors should expect to receive new disclosures and amended contracts from their advisers and need to review and understand the nature of the relationships they have with their advisers. The decision to hire or retain service providers remains a fiduciary decision, and plan sponsors have an ongoing duty to monitor advisers. Failure to do so could subject plan sponsors to potential ERISA fiduciary violations.

Since rollover or distribution recommendations will be covered by the new conflict of interest rule, some service providers may be less willing to assist participants with the decision of whether or not to roll over their plan assets to an IRA in order to avoid being held to the standard of fiduciary in giving advice on such a decision. This is a significant change to the rules and may result in participants electing to leave assets in the plan following termination.

Plan sponsors should also take a close look at the investment education that is provided to plan participants and beneficiaries to ensure that the investment education qualifies as education rather than advice under the new rules.

Pending lawsuits could delay or overturn the regulation. Also a new administration in the White House may result in the rules possibly getting delayed or killed. Even the DOL may take action…the DOL acknowledges that additional "sub-regulatory guidance will likely be necessary." Time will tell.



PRIMARK BENEFITS
RETIREMENT ♦ PLAN ♦ EXPERTS

875 Mahler Road, Suite 105
Burlingame, CA 94010-1606

Tel (650) 692-2043
www.primarkbenefits.com