May 2015

Weil

# Alert
# Executive Compensation & Benefits

## DOL Issues New Proposed Fiduciary Rules under ERISA

*By Jeffrey Lieberman and Paul Wessel*

### Introduction

On April 20, 2015, the U.S. Department of Labor (DOL) published in the Federal Register its long-anticipated re-proposed regulations (Proposed Regulation) modifying the definition of "fiduciary" for purposes of the Employee Retirement Income Security Act or 1974, as amended (ERISA) and Section 4975 of the Internal Revenue Code of 1986, as amended (Code). The Proposed Regulation significantly revises the DOL's controversial 2010 proposed fiduciary regulation, which, following strong criticism from many sectors, was withdrawn by the DOL several months after its release. Along with the Proposed Regulation, the DOL has also issued new proposed prohibited transaction exemptions (PTEs), and proposed amendments to several existing PTEs, which may limit the impact of the Proposed Regulation in certain circumstances.

### Definition of "Fiduciary"

Under ERISA and the Code, a person is generally a "fiduciary" with respect to a plan or Individual Retirement Account (IRA) if the person exercises authority or control over the management of the plan or its assets, has discretionary responsibility in the administration of the plan, or renders "investment advice" for a fee or other compensation, direct or indirect, with respect to the plan assets. In general, the Proposed Regulation addresses and expands the scope of persons considered to be "fiduciaries" as a result of providing "investment advice" to a plan, plan fiduciary, participant or beneficiary for the purposes of ERISA and the Code. By capturing more activities within the scope of fiduciary duties, the Proposed Regulation arguably offers plans and participants increased protection against conflicts of interest and other activities prohibited under ERISA and the Code. Although the Proposed Regulation is broad in scope, one of its goals is the protection of small qualified retirement plans and IRAs from what the DOL perceives as inherent "conflicts of interest in the retirement investment marketplace." Therefore, many of the protections explicitly apply to such smaller plans, IRAs and IRA owners.

Under the Proposed Regulation, and subject to the application of various "carve-outs" described below, a person renders fiduciary "investment advice" when, with respect to the assets of a plan or IRA, the person provides one of the following:

- Recommendations as to the management of plan or IRA assets (including acquiring, holding and disposing of investments)
- Recommendations as to whether to take a distribution (including whether to roll over a distribution) from a plan or IRA
- Appraisals or fairness opinions (or similar statements) concerning the value of securities or other property (with respect to a particular transaction)
- Recommendations as to persons to provide fiduciary advice for a fee

and either (a) the adviser acknowledges or represents that the adviser is acting in a fiduciary capacity or (b) there is an agreement, arrangement or understanding that the advice is individualized to, or specifically directed to, the recipient for consideration in making investment or management decisions. As noted above, under ERISA and the Code, investment advice must be rendered for a fee or other compensation, direct or indirect, in order for the adviser to be considered a fiduciary. The Proposed Regulation potentially casts a wide net to "capture" many investment advisory arrangements that, in some cases, have not previously been viewed as clearly fiduciary in nature.

## Carve-Outs

The Proposed Regulation carves out several categories of communications from the general definition of "investment advice," such that an adviser will not be a fiduciary solely by virtue of such communications. However, under the Proposed Regulation, an adviser that affirmatively acknowledges its fiduciary status effectively forgoes the possible application of these carve-outs, meaning that such acknowledgement acts as a final determination of ERISA fiduciary status. Provided the adviser has not acknowledged his or her fiduciary status, and subject to certain requirements, the Proposed Regulation sets forth the following general carve-outs:

**(1)** **Seller's Carve-Out.** A "seller's carve-out" exempts arm's-length dealings between sophisticated fiduciaries of large plans and financial institutions acting as counterparties to such fiduciaries (for example, investment product sales pitches to a plan), provided that certain requirements are satisfied. In general, subject to certain disclosure and independence requirements, the Proposed Regulation views plans with an independent fiduciary (i.e., a plan fiduciary independent of the financial adviser) and at least 100 participants, as well as plans with an independent fiduciary who is responsible for managing at least $100 million in plan assets, as sufficiently sophisticated to engage in arm's-length dealings with financial advisers without the need for additional ERISA fiduciary protection.

**(2)** **Swaps Carve-Out.** This carve-out exempts certain advice and other communications by a counterparty to a plan in connection with certain swap or security-based swap transactions with the plan.

**(3)** **Employee Carve-Out.** This carve-out exempts advice provided by an employee of a plan sponsor, provided the employee receives no additional compensation for the advice.

**(4)** **Marketing Carve-Out.** This carve-out exempts marketing or making available investment vehicles to a participant-directed individual account plan, without regard to the individualized needs of the plan or its participants and beneficiaries, by a recordkeeper or a third party administrator that discloses in writing that it is not undertaking to provide impartial investment advice or act in a fiduciary capacity.

**(5)** **Recordkeeper Carve-Out.** This carve-out exempts the mere identification and monitoring by a recordkeeper or a third party administrator of investment alternatives meeting objective criteria specified by the plan fiduciary.

**(6)** **Financial Reports and Valuations Carve-Out.** This carve-out exempts the provision of financial reports and other valuations to employee

stock ownership plans and certain investment funds holding plan assets, as well as to plans, participants, beneficiaries, IRAs and IRA owners for the purposes of governmentally required reporting and disclosure.

(7) **Investment Education Carve-Out.** This carve-out exempts the provision of "investment education" to a plan, plan fiduciary, participant, beneficiary or IRA owner, provided no advice is provided concerning specific investment products or the value of particular securities or other property. The Proposed Regulation specifically notes that existing and longstanding guidance as to what is "education" versus "advice" (Interpretive Bulletin 96-1) will be superseded and modified in the final regulation.

As we discussed above, an adviser that acknowledges its fiduciary status forgoes the application of these carve-outs. Therefore, service providers who wish to avail themselves of one of the carve-outs will need to review and possibly renegotiate their service agreements with plans and IRAs to remove any such representations.

## Proposed Prohibited Transaction Exemptions

Along with the Proposed Regulation, the DOL released new proposed PTEs and several proposed amendments to existing PTEs, which are intended to coordinate with the Proposed Regulation to define the activities and advisers that the DOL believes should be (and should not be) subject to fiduciary responsibilities. The DOL recognized that there will be appropriate compensation arrangements with service providers who may become ERISA fiduciaries under the Proposed Regulation but who would not previously have been clearly considered fiduciaries. As a result, such arrangements may constitute a prohibited transaction under the new rules, unless there is specific relief for the arrangements. The proposals are as follows (each are subject to various requirements and conditions set forth in the particular PTE):

(1) **Proposed New "Best Interest Contract Exemption."** The most original and potentially the most impactful of the new PTEs is the so-called "Best Interest Contract Exemption." It is of particular relevance since, as described below, several of the other proposed PTE changes seek to impose the standard of conduct required under this exemption. This PTE is intended to permit, in certain circumstances, advisers who make investment recommendations to individual plan participants, IRA investors and small plans, and who may not have been viewed as plan fiduciaries prior to the issuance of the Proposed Regulation, to retain their existing compensation arrangements (including commissions, revenue sharing, and 12b-1 fees). To qualify for the PTE, the adviser must enter into a contract with each client, whereby the adviser formally acknowledges its fiduciary status, commits to adhere to certain standards of impartial conduct, adopts policies designed to mitigate the harmful impact of any conflicts of interest, and discloses information about the adviser's conflicts of interest and compensation arrangements. The DOL describes the approach as not aimed at any specific transaction (which has, in general, been the approach in prior PTEs), but rather as being "broad, principles-based and adaptable to changing business practices."

(2) **Proposed New "Principal Transactions Exemption."** The DOL has also proposed a new exemption to permit broker-dealers and other investment advice fiduciaries to engage in "principal transactions" to sell qualifying debt securities out of their own inventory to plans and IRAs, provided the parties enter into a contract that satisfies the requirements under the Best Interest Contract Exemption, discloses the material conflicts of interest associated with the proposed transaction and the debt security pricing information, and documents the plan's prospective consent. The PTE also requires an adviser to be subject to certain conditions (including with respect to the pricing of the securities) and to make certain disclosures.

(3) **Proposed Amendments to PTE 86-128 and PTE 75-1 (Parts I(b) and (c), and II(2)).** The DOL has proposed an amendment to PTE 86-128, which would (a) add the impartial conduct standards requirement set forth in the Best Interest Contract Exemption, (b) revoke relief under the PTE for fiduciaries rendering investment advice to IRAs (although ERISA “investment managers” may continue to rely on the PTE), and (c) add a third covered transaction, permitting fiduciaries to receive commissions in connection with selling mutual fund shares out of their own inventory to plans and IRAs (this transaction is currently addressed under Part II(2) of PTE 75-1). In the same proposal, the DOL has amended PTE 75-1 to (a) revoke the mutual fund exemption in Part II(2) of the PTE in connection with moving it to PTE 86-128, and (b) revoke Parts I(b) and (c) of the PTE, which exempt certain non-fiduciary services to plans and IRAs, such that the affected parties would need to rely on the statutory exemptions under ERISA Section 408(b)(2) and Code Section 4975(d)(2) (for “necessary services”) and the regulations thereunder.

(4) **Proposed Amendment to PTE 75-1 (Part V).** The DOL has also proposed an amendment to Part V of PTE 75-1 to permit investment advice fiduciaries to receive compensation in connection with an arm’s-length extension of credit to plans or IRAs for the purpose of avoiding a failed securities transaction, provided the fiduciary makes advance written disclosures to the plan or IRA.

(5) **Proposed Amendment to PTE 84-24.** The DOL has also proposed an amendment to PTE 84-24 to (a) add the impartial conduct standards requirement set forth in the Best Interest Contract Exemption and (b) revoke the application of the PTE to insurance agents, insurance brokers and pension consultants engaging in transactions with IRAs involving annuity contracts that are securities under federal law.

(6) **Proposed Amendments to PTEs 75-1 (Parts III and IV), 77-4, 80-83 and 83-1.** The DOL has also proposed to amend PTEs 75-1, 77-4, 80-83 and 83-1 to add the impartial conduct standards requirement set forth in the Best Interest Contract Exemption.

(7) **Comments Requested on Potential Streamlined “Low Fee” Transaction Exemption.** Lastly, the DOL requested comments on whether to issue an additional streamlined exemption for compensation received in connection with investment by plans or IRAs in the lowest-fee investment products in a given product class.

## Comment Period and Effective Date

The DOL has invited written comments to be submitted on the proposed rules during a 75-day notice and comment period commencing after the publication of the Proposed Regulation in the Federal Register (which occurred on April 20, 2015), which means that all comments to the DOL are due by July 6, 2015. The DOL will schedule a public hearing (or hearings) within 30 days after the close of the comment period. The rules, once finalized, will become effective 60 days after their publication in the Federal Register, and will generally require parties to become compliant within eight months after the publication (unless these deadlines are extended).

## Conclusion

There will undoubtedly be much discussion and debate about the Proposed Regulation and the proposed PTEs in the coming weeks and months. At a minimum, the Proposed Regulation, if adopted, will pose various compliance challenges. In many ways, the new requirements could fundamentally change how advisers must interact with plans and IRAs.

We will keep you updated on further developments in this area as they occur.

***Executive Compensation & Benefits Alert*** is published by the Executive Compensation & Benefits practice group of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

If you have questions concerning the contents of this issue, or would like more information about Weil's Executive Compensation & Benefits practices, please speak to your regular contact at Weil, or to the editors or practice group members listed below:

**Editor:**

| | | | |
|---|---|---|---|
| Paul J. Wessel | Bio Page | paul.wessel@weil.com | +1 212 310 8720 |

**Practice Group Members:**

| | | | |
|---|---|---|---|
| Michael Nissan | Bio Page | michael.nissan@weil.com | +1 212 310 8169 |
| Amy M. Rubin | Bio Page | amy.rubin@weil.com | +1 212 310 8691 |
| Jeffrey Lieberman | Bio Page | jeffrey.lieberman@weil.com | +1 212 310 8740 |
| Steven M. Margolis | Bio Page | steven.margolis@weil.com | +1 212 310 8124 |

© 2015 Weil, Gotshal & Manges LLP. All rights reserved. Quotation with attribution is permitted. This publication provides general information and should not be used or taken as legal advice for specific situations that depend on the evaluation of precise factual circumstances. The views expressed in these articles reflect those of the authors and not necessarily the views of Weil, Gotshal & Manges LLP. If you would like to add a colleague to our mailing list, please click here. If you need to change or remove your name from our mailing list, send an email to weil.alerts@weil.com.