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What the DOL's Proposed "Conflict of Interest" Rule Means for Retirement Professionals

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Historical Background

- October 2010—the DOL proposed a greatly expanded definition of who would be considered a fiduciary under ERISA, particularly relating to investment advisers.
  - The DOL subsequently withdrew the proposal.
  - The DOL consistently repeated its intention to re-propose a new definition.

Proposed Reg. Rollout

February 23, 2015—The DOL sent an expanded definition of who would be considered a fiduciary under ERISA to the OMB.

- President Obama gave a press conference
- Proposed Regulations published by April 20, 2015
- Comment period expanded until July 21, with public hearings the week of August 10

Proposed Reg. Rationale

- Prior regs. issued in 1975—when DB plans ruled the earth.
- Conflicts of interest in the Mutual Fund segment alone could cost investors $500 billion over the next 20 years.
- DOL's Regulatory Impact Analysis is extensive and available online.

What’s Changing?

- 3(21) Fiduciary—General Fiduciary Definition
- 3(16) Fiduciary—Plan Administrator
- 3(38) Fiduciary—Investment Manager Fiduciary (Registered Investment Advisor)

What's Changing?

- A "fiduciary" is a person who:
  - Has any authority or control over the ***management of plan assets***,
  - Has discretionary authority over ***plan administration***, OR
  - Renders investment advice to the plan for a fee.
- Definition of "fiduciary" is functional

Old Investment Advice Rule

Under current DOL regulations, a "fiduciary" investment adviser is a person who

1. Advises a plan regarding the value of securities or other property or makes recommendations as to advisability of investing in securities or other property, and
2. The advice is
   - Provided on a regular basis, and
   - Pursuant to a mutual understanding that the advice will form a primary basis for the plan's decision-making, and
   - Individualized based on the particularized needs of the plan, and
   - Provided for a fee.

New Investment Advice Rule

Under proposed DOL regulations, a "fiduciary" investment adviser is a person who

1. Provides covered advice for a fee, and
2. Either directly or indirectly
   - Represents or acknowledges fiduciary status, or
   - Renders the advice under a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

New Investment Advice Rule

- Covered Advice includes recommendations to
  - Acquire, hold, dispose or exhange securities or other property, or
  - Management of securities or other property, or
  - Take (or not take) a distribution or rollover, or
  - Hire any person to provide the above advice for a fee

New Investment Advice Rule

- Covered Advice also includes appraisals or fairness opinions if made for a specific transaction.
  - Does not include valuations used solely for reporting purposes.
  - Does not include ESOP valuations.

New Investment Advice Rule

"Recommendation" is defined as "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".

New Investment Advice Rule

- Includes one time advice.
- No need for “mutual understanding” of parties.
- Advice need not be individualized.
- Investment management expressly covered.

Comparison of Old and New Rule

Activity	Current Rule	Proposed Rule
Recommending an Advice Fiduciary	Not Fiduciary	Fiduciary
Advice to Participants Regarding IRA Rollovers	Not Fiduciary	Fiduciary
Valuations/Fairness Opinions for a Specific Transaction	Not Fiduciary	Fiduciary
Participant Education	Not Fiduciary	Not Fiduciary

Carve Outs

- Sales/Counterparty Transactions for Large Plans
- Swap Transactions
- Advice from Employees of Plan Sponsor
- Non-individualized Marketing by Platform Provider
- Financial Reports/Valuations
- Investment Education

Carve Outs—Education

- Plan Information
- General Financial, Investment and Retirement Information
- Asset Allocation Models
- Interactive Investment Materials

Expanded to include retirement income guidance. Contracted to exclude specific investment products.

Prohibited Transaction Exemptions

Prohibited Transactions

- New rule greatly expands who is a fiduciary
- ERISA section 406(b) prohibits fiduciaries from earning variable compensation
- PT Exemption will be required for advisors who are fiduciaries under the new rule

Institutional v. Retail Investors

Which prohibited transaction exemption(s) is available depends upon whether investor is retail or institutional.

- Retail Investor = Plan participants and beneficiaries, IRA owners and non-participant directed plans with less than 100 participants.
- Institutional Investor = Plans above 100 participants (and all participant directed plans).

Institutional Investors

- Fiduciaries must rely on existing prohibited transaction exemptions for institutional investors.
- DOL has updated relevant exemptions in conjunction with the new rules.
- Changes to exemptions may require contract adjustments or additional disclosures.

Retail Investors

- For retail investors, fiduciaries may <u>only</u> rely on the new Best Interest Contract (BIC) Exemption.
- Designed to preserve existing compensation structures.
- BIC Exemption covers
  - Variable compensation based upon recommendations
  - Compensation from third parties.

BIC Exemption—Requirements

- Written contract—prior to advice
  - Provide certain warranties
  - Required disclosures
- Acknowledge fiduciary status
- Commit to adhere to "Impartial Conduct Standards"
  - Reasonable compensation
  - No misleading statements

BIC Exemption—Requirements

- Adopt policies and procedures
- Public website
- Point of sale disclosures
- Annual disclosures
- Notice to DOL
- Maintenance of records

BIC Exemption—Requirements

Fiduciary must commit to provide advice that is in the “Best Interest” of the investor.

- Best interest standard is based upon ERISA prudence standard.
- Intended to create a cause of action—enforceable in state courts—for investors.

Closing Thoughts

Impact on Health Plans

- New rule focused on retirement plans—does not generally consider business practices of health and welfare plans.
- No specific carve out for health plans.
- Advice includes recommendations on "other property" which includes health life and disability insurance contracts.
- New rule specifically applies to HSAs.

Implications for Plan Sponsors

- Know who your fiduciaries are.
- May have new disclosures to review and contracts to sign.
- Review participant communications and educational materials.
- Get a grip on discussions with participants about rollovers and distributions.

Questions?