DOL Proposal Would Fundamentally Alter Fiduciary Relationship

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Nearly five years after proposing a failed rule that would have dramatically expanded the definition of fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA), the Department of Labor has decided to try again. On April 14, the Department released a series of proposed rules, regulations, and exemptions under ERISA. The proposal dramatically expands the definition of a "fiduciary" as to plans subject to ERISA, sweeping in many insurance agents, broker/dealers, advisers and others that were not fiduciaries under the original regulation. The proposal also applies the same definition to the term "fiduciary" under the excise tax provisions of the Internal Revenue Code, sweeping in individuals or entities that offer investment advice to IRAs and health savings accounts. If enacted in its present form, the proposal will also likely dramatically alter current compensation arrangements. Although these proposals are open to comment until July 6, 2015, all those dealing with employee benefit plans covered by ERISA, as well as IRAs, should pay close attention to the proposal now. The fundamental shift relates to the definition of "investment advice." Under the new definition, a person becomes a "fiduciary" by providing:

1. recommendations as to the acquisition, holding, disposing or exchanging of securities or other property,
2. management of securities or other property, including IRA rollovers,
3. an appraisal or fairness opinion, or
4. recommendations as to persons to provide the investment advice or to manage plan assets for a fee.

The person making one or more of the recommendations discussed above, must also represent or acknowledge, either directly or indirectly, their fiduciary status or provide the advice under 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 to securities or other property. **This latter requirement is a dramatic change from the current definition of "fiduciary"** which requires that the advice be furnished on a "*regular basis*" pursuant to a "*mutual*" agreement or understanding, and that it must serve as the "*primary basis*" for investment decisions. The proposal provides a number of "carve-outs" from the general definition of fiduciary outlined above, subject to certain conditions depending on the nature of the "carve-out." For example, there is a "carve-out" for service providers, such as record keepers or third-party administrators, that offer a platform of investment vehicles to participant-directed individual account plans if a plan fiduciary chooses the specific investment alternatives that will be made available to the plan's participants. Importantly this "carve-out" does not apply to IRAs. The proposed regulation also provides a "carve-out" for investment education similar to that provided in Interpretive Bulletin 96-1, so long as the information and materials do not include advice or recommendations as to specific investment products. The Department is also proposing a new prohibited transaction class exemption, the *Best Interest Contract Exemption*, which would allow fiduciaries to receive compensation that would otherwise not be permitted (*e.g.,* commissions, revenue sharing, 12b-1 fees and shareholding servicing fees). The proposed exemption contains several limitations and conditions that may make it impractical to rely on. Most significantly, before any advice is given, the person must enter into a written contract acknowledging his/her fiduciary status and must commit to provide advice in the "best interest" of a plan's participants and beneficiaries. The adviser must also provide certain warranties as well as disclose any material conflicts of interest. The "best interest" standard is almost identical to that part of ERISA's Section 404(a)(1)(B) prudent man standard of care. Moreover, the exemption only applies to advice provided to plan participants and beneficiaries in participant-directed account plans, IRA owners, and plan sponsors of non-participant directed plans with fewer than 100 participants. It does not cover fiduciaries who have discretionary authority over the administration of the plan or IRA. It is critical that the proposed exemption would create *a private right of action* for breach of contract if an advice recipient, including an IRA owner, believed the adviser did not act in his/her best interest. Finally, the Department is also proposing to modify several existing prohibited transaction class exemptions including PTE 84-24, which covers transactions involving insurance or annuity contracts sold to plans or IRA investors by pension consultants, insurance agents, or brokers. The exemption allows these fiduciaries to receive a sales commission, subject to certain conditions, regarding products purchased by plans or IRA investors. The proposed modifications include: (1) requiring all fiduciaries relying on the exemption to adhere to the same impartial conduct standards required in the Best Interest Contract Exemption; (2) revoking reliance on the exemption as to transactions involving variable annuity contracts and transactions involving the purchase of mutual fund shares with respect to IRA investors; and (3) narrowing the definition of commissions to exclude revenue sharing, administrative or 12b-1 fees. To receive such compensation, or any variable compensation related to the sale of a variable annuity contract, the insurance agent or broker will have to rely on the Best Interest Contract Exemption. Based on the reaction to the 2010 proposal, there will be numerous comments on the current proposal and an extensive lobbying effort to obtain significant changes to the proposed rule. It is unlikely that a final rule will be adopted this year. Some predict that a final rule will not be adopted before the end of President Obama's term. We at Carlton Fields continue to analyze the proposal and monitor developments. We are also prepared to help our clients determine the proposal's impact on their businesses.

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