

The DOL's New "Fiduciary" Regulations: Heightened Standards and Pending Challenges

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ERISA § 3(21)(A)(ii)'s “Fiduciary” Definition:

- Any person to the extent he or she “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.”
 - **DOL’s 1975 regulations:** unless the investment advisor *acknowledged* fiduciary status, he or she was a fiduciary *only* if the advice was provided for a fee under a mutual arrangement and understanding that the advice would be relied on and would take into consideration the plan’s individualized investment needs.
 - **New regulations:** greatly expand the definition of “investment advice” subject to fiduciary standards.

“Investment Advice” Under New DOL Rule:

1. a recommendation:
 - a. as to the advisability of buying, holding, selling or exchanging securities or other investment property, including recommendations as to the investment of securities or other property after the securities or other property are rolled over or distributed from the plan or IRA;
 - b. as to the management of securities or other investment property, including recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, and selection of investment account arrangements (e.g., brokerage versus advisory); or
 - c. 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;
2. that is made to a plan, plan fiduciary, plan participant or beneficiary, or IRA owner; and
3. that is for a fee or other compensation, direct or indirect.

“Investment Advice” Under New DOL Rule:

- What constitutes a “recommendation?”
 - A “communication” that would “reasonably be viewed as a suggestion” that the investor make a particular investment decision.
 - The more individually tailored, the more likely the communication will be found to be a “recommendation.”
 - The suggestion need not be specific—providing a selected list of securities and suggesting that that they are appropriate investment options could be enough.
 - An adviser could become a fiduciary by suggesting that the plan or IRA choose an investment or hire an investment manager.
- “Hire me” solicitations are not enough to create fiduciary status.
 - But, if coupled with an investment recommendation or recommendation that the plan hire a particular investment advisor, that may be sufficient to create a fiduciary relationship.

“Investment Advice” Under The New DOL Rule:

- What constitutes a “a fee or other compensation?”
 - Includes commissions, loads, finder’s fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees (12b-1 fees), underwriting compensation, payment to brokerage firms for shelf space, recruitment compensation, gifts and gratuities, and expense reimbursements.
 - May not matter that the compensation was associated with the purchase of an investment rather than strictly with the recommendation.
 - Thus, an adviser can become a fiduciary by making a suggestion that the plan fiduciary or an individual retirement account choose an investment or hire an investment manager.



Exceptions to Fiduciary Investment Advice Definition Under New DOL Rule:

- Platform providers can respond to request for proposals, inquiries, or solicitations and can include an array of possible investment options from which the plan fiduciary might select specific investment options.
- General communications, such as newsletters, public commentary and speeches, general market data, and performance reports not covered.
- Investment education such as plan or IRA information describing performance, risk, historical returns for included investments are excluded from the rule.
- General information presenting historic rates of returns for different asset classes, the effects of fees on rates of return, estimates of retirement needs, and general approaches to managing assets are not covered.
- Asset allocation models and interactive materials based on generally accepted investment theories are excluded.

Non-Fiduciaries Under New DOL Rule:

- Broker-dealers who execute securities transactions in the ordinary course of their business pursuant to instructions of a fiduciary.
- Those providing incidental advice in an arms length transaction with an independent fiduciary of a plan or IRA that is financially sophisticated or an independent fiduciary of a plan with at least \$50 million in total assets.
- A swap dealer who does not provide advice to the plan, receives no direct fee or compensation, and obtains a written representation from the independent plan fiduciary that the fiduciary understands the dealer is not providing impartial advice or acting as a fiduciary.
- An employee whose job responsibilities do not involve investment advice and who is not registered or licensed under federal or state securities or insurance laws and who receives only his or her normal compensation.

Implications of Expanded Fiduciary Status:

- New rule requires financial professionals who advise plans and IRAs to act in their clients' "best interests" when recommending investment products.
 - This raises the standard from that under the prior rule, which only required that the adviser promote products that are "suitable" for the investor.
 - "Best interest" means "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 [fiduciary]"



Implications of Expanded Fiduciary Status:

- Under ERISA and IRC prohibited transaction rules, plan fiduciaries are generally not permitted to receive payments that give rise to a conflict of interest.
 - Thus, for example, under the new investment advice fiduciary standard, commissions or revenue sharing arrangements that an investment adviser's firm receives related to the advice provided may be deemed a prohibited transaction.

The Best Interest Contract Exemption:

- The final rules include a new prohibited transaction class exemption—the “Best Interest Contract Exemption” or BICE.
 - Allows brokers to continue to earn commissions and other compensation from the sale of investment products notwithstanding the prohibited transaction rule provided they enter into a contract with their customer in which they pledge to act in the client’s best interest, disclose any conflicts of interest, and maintain standards of impartial conduct.
 - Permits registered investment advisers, broker-dealers, and insurance carriers and their agents/representatives who are fiduciaries by virtue of their provision of investment advice to receive otherwise prohibited compensation in connection with a transaction involving IRA owners, plan participants and beneficiaries, and small plan sponsors.
 - Prohibits the use of individual arbitration and class action waiver agreements in client contracts.

The Best Interest Contract Exemption:

- In order to qualify for BIC exemption, a fiduciary must:
 - Acknowledge fiduciary status;
 - Provide advice that is in the retirement investor's best interest;
 - Develop and implement policies and procedures designed to ensure that fiduciaries provide advice that is in the retirement investor's best interest;
 - Charge no more than reasonable compensation;
 - Refrain from providing incentives that may encourage fiduciaries from acting in the retirement investor's best interest;
 - Disclose the fees and compensation received by the fiduciary;
 - Disclose any material conflicts of interest that the fiduciary is subject to; and
 - Make no misleading statements regarding investment transactions, compensation, and conflicts of interest.

Objections to the Proposed Fiduciary Rules:

- DOL made substantial revisions to the final rule based on thousands of public comment and objections to its proposed rule published a year earlier.
- Extended period for phase in – begins taking effect April 2017, with full implementation due in January 2018.
- But many objections and areas of uncertainty remain.
 - Critics contend that BICE threshold of \$50MM in assets will raise costs for small plans and limit the types of advice available to small business plan sponsors.
 - Judgment calls regarding whether fiduciaries are meeting BICE conditions will lead to litigation.
 - Employers with responsibility for overseeing plans must monitor their fiduciaries; new rules may cause formerly nonfiduciary service providers to plans to become fiduciaries; employers must be aware of changes in order to discharge their responsibilities.



Legal Challenge to New Fiduciary Rule:

- Legal challenge filed June 1, 2016 in Dallas federal district court seeking to invalidate the new Rule.
- Plaintiffs challenging the Rule are:
 - U.S. Chamber of Commerce
 - Financial Services Institute
 - Financial Services Roundtable
 - Irving-Las Colinas Chamber of Commerce
 - Humble Area Chamber of Commerce
 - Lake Houston Chamber of Commerce
 - Insured Retirement Institute
 - Lubbock Chamber of Commerce
 - Securities Industry and Financial Markets Association
 - Texas Association of Business

Legal Challenge to New Fiduciary Rule:

- DOL ignored commenters who expressed concern over how the rule would impact retirement savers and smaller broker-dealers, including comments from SEC staff.
- DOL didn't comply with Administrative Procedures Act by not properly considering the costs and benefits of the rule and instead passing it in an arbitrary and capricious manner.
- DOL overstepped its authority and usurped authority delegated by Congress to the SEC.
- DOL exceeded authority delegated by IRS when it expanded "fiduciary" definition and imposed ERISA fiduciary duties on IRAs.
- BICE prohibition on including class action waivers conflicts with the Federal Arbitration Act.
- BICE restriction on adviser's freedom to advise clients violates the First Amendment of the U.S. Constitution.

Legal Challenge to New Fiduciary Rule:

- Examples of alleged practical harm to investors and businesses:
 - prohibition on transaction-based compensation will push investors into fee-based accounts that can be prohibitively expensive for low-income savers and those who do not make frequent trades.
 - put financial institutions in the position of “having to choose which regulator to obey” because SEC and FINRA both require firms to ensure fee-based accounts are only recommended for suitable investors.
 - will burden “main street” financial advisors with extensive new requirements and ongoing threats of liability, forcing them to limit the options and guidance they provide to retirement savers and smaller plans.



Legal Challenge to New Fiduciary Rule:

- What happens next?
 - additional possible suits?
 - injunctive relief?
 - eventual appellate review?

Presenter Profile



Karl G. Nelson

Labor and Employment Partner

Gibson, Dunn & Crutcher LLP – Dallas, TX

Contact:

2100 McKinney Avenue

Dallas, Texas 75201

Tel: +1 214.698.3203

KNelson@gibsondunn.com

Karl Nelson counsels and represents clients in all aspects of federal and state fair employment law, labor relations, and compensation and benefits matters. He has extensive experience and an impressive record of successes in defending class and collective labor, employment, and benefit litigation, and also regularly advises clients in connection with trade secret, competition, and employee-raiding issues. Among the many high-profile matters he has handled, Nelson was a lead member of the team that litigated and ultimately won the U.S. Supreme Court’s unanimous reversal in *Wal-Mart v. Dukes* – the largest employment discrimination class action in history. In addition, Nelson regularly advises and represents clients in connection with investigations and proceedings before federal and state administrative agencies regulating the workplace. Nelson is a Fellow in the College of Labor and Employment Lawyers and a frequent writer and speaker in the area of employment law and litigation.