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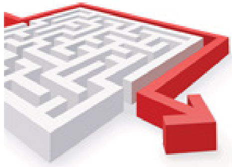

# DOL Issues Final Fiduciary Rule: How Does The New Definition Affect Plan Sponsors

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On April 8, 2016, the Department of Labor (DOL) issued its final regulations significantly redefining the standards for determining when an adviser is a fiduciary under the Employee Retirement Income Security Act of 1974, as amended (ERISA) and the Internal Revenue Code of 1986, as amended (Code). Generally, the revised fiduciary definition is to the advantage of plan sponsors, plan participants, and owners of individual retirement accounts (IRA) because it now extends fiduciary status to a broader range of brokers, insurance agents and financial service provisions that provide investment advice to ERISA retirement plans and IRAs.

## Background of the Definition of Fiduciary

Under ERISA, a person is a fiduciary to a plan if that person renders "investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan." In 1975, the DOL issued the first regulations clarifying the definition of fiduciary and explaining when a person became an investment fiduciary. The 1975 fiduciary rule used a five factor test to determine fiduciary status and was issued during a time when the most prevalent employer-sponsored retirement plan was a defined benefit pension plan. At that time, most employers did not provide participant-directed plans and in fact, 401(k) plans did not exist in 1975. Today, however, an overwhelming majority of employer-sponsored retirement plans are 401(k) plans which permit participant direction of investments and the number of employers sponsoring pension plans has decreased significantly.

As retirement plans evolved, the DOL became concerned that the existing fiduciary rule did not treat many investment advisers as fiduciaries, allowing such advisers to engage in practices, including self-dealing, generally prohibited by ERISA and the Code. Further, the prior fiduciary rule did not address investment advice provided to owners of IRAs, which generally are not subject to ERISA's fiduciary rules. In response to these concerns, the DOL has spent the past several years developing the new fiduciary rule, which is intended to ensure that investment advisers are acting in the best interests of their clients when they provide advice to retirement plans, plan sponsors, plan participants and IRA owners.

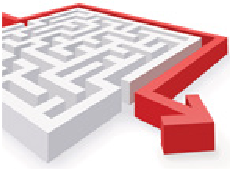
It should be noted that the new fiduciary rule was first proposed during 2010, which resulted in a significant level of criticism. That proposal was soon thereafter withdrawn and reintroduced during 2015 as a set of proposed regulations. Those proposed regulations have now been finalized, with significant modifications, as the final rule issued on April 8, 2016.

## Definition of Fiduciary under the Rule

The final rule replaces the five factor test with a new standard. The new test for determining whether a person would be an investment advice fiduciary under ERISA focuses on whether the adviser provides certain categories or types of investment advice for a fee or other compensation, and whether the advice is provided in connection with certain types of relationships.

### *What is Investment Advice?*

The final rule defines "investment advice" as a "recommendation" to a plan, plan sponsor, plan fiduciary, plan participant or IRA owner for compensation, direct or indirect, as to the advisability of buying, holding, selling or exchanging investment property. Investment advice also includes recommendations as to the management of investment property, such as recommendations on



investment policies or strategies, selection of other persons to provide investment advice or investment management services or recommendations with respect to rollovers, distributions or transfers from a retirement plan or IRA. For this purpose, the term "recommendation" is defined broadly, to include 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."

*Investment Adviser Relationship*

The final rule describes the types of relationships that must exist for the investment "recommendations" described above to give rise to fiduciary investment advice responsibilities. A party (either directly or through an affiliate) who make recommendations for a fee will be considered a fiduciary with respect to a retirement plan or IRA if the person:

- represents that he is acting as a fiduciary within the meaning of ERISA,
- renders advice pursuant to a written or verbal agreement and the advice is based on the particular circumstances of the recipient, or
- directs advice to a specific recipient regarding the advisability of a particular investment decision with respect to property in the plan or IRA.

In short, if an adviser is making a recommendation as to the investment of plan assets, and the adviser is receiving compensation, direct or indirect, from a plan or an IRA, the adviser will be an investment fiduciary with respect to the plan or IRA.

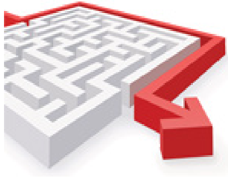
*Impact on Distributions from Qualified Plans and Rollovers to IRAs*

Under the final rule, investment advice now includes recommendations with respect to rollovers, transfers, or distributions from a plan or IRA. This is a significant change to the rules in this area. During the past several years, it has been relatively common for plan participants to take a distribution from a qualified retirement plan and rollover that distribution to an IRA. It also has been fairly common for financial advisers, which often include individuals who works for affiliates of the plan's third party record keeper, to contact plan participants and recommend that they rollover their account balances to an IRA, after which those account balances were no longer subject to the protections provided by ERISA. Under the final rule, any recommendation to take a distribution from a retirement plan or IRA or any recommendation to rollover a retirement plan distribution to an IRA will constitute investment advice under ERISA. As a result, plan sponsors should confer with the plan's recordkeeper to determine how requests for plan distributions will be handled after the final rule becomes effective. For example, when a participant is making a request for a distribution through the recordkeeper's website, some recordkeeping systems provide the default distribution option to be a direct rollover to an IRA offered by the recordkeeper. Plan sponsors should consider whether such default rollover to an IRA offered by the record keeper is prudent. In other situations, a record keeper may provide contact information for an affiliated financial adviser who can assist a participant in making a rollover to an IRA, which action will be treated as the provision of investment advice under the final rule.

*What is Not Investment Advice?*

Under the final rule, certain communications from investment advisers are not considered to be "recommendations" as to the investment of property and would not cause the person providingsuch information to be an investment advice fiduciary. Accordingly, the following materials do not constitute investment advice:

- Investment Education. Education materials, regardless of who provides the educational information, the frequency with which the information is shared, or the form in which the information is provided.
- General Communications. General communications that a reasonable person would not view as an investment recommendation, such general circulation newsletters, research or news reports prepared for general distribution, general marketing materials, and general market data.
- Platform Providers. Platform providers who offer a selection of investment alternatives to plan fiduciaries who choose the specific investment alternatives that will be made available to



participants for investing funds in their individual accounts, provided the platform is offered without regard to the individualized needs of the plan and such provider represents in writing that they are not undertaking to give advice in a fiduciary capacity.

### Effective Date

Compliance with the final rule is not generally required until April 10, 2017, with a transition period until January 1, 2018.

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