

# The New Fiduciary Proposal and Its Consequences

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## Fiduciary Status for Investment Advice

On October 22, 2010, the Department of Labor issued a proposed regulation that, if finalized, will:

- Expand the definition of fiduciary investment advice; and
- Cause the current practices of many financial advisers and benefits brokers to be considered fiduciary investment advice.

# Fiduciary Status

The DOL explains their rationale:

“Many pension consultants believe they have taken appropriate actions to insulate themselves from being considered a ‘fiduciary’ under ERISA. As a result, it appears that many consultants believe they do not have any fiduciary relationships with their advisory clients....”

## Significance of Fiduciary Status

The preamble to the proposed regulation explains:

“ERISA imposes a number of stringent duties on those who act as plan fiduciaries, including a duty of undivided loyalty, a duty to act for the exclusive purposes of providing plan benefits and defraying reasonable expenses of administering the plan, and a stringent duty of care grounded in the prudent man standard from trust law.”

*(continued . . .)*

## Significance of Fiduciary Status

“Congress supplemented these general duties by categorically barring, subject to exemption, certain ‘prohibited’ transactions. Fiduciaries are personally liable for losses sustained by a plan that result from a violation of these rules.”

## The Proposed Regulation

Under the proposal, a person will be rendering fiduciary investment advice if the person:

- Provides advice (or an appraisal or fairness opinion) about the value of securities or other property;
- make recommendations about the advisability of investing in, purchasing, holding, or selling securities or other property; or

*(continued . . .)*

## The Proposed Regulation

- Provides advice or makes recommendations about the “management” of securities or other property.

. . . to a plan, a plan fiduciary or a plan participant or beneficiary;

# Management of Securities

The preamble explains:

“This would include, for instance, advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies), and as to the selection of persons to manage plan investments.”



## The Proposed Regulation

And the person, either directly or indirectly (*e.g.*, through an affiliate):

- Represents or acknowledges fiduciary status for the advice or recommendations; or
- Is otherwise a fiduciary under ERISA (*i.e.*, sections 3(21)(A)(i) or (iii)); or
- Is an investment adviser (as defined in section 202(a)(11) of the Investment Advisers Act of 1940); or

*(continued . . .)*

## The Proposed Regulation

- Provides the advice or makes the recommendations:
  - pursuant to an agreement, arrangement or understanding, written or otherwise;
  - that the advice may be considered for investment or management decisions; and
  - will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary.

## Limitations on Advice

A person (other than an acknowledged fiduciary) will not be considered a fiduciary if the person can demonstrate that the recipient of the advice knows, or reasonably should know, that the person is the purchaser or seller of the investment (or is an agent or appraiser for the purchaser or seller) and:

- whose interests are adverse; and
- who is not providing impartial advice.

## Limitations on Advice

For individual account plans, the following acts will not, in and of themselves, be considered fiduciary investment advice:

- The provision of investment education information and materials within the definition of DOL Interpretive Bulletin 96-1;

*(continued . . .)*

## Limitations on Advice

- Marketing or making available securities or other property (e.g., through a platform) from which a plan fiduciary may select investment alternatives for participant direction:
  - if the investments are offered without regard to the individualized needs of the plan, its participants or beneficiaries;
  - and if written disclosures are given that the person is not providing impartial investment advice.

*(continued . . .)*

## Limitations on Advice

- If, in connection with that offering of investments, the provider gives plan fiduciaries general financial information and data to assist in the selection or monitoring of the investments, that information will not be considered to be fiduciary investment advice . . .

. . . if a written disclosure is given that the person is not providing impartial investment advice.

## Fee or Other Compensation

A “fee or other compensation, direct or indirect, received by a person for rendering investment advice” means:

- any compensation for the advice received from any source; and
- any compensation incident to the transaction in which the investment advice is rendered.

“Fee or other compensation” includes brokerage, mutual fund sales, and insurance sales commissions.

## Internal Revenue Code

The Internal Revenue Code also includes a definition of fiduciary advice in section 4975(e)(3)(B).

The definition applies to the prohibited transaction rules for qualified plan and other specified “plans,” including IRAs.

But, see PTCE 86-128.



## The Fiduciary Process

Obviously, if a person becomes an ERISA fiduciary, that person must comply with ERISA's fiduciary standards, including the duty of loyalty and the prudent man rules.

## The Fiduciary Prohibited Transactions

The more difficult issue, though, may be complying with the ERISA prohibited transaction rules that apply to fiduciaries.

## Fiduciary Prohibited Transactions

The fiduciary prohibited transaction rules are found in ERISA section 406(b).

406(b)(1) prohibits a fiduciary from dealing with the assets of the plan in his own interest or for his own account.

406(b)(3) prohibits a fiduciary from receiving any consideration for his account from any party dealing with the plan in connection with a transaction involving assets of the plan.

# Capturing Rollovers

The preamble states:

“The Department, therefore, is requesting comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution.”

## Integration of Advice and 408(b)(2) Disclosures

The 408(b)(2) regulation requires a written disclosure if a service provider “reasonably expects” to be an ERISA fiduciary.

How will the new fiduciary advice definition impact the services of intermediaries?

## Scope of Fiduciary Responsibility

A person is a fiduciary with respect to a plan by reason of rendering investment advice . . . shall not be deemed to be a fiduciary regarding any assets of the plan with respect to which such person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority, does not render investment advice . . . and does not have any authority or responsibility to render such investment advice.

# Scope of Fiduciary Responsibility

Additional fiduciary issues:

- Co-fiduciary responsibility under ERISA section 405(a).
- Terms of service agreement.

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