

The Fiduciary Re-Proposal: The New Definition and Its Consequences

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Fiduciary Status for Investment Advice

The Department of Labor is preparing a new proposal that, if finalized, will:

- Expand the definition of fiduciary advice; and
- Cause the current practices of many service providers to be fiduciary investment advice.

Re-Proposal of Regulation

The DOL has announced that it will re-propose the regulation--probably in mid-2012. Possible changes:

- IRAs.
- Re-affirming prior guidance.
- “Individualized” advice.
- Arm’s length commercial transactions.
- Brokerage commissions.

The Proposed Regulation

Under the proposal that was withdrawn by the DOL, a person would have been rendering fiduciary investment advice if the person:

- . . .
- make recommendations about the advisability of investing in, purchasing, holding, or selling securities or other property; or
- 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

With regard to recommendations about “management,” 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.” [Emphasis added.]

Note: This is a long-standing DOL position and has been accepted by at least one court.

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

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.



"HAVE LEGAL CHECK IT OUT. IF THERE ARE REGS, AND EVERYONE FINDS WAYS TO AVOID THEM, ARE THERE REALLY REGS?"

Key Changes Affecting Advisers

➤ Deletions:

- Advice “on a regular basis.”
- Pursuant to a “mutual” understanding.
- As “a primary” basis for investment decisions.
- “Regarding matters such as . . . investment policies or strategy, overall portfolio composition, or diversification of plan investments.”

Selling Limitation

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**;
- 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:

continued . . .

Limitations on Advice

- 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**.

And . . .

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**.

Issues for Platform Providers

- Conversions.
- Revenue sharing illustrations.
- Investments for new plans.
- Refreshing investment offerings.
(Advisory Opinion 97-16A)

Issues for Broker-Dealers

- IRAs, but PTCE 86-128.
- “Individualized” advice.
 - Suitability
 - duty of loyalty
 - conflicts of interest
 - Advice incidental to . . .
- Variable compensation
 - Commissions
 - Revenue sharing

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 plans and other specified “plans,” including IRAs.

Fiduciary Issues for Advisers

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

Fiduciary Issues for Advisers

The prudent man rule requires that the adviser engage in a prudent process to develop and deliver his investment advice, *e.g.*:

- Criteria
- Software
- Databases
- Reports

ERISA's investment provisions are based on generally accepted investment principles, including modern portfolio theory.

Fiduciary Prohibited Transactions

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

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

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



"What would you prefer; my professional legal opinion, or the truth?"

Impact of Fiduciary Definition

- On broker-dealers:
 - levelized compensation
 - RIA programs
 - affiliated products
 - investment managers
- On insurance brokers and agents.
- On providers:
 - Plan sponsor proposals
 - Adviser “solutions”

continued . . .

Impact of Fiduciary Definition

- On RIAs:
 - the need to distinguish.
 - 3(38) investment management.
 - fee benchmarking.
 - retirement outcomes.

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.”

Parting Thoughts and Questions . . .

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