



The Fiduciary Trend: The Combined Effects of the Proposed Advice Regulation and 408(b)(2)

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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.



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;
- And . . .


continued . . .

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.

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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.

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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.



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 by the person or any affiliate from any source; and
 - any compensation incident to the transaction in which the investment advice is rendered.
- Compensation includes, for example, brokerage, mutual fund, and insurance 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.
- Note regarding Prohibited Transaction Class Exemption 86-128.



The Fiduciary Prohibited Transactions

- 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.



The 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.





Scope of Fiduciary Responsibility

- Additional fiduciary issues:
 - Co-fiduciary responsibility under ERISA section 405(a).
 - Terms of service agreement.
 - 408(b)(2) compliance.





Reasonable Contract or Arrangement

- The regulation states:
 - No contract or arrangement for services between a “covered plan” and a “covered service provider,” nor any extension or renewal, is reasonable unless the requirements in the regulation are satisfied.
 - Effective date: January 1, 2012 for both new and existing arrangements . . . transition issues.





Disclosures

- A written contract or arrangement will not be required. However, the following disclosures must be made in writing:
 - Services
 - Status
 - Compensation



Disclosures



- Initial disclosure requirements: The RIA must disclose the following information to a “responsible plan fiduciary,” in writing.
 - Services: A description of the services to be provided to the plan pursuant to the arrangement.

Disclosures

- Status: A statement that the service provider will provide, or reasonably expects to provide:
 - services directly to the plan (or to an investment contract, product or entity that holds plan assets and in which the plan has a direct equity investment) as a fiduciary and/or . . .

continued . . .

Disclosures

- services pursuant to the arrangement directly to the plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.



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?



Disclosure of Compensation

- A description or an estimate of compensation may be expressed as a monetary amount, formula, percentage of the covered plan’s assets, or a per capita charge for each participant or beneficiary or, if the compensation cannot reasonably be expressed in such terms, by any other reasonable method.
- Any description or estimate must contain sufficient information to permit evaluation of the reasonableness of the compensation.



Disclosure

- Neither the proposal nor the interim final rule requires the service provider to make disclosures in any particular manner or format.
- As a result, multiple documents may be used.



Disclosure

- However, the preamble explains:
 - *The Department is considering adding a requirement that service providers furnish a “summary” disclosure statement.*
 - *For example, limited to one or two pages, that would include key information intended to provide an overview for the responsible plan fiduciary of the information required to be disclosed.*
 - *The summary also would be required to include a roadmap for the plan fiduciary describing where to find the more detailed elements of the disclosures required by the regulation.*



Other Consequences

- Benchmarking
- Expansion of fiduciary advisers
- Specialization of fiduciary advisers
- Branding of fiduciary advisers



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Additional 408(b)(2) Resources

- Reish & Reicher is preparing a 408(b)(2) template Services Agreement for Independent Advisors to be made available through fi360 and Pioneer
- A CEFEX assessment includes a comprehensive checklist prepared by Reish & Reicher of the 408(b)(2) requirements – www.cefex.org



Announcements

- Come see Fred Reish, CEFEX, fi360 and many more at the 2011 fi360 Conference, May 4-6 in San Antonio

For more information or to register, visit
www.fi360.com/conference



Thank you

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