

Newly Proposed DOL Fiduciary Regulation:

A New Playing Field for Fiduciary Activity

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Introduction

- Agenda for Today
 - Background on Existing Rule
 - Proposed Fiduciary Definition
 - Carve-outs from Definition
 - Proposed Best Interest Contract Exemption
 - Other Proposed Exemptive Relief
 - Timeline for Rulemaking

Background and Historical Context

- Evolution of Retirement Marketplace
 - Existing “fiduciary” definition was issued in 1975
 - Many financial advisors (including brokers) are not fiduciaries under existing definition
- DOL’s Initial Proposal (2010)
 - Withdrawn amidst controversy
 - DOL releases new proposal on Apr. 20, 2015

Existing Fiduciary Definition

- Fiduciary Status
 - Covers person who provides “investment advice” relating to plan assets for compensation
 - Not a fiduciary if no investment advice is given
- 5-Prong Definition for “Investment Advice”
 - Making investment recommendations
 - On regular basis
 - Mutual understanding
 - Primary basis for plan’s decisions
 - Individualized to plan’s needs

Proposed Fiduciary Definition

- Fiduciary Status
 - Covers person who provides “investment advice” for compensation to plans, plan fiduciaries, participants, IRAs and IRA owners
- 4-Prong Definition for “Investment Advice”
 - Making covered recommendations
 - Understanding (does not need to be mutual)
 - Individualized or specifically directed to recipient
 - For consideration by recipient (need not be primary basis)

Scope of “Investment Advice”

- Covered Recommendations
 - Investment recommendations, including taking/investing rollovers
 - Investment management recommendations, including management of rollover assets
 - Giving appraisal or fairness opinion
 - Recommending person who provides any of above services for compensation

Acknowledging Fiduciary Status

- Deemed “Investment Advice”
 - Advisor makes covered recommendations
 - Represents or acknowledges that it is a fiduciary with respect to advice
 - No written acknowledgement is required
 - Fiduciary status applies automatically, even if proposed 4-prong definition is not met

Observations on Proposed Definition

- Proposed Changes to “Investment Advice”
 - Includes one-time advice (without “regular basis” condition)
 - No need for “mutual understanding” of parties
 - Advice merely needs to be specifically directed to recipient (and does not need to be individualized)
 - Recipient merely needs to consider advice when making decision (even if not “primary basis”)
 - Expressly revises definition to cover investment management recommendations

Carve-outs from “Investment Advice”

- 6 Carve-outs from Fiduciary Rule
 - Counterparty to Large Plan
 - Swap Counterparty
 - Employees of Plan Sponsor
 - Platform Providers
 - Financial Valuations and Appraisals
 - Investment Education
- Limitations of Carve-out
 - Carve-out does not apply if advisor represents or acknowledges fiduciary status

Carve-out: Counterparty to Large Plan

- Conditions for Fiduciary Carve-out
 - Counterparty provides advice relating to arm's length purchase/sale, loan or contract
 - Written representation from plan fiduciary
 - Plan has at least 100 participants, it has sufficient expertise, and it will not rely on counterparty to act as fiduciary
 - Not required if plan fiduciary has \$100M+ AUM
 - Counterparty discloses nature of its role
 - No direct fee from plan or plan fiduciary
- Carve-out Not For Agency Services
(e.g., broker's receipt of 12b-1 fees)

Carve-out: Swap Counterparty

- Conditions for Fiduciary Carve-out
 - Counterparty is swap dealer (or security-based swap dealer) or major swap participant
 - Not acting as “advisor” to plan under Commodity Exchange Act or Securities Exchange Act
 - Written representation from plan fiduciary that it will not rely on advice from counterparty

Carve-out: Plan Sponsor Employees

- Conditions for Fiduciary Carve-out
 - Employee may provide advice to plan fiduciary
 - Must not receive compensation beyond employee's normal pay
 - Carve-out is designed to protect employees from potential fiduciary liability

Carve-out: Platform Providers

- Conditions for Fiduciary Carve-out
 - Carve-out applies to providers of investment platforms for DC plans (recordkeeping platforms)
 - Platform may market investment alternatives without regard to individualized needs
 - Must disclose that platform does not provide impartial fiduciary advice
 - Can identify investment alternatives that meet objective criteria
 - Can provide objective financial data and benchmark comparisons

Carve-out: Financial Valuations

- Covers valuations/appraisals for:
 - ESOPs
 - Pooled Investment Vehicles (such as CIFs)
 - Regulatory reporting purposes
- Carve-out applies to both plan and IRA clients

Carve-out: Investment Education

- Similar to Current Safe Harbor (IB 96-1)
 - Plan Information
 - General Financial/Retirement Information
 - Asset Allocation Models
 - Interactive Investment Materials
- Observations
 - Carve-out applies to both plan and IRA clients
 - Expanded to include retirement income guidance
 - Education must not recommend specific investment products
 - Asset allocation models and interactive materials cannot reference plan's investment alternatives

Proposed Exemptions

- Need for “ERISA 406(b)” Exemptive Relief
 - Proposed “investment advice” definition confers fiduciary status on all types of advisors
 - Prohibited transaction rules ban advisors from earning variable compensation (commissions)
 - Exemption required for brokers and insurance agents, including advisors to IRAs
 - DOL proposed Best Interest Class Exemption

Best Interest Contract (BIC) Exemption

- Retail Scope of Proposed Exemption
 - Permits fiduciary advisor to earn variable compensation (commissions) for services to:
 - Participants
 - IRA owners
 - Sponsors of small, non-participant-directed plans (less than 100 participants)
- Observations
 - No exemptive relief for small, participant-directed plans (DOL requesting comments)
 - No exemptive relief for large plan sponsors (participant-directed or otherwise)

Product Scope of BIC Exemption

- Covered Products
 - Bank deposits and CDs
 - Mutual funds, ETFs, CIFs and insurance company separate accounts
 - Exchange-traded REITs
 - Corporate bonds (registered offering) and equity securities (exchange-traded)
 - Treasury and agency debt securities
 - Insurance/annuity contracts and GICs
- Observations
 - No exemptive relief for privately placed debt, non-traded REITs and alternative investments

Required Contract for BIC Exemption

- **Mandatory Terms for Written Contract**
 - Must state that advisor is fiduciary for ERISA/Code purposes with respect to advice
 - Impartial Conduct Standard
 - Advice is in “best interest” of client
 - Reasonable compensation
 - No misleading statements
 - Warranties
 - Compliance with law
 - Policies reasonably designed to mitigate conflicts
 - No incentives to provide improper advice
 - No Liability Limit for Contract Violations
 - Arbitration permitted (with class action rights)

Disclosures Under BIC Exemption

- Disclosures in Written Contract
 - Must identify conflicts
 - Client's right to obtain complete fee information
 - Whether advisor offers proprietary products or receives third party payments
 - Address of webpage disclosing compensation
- Transaction Disclosures
 - Upfront chart with cost of investing for 1-, 5- and 10-year periods (model chart may be used)
 - Annual disclosures of investment and fee activity
 - Webpage disclosure of compensation

Investment Range and BIC Exemption

- Required Range of Investments
 - Advisor must offer broad range of investments covering all reasonably necessary asset classes
 - But limited range may be permissible
 - Written finding that range limitations do not interfere with “best interest” standard for advice
 - Reasonable compensation for services
 - Written notice of range limitations
 - Must notify if recommended investments are not sufficiently broad for client’s needs
 - Examples of range limitations
 - Offering limited to proprietary products or investments with third party payments

DOL Notice for BIC Exemption

- Required Notice to DOL
 - One-time notice must be filed with DOL before firm can rely on BIC Exemption
 - Notice does not need to identify plan or IRA client
 - DOL approval is not required

Insurance/Annuities and BIC Exemption

- “ERISA 406(a)” Exemptive Relief
 - Insurer is “Party In Interest” if provides any services to plan or IRA
 - Additional relief necessary for purchase of insurance/annuity from Party In Interest
- Purchase of Insurance/Annuities
 - Transaction is in ordinary course of business
 - Reasonable compensation
 - Purchase is for cash only
 - Terms are least as favorable as arm’s length transaction

Observations on BIC Exemption

- Regulatory Jurisdiction
 - DOL has no enforcement authority over IRAs, but required contract gives authority to clients
 - Violation of Impartial Conduct Standard will breach contract (but not BIC Exemption)
- Impact on Brokers and Insurance Agents
 - Will regulate advisors without any plan clients (who merely have personal clients with IRAs)
 - May be difficult for firms to eliminate incentives that encourage improper advice

Other Proposed Exemptive Relief

- Principal Transactions Exemption
 - Illustrative Problem
 - Broker-dealer is deemed to be fiduciary advisor
 - BIC Exemption covers brokerage services
 - Additional relief needed for sale of securities from firm's inventory to plan or IRA client
 - Conditions are similar to BIC Exemption
 - Covers purchase/sale of certain debt only
 - U.S. corporate bonds (registered offering)
 - Treasury securities
 - Agency debt securities

Proposed Amendments to PTEs

- DOL is integrating Impartial Conduct Standard and proposing related changes
- Prohibited Transaction Exemptions
 - PTE 75-1 (Part III): Underwriting Syndicates
 - PTE 75-1 (Part IV): Trades with Market Makers
 - PTE 75-1 (Part V): Extensions of Credit
 - PTE 77-4: Mutual Fund-Related Conflicts
 - PTE 80-83: Sale Proceeds Reducing Debt
 - PTE 83-1: Mortgage Pool Certificates
 - PTE 84-24: Insurance/Annuity-Related Conflicts
 - PTE 86-128: Executing Securities Transactions

Possibility of Low Fee Exemption

- DOL has requested comments on Low Fee Exemption
 - Would permit advisor to earn variable compensation
 - Exemption would be similar to BIC Exemption
 - Lesser requirements for recommending lowest fee product in product class

Timeline for Rulemaking

- Initial 75-Day Comment Period
 - Proposal released on April 20, 2015
 - First comment period was to end on July 6, 2015
 - EXTENDED: TO July 21, 2015 (i.e., for an additional 15 days).
- Public Hearing
 - To be scheduled within 30 days after July 21st
 - Reopening of record after hearing transcript released
- Delayed Applicability Date for Final Rule
 - Final rule effective 60 days after publication
 - Requirements of final rule generally not applicable until 8 months after publication

Prospects for Final Rule

- Obama Administration
 - Has heavily promoted importance of new fiduciary rule
 - Committed to finalizing before end of second term (January 2017)
 - Congress is unlikely to be able to delay final rule by forcing coordinated rulemaking with SEC

Conclusions

- Moving to Universal Fiduciary Standard
 - DOL is seeking to impose “best interest” fiduciary standard on all types of advisors to plans/IRAs
 - Proposal leverages off of existing “principles-based” regulatory approach for RIAs
- Irony of Policy Goals
 - New regime would effectively create 2 classes of fiduciaries (with or w/o variable compensation)
 - Plan and IRA clients may not realize fiduciary advisors can still earn variable compensation

Conclusions (*cont'd*)

- Expected Impact on Advisors
 - DOL proposal will affect substantially all advisors because of reach to IRA assets
 - Costly for broker-dealers and insurance agencies
 - BIC Exemption disclosures appear to significantly exceed 408(b)(2) fee disclosures
 - Little or no impact on RIAs, but certain advisors may decide to join or become RIAs

Final Thoughts

- Next Steps and Following up
 - Be sure to stay abreast of rulemaking process and consult ERISA counsel as appropriate
 - Advisors may wish to re-examine their client service models and documentation
 - Plan sponsors may wish to confirm fiduciary status of advisors, and whether DOL proposal will impact services or fees



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