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Publications

Overview of Department of Labor’s Final Fiduciary Rule

By Joy M. Napier-Joyce, Melissa Ostrower and Stephanie O. Zorn

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The Department of Labor has issued its much-anticipated final rule (the “Rule”) concerning the expanded definition of who is considered a fiduciary under the Employee Retirement Income Security Act, as amended (“ERISA”), and the Internal Revenue Code of 1986, as amended (the “Code”), as well as certain exemptions addressing conflicts of interest.

The Rule, released on April 8, 2016, updates a 1975 regulation defining fiduciary investment advice in order to better protect retirement plans, plan participants, beneficiaries, and individual retirement account (“IRA”) owners from conflicts of interest, imprudence, and disloyalty.

The changes in the definition of fiduciary become *applicable* on April 10, 2017, although the change becomes technically effective on June 7, 2016. This delayed application date gives affected parties a full year to adapt to the new definitions and standards of conduct. In addition, the requirements under the conflict-of-interest exemptions will not be fully applicable until January 1, 2018.

Below is a brief overview of the final Rule and the new conflict-of-interest exemptions. We will continue to review this guidance and communicate through more detailed articles, focusing on the many audiences impacted by this Rule, including employer-sponsored plans, investment advisers, plan participants, and IRA owners.

Covered Investment Advice

The Rule primarily addresses the provision of covered “investment advice.”

More specifically, a person renders investment advice if he or she provides direct or indirect investment advice within certain categories for a fee or other compensation.

This includes:

- A *recommendation* as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA.
- A *recommendation* as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, selection of investment account arrangements (*e.g.,* brokerage versus advisory); or recommendations with respect to rollovers, distributions, or transfers from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made.

The Rule also includes detailed guidance as to what constitutes a recommendation.

Not Covered Investment Advice

Although the Rule sweeps broadly, it also clarifies that many types of communication are *not* treated as covered investment advice, including:

- Providing certain educational materials about retirement savings and general investments, including hypothetical asset allocation under plans using a plan’s designated investment alternatives;
- Sending general communications, including newsletters, marketing materials, and general market data;
- Offering investment alternatives as a platform provider;

Meet the Authors

Joy M. Napier-Joyce

Principal
Baltimore 410-415-2028
Email

Melissa Ostrower

Principal
New York Metro
New York City 212-545-4000
Email

Stephanie O. Zorn

Principal
St. Louis 314-827-3970
Email

- Communicating with certain independent plan fiduciaries with financial expertise;
- Communicating with plans in swap transactions if certain conditions are met; and
- Providing investment recommendations as employees where such employees receive no additional compensation beyond their normal compensation for such work.

The Best Interest Contract Exemption

The Best Interest Contract Exemption ("BIC Exemption") allows many current forms of compensation and fee practices to continue, even though they otherwise would constitute prohibited transactions, as long as the BIC Exemption requirements are satisfied. Generally, the BIC Exemption requires that fiduciary status be acknowledged in writing, basic standards of impartial conduct be adhered to, basic information concerning compensation be disclosed, and a website be maintained concerning compensation practices and other information.

The BIC Exemption also includes more limited requirements for level fee fiduciaries. This is because the ongoing receipt of a level fee, such as a fixed percentage of the value of a customer's assets under management, typically does not raise prohibited transaction concerns as the interests of the adviser and retirement investor are aligned. A conflict does exist, however, when an adviser recommends that a participant roll money out of a plan into a fee-based account that will generate ongoing fees for the adviser that he or she would not otherwise receive, even if the fees going-forward do not vary with the assets recommended or invested. Recognizing that the prohibited transaction in such a case is relatively discrete and limited in duration, the BIC Exemption is easier to satisfy for level fee fiduciaries.

Principal Transactions Exemption

The Principal Transactions Exemption permits investment advice fiduciaries to deal in investments out of their firm's own inventories. In addition to the requirements generally applicable to the BIC Exemption, the Principal Transactions Exemption also requires that the fiduciary seek the best execution reasonably available under the circumstances.

PTE 84-24

PTE 84-24 allows insurance companies, agents, and brokers to receive compensation for recommending fixed rate annuity contracts to plans and IRAs on a more streamlined basis than would be required under the BIC Exemption. The BIC Exemption, however, does apply to recommendations of more complex annuities (such as variable and indexed annuities).

Next Steps

In preparing for compliance with the Rule, firms that offer retirement advice will undoubtedly need to:

1. identify employees that engage in offering covered investment advice;
2. review compensation arrangements of plan advisers for compliance under the Rule;
3. prepare for compliance with the Rule's exemptions; and
4. monitor additional guidance as it is issued.

Employers who sponsor qualified retirement plans now, and in the year to come, should actively review their service provider relationships, while also reviewing their own fiduciary procedures and governance. Now is the time to review internal processes to ensure best practices are followed to guard against risk of fiduciary liability. This will include, at a minimum, reviewing service agreements, monitoring relationships, understanding adviser compensation, and conducting fiduciary trainings where necessary.

Jackson Lewis will continue to provide updates on these topics and can assist in navigating the new and expanding fiduciary landscape.