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MEMORANDUM

TO: AFHE

FROM: Michael de Leon Hawthorne

DATE: April 12, 2016

RE: DOL LEVELS PLAYING FIELD FOR ADVISORS; NEW FIDUCIARY DUTY IMPOSED ON BROKERS

On Wednesday, April 6, the Department of Labor released the final version of its highly anticipated "fiduciary rule." The final rule is the culmination of six years of study, commentary and revisions after the rule was initially proposed in October of 2010 (later withdrawn) and released again on April 20, 2015. The essence of the rule—to subject more advisers of employee benefit plan participants to the fiduciary standards of ERISA—remains unchanged from the 2015 proposal, but the Department of Labor made several key concessions to ease the burden on advisers.

Overview

At its most fundamental level, the new rule expands the definition of who is considered a fiduciary of an employee benefit plan participant or IRA accountholder. The definition answers two questions. First: what constitutes investment advice? And second, what type of investment advice gives rise to a fiduciary duty?

The new rule defines "investment advice" to include:

- A recommendation as to the prudence of buying or selling investments;
- A recommendation as to how assets should be invested after they are rolled over, transferred or distributed from, a retirement plan or IRA to an accountholder;
- A recommendation as to the management of investments; and
- A recommendation as to what to do with rollovers, transfers or distributions from a retirement plan or IRA.

A recommendation, in this context, is broadly defined as a "communication in exchange for compensation that would reasonably be seen as a suggestion that the advisee take or not take the particular action." The more narrowly tailored the advice to the particular investor, the more likely that the communication will be considered a recommendation. The rule specifically states that certain activities related to marketing, such as advertising available investment options, and hosting investment or retirement education seminars, specifically would not be recommendations. Specific educational asset allocation models and interactive investment materials, when provided to multiple plan participants and beneficiaries, are not considered recommendations; however, when provided to individual IRA accountholders, these same materials may be seen as recommendations.

When a person provides investment advice, as defined above, to a plan participant or IRA accountholder, that person may become subject to a fiduciary duty depending on the relationship with the advisee. Specifically, providing investment advice will give rise to a fiduciary duty when:

- The person providing recommendations represents that such person is a fiduciary as defined by ERISA or the Internal Revenue Code;
- The advice is given pursuant to a written or verbal agreement or understanding that the advice is tailored to the investment needs of the advisee; or
- The recommendation is made to one or more particular advisees on the prudence of a particular investment decision regarding the plan's or IRA's investment options.

Available Exemptions

The new rule also includes two new exemptions from the prohibition on a fiduciary engaging in a conflict of interest with a retirement plan accountholder; provided that the fiduciary deals fairly with, and acts in the best interest of, its customer, avoids misrepresentations, and receives only reasonable compensation. The exemptions are as follows:

- *Best Interest Contract Exemption*. Brokers may receive commissions and 12b-1 payments with respect to retail investments by plan participants and IRA accountholders, which would otherwise be a conflict of interest. The broker must sign a contract with the accountholder acknowledging their fiduciary status to the customer.
- *Principal Transactions Exemption*. Fiduciaries may buy securities from their own accounts, and sell such securities to, retirement plans and IRAs with respect to certain kinds of investments. For example, this exemption would permit a bank to sell a bond from its inventory to a retirement plan advised by the bank or its affiliates.

Key Differences from 2015 Proposed Rule

The Department of Labor made some important concessions in the final rule to allay concerns raised during the comment period that the fiduciary rule would excessively restrict legitimate advisory activities. These include:

- Prospective clients no longer need to sign a Best Interest advisory contract after a first meeting; instead, the client may sign the advisory contract after the client has decided to open an account, along with other paperwork required to open the account.
- Advisers relying on the Best Interest Contract Exemption will not be required to provide one-, five- and ten-year projections of their fees to clients. This provision was eliminated and other disclosure requirements have been streamlined.
- The new definition of fiduciary will now become effective **April 10, 2017**, but full compliance with certain requirements for the new exemptions will not become mandatory

until **January 1, 2018**. There has been speculation in the industry whether, after the November elections, any new administration would reverse or revise the fiduciary rule.

- Although some commentators expressed concern that certain types of investments, such as variable annuities or non-public REITs, would no longer be permitted investments for retirement accounts, the final rule clarifies that all investment products will be allowed, provided that the adviser complies with the Best Interest Contract Exemption.

For More Information

The DOL posted answers to "Frequently Asked Questions" about the new rule at: http://www.dol.gov/ebsa/faqs/faq-conflict-of-interest.html.

The full text of the final rule release is available at: https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-07924.pdf.

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