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BENEFITS BRIEF

The New DOL Investment Fiduciary Rules - Effective June 9, 2017, But How Long Will They Last?

June 2017

On June 9, 2017, Department of Labor final regulations and related guidance clarifying what it means to be an "investment advice" fiduciary to retirement plans and other specified savings vehicles become effective, subject to a January 1, 2018 effective date for certain provisions. These new rules[1] were adopted in the final year of the Obama administration and generally provide that any person or entity making an investment "recommendation" to a plan sponsor or a participant in a covered plan will be considered a fiduciary for purposes of the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the prohibited transaction provisions of the Internal Revenue Code. Commonly referred to as the "conflict of interest" regulations, the rules are designed to minimize the risk an advisor's conflicts of interest will adversely affect the advice recipient.

Despite the June 9, 2017 general effective date, the change of the political party occupying the White House has created considerable uncertainty that the rules to be effective the first of next year will become effective on that date or even that some of the rules becoming effective June 9, 2017 will not see some significant amendment in the near future.

In this issue of Benefits Brief, we will explain the key provisions of the new rules affecting retirement plans effective June 9, 2017, highlight the key changes to be effective January 1, 2018, and provide suggestions for plan sponsors and fiduciaries in responding to these new rules in spite of the uncertainty as to their permanence. Part 1 of this Benefits Brief summarizes the background of these rules and the prospects for change. Part 2 provides a general overview of the rules effective June 9, 2017 and Appendix A provides a general overview of the rules slated to become effective January 1, 2018. Part 3 of this Benefits Brief provides suggested action items for plan sponsors and fiduciaries and some concluding thoughts.

Part 1
Background and Prospects for Change

Why These Rules Came To Be

The conflict of interest rules grew from the Department of Labor's frustration how persons and entities providing advice to retirement plans and plan participants under prior law could escape classification as a fiduciary and therefore escape liability for the consequences of their advice, however conflicted it may have been. Simply stated, the DOL thought that advisors were able to rely on technicalities under the predecessor language that had been in place before the advent of 401(k)-type plans with participant investment direction and when defined benefit plans managed by large financial institutions and advisory firms were the norm. Of equal concern to

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[1] The DOL guidance consisted of final regulations and a number of prohibited transaction exemptions. For purposes of this Benefits Brief, we will refer to the guidance as the "rules."

the DOL was the increased risk of abuse in connection with rollovers from retirement plans to individual retirement accounts by retiring employees, especially given the growing number of retirees each year, starting with the baby boomer retirements.

Effective and Applicability Dates

The rules followed five years of study by the Department of Labor and were issued in the final year of the Obama administration. They technically became effective June 7, 2016, however, originally they were not made "applicable" (i.e., enforceable) until April 10, 2017 for some provisions and not until January 1, 2018 for other provisions.

Why These Rules Are Relevant to Plan Sponsors And Fiduciaries

While the impact of these rules is primarily on advisors to retirement plans and financial institutions providing investment services to retirement plans and participants[2], plan sponsors and plan fiduciaries must understand these rules to prudently discharge their own plan duties.

A compliance failure will constitute a breach of fiduciary duty, which will subject the advisor to personal liability to make good the loss to the plan and its participants, including disgorging any profits made by the advisor. If the Department of Labor becomes involved, there is also the potential for the imposition of a breach of fiduciary duty penalty on the advisor equal to twenty percent of the amount involved and, if the acts or omissions are significant enough, the potential for further enforcement action by the DOL. Finally, the advisor will also be subject to prohibited transaction excise taxes annually until the prohibited transaction is "corrected."

Aside from the person or entity actually providing the fiduciary advice, other plan fiduciaries, including the plan sponsor, the plan administrator, and plan administrative committee members, could be personally liable if their acts or omissions allowed the advisor to breach his/her/its fiduciary duties.

Questions About Permanence of the Rules/Transition Relief

Following last year's presidential election, speculation began immediately about the viability of a number of Obama-era regulations, including these conflict of interest rules. On February 3, 2017, President Trump issued a presidential memorandum mandating further Department of Labor review of these rules but the memorandum stopped short of calling for an outright withdrawal of the rules (presumably because of problems satisfying the Administrative Procedures Act). Following that memorandum, the Department of Labor delayed the "applicability" date of the rules from April 10, 2017 to June 9, 2017 for some provisions and the applicability date for a number of other provisions until January 1, 2018. More recently, the newly sworn-in Secretary of Labor, Alexander Acosta, penned a Wall Street Journal Op-Ed that the rules would go into effect on June 9 but also indicated that the rules "may not align" with the Administration's deregulatory goals and therefore they would be undergoing further review. Many commentators have read this to mean that the chances of significant revision to portions of the rules are quite likely.

Additional guidance from the Department of Labor supports the notion that changes in the rules are likely. Concurrently with the publication of the Wall Street Journal Op-Ed, the Department of Labor issued a Field Advice Bulletin providing that prior to January 1, 2018, the

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[2] For simplicity, we will use the term "advisor" in this Benefits Brief to refer to the person or entity providing the investment services.

Department would not pursue claims against fiduciaries who were working diligently and in good faith to comply with these rules. The Bulletin also indicated that a similar enforcement policy would apply to aspects of the rules over which the Internal Revenue Service had primary authority (i.e., IRAs).

Part 2
Rules Effective June 9, 2017

Summary of the General Rule

An advisor is a fiduciary if a "recommendation" is made to a covered recipient for direct or indirect compensation and the advisor either represents or acknowledges fiduciary status, renders advice pursuant to an agreement or understanding based on the recipient's particular investment needs, or provides advice regarding advisability of a particular investment or investment management decision.

Covered Advice Recipients

The primary types of benefit plans subject to these rules are plans subject to Title I of ERISA. These include retirement plans of for-profit and non-profit employers, including tax-qualified plans (like 401(k), profit sharing, and defined benefit plans), Section 403(b) tax-sheltered annuities, and Section 457 plans. Excluded from coverage are governmental plans, plans of churches which have not affirmatively elected to be subject to ERISA, plans of employers without common law employees (i.e., plans covering self-employed individuals and their spouses), and health and welfare benefit plans.[3]

In addition, individual retirement accounts (both traditional and Roth IRAs) and certain other savings vehicles[4] are also arrangements subject to these new rules, however a discussion of the impact of these rules on those arrangements is beyond the scope of this Benefits Brief.

Covered Recommendations

In General

Whether an advisor makes a recommendation is an objective determination based on all of the facts and circumstances. Unlike prior law, the advice does not have to be the primary basis for investment decisions and does not have to be a communication on a regular basis - so a single communication can suffice. There also is no need for a mutual understanding between the advisor and the recipient. Rather, the test is whether based on the content, context, and presentation, the communication would reasonably be viewed as a suggestion to engage in or refrain from taking a particular course of action.

"Hire Me" / Response to RFP

[3] While these plans are not subject to these rules, these new rules could become the "de facto" standard for these types of plans. Health and welfare plans are not subject to these rules provided that they do not have an investment component to them.

[4] Other covered savings vehicles include health savings accounts (HSAs), Archer medical savings accounts, and Coverdell education savings accounts.

Sales pitches and recommendations that the recipient hire the advisor do not rise to level of a covered recommendation. Similarly, responses to requests for proposals are also not generally considered a covered recommendation.

Platform Providers/Selection & Monitoring Assistance

The provider of a platform of investment alternatives to a plan fiduciary without regard to the individualized needs of the plan or its participants is not considered as making a recommendation. The platform provider must be independent of the plan fiduciary and must disclose in writing that it is not providing impartial investment advice or acting in a fiduciary capacity. If the platform provider has any financial interest in the alternatives included in the investment line-up, it must be specifically identified.

Activities historically performed by platform providers to assist plan fiduciaries in selecting and monitoring the investment alternatives will not cause the platform provider to be considered an investment fiduciary. For example, the platform provider can identify investment alternatives that must specific objective criteria indicated by the plan fiduciary (e.g., expense ratios, fund size, etc.) or provide objective financial data regarding investment alternatives.

Investment Education

Advisors can provide investment education without it being considered a recommendation subject to these rules. For the most part, the regulations follow the existing guidance on investment education. This means that the advisor can provide information about the plan (e.g., a description of the distribution options and the advantages and disadvantages of different forms of payment), general financial and retirement information (e.g., information regarding retirement-related risks such as inflation, market/interest rate risk, inflation, etc. and strategies for managing those risks), asset allocation model information (e.g., pie charts), and interactive investment materials.

In an important departure from current law, asset allocation models and interactive materials cannot contain references to specific investment options unless they are subject to oversight of the plan fiduciary, all options with similar risk and return characteristics are identified, and they include a statement how more information can be obtained.

General Communications

General communications on retirement investment matters are not subject to these rules. For example, television shows, presentations, general newsletters, and the like are not covered recommendations.

Specific Exceptions to "Recommendations"

Transactions with Independent Fiduciaries

An exception to the investment fiduciary definition applies to certain advisors to independent fiduciaries who are independent of the advisor. The following conditions apply to this exception: (1) the independent fiduciary must be a bank, an insurance company, a registered investment advisor, or a broker-dealer, or must have $50 million in assets under its management or control; (2) the advisor must disclose that it is not providing impartial investment advice; (3) the advisor cannot receive any direct compensation from the plan or the plan sponsor; and (4) the advisor must reasonably believe that the independent fiduciary is capable of independently

evaluating the investment risks. While this exception can apply to advice to fiduciaries of large retirement plans (e.g., the plan administrative committee), satisfaction of this last condition will likely be the most troublesome for the advisor to establish.

Employee Communications

Another important exception to the fiduciary definition concerns employees of the plan sponsor who provide plan information to participants in the plan. The good news is that they will not be considered an investment fiduciary subject to these rules so long as they do not receive compensation beyond their normal compensation for providing these services.

How the Rules Address Variable Compensation -
The Best Interest Contract Exemption

Advisors to retirement plans are generally compensated on a percentage of the plan assets (commonly referred to as assets under management or "AUM") or by commissions. Under the new rules, significantly more advisors will become fiduciaries. The problem is that a fiduciary cannot "self-deal," meaning that the advisor cannot determine the compensation the advisor will receive for services to the plan. Prior to these rules, advisors paid by commissions would often contend that they were not fiduciaries and therefore in practice they could determine the compensation they received based on the investment recommended. Because the new rules will effectively prohibit commissions and variable compensation, they would preclude the business models used by a significant portion of advisors to retirement plans (especially smaller plans) absent some exception.

The compromise in the new rules is the Best Interest Contract Exemption, commonly referred to as "BICE" or the "BIC" exemption. Simply stated, this exemption permits the advisor to be compensated by commissions and certain other variable compensation for *non-discretionary advice* (as distinguished from discretionary advice – where the advisor has complete investment authority over the assets) for specified advice recipients so long as certain conditions are satisfied by the financial institution to whom the advisor is associated, including satisfying written contractual requirements, acknowledging fiduciary status, meeting impartial conduct standards, adopting and maintaining required policies and procedures, making specified disclosure obligations, and undertaking DOL notice and recordkeeping obligations. The intent of these detailed requirements (discussed in Appendix A) is to minimize the risk that the advisor's method of compensation will compromise the advice given. The advice recipients to whom this exemption applies are participants in covered plans, non-ERISA qualified self-employed plans (i.e., so called "Keogh" plans), and fiduciaries of ERISA plans that do not fall within the "Transactions with Independent Fiduciaries" exception described above. Subject to the 2017 BICE transition relief (discussed below), the requirements summarized in Appendix A must be satisfied to claim the exemption.

"BICE Lite" for Level Fee Fiduciaries

Less rigorous Best Interest Contract Exemption requirements (dubbed "BICE Lite" or "BIC Lite") apply to fiduciaries who qualify as a "level-fee" fiduciary. A level fee fiduciary is a fiduciary whose fee is a fixed percentage of the value of plan assets or a set fee that does not vary based on the investment used, taking into account the compensation paid to the financial institution, the advisor, and related parties and affiliates. A fee offset is also permitted, for example, where third party payments received by the advisor reduce the set or formula fee the advisor was to be paid. Subject to the 2017 BICE transition relief (discussed below), a fiduciary who is considered a level fee fiduciary need only satisfy the Fiduciary Acknowledgement and

Impartial Conduct Standards (see Appendix A) but is exempt from the other BICE requirements.

Special Provisions for Insurance and Annuity Products

Department of Labor guidance has long provided relief from the prohibited transaction penalties for advisors selling insurance and annuity contracts to retirement plans. Under these rules, an advisor can receive commissions (including renewal fees and trailing compensation but not revenue sharing or marketing payments) in connection with the sale of an insurance or annuity contract to a retirement plan provided: (1) the advisor is not a discretionary trustee or discretionary investment advisor; (2) the transaction must be on terms at least as favorable to the plan as an arm's length transaction with a third party; (3) the combination of all fees and compensation must be reasonable; (4) specified disclosure requirements are satisfied; and (5) the plan fiduciary must provide authorization after receipt of the disclosure. Subject to the 2017 BICE transition relief (discussed below), all sales of annuity and insurance products will have to satisfy the Impartial Conduct Standards of the BICE exemption (described in Appendix A). In addition but subject to the same transitional relief, sales of annuities other than fixed rate annuities (such as variable annuities and fixed indexed annuities) must satisfy all of the more demanding BICE requirements (described in Appendix A) rather than the requirements listed above.

"Transition" BICE Requirements (until January 1, 2018)

The "full" BICE requirements effective January 1, 2018 are summarized in Appendix A. In the meantime, the only BICE requirements are to: (1) provide advice in the plan and plan participants' best interests (in other words, provide advice that is prudent and loyal); (2) charge no more than reasonable compensation; and (3) avoid misleading statements. The first part of this requirement is the ERISA standard of care, which means that the advice must be based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan and plan participants, and the advice must be without regard to the interests of the financial institution, advisor, and related parties.

Part 3
Implications and Actions Items
for Plan Sponsors and Fiduciaries

While the onus for compliance with these rules is primarily on the advisor and the financial institution with which the advisor is associated, plan sponsors and fiduciaries should consider actions to prudently discharge their fiduciary duties:

- Plan sponsors and fiduciaries should familiarize themselves with these new rules. We recommend that you discuss them with the plan's advisor to solicit the advisor's perspective on how it will change the advisor's relationship to the plan and its participants. In many cases, the impact may be relatively minimal despite the broad sweep of the rules.

- Plan sponsors and fiduciaries should review their advisor agreement to assure that it is consistent with the new rules and the relationship as represented by the advisor. This is especially important if the agreement has been revised since June, 2016. Under the DOL regulations, revisions of existing agreements to address the rules was permitted to

be made by “negative consent,” meaning that contract amendments could have been automatically effective unless the plan sponsor or fiduciary objected to the contract changes within a specific period of time. Plan sponsors and fiduciaries that do not have an agreement with the plan’s advisor would be well advised to promptly obtain one.

- An update of the required service provider fee disclosure[5] by the advisor will be needed if the advisor to the plan or its participants previously has not acknowledged fiduciary status in that disclosure. This will be more common in retirement plans permitting the use of self-directed brokerage accounts with outside brokers or the investment in insurance contracts or annuities. Plan fiduciaries who have not received a service provider fee disclosure from each advisor serving the plan or its participants should obtain that disclosure immediately.

- Plan sponsors and fiduciaries should review their participant disclosures to assure that they are consistent with the new rules. To avoid crossing the line from exempt “investment education” to “investment advice” covered by these rules, pie charts and other educational materials showing sample asset allocations must reflect all available funds under the plan with similar risk and return characteristics, not just one or some of those funds.

- We understand it has been a common practice in some plans to provide the plan’s advisor with a list of participants as they terminate from employment so the advisor can discuss IRA rollovers with them. In light of the new restrictions governing advice with respect to IRA rollovers by fiduciaries to the distributing plan, plans doing this will want to consider whether this practice should be continued.

- There are at least a couple of implications for retirement plans if the IRA rollover rules remain effective after December 31, 2017. First, plan sponsors and fiduciaries can expect an elevated level of inquires about plan fees and expenses from advisors advising participants on rollovers from the plan to an individual retirement account; in order to establish the prudency of its advice, the advisor will need information about the plan fees vis-à-vis the estimated fees of the individual retirement account. The second implication results from the fact that investment fees and expenses in retirement plans are typically lower than similar fees in individual retirement accounts. Discerning retirees (i.e., those who are comparing the plan fees and expenses with the estimated fees and expenses associated with a proposed IRA rollover) may prefer to keep their funds in the retirement plan after termination of employment but the plan may not provide enough flexibility in distribution options to suit the retiree; thus, plan sponsors may be requested to amend the plan to provide different distribution options to accommodate retirees.

Concluding Thoughts

There are a couple of schools of thought as to the permanence of these rules. One is that there will be substantial changes to, if not outright repeal of, the rules in light of the low standard that the February 3, 2017 presidential memo laid out for the review and analysis of the rules. The competing thought is that while there may be some tweaking of the rules, they will generally remain intact. Proponents of this position point to the lack of success in the three primary lawsuits challenging the rules on various grounds as well as the extensive economic analysis of

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[5] See https://www.butlersnow.com/2012/05/benefits-brief-benefits-commentary-may-2012-issue-2/ for an overview of these requirements.

the rules undertaken by the Department of Labor before the rules were finalized last year. It has been reported that there are several consumer groups prepared to challenge the repeal or significant revision of the rules by the new administration should that occur.

Time will tell which of these prognostications is correct. Even if the rules are repealed or substantially revised, a practical effect of their issuance will be to educate and inform plan sponsors and plan fiduciaries that not all advisors to retirement plans have the interests of the plan and its participants as its paramount concern. The thought here is that the genie is already out of the bottle so to speak and therefore it will be difficult for advisors to disavow fiduciary status in the future even if not compelled by regulation to accept that responsibility. While plan sponsors and fiduciaries can certainly insist that an advisor acknowledge fiduciary status as a condition to providing services to the plan, market conditions may be such to make that a difficult task, especially for smaller plans.

APPENDIX A

Best Interest Contract Exemption provisions
effective January 1, 2018

Contractual Requirements

A contract is required for an advisor utilizing the BICE exemption unless the recipient is an ERISA plan. It can be signed at the time of the first transaction (rather than when the first advice is provided). It cannot contain any exculpatory language or a liquidated damages provision but it can require a waiver of punitive damages and it can preclude the remedy of contract rescission. It may also require mediation and arbitration of disputes but cannot preclude participation in a class action.

Fiduciary Acknowledgment

A financial institution must acknowledge fiduciary status on behalf of itself and its financial advisor. A separate fiduciary acknowledgment by the individual advisor is not required.

Impartial Conduct Standards

The advisor must agree to adhere to the impartial conduct standards. This means that investment advice must be in the best interest of the recipient, compensation must be reasonable, and the advisor must not make misleading statements about the plan investments. For purposes of satisfying the best interests requirement, the advice (1) must satisfy the ERISA prudence standard, (2) must be based on the investment objectives, risk tolerance, financial circumstances, and needs of the investor, and (3) must be made without regard to the interests of the financial institution, advisor or any related parties.

Policies and Procedures

The financial institution to which the advisor is affiliated must adopt policies and procedures when, viewed as a whole, are reasonably and prudently designed to avoid misalignment of the interests of the advisor and the plan and plan participants. The policies and procedures must (1) include identification of material conflicts of interest; (2) address adoption of measures to

prevent material conflicts causing the advisor to violate the Impartial Conduct Standards; (3) designate person(s) responsible for addressing conflicts and monitoring the advisor for compliance; and (4) avoid incentives likely to result in advice contrary to the investor's best interests (e.g., no quotas, appraisal, contests, or other differential compensation).

Disclosures

The financial institution most provide specific written disclosures to the plan fiduciary: (1) intent to comply with the best interest standard and how the advisor will be paid (i.e., either directly or through third party payments): (2) material conflicts of interest and compensation expected to be received from third parties; (3) how to obtain copies of the institution's policies and procedures and information about the fees and costs of recommended investments; (4) a link to the institution's website and a statement that the copy of the policies and procedures is available free of charge; (5) whether proprietary products are offered and whether the advisor is limited to those products or other products that generate third party payments to the financial institution; and (6) whether the investments will be monitored and if so, with what frequency and whether the plan fiduciary will be notified.

In addition, the financial institution's website must contain specific disclosures: (1) a discussion of its business model and material conflicts of interest associated with that model; (2) a schedule of typical account or contract fees and service charges; (3) a model contract and required disclosures needed for BICE (updated quarterly); (4) a copy of policies and procedures described above and a description of policies and procedures related to conflict mitigation and incentive practices; (5) a list of all product providers from whom third party payments could be received, how they affect advisor compensation, and what services the financial institution provides for the third party payments; and (6) a description of compensation and incentive arrangements with advisor, including incentives for specific investments or to move from one financial institution to another or to stay at the current financial institution.

DOL notification and recordkeeping requirements

Before receiving any compensation subject to BICE, the financial institution must notify DOL of intent to rely on BICE. This is a one-time notification and the client does not have to be identified.

The financial institution must maintain records of BICE compliance for at least six years and the records must be reasonably accessible for examination by DOL, a plan fiduciary, a contributing employer, or any participant or beneficiary (or authorized representative).

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