



# ERISA Regulatory and Litigation Update and Current Fiduciary Issues

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## FIRMA 29<sup>th</sup> National Risk Management Training Conference

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## Agenda

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- DOL Regulatory Update
  - Fiduciary Regulation Update
  - Credit Suisse Hearing
  - Brokerage Window RFI
  - 408b-2 "Guide"
  - Target Date Disclosure
  - Lifetime Income
- Litigation and Enforcement Update
  - Company Stock
  - Fee Cases
  - Proprietary Funds
  - DOL Enforcement Statistics

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## Public Policy Debate on the Role of Retirement Plan Advisers

- Both sides agree American workers need professional retirement advice
- But battle lines are hardening over how advisers should be compensated and how conflicts of interest should be resolved
- Focus now on DOL's re-interpretation of the definition of "fiduciary"

## Public Policy Debate on the Role of Retirement Plan Advisers

### White House/DOL View\*

- Perverse incentives permit financial advisors to thrive at the expense of workers
- Advisors excessively churn retirement assets and steer savers to higher cost products for profit
- Conflicted payments for advice (also known as commissions) cost Americans billions of dollars in excess fees and lower returns annually
- Many advanced industrialized nations (e.g., U.K., Australia, the Netherlands, Belgium and Italy) completely ban or strictly limit conflicted commissions

\* Source: Jason Furman and Betsy Stevenson Memorandum to White House Senior Advisors dated January 13, 2015

### Financial Svcs. Industry View\*

- Existing consumer protections adequately protect individual workers
- SEC and FINRA conduct regular examinations of broker-dealers for customer interest conflicts
- Prohibiting or severely restricting commissions will dramatically reduce the availability of professional investment advice for small and moderate savers
- Comparisons to the U.K., Australia, etc. are inappropriate

\* Source: Memorandum Concerning Expected DOL Conflict of Interest Rule Dated February 17, 2015 available at [fsroundtable.org](http://fsroundtable.org)

## Implications of ERISA Fiduciary Status

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- Legal Duties:
  - Loyalty
  - Prudence
  - Diversification
  - Follow plan terms
  - Avoid prohibited transactions
- Liability for:
  - Plan Losses
  - Disgorgement of profits
  - Excise taxes on prohibited transactions

## Current Fiduciary Test

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- ERISA defines 3 ways to become a “fiduciary”–
  - Exercising discretionary authority over the management of a plan or over management or disposition of plan assets.
  - **Having or exercising authority to provide investment advice “for a fee or other compensation.”**
  - Having or exercising authority over plan administration.



## Current Fiduciary Test

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- Existing regulations under 3(21)(A) define what constitutes “investment advice” under the second category – using a “five part test”—
  - (1) make recommendations on investing in, purchasing or selling securities or other property, or give advice as to their value
  - (2) on a regular basis
  - (3) pursuant to a mutual understanding that the advice
  - (4) will serve as a primary basis for investment decisions, and
  - (5) will be individualized to the particular needs of the plan.



## Current Fiduciary Test

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- Certain things generally are not “investment advice” under current regulations:
  - Sale pitches
  - Recommendations regarding selection of other advice fiduciaries
  - Recommendations regarding selection of investment managers
  - Valuations/“fairness opinions”
  - Recommending asset allocations
  - Participant education (IB 96-1)



## 2010 Proposal

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- Eliminated some aspects of the existing 5-part test and expanded the definition of “fiduciary” advice.
- Did not include any changes to existing PT exemptions, and therefore called into question many existing practices.
- The 2010 proposal was very controversial and was withdrawn by DOL in September 2011.



## 2015 Proposal

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- On April 14, 2015, DOL released long-awaited re-proposed fiduciary rule.
- Package included:
  - A regulation re-defining who is a “fiduciary” by reason of providing investment advice to a plan or an IRA (the “2015 Proposed Regulation”);
  - Two new prohibited transaction class exemptions; and
  - Amendments to several existing prohibited transaction class exemptions.



## 2015 Proposal - Overview

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- Fundamental changes for IRA service market.
- Expands universe of ERISA advice fiduciaries
- PT Class exemption proposals would require significant changes to current service delivery and compensation models for many banks, insurance companies, brokers, RIAs and consultants



## 2015 Proposal – Advice Definition

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- Fiduciary status depends on providing:
  - “Covered Advice” for a fee or other compensation to a plan, plan fiduciary, participant or beneficiary, IRA or IRA Holder: and
- either directly or indirectly:
  - representing or acknowledging fiduciary status, or
  - providing the advice under an agreement, arrangement or understanding that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property.

## 2015 Proposal – Advice Definition

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- Covered Advice means a recommendation as to:
  - acquiring, holding, disposing or exchanging securities or other property;
  - the management of securities or other propertyAny person who will receive a fee for
  - Applies to IRA rollovers and other distributions
- “Covered Advice” also includes:
  - Appraisals or fairness opinions if made in connection with a specific plan or IRA transaction
  - Recommendations of any person to provide above advice for a fee

## 2015 Proposal – Advice Definition

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- “Recommendation” is broadly defined:
- “a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.”

## Examples of 2015 Changes

Activity	Current Rule	Proposed Rule
Sales presentations involving sample line-ups or recommendations	Not Fiduciary	Fiduciary
Recommending other advice fiduciaries / managers	Not Fiduciary	Fiduciary
Advice to participants regarding IRA rollovers	Not Fiduciary	Fiduciary
Valuations / fairness opinions	Not Fiduciary	Fiduciary
Participant education	Not Fiduciary	Not Fiduciary

## 2015 Proposal – Advice Definition Carve-Outs

- Sales exception
  - Does not apply to advice to Ps, Bs, IRAs, and
  - Does not apply where advisor has acknowledged Fiduciary status
  - Applies to Covered Advice to
  - Independent plan fiduciary
    - Either with > \$100 million in AUM; OR
    - Representing a plan over 100 participants and has agreed that it has proper authority and will not rely on advice
  - Arm's length purchase, sale, loan, bi-lateral contract or proposal for same
    - Advisor makes required disclosures – that it is not undertaking to provide impartial investment advice
    - Advisor does not receive a fee from recipient plan or fiduciary (can receive fees for other services)
  - Swaps based carve-out



## 2015 Proposal – Advice Definition Carve-Outs

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- Employee Carve-Out
  - Covers employees providing “covered advice” to plan sponsor in scope of employment relationship.
  - Employee can’t receive compensation other than normal comp.

## 2015 Proposal – Advice Definition Carve-Outs

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- Platform provider
  - Plans only - Not IRA platforms
  - Marketing – not individualized
  - Disclosure of non-impartiality required
- Selection and monitoring – in connection with platform
  - IDs investments meeting screens specified by plan fiduciary
  - Objective financial data and comparisons with independent benchmark to fiduciary

## 2015 Proposal – Advice Definition Carve-Outs

- Financial Report and Valuations - Covered advice definition already carves out many standard reporting items (e.g., not in connection with a transaction). Also carved out:
  - ESOP valuations (subject to separate rule)
  - Valuations to an “Investment Fund” (CIT)
  - Or a Plan, F, P, B, IRA, IRA owner SOLELY:
    - R&D compliance – ERISA, Code and other applicable R&D requirement under a federal or state law, rule or regulation or SRO rule or regulation
  - No separate rules for hard-to-value assets.

## 2015 Proposal – Advice Definition Carve-Outs

- Participant Education
  - Applies to communications to Fs, Ps, Bs and IRAs
  - Similar to IB 96-1 EXCEPT:
    - Can no longer populate asset allocation or interactive materials with specific investment products.
    - Expanded to permit discussion of distribution forms, retirement risks, and allow tools to evaluate distribution options



## 2015 Proposal – New PTEs

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- Best Interest Contract Exemption
  - Pre-existing Transaction Exemption
  - Insurance and Annuity Contract Exemption
- Exemption for Principal Transactions in Debt Securities



## 2015 Proposal – Revisions to Existing PTEs

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- Significant revisions to:
  - PTE 75-1
  - PTE 84-24
  - PTE 86-128
- Also Revised:
  - PTE 77-4
  - PTE 80-83
  - PTE 83-1

## 2015 Proposal – Overview of New BIC PTE

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- Best Interest Contract Exemption would be the only exemption available for advice fiduciaries dealing with Ps, Bs, IRAs or small plan sponsors.
- Would apply to certain commonly-held “assets” (bank deposits, CDs, mutual funds, CITs, ETFs . . .)

## 2015 Proposal – Overview of New BIC PTE

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- Would cover receipt of compensation by individual advisor, his or her employing/contracting financial institution and related entities.
- Would effectively impose ERISA duties of loyalty and prudence on IRA transactions under exemption

## 2015 Proposal – Overview of New BIC PTE

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- Extensive Conditions, including imposition of “Impartial Conduct Standards”
  - “Best Interest” conduct – ERISA duties of loyalty and prudence based on the investment objectives, risk tolerance, financial circumstances and needs of investor
  - Reasonable compensation
  - Statements by advisor re: assets, fees, material conflicts of interest may not be misleading

## 2015 Proposal – Overview of New BIC PTE

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- Other Conditions:
  - Contractual warranties
  - Policies and Procedures related to conflicts
    - Including relating to advisor compensation
  - Contractual disclosures
  - Prohibited contract terms
  - Website disclosures
  - Point of sale disclosures
  - Further conditions apply if range of options is limited
  - Disclosure to EBSA
  - Maintain data and provide to EBSA

## Changes to Existing PTEs

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- PTE 75-1
  - Part I (non-fiduciary effecting securities transactions / valuation) – revoked
  - Part II (2) (406(b) relief for unaffiliated MF purchases) – revoked and moved to 86-128
  - Parts III, IV – adds Impartial Conduct Standards
  - Part V – expands to cover extension of credit, if conditions are met.

## Changes to Existing PTEs

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- PTE 84-24 – currently provides relief (406(a) and (b)) for:
  - agents, brokers or pension consultants for Commissions for purchase of annuity contract, and effecting plan purchase of same and mutual fund
  - Commission to principal underwriter for purchase of mutual fund shares
  - Purchase of an insurance or annuity contract

## Changes to Existing PTEs

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- PTE 84-24
  - No longer available for advice to IRA regarding mutual funds and variable annuities
  - Adds Impartial Conduct Standards
  - Narrows definition of “commissions” – no longer covers revenue sharing, administrative or marketing fees (12b-1)
  - Updates recordkeeping requirements
  - Applies to HSAs and other Code plans, in addition to IRAs

## 2015 Proposal – Changes to Existing PTEs

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- PTE 86-128 – currently provides relief (406(b)) for a fiduciary:
  - Causing plan to pay fee to affiliated BD for effecting or executing securities transactions; and
  - Acting as an agent in an agency cross transaction and receiving a commission from one or both parties
- Currently, virtually no conditions apply to IRAs under 86-128

## 2015 Proposal – Changes to Existing PTEs

- PTE 86-128 – Executing Securities Transactions:
  - No longer available for advice fiduciaries to IRAs (discretionary only – and all other conditions apply to IRAs)
  - Adds Impartial Conduct Standards
  - Narrows definition of “commissions” – no longer covers revenue sharing, administrative or marketing fees (12b-1)
  - Updates recordkeeping requirements
  - Applies to HSAs and other Code plans, in addition to IRAs
  - Expands “related party” relief
  - Permits discretionary trustees to use alternative conditions

## 2015 Proposal – Changes to Existing PTEs

- PTE 86-128 – New Mutual Fund Exemption (moved from PTE 75-1(II)(2) – provides relief for plan purchase of mutual fund shares from a fiduciary, acting as principal, and for receipt of commission.



## 2015 Proposal – Changes to Existing PTEs

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- PTE 86-128 – New Mutual Fund Exemption – conditions:
  - Shares sold at NAV plus commission (no 12b-1 fees)
  - Impartial Conduct Standard met
  - All other 86-128 conditions met

## 2015 Proposal – Changes to Existing PTEs

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- PTEs 77-4, 80-83 and 80-1:
  - Adds Impartial Conduct Standards – effectively and intentionally imposing ERISA-like prudence and loyalty standards in IRA fiduciaries as a condition of relief.



## 2015 Proposal – The Latest

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- Current deadline for comments is July 6, 2015.
- DOL has said it will hold hearings and will re-open comment period after hearings.
- DOL has also said that the regulation and exemption changes will be effective 8 months after publication of the final versions in the Federal Register.
- In order to survive, final rule likely must be published by early May, 2016.



## 2015 Proposal – The Latest

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- April 21, 2015 joint trade organization letter to DOL requesting extension of 75 day comment period to 120 days
  - Would move current comment deadline to August 18, 2015



## Questions?

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