July 27, 2017

THE NEW DOL FIDUCIARY RULE

The Department of Labor ("DOL") regulation that expands the range of persons considered "fiduciaries" under the Employment Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code ("Code") in connection with marketing investment products to employee benefit plans covered by ERISA ("Plans") and Individual Retirement Accounts ("IRAs") took effect on June 9, 2017 (the "Fiduciary Rule").[1] Since that time, SEC Chairman Jay Clayton has acknowledged the complexity of the fiduciary duty issue, Chairman Clayton and DOL Secretary Alexander Acosta have pledged to cooperate to implement a revised Fiduciary Rule, and bills will be introduced (and opposed) that would eliminate the Fiduciary Rule and replace it with a "best-interest" standard for brokers providing retail investment advice. The DOL has issued a request for information (RFI) concerning the impact of the Rule and whether it will require more time to implement full compliance. Fund managers are considering how to supplement or revise their subscription documents for their ERISA Plan and IRA investors that currently are subscribed for interests, or wish to subscribe for additional interests in the funds they manage, so that they are in compliance with the Fiduciary Rule and are not deemed fiduciaries under the Rule.

Fiduciary Status and the Consequences of Fiduciary Status

Under the Fiduciary Rule, an investment manager becomes a fiduciary under ERISA or the Code by (a) exercising discretionary authority or control with respect to the management of a Plan or an IRA; or (b) rendering investment advice to a Plan or IRA for a fee or other compensation, or by having responsibility to do so. Investment advice includes certain

[1] The DOL is continuing to examine the Fiduciary Rule. The applicable date for compliance with the more onerous provisions of the Fiduciary Rule is January 1, 2018. June 9, 2017 through December 31, 2017 is the "Transition Period."

"recommendations"[2] that reasonably would be viewed as suggestions to take or refrain from taking a particular course of action. Under the new Rule, certain investment advice activities associated with marketing that previously were not considered fiduciary in nature now may be considered fiduciary investment advice.

If an investment manager is deemed a fiduciary as a result of providing services to ERISA and IRA investors, it is prohibited from using that authority to cause the investor to pay an additional fee to the investment manager. As a result, the investment manager could not accept an investment into a fund and the concomitant earning of a management fee. The investment manager would have to develop a means of communication with ERISA Plans and IRAs without being deemed a fiduciary. For an investment manager to communicate with and market to ERISA and IRA investors and not be deemed a fiduciary, the investment manager would have to avail itself of the "general communication" or "investment-education" exceptions to what constitutes a "recommendation," or communicate only with a sophisticated, independent fiduciary acting on behalf of the ERISA or IRA investors where there is no expectation of reliance on the investment manager (the "Independent Fiduciary Exception"). It should be noted that a fund manager is subject to the Fiduciary Rule despite the fact that the fund it manages is *not* a plan assets fund in that ERISA and IRA participation is below the 25% threshold. In determining whether the new Fiduciary Rule has implications for an investment manager, it is irrelevant whether the manager is managing a plan assets or non-plan assets fund. The new Fiduciary Rule has implications if the manager is marketing its products and services to ERISA Plans and IRAs.

<u>Using the Independent Fiduciary Exception to Avoid Fiduciary Status under the Fiduciary Rule</u>

Investment managers should determine whether their communications with investors are covered by the Independent Fiduciary Exception to the Fiduciary Rule. To satisfy the exception, the independent fiduciary must be a bank, insurance company, registered investment adviser, registered broker-dealer, or otherwise have at least $50 million in assets under its management or control.

In order to rely upon the Independent Fiduciary Exception, the investment manager must inform the independent fiduciary (a) that the investment manager is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity; and (b) of the nature of the investment manager's financial interests in the transaction. In addition, an investment manager looking to rely on the exception must know or "reasonably believe" that the independent fiduciary (a) is a fiduciary under ERISA or the Code with the responsibility to exercise independent judgment in evaluating the transaction; and (b) has the capability to evaluate investment risks. After providing appropriate written disclosure, the investment manager may rely on negative consent with respect to the "reasonable belief" requirement.[3]

<u>To Market or Not to Market</u>

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[2] A fuller description of what constitutes a recommendation is set forth in our prior Client Alert dated April 29, 2017, available [*here*].

[3] Investment managers can send negative consent representation letters that state that if the recipient does not respond within a specified period of time, the recipient will be deemed to agree with the contents of the letter.

An investment manager will have to consider the issue as to which investors it will continue to market and accept investments from. An IRA account (without an independent fiduciary) cannot meet the Independent Fiduciary Exception regardless of the level of assets in the account, and smaller ERISA Plan investors may not meet the $50 million minimum to qualify as a sophisticated, independent fiduciary. An investment manager will have to decide whether to stop marketing to investors that do not meet the requisite criteria for the Independent Fiduciary Exception or continue marketing to them and rely on a prohibited transaction exception called the "Best Interest Contract exemption ("BICE"). It should be noted that until January 1, 2018 (when the Transition Period ends), the parties relying on BICE must comply only with the "impartial conduct standards," which require that an investment manager (a) act in the best interest of investors; (b) not make material misleading statements to investors; and (c) not charge investors more than reasonable compensation. Thereafter, the more onerous requirements of BICE will become applicable.

After the Transition Period

During the Transition Period, the DOL has stated that it will not pursue claims against fiduciaries that are "working diligently and in good faith" to comply with the Fiduciary Rule. After the Transition Period ends, fiduciaries will have to comply with all exemption requirements. As stated above, review of the Fiduciary Rule is ongoing and challenges to the Rule continue. The final status of the Rule is not yet fixed and it is reasonable to foresee additional developments. Nevertheless, despite the continuing uncertainty about the final parameters of the new Fiduciary Rule, it appears here to stay. We continue to monitor the situation.

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If you have any questions concerning applicability of the Fiduciary Rules during the Transition Period or thereafter, or what steps you should be taking with your current investors, please call Meryl Wiener, any of the undersigned or your regular Warshaw Burstein attorney.

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