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DOL Proposes to Expansively Redefine "Fiduciary" in the Investment Advice Context

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Background

The Department of Labor ("DOL") recently issued a proposed regulation redefining the term "fiduciary" for purposes of ERISA and Code Section 4975. If finalized, the regulation would more broadly define the circumstances under which a person is considered a fiduciary by giving investment advice to an employee benefit plan or a plan participant. The DOL stated that the new regulation, which amends a thirty-five year-old regulation, is designed to protect participants from conflicts of interest and self-dealing by giving a broader and clearer understanding of when persons providing investment advice are subject to ERISA's fiduciary standards.

ERISA Section 3(21)(A) provides that a person is a fiduciary to a plan if it (a) exercises discretionary control in the administration of a plan or over the management of a plan or its assets or (b) renders (or has authority to render) "investment advice" for a fee with respect to a plan's assets.

"Investment Advice" under the Existing Regulation

The existing regulation defining the circumstances under which a person renders "investment advice" creates the following 5-part test which must be satisfied for advice to constitute "investment advice." The person must:

1. Render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property,

2. on a *regular basis*,

3. pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that

4. the advice will serve as a *primary basis* for investment decisions with respect to plan assets, and that

5. the advice will be individualized based on the particular needs of the plan.

In 1976, the DOL further limited the term "investment advice"' to exclude the valuation of closely-held employer securities on which an employee stock ownership plan ("ESOP") would rely to purchase such securities.

“Investment Advice” under the Proposed Regulation

Under the proposed regulation, a person would be a fiduciary as the result of giving investment advice for a fee with respect to a plan’s assets if such person satisfies one of the conditions in both (1) and (2) below:

1. With respect to a plan, a plan fiduciary *or a plan participant or beneficiary*, the person:

    a. provides advice, *or an appraisal or fairness opinion*, concerning the value of securities or other property,

    b. makes recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property, or

    c. *provides advice or makes recommendations as to the management of securities or other property*.

2. The person, directly or indirectly (such as through an affiliate)

a. represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA with respect to providing such advice or recommendations,

b. is a fiduciary with respect to the plan as a result of exercising discretionary control with respect to management of the plan, management of its assets, or in the administration of the plan,

c. is an “investment adviser” within the meaning of section 202(a)(11) of the Investment Advisers Act of 1940 (the “Advisers Act”), or

d. provides such advice or recommendations pursuant to an agreement, arrangement or understanding, written or otherwise, between such person and the plan, a plan fiduciary, or a plan participant or beneficiary that such advice may be considered in connection with making investment or management decisions with respect to plan assets, and will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary.

The proposed regulation provides that the phrase “fee or other compensation” means any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered. The term also includes, for example, brokerage, mutual fund sales, and insurance sales commissions. It includes fees and commissions based on multiple transactions involving different parties.

Proposed Regulation Compared with Existing Regulation

In its preamble, the DOL indicated that the addition of appraisals and fairness opinions in the proposed regulation is intended to overturn its earlier opinion that valuation of employer securities provided in connection with an ESOP’s purchase of those securities would not constitute investment advice. However, this new requirement is not limited to employer securities. For example, a person retained by a plan fiduciary to appraise real estate being purchased by the plan may be an ERISA fiduciary under the proposed regulation.

The existing regulation limits fiduciary activity to making recommendations as to the advisability of investing in, purchasing or holding securities or other property. The proposed regulation broadens the scope of fiduciary activity by including advice and recommendations as to the “management” of securities or other property, such as advice as to the voting of proxies and the selection of persons to manage plan investments.

The proposed regulation makes clear that ERISA fiduciary status may result from the provision of advice or recommendations to a plan participant or beneficiary as well as to a plan or plan fiduciary. In 2005, the DOL opined that a recommendation to a plan participant to take an otherwise permissible distribution does not constitute investment advice under the current regulation, even when combined with an investment recommendation._ Some have expressed the opinion that this position does not adequately protect plan participants. The DOL is requesting comments on whether the

final regulation should define the provision of investment advice to encompass investment recommendations related to taking a plan distribution.

Under the existing regulation, persons who exercise discretionary authority must do so with respect to purchasing or selling securities or other property. The proposed regulation broadens the existing regulation to include a person exercising any discretionary control with respect to management of the plan, management of its assets, or in the administration of the plan.

Unlike the existing regulation, the proposed regulation does not require that the person render advice to the plan on a *regular* basis pursuant to the mutual understanding with the plan or a plan fiduciary or that the advice will serve as a *primary basis* for investment decisions with respect to plan assets. In contrast, it is sufficient if the advice is *discrete advice* with respect to a *distinct investment transaction* and that the parties understand that the advice will be *considered* in connection with making a decision relating to plan assets.

Other new provisions in the proposed regulation include the provisions that a person can become a fiduciary by simply by (a) representing or acknowledging that it is acting as a fiduciary with respect to providing advice or recommendations or (b) being an investment adviser under the Adviser's Act.

Limitations on Fiduciary Status under the Proposed Regulation

Under the proposed regulation, a person (other than a person who represents or acknowledges that it is acting as an ERISA fiduciary) will *not* be considered to be a fiduciary as the result of giving investment advice if the person can demonstrate that the recipient of that advice knew (or reasonably should have known) that the person was providing the advice in its capacity as a purchaser or seller of a security or other property (or as an agent of, or appraiser for, such a purchaser or seller) whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice.

In addition, the proposed regulation clarifies that certain activity in connection with an individual account plan will not be considered investment advice. First, the provision of certain investment education information and materials (such as plan information, general financial and investment information, asset allocation models and interactive materials) described in current regulations in connection with an individual account plan will not, in and of itself, be treated as the rendering of investment advice.

Second, marketing or making available securities or other property from which a plan fiduciary may designate investment alternatives into which plan participants may direct the investment of their individual accounts (for example, through a "platform" or similar mechanism provided by a record-keeper or third-party administrator), without regard to the individualized needs of the plan, its participants, or beneficiaries, will not, in and of itself, be treated as the rendering of investment advice. However, in order to satisfy this limitation, the person must disclose in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice.

Third, in connection with the marketing and other activities described above, the provision of general financial information and data to assist a plan fiduciary's selection or monitoring of securities or other property as plan investment alternatives, will not, in and of itself, be treated as the rendering of investment advice. However, as above, the person must disclose in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice

Finally, the proposed regulation clarifies that the term "advice, or appraisal or fairness opinion" does not include the preparation of a general report or statement merely reflecting the value of a plan investment for reporting and disclosure purposes under ERISA, the Code, and the related regulations, forms and schedules, unless such report involves assets for which there is not a generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

The DOL is accepting comments on the proposed regulation until February 3, 2011.

King & Spalding would be pleased to assist you with understanding the implications of the proposed regulation for employee benefit plan sponsors and persons who provide services to employee benefit plans.

The proposed regulation is available at http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=24328.

The Employee Retirement Income Security Act of 1974, as amended.

The Internal Revenue Code of 1986, as amended.

29 CFR 2510.3-21(c)

DOL Advisory Opinion 2005-23A (December 7, 2005).

IRS Notice 2011-02 Provides Important Guidance on the Compensation Deduction Limit for Health Insurance Providers

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The Internal Revenue Service recently issued Notice 2011-02 providing much-needed guidance on the Code Section 162(m)(6) deduction limit for compensation paid by "covered health insurance providers," which was enacted as part of the Patient Protection and Affordable Care Act. As we reported in our November 2010 Compensation and Benefits Insights, new Code Section 162(m)(6) generally limits the deduction allowable for compensation paid to a service provider by a covered health insurance provider (and its related entities) to $500,000, effective for amounts deductible in 2013 or later tax years. Notice 2011-02 clarifies the application of this limit in a number of important respects.

Background

Code Section 162(m)(6) limits the allowable deduction by a "covered health insurance provider" for the 2013 and later tax years to $500,000, for both current compensation and deferred deduction remuneration that is attributable to services performed by a covered individual. "Deferred deduction remuneration" is compensation relating to services a covered individual performs during the 2010 or later tax years in which the employer is a "covered health insurance provider" and that is not deductible until the 2013 or later tax years.

The term "covered health insurance provider" is defined differently under Code Section 162(m)(6) for each of two different periods. For the 2010 through 2012 tax years, a "covered health insurance provider" is defined broadly as any employer that is a health insurance issuer receiving premiums from providing health insurance coverage.

For the 2013 and later tax years, a "covered health insurance provider" is defined more narrowly as an employer that is a health insurance issuer with respect to which not less than 25 percent of the premiums received by the employer from providing health insurance coverage is from the provision of the "minimum essential coverage" that individuals will have to maintain under the new health care reforms.

Definition of "Covered Health Insurance Provider"

Confusion Arising As a Result of Two Different Definitions

As a result of the two different definitions of "covered health insurance provider," questions have been raised regarding whether an employer who satisfies the broad pre-2013 definition, but who never satisfies the more narrow post-2012 definition, would be subject to the Code Section 162(m)(6) deduction limit. Notice 2011-02 clarifies that such an employer would *not* be subject to the new deduction limit.

Specifically, Notice 2011-02 provides that the deduction limit applies to "deferred deduction remuneration" for the 2010 through 2012 tax years *only if* (1) the employer was a pre-2013 covered health insurance provider *and* (2) the employer is

a post-2012 covered health insurance provider for the tax year in which the deferred deduction remuneration is otherwise deductible.

Both a Pre-2013 and a Post-2012 Covered Health Insurance Provider: For example, assume that XYZ corporation is a pre-2013 covered health insurance provider for the 2010, 2011 and 2012 tax years and a post-2012 covered health insurance provider for all tax years after 2012. Any deferred deduction remuneration attributable to services performed in the 2010, 2011 or 2012 tax year would be subject to the Code Section 162(m)(6) deduction limit in the tax years after 2012 in which such amounts are otherwise deductible.

In addition, assume that XYZ corporation is a pre-2013 covered health insurance provider for the 2010, 2011 and 2012 tax years and a post-2012 covered health insurance provider for all tax years *after 2016*. Any deferred deduction remuneration attributable to services performed in the 2010, 2011 or 2012 tax year would be subject to the Code Section 162(m)(6) deduction limit in the 2016 and later tax years in which such amounts are otherwise deductible. However, any deferred deduction remuneration attributable to services performed in the 2010, 2011 or 2012 tax year that is otherwise deductible in the 2013, 2014 or 2015 tax year would *not* be subject to the deduction limit. Moreover, any deferred deduction remuneration attributable to services performed in the 2013, 2014 or 2015 tax year would similarly *not* be subject to the deduction limit for the tax years in which such amounts are otherwise deductible.

Neither a Pre-2013 nor a Post-2012 Covered Health Insurance Provider: On the other hand, if XYC corporation was not a pre-2013 covered health insurance provider, and never becomes a post-2012 covered health insurance provider, any deferred deduction remuneration attributable to services performed in the 2010, 2011 or 2012 tax year would *not* be subject to the Code Section 162(m)(6) deduction limit in the tax years after 2012 in which such amounts are otherwise deductible.

Only a Post-2012 Covered Health Insurance Provider: Moreover, if XYZ corporation was not a pre-2013 covered health insurance provider, but is a post-2012 covered health insurance provider, any deferred deduction remuneration attributable to services performed in the 2010, 2011 or 2012 tax year would *not* be subject to the Code Section 162(m)(6) deduction limit in the tax years after 2012 in which such amounts are otherwise deductible.

De Minimis Rule

In addition, Notice 2011-02 provides a "de minimis" exception to the definition of "covered health insurance provider." For the 2010 through 2012 tax years, an employer will come within this exception if the premiums received by the employer for providing health insurance coverage for that year are less than 2% of the employer's gross revenues for that year. For the 2013 and later tax years, an employer will come within this exception if the premiums received by the employer for providing health insurance coverage are from providing *minimum essential coverage* for that year are less than 2% of the employer's gross revenues for that year.

Reinsurers not Covered

Moreover, Notice 2011-02 clarifies that for purposes to determining whether an entity is a "covered health insurance provider," premiums received under an indemnity reinsurance contract will not be treated as premiums from providing health insurance coverage.

Certain Independent Contractors

Notice 2011-02 also clarifies that an employer's independent contractors whose compensation arrangements are exempt from Code Section 409A (which generally exempts arrangements with independent contractors providing substantial services to multiple unrelated customers) are not subject to the Code Section 162(m)(6) deduction limit.

Effective Date

The guidance under Notice 2011-02 is effective for the 2010 and later tax years.

King & Spalding would be pleased to assist you with understanding the implications of the compensation deduction limit for health insurance providers under Code Section 162(m)(6).

Internal Revenue Code of 1986, as amended.

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