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New Fiduciary Rule for Retirement Plans

By: Debra Lee Mackey

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On April 6, 2016 the Department of Labor's Employee Benefits Security Administration ("EBSA") issued its long awaited final rule redefining a fiduciary investment advisor (also known as the "conflict of interest rule"), greatly expanding who will be considered a fiduciary when providing "investment advice" to retirement plans. This is important to the health care community because most providers sponsor retirement plans for employees – and if there is no fiduciary advisor, the provider is likely responsible. Along with the new rule, EBSA issued new exemptions and revised existing exemptions. *The new rule and most exemptions will be applicable on April 10, 2017*. Together, the new rule and exemptions directly impact the financial services industry and are expected to result in significant changes in the way many financial institutions provide investment services to ERISA plans and IRAs. The goal is for retirement plan sponsors and IRA owners to receive better (*i.e.*, *nonconflicted*) advice due to the elimination or disclosure of conflicts of interest, although some in the financial services industry predict costs will escalate as advisors exit the market. This article provides an overview of the new rule.

The new rule replaces a five-part test that has been in effect since the inception of ERISA in 1975. Under the new rule, a person is a fiduciary investment advisor if (1) the recipient of the advice is a plan, plan fiduciary, plan participant, plan beneficiary, IRA or IRA owner, and (2) the advice consists of a *recommendation* about (a) acquiring/holding/selling/exchanging securities/property, as well as how to invest securities/property after they are rolled over/transferred/distributed from a plan or IRA, or (b) the management of securities/property, including recommendations on investment policies or strategies, portfolio composition, selection of others to provide investment advice or management, selection of investment account arrangements (*e.g.*, brokerage verses advisory), as well as recommendations with respect to rollovers/transfers/distributions from a plan or IRA, including whether and in what amount, form and destination such transactions should be made. For this purpose, a "recommendation" means a communication that would reasonably be viewed as a suggestion that the recipient of the communication engage in or refrain from taking a particular course of action. The advisor must acknowledge its fiduciary status, provide the advice pursuant to an agreement or understanding that it is based on the particular investment needs of the recipient, or provide advice to a specific investor on the advisability of a particular investment or management decision regarding securities/property of a plan or IRA.

Why the change? Retirement plans have changed substantially in the last 40 years. The dominant plan today is a participant directed 401(k); this did not exist in 1975. Today, there is widespread use of IRAs and every 401(k) participant will face a distribution/rollover decision. Currently, many investment professionals have no obligation under ERISA or the Code to act in the best interest of their client. The advisor may legally steer plans and individuals into investments based on the best interest of the advisor. In announcing the change, EBSA said: the Department's conflict of interest final rule and related exemptions will protect investors by requiring all who provide retirement investment advice to plans and IRAs to abide by a "fiduciary" standard – putting their client's best interest before their own profits.

What does the new rule mean for physician practices, hospitals and care facilities? If a provider currently employs a fiduciary investment advisor, the new rules will have little direct effect on the plan. There is no one who is a fiduciary under the current rule who will fall outside of the definition under the new rule. But – if a nonfiduciary investment advisor is currently employed, that advisor will have to decide whether it will do what is necessary to comply with the new rule (or an exemption), or cease providing the services. Many common plan services are excluded from the new rule because they do not involve a recommendation. These are: (1) providers who make available, without regard to individual plan needs, a platform from which a plan fiduciary may select investment alternatives; (2) selection and monitoring assistance such as identifying investment alternatives that meet objective criteria established by the plan fiduciary, and identifying a sample set of investment alternatives based only on employer or plan size or current investment alternatives in response to a solicitation, or providing objective financial data and comparisons with independent benchmarks; (3) general communications that a reasonable person would not view as an investment recommendation, such as newsletters of general circulation, television shows, presentations at widely attended conferences, trading data, and prospectuses; and (4) providing investment education, such as information on the terms or operation of a plan including contribution/distribution/investment options, general risk and return information, historical returns and prospectuses, general financial and retirement information that does not address specific investment products or distribution options outside of the plan, and hypothetical asset allocation models and interactive investment materials.

One of the key changes is the introduction of a “best interest contract exemption” along with new or revised prohibited transaction exemptions that provide special conditions which, if met, permit the provision of advice and the receipt of fees and compensation under circumstances that would otherwise be prohibited by the new rule. Most current nonfiduciary investment advisors will have to modify their business practices in order to be covered by one or more of the special rules.

One of EBSA's primary objectives was to extend coverage of the investment advisor rule to persons who advise individuals about rollovers and distributions from plans and IRAs. *This change does not turn your HR department into a fiduciary*. Unless they represent that they are a fiduciary, a person will not be deemed to be a fiduciary *solely* because they perform the following activities: employees who provide advice to the plan sponsor provided they do not receive any pay above their normal compensation; employees who advise plan participants about the operation of the plan and distribution options provided the employee is not an investment professional and does not receive any pay above normal compensation; transactions with independent plan fiduciaries who have financial expertise (*e.g.*, a bank, insurance company, registered advisor or broker dealer, or a fiduciary that has total assets of at least $5 million under management); and certain communications regarding swap transactions under Dodd/Frank.

Providers who sponsor ERISA retirement plans should consider the following *action items* now: (1) identify anyone who is or may be an investment advisor to your plan; (2) review all written contracts with the identified advisor; (3) determine if the advisor is currently a fiduciary under current rules; (4) begin discussions with nonfiduciary investment advisors about whether they will comply with the new rules; and (5) consider sending out an RFP for a fiduciary advisor.

For more information, please contact:

Debra Lee Mackey
Birmingham, AL
Phone (205) 458-5484
E-Mail dmackey@burr.com

Debra Mackey practices at Burr & Forman LLP and specializes in employee benefits.