DOL’s Final Conflict of Interest Rule—
Implications for Qualified Retirement Plans

by | Steven E. Grieb, CEBS

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The Department of Labor’s new definition of ERISA fiduciary status will have a significant impact on qualified retirement plans. This first of two articles describes how someone will become a fiduciary under the new rule.

On April 6, 2016, the Department of Labor (DOL) published the final conflict of interest rule under the Employee Retirement Income Security Act (ERISA). The rule changes the scope of who is and is not an ERISA fiduciary.

To comprehend the significance of this change, understand that this is the first time DOL has adjusted the definition of ERISA fiduciary status since 1975, shortly after ERISA was adopted. While the primary targets of the rule may be broker-dealers and investments made by individuals holding individual retirement accounts (IRAs), the rule will have a significant impact on qualified retirement plans as well. Plan sponsors, administrators and service providers need to familiarize themselves with the rule and understand how it impacts them and the retirement plans they work with.

This first article of two covers the background of how the rule came to be in its final form. It compares the current standard
with the rule and covers how someone will become an ERISA fiduciary under the rule. The article also touches on steps plan sponsors should take before the rule’s applicability date. The second article will address how the rule adjusts nonfiduciary education for plan participants and what plan sponsors should be looking for in preparing participant communications going forward. It will also examine the best-interest contract exemption, which has direct implications for active plan participants and some plan sponsors.

Historical Background

In October 2010, DOL initially proposed a greatly expanded definition of who would be considered a fiduciary under ERISA, particularly relating to investment advisors. The proposal was fairly controversial, and DOL withdrew the proposed regulation in early 2011. But DOL immediately began laying the groundwork for a revised version of the new fiduciary definition. When the updated regulation was issued in April 2015, it was expanded to include new and revised prohibited transaction exemptions and backed up by DOL analysis and research. DOL had also built a solid foundation of support from Capitol Hill and the Obama administration.

In preparing the rule, DOL assembled a regulatory impact analysis, which was informed and supported by a review of independent research. Based on its analysis, DOL believes that the rule would save families with IRAs invested in front-end load mutual funds between $33 billion and $36 billion collectively over ten years. A White House Council of Economic Advisers analysis concluded that conflicts of interest in the retirement investment marketplace result in annual losses of about one percentage point for affected investors, totaling an eyebrow-raising $17 billion per year.

In 2015, DOL allowed for multiple comment periods lasting over five months, as well as four days of public hearings. The 2015 proposed version of the rule generated an unprecedented amount of public comment for a DOL regulation. According to a fact sheet issued by the Obama administration, DOL received and reviewed more than 3,000 comment letters and over 300,000 petitions regarding the rule. More than 70 witnesses testified at the public hearings, and their testimony was transcribed and posted on the DOL website.

What's Changing, What's Not?

ERISA generally provides for three ways in which a person can become a fiduciary. Specifically, a fiduciary is a person who (1) has authority or control over the management of plan assets, (2) has discretionary authority over plan administration or (3) renders investment advice for a fee.

Under the rule, the first two ways of becoming a fiduciary remain unchanged. However, the scope of who is providing investment advice for a fee will expand significantly. As a rule of thumb, anyone who was an ERISA fiduciary before the rule will continue to be a fiduciary after the rule. However, many service providers that previously provided nonfiduciary investment-related services for a fee may become subject to fiduciary standards under the rule if they do not change their service models.

As before the rule, the definition of fiduciary remains functional. In other words, a person becomes a fiduciary when he or she has any control or authority over the management or administration of an employee benefit plan or its assets. Fiduciary status depends on the role a person plays, not the title he or she holds. A person claiming he or she isn’t a fiduciary or having a service agreement in which a client agrees he or she isn’t a fiduciary doesn’t prevent the person from being a fiduciary if he or she actually is making fiduciary decisions for the plan or giving investment advice. In addition, the rule does not

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change the standard that fiduciaries are personally liable for any breaches in which they engage.

Current Definition

Under the current definition of who renders investment advice for a fee, service providers have had to meet a fairly strict test before becoming a fiduciary. Specifically, advisors would have to meet all five of these requirements to be a fiduciary:

1. They must have advised the plan regarding the value of securities or other property or have made recommendations as to the advisability of investing in securities or other property.
2. The advice must have been provided on a regular basis. One time or sporadic advice did not count.
3. The advice must have been provided pursuant to a mutual understanding that it would form a primary basis for the plan's decision making.
4. The advice must have been based on the particular needs of the plan.
5. The advice must have been provided for a fee. Any service provider that failed to meet even one of the five requirements was not rendering investment advice for a fee.

As a result, an advisor had numerous ways of avoiding fiduciary status. Service agreements typically include an understanding that the service provider was not making “recommendations” or that the advice would not serve as a primary basis for making decisions. This definition gave service providers wide latitude to address investment issues with retirement plan fiduciaries without becoming a fiduciary themselves.

New Definition

Under the rule, the test is not nearly as restrictive. The rule replaces the five-part test with a new, easier-to-meet standard. Specifically, to meet the new fiduciary definition, the advisor will need only to (1) give certain types of covered advice for a fee and (2) have a certain type of relationship with the advice recipient.

Under the rule, it’s going to be much easier for service providers that deal with plan investments to become a fiduciary. If a service provider is a fiduciary before the rule goes into effect, it’s safe to say that the service provider will be a fiduciary after the rule becomes applicable. But if a service provider is not a fiduciary, it’s entirely possible that he or she will become a fiduciary once the rule goes into effect, if he or she continues to provide investment advisory-type services.
**Recommendation** means 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. That may seem like a subjective standard, but the rule expressly states that DOL intends for determination of whether a communication rises to the level of recommendation to be an objective rather than subjective inquiry. The more individually tailored the communication is to a specific recipient, the more likely DOL will view the communication as a recommendation.

The rule lists several types of materials that do not constitute a recommendation and, as a result, will not rise to the level of a fiduciary communication. The rule makes clear that the items described as outside the scope of the term recommendation merely serve as examples and do not create an exhaustive list of communications beyond the term’s range:

- Materials from a platform provider that gives information about investment alternatives to a plan fiduciary without regard to the individualized needs of the plan or its participants, presuming the fiduciary selecting the investment(s) is independent of the platform provider
- Identifying investment alternatives available on a platform that meet objective criteria specified by the plan fiduciary
- Platform selection and monitoring activities, such as providing a sample investment menu from the platform in response to a request for proposal, if certain conditions are met
- Materials providing objective financial data and comparisons with independent benchmarks to the plan fiduciary
- General communications that a reasonable person would not view as an investment recommendation
- Materials providing investment education.

**Types of Applicable Relationships**

Providing covered advice becomes a fiduciary act under the rule only if given by a service provider who has a specific type of relationship with the recipient. Specifically, the recommendation must be made by a person who:

- Represents or acknowledges that he or she is acting as a fiduciary
- Renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular needs of the advice recipient or
- Directs the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to the investment property.

Unlike the current standard, the rule does not require that the parties have a subjective meeting of the minds regarding the extent to which the advice recipient will actually rely on the advice. Service providers will not be able to specifically direct investment recommendations to individuals but then avoid fiduciary responsibility because they did not consider individuals’ needs or intend that recipients base investment decisions on the recommendations. Nor can they escape fiduciary status through boilerplate language in a service agreement that the investment recommendations do not qualify as fiduciary advice.

**Activities Not Deemed Fiduciary**

The rule also lists several types of functions that will not be fiduciary, even if the service provider would technically fall within the definition laid out above. The special exceptions will not apply if the individual has represented or acknowledged that he or she is a fiduciary or receives a fee or other compensation for providing advice in connection with a transaction. First, the rule exempts transactions with independent plan fiduciaries with sufficient financial expertise such that the plan fiduciary will not have a legitimate expectation that the service provider is acting in a fiduciary capacity and providing impartial advice.

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**bio**

Steven E. Grieb, CEBS, is director of regulatory services for Empower Retirement in Milwaukee, Wisconsin. He has practiced in a variety of employee benefits areas, including retirement plans, health plans, cafeteria plans, single and multiemployer plans and executive compensation. He holds a J.D. degree from the University of Iowa School of Law. Grieb currently serves as a member of the International Foundation of Employee Benefit Plans CEBS Committee and is a former President of the International Society of Certified Employee Benefit Specialists Governing Council.
The plan fiduciary must be a bank, an insurance carrier, a registered investment advisor, a registered broker-dealer or an independent fiduciary with at least $50 million under management. This exception is not available for direct communications with plan participants or IRA holders.

Second, the rule exempts swap and security-based swap transactions between an employee benefit plan and a swap dealer if the plan is represented by an independent fiduciary.

Finally, the rule will not include communications by employees of the plan sponsor to fiduciaries of the plan, such as routine reports. This last exception also covers communications among employees, such as human resources staff communicating information to other employees about plan distribution options.

A service provider that provides investment advice for a fee with respect to some plan assets will not be a fiduciary regarding any other assets of the plan with respect to which the provider does not provide investment advice (or meet one of the other definitions of fiduciary as described earlier in this article). In addition, a broker-dealer will not become a fiduciary solely by executing transactions for the purchase or sale of securities on behalf of the plan or a participant.

Steps for Plan Sponsors

The applicability date of the rule is April 10, 2017. In the meantime, plan sponsors should take the following four steps in preparation prior to April 2017:

1. **Know who your fiduciaries are.** It’s very possible that service providers that provide nonfiduciary services today will be fiduciaries in April 2017 if they don’t change their service model. The first step here can be as simple as asking your service providers if they will be a fiduciary. Because of co-fiduciary liability, a plan sponsor should always be aware of who else is serving the plan in a fiduciary capacity.

2. **Review participant communications and educational materials to make sure they comply with the new definition of education under the rule.** The second article in this series will address the definition of education more thoroughly.

3. **Check in with service providers that have direct communications with plan participants.** What are they doing to prepare for compliance with the rule? What new protocols are they putting into place as a result of these changes?

4. **Read and understand all service contracts and disclosures relating to the plan.** This one is crucial if the rule requires a service provider to give you an updated contract or other disclosure. Consider involving your attorney in this step of the process.

It is important to note that DOL has yet to issue guidance with respect to interpretation of the rule, and it may take time for service providers to determine how they intend to operate under the new rule. We may not understand the true impact of the rule for years to come. But taking steps to respond to the new rule even before its applicability date may be necessary for plan sponsors and administrators to satisfy their own fiduciary requirements.

Endnotes

1. Since 1975, the concept of retirement savings in America has changed significantly. At that time, qualified retirement plans primarily were defined benefit plans, 401(k) plans did not exist, and IRAs were a fairly new idea. Today, individuals (as opposed to plan sponsors or administrators) typically bear responsibility for investment decisions in defined contribution plans or IRAs. In addition, investment vehicles and financial products have grown increasingly more complex.

2. DOL’s regulatory analysis can be found at www.dol.gov/ebsa/pdf/conflictsinterestria.pdf.


6. Prior DOL Regulation §2510.3-21(c)(1).

7. The rule uses the term investment property to make very clear that a recommendation to purchase group health, disability, term life insurance or similar insurance policies that do not have an investment component does not constitute covered advice. Recommending a policy or insurance product that has an investment component can qualify as advice under the rule. The rule will also attach fiduciary status to those giving investment advice in conjunction with a health plan funded through a voluntary employees’ beneficiary association (VEBA) or in relation to a health savings account.

8. The 2015 proposed regulations included certain valuations of investment property within the scope of covered advice. Under that proposal, anyone advising a plan or participant as to the value of a nonpublicly traded security could become a fiduciary. Under the rule, DOL reserved the possible coverage of appraisals, fairness opinions and similar statements to a future rulemaking project. Until DOL issues that future guidance, appraisals, fairness opinions and similar statements will not be considered fiduciary investment advice.

9. The platform provider provision does not extend to IRAs or individually directed brokerage accounts. Those contexts typically involve no independent fiduciary who interacts with the platform provider.

10. General communications would include newsletters for general circulation; commentary in publicly broadcast talk shows; remarks and presentations in widely attended speeches and conferences; research or news reports prepared for general distribution; general marketing materials; general market data including data on market performance, market indices or trading volumes; price quotes; performance reports; and prospectuses.