



# Issue Brief

## In this Issue:

- Types of Fiduciaries
- Proposed Regulation Updating the Definition of Fiduciary
- Benefits of the Proposed Regulation
- Suggestions for Improving the Proposed Regulation

## DEFINING “FIDUCIARIES” UNDER ERISA

### Overview

Administering a retirement plan and managing its assets are the responsibility of the plan’s “fiduciaries.” Because of the important role they play, the Employee Retirement Income Security Act of 1974 (ERISA), sets standards for the way in which fiduciaries do their job. The U.S. Department of Labor (DOL) recently proposed changes to the regulations that define “fiduciary.” This proposal will significantly affect the way in which participants and plan officials receive advice regarding plan investments.

ERISA provides for several different types of fiduciaries. Fiduciaries are generally categorized as either a “named fiduciary” or a “functional fiduciary.”

- **Named fiduciaries** - These are individuals who are identified as fiduciaries by name, title or through a procedure described in the plan. Named fiduciaries are typically the plan officials who have control over the plan’s operations. For example, they generally hire and monitor the plan’s service providers. ERISA requires each retirement plan to have at least one named fiduciary. Often this is a senior executive, a committee of employees or the board of directors of the plan sponsor.
- **Functional fiduciaries** - Under ERISA, individuals can also be fiduciaries as a result of their actions. These are often referred to as functional fiduciaries. ERISA generally provides that individuals are fiduciaries if they have discretion over the management or administration of a plan; have authority or control over a plan’s assets; or provide investment advice or recommendations for compensation.

### Proposed Regulation Updating the Definition of Fiduciary

In 1975, the DOL issued a regulation under the recently enacted ERISA statute defining fiduciary. In particular, the regulation provides detailed rules regarding who should be considered a functional fiduciary as a result of giving advice or recommendations about the plan’s investments. The DOL now believes the regulation needs to be updated because of the substantial changes in the retirement plan industry that have occurred over the last 35 years. For example, the concept of a 401(k) plan where employees can elect to contribute part of their pay into the plan (known as a “cash or deferred arrangement”) had not yet come into the law when the current regulation was written. As a result, the DOL has proposed modifications which are intended to update the regulation and expand its application.

Under the proposal, an individual will be categorized as a fiduciary if he or she receives compensation for: (i) making recommendations about the advisability of investing in, buying, holding, or selling securities or other property; or (ii) giving advice about the management of securities or other property. In order to be considered a fiduciary, these individuals would also have to:

- Represent or acknowledge that they are acting as a fiduciary for this purpose under ERISA;
- Otherwise be a fiduciary as a result of: (i) exercising any discretionary authority or control over management of the plan; (ii) exercising any authority or control over management or

disposition of the plan's assets; or (iii) having any discretionary authority or responsibility in the administration of the plan;

- Provide advice or recommendations and be a Registered Investment Advisor (RIA) under the Investment Advisers Act of 1940; or
- Provide advice pursuant to an arrangement or understanding with the plan, fiduciary, participant, or beneficiary that: (i) the advice may be considered when making decisions regarding the investment or management of plan assets; and (ii) the advice will be individualized based on the needs of the plan, fiduciary or participant.

The current rule has a detailed five-part test which must be satisfied in order to classify an individual as an investment advice fiduciary. The new proposal would change this test in many ways. Perhaps most significantly, the new rule would no longer mandate that to be a fiduciary, the investment advice must be given on a "regular" basis and serve as the "primary" basis for an investment decision. Instead, under the proposal, a person could be deemed a fiduciary for investment advice that was given only once and merely "considered" by the recipient. If included in the proposal when finalized, these changes are likely to extend the reach of the regulation to advisors who presently would not be considered fiduciaries. For example, a broker or agent who advised a small business owner on setting up an initial investment menu for a 401(k) plan would likely be classified as a fiduciary, even if no other recommendations were ever made.

### Limitations Contained in the Proposed Regulation

The proposed regulation also contains several significant exceptions, which if met, would allow a person giving advice or recommendations to avoid fiduciary status.

#### *Provision of Advice by Purchaser or Seller of Securities*

The limitation on the general rule that will likely

have the broadest application is often referred to as the "seller's exception". Under this limitation, a person will not be considered to be an investment advice fiduciary if it can be demonstrated that the recipient of the investment advice or recommendation knew, or reasonably should have known, that the person providing the advice or recommendation:

- Is a purchaser or seller of securities;
- Has interests that are adverse to the interests of the plan or its participants; and
- Is not providing impartial investment advice.

Under this exception, it is the provider of the advice who has the burden of demonstrating that the recipient had (or reasonably should have had) the knowledge described above. This change in the legal burden of proof is significant.

#### *Marketing or Making Securities Available*

Another significant exception applies to individuals marketing or making securities available through a platform or similar mechanism from which fiduciaries may designate investment alternatives if done without regard to the individualized needs of the plan (or its participants and beneficiaries). Thus, the proposed regulation clarifies that an independent third party plan administrator or recordkeeper will not be covered by the rule merely because they make such a product available. However, in this exception, the proposal specifically requires written disclosure that includes wording that the person is not "...undertaking to provide impartial [investment] advice."

#### *Investment Education and General Financial Data*

Another exception in the new rule is for the provision of information that constitutes "investment education" rather than "investment advice." This reaffirms the existing position of the DOL and the standards found in DOL Interpretative Bulletin 96-1 to distinguish between the two. Additionally, preparing general financial data to assist a plan fiduciary's selection and monitoring of one or more designated investment alternatives is likewise exempted if written disclosure is made that the

provider of the data is not giving impartial advice.

### **Benefits of the Proposed Regulation**

By updating the definition of fiduciary so that it is consistent with current practices in the industry, the proposed regulation would provide enhanced protections for a plan's named fiduciaries, participants and beneficiaries. In particular, it would bring clarity to an area in which considerable uncertainty exists. Under the DOL's current five-part test, it is often not clear whether an individual is acting as a fiduciary. The proposed changes are more consistent with the reasonable expectations of the plan's named fiduciaries.

The need for clarity is particularly important for small businesses. A large percentage of small retirement plan sponsors believe that they are receiving fiduciary investment advice from their service providers. In a 2010 survey by the Profit Sharing/401k Council of America, 60% of the fiduciaries of small retirement plans indicated that they had received investment advice with regard to their plans' investments. It has been the experience of ASPPA members that the named fiduciaries at most small companies are receiving more generic "investment education," rather than investment advice. Retirement plan fiduciaries should not have to guess as to the nature of the guidance that they receive from their advisors. If it is not intended as true, non-conflicted "investment advice," they should be told as such.

### **Suggestions for Improving the Proposed Regulation**

ASPPA is very supportive of this DOL initiative. However, the proposed regulation could be improved upon if the following changes were made.

*Plan Level Advice Limitation* - The "seller's exception" for plan level investment advice given to fiduciaries that is not impartial should require that the seller/purchaser's conflict of interest be disclosed in clear and conspicuous language, and be acknowledged in writing or electronically by a plan fiduciary.

*Participant Level Advice* - The regulation should not include a "seller's exception" for participant-level investment advice. Congress has created specific rules for participant-level advice in the Pension Protection Act and the limitation included in the proposed regulation would circumvent those rules.

*IRAs and Rollovers* - The regulation should not be applied to IRAs; rather a comprehensive approach, which would include consideration of fee transparency, should be examined at some future date and perhaps in conjunction with the newly formed Consumer Protection Financial Bureau. Additionally, the DOL should consider the question of whether a recommendation with respect to taking a plan distribution constitutes investment advice in conjunction with more comprehensive guidance regarding IRAs.

*Appraisals and Fairness Opinions* - Appraisals and fairness opinions should be exempt from the rules contained in the proposed regulation due to the likelihood of added costs to plans and plan participants and the potential chilling effect on the availability of these services.

*Applicability to RIAs* - The regulation should be clarified to provide that the proposal applies to an individual who has actually registered as an investment advisor with the Securities and Exchange Commission (SEC) or a state agency of appropriate jurisdiction (and not someone who merely satisfies the definition of an investment advisor).

*Definition of Investment Advice* - The regulation should be clarified to provide that investment advice does not include information regarding the relative value and financial effect of optional forms of benefit available to participants, valuations related to lump sum distributions or the division of property under a qualified domestic relations order ("QDRO"), or the offering of 403(b) investment products, and should clarify that the provision of recommendations or advice regarding the selection of fiduciaries would not, without additional action, cause a person to be considered a fiduciary.

For more information, please see ASPPA's Comment Letter filed with the DOL at [http://www.asppa.org/Document-Vault/Docs/GAC/Definition\\_of\\_Fiduciary\\_Comment\\_Letter.pdf.aspx](http://www.asppa.org/Document-Vault/Docs/GAC/Definition_of_Fiduciary_Comment_Letter.pdf.aspx).