



OVERVIEW AND STATUS OF THE PROPOSED FIDUCIARY REGULATION

Workshop 67
October 21, 2015

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Structure of Fiduciary Package

- Proposed expansion of definition of fiduciary investment advice:
 - covers almost all advice and sales practices.
 - includes recommendation of distributions and rollovers.



Structure of Fiduciary Package

- Financial conflicts of fiduciaries are prohibited, but there are exemptions:
 - 84-24 for insurance products, except variable annuities to IRAs.
 - Best interest contract exemption (BICE) for almost all other advice.



Timeline of Proposed Regulation

- April 20: DOL released proposed fiduciary “package.”
- August 10: Public hearings.
- Late September: Comment period ended.
- May or June 2016 (est.): Final regulation and exemptions are published.
- First quarter of 2017 (est.): “Applicability” date.



Definition of “Fiduciary”

- Under the existing regulation, there is a 5 part test (DOL Reg. §2510.3-21(c))
- Someone is a fiduciary if the person:
 - Renders advice to a plan or participant
 - On a regular basis
 - Pursuant to a *mutual* arrangement, agreement or understanding
 - That the services are the *primary* basis for investment decisions, and
 - The advice will be individualized, based on the particular needs of the plan or participant



Definition of “Fiduciary”

Under the proposal, a person renders investment advice if the person:

- Provides to a plan, fiduciary, participant or IRA owner advice in exchange for a fee or compensation, whether direct or indirect, and
- Either acknowledges it is a fiduciary *or* renders the advice pursuant to an arrangement that the advice is
 - individualized to or specifically directed to the recipient
 - For their consideration in making investment or management decisions regarding property of the plan or an IRA



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Definition of “Fiduciary”

What’s missing?

- The “regular basis” requirement
- Mutuality of the arrangement
 - though it’s hard to imagine having an “agreement, arrangement or understanding” if it *isn’t* mutual
- The “primary basis” requirement
 - this can now be just for “consideration” in making a decision
- The “individualized, based on the particular needs” requirement
 - Though “individualized” is still there, it is enough if the advice is “directed to” the recipient for “consideration”



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Definition of “Fiduciary”

Advice about what?

- Buying, selling or holding securities or other property
- Taking a distribution or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from a plan or IRA [*new and a lot of nuances*]
- Management of securities or property, including assets to be rolled over or otherwise distributed from a plan or IRA [*same*]
- Recommendation of a person who will make a fee for any of these services [*same*]



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Definition of “Fiduciary”

What’s a “recommendation”?

- It’s a defined term
- It’s *any* communication that can reasonably be viewed as a **suggestion** that the recipient engage in or refrain from taking a course of action
- So you can be a fiduciary for directing a suggestion to a plan, a plan fiduciary, a participant or an IRA owner

Note that this may have been taken from FINRA rules



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Definition of “Fiduciary”

The determination of whether a “recommendation” has been made . . . is an objective rather than subjective inquiry. An important factor in this regard is whether—given its content, context and manner of presentation—a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy.

(FINRA Regulatory Notice 11-02)



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Impact of Changes to Definition

If finalized in its current form, the proposed regulation would cause most common investment sales practices to plans and IRAs to be classified as fiduciary investment advice, implicating the

- Duty of loyalty
- Duty of prudence
- Duty for reasonable costs and compensation
- Self-dealing prohibited transaction rules



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Impact of Changes to Definition

- Biggest change is probably the addition of distributions and rollover advice
- But see
 - *DOL Advisory Opinion 2005-23A*
 - *FINRA Regulatory Notice 13-45*



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What's Not Advice?

The proposed regulation provides exceptions – what DOL refers to as “carveouts” (these are the most important):

- “Seller’s” carveout
- **Swaps** (not the 1955 Kentucky Derby winner)
- Platform carveout
- Selection and monitoring
- Investment education



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Seller's "Carve-Out"

Under the "seller's carve-out," the proposal would not treat as fiduciary advice recommendations made to a plan in an arm's length transaction where there is generally no expectation of fiduciary investment advice, provided that the carve-out's specific conditions are met.

Note: Not for small plans, participants or IRA owners.

Prognosis: No change, except possibly for sophisticated or accredited investors.



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Platform Providers "Carve-Out"

Under the [platform] carve-out, persons would not act as investment advice fiduciaries simply by marketing or making available such investment vehicles, without regard to the individualized needs of the plan or its participants and beneficiaries, as long as they disclose in writing that they are not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.



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Selection and Monitoring

Platform providers can:

- Identify investments that meet objective criteria specified by the plan fiduciary; and
- Provide objective financial data and comparisons with independent benchmarks.

- Prognosis:
- Issue for discretion.
 - Tools to help plan fiduciaries.
 - IRA platforms.



Education “Carve-Out”

- Pretty much the same as the current DOL position in Interpretive Bulletin 96-1, *except*
- A new condition of the carve-out is that the information and materials *not* include advice or recommendations about specific investments.

- Prognosis:
- Asset allocation models permitted.
 - All investments included.
 - Consider one investment for each category.



Education and Rollovers

From the Preamble:

*“However, as the proposal’s text makes clear, one **does not act** as a fiduciary merely by providing participants **with information about plan or IRA distribution options**, including the consequences associated with the available types of benefit distributions.” [Emphasis added.]*

Distribution education is discussed in FINRA Regulatory Notice 13-45.



Prohibited Transaction Rules

Both ERISA and the Internal Revenue Code prohibited transaction rules prohibit fiduciary advice:

- that results in receipt of compensation by a “fiduciary adviser”* from a party dealing with a plan in a transaction involving plan assets
- where the “fiduciary adviser” causes himself to receive a benefit (e.g., compensation).

*Adviser includes affiliates.



Prohibited Transaction Rules

The fiduciary regulation package includes proposed prohibited transaction exemptions for

- Insurance sales – the exemption modifies existing PTCE 84-24
- Conflicted investment advice – *i.e.*, where the adviser will receive variable compensation based on his/her advice – the “best interest contract exemption” or BICE



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Proposed PTCE 84-24

Major conditions for exemption for insurance commissions (but not revenue sharing):

- Insurance agent must act in “best interest” of plan or IRA.
- Statements about recommended investments, fees, material conflicts and other matters must not be misleading.

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Proposed PTCE 84-24

Continued . . .

- Commissions and compensation must be reasonable for services.
- Commissions must be disclosed as percentage.
- Charges, surrender fees, etc., must be disclosed.
- Transaction must be approved in writing.

Notes:

- Existing requirements.
- Existing practices.

Prognosis



Proposed PTCE 84-24

Selected Issues:

- Best interest requirement, though no contract
- Definition of “commissions” only includes sales commission, plus renewal fees and trailers
- Calculation of disclosure for commissions
- “Reasonable” compensation limitation
- Exclusion of variable annuities
- Enforcement



BICE

Preamble to the Proposed Exemption:

“It should be noted, however, that compliance with the exemption’s conditions is necessary only with respect to transactions that otherwise would constitute prohibited transactions under ERISA and the Code.”

This means that, where the advice would not increase the fiduciary adviser’s (or affiliates’) compensation, there is not a prohibited transaction. As a result, BICE is not needed.



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BICE applies to advice to “Retirement Investors”:

- A participant or beneficiary of an ERISA-governed plan with authority to direct the investment of assets in his or her account or to take a distribution;
- The owner of an IRA; or
- The sponsors of non-participant directed plans with fewer than 100 participants.

So, no exemption for 401(k) plans.



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BICE applies to advice to related to “Assets”

- Basically, common investments and securities used in plans
- But not managed accounts, hedge funds, non-publicly traded securities
- Includes group annuities and also variable annuities, which would not be covered by 84-24



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BICE

BICE Requirements

The most significant conditions for the relief offered by the exemption are:

- A written contract must be entered into before a recommendation:
 - the contract is tri-party: the advisor, the broker-dealer and the investor.
 - the contract must acknowledge fiduciary status.
 - the contract agrees to “Impartial Conduct Standards.”
 - the agreement must affirmatively warrant certain conduct by the advisor and the broker-dealer.

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BICE

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➤ Disclosure Requirements

- Transactional disclosures must be made about specified costs.
- Annual disclosures must be made about transactions, costs and compensation.
- Website disclosures about compensation must be made.

Prognosis:

- Introductory conversations allowed pre-contract.
- Elimination of dollar disclosures.



BICE

An adviser acts in the Best Interest of the plan or IRA:

“ . . . when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances when prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances and needs of the plan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party.”

Prognosis: Removal of “without regard to.”



BICE

Impartial Conduct Standards

The Adviser and the Financial Institution must affirmatively agree that:

- *“ . . . the Adviser and Financial Institution will not recommend an Asset if the total amount of compensation anticipated to be received by the Adviser, Financial Institution, Affiliates and Related Entities in connection with the . . . will exceed **reasonable compensation in relation to the total services they provide** to the Retirement Investor; . . .” [Emphasis added.]*



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Why a contract?

“ . . . the exemption ensures that IRA owners and investors have a contract-based claim to hold their fiduciary advisers accountable if they violate these basic obligations of prudence and loyalty. As under current law, no private right of action under ERISA is available to IRA owners.”

Notes: No exculpatory provisions
Arbitration can't preclude class actions.



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Parting Thoughts and Questions . . .

Q&A



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