"Mamas, Don’t Let Your Babies Grow Up to be Fiduciaries"

DOL Expands definition of Fiduciary

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Speaker today

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Sharon Whittle

Experience

Sharon has spent the last 25 years serving the Human Capital needs of businesses both as a consultant to organizations and as a Benefits Director for several Fortune 500 companies. Her diversified experience includes working closely with organizations that are conducting significant merger, acquisition, restructuring or realignment activity, experiencing changes in top management and business strategy, being spun-off from a larger company, or are financially distressed. Her experience includes:

- Aligning total compensation programs to the People and Business Strategy of an organization.
- Managing the Human Resources portion of enterprise wide Business Process Improvement Projects and Benefit Plan Audits focusing on legal, compliance and systems risk management and plan and operating efficiencies.
- Developing, managing and implementing business restructuring and realignment plans for the Human Resources and People function of an organization.
- Creating common compensation and benefit programs across business units within a single organization.
- Evaluating current Human Resources programs in terms of best processes and practices, fit to the overall mission of the organization, impact to attracting and retaining the right talent, and the cost/value trade-off and proposition.

Sharon served on a leadership team at Grant Thornton, charged with reinventing our own culture by specifically focusing on refreshing our core values, enhancing our employee experience and improving our internal feedback channels.

Professional qualifications and memberships

- Member of the Southern Employee Benefits Conference and has attended leadership development courses at the Center for Creative Leadership.
- Member of the Aetna Client Advisory Board.

Presentations and publications

- Spoken at the ICEBS conferences about the advantages of leveraging benefit programs across the provider market.
- Frequently speaks on employer responsibilities and risk management associated with the Affordable Care Act.

Education

- BS in Business Management from North Carolina State University
- MBA- University of North Carolina at Charlotte

Today’s Agenda

1. Background: The ERISA Fiduciary Rules
2. DOL's New Fiduciary Rule
3. What Does It Mean for Plan Sponsors?

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Background: The ERISA Fiduciary Rules

Fiduciary Rules - General

- Much more focus on fiduciary issues in recent years

  - **Plan expenses litigation**

  - **Increased DOL activity**
    - *General concern to ensure that financial services industry deals with plans and participants fairly*
    - Plan expense disclosure regulations
    - Increased examination activity
    - Voluntary Fiduciary Compliance Program

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Fiduciary Rules - General

Who is a fiduciary?

- ERISA section 3(21)

- Generally, any party who exercises any discretionary authority or control with respect to:
  - Management of an employee benefit plan
  - The administration of the plan
  - The management or disposition of plan assets, or
  - Renders investment advice as to plan assets for a fee or other compensation (this is where the new rule will focus)

Fiduciary Rules - General

Who is a fiduciary?

- ERISA section 3(38) investment manager
  - Formally appointed investment manager for a plan.
  - Actually controls plan investments (vs. 3(21) advisor who only recommends investments)

Fiducary Rules - General

Who is a fiduciary?

- The following are often fiduciaries with respect to a plan:
  - Plan sponsor
  - Plan administrator
  - Registered investment advisor (more on this later)
  - Trustee (though usually pretty limited role in most 401(k) plans)

Fiduciary Rules - General

Who is a fiduciary?

- The following are generally <u>not</u> considered fiduciaries to a plan:
  - Third-Party Administrator
  - Mutual fund investment managers
  - The plan's auditor
  - Law firms and other providers
- Note that the definition of parties in interest, used to determine whether prohibited transactions have occurred, is much broader

Fiduciary Rules - General

Who is a fiduciary?

- Any party who exercises <u>any discretionary authority or control with respect to:</u>
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Fiduciary Rules - General

- **Under what standards must fiduciaries discharge their duties?**
  - Act solely in the interest of plan participants and their beneficiaries;
  - Act for the exclusive purpose of providing benefits to plan participant and the beneficiaries and defraying reasonable expenses of administering the plan;
  - Exercise the same care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and with like aims;

Fiduciary Rules - General

- **Under what standards must fiduciaries discharge their duties?**
  - Diversify plan assets so as to minimize the risk of large losses (unless it is clearly prudent not to do so under the circumstances);
  - Act in accordance with the documents and instruments governing the plan

Fiduciary Rules - General

- **Plan Sponsor Fiduciary Best Practices?**
  - ?

DOL's New Fiduciary Rule

New Fiduciary Rules

- **Acknowledges growth of participant-directed investments since the 1970s**
  - 401(k) plans and IRAs were new concepts back then
- **New approach is more principal-based**
- **Broadens current rules to apply to more situations/advisors**
- **Expressly treats rollover and distribution recommendations as fiduciary advice**

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Selected Dialogue: DOL and Financial Services Industry on the Rule

Education	The Department should establish a clear line between education and investment advice and avoid a result in which service providers refrain from providing essential information and education to participants and investors due to concerns about triggering fiduciary status. In addition, when using asset allocation models to educate participants and investors, service providers should be able to identify specific investment options.	The final rule clearly describes the types of information and activities that constitute non-fiduciary investment education-including plan information and general financial, investment, and retirement information. The Department also revised the final rule to allow asset allocation models and interactive investment materials to identify specific investment alternatives under ERISA-covered and other plans if certain conditions are met. However, in the IRA context there is no independent plan fiduciary to review and select investment options so references to specific

Selected Dialogue: DOL and Financial Services Industry on the Rule

"Hire me"	An adviser should be able to recommend that the customer hire the adviser for a reasonable fee without that recommendation to "hire me" being treated as a fiduciary recommendation.	The Department has made clear in the final rule that a person or firm can recommend that the customer hire the adviser (or its affiliate) for advisory or asset management services without the recommendation counting as a fiduciary recommendation. However, the adviser's investment recommendations, such as the recommendation to roll money out of a plan or invest in a particular investment, are fiduciary recommendations.

Selected Dialogue: DOL and Financial Services Industry on the Rule

Timing of the contract	The contract requirement is unwieldy, calls for the signatures of too many parties, and must be executed too early in the process—before the customer even knows he or she will make an investment.	The contract requirement was eliminated for ERISA plans; it only applies to IRAs and other non-ERISA plans. The Department also adjusted the contract requirement to make it clear that it can be incorporated into other account opening documents and can be entered into before or at the same time the recommended transaction is executed. Any advice given before the contract was signed must be covered by the contract. The exemption provides a special "negative consent" procedure for existing clients to obtain the new protections. In other words, the firm can send out a notification to its client informing them of proposed contract amendments. If the client does not terminate the amended contract within 30 days, the amended contract is effective.

Selected Dialogue: DOL and Financial Services Industry on the Rule

Inappropriate bias towards low fee products	The proposal favors low-fee and low-cost products over all else, ignoring returns, quality, and other factors that may be important to consumers.	The Department did not adopt the low-fee streamlined option considered in the proposal, and clarified in the preamble that the adviser is not required to recommend the lowest fee option if another product is better for the client.

Lifetime Income Products	The focus on fee transparency in the proposal disadvantages lifetime income options and other insurance products, whose value – particularly the guaranteed lifetime income – may not be as easily understandable by consumers.	The Department has included language in the BICE to make clear that advisers may recommend insurance products and revised the disclosure provisions to better reflect how insurance products are sold. In addition, the final amendment to PTE 84-24 provides a streamlined exemption for recommendations of "fixed rate annuity contracts." which are less complex lifetime income products.

New Fiduciary Rules

- **Expands ERISA section 3(21) definition of fiduciary to include advisors/brokers for:**
  - individual plan participants
  - IRA investors
  - Small plans
- **DOL's key concern: conflicts of interest**
  - Many advisors are essentially selling investment products
  - Some investment products pay higher commissions to advisors than others
  - *Which ones do we assume advisors will recommend?*

New Fiduciary Rules

- **Existing regulations concerning investment advice under ERISA section 3(21) were promulgated in 1975**

- **Five-part test for determining fiduciary status when rendering investment advice:**
  - Advice to a plan as to the value of the securities/other property or recommends as to advisability of investing in securities other property, and
  - *Discretionary authority or control with respect to purchasing or selling investments, or*
  - *Renders advice pursuant to an agreement that services will serve as a primary basis of investment decisions with respect to plan assets*, and
  - Renders advice on a regular basis, and
  - Will render individualized investment advice based on particular needs of the plan concerning investment policies, diversification, etc.

New Fiduciary Rules

- **Key point:** **Fiduciaries may not act or advise where they have a conflict of interest**
- **If fiduciary makes recommendations that affect level of compensation, this may be a prohibited transaction**
- **Some class exemptions added/modified**

New Fiduciary Rules

Types of relationships that give rise to fiduciary status:

- Represents or acknowledges acting as a fiduciary, or
- Renders advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient, or
- Directs advice to a specific recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the of the plan or IRA, and
- For a fee or other compensation:
  - Whether direct or indirect
  - Broadly defined: essentially any compensation that would not have been paid but for the recommended transaction occurring

New Fiduciary Rules

Covered Investment Advice:

- **Recommendation to:**
  - Plan
  - Plan fiduciary
  - Plan participant/beneficiary
  - IRA owner

- **For a fee or other direct/indirect compensation**
  - e.g. 12b-1 fees

- **As to:**
  - SEE NEXT PAGE

New Fiduciary Rules

Covered Investment Advice:

- **As to:**
  - Advisability of:
    - Buying investments
    - Holding investments
    - Selling investments
    - Exchanging investments
    - Includes recommendations as to investments after securities, etc. are rolled over or distribution from a plan or IRA

  - Recommendations concerning management of investments:
    - Investment policies/strategies
    - Portfolio composition
    - Selection of others to provide investment advice
    - Selection of others to provide investment management services
    - Selection of investment account arrangements
      - e.g., brokered vs. advisory

New Fiduciary Rules

Covered Investment Advice:

- **As to:**
  - Recommendations with respect to rollovers, transfer, or distributions from a plan or IRA
  - Including whether, in what amount, in what form and to what destination such a rollover, transfer or distribution should be made.

New Fiduciary Rules

Covered Investment Advice:

- **Definition of "Recommendation"**
  - DOL notes that whether a recommendation has been made is the "fundamental threshold element" in establishing the existence of fiduciary investment advice.
  - *A "recommendation" is 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.*
  - The more individually tailored the communication is to specific advice recipient or recipients, the more likely the communication will be viewed as a recommendation
  - DOL notes this approach to defining recommendation is consistent with and based upon the approach taken by FINRA

New Fiduciary Rules

What Is <u>Not</u> Covered Investment Advice:

- **Education**
  - General information about retirement saving, finances and investments
  - May use approved plan investment alternatives in examples (Not applicable to IRAs)
  - Computerized asset allocation modeling
  - Any communication method permitted
    - Group meetings, website, etc.
- **General Communications**
  - General newsletters, commentary on television shows, widely-attended speeches and conferences, news reports, etc.

New Fiduciary Rules

What is Not Covered Investment Advice:

- **Platform Providers**
  - Many TPAs and recordkeepers offer "open architecture" platforms
  - Merely stating what funds can be maintained on service provider's platform not covered

Communications by Employees of Plan Sponsors, Plan Fiduciaries, etc.

Employees in payroll, accounting, HR and financial departments

Their reports, recommendations, etc. not covered

So long as they receive no fee or other compensation beyond normal salary

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New Fiduciary Rules

What Is Not Covered Investment Advice:

- **Swap and Security-Based Swap Transactions**
    - Generally derivative contracts such as interest rate swaps and commodities contracts
- **Communications by Employees of Plan Sponsors, Plan Fiduciaries, etc.**
    - Employees in payroll, accounting, HR and financial departments
    - Their reports, recommendations, etc. not covered
    - So long as they receive no fee or other compensation beyond normal salary

New Fiduciary Rules

New/Revised Class Exemptions:

- **Best-Interest Contracts**
  - PTE needed because many current fee practices create a conflict of interest, which results in a prohibited transaction under ERISA absent a DOL exemption.
  - Covers any investment product (expanded in the final rule)
  - Acknowledge fiduciary status of company and its advisers
  - Adhere to "basic standards of impartial conduct"
  - Financial Institutions must notify DOL of intent to rely on the exemption

New Fiduciary Rules

New/Revised Class Exemptions:

- **Best-Interest Contracts**
  - Written, enforceable contract required (for non-ERISA accounts)
    - Allows breach of contract claims where ERISA doesn't apply
  - For ERISA accounts, acknowledge fiduciary status
    - Allows enforcement under ERISA sections 502(a)(2), (3)
  - Provide advice in the "best interest" of the investor
    - Meet ERISA prudence requirement
    - Provided without regard to financial or other interest of adviser or institution
  - Disclose all material conflicts of interest

New Fiduciary Rules

New/Revised Class Exemptions:

- **Best-Interest Contracts**
  - Avoid making misleading statements
  - Receive no more than reasonable compensation
  - Disclose all material conflicts of interest
  - Disclose fees, both direct and indirect
  - Individual advisers' compensation not required to be disclosed

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New Fiduciary Rules

New/Revised Class Exemptions:

- **Best-Interest Contracts**
  - Implement policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest
  - Recordkeeping requirements
  - Investors have rights to obtain specific disclosure of costs, fees, etc.
  - Institution's conflicts, written policies and procedures to mitigate conflicts, etc. must be posted on website.
  - Streamlined version for "Level Fee Fiduciaries"
    - Fee based on fixed percentage of assets under management

New Fiduciary Rules

New/Revised Class Exemptions:

- **Amendments to PTE 84-24**
  - Covers insurance agents' compensation for sales of fixed-rate annuity contracts
  - Amended to provide streamlined version of Best Interest Contract exemption
  - Variable annuities, indexed annuities and other more complex products will remain covered by Best Interest Contract rules

New Fiduciary Rules

New/Revised Class Exemptions:

- **Principal transactions**
  - allows advisors to engage in purchases and sales of debt securities as principal
  - similar disclosure, etc. requirements as for best interest contracts
- **Order-taking.**
  - Similar to the current rule, if a customer calls a broker to buy or sell a specific investment without asking for advice, the transaction will not constitute investment advice.

Impact on Plan Sponsors

Impact on Plan Sponsors

- **Perform due diligence concerning advice, etc. being given to plan participants**
- **Consider how/when departing participants are being advised on rollover IRAs**
- **Don't lose sight of best practices**

Questions?

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