Chapman and Cutler LLP

Chapman Client Alert

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DOL Releases Additional Guidance on New Fiduciary Rule

The Department of Labor (the "DOL") released on January 13, 2017 two sets of frequently asked questions ("FAQs") to provide additional guidance on its new fiduciary rule (the "Rule"). One set of FAQs is directed at consumers to better help them understand the Rule and the role of financial advisers with respect to their retirement assets and is available here. The other set of FAQs is directed at financial service providers to address the regulation defining "investment advice" and is available here. In October 2016, the DOL issued an initial set of FAQs, directed at financial service providers that focused on the prohibited transaction exemptions that accompanied the regulations. For more information on the 2016 FAQs, see our client alert available here.

The consumer FAQs generally provide consumers with background on the Rule, information regarding fiduciary advisers, information about IRA, 401(k) plans and health savings accounts, and other information about timing of the Rule. The DOL also attached an appendix which lists questions that 401(k) and IRA investors should ask their financial adviser. The consumer FAQs do not provide substantive guidance, but do include information which most financial institutions should review in preparation for consumer's questions.

The second set of the recently released FAQs were aimed at financial service providers. They not only reiterate guidance from the previously issued regulations, but also in some cases, provide answers to certain questions regarding the regulations. The financial service provider FAQs cover the following categories: (1) investment "recommendations" under the Rule, (2) investment education, (3) general communications, (4) transaction with independent fiduciaries with financial expertise and (5) marketing platforms for individual account plans.

Although it is possible that the effective date of the Rule could be delayed, most financial institutions are continuing to prepare for the Rule.

The following provides highlights of the second set of FAQs aimed at financial service providers:

Investment Recommendations Covered Under the Rule

The FAQs highlight that not every communication with a financial adviser about retirement accounts is a fiduciary recommendation. Under the Rule, whether a person is giving fiduciary investment advice depends on whether the advising person makes a "recommendation" regarding an investment or investment management and receives direct or indirect fees or other compensation. The FAQs provide that a "recommendation" is a "call to action" — a communication that a reasonable person would view as recommending that he or she actually buy, hold or sell a particular investment, or as a recommendation on managing investments or investment accounts. The FAQs reiterate that the more individually tailored the communication is to a specific advice recipient, the more likely the communication will be viewed as a recommendation. The FAQs also reiterate that certain communications are excluded from the Rule even though they may rise to the level of being a recommendation. The following communications, for example, without a "specific recommendation," would be excluded from being a "recommendation" under the Rule: the mere furnishing of information and materials that describe product features or investment alternatives available under a retirement plan or IRA, general financial investment and retirement information, and certain asset allocation models.

The DOL noted that the adviser must also receive a "fee or other compensation" for a communication to be investment advice covered under the Rule. This would include both explicit fee or compensation for the advice from any source, as well as fee or compensation from any source in connection with a recommended transaction or service, including commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing and distribution fees, underwriting compensation, payments to firms in return for shelf space, recruitments bonuses, gifts and gratuities, and expense reimbursements.

The DOL indicated in the FAQs that certain information about distributions is not a recommendation. For example, an explanation of minimum required distributions is not a

"recommendation," but recommendations of specific investment products in which the MRD could be invested is a "recommendation" under the Rule.

The FAQs provide that the firm's internal communications with its employees, including training materials, as well as development of internal materials and models, will not be treated as recommendations under the Rules. However, depending on the facts and circumstances, such internal communications could be treated as a recommendation if they are forwarded to a retirement investor. Care should be taken that the materials are used only for internal use.

The FAQs reiterate that, consistent with DOL Advisory Opinion 97-15A (May 21, 1997), if an adviser receives certain fees (e.g., 12b-1 fees, sub-transfer agency fees, or other third-party compensation), the receipt of such fees will not result in a prohibited transaction if the adviser uses such fees to offset its advisory fee, discloses the receipt of such fees and credits the fees in excess of the advisory fees to the plan. Notably, the DOL provides that the receipt of such fees in connection with purchase or sale of a security or providing advice will still cause the adviser to be a fiduciary under the Rule.

Investment Education

The Rule provided that the provision of certain investment education will not result in a service provider becoming a fiduciary. The FAQs generally reaffirm what is already included in the Rule. Non-fiduciary investment education includes the provision of certain plan and investment information, including materials that describe investment or plan alternatives without specifically recommending particular investment strategies. Thus, an adviser would not become a fiduciary merely by describing information about an investment. Non-fiduciary investment education also includes certain general financial, investment and retirement information as long as the adviser does not cross the line to recommending a specific investment or investment strategy. Advisers can also provide information on hypothetical asset allocation models provided they are based on generally accepted investment theories, explain the assumptions on which they are based, and do not cross the line to making specific investment recommendation. Finally, non-fiduciary investment education can include certain interactive investment materials subject to certain conditions.

In the FAQs, the DOL provides that the following would be considered non-fiduciary investment education:

- A call center representative's description of a product feature, without addressing the appropriateness of a certain lifetime income features;
- A call center employee's providing information to a plan participant regarding the benefits of increasing contributions to maximize an employer match without reference to the appropriateness of any individual investment alternative or individual benefit distribution option;
- A service provider's interactive investment tool that generates estimated future retirement income needs of a participant based on certain participant-input data;
- An adviser provides educational information and materials on rollover options to an existing client as long as the adviser does not provide any specific investment recommendation; and
- The charging of a fee to a plan to provide investment education to plan participants would not, by itself, cause the provider to be a fiduciary; however, the adviser should be careful to not make an investment recommendation.

Note that the referral of a participant to an adviser in return for a referral fee would be considered fiduciary investment advice.

General Communications

Certain general communications are not considered fiduciary investment advice if a reasonable person would not view such communication as a "recommendation." For example, general circulation newsletters, television, radio and public media commentary, remarks in widely attended speeches and conferences, research and news reports for general distribution, general marketing materials and general market data are considered general communications under the Rule, and, thus, are not fiduciary investment advice. The FAQs specify that the following will be considered "general communications" under the Rule:

- A life insurance company wholesaler's non-individualized description to broker-dealers at a conference that is widely attended by retirement industry professionals (but not by individual retirement investors) of the potential features and benefits for 401(k) plans investing in a group annuity contract;
- The recommendation by a third party administrator (TPA) to a plan fiduciary regarding the hiring of a non-fiduciary recordkeeper for the plan where the TPA does not make any representations regarding the investment options available on the recordkeeper's platform; and
- The recommendation by a financial institution to a prospective customer to hire it to provide certain rollover services (either self-directed brokerage, an investment

advice program, a discretionary advice program, or robo-advice program) where the financial institution simply describes the different services and markets itself, but does not recommend a particular investment or account type or service.

The DOL also noted that providing free meal seminars for the purpose of marketing services or investments are not considered widely attended speeches or conferences and could be considered general communications because a reasonable person, based on the facts and circumstances, could view the statement made to all attendees as a recommendation to each attendee.

Transactions with Independent Fiduciaries with Financial Expertise

A party providing recommendations with an independent fiduciary of a plan or IRA in an arm's length transaction is excepted from the Rule if certain disclosure requirements are satisfied and the party reasonably believes that the independent fiduciary is a bank, insurance carrier, registered broker-dealer or investment adviser, or any other independent fiduciary who manages or controls at least $50 million.

The FAQs confirm that the recommending party's reasonable belief can be based on written representations from the independent fiduciary.

The FAQs provide that if a recordkeeper meets with a fiduciary adviser to a plan and with the plan's fiduciary committee, the presence of the committee members would not disqualify the recordkeeper from relying on the exception. This is the case only if the recordkeeper knows or reasonably believes that the adviser is acting as a plan fiduciary with responsibility for exercising independent judgement in making a fiduciary recommendation to the plan's fiduciary committee. It would be prudent to clearly provide and document that advice is being given solely to the adviser and to have any follow-up communications with the adviser.

The FAQs make clear that the exception is available for transactions involving an IRA provided that the conditions of the exception are satisfied, including that the party know or reasonably believe that the registered investment adviser is responsible for exercising independent judgment in evaluating the transaction. The FAQs provide that the party may rely on written representations from the IRA or independent fiduciary to satisfy this requirement, but the mere fact that the registered investment adviser is a fiduciary under the Internal Revenue Code would not be sufficient to establish that the condition of the exception requiring that the party have a reasonable belief that the registered investment adviser was responsible for exercising independent judgement with respect to the transaction at issue was met. In order to address this requirement, it may be helpful for the party to add to its distributed materials and website a statement that affirms its belief that the receiving financial adviser is a fiduciary and is responsible for exercising independent judgment in evaluating the transaction.

IRA owners who have assets of more than $50 million will not qualify as being an "independent fiduciary" who manages or controls at least $50 million of assets. The DOL provided that, for purposes of the Rule, an IRA owner is not a "plan fiduciary" with respect to the IRA and, therefore, cannot be an "independent fiduciary" with respect to an IRA for purposes of the Rule.

With respect to a qualified retirement plan, the DOL provided that a corporate officer, who is a plan participant and a member of the plan's fiduciary investment committee can be considered an "independent fiduciary" even though he or she is a participant in the plan.

The FAQs provide an example in which a recordkeeper works with a broker-dealer, who was hired by a 401(k) plan to act as a fiduciary in evaluating whether to select the recordkeeper's platform of mutual funds as investment alternatives for the plan. In concluding that the recordkeeper may rely on the independent fiduciary exception even if the broker-dealer receives indirect compensations such as 12b-1 fees as a result of the selected mutual funds, the DOL provided that, as long as the broker-dealer complies with the Best Interest Contract Exemption, in the absence of any common ownership with the recordkeeper, the broker dealer will be considered to be "independent" for purposes of the Rule even though the broker-dealer has a financial interest due to the receipt of 12b-1 fees.

The DOL also indicated that the requirement that the financial institution not receive a direct fee would not be violated if the investment adviser (not the plan or IRA) paid a fee to use the financial institution's model portfolio services to develop asset allocation recommendations for the adviser's plan and IRA clients.

Marketing Platforms

A person can market or make available to an independent plan fiduciary a platform from which the fiduciary may select and monitor plan investment alternatives for an individual account plan (such as a 401(k) plan) without being deemed to make a fiduciary recommendation under the Rule as long as the marketing is done without regards to the individual needs of the plan and the other conditions of this exception are met. The FAQs provide some clarity as to what is a "platform."

The FAQs include the following:

- A group annuity contract could constitute a "platform or similar mechanism" within the meaning of the Rule. Further, the inclusion of proprietary investment products or a single proprietary investment product in certain asset classes would not necessarily violate the platform exception;
- If a recordkeeper narrowed the investment options that if offers on its platform to comply with specifications in the plan's investment policy, as long as the recordkeeper does not use discretion in narrowing its response, the recordkeeper would not be barred from relying on the platform exception;
- Communications regarding the use of a daily cash sweep service by a plan or IRA in which the financial institution receives fully-disclosed shareholder servicing fees will not constitute an investment recommendation under the Rule if the financial institution merely offers the cash sweep services and describes the features of the service;
- The platform exception is available to a recordkeeper who includes recordkeeping and other services as a part of a platform of investment alternatives. As an example, a recordkeeper could offer "connectivity services," such as access to one or more investment advisory firms, who a plan sponsor may use to assist in selecting specific investment alternatives from the available alternatives. Whether a recommendation was in fact made would depend on the content, context, and presentation of the available services.

For More Information

For more information on the FAQs on the Rule in general, please contact the Chapman and Cutler LLP attorney with whom you regularly work.

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