

HALLOWEEN HORROR: DOL'S EXPANDED DEFINITION OF "INVESTMENT ADVICE" MAY TURN YOU INTO A FIDUCIARY

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To Our Clients and Friends:

The Department of Labor (the "DOL") recently proposed to greatly expand the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), for those who provide investment advice for a fee. The proposed regulations would:

- Broaden the scope of who is subject to ERISA's strict fiduciary framework. The DOL expects this change would discourage consultants from being influenced by what the DOL views as inappropriate fee arrangements.
- Expand the definition of "investment advice" to include appraisal services. This change is meant to primarily address abuses in the area of employee stock ownership plans by aligning the interests of an appraiser with those of the plan, but – at least in its proposed form – the regulation goes further by picking up other asset classes with no readily ascertainable fair market value.

The DOL claims that its proposed changes would better address conflicts of interest and fee arrangements resulting from changes in the investment climate since ERISA was enacted, including the growth of 401(k) plans and the complex investment opportunities available to defined benefit plans. Written comments should be submitted to the DOL by January 20, 2011.

CURRENT REGULATORY FRAMEWORK

ERISA fiduciaries are subject to strict standards of conduct, including (among other things) the obligation to act solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them. Breach of fiduciary duty results in personal liability to the fiduciary for plan losses as well as the imposition of excise taxes under the Internal Revenue Code.

Under ERISA, a "fiduciary" includes, in relevant part, an advisor who renders investment advice for a fee or other compensation or has the authority or responsibility to do so. Longstanding DOL regulations provide that for an advisor who does not have any discretionary authority with respect to a plan to be considered an ERISA fiduciary under this

definition, the advice provided must serve as a *primary* basis for investment decisions and be provided on a *regular* basis. These elements may be difficult to establish in many common fact patterns and do not cover a variety of circumstances that the DOL believes may include fiduciary functions such as where consultants advise on investment-related matters, including a plan's investment in complex investment products.

NEW TWO-PART TEST

The DOL proposes to instead apply a two-part test for determining the fiduciary status of persons who provide investment advice for a fee. Under the first part of the test, the person must provide a plan, other plan fiduciary, plan participant or beneficiary with certain services with respect to the securities or other property of the plan, including appraising, rendering fairness opinions and making recommendations as to the management or advisability of investments. Under the second part of the test, the person providing such services must either (1) acknowledge his or her ERISA fiduciary status with respect to such services; (2) otherwise be a fiduciary under ERISA¹ (this category appears to extend a fiduciary's status to the services at issue where the fiduciary manages unrelated plan assets or provides a different fiduciary function such as plan administration); (3) an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940; or (4) provide individualized advice pursuant to an understanding that the advice may be considered in connection with making investment or management decisions with respect to plan assets. Consequently, the common example described above – *i.e.*, the case in which a person makes recommendations as to the management or advisability of plan investments – would likely result in a fiduciary relationship under the regulations.

EXCEPTIONS

Certain activities are explicitly excepted from fiduciary status. For example, providing advice or making a recommendation as a seller or purchaser of property (or as an agent or an appraiser for such party) where the plan, other plan fiduciary or participant or beneficiary knows or should reasonably know that the person providing the advice or making the recommendation is adverse to the plan, other plan fiduciary or participant or beneficiary and not undertaking to provide impartial investment advice. Here, the burden to demonstrate satisfaction of this standard falls on the adverse party. As a precautionary measure, offering documents should contain a disclaimer that advice offered by the seller is not impartial

¹ *A fiduciary under ERISA also includes a person who exercises discretionary authority or control respecting the management of a plan, exercises authority or control respecting the management or disposition of plan's assets, or has discretionary authority or responsibility in the administration of a plan.*

investment advice. Note, however, that this exception does not apply if the adverse party has acknowledged fiduciary status.

In addition, providing information for compliance purposes, such as a report that merely reflects the value of an investment provided for reporting and disclosure purposes under ERISA and the Internal Revenue Code, does not cause the person providing such information to be deemed to be an ERISA fiduciary, unless the information involves an asset for which there is no generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

Additional Exceptions for Individual Account Plans. To provide greater clarity for popular individual account plans, such as 401(k) plans, the DOL proposes an additional exception in cases where a written disclosure provides that there is no undertaking to provide impartial investment advice. This exception would apply to the following conduct:

- Marketing or making available securities or other property from which a plan fiduciary may designate investment alternatives in a 401(k) plan, such as through a 401(k) platform, so long as the person making the securities available does so without regard to the individualized needs of the plan.
- Providing general financial information to assist a plan fiduciary in selecting or monitoring investment alternatives.

Investment education information provided to participants and beneficiaries in accordance with certain safe-harbor guidelines previously established by the DOL is also exempt.

If adopted in their current form, we expect that these regulations will result in changes in the ways in which persons who do not intend to be fiduciaries provide services to benefit plans and increased costs for valuation services. Please feel free to contact us with any questions.

This memorandum was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax law.

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