

DOL's Third Bite at the Fiduciary Apple: The BIC Light(er)

July 2, 2020

On June 29, the Department of Labor (“DOL”) announced new regulatory action that will expand the scope of what constitutes fiduciary investment advice to retirement plans subject to the Employee Retirement Income Security Act of 1974 (“ERISA”) and individual retirement accounts (“IRAs”). For fiduciaries providing investment advice, the DOL has offered exemptive relief (the “Proposed Exemption”) that enables them to continue to engage in common compensation practices and to market proprietary investment products without violating the prohibited transaction provisions of ERISA and the Internal Revenue Code of 1986 (the “Code”), including in the context of rollovers. The DOL’s actions also confirm longstanding principles on fiduciary status, thus providing greater clarity to the market as to when the Proposed Exemption may or may not be needed. This is the DOL’s third attempt since 2010 to impose fiduciary status on financial institutions, insurance companies and certain other service providers that solicit customers in the retail retirement market; the most recent attempt was vacated by an appeals court in 2018. The Proposed Exemption is much less onerous, and the scope of activity that the DOL intends to be fiduciary investment advice is significantly narrower, than under the 2016 rule.

- One of the most consequential components of these DOL actions is not in the text of the proposed regulation but in the DOL’s preamble. There, the DOL sets forth its interpretation of the existing, five-part fiduciary investment advice test. In doing so, it makes clear that a recommendation to roll assets over from a qualified retirement plan to an IRA can be considered fiduciary investment advice if provided by someone with an existing relationship with the plan or IRA owner or in anticipation of the establishment of such a relationship. This clarification is notable because it rejects an earlier DOL interpretation that suggested that rollover advice did not constitute fiduciary investment advice. In this manner, the DOL is able to achieve its desired outcome of subjecting a subset of rollover recommendations to the fiduciary rules of ERISA and the Code without a wholesale revision of the existing regulatory framework. Furthermore, the guidance reinforces that the existing five-part test for determining investment advice fiduciary status is the law of the land, and if the person making a rollover recommendation is not a fiduciary under that test, then the relief provided under the Proposed Exemption will not be needed.

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- A financial institution must acknowledge fiduciary status in order to rely on the Proposed Exemption. As a result, it will not be possible to claim not to be a fiduciary and rely on the exemptive relief as a backstop in the event that this position is not respected by the DOL or a court. In other words, the DOL has offered financial institutions the chance to pick their poison: accept fiduciary status and comply with the Proposed Exemption or deny fiduciary status and structure their businesses accordingly (and hope the finder of fact agrees with that conclusion).
 - The Proposed Exemption provides relief from the self-dealing and conflict of interest prohibited transaction rules contained in Section 406(b) of ERISA and Section 4975(a)(1)(D) and (E) of the Code. If a financial institution is an investment advice fiduciary under the five-part test, whether because of a rollover recommendation or an ongoing investment advice relationship, the Proposed Exemption still permits it to recommend proprietary products as long as the Proposed Regulation's impartial conduct standards and policies and procedures and recordkeeping requirements can be met.
 - The impartial conduct standards are based largely on the standards set forth in 2016's Best Interest Contract Exemption (BIC Exemption) for prohibited self-dealing and conflict of interest transactions. Specifically, a fiduciary relying on the Proposed Exemption's relief must (1) act in accordance with a prudent person standard of care, (2) receive no more than reasonable compensation for services provided and (3) not make any material misleading statements in connection with the provision of fiduciary investment advice.
 - There are two notable departures from the conduct standards of the BIC Exemption:
 - Rather than imposing an affirmative obligation to provide investment advice without any regard to the fiduciary's financial or other interests—which appeared to us an impossibly high standard for most businesses to meet from the perspective of practicality and legal risk—the Proposed Exemption requires that the fiduciary not place its interests ahead of the plan or IRA. Thus, the recommendation can benefit the financial institution, so long as it is also in the best interest of the plan or IRA. This component is largely the same as a similar component of the conduct standards applicable to registered broker-dealers who make recommendations to retail clients under the Securities and Exchange Commission's Regulation Best Interest.
 - There is no obligation to enter into a written contract or make any warranties that would give an IRA investor a private contractual right of action for a violation of the prohibited transaction rules under Section 4975 of the Code or a violation of any condition of the exemption. Indeed, the DOL is explicit that no

private right of action for IRA investors is intended by the Proposed Exemption. However, if the initial recommendation to roll assets over from an ERISA-covered plan is fiduciary investment advice, that would be an ERISA fiduciary action, and the participant would, solely in respect of that initial recommendation, have a right of action under the statute for a violation of ERISA's fiduciary duties.

- The DOL expressly states the impartial conduct standards are intended to be interpreted and applied consistently with the requirements of the comparable conduct standards under Regulation Best Interest, in what we understand to be an attempt to provide investment advice fiduciaries with a cohesive and consistent regulatory landscape in which to operate.
- Like the BIC Exemption, the Proposed Exemption also imposes certain recordkeeping and disclosure requirements, though like the new impartial conduct standards, these requirements are likely going to be less onerous than under the BIC Exemption for most fiduciaries. The Proposed Exemption will also require fiduciaries that are relying on it to undergo an annual, self-administered review of their compliance with the Proposed Exemptions conditions.
- While the scope of the relief under the Proposed Exemption is broad, it is not available with respect to advice that is generated solely by a robo-adviser that is not accompanied by personal interaction or personal advice, and it is not available to discretionary fiduciaries.

While overall timing on the rulemaking process is not known, there will be a 30-day comment period on the Proposed Exemption starting on the date that it is published in the Federal Register, and the DOL has proposed that the final rule would become effective 60 days after it is published in the Federal Register, suggesting that this may become part of the regulatory landscape before the end of the year.

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Please do not hesitate to contact us with any questions.

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