Proskauer

Department of Labor Considers Expanding Definition of Fiduciary Under ERISA for Those Providing Investment Advice

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On October 21, 2010, the U.S. Department of Labor (the "DOL") issued a proposed rule addressing when a person providing investment advice with respect to an employee benefit plan is considered a fiduciary under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The proposed rule, if adopted, would broaden in a number of significant ways the circumstances under which such a person could become a fiduciary.

Background

By way of background, Section 3(21)(A) of ERISA provides that a fiduciary includes individuals who exercise any discretionary authority or discretionary control with respect to management of a plan, exercise authority or control with respect to management or disposition of plan assets or render (or has the authority to render) investment advice for compensation (whether direct or indirect) with respect to property of a plan. Under current DOL Regulations (which were adopted 35 years ago), a person is treated as providing investment advice if the person (i) renders advice to the plan as to the value of property, makes recommendation as to the advisability of investing in, purchasing, or selling property; and (ii) the person (directly or indirectly, including through an affiliate) has discretionary authority or control with respect to purchasing or selling plan property, or renders the advice described above on a *regular* basis to the plan pursuant to a mutual agreement, arrangement or understanding with the plan or its fiduciary that the services will be the *primary* basis for investment decisions and that the advice will be individualized for the plan. The DOL has stated that it proposes a revision to existing law because of changes to the financial marketplace and concerns regarding potential conflicts of interest that would arise if investment advisors on whom plans rely operate with undisclosed conflicts of interest.

Proposed Rule

Under the proposed rule, a person is generally considered to be providing investment advice when the person provides any of the following to a plan or a plan participant or beneficiary:

- Advice, or an appraisal or fairness opinion, concerning the value of securities or other property (other than for the purposes of reporting and disclosure, unless the property is not marketable and the report serves as the basis for benefit distributions). This is a departure from prior DOL guidance that suggested that, based on the facts and circumstances considered, valuation was not considered investment advice;
- Recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property;
- Advice or recommendations as to the management of securities or other property if certain requirements are met. The DOL noted that this would include, for example, providing recommendations regarding the voting of proxies or the selection of investment managers, which arguably were not encompassed by existing rules. Notably, the DOL requested comments on whether a recommendation to a plan participant to take a plan distribution constitutes investment advice, particularly where that is combined with a recommendation as to how the distribution should be invested.

A person providing the investment advice described above will only be a fiduciary if the person also does any of the following (directly or indirectly, including through an affiliate):

- Represents that he is acting as a fiduciary with respect to the advice or recommendation;
- Otherwise exercises any discretionary authority or control with respect to management of the plan or management or disposition of plan assets or has discretionary authority or responsibility in plan administration. This would broaden the current rule, which generally only applies where the fiduciary has discretionary authority or control with respect to purchasing or selling securities or other property;
- Is an investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940. Section 202(a)(11) covers a person who is in the business of advising others as to the value of securities or the advisability of investing in, purchasing, or selling securities, or who promulgates analyses or reports concerning securities. However, it excludes certain banks and bank holding companies, lawyers, accountants, engineers, and teachers whose advice is incidental to the practice of their

profession; brokers or dealers whose advice is incidental to the conduct of business as a broker or dealer and is uncompensated; media publishers; those providing advice only related to certain government securities; and certain rating organizations.

- Provides advice or recommendations in this manner pursuant to an agreement, arrangement or understanding, written or otherwise, with the plan (or plan fiduciary or participant or beneficiary) that the advice may be considered in connection with making investment or management decisions with respect to plan assets and will be individualized to the needs of the plan (or the fiduciary, participant or beneficiary). While this is similar to the existing rule, it is notable that under the proposed rule it is irrelevant whether the advice is provided on a regular basis. In addition, there need not be a mutual understanding that the advice serves as the primary basis for a decision – it is sufficient that the parties understand that the advice will be considered in connection with decision making.

The proposed rule also clarifies certain circumstances in which a person will not be giving investment advice. For example, a person is not providing investment advice if the person has not acknowledged fiduciary status and can demonstrate that the recipient of the advice knows (or reasonably should know) that the person is providing the information as a purchaser or seller of securities or property and is not undertaking to provide impartial advice. In addition, in an individual account plan, a person providing investment education (as previously defined by the DOL) is not considered to be providing investment advice. Further, a person marketing or making available investments through a platform (without regard to individualized needs of the plan, participant or beneficiary) is not providing investment advice, even where the person provides general financial information and data for the plan sponsor’s selection and monitoring purposes, provided that the person discloses that it is not providing investment advice.

With respect to the requirement that the investment advice be for compensation, consistent with recent DOL initiatives regarding direct and indirect compensation, the proposed rule makes clear that compensation can be direct or indirect, to the person or an affiliate and from any source. Thus, for example, compensation can include brokerage, mutual fund sales and insurance sales commissions, as well as fees and commissions from transactions involving multiple parties.

The proposed rule also confirms the long-standing notion that a person who is a fiduciary by virtue of providing investment advice for compensation is not deemed a fiduciary with respect to plan assets over which it does not have discretionary authority or control or is not rendering investment advice for compensation. Finally, the proposed rule clarifies that it applies both for the purposes of ERISA and the prohibited transaction rules of the Internal Revenue Code governing, among other types of retirement arrangements, individual retirement accounts.

The proposed rule is intended to become effective 180 days after the publication of final regulations, although the DOL solicited comments on whether that is an appropriate time frame. Written comments on the proposed rule should be submitted to the Department no later than January 20, 2011.

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