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Proposed ERISA Regulation Would Expand Persons Considered Fiduciaries

By Paul Borden

On October 21, 2010, the Department of Labor issued a proposed regulation that could significantly expand the categories of persons considered fiduciaries as a result of their providing investment advice to plans subject to ERISA or to participants or beneficiaries of such plans. This proposed regulation was issued under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), which subjects fiduciaries to standards of prudence and loyalty to the plans for which they are fiduciaries as well as to conflict of interest rules, referred to as the “prohibited transaction rules”.

Because of the far-reaching nature of the proposed regulation, financial institutions and service providers such as broker-dealers, investment managers, consultants and appraisers should consider evaluating their relationships with employee benefit plans now to determine whether this regulation could cause them to be considered fiduciaries for ERISA purposes. This evaluation should be conducted together with the analysis that many broker-dealers are currently undertaking regarding their activities and services in light of the pending SEC study (required by Dodd-Frank) on the standard of care, including the application of a fiduciary duty for broker-dealers.

OVERVIEW.

In the preamble to the proposed regulation, the Department of Labor says that one of its purposes in proposing the new regulation is an enforcement initiative, namely, to prevent pension consultants and others from operating under conflicts of interest with the plans they serve, as the Department states they are able to do under the current regulation. The proposed regulation provides that the comment period will remain open until January 20, 2011, and that the final regulation will become effective 180 days after its publication in the Federal Register.

Some of the more significant changes the proposed regulation would include the following as “investment advice” for the purpose of establishing fiduciary status (i) real estate appraisals and valuations, (ii) advice given on a one-time or irregular basis, and (iii) advice that *may be* considered in making an investment decision but that does not necessarily serve as the *primary basis* for an investment decision.

The statutory source of the new proposed regulation, ERISA Section 3(21), provides generally that a person is considered a fiduciary with respect to an ERISA-covered plan if he or she, among other things, “renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so”.

CURRENT REGULATION.

The current regulation, which has been in effect for 35 years, provides that a person is a fiduciary as the result of rendering investment advice to an ERISA plan, if the person:

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- (1) Renders advice as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property,
- (2) On a regular basis,
- (3) Pursuant to a mutual agreement, arrangement, or understanding with the plan or a plan fiduciary,
- (4) That will serve as a *primary basis* for investment decisions with respect to plan assets, and
- (5) That will be individualized based on the particular needs of the plan.

PROPOSED REGULATION.

Under the proposed regulation, a person is treated as a fiduciary if **(1)** the advice is considered investment advice, **(2)** the arrangement is one in which the person is considered to be rendering the investment advice to a plan, and **(3)** the person receives a fee for such advice.

(1) What Is Considered Investment Advice? The proposed regulation provides that “investment advice” includes:

- (a) Advice, or an appraisal or fairness opinion concerning the value of securities or other property,
- (b) Recommendations as to the advisability of investing in, purchasing, holding or selling securities or other property, or
- (c) Advice or recommendations as to the management of securities or other property.

Note: that the above definition of investment advice expands the current regulation by including appraisal and valuation services, which could include service providers who were previously not considered fiduciaries, such as real estate appraisers, real estate brokers, and property managers who give recommendations as to the value of real property. Also note that the scope of (c) above, which refers to the “management” of property, is unclear as to what it includes that is not already covered by (a) and (b) above.

(2) Under What Arrangements Is Investment Advice Being Rendered to a Plan? A person is considered to be rendering investment advice to a plan if the person has given investment advice to the plan, participant, or beneficiary, and such person either directly or indirectly (i.e., through an affiliate):

- (a) Represents or acknowledges that it is acting as an ERISA fiduciary with respect to such advice,
- (b) Is a fiduciary with respect to such plan under ERISA’s rules other than by reason of rendering investment advice (such as the result of exercising discretion with respect to the management or administration of the plan or authority or control over the management or disposition of the plan’s assets),
- (c) Is an investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940, **or**
- (d) Provides one of the types of investment advice described in (1) above pursuant to an agreement, arrangement, or understanding (written or not) between such person and the plan or plan fiduciary, and such advice *may be* considered in connection with making investment or management decisions with

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respect to plan assets and will be individualized to the needs of the plan, participant, or beneficiary.

Note: That category (d) above significantly expands the current regulation, which requires that advice be given on a *regular basis*, and that it serve as the *primary basis* for investment decisions. Under the proposed regulation, there is no requirement that advice be given on a regular basis or that it serve as the primary basis for the investment decision. Instead, the proposed regulation provides merely that the advice may be considered in connection with the investment decision and encompasses situations where the advice is one-time or irregular.

(3) What Is Considered the Receipt of Fees for Rendering Investment Advice? A person is considered to have received fees for rendering investment advice if he or she or any of his or her affiliates receives any fee or other compensation direct or indirect for such advice, from any source, and any fee or compensation incident to the transaction in which advice has been rendered or will be rendered.

Note: The proposed regulations provide that fees under (3) above would include brokerage, mutual fund sales, and insurance sales commissions, and fees and commissions received in connection with multiple transactions involving different parties.

EXCEPTIONS UNDER PROPOSED REGULATION TO IMPOSITION OF FIDUCIARY STATUS AS THE RESULT OF PROVIDING INVESTMENT ADVICE.

The proposed regulation provides for two exceptions to the imposition of fiduciary status on persons providing investment advice to plans for a fee:

(1) Person Providing Advice Is Buyer or Seller of Security or Other Property. If the person providing the investment advice can demonstrate that the recipient of the advice knows, or reasonably under the circumstances should know, that (i) the person providing the advice is doing so in its capacity as a purchaser or seller (from or to the plan) of a security or other property, and (ii) the person giving the advice is not intending to provide impartial investment advice, then the person providing the advice will not be considered a fiduciary under the proposed regulation. This exception, while useful, puts the burden of proof on the person providing the investment advice. Therefore, if fiduciary status is not intended, it is always good to obtain the plan fiduciary's agreement in writing that the person giving the advice is not a fiduciary to the plan. Also note that this exception does not apply if the person giving investment advice has represented that he or she is a fiduciary of the plan.

(2) Certain Information Given in Connection with Individual Account Plan (e.g., 401(k) Plan). The following acts will also not be treated as giving investment advice if given in connection with an individual account plan:

- (a) Providing of investment education information and materials that meets Department of Labor Regulation requirements so as to be providing advice about the advantages of participating in a 401(k) or other individual account plan, or giving information (but not advice) as to investment alternatives under the plan, such as risk and return characteristics of individual fund choices, fees, and historical performance, and
- (b) Marketing or making available (without regard to the individualized needs of the plan or participant) through a platform or other mechanism securities or investment funds.

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CONCLUSION.

Although the proposed regulation is not likely to become final until late next year, and will undoubtedly be subject to a significant amount of comment, employers, financial institutions, and service providers such as broker-dealers, investment managers, consultants, and appraisers should consider evaluating their relationship with employee benefit plans to establish whether they would be considered ERISA fiduciaries under the proposed regulation, and if so, take steps to ensure their compliance with the requirements of ERISA.

If you have any questions, contact your Morrison & Foerster attorney or any member of the Employee Benefits and Executive Compensation Group.

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