



## DOL Issues Additional Guidance on Fiduciary Rule

On January 13, 2017, the U.S. Department of Labor (“DOL”) issued a second set of guidance on its new fiduciary rules, which are scheduled to become effective on April 10, 2017. The guidance was issued in the form of FAQs (“FAQs”) and is the second round of guidance to be published by the DOL prior to the effective dates of the new rules.<sup>1</sup> Earlier in January, the DOL issued FAQs directed at consumers instead of practitioners that contain general information about the new fiduciary rules.<sup>2</sup>

### Background

In April 2016, the DOL issued a regulation<sup>3</sup> (the “Regulation”) that greatly expanded the scope of persons who would be deemed fiduciaries under ERISA<sup>4</sup> and the Internal Revenue Code (the “Code”) when dealing with retirement plans and IRAs. As revised, any broker-dealer or financial intermediary, including individual advisers or registered representatives employed by them (“Financial Institution”) that makes any suggestions as to how or where a retirement investor should invest may be a fiduciary. Given the prohibitions under ERISA and the Code regarding self-dealing by fiduciaries, the expanded definition effectively proscribes the use of commissions and other variable compensation in dealings with retail retirement investors unless the transaction can fit into an available exemption.

Of particular interest when dealing with retail retirement investors are two new exemptions released by DOL in April 2016: the Best Interest Contract Exemption (“BIC Exemption”) and the Principal Transactions Exemption (“Principal Exemption”). The DOL’s first set of FAQs, issued on October 27, 2016, addressed a number of issues under those exemptions.<sup>5</sup>

The latest round of FAQs do not address the exemptions that accompanied the Regulation, but rather speak to a number of exceptions to the Regulation, such as (a) communications that are not considered recommendations that would be subject to the Regulation, (b) non-fiduciary investment education communications, (c) non-fiduciary general communications, (d) communications that qualify for the seller’s carve-out, and (e) communications that qualify for the platform exception to the Regulation.

<sup>1</sup> <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-2.pdf>

<sup>2</sup> <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/consumer-protections-for-retirement-investors-your-rights-and-financial-advisers.pdf>

<sup>3</sup> <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28806>

<sup>4</sup> The Employee Retirement Income Security Act of 1974, as amended.

<sup>5</sup> See our earlier client alert on the first set of DOL FAQs: <https://media2.mofo.com/documents/161031-dol-guidance-fiduciary-rule.pdf>

## Guidance from the FAQs

The FAQs address a number of important topics as summarized below.

### **(a) What Communications are Considered “Recommendations”?**

In general, under the Regulation, a person making a “recommendation” to a retirement plan investor for a fee is considered an investment fiduciary to that plan. The FAQs confirm the formulation in the Regulation that a “recommendation” is a communication that, based on its content, context, and presentation, is a “call to action” that would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular investment-related course of action, such as buying, holding, or selling a particular investment, or as a recommendation on managing investments or investment accounts. Q&A 1.

*Financial Institutions and Employees of Financial Institutions.* The FAQs provide that internal communications that Financial Institutions make to their own employees in their capacities as employees are not considered recommendations. Q&A 2. By the same token, employees working for a Financial Institution who develop reports, recommendations and products for their employer as part of their normal job responsibilities would not be considered to be giving fiduciary investment advice under the Regulation. Q&A 3. If, however, any such communications were forwarded or made available to retirement investors, an analysis would need to be conducted to determine whether those materials would be considered a recommendation. Q&A 2.

*Explanation of Law or Plan Terms vs. Investment Recommendations.* The FAQs make clear that explanations by a retirement adviser to a retirement investor of (i) what the law requires with regard to a retirement plan, such as required minimum distributions from the plan, or (ii) what action will be taken under the terms of the plan without the participant’s consent, such as the automatic cash-out of small account balances of terminated participants, are not considered fiduciary investment advice. Q&As 4 and 5. However, a recommendation by an adviser as to how any funds distributed from the plan should be invested would be considered fiduciary investment advice. Q&A 4.

*Retirement Adviser Not Responsible If Advice Not Followed.* The FAQs also clarify helpfully that an adviser is not responsible for any action a retirement investor takes against the recommendation of the adviser. In that instance, however, the FAQs state, under the general fiduciary provisions of ERISA or the adviser’s agreement with the retirement investor, the adviser may still have an ongoing responsibility to monitor the retirement investor’s investment decisions. Q&A 6.

*Retirement Advisers Can Continue to Receive Third-Party Fees under Offset Arrangement.* The FAQs confirm that DOL guidance preceding the issuance of the Regulation is still valid. DOL Advisory Opinion 97-15A provided that an adviser may receive revenue sharing or other fees from a mutual fund in which a retirement investor is invested, so long as the agreement between the adviser and the retirement investor expressly provides for a fee offset. Under the fee offset provision permitted by the Advisory Opinion, the agreement between the adviser and the retirement investor must provide that any third-party fees received by the adviser as a result of the retirement investor’s investment in the mutual fund would be used to pay all or a portion of the compensation that the retirement investor would otherwise be obligated to pay to the adviser. In addition, the retirement investor would be entitled to any such fees that exceed the retirement investor’s liability to the adviser. Q&A 7.

### **(b) What Communications are Considered Non-Fiduciary Investment Education?**

The FAQs also elaborate on the categories of communications that are considered under the Regulation to be educational and non-fiduciary in nature: (i) plan and investment information (e.g., communications describing the investment objectives, risk and return characteristics, historical return information, and related prospectuses of various investment alternatives without specifically recommending any investments); (ii) general financial, investment, and retirement information (e.g. information on standard financial and investment concepts, such as diversification, risk, and return, etc.); (iii) asset allocation models (e.g., information regarding hypothetical asset allocations based on generally accepted investment theories that does not make a specific investment

recommendation); and (iv) interactive investment materials (e.g., questionnaires, worksheets, software to enable workers to estimate future retirement needs).

*Information About Plan Terms or Operation vs. Recommendation.* The FAQs clarify that a factual explanation of the features of an annuity alternative (such as an optional life income feature) that is provided under a plan would be considered non-fiduciary plan information, as long as the appropriateness of any such feature as an investment is not discussed. Q&A 8. Likewise, *information* given by a call center employee to a retirement investor regarding the benefits of increasing plan contributions in order to maximize a company matching contribution is plan information and not fiduciary advice. Q&A 9. A *recommendation*, however, by an employer that a plan participant increase his or her contributions to a plan in order to maximize the employer matching contribution is not considered investment advice only if, as is almost always the case, the employer does not receive a fee in connection with such communication. Q&A 10. The difference between information and a recommendation is a thin line.

*Receipt of Fees Does Not Convert Educational Information into Fiduciary Advice.* The FAQs clarify that the receipt of a fee by the provider of general educational information to a retirement investor, including information regarding rollover options, does not convert what is otherwise non-fiduciary educational information into fiduciary advice. Q&A 12. If, however, after providing such educational advice the provider refers the retirement investor to a third party who provides investment advice, and the provider receives a referral fee from the third party, that would be fiduciary investment advice, and also a prohibited transaction, unless the provider were able to avail itself of an applicable exemption. Q&A 13.

*Brokerage Window Options Can be Narrowed Without Causing Fiduciary Status.* The FAQs state that a plan can offer a limited set of the investments available under a brokerage window (for example 15 investment options out of 2,000 available) and qualify under the asset allocation model prong as non-fiduciary educational information, as long as the retirement investor is provided with information regarding (i) the other investment alternatives in the limited set that have similar risk and return characteristics, and (ii) where information on those investment alternatives may be obtained. Q&A 15.

*Interactive Investment Materials.* The FAQs provide that a plan service provider's interactive investment tool that requests information from a retirement investor regarding such investor's age, expected retirement date, current retirement savings, annual retirement contributions, etc., that it uses to generate the future retirement income needs of the participant can qualify as educational interactive investment materials and not fiduciary advice. Q&A 11.

### **(c) What Kinds of Information are Considered Non-Fiduciary General Communications?**

Under the Regulation, general communications are not considered fiduciary investment advice if a reasonable person would not view the communication as an investment recommendation. Examples of general communications include general circulation newsletters, television, radio, and public media talk show commentary, remarks in widely attended speeches and conferences, research or news reports prepared for general distribution, general marketing materials, and general market data.

*Communications Made at Widely Attended Seminars Not Considered Fiduciary Advice if Individual Retirement Investors Not Allowed to Attend.* The FAQs provide an example of a communication that is considered general and non-fiduciary under the Regulation because it is given at a "widely attended" conference. In the example, the conference, sponsored by a broker-dealer, is generally open only to professionals in the retirement industry, including retirement plan fiduciaries, but is not open to individual retirement plan investors. The example provides that the conference has approximately 300 attendees. The FAQs provide that in those circumstances, a speaker's presentation about the features of a 401(k) plan annuity product, including its flexible pricing features, how it can accommodate a variety of broker-dealer compensation structures, and the value it would provide for "many" 401(k) plans, would be considered a non-fiduciary general communication, as long as the speaker's

comments did not purport to be making specific or individualized retirement investment recommendations. Q&A 16.

*Communications Made at Dinner Seminars Are Considered Fiduciary Advice.* The FAQs provide another example in which a free dinner seminar is given by an investment adviser to potential retirement account clients. The FAQs conclude that such a gathering is not considered a “widely attended” speech or conference that would be considered general and non-fiduciary. The FAQs go on to say that a reasonable person might consider statements made by the investment adviser to be investment recommendations even if the statements were made to all of the attendees. Q&A 17.

Two of the relevant factors in the two contrasting examples appear to be the size of the conference and whether any individual retirement investors are in attendance.

*Recommendation to Hire Oneself or a Third Party Non-Fiduciary Not Investment Advice.* The Regulation provides that a recommendation to hire a third party to manage securities or other investment property held in retirement accounts is a fiduciary communication. The FAQs clarify that recommendations to a retirement account client to hire a *non-fiduciary* record-keeper is not fiduciary advice, although a recommendation to hire a third party to serve as an asset manager or adviser would constitute fiduciary recommendation. Q&A 18.

In a similar vein, the FAQs provide that a representative of a Financial Institution who explains the services provided by the Financial Institution, and they state that the Financial Institution is a recognized leader in providing high quality services with low fees is not considered to be giving fiduciary investment advice because (i) the Financial Institution through the representative recommended itself, not a third party, to manage retirement account assets, and (ii) the representative did not recommend any particular “account type or service.” Q&A 19.

Note: The exception from giving fiduciary advice for recommending oneself is limited to the services that the person would provide and does not extend to a recommendation to purchase any particular retirement investment. The FAQs, without explaining what an “account type or service” in (ii) above is, appears to assume that embodied within an “account type or service” are particular securities with respect to which the representative would be giving fiduciary advice.

#### **(d) How Does the Independent Fiduciary or Seller’s Exception Apply?**

The Regulation contains an exception to applying fiduciary status to a party who provides investment recommendations to a retirement account, called variously throughout the history of the proposed and final Regulation as “the seller’s exception”, “the seller’s carve-out”, or “transactions with independent fiduciaries with financial expertise.” One requirement for the applicability of the independent fiduciary exception is that certain disclosures must be made by the investment adviser (who seeks to rely on the independent fiduciary exception) to the retirement account’s fiduciary. Another requirement is that the investment adviser must know or reasonably believe that the retirement account fiduciary is a bank, insurance carrier, registered broker-dealer, registered investment adviser, or independent fiduciary who manages or controls at least \$50 million.

*Establishing the Status of the Independent Fiduciary.* The FAQs confirm that in meeting the \$50 million under management requirement, amounts can be aggregated from the fiduciary’s retirement and non-retirement accounts and from multiple investors. Q&A 20. In addition, the FAQs confirm that the requirements are deemed met if a retirement adviser reasonably relies on representations of the plan fiduciary that it meets those requirements. The FAQs provide that a party could reasonably rely on written disclosures from the plan fiduciary that it manages at least \$50 million and will notify the retirement adviser in writing if the amount of investments drops below \$50 million. Q&A 21. The FAQs do not address whether “deemed representations” in disclosure documents (e.g., a statement in a disclosure document that a purchaser of the security is deemed to represent that it meets the requirements of the independent fiduciary exception) can be relied on by an adviser for purposes of the independent fiduciary exception.

*Broad Application of the Independent Fiduciary Exception.* The FAQs confirm that this exception applies to any transaction related to the investment of securities or other investment property, including advice regarding entering into investment advisory and investment management arrangements. Q&A 22. The FAQs also confirm that the exception to fiduciary status applies to communications with a representative of a fiduciary who is a registered investment adviser; provided that the representative is acting under the control and supervision of the registered investment adviser. Q&A 23. Further, the FAQs confirm that the independent fiduciary exception is available to a retirement adviser who gives recommendations to an IRA retirement investor; provided that the IRA is represented by a fiduciary who meets the requirements of the independent fiduciary exception and the retirement adviser reasonably believes that the fiduciary is responsible for exercising independent judgment in evaluating the transaction. Q&A 25.

*Individual Retirement Investors May Attend Meetings Between Fiduciary and Adviser.* Since the issuance of the Regulation, there has been some question as to whether the independent fiduciary exception requires that the retirement investors who are being protected by the independent plan fiduciary are required to be absent from any meeting between the plan fiduciary and the investment adviser where investment matters are being discussed. Thankfully, the FAQs clarify that the application of the independent fiduciary exception will not be invalidated by the presence of a retirement investor at a meeting with the retirement investor's registered investment adviser fiduciary who meets the requirements of the independent fiduciary exception; provided that the retirement adviser reasonably believes that the registered investment adviser is acting as a plan fiduciary with responsibility for exercising independent judgment in making a fiduciary recommendation to the retirement investor with respect to the transaction at issue. Q&A 24.

*Participant in Plan Can be Independent Fiduciary, but IRA Owner Cannot.* The FAQs clarify that a corporate officer, who is a participant in a retirement plan sponsored by the corporation, can be a fiduciary that meets the requirements of the independent fiduciary exception; provided that the officer manages at least \$50 million, which can consist of a combination of retirement plan and non-retirement plan assets. Q&A 27.

Even though a participant in a qualified plan can be a fiduciary to that plan that meets the independent fiduciary exception, the FAQs clarify that an IRA owner cannot qualify as the fiduciary of his or her own IRA. This somewhat non-intuitive conclusion results according to the FAQs because under the Regulation, an IRA owner is not a fiduciary with respect to the IRA, and so therefore it cannot be an "independent fiduciary" as required under the independent fiduciary exception. Q&A 26.

*Requirement that Fiduciary be "Independent."* The FAQs discuss the requirement of the independent fiduciary exception that the fiduciary for the plan be "independent", noting that the Regulation does not specifically define "independent", but that the preamble to the Regulation provides that whether a party is independent for purposes of the Regulation will generally involve an analysis of whether there exists a financial interest, ownership interest or other relationship, agreement, or understanding that would limit the ability of the party to carry out its fiduciary responsibility to the retirement investor beyond the control, direction, or influence of other persons involved in the transaction. The preamble to the Regulation further provides that parties would likely not be independent in any of the following circumstances: (i) the parties belong to a group of corporations under common control or are members of an affiliated service group; (ii) the transaction includes an agreement designed to relieve the fiduciary from any responsibility to the plan or IRA; (iii) the fiduciary is under substantial control and close supervision by a common parent of the parties; or (iv) a fiduciary receives compensation in violation of ERISA's self-dealing prohibited transaction rules. Q&A 28.

*Fiduciary Can be Considered Independent Even if it Receives Third Party Compensation.* In applying these concepts to the question of whether a plan fiduciary could be considered independent if it receives indirect compensation in the form of revenue sharing or 12b-1 fees, the FAQs concludes that the plan fiduciary could be considered independent if (i) the fiduciary had no common ownership or control affiliation with other parties involved in the transaction; (ii) the fiduciary meets the requirements of the BIC Exemption (presumably to exempt any self-dealing prohibited transaction issues); and (iii) there is no agreement or understanding between

the fiduciary and other parties involved in the transaction that would limit the fiduciary's ability to carry out its fiduciary duty to the plan. Q&A 28.

Although the FAQs do not mention this, it would also seem possible to establish the independence of a fiduciary without meeting the requirements of the BIC exemption in (ii) above by ensuring that any third-party payments or revenue sharing payments to the fiduciary were subject to an off-set, as discussed in connection with the discussion above regarding DOL Advisory Opinion 97-15A; see discussion of Q&A 7 above.

*Retirement Adviser Cannot Receive any Direct Fees from Plan or IRA.* Another issue addressed by the FAQs with regard to the independent fiduciary exception is the requirement that the retirement adviser not receive any fee or other compensation directly from the plan, plan fiduciary, plan participant, or beneficiary, IRA, or IRA owner. The FAQs address an example where the retirement adviser recommends to the plan's independent fiduciary that it use the retirement adviser's model portfolio services and then charges the independent fiduciary a fee for investment advice. The question is whether the fee paid by the independent fiduciary to the retirement adviser is a direct fee for investment advice that would invalidate the use of the independent fiduciary exception. The FAQs helpfully respond that the DOL would not treat the payment between financial intermediaries (i.e., the fee paid by the independent fiduciary to the retirement adviser) as a direct fee for investment advice for purposes of the independent fiduciary exception as long as the fee is not paid with plan or IRA assets, and the plan or IRA does not reimburse the independent fiduciary for its payment of those fees. Q&A 29.

**(e) How Does the Platform Exception Apply?**

In general, under the Regulation, a person can avoid characterization as an investment fiduciary if it provides a platform or similar mechanism from which an independent fiduciary for the plan selects or monitors plan investment alternatives for an individual account plan; provided that the person markets the platform without regard to the individualized needs of the plan. In addition, a person who identifies investment alternatives for such a platform based on objective criteria specified by the plan's independent fiduciary is also saved from characterization as an investment advice fiduciary, as long as certain disclosure requirements are met.

*Group Annuity Contract Can Qualify as a Platform.* The FAQs clarify that a platform for this purpose can consist of a group annuity contract issued by an insurance company that provides a range of investment alternatives. Q&A 30. The FAQs also clarify that such an annuity contract would still be considered a platform if the only capital preservation asset class on the platform were the insurance company's own proprietary fixed income separate account. The broader principle of the FAQs is that (i) inclusion of proprietary investment options is consistent with the requirements of the platform exception, and (ii) the existence of only one investment option in certain asset classes does not make the platform exception unavailable. Q&A 31.

*Record-Keepers Can Rely on Platform Exception.* The FAQs provide that a record-keeper for a plan can rely on the platform exception with respect to a platform that it makes available to plans and for which it provides record-keeping services. Q&A 32.

The FAQs contain an example in which a plan representative requests a record-keeper to provide a list of investment alternatives available on its platform that would meet the plan's investment policy. In the example, the investment policy specifies the asset classes, investment strategy, expense ratio range, risk and return characteristics, and type of investment vehicle for investment alternatives that may be included in the plan. The FAQs provide that the record-keeper could rely on the platform exception in such an instance if it provided a list of all of the investment alternatives available on the platform that meet the requirements of the plan's investment policy statement. To the extent the record-keeper exercises discretion in narrowing the list of investment alternatives, the record-keeper could be treated as providing an investment recommendation if a reasonable person would view the communication as a recommendation that the fiduciary choose investments from the selective menu screened by the record-keeper. Q&A 33.

The FAQs provide that the platform exception is available to a record-keeper who includes record-keeping and other services as part of the record-keeper's platform of investment alternatives, such as access to one or more investment managers to assist a plan sponsor or participant in choosing investment alternatives. The FAQs state that merely connecting plans with investment management firms as an elective option would not necessarily constitute a recommendation that the plan sponsor or participant use the investment management firm for investment advice, depending on the content, context, and presentation of the available services. Q&A 35.

## Conclusion

The FAQs provide helpful guidance on a number of issues relating to exceptions to the application of the Regulation. There are still unanswered questions, but more significant in the short run will be the practical effect of the presidential election and whether the Regulation will survive Congress and the incoming administration.

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