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PROPOSED RULE RE-DEFINING ERISA "FIDUCIARY" DELAYED (STILL)

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Broker-dealers and financial advisers may have gained some breathing room as a congressional battle to broaden ERISA's definition of "fiduciary" loses steam. In the following discussion, we will summarize the current state of that battle.

At issue is the innocuous-sounding "Conflict of Interest Rule" proposed by the Employee Benefit Security Administration ("EBSA"), that has nonetheless sparked searing critiques from the investment advice industry, which contends it could dramatically increase costs and reduce access to quality investment advice for millions of American workers. The re-proposal of the controversial rule has been delayed again, this time until January 2015, well after the mid-term elections in November. Assuming a six-month comment period and six months of hearings to develop final regulations, the final rule could be up for a vote in early 2016. But pundits have expressed doubt that such a controversial rule could be passed in an election year, which means that the Conflict of Interest Rule may be stalled indefinitely. Amidst this uncertainty and uproar, many in the benefits community are asking where a new rule would draw the line for determining who is a fiduciary, and how it would impact plan sponsors and participants.

The current definition of investment advice fiduciary still stands as it was established under ERISA in 1974. The regulation sets forth a five-part test, and an individual must satisfy all five of the criteria to be considered an investment advice fiduciary. 29 C.F.R. 2510.3-21(c). To be considered a fiduciary, a person must give investment advice: (1) about the value or advisability of investing in securities or other property; (2) on a regular basis; (3) pursuant to an agreement with the plan; (4) individualized to the specific plan; and (5) with the mutual understanding that such advice will serve as a primary basis for investment decisions. Under the current rule, fee-based advisory services used primarily by the wealthy are subject to a fiduciary duty, but full service and discount brokerage services used primarily by working-class Americans are not. The proposed rule would broaden the definition of fiduciary to include brokerage services offered by broker-dealers, along with the more expensive traditional advisory services.

EBSA proposed the new rule in response to industry changes that have elevated the importance of investment advice to retirement plan participants. Since ERISA was passed in 1974, there have

been significant changes in the retirement plan industry. There has been a shift from defined benefit plans to 401(k)-type plans, which give plan participants more responsibility for their own investments. There are also more complex investment products and services available to plans and IRA investors today than there were in the past. Accordingly, investment advice has become more important to plan sponsors when they develop an appropriate menu of investments for their workers, and to workers themselves as they select investments for their individual accounts. With these changes in mind, EBSA sought to broaden the definition of investment advice fiduciary in order to reduce the opportunities for conflicts of interest to compromise the impartiality workers expect when they rely on a financial adviser's expertise.

The new rule would strip away the "regular basis" requirement of the five-part test, instead starting with a broad definition of "investment adviser" and carving out narrow exceptions. The definition of investment adviser would, subject to certain exceptions, include anyone who (A) receives compensation, directly or indirectly, for the requisite type of advice (e.g., advice, appraisals, or fairness opinions about the value of any investment; recommendations to purchase, hold, or sell any investment; or recommendations as to the management of any investment) and (B) meets one of the following conditions: (i) is or represents his or herself to be an ERISA fiduciary; (ii) is an investment advisor under the Investment Advisor's Act of 1940; or (iii) provides the advice pursuant to an agreement or understanding that the advice may be considered in connection with investment or management decisions with respect to plan assets and will be individualized to the needs of the plan. Accordingly, much if not all of the full-service and discount brokerage services that broker-dealers offer to plan sponsors and plan participants would be subject to a fiduciary duty under the proposed rule.

The response from the investment advice industry was fast, fierce, and focused on three issues: cost, access, and choice. The dominant criticism was that the proposed rule would drive up the cost of brokerage services as the broker-dealers become fiduciaries, subject to all the duties and potential liabilities that accompany a fiduciary relationship. In fact, the Department of Labor ("DOL") commissioned a study on the issue, which substantiated the proposed rule's adverse impact on such costs.

The fact that the hearing for the re-proposed rule was delayed again is a sign that both Congress and the DOL are taking these concerns seriously. While it is true that the way Americans save for retirement looks different today than it did in 1974, the challenge for the DOL is to ensure the cure is no worse than the ailment. The EBSA's challenge is to draft regulations that protect plan participants and IRA investors from true conflicts of interest resulting in unsuitable investment advice, but that do not have a significant unintended chilling effect on the provision of suitable investment advice. After yet another delay, and with the 2016 election looming, the agency should have plenty of time to find the right balance.

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