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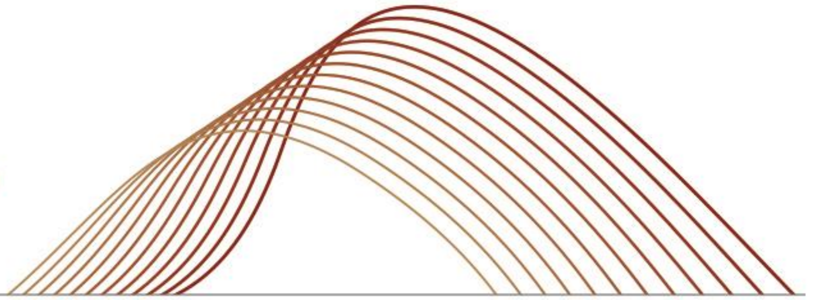

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# *Department of Labor's New Fiduciary Rule Effect on Investment Funds*

By Lawrence J. Hass & Craig W. Spenner Jr.

The Department of Labor (the "DOL") recently announced that its new ERISA regulation that greatly expands the categories of persons that can be deemed to be "fiduciaries" of pension plans subject to ERISA by reason of providing "investment advice" (the "New Fiduciary Rule") will go into effect on June 9, 2017. The New Fiduciary Rule raises a major concern that investment fund sponsors and others who market investment products to ERISA-covered plans and IRAs could be deemed to be "fiduciaries" in connection with their marketing activities and, therefore, subject to ERISA's prohibitions on self-dealing and conflicts of interest. Consequently, investment fund sponsors need to prepare appropriate measures to avoid becoming ERISA fiduciaries in connection with their marketing activities.

The New Fiduciary Rule was originally supposed to become effective on April 10, 2017, but based on a Memorandum issued by President Trump on February 3, 2017, the New Fiduciary Rule's effective date was delayed until June 9, 2017. It was speculated that the New Fiduciary Rule might be delayed further, but on May 22, 2017, the new Labor Secretary, Alexander Acosta, wrote an Op-ed in the Wall Street Journal where he stated that portions of the New Fiduciary Rule would go into effect on June 9, 2017 without further delay because of legal constraints imposed by the Administrative Procedures Act. However, Secretary Acosta also stated that until January 1, 2018, the Department will not pursue claims against fiduciaries who are working diligently and in good faith to comply with the New Fiduciary Rule and related requirements, or treat those fiduciaries as being in violation of ERISA.

## Background

ERISA defines the term "fiduciary" to include any person who provides investment advice to an ERISA-covered employee benefit plan for compensation. Shortly after ERISA was enacted more than 40 years ago, the DOL issued a regulation clarifying that brokers and others who merely market investments to plans would not be deemed to be providing "investment advice" and, therefore, would not be deemed to be fiduciaries subject to ERISA's prohibitions on self-dealing and conflicts of interest.

The Obama Administration sought to reverse this position by repealing the 40-year old regulation and replacing it with the New Fiduciary Rule that will subject brokers and others to ERISA's fiduciary duty requirements in their interactions with ERISA-covered plans and IRAs. Under the New Fiduciary Rule a person will be deemed to render "investment advice" to a plan or IRA if the person provides a recommendation to the plan as to the advisability of acquiring, holding, disposing of or exchanging securities or other investments for a fee or other compensation. If a person makes a recommendation

and it is individualized pursuant to a written agreement or verbal understanding or is merely directed to a specific recipient, then such person would be deemed to be an ERISA fiduciary. The New Fiduciary Rule defines a recommendation to include a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the recipient engage in or refrain from taking a particular course of action. Thus, for example, under the New Fiduciary Rule, an investment fund sponsor who makes a presentation to a plan representative for the plan to investment in the fund could be deemed to be a fiduciary subject to ERISA.

The preamble to the New Fiduciary Rule explains that a solicitation or marketing to an employee benefit plan or IRA, without a recommendation to invest, is not alone something that would normally constitute "investment advice." However, if the solicitation includes a recommendation to invest in a specific investment or fund, the recommendation could be deemed to be "investment advice." Unfortunately, neither the New Fiduciary Rule nor its preamble provide much guidance on what constitutes a solicitation or general marketing of an investment and what constitutes a recommendation and, therefore, "investment advice."

Instead, the New Fiduciary Rule provides an exception from "fiduciary" status for a person marketing to a plan when the plan is deemed to be, or represented by, a "sophisticated investor." Under the New Fiduciary Rule, if a communication or recommendation is made to a fiduciary of a plan or IRA and it is reasonably believed that such fiduciary is either a bank, an insurance company, a registered investment advisor or registered broker dealer or that the fiduciary has at least $50 million in assets under management, then, provided that the fiduciary is informed that the communication is not intended to be "impartial investment advice" or that the communication is not made by the solicitor in a fiduciary capacity, the fiduciary will be deemed to be capable of evaluating the investment and exercising its own discretion and judgment on an independent basis and, therefore, the communication or recommendation will not be deemed to be "investment advice."

## Conclusion

In order to avoid becoming fiduciaries to ERISA-covered plans and IRAs and thereby avoid engaging in inadvertent violations of ERISA's self-dealing and conflicts of interest prohibitions, investment fund sponsors and others who market investment funds to pension plans and IRAs are advised to include representations in the subscription agreements for their investment funds that the investor's representative is a "sophisticated investor" who is independent of an unrelated to the investment fund sponsor and any person who has marketed the investment fund to the plan or IRA, and understands that none of the communications made by the fund sponsor or any other person marketing the investment fund to the plan or IRA were intended to be "investment advice" or a "recommendation" for the plan or IRA to invest in the fund and that the decision to invest in the fund is being made on behalf of the plan solely by such investor representative.

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