New Department of Labor 'Fiduciary' Rule Goes Into Effect

By Susan A. Wetzel, Chris M. Kang | June 12, 2017

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After several delays, the Department of Labor's (the "***DOL's***") final "fiduciary" rule expanding the definition of who is an investment advice fiduciary became effective on June 9, 2017. The final rule significantly expands the concept of "investment advice" for purposes of determining fiduciary status under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and the Internal Revenue Code of 1986, as amended (the "***Code***"). The final rule originally was to go into effect on April 10, 2017. However, on February 3, 2017, President Trump signed a Presidential Memorandum directing the DOL to reexamine the final rule, upon which, if certain findings were met, the DOL was instructed to publish for notice and comment a proposed rule rescinding or revising the final rule, as appropriate. The DOL then delayed the effective date of the final regulation until June 9, 2017. While many hoped the final rule would be delayed further, the Secretary of Labor recently announced that while he is concerned that the new fiduciary rule is not consistent with President Trump's deregulatory goals, the DOL did not have the authority to further delay the rule. The Secretary of Labor has stated that the DOL will continue to study the final rule, and may propose further changes.

Private Investment Funds

The offering and marketing of interests in private investment funds to ERISA-covered plans and "plan asset" entities ("***ERISA Plans***") and individual retirement accounts ("***IRAs***," together with ERISA Plans, referred to herein as "***Benefit Plan Investors***"), may raise issues under the final rule. Although most fund documents expressly provide that no recommendations or investment advice is being provided to prospective investors in connection with their investment in the fund, it is possible that certain statements in the fund documents or communications in the marketing efforts (or later discussions with investors) could be construed as "recommendations" (and therefore, fiduciary advice) under the final rule. The term "recommendation" is very broad and encompasses any form of communication which a reasonable person could view as recommending how that person should act with respect to an investment. Thus, the manager of a fund may become a fiduciary of its investors if there is a recommendation with respect to the purchase of, continued holding of, or disposition of interests in a fund, unless a carve-out applies. The final rule provides a carve-out (sometimes called the "seller's carve-out" or "sophisticated plan exception"), which if applicable, would exempt managers from becoming a fiduciary in connection with any recommendations made by such managers. Many Benefit Plan Investors will likely satisfy the requirements for one of the carve-outs.

Carve-out from Fiduciary Status

The DOL recognized that not all recommendations should be construed as "investment advice," and understood that some Benefit Plan Investors are either sufficiently sophisticated or are advised by sophisticated professionals so as to understand that parties that have an interest in selling a product are not fiduciaries of such Benefit Plan Investors in connection with any recommendations

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in making a sale. The final rule provides a carve-out if the responsible fiduciary making the investment decision on behalf of a Benefit Plan Investor subscribing for an interest in the fund (or making a decision with respect to an existing investment) is an independent fiduciary that is either:

1. a bank (as defined in section 202 of the Investment Advisers Act of 1940, as amended (the "***Advisers Act***") or similar institution that is regulated and supervised and subject to periodic examination by a State or Federal agency;
2. an insurance carrier that is qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of assets of a plan;
3. an investment adviser under the Advisers Act or the laws of the State in which it maintains its principal office and place of business;
4. a broker-dealer registered under the Securities Exchange Act of 1934, as amended; or
5. an independent fiduciary that holds, or has under management or control, total assets of at least $50 million.

In order for a fund manager to rely on this carve-out, the fund manager should know or reasonably believe (and should receive representations) that the Benefit Plan Investor's fiduciary is (i) capable of evaluating investment risks independently, both in general and with regard to the fund's investment program and strategies; (ii) independent of the fund, the fund manager and their affiliates and there does not exist any financial interest, ownership interest or other relationship that would limit the fiduciary's responsibility to the Benefit Plan Investor; and (iii) acting as a fiduciary with respect to the investment transaction and is exercising independent judgment in evaluating such transaction.

The fund manager must also: (i) inform the Benefit Plan Investor that it is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the investment in the fund; (ii) inform the Benefit Plan Investor of the existence and nature of its financial interests in the transaction (which should be provided in the fund documents); and (iii) not receive a fee, directly or indirectly, for the provision of investment advice to the Benefit Plan Investor in connection with the transaction (note, this does not include management fees or other incentive compensation payable by the fund).

Next Steps

To the extent not already updated, fund managers should consider amending their subscription documents (or adding a supplement) to incorporate the carve-out concepts described above with respect to new (or additional) investments in their funds. With respect to existing Benefit Plan Investors, fund managers may consider sending out a notice or supplement to such investors to obtain the appropriate representations for reliance on a carve-out. Alternatively, under certain circumstances, for investments made prior to June 9, 2017, a grandfathering rule may apply with respect to such existing investments. Note, for self-directed ERISA Plans and IRAs whose owners are not represented by a sophisticated independent fiduciary, any recommendations to such investors will not fall into one of the carve-out categories. Thus, fund managers may want to suspend taking investments (or additional investments) from such investors until further guidance is issued.

Fund managers should also evaluate the way and manner in which interests in their funds are marketed and sold, to minimize making any "recommendations," and if made, to make sure that the carve-out conditions are satisfied. Depending on the platforms used, additional agreements with sales agents, placement agents, investment banks, or broker-dealers, as applicable, may be needed to ensure compliance with the carve-out conditions.

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If you have any questions related to this alert, please contact any of the lawyers below.

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