

# What the DOL's Final Fiduciary Rule Means for 401(k) Plans

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**O**n the off-chance you have been vacationing on Mars, let me be the first to bring you the news that the Department of Labor has issued its long-awaited fiduciary rule broadening the scope of advisers who will have fiduciary responsibility to their retirement investor clients, including sponsors of and participants in 401(k) plans. Beginning April 10, 2017, the definition of fiduciary investment advice will cover a wider range of recommendations than in the past. This article will focus on aspects of the new rule affecting 401(k) plans.

**Expansion of Fiduciary Definition.** Covered recommendations will almost certainly include an adviser's communications relating to the advisability of making a particular investment as well as recommending an investment strategy or an investment manager for a plan account. Suggestions to take rollovers from a plan or IRA will also be broadly viewed as fiduciary advice under the new definition. Advisers will be viewed as fiduciaries if they make any of these recommendations in circumstances where the adviser has acknowledged that he or she is acting as a fiduciary, if the retirement investor receiving the recommendation reasonably understands that the recommendation is based on the investor's particular needs or if the recommendation is directed to a specific client with respect to investment property.

**Investment Education Exclusion.** Not all investment guidance will be considered fiduciary advice under the new rule. For example, there is an exclusion from fiduciary advice based on the existing safe harbor for nonfiduciary investment education. Like the current safe harbor, there would be four categories of investment guidance that could be provided to retirement clients in a 401(k) plan without triggering fiduciary status. They include plan information, general financial information, asset allocation models, and interactive investment materials, such as retirement calculators and questionnaires. Under the new exclusion, which now applies to plan sponsors as well as participants, asset allocation models and interactive materials of 401(k) plans (but not IRAs) will be able to refer to the plan's specific investment menu options, as long as the menu options are subject to the plan sponsor's fiduciary oversight.

**Platform Provider Exclusion.** 401(k) plans will also be indirectly affected by an exclusion enabling third party

administrators marketing or offering an investment platform to retirement investors to maintain their nonfiduciary status. Without this exclusion, these platform providers would have been reluctant to provide any information regarding the investment alternatives available on a platform. The new relief is conditioned on the provider's furnishing written disclosure that in making the platform available, the provider is not purporting to give impartial investment advice or to render advice in a fiduciary capacity. However, to qualify under this relief, the provider's assistance needs to be made without regard to the individualized needs of the particular plan or its participants. This means that the platform provider's information is going to be very general, which will limit its usefulness.

**BIC Exemption.** ERISA's prohibited transaction rules prohibit a fiduciary from providing conflicted advice, making it unlawful for a fiduciary adviser to earn commissions or any other type of "variable compensation," since they create an improper incentive for the adviser to recommend investments with higher payouts for the adviser. Since the DOL is expanding its fiduciary definition for both plan and IRA advisers, a critical need arises for an exemption from these prohibited transaction rules. In light of this need the DOL has included a new prohibited transaction exemption along with the new fiduciary definition in order to avoid completely disrupting the ways advice is delivered. The new exemption is called the "Best Interest Class Exemption" (known informally as the BIC exemption), and it is necessary for 401(k) plan sponsors and advisers to be aware of what needs to be done to come within the exemption.

The first thing to note is that the BIC exemption's relief is only available for advice offered to retail plan clients with less than \$50 million in assets and IRAs. Advisers dealing with larger plans are likely to be carved out of the fiduciary definition because they are a counterparty to the plan's institutional or otherwise sophisticated fiduciary. Where applicable, the BIC exemption only covers variable compensation earned by a fiduciary adviser in connection with nondiscretionary advice. It does not apply to discretionary advice.

The BIC exemption imposes numerous conditions on advisers and their firms that seek to qualify for its protection. Their advice will need to meet the new "best interest" standard,

which is a combination of ERISA's duties of prudence and loyalty. The best interest standard specifically requires that advice be given without regard to the adviser's own interests. Additionally, the adviser is only permitted to earn "reasonable" compensation in connection with the advice, and the adviser cannot make any misleading statements to the retirement investor.

The BIC exemption also has a number of operational conditions that differ depending on the circumstances of the retirement client receiving the advice. 401(k) plans will need to understand where they fit in this scheme. For example, one set of requirements will apply to sole proprietor 401(k) plans, while a different set will apply to 401(k) plans that provide employee benefits. As detailed below, there are actually four versions of the BIC exemption.

**BIC Exemption for Small Plans and IRAs.** An adviser must enter into a written "best interest" contract with any new IRA or sole proprietor client, and this contract must include relevant fiduciary standards and general disclosures of compensation and conflicts of interest. In addition to the contract, the adviser must provide transaction disclosures for each recommended investment showing the applicable fiduciary standards and the adviser's conflicts. Webpage disclosures must also be made on a public Web site discussing the firm's business model and its conflicts. Specific compensation figures relating to a recommended investment must be provided on a retirement investor's request. The advisory firm must also adopt written policies and procedures that will mitigate any conflicts, including restrictions on differential compensation that tie it to the differences in services needed for different investments.

The contract needs to be executed no later than execution of the recommended investment transaction. Fortunately, this requirement can be met for existing clients by delivering a proposed amendment to the existing contractual relationship prior to January 1, 2018, and treating the failure to terminate the amended contract within 30 days as assent by the client.

**BIC Exemption for ERISA Plans.** Another version of the BIC Exemption applies when the retirement client is an employer sponsored plan, such as a 401(k) plan with participants who are common law employees. The operational requirements in this instance mirror those for IRAs and sole proprietor plans. A big difference, however, is that no written contract is required, which eliminates a potential for contract-based lawsuits. Instead, a client that is an ERISA plan must

be given a written statement of fiduciary status and general disclosures relating to compensation and conflicts of interest. Transaction disclosures and Webpage disclosures also need to be provided, and transaction specific compensation figures must be provided on request.

**BIC Exemption for Level-Fee Fiduciaries.** A further softening of the BIC exemption's conditions applies to advisers who will not receive variable compensation. Accordingly, advisers compensated by a level fee (*i.e.*, a fixed percentage of assets under management or a set fee that does not change) will be entitled to rely on an even more streamlined set of BIC requirements under which it will only be necessary for the adviser to deliver a written statement of fiduciary status to the 401(k) plan sponsor or participant and ensure that the advice meets the BIC exemption's impartial conduct rules, including the best interest standard. If the recommended transaction involves a rollover, the adviser will need to document the specific reasons why the rollover is in the plan participant's best interest, but this document does not need to be shown to the participant. No other disclosures are required and there will be no need to adopt any special compliance policies.

**Transition BIC.** Given the need to prepare for the BIC exemption, transition relief is available under which fewer operational requirements will be needed to qualify. During the transition period beginning April 10, 2017 and ending January 1, 2018, an adviser will merely need to provide a written statement of fiduciary status and certain conflicts-related disclosures. No other disclosures will be required, and the firm will not need to adopt compliance policies during this period, although advice will still need to comply with the best interest standard.

**Big Picture.** The BIC exemption, which imposes a universal best interest standard, is the centerpiece of the DOL's new fiduciary rule. Under this standard, 401(k) plans with less than \$50 million in assets are entitled to advice that excludes the adviser's compensation as a relevant factor in forming the advice. However, plans need to be aware that some advisers will continue to be allowed to receive types of compensation that have built-in conflicts if they meet the applicable BIC exemption requirements.

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