ACEC RT© | Retirement Trust

White Paper on the New Fiduciary Rule for our Plan Sponsors

We've Got You Covered

The Employee Retirement Income Security Act ("ERISA") **and the Internal Revenue Code** (the "Code") **govern empolyee benefit plans, like yours.**

What is a Fiduciary?

ERISA requires that every employee benefit plan be established and maintained pursuant to a written plan document, which must provide for one or more "named fiduciaries." These fiduciaries have the authority to control and manage the operation of the plan.

Even if not named in the written plan document, ERISA also provides that a person is a fiduciary in regard to an employee benefit plan if:

1. He or she exercises any discretionary authority or discretionary control respecting management of the plan or exercises any discretionary authority or control respecting management or disposition of its assets; or
2. He or she has any discretionary authority or discretionary responsibility in the administration of the plan.

A fiduciary acting on behalf of an employee benefit plan must discharge his or her duties with respect to the plan solely in the interest of the participants and beneficiaries, and:

1. For the exclusive purposes of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses of administering the plan;
2. With the care, skill, prudence, and diligence under the circumstances then-prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims;
3. In accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with ERISA; and
4. Refrain from causing the plan to engage, or engaging with the plan in certain transactions which pose special dangers to the security of retirement, health, and other benefit plans.

A person can be a fiduciary for some purposes but not others, and a single fiduciary is not responsible for **all** the fiduciary actions that apply to a plan, instead, the fiduciary will only have fiduciary duties with respect to actions for which he/she exercises discretionary authority.

What is the "New Fiduciary Rule"?

Under the new fiduciary rule, which takes effect in April 2017, entities which provide investment advice or recommendations for a fee or other compensation with respect to plan or individual retirement account assets are considered plan fiduciaries. As plan fiduciaries, these "fiduciary investment advisors" must act in the best interest of their clients and disclose any potential conflicts of interest.

The new fiduciary rule is really a set of new regulations and amendments from the Department of Labor ("DOL") which include:

1. A new definition of a fiduciary for the purpose of providing "investment advice" to ERISA-governed plans and individual retirement accounts ("IRAs").

2. A new exemption called the "Best Interest Contract Exemption" which allows for a fiduciary investment advisor to receive compensation paid by an employee benefit plan, participant, beneficiary, or IRA, as well as commissions, sales loads, 12b-1 fees, revenue sharing, or other payments from third parties that provide investment products that would otherwise violate the prohibited transaction provisions of ERISA because of the amount of the fiduciary's compensation would be affected by the investment advice it provides.

3. An exemption for principal transactions in which advisers sell certain investments to plans and IRAs out of their own inventory.

4. Amendments to existing exemptions that would permit advisers to receive compensation for extending credit to plans or IRAs to avoid failed securities transactions.

5. Amendments to existing exemptions to ensure basic standards of fiduciary conduct.

So, What Changed?

Since 1975, the only way in which a non-discretionary investment advisor could be considered a fiduciary was if the advisor met every prong in a 5-prong test in regard to the information it provided. The new rule eliminates three of the trickier pieces of the old rule. No longer does fiduciary investment advice have to be offered (1) on a regular basis, (2) pursuant to a mutual understanding that the advisor is acting as a fiduciary, and (3) pursuant to the mutual understanding that the advice will be a primary basis for investment decisions with respect to plan assets.

For example, imagine you go to the doctor's office with back pain, and the doctor offers you:

(A) Ibuprofen and rest (and the doctor gets paid $20 for every Ibuprofen purchase he recommends)
(B) Physical therapy (and the doctor will receive a share of the fees for each therapy session); or
(C) Amputate your foot (and the doctor gets a sports car for every surgery he performs).

You reasonably understand that the doctor's job is to help heal your back, what do you want him to provide?

This is the fiduciary rule. The rule requires any individual (who manages greater than $50 million of assets), or entity, who provides covered investment advice to an ERISA plan, participant, beneficiary, <u>or</u> IRA to uphold fiduciary standards under ERISA. This means that these "fiduciary investment advisors" must make recommendations which put the long-term individualized financial needs of plan participants and beneficiaries before tempting compensation incentives. New prohibited transaction exemptions, like the best interest contract exemption, allow incentive compensation arrangements to survive, but only in the situations where they are attached to the best interest of the investment advice recipients, not the advisors. No matter how nice that sports car may look to the doctor, this rule is meant to ensure that your foot does not get amputated when ibuprofen is in your best interest.

In other words, the DOL believes that the new regulations are a principals-based approach to align advisers' interests with the participant or IRA owners while leaving the individual advisor and employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business.

We've Got You Covered

Plan sponsors will need to review and renegotiate contracts with many plan service providers, review and update investment education programs, conduct fiduciary training for plan fiduciaries, and revise fiduciary liability insurance coverage to make sure it covers all exposure under the new rule. This is an expensive process. Many investment advice providers that have not acknowledged their status as fiduciary investment advice fiduciaries will require renegotiated contracts that ensure either (1) advice provided is not a recommendation under the new rule, or (2) that fiduciary status is recognized. Many brokerage firms, platform providers, investment advisors, and tax advisors have expressed worry that it is risky and expensive to change business models and fee structures, especially for small plans. These now-fiduciary investment advisors will have to retain—and provide upon request--records proving compliance with prohibited transaction exemptions like the best interest contract exemption. For example, advisors to participants who choose to rollover ERISA plan assets to an IRA will have to establish why their recommendation is in the best interest of the participants.

As part of our status as an IRS Revenue Ruling 81-100 trust, we have extensive experience with managing investment advice and advisors. Our streamlined recordkeeping, investment advisory services, participant education, and an expansive investment menu services provide us with the economy of scale necessary for renegotiation and monitoring of our service provider contracts.