



November 12, 2015

DOL's 2015 Proposed Fiduciary Rule on Investment Advice

On April 20, 2015, the Department of Labor (DOL) proposed redefining the term *investment advice* within pension and retirement plans. Currently, under the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), a person who provides investment advice has a fiduciary obligation to provide the advice in the sole interest of plan participants. Thus, redefining the term investment advice could affect who is subject to this fiduciary standard. More detailed information about the proposal is available in CRS Report R44207, *Department of Labor's 2015 Proposed Fiduciary Rule: Background and Issues*.

Current Regulation

Regulations issued in 1975 define investment advice using a five-part test. To be held to ERISA's fiduciary standard with respect to his or her advice, an individual must (1) make recommendations on investing in, purchasing, or selling securities or other property, or give advice as to the value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions, and (5) will be individualized to the particular needs of the plan.

Proposed Regulation

DOL proposed broadening the term's definition to capture activities that currently occur within pension and retirement plans, but do not meet the existing definition of investment advice. The proposed rule would replace the current five-part test with a more inclusive definition. The following are the types of activities that would constitute investment advice under the proposed rule, if they are done for a fee or other compensation:

- investment recommendations and recommendations (1) as to the advisability of taking a distribution from a pension plan or Individual Retirement Account (IRA); (2) for the investment of securities or other property that are rolled over from a plan or an IRA; (3) for the management of securities or other property, including rollovers from a plan or IRA;
- the appraisal or a fairness opinion of the value of securities or other property if connected with a specific transaction by a plan or IRA; or
- a recommendation of a person to provide investment advice for a fee or other compensation.

The following activities would *not* constitute investment advice under the proposal:

- recommendations made to a plan fiduciary if the plan has 100 or more participants or at least \$100 million in plan assets;

- selection and monitoring assistance if an individual is identifying alternatives that meet objective criteria specified by the plan fiduciary or is providing objective financial data and benchmarks;
- marketing by platform providers who market to a plan without regard to the individual needs of the plan or the plan's participants;
- appraisals for Employee Stock Ownership Plans (ESOPs), though DOL might issue additional regulations for appraisals of ESOPs; and
- provision of investment education, such as information about the plan, general financial, investment, and retirement information.

The proposal provides that certain individuals would not be subject to the fiduciary standard. These include swaps dealers; employees of the plan sponsor or employee organization provided they do not receive compensation for the advice beyond their normal compensation; and individuals who engage in executing securities transactions.

Best Interest Contract Prohibited Transaction Exemption

In addition to requiring plan fiduciaries to adhere to certain standards of conduct, ERISA prohibits fiduciaries from engaging in transactions deemed likely to injure a pension plan. A number of prohibited transaction exemptions (PTEs) have been issued, both in statute and via DOL-issued exemptions, which allow individuals or classes of individuals to engage in specified transactions that would otherwise be prohibited under ERISA.

Accompanying the 2015 proposed rule, DOL has proposed or modified a number of PTEs. DOL has proposed a best interest contract (BIC) exemption so that certain broker-dealers and others who act as plan fiduciaries would be able to continue to receive compensation that would otherwise be prohibited. For example, absent the exemption, fiduciaries would not be able to receive commissions, load fees, or other fees as a result of their advice.

The proposed BIC exemption would require compliance with certain conditions, including that the financial institution must

- acknowledge fiduciary status in a contract with the retirement investor.
- adhere to impartial conduct standards, which include acting in the best interest of the retirement investor and not accepting more than reasonable compensation.

- warrant that it has adopted written policies to mitigate the impact of conflicts of interest and must disclose whether it offers proprietary products or receives third-party payments for the purchase, sale, or holding of any asset that it offers.
- provide, prior to the execution of a transaction, an individual disclosure to the retirement investor of the acquisition, ongoing, and disposition costs (if any) of the investment.
- provide to retirement investors annual disclosures from the financial institution. Each financial institution relying on the exemption must maintain a web page that describes the types of compensation payable to the adviser and to the financial institution.
- notify DOL that it intends to rely on the exemption and it must maintain records of its compliance with the exemption. DOL may request the records.

Perspectives from the Administration

DOL argues that the definition of investment advice be revised because the nature of how Americans prepare for retirement has changed since 1975, following the enactment of ERISA. Specifically, the number of participants in traditional defined benefit (DB) plans has decreased, whereas the number of participants in defined contribution (DC) plans, such as 401(k) plans, has increased. Participants in DC plans have more decisions (such as contribution amounts, investment allocations, rollovers, and withdrawals) to make than participants in DB plans and may be in greater need of or be offered assistance and advice.

The Regulatory Impact Analysis (RIA) issued by DOL with the proposed rule makes the following points:

- The structure of the market in which retirement plans operate creates conflicts of interest that are not adequately addressed by current regulations.
- Advisers that offer advice to plans regarding which investment options to include in their plans (platform providers) might have fee arrangements that create conflicts of interest.
- DOL has found enforcement challenges because it must demonstrate that an individual meets each element of the five-part test.
- IRA investors might be particularly vulnerable to advisers' conflicts of interest, even in the existing regulatory framework.
- The RIA also looked at changes to the investment advice regulation in Great Britain (which implemented new regulations on financial advisers in January 2013). The RIA concluded that there had been little impact on the ability of small investors to receive advice in Great Britain.

Perspectives from Stakeholders

Support for Best Interest Standard. Professionals in the financial services industry have indicated that they support a best interest standard; that is, they contend that they should be required to operate in the best interests of their clients. Many have indicated that they already do so.

Restrictions on Firms from Offering Own Products.

Some firms contend that the proposal could restrict them from offering their own products. Marketing materials might currently contain information about products that a particular financial institution offers. Such communications could be prohibited under the proposed rule.

Unworkable Disclosures. Some industry professionals have expressed concern about the BIC exemption. They indicate that the disclosures required from service providers make the BIC unworkable. If firms do not use the BIC exemption, they might be unwilling to service smaller retirement accounts because the fee structure could then be cost prohibitive.

Potential Harm on Small Businesses. Under the proposal, small businesses might not receive advice. Advisers to small plans would not be able take advantage of the BIC exemption and would be fiduciaries. They would generally be required to provide their services for a level fee. Because of the disruption to the business model, some have suggested that some advisers may exit the market rather than try to comply with the new regulations.

Support from Some Consumer Advocacy Groups. Some consumer advocacy groups (such as the Consumer Federation of America, AARP, and the AFL-CIO) are supportive of the DOL proposal.

Investment Education Definition. Unlike investment *advice*, investment *education* is not held to a fiduciary standard. Some have suggested that the proposed rule would define investment education too narrowly, which could limit the information.

Coordination Between DOL and SEC. Some Members of Congress and some financial services companies have suggested that the Securities and Exchange Commission (SEC) and DOL better coordinate their efforts to create a uniform fiduciary standard for registered investment advisers and broker-dealers. Because DOL is further along in the process than the SEC, some have viewed this suggestion as a delaying tactic. DOL noted that under current law, fiduciary standards are different under ERISA and the IRC compared with the standards under the Investment Advisors Act. It also noted that in ERISA, Congress provided higher standards of conduct because of the importance of retirement plans and IRAs to retirement income security and because of the tax advantages they receive.

John J. Topoleski, Analyst in Income Security

IF10318

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.