THE DEPARTMENT OF LABOR'S FIDUCIARY RULE – AN OVERVIEW OF THE MARKETING AND SALES IMPLICATIONS FOR INVESTMENT MANAGERS

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According to the Investment Company Institute, at the end of the first quarter of 2017, assets in IRAs totaled approximately $8.2 trillion, assets in defined contribution plans totaled approximately $7.3 trillion, and assets in defined benefit pension plans totaled approximately $3.0 trillion.[1] The Department of Labor's fiduciary rule will impact the way many investment managers market their products and services to these types of clients. Below is an overview of the fiduciary rule with a focus on the marketing and sales implications for investment managers.

When is an investment manager an ERISA fiduciary?
An investment manager is an ERISA fiduciary when (i) the manager has discretion over ERISA or IRA assets or (ii) the manager provides "investment advice" for a fee (as defined in Department of Labor regulations).

What has changed?
The definition of "investment advice" has changed. The fiduciary rule broadly defines "investment advice" to include tailored investment suggestions. As a result, the timing of when ERISA fiduciary status attaches to an investment manager could be impacted.

Does the fiduciary rule impact discretionary investment managers?
Yes. The fiduciary rule could cause a discretionary investment manager to become an ERISA fiduciary before the investment manager is hired and has discretionary responsibility. For example, while promoting its products and services, an investment manager may provide tailored investment recommendations to a prospective ERISA client. If the investment manager does not take certain steps, the tailored investment recommendations, such as those sometimes included in RFP responses, may constitute fiduciary investment advice.

Does the fiduciary rule impact the distribution of funds that do not hold ERISA "plan assets" (e.g., private funds that limit ERISA and IRA investors to below 25% of the fund and mutual funds)?
Yes. One can become an ERISA fiduciary under the fiduciary rule by virtue of marketing a non-plan asset fund to an ERISA or IRA investor, even though the manager of the fund is not acting as an ERISA fiduciary over the client's assets once the client invests in the fund.

Why should investment managers avoid fiduciary status in connection with sales and marketing activity?
If an investment manager were to become an ERISA fiduciary in connection with marketing its products and services, getting hired and receiving an investment management fee may constitute a prohibited transaction

under ERISA. This is because an ERISA fiduciary cannot use its fiduciary authority to cause a plan to pay an additional fee to the fiduciary (or a person in which the fiduciary has an interest which may affect the exercise of the fiduciary's best judgement as a fiduciary).

How can an investment manager avoid fiduciary status when marking its products and services?
There are a few approaches for investment managers to avoid fiduciary responsibility when marketing their products and services to ERISA and IRA clients. The approaches include: (i) ensuring communications are general in nature and not tailored to a specific recipient or recipients, (ii) limiting communications to the provision of investment education and (iii) adhering to the requirements of an exception for transactions with independent fiduciaries (the "independent fiduciary exception").

What is the independent fiduciary exception?
The independent fiduciary exception is an exception to the fiduciary rule that enables parties, such as investment managers, to provide ERISA plans with information and materials that could otherwise constitute "investment advice," without the party becoming an ERISA fiduciary. The requirements of the independent fiduciary exception include the following: (i) the party seeking to rely on the exception must make certain disclosures to the ERISA plan's fiduciary and (ii) the party seeking to rely on the exception must make a reasonable determination regarding the sophistication level of the ERISA plan's fiduciary in connection with investment matters.

Why are some investment managers asking ERISA plans to make representations regarding the fiduciary that is responsible for the plan's investments?
Some investment managers are asking ERISA plans to make representations regarding the fiduciary that is responsible for the plan's investments to enable the investment manager to comply with the requirements of the independent fiduciary exception. These representations may be found in (i) subscription agreements (or supplements thereto), (ii) investment management agreements or (iii) stand-alone notices sent to the ERISA plan, in the form of a negative or affirmative consent.

Why are some investment managers sending notices to consultants and other gatekeepers?
Some investment managers are sending notices to consultants and other gatekeepers to document that such party is acting as an independent fiduciary of ERISA clients. Doing so will enable the investment manager to avoid fiduciary status when marketing its products and services to the consultant's or gatekeeper's clients.

Are investment managers more limited when marketing to smaller retirement plans?
Yes. An investment manager cannot rely on the independent fiduciary exception, if the client's fiduciary, such as an investment committee, has less than $50 million in assets under its management and control. If an investment committee has responsibility for multiple pools of assets, the pools can be aggregated for purposes of this test. For example, if an investment committee is responsible for a $30 million welfare plan and a $40 million retirement plan, the $50 million test is met. If the investment committee does not meet the asset under management or control test, marketing and sales communications with the investment committee would not fall under the independent fiduciary exception. In that situation, an investment manager may direct marketing or sales-type communications only to the plan's consultant, if any, to avoid providing fiduciary investment advice. Alternatively, an investment manager may look to comply with the new best interest contract prohibited transaction exemption.

Could the fiduciary rule be rescinded or amended?
Yes. There is a high level of uncertainty regarding the ultimate fate of the fiduciary rule. The Department of Labor is engaging in an analysis of the issues raised in the President's February 3, 2017 Memorandum which directed the Department of Labor to conduct an examination of the fiduciary rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. As part of this effort, in June, the Department of Labor issued a request for information seeking public input that could form the basis of new exemptions or changes to the fiduciary rule and already issued exemptions.

On July 19, the House Education and Workforce Committee marked up H.R. 2823, "Affordable Retirement Advice for Savers Act" and voted to move it forward along party lines. The bill would rescind the fiduciary rule, restore regulations and exemptions that the fiduciary rule removed or modified, and establish a statutory definition of investment advice. Separately, the House Appropriations Committee considered and approved a draft funding bill for the Department of Labor that currently contains a rider that would repeal the fiduciary rule. There are also several legal challenges to the fiduciary rule that are currently winding their way through the court system.

Notes:

1. Investment Company Institute, "Retirement Assets Total $26.1 Trillion in First Quarter 2017", *available at*: https://www.ici.org/research/stats/retirement/ret_17_q1.

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